TECHNICAL ASSISTANCE REPORT

GEORGIA

Fiscal Transparency Evaluation

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Contents

Abbreviations and Acronyms

AFS	Annual Financial Statements
BDD	Basic Data and Directions Document of Georgia
CfD	Contract for Difference
CIT	Corporate Income Tax
DPT	Distributed Profit Tax
DSA	Debt Sustainability Analysis
ELA	Economic Liberty Act 2011
FiP	Feed-in Prices
FRS	Fiscal Risks Statement
GDP	Gross Domestic Product
GEL	Georgian Lari
LEPL	Legal Entities under Public Law
NNLE	Non-Entrepreneurial (Non-commercial) Legal Entity
MoF	Ministry of Finance
NAMR	National Agency for Mineral Resources
NBG	National Bank of Georgia
NER	Nominal Exchange Rate
NDRRS	National Disaster Risk Reduction Strategy
PBO	Parliamentary Budget Office
PC	Public Corporations
PDL	Public Debt Law
PIT	Personal Income Tax
PPA	Power-Purchase Agreement
PPP	Public-Private Partnership
SAO	State Audit Office
SNG	Sub-national Governments
SOE	State-owned Enterprise
TSA	Treasury Single Account

Preface

At the request of the Ministry of Finance (MoF) of Georgia, a team from the IMF's Fiscal Affairs Department (FAD) undertook an update of the 2016 Fiscal Transparency Evaluation (FTE) during the period from April 19 to May 3, 2023. The mission team was led by Isabel Rial and comprised Arturo Navarro (both FAD), Mary Betley, David Gentry, Viera Karolova, and Rimantas Veckys (all FAD expert).

The mission met Mr. Giorgi Kakauridze, First Deputy Minister of Finance, Ms. Ekaterine Guntsadze and Mr. Mirza Gelashvili, both Deputy Ministers of Finance, to discuss the key findings of the evaluation and proposed actions. During the mission, the team had extensive meetings with senior staff in the MoF including with: Mr. Vakhtang Chalapeikrishvili, Head, and Mr. Pridon Aslanikashvili, Deputy Head, of the Macroeconomic Analysis and Fiscal Policy Planning Department; Ms. Natia Gulua, Head of Budget Department; Mr. Shota Gunia, Head of Fiscal Risks Department; Mr. Irakli Katcharava, Head of Public Debt Management Department; Mr. Davit Gamkrelidze, Head of Treasury Service, Mr. Zurab Tolordava, Head of the Reporting and Methodology Department of the Treasury Service and Ms. Lela Pataraia, Deputy Head of the Reporting and Methodology Department of the Treasury Service. The mission conducted meetings with representatives of other Georgian government entities including: the National Bank of Georgia, the National Statistics Office, the Parliamentary Budget Office, the State Audit Office, the Ministry of Economy and Sustainable Development, the Public-Private Partnerships (PPP) Agency, the Ministry of Environmental Protection and Agriculture, and the Municipality of Tbilisi.

The mission team would like to thank the Georgia government for their cooperation and their participation in constructive discussions during the mission, and especially Ms. Nino Mikeladze for coordinating mission activities and information requests, and Ms. Natia Gulua and Mr. Shota Gunia for being available for regular consultation. Finally, the team would like to thank the interpreters Ms. Ketevan Avaliani and Ms. Natia Jakhia for their excellent translation and interpretation assistance.

Executive Summary

This report updates the 2016 Fiscal Transparency Evaluation (FTE) of Georgia that was published in 2017.[1] The report focuses on the first three pillars of the Code, excluding the evaluation of Pillar IV (Resource Revenue Management), given that Georgia is not a resource rich country.

Georgia has historically placed a high importance on openness and fiscal transparency as a tool to strengthen public financial management. At the time of the 2016 assessment many elements of sound fiscal transparency practices were in place. Yet, several gaps were identified that undermined the overall transparency and efficiency in public financial management and exposed the government to substantial fiscal risks. Seven years later, Georgia has made significant progress in addressing main transparency gaps highlighted by the 2016 evaluation, which have underpinned reform efforts in pensions, public investment management, public corporations, and the energy sector. Progress in fiscal transparency practices has been also recognized by the Open Budget Index, which upgraded Georgia's fiscal transparency ranking from 16th place in 2015 to first place in 2021.

Since 2016, progress was achieved in all three pillars of the Fiscal Transparency Code, with improved ratings in 15 of the 36 principles of the Code. As summarized in Table 0.1, in 2023 Georgia meets good or advanced practices on 27 out of the 36 principles of the Code, basic practice on a further 8, while only one principle is not met. Since 2016, specific areas of improvement include:

- **Fiscal reporting** has become more comprehensive with the incorporation of the legal entities of public law (LEPLs) across all fiscal reports; the publication of central and sub-national governments annual consolidated financial statements follows International Public Sector Accounting Standards (IPSAS); the publication of the first detailed report on the cost of tax expenditure; and the publication of revisions to historical data and reconciliation tables to improve data consistency. Consolidated Annual Financial Statements (AFS) for the central government have been published since 2020 and for autonomous republics and municipalities since 2021.
- **Fiscal forecasting and budgeting practices** have improved with the recalibration and adoption of a new set of fiscal rules; the publication of alternative macroeconomic scenarios; and the reconciliation and explanation of material changes to the government's previous forecasts.
- **Fiscal risk analysis and management** have improved considerably by: broadening the coverage and analytical complexity of the Fiscal Risks Statement, notably in the area of state-owned-enterprises (SOEs), and estimates of the government's net and gross exposure to power-purchase agreements (PPAs); extending the long-term perspective of the debt sustainability analysis; publishing the Financial Sector Stability Report by the National Bank of Georgia (NBG); and quantifying fiscal costs and the likelihood of natural disasters.

At the same time, there are some areas where Georgia's transparency practices could be further improved. Notably:

[1] Georgia: Fiscal Transparency Evaluation (imf.org)

- **Coverage of fiscal reports can be enhanced** to provide a better picture of the public sector net worth. The estimation of the comprehensive public sector wealth position (Table 0.2) suggests that net worth is underestimated, primarily due to uncovered non-market SOEs and public corporations, and the limited recognition and valuation of nonfinancial assets in the balance sheet. Unreported expenditure of non-market SOEs and public corporations accounts for 3.5 and 8.4 percent of GDP in 2021, respectively; while the gap in the valuation of nonfinancial assets is estimated at 30.5 percent of GDP for government, and 5.5 and 46.7 percent of GDP for non-market SOEs and public corporations, respectively. A reporting gap also exists on the liability side of the balance sheet, estimated at 14.3 percent of GDP in 2021.
- **Limited progress has been achieved in improving the consistency and comparability of fiscal reports**. No reconciliation between government financing and debt stock is published, or between main fiscal aggregates across different fiscal reports (i.e., statistics, accounting, and budget).
- **The external oversight of the government's financial position remains weak**. The SAO audits the annual financial statements of individual line ministries and publishes an assessment of the annual budget execution reports. However, it does not audit the annual consolidated financial statements of the central government. There are plans to audit the consolidated general government annual financial statement starting in 2026.
- **Credibility of fiscal forecast and budgets can be further strengthened**. This can be achieved by disclosing an ex-post analysis of forecast errors, including breakdown of the impact of new policies and change of macroeconomic indicators.
- **The quantification and disclosure of fiscal risks could be further improved and extended to include low probability but high fiscal impact type of events**. These include, for example, the potential government direct support to the financial sector in the event of extreme risks materializing (e.g., distress in a highly concentrated market). PPAs and risk arising from long-term contracts in the energy sector should continue to be closely monitored, factoring in the impact of future measures in the context of the implementation of the energy reform. Similarly, monitoring and management of fiscal risk from public corporations should be sustained, with special attention to be given on the impact of measures taken in the context of the public corporation reform currently underway. Although with a significantly lower potential fiscal impact, the capacity of sub-national governments to repay government's on-lending should also be monitored and managed.
- **Risk management practices should be gradually expanded to cover long-term sources of fiscal risks**. Recent progress in estimating and assessing sources of long-term fiscal risks arising from demographic and climate changes should be sustained and further improved, including the fiscal impact of the recent pension reform. Moreover, a strategy for managing the fiscal impacts of crises arising from natural or man-made disasters that can affect the society, the economy, and the environment, and which require immediate government response should be developed.

Sustained progress in the implementation of structural reforms and increasing the coverage of fiscal reports and information disclosure should deliver short-term improvements in fiscal transparency. Reforms in accounting, public corporations, and the energy market should be a priority. Incorporating non-market SOEs in fiscal reports would push current ratings closer to advanced practices. Credibility of fiscal data would benefit from publishing a reconciliation between government financing and debt, and between main fiscal aggregates presented in various reports.

To build on recent progress and address the gaps identified in this updated evaluation, the report provides eleven main recommendations to further strengthen fiscal transparency in Georgia. The detailed recommendations are set out under each pillar of this report.

Table 0.1. Georgia: Summary Assessment Against the Fiscal Transparency Code[1]

I. Fiscal Reporting[2]	II. Fiscal Forecasting & Budgeting	III. Fiscal Risk Analysis & Management
1.1.1. Coverage of Institutions ↑	2.1.1. Budget Unity ↑	3.1.1. Macroeconomic Risks
1.1.2. Coverage of Stocks	2.1.2. Macroeconomic Forecasts ↑	3.1.2. Specific Fiscal Risks
1.1.3. Coverage of Flows ↑	2.1.3. Medium-term Budget Framework	3.1.3. Long-term Fiscal Sustainability ↑
1.1.4 Coverage of Tax Expenditure ↑	2.1.4. Investment Projects	3.2.1. Budgetary Contingencies
1.2.1. Frequency of In-Year Reporting	2.2.1. Fiscal Legislation	3.2.2. Asset and Liability Management
1.2.2. Timeliness of Annual Accounts	2.2.2. Timeliness of Budget Documentation	3.2.3. Guarantees
1.3.1. Classification	2.3.1. Fiscal Policy Objectives ↑	3.2.4. Public Private Partnerships
1.3.2. Internal Consistency ↑	2.3.2. Performance Information	3.2.5. Financial Sector ↑
1.3.3. Historical Revisions ↑	2.3.3. Public Participation	3.2.6. Natural Resources
1.4.1. Statistical Integrity ↓	2.4.1. Independent Evaluation	3.2.7. Environmental Risks ↑
1.4.2. External Audit	2.4.2. Supplementary Budget	3.3.1. Sub-national Governments ↑
1.4.3. Comparability of Fiscal Data	2.4.3 Forecast Reconciliation ↑	3.3.2. Public Corporations ↑

1/ Arrows indicate which ratings were improved or worsened between the 2016 and 2023 evaluation. Other ratings remained unchanged relative to 2016.

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

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[2] In the case of the integrity of fiscal statistics, no material changes took place since 2016. The downgrade in the rating reflects tighter criteria prescribed in the 2018 IMF's Fiscal Transparency Handbook.

Table 0.2. Georgia: Public Sector Financial Overview, 2021 (Percent of GDP)

	General Government								Public Corporations				
										Financial			
	Budgetary Central Government	Extrabudgetary units	Consolidation	**Consolidated Central Government**	Non-market SOEs	Local Govt.	Consolidation	**Consolidated General Government**	Non-financial	Pension Fund	Central Bank	Consolidation	**Public Sector**
Transactions													
Revenue	**24.0**	**8.2**	**-4.7**	**27.6**	**3.5**	**5.3**	**-5.5**	**30.9**	**4.2**	**0.0**	**0.8**	**-1.1**	**34.9**
Expenditure	**29.9**	**8.1**	**-4.7**	**33.3**	**3.5**	**5.2**	**-5.5**	**36.5**	**4.1**	**0.0**	**0.3**	**-1.1**	**39.9**
Expense	27.0	6.9	-4.7	29.2	2.6	3.6	-5.5	30.0	4.0	0.0	0.3	-1.1	33.2
Investment in Non-fin. assets	2.9	1.2	0.0	4.1	0.8	1.6	0.0	6.5	0.1	0.0	0.0	0.0	6.7
Gross operating balance	-3.0	1.3	0.0	-1.7	1.1	1.6	0.0	1.0	0.6	0.0	0.6	0.0	2.2
Net lending/borrowing	**-5.9**	**0.1**	**0.0**	**-5.8**	**0.1**	**0.0**	**0.0**	**-5.7**	**0.1**	**0.0**	**0.5**	**0.0**	**-5.0**
Stocks													
Assets	**75.7**	**3.7**	**-0.4**	**79.0**	**5.7**	**31.1**	**-5.7**	**110.1**	**12.6**	**3.4**	**30.4**	**-14.6**	**142.0**
Nonfinancial	**49.7**	**0.0**	**0.0**	**49.7**	**4.3**	**27.3**	**0.0**	**81.3**	**9.0**	**0.0**	**0.2**	**0.0**	**90.5**
o/w Mineral resources	19.4			19.4				19.4					19.4
Financial	**26.0**	**3.7**	**-0.4**	**29.3**	**1.4**	**3.8**	**-5.7**	**28.8**	**3.6**	**3.4**	**30.3**	**-14.6**	**51.5**
Debt securities and loans	5.9	1.8	0.0	7.7	0.0	0.2	-2.7	5.3	0.3	0.0	21.5	-2.4	24.7
Equity	12.2	0.0	0.0	12.2	0.2	2.4	-2.7	12.1	0.0	0.0	0.0	-9.4	2.7
Other	7.9	1.8	-0.4	9.4	1.2	1.2	-0.3	11.5	3.3	3.4	8.8	-2.8	24.1
Liabilities	**67.5**	**2.5**	**-0.4**	**69.7**	**5.7**	**0.9**	**-5.7**	**70.6**	**12.6**	**3.4**	**30.4**	**-14.6**	**102.4**
Debt securities and loans	49.6	1.6	0.0	51.2	2.2	0.7	-2.7	51.4	6.7	0.0	3.2	-2.4	58.9
Equity	0.0	0.0	0.0	0.0	2.7	0.0	-2.7	0.0	4.8	0.0	4.7	-9.4	0.1
Civil servants pension entitlements	14.3	0.0	0.0	14.3	0.0	0.0	0.0	14.3	0.0	3.4	0.0	0.0	17.7
Other	3.6	0.9	-0.4	4.2	0.8	0.2	-0.3	4.9	1.2	0.0	22.5	-2.8	25.7
Liabilities other than equity	**67.5**	**2.5**	**0.0**	**69.7**	**2.9**	**0.9**	**-3.0**	**70.6**	**7.8**	**3.4**	**25.7**	**-5.2**	**102.3**
Net worth	**8.2**	**1.2**	**0.0**	**9.3**	**0.0**	**30.2**	**0.0**	**39.6**	**0.0**	**0.0**	**0.0**	**0.0**	**39.6**
Net financial worth	**-41.5**	**1.2**	**0.0**	**-40.3**	**-4.3**	**2.9**	**0.0**	**-41.8**	**-9.0**	**0.0**	**-0.2**	**0.0**	**-51.0**
Memorandum item:													
Implicit Obligation - NPV of Social assistance pension payment	109.0			109.0				109.0					109.0

Source: GFS, Budget execution report, MoF's database of SOEs, financial statements, IMF staff estimates.
Note: Non-financial public corporations include 22 largest units and non-market SOEs include 17 largest units covering around 90 percent of all enterprises in terms of the annual turnover.

I. FISCAL REPORTING

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

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

2. **Georgia has made a concerted effort over the past years to increase transparency and improve the quality and comprehensiveness of information on public finances available to the public.** Starting from 2016, the institutional coverage of the budget reporting was expanded to include Legal Entities under Public Law and Non-Entrepreneurial (Non-commercial) Legal Entities (NNLEs). The authorities also corrected the treatment of specific government operations in line with the previous IMF recommendations. In 2021, the Treasury introduced IPSAS-based consolidated financial statements for the central government and individual local governments comprising budgetary organizations, LEPLs and NNLEs. Historical GFS time series have been revised to: (i) include LEPLs and NNLEs (except for schools and kindergartens); (ii) develop a general government balance sheet including non-financial assets, financial assets, and liabilities from 2019 onwards; and (iii) incorporate further adjustments based on the improved source data. In addition, the MoF compiled a list of public enterprises, reviewed their financial results in line with the Government Finance Statistic Manual, 2014 (GFSM 2014), identified non-market State Owned Enterprises (SOEs), and compiled a pilot GFS for these units. Georgia's main summary fiscal reports are presented in Table 1.1. While the list of reports is unchanged from 2016, the quality of reports has improved as described above.

Table 1.1. Georgia: List of Fiscal Reports

Report	Author	Coverage			Accounting		Publication	
		Institution	Flows	Stocks	Basis	Classif.	Frequency	Lag
IN-YEAR REPORTS								
Daily Operation Reports	Treasury	CG	R, E	…	Cash	Nat.	Daily	1d
Monthly Budget Execution Tables	Treasury	CG	R, E, Fin	…	Cash	Nat.	Monthly	20d
Quarterly Budget Execution Reports	BD	CG	R, E, Fin	…	Cash	Nat.	Quarterly	30d
Monthly Debt Statistics	PDEFD	GG	...	Debt	…	Nat.	Monthly	n.a.
Public Debt Statistics Bulletin	PDEFD	…	…	Debt	…	PSDS	Semi-annual	3m
Government On-lending Data	PDEFD	CG to SNG, LLC and JSC	…	Loans	Cash	Nat.	Quarterly	6m
Monthly Government Financial Statistics (GFS)	MAFD	GG	R, E, Fin	…	Cash	GFSM 2014	Quarterly	30d
Quarterly Government Financial Statistics (GFS)	MAFD	GG	R, E, Fin	Debt	Cash	GFSM 2014	Monthly	30d

Report	Author	Coverage			Accounting		Publication	
		Institution	Flows	Stocks	Basis	Classif.	Frequency	Lag
YEAR-END REPORTS								
Annual Budget Execution Report	BD	CG	R, E, Fin	…	Cash	Nat.	Annual	3m
Annual Financial Statements	Treasury and Spending Entities	CG	R, E	L, FA, NFA	Mod- Accr	Nat.	Annual	6m
Annual Financial Statements	Treasury and Autonomous Republics and Municipalities	SNG	R, E	L, FA, NFA	Mod- Accr	Nat.	Annual	6m
Government Finance Statistics (GFS)	MAFD	GG	R, E, Fin	A.L	Cash	GFSM 2014	Annual	6m

Source: IMF staff based on official data.
Notes: BD – Budget Department, MAFD – Macro-economic Analysis and Fiscal Policy Department, PDEFD – Public Debt Department, CC- central government, SNG – sub-national government, GG – general government; LLC – limited liability companies, JSC – joint-stock companies; R- revenue, E – expenditure, FIN– financing; PSDS – public sector debt statistics

3. **Since 2016, the rating on 5 principles of Pillar I of the Code has improved, one has deteriorated, and 6 have remained unchanged** (Table 1.2). The improvements in the ratings are discussed below. Since 2016, substantial improvements have been made to fiscal reporting practices, summarized in Table 1.3.

Table 1.2. Georgia: Fiscal Reporting: Summary of Changes since 2016

Area	Principle		2016	2023
Coverage	1.1.1	Coverage of Institutions	Basic	Good
	1.1.2	Coverage of Stocks	Good	Good
	1.1.3	Coverage of Flows	Basic	Good
	1.1.4	Coverage of Tax Expenditure	Not Met	Good
Frequency and Timelines	1.2.1	Frequency of In-Year Reporting	Advanced	Advanced
	1.2.2	Timeliness of Annual Financial Statements	Advanced	Advanced
Quality	1.3.1	Classification	Advanced	Advanced
	1.3.2	Internal Consistency	Basic	Good
	1.3.3	Historical Consistency	Not Met	Basic
Integrity	1.4.1	Statistical Integrity	Good	Basic
	1.4.2	External Audit	Basic	Basic
	1.4.3	Comparability of Fiscal Data	Basic	Basic

Source: IMF staff

Table 1.3. Georgia: Fiscal Reporting: Progress on Recommendations since 2016

Recommendation in 2016		Progress made
1.1.	**Expand the institutional coverage of fiscal and statistical reports, by:** ▪ Including LEPLs in GFS reports, ▪ Extending accounting reform to local governments and producing an annual consolidated general government financial report.	**Some progress. General government statistics are compiled and reported in line with GFS 2014, for each subsector and consolidated.** LEPLs and NNLEs are included in budget execution reports, financial statements, Treasury, and GFS reports (the latter excludes schools and kindergartens).). In terms of financial accounting reports, the MoF produces annual consolidated financial statements for central government and for individual municipalities in line with accrual--based IPSASs. Autonomous republics and municipalities are producing their annual consolidated financial statements in line with 24 accrual-based IPSASs. Central government, autonomous republics and municipalities are not consolidated to produce a general government consolidated annual financial statement.
1.2	**Enhance the quality of fiscal reporting, by**: ▪ revising the treatment of payment of previous years' invoices, ▪ expanding the coverage of central government balance sheet, ▪ Publishing reconciliation of changes in net financing and the stock of government debt, and reconciliation main fiscal aggregates reported in various fiscal reports.	**Some progress.** Treatment of previous years' invoices revised. Balance sheet expanded to cover consolidated general government. including some improvements in the coverage of specific assets and liabilities such as financial leasing and concessions. An inventory of state non-financial assets has not been completed and no process has been established regarding their valuation. No reconciliation of changes in the stock of debt and net financing is available. While financial statements include a table showing some differences between the budget execution and cash-flow statement, the table doesn't present a real reconciliation explaining the differences in a user-friendly manner.
1.3	**Strengthen the integrity of fiscal reports** by requiring the State Audit Office (SAO) to audit annual financial statements and provide a formal opinion on the annual budget execution report.	**Limited progress**. From 2021, Consolidated financial statements for central government are prepared based on 24 accrual-based IPSAS standards and published on the Treasury's website, but they have not been audited by the SAO.
1.4	**Enhance reporting and control over tax expenditure**. Publish an estimate of revenue forgone from tax expenditure in the budget documentation.	**Good progress**. Starting 2022, a Tax Expenditure Assessment Report is published as an annex to the draft State budget package. The report sets out a detailed analysis of estimated forgone tax revenue.

Source: IMF staff.

1.1. Coverage of Fiscal Reports

1.1.1. Coverage of Institutions (Good, Improved from Basic in 2016)

4. **Georgia's public sector comprises 4,086 units of various legal forms**. According to the MoF, these entities are broken down into the following subsectors (Table 1.4):

- **Central government.** It comprises 2,583 units, of which 168 are budgetary units (including ministries and central government administration) and 2,415 are extra- budgetary units. The latter includes Legal Entities under Public Law (LEPL),[3] Non-Entrepreneurial (Non-commercial) Legal Entities (NNLEs), and the Deposit Guarantee Fund. The employment-related public service pension scheme for selected professions (e.g., armed forces) are also integrated within the central budgetary organizations. There is no social security fund to pay pension benefits as they are payable from the

[3] LEPLs include Legal Entities Under Public Law and Non-Commercial Legal Entities (LEPLs)

funds of the state budget.

- **Local governments.** They comprise 1,097 units: 110 are budgetary units, broken down in 108 municipalities (administrative districts, towns, and cities) and 2 autonomous regions; and 987 are LEPLs and NNLEs controlled by local governments.
- **Non-market SOEs.** They comprise 352 public enterprises and other types of units that have been legally established as 'commercial' entities but operate on a non-market basis and therefore should be consolidated within the general government. Out of 352 units, 202 are controlled by the central government and 150 by the local governments.
- **Public nonfinancial corporations**. They comprise 52 corporations, of which 40 are state controlled enterprises and 12 are companies controlled by local governments.
- **Public financial corporations.** They comprise[4] the National Bank of Georgia (NBG) and the Pension Fund (defined contribution pension).

Table 1.4. Georgia: Public Sector Institutions and Finances, 2021
(Percent of GDP unless specified otherwise)

	Number of entities	Revenue	Expenditure	Balance	Intra-PS expenditure	Net expenditure	Percent of total
Public Sector	**4,086**	**34.9**	**39.9**	**-5.0**		**39.9**	**100.0**
General government	**4,032**	**30.9**	**36.5**	**-5.7**	**1.1**	**35.5**	**88.9**
Central government	2,583	27.6	33.3	-5.8	5.2	28.1	70.5
Budgetary Central gov.	168	24.0	29.9	-5.9	9.9	20.0	50.3
Extra-budgetary units	2,415	8.2	8.1	0.1	0.0	8.1	20.3
Local governments	1,097	5.3	5.2	0.0	1.3	3.9	9.8
Non-market SOEs	352	3.5	3.5	0.1	0.0	3.5	8.7
Nonfinancial public corp.	**52**	**4.2**	**4.1**	**6.0**	**0.0**	**4.1**	**10.4**
Financial public corp.	**2**	**0.8**	**0.3**	**0.5**	**0.0**	**0.3**	**0.7**

Source: GFS, annual financial statements, and IMF staff estimates

5. Georgia's public sector expenditure is estimated at 39.9 percent of GDP in 2021. Table 1.4 summarizes the distribution of public sector revenue and expenditure across the different subsectors and shows that:

- **General government** expenditure accounted for 35.5 percent of GDP on a consolidated basis, of which 80 percent was spent by the central government, 11 percent by local governments, and 9 percent by non-market SOEs.
- **Public corporations'** expenditure accounted for 4.4 percent of GDP, that is about 10 percent of total public sector expenditure.

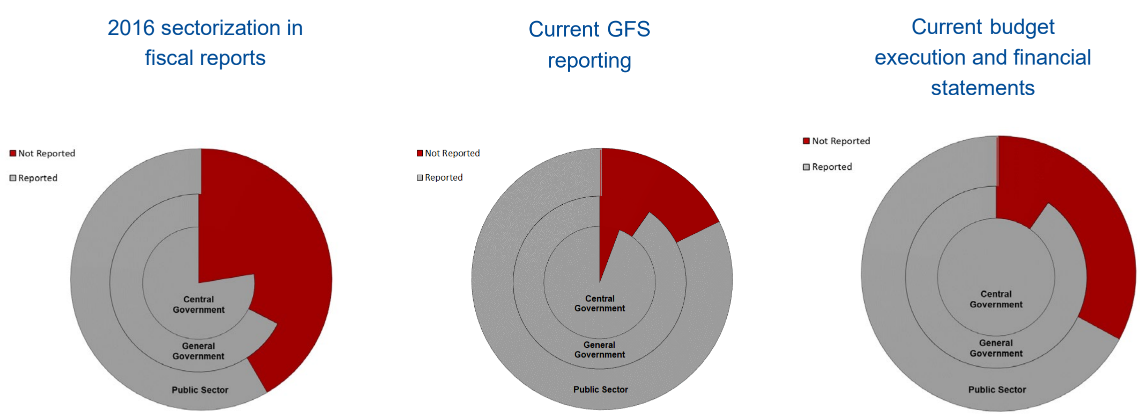
6. Almost all general government is covered in fiscal reports, with the outstanding entities not having a significant impact on public finances. The budget execution reports, and the financial statements are the most comprehensive fiscal reports, and their coverage has been expanded beyond the general government to include about 80.2 percent of total public sector spending. These reports cover

[4] The Partnership Fund has recently been classified as a non-market SOE.

the general government sector including budgetary organizations, LEPLs and NNLEs at the central and local government level, except for non-market SOEs and some sport federations, the Communication Commission of Georgia, and the Water Regulatory Commission. The latter have a minimal impact on public finances. Compared to the budget execution reports and financial statements, the GFS reporting does not cover all LEPLs and NNLEs, as it omits schools and kindergartens, which account for expenditure of 1.7 percent of GDP.[5]

7. **Significant progress has recently been achieved in expanding the sectoral coverage of fiscal reporting.** During the 2016 FTE mission, none of the fiscal reports covered LEPLs and NNLEs. Their inclusion since 2016 added expenditure of 8.1 percent of GDP and revenue of 5.3 percent of GDP in 2021. Georgia is a pioneer in the region which has compiled a list of public enterprises controlled by the central and local government and completed a comprehensive sectorization exercise distinguishing the SOEs which operate on a non-market and market basis in line with international statical standards. Based on this effort the MoF identified 352 non-market enterprises to be consolidated within the general government, and 52 market producers to be classified in the sector of non-financial public corporations. In addition, the MoF compiled GFS for non-market SOEs (statement of operations and balance sheet) with the technical assistance of the IMF. The MoF has shared the list of public SOEs with the NBG, which is now consistently used to compile Monetary Financial Statistics. The authorities are encouraged to also harmonize the sectorization of public entities with the Georgian Statistical Agency (GEOSTAT) that compiles sectoral national accounts based on 2008 System of National Accounts (2008 SNA).

Figure 1.1. Georgia: Coverage of Public Sector Institutions in Fiscal Reports, 2021
(Percent of GDP at each level)



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

8. **Further expanding the coverage of the fiscal reports will provide a more comprehensive picture of public finances.** A priority should be to consolidate the non-market SOEs within the general government sector (unreported expenditure accounted for of 3.5 percent of GDP in 2021). As a second step, the coverage of fiscal reporting should be expanded to the whole public sector by including public

[5] Schools and kindergartens were not included in the Treasury in 2021. The authorities have recently initiated a process of integration these units in the TSA that should be completed by 2024.

corporations (unreported expenditure accounted for 4.1 percent of GDP in 2021). The MoF maintains a database including annual financial statements of market and non-market SOEs, and it has recently updated the Budget Code to transfer non-market SOEs to the services of the State Treasury by 2026. In the meantime, quarterly and annual data will be submitted by non-market SOEs based on a special government decree. Inclusion of non-market SOEs and public corporations in the fiscal reporting would provide a more comprehensive picture on the fiscal performance and of the extent of government-directed activity in the economy.

1.1.2. Coverage of Stocks (Good, Unchanged from 2016)

9. **Financial and non-financial assets and liabilities are reported in financial statements and GFS, but gaps remain regarding the valuation and coverage of assets and liabilities.** The authorities have recently improved financial reporting to get closer to the international accounting standards. Starting from 2021, the Treasury compiles and publishes IPSAS-based consolidated financial statements for the central government in accordance with 24 accrual-based IPSAS standards. Autonomous republics and municipalities prepare their consolidated financial statements based on these 24 accrual-based IPSAS standards and submit them to the Treasury and individual local governments. GFS reporting presents a consolidated general government balance sheet. Introducing IPSAS led to gradual improvements in the quality and coverage of the consolidated balance sheets. Additional adjustments were introduced by the Treasury to close some previous reporting gaps. For example, they imputed data on concessions and financial leasing; and deposits of the autonomous republics, local governments, and LEPLs deposits in the Treasury Single Account (TSA). They also moved the historical debt of government vis-a-vis households from the Soviet era to contingent liabilities as was agreed with the IMF. Despite recent substantial improvements in the government balance sheet, a few gaps remain related to the coverage of stocks**:**

- **Government assets**. The coverage of assets in the central and local budget organizations and LEPLs and NNLEs' financial statements is still incomplete. Budgetary organizations mainly report fixed assets that are used for their operation activities (e.g., buildings, cars, inventories). In addition, there are unreported mineral and energy resources and some municipal non-financial assets. Estimated amount of unreported assets amounted to 30.5 percent of GDP, of which mineral resources account for 19.4 percent of GDP,[6] underestimated value of non-financial assets accounts for at least 7 percent of GDP, and underestimated value of shares and equities held by the government for 4.1 percent of GDP at end-2021.
- **Government liabilities**. The estimated net present value amount of pension liabilities from the employment-related pension scheme for special groups of government employees (police and army) not disclosed through regular reporting account for 14.3 percent of GDP in 2021.[7]
- **Assets and liabilities of non-market SOEs**. The unreported amount of assets of non-market SOEs which have not been consolidated yet in the fiscal reporting is 5.7 percent of GDP in 2021, of which

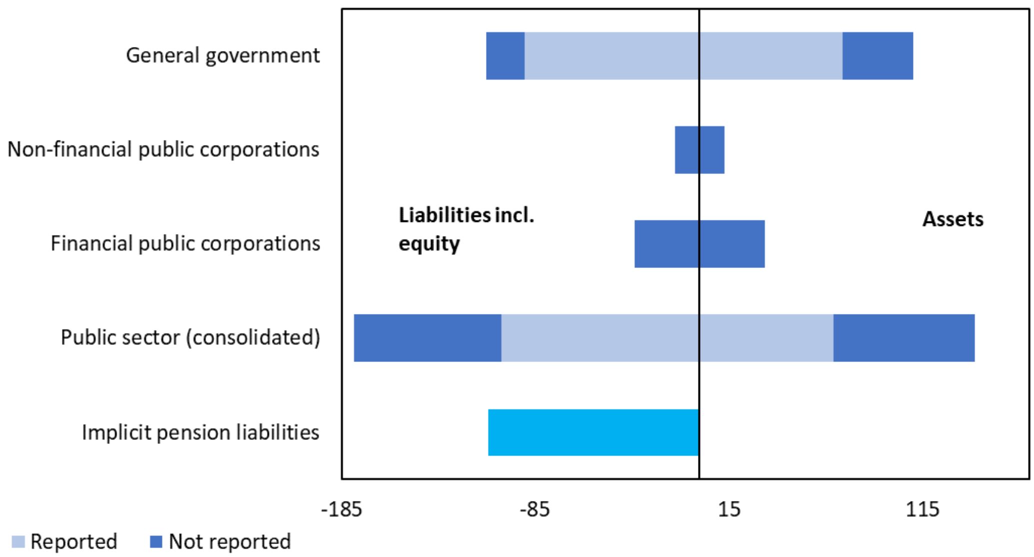
[6] IMF staff estimates.

[7] Government social assistance-related pension payments are fully financed by the state budget; therefore, the estimated implicit obligation refers to future pension benefits and does not consider future contributions as these are not relevant. Because of its social assistance nature, it is not considered a government liability, but the 2014 GFSM considers the disclosure of an estimate of the net present value of (NPV) these types of payments a good practice for increasing transparency. The mission estimated the NPV from the social assistance-related pension payments (Pillar 1) in Georgia to be 109 percent of GDP.

non-financial assets are 4.3 percent of GDP and financial assets 1.4 percent of GDP. The amount of liabilities other than equity account for 2.9 percent of GDP in 2021.

- **Assets and liabilities of public corporations.** Based on the available financial statements covering most public corporations, their assets accounted for 46.5 percent of GDP, and the outstanding liabilities other than equity 37 percent of GDP by end-2021. Most financial assets and liabilities are held by the NBG, that account for 30.3 percent of GDP and 25.7 percent of GDP, respectively.

Figure 1.2. Georgia: Public Sector Balance Sheet Coverage in Fiscal Reports, 2021
(Percent of GDP)



Source: Financial statements, GFS, IMF staff estimates

10. Addressing these gaps and expanding the balance sheet to the public sector would provide a more comprehensive view of the public sector's net worth. As shown in Table 0.2 and Figure 1.2, consolidated public sector asset holdings and liabilities are estimated to be around 142 percent of GDP and 102.4 percent of GDP, respectively, at end-2021. Public sector net worth and net financial worth are estimated to be 39.6 percent of GDP and -50.9 percent of GDP. The main components include:

- Nonfinancial assets of 90.5 percent of GDP, which primarily comprise fixed assets;
- Financial assets of 51.5 percent of GDP, which mainly comprise debt securities held by the NBG and deposits of public sector assets units in commercial banks.
- Liabilities other than equity of 102.4 percent of GDP, which comprise the general government debt in loans and debt securities of 51 percent of GDP, currency reserves of the NBG of 17 percent of GDP,

pension liabilities of the government civil servants pension scheme of 14.3 percent of GDP, and of the defined-contribution Pension Fund of 3.4 percent of GDP.[8]

1.1.3. Coverage of Flows (Good, Improved from Basic in 2016)

11. Fiscal reports cover cash flows, cash revenue, accrued revenue and expenditure, financing, and to a limited extent other economic flows. In addition to the cash-based budget execution and GFS reports covering the general government, the Treasury compiles IPSAS-based consolidated financial statements for the central government. Autonomous republics and municipalities prepare their IPSAS-based consolidated financial statements. The financial statements include: (i) a cash-flow statement; (ii) a statement of operations, including accrued revenue and expense; (iii) a statement of changes in net assets/equity, including limited information on other economic flows; and (iv) a balance sheet. The significant remaining gap relates to the time of recording of tax revenue, which are still recorded on a cash basis in all fiscal reports.

12. Since 2016, fiscal reporting of flows has been improved in line with good international practices. In the past, the payments associated with previous years' invoices were recorded below-the-line, which resulted in expenditure being underestimated.[9] In line with the IMF's recommendations, the MoF revised the treatment and recorded the payment of arrears as an expenditure in the cash-based reporting. Moreover, significant progress has been achieved in financial reporting as the result of the gradual implementation of the government's accounting reform. Starting in 2021, the Treasury compiled new IPSAS-based consolidated financial statements, which introduced several substantial improvements with respect to the comprehensiveness of the coverage of flows and stocks for central and local governments.

13. Further improvement efforts should focus on the comprehensiveness of flows on an accrual basis. This mainly relates to taxes, being the government's main revenue source, which should be available on an accrual basis alongside the currently reported cash data. According to the international statical standards, data on accrued taxes should be based on assessments and declarations less the amounts unlikely to be collected. Introducing such an accounting system is a time-consuming task, therefore the authorities may consider for the interim period an alternative method of recording taxes using a time-adjustment cash method that is widely applied by the European Union countries.

1.1.4. Coverage of Tax Expenditure (Good, Improved from Not Met in 2016)

14. The government publishes a Tax Expenditure Statement annually as part of the State budget documentation, including sectoral estimates, but there are no legal limits on the size of tax expenditures. The information is also not yet reviewed together with expenditure policies during detailed budgetary planning.[10] Following the 2022 amendment to the Budget Code, the first Tax Expenditure

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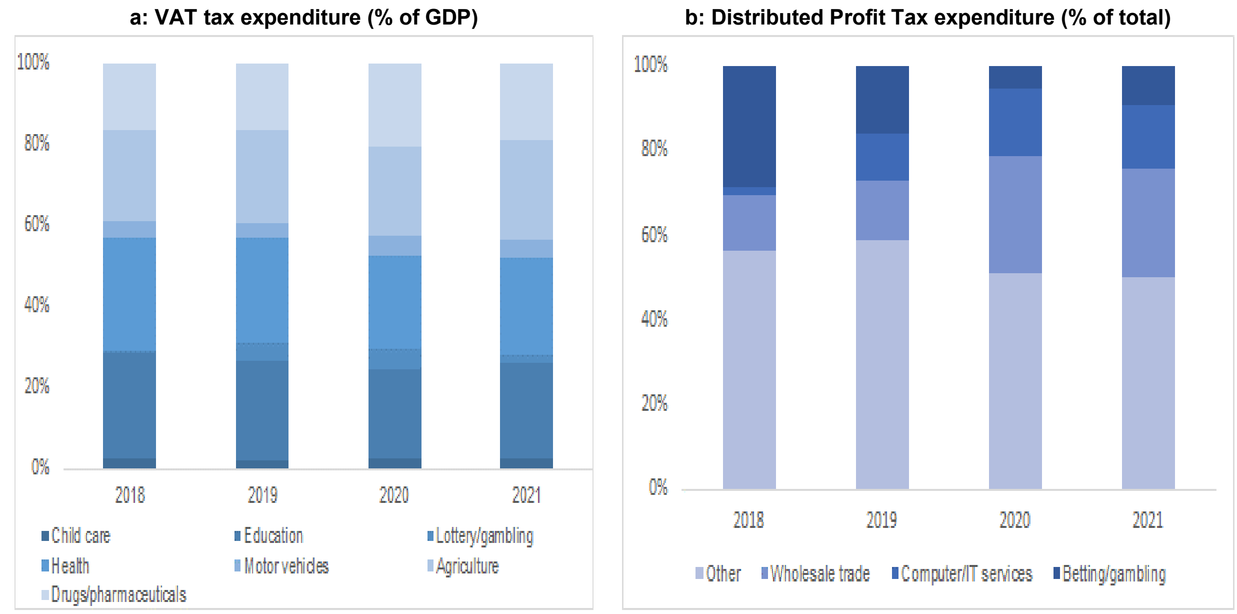
[8] Though not part of the government's net worth estimation, disclosure of the implicit long-term obligations for the government's social assistance-related pension payments payable from the state budget—NPV estimate of 109 percent of GDP—would provide an even more comprehensive view of the public sector balance sheet.

[9] As repayments of arrears which are not recognized in the cash-based reporting.

[10] The latter is one of the stated practices which qualifies for an "Advanced" rating, as set out in the FTE Handbook.

Statement was published as an annex to the 2023 State budget, building on MoF's analytical work since 2018. The estimates presented in the statement comprise personal income tax (PIT), corporate income tax (CIT),[11] distributed profit tax (DPT)[12] and VAT, covering more than 90 percent of tax expenditure. For 2021, total forgone revenue was calculated as GEL 2.76 million, or 4.6 percent of GDP. Estimates of tax expenditure by sector[13] are published for the four main types of tax expenditure (PIT, CIT, DPT and VAT) for the period 2018−22 (see Figure 1.3 for the sectoral analyses for VAT and DPT). Additional information on policy objectives for each type of tax expenditure is published as an annex. While the estimates of losses from forgone revenue are provided to Parliament alongside the expenditure allocations in the budget package, these estimates are not yet an active part of line ministries' budget planning process. There are no legal limits on the size of tax expenditure.

Figure 1.3. Tax Expenditure Estimates by Sector, 2018−21



Source: MoF

15. **Since the 2016 FTE, the MoF developed capacities for estimating forgone revenue losses, and published a detailed tax expenditure assessment.** The Macroeconomic Analysis and Fiscal Planning Department (MAFPD), together with the Tax and Customs Policy Department (TCPD), received external technical assistance to develop the estimation methodology, based on forgone revenue;[14] they put together an inventory of the tax expenditure in the Tax Code, and undertook the analysis. The estimates published in the annex to the State Budget are shown in GEL and as a share of GDP, with the underlying analyses including calculations by share of total revenue.

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[11] CIT is referred in the Statement as "(old) CIT" as it is being phased out, with its replacement by DPT. During the transition period, both types of tax expenditure are in place.

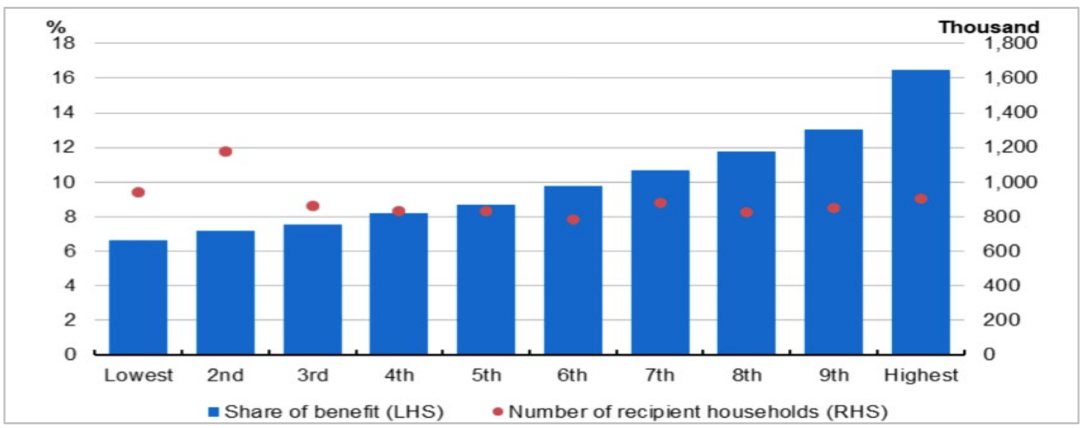
[12] DPT covers distributed profits and dividend withholding taxes.

[13] For CIT and DPT, sectors are defined according to NACE-2, the statistical classification of economic activities in the European Community ("Nomenclature statistique des activités économiques dans la Communauté européenne").

[14] This approach involves comparing the current and benchmark tax treatments for the items in question, assuming no taxpayer behavioral responses and changes in tax administration.

16. **The active consideration of revenue policy measures alongside existing and proposed tax expenditure measures would provide a more complete picture of the trade-offs between the two.** Forgone revenue is potentially lost expenditure for sector budgetary policies. These revenue-based policy measures may not be cost-effective compared to expenditure-based policies.[15] Introducing in the budget preparation guidelines the requirement for line ministries to consider the amount of revenue "lost" from each sector as an integral part of budget planning, would indicate the potential size of cost of policy measures provided to the sector. This practice would facilitate a comparative value-for-money analysis of the relative costs and benefits between the revenue and expenditure measures. Using this information, together with the cost-benefit analyses of individual tax expenditure currently being undertaken by MAFPD, would provide a good analytical base for rationalizing tax expenditure in the future. The example in Figure 1.4 illustrates the skewed impact of some revenue-based policies towards richer deciles and thus the potential for better value-for-money with careful targeting of an expenditure-based measure.

Figure 1.4. Australia, Distributional Analysis of a Revenue-based Policy Measure[1]



Source: 2022/23 Tax Expenditure and Insights Statement, Commonwealth of Australia, February 2023

1/ The policy measure depicted is the exemption from Goods and Services Tax (sales tax) on most staples and basic food.

1.2. Frequency and Timeliness of Fiscal Reporting

1.2.1. Frequency of In-Year Reporting (Advanced, Unchanged from 2016)

17. **In-year fiscal reports are prepared monthly and quarterly and are published within one month of the reference period.**[16] The required timings for submission to Parliament are set out in the Budget Code, and the reports are published upon submission. The MoF prepares and publishes on its website cash-based quarterly reports on budget execution, which follow the same format as for the

[15] Tax expenditure in the health sector, for example, apply to all relevant services included in the tax benefit policy, not targeted to those who need the support most, and, as such, the "lost expenditure" might be more cost effective using expenditure-based policies instead.

[16] The quarterly reports are shown cumulatively, and the fourth quarter report is considered as the annual budget execution (performance) report (see sub-section 1.2.2).

approved budget, including the annexes. The Treasury produces and publishes on its website monthly budget execution reports, which present expenditure by administrative and program classifications.[17]

18. Guided by fiscal legislation requirements, the government has continued the advanced practice as demonstrated in the last FTE. Monthly and quarterly budget execution reports are published on the MoF's and the Treasury's websites within the legislated time (within one month for monthly and quarterly reports). In line with the recent amendments to the Budget Code, the quarterly budget execution reports include new budget annexes, such as those on tax expenditure and fiscal risks.

1.2.2. Timeliness of Annual Financial Statements (Advanced, Unchanged from 2016)

19. Final unaudited consolidated Annual Financial Statements (AFS) for central government are published within six months of the end of the financial year. The consolidated AFS for central government are consistently submitted to SAO on or a few days before July 1 each year and are published on the Treasury's website upon submission. Consolidated central government AFS are based on the consolidated financial statements of individual budgetary organizations (e.g., line ministries and their subordinated agencies). Consolidated AFS, for central and local governments, are prepared according to 24 accrual-based IPSAS standards. While LEPLs and NNLEs use IPSAS-based accounting and reporting frameworks, some LEPLs, NNLEs and some other SOEs, specifically those which are sectorized as general government and currently prepare their financial statements according to IFRS standards, are exempt from using IPSAS.[18]

20. Notable progress since the previous FTE includes the preparation of the first consolidated AFS based on 24 accrual-based IPSAS standards by central and local governments. Consolidated AFS for central budget entities in accordance with 24 accrual-based IPSAS standards was prepared for end-year 2020 and published on the Treasury's website at the end of June 2021. Autonomous republics and municipalities prepared consolidated financial statements for the 2021 financial year based on 24 accrual-based IPSAS standards and submitted to the Treasury before April 1, 2022. Prior to 2021 autonomous republics and municipalities were not obliged to prepare financial statements and submit to the Treasury. Before implementation of IPSAS in autonomous republics and municipalities, the main end-of-year consolidated financial reports were the annual budget execution (performance) reports and accounting reports, which mainly focused on comparisons between the planned budget and actual outturns. The SAO reports on the annual budget execution reports and undertakes financial audits of the individual budget organizations' consolidated financial statements. However, to date, the SAO has not audited the 2021 consolidated central government AFS (see sub-section 1.4.2).

21. Ensuring that the consolidated central government AFS are audited in a timely manner would strengthen the comprehensiveness and accuracy of the central government's financial position and improve its oversight by Parliament and the public. There is currently no statutorily defined basis, including timing requirements, for the preparation, submission or audit of financial statements. The AFS for central government and the financial statements for budgetary organizations are

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[17] In the report, programs are shown by the relevant administrative body as they are unique to each budget organization.

[18] Examples of LEPLs and NNLEs include the Sport Federations, the Communication Commission of Georgia, and the Water Regulatory commission.

prepared in accordance with the MoF Order N24 of 4 February 2021 (regulation under Article 14 of the Budget Code). The latter sets out the procedure for preparation and submission of financial statements of budgetary organizations, as well as the format of the required statements and the explanatory notes. Article 9(5) stipulates both the preparation of consolidated AFS for the "State budget" (i.e., central government) and the deadline (by July 1) by which these should be published on the Treasury's website. There is no requirement in the Order for these statements to be submitted to Parliament or to the SAO to be audited.

1.3. Quality of Fiscal Reports

1.3.1. Classification (Advanced, Unchanged from 2016)

22. The administrative, functional, economic, and program classifications are used uniformly by all general government units. The budget itself and budget execution reports are presented using administrative, functional, economic, and program classifications, in line with the requirements in the Budget Code. The economic classification is aligned with the GFSM 2014, distinguishing revenue, expenditure and financing operations. The functional classification follows the United Nations' Classification of the Functions of Government (COFOG), which enables the government to allocate resources to different policy objectives and link those resources to specific nonfinancial performance indicators. Spending is also presented by programs and subprograms in a detailed annex to the budget execution report. There have been no significant changes in the classifications used since 2016.

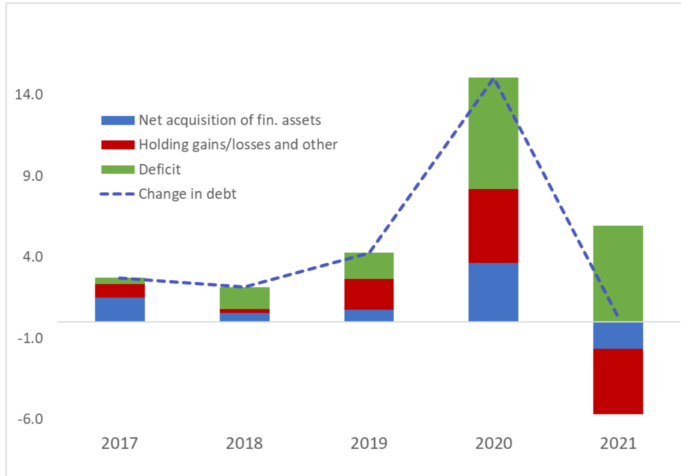
1.3.2. Internal Consistency (Good, Improved from Basic in 2016)

23. Fiscal reports include two of the three internal consistency checks required by the Fiscal Transparency Code (FTC).

- The budget execution and GFS reports provide full reconciliation between the above-the-line fiscal balance (i.e., revenue less expenditure) and the below-the-line financing (i.e., transactions in financial assets less transactions in liabilities). The budget execution reports provide details on the acquisition and drawdown of financial assets and incurrence and repayment of liabilities, while GFS reports provide these data on a net basis split by financial instruments.
- The MoF's Debt Management Department compiles and publishes data on government's debt holders, which was not published in 2016. Data on individual external bilateral and multilateral debt holders are published in the Debt Bulletin. Data on holders of domestic debt are published in a separate document, broken down by: NBG, commercial banks, other residents, and non-residents. Around 90 percent of total domestic debt is held by the NBG and domestic commercial banks.
- There is no reporting for the reconciliation of net financing and the change in the stock of government debt (i.e., Stock-Flow-Adjustment).

24. Internal consistent fiscal reports are key to ensuring their accuracy and credibility. The absence of a report reconciling government's net financing and the change in the stock of debt can raise serious questions about the accuracy of fiscal data. As illustrated in Figure 1.5, in 2017, the main element increasing the Georgian general government debt was financing of the acquisition of financial assets (such as loans or equity injections to public corporations). During the following years (2018−21), the deficit was the main contributor to the increasing debt. The significant fluctuations of holding gains and losses between 2017−21 referred namely to the volatility in nominal exchange rate (NER) over this period, with adjustments accounting from +4.6 to -4 percent of GDP. Due to the data constraints, this item also includes other unidentified factors that may cover possible errors and omissions.

Figure 1.5. Georgia: Stock-Flow Adjustments
(In percent of GDP)



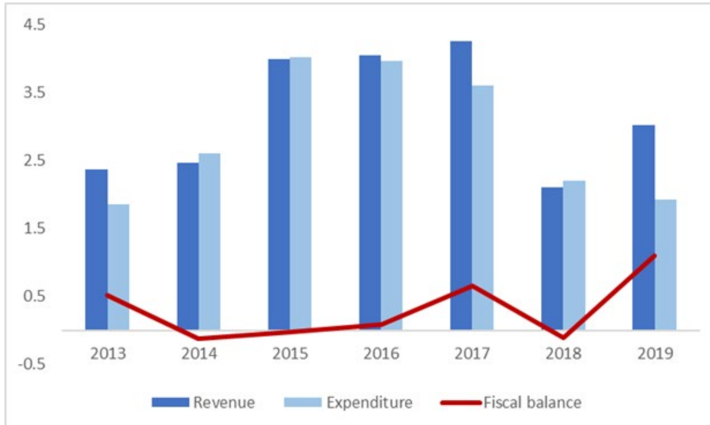
Source: GFS and IMF staff calculations

1.3.3. Historical Consistency (Basic, Improved from Not Met in 2016)

25. In 2021, the MoF carried out and published a major revision of GFS, covering the period 2004−19. Revised annual time series comprising detailed revenue, expenditure, and financing, were submitted to the IMF and published at the MoF's website. The main purpose of the revision was to expand the sector coverage of GFS by including LEPLs in line with the IMF's recommendations. Other improvements to GFS were also introduced in 2021, notably: moving repayments of arrears from financing to expenditure; recording of tax refunds and tax revenue sharing; and reclassification of the stock of historical debt as contingent liabilities. Figure 1.6 shows that the impact of the revision was material. On average for 2013−19, historical revisions increased the general government's revenue and expenditure, and improved the fiscal balance by 3.2 percent of GDP, 2.9 of GDP, and 0.3 percent of GDP, respectively.

26. While the major GFS historical revision was reported, no explanations and/or reconciliations of the significant changes that affected historical fiscal data have been published. Good practice requires alerting users that earlier reported fiscal statistics have been revised and publish an explanatory note with the reasons for the revisions (e.g., changes in the methodology, institutional coverage, introduction of alternative source data, and corrections of errors and omissions). The explanatory note should also disclose information on the impact of such changes on the main fiscal aggregates and balances.

Figure 1.6. Georgia: 2021 Historical Revision of GFS
(Percent of GDP)



Source: Annual GFS. [1]
1/ https://www.mof.ge/en/4547

1.4. Integrity of Fiscal Reports

1.4.1. Statistical Integrity (Basic, Reduced from Good in 2016)

27. Government finance statistics are compiled and published by the MoF on a GFSM 2014 basis, in compliance with the IMF's Special Data Dissemination Standard (SDDS) requirements. [19] The MoF's Macroeconomic Analysis and Fiscal Policy Planning Department (MAFPPD) is responsible for compiling and reporting GFS on the MoF' website. There is currently no standalone fiscal statistics team within the MoF. The capacities devoted to GFS are limited, as the GFS compilers are also responsible for numerous other tasks related to macro-economic analysis and fiscal policy.

28. No material changes occurred since 2016, yet the 2018 Fiscal Transparency Code prescribes more stringent requirements that lead to a downgrade of the scoring from good to basic. The 2018 Fiscal Transparency Handbook prescribes as good practice a clear delineation between the statistical data compilers and the users of the data. There are several benefits of this practice. It provides some operational independence for the compilers of fiscal statistics and encourages the introduction of policies conducive to statistical integrity and professional independence. It also promotes a more independent analysis of the quality of source data and compilation procedures, mitigating the risk of political interference in the production of statistics.

1.4.2. External Audit (Basic, Unchanged from 2016)

29. The SAO audits and publishes its review of individual central budgetary units' and two sub-national governments' (SNG) consolidated financial statements. The consolidated AFS for central government is not yet audited by the SAO, which instead publishes its review of the government's

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[19] https://dsbb.imf.org/nsdp#G

annual budget execution report,[20] including its assessment of the reliability of the main cash-based parameters.[21] SAO's independence (financial, organizational, and administrative) is guaranteed by the Constitution, Budget Code and SAO's Organic Law. As set out in the Budget Code, the SAO's primary statutory activity related to budget performance is to report on the annual budget execution report. The SAO's assessment of the 2021 central government annual budget execution report states that it provides an accurate depiction of budget performance in that year. However, the audit of financial statements by the SAO, for individual budgetary organizations or for consolidated government levels (e.g., central), is not mandated in the Budget Code or in its Organic Law. To date, the SAO has not audited the 2021 consolidated AFS for central government, but it audits the AFS of individual central budgetary units and two sub-national governments (SNG).[22] However, a review of the past year's financial audits of central government budgetary organizations' financial statements indicates systemic issues, leading to adverse opinions for nearly 50 percent of them and undermining a "true and fair view" of the consolidated central government financial statements.

30. **Progress since the 2016 FTE has largely involved strengthening SAO's legal independence and its audit capacities.** In particular, the amendments to the SAO's Organic Law made the SAO's legal independence more explicit, as well as clarified its purpose. In addition, progress has been made in building stronger technical audit capacities, including adopting new manuals for financial and compliance audits which are fully aligned to the International Standards of Supreme Audit Institutions (ISSAIs).

31. **While the SAO's legal independence is strongly established and its activities are wide-ranging, strengthening the legal scope of its mandate would provide a firmer foundation for external oversight.** Introducing in legislation the requirement for the timely audit of the general government's annual financial statements (for both consolidated general government and individual budgetary organizations) would enable Parliament and the public to have a more accurate picture of the government's overall financial position. Audit report recommendations in the audits of budgetary organizations' financial statements provide an overview of the necessary systemic improvements and can facilitate government's preparation of an action plan to address these issues.

1.4.3. Comparability of Fiscal Data (Basic, Unchanged from 2016)

32. **Budget execution reports are produced on the same basis as fiscal forecasts and budget, but there are differences across fiscal and statistical reports that are not reconciled.** The newly introduced IPSAS-based financial statements include a "statement of comparison of the budget and actual amounts." This statement attempts to reconcile the budget execution data with the sources and uses of cash as presented in the cash-flow statement. Although this is a step in the right direction, this statement does not clearly explain the reasons behind the difference in the fiscal balance. The MoF internally maintains a bridge table between the budget execution data and GFS quantifying different

[20] The authorities call these "performance" reports but are actually annual reports on budget execution.

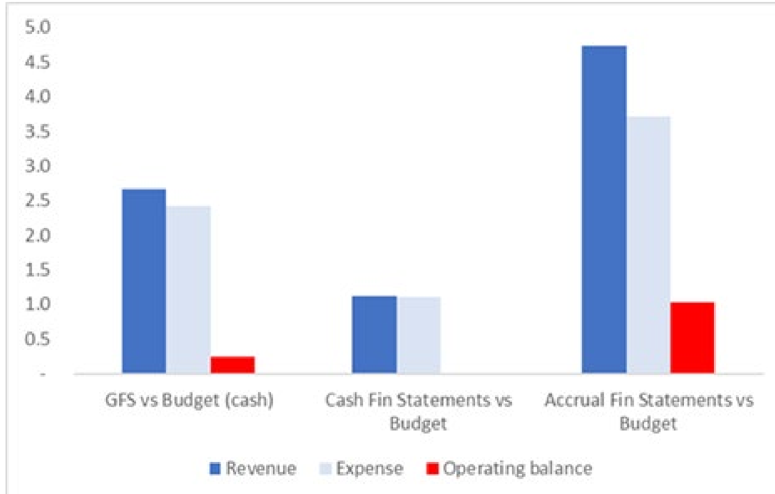
[21] Revenues, expenditures and balances.

[22] SAO has produced financial audits at the municipal level only for Tbilisi and Batumi's municipal governments' financial statements.

adjustments to transit to the GFSM 2014 methodology. However, such a reconciliation is not publicly available.

33. **Effective fiscal management and accountability require consistency and comparability of fiscal reports.** As illustrated in Figure 1.7, the differences across reports have been significant in 2021, in particular with respect to aggregated revenue and expense. Even if different fiscal reports such as budget execution, financial statements, and GFS might be compiled on a different basis, covering different sets of public units, and applying different methodology to treat specific government operations, good practices call for a reconciliation between these reports. When comparing data for the central government as reported in GFS and budget execution for 2021, even though both reports are cash-based, the difference between revenue and expense in 2021 accounted for 2.7 percent of GDP and 2.4 percent of GDP, respectively. Publishing information explaining the differences would enhance the credibility of the reporting and will enable policy makers and other users to process the fiscal results appropriately.

Figure 1.7. Georgia: Differences across Fiscal Reports, 2021
(Percent of GDP)



Source: GFS, budget execution, financial statements

1.5. Recommendations

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

- **Recommendation 1.1. Expand the coverage, presentation, and transparency of fiscal reports.**
  - Consolidate non-market SOEs in the GFS reports;
  - Progressively expand the coverage of the general government balance sheet to include all liabilities and better reflect the value of nonfinancial assets by completing the inventory of state assets and establishing a process for their valuation;
  - Incorporate in the financial statements accrued taxes based on assessments and declarations and estimate provisions for the amounts unlikely to be collected. In the meantime, use an alternative statistical method (e.g., time-adjusted cash) to estimate accrued taxes.

- **Recommendation 1.2. Strengthen consistency and comparability between and within fiscal reports**.
  - Publish reconciliation of financing and changes in debt;
  - Publish reconciliation statements of the differences between main fiscal aggregates published in various fiscal reports (i.e., budget execution, GFS, and financial statements).
- **Recommendation 1.3. Ensure that tax expenditure is reviewed as part of revenue and expenditure policies during the budget planning process**.
  - Include in the budget preparation guidelines for spending units on the incorporation of analyses of forgone revenue so that the costs of these revenue policy measures are reviewed alongside spending policy measures during budget planning.
- **Recommendation 1.4. Strengthen the integrity of fiscal reporting and the external oversight of the government's financial position.**
  - Establish a dedicated GFS team to enhance capacities and professional independence and ensure transparent delineation among the statistical data compilers and the users of the data.
  - Strengthen the legal basis for the timely audit of the general government's annual financial statements (for consolidated general government and for individual budgetary organizations);
  - Prepare an action plan to address the systemic issues in the audits of individual budget entities' consolidated annual financial statements

Table 1.5. Georgia: Summary Evaluation: Fiscal Reporting

	Principle	Assessment	Importance	Recs
1.1.1	**Coverage of Institutions**	**Good**: Fiscal reports consolidate general government data including LEPLs.	**High:** Expenditure of non-market SOEs and public corporations are excluded from fiscal reporting, accounting for 3.5 and 8.4 percent of GDP in 2021.	**#1.1**
1.1.2	**Coverage of Stocks**	**Good:** Fiscal reports cover non-financial and financial assets and liabilities, but the incomplete coverage and valuation issues remain.	**High:** Unreported government assets of 30.5 percent of GDP and liabilities of 7.1 percent of GDP (civil servants pensions scheme).	**#1.1**
1.1.3	**Coverage of Flows**	**Good**: Consolidated IPSAS-based financial statements largely cover cash and accrued revenue and expenditure, and other economic flows. Taxes accounted on a cash basis.	**Medium**: Tax revenues represent around 23.5 percent of GDP on an accrual basis.	**#1.1**
1.1.4	**Coverage of Tax Expenditure**	**Good**: Estimates of forgone revenue are published with the annual budget and include estimates by sector but are not considered during budget planning.	**Medium:** Forgone revenues represent around 4.6 percent of GDP, in line with the average for OECD countries.	**#1.3**
1.2.1	**Frequency of In-Year Reporting**	**Advanced**: Monthly and quarterly budget execution reports are published within 1 month	**Low**: Consistent and transparent monitoring of budget execution takes place during the year.	
1.2.2	**Timeliness of Annual Financial Statements**	**Advanced**: Unaudited annual financial statements for CG are published within 6 months of the end of the financial year.	**Medium**: No statutory audit requirement for financial statements; high proportion (50 percent) of adverse opinions to financial statements.	**#1.4**
1.3.1	**Classification**	**Advanced:** Administrative, functional, economic, and program classifications consistent with international standards, are used by fiscal reports.	**Low:** Detailed information on the use of public resources across classifications provides a sound information base for decision making.	
1.3.2	**Internal Consistency**	**Good**: Fiscal reports include reconciliations of the fiscal balance and financing, and debt issued and debt holders	**High:** Differences between net debt issuance and change in debt varied between -4.6 to +4 percent of GDP over 2017-2021.	**#1.2**
1.3.3	**Historical Revisions**	**Basic:** A major revision of historical GFS time series performed and published in 2021.	**Medium**: Unexplained reasons for revised revenue of 3.2 and expenditure of 2.9 percent of GDP, on average over 2013-2019.	**#1.2**
1.4.1	**Statistical Integrity**	**Basic**: Fiscal statistics are disseminated in accordance with international standards. No clear delineation between compilers and users of fiscal statistics.	**Medium:** Meeting EU standards will require stronger safeguards of statistical integrity.	**#1.4**
1.4.2	**External Audit**	**Basic**: SAO publishes report on reliability of budget execution report. A significant share of audited FS of budgetary units receives adverse opinions.	**High**: High rates of adverse opinions on underlying FSs (about 50 percent) prevent a 'true and fair view' of the consolidated CG AFS.	**#1.4**
1.4.3	**Comparability of Fiscal Data**	**Basic:** Budget execution reports are prepared on the same basis as the budget	**High:** Information bridging budget execution reports and GFS data exist.	**#1.2**

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

LEVEL OF IMPORTANCE	RATING		
	High	Medium	Low

II. FISCAL FORECASTING AND BUDGETING

35. Budgets and their underlying fiscal forecasts should provide a clear statement of the government's budgetary objectives and policy intentions, and comprehensive, timely, and credible projections of the evolution of the public finances. It is important that fiscal forecasts and budgets:

- Provide comprehensive information on the government's fiscal objectives and budgetary plans, facilitate policy analysis and accountability.
- Enhances orderliness in the budget calendar by giving the legislature enough time to scrutinize and approve the plans before the budget year begins.
- Has a clear policy orientation that facilitates policy analysis and accountability.
- Are based on credible projections of macroeconomic developments.

36. Georgia continues to perform well in the overall transparency of its fiscal forecasting and budgeting practices, underpinned by a strong legal framework, macroeconomic forecast, and medium-term budget framework (MTBF). Since 2016, the rating of four principles has increased, while 8 remain unchanged (Table 2.1). Overall, there has been good progress in implementing the recommendations of the 2016 evaluation (Table 2.2). LEPLs were added to the budget documentation, which resulted in more comprehensive budget expenditure reports used to assess compliance with fiscal rules. Credibility of fiscal data has improved by disclosing forecast reconciliations between successive vintages of main fiscal aggregates as an annex in the budget documentation.

Table 2.1. Fiscal Forecasting and Budgeting: Summary of Changes since 2016

Area	Principle		2016	2023
Comprehensiveness	2.1.1	Budget Unity	Basic	Good
	2.1.2	Macroeconomic Forecast	Good	Advanced
	2.1.3	Medium-term Budget Framework	Advanced	Advanced
	2.1.4	Investment Projects	Good	Good
Orderliness	2.2.1	Fiscal Legislation	Advanced	Advanced
	2.2.2	Timeliness of Budget Documents	Good	Good
Policy Orientation	2.3.1	Fiscal Policy Objectives	Not met	Good
	2.3.2	Performance Information	Good	Good
	2.3.3	Public Participation	Basic	Basic
Credibility	2.4.1	Independent Evaluation	Good	Good
	2.4.2	Supplementary Budget	Good	Good
	2.4.3	Forecast Reconciliation	Not met	Basic

Table 2.2. Fiscal Forecasting and Budgeting: Progress on Recommendations since 2016

Recommendation in 2016		Progress made
2.1	Improve the comprehensiveness of the budget coverage	**Good progress:** own source revenue and related expenditure of LEPLs on a gross basis were added to budget documentation.
2.2	Improve the credibility of the government's fiscal objectives. ▪ Review fiscal rules, expand coverage of reporting, and tighten budget accounting ▪ Report on performance against each fiscal rule, including reasons for possible deviations ▪ PBO should evaluate compliance of government with fiscal rules and publish the assessment	**Good progress:** as noted above, LEPLs were added to the budget documentation, which resulted in more comprehensive budget expenditure reports used to assess compliance with fiscal rules. The December 2018 revision to the Economic Liberty Act eliminated the expenditure rule, leaving the deficit and debt rules. MoF and PBO each annually publish an assessment of compliance with fiscal rules.
2.3	Improve the credibility of the macroeconomic forecasts and MTBF	**Some progress**: alternative scenarios of GDP, inflation, and current account deficit dynamics are discussed in relationship with their underlying variable assumptions. Outer-year fiscal aggregates in the MTBF have faced extreme volatility, in large part driven by the Covid-19 pandemic.

Source: IMF staff

2.1. Comprehensiveness

2.1.1. Budget Unity (Good, Improved from Basic in 2016)

37. Budget documentation incorporates all gross revenue, expenditure, and financing of general government entities except non-market SOEs. In Georgia, there are no extrabudgetary entities or funds (other than non-market SOEs) and there is no social security fund. The non-market SOE expenditure represents approximately 3.5 percent of GDP.[23] All major financing sources are included in budget documents, including regular budget funds, expenditure from own revenue, external loans, and external grants. While externally financed projects are shown in the budget, spending may exceed budgeted amounts as agreed bilaterally with donors. All revenue, expenditure, and financing are included in the budget on a gross basis.

38. LEPLs were included in the budget documents starting from the 2016 budget. Before 2016, LEPLs submitted budget data through the budget unit supervising them, but they were not required to use the TSA, resulting in incomplete budget execution reports. Beginning in 2018 the majority of LEPLs and NNLEs were included in the TSA, with some exceptions noted in Pillar I. In early 2023, authorities began the transition to TSA of the remaining LEPLs and NNLEs, which is expected to be completed by the end of 2024.

39. Budget documentation is fairly comprehensive but gaps in spending control and expenditure reporting remain. The major outstanding issue is not yet including non-market SOEs in

[23] See Table 0.2 of this report.

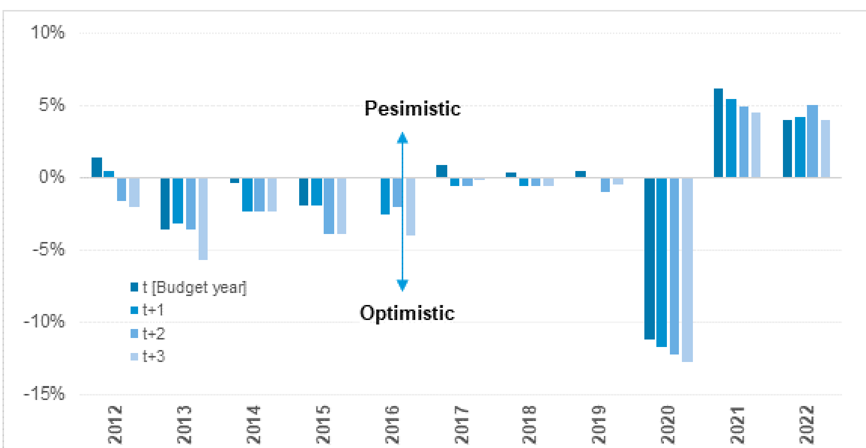
budget documentation. A full sectorization exercise was conducted by MoF in 2022. The MoF adopted plans to include these entities in the TSA by 2026.

2.1.2. Macroeconomic Forecast (Advanced, Improved from Good in 2016)

40. The budget documentation provides full explanation of the macroeconomic forecasts, analyses the drivers of each component, key relationships, and the reasons for deviations. The government prepares and publishes in the Basic Data and Directions Document of Georgia (BDD) a four-year forecast for the main macroeconomic variables at least twice a year, for the initial MTBF in May and for the draft budget in September. Forecasts tables include estimations for GDP, inflation, exchange rates, current account deficit, as well as their underlying assumptions and actual data for 3-year preceding the planning period. The assessment is accompanied by domestic and international economic outlook. Deviations occurred during different forecasting periods are explained. The government also produces three alternative macroeconomic scenarios (i.e., baseline, optimistic, and pessimistic).

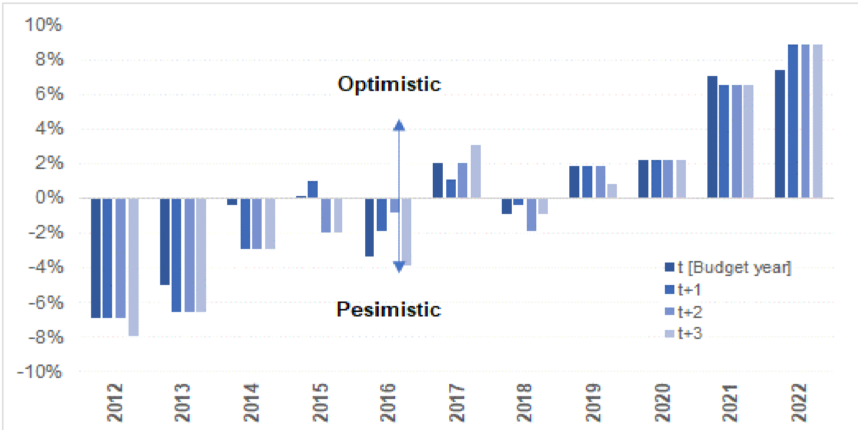
41. Since the 2016 FTE the government has consistently improved disclosure of the three macroeconomic development scenarios which are annexed to the draft budget. Alternative scenarios of GDP, inflation and current account deficit dynamics are discussed in relationship with their underlying variable assumptions. The forecast provides details on the most important sectors relevant to the country (e.g., tourism). The MTBF and the government budget proposal derive from the baseline scenario. In turn, NBG and the Parliamentary Budget Office (PBO) perform alternative macroeconomic forecasts.

Figure 2.1. Real GDP Forecast Bias, Average Forecast Error (In percent)



Source: IMF staff estimates based on official data. Absolute error.

Figure 2.2. Inflation Forecast Bias, Average Forecast Error (In percent)



Source: Staff estimates based on official data. Absolute error.

42. **During 2012-2019, real GDP forecasts have had an optimistic bias, in contrast to the 2020−22 Covid-19 period.** For the pre-Covid period, real GDP outturns were consistently weaker than forecasts. Average real GDP forecast errors for the first year were 0,4 percent, for the second and third year forecasting errors were 1.4 percent and 2 percent, respectively (Figure 2.1). In 2020, the first year of the Covid-19 pandemic, forecast errors increased dramatically reaching to about 12 percent for the first outer year. However, real GDP recovered faster than forecasts in 2021 and 2022. For the inflation rate, on the other hand, forecasts showed a pessimistic bias in the pre-Covid period, with outturns being lower than forecast, on average. This situation was reversed during Covid, with actual inflation rates being much higher than forecasts. (Figure 2.2).

2.1.3. Medium-term Budget Framework (Advanced, Unchanged from 2016)

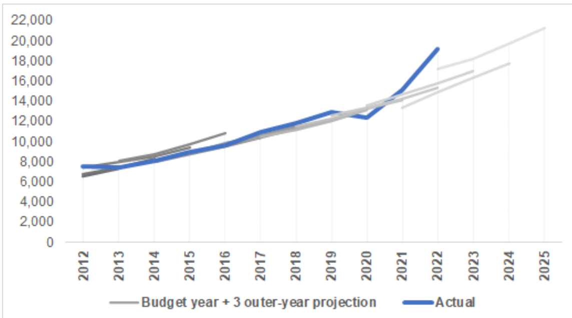
43. **A MTBF has been in place since 2004, including outturns for the two preceding years and medium-term projections of revenue, expenditure, and financing by economic category at a consolidated, state and local government budget's level and by program and administrative unit.** In the BDD, expenditure is projected by major economic categories, and revenue by tax and non- tax revenue. BDD is guided by line ministries' activity plans, which provide government political commitment for drafting the budget. Since 2021 the MoF implemented a new annex to the BDD document which provides information on baseline and new policy expenditure.

44. **Until 2019, medium-term fiscal forecasts had been relatively low compared to outturns for both for revenue and expenditure, increasing significantly afterwards due to the Covid 19 pandemic.** Between 2012 and 2019, revenue outturns were higher than planned revenue for the budget year by an average of 0.1 percent on GDP (Figure 2.3 and 2.4). In turn, expenditure outturns were lower than planned expenditure for the budget year by an average of 0.2 percent of GDP. For both revenue and expenditure, the magnitude of the deviations between forecasts and outturns (i.e., forecast errors) gets larger as the time interval increases between the date of the forecast and the relevant budget year (i.e., t, t+1, t+2, t+3). Forecast errors for both revenue and expenditure for the two outer years have averaged less than 0.5 percent of GDP, almost doubling as percent of GDP for the third outer year. Both

revenue and expenditure forecast errors increased significantly during the Covid 19 pandemic and the supporting spending measures introduced by government.

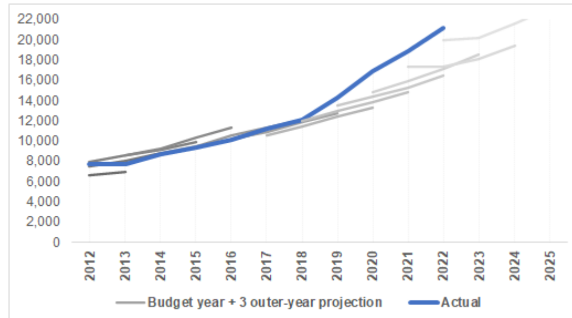
Figure 2.3. Forecasting Errors: Actual vs. Budget (In million GEL)

Revenue



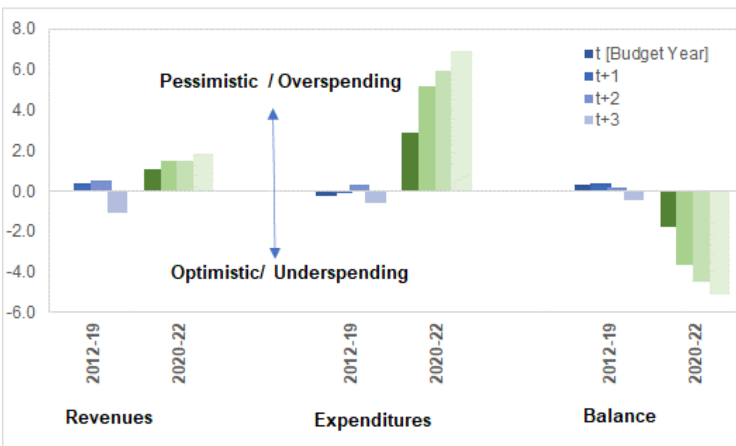
Sources: IMF staff based on official data.

Expenditure



Sources: IMF staff based on official data.

Figure 2.4. Average Forecasting Errors (In percent of GDP)



Sources: IMF staff based on official data.
For revenue*: (+) indicates actual revenue higher than expected [pessimistic forecast]; (-) indicates actual revenue lower than expected [optimistic forecast].* ***For expenditure****: (+) indicates actual expenditure higher than expected [overspending]; (-) indicates actual expenditure lower than expected [underspending].* ***For balance****: (+) indicates actual deficit lower than expected [pessimistic forecast]; (-) indicates actual deficit higher than expected [optimistic forecast].*

2.1.4. Investment Projects (Good, Unchanged from 2016)

45. The total obligations of multiyear projects are disclosed in budget documents and procurement is competitive, but not all projects are appraised. An annex to the budget states the sum of payments made to date, current year budget plan, year-by-year over the medium team, and total obligations for each project included in the budget. Major projects are defined as financially significant projects, or those costing more than GEL 20 million.[24] Standards for appraisal, selection, and implementation are included in the Public Investment Management (PIM) Methodology and vary based on

[24] The 2016 PIM Methodology defines a financially significant project as costing more than GEL 5 million.

cost size. Appraisals for projects costing over GEL 5 million are published as an annex to the budget. All externally financed projects are included in budget documentation and budget expenditure reports, including payments made directly by the financing partner to a vendor. Procurement of major individual public works, enumerated in Table 2.3, were procured using competitive methods in 2021 and 2022. State Procurement Agency Order 13 of 2015 provides criteria and procedures for exemptions from competitive procurement procedures, and these decisions are documented. All major donors use the state electronic procurement system when implementing projects that they fund. Special modules have been designed to reflect internal donor requirements, and thus statistics published by the State Procurement Agency cover domestic and externally funded capital project tenders.

46. Appraisals are not always completed before budget approval. When a budget project is for a major single structure or facility, appraisals are prepared and published along with the budget proposal. However, when a major budget project contains more than one capital purchase,[25] the structures or facilities commonly are not appraised individually.[26] For example, the 2023 project "Tourism Infrastructure Improvement Measures"[27] for GEL 600 million does not identify individual structures or facilities, some of which could cost more than GEL 20 million. The number of such budget projects is significant, as shown in Table 2.3. The total value of the 8 budget projects containing multiple capital purchases in 2023 is GEL 2.14 billion, compared to the total 2023 capital budget of GEL 3.88 billion. While the total value of these projects will be spent over multiple years, comparing this total to the amount of money currently available to fund capital projects shows that these projects represent a significant claim on the capital budget for years to come.

Table 2.3. Georgia: Selected Characteristics of New Major Budget Capital Projects

	Total number of new major budget projects (total cost over 20 million GEL)	Of which, primarily and directly* donor funded	Of which, contain one or multiple capital purchases
2021	7	6	3 one; 4 multiple purchases
2022	2	2	2 one
2023	9	5	1 one; 8 multiple purchases

**Note: donors indirectly finance some projects through the Municipal Development Fund*

47. Several reforms have been undertaken since 2016 to improve public investment management and procurement. MoF adopted a PIM reform framework in 2016. In terms of transparency, the highlight of the reform relates to expanding the process for appraising projects before their selection in the budget and publishing the analysis. At the same time, several reforms have occurred in public procurement since 2019, mostly driven by the alignment process with the EU's procurement standards. The Public Procurement Law was amended and approved by Parliament in February 2023, which will take effect in January 2025.

[25] The phrase "capital purchase" is used to eliminate possible confusion with the word "project" in this context. It is customary to refer to an item in the capital budget as a project. Usually, it pertains to one major item to be purchased, such as land, or a building, road, or water system. However, when more than one major capital item is included in a single capital project in the budget, the use of the word "project" is confusing: one project in the budget does not mean there is one project to be purchased or constructed.

[26] Article 11 of the PIM Methodology allows for multiple donor-funded projects to be consolidated under one appropriation but is silent on whether the appraisals of projects in the appropriation are similarly conducted or published in a consolidated manner.

[27] Program 25 08, funded by the Municipal Development Fund of the Ministry of Regional Development and Infrastructure

48. **The practice of grouping multiple capital purchases under one budget project represents a loophole in the PIM Methodology and undermines the efficiency of public investment spending.** Providing some flexibility in the capital budget is good practice. However, the desire for flexibility should not mean that major individual capital purchases and their costs are not fully identified before budget approval. If budget projects with multiple major capital purchases continue, individual capital purchases expected to cost more than GEL 5 million should be identified, total costs estimated, and appraisals conducted in line with the PIM Methodology applicable to similar stand-alone projects.

2.2. Orderliness

2.2.1. Fiscal Legislation (Advanced, Unchanged from 2016)

49. **Georgia's legal framework defines the budget preparation and approval timetable, the key requirements for the government's budget, and executive and legislative responsibilities for amendments to the draft budget.** The Budget Code specifies the timetable for submission and approval of the government budget in Chapter V (Articles 33-40), and the main requirements for the contents of the annual budget law, including annexes, in Article 38.[28] As set out in Article 7, the government's responsibilities in the budget process focus on budget preparation, implementation, and reporting; while the Parliament is responsible for the budget review and approval. As legally stipulated, Parliament is permitted to revise the draft budget only with government agreement. The Budget Code also defines the timing for preparation of in-year and annual budget execution reports.

50. **Since the 2016 FTE, fiscal legislation has been strengthened to foster improved government accountability and external oversight.** Notable amendments introduced during the past 6 years have codified the requirement for expanded content for the State budget, including tax expenditure analyses and a fiscal risks statement (FRS).

2.2.2. Timeliness of Budget Documents (Good, Unchanged from 2016)

51. **The draft annual budget bill is submitted to Parliament and made available to the public at least three months before the beginning of the next fiscal year and is approved and published within one month of the coming fiscal year.** The scrutiny and approval process for the draft budget, including the required timing, is set out in the Budget Code. The Code specifies an interactive process between the government and Parliament, involving Parliamentary committees scrutinizing the drafts and providing their comments for government review and response, which may or may not result in changes. The final (third) draft is provided to Parliament by the end of November, with approval taking place on or before the third Friday in December, and publication within the following week and before the beginning of the new fiscal year. The initial and resubmitted drafts are published on the MoF's website upon submission (see Table 2.4). Since the 2016 FTE, the government has continued to adhere to the same legislated requirements for budget submission and approval.

[28] For SNGs and the autonomous republic, the preparation and approval timetable and required contents of the budgets are set out in Section IV (Articles 65-103) of the BC.

52. Given the frequent interaction between the government and Parliament during the more than three months from initial budget submission to approval, the time for scrutiny is considered to be adequate. The process is well-established and well-respected.

Table 2.4. Georgia: Timing of Draft Budget Bill Submission, Approval and Publication, 2018−23

	Government submission of draft State budget bill to Parliament	Parliamentary approval of State budget Law	Publication of draft State budget bill	Publication of State budget Law
2018 budget		13 Dec 2017		20 Dec 2017
1st submission	26 Sep 2017		26 Sep 2017	
2nd submission	27 Oct 2017		27 Oct 2017	
3rd submission	29 Nov 2017		29 Nov 2017	
2019 Budget		13 Dec 2018		19 Dec 2018
1st submission	25 Sep 2018		25 Sep 2018	
2nd submission	01 Nov 2018		01 Nov 2018	
3rd submission	30 Nov 2018		30 Nov 2018	
2020 Budget		10 Dec 2019		16 Dec 2019
1st submission	30 Sep 2019		30 Sep 2019	
2nd submission	05 Nov 2019		05 Nov 2019	
3rd submission	29 Nov 2019		29 Nov 2019	
2021 Budget		29 Dec 2020		31 Dec 2020
1st submission	25 Sep 2020		01 Oct 2020	
2nd submission	05 Nov 2020		05 Nov 2020	
3rd submission	30 Nov 2020		30 Nov 2020	
2022 Budget		17 Dec 2021		21 Dec 2021
1st submission	24 Sep 2021		26 Sep 2021	
2nd submission	05 Nov 2021		05 Nov 2021	
3rd submission	30 Nov 2021		01 Dec 2021	
2023 Budget		15 Dec 2022		23 Dec 2022
1st submission	30 Sep 2022		30 Sep 2022	
2nd submission	04 Nov 2022		04 Nov 2022	
3rd submission	30 Nov 2022		30 Nov 2022	

Source: MoF

2.3. Policy Orientation

2.3.1. Fiscal Policy Objectives (Good, Improved from Not Met in 2016)

53. The government states and regularly reports on numerical objectives, but measurement of compliance with the deficit rule is incomplete. Fiscal objectives have been adopted in two forms: two fiscal rules established in the Economic Liberty Act (ELA)[29] and annual targets for fiscal aggregates

[29] Initially adopted in 2011 with three fiscal rules.

(revenue, expenditure, and deficit) in the medium-term budget that serve as pathways for achieving the objectives embodied in the fiscal rules. The fiscal rules apply to general government.

54. The fiscal rules are precise and time bound, and include an escape clause, but adherence to the rules cannot be measured precisely. The two fiscal rules relate to the budget deficit (3 percent of GDP) and the stock of gross debt (60 percent of GDP). The ELA prescribes the conditions under which escape clauses can be triggered, as well as the reporting requirements. The MoF reports annually on the compliance with the fiscal rules and explains the strategy to return to the rules in the event of a deviation.[30] Any planned deviation from the rules should be remedied within 3 years, except in certain circumstances.[31] Recent compliance with the fiscal rules is shown in Table 2.5.

55. The budget document includes a medium-term fiscal framework that provides fiscal aggregates for the budget year plus each of three forward years. The medium-term approach to budgeting has been in place at least since 2010. Chapters of the budget document, approved by Parliament, cover fiscal aggregates only for the budget year. The fiscal aggregates for the forward years are clearly time bound and quantifiable. However, the forward years of the fiscal framework, described in Institution 2.1.3., are included in the BDD, a non-binding annex to the budget. They are reviewed annually and may be revised. The strategy behind the fiscal aggregates, and how they show evolution toward the fiscal rules, is explained in the BDD.

Table 2.5. Georgia: Compliance with Fiscal Rules (unified budget)

(In percent of GDP)	2018	2019	2020	2021	2022	2023 (planned)	Target
Actual Deficit	-0.7	-2.6	-9.0	-6.2	-2.1	-2.8	**-3.0**
Non-compliance	0.0	0.0	6.0	3.2	0.0	0.0	
Actual Debt	38.9	41.2	61.0	50.3	40.3	38.8	**60.0**
Non-compliance	0.0	0.0	1.0	0.0	0.0	0.0	

Source: Parliamentary Budget Office

56. Several important reforms have been introduced since 2016. The expenditure rule was abolished in the December 2018 amendment of the ELA. At the same time the coverage of the deficit and debt rules was partially expanded to general government.[32] Compliance with the rules is now reported annually by the MoF and the Parliamentary Budget Office.

57. Fiscal rules are not effective if compliance with them cannot be measured precisely. While the fiscal rules are stated precisely, the adherence to the rules cannot be measured accurately. As noted in Institution 2.1.1, budget execution reports do not include non-market SOEs. Progress in incorporating appropriate entities into the budget process has been noted in 2.1.1., but more work is required. In addition, budget expenditure reports show expenditure exceeding appropriations by small percentages for

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[30] The MoF complies with this requirement. See the budget annex commonly titled "Comparison of medium-term forecasts and compliance with fiscal rules determined by the organic law of Georgia".

[31] Article 2, paragraphs 7 and 8 of the amended ELA.

[32] The ELA defines coverage of the deficit rule as the consolidated state budget, and the debt rule as government debt. MoF is in the process of moving these coverages to conform to the GFS 2014 definition of general government.

each year 2017−21. This occurs when donors, using authority in their bilateral agreements with the government, make payments that exceed estimates in the approved budget.

2.3.2. Performance Information (Good, Unchanged from 2016)

58. Budget documentation contains targets for, and performance against, outputs but not outcomes of major policy areas. Performance planning and monitoring was introduced in 2012, focusing on outputs and covering all years of the medium-term budget. A program budget classification was introduced at that time, linking programs to 12 policy classifiers that represent broad priorities and objectives. Compilation and presentation of performance information has evolved. In 2012, program funding and non-financial information were used to justify budget funding requests. In 2012, the budget document was expanded to include annexes for policy directions and programs and funding for these policies. Non-financial performance information is reported quarterly and annually, with the annual report comparing achievements with what was planned, identifying the difference, and explaining why the difference occurred.

59. Since 2016, there has been progress regarding presentation of performance information, and expansion of policy information in the e-Budget system. In 2018 performance information was expanded to include baseline, targeted possible risks, and possible deviations. In 2021, information on new policies was included in budget documents. Greater focus on the impacts of programs is being introduced, which represents first steps toward identifying outcomes. The e-Budget information system is being expanded to include the 12 priorities, which are already linked in budget classification coding. This will allow reports from the e-Budget system to organize data from a broad strategic policy level and drill down to sub-program, non-financial performance information, and associated funding.

60. Performance information enhances spending efficiency, but only indirectly affects fiscal policy. Over the last 10 years, MoF has steadily improved the type of performance data collected, its presentation, and associated legal framework. A performance-focused culture has a positive influence on program management by budget units as well as on allocation of funding. High-performing programs mean achieving more with the same or less money, which may reduce pressure to increase total budget expenditure. However, it is very difficult to assess the impact of performance information on management, resource allocation, or total expenditure.[33]

2.3.3. Public Participation (Basic, Unchanged from 2016)

61. The published Citizens' Guide to the budget provides an accessible description of recent economic and fiscal performance and medium-term prospects and its implications from a typical citizen's standpoint, but opportunities for citizens to have a formal voice in budget deliberations are limited. The MoF produces and publishes on its website a comprehensive overview of the annual State budget, giving simple explanations of budget-related terms and processes. A Citizens' Guide is published for each of the budget (re-)submissions and the final approved budget, includes information on

[33] This is not just a data issue. For example, if performance is poor for a particular program, there are multiple possible causes: funding is too low to meet its target, the target is too ambitious, management is ineffective, or poor program design. Therefore, it is just as likely that the response to poor performance should focus on management as on budgets.

aggregate fiscal parameters and budget allocations (by administrative, programmatic and functional classifications) for the two most recently completed fiscal years and for the medium-term budget period, and highlights policies (distinguishing new policy directions) and their budgetary allocations. Additionally, an easy-to-follow two-page brochure is published, highlighting the main budget parameters using clear and colorful graphics.[34] Relatively few SNGs publish a Citizen's Guide to their budgets.[35] The PBO publishes citizen accessible information on the annual state budget, presenting key trends in infographics form. [36,37]

62. **There is no formal mandate at central level for public participation as part of budget deliberations, such as the right to allocate a certain percentage of the budget according to priorities identified by citizens.** Georgia's Parliamentary Rules of Procedure do not give a formal voice to citizens or civil society groups during the review of the annual budget.[38] While members of the public may be invited to attend Parliamentary Committee budget hearings, their inputs are not a formal part of the hearings. More broadly, a budget transparency portal[39] was established in the last five years, which includes space for providing suggestions for the next budget, but very few people have done so over the last three years, and the portal contains some broken links.

63. **Since the 2016 FTE, the government has continued to publish its range of citizens' guides but increasing the level of public participation has been a challenge.** Public participation is greater in SNGs, particularly due to the Budget Code mandate for public discussions after publication of the draft municipal budgets. Other initiatives include portals which enable citizens to suggest ideas for budget proposals to the city or municipal mayor and to vote on others' ideas. However, generating sufficient ideas and encouraging citizens to vote on them have proven to be difficult.

64. **Increasing the accessibility of the Citizens' Guide, improving the amount of information more directly relevant to citizens, as well as providing more structured opportunities for participation may facilitate better understanding of the importance of budgets for typical citizens.** Streamlining the current full Citizens' Guide and disseminating it publicly by various means would improve its accessibility and its reach to as many citizens and civil society groups as possible, including those without internet access. Providing additional analyses of new revenue measures in the budget, for example, could look at the impact on different groups in the economy. Finally, more structured opportunities for public participation, such as convening several town hall-style meetings for different groups of stakeholders, including civil society groups, to discuss priorities for the coming budget as part of the initial stage of budget preparation. For sustainability, the structured opportunities would require institutionalization (institutional responsibilities and active management) and be supported by legislation.

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[34] In addition to the citizens' guide to the budget, MoF publishes brief guides to budget execution reports and the BDD on its website: https://mof.ge/mokalakis_gzamkvlevi

[35] The Citizens' Guide for the budget of Rustavi municipality provides a good example of one that does.

[36] https://pbo.parliament.ge/reports/diagram.htm

[37] PBO has published methodological guidelines and an explanatory video for citizens to help them prepare financial impact assessments for their legislative proposals. https://pbo.parliament.ge/images/1.Methodological%20guidelines%20for%20preparing%20the%20FIA%2028.03.2023.pdf?_t=1679997564 (methodological guidelines) and https://www.youtube.com/watch?v=wgS6gfszEhY (video)

[38] Members of the public are not one of the groups specifically required to provide an opinion on the draft budget.

[39] https://ebtps.mof.ge/

2.4. Credibility

2.4.1. Independent Evaluation (Good, Unchanged from 2016)

65. **The Parliamentary Budget Office (PBO) independently produces economic and fiscal forecasts, but it does not regularly perform ex-post reviews of forecasts.**[40] Established in 1997, the current role of the PBO is defined in Parliament Order 1/30/20 of February 3, 2020, and the Rules of Procedure of the Parliament of Georgia. PBO's forecasts are detailed, showing the assumptions, rationale, cost drivers, and policy inputs feeding into the forecasts. PBO compares its forecast with MoF's forecasts, and evaluates assumptions made by MoF. The NBG regularly issues monetary- and financial stability-related forecasts, each with macroeconomic assumptions. In 2022, the PBO identified ex-post forecast errors for real and nominal GDP growth rates. It compared forecasts issued in 2017, 2018, and 2019 by itself, MoF, NBG, and IMF. However, such ex-post assessments were part of a one-off self-assessment and have not been produced regularly. In addition to alternative macroeconomic and fiscal forecasts, the PBO regularly produces analyses of the executive's proposed detailed budget[41], budget execution, and financial impacts of proposed legislation. All PBO's analyses are published.

66. **Since 2016, the PBO publishes an annual assessment of compliance with fiscal rules and has expanded its monitoring of budget execution.** An annual assessment of compliance with fiscal rules has been produced starting with the 2020 budget. The analysis covers compliance with fiscal rules in the budget year, plus the medium-term aggregates included in each budget. This report is not explicitly mandated in PBO's legal framework. In addition, supported by Parliament Order 1/30/20 of 2020, the PBO produces analyses of monthly, quarterly, and annual budget execution reports issued by the MoF.

67. **Ex-post analysis of forecast errors is an important tool to evaluate the government's economic and fiscal forecasts.** Regularly comparing errors of forecasts prepared by MoF, PBO and others (as noted above) can be very effective in highlighting persistent optimism bias among them. Expanded identification of trends in analysis of the detailed budget is also very useful. Common examples are showing the change in share of the total budget taken by different ministries or programs, and showing how allocations from contingency funds in prior years influence the funding for specific programs in the proposed budget. In addition, scanning the detailed budget for issues identified by the AGO reinforces the authority of both the AGO and PBO. These types of analysis do not violate Parliament Order 1/30/20 which prohibits the PBO from making recommendations on budgetary, tax, monetary, and public finance supervision policy.

2.4.2. Supplementary Budget (Good, Unchanged from 2016)

68. **A supplementary budget is required for an increase in total expenditure, but some changes to the composition of spending might occur outside the authority delegated to the executive.** The Constitution states that Parliament annually adopts the State Budget Law. However, the Constitution does not include a provision stating that expenditure or disposal of assets can occur only in

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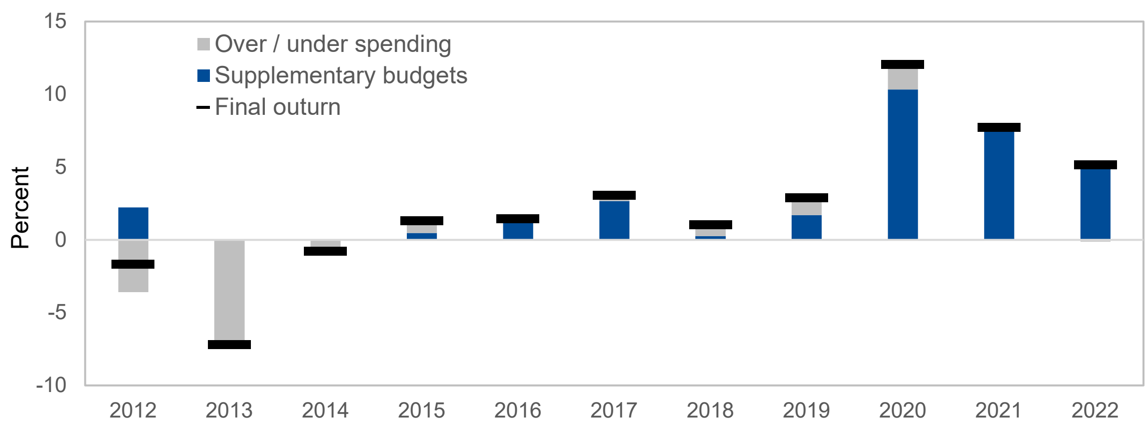
[40] Published forecasts and analyses can be found at https://pbo.parliament.ge/index_en.htm

[41] Analyses of the proposed detailed budget, and budget execution, are primarily summaries of the documents. In some instances, trend data is added.

accordance with law. There is an implicit understanding that the budget controls spending; and the understanding about budget control of disposal of state assets is less clear. Over many years the executive has consistently adhered to this understanding, with the one exception of donor financed expenditure that may exceed budget approved amounts based on bi-lateral agreements between a donor and the government.

69. Central government appropriations of the annual budget law serve as a cap on spending but there is no floor. Although not an immediate problem, there are no rules governing decisions or circumstances leading to substantially less spending than authorized and the need to obtain Parliament's approval for such underspending and associated policy impacts. Figure 2.5 shows over / under execution. Using the approved budget as the baseline (i.e., 0), the figure shows the percent change of supplementary budgets, plus the gross effect of over / under execution. The resulting outturn, represented by a horizontal line, is the net effect of execution (i.e., over execution adds to the original budget plus any supplementary budgets; under execution reduces the original budget plus supplementary budgets). The Figure shows that implementation is very close to what was approved as measured by expenditure. Since 2020 supplementary budgets have significantly changed the original approved budget, in part due to the Covid-19 pandemic. Over expenditure occurs due to donor expenditure that exceeds estimates in the approved budget, noted also in Institution 2.3.1.

Figure 2.5. Georgia: Components of Deviation in Outturn from Approved Budget
(In Percent of Approved Budget)



Source: IMF staff based on official data.

70. The executive is authorized by Parliament to change the budget's composition through contingency funds, limited re-allocations, and emergencies. Reserve, or contingency, funds are authorized in Article 28 of the Budget Code. The various funds are not large enough to enable a material change in policy without Parliamentary approval. These are discussed in more detail in Institution 3.2.1 Budgetary Contingencies. The Budget Code Article 31 provides rules for re-allocations without prior Parliamentary approval. In summary, re-allocation between budget units is prohibited, and re-allocation between programs (within a budget unit) is limited to 5 percent of the spending institution's budget with MoF's consent. Since capital and current spending can be assigned the same high level program code, this allows shifting between capital and current budgets. Budget Code Article 31 also authorizes transfers to areas of general state significance, which are defined in the Budget Code. For both types of re-allocations, the law is silent on the effect on budgets losing funding. There have been no material changes to these rules since 2016.

71. Three gaps were identified that can reduce Parliament's oversight of spending and policy. Firstly, most national constitutions lay down the fundamental policy that spending and disposal of state assets occur only in accordance with law. No serious challenge to the implicit understanding of this principle has arisen in Georgia, but the absence of such a constitutional or statutory provision is notable. The legal framework should be adjusted over the medium to long term to address this gap. Secondly, policy changes can occur by under-execution as well as spending more than budgeted. Currently, there is no guidance on how to deal with spending that is less than authorized in the budget if revenue is less than anticipated. Cash allocations in such circumstances could favor some programs over others. The re-allocation rules in the Budget Code limit changes to 5 percent of an institution's budget, not of the program budget. In a large ministry, and a small program providing funding to another could be substantial. Article 31 of the Budget Code should provide percentage limits on programs losing funding, as well as gaining funding, including transfers to cover expenditure of general state significance. Thirdly, the existing re-allocation rules allow movement of funding between current and capital spending within a single program. Given the sensitivity of capital projects, shifting funds from capital to current spending within a program could be viewed as a significant policy change. Consideration should be given to either restricting or prohibiting shifts from capital to current budgets.

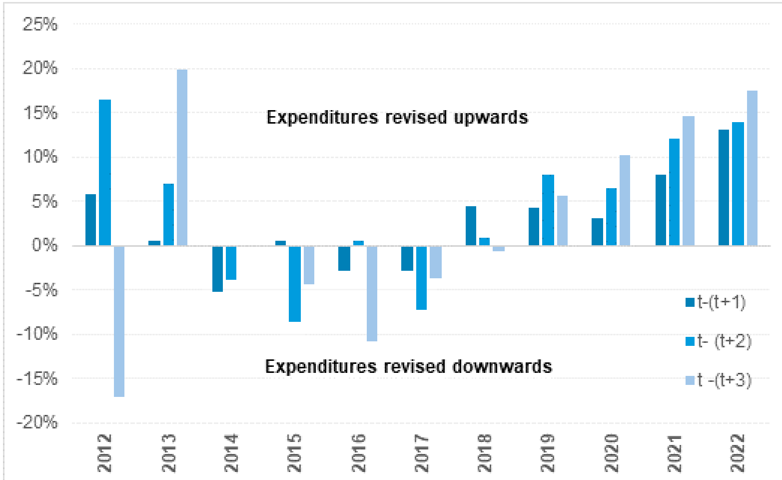
2.4.3. Forecast Reconciliation (Basic, Improved from Not Met in 2016)

72. The budget documents clearly identify changes in aggregate-level forecasts and discuss policy implications. Beginning in the 2018 budget, authorities disclose in an annex the reconciliation of successive vintages of government's revenue, expenditure (current and capital), deficit, and financing.[42]. The annex discusses changes of the main macroeconomic variables, changes in key assumptions raised from global instability, and other factors. However, the budget annex does not distinguish the fiscal implications of new policies from the impact of changes in macroeconomic variables.

73. In the last decade, medium-term expenditure plans have been substantially revised due to extreme volatility partly driven by both domestic and international factors. During 2012−19, the average of the revisions to the second-, and third year expenditure were 1.7 percent, and 1.4 percent, respectively. From 2020 onwards, expenditure plans have been revised upwards due to the pandemic. The average revisions during 2020−22 were 11 percent and 14 percent for second and third year, respectively (Figure 2.6).

[42] https://www.mof.ge/5603

Figure 2.6. Georgia: Revisions of Medium-term Expenditure Plans (Average forecast errors, percentage of expenditure in the first forecast year)



Sources: IMF staff based on official data.

74. There is room for improving the credibility of the government fiscal forecasts. Improved credibility of the revenue and expenditure plans would strengthen multi-year fiscal discipline and facilitate policy planning and implementation. As a starting point, the reconciliation budget annex should distinguish between the impact of new policy initiatives from the impact of change in macroeconomic variables. Over time, the annex could be further improved by including the breakdown of the effects of individual policy changes, macroeconomic determinants, and other factors, such as technical and accounting adjustments. Table 2.6 presents and indicative reconciliation table for expenditure.

Table 2.6. Indicative Reconciliation Table for Expenditure

2014 Budget	2014 Budget Year	2015 BY+1	2016 BY+2	2017	2018
	100	110	120		
Reconciliation in terms of:					
- Accounting or one-off	-5	-6	-8		
- Macroeconomic Factors	3	4	6		
- Policy Measures	0	5	3		
Total Variation	**-2**	**3**	**1**		
2015 Budget	**Estimated Actual**	**Budget Year**	**BY+1**	**BY+2**	
Total Expenditure	98	113	121	130	
Reconciliation in terms of:					
- Accounting or one-off		2	13	15	
- Macroeconomic Factors		-2	-2	-3	
- Policy Measures		0	-11	-12	
Total Variation		**0**	**0**	**0**	**0**
2016 Budget		**Estimated Actual**	**Budget Year**	**BY+1**	**BY+2**
Total Expenditure		113	121	130	139

Source: Fiscal Transparency Handbook, IMF, 2018, Table 3.6.

2.5. Recommendations

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

- **Recommendation 2.1. Ensure appraisal of all major components contained within a single budget project before the budget is approved.**
  - Require that the cost of any component expected to cost more than GEL 5 million is presented.
  - Appraise each component that reaches the cost thresholds contained in the PIM Methodology as if it were a stand-alone project.
- **Recommendation 2.2. Improve public understanding and participation in the budget process.**
  - Streamline the main Citizens' Guide to the budget and increase the amount of information provided on implications for a typical citizen;
  - Broaden the forms of dissemination of the Citizens' Guide to reach as many citizens and civil society groups as possible; and
  - Provide more structured opportunities for public participation in the budget process.
- **Recommendation 2.3. Strengthen the credibility of fiscal forecasts and budgets**.
  - Publish annual ex-post analysis of forecast errors comparing all agencies publishing forecasts: MoF, NBG, PBO, IMF, and World Bank.
  - Improve the transparency of fiscal reconciliation data through presentation of fiscal implications on new policies separately from the impact changes in macroeconomic indicators.
- **Recommendation 2.4. Clarify limits on the executive to adjust the budget without prior Parliamentary approval.**
  - Prohibit movement of funds from capital to current budgets.

Table 2.8. Georgia: Summary Evaluation: Fiscal Forecasting and Budgeting

	Principle	Assessment	Importance	Rec
2.1.1	**Budget Unity**	**Good:** Non-market SOEs are not included in budget documentation.	**High:** Non-market SOEs represent 3.5 percent of GDP. Existing plans are in place to complete this work.	**#1.1**
2.1.2	**Macroeconomic Forecasts**	**Advanced:** Macro economic forecasts include estimations of main economic variables and their underlying assumptions. Actual data for the 3 years preceding planning period disclosed.	**Low:** After the pandemic shock real GDP projections are pessimistic (real GDP forecasting error for 2022 is 4 percent).	
2.1.3	**Medium-term Budget Framework**	**Advanced:** A MTBF includes outturns for the two preceding years and medium- term projections of revenue, expenditure, and financing by economic category and by program and administrative units.	**Low:** Over the period 2020-2022 MTBF forecasting errors increased due to Covid.	
2.1.4	**Investment Projects**	**Good:** Multi-year costs of projects are disclosed, and procurement of works is generally competitive, but appraisals of multiple projects within a single large appropriation are commonly not performed.	**Medium:** 8 out of 9 new projects in 2023 budget, contain multiple unidentified capital purchases.	**#2.1**
2.2.1	**Fiscal Legislation**	**Advanced**: Budget Code defines timetable for budget preparation and approval, contents of budget documentation and responsibilities of executive and legislature.	**Low**: Parliament is permitted to revise draft budget only with government agreement; very limited instances in recent years.	
2.2.2	**Timeliness of Budget Documents**	**Good**: Budget is submitted and published at least three months before budget year starts and approved within 1 month of start of year.	**Low**: Budgets have been consistently submitted and approved within timeframe set by the Budget Code.	
2.3.1	**Fiscal Policy Objectives**	**Good:** Precise and time bound fiscal rules and targets exist. Precise compliance with the deficit rule cannot be measured because data is not available for non-market SOEs.	**Low:** Non-market SOEs represent 3.5 percent of GDP. Existing plans are in place to complete this work.	
2.3.2	**Performance information**	**Good:** Extensive information on performance outputs is provided, but not on outcomes.	**Low:** Performance measures relate to the efficiency of spending, and outcome measures are difficult to achieve.	
2.3.3	**Public Participation**	**Basic**: A Citizens' Guide and accessible brochure present a summary of the state budget, with focus on an individual citizen.	**Medium**: Participation in central government budget process is relatively limited.	**#2.2**
2.4.1	**Independent Evaluation**	**Good**: The Parliamentary Budget Office produces alternative macro-fiscal forecasts, but it does not publish ex-post reviews of forecasts errors regularly.	**High:** Ex-post review of forecast errors was published in the 2022 self-assessment. Can easily be done regularly.	**#2.3**
2.4.2	**Supplementary Budget**	**Good**. Parliament must approve an increase in total spending, but not necessarily reductions in total spending nor some changes in composition.	**Low:** Shortcomings pertain to accountability to Parliament for some policy changes resulting from reductions in spending.	**#2.4**
2.4.3	**Forecast Reconciliation**	**Basic:** Fiscal reconciliation in place and discusses and explains changes in the main macro variables and discloses changes in the fiscal forecast	**High:** Identifying impact of new policy supports budget credibility	**#2.3**

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

LEVEL OF IMPORTANCE	RATING		
	High	Medium	Low

III. FISCAL RISKS

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

- General arrangements for the disclosure and analysis of fiscal risks;
- The management of risks arising from specific sources, such as government contingencies and guarantees, public private partnerships (PPP), and the financial sector; and
- Coordination of fiscal relations and performances between central government, local governments, and PCs.

77. Georgia has gradually increased its disclosure and analysis of main sources of fiscal risks. Since 2016, the rating of 6 principles has improved, and 6 remained unchanged (Table 3.1). The DSA horizon was extended to a ten-year period, and an initial long-term sustainability exercise have been undertaken to assess the fiscal impact of demographics and climate change. Notably, monitoring and managing of public corporations in general, and particularly of those in the energy sector including the fiscal implications of PPAs, have steadily improved and disclosed by the MoF in the Fiscal Risks Statement. The NBG has published the annual Financial Stability Report since 2019, while data disclosure by the MoF on sub-national governments has also improved. Improved ratings reflect progress in the implementation of the 2016 evaluation (Table 3.2). Yet, limited progress has been achieved in terms of tightening criteria for drawing on budget contingency provisions.

Table 3.1. Georgia: Fiscal Risks: Summary of Changes since 2016

Area	Principle		2016	2023
Risks Disclosure and Analysis	3.1.1	Macroeconomic Risks	Advanced	Advanced
	3.1.2	Specific Fiscal Risks	Advanced	Advanced
	3.1.3	Long-term Fiscal Sustainability Analysis	Not met	Basic
Risks Management	3.2.1	Budgetary Contingencies	Basic	Basic
	3.2.2	Asset and Liability Management	Good	Good
	3.2.3	Guarantees	Good	Good
	3.2.4	Public Private Partnerships	Not met	Good
	3.2.5	Financial Sector Exposure	Good	Advanced
	3.2.6	Natural Resource Stock and Flows	Not met	Not met
	3.2.7	Environmental Risks	Basic	Good
Fiscal Coordination	3.3.1	Sub-National Governments	Not met	Good
	3.3.2	Public Corporations	Basic	Good

Table 3.2. Georgia: Fiscal Risks: Progress on Recommendations since 2016

Recommendation in 2016		Progress made
3.1	Publish long-term sustainability analysis	**Good progress.** The DSA has been extended to a ten-year horizon and initial long-term sustainability exercises have been undertaken to assess impact of climate change and pension fiscal costs.
3.2	Tighten criteria for drawing on budget contingency provisions	**Limited progress.** Criteria has not been amended to ensure that only unforeseeable or unavoidable expenses are funded through the Presidential and Government Reserve Funds. Appropriations to the Highlands Settlement Development Fund started in 2016.
3.3	Strengthen controls on contingent liabilities	**Good progress.** FRS discloses and assess contingent liabilities from PPA, PCs, quasi-fiscal activities, and legal claims against the state. Qualitative and historical analysis of pension and natural disasters also presented.
3.4	Improve reporting on SNGs	**Some progress.** Increased availability of information on the budget balance of SNGs, the on-lending portfolio.

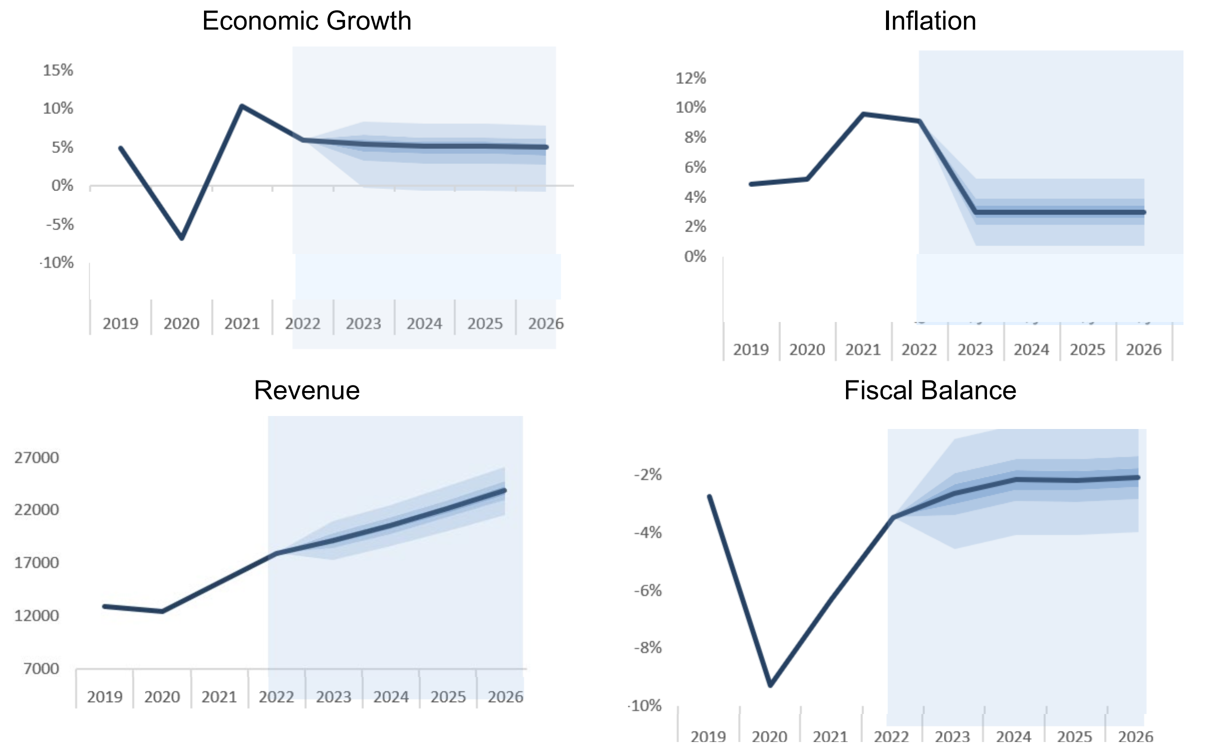
Source: IMF staff.

3.1. Risk Disclosure and Analysis

3.1.1. Macroeconomic Risks (Advanced, Unchanged from 2016)

78. A detailed and robust macroeconomic risk analysis is included in the budget documentation. The FRS, published as an annex to the budget and submitted to Parliament, includes detailed analysis and the quantification of the impact of alternative macroeconomic scenarios (i.e., baseline, optimistic and pessimistic). The FRS identifies risks from previous periods and their realization, as well as new risks for the medium-term forecast period, including for example, the impact of the pandemic, global tourism, decrease in global trade turnover, regional risks, among others. Since 2017, the FRS includes probabilistic fan charts for GDP growth, inflation, revenue, and fiscal balance (Figure 3.1). No significant changes were introduced to macroeconomic risk analysis since the previous evaluation.

Figure 3.1. Georgia: Probabilistic Fan Charts for Main Macrofiscal Indicators (Baseline Scenario)



Sources: FRS: Analysis of Macroeconomic Scenarios.

3.1.2. Specific Risks (Advanced, Unchanged from 2016)

79. **Main specific risks are disclosed in the FRS, including estimates of their magnitude and likelihood, and a description of policies implemented to manage them.** The financial health of PCs and potential claims on the state budget arising from PPA are identified as Georgia's main sources of fiscal risks. The coverage and complexity of their assessment have improved throughout the different vintages of the FRS, allowing to estimate that the overall gross exposure for these sources of fiscal risks account for around 14.1 percent of GDP (Table 3.3). For PPAs, a scenario analysis of the potential fiscal impacts of the energy support scheme is presented using different macroeconomic and policy assumptions. For PCs, the 2022 FRS estimates the quasi-fiscal activities undertaken by three key PCs, which are requested to provide service at below market prices. According to the FRS, this decision creates an estimated loss of 0.6 percent of GDP in 2021 (Institution 3.3.2).

80. **The coverage of the FRS has gradually increased to include a wider range of issues and provide a longer-term perspective of risks to fiscal forecasts.** The 2022 FRS presents an initial analysis of the potential fiscal impact from legal claims against the state, based on their size and court of jurisdiction (i.e., domestic, or international). Claims presented in local courts represent approximately one percent of GDP in 2021 and are mainly related to contested expropriations and to the execution of procurement contracts. The potential fiscal impact from claims in international courts is estimated at a maximum of 13 percent of GDP in 2021 and is mostly linked to the implementation of large infrastructure projects. Fiscal risks arising from natural disasters and climate change, including a detailed description of

past trends, were introduced for the first time in the 2022 FRS. Within the long-term sustainability of public finances, the 2022 FRS describes the expected evolution of health and pension costs, and how they change depending on macro and demographic assumptions.

Table 3.3. Georgia: Selected Specific Fiscal Risks, Gross Exposure

Specific Fiscal Risk	Magnitude		Reporting
	Billions (GEL)	Percent of GDP	
Non-financial Public Sector			
Public Corporation Liabilities[1]	6.4	10.8	FRS
Public Private Partnerships	0.38	0.6	Partly reported in FRS
Power Purchase Agreements[2]	1.4	2.8	FRS
Guarantees issued by CG	0.003	0.0	MoF debt statistics
Financial Sector			
Explicit Exposure to financial sector	0.0	0.0	NBG FSR
Contingent Events			
Natural Disasters[3]	N/A	N/A	FRS
Legal Claims[4]	8.5	14.0	FRS
Long-term risks			
IPSGS	8.5	14.3	Not Reported
NPV of Social Assistance Pension Payments [5]	65.4	109	Not Reported

1/ Commercial and non-commercial PC
2/ Net exposure of PPA as reported in the 2021 FRS. The estimated cost of the energy market is estimated at 3 percent of GDP in a baseline scenario that includes PPAs, contract for differences (CfD), feed-in-premiums (FiPs) and strategic projects – Namakhvani, Nenskra and Khudon. Total cost to the government is contingent on price evolution and pass through to tariffs.
3/ The 2022 FRS presents a graphical estimation of the potential fiscal costs under different climate scenario, but is not possible to determine an exact number of the expected impact.
4/ Represent the maximum exposure for cases in both domestic and international courts. This does not represent an acknowledgement from the government that these amounts will be paid, nor has the government exhausted all its legal options of a potential negative outcome.
5/ Implicit obligations—NPV—of the government social assistance-related pensions payable from the state budget.

81. The authorities could take actions to further enhance the disclosure and analysis of fiscal risks. From a coverage perspective, the FRS could be expanded to disclose risks related to SNGs and the financial sector. There is value in disclosing information on all sources of specific risks in a single report, even when their fiscal impact is not material and/or they have a low probability of materializing (see Institution 3.2.5 and 3.3.1). Another opportunity to strengthen the FRS is to take a more forward-looking approach in some cases and less description of past trends, which could be part of a separate document or Annex to the same document.

3.1.3. Long-term Fiscal Sustainability Analysis (Basic, Improved from Not Met in 2016)

82. The government publishes a debt sustainability analysis (DSA) of the main fiscal aggregates along the budget documents and is developing one with a long-term perspective. The DSA estimates a ten-year path of public debt and its sensitivity to multiple changes in the macroeconomic and fiscal assumptions behind the baseline forecast. The analysis allows authorities to assess the likelihood that fiscal rules (i.e.,60 percent of GDP) are breached. An analysis of the impact of pension, social assistance, and health payments due to changing long-term demographics and entitlements is not presented. The 2022 FRS acknowledges the importance of social security payments and climate change-related expenditure for fiscal sustainability, but it is just an initial assessment of these trends. To reach a higher transparency level, the long-term sustainability analysis should consider the changes introduced by the 2018 pension reform and expected demographic changes, including a sensitivity analysis to underlying macroeconomic and fiscal assumptions.

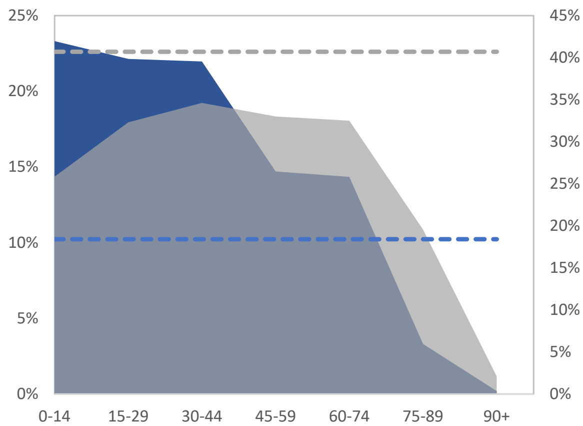
83. The increased outlook of the DSA is the main improvement since the 2016 transparency evaluation. The exercise was extended from seven to ten years and assumes shocks to the budget's baseline forecast of macro and fiscal variables (i.e., interest rate and primary balance, among others) to forecast public debt trends. The 2022 FRS discusses qualitatively the factors that could drive health expenses in the future, underscored by the increase from 5 to 13 percent of general government expenditure between 2002 and 2021. Long-term trends in pension payments used to support the introduction of a reform in 2018 were also presented. Finally, building on FAD capacity development assistance, the 2022 FRS discussed the potential fiscal impacts of climate change on debt sustainability.

84. The impact of the 2018 pension reform of the pension regime should be included as part of assessment of the long-term fiscal pressures. The post-2018 pension system is based on three pillars: (i) a basic pillar, in which pension payments are indexed and is fully funded by the government; (ii) a second pillar, which is fully funded by employee, government, and employer contributions; and (iii) a third pillar, which is supplementary and voluntary, that is also fully funded by the employee. The 2022 FRS recognizes that risks arise mainly from the basic pillar where indexation to inflation and GDP are sources of volatility in the fiscal cost. Current estimates set the long-term cost at no more than 5.2 percent of GDP, which authorities consider manageable. There could also be implicit contingencies in the other pillars worth analyzing from a fiscal risk perspective.

85. Gaining a better understanding of the country's long-term sustainability is of high importance. There are rising costs from climate-related disasters across the globe to be considered. UN population forecasts for Georgia highlight a declining population with a higher dependency rate. A net present value estimate of government payments to Pillars I and II, and special pension regimes underscore the magnitude of the problem and its sensitivity to macro assumptions (Figure 3.2).

Figure 3.2. Georgia: Demographics and NPV of Social Security Payments

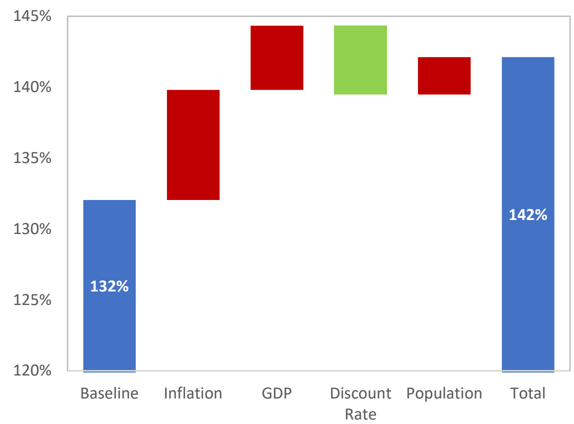
Share of Population per Group Age and Dependency Ratio



Source: United Nations, World Population Prospects

Note: Blue and gray areas represent share of population per age group in 2000 and 2060, respectively. Blue and grey dotted lines represent the dependency ratio of people aged 65+ to the 15-64 population for years 2000 and 2060 respectively.

NPV of Pension Payments



Source: IMF staff calculations based on UN World Population Forecasts, MoF budget execution reports

Note: blue bars = NPV of government contributions to Pillar I, II and special regimes; red bars = marginal increase in the NPV of payments; green bars = marginal decrease in the NPV. Long-term baseline assumptions: inflation= 3 percent; GDP growth = 5 percent; discount rate = 8.7 percent; UN population forecast. Alternate scenario assumptions: inflation = 5 percent; GDP growth = 4 percent; discount rate = 9.0 percent; population growth of 1 percent.

3.2. Risk Management

3.2.1. Budgetary Contingencies (Basic, Unchanged from 2016)

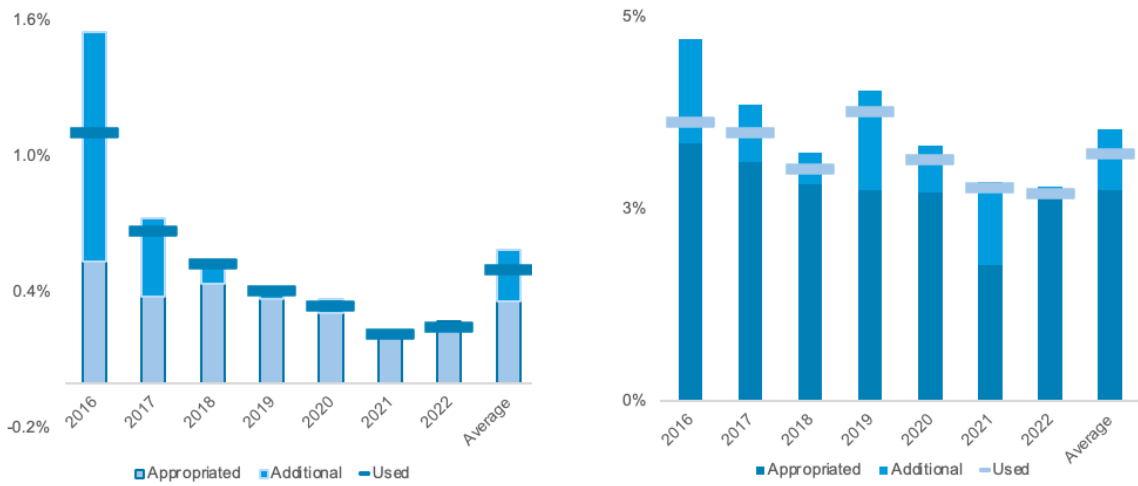
86. The State budget includes allocations for contingency reserves, but no specific criteria for accessing these reserves currently exist. The Budget Code provides for the following reserve funds: (i) Reserve Fund of the President; (ii) the Government's Reserve Fund; (iii) two reserve funds of a contingent and development nature, respectively; and (iv) a reserve fund, developmental in type, established under a separate law. The first two reserve funds, referenced in the Budget Code as State budget reserve funds under a separate Article (28), have an aggregate limit of 1 percent of total appropriations in the annual budget is stipulated; in practice, this limit is respected. No limits, in aggregate or individually, are set for the other reserve funds. Annual allocations for each reserve fund are set out in a separate budget lines in the State budget. In the 2023 budget, the aggregate amount appropriated for the State budget reserve funds[43] was 0.3 percent of total expenditure appropriations, compared to 2.6 percent for the remaining funds (see Figure 3.3). Requests for the use of these reserve funds are managed by the MoF and approved by governmental decree.

[43] In practice, of the two State budget reserve funds, only the Reserve Fund of the Government has been allocated resources in recent years; the Reserve Fund of the President has not had budgetary appropriations for the last four years.

Figure 3.3. Georgia Contingency Reserves

a: State Budget Reserve Funds as share of total state budget expenditure

b: Total Reserve Funds as share of total state budget expenditure



Source: MoF

87. **Since 2016, there have not been substantial changes in the management of budgetary contingency funds.** No specific access criteria have been introduced but the number of reserve funds has increased.[44] The Budget Code classifies the State budget reserve funds and the other reserve funds under the budget category for "Expenditure of general state importance," which include debt servicing payments, and which are not included in the program budget.

88. **The lack of specific access criteria for the State Budget Reserve Funds results in the use of resources for foreseeable and non-urgent activities.** The Budget Code contains the only, and very general, criterion for accessing these Reserve Funds, namely to "finance unforeseen spending." In the absence of more specific criteria (e.g., as set out in a regulation under Budget Code Article 28), resources can be spent on activities which could have been planned in advance and included in a line ministry's planned budget, including, in the 2022 budget, expenses for the annual Independence Day celebrations, a new wine festival, and the second round of elections. This practice potentially undermines effective planning, as "unforeseen" can also mean "unplanned.".

89. **Using the State Budget Reserve Funds only for unforeseeable and unavoidable situations would provide a clear focus for contingency resource planning and ensure resources are available for such situations.** This should be supported by regulations setting out specific criteria to use resources which are consistent with unforeseeable and unavoidable situations (see example in Box 3.1). More broadly, the reserve funds that are developmental in nature could be more effectively managed as policies if they were reclassified as policy programs and budgetary resources planned accordingly. Codifying rules for establishing and accessing reserve funds, including statutory limits on their size, would guard against the creation of a new envelope for a policy direction without the processes and checks that other new policies go through as part of ordinary budget preparation and scrutiny.

[44] The Highlands Settlement Development Fund was established by law in 2015, with first appropriations in 2016.

Box 3.1. Good Practice Example, Access Criteria for Contingency Reserves[1]

South Africa regulates the use of its contingency reserve appropriations at three levels: (i) a broad clause in the Public Financial Management Act (PFMA); (ii) a more specific regulation in the Treasury Regulations; and (iii) pro forma tables, with explanatory requirements, in the annual technical guidelines for the preparation of the supplementary budget (known as the Adjusted National Expenditure Estimates).

The clause in the PFMA allows for contingency-related adjustments only for significant and unforeseeable economic and financial events affecting the fiscal targets set by the annual budget; and for those unforeseeable and unavoidable expenditure recommended by the national executive (comprising the President, Vice-President, and members of the Cabinet).

The relevant Treasury regulation specifies what is not considered to be unforeseeable or unavoidable and thus not permitted to be used as justification for additional funds from the reserve appropriation. Specifically, expenditure not deemed to be unforeseeable or unavoidable include: (a) those which were known when finalizing the estimates of expenditure but could not be accommodated within their allocations; (b) tariff adjustments and price increases; and (c) extensions of existing services and the creation of new services that are not unforeseeable and unavoidable.

Finally, at the technical level, the guidelines for the adjusted budget include the relevant pro forma tables and explanations required for each. The adjustment tables are disaggregated by type of adjustment, including unforeseen/unavoidable expenditure, as well as rollovers, virement and shifts, and other types of adjustments. An example of such a table is included in Annex 2 of this FTE report.

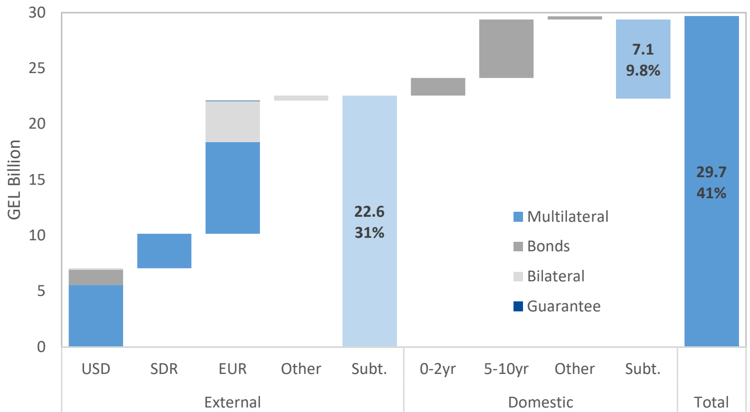
Source: National Treasury, Republic of South Africa

[1] For the documents described in this box, see: (i) PFMA: https://www.treasury.gov.za/legislation/pfma/PFMA%201999%20as%20amended%20March%202017.pdf; (ii) Treasury Regulations: https://www.treasury.gov.za/legislation/pfma/regulations/gazette_27388.pdf; and (iii) 2022 AENE technical guidelines: https://www.treasury.gov.za/publications/guidelines/2022%20AENE%20Technical%20Guidelines.pdf

3.2.2. Asset and Liability Management (Good, Unchanged from 2016)

90. The legal framework covers all public borrowing, the MoF prepares a management strategy, and analyzes key risks for the debt portfolio. The Public Debt Law (PDL) covers all debt transactions, clearly assigns accountability to the MoF, defines limits to and uses of loans, and ensures an appropriate recording and disclosure framework. Transactions on non-financial assets are guided by legal documents such as the Law on State Property or PPP Law, which define parameters to be followed for asset disposal or use by the private sector. Disclosure is stronger on the liability side through periodic debt bulletins published by the MoF that provide a detailed breakdown of debt (Figure 3.4). On assets, the FRS discloses information on public corporations, and the MoF publishes the on-lending portfolio quarterly. A DSA (see institution 3.1.3) and a debt strategy covering a four-year horizon are published annually including priorities, target objectives, and risk analysis. A parallel strategy on the asset side is lacking.

Figure 3.4. Public Debt Portfolio in Georgia



Sources: Ministry of Finance (https://www.mof.ge/en/4807)

91. Though improvements have been achieved in both asset and liability management in recent years, these have concentrated more on the liability side. Debt management has benefited from the introduction of fiscal rules on debt, increased detail in debt bulletins, and a strengthened DSA exercise. On the asset side, the Treasury has successfully implemented an active cash management policy and the coverage of the TSA has been gradually increased. Information on the on-lending portfolio of approximately 3 percent of GDP, whose beneficiaries are mainly public corporations and SNGs, is now published quarterly. However, there is limited analysis on the health of this portfolio, particularly, an assessment of beneficiaries' repayment capacity or a contingency-built buffer to cover any costs from renegotiations, even though these are frequent. Disclosure and analysis of public corporations have been enhanced through the FRS, but a policy that guides the management of these assets is yet to be approved.

92. The FRS has raised awareness on the importance of strengthening the management of public assets, particularly public corporations, and of non-debt liabilities, but reforms are yet to be completed. On public corporations, the FRS has evidenced their low profitability compared to the private sector (average return on equity of 1 percent for public corporations versus 8 percent for similar private initiatives is discussed in the 2022 FRS). The MoF also undertook an assessment of corporate governance practices which identified key weaknesses to be addressed. Based on this analysis, a public corporation reform strategy, that includes the development of an ownership policy, was approved. On non-debt liabilities, the FRS disclosed the fiscal costs and contingencies of PPAs, which are being addressed through a reform to the energy market. The completion of these reform processes should ensure better coordination of asset and liability management (Institution 3.2.4).

3.2.3. Guarantees (Good, Unchanged from 2016)

93. There is a strong legal and regulatory framework for managing government guarantees, but these have seldom been used in the past two decades. The PDL gives the MoF the right to issue guarantees with the consent of the President of Georgia, and the obligation to (i) record them in the National Public Debt Register; (ii) periodically report on the outstanding stock; and (iii) to assess the likelihood of guarantees being called. The PDL also states that the annual quotas for debt and guarantees shall be defined in the annual budget law approved by Parliament, as well as the process for guarantees to be granted. The PDL requires the MoF to assess the risk from issuing a guarantee to determine the resources that the guarantee receiver should deposit in a risk fund. There are no standardized-guarantee schemes (e.g., student loans) on which the government has issued a guarantee. The government includes the stock of loan guarantees within the monthly and annual debt reports. As of 2022, there was only one government guarantee outstanding worth GEL 3.3 million (0.01 percent of GDP) that was granted in 1998, and that is assessed to have a negligible risk of being called. The low stock is consistent with the implicit government policy that no new guarantees should be issued.

94. No changes have been introduced to the legal and regulatory framework supporting guarantees since 2016 nor have explicit guarantees been issued. A methodology to assess the likelihood of guarantees being called, as required in the PDL, has not been developed. A Deposit Insurance System was created in 2017 through the Law of Georgia on Deposit Insurance System, administered by the Deposit Insurance Agency, who also administers the Insurance Fund. There is no explicit government guarantee provided to the system or the fund. The system is funded primarily through member contributions and insurance premiums, as well as revenue from investment activities, which also cover the system's operation.

95. The limited government exposure to explicit guarantees should be highlighted in the FRS. For transparency purposes, the FRS could be improved by disclosing both the stock of explicit guarantees and the likelihood of being called, broken down by categories (e.g., loans, project guarantees, etc.). There is a commitment by the government to support the Partnership Fund,[45] as highlighted in the 2021 FRS, for which a thorough assessment has not been done. The FRS could also assess when the resources in the deposit insurance fund will reach the 6 percent of insured deposits, as targeted in the law, and implications to the fund of changes in the insured value of deposits. Also, it is useful for MoF to understand under what extreme conditions government support could be needed for these schemes.

3.2.4. Public Private Partnerships (Good, Improved from Not Met in 2016)

96. Most government's PPP liabilities and related spending are disclosed in the annual FRS and included in the coverage of the fiscal rules. Georgia's PPP portfolio is mainly comprised by PPAs, under which the government has a firm commitment to purchase energy production at a fixed price over a fixed period. The government does not provide support to PPPs through on-lending, nor does it control financial institutions that provide financing to PPP operators. The 2022 FRS includes an estimation of the government's net and gross exposure to PPAs under alternative macro fiscal scenarios, including assumptions on the ongoing reform in the energy sector.[46] Although disclosure of information on PPAs has been gradually improving since 2017, authorities publish limited information on other PPPs.[47]

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[45] The Partnership Fund is Georgia's state-owned investment fund established in 2011 that, together with the private sector, invests in commercially viable projects in 5 key sectors in Georgia: agribusiness, energy, manufacturing, logistics, and real estate and tourism. Official Website: fund.ge

[46] Due to its contingent nature – contract versus market price – the FRS bases its assessment on a scenario analysis to identify the conditions under which the state budget would need to compensate energy producers. The government plans to introduce two new types of contracts to replace PPA: CfDs and FiPs. In CfDs the government will pay/receive the difference between the contract and market price and in FiPs the government will pay an additional fee per unit of energy.

[47] The MoF has no information on the airport's PPP contract, which undermines its fiscal risks management function. The analysis of Nenskra PPP in the 2022 FRS was pending the results of an audit.

According to the 2018 amendment to the ELA Act and the 2018 PPP Law, new PPPs should be included in both the fiscal deficit and debt rules, and accounted in the government's balance sheet following as per IPSAS accrual basis.[48]

97. The authorities have substantially enhanced the supporting PPP legal framework and fiscal transparency, especially as it relates to PPAs. Since 2016, information of PPAs' fiscal implications has been gradually disclosed in the FRS, including future service payments and contract provisions representing contingent liabilities for government. The increased disclosure raised awareness on the costs of PPAs and supported ongoing reform efforts in the energy sector. The FRS presents a detailed analysis of the proposed electricity market structure and identifies key parameters and policies (e.g., market price, pass-through to consumer price) underpinning the expected value of government contributions (Box 3.2). The role of the MoF in monitoring and managing fiscal implications of PPPs was strengthened by the 2018 PPP Law and supporting regulation.[49] Specific stages on project preparation and implementation, including gateways for project review by the MoF and other government entities were defined. The MoF's fiscal assessment of PPPs should inform the government's decision to proceed with or request amendments to a proposal. Since the approval of the PPP law, no new PPPs have been approved, so full implementation of the new framework is still pending.

Box 3.2. Georgia's Energy Reform and Support Framework

Georgia committed to the deregulation of the electricity market in line with the EU' regulations for the energy sector. As part of this process, authorities expect to reduce fiscal risks related to electricity generation and to pursue a more targeted approach to supporting vulnerable households. The reform and the new framework should help reduce the fiscal risks related to electricity generation and distribution, and properly manage contingent liabilities of the government by introducing a revenue sharing mechanism with energy producers. The latter could apply the windfall from the periods when market energy tariffs are below production costs to offset the periods with low market tariffs. Some characteristics of the new framework are:

- PPAs would be gradually replaced by two types of contracts: contracts for differences (CfDs) and feed-in-prices (FiP), which should improve risk sharing between the government and investors.
- A regulated market will continue for households and the territory of Abkhazia.
- A stabilization fund will be created that is to be replenished/spent when market prices are above/below CfD and regulated prices.
- Any shortfall will be covered by the state budget.

The 2022 FRS estimates the net present value of the cost of operating framework at 3 percent of GDP in the baseline scenario and as much as 8 percent of GDP in an unfavorable combination of prices and demand from regulated markets. Depending on the cost pass through to final tariffs, the system can move from being balanced – 100 percent pass through – to having a deficit of 3.9 percent of GDP – 54.5 pass through – that would be covered by the stabilization fund, or the state budget if the fund is fully depleted.

Source: 2022 FRS.

[48] Putting a PPP on the government's balance sheet means that (i) the private partner's investment spending counts as government spending; (ii) the project is recorded as an asset on the government's balance sheet; and (iii) the government also records a liability initially equal to the value of the asset. Although this approach is usually associated with accrual accounting, it can also be used with cash accounting, though no asset would be recorded.

[49] The Law of Georgia on Public Private Partnerships was adopted in 2018 and the. Government decree No 426 17/08/2018 on "Approving the Rules on Development and Implementation of PPP Projects" regulate PPP projects and provide a framework for the preparation and implementation of PPP projects in Georgia. The MoF prepared a set of Guidelines that were adopted by the Government to support private and public actors in the stages of project preparation, identification, selection of private partner, implementation, and post evaluation.

98. **Fully implementing the approved regulatory framework and increasing the coverage of the FRS would place Georgia in an "advanced" level of transparency with respect to PPPs.** Improved information and disclosure on the legacy PPPs are necessary conditions for this change to be possible. Additionally, consideration should be given to streamlining the existing information included in the FRS. An option would be to simplify the assessment in the core text and develop detailed annexes for specific risks. Similarly, standardizing existing tables and making the analysis more user friendly for a non-expert audience would allow better understanding of the commitments existing behind PPPs. Finally, the announcement of new projects that could be procured as PPPs, such as the Anaklia Deep-Sea Port, will test the role of the MoF in the PPP process, and the transparency of the new framework.

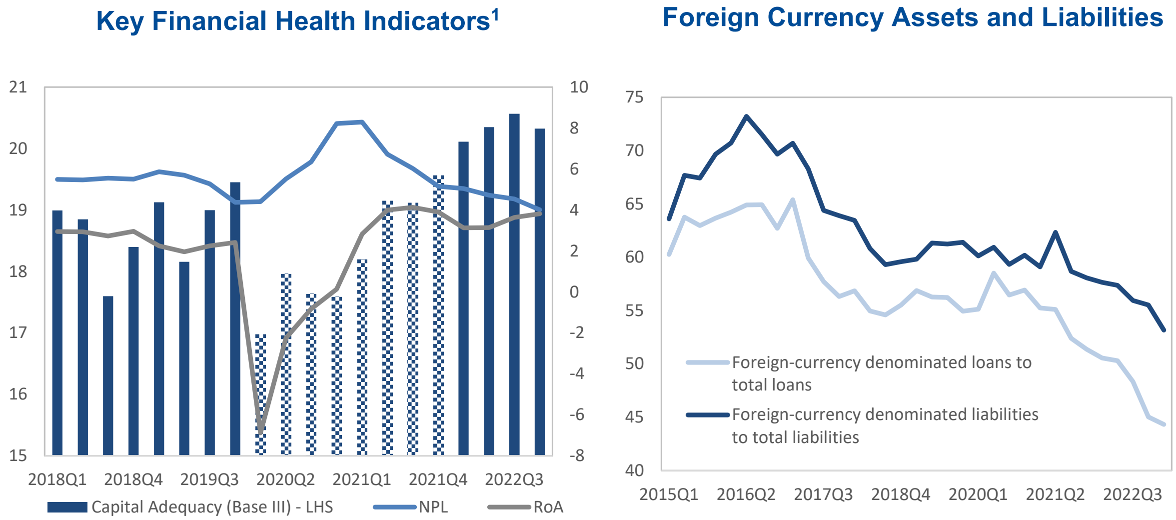
3.2.5. Financial Sector Exposure (Advanced, Improved from Good in 2016)

99. **There are no explicit government liabilities with the financial sector, and the NBG has sound reporting mechanisms in place.** The government has no equity in commercial banks, and it does not provide guarantees to the banking sector. The government's liabilities with the financial sector are mostly limited to Treasury bills and notes held by financial institutions for investment purposes. The NBG prepares and publishes an annual financial stability report that provides a detailed analysis of the health of the financial system, including main vulnerabilities, stress testing, and policy recommendations to ensure the sector's stability. A deposit insurance guarantee scheme was introduced in 2017, funded through the contributions of financial institutions, and with no explicit guarantees from the government. The target size of the fund is six percent of the insured deposits. As of December 2022, GEL 137.8 million have been accumulated, while insured deposits were GEL 5.9 billion.

100. **Transparency on fiscal exposure to the financial sector was strengthened with the annual publication of the financial stability report since 2019.** The report describes the evolution of key financial health indicators such as liquidity, solvency, or non-performing loans. It also discusses the resilience of the financial system to the expected evolution of key sectors of the economy (households, non-commercial companies, and real estate). A stress test analysis at the consolidated sector level estimates potential losses and assesses whether capital adequacy ratios are enough to withstand different types of shocks. Annual reports published by the Deposit Insurance Agency disclose the resources accumulated in the fund and the total amount of insured deposits.

101. **The financial sector in Georgia continues to recover from the impact of the pandemic amid the spillovers of the ongoing Russian war in Ukraine.** Key indicators of the system's financial health have rebounded from their lows in 2020, with capital ratios being above the regulatory thresholds set by the NBG. Asset quality and profitability also register a favorable trend and lessen the likelihood of emergence of fiscal risks. The dollarization of the financial sector is high by international standards, although the authorities have been able to reduce it over the last decade (Figure 3.5 and Table 3.4).

Figure 3.5. Georgia Financial Sector Trends



Source: National Bank of Georgia
1/ Patterned bars indicate years of COVID-19 pandemic.

Table 3.4. Georgia Financial Sector Trends

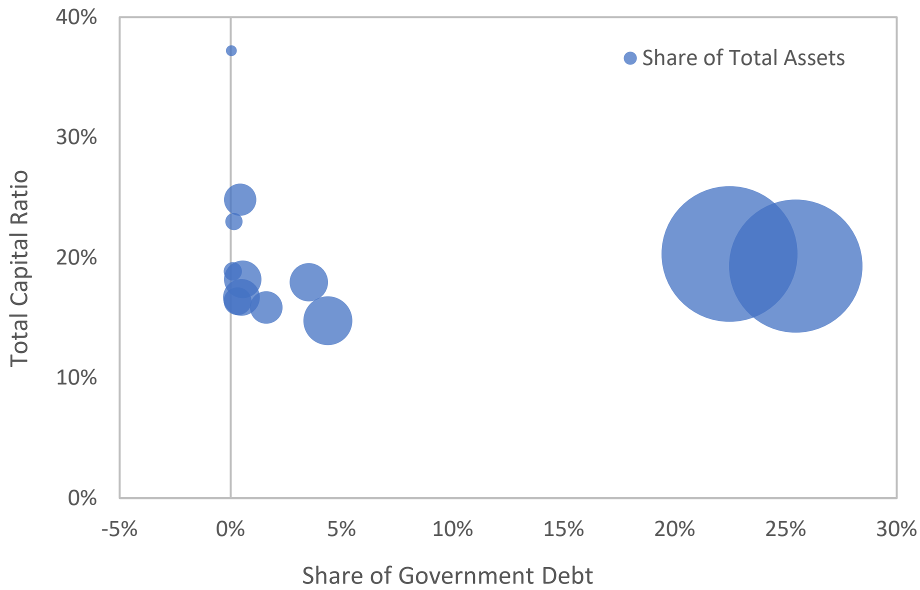
	Capital		Asset Quality	Liquidity		Profitability
	Tier 1 Capital	Capital to Assets	NPLs	Liquidity Coverage	Liquid Assets	Return on Assets
Georgia	**17.1**	**12.9**	**4.1**	**141.6**	**22.9**	**3.8**
Croatia	23.5	10.3	0.4	198.8	33.5	1.5
Netherlands	18.0	6.0	9.8	153.3	19.7	0.6
Sweden	20.4	6.6	0.4	--	25.3	1.2
Slovak	18	7.3	6.7	180	28	1.0
Slovenia	16.2	9.1	1.1	262.5	27.7	1.5
Uzbekistan	14.5	12.2	9.0	211.6	21.5	2.5

Source: National Bank of Georgia and IMF Financial Soundness Indicators (https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA)

102. It is important for the government to have a complete understanding of fiscal risks from the financial sector. As of December 2022, the financial sector held approximately 60 percent of outstanding domestic government bonds. Holdings are concentrated in a few banks, which account for over 75 percent of assets and liabilities in the sector (Figure 3.6). The 2022 FSR addresses market concentration by looking at its impact on competition, but not from standpoint of its fiscal implications. It is also important for the government to assess the coverage of the deposit insurance scheme on a regular basis under different macroeconomic scenarios. A better understanding by government of the resources potentially needed in a crisis event is warranted and would be beneficial for designing a risk mitigation and management strategy.[50]

[50] Given the moral hazard implications from disclosing such an analysis, it is not expected such an analysis is published, but it should be within the scope of the work done by the MoF.

Figure 3.6. Market Concentration and Capital Adequacy in Georgia



Source: 2021 Audited Financial Statements for each financial institution published on the website of the National Bank of Georgia (https://nbg.gov.ge/en/supervision/banking-supervision)

3.2.6. Natural Resource Stocks and Flows (Not met, Unchanged from 2016)

103. The government publishes the volume of mineral assets but not their value, and it does not disclose the production, sales value, or fiscal revenue from mineral assets in the previous year. Georgia is not a resource rich country,[51] and does not belong to the Extractive Industries Transparency Initiative.[52] The country's primary mineral deposits are manganese, copper, and gold, none of which is large on a world scale. Sub-soil mineral resources are the property of the state. The National Agency for Mineral Resources (NAMR), part of the MoESD, oversees the mining industry. Over many decades, NAMR and its organizational predecessors have conducted geological surveys, and compiled an inventory of the size, type, and location of mineral deposits. The deposits are not valued at current market prices. NAMR issues mining licenses, maintains the mining cadaster, carries out mining inspection, and monitors annual production levels but does not publish the information. Fiscal revenue arises from fees, license auctions, and royalties from these activities, but they are not separately identified in the BDD.

104. NAMR is in the midst of a multiyear reform of the mining sector. The program consists of preparing a new sector strategy, compiling information on specific mining opportunities, conducting a marketing campaign to attract investors, conducting auctions for licenses, and issuing licenses. To date under the program, 378 license sites were announced, 69 auctions were held, and 541 licenses for mineral extraction were issued. The legal and regulatory framework, based on the strategy document, is being updated with support from the European Bank for Reconstruction and Development.

[51] IMF, Guide on Resource Revenue Transparency, https://www.imf.org/external/np/pp/2007/eng/101907g.pdf

[52] https://eiti.org/

105. Mining production is economically important but not fiscally significant in Georgia. The mining sector accounted for 1.6 percent of national output in 2021 and approximately 19 percent of goods exports by value.[53] Fiscal revenue from mining was estimated to be 71.1 million GEL in 2018.[54] The current reform program of NAMR addresses many issues in the sector.

3.2.7. Environmental Risks (Good, Improved from Basic in 2016)

106. The government publishes quantitative estimates of fiscal risks from natural disasters based on historical experience but does not have a strategy to address fiscal impacts of disasters. Earthquakes, floods, and landslides represent the major natural disaster risks in Georgia. The MoF's FRS provides information on the cost of the 2002 earthquake and the 2015 Tbilisi flood. Looking forward, the FRS adds probabilities of such events occurring using EM-DAT, the international disaster database, and estimates costs for these events based on severity and historical experience in Georgia. A strategy for managing crises and disasters has been developed. Under the auspices of the National Security Council, headed by the Prime Minister, the National Crisis Management System was developed to empower governmental sectors to prevent risk, respond, and rapidly recover from natural and man-made disasters. Based on a National Threat Assessment document, the NSC has adopted the National Disaster Risk Reduction Strategy (NDRRS), and related inter-ministerial Action Plan. The Action Plan is detailed, and addresses damage caused by a variety of natural events. The system is managed by the State Security and Crisis Management Council. Funding for natural disasters is available through reserve funds, described in Institution 3.2.1 Budgetary Contingencies, but amounts appropriated annually are limited.

107. Both the chapter on fiscal risks from natural disasters published in MoF's FRS and the NDRRS have been developed since 2016. The FRS includes disaster risk beginning from the 2021 budget, and the NDRRS was adopted by government in 2017, covering the period 2017−20.

108. The NDRRS does not address fiscal aspects of disaster management. The 2017−20 Action Plan focuses on identifying, measuring, and mitigating physical damage from various sources. However, it does not address the fiscal impact of the damage or the financing of response to a disaster. There is only one mention of the MoF in the Action Plan, and that relates to customs collection at borders. From the perspective of fiscal risk, the NDRRS and Action Plan are not effective. The current attention given to disaster management is not clear. An update to the 2017−20 NDRRS and its Action Plan have not been published, nor has a report on implementation of the 2017−20 Action Plan. The NDRRS and associated Action Plan should be updated, and the update should include fiscal impacts of disaster management.

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[53] 2021 National Accounts, National Statistics Office for percent national output and goods exports figures.

[54] Sub-Soil Sector Strategy, December 2019

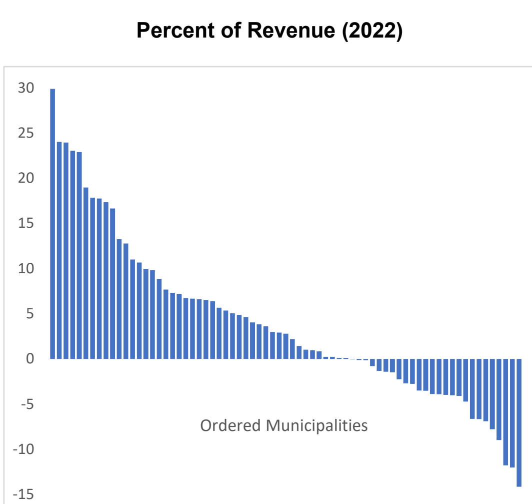
3.3. Fiscal Coordination

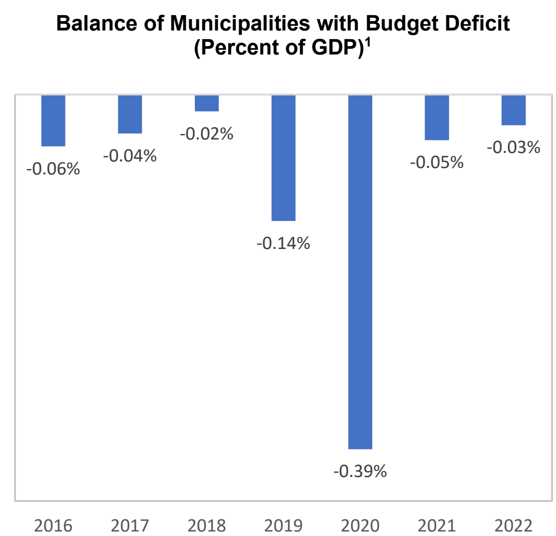
3.3.1. Sub-National Governments (Good, Improved from Not Met in 2016)

109. Information on the financial performance of SNGs is published regularly by the MoF and the local governments. The MoF publishes the annual budget of each SNG and autonomous region, while the Treasury publishes the annual financial statements of Autonomous Republics and Municipalities. The Budget Code and the Law on Local Self-Government require SNGs to submit financial information to the MoF on a quarterly basis. Information on approved budgets, their execution, and brief description of results is also published at the municipal level, though with varying degrees of detail. The PBO prepares and publishes a descriptive report on the execution of SNGs. Although a detailed and consolidated analysis of the financial performance of SNGs is lacking, the risks are not significant due to the sector's relatively small size; the sum of all negative budget balances in 2020 represented only 0.39 percent of GDP, when revenues were significantly affected by the pandemic (Figure 3.7).

110. The update and implementation of the SNG legal framework has improved transparency on potential fiscal risks. Controls on borrowing by SNGs have been strengthened, requiring MoF approval for new loans and/or guarantees, and the 2018 ELA included SNG debt within the 60 percent of GDP ceiling**.** Article 100 of the Organic Law of Georgia on the Local Self-Government Code links SNGs' debt levels with their repayment capacity: new loans taken by SNGs, including LEPLs under their control, should not exceed 10 percent of their annual own revenue, on average over a three-year period. Inclusion of SNGs in the TSA has also enhanced the control and monitoring capacity of the Treasury.

Figure 3.7. Georgia: Municipalities Budget Balance



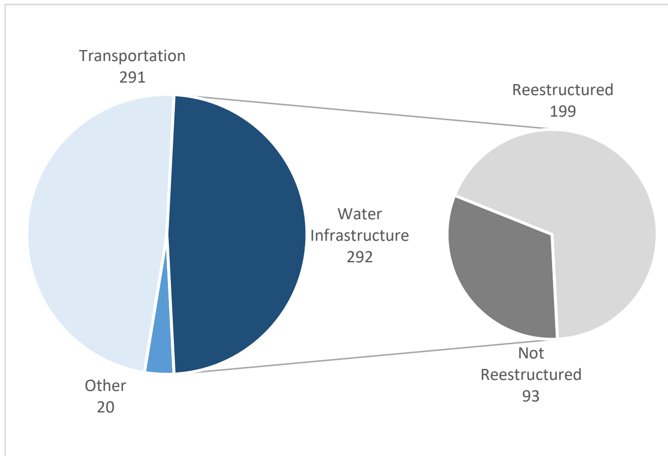


Source: Ministry of Finance
1/Sum of the budget deficit of municipalities with a negative outturn

111. Despite the significant amount of information currently compiled on SNGs, the analysis of their potential fiscal risks is neither discussed nor disclosed in the FRS. Local governments rely on government transfers and on-lending resources to fund their expenses, with Tbilisi municipality being the least dependent on the central government. Due to their small size, the risk that individual SNGs represent to the central government is not macro-critical. However, on aggregate on-lending to SNGs is estimated at 0.8 percent of GDP at end 2022 (down from 1.2 percent in 2021 mainly due to the exchange rate appreciation). Out of approximately 28 SNGs projects between 2016 and 2022, 8 were restructured, half of these between 2021 and 2022 (Figure 3.8). Additionally, SNG-owned PCs are also beneficiaries of on-lent resources, increasing the portfolio's exposure to the financial health of SNGs.

112. **Fiscal transparency and risk monitoring practices can be substantially improved by focusing on a limited number of SNGs.** The relatively large size of a few SNG entities reduces the oversight burden for the MoF. Monitoring of the financial performance of SNG could be limited to the municipalities of Tbilisi, Batumi, and Kutaisi, which together represent 43 percent of the total SNGs' expenditures of the sector. Developing priority-based analysis and disclosing it in the FRS would complement the existing reporting mechanism and would support an advanced level of practice.

Figure 3.8. Georgia: On-lending Portfolio of SNGs (GEL Million)



Source: Ministry of Finance, IMF staff calculations

3.3.2. Public Corporations (Good, Improved from Basic in 2016)

113. **The government publishes detailed information on public corporations, including estimates of quasi-fiscal activities, but no government ownership policy has yet been approved.** Assets and liabilities of PCs represented approximately 12.6 and 7.8 percent of GDP in 2021, with PCs generating a net profit of GEL 543 million or 19 percent of return on equity. The 2022 FRS identifies subsidies and dividends as main flows with government (0.4 and 0.1 percent of GDP, respectively). PCs are also beneficiaries of on-lending from the government, with an estimated stock of 4.2 percent of GDP in 2021. The FRS also presents first estimates of quasi-fiscal activities undertaken by three PCs, including for the Georgian Oil and Gas Corporation which is estimated at GEL 302 million or 0.5 percent of GDP in 2021. Figures 3.9 and 3.10 present some key financial indicators for a subset of PC analyzed in the FRS.

Figure 3.9. Public Corporation Liabilities[1]
(Percent of GDP)

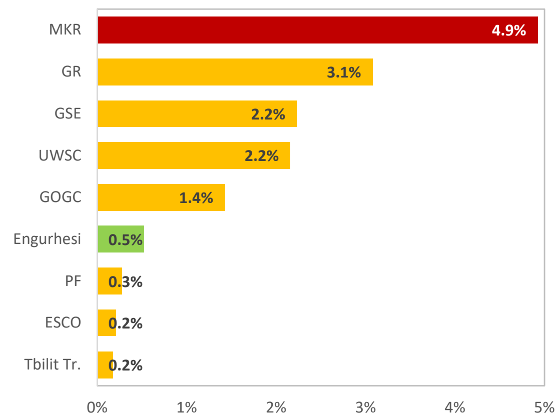
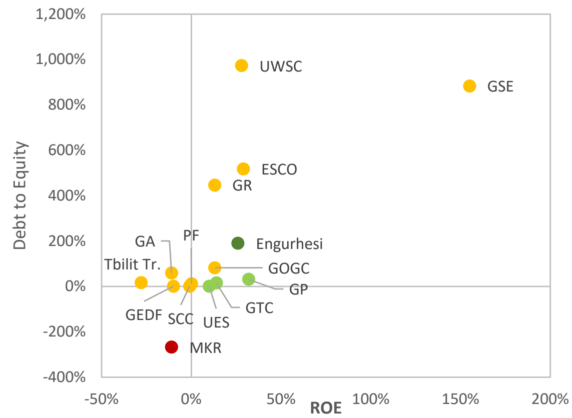


Figure 3.10. Financial Ratios
(ROE vs. D/E)



Source: Fiscal Risks Statement 2022, MoF
Note: Colors in both graphs indicate the overall level of risk of each entity: red = high risk; yellow = medium risk; light green: low risk; green = very low risk.
1/ MKR is joint venture classified in the sector of corporations under foreign control. It is included in the FRS for transparency purposes and presented in the report to showcase the analytical exercise in the FRS.
Tbilit Tr.: Tbilisi Transport Company LLC; ESCO: JSC Electricity System Commercial Operator; PF: JSC Partnership Fund; Engurhesi: Engurhesi LLC; GOGC: JSC Georgian Oil and Gas Corporation; UWSC: United Water Supply Company Georgia LLC.; GSE: JSC Georgian State Electrosystem; GR: JSC Georgian Railway; MKR: Marabda-Kartsakhi Railway LLC; GTC: Georgian Gas Transportation Company LLC; SCC: State Construction Company; GP: Georgian Post; UES: JSC UES Sakrusenergo; GEDF: Georgia Energy Development Fund;

114. **The analysis of fiscal risks arising from public corporations has been significantly enhanced since 2016.** Data coverage was expanded from mostly budget flows to financial performance indicators and risk analysis. The 2022 FRS provides a consolidated view of the sector as well as a “deep dive” into the health of key institutions, ranking PC based on the perceived level of risk. The analysis of QFAs, considered an advance practice in the Code, has been enhanced to disclose not only the estimated value of the activity, but to increase visibility to the foregone revenue of the PC and the actual cost of providing the service.

115. **The authorities are implementing a wide range of reforms related to their public corporations and non-market SOEs.** A reform strategy was approved by the Government in 2022. The law on public corporations is currently being drafted with World Bank’s technical assistance, which will cover the development of the government’s SOE ownership policy. Authorities expect the public corporation law to be finalized by end-2023 and to be approved in 2024.

116. **The ongoing strengthening of the legal and regulatory framework for managing PCs should allow Georgia to reach an “advanced” level of transparency.** The reform is based on five pillars, two of which are closely related to the existing gaps for a higher rating: developing an ownership policy and ensuring competitive neutrality. The policy is expected to set guidelines for PC management and oversight, including for dividend distribution. The latter has worked in an ad-hoc way, as highlighted in the 2021 FRS, when a dividend payment was approved to ensure the Partnership Fund could meet a debt service obligation. Achieving PCs’ competitive neutrality is important to ensure fair competition with the private sector. It will require the authorities to identify other implicit or indirect support provided by the state—– i.e., on-lending at market conditions will require charging a spread over the conditions received by government. In parallel, implicit QFAs that might be undermining the profitability of the PC will also

need to be identified and addressed— i.e., overemployment discussed in the FRS, or other public service obligations imposed on PCs.

3.4. Recommendations

117. Based on the above assessment, the evaluation highlights the following priorities for achieving greater transparency in the disclosure of fiscal risks.

- **Recommendation 3.1. Strengthen the quantification and disclosure of fiscal risks in the Fiscal Risks Statement**.
  - Provide more detailed information about planned policy responses for negative macroeconomic scenarios.
  - Expand the coverage of the FRS to include specific risks arising from SNGs and the financial sector, including both likelihood and potential fiscal impact. Leverage information compiled and reported by entities outside the MoF (e.g., the NBG's Financial Stability Report, PBO).
  - Further develop the long-term sustainability analysis included in the 2022 FRS, covering fiscal implications of the pension reform and the health sector.
    - Strengthen assessment of new pension schemes and existing social assistance payments to determine NPV of pension commitments.
    - Complete sensitivity analysis of above commitments to key macro variables.
  - Streamline the analysis in the PC section of the FRS, while providing the detailed assessment as an annex to the statement.
  - Improve the disclosure of PPPs/PPAs by standardizing tables used in successive vintages of the report, and by presenting government commitments not only in NPV but also by year over the overall project life cycle.
- **Recommendation 3.2. Tighten criteria for accessing contingency reserves.**
  - Rationalize the number and objective of reserve funds to include only those which relate to unforeseen and unavoidable situations.
  - Develop and publish regulations on: (i) rules for establishing new reserve funds; (ii) limits on the total size of all reserve funds; and (iii) specific criteria for use of resources from the reserve funds.[55]

[55] The Budget Code specifies the size and adjustment limits for the State Budget Reserve Funds but not for other reserve funds.

- **Recommendation 3.3. Enhance fiscal risks monitoring and management.**
  - Ensure full adherence to the requirements of Public Debt Law (risk assessment and risk fund creation) before considering the issuance of new guarantees.
    - Develop methodology to assess risks to the state budget from issuing guarantees.
    - Use this methodology to determine the fees to be paid by the beneficiary to the risk fund.
  - Improve monitoring of three largest SNGs to assess likelihood of government support and to identify potential mitigation measures.
    - Disclose on-lending portfolio from state budget, subsidies from SNGs to PCs, key fiscal performance indicators.
    - Analyze SNGs capacity to repay the on-lending portfolio, and include it into the FRS.
  - Undertake a comprehensive analysis of financial sector risks from a fiscal perspective. Fiscal risk analysis should consider the impact of market share concentration of market share in a few institutions. Due to moral hazard risk, this analysis could remain confidential for MoF and NBG use only.
    - Enhance asset management through better management of the on-lending portfolio and of equity investments in PCs. Introduce risk spread in the on-lending portfolio to offset the cost of restructuring of loans.
    - Develop and approve a PC ownership policy as part of the new Public Corporation Law currently being drafted by the authorities.
  - Prepare a strategy to guide the government's response to crises that can have social, economic, and environmental effects that demand immediate government action. The strategy should identify the potential triggers (e.g., natural or man-made disasters), types of activities within the scope of government response, potential financing vehicles, and fiscal impacts of disaster risk management.
  - Update the 2017-2020 National Disaster Risk Reduction Strategy and associated Action Plan.
    - Report on what has been achieved as intended in the 2017-2020 Action Plan.
    - Develop and adopt policies and methods for managing fiscal impacts of natural disasters.

Table 3.5. Georgia: Summary Evaluation: Fiscal Risks

	Principle	Rating	Importance	Rec
3.1.1	**Macroeconomic Risks**	**Advanced:** Macro analysis includes alternative scenarios of fiscal forecasts. Scenarios are presented in the probabilistic "fan chart" for main fiscal parameters.	**Low**: Lessons from the pandemic warrant continuous risk monitoring and management.	
3.1.2	**Specific Fiscal Risks**	**Advanced:** FRS includes basic analysis of quasi-fiscal activities and long-term risks, such as natural disasters and demographic changes.	**Medium:** High concentration in financial sector and SNGs warrants detailed assessment in FRS.	**#3.1, 3.3**
3.1.3	**Long-term Fiscal Sustainability**	**Basic:** Annual DSA provides a long-term perspective on government's financial indicators. Limited disclosure of long-term sustainability analysis of health and pension.	**High:** Changing demographics and government commitments from new pension schemes require regular and more detailed analysis.	**#3.3**
3.2.1	**Budgetary Contingencies**	**Basic**: Budget includes allocations for reserve funds, but access criteria do not exist. Use is regularly reported but is not restricted to unforeseeable or unavoidable circumstances.	**Medium:** Aggregate amount appropriated for reserve funds account for 2.9 percent of total expenditure appropriations for the 2023 budget.	**#3.2**
3.2.2	**Asset & Liability Management**	**Good:** Strong legal framework for debt management in place (approval, recording, monitoring), a strategy and detailed analysis published at MoF. Asset management is mostly focused on Treasury-related assets.	**Low:** Positive impact of PC reform and enhanced on-lent portfolio oversight to benefit asset and liability management and support ongoing work on balance sheet analysis.	
3.2.3	**Guarantees**	**Good:** Stock regularly published. Strong legal framework for approving and managing related risks. No explicit guarantee to the deposit insurance fund, but risk of implicit support not discussed by FRS.	**Low:** Guarantees account for 0.01 percent GDP. Methodology for evaluating risk and defining amount to be deposited in Risk Fund is pending.	
3.2.4	**Public Private Partnerships**	**Good:** Updates to regulatory framework placed limits on PPP commitments and strengthened the role of MoF. FRS discloses PPA commitments annually, but information on legacy PPPs is limited.	**Medium:** Contingent cost of energy market of 8 percent of GDP in adverse scenario. MoF to enforce disclosure of new projects as required in new regulation.	**#3.3**
3.2.5	**Financial Sector Exposure**	**Advanced:** NBG's AFSR provides a detailed overview of sector's health. Limited direct government exposure to the financial sector.	**Medium:** Low likelihood due to system's strong performance, but high potential fiscal impact as few banks comprise about 75 percent of assets and loans and hold 50 percent public domestic bonds.	**#3.3**
3.2.6	**Natural Resources**	**Not met:** Estimates of the volume of mineral deposits are published, but not their cost. Does not publish production, sales, or fiscal revenue of previous year.	**Low:** Georgia is not endowed with large and valuable natural resource deposits. Current fiscal revenue is low.	
3.2.7	**Environmental Risks**	**Good:** Historical and likely future costs of natural disasters are quantified and published in the FRS, but there is no strategy to manage fiscal risks from them.	**High:** Fiscal impacts of natural disasters can be very high and are unpredictable. Having a plan in place before a disaster is essential.	**#3.3**
3.3.1	**Sub-national Governments**	**Good:** Quarterly and annual reporting on financial indicators of SNGs are published. Limits on SNG debt defined in regulation.	**Medium:** On lending to SNGs represents 1 percent of GDP. Limited analysis of repayment capacity.	**#3.3**
3.3.2	**Public Corporations**	**Good:** Analysis of PC financial results, related fiscal risks, quasi-fiscal activities, and government transactions included in FRS. PC ownership policy is being developed.	**High:** Exposure to economic shocks due to average debt to assets ratio of 60 percent and FX linked; as of 2022 on lending of 3 percent of GDP.	**#3.3**

Appendices

I. Presenting Disaggregated Data on In-Year Budget Adjustments (example)

The extract below is from South Africa's Technical Guidelines for the 2022 Adjusted Estimates of National Expenditure, their equivalent of a supplementary budget. It shows the disaggregated categories for in-year budget adjustments by the economic classification. [56]

Adjusted Estimates of National Expenditure 2022

[The table below will be created from the AENE data workbook].

Programme	2022/23									
			Adjustments appropriation							
R thousand	Appropriation	Special appropriation	Roll-overs	Unforeseeable/ Unavoidable	Virements and shifts	Amounts announced in the budget	Declared unspent funds	Other adjustments	Total adjustments appropriation	Adjusted appropriation
Programme name										
Sub-total										
Direct charge against the National Revenue Fund										
Item										
Total										
Economic classification										
Current payments										
Economic classification item										
Transfers and subsidies										
Economic classification item										
Payments for capital assets										
Economic classification item										
Payments for financial assets										
Total										

1. *Other adjustments include Shifting of funds between votes or to follow function shift, Self-financing, shifting of funds following function shift within a vote, Significant and unforeseeable economic and financial events, Section 16 of the PFMA*

[56] *Source:* https://www.google.com/url?client=internal-element-cse&cx=018115738860957273853:j5zowsrmpli&q=https://www.treasury.gov.za/publications/guidelines/2022%2520AENE%2520Technical%2520Guidelines.pdf&sa=U&ved=2ahUKEwjC2tCgvNb-AhWhhP0HHei1AgQQFnoECAgQAg&usg=AOvVaw3RtsziVGqo0R-jReuvglCS