International Monetary Fund

Georgia and the IMF

Press Release:
IMF Executive Board Completes the First Review of the Extended Arrangement under the Extended Fund Facility for Georgia
December 6, 2017

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Georgia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 17, 2017

The following item is a Letter of Intent of the government of Georgia, which describes the policies that Georgia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Georgia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Appendix I. Letter of Intent

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C.

Tbilisi, November 17, 2017

Dear Ms. Lagarde:

1. **We remain committed to the policies set forth in our original Letter of Intent and Memorandum of Economic and Financial Policies of March 27, 2017.** Our policy agenda is based upon the Government's Four Point Reform Plan, which focuses on the following strategic directions: (i) reforming education to promote adequate skills development, labor productivity and job creation; (ii) accelerating core infrastructure to leverage Georgia's strategic geographic location as a transit and tourism hub as well as improving connectivity between regions; (iii) improving the governance and efficiency of the government; and (iv) enhancing the role of the private sector as an engine for growth. The central bank's reforms plan aims at strengthening monetary policy and enhancing the supervisory and regulatory framework and financial safety nets. Together with this ambitious reform package, we are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable and more inclusive economic growth.

2. **The rebound of our economy offers a window of opportunity to decisively implement our reform program.** Annual growth through September averaged 4.7 percent, higher than the 3.5 percent expected for the whole year under the program. As anticipated, inflation has started to abate. The current account deficit has narrowed to 9.4 percent of GDP in 2017H1, from 12.8 percent of GDP in 2016, driven by strong growth in good exports, tourism and remittances. Amid a better economic performance, however, we acknowledge no time for complacency and remain fully committed to steadfast implementation of reforms.

3. **We have hitherto met all the conditionality under our IMF-supported program**. We have met all end-June quantitative performance criteria, and inflation has remained within the inflation bands proposed under the inflation consultation bands (ICC). Structural benchmarks for end-June and end-September have also been fully implemented.

4. **We request the completion of the First Review under the Extended Fund Facility and the release of the related purchase.** Given the performance under the program so far, and the policies

described in the enclosed Memorandum of Economic and Financial Policies (MEFP), we intend to purchase a further SDR 30 million from the Fund, bringing our drawings under this program to SDR 60 million. Our program will continue to be monitored through quantitative performance criteria for end-June and end-December test dates, a continuous performance criterion, an indicative target, and an inflation consultation clause. Consistent with our reform agenda, our program also envisages structural benchmarks. These are set out in Tables 1–3, and described with definitions in the attached Technical Memorandum of Understanding (TMU). Reviews will be conducted semi-annually. The Second Review will be based on end-December 2017 performance criteria and is expected to be completed on or after April 13, 2018. The Third Review will be based on end-June 2018 performance criteria and is expected to take place on or after October 26, 2018.

5. The attached MEFP, which updates and extends the previous one, will enable us to achieve the objectives of our economic program. We will monitor progress continuously in consultation with the IMF, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this Letter of Intent in accordance with the IMF's policies on such consultation. We will also provide the IMF with the information it requests for monitoring program implementation. We authorize the IMF to publish this Letter of Intent and its attachments (including the MEFP and TMU), as well as the related Staff Report. These documents will also be posted on the official websites of the Georgian government after the approval by the IMF Board.

Very truly yours,

/s/
Dimitri Kumsishvili
First Deputy Prime Minister and
Minister of Economy

/s/
Mamuka Bakhtadze
Minister of Finance

/s/
Koba Gvenetadze
Governor of the National Bank of Georgia

Attachments:
1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

1. This memorandum reports on recent economic developments and updates the economic and financial policy agenda of the National Bank of Georgia (NBG) and the Government of Georgia to address the Georgia's medium-term economic challenges.

Macroeconomic Framework

2. Our economy has performed well this year, supported by our prudent policies and a strengthening of economic activity in our main trading partners. Through September, real GDP has increased by 4.7 percent year-on-year (y-o-y), higher than the 3.5 percent expected for the whole year under the program. Goods exports, tourism receipts, and remittances (in lari terms) have increased almost 30 percent y-o-y. This has led to a significant improvement in our trade and current account balances. Inflation peaked in June at 7.1 percent y-o-y and has started to come down, remaining well within the program's consultation bands. A stronger-than-envisaged current account balance has allowed us the opportunity to boost our FX reserves, which have remained well above the program ceiling. Our larization policy has led to a decline in both deposit and loan dollarization. These positive economic developments and our commitment to continue prudent policies have resulted in an upgrade of Georgia's sovereign rating by Moody's. We are among the top 10 performers in the 2018 Doing Business Report, with improvements in getting electricity, protecting minority shareholders and resolving insolvency.

3. The vibrancy of economic activity and our commitment to steadfast implementation of our program call for positive revisions to our economic outlook.

- We expect economic growth to stay robust in 2018, higher than in our main trading partners, driven by higher investment, consumption and net exports. Because of important reforms, we believe that growth of over 4.5 percent is achievable in 2018. However, considering potential risks, including from the external environment, our program is purposefully based on a cautious growth assumption of 4.2 percent. Growth is projected to gradually accelerate over the medium term because of higher investment, structural reforms and an expected improved external environment.

- Stronger-than-expected economic activity has resulted in higher government revenues, which will allow for higher infrastructure spending and for rebuilding fiscal buffers faster than initially considered under the program (see below).

- Robust exports of goods and services and remittances will improve the current account deficit in 2017 by 2.4 percentage points of GDP compared to 2016. The current account deficit is projected at 10.4 percent of GDP in 2017 and 10.6 percent of GDP in 2018. External financing will continue to rely mostly on FDI. International reserves will continue to increase over the medium term.

4. Our program will improve external competitiveness. Ambitious structural reforms, together with the continued implementation of the EU-Georgia Association Agreement and free trade agreements with China and other countries, will support access to new markets and economic diversification. Improving further the business environment will help mobilize FDI in tradable sectors, improve competitiveness and reduce external vulnerabilities.

5. Risks to the outlook are balanced. Upside risks stem from stronger domestic demand and a more supportive external environment. Downside risks include inward-looking policies in some countries and weaker-than-expected growth in advanced and emerging economies. However, as a first line of defense against downside risks, we have a flexible exchange rate and a well-capitalized and liquid banking system. We stand ready to further adjust policies as necessary. The IMF arrangement would provide an additional anchor to help us cope with negative shocks.

Economic Policies

A. Fiscal Policy

6. Stronger-than-expected revenues will allow us to rebuild fiscal buffers faster than originally expected, while still providing fiscal space for capital investment. We will reduce the augmented cash deficit of the general government (TMU definition) to 2.8 percent of GDP by 2020. Rebuilding fiscal buffers will allow for some countercyclical policies in the future, if needed. We aim to reduce primary current spending (excluding budget lending activities) from almost 25 percent of GDP in 2016 to 21.1 percent of GDP by 2020. This will generate the fiscal space required to substantially scale-up public investment to address infrastructure bottlenecks. In consultation with the IMF, we are committed to use revenue over-performance or additional savings in current spending toward high priority growth-enhancing capital spending, and any under-execution in investment towards a lower deficit.

7. We are committed to keep the 2017 augmented fiscal deficit as planned. Our 2017 augmented deficit is projected at GEL1,328 million or 3.6 percent of GDP, below the program ceiling (GEL1,335 million, performance criterion). Measures envisaged under the 2017 budget (detailed in the previous MEFP) and stronger fiscal revenues helped keep the deficit below this ceiling. Through end-June, we met our augmented deficit ceiling by a wide margin, mostly due to higher revenues. Consistent with our commitment under the program, 75 percent of the revenue overperformance in 2017 will be used to increase public investment by 0.4 percent of GDP. The remaining revenue overperformance will be used to repay VAT claims. We will strive to keep primary current expenses below GEL8,685 million (indicative target), while increasing net acquisition of nonfinancial assets and net lending to GEL2,908 million (7.8 percent of GDP).

8. We will maintain fiscal consolidation efforts in 2018, while generating space for higher capital spending. Consistent with the Fund-supported program, the 2018 budget projects the augmented fiscal deficit at GEL1,206 million (3.0 percent of GDP) (structural benchmark, December 2017). We will continue to contain current primary spending (indicative target), by keeping them constant in real terms. However, social security expenses are expected to increase above inflation due to the upcoming pension reform. The budget includes a GEL200 million in repayment of value-added tax (VAT) credits, which will be subject to an adjustor under the program (see Technical Memorandum of Understanding (TMU, ¶14)). We stand ready to adopt contingency measures, if needed, to bring the augmented deficit below the 2018 program ceiling.

9. We aim to reduce fiscal risks.

- We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion); (ii) accumulate net domestic expenditure arrears of the general government (indicative target); and (iii) issue new public guarantees (performance criterion), or comfort letters. Given that only the MoF is authorized to issue public guarantee, and that these are explicit in nature, we request the elimination of the reference to implicit guarantees in the ceiling on new public debt.

- The Partnership Fund (PF) will continue to pursue only commercial objectives (providing minority equity or loan co-financing), will not run a cash deficit (performance criterion), or issue any guarantees. In order to avoid reducing the balance sheet size of the PF when debt is repaid, we request that the ceiling on the PF's new borrowing be expressed in net rather than gross terms. The new net borrowing of the Partnership Fund will be limited to $20 million in 2017 (performance criterion). We remain committed to maintain a non-negative cash position at the Partnership Fund by end-June 2018 and will limit its net borrowing to $20 million by June 2018 (cumulative from the beginning of the EFF program, performance criterion).

- We will refrain from initiating any Public-Private Partnerships (PPPs), including Power-Purchasing Agreements (PPAs), until the PPP law and institutional framework is operationalized. We are committed to reassess and implement, if needed, additional fiscal adjustment based on our fiscal risk profile.

- Taking into consideration existing fall-winter period power deficit, and except for the PPAs described in the next bullet, partial PPAs currently under negotiation will be permitted to proceed (prior to the new PPP law) only under the following terms:

- The guaranteed purchase period shall not be more than 8 months in each year;

- The guaranteed purchase tariff shall not be more than US 6c kWh; and

- The cumulative installed capacity of these projects under negotiations will not exceed MW500.

- Additionally, we have two PPAs under negotiation (the Namakhavani HPP Cascade Project and Koromkheti Hydro Project) —with cumulative capacity of MW600—outside of the terms mentioned above. These projects will only be allowed to proceed under the following conditions:

- The government will not sign these projects before having conducted a thorough fiscal risk analysis for the projects itself and comprehensively for all fiscal risks, in consultation with the energy expert of the World Bank and the IMF.

- The risk assessment will update the analysis of gross exposure of all signed PPA projects and these two large projects; and analyze the net risk exposure with different demand, price and exchange rate assumptions. The scenario analysis will be defined in coordination with the IMF.

- For these two last projects, the risk assessment will describe and quantify other risk-sharing contractual obligations (including, for instance, termination risk or construction risk).

- We will limit the fiscal risks stemming from our proposed export credit agency (ECA). We will coordinate with the IMF on the preparation of the charter creating the ECA to ensure that the agency will (i) only provide guarantees and insurances related to export operations; (ii) be subject to insurance regulation and supervision; and (iii) not receive explicit government guarantees. ECA's capital will be constituted by a $20-million equity injection by the Partnership Fund distributed over 3 years. A revolving fund for potential losses, totaling GEL50 million, will come from the state budget.

10. We remain committed to increasing capital spending while achieving medium-term fiscal consolidation. Under our program, capital spending is expected to increase significantly over the coming years, especially investment in major road infrastructure projects financed by IFIs and bilateral donors. Such increase may result in deviations from the program due to the natural uncertainty related to project execution. We therefore request an increase in our adjustor related to foreign-financed project loan disbursements for the augmented cash deficit from $30 million to $60 million (0.4 percent of GDP, TMU, ¶13). We will continue rationalizing current spending, mostly based on improving the efficiency of the public administration including by (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and (iv) improving performance-based budgeting. To support the vulnerable population, the existing social safety net will be maintained and the basic public pension will be increased (see below). In addition, we do not plan to extend the dividend distribution model to financial institutions and insurance companies in 2019, which would limit the revenue loss (up to 0.5 percent of GDP). To achieve our deficit target, we will identify additional contingency measures, if needed, in coordination with the IMF, including on the revenue side within the scope of our fiscal framework.

B. Structural Fiscal Policies

11. We will strengthen our revenue administration to secure full and equitable compliance by all taxpayers and improve taxpayer services. Following the 2016 Tax Administration Diagnostic Assessment, we will enhance the efficiency of revenue administration. The plan, to be implemented under a 3-year program, includes revising the organizational structure of Georgia's Revenue Services (GRS), improving risk and compliance management, and improving automatic tax refunds and the taxpayer register. We will initially focus on the following steps:

- **Organizational structure.** We will restructure the GRS headquarters into a function-based organization to modernize tax administration (new structural benchmark, February 2018). For this, the GRS will structure its work in logical groupings of core functions – such as taxpayer service, returns filing and payment, audit, appeals, arrears management, policy and interpretations and compliance management. This structure relies on a strong headquarters (HQ) department providing operational policy and ensuring consistency.

- **Improve filing compliance.** In consultation with the IMF, we have established key performance indicators to help improve filing compliance, especially to provide for early and effective action where returns are overdue. Initially developed for VAT, the program could expand to all tax categories. The GRS will also improve the taxpayer register, and submit legal amendments so that an unfiled declaration is no longer deemed to be a nil declaration where the GRS requires a declaration, and set up an organizational unit that deals with filing default and late filing.

- **VAT refunds.** We are committed to expand a risk-based automated system to check VAT refund claims by September 2018, replacing the resource-intensive manual system currently in place. This will improve efficiency and allow resources to be directed towards auditing. With IMF TA support, we approved an action plan to address outstanding VAT claims in an orderly manner over time (including analysis, refund, set-offs, and write-offs as appropriate) (structural benchmark, September 2017). We will create a steering committee with representatives from the MoF, GRS, and GTS by end-2017. The committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the plan (new structural benchmark: The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims, March 2018). A new specialized VAT unit in the GRS will focus on validating VAT claims (new structural benchmark: create a new specialized VAT unit focusing on validating VAT claims, June 2018).

- **Tax Audits.** We have received IMF TA on enhancing compliance risk analysis and improving data management for new risk models. We are committed to increase audit capacity, efficiency, and impact on compliance. To that end, we plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We will better manage the audit scope and develop audit plans to give a balanced coverage of tax categories. We will introduce an audit case management system to enhance audit timeliness and productivity, and implement a systematic approach to terminate non-productive audits.

12. We are reforming the civil service to contain costs, increase efficiency, and improve the link between performance and pay. A new Civil Service Law introduced grade structures. We submitted to Parliament a civil service remuneration law (structural benchmark, December 2017). This law will set salary ceilings for different grades of civil service (compensation grid) and consolidate current bonuses and supplements into the base salary structure. These ceilings and provisions will ensure that our wage bill will be consistent with the projected medium-term wage bill under the program.

13. We are committed to contain fiscal risks to safeguard fiscal sustainability. We understand that key sources of fiscal risk in Georgia, in addition to those associated with macroeconomic risks, could arise from state-owned enterprises (SOEs) and PPPs, including PPAs in the energy sector. At the same time, we recognize that PPPs and PPAs can play a pivotal role in Georgia's development by attracting investment, including FDI. In this vein, improvements in the relevant legislation are required to reap the benefits of further PPPs and PPAs.

Hence, we are committed to:

- **Adopt a new PPP law and associated regulations**, with assistance from the World Bank (WB) the Asian Development Bank (ADB), the EBRD, and the IMF. We are committed to ensure that the law will include sound elements following best international practice: (i) a wide institutional and sectoral coverage of PPPs (including PPAs in the energy sector) and a clear definition focused on optimal risk sharing; (ii) a strong integration of PPP projects with the overall investment strategy and budget cycle; (iii) a strong role for the MoF in the approval process (using cost-benefit and VfM analysis), checking budget affordability, and assessing fiscal risks (Fiscal Risk Management Unit); (iv) transparent and competitive procurement processes (e.g. restricting narrowly direct agreements); and (v) providing for transparent reporting, accounting, and auditing of all PPP arrangements, including a ceiling on government exposure from such partnerships. We have submitted the PPP Law to Parliament (structural benchmark, December 2017). The law calls for the establishment of a ceiling on PPP and PPA obligations to be included in the budget law; and we will set up a PPP unit at the Prime Minister office to provide technical support. We will consult with the IMF on secondary legislations that we plan to develop by March 2018.

- **Widening the coverage of fiscal risks in the Fiscal Risk Statement (FRS) accompanying the 2018 budget.** Our 2017 FRS reported on PPA and SOE liabilities. In the 2018 Budget, the FRS will report more comprehensively all existing PPP-associated firm and contingent liabilities; include a quantitative reporting of quasi-fiscal relationships; and expand the analysis of SOE's contingent liabilities (structural benchmark, December 2017). Specifically, we will (i) expand the historical analysis of SOEs' contingent liabilities by up to five years; (ii) describe historical trends of the size of the SOE sector relative to the economy; (iii) have conclusive analysis of the factors driving the SOEs' aggregate and individual financial performance and position; (iv) identify and evaluate quasi-fiscal relationships; (v) develop the methodology for sensitivity analysis and stress tests examining the impact of changes in key variables on SOE's financial performance and fiscal risks.

- **Improve the Public Investment Management Framework (PIMF).** We will strengthen MoF's role in public investment management. To this end, we have created a dedicated public investment unit at the MoF, where information on public investment projects will be centralized. This unit will evaluate investment projects based on cost/benefit analysis and other relevant analyses. This will help establish a single project pipeline, support adequate project evaluations, help prioritize investments and identify their financing, and integrate them within the multi-annual budget process. The PIMF will cover PPP-type projects to ensure they are prioritized and assessed alongside traditionally-procured projects. We have requested IMF TA to conduct a Public Investment Management Assessment to help strengthen our PIMF.

14. We believe that accurate and transparent public financial management is a cornerstone of fiscal stability. Accordingly, we are committed to:

- **Improve our fiscal rule to safeguard fiscal sustainability.** With IMF support, we have initiated a review of our fiscal framework, including our fiscal rules, with the aim of ensuring that they support our medium-term fiscal objectives toward sustainability while also granting flexibility in formulating fiscal policy over the economic cycle. We will explore, in consultation with the IMF, enhancements to our fiscal framework, including improving corrective mechanisms, escape clauses, accountability and transparency. Within the context of reviewing the fiscal rule, we will upgrade the presentation of public finances from GFSM 2001 to GFSM 2014 classification.

- **Issue guidelines for new budget lending operations,** requiring reasonable expectation of repayment (structural benchmark, December 2017). We will prepare the 2019 State Budget applying the GFS classification of equity injections and on-lending, per the reasonable commercial return test and, if not met, these will be treated as subsidies or transfers.

- **Comply with international accounting standards**. In our efforts to improve fiscal transparency, we will produce an annual consolidated general government sector financial report on an International Public Sector Accounting Standards (IPSAS) basis starting in 2021.

- **Improve the quality of fiscal reports.** We will explain revisions to the medium-term budget estimates in the annual budget document. We will also include LEPLs' revenues and expenditures in the budget documentation starting in the 2018 state budget. To expand the institutional coverage of fiscal reports, we will assess existing LEPLs by end-2018 and create rules for classifying them as general government units or non-general government units, based on international statistical standards.

- **Improve our treasury account management**. To this end, the MoF has started auctioning its deposits to the banking sector.

C. Monetary Policy

15. We are committed to our inflation targeting (IT) framework to maintain price stability. We lowered our inflation target to 4 percent in 2017 and 3 percent from 2018 onwards. While inflation has been above the target during 2017 due to a one-off price increase resulting from higher excises and import prices, we project inflation to return to the target in 2018. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. As such, inflation developments will be monitored via dual consultation bands set symmetrically around the central point for headline CPI (Table 1). Should actual inflation be higher or lower than the inner consultation band of ± 2 percent, the NBG will consult with IMF staff on the reasons for the deviation and the policies to return to target. Should actual inflation be higher or lower than the outer consultation band of ± 3 percent, a consultation with the IMF Board will be triggered.

16. We will maintain a flexible exchange rate regime to protect the economy against external shocks. Foreign exchange interventions will be limited to smoothing excessive exchange rate volatility. While the current level of gross international reserves is still below the level recommended by the IMF-composite metric (ARA), we will buildup international reserves throughout the program, which will be monitored by a floor on net international reserves (performance criterion). Positive external developments earlier this year allowed us to accumulate more reserves than envisaged under the end-June program floor. This has enabled us to strengthen our external buffers and we therefore increase the end-December 2017 NIR performance criterion by $40 million to $1,390 million.

17. We will continue strengthening the monetary policy transmission mechanism. We have made progress in implementing our larization plan (see below). We have improved our lari liquidity facilities and monetary instruments by introducing a one-month liquidity instrument and broadening the eligible collateral pool. This will help provide confidence in NBG's liquidity management, facilitating maturity transformation in the banking sector. The interbank market is working well, and interbank interest rates are close to the policy rate. Since August 2017, we have narrowed the interest rate corridor, which will reduce the volatility of interbank interest rates. We signed a memorandum of understanding on information sharing for liquidity forecasting purposes between the MoF and the NBG (structural benchmark, June 2017). We will also submit to Parliament legal amendments to allow for derivatives and repo transactions, including netting and close-out netting provisions by March-2018. We plan to strengthen lari liquidity management by extending open market operations to outright sales and purchases of treasury securities by mid-2018.

18. Monetary policy will be enhanced by improving our communication. We will continue publishing our quarterly monetary policy reports on a fixed pre-announced schedule in par with associated meeting with experts. Every second monetary-policy meeting will also continue to be followed by a press conference. While being at the frontier of monetary policy making among emerging market economies, by introducing forward guidance, we will further strengthen our communications by issuing a manual for monetary policy operations with the help of IMF TA.

D. Financial Sector Policy

19. Our policies will strengthen financial sector stability. This will support the banking sector's ability to cope with shocks and improve financial intermediation. We will (i) further strengthen the supervisory and regulatory framework; (ii) improve the safety nets and the bank resolution framework, enhancing our crisis preparedness; (iii) step-up efforts to incentivize the use of the domestic currency, aiming at reducing dollarization in the economy; and (iv) develop capital market and implement pension reform.

20. We have made progress on strengthening financial regulation and supervision.

- We introduced (i) liquidity coverage ratios (LCRs) for commercial banks, with preferential treatment for GEL deposits (structural benchmark, September 2017); and (ii) limits on loan-to-value and debt-service capacity ratios, with a preferential treatment for local currency. We also submitted to Parliament legal amendments giving to the NBG oversight power for credit information bureaus (structural benchmark, December 2017);

- We adopted regulations to increase the minimum regulatory capital for commercial banks to GEL 50 million to be phased in by 2019 (structural benchmark, June 2017) and introduced Basel's Pillar 3 disclosure requirements seeking to promote market discipline through regulatory disclosure requirements.

- We have submitted to Parliament amendments to the NBG Organic Law to allow NBG's supervision of banking groups. This will allow the NBG to set requirements on an individual as well as consolidated basis on (i) minimum capital and liquidity; (ii) leverage ratios; (iii) corporate governance; and (iv) disclosure, accounting, and reporting. Furthermore, the NBG and the State Insurance Supervision Agency are working together on developing a supervision framework for financial conglomerates.

- We established a financial stability analysis department at the NBG. The main responsibilities of this department are: (i) macro-financial analyses, including macro-stress testing and analytical support for macro-prudential policy; (ii) work on the publication of our forthcoming financial stability report with forward-looking analysis; and (iii) support implementing new IFRS9 standards by the financial sector. With IMF TA support, we started calibrating a macro-financial model tailored to the Georgian economy, to help analyze policy trade-offs.

- We are making progress toward implementing IFRS-reporting standards. By March 2018, we plan to introduce impairment guidelines to help the financial sector to establish proper credit loss calculation system following IFRS 9. A roadmap to transition to IFRS regulatory reporting will be prepared by June 2018. Ultimately, NBG aims to transfer regulatory reporting in commercial banks to IFRS framework through EU FINREP/COREP forms.

21. We will continue strengthening financial regulation and supervision. Our banking system has remained resilient after the 2014 external shocks due, in large part, to good regulation and supervision by the NBG.

- In line with FSAP recommendations, we will issue regulations to phase-in additional capital requirements for systematically important banks (structural benchmark, December 2017). In close consultation with the banking sector, we have significantly overhauled the overall capital adequacy framework, including Pillar II. To facilitate a smoother transition, we consider it appropriate to extend the phase-in period from 2020 to 2022. Banks' existing high capitalization and solid profitability further supports this decision.

- We are making progress towards the implementation of the Pillar II of Basel III regulation. To increase transparency of Pillar 2 capital requirements, we are working on General Risk Assessment Program (GRAPE) guidelines, describing the general principles of risk-based supervision and the rationale behind capital add-ons. We expect to publish these guidelines by December 2017.

- We will introduce regulations on (i) leverage ratios based on Basel Principles and relevant EU regulations (new structural benchmark, September 2018); (ii) credit information bureaus with the support of WB TA – set requirements and limits, issue guidelines and apply fines, protect consumers and limit business-continuity risks– following parliamentary approval of NBG's powers to regulate credit information bureaus; (iii) bank's real estate appraisal of collateral in line with International

Valuation Standards (new structural benchmark, June 2018) and (iv) corporate governance guidelines in line with Basel Principles (new structural benchmark, September 2018).

- With the help of IMF TA, we will enhance regulation, supervision and oversight of non-banks. Ultimately, all non-bank lending institutions will be brought under prudential regulation or non-prudential oversight depending of the source of their funding. We have already submitted to the Parliament a package of legislative amendments which will empower NBG to ultimately supervise and regulate micro-financial institutions (MFIs). NBG has also initiated legislative amendments to oversee currently unregulated lenders, focusing on consumer protection rights in the financial sector. We expect these changes to be approved by Parliament by the end of 2017. This will allow regulations regarding MFIs and other lenders to be introduced by end-June 2018 and end-September 2018, respectively.

- To improve consumer protection in the financial sector, we have created a consumer protection and financial literacy department within the NBG, and amended regulations on product disclosure requirements and effective interest rates calculations. The framework was substantially strengthened by extending the regulatory perimeter to micro finance institutions and credit unions.

22. While the banking sector is healthy, we are strengthening financial safety nets.

- Consistent with FSAP recommendations, we have submitted amendments to the NBG Organic Law that gives NBG the authority to resolve a bank through a temporary administration at an early stage, facilitating the application of resolution tools and reinforcing safeguards in the resolution process (structural benchmark, September 2017).

- With the support of the World Bank and ADB, we submitted to Parliament a law to introduce deposit insurance (structural benchmark, June 2017). The Deposit Insurance Agency was established in July 2017 and is expected to become operational on January 1, 2018. By June 2018, we will approve a medium-term strategy for the deposit insurance system.

- Consistent with the FSAP recommendations, we will request the largest banks to strengthen recovery plans based on Financial Stability Board's principles. We will also strengthen the bank resolution framework in line with best international practices. This will include revising the NBG law to state clearly NBG's resolution authority, including the set-up and control of bridge banks, and override shareholders' economic interests.

- We will strengthen our capacity to act as lender of last resort by identifying required legal amendments to remove the possibility to give unsecured lending, mandate a penalty rate for emergency liquidity assistance (ELA), and clarify the role of the Ministry of Finance to ensure an effective ELA framework, following international best practices.

23. We will continue to implement our larization strategy to reduce foreign-exchange risks and improve monetary policy transmission mechanisms. We adopted a comprehensive plan consisting of measures to (i) increase long-term lari funding; (ii) reduce foreign-exchange credit risks; and (iii) promote pricing in lari. The mortgage conversion program, which provided incentives for shifting towards lari-denominated currency, resulted in conversion of mortgages amounting to $80 million. Since July 2017, prices must be displayed in lari.

24. Capital market development will support larization while reducing external vulnerabilities. The non-banking financial system is shallow in Georgia, limiting competition for savings and their efficient use within the economy.

- We will upgrade our exchange infrastructure by having a single settlement system for all Georgian securities with two participating central security depositories (CSDs), one for commercial bonds and shares, and another one for government bonds. The new system will allow for delivery-versus-payments settlements for all securities and full integration with the Georgian Stock Exchange and OTC trading platforms. We expect the system to be fully operational by the summer of 2018.

- In consultation with IMF TA, we submitted to Parliament amendments to the tax code to help the development of local capital markets. This will ensure taxation of financial instruments including securities interest, dividend and capital gains, REPOs, securities lending and derivatives, in line with international best practices.

- To facilitate price discovery for private-sector bonds, in addition to our current publication of a quarterly calendar, we will publish a multi-year plan of government bond issuance to develop benchmarks along the yield curve (structural benchmark, December 2017).

- A law establishing investment funds will be submitted to Parliament in early 2018. We will also help develop a primary dealer institute and introduce mandatory third-party vehicle insurance to help develop the insurance sector. We will continue to align the legal framework with EU directives, including on securities holding, insolvency and securities market.

E. Structural Reforms

25. Achieving more robust and inclusive growth will require implementing a comprehensive structural reform agenda. We are counting on our partners to support our reform program, including the World Bank (WB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the European Commission. Our reforms aim at scaling-up infrastructure spending, and improving education and vocational training, the business environment, foreign trade relations, and land reform. We firmly believe that our reform program will boost long-term growth, diversify the economy, strengthen our external position, created jobs and reduce poverty. At the same time, targeted social assistance and health care will continue protect the most vulnerable.

26. Scaling-up infrastructure and spatial planning is key to Georgia's development. With our international partners, we aim to finalize the East-West highway and the South-North corridor by 2020. Additional infrastructure projects, including ports, airports, and railways, will transform Georgia into a transport and logistics hub connecting Europe with Asia. We are also developing radial roads to better connect regions and urban and rural areas. To improve public investment efficiency and transparency, we have brought our public procurement process closer to international standards. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season touristic destination.

27. Job creation is a central element of our economic policies. Our planned education reform, including vocational training, is crucial to improve job creation, productivity and wages. The lack of qualified labor force is repeatedly reported as one of the most problematic factors for doing business in Georgia. At the same time, unemployment and underemployment remains high. This suggests that the skills of our labor force are not well aligned with employers' demands. In line with our Four-Point Plan, we are committed to reforming the education system by, among other things, setting curriculum standards and a new teacher policy framework, and introducing vocational training and adult learning. We will encourage the participation of employers in the design of curriculum to better prepare the young for labor market demands. Finally, we will support job seekers with guidance on job selection, preparation and retraining.

28. We are committed to introducing a funded pension pillar in 2018, which will promote savings and create an institutional investor for long-term lari assets. With the assistance of the World Bank and the Asian Development Bank, we will submit a pension law to Parliament establishing a Pilar II pension system (structural benchmark, December 2017), to be followed by the creation of an independent pension agency (new structural benchmark, June 2018). In parallel, we are committed to develop a private pension savings system (Pillar 3) in 2018. Our basic public pension, amounts to GEL180 per month, is marginally higher than the subsistence minimum. Hence, we are committed to increase the basic monthly pension to GEL200 and GEL220 per month in 2019 and 2020, respectively. Further increases will be followed by the indexation rule envisaged in our pension reform.

29. We will continue improving the business environment. We have improved the tax system, our tax dispute resolution mechanism and the taxation environment, to promote savings and investments. Bank accounts of taxpayers are no longer garnished without a court ruling and the tax audit timeframe is regulated. We will establish a Business House by 2019 to provide public services to enterprises under a one-stop shop. We also plan to introduce IFRS for corporations and to submit to Parliament a new insolvency law to support an adequate restructuring for viable non-financial corporations. In addition, we will widely apply regulatory impact assessments on businesses to analyze the possible impact of major policy decisions and protect them from undue costs.

30. Land registration will be pivotal for rural and agricultural development. Land cadasters are important to protect property rights, simplify land transactions and provide collateral for borrowing. We have simplified land registration, especially for agricultural land plots, through a fee waiver program. We will assist citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Since the launch of the project, the number of citizens' applications has increased by 57 percent.

31. Deepening trade relations with the rest of the world is one of Georgia's key priorities. As a small open economy, free trade agreements (FTAs) will help Georgia mobilize FDI in tradable sectors to improve competitiveness, reduce external vulnerabilities, and generate balanced growth. In addition to the Deep and Comprehensive Free Trade Area (DCFTA) with the EU, Georgia signed a FTA with the European Free Trade Association (EFTA) in June, 2016. A FTA with the People's Republic of China will become effective in early 2018. FTA negotiations were concluded with Hong Kong Special Administrative Region and an agreement is expected to be signed in the first half of 2018. At the same time, we are negotiating with Turkey aiming at expanding the current FTA. We remain committed to pursue other FTAs with priority countries, including the United States and India.

32. **We are committed to strengthening our statistics as they serve as a precondition for strong economic policy-making**. We are grateful for the technical assistance provided by the IMF in the areas of national accounts external sector statistics and financial and sectoral accounts. Unfortunately, due to technical issues related to the new census, we have not been able to start publishing quarterly unemployment figures in May 2017, but we will do so by September 2018. We will also broaden the coverage of employment statistics by publishing hours worked. In 2018, we will conduct an earnings survey to have a detailed view of the population's living standards. In the first half of 2018 we will complete back-calculations for population figures to reconcile the differences between the 2014 and the 2002 census results. We will also start publishing national accounts based on the NACE 2 sectoral classification by November 2019. Along with the migration to NACE 2 classification, we will compute GDP-based on supply and use tables (capitalizing on the TA provided by the IMF) and publish quarterly GDP by expenditure in constant prices. This will provide a more detailed picture of the structural transformations in our economy.

F. Program Monitoring and Safeguards

33. **The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause and structural benchmarks.** Semi-annual program reviews will be based on December and June test dates. All quantitative performance criteria and indicative targets are listed in Table 2, and structural benchmarks are set out in Table 3. The Technical Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the inflation consultation clause as well as data provision requirements.

34. **The NBG continues to maintain a strong safeguards framework and internal controls environment**. Since the last assessment and in line with IMF recommendations, we have submitted to Parliament amendments to the NBG Organic Law on (i) Audit Committee's definition and mandate; (ii) specifying the Chief Internal Auditor eligibility criteria and grounds for dismissal and (iii) early appointment of external auditor for NBG. As required by the safeguards policy, we will continue to engage independent external audit firms to conduct the audit of the NBG in accordance with international standards.

Table 1. Georgia: Inflation Consultation Targets and Bands for 2017–18

	2017			2018	
	End June	Outturn	End Dec.	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)					
Central point	6	7.1	5	3	3
Inner band, upper limit/lower limit	8/4	…	7/3	5/1	5/1
Outer band, upper limit/lower limit	9/3	…	8/2	6/0	6/0

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for 2017 and end-June 2018

(Unless otherwise indicated: cumulative from the beginning of the calendar year, millions of GEL)

	2017				2017	2018
	End-June Target	Adjusted Target	Outturn	End-Dec.	Proposed revised End-Dec targets	End June
Performance Criteria						
Ceiling on augmented General Government deficit (in mn lari, cash basis)	330	359	102	1,335	1,335	430
In Percent of GDP	*0.9*	*1.0*	*0.3*	*3.7*	*3.7*	*0.7*
Floor on NIR of NBG[1] (End-period stock, in mn US$)	1,210	1,247	1,366	1,350	1,390	1,450
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (in mn US$)	0	…	0	0	0	0
Ceiling on new public guarantees (continuous criterion) (in mn lari)	0	…	0	0	0	0
Ceiling on the cash deficit of the Partnership Fund (in mn lari)	0	…	0	0	0	0
Ceiling on the new net borrowing of the Partnership Fund (in mn US$, cumulative from the beginning of the EFF program)	20	…	0	20	20	20
Indicative Targets						
Ceiling on the accumulation of net domestic expenditure arrears of the General Government (in mn lari)	0	…	0	0	0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	…	…	…	8,685	8,685	4,675

[1] The NIR target is set at a program rate defined as the exchange rate on December 31, 2016, which for the GEL/US$ was 2.6468.

Table 3. Georgia: Structural Benchmarks

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits (MEFP ¶19)	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks, (MEFP ¶20)	End-December 2017	In progress
Submit to Parliament legislation giving NBG oversight power over credit information bureaus, (MEFP ¶19)	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019 (MEFP ¶19)	End-June 2017	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds (MEFP ¶23)	End-December 2017	In progress
Monetary policy operations and communication		
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes (MEFP ¶16)	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018 (MEFP ¶21)	End-June 2017	Met
Bank Resolution Framework		
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations (MEFP ¶21)	End-September 2017	Met
Fiscal		
Submission to Parliament a 2018 budget consistent with the fiscal deficit in the Fund-supported program (MEFP ¶7)	End-December 2017	In progress
Adopt a remuneration law for public civil service (MEFP ¶11)	End-December 2017	In progress (expected Fall 2017)
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs) (MEFP ¶10)	End-September 2017	In progress
Public-Private Partnership and Fiscal Risk		
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships (MEFP ¶12)	End-December 2017	In progress (expected Fall 2017)
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement (MEFP ¶12)	End-December 2017	In progress
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns (MEFP ¶13)	End-December 2017	In progress
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system, and introducing indexation of basic public pensions (MEFP ¶27)	End-December 2017	In progress

Table 3. Georgia: Structural Benchmarks (concluded)

Measure	Date
Restructure the GRS headquarters into a function-based organization (MEFP ¶11).	Feb-18
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims (MEFP ¶11).	Mar-18
Create a new specialized VAT unit focusing on validating VAT claims (MEFP ¶11).	Jun-18
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards (MEFP ¶21).	Jun-18
Establishing an independent pension agency (MEFP ¶28).	Jun-18
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation (MEFP ¶21).	Sep-18
Introduce regulation on banks corporate governance in line with Basel Principles (MEFP ¶21).	Sep-18

Attachment II. Technical Memorandum of Understanding (TMU)

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria, inflation consultation mechanism and indicative targets) and describes the reporting requirements used to monitor developments under the Extended Fund Facility and methods to be used in assessing the program performance with respect to these targets. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available.

A. Program Assumptions

2. For the purposes of the program monitoring, all foreign currency-related assets will be valued in lari at program exchange rates as specified below. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of December 31, 2016, published on the IMF web site http://www.imf.org/.

Table 1. Program Exchange Rates

	Currency Name	Currency/U$
SDR	Special Drawing Rights	0.7439
GEL	Georgian lari	2.6468
AUD	Australian dollar	0.7227
CAD	Canadian dollar	0.7419
EUR	Euro	1.0556

B. Institutional Definition

3. The **general government** is defined as comprising the central government and local governments, excluding Legal Entities of Public Law (LEPLs). The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001 (GFSM 2001). The authorities will inform IMF staff on the creation of any such entities without delay. The general government coverage excludes state-owned companies and the Partnership Fund. The **public sector** consists of the general government, LEPLs and public financial and non-financial corporations, including the National Bank of Georgia.

4. **Supporting material:** The Treasury Department of the Ministry of Finance will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month and monthly expenditures and arrears of the central government within four weeks of the end of each month. The Ministry of Finance will provide the stock of general government debt, broken down by currency and original maturity within one month from the end of each quarter. The Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the end of the previous business day.

C. Quantitative Program Targets

5. The program will be assessed through performance criteria and an indicative target (Tables 2 attached to the Letter of Intent). Performance criteria are set with respect to:

- a performance criterion (ceiling) on the augmented cash deficit of the general government;
- an indicative target (ceiling) on the primary current spending of the general government;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (ceiling) on the accumulation of external debt arrears by the general government;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government;
- a performance criterion (ceiling) on the new guarantees issued by the public sector;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund;
- a performance criterion (ceiling) on new net borrowing by the Partnership Fund.

In addition, the program will include a consultation clause on the 12-month rate of inflation.

6. Performance criteria and indicative targets have been set for end-December 2017 and end-June 2018 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (except for (i) the NIR target, which is monitored in term of stock levels and (ii) the new net borrowing by the Partnership Fund, which is monitored since program approval), while continuous performance criteria are monitored on a continuous basis.

D. Inflation Consultation Mechanism

7. Inflation consultation bands around the projected path for inflation are set for each test date under the program. Inflation is identified as the 12-month percentage change of the consumer price index (CPI) as measured and published by the National Statistics Office of Georgia (GEOSTAT).

8. If the observed year-on-year inflation for the test dates falls outside the outer bands specified in Table 1 of the MEFP, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) the proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the observed

year-on-year inflation falls outside the inner bands specified in Table 1 for the test dates, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

E. Program Definitions, Adjustors, and Reporting Requirements

General Government

Ceiling on the augmented cash deficit of the general government

9. Definition: The **augmented cash balance of the general government** is defined as: revenues minus expense, minus net acquisition of non-financial assets (as defined by GFSM 2001) minus net budget lending (as defined below). A negative augmented cash balance is a deficit.

10. The **augmented cash balance of the general government** will be measured from the financing side at current exchange rates established by the NBG at the date of the transaction. Accordingly, augmented cash deficit of the general government will be measured by: i) net acquisition of financial assets (including changes in balances of the revenue reserve account), excluding net budget lending as defined by GFSM 2001; minus ii) net incurrence in domestic and foreign liabilities as defined in GFSM 2001.

11. Definition: Consistent with GFSM 2001, **net budget lending** is defined net acquisition of financial assets for policy purposes by the general government.

12. Adjustor: The ceiling on augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of foreign-financed project loan disbursements above/below the program amounts (Table 2), subject to a cap of $60 million per year.

13. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted downward (lower deficit) by the cumulative amount of receipts from sale of non-financial assets above the program amounts (Table 2).

14. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the amount of VAT refunds above/below the program amounts (Table 2).

Table 2. Projected Financing for Cash Deficit of the General Government (in millions of GEL, cumulative from the beginning of the calendar year)		
	December 31, 2017	**June 30, 2018**
Disbursements of foreign-financed project loans	915	673
Receipts from sale of non-financial assets	185	69
VAT refunds	180	50

15. Supporting Material:

a. Data on domestic bank and nonbank financing will be provided to the IMF by the NBG and the Treasury Department of the Ministry of Finance within four weeks after the end of each month.

b. Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Ministry of Finance (specifying projects by creditor) within two weeks of the end of each month.

c. Data will be provided at actual exchange rates.

d. Data on receipts from sales of non-financial and financial assets of the general government will be provided by the Treasury Department of the Ministry of Finance to the IMF on a monthly basis within two weeks of the end of each month.

e. Data on securitized debt sold by the NBG, including the securities that have been purchased by nonbanks, will be reported by the NBG to the IMF on a monthly basis within two weeks of the end of each month.

f. Data on repayments of VAT claims.

Ceiling on the Current Primary Expenditures of the General Government

16. Definition: primary current expenditures is defined as expense (as defined by GFSM 2001) on a cash basis, minus interest payments.

17. Supporting material: Data for monitoring expenditures will come from the accounts of the general government covered under the ceiling on the augmented cash deficit of the general government (including autonomous regions). The Ministry of Finance is responsible for providing reporting according to the above definition. Data on expense and net acquisition of non-financial assets of the general government should be reported to the IMF within four weeks after the end of the quarter.

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

18. Definition: Debt is defined as set forth in point No. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Decision No. 15688-(14/107) adopted on December 5, 2014. External debt is defined by the residency of the creditor.

19. For the program, **external payment arrears** will consist of all overdue debt service obligations (i.e. payments of principal or interest, taking into account contractual grace periods) arising in respect of any debt contracted or guaranteed or assumed by the central government, or the NBG, or any agency acting on behalf of the general government. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, and more specifically, to external payments arrears in respect to which a creditor has agreed that no payment needs to be made pending negotiations.[1]

20. Supporting Material. The accounting of non-reschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within two week of the end of each month.

Continuous indicative target on Accumulation of General Government Domestic Expenditure Arrears

21. Definition: For program purposes, domestic expenditure arrears are defined as non-disputed (in or out-of-court) payment obligations whose execution term has expired and became overdue. They can arise on any expenditure item, including debt service, wages, pensions, and goods and services. Arrears will arise from non-debt liabilities that are not paid after 60 days of the contractual payment date or—if there is no contractual payment date—after 60 days of the receivable. Any wage, pension or other entitlement obligation of the general government that is not paid after a 30-day period from the date that they are due, is in arrears.

22. Supporting Material: The accounting of new domestic expenditure arrears (if any) will be transmitted within four weeks after the end of each month.

Guarantees

23. For the purpose of the program, a **guarantee** of a debt arises from any explicit legal obligation of the public sector to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind).

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

24. Definition: The **cash deficit of the Partnership Fund** will be measured as its expenditures minus its revenues.

[1] Arrears to Turkmenistan.

25. The Partnership Fund's revenues comprise the dividends from its assets and investments, the interest earnings from the loans it provides, the fees it charges for the services and guarantees it provides and any other income earned from its assets.

26. The Partnership Fund's expenditures comprise all current and capital expenditures. Current expenditures comprise compensation of employees, the purchase of goods and services, transfers to

other entities, other account payables and domestic and external interest payments. Capital expenditures comprises the net acquisition of nonfinancial assets as defined under GFSM 2001. The Partnership Fund's purchase of financial assets (e.g. lending and equity participation) will not be considered part of its expenditures.

Ceiling on New Net Borrowing by the Partnership Fund

27. **Definition:** Net borrowing by the Partnership Fund is defined as contracted debt liabilities minus principal repayments.

28. **Supporting Material:** The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly revenue, expenditure, and amounts related to new contracted debt and principal repayments, within four weeks of the end of each quarter.

Net International Reserves

Floor on the Net International Reserves of the NBG

29. **Definition: Net international reserves (NIR)** of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. **Foreign assets of the NBG** include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. **Foreign liabilities of the NBG** shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to $1,366 million as of June 30, 2017 (at program exchange rates).

30. For the purpose of the program, **budget support grants to the general government** are defined as grants received by the general government for direct budget support from external donors and not related to project financing. **Budget support loans to the general government** are defined as disbursements of commercial loans and loans from bilateral and multilateral donors for budget support.

31. Adjustors. For program purposes, the floor on NIR will be adjusted

- Upward (downward) by the cumulative amount of any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.
- Upward (downward) by the cumulative amount of any excess (shortfall) of budget support grants and loans compared to program amounts (Table 3).
- Upward/downward for any excess/shortfall related to net issuance of the Eurobond from the general government relative to program amounts (Table 3).
- Upward/downward by 75 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Projected Balance of Payment Support Financing
(in millions of U.S. dollars, cumulative from the beginning of the calendar year)

	December 31, 2017	June 30, 2018
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	73.2	6
Budget support loans, including bilateral and multilateral donors for budget support	193.3	58.4
Net issuance of the Eurobond from the general government	0	0
Disbursements of project loans and grants	204.1	114.1

32. Supporting material: Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payment support loans, cash grants to the general government, amortization (excluding repayments to the IMF), interest payments on external debt by the Ministry of Finance and the NBG; and conversions for government imports will be provided to the IMF in a foreign exchange cash flow table (which includes details of inflows, outflows and net international reserves) on a weekly basis within three working days following the end of the week.

Appendix to the TMU: The Partnership Fund

A. Organization and Operational Structure

Legal Structure and Corporate Governance

The Partnership Fund (PF) is incorporated as a Joint Stock Company (JSC). Under civil law, JSCs are profit maximizing entities, organized with value creation as their main objective.

The PF is organized as a commercial financial institution. Its governance structure includes:

- An investment board, currently composed of internal members (CEO, CIO, portfolio officers) and can add external members (like experts and private sector representatives), which approves business cases and initiates projects;

- A risk management committee, composed of internal members (CFO, Chief Legal Officer, and Chief Accountant), which advises on project risks to be reflected in project implementation agreements;

- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes members of the government and is chaired by the Prime Minister; and

- In cases of equity participation in projects, the PF needs government approval.

B. Corporate Mandate and Portfolio Management

Corporate Mandate

The corporate mandate of the PF is approved by the supervisory board and the government. The PF will provide project financing through equity participations, senior loan, quasi-equity through subordinated convertible debt, and performance bonds/guarantees. Investments will focus on the following sectors: energy, agriculture, manufacturing, and real estate. Under its corporate mandate, the PF is not allowed to provide financing to the service industry. The PF will charge market rates for services provided.

Portfolio Management Strategy

The PF's portfolio management strategy has been developed. It sets portfolio limits, performance management objectives, and project evaluation guidelines, and will be based on the following principles:

- The PF will participate only in commercially viable projects; and

- The PF's performance will be monitored on the basis of the following evaluation criteria: IRR, adjusted present value, sharp ratio, and risk adjusted return.

Project Development Methodology

The PF will only participate in projects in which a corporate investor, with sufficient experience in industry, expresses its willingness to take an equity participation that represents at least 51 percent of the project's total equity. PF financing (debt plus equity plus guarantees) will not be allowed to exceed 100 percent of the equity of the private partner in the project. The PF will pursue only commercial objectives.

Reporting and Auditing

The PF will engage an internationally recognized auditing company to conduct IFRS audits of its financial statements.

The PF will hire on a permanent basis the services of rating agencies, which will prepare regular ratings reports—there will no minimum rating requirement for the PF.

The PF's audited financial statements, as well as the ratings reports will be available on permanent basis to a broad audience.

Fiscal risks associated with the PF will be limited since:

- All liabilities of the PF are limited to its own balance sheet;

- The PF has its own revenue sources, namely: the dividends from its investments, the interest earnings from the loans its provides, the fees it charges on the guarantees it provides, and the proceeds of asset sales; and the PF may decide to borrow from credible financial institution with recourse to its balance sheet facility and without state guarantee.