



Comments on the Georgian government's 4-point plan

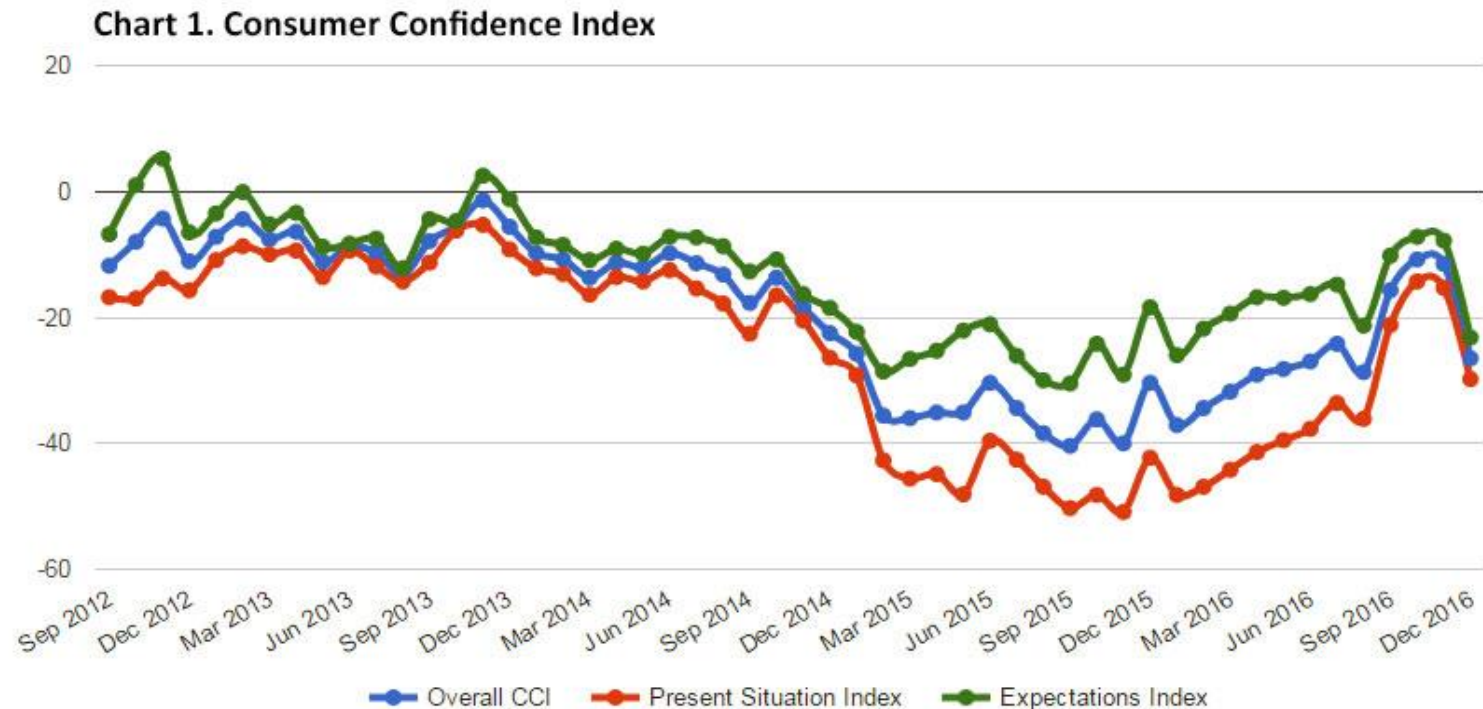
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OUTLINE

- The 10-point 'larization' plan
- Pension reform
- The 4-point plan:
 - Tax reforms (profit, excise taxes, VAT)
 - Education (dual approach)
 - Governance (single window, RIA)
 - Regional/spatial development (investment in transport infrastructure)

LARIZATION

- Excellent understanding of the government's rationale.
- Consumer confidence took the greatest hit in just one month (15 points) in the CCI history, when GEL started losing ground in November 2016 (after the US elections).
- However, there is no need for panic. The devaluation most likely originated in global speculation and flight to safety (US). It **will come to an end with or without NBG interventions.**



SPECIFIC LARIZATION MEASURES

- Two types of measures are proposed:
- Measures that increase the supply of GEL or reduce the cost of using GEL for lending or monetary transactions (real estate). **There are no concerns.**
 - Corporate bonds are already accepted as collateral for NBG loans (haircut determined according to rating, e.g. 15% for Georgian Water & Power).
 - Escrow accounts for real estate (and other) transactions would be a great improvement (also for commercial deals)
 - Very positive experience from last year: lower reserve requirements for GEL deposits increased GEL supply and reduced interest rates.

SPECIFIC 'LARIZATION' MEASURES

- Measures that increase the cost, or restrict the use of, other currencies (pricing, lending).
 - Some measures are already in force (larization of small mortgages, microfinance loans), others are still being elaborated by the National Bank.
 - **Need careful monitoring and regular discussion with the banking industry.** If GEL starts appreciating, these measures may turn out to be overly restrictive and difficult to sustain politically.

PENSION REFORM

- A rigorous RIA is being conducted by ISET at the MoESD request. The precise formula is not yet set in stone (which provides opportunities for further improvements).
- ISET's view is that further elaboration is in order:
 - The conditions for **opting in and out**;
 - Adjustment of the **basic pension** (for those who opt out or cannot enroll) in line with real wages, inflation. With no adjustment, the losers lose more. With full indexation, the reform will be very costly for the budget; people will have weaker incentives to enroll.
 - There may be need for **other social policy instruments** to compensate losers (older people; women; low wage earners, unemployed and/or self-employed in agriculture, etc.).

TAX REFORMS

- **Profit tax:** generally, very welcome. As with any new policy, it comes with some challenges (new reporting rules, uncertainty about audit procedures). **Training/additional communication would help.**
- **VAT:** advance VAT payments have to be financed by businesses out of their cash flow or borrowing. There has been a lot of back and forth on this subject in recent years, would be good to **set the rules once and for all after a thorough discussion with the business community.**
- **Excise tax**
 - The need is very well understood. Yet, there can never be enough (**proactive**) communication around tax hikes.
 - The outcomes have to be closely monitored. The increase in excise tax on tobacco (almost 60%) may potentially induce smuggling (from Armenia) and a shift to low quality cigarettes;
 - The target (90 Euro per 1000 sticks in 8 years) may have to be adjusted. Would be better to **move in smaller steps and monitor consumption and fiscal revenues.**

EDUCATION REFORMS

- Fully appreciate the emphasis on getting businesses involved, particularly in VET.
- To get them actually involved may require a more **proactive approach**, involving not only the Ministry of Education but also MoESD and other line ministries (agriculture, energy).
 - Engage existing or specially created business associations (HPPs, wine?) or directly engage leading companies
 - Explain the benefits of a VET PPP from the industry's perspective
 - Present alternative models/institutional setups
 - Provide assistance with the bureaucratic authorization/accreditation process, land and infrastructure.

GOVERNANCE AND REGIONAL DEVELOPMENT

- **GOVERNANCE:**
- Most welcome elements:
 - Reactive: the single-window approach
 - Proactive: mainstreaming of Regulatory Impact Assessments (RIA)
- **REGIONAL DEVELOPMENT/INFRASTRUCTURE**
 - Very welcome, very timely.