



GEORGIA

TECHNICAL ASSISTANCE REPORT—DRAFT PUBLIC CORPORATION REFORM STRATEGY

December 2021

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Draft Public Corporation Reform Strategy

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Technical Assistance Report

October 2021

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GLOSSARY

ADB	Asian Development Bank
CD	Capacity Development
EFF	Extended Fund Facility
EU	European Union
FAD	Fiscal Affairs Department
FRMU	Fiscal Risks Management Unit
FRS	Fiscal Risks Statement
GFSM	Government Finance Statistics Manual
GSE	Georgia State Electrosystem
IMF	International Monetary Fund
JSC	Joint Stock Company
LLC	Limited Liability Company
KPI	Key Performance Indicator
LEPL	Legal Entity of Public Law
MEFP	Memorandum of Economic and Financial Policies
MoF	Ministry of Finance
MoESD	Ministry of Economy and Sustainable Development
NASP	National Agency for State Property
OECD	Organization for Economic Cooperation and Development
PFM	Public Financial Management
PIE	Public Interest Entity
QFA	Quasi Fiscal Activity
SCI	Statement of Corporate Intent
SOE	State Owned Enterprise
UWSC	United Water Supply Company

PREFACE

In response to a request from the Ministry of Finance (MoF), a Fiscal Affairs Department (FAD) mission assisted the authorities in developing a draft public corporation reform strategy. The mission was conducted remotely during January to March, 2021 and comprised John Zohrab (FAD regional PFM advisor) and Avril Halstead (FAD expert). The mission was financed partly by the government of Japan and partly by the European Commission DG for International Cooperation and Development.

The mission met from the MoF: Mr. N. Gagua, Deputy Minister; and Mr. S. Gunia.

The mission team is grateful to the authorities for the frank and open discussions and close cooperation. The mission also expresses its appreciation to Mr. S. Cakir, IMF Resident Representative in Georgia, for his invaluable support for its work.

EXECUTIVE SUMMARY

State-owned enterprises (SOEs) are a key part of Georgia's economy, accounting for a significant portion of GDP, employment and public investment. They deliver critical services in important economic sectors, including gas, electricity, water and transportation. Improving their performance is a critical step in the path to becoming a high income country.

Since 2012, the authorities have been taking concrete steps to address challenges arising from the SOE sector. Substantial progress has been achieved in disclosing fiscal risks arising from SOEs in the Fiscal Risk Statement; increasing the monitoring capacity at the Ministry of Finance (MoF) by establishing a Fiscal Risk Management Unit (FRMU); rationalizing the number of SOEs; sectorizing them in line with international statistical standards; partially unwinding the role of the Partnership Fund; and restructuring some specific SOEs.

Notwithstanding the improved transparency and monitoring of SOEs in recent years, their financial performance has continued to be unsatisfactory. It is therefore clear that, while being critical factors, better disclosure and monitoring cannot by themselves improve SOE performance to the extent necessary. Comprehensive legal and institutional reform is also required.

Drawing on established international models and good practice guidelines for the supervision of public corporations in a market economy, a reform strategy has been developed for those SOEs in Georgia that are, or could become in the near future, public corporations. The MoF has identified these SOEs on the basis of the international standards for defining a public corporation i.e. an SOE that operates on an essentially commercial basis.

The strategy has 5 interdependent pillars: commercial objectives; corporate governance; ownership policy; performance framework; and competitive neutrality. The key provisions under each pillar are as follows:

- Commercial objective: the primary objective of the public corporations should be to operate commercially.
- Corporate governance: public corporations will be required to apply good international corporate governance practices. Importantly, all supervisory board members would be required to be independent and they would be appointed through a well-structured, merit-based and transparent process. No politicians or civil servants would be permitted to serve on public corporation boards.
- Ownership policy: an ownership policy statement is to be developed and published by the central government and each local government that has responsibility for supervising public corporations. The statement will articulate the principles that will inform the public corporations' supervision and the institutional arrangements for doing so.

- Performance framework: Each year, the public corporations will be required to develop a Statement of Corporate Intent (SCI), defining the financial and non-financial objectives to be achieved within the specified risk thresholds. This will be submitted to the Ministry of Finance or local government finance department and Parliament and used to hold the public corporation supervisory boards accountable.
- Competitive Neutrality: public corporations will be required to operate on a competitively neutral basis, i.e. they should not enjoy any competitive advantages or face competitive disadvantages as a result of their ownership or control by the central or local government. Specifically, public corporations will be prohibited from undertaking public policy activities that may negatively impact on their finances, i.e. quasi-fiscal activities (QFAs)) unless explicitly mandated and fully compensated for doing so.

The strategy makes provision for the responsibility for exercising the shareholder functions of public corporations to be centralized under the MoF. This is in line with international good practice as it would ensure a clear separation between the state's shareholder and policymaking functions, as per the OECD's recommendations. However, in order to comply with the European Union (EU) unbundling directive, the MoF will be the ownership entity for the state-owned electricity transmission company whereas the MoESD will be the ownership entity for the electricity generation companies.

Nevertheless, in order to reduce the impact of the MoESD's conflict of interest between its ownership entity role and its policy/regulatory role, additional measures will be taken to separate these roles within the MoESD.

The strategy provides that a framework public corporations law be put in place that will provide a clear statutory foundation for the implementation of the principles and procedures set out in the strategy. It will also provide for reporting and disclosure requirements by both public corporations and their ownership entities to be brought in line with international good practice.

The strategy will be used to initiate a process of wider discussion in Georgia that would assist the Government to decide on how best to implement the strategy. The interdependencies between the five pillars will require careful design, sequencing, and implementation of the reform.

Implementation will be informed by pilots to be conducted in a few selected public corporations.