



THE UNITED NATIONS



THE WORLD BANK



GEORGIA

SUMMARY OF JOINT NEEDS ASSESSMENT FINDINGS

Prepared for the Donors' Conference of October 22, 2008 in Brussels

The United Nations
The World Bank

With the Participation of
The Asian Development Bank
The European Bank for Reconstruction and Development
The European Commission
The European Investment Bank
The International Finance Corporation

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SUMMARY OF THE MAIN FINDINGS OF THE JOINT NEEDS ASSESSMENT

Prior to the conflict of August 2008, the Georgian economy was on a strong growth track, with GDP rising by 10½ per cent annually. Rising public expenditures, financed by a substantial increase in the tax to GDP ratio, were being directed at improvements in education and health services and in targeted social assistance for the poor as well as infrastructure. Economic policies were guided by reliance on the private sector for growth in a highly liberal trade, investment and business environment. Also central to government policies were a belief in a small, effective government that formulated policies and financed services with delivery being delegated to the private sector, and an emphasis on high governance standards. The country attracted large volumes of foreign direct investment to sustain growth. Despite high growth, job creation was weak, but poverty had begun to fall.

The conflict dealt a shock to the key pillars of economic growth. There occurred a weakening of investor, lender and consumer confidence, a contraction of liquidity in the banking system, stress on public finances, damage to physical infrastructure, and increased numbers of internally displaced persons.

The government has launched immediate post-conflict recovery activities, nevertheless, sustained success will prove elusive unless international donors provide adequate and rapid financial support to buttress Georgia's own efforts. **The JNA has identified the need for donor support in three major areas:**

- **Support for the rapid restoration of confidence.** Georgia will be able to help itself best if economic growth can be re-established so that resources for investment and poverty reduction can be generated internally. Donors can help best by providing resources for the budget to support the counter-cyclical budget policy and thereby ensure funding for critical economic and social needs. Moreover, donors may consider equity, debt or guarantee support to domestic banks so that lending to enterprises and consumers can be re-ignited.
- **Support for social needs.** The resettlement of the internally displaced and the needs associated with other conflict-affected populations has put an unsustainable burden on fiscal resources. Through support for housing, social protection and other social programs identified in the JNA as well as via budget support, donors can make an important contribution to economic and social recovery.
- **Support for critical investments.** The JNA has found that certain high value and high yield investments are essential to maximizing recovery prospects – these are discussed as “core investments” in the report. Donor financing for such investments remains essential as a bridge to the period when the private sector resumes investing. Such financing would also help to enhance the economic security of the country by broadening choice in energy and transport.

The JNA proposes that donors extend fresh commitments in the amount of \$3¼ billion over a three year period (Annex I).

CHAPTER I. BACKGROUND

1. **Context and Purpose.** In early August, hostilities occurred in northern Georgia. On August 13, a cease-fire agreement that triggered a staged withdrawal of troops from the territory of Georgia was signed between the parties. Monitors from the European Union have now started patrols in an area north of Gori and adjacent to the administrative border with South Ossetia, Georgia, which contains some 50 villages with an estimated population of 24,000, and is known as the “adjacent areas”, the remaining military forces have now begun to withdraw. The European Union-brokered agreement also calls for the return of OSCE monitors to South Ossetia. UN observers are expected to remain in Abkhazia, Georgia.

2. This report – the *Joint Needs Assessment* (JNA) – responds to a request from the Government of Georgia for the World Bank to lead a post-conflict needs assessment of the damage and economic loss resulting from the conflict and to develop estimates of the financial assistance required to address the losses and re-establish the conditions for a return to sustained growth.

3. The United Nations Development Group (UNDG) and the World Bank have developed a joint methodology for post-conflict needs assessments (PCNA), and have endorsed it as the framework to be used jointly in these situations.¹ Building on the partnership on the same topic with the European Commission², a needs assessment mission was mounted between September 7-21, 2008.

4. **Coverage.** The assessment covers the whole territory of Georgia, although the JNA team did not make field visits to South Ossetia because of difficulties of access, nor to Abkhazia given the minor extent of conflict-related damage there. Consequently, a partial listing of the needs in these two regions is presented in the JNA, based on information and data from other parties, such as EC satellite imagery and assessments by the UN system. Once in-depth assessments can be made, the UN may make a separate appeal for these regions.

5. **Organization of the Report.** The *JNA* examines the overall impact of the conflict, and needs for early and medium-term recovery based on losses and damages resulting from the conflict, and presents an overall strategy for recovery as well as priority actions and investments.

6. Chapter I presents the background to the work of the JNA mission. Chapter II discusses the immediate impact of the conflict and response to it, as well as information on

¹ The PCNA methodology has been endorsed by the WB, UNDG principals, as well as by the regional development banks and has been included by the OECD-DAC on the principles of engagement in fragile states. Building upon this experience, the UN system and the WB are finalizing the negotiations of a broader partnership agreement for post-conflict situations.

² This EC-UN-WB partnership was formalized by the signature of the tripartite *Joint Declaration on Post-Crisis Assessments and Recovery Planning*, signed by the three institutions in New York, on the 26th of September 2008.

the regions of Abkhazia and South Ossetia. Chapter III discusses the strategy for economic recovery, associated risks and measures to mitigate risks. Chapter IV presents priority activities and financing needs to support the strategy. Chapter V discusses financing options that are open to donors and how coordination, implementation and reporting arrangements are being developed so as to ensure the integrity of the recovery and growth program. Annex I contains a comprehensive table of the financing needs for the recovery program that is being presented to donors for assistance.

7. Actions required have been prioritized and presented in three sequential time frames, the first six months (to March 2009); the next 12 months (to March 2010) and a last phase of a further 12-18 months (up to September 2011). Actions presented in the first phase include the immediate humanitarian response, which is also reflected in the U.N. Georgia Humanitarian Flash Appeal.

8. **Acknowledgement.** The JNA team would like to recognize the Georgian government's close partnership in the work. The Prime Minister, Mr. Lado Gurgensidze, and several government colleagues provided detailed comments on drafts of the report and were generous with their time in assisting the mission. Numerous ministers have taken part in discussions in their areas of responsibility. The engagement of the authorities has enhanced the quality and the relevance of the report. The mission also held consultations with civic society at various stages.

Questions on this document may be sent to smitra@worldbank.org (Tel +1 202 458 9713) or vsouthworth@worldbank.org (Tel +995 32 91 30 96) or sofia.carrondo@undg.org.

CHAPTER II. IMMEDIATE IMPACT OF THE CONFLICT AND THE INITIAL RESPONSE

OVERALL IMPACT ON THE ECONOMY

9. Over the last five years, Georgia has implemented far reaching strategic reforms centered on anti-corruption measures and has established strong mechanisms of accountability and transparency in government. The reforms aim at developing a competitive private sector as the main engine of growth, with the state playing a supportive role by providing basic public goods and services – as seen in improvements in education and health care delivery and the introduction of a well targeted social safety net to protect the extreme poor. Driven by rapidly rising foreign direct investment (FDI) flows, economic growth averaged 10½ percent per year over the last three years and reached 12½ percent in 2007.

10. The recent growth has largely been jobless in net terms, as high quality private sector jobs created have just about compensated for job cuts resulting from public sector reforms. The pre-conflict unemployment rate of 13 per cent concealed much under-employment. The government estimated that over the next four-five years up to net 250,000 jobs would have been created on the basis of rising foreign direct investment, (pre-conflict FDI forecast: \$4-8 billion over the same period), sufficient to lower unemployment to single digits.

11. The crisis of August 2008 has resulted in shocks to economic growth and stability in Georgia. These shocks have led to a weakening of investor, lender and consumer confidence, a contraction of liquidity in the banking system, stress on public finances, damage to physical infrastructure and other infrastructure bottlenecks, and increased numbers of internally displaced persons.

Table 1: Impact of the Conflict

	2008	
	Pre-conflict	Post-conflict
Growth (percent)	9.0	3.5
Inflation (percent)	10.0	8.0
Fiscal balance (percent of GDP)	-4.0	-6.0
FDI (\$billion)	2.1	1.2
External current account (percent of GDP)	-16.6	-20.8
Budget support needed (\$ million)	--	480

Source: JNA staff calculations.

12. Now, two months into the crisis, output continues to be weak and the near-term outlook is of a rise in unemployment, with consequent negative effects on poverty reduction. The construction, real estate, retail and tourism sectors have been particularly badly hit and the long term confidence effects on the country's potential as a transit centre for trans-continental energy and trade is also a matter for serious concern.

13. A key point of stress arising from the crisis is to Georgia's public finances, as the economic downturn results in shortfalls in revenue collection. To avert a sharper and more protracted downturn, it is critical to adopt a counter-cyclical fiscal stance with reductions in public expenditures amounting to much less than the projected fall in budgetary revenues. This will require significant budgetary support from donors.

14. In the immediate aftermath of the crisis, the economy experienced an increase in the demand for dollars and withdrawal of deposits from the banking system. Deposits have recovered since but are below pre-crisis levels. The immediate risks of a liquidity crunch were rapidly addressed by the National Bank of Georgia (NBG) and the Financial Services Authority (FSA) through easing monetary conditions and selected regulatory forbearance.

15. The economy is expected to begin recovering in the second quarter of 2009 after experiencing a contraction in the second half of 2008 and the first quarter of 2009 – provided budget support in the required amounts is received. As a result, growth is projected at 3.5 percent in 2008 (Table 1) and 4 percent in 2009, which represents a downturn compared to the pre-crisis projections of 8-9 percent growth for 2008-09. Growth is expected to subsequently accelerate to 6 percent in 2010-2011. As a result of the economic downturn, GNI per capita by 2011 is projected to be \$660 below pre-crisis projections.

16. Revenue shortfalls compared to pre-crisis projections are \$385 million for 2008 and \$640 million for 2009. Additional shortfalls are expected in privatization receipts. Reductions in total expenditures of about \$120 million in 2008 and \$570 million in 2009 are planned; these figures include rises in certain categories of spending (such as shelter and support for displaced populations). This fiscal stance will require donor budgetary support of \$480 million in 2008.

17. Preliminary estimates indicate that unemployment may increase from 13.3 percent in 2007 to 15.1 percent by 2010, and poverty levels increase from the current 23.6 percent to 25.9 percent. Under these circumstances, protecting public social expenditures would be important to ensure that the social safety net remains intact and addresses the needs arising from higher unemployment and poverty levels and the increased numbers of IDPs.

18. In order to ameliorate the employment shock, the authorities are asking various donor countries to provide temporary work permits for about 100,000 Georgian workers for a period of several years.

Sector Impacts

19. The impact of the conflict on Georgians living in the conflict-affected areas has been considerable. They have seen their lives suddenly uprooted and for many of them the future is uncertain. Damages have been amplified by the massive displacement of people (Tables 2 and 3). The longer-term impacts, if not addressed promptly, may be sizeable. Those already poor might fall deeper into poverty, and many of the newly vulnerable may become poor.

20. Physical damage to the infrastructure sectors as well as to the environment is tragic but not large as measured by post-conflict conditions elsewhere in the world and is being rapidly addressed largely by the government's own efforts. In infrastructure, critical sectors

such as energy and roads would remain vulnerable to exogenous shocks which could lead investors to search for opportunities elsewhere in the region. A sharp reduction in investment, compared to pre-conflict levels, is being experienced. These effects could combine to stunt the long-term development potential of the country.

SOCIAL SECTORS

21. The affected population is largely rural and poor. As with the rest of the population, the poor will be supported through the targeted social assistance program – it is important that equity considerations require identical treatment of the poor. Certain needs particular to the conflict-affected will be addressed as follows:

- the newly long term displaced (up to about 30,000 people): in need of temporary shelter (until permanent housing is provided); food and non-food support; access to health and education; permanent housing; source of livelihood, start-up assistance;
- the temporarily displaced (about 34,000 people; expected to return to their homes by next spring): in need of temporary shelter; food and non-food support; psycho-social assistance; access to health and education as well as support to repair damage to their houses, assets and to restore livelihoods once they have returned;

Table 2: Groups of IDPs³

Internally Displaced Persons	In collective centers	With host families	Returnees	Spontaneously settled	Total
1992 IDPs	94,169	55,005		73,460	222,634
2008 IDPs	41,992	17,211	68,269		127,472
Total	136,161	72,216	68,269	73,460	350,103

Table 3: IDPs by Geographical Distribution

Regions of origin	South Ossetia	Area adjacent to South Ossetia	Abkhazia	Area adjacent to Abkhazia	Total
2008 IDPs	22,085	68,394	30,802	1,218	5,000
1992 IDPs	12,493			210,141	
Total	34,578	99,196	211,359	5,000	350,133

Source: JNA staff calculations.

- the returnees (about 73,000 people): population that had experienced temporary displacement but has returned back: In need of assistance to restore their livelihoods and repair damage to their property;

³ As of end-September 2008.

- the population residing in conflict affected areas (estimated at 31,000). Conflict induced economic deterioration might push more people into poverty and/or already poor people might be pushed deeper into it;
- the IDPs from 1992 (approximately 220,000 people – 55,000 households): New displacements have highlighted the situation of the persons displaced for over 15 years, particularly those still living in collective centers or with host families and those who are particularly vulnerable to poverty.
- the population elsewhere in Georgia might be affected by conflict induced economic deterioration, leading to jobs (the swing in employment, as noted, is equivalent to almost a fifth of the labor force) and income loss, might be pushed into poverty and already poor people might be pushed deeper into it.

22. **Return, relocation and resettlement.** For the most part, IDPs have access to water, sanitation facilities and secure shelter, although conditions in the collective centers vary from adequate to sub-standard. Preliminary data indicate that 90 per cent of the houses in the accessible villages north of Gori were either undamaged or suffered only minor damage, with more damage occurring inside homes due to looting. On September 11, 2008 the government issued a decree outlining its preliminary strategy to respond to the needs of the newly displaced. The search for an adequate response has highlighted the predicament of the IDPs displaced since 1992 of whom almost 150,000 still live in 1,600 collective centers or with host families. Emergency (winterization) and longer-term (durable housing) measures have been identified for this group as well as efforts to secure the protection and fulfillment of the rights of the displaced people.

23. **Social protection.** The conflict led to a rise in the number requiring social assistance, thereby adding to the administrative burden. It is estimated that an additional c. 100,000 people who have been affected by the conflict, directly or indirectly, are now vulnerable and thus in need of social protection assistance. A possible economic deceleration combined with increasing food prices would lead to a deepening of poverty and food insecurity among the vulnerable. The costs of the targeted social assistance program will rise.

24. **Education.** The most important impact in the sector is the interruption of education of newly displaced children and of those children who attended schools that are now housing IDPs. About 99 schools have suffered damage to varying degrees. Of these, six schools were burned down, and one school and the State University in Gori were heavily damaged. Schools and kindergartens have been used to house many of the internally displaced—by mid-September approximately 18,000 IDPs were still occupying such facilities. The school year started as planned in most schools, with double shifts introduced in some schools to offset the loss in capacity. The resumption of pre-schooling, however, is severely affected by the lack of facilities, especially in Tbilisi.

25. **Health.** The conflict had a severe impact on the capacity of health care providers to ensure the delivery of services. . In terms of human suffering, the officially registered number of citizens killed during the conflict is 391, with the injured at 2,234. Health

infrastructure in the conflict area has suffered considerably. In the buffer zone, 13 primary health care facilities were damaged to varying degrees. Equipment was looted from many of these, and many health workers were displaced. The emergency center in Gori was totally destroyed.

26. **Employment and livelihoods.** The deceleration of the economy will inevitably lead to an increase in poverty and unemployment. As noted, the government is requesting increased work permit quotas for Georgians from donor countries. If quotas for about 100,000 workers were to be granted, economic and social pressures would abate greatly. There has also been a disruption to non-agricultural and trading enterprises throughout the country but particularly in and around the conflict areas.

27. **Food security and agricultural livelihoods.** The conflict separated people from their land which for most had been the main source of income and food. Having been able to nourish themselves independently, all of a sudden the displaced not only could not attend to their crops but also had to rely on food aid. The cutoff of irrigation supplies from South Ossetia before the recent conflict, and the massive displacement caused by the crisis provoked the disruption of agricultural activities, particularly the harvest of field and fruit crops. Losses to agricultural production in the Gori plain are large, borne largely by the area's 40,000 smallholder families. Without resumption of irrigation, not only will this year's fruit crops be lost but the trees themselves may eventually die.

Infrastructure Sectors

28. **Transport.** *Roads* suffered only minor damage and repairs have already been carried out. Some road construction machinery and equipment was looted. The conflict has, however, highlighted the vulnerability of the road network, especially of the main road network, as well as the need to upgrade alternative routes that have fallen into disrepair. This would also link local communities to the main network thus improving access to services and markets and bringing more economic benefits to the country.

29. *Georgian Railway (GR)* suffered conflict-related damage to one major bridge, damaged the signaling, fiber optic communications cable and electrification attached to the bridge, and damaged other infrastructure in several locations (including damage to tracks and electrification, and station buildings). GR restored service quickly through the construction of a temporary detour of the main bridge. Other infrastructure has also been repaired and is fully operational. *Poti Port* suffered minor physical damage but suffered revenue and reputational losses, leading to sharp rises in insurance cover costs.

30. *Aviation* suffered the destruction of the primary and secondary radar in Tbilisi. There is now no primary radar coverage of the Georgian air space. Though other radars are being used at the moment, they can handle fewer flights, leading to a loss of revenue. The Tbilisi airport runway is in need of urgent repair.

31. **Energy.** The direct impact to energy infrastructure is modest and includes torn-off and broken power lines, damaged gas pipelines, a resulting temporary interruption in gas power and gas supply, and a temporary suspension of oil shipments. Damages have largely

been repaired and service to customers restored, although power transformers and switchgear have not been replaced yet, thus relying on backup systems. The conflict has brought to the fore the vulnerability of the all-important Enguri hydropower plant as it straddles the administrative boundary with Abkhazia. Repairs to the natural gas network in the Gori region have been undertaken as temporary measures and should be followed by more comprehensive rehabilitation as soon as possible to maintain safety and reliability of operations. Customers' payment discipline has been markedly lower since the conflict, however, particularly in regions that suffered directly.

32. **Urban and municipal sector.** Damage to municipal infrastructure in Gori, Senaki, Poti and Zugdidi was minimal, limited mainly to cracking on c. 100 kms of local roads caused by heavy military vehicles and damages to over 70 kms of water pipes, two wastewater treatment plants and public and private buildings. Only few repairs have been undertaken so far. The conflict put additional strain on the already dilapidated infrastructure in these towns. It is critical that needs associated with the new settlements are addressed.

33. **Environment.** Environmental damage is localized, but possibly significant future damage can be expected if various mitigating actions are not put in place quickly. Major damage includes the following. *Protection and production forests.* Forest fires broke out almost simultaneously at several sites in Georgia around August 14. Fires were largely extinguished by the beginning of September. *Natural habitats and protected areas.* Damage has been limited to two national parks and one nature reserve.

IMPACT ON THE GEORGIAN REGIONS OF ABKHAZIA AND SOUTH OSSETIA

34. The impact of the conflict on Abkhazia appears to have been moderate. A 2007 review of socioeconomic needs found widespread poverty and very high unemployment, partly related to the effects of the 1992 conflict. Most of the population lives in rural areas and most farms measure between 0.3 and 0.6 hectares. Assistance, largely from the UN, focuses on returnees and the area of the conflict for development (micro and small enterprises), food security and agriculture production, health, education, social protection, child, IDP and returnees' protection and housing.

35. A UN humanitarian assessment mission to South Ossetia, in mid-September found extensive destruction of property in Tskhinvali and in some nearby villages. Public claims of up to 80 per cent destruction of the housing stock in Tskhinvali appear exaggerated, but neither is the destruction light. No quantified estimates could be made. The UN mission found that the most severe needs for emergency relief had been covered in the first 5-6 weeks following the conflict, but certain important gaps remain. The protection of civilians emerged as the most urgent humanitarian concern, especially in conditions for return and durable solutions for the most vulnerable displaced persons. The mission also noted an insufficient rule of law, widespread violations of property rights. There is also an urgent recommendation concerning reestablishment of mass vaccination campaigns for polio and measles.

IMMEDIATE HUMANITARIAN RESPONSE

36. From the onset of the crisis, the government and the UN system triggered the humanitarian response, together with NGO partners, through the establishment of sectoral groups and immediate delivery of assistance to the affected population. This response has focused on provision of essential support to newly displaced populations across the country and the setting up of a camp hosting 2,500 IDPs in Gori. Food and non-food items (NFI), health care and psycho-social support were put in place and vital repairs to water and sanitation in collective centers enabled the continued accommodation of IDPs.

37. Soon after the cessation of hostilities, IDPs began to return to their places of origin and the humanitarian response began to focus both on support to those able to return and continued attention to those who remained displaced. The government led efforts to rehabilitate houses and apartments of the returnees with support from other partners in the overall return process, and reorganized the collective centers and postponed the start of the school year to 1 October, 2008 to allow the accommodation of IDPs to be better managed.

38. On 18 August, 2008, the UN launched a 'Flash Appeal' to raise funds for the Humanitarian Response in Georgia. The Appeal aimed to raise a total of US\$60 million for 40 NGO projects, 24 UN projects and 2 IOM projects to respond to the needs provoked by the crisis in the period to March 2009 in the sectors of food aid, health and nutrition, logistics and communication, coordination and support, protection, shelter and NFIs and water, sanitation and hygiene.

39. Particular achievements of the humanitarian response were: the delivery of food assistance to IDPs; the operation of mobile clinic teams in conflict-affected areas; the creation of child friendly spaces for play and recreation in 50 collective centers; the opening of psycho-social support desks in 20 IDP centers in Tbilisi; water and sanitation interventions in Tbilisi collective centers, including establishment of rapid response teams for emergency infrastructural rehabilitation in collective centers; distribution of personal hygiene articles and household water kits to IDPs in Gori, Tbilisi, and West Georgia; support with provision of safe water for Gori; and coordination across all agencies.

40. The response from the government has overall been speedy and adequate. The government has endorsed a policy of "full support to local integration of IDPs from South Ossetia and Abkhazia" and has quickly adopted measures to implement it, in particular providing durable housing solutions.

41. The government has added to its 2007 IDP strategy, in order to encompass the response to the new displacements. The supporting action plan contains measures for the (i) creation of conditions for the dignified and safe return of IDPs, including creation of conditions for return and provision of assistance to presumed returnees; (ii) support to decent living conditions for the displaced population and their participation in society, including improvement of the living and socio-economic conditions of IDPs. The action plan has two parts, the first including measures to be undertaken by the state budget and the second presenting complementary measures to be funded and implemented by the international and non-governmental organizations within the framework of the State

Strategy. The continuing humanitarian response is guided by and complementary to the government plan.

42. Access remains the main issue affecting humanitarian operations. The current lack of humanitarian access into either South Ossetia or western parts of the country, the nature of the access requirements put in place by foreign forces for entry into the 'adjacent areas' (including prior notification of missions, locations to be visited, cargoes, etc) and the state of lawlessness in those areas continue to prevent full implementation of humanitarian operations. The potential impact explosive remnants of war (ERW) in areas of return is as yet unknown. There is undoubtedly a need for mine risk education (MRE) and clearance activities in the 'adjacent areas'.

JOINT NEEDS ASSESSMENT AND FLASH APPEAL

43. To ensure consistency amongst the humanitarian and the transitional and development oriented actions, promoting the necessary continuum from humanitarian response to development, the JNA and the Flash Appeal have been coordinated. To this aim, the revision of the Flash Appeal and the JNA has been conducted in parallel.

44. However, these two instruments have different scopes and foci. Whereas the Flash Appeal focus on the immediate humanitarian needs of those affected directly by the conflict, the JNA looks at the needs of those directly and indirectly affected by the conflict, in addition to the macro-economic impact and infrastructure damages and losses. As such, the JNA sets the basis for mainstreaming of early recovery efforts within all sectors, determines the recovery requirements and priorities from early to full recovery and provides links to the longer term development objectives.

45. The initial phase of the JNA has been tailored to ensure consistency with the Flash Appeal. Thus, the revised Appeal will run seven and a half months instead of the usual six, to end March 2009, therefore coinciding with the initial six months period of the JNA.

CHAPTER III. THE STRATEGY FOR RECOVERY AND SUSTAINED GROWTH

46. The over-arching objective of donor assistance is to help Georgia attain its pre-conflict economic growth and social development trajectory. This would require addressing the immediate effects of the conflict on economy, society and infrastructure as well as strengthening the capital base through public and donor-funded investments thereby bridging to the period when full confidence returns and private investment flows are resumed. It would also create the room in the budget for higher social spending.

47. The strategy for recovery and sustained growth is based on the recognition that the sharp knock to business confidence will undermine private sector investment, bank lending and private consumption and, thus, economic growth. Falling domestic demand will affect fiscal revenues, reducing the capacity of the state to undertake vital expenditures, including additional social spending (related to internally displaced and conflict-affected populations). Therefore, the need arises for public expenditures to bridge to the period when private confidence is substantially restored – perhaps a period of about two years – by:

- a combination of externally provided budget support funds and some counter-cyclical fiscal policy, implying a relaxation of the pre-conflict fiscal deficit targets, to finance current expenditures largely associated with social spending needs; and
- external support for core investments to be undertaken largely by the public sector to substitute for private investment shortfalls and to accelerate planned public investments so as to lay the foundations for the restoration of economic growth as well as for the provision of support to the banking system.

48. Such a macroeconomic policy stance boosting demand and domestic output will help to cushion the reduction in economic growth, although it will nevertheless be lower than projected in the pre-conflict period and fiscal revenue losses will be experienced. Reductions in outlays in certain areas (chiefly non-social spending) will be needed to make room for the additional social spending and to limit the rise in the fiscal deficit to the programmed levels.

49. The implementation of core investment needs through external financing will also address new urgencies that have emerged from the conflict. These include certain new investments to strengthen the economic security of energy, infrastructure and public services by *inter alia* improvements in the reliability of power transmission or storage of gas to deal with possible interruptions in imports and a broadening of choices in road connectivities.

50. The approach to addressing post-conflict needs is rooted in the authorities' overall long term strategy of reliance on the private sector as the engine of growth and hence on the establishment of an environment conducive to business and to foreign investment. The trade and investment regime is highly liberal, thereby fostering integration of the economy

with the rest of the world. The regulatory apparatus is modern in design, light and confined to core areas of safety and prudential behavior. With the introduction of low and flat taxes, the tax burden is regionally competitive so as to attract investment and to fund a small government that focuses on financing the provision of essential public goods and services, with delivery of such services being undertaken by the private sector to the extent feasible.

51. The authorities have adopted a program of fiscal prudence – with requirements for budget surpluses that would be transferred to savings funds – continued reduction of tax rates and abolition of taxation of financial instruments and a steady reduction of the share of the state in the economy eventually to 25 per cent. The privatization of assets will continue, although the asset prices and, consequently, privatization proceeds may be expected to decline in the short- to medium-term. Competition for investment flows has been further enhanced through streamlining of financial regulations and stock exchange demutualization. Finally, monetary policy would be geared towards explicit inflation targeting.

52. This program would now be adjusted in light of post-conflict shocks to the economy, with the emergence of temporary fiscal deficits for example, but the authorities are determined that the reform thrust would be kept up and in certain areas structural reforms efforts will be made to accelerate.. The authorities have stated that there is a new urgency to negotiating free trade agreements with the European Union and the United States; as a first step, a broadening of GSP preference products from the United States is envisaged. It would be helpful to have a relaxation of worker visa requirements from donor countries.

53. Consistent with this approach to ensuring high growth rates over the long run, the authorities intend to continue their long-established privatization programme, which provides for sale, or setting up concessions or developing other instruments for private sector participation in those projects that can be structured to attract such investment. The privatization processes are expected to follow high international standards of transparency. Privatization proceeds are expected to be placed either in the budget or in long term publicly-owned investment vehicles, such as the Fund for Future Generations or the Stabilization Fund.

54. The conflict has greatly affected the civilian population, both the IDPs as well as host communities, and requires a sensitive, human rights based approach. While the specific immediate needs of the newly displaced are being addressed, a harmonized, non-discriminatory approach toward both old and new IDPs is essential. Moreover deceleration of the economy will affect the most vulnerable groups of the population (displaced persons, but also the unemployed, rural population and pensioners). The government strategy respects these considerations and is grounded in reliance on targeting social assistance for the needy and on maximizing the choice of recipients of social benefits, e.g., a menu of choices in resettlement will be offered to IDPs.

55. *Reform strategy:* The government has pursued an ambitious human development reform program sector with an overarching objective of improving access to good quality health and education services for the poor and vulnerable. The underlying principles have been equity, support first for the poorest and most vulnerable, private provision of social services, efficiency and effectiveness, decentralized management, transparency, and fiscal responsibility. The key elements of the strategies employed in implementing the reform are:

56. Health: limit state provision to health public goods; public financing for universal access to primary health care services; private provision of in-patient services (hospital privatization); publicly financed health insurance for the poor for in-patient care; state focus on regulation, monitoring, stewardship role.

57. Education: decentralization; autonomous boards for schools with local choice; per capita-financing; human resources development; performance testing; monitoring and evaluation; participation in international tests, promotion of choice of schools, through the voucher system and aiming at 100 per cent enrollment; student loans from banks for tertiary education. The government aims to stimulate enrollment in private schools from 6 per cent of the student body currently to 20 per cent by 2012.

58. Social protection: target social transfers and other programs to the poorest and most vulnerable; consolidate smaller programs into a bigger, better targeted one; move from status to needs based targeting; ensure sufficient funding to cover the neediest; modernize social protection administration.

59. *Post-conflict strategy:* In the post-conflict period the immediate challenges are to ensure: adequate shelter (including durable housing), access to health and education services and appropriate social protection to the population directly and indirectly affected by the recent conflict, but without compromising the achievements of the reforms to date.

60. The key short term priorities include: providing the repair of the health and education infrastructure damaged during the conflict, timely resumption of academic year, regular flow financing of health and education services, payment of pensions, targeted social assistance and other social transfers, effective provision of basic health services, one-time income support for poor and vulnerable population and appropriate protection of people who have experienced displacement because of the recent conflict. This process should ensure that internally displaced children, and children otherwise directly and indirectly affected by conflict, have equal access to quality mainstream education from kindergarten, through to primary, secondary and tertiary level. The medium-term aim is to fully rehabilitate education infrastructure damaged by the conflict. Over the period of the recovery program, steadily improving the quality of education at all levels and gradually reducing existing inequalities, including rural/urban, IDP/non-IDP and poor/non-poor disparities, are other important objectives.

61. While the immediate concern is to adequately protect people affected by the conflict, it is vital to sustain progress achieved in the reforms of health, education and social protection and to maintain the overall thrust of long term reforms.

62. Key to safeguarding employment will be re-starting agriculture and providing for productive urban livelihoods. It is the policy of the government to pursue these objectives on a nation-wide basis as the impact of the conflict is being felt nation-wide, and poverty is widespread, especially outside Tbilisi. It is notable, however, that agriculture is the basis of the economy of the most conflict-affected region, Shida Kartli, which is also a poor region. The impact of the conflict on agriculture threatens the future of Shida Kartli as a viable

economic region. Moreover, water (both potable and for irrigation) flows to the region from South Ossetia have been largely cut off.

63. Employment of the affected groups will benefit from job opportunities that will be created in the course of the implementation of the priority recovery and investment program. Even if only temporary, such jobs will benefit individual households by mitigating the risks of these groups falling deeper into poverty and increasing their employability as well as, through increased purchasing power, the wider community.

64. The multi-sectoral strategic response consists of:

- Infrastructure rehabilitation: Damaged/looted/destroyed schools, health facilities and targeted social assistance offices will need to be reconstructed/refurbished and made functional again.
- Access to health services: All affected population will have access to health services under the same conditions as other citizens. The poor and vulnerable will be covered by medical assistance program (health insurance program for in-patient services covered by the government), if they test eligible.
- Targeted social assistance: All the newly affected are eligible to apply for targeted social assistance and all will go through an eligibility testing process having chosen to register with the data base on poor and vulnerable population. All household assessed as eligible qualify for regular income support (targeted social assistance). In addition, about 25,000 IDP households will receive a one-off cash assistance and IDPs-92 will still receive IDP allowance until their inclusion in the TSA system.
- Food security: About 110,000 people directly affected by the conflict, including the displaced currently in shelters, are expected to experience food insecurity during the next 6-18 months. Therefore, distribution of food and non-food items will be maintained for this period. Children of age 0-2, pregnant women, and nursing mothers might be in need of a more diversified diet than normally provided through food aid.
- Education: Basic education for all children is compulsory and free of charge. All children affected by the conflict have been enrolled in schools and the academic year has begun in most schools across Georgia.

65. The responses specific to affected groups are:

- Displaced population is currently sheltered in public buildings including kindergartens and schools. The shelters are in need of winterization. At the same time, the government is taking actions to provide permanent housing, restoration of livelihoods and start up assistance for this group of affected population. In addition, programs to foster integration of resettled population into new communities will also be provided.

- The 1992 IDPs: Some of the collective centers housing population displaced since 1992 are in need of winterization. Furthermore, the government is developing options to provide 1992 IDPs with permanent housing in the medium term.

RISKS AND MITIGATION

66. The success of the overall strategy relies upon re-establishment of private sector confidence, which, in turn, depends on regional and internal factors. With regard to external risks, a reduction in tensions along international borders and the administrative boundaries with the regions of Abkhazia and South Ossetia and the implementation of the agreement ending hostilities in all its aspects would contribute to security and confidence.

67. With regard to internal risks, the greater participation of all strands of political opinion in the country in implementation of the recovery and growth strategy would add to the prospects of success of the economic recovery program. In this connection, the decision by the government to provide for significant opposition representation in bodies to monitor the implementation of donor-financed programs is encouraging. Recently announced measures to strengthen democratic processes, including reforms related to freedom of media and parliamentary reforms and measures to bolster the independence of the judiciary would add to social cohesion.⁴ The combination of the decisive steps that the government is taking to address post-conflict needs and the provision of adequate finance by donors is expected to lead to restoration of confidence.

68. In particular, flexibility in its public policy, to redirect public spending to the new high priority needs, to mobilize external resources for budget contingencies, and to obtain a standby arrangement with the IMF to support international reserves as well as the prompt provision of liquidity to the banking system by the central bank are highly encouraging developments.

69. The government has succeeded in stabilizing confidence – bank deposits are beginning to recover, and fiscal revenues are becoming in line with targets. The provision of financing to leading banks by IFIs is helping to address liquidity constraints and raise confidence. Public services and infrastructure services are being provided with no interruptions or loss in quality. The authorities have acted swiftly to repair conflict-related damage. Parliament has passed a supplementary budget for 2008 to recognize the new realities. The early provision of budget support by international financial institutions and key bilaterals for 2008 has mitigated risks significantly.

⁴ These government decisions and measures were outlined in the statement of the President of Georgia to the 63rd UN General Assembly on September 23, 2008.

70. The quick and decisive actions taken by the authorities to provide housing for all displaced and to construct 4,700 of houses and refurbish 2,500 flats before next spring, thereby meeting an estimated 70 per cent of the total requirement – financed entirely through the 2008 budget is commendable. The authorities have also made provision for sustainable livelihoods by allocating arable farm land to those to be resettled in villages.

THE ROLE FOR DONOR FINANCING IN STRATEGY IMPLEMENTATION

71. The major areas where needs for financing arise are:

- the macro-economic and fiscal shocks and hence the case for budget support;
- banking system need to roll over its external liabilities and to resume lending aggressively. This gives rise to the case for refinancing operations and guarantees related to the external liabilities of the major banks;
- social needs associated with conflict-affected people, including housing and related support; education, health and social protection; restoration of agriculture and of livelihoods,
- the investment needs in infrastructure – transport and energy, municipal and urban investments, including water and waste management, and addressing the rehabilitation needs in environment.

CHAPTER IV. THE PRIORITY RECOVERY AND INVESTMENT PROGRAM

72. This chapter outlines the priorities that emerge from the overall recovery strategy (described in the preceding chapter) organized by the major themes – economics, banking, social needs – as well as the major sectors for investment.

ECONOMIC AND BANKING PRIORITIES

Economic Management and the Budget

73. Chapter II presented an assessment of the immediate impact on the economy and the budget of the conflict. Looking beyond 2008, the impact of the shocks on the economy would depend on the policy response and the extent of support received from the international community (Table 4). The important policy priorities lie in maintaining a counter-cyclical budgetary stance (aided by donor budget support), outlays for essential social needs, carefully managing the risks to the financial sector, and continuing infrastructure development.

74. Fiscal adjustments in 2008 have been presented to Parliament in the form of a supplementary budget and further adjustments in 2009 and beyond will be necessary. Revenue shortfalls compared to pre-crisis projections are \$385 million for 2008 and \$640 million for 2009. Additional shortfalls are expected in privatization receipts. Reductions in total expenditures of about \$120 million in 2008 and \$570 million in 2009 are planned; these figures include rises in certain categories of spending (such as shelter and support for displaced populations).

75. These estimated expenditure levels include additional expenditures associated with IDPs, infrastructure reconstruction, social protection, health, and education, so that expenditure savings would still have to be identified from other areas (Table 5). The additional expenditure needs amount to \$328 million in 2008 and \$390 million in 2009. As a result of these additional expenditure needs, Georgia will have to identify expenditure cuts in other areas amounting to \$450 million in 2008 and \$930 million in 2009. The draft 2009 budget provides for substantial cuts in defense and ministry of interior expenditures and rises in justice, education, health and labor spending.

Table 4: Medium Term Economic Impact

	2007	2008	2009	2010	2011
PRE-CRISIS SCENARIO					
GDP Growth Rate	12.4	9.0	8.0	7.0	7.0
Inflation (eop)	11.0	10.0	9.0	8.0	8.0
GNI per capita	1,990	2,510	3,160	3,770	4,270
Foreign Direct Investment (% GDP)	15.2	15.0	12.0	10.0	8.9
Foreign Direct Investment (M US\$)	1,535	2,081	1,845	1,775	1,825
Current Account Balance (% GDP)	-20.0	-16.6	-14.0	-12.5	-11.6
Consolidated Public Revenues (% GDP)	29.2	28.5	26.9	26.4	26.4
Consolidated Public Revenues (M US\$)	2,954	3,944	4,111	4,642	5,344
Consolidated Public Expenditures (% GDP)	34.0	32.4	29.9	28.5	27.5
Consolidated Public Expenditures (M US\$)	3,433	4,494	4,566	5,001	5,548
Overall Fiscal Balance (% GDP)	-4.7	-4.0	-3.0	-2.0	-1.0
Budgetary Financing Needs (M US\$)	-46	64	272	149	-39
POST-CRISIS BASELINE SCENARIO					
GDP Growth Rate	12.4	3.5	4.0	6.0	6.0
Inflation (eop)	11.0	8.0	8.0	6.0	6.0
GNI per capita	1,990	2,370	2,830	3,280	3,610
Foreign Direct Investment (% GDP)	15.2	9.3	8.6	9.2	9.2
Foreign Direct Investment (M US\$)	1,535	1,201	1,169	1,398	1,564
Current Account Balance	-20.0	-20.8	-18.7	-15.9	-14.2
Consolidated Public Revenues (% GDP)	29.2	27.7	26.0	25.5	25.1
Consolidated Public Revenues (M US\$)	2,954	3,575	3,529	3,871	4,258
Consolidated Public Expenditures (% GDP)	34.0	33.9	29.8	27.0	25.7
Consolidated Public Expenditures (M US\$)	3,433	4,379	4,051	4,104	4,368
Overall Fiscal Balance (% GDP)	-4.7	-6.2	-3.8	-1.5	-0.6
Budgetary Financing Needs (M US\$)	-46	481	453		25

Source: JNA staff calculations.

Table 5: Impact on Public Finances and Public Expenditure Needs

	2007	2008	2009	2010	2011
Consolidated Public Revenues (% GDP)	29.2	27.7	26.0	25.5	25.1
Consolidated Public Revenues (Mn US\$)	2,954	3,575	3,529	3,871	4,258
Revenue Shortfall (Mn US\$)	..	-369	-582	-771	-1,086
Consolidated Public Expenditures (% GDP)	34.0	33.9	29.8	27.0	25.7
Consolidated Public Expenditures (Mn US\$)	3,433	4,379	4,051	4,104	4,368
Net Expenditure Cuts vs Pre-Crisis (Mn US\$)	..	-114	-515	-897	-1,180
<i>Increased Expenditure Needs</i>	..	316	350	154	108
Rehabilitation of IDPs	..	106	141	51	19
Social Protection & Health	..	24	67	38	38
Education	..	14	26	13	13
Reconstruction of Damaged Infrastructure	..	172	116	51	38
<i>Other Expenditure Cuts vs Pre-Crisis</i>	..	-430	-866	-1,050	-1,289
Overall Fiscal Balance (% GDP)	-4.7	-6.2	-3.8	-1.5	-0.6
Overall Fiscal Balance (Mn US\$)	-479	-804	-521	-233	-110
Budgetary Financing Needs (Mn US\$)	-46	481	453		25
Additional Public Investment Needs (Mn US\$)	..	309	656	761	710
Additional Public Investment Needs (Mn US\$)	..	309	656	761	710
Transport	..	117	244	301	306
Energy	..	55	135	147	115
Urban and Municipal	..	34	84	90	76
Agriculture & Environment	..	31	55	61	48
Education	..	24	48	54	51
Social Protection & Health	..	48	90	109	115

Source: JNA staff calculations.

76. Georgia will also require financing for important public investment needs to sustain its growth prospects, on the order of \$310 million in 2008 and \$650 million in 2009 and staying at the \$0.8 billion range over 2010 and 2011. These figures are consistent with the donor financing requirement in the infrastructure and social sectors totaling around \$2¼ billion in commitments over the next three years. They are critical for Georgia to reduce the risks of a deeper and more protracted economic downturn and to lay the foundation for sustained economic recovery, growth, and poverty reduction in 2010 and beyond.

Under the scenario outlined above, investor and consumer confidence will begin to recover in the course of 2009; even so, FDI is projected to amount to well below pre-conflict levels. The financing gap in the budget that emerges shows that budget support required amounts to \$480 million in 2008 and \$450 million in 2009.

The Banking Sector

77. The banking sector has weathered the immediate impact of the conflict, but near-term post-conflict challenges remain. Key banks face external obligations falling due in early 2009. In the immediate aftermath of the crisis, the economy experienced an increase in the demand for dollars and withdrawal of deposits from the banking system as noted in Chapter II of this report. The stress on international reserves and commercial banks has diminished although risks remain and these risks would be exacerbated by a deeper and more protracted economic slowdown. Banks have managed to withstand the first, immediate stress on their institutions from the conflict in the form of significant withdrawals of deposits, including in foreign exchange. Banks are re-evaluating risk in their portfolio and preparing to avoid a rise in nonperforming loans (NPLs).

78. *Policy response.* The monetary authorities and the government fully recognize the task ahead. The central bank and the supervisory agency took a number of emergency measures to ease liquidity constraints and further relax the foreign exchange risk weighting for the purposes of capital adequacy calculations. Meeting external obligations is a priority so as to maintain investor confidence. A sudden drastic reduction in lending and provisioning beyond what is necessary would lead to an unnecessary decline in credit activity.

79. *Financing needs.* The refinancing needs of the banking sector to roll over liabilities and to provide for support for the moderate growth scenario being supported by the standby arrangement amounts to about \$700 million through 2009. This estimate is tentative as conditions in international capital markets for Georgia and emerging markets in general in the months ahead and especially through 2009 are exceptionally hard to project today. These needs could be satisfied by a combination of equity and debt finance as well as guarantees by international financial institutions and by donors.

PRIORITIES IN SOCIAL NEEDS

Return, Relocation and Resettlement

80. *Recovery and core investments.* Three areas of priorities have been identified: housing, social aspects, and protection and rights. The housing response strategy developed by the

government is based on two pillars: temporary shelter pending solutions, and durable housing. A menu of options will be offered to the displaced including: one time cash and utility-payment vouchers for resettling IDP families; conversion of public buildings; and construction of individual rural and urban houses.

81. International experience shows that socially focused actions such as arrangements to fully consult with IDP beneficiaries and to give them complete information on their resettlement and relocation possibilities are needed in a resettlement process to ensure success.

82. With regard to protection and rights, priority activities include: ensuring early, clear and coordinated registration and documentation of all new IDPs to enable them to access IDP benefits immediately; raising the awareness of IDPs of their rights through information campaigns.

83. *Costs.* Total costs for the three-year period amount to \$796 million, largely accounted for by housing construction and rehabilitation.

Table 6: Financing Needs in Housing
(\$ million)

Item	By March 2009*	By March 2010	By September 2011	Total
Housing construction/ shelter and housing rehabilitation costs	157	260	349	766
Non-food items for 12,000 HHs	7	--	--	7
Supporting arrangement related costs	5	8	10	223
Total	169	268	359	796

Source: JNA staff calculations.

*Post-conflict damage related.

Social Protection

84. *Recovery and core investments.* A range of measures are considered critical. They span over the three phases of the priority and core investment program and include: providing emergency and recovery food and cash transfers to newly displaced persons, returnees and others directly affected in the conflict zone – initially for an estimated 101,000 and later for c. 40,000 people; providing emergency complementary support to other vulnerable groups; rebuilding/refurbishing damaged Targeted Social Assistance (TSA) offices; and including those who are newly eligible in the existing social safety nets (TSA, medical assistance program and others) following eligibility procedures. These measures need to be supported by activities that strengthen capacities to, among others, accommodate the additional needy in the TSA system; recruit, train and deploy new social workers (who are already budgeted for 2009) to conflict-affected zones.

85. *Costs.* The total cost for social protection is estimated at \$122 million.

Table 7: Financing Needs in Social Protection
(\$ million)

	Immediate needs (6 months)*	Intermediate needs (12 months)	Medium term (18 months)	Total
Temporary emergency support (in-kind and cash)	24	18		42
Emergency supplementary feeding (children 0-2, pregnant women)	2			2
Targeted social assistance for newly poor	12	23	35	70
One-time cash assistance to resettled IDPs	4			4
Refurbishment of damaged regional SSA branches	2			2
Other	2	1	--	3
TOTAL	46	42	35	122

Temporary emergency support: 110,000 people*52 gel per month*6 months/1.405 (\$/gel exchange rate). For the subsequent 12 months, 40,000 people are estimated to be in need of this support.

TSA for newly poor: 130,000 people * 21 gel per month.

One-time start up cash assistance for IDPs who have been provided durable housing: 100,000 people*200 gel.

Source: JNA staff calculations.

* Post-conflict damage related.

Education

86. *Recovery and core investments.* Damage and loss of equipment, including furniture, text books, and computers has to be addressed. Given the state of disrepair of many school buildings, core investments to rehabilitate damaged education infrastructure need to be accompanied by a program for urgent rehabilitation and repair of such buildings, especially in areas where IDPs will be resettled. The psychosocial needs of those IDP children suffering from the trauma of violence and separation from home warrant addressing, including through training teachers to provide such support.

87. *Costs.* The priority recovery and core investment costs in education are estimated at \$53.3 million over a three-year period. This includes goods and services expenses to cover the shortfall in the education budget and support to the continuation of the reform program in an amount of \$22.9 million.

Table 8: Financing Needs in Education
(\$ million)

Total Costs	By March 2009*	By March 2010	By September 2011	Total
Infrastructure and equipment	2.8	10.7	13.4	26.9
Provision of Goods and Services	13.3			0.4
Emergency activities	3.4			1.7
Total	19.1	15.8	18.4	53.3

Source: JNA staff calculations.

*Post-conflict damage related.

Health

88. *Recovery and core investments.* Priority measures should focus on re-establishing the provision of health services in the affected areas and monitoring the health status of the affected population. In the immediate term, the emergency medical center in Gori needs to be rehabilitated, furnished, equipped, and supplied with ambulances. High priority measures also include the renovation of three health facilities and the refurbishment of seven damaged ambulatories in Shida Kartli during the crises. While these facilities are being rehabilitated, health services should be provided through mobile clinic teams that should be set up and rendered operational quickly. In the intermediate term, three health facilities and one hospital should be reconstructed in the 'adjacent areas' and physical rehabilitation should be provided to those physically impaired as a result of the conflict.

89. *Costs.* The total financing needs of the three-year recovery and core investment program in the health sector amounts to \$175 million. The most important element is the cost of the widened coverage of the medical assistance program, funded by the government, to cover an additional 130,000 new beneficiaries.

Table 9: Financing Needs in Health
(\$ million)

	6 months*	+12 months	+18 months	Total
Medical Assistance Program for Poor and Vulnerable Population: increased coverage and premium	28.0	56.1	84.2	168.3
Reconstruction and rehabilitation of infrastructure	0.4	2.0	2.7	5.0
Health services	0.5	0.7		1.2
Mobile health teams	0.1	0.1		0.2
Physical rehabilitation and prosthesis	0.35	0.6		1.0
TOTAL	28.9	58.7	86.9	174.6

Source: JNA staff calculations.

*Post-conflict damage related.

Agriculture and Livelihoods

90. *Recovery and core investments.* Activities have been prioritized according to the immediacy of need – to protect, to restore and to improve agriculture and agricultural livelihoods – and the time frame in which it is possible to implement them. Immediate activities in this sector include: (i) providing inputs necessary for the winter cropping season and ensuring livestock do not die, (ii) providing water supply for human and animal consumption, and (iii) beginning the process of identifying sustainable solutions to water needs. Intermediate needs activities are to: (i) provide small-scale irrigation to conflict-affected areas and provide seeds for planting in 2009; (ii) rehabilitate rural infrastructures and improve small-holder production capacity, and (iii) restock lost livestock.

91. The recovery of and investments in the agriculture sector would have a significant effect on employment. The various components of the sector program (planning of winter

crops, the cattle program for the coming winter, the provision of temporary irrigation, small-scale rural infrastructure works, the livestock restocking program, and the completion of the large Tiripone Irrigation Scheme) are estimated to provide 15,000 jobs over the three-year recovery period.

92. *Costs.* The total estimated costs for agriculture amount to \$81 million. Costs are based on current estimates for locally-procured goods and services or for imported goods where required (particularly winter wheat seeds).

Table 10: Financing Needs in Agriculture
(\$ million)

Timeframe	Cost
Immediate: October 2008-March 2009*	28
Intermediate: April 2009 – March 2010	53
Total	80

Source: JNA staff calculations.

* Post-conflict damage related.

Employment

93. *Recovery and core investments.* Local priority measures related to the impact of the conflict on employment need to focus on supporting small and medium enterprises (SME) affected by disrupted trade linkages and interruptions due to the conflict by providing access to financing, business advisory services, and continued improvements to the business enabling environment. The key instrument is the provision of microfinance. It is envisaged that credit lines would be extended to existing banks and microfinance institutions and that some business support activities will be a part of the package for borrowers.

94. *Costs.* Total costs in this sector are estimated at \$22 million over the three-year period.

Table 11: Financing Needs in Employment
(\$ million)

	By March 2009*	By March 2010	By September 2011	Total
Micro-finance	4	10	6	20
Local capacity building	0.5	1	0.5	2
Total	4.5	11	6.5	22

Source: JNA staff calculations.

* Post-conflict damage related.

PRIORITIES IN INFRASTRUCTURE AND ENVIRONMENT

Transport

95. The immediate damage-related needs are confined to \$61 million, mostly related to superficial damage to roads resulting from the transport of heavy military vehicles, to loss of aviation radar, and the need to rehabilitate the Tbilisi airport runway. The underlying strategy driving the core investment needs in the transport sector relate to economic security, which now requires the construction of an alternative network so as to minimize risks of severance of major transport links. Moreover, road construction would help bolster economic growth and employment in the ‘bridging period’ to the return of confidence. The authorities have also begun to explore the prospects for a long term concession for the main road network.

Table 12: Summary of Transport Recovery and Investments⁵
(\$ million)

Sector	Direct Damage Assessment	Direct Damage plus Core Investment
Road (main and secondary network)	18	969
Railways	4	22
Port	1	1
Aviation	38	38
Total	61	1,030

Source: JNA staff calculations.

The road estimate comprises US\$0.7 million of urgent repairs (already done), US\$1.5 million for looted or destroyed equipment of local contractors and US\$16 million of minor damages which can be addressed when periodic maintenance of these roads is performed.

96. **Roads.** Georgia serves as a key transit route: the shortest link between Central Asia and Europe as well as between Russia and Turkey. Future road sector development focuses on two strategic elements: (i) development of the main road network, including the east-west highway up to the Turkish border, and (ii) development of a network of roads to serve as alternative routes – primarily southern -- which would also link the local communities (such as small scale farmers) to the main network thus given better access to services and markets and bringing more economic benefits to the country.

97. The government intends to explore private sector participation in the main road network; in particular, it is giving consideration to tendering out the main road network to a 40 to 50 year concession and discussions are taking place with investment banks. In order to sustain these investments, the management of the road network should be modernized. The concession of the main road network would be key. Other activities include: gradually introducing in the roads authority state-of-the-art asset management capabilities as well as concepts of benchmarking and performance targets and instituting a road financing system.

⁵ The core investment road program is estimated with all taxes. The amount net of all kind of taxes is about 70% of this estimated amount. Therefore, the figure for total core investment financing presented to the donor conference for donor participation is about \$700 million for the road sector.

98. Modernization of the road network will also generate substantial employment. In particular the rehabilitation of the secondary and local roads network is more labor intensive (less mechanized) than construction of the highways. Preliminary estimates show that \$35,000 (net of taxes) of works creates one job for one year. A \$100 million program of secondary and local roads rehabilitation would create about 3,000 jobs for one year.

99. **Rail.** The rail link serves largely to carry transit cargo (oil and oil products from the Caspian) and vital trade of Armenia and Azerbaijan with the rest of the world using the Black Sea ports. Conflict-related damage concerned a significant bridge and a rail line spur – repairs are at an advanced state. The damage is estimated at \$4 million. Critical core investments include the repair of bridges, amounting to an additional \$18 million.

100. **Ports.** The ports -- the two major ones of Poti and Batumi, Supsa Terminal (oil exports transported by pipeline) and the new Kulevi Port (oil transported by rail) -- are all privately owned and operated, and have dramatically increased their turnover over the past decade and have sufficient capacity to further attend the expected increase in regional demand.

101. Damage was minor; there is no need for rehabilitation. The port is profit-making; the port administration expects traffic to fully recover to pre-conflict levels before the end of the year. Furthermore, the investors appear confident that they will pursue their investments as planned.

102. **Telecommunication** services are largely provided by private operators. While damage is minimal, there have been revenue losses and severe disruption of services for periods of time affecting telecom and internet. The vulnerability of telecommunications to external disruptions is a cause for concern.

103. **Aviation.** The conflict resulted in the destruction of the primary and secondary radar in Tbilisi. There is no primary radar coverage of the Georgian air space. Immediate investments are necessary to ensure the safety of take-offs and landings and the passage of over-flights through airspace by the acquisition of a replacement radar, costed at \$8 million. There is, moreover, an urgent need to rehabilitate the runway of Tbilisi airport at an estimated cost of \$30 million.

Energy

104. Georgia has achieved dramatic improvements in the provision of electricity services in the last three years after years of unreliable supply, and has emerged as a small net exporter. The government's policy is based on private sector operators of power plants and distribution networks. Gas and power transmission are handled by state utilities, and the major Enguri hydropower plant is owned by the state. However, the power system is vulnerable: (a) its current substantial dependence on one large hydropower plant, Enguri (whose dam and reservoir are under the control of the central authorities but whose turbines and generators are in Abkhazia); (b) its dependence on thermal power plants for winter supply – plants that are fueled by imported natural gas; and (c) a transmission grid short of

capacity and prone to technical breakdowns, in part because the 500 kV backbone grid traverses the Caucasus Mountains.

Table 13: Conflict-related Damage and Reconstruction in Energy
(\$ million)

	Cost Estimate
Direct conflict damage and losses	12
Strategic reserve of mazut (heavy fuel oil) as back-up fuel for gas power plants	26
Total	38

Core Investment Needs in the Energy Sector	
	Cost Estimate
220 kV Senaki Power Transmission Line Rehabilitation	28
Natural Gas Storage	177
Total	205

Source: JNA staff calculations.

105. The conflict-related damage to energy infrastructure was \$38 million and the infrastructure element has largely been repaired and service to customers restored. However, power transformers and switchgear have not been replaced yet; thus there is continued reliance on backup systems. There is a new need to ensure distribution and connection to new settlements being built for displaced populations. In the immediate term, it would be advisable to build up a strategic reserve of mazut (heavy fuel oil) as back-up fuel for the gas power plants.

106. Core investments are directed at enhancing energy security and reducing the risks of major black-outs and lack of access to heating in the winter. A double 220 kV power transmission line requires urgent rehabilitation to address power system weaknesses in western Georgia. Lastly, it is likely that gas-fired thermal power plants will continue to be necessary in the longer run to secure adequate power supply during winter. The development of underground natural gas storage would mitigate the risk of interruptions to supply associated with this imported energy source. The core investment needs amount to about \$205 million, and the total to \$243 million. Donor request amounts to \$223 million.

107. In the longer-term (i.e., beyond the horizon of the funding needs being presented to donors), Georgia needs to enhance its energy security by continuing to develop domestic energy resources. Investments include small, medium and large hydropower plants. Chief among these are the Khudoni hydropower plant (\$800 million), the Namakhvani hydropower cascade (\$540 million), the Oni hydropower cascade (\$525 million), with the total program amounting to \$2.7 billion.

Municipal and Urban Services

108. The infrastructure and services in most cities and municipalities is generally in need of a major overhaul. Infrastructure has suffered from years of under-investment and lack of proper maintenance. Nearly all the water supply and sanitation infrastructure requires

immediate rehabilitation simply to a minimal level of service. Most municipal roads are in very poor condition and require urgent improvement/ rehabilitation and systematic maintenance. At present sanitary landfill management is not satisfactory. The solid waste sector is characterized by un-sanitary landfills in urban areas and ad hoc dump sites in rural areas.

109. Moreover, there is an acute scarcity of capacity, managerial and technical talent in the municipalities. This is a serious constraint and one that cannot be solved in the medium term. The engagement of the private sector in municipal activities offers an attractive solution to the structural difficulties that today confront this sector.

110. Immediate conflict-related damage consists of cracking on local roads caused by heavy military vehicles. There are some direct damages on water pipes and wastewater treatment plants. For damaged road surfaces and water pipes and treatment plants, an immediate work is required to resurface, repair and restore them. Before repairing the damaged roads in Gori, the water supply and wastewater system in Gori should first be rehabilitated.

Table 14: Proposed List of Damage and Core Investments in Urban/Municipal
(\$ million)

Project	Cost estimates ⁶	Key components/description
1 Kutaisi Infrastructure	36	Water pipes, treatment facilities, utility, roads, etc.
2 Poti Infrastructure	36	water pipes, treatment facilities, wastewater, utility, roads, etc
3 Zugdidi Restoring water supply pipe lines	7	Urgent: no later than March 2010
4 Zugdidi Infrastructure	22	upgrading of urban and municipal infrastructure
5 Senaki Infrastructure	22	
6 Tbilisi Urban Transport	46 (excl private sector share)	preparatory studies, traffic control and management, public transport, parking space, road network
7 Kutaisi Urban Transport	46 (excl private sector share)	
8 Batumi Urban Transport	46 (excl private sector share)	road improvement, traffic control, parking spaces
9 Management contract related expenses	24	
Total	257	

Source: JNA staff calculations.

⁶ The cost estimates provided by the cities were benchmarked in scope and price against similar ongoing investment project throughout the country.

111. Turning to core investments, the government's municipal investment plans include both institutional and capacity building and physical improvements. Physical improvements focus on providing potable water and improving the efficiency of the distribution system, improving sewerage facilities and solid waste management, developing city master plans for the water, sanitation and urban transport sector, and expanding water supply and sanitation coverage in both urban and rural areas.

112. In parallel with the proposed investments, a series of policy and institutional reform measures are being undertaken, with the central aim of attracting private management and investments. In water, the establishment of tariffs and the definition of prerequisites for successful privatization or concessioning of water and sanitation assets should be looked into.

113. In municipal roads, the development of policies to help raise efficiency, for example by competitively allocating funding to municipalities through a bidding process should be attempted. For solid waste, the exploration of private sector participation for collection and for landfill operations should be examined. The government could allocate identified landfill sites to a special purpose public company that would obtain equity and debt from external funding and would be regulated.

114. Investment needs beyond 2012 amount to \$430 million, divided equally between roads and general urban infrastructure.

Environment

115. Environmental damage is comprised of damage to forests; damage to habitats and infrastructure in several protected areas; coastal and marine pollution; pollution from several terrestrial oil spills; and hazardous waste issues associated with infrastructure damage. Forest fires broke out almost simultaneously at several sites in Georgia; the largest areas damaged by fire are primarily in two sites in Ateni Gorge and in the Borjomi Gorge.

116. The critical short term risks from forest fire damage include soil erosion, insect infestation, and new fire outbreaks. Soil erosion will be potentially most serious in Borjomi Gorge, where downstream communities are likely to be threatened by flooding. Insect infestation can have profound long-term consequences for the forest sector if control measures are not put quickly in place. Finally, terrestrial oil spill damage also requires addressing.

117. Priority activities of an immediate character are salvaging damaged timber and weakened trees using low-impact logging methods and dealing with oil spillages. This is estimated at \$2 million. Core investments centre on rehabilitation, replanting, and soil erosion activities in fire damaged sites and beginning repair of damaged infrastructure in protected areas as well guarding against flooding in villages downstream of affected forests – this is estimated at below \$5 million.

CHAPTER V. FINANCING OPTIONS AND INSTITUTIONAL MECHANISMS

FINANCING OPTIONS

118. Georgia's specific post-conflict needs require different forms of financing. Consistent with the *Paris Declaration on Aid Effectiveness*, aid should be predictable, harmonized, and aligned with national priorities and use the country's own institutions and systems. The government would wish donors to employ existing and already planned mechanisms to the greatest degree, thereby strengthening the linkages to the national budget process.

119. First, **budget support**, provided by donors directly into the government's single treasury account, to fill the fiscal gap associated with the revenue shortfall and expenditure increase that are a direct result of the crisis. Donors could use this mechanism to finance costs associated with the social consequences of the conflict, including shelter, livelihood, agriculture, education and health needs of the affected populations,⁷ as well as investment activities that the government intends to initiate. Moreover, fiduciary reviews of the country's budget systems show that Georgia has high standards of governance. The country has undertaken to further improve these standards, including those in public finance management. This finding would give comfort to donors.

120. Second, **support for the financial sector** in the form of participation through debt or equity instruments and guarantees to banks that would help bolster investor and consumer confidence and thus accelerate the restoration of the banking system to financial intermediation functions.

121. Third, Georgia's **Municipal Development Fund (MDF)** has a strong track record of implementing projects financed by donors, including the ADB, EBRD, KfW, MCC and IDA. The government plans to expand MDF's mandate and rename it Georgia Agency for Reconstruction and Regional Development (GARRD). Use of GARRD for rehabilitation of and core investments in the municipal and other infrastructure sectors is encouraged.

122. Fourth, the government is designing a multi-donor trust fund to attract debt and equity financing for large infrastructure projects – **the Phoenix Fund**. This fund could also have a window to finance infrastructure outlays associated with the absorption of the internally displaced and other conflict-affected populations. This fund would be administered by a highly qualified chief executive officer and supervised by an independent board with substantial (most likely, majority) donor representation. The fund would adhere to World Bank standards in financial management and procurement or equivalent standards.

⁷ For the provision of humanitarian aid as well as immediate social sector support, however, the expertise and capacity of UN agencies and NGOs would be vital in areas where government capacities require further strengthening (see below).

123. Fifth, donors could also use **co-financing trust funds**, pooling their resources to finance a single project. These trust funds are usually administered by an international financial institution that finances part of a particular project. Co-financing may be attractive in particular for large-scale infrastructure projects that require multiple donors to fund it.

124. Finally, donors could use **direct funding** to the entity implementing a given project, including parallel financing whereby several donors finance the same project but without pooling their funds. Direct funding to UN agencies and NGOs is of particular relevance in post-crisis situations, for humanitarian assistance and urgent social sector activities and where delivery needs to be coupled with capacity building. Those areas where UN agencies and NGOs can help speed implementation are presented in the *UN Flash Appeal*.

Monitoring and Implementation Arrangements

125. Building on current government practice a comprehensive monitoring system should be built around three components, namely monitoring results, tracking aid, and assessing impact.

126. **Monitoring results.** Results Frameworks have been developed for all social and infrastructure sectors to track outcomes of priority activities. The government will review progress periodically.

127. **Assessing impact.** In addition to project related impact assessments, there could be periodic monitoring at the household level that uses a quantitative and/or qualitative method to measure the outcomes and impact of the overall post-crisis program. Such a tool would provide valuable information and help reinforce and/or redirect the recovery effort, as needed, in real time.

128. **Implementation arrangements.** Prior to the conflict, Georgian public and private entities have been successfully implementing projects financed by the government and the donor community. Consequently, to the extent possible, existing local entities should implement the activities proposed under the priority recovery and core investment program. In certain cases, particularly where private sector participation is being sought, it would be necessary to establish special purpose vehicles.

**I. Financing Requirements for the Recovery Program and UN Flash Appeal
(\$ million)**

	1 Immediate (to March 2009)	2 Core Investment (to March 2010)	3 Core Investment (to Sept. 2011)	4=(1+2+3) Total: Immediate plus Core	5 Already included in Budget/ Budget Support	6=(4-5) Total Funding Needs
I. BUDGET SUPPORT	480	450		930		930
II. SOCIAL SECTOR	294	448	506	1,248	251	996
RETURN, RELOCATION & RESETTLEMENT	169	268	359	796	220	576
SOCIAL PROTECTION	45	42	35	122	31	91
EDUCATION	19	16	18	53		53
HEALTH	29	59	87	175		175
AGRICULTURE & LIVELIHOOD	28	53		80		80
EMPLOYMENT	5	11	7	22		22
III. INFRASTRUCTURE	99	300	874	1,273	315	958
TRANSPORT	61	262	707	1,030	295	735
Roads	18	244	707	969	295	674
Rail	4	18		22		22
Ports	1.0			1.0		1.0
Aviation	38			38		38
ENERGY	38	38	167	243	20	223
IV. URBAN AND MUNICIPAL SERVICES	20	118	119	257		257
Water Supply and Wastewater	1	7		9		9
Urban and Municipal Roads	17	18	72	107		107
Urban Infrastructure Development, Housing and Public Buildings	1	81	35	117		117
Management contract related expenses		12	12	24		24
V. ENVIRONMENT	2	2	3	7		7
Protection and Production of Forests	1.4	1.0	2.7	5.1		5.1
Natural Habitats and Protected Areas	0.3	0.5		0.8		0.8
Coastal and Marine Pollution		0.1		0.1		0.1
Terrestrial Oil Pollution	0.3	0.2	0.1	0.6		0.6
Other infrastructure: Buildings south west of Gori	0.1	0.1		0.2		0.2
TOTAL	895	1,317	1,502	3,715	566	3,148
BANKING SECTOR FUNDING	500	200		700		700

Source: JNA Staff Calculations.

Link between the JNA and the Revised UN Flash Appeal

(\$ million)

This table presents the comparison between the needs identified through the JNA and their presentation through the Flash Appeal. It aims at providing a full perspective of the same needs presented through these different instruments. As the flash appeal covers the period up to March 2009, only the needs comprised in the first phase of the JNA (October 2008 to March 2009) are represented in this table. The table also provides information regarding the amounts under each outcome which have already been funded through the flash appeal, so that a clear picture of the remaining funding needs is easily identifiable. The last column presents comments and remarks pertaining to each outcome/sector.

JNA sector outcomes	Estimated cost of assessed needs from Oct. 08 to Mar. 09	Flash Appeal requested funds towards these outcomes	Comments
Education			
Outcome 1: All internally displaced children and children directly and indirectly affected by conflict pre and post August 08 return to full-time education and access to pre-school education is provided for the most vulnerable	19.00	-	
	5.46	1.8 (protection, 66% already funded)	The Flash Appeal does not cover the education sector, but proposes emergency response to children protection needs overlapping with the education section of the JNA
Outcome 2: 2.1 Access to kindergarten education is preserved at pre-conflict levels 2.2 Schools in affected areas are re-opened or suitable alternative arrangements are in place and attendance registers reflect the pre-conflict levels	0.62	-	
Outcome 3: 3.1 Access to education improves at all levels for all children regardless of their socio-economic status 3.2. The average quality of learning outcomes improved	12.90	-	

	Estimated cost of assessed needs from Oct. 08 to Mar. 09	Flash Appeal requested funds towards these outcomes
Health	28.82	1.71
Outcome 1: Population impoverished by the conflict has adequate access to health services by being included into the medical assistance program following established eligibility testing procedures.	28.00	Budgetary support for the improved coverage of Medical Assistance Program for Poor and Vulnerable is not included in the Flash Appeal. In addition to responding to the JNA identified needs, the Flash Appeal plans for a "safety net" of additional support projects to respond to the IDPs healthcare needs during the immediate and forthcoming winter period until the mechanisms outlined in the JNA (such as inclusion of IDPs under the Medical Assistance Program for the Poor) become fully operational.
Outcome 2: Provision of basic health services to affected population is maintained through mobile clinics and rehabilitated, reequipped and operational health care facilities	0.47	1.36 (28% already funded)
Outcome 3: Mental Health needs of the affected population are addressed through strengthening mental health component of routine primary care as well as implementing targeted mental health programs	0.35	0.35
Food security and Agriculture	28.00	14.04
Outcome 1: Agricultural production, livelihoods and food security among conflict-affected and other food-insecure, small-holder farm families are restored and improved	28.00	14.04
		The gap mostly comes from the difference in target population. The JNA addresses agriculture and food security livelihoods needs of 92 and 08 IDPs as well as vulnerable groups, whereas the appeal focuses on population directly affected by the crisis.

Estimated cost of assessed needs from Oct. 08 to Mar. 09	Flash Appeal requested funds towards these outcomes
168.70	58.00
Return, Relocation and Resettlement	
Outcome 1: 2008 IDPs are immediately provided with temporary shelter as well as the basic non food items and, in the mid-term, with durable housing solutions, in keeping with the GoG policy and Action policy and Action Plan, by the end of the recovery period	47.2 (shelter) + 3.4 (WASH 47% already funded)
	The costs related to Return, Relocation and Resettlement are higher in the JNA than in the revised Flash Appeal as they include durable housing and also address the needs of 92 IDPs. The needs identified in the Shelter chapter of the JNA are addressed by projects proposed in different sections of the appeal: Shelter, protection, WASH (for hygiene kits and sanitation rehabilitation of collective centers)
7.00	
Outcome 2: 1992 IDPs are provided with winterization assistance and durable housing solutions according to the GoG policy and Action Plan, by the end of the recovery period	
4.70	7.35
Outcome 3: IDPs resettlement is carried out in conformity with the UN guidelines on Internal Displacement	

Estimated cost of
assessed needs
from Oct. 08 to
Mar. 09

Flash Appeal
requested funds
towards these
outcomes

	63.15	24.13
Social Protection		
Outcome 1: Population directly and indirectly affected by the conflict access their entitlements within the national social protection system, including temporary protection measures	46.90	21.82 (food security:60% already funded) + 0.62 (WASH: 36% already funded) + 1.48 (nutrition: 22% already funded) = 23.92
		The needs identified in the social protection chapter are addressed by project proposed in different sections of the appeal: WASH (for water distribution), Food security (for food distribution). The JNA includes the payment of a "one-time" cash allowance to IDPs which infer assistance under the form of budget support and is therefore not reflected in the revised appeal (\$17.2m). The difference also stems from the inclusion in the JNA of budget support to the increased coverage of the Targeted Social Assistance (\$16m), the refurbishment of SSA regional branches, TSA administrative cost related to identification and eligibility testing of newly poor, all not covered by the Flash Appeal.
Outcome 2: GoG managing rationalized and more equitable social protection programmes for vulnerable groups - including those affected by unforeseen shocks/ emergency	16.25	0.25 (protection of gender-based violence)
Employment and Livelihoods (non-agricultural)	4.50	6.10
Significant part of the neediest population directly and indirectly affected, benefits from immediate livelihood opportunities/solutions and, by 2011, is gainfully in the labor market and/or has obtained stable livelihood	4.50	6.10
		The projects of the appeal exceed the JNA estimates as they include some activities aiming at responding to immediate integration needs especially those of the young population to mitigate the risk of violence and social unrest



THE UNITED NATIONS



THE WORLD BANK

This report addresses the post-conflict recovery and investment needs of Georgia. Prior to the conflict of August 2008, the Georgian economy was on a strong growth track. The conflict dealt a shock to the key pillars of economic growth: to investor and consumer confidence, leading to a contraction of liquidity in the banking system, to a stress on public finances, damage to physical infrastructure, and increased numbers of internally displaced persons.

The major impact of the conflict has been a fall in investment, domestic and foreign, and a steep decline in economic growth amidst rising unemployment. A social burden has arisen from the internal displacement of persons, which has led to the need for shelter, food and social services programs.

The government has launched an impressively swift post-conflict recovery program. This report finds that physical damage to the infrastructure sectors and the environment is being rapidly addressed. Nevertheless, sustained success will prove elusive unless the international community provides adequate and rapid financial support to buttress Georgia's own efforts.

The JNA has identified the need for international support in three major areas:

- *Support for the rapid restoration of confidence.* Donors can help by providing resources for the budget and thereby ensuring funding for critical post-conflict activities without slowing the momentum and quality of Georgia's governance, economic and social reform efforts.
- *Support for social needs.* The resettlement of the internally displaced and the needs associated with other conflict-affected populations have put a substantial burden on fiscal resources.
- *Support for critical investments.* The JNA finds that donor financing for high-return investments remains essential as a bridge to the period when the private sector fully resumes investing. Such financing would help to enhance Georgia's economic security, recovery and growth, and thereby mitigate the risks of increasing poverty and unemployment.

