

**Macro-Financial Assistance from the European Union to Georgia
of up to EUR 46 million**

MEMORANDUM OF UNDERSTANDING

between

**THE EUROPEAN UNION
as Donor**

**GEORGIA
as Beneficiary**

and

**THE NATIONAL BANK OF GEORGIA
as Beneficiary's Financial Agent**

MEMORANDUM OF UNDERSTANDING BETWEEN THE EUROPEAN UNION AND GEORGIA

1. On 12 August 2013, the European Parliament and the Council of the European Union adopted a decision to make available to Georgia (hereafter referred to as "the Beneficiary") macro-financial assistance (hereafter referred to as "the assistance") of up to EUR 46 million, half in loans and half in grants (Decision n° 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing macro-financial assistance to Georgia¹). The assistance shall be made available for two and a half years starting from the first day after the entry into force of the Memorandum of Understanding (hereafter "the MoU").

The objective of this assistance is to alleviate Georgia's balance of payments and budgetary needs, strengthen its foreign exchange reserve position and support reforms aimed at reinforcing economic governance, raising sustainable growth and increasing social inclusiveness while promoting closer economic integration with the European Union (hereafter "the EU"). This assistance from the EU is complementary to the resources provided to Georgia by International Financial Institutions and bilateral donors in support of the authorities' economic stabilisation and reform programme.

The reform program supported by the assistance recognises the importance of consistency of policies between the government of the Beneficiary and the National Bank of Georgia (hereafter "the NBG"), while reaffirming the strong institutional and financial independence of the NBG, consistent with the NBG's organic law and the Constitution of Georgia.

2. The assistance shall be disbursed in two equal instalments of EUR 23 million each.
3. The first instalment of the assistance shall be disbursed upon the signature and entry into force of this MoU and after necessary requirements under the corresponding Loan Facility Agreement and MFA Grant Agreement are fulfilled. The disbursement of the second instalment shall not take place earlier than three months after the release of the first instalment.
4. The disbursement of the assistance will be conditional upon a satisfactory track record in the implementation of the current Stand-By Arrangement agreed between Georgia and the International Monetary Fund (hereafter "the IMF"), as well as upon a positive assessment by the European Commission (hereafter "the Commission"), on behalf of the EU, of progress made with respect to a number of economic reforms identified in Annex I of this MoU.

The macroeconomic and structural adjustment policy measures attached to this assistance are based on the economic stabilisation and reform programme endorsed by the Georgian authorities and are consistent with agreements reached by Georgia with the IMF. Before the release

¹ O.J. L 15 of 21.5.2013, p. 9

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of each instalment of this assistance, the Commission, in co-operation with the national authorities and IMF staff, will verify that Georgia is making good progress under the programme supported by the Stand-By Arrangement agreed with the IMF.

In addition, prior to the release of the second instalment by the Commission, the Georgian authorities shall provide the Commission with a Compliance Statement on the fulfilment of the policy measures identified in Annex I of this MoU. Upon receipt of the compliance statement from the Georgian authorities, the Commission will evaluate, in co-operation with the Georgian authorities and, where appropriate, the International Financial Institutions progress made with respect to the fulfilment of policy measures contained in Annex I of this MoU. These measures focus on reforms to improve public finance management, increase efficiency of the social safety net, strengthen banking regulation, and adopt trade and competition policies supporting the implementation of the Association Agreement, including the Deep and Comprehensive Free Trade Area (hereafter "the DCFTA"), signed between the EU and Georgia on 27 June 2014. In case of a negative evaluation, the Commission may withhold the disbursement of the second instalment until Georgia demonstrates compliance with the measures in Annex I of this MoU.

5. The Commission will also continuously verify the financing needs of Georgia and may reduce, suspend or cancel the assistance in case they have decreased fundamentally during the period of disbursement compared to the initial projections.
6. The Commission shall transfer the instalments to a euro account held by the National Bank of Georgia at a foreign intermediary bank. Given the budgetary financing needs faced by the Beneficiary, the proceeds of the assistance will then be transferred to an account of the Treasury of Georgia's Ministry of Finance at the National Bank of Georgia.

The National Bank of Georgia will act as the Financial Agent of the Beneficiary and shall not be liable for the financial liabilities of the Beneficiary under this MoU and any other agreements concluded in connection with it.

7. During the implementation of the assistance, the Georgian authorities shall supply the Commission with all information that is relevant for the monitoring of its economic and financial situation and for the assessment of progress in structural reforms. In particular, the authorities will supply to the Commission on a timely basis the relevant information as set out in Annex II of this MoU.
8. With a view to preventing irregularities and fraud related to the use of the assistance and ensuring the protection of the EU's financial interests, the relevant provisions of the Loan Facility Agreement and the MFA Grant Agreement will apply, notably those regarding regular checks by the Beneficiary on the use of EU assistance, and checks and audits performed by the Commission and the Court of Auditors. Also, the provisions of the Loan Facility Agreement on early repayment will apply in case it has been established that the Beneficiary has engaged, in relation to the management of this assistance, in any act of fraud, corruption or any other illegal activity.
9. The Commission, represented by its own agents or its duly mandated experts, shall have the right to carry out operational assessments of the administrative procedures and financial circuits of the Beneficiary that relate to the management of EU macro-financial assistance throughout the duration of this MoU and for five years after the disbursement of the last instalment (*ex-post* period).

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10. An independent ex-post evaluation of the assistance may be carried out by the Commission or its duly authorised representatives. The Beneficiary is committed to supply all necessary information to the Commission, represented by its own agents or its duly mandated experts, for the duration of this process. The evaluation report will be made available to Georgian authorities for comments.
11. The authorities will ensure, as appropriate, close co-operation with the Commission.
12. This assistance is implemented on the understanding that the authorities of Georgia will continue to respect effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, and to guarantee the respect for human rights.
13. Annexes I and II are an integral part of this MoU.
14. All notices in relation with the present MoU shall validly be given if in writing and sent to:

For the European Union

European Commission
Directorate General for
Economic and Financial Affairs
CHAR 11/248, B-1049, Brussels

For Georgia

Ministry of Finance
HE the Minister of Finance
Gorgasali str. 16
Tbilisi 0114, Georgia

National Bank of Georgia
HE the President of the National Bank of Georgia
Sanapiro str. N2
Tbilisi 0114, Georgia

15. The present MoU shall enter into force following its signature by Georgia and the EU and upon its ratification by the Parliament of Georgia.
16. The MoU may be amended upon mutual agreement of the parties in form of a written Addendum. The Addendum will be an integral part of this MoU and will enter into force according to the same procedures as the MoU.

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The Memorandum of Understanding has been signed in four originals in the English language.

Signed in Tbilisi on

Signed in Brussels on 11 DEC. 2014

GEORGIA
as Beneficiary

EUROPEAN UNION
as Donor

Represented by

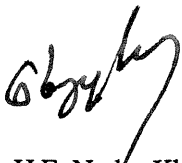
Represented by

the MINISTRY OF FINANCE

the EUROPEAN COMMISSION

Represented by

Represented by



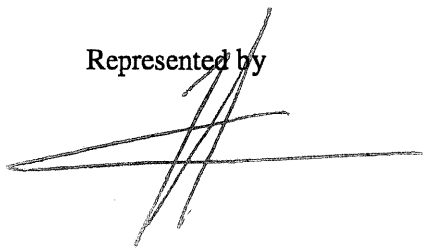
H.E. Nodar Khaduri
Minister of Finance



H.E. Pierre Moscovici
Member of the European Commission

the NATIONAL BANK OF GEORGIA
as Beneficiary's Financial Agent

Represented by



H.E. Giorgi Kadagidze
President of the National Bank of Georgia

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ANNEX I

STRUCTURAL REFORM MEASURES FOR THE SECOND TRANCHE

At the time of the Commission staff review that will precede the decision on the disbursement of the second instalment, the authorities of Georgia are committed to have accomplished the following actions:

PUBLIC FINANCE MANAGEMENT

Action 1

Consistent with the Strategic Plan of the State Procurement Agency, increased efforts will be made to improve awareness about public procurement legislation and procedures on the part of both public agencies organising tenders and potential bidders. This will include, in particular, the creation of a training centre on public procurement at the new premises of the State Procurement Agency and/or the development, in close co-operation with the State Procurement Agency, of the permanent training module on public procurement at the Academy of the Ministry of Finance. Also, substantial progress will be made towards the introduction of a certification system.

Action 2

In order to protect the operational independence of the State Audit Office (SAO), as enshrined in the Constitution of Georgia, and consistent with INTOSAI Mexico Declaration, the Parliament will amend article 35 of the Law on the State Audit Office to ensure that the Parliaments' oversight of the SAO's activities is limited to auditing of its financial and economic performance based on SAO's annual financial statements.

SOCIAL SAFETY NET

Action 3

The Ministry of Labour, Health and Social Affairs will complete, with technical assistance from the World Bank, USAID and the World Health Organisation, the Health Utilisation and Expenditure Survey. The results of the Survey will provide input for the evaluation of the impact of health sector reforms on accessibility, utilisation, satisfaction and the financial protection of the population vis-à-vis health care and serve as a basis for further refining the design, operation and financial management of the Universal Health Care (UHC) programme introduced in 2013.

Action 4

With a view to improving the efficiency and cost-effectiveness of the Universal Health Care and other State Health Care Programmes, the Ministry of Labour, Health and Social Affairs will establish a special Unit for Health Care Quality Improvement.

FINANCIAL SECTOR

Action 5

Consistent with the regulation on capital adequacy adopted by the National Bank of Georgia in 2013 and Basel II rules on capital adequacy, banks in Georgia will submit to the NBG Internal Capital Adequacy Assessment Process (ICAAP) reports. Based on the ICAAP reports submitted by banks, the NBG will provide two largest banks assessments and recommendations in the context of the Supervisory Review and Evaluation Process (SREP).

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Action 6

The NBG will implement the centralized risk-management framework action plan approved by the NBG Council in April 2013. As part of this plan, a Centralized Risk-Management Department will be established at the NBG. The Department will be in charge of managing operational risks, including Business Continuity Management Procedures.

TRADE AND COMPETITION POLICY

Action 7

In order to be able to fully exploit the opportunities offered by the DCFTA, following its entering into force on 1 September, the Ministry of Finance will adopt a new internal order centralising in the Revenue Service the issuance and ex-post control of EUR1 certificates of origin.

Action 8

Consistent with the commitments under the DCFTA, the Government or, where appropriate the Competition Agency, will adopt all normative secondary legislation foreseen in the Law on Competition adopted in March 2014.

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ANNEX II

MONITORING SYSTEM

During the implementation of the European Union macro-financial assistance, the following indicators and reports shall be provided to the Commission by the relevant authorities, on a quarterly basis.

1. Monitoring of macro-economic and financial developments and policies

a) Information submitted by the Ministry of Finance:

- GDP or national income (quarterly data)
- Main components of GDP (quarterly data)
- Employment and unemployment rates (annual data)
- Level and composition of general and central government revenue and expenditure as well as government payment arrears (quarterly data)
- Fiscal balance of the central government (quarterly data)
- Fiscal balance of the general government (annual data)
- External public debt, including external arrears (quarterly data)
- External public debt service payments (quarterly data)
- Domestic public debt and debt service (quarterly data)
- Consumer and producer prices (monthly data)
- Interest rates on benchmark government bonds at liquid maturities (monthly data)

b) Information submitted by the National Bank of Georgia

- Interbank interest rates at benchmark maturities (monthly data)
- Banks' overall lending rate (monthly data)
- Balance-of-payments and main components (quarterly data)
- International reserve position (monthly data)
- Nominal bilateral exchange rates against the euro and the USD (monthly data)

2. Monitoring of structural policies:

- Progress reports on reforms in the areas specified in Annex I (quarterly data)

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