ICRR 11389
Report Number : ICRR11389

ICR Review
Operations Evaluation Department

1. Project Data: Date Posted : 11/01/2002

		Appraisal	Actual
PROJ ID : P064094			
Project Name : Energy SECAC	Project Costs (US$M)	25	25
Country : Georgia	Loan/Credit (US$M)	25	25
Sector (s): Board: EMT - Power (39%), Oil and gas (32%), Central government administration (18%), Other social services (7%), Telecommunications (4%)	Cofinancing (US$M)		
L/C Number : C3266			
	Board Approval (FY)		99
Partners involved :	Closing Date	06/30/2000	03/01/2002

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2. Project Objectives and Components

a. Objectives

The credit objectives were, for the energy sector, to (1) maintain the momentum of reform; (2) help mitigate its social costs; (3) enhance financial management; (4) combat corruption; (5) increase energy availability on a sustainable basis; (6) catalyze private investment; (7) realize Georgia's pipeline transit potential; and (8) upgrade environmental management.

b. Components

A. Power Sector : Privatization of distribution and generation companies; adoption of electricity market rules and stakeholders' management of wholesale electricity market; maintaining cost -reflective tariffs; introducing budgetary compensation for electricity delivered to Abkhazia; increasing poverty benefits to poor single pensioners; B. Natural Gas Transmission and Distribution : Georgian National Energy Regulatory Commission (GNERC) to regulate domestic gas supply; GNERC to adopt transparent tariff methodology and license firms; pursue privatization of gas distribution and supply firms; C. Oil and Gas Exploration and Production : Adopt oil and gas law; separate government regulatory and commercial activities; D. Oil and Gas Transit Pipelines : Attract private investment; adopt eminent domain law; enact appropriate legislation and enact /ratify taxation and environmental agreements with other countries; adopt operational safety standards; E. Environment : adopt law on environmental liability; ratify international convention on marine oil pollution damage; amend privatization law to include environmental due diligence.

c. Comments on Project Cost, Financing and Dates

3. Achievement of Relevant Objectives:

(1) Maintain the momentum of reform ; The project was successful in this area: Telasi (the Tbilisi distribution company) was purchased by an American firm, AES, which also purchased several key generation units; electricity tariffs were increased substantially; several important laws were enacted and regulatory frameworks adopted .

(2) Mitigate the social costs of reform ; The project was successful in this area; a poverty benefits program was established for single pensioners and orphans to help them deal with increased electricity costs; the government paid accumulated arrears, actual budgetary expenditures reflected allocations, and poverty expenditures were current as of the ICR writing;

(3) Enhance financial management : Moderately Satisfactory: The project facilitated improvements in financial management in the part of the electricity sector owned by Telasi; collections improved, nonpaying customers were disconnected, and tariffs were increased . However, the financial performance of the remaining parts of the electricity sector worsened, as collections fell and the politically -motivated diversion of power (to mostly nonpaying customers) increased. After the sale of Telasi, efforts to sell most remaining distribution companies were unsuccessful (no offers were received). Establishment of the Wholesale Electricity Market (WEM) increased the transparency of transactions in this area.

(4) Combat corruption; Satisfactory: While corruption in Georgia remains rampant and is a major obstacle to economic development, with the entry of Telasi the project succeeded in introducing an actor that moved to reduce corruption within the ambit of its own control . So with the removal of significant elements of the power sector from government ownership, the project reduced the effects of corruption, which, however, remains a serious obstacle .

(5) Increase energy availability on a sustainable basis; The project was satisfactory in this area: Hard data are not available on energy availability, but anecdotal reports indicate that the winter supply of electricity --a key indicator of availability in the Georgian context --has improved (in areas served by Telasi), while availability elsewhere in the country (served by state-owned firms) has remained poor.

(6) Catalyze private investment; Satisfactory: The purchase of Telasi for US$ 250 million as well as additional AES investment in generation were significant; unfortunately, these investments were not followed by additional investment in the electricity sector, mainly because : the remaining assets were not as attractive as Telasi, AES did not have a positive experience in tis first years after investing, perceptions of Georgia as an investment destination became worse, and the international economic climate deteriorated . The Gardabani thermal generation

plant was
also sold (see section 4). Substantial investment was also made in pipeline assets (see next paragraph).
7) Realize Georgia's pipeline transit potential; The project was successful in this area: the so-called "early oil"
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pipeline from Baku to Supsa is operational, and in September, 2002, construction of the 1100 mile Baku-Tblisi-Ceyhan pipeline was started, which will transport oil from Azerbaijan to the Turkish port of Ceyhan . Also,
the South Caucasus Gas pipeline along roughly the same route is expected to be completed by 2005, earning
additional revenue or payment in kind . A law on eminent domain was adopted, and agreements were reached with
numerous foreign governments to avoid double taxation of pipeline transit fees .
(8) Upgrade environmental management : Goals in this area were achieved , including ratification of international
conventions on marine pollution damage, and enactment of a law governing liability for pollution damage .

4. Significant Outcomes/Impacts:

Telasi was sold to a foreign investor, thereby making Georgia the second FSU republic (after Kazakhstan) to sell an electricity company to a strategic investor

In 2000, the Gardabani thermal generation plant was sold to AES . The facility is the largest in the country, and had been responsible for incurring considerable government -backed debt in payment for fuel .

Ground was broken for the Baku -Tbilisi-Ceyhan pipeline, which could result in earnings of as much as US$ 42 million per year

The legal and regulatory framework for the energy sector was considerably enhanced

Electricity tariffs for Telasi customers increased substantially

5. Significant Shortcomings (including non-compliance with safeguard policies):

During the period of the ESAC, the financial position of the state -owned sector deteriorated.

6. Ratings :

	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Satisfactory	Satisfactory	
Institutional Dev .:	Modest	Modest	
Sustainability :	Likely	Likely	Sustainability is diminished by uncertainty over whether AES will remain in Georgia, and questions over commitment to reform stemming from parliament's 13-month delay in ratifying the Electricity Market Support Project (ESMP). However, the legal and regulatory framework is firmly anchored, the pipeline achievements will continue, and the payment of poverty benefits will likely continue to be kept current. Overall, the country's continued dependence on and involvement with International Lending Institutions enhance sustainability.
Bank Performance :	Highly Satisfactory	Highly Satisfactory	The project appropriately focused on privatization as the strategy which could have the greatest impact on the sector's enormous problems. Supervision was

quite effective in withholding disbursement of the second tranche until macroeconomic and poverty alleviation conditions had been fully met.

Borrower Perf .:	Satisfactory	Unsatisfactory	The government was helpful and positive in promoting privatization of energy sector assets (even if some privatizations were not achieved due in part to reasons beyond their control). However, the government--considered broadly to include state-owned entities and the parliament--did not maintain policies and conditions that supported achievement of project goals (especially the objective of "maintaining the momentum of reform"):

--Worsening performance of state -owned firms: During the time that sale of distribution companies was being attempted, their financial performance worsened; in effect, theft accelerated in contemplation of potential privatization .

--Politically-motivated diversion of electricity:
The state-owned dispatch organization diverted electricity to nonpaying customers for political reasons; this damaged the financial viability of the sector, and sometimes caused AES to impose rolling brownouts on its own paying customers

--Ineffective legal system: The length and uncertainty of court proceedings impeded AES from collecting funds due from customers; when AES discovered that some of its employees were involved with theft, it fired them, but was forced to rehire them on the order of a Georgian court .

--Uncertain commitment to reform:

The 13-month delay in the ratification of ESMP further diminished the interest of potential investors, who in any case were deterred by the poor investment climate, which was due in part to government policy.

Regional and local interests who benefited from continued public ownership of the remaining distribution companies impeded grouping them into potentially salable units.

--Predatory revenue collection agencies : The government tolerated a culture in which revenue collection agencies hindered the operation of private firms--including AES and the private firm managing WEM--by arbitrary demands for payment that were of dubious legality .

Quality of ICR : Satisfactory

NOTE:

NOTE ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

The key energy sector issue in many transition economies is how to manage and eventually eliminate the quasi-fiscal deficit

Energy privatization may be possible even under adverse circumstances (e.g., poor financial performance, high corruption, weak state capacity), although the outcome may include low privatization proceeds, higher tariffs, and worse performance of state -owned companies before and during privatization

Government support to private investors after privatization is critical, especially in helping to fight vested interests and corruption; this is a key element affecting the sustainability of privatization

Where government capacity is sufficient, it is desirable to improve energy company financial performance prior to privatization

If government capacity is low, a high level of coordination between ILIs is necessary to assure sufficient temporary financial support for energy firms to make them viable candidates for privatization

8. Assessment Recommended? Yes No

Why? PPAR is already underway. ESAC can best be considered in the context of the overall Georgian reform program.

9. Comments on Quality of ICR:

The ICR presents clear and cogent arguments . It is particularly effective in describing the project design and explaining why the approach chosen was considered as most likely to have a beneficial effect . The lessons learned are also excellent. The ICR should have stated that accurate data on the technical and financial performance of the energy sector are not generally available .