ICR Review
Operations Evaluation Department

Report Number : ICRR11524

1. Project Data:		Date Posted :	07/28/2003	
PROJ ID:	P052153		Appraisal	Actual
Project Name :	Sac 3	Project Costs (US$M)	60	60
Country:	Georgia	Loan/Credit (US$M)	60	60
Sector(s):	Board: EP - Central government administration (40%), General industry and trade sector (30%), Health (15%), Housing finance and real estate markets (10%), Other social services (5%)	Cofinancing (US$M)		
L/C Number:	C3265			
		Board Approval (FY)		99
Partners involved :		Closing Date	12/31/2000	10/30/2002

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2. Project Objectives and Components

a. Objectives

The credit had two overall objectives: (i) to support the implementation of GOG's reform program to reduce macro-economic imbalances and (ii) to provide an adequate incentive structure for private sector development (PSD). An important rationale for the credit was also to meet Georgia's urgent need for adjustment financing due to a weak public finance performance and the adverse impact of the crisis in Russia on Georgia's economy .

b. Components

For the first objective, the Credit supported measures to strengthen revenue administration and expenditure management. To mitigate the adverse impact of stabilization on the poor, the credit included conditions to ensure budgetary provisions for basic health care, education, and social protection . For the second objective, the credit supported measures to improve the quality of the business environment through enactment of laws, streamlining business procedures, promoting land and real estate markets, fostering private participation in infrastructure and facilitating hospital restructuring.

c. Comments on Project Cost, Financing and Dates

The Credit was expected to close by December 31, 2000, but, because of delays in meeting the tranche release conditions, the closing date was postponed three times . The three tranches were disbursed, the first one on effectiveness on August 2, 1999, based on measures adopted prior to Board presentation, the second one on December 26, 2001, and the third one on October 17, 2002.

3. Achievement of Relevant Objectives:

Although conditions for tranche release were met without amendment to the Credit Agreement, the objectives of the project were not fully met.

1) Although not subject to quantitative targets, the fiscal deficit was reduced in 2000 and 2001, and kept stable in 2002, while the current account deficit decreased substantially in 2000-02, compared to 1998. Board conditions for strengthening revenue administration were met: a decree was adopted for the reorganization of the Georgia State Tax Department; and monitoring systems and performance targets were established for management and technical staff. For strengthening expenditure management, decrees were adopted for reorganization of the Ministry of

Finance. While the share of health and education expenditures could not be maintained at 7 percent of consolidated budget for health and 13 percent of consolidated budget for education in 1999, these budgeted levels were reached in 2002. GOG was also current on payments of poverty benefits (mainly to poor single pensioners) in 2001 and 2002, and cleared arrears on these benefits for 1999 and 2000.

2) Under the second objective, (i) a number of laws were enacted (a new Licensing Law, a new Procurement Law, a Law on Fees, a Law on Accreditation for a number of professions, and a Law on Certification bringing technical regulations in compliance with WTO and EU standards and requirements); (ii) an institutional strengthening plan to conduct public procurement was adopted; (iii) land registration was carried out for 3,000 enterprises; (iv) the Law on Administration and Disposition of State-owned nonagricultural land was amended to stimulate the development of transactions in real estate and urban land and to diversify financial markets; the role of different entities in the sector was also clarified; (v) a strategy for the restructuring of the Poti Port was adopted and the process for granting a concession for two berths was initiated; and (vi) an offer for sale was made for the two telecom companies, but with no interest shown by investors. In addition, 244 non-infrastructure medium enterprises were sold through zero-price auctions; 16 out of 29 large industrial enterprises were sold, mostly through management buy-outs, and 8 liquidated; and 26 out of 31 were sold through auctions or liquidated. Finally the hospital sector was restructured according to a first phase implementation plan and a second phase was prepared.

4. Significant Outcomes/Impacts:

The main outcomes were: (i) the social sector budget was preserved; (ii) the MOF was reorganized with 10 percent downsizing of staff; (iii) an increasing share of Government contracts were competitively bid, although a small portion of GOG budget is contracted out; (iv) the number of business activities subject to licensing was reduced from 300 to 12; (v) the sale of land on which the plant is located to enterprise owners, led to a significant increase in investment and in improvement of the land by the owners and to the development of a secondary market in real estate; (vi) some 286 enterprises were sold; and (vii) operations and finances in the hospital sector were improved.

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

The impact of the credit in strengthening revenue administration and expenditure management was marginal. According to the ICR, during the period of the credit, total revenues as percent of GDP increased from 15.4 percent in 1999 to 16.2 percent in 2002. Of this, around half must be shared with local governments or on mandated social expenditures, leaving less than 8 percent for all other central government requirements including debt service. According to the recent PER, Georgia's tax revenue at 14.3 percent of GDP was the second lowest in the CIS and well below the average for the CIS of 21.6 percent of GDP. A more comprehensive tax reform lacked the support from parts of government and the Parliament. Expenditure management continued to be hindered by lack of cooperation and coordination in policy making among ministries. The ICR indicates in several sections that reforms formulated by the central ministries were often challenged and at times undermined by other ministries and/or agencies, or were negatively affected by the pervasiveness of corruption and lack of governance, or by the lack of cohesion between the Executive and Legislative. These findings are consistent with the conclusions of the May 2003 OED's PPAR on SAC I and SAC II and which were agreed to by the Ministry of Economy, Industry, and Trade (letter of Deputy Minister of 06/06/03 to OED). They also conform to the findings of the draft Country Financial Accountability Assessment (CFAA) report for Georgia with respect to four major critical areas of risk for GOG.

The impact of the credit's components on private sector development was negligible. There was a wide gap between the nominal adoption of laws and/or measures and their effective implementation and application in reality. The ICR correctly points out (section 4.1) that while an increasing number of government contracts were competitively bid, the impact was limited because only a very small share of government budget was contracted out. The number of activities subject to licensing were reduced but this did not prevent the emergence of licensing requirements outside the scope of law. The law was further revised in May 2002 but impact will depend on proper enforcement which is unlikely in the environment prevailing in Georgia and the experience from earlier years. The presidential elections and a high turnover of ministers and senior officials also had a negative impact on investment climate. Data on governance developed by the Bank which allow comparisons over time shows a deterioration in political stability, governance effectiveness, the rule of law, and control of corruption. According to the ICR, business surveys conducted in Georgia show that while direct regulatory burden may have been reduced, corruption has increased. Poti Port and the 2 largest telecom companies were not sold. The revenue to the State from the sale of public enterprises was meager because of the widespread use of zero-price auctions, and the large debts assumed by the purchasers. The outcome of divestitures on private sector development according to the ICR was negligible because of the poor investment climate.

The first phase of the hospital restructuring plan was implemented but the impact was again limited because a court decision rescinded the second phase of restructuring.

The credit had satisfactory impact on reform of land ownership.

The justification for SAC III was weak for two main reasons. First, the Government's track record for undertaking structural reforms needed to maintain macroeconomic stability was weak. The State tax department had not worked effectively despite its reorganization in 1995 and the establishment of a Large Tax Payer unit in 1996. The IMF maintained a shadow program until end- June 1999. Then during the SAC III implementation period, the macro performance did improve in 2001 but soon after the release of the third tranche and project closing in October 2002, the IMF in November 2002 reported slow implementation of reforms in some areas that are central to macroeconomic performance- tax policy and administration...." Second, it was questionable whether adjustment lending would be effective in the environment that prevailed and continues to prevail in Georgia with increasing fragmentation of political power, the government's inability to implement reforms because of tightly -connected interest groups that were sometimes aligned with the Parliament, and pervasive corruption. Servicing Georgia's external debt (with the Net Present Value of External Debt to exports estimated in end -1999 at 213 percent and to central government revenue at 688 percent), was not likely to be facilitated by additional concessional lending. This principle has been explicitly recognized by the international community and is the underlying rationale for debt forgiveness in many IDA countries. The absence of adjustment lending would have forced much needed governance and structural reforms to the forefront at an earlier stage.

The quality at entry was unsatisfactory for three reasons. First, in view of a lack of respect for laws and their inadequate enforcement, the Bank should have refrained from including conditionality that was directed primarily to passage of laws and decrees. For example, Board Presentation was based on 17 conditions, of which 13 entailed the establishment of committees, adoption of decrees, establishment of performance targets or monitoring mechanisms, enactment of laws, submission of laws, amendments of laws and agreements on a hospital restructuring program. SAC III conditionality should have focused much more on actual implementation and effective application of actions/measures taken. Second, despite serious revenue problems, conditionality with respect to strengthening revenue administration was confined to conditions for Board presentation; adopting a reorganization decree for the State Tax Department and establishing job descriptions and performance monitoring systems for management and technical staff of the tax department. As mentioned above, the state tax department had not worked effectively despite been reorganized in 1995. The release of the second and third tranches should have been conditioned on additional measures to address revenue issues. Third, despite serious problems of budget execution, conditionality on expenditure shares for health and education referred to allocations and not to actuals. Key ESW had not been undertaken prior to SAC III; the PER was completed only in 2002.

Quality of supervision improved from June 2001 about 2 years after project effectiveness. There were 3 task managers during the life of the project. Budget execution rates and implementation of performance monitoring systems for management and technical staff of the State Tax Department were not reported in project supervision reports (PSRs), but according to the region, "actual expenditures in the social sectors were monitored regularly and reported in the annexes of the supervision reports and the revenue policy and administration issues were being addressed by the Bank staff through the PER work."

In response to the ES, Ms. D-M Dowsett-Coirolo, the country director for Georgia notes that the "The ECA Region finds OED's ratings of Credit Outcome and Bank Performance excessively negative. Despite a hiatus in implementation during 1999/2000, SAC III contributed to a number of important achievements in Georgia, including : substantial improvements in most macro indicators (e.g., growth,inflation, fiscal deficit and debt); protection of critical social expenditures, which was quite important after the Russian financial crisis of 1998-99; and improvements in the business climate, especially in the areas covered by the credit, as evidenced by the results of the 2002 WB/EBRDBEEPS survey and discussed in the *2003 EBRD Transition Report.* With hindsight, as acknowledged in the ICR, some elements of SAC III design could have been stronger. However, at the time of SAC III approval, the available evidence on borrower performance, including OED evaluations of SAC I and SAC II, was quite positive."

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Unsatisfactory	See Sections 3 and 5 above.
Institutional Dev .:	Modest	Modest	
Sustainability :	Unlikely	Unlikely	
Bank Performance :	Satisfactory	Unsatisfactory	See section 5
Borrower Perf .:	Satisfactory	Unsatisfactory	Implementation was negatively affected by ministries and/or agencies, vested interests, corruption and very poor governance. In fact, implementation "muddled through" three postponements of the closing date over 22 months.

Quality of ICR :		Satisfactory	

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

7. Lessons of Broad Applicability:

In countries of high political instability, widespread corruption, and poor governance, preparation and appraisal should pay particular attention to completing sound diagnostic work, past lessons and actual results achieved on the ground. This includes assessing the relevance of the objectives sought given the actual country context at the time . In addition, "safeguards" should be put in place in the form of a limited and clear-cut agenda, realistic implementation scheduling, applicability of reform measures, strict monitoring of benchmarks verified by frequent and tight supervision missions, and realistic assessment of risks .

Preparation/appraisal teams should make realistic estimates of the time required to adopt /amend legislation.

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

Although the ICR is of satisfactory quality and provides information on credit implementation, Annex 1 simply reproduces the matrix of the President's Report. To be useful, when assessing performance, such an annex should contain an additional column showing, to the extent possible, how and when each condition for tranche release was met. The ICR should have reported on actual expenditures on health and education since this information was available as part of the work on the PER.