



Economic Policy Research Center

ეკონომიკური პოლიტიკის კვლევის ცენტრი

«Monitoring of Millennium Challenge Program»

II Stage Report



The Project is implemented with support of the "Open Society Georgia Foundation"



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Abbreviations and terms used in the text

MCG	Millennium Challenge Georgia Fund
MCC	Millennium Challenge Corporation, USA
EPRC	Economic Policy Research Center
OSGF	Open Society Georgia Foundation
Compact	Grant agreement between government of the U.S.A. and government of Georgia in the framework of the Millennium Challenge program.
Monitoring/working group	Representatives of Economic Policy Research Centre and Open Society Georgia Foundation
IRR	Internal Rate of Return
ERR	Economic Rate of Return
GIGC	Georgian International Gas Corporation

Foreword

2006 Economic Policy Research Center (EPRC) in cooperation with Open Society Georgia Foundation (OSGF) has been implementing a project "Monitoring of Millennium Challenge Program" since January 2006. The project is implemented with the assistance of Open Society Georgia Foundation within the scope of Coalition for Transparency of Public Finances¹. Main activities under the project (information gathering, conducting analysis, report writing etc.) are carried out by the Economic Policy Research Center. The Coalition takes an active part in the project implementation as well. The report is actively discussed and reviewed by the coalition board before it is published.

Considering that the Millennium Challenge Program (hereinafter Program) funded by US Government represents a significant financial source for Georgia's economic development, the coalition "for Transparency of Public Finances" decided to monitor the activities carried out under the Program and check the effectiveness of the Program implementation process.

The present report is prepared on the basis of the data collected from January 2007 until August 2007; the report describes the second stage of the monitoring process. The document analyzes activities carried out under Millennium Challenge Program in 2006 in terms of its relations with the State Budget; the present report also analyzes the whole program year from April 2006 to March 31, 2007; besides, the report describes the part of the second program year – 5 months from April 2007 to August 2007.

Before its publishing this monitoring report was submitted to the Millennium Challenge Georgia Fund (hereinafter MCG) for comments and suggestions, which demonstrates the desire of the Coalition to collaborate effectively with MCG. MCG representatives submitted their written comments on the report, they outlined the viewpoints expressed in the report that MCG management team doesn't agree with. The monitoring/working group² took into account some of the suggestions received from MCG management team, which was correspondingly reflected in the report. However, there were some essential issues that the monitoring group didn't change in the report.

Introduction

The US Government rendered Georgia unprecedented assistance by allocating 295.3 million US dollars to Georgia under Millennium Challenge Program. During the five years two main sectors are planned to be financed from the aforementioned amount: Regional Infrastructure Rehabilitation and Enterprise Development in Regions. The Regional Infrastructure Rehabilitation component is divided into three main activities:

1. Samtskhe-Javakheti Road Rehabilitation Activity (\$102.2 million)
2. Energy Infrastructure Rehabilitation Activity (\$49.5 million)
3. Regional Infrastructure Development (\$60 million)

The Enterprise Development component includes the following activities:

1. Georgian Regional Development Fund (\$ 32.5 million)
2. Agribusiness Development Activity (\$15 million)

Implementation of a wide scale monitoring process and research activities was necessary due to the wide scale of Millennium Challenge initiative itself. As the proper monitoring of all the directions of the compact, signed between the Georgian Government and United States of America requires a lot of resources and as the Millennium Challenge Grant is going to be disbursed in several installments, the Coalition "for Transparency of Public Finances" decided to conduct the monitoring project in several stages. The first monitoring report, published in December 2006, analyzed the following issues: macroeconomic issues concerning Millennium Challenge Program, transparency of

¹ The coalition member organizations are the following: Open Society Georgia Foundation, Economic Policy Research Center, Georgian Young Lawyers' Association, Young Economists' Association of Georgia and Transparency International Georgia.

information and problems concerning that the information disclosure policy, civic participation issues, implementation of Samtskhe-Javakheti Roads Rehabilitation project, monitoring of activities conducted under Regional Infrastructure Development program, monitoring of the fulfilling of the obligations assumed by the Georgian government in connection with rehabilitation of the main gas pipeline and monitoring of the reports on expenditure of amounts from the State Budget and Millennium Challenge grant.

This monitoring report is prepared on the second stage of the project implementation and includes the following main objectives:

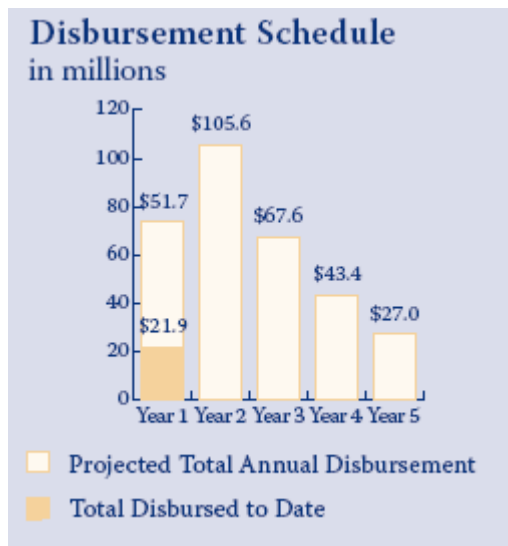
1. Monitoring of the expenditure of the amounts allocated for Georgia under the Millennium Challenge Program in order to evaluate the adequate and transparent spending of those sums;
2. Monitoring of the expenditure of the amounts allocated for Samtskhe-Javakheti Roads Rehabilitation project in order to evaluate the proper expenditure of those sums and transparency of the bidding process;
3. Monitoring of the expenditure of the amounts allocated for Regional Infrastructure Rehabilitation project in order to evaluate the proper and transparent expenditure of those sums, transparency of bidding processes and the way the obligations assumed under the contract were fulfilled;
4. Monitoring of the Main Gas Pipeline Rehabilitation project – in order to evaluate the way obligations assumed by Georgian government under the compact were fulfilled and how properly and transparently the amounts were expended as well as how transparent the bidding processes were;
5. Evaluation of macroeconomic impact and expected economic changes. Analysis of macroeconomic issues concerning the Millennium Challenge Program;
6. Besides, the project aims at informing the Georgian authorities, local government and self-government bodies, media, civil society at large and international donor organizations about the collected data and conclusions made as a result of the analysis. That will guarantee the transparency of the whole process as much as it's possible.

1. Millennium Challenge Program Funds

Millennium Challenge Compact between the United States of America (acting through Millennium Challenge Corporation) and Georgian government was signed on September 12, 2005, the compact entered into force in April 2006.

According to the compact, \$295.3 million was allocated for Georgia, that has to be spent during five years from 2006 till 2011.

The official documents of Millennium Challenge Corporation (MCC) indicate scales of the aforementioned sum spending during each year; the following table indicates parts and shares of the above-mentioned sum according to each year:



Source: Millennium Challenge Corporation (MCC)

The above-mentioned schedule indicates that during the first year of the project Georgia received only \$21.9 million from MCC (only 42% of preliminary defined amount), correspondingly, the amounts allocated under compact for the first year had to be modified and the above-mentioned dates were violated. This will have a similar effect on the activities that have to be conducted in the following years as the corresponding changes will have to be made in the initial design.

However, as the detailed analysis of the reporting period indicates, failure to meet the deadlines was not the only problem. There were problems not only with timely allocation of the monetary resources, but also with timely expenditure of the amounts and their timely inclusion in the State Budget.

1.1 State Budget and Millennium Challenge Grant Sums – 2006-2007

Compact requires that the Government of Georgia take all necessary steps in order to fully reflect the long-term grant sums in the State Budget of Georgia (Article 2, Financing and Resources, part 2.2 Government Resources, paragraph c). According to the same article, the State Budget of Georgia must fully reflect the projects for which the sums allocated under Millennium Challenge Program have to be spent. It should be noted that 32,340.7 million GEL included in the 2006 Law on Georgian State Budget for the implementation of Millennium Challenge Georgia's programs (**24,655 million GEL of which was a grant and 7,684.9 million GEL of which was budget resources**) and the correspondence of that sum with the financial data of other official sources clearly indicates whether that requirement was met or not in the 2006 State Budget of Georgia.

Despite the assumed obligations the 2006 Law on State Budget didn't describe in detail the categories for which the amounts received from Millennium Challenge Corporation would be expended, this is an indication of ineffective work of both the management of the Millennium Challenge Georgia and the Ministry of Finance of Georgia.

At the same time the Ministry of Finance's data and the data published by Millennium Challenge Georgia contradict each other. According to Executive Director of the MCG - based on his May 14, 2007 official letter - by December 31, 2006, \$21,881 million was received from Millennium Challenge Corporation, which is \$8 million more (60% more) than the amount indicated in the State Budget of Georgia (24,655 million GEL – about \$13,8 million). See the table #1.

Table #1:

	Amounts received from the Corporation by December 31, 2006	Amounts disbursed by Millennium Challenge Georgia by December 31, 2006
Road rehabilitation	\$ 556 200,00	\$ 0,00
Regional Infrastructure Development	\$106 000,00	\$106 000,00
World Bank Service	\$106 000,00	\$106 000,00
Regional rehabilitation	\$16 042 811,00	\$4 840 339,00
Georgian Oil and Gas Corporation service	\$705 911,00	\$631 000,00
Pipes	\$4 749 800,00	\$3 785 802,00
Minor works (Gldanula, corrosions 194 km)	\$1 224 500,00	\$0,00
Major works (Naniani, Zootikaantkari, Arkala)	\$8 359 000,00	\$397 050,00
Land compensation	\$93 600,00	\$26 487,00
Project Management Consultant and Environment Impact Consultant	\$900 000,00	\$0,00
Georgian Regional Development Fund	\$317 600,00	\$12 450,00
Loan investments	\$180 100,00	\$0,00
Management company	\$75 000,00	\$0,00
Foundation's expenses	\$62 500,00	\$12 450,00
Agribusiness Development Activity	\$1 309 902,00	\$659 861,00
The Project management company	\$857 900,00	\$659 861,00
Enterprise Initiative	\$430 502,00	\$0,00
Regional consultations	\$21 500,00	\$0,00
Monitoring and evaluation	\$105 924,00	\$63 270,00
Administering the program	\$2 943 153,00	\$2 336 577,00
Working capital	\$500 000,00	\$0,00
	\$21 881 590,00	\$8 018 497,00

*Sums disbursed in energy sector include the letter of credit in the amount of \$2,849,895.

Source: Millennium Challenge Georgia Fund (MCG)

The same can be said about the 2007 State Budget, that is evident in the 2007 Law on State Budget, which has been amended three times already (including the corrections made to the funding of Millennium Challenge Program).

When the 2007 State Budget was being approved 125,190 million GEL was to be expended on the Millennium Challenge Program, including 106,480 million GEL grant.

It's noteworthy that the minutes of the meeting held by Supervisory Board of Millennium Challenge Georgia indicated that MCG was not going to expend the amounts indicated in the State Budget of Georgia this year. According to the minutes of April 6, 2007 meeting of the Supervisory Board MCG was going to spend 93 million GEL by the end of the year, which is much less than the amounts indicated in the State Budget (125,190 million GEL, 106.5 million GEL of which is the grant received from Millennium Challenge Corporation).

Besides, the minutes of one of the recent meetings held by the Supervisory Board of the MCG on May 29, 2007 indicates that the Ministry of Finance of Georgia and MCG didn't coordinate their activities during the year in terms of defining the amounts of sums to be expended and coordinating these parameters. During that meeting Georgian Minister of Finance noted that the amount allocated in the State Budget for Millennium Challenge Georgia was much higher than the sum the Fund actually needed to expend during the current year.

Even more interesting are the changes that were made in 2007 State Budget before September 2007. In June the Parliament approved the Budget amendments according to which, instead of 106.7 million GEL grant for Millennium Challenge Program only 73,796 million GEL was allocated for

the Program. In September 2007 new draft amendments to the State Budget were sent to the Parliament according to which 37,404 million GEL was allocated for the Millennium Challenge Program. That means the expenditure of amounts allocated under Millennium Challenge Program is impeded, correspondingly, budget changes are required. The size of changes is also noteworthy: in comparison with the initially planned amounts the sums allocated for the Millennium Challenge Program are decreased almost 2.5 times, which on the one hand denotes the problems with planning and on the other the inability of the MCG management team to effectively plan and implement the projects and therefore fully use the allocated amounts.

That fact confirms our assumptions indicated in the previous monitoring report that uncoordinated actions of the relevant Georgian agencies and delays in the activities impede a proper and timely implementation of the projects under the Millennium Challenge Program.

1.2 Received amount (transfers) from Millennium Challenge Corporation

According to the compact, the amounts are allocated by Millennium Challenge Corporation based on the joint request of Georgian Government and Millennium Challenge Georgia Fund (appendix I-4. Finances and Fiscal Accountability, paragraph (b) Disbursement and Re-Disbursement).

Based on such requests the amounts were transferred three times during 2006: in the second, third and fourth quarters of 2006.

MCG requested and received \$3.6 million by first amount (that amount was intended for the activities that were to be carried out from April 1 through June 30), the second time the Fund requested and received \$6.5 million (July 1 – September 30), the third time the Fund requested and received \$11.8 million (October 1 – December 31).

It's noteworthy that Millennium Challenge Georgia planned the parameters of the State Budget based on the above-mentioned transfers.

As we have already mentioned, according to the compact, the annual budget was to be \$51.7 million in 2006. Besides requesting \$3.6 million as the first transfer, Millennium Challenge Georgia allotted only \$35 million for the first year's Budget of the program (indicated in the compact) instead of the already mentioned \$51.7 million; the same thing happened when the following two transfers were received: after receiving the second transfer (\$6.5 million) the amount allotted for the whole year changed once again and amounted to only \$44.1 million, after receiving the third transfer (\$11.8 million) the sum allotted for the whole year was modified one more time and amounted to \$41.2 million (see table #3).

Table #3: Four Modifications of the First Year of Millennium Challenge Georgia's Long-term Financial Plan

	April-June 2006 version	June- August 2006 version	September- December 2006 version	January- March 2007 version
Categories	Program Year (PY) 1	PY1	PY1	PY1
Roads Rehabilitation Project	12059,0	12214,8	11264,8	0,0
Regional Infrastructure Development project	1355	1355	759,6	271,7
Energy Sector Rehabilitation project	9971,7	18935	17884,9	6371,5
Agribusiness Development project	2687,9	2688	3196	1310,4
Regional Development project	3113,1	3113,1	3060	370,1
Monitoring and evaluation	998,1	998,1	290,2	129,1

Administering and control of the program Second 609 grant	4807,7	4807,7	4724,8	3828,7
Total	34992,5	44111,7	41180,3	12281,5

Source: Millennium Challenge Georgia Fund

The fact that the Budget was changed every quarter indicates that expenses were poorly planned and funded with delays. At the same time, the fact that Millennium Challenge Georgia used different figures in different quarters demonstrates that the proper analysis of the budget, realistic evaluation of needs and requirements and requesting the corresponding amounts didn't take place.

We believe that changes in the plan are acceptable to certain extent, but requesting only 42% of the amount allocated for the first year of the program and expending only \$8,019,497 million out of that sum cannot be considered an unavoidable deviation from the plan. Any financial plan is based on certain assumptions and approximations. Even a difference of 20% between the planned and actually expended amounts is acceptable, but if the actually expended amounts differ from the planned sums by more than 20% then one can assume that the initial calculations were wrong. That assumption seems more plausible when considering the four changes made to the budget of the compact, but none of those changes enabled the MCG to observe the initially intended parameters. It's noteworthy that previously, several investment and infrastructural projects were successfully financed in Georgia through the Georgian Government and donor funding, one of the reasons for their success was meeting the deadlines. We believe that the differences between the plans and actual implementation process in future may become alarming. We think that such deviations from the plans can decrease the effectiveness of the activities and cause essential material losses.

The imbalance between the requested and transferred amounts will most probably exist in 2007 as well, which is confirmed by the official letter from Millennium Challenge Corporation. Millennium Challenge Georgia Fund requested \$4,739 million for the expenses of the first quarter of 2007; however, only \$3,655 million was transferred.

According to the official letter from Operations Vice-President of Millennium Challenge Corporation John Hiuko dated March 23, 2007, he believed that implementation of the Roads Rehabilitation activity in the indicated period of time was impossible; therefore MCG received \$1,084 million less than requested.

The fact that there are problems with spending the transferred amounts is confirmed also by the following circumstance: by March 31, 2007 MCG had \$13,766 million which was transferred but not expended. That means that from April 1, 2006 till April 1, 2007 only 46% of the transferred \$25,536 million (\$21,881 million transferred during the last three quarters of 2006 plus \$3,655 million transferred in the first quarter of 2007) was actually expended for the planned activities. The fact that the expenditure of the amounts in relation with the whole year's budget is even smaller than the previous year is one more indication of the existing problems. That last circumstance indicates the insufficient funding of the planned activities within the preliminary established time frames.

Such developments had to be ruled out from the very beginning through the agreement that was made between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia Fund. According to "b" paragraph of part 1.2 of April 7, 2006 Disbursement Agreement: "if not otherwise agreed between the parties in the written form, no financial obligations can be assumed in connection with Millennium Challenge Corporation funding, no financial obligations must be assumed on behalf of Millennium Challenge Corporation, no payments shall be made from the amounts allocated by Corporation or payment requests made in connection with activities or expenses to the Corporation if the expenses are not included in the detailed financial plan and if there are free resources indicated in the accounting report of the detailed financial plan for the corresponding period".

Because of the presence of the unexpended sums accumulated on the accounts of MCG from the previous quarters, there is no request for sums in the official documentation concerning the

expenses for the first quarter of 2007 program year, because, first of all, the above-mentioned amounts have to be spent.

It's noteworthy that according to the comments submitted by the management team of Millennium Challenge Georgia Fund, Millennium Challenge Corporation doesn't consider such permanent modifications a violation. However, the monitoring group believes that despite the fact that Millennium Challenge Corporation and Millennium Challenge Georgia may not consider the permanent modifications a violation the ultimate beneficiaries of the project, in other words Georgian population suffers from the delays in the activities. We'll discuss that issue in much more details in the following chapters.

1.3 Expenses

As we have already mentioned Millennium Challenge Georgia decided that \$41.2 million had to be spent for the Program activities in the first program year. However, one more change was made in the final quarter of the first program year (January-April 2007) and for some reason \$12,281.5 million was named as the budget for the first program year.

However, as the aforementioned May 14, 2007 official letter from Executive Director of Millennium Challenge Georgia indicates, that in reality only \$8 million was expended by December 31, 2006 (see table #2).

Expenses incurred by Millennium Challenge Georgia

According to Millennium Challenge Georgia, the biggest share from the actually expended \$8 million was directed to finance the Energy Rehabilitation project (\$4.84 million or 60% of all expenditures).

However, the biggest amount from the \$8 million (\$3,785 million) was allocated for one activity – procurement of 5 kilometer long pipes from Azerbaijani company "KHAZARDENIZNEFTEGAZTIKINTI" necessary for repairing North-South Main Gas Pipeline under Energy Rehabilitation project.

The second biggest amount from the expended \$8 million was allotted for the program administration, by December 31, 2006 program administration received 2,236 million (28% of all expenses).

The rest of the expenses were actually symbolic:

Roads Rehabilitation project: according to the plan \$556 thousand had to be expended, but nothing was actually spent on that sector.

Energy Infrastructure Rehabilitation: As we have already mentioned, the biggest share from the \$8 million was spent on that sector (\$4.84 million); however, it's a little more than a quarter of what was initially planned (\$16 million);

Georgia Regional Development Fund: instead of planned \$318 thousand, only \$12 thousand was actually spent (3.8%);

Agribusiness Development: only \$660 thousand was spent out of the \$1.3 million, which was transferred for that sector.

Even as far as **administrative cost** category is a subject of concern, according to fiscal agent Ernst & Young (accrual basis accounting), even more – 2.889 million was spent for that category; however, the share of that budgeted category in the general expenses (\$12,733 million) is not more than 23%.

As for fiscal agent GFA Consulting Group's conclusion (cash basis accounting), last year \$5,518 million was spent in total, the administration costs were even higher – more than 45% (\$2.33 million).

1.4. Conclusions

Deadlines

The analysis of the past period indicates that funding of the activities under MCG is seriously delayed. That may cause the serious changes in the quarterly or annual plans as well as the whole 5 year design.

We would like to present a table where one can clearly see how seriously the pre-planned dates and cash flow schedules are violated and how big is the difference between the schedule approved by Millennium Challenge Corporation and the project implementation schedules modified by Millennium Challenge Georgia during the year:

Table #4: Distribution of Sums be Millennium Challenge Corporation and Millennium Challenge Georgia Fund According to each Year (2006-2010³):

Year	Millennium Challenge Corporation	Millennium Challenge Georgia Fund
2006	51,7	12,3
2007	105,6	69,9
2008	67,6	99,6
2009	43,4	74,0
2010	27,0	38,9

Units are shown in US dollars

It's evident that the inability to observe the schedule in the first year requires the modification of the whole project's design. According to Millennium Challenge compact, the current 2007 had to be the most active year out of the 5 year plan and it should have guaranteed much rapid development of certain parts of Georgian economy.

Based on Millennium Challenge Georgia Fund's suggestion the main bulk of activities has been moved to 2008-2009, which means the deadlines for the projects will be moved too and that may become the precondition for decreasing the effectiveness of the whole Program.

That danger is even more real if we take into consideration the fact that MCG has quite significant amounts accumulated on its accounts, which are being expended very slowly.

Relations with Budget and Transparency issues

Both 2006 and 2007 State Budgets indicate that the amounts allocated by Millennium Challenge Corporation were not fully reflected and described in detail, which is a direct violation of the compact conditions; because the conditions of the compact state that the State Budget must fully and thoroughly reflect the amounts and destination of the resources allocated by Millennium Challenge Corporation. The aforementioned condition is one of the main and mandatory preconditions for validity of the compact; therefore its violation may cause the suspension of the whole project.

According to the compact, lack of transparency and insufficient reflection of the transferred amounts in the State Budget may become a basis for termination of money transfers.

Accountability and Transparency

There are several serious preconditions for the lack of proper accountability and transparency. First of all we must note the permanent amendments made to budget and changes in the project implementation dates, which complicates proper monitoring.

³ 2010 includes the first quarter of 2011 as Millennium Challenge Agreement (compact) was signed by United States of America (acting through Millennium Challenge Corporation) and Georgian government on September 12, 2005, the compact entered into force in April 2006 therefore the compact shall be valid till April 2011.

We'd like to explain one more time why we believe that the significant difference between the plan and actual reality as well as constant changes in plans is dangerous.

If Millennium Challenge Georgia Fund considered and considers the significant difference between plans and actual reality acceptable in the first few years of the Program then it was possible to use the first several years only for planning activities and the rest of the time could be used for implementing the actual projects.

As the activities carried out by Millennium Challenge Georgia are directed at poverty reduction in the country and if the activities planned for this or that year are not carried out we presume that the conditions of direct and indirect beneficiaries in the aforementioned period will not improve, moreover, they may even worsen. For example if, let's say, in 2007 employment programs were supposed to be supported, but it didn't happen so how can we say that the implementation of Program goals was not open to question? We believe that the current conditions of potential beneficiaries may even worsen in terms of employment and incomes. If that's the case and the poverty level increases or even remains unchanged isn't it going to take a lot more to solve their problems in future?

According to the management team of Millennium Challenge Georgia, the country is going to receive the sums indicated in the compact anyway, whether the program is implemented year by year or the main bulk of the resources under MCG are expended in the last year of the Program.

We'd like to point out that a special methodology has been worked out in order to evaluate any program's effectiveness, which implies the elaboration of Internal Rate of Return (IRR) and Economic Rate of Return (ERR) parameters. These two parameters are necessary for evaluating the profitability of any long-term project. We maintain that moving the project activities (correspondingly, the expenses and benefits) to a later date will decrease the real benefit for the beneficiaries. For example let's say that during a three year project the annual income should amount to \$1000 and annual expenses should be \$ 500. That means the net profit every year should be \$ 500. Let's say the discount rate is 10%, in that case if hypothetical project is evenly implemented during each year the real net profit under current conditions shall amount to \$1245.5. If in the first year of the project the net profit amounts to zero, the next year it will be \$ 500 and the third year the net profit will amount to \$1000, in that case the total net profit will be \$1169. One can clearly see that the loss is quite significant. Therefore, we believe that the more long-term and complex is a project the bigger losses there will be due to the delayed and postponed activities.

Besides, we must take into account some practical and very important circumstances:

1. Gradual fall of the US dollar exchange rate, which of course decreases the real resources of the compact budget, especially if the activities are postponed. This will create problems in procurement if the procurement is done in hard currency.
2. Inflation rates in the country and abroad, which will surely make the activities more expensive. The longer the implementation process is delayed the harder the planning will be because if, for example, the activities that need to be conducted now are postponed then the inflation prognosis must be done for later periods of time, which will surely increase risks.
3. Changes in macroeconomic parameters, both internal and external changes, which will influence the IRR and ERR parameters.

Besides, one can also add lots of difficulties that exist nowadays as well as macroeconomic and microeconomic issues. We still maintain that receiving profit as soon as possible is essential for any project which budget is planned for several years ahead. In Millennium Challenge Program's case this is possible only through timely funding of activities under the Millennium Challenge Program and quick implementation of all planned projects.

2. Monitoring of Procurement

2.1. Accessibility of Information on Procurement

Based on the last year's successful monitoring experience, the collaboration between Economic Policy Research Center and Millennium Challenge Georgia Fund in 2007 was relatively more active. The first meeting between the representatives of Economic Policy Research Center and Millennium Challenge Georgia Fund took place on January 24, where the cooperation details were coordinated. Besides the data published on the website, the Fund gave us the initial data on February 22. Fund continued to supply Economic Policy Research Center with certain pieces of information based on the letter of inquiry; however, Economic Policy Research Center still encountered certain problems with accessibility of information. In particular: we failed to receive systematized and full procurement plans and procurement reports done in accordance with the format established by Millennium Challenge Corporation (see forms at www.mcc.gov). (MCG sent us the report on four quarters of the first program year on July 18).

The insufficient data complicated the full monitoring. However, we managed to single out several problems in the interim report and work out adequate recommendations.

2.2 Procurement Planning

During the monitoring period certain flaws in the procurement planning were revealed, in particular: according to the Procurement Agreement between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia, which is a guiding document for MCG during the procurement processes: "the procurement needs for 6 months needs to be defined (the period of 6 months starts when the procurement plans take effect)". In other words that obligation means that the detailed procurement plan must be drawn up in every 6 months.

The analysis done during the first stage showed that the above-mentioned obligations included in the Agreement on Procurement between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia were insufficiently fulfilled during 2006 and the first quarter of 2007 – according to the existing materials, the dates of publication and implementation of the 6 month plans were not indicated clearly – the plans indicated only the goods and/or services that needed to be procured as well as the procurement methods and costs as required by the Agreement on Procurement.

The plan published in July 2006 is identical to the plan published on October 6. The plan published on February 16, 2007 includes the list of previous 6 month procurement plans and the following items: computer equipment and furniture; services by individual environment consultant; selective and experienced design, polygraphic, creative services for public relations activities; method of technical-economic study of the main irrigation channels was changed; selection method based on quality and prices was replaced with the method based on consultant's experience.

It's interesting that none of the 6 month plans indicated the "starting point" and implementation dates, the procurement plans failed to indicate which procurement processes were finished and which were ongoing, it all complicated the monitoring process. Besides, the organizations that took part in the procurement process didn't know what the Fund was actually planning to procure during the next 6 months; therefore they had problems in planning their future activities.

After analyzing the data published on the Millennium Challenge Georgia Fund's website (www.mcg.ge) Economic Policy Research Center sent the MCG a written inquiry on March 21, 2007 requesting additional information from MCG. We asked for the procurement plans that needed to be made under Agreement on Procurement between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia, in other words we wanted to receive the 6 month procurement plans in which the starting point of each plan would be indicated. The 6 month procurement plans published on the website of Millennium Challenge Georgia Fund do not indicate the date from which the plans were supposed to be implemented. Therefore, it's unclear when the modifications were made in them or whether such modifications were made at all or whether Millennium Challenge Corporation sanctioned them as required by the Agreement.

According to management team of MCG, the recommendation was partly taken into consideration: the already finished procurement processes were not included in the August 2007 plan. However, the plan still fails to indicate the preliminary or in other words "presumed dates".

We must note that the flaws existing in the planning are evidenced not only by the absence of a plan as such (or lack of its transparency) but also by the following factors:

One more flaw in the planning procedures is evidenced by one of the first procurements made by the Fund: selection of the bank. Millennium Challenge Georgia carried out the selection of banks as an implementing body. The selection of a local commercial bank was one of the preconditions for validity of the compact. Therefore, the bank was selected in 2005. However, the contract with that bank was made only on March 30, 2007. One of the reasons of such a delay was the problems with selecting a fiscal agent – the competition for selection of the fiscal agent was announced in summer 2006; selection of the fiscal agent was done after 8 months the bank was selected, the contract with the fiscal agent was made 13 months later – on December 22, 2006 (published on January 5, 2007).

MCG management team believes that this comment is not valid enough as the commercial bank, fiscal and procurement agents were selected during the initial stages of the program implementation: "However, through no fault of MCG the selected fiscal agent refused to fulfill its obligations under the agreement and correspondingly, MCG was forced to conduct the procurement process once again". It's evident that the failure to keep the fiscal agent can't be viewed as a sign of successful activities of MCG management.

There were certain problems with planning the Samtskhe-Javakheti Roads Rehabilitation Project and Energy Rehabilitation project as well, which we'll discuss below.

2.3 Transparency of Procurement Process

Procurement Agreement between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia defines the media outlets where the procurement plans and procurement announcements must be published, in particular the compact reads that: "after receiving a written consent on the procurement plan the Fund shall publish information on the activities planned under the approved procurement plans at least once in 6 months. The published procurement plan must contain corresponding message about the planned procurement activities, the proposal on procurement must be published on the MCG website, DJ-market website www.dgmarket.com and UN business online website www.devbusiness.com, the procurement plans must be published in daily popular newspapers and other media outlets based on the periodic requests from the Corporation..."

The above-mentioned requirement of the agreement was fulfilled by the Fund and that made the information on procurement really accessible for public. However, in some cases, the Fund refrained from publishing the aforementioned information in "other media outlets", which caused the complication of the process, violation of procurement dates and delayed commencement of certain activities in some cases: for example, the quarterly report for the Millennium Challenge Corporation (reporting period: July 1, 2006 – September 30, 2006) reads that: "the main obstacle during the selection of the manager of the Fund was the fact that not many organizations that had the experience in fund management responded to the announcements made by Millennium Challenge Georgia Fund on UNDB and DJ-market websites. In order to guarantee the high level of competition the period for proposal submission was extended for one more month and the request for proposals was published in "The Economist" magazine. As a result, the number of interested organizations increased from 11 to 20 and the level of the competition was improved". According to the report, the publication of the additional announcements required some time, which hindered the work of Regional Development Fund.

Therefore, we believe that when we speak about inviting international experts or conducting international biddings, besides using the aforementioned media outlets, it's highly desirable to resort to other media outlets. The above-mentioned example indicates that publication of the announcement in "The Economist" magazine increased the interest almost twice.

2.4 Procurement Reports

Besides the procurement transactions carried out in 2005, as far as EPRC is aware 34 procurement transactions have been carried out since the compact took effect (from April 7, 2006 till December 31, 2006).

Procurement Agreement made between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia stipulates that: "MCG shall deliver or cause the delivery of quarterly reports to MCG of all procurement actions in the most recent completed quarter, including written explanations of any variance from the Procurement Plan for that period". (Section 2.5. reports)

As we have already noted, thanks to the experience received during the last year's monitoring process the interaction between Economic Policy Research Center and Millennium Challenge Georgia Fund was quite active. MCG supplied Economic Policy Research Center with report on the past four quarters on July 18, 2007; the report was made according to the format requested by Millennium Challenge Corporation. Besides, the procurement report published on Millennium Challenge Georgia's website includes information on the procurement form, cost and contract period.

2.5 Procurement Methods

Procurement methods that Millennium Challenge Georgia can use are indicated in the Procurement Agreement made between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia. The procurement of goods and services was carried out by MCG according to the following methods: (local and international) bidding, limited bidding, individual negotiations (direct contracts), quotations, quality-based selection, experience-based selection, quality and price-based selection, selection according to fixed budget, selection on the basis of the least offered price, individual consultant.

It's true that the "individual negotiations" method is not often used, but one major procurement transaction was carried out using that method, for example:

Georgian International Gas Corporation (GIGC) was selected as a management consultant of North-South Gas Pipeline Rehabilitation Project. The contract for \$1,145,631.44 was made with the Corporation.

It's noteworthy that "individual negotiations" was written on the procurement form of managing company of Energy Rehabilitation Project from the very beginning of the procurement process.

Naturally, when the cost of the rendered services or goods is more than \$1 million the use of "individual negotiations" method needs to be specifically substantiated. The Fund explained its use of the aforementioned method to the Corporation; the explanations were also given to EPRC.

According to the Millennium Challenge Georgia Fund: "that was the only company that had experience in rehabilitation and use of Georgian gas pipeline. Besides, the Corporation had the experience of collaborating with BP, which was also important". MCG also noted that the Fund had limited time for project implementation as the contract needed to be made before the end of July, which would enable Georgian International Gas Corporation to launch the activities from August 2006.

According to farther explanations presented by MCG, Millennium Challenge Georgia didn't organize a bidding process because:

"Georgian International Gas Corporation is an owner/operator of North-South Gas Pipeline and Millennium Challenge Georgia is very much interested in preserving the experience in management and rehabilitation of the gas pipeline that International Gas Corporation of Georgia has. Georgian International Gas Corporation can quickly mobilize its resources in order to carry out the activities. Georgian International Gas Corporation is the only organization that has such experienced employees in Georgia. Georgian International Gas Corporation has conducted economic plausibility study of the sections of the pipeline that need to be repaired. That is the only company that can

timely prepare necessary technical specification for the procurement documents. Georgian International Gas Corporation has relations with British Petroleum, BP acts as a technical advisor to the Corporation. BP is familiar with Georgian International Gas Corporation and the work the Corporation conducted on the gas pipeline. BP supervised the economic plausibility study of the pipeline carried out by Georgian International Gas Corporation".

One of the main arguments given by the Fund was the necessity to immediately (!) launch the rehabilitation works on the pipeline in order to guarantee the safe gas supply to the country in winter. However, despite the acceleration of the process through using "individual negotiations" method, **the major rehabilitation activities on the pipeline were not finished till winter** (see the details below).

3. Project Implementation

As mentioned above, during five years two main spheres are going to be financed from \$295.3 million allocated for Georgia from Millennium Challenge Program: Regional Infrastructure Rehabilitation and Enterprise Development in Regions. The Regional Infrastructure Rehabilitation is divided into three main activities:

4. Samtskhe-Javakheti Roads Rehabilitation Activity (\$102.2 million)
5. Energy Infrastructure Rehabilitation Activity (\$49.5 million)
6. Regional Infrastructure Development (\$60 million)

The Enterprise Development Project includes the following main activities:

3. Georgian Regional Development Fund (\$ 32.5 million)
4. Agribusiness Development Activity (\$15 million)

At this stage we'd like to present the results of monitoring of procurement transactions that were carried out under Energy Infrastructure Rehabilitation and Samtskhe-Javakheti Roads Rehabilitation activities, there are some interesting tendencies in them:

3.1 Energy Infrastructure Rehabilitation Project

The aim of the North-South Natural Gas Pipeline Rehabilitation project is: rehabilitation and repairing of various damaged sections of North-South Natural Gas Pipeline. Natural gas is supplied to Georgia and Armenia through that pipeline. Its total length is 240 kilometers. The project implementation will have a positive impact on the economic growth, because after the project is implemented in-country customers and businesses will have an uninterrupted natural gas supply. The damaged sections of the natural gas pipeline are going to be repaired according to requirements of technical safety, as a result, the loss of natural gas will decrease; according to various estimates, amount of natural gas losses in previous years equaled 10%.

We'd like to underline here that the project management company used the "individual negotiations" method during the selection of International Gas Corporation of Georgia as the management consult of the project, MCG had substantiated its choice of the aforementioned method by following arguments:

"That was the only company that had experience in rehabilitation and use of Georgian gas pipeline. Besides, the Corporation had the experience of collaborating with British Petroleum, which was also important". The Fund also notes that it had limited time for project implementation as the contract needed to be made before the end of July, which would enable International Gas Corporation of Georgia to launch the activities from August 2006.

Besides, one of the main arguments supplied by MCG was the necessity to immediately (!) launch the rehabilitation works on the pipeline in order to guarantee the safe gas supply to the country in winter. However, despite the acceleration of the process through using "individual negotiations" method, **the major rehabilitation activities on the pipeline were not finished till winter**.

On June 21, 2006 Millennium Challenge Georgia Fund signed an agreement with International Gas Corporation of Georgia, according to which the latter was to manage the emergency rehabilitation works on the North-South Natural Gas Pipeline.

Millennium Challenge Georgia signed the agreement on procurement of pipes on September 26, the agreement with the company that was to implement the rehabilitation works was signed on November 3, 2006.

Naturally, conduction of rehabilitation activities in the winter period, especially due to harsh conditions in that region, was complicated.

Interestingly enough, in its monitoring report published last year the Economic Policy Research Center noted that the rehabilitation of the natural gas pipeline was unlikely if the activities were not sped up. Management team of Millennium Challenge Georgia Fund didn't share EPRC's comments then; however, the ultimate result was exactly the same as predicted by monitoring group: the rehabilitation activities were delayed.

In the monitoring report published by EPRC last year, EPRC noted that the import of pipes necessary for the rehabilitation works would be complicated due to the sanctions imposed by the Russian Federation against Georgia. That opinion was not shared by the management of Millennium Challenge Georgia. (According to the comments prepared by Millennium Challenge Georgia for Millennium Challenge Program in connection with the EPRC's report: "...according to the aforementioned document, the tense relations between Georgia and Russia may hinder the process of importing the pipes necessary for the rehabilitation works. Millennium Challenge Georgia confirms that the tense relations between the countries didn't have any impact on the delivery of the pipes, as Millennium Challenge Georgia purchased the pipes from an Azerbaijani company. The delays in transportation of the pipes were caused by objective reasons. However, Millennium Challenge Georgia set new dates for the contractor during which the pipes need to be supplied, therefore, that is not going to hinder the rehabilitation works".)

However, the report on the fourth quarter prepared by Millennium Challenge Georgia (dated April 27, 2007) reads that: "The contractor requested that the Millennium Challenge Georgia paid \$120,000 more as it had to incur additional expenses due to the trade embargo imposed by Russia, the supply dates had to be moved for that reason too".

The report also indicates that besides increasing the price of the works, the delayed delivery of the pipes farther slowed down the gas pipeline rehabilitation process. The report on the fourth quarter prepared by Millennium Challenge Georgia (covering the period from January 1, 2007 till March 31, 2007) reads that:

"The delayed delivery of pipes caused delayed commencement of the rehabilitation works on Meneso site. The results of such a delay on Meneso site were not very serious as the construction works were delayed due to the flood anyway". It's an established fact that besides delayed delivery of pipes, the project was also hindered by the fact that due to the initial delay (which EPRC pointed out at the time) the rehabilitation process coincided with the flood period and that became one more reason for hindering the rehabilitation process.

It all indicates that the management of the Fund didn't take into account the real risks that, as we have already mentioned, were pointed out by EPRC too. As for the procurement of the pipes, the Fund had to allocate additionally \$120,000 to the contractor ("Khazardenizneftgaztikint" company). The reports don't indicate whether certain sanctions were imposed upon the contractor for delaying the delivery of the pipes (such a possibility was implied in the contract).

According to the MCG management team, no decision has yet been made on fining the contractor. During the #19 meeting of the Supervisory Board the following decision was made: "the final decision in connection with fining or not fining the contractor will be made after "Khazardenizneftgaztikint" completes its activities."

However, the delayed delivery of the pipes, floods or natural disasters as such are not the only reasons for the complication of the project implementation. According to the aforementioned April 27, 2007 report: "Delayed submission of drawings, technical specifications and other documents

required in the bidding documentation is one more risk for the implementation process. Millennium Challenge Georgia has a little control over that process, as International Oil and Gas Corporation of Georgia is responsible for supplying the documentation" – and this is a company that was selected on the basis of individual negotiations due to its "high competence".

3.2 Samtskhe-Javakheti Roads Rehabilitation Project

Before the launching of Samtskhe-Javakheti Roads Rehabilitation Project, Millennium Challenge Georgia needed to: a) study the legal and technical-economic issues concerning the territories along the rehabilitated road and b) conduct environment impact studies and draw up final design.

- a) Ernst & Young conducted open biddings in order to select the consultants, as a result the following winners were selected: a) TBILISI, SPECTRUM & ALLIGATOR company was selected for studying the legal and technical-economic issues concerning the territories along the rehabilitated road; on September 30, 2005 an agreement was signed with that company the full amount of which is \$81,864.86 (609 grant). "Tbilisi Ltd." Conducted "planning/research of the road" activities. Technical-economic justification was done by KOCKS CONSULT company.
- b) Initially 7 companies were selected during the bidding for environment impact study, technical-economic justification activities and consultant for final designing; however, the following companies were able to present acceptable and full proposals: 1. BONIFICA, SGI STUDIO, engineering-geological research center and IDC; 2. KOCKS CONSULT and BT; 3. WHITE YOUNG GREEN INTERNATIONAL and "Gzaproekti". General criteria used for their evaluation were experience, methodology/working plan, main staff and technical qualification. KOCKS CONSULT and BT offered the lowest price for the project implementation: \$3,196,412.

KOCKS CONSULT and BT was selected for conducting environment impact study and final designing, Millennium Challenge Georgia signed a contract with the company on February 10, 2006. **The delay was explained by the fact that the consultant that conducted the technical-economic justification was late with carrying out its activities. According to MCG, that delay was not the contractor's fault; however, it's still a fact that the contract was signed two months late. Selection of consultants and other works are conducted according to schedule and this process should be over in summer 2007 at the latest.**

The delays in project implementation didn't take place only at the aforementioned stage. In the report on the fourth quarter MCG names several reasons for delaying the commencement of rehabilitation works. One of the reasons named was the fact that MCG was initially unable to involve the Road Department of Georgian Ministry of Economic Development in the project, MCG admits that "this was one of the reasons for delaying the initial phase of the project implementation".

The delayed decisions made by management of MCG and in some cases failure to take into account the need to get environment, construction and other permits necessary for certain activities during the planning of procurement and other activities caused significant delay of the rehabilitation works.

The bidding dates announced by MCG caused certain questions during the meetings of the Supervisory Board: during the January 23, 2007 meeting Chairman of the Board Mr. Zurab Noghaideli said: "if the rehabilitation works under the Roads Rehabilitation Project are not commenced in spring, there is no reason to start these works in summer, correspondingly, the implementation of the whole Roads Rehabilitation Project will become doubtful".

During the April 6 meeting of the Supervisory board it became evident that the bidding couldn't be conducted before the end of April 2007. The Chairman of the Board notes that "according to present schedules, the actual construction works can be started only in the end of August" he also doubts whether the project can be finished by the end of 2008.

Management of Millennium Challenge Georgia Fund notes in its report on fourth quarter (dated April 27, 2007) that without solving certain problems "...and if procurement of construction companies is postponed we'll lose one more construction season. Some sections of the road are situated in the high mountainous regions where the climatic conditions are very harsh. Therefore, speeding up the bidding process is essential for the successful implementation of the project".

The short report submitted by Millennium Challenge Georgia to Economic Policy Research Center (dated May 14, 2007) reads that: "The commencement of the construction activities are set for July-September 2007 after the mobilization stage is completed. The main activities will be finished by autumn 2009; by 2010 the construction of the road will be fully completed". – That means MCG has moved the deadlines.

Moreover: on June 2007 the bidding proposals have been opened, those proposals had been submitted by construction companies selected as a result of pre-qualification selection process. The quotations presented by the companies significantly exceeded the budget of the project. Therefore, based on the analysis of those proposals MCG decided to terminate the bidding process. Currently the new bidding process is being prepared for the construction contracts.

It's clear that it will farther complicate the implementation of Samtskhe-Javakheti Roads Rehabilitation Project and most probably the project cost will be significantly increased. Why weren't the activities preliminarily and properly evaluated? Or why were the quotations presented by the companies so high? Was the bidding unprepared? And how much more MCG will have to expend in case a new bidding process is conducted? – These questions need to be specially studied.

The examples of the aforementioned two projects demonstrate that the projects are not implemented within the established time periods. The biddings are also conducted late and that influences prices, similar examples will continue to take place in future as well and they'll be even more serious than the current ones.

3.3. Conclusions

1) Procurement Agreement made between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia stipulates that the 6 month procurement plans must be drawn up. However, that stipulation was only partly fulfilled both in 2006 and in the first quarter of 2007 – according to the available materials; the dates of publication of the procurement plans and the implementation deadlines were not clearly indicated. It may be interesting for the readers to know why the proper 6 month procurement plans need to be drawn up.

The detailed procurement transactions indicated in the 6 month procurement plans allows one to see the whole picture. Existence of a plan and efforts to implement it exclude the possibility of delay of procurement transactions that are interconnected and follow each other. Besides, the procurement plan can be compared with the detailed report on procurement (we'll discuss those reports below), that simplifies the control over the project implementation by Millennium Challenge Corporation as well as makes public monitoring of the project easier. Therefore, we believe that the 6 month detailed procurement plans need to be drawn up at least from now on, those plans must indicate dates, procurement methods and sequence of transactions to make the process more organized and transparent.

2) Monitoring of transparency of the procurement process showed that Millennium Challenge Georgia publishes indeed the announcements about the expected procurements in the media outlets indicated in the corresponding agreement and as far as that requirement is concerned MCG fully meets its obligations, which should be only welcomed. However, at the same time, in order to increase the competition and improve the quality of procurement process we believe that other media outlets also need to be actively used for this purpose. Incurred expenses are justified in this case – the above-mentioned example about the procurement of services of the Regional Development Fund's manager confirmed that circumstance once more.

3) As for the procurement methods – MCG doesn't use the "individual negotiations" method often; however, that method was used for a significant procurement transaction during the monitoring period, for example:

Georgian International Gas Corporation was selected as a management consultant for North-South Gas Pipeline Rehabilitation Project. The contract for \$1,145,631.44 was made with the Corporation.

In justification of that decision MCG noted that immediate launching of rehabilitation works was necessary for securing the country's energy safety during winter.

It's noteworthy that the activities were not launched within the indicated time period, moreover: some of the activities were launched in 2007. Therefore, the justification of use of individual negotiations method, which was based on the necessity to immediately launch the rehabilitation activities, seems baseless.

By the way, according to the 6 month procurement plan published in August 2007, the individual negotiations method was used several times; EPRC will continue to demand explanations for the use of that procurement method.

4) During the monitoring period we noted the relatively small number of procurements and generally slow rate of expenditure – for example: during the first year of the project implementation instead of planned \$51.7 million only \$21.9 million was actually received (2.5 times less than the planned amount), and according to the recent reports, only \$8 million was actually expended out of the received \$21.9 million (those data are published on the MCG website).

The emergency rehabilitation works on North-South Natural Gas Pipeline were delayed. The launching of Samtskhe-Javakheti Roads Rehabilitation was also significantly complicated. During the initial stages the complications with launching the activities had the following objective reasons:

Millennium Challenge Program compact took effect on April 7, 2006. The compact came into force late because the standard procedures required for formalization of the international agreements lasted longer than expected. The compact couldn't take effect without the following additional agreements: 1) Governance Agreement; 2) Procurement Agreement; 3) Designation Agreement; 4) list of conditions for additional agreements; 5) Disbursement agreement; 6) Interim Bank Agreement and etc.

Naturally, due to the fact that the compact came into force later than planned the planned activities were launched at a later date.

However, some other factors were added to the above-mentioned circumstances: failure to take into account certain details during the planning process (for example Russian economic sanctions, necessity to get licenses etc., failure to meet the deadlines by contractors, delay in preparation of technical documentation, the fact that decisions about coordinating the activities with the state agencies were made quite late etc.). Eventually, the project deadlines were not met on time.

The slow implementation of the project means that the allocated amounts may not be expended within the established time periods.

Procurement Agreement made between Millennium Challenge Corporation, Ministry of Finance of Georgia and Millennium Challenge Georgia notes that: [...] the term of this agreement may be extended for a period that is longer than one hundred twenty (120) days following the termination or expiration of the compact if MCC determines that obligations incurred prior to the expiration or termination of the compact remain to be carried out. (Article IV section 4.21)

The limited deadlines make the implementation of the major activities questionable considering the slow tempo of the project implementation process; as a result, the Millennium Challenge Program may not be fully implemented in Georgia.

4. Considerations Concerning the Document Titled “Georgia Program Monitoring and Evaluation Plan”⁴

“Monitoring and Evaluation Plan” has been elaborated in order to evaluate the activities conducted and activities that will be conducted under Millennium Challenge Program. The plan implies the following:

- 1) Elaboration of program levels, which means description of programmatic components under the whole compact at different levels (levels mean the benefits received as a result of implementation of general goals of the Program and the benefits of each project included in those general goals);
- 2) Indicators of implementation of long-term goals and tasks;
- 3) Structural and functional responsibilities necessary for implementing the monitoring process;
- 4) Methodology for evaluation of the activities conducted under the Program during the monitoring period.

The materials presented below will discuss the indicators of the activities under each programmatic component, the risks that may hinder the realization of the goals and progress evaluation methodology.

4.1 Review of Program Components of Monitoring and Evaluation Plan

4.1.1. Improved Transport for Regional Trade (Samtskhe-Javakheti Road)

Description of the component

Existence of effective contacts with the rest of Georgia is very important for Samtskhe-Javakheti region. It will surely induce economic and cultural development of that region; in that aspect we fully share the opinions of the authors of the document; however, the direct relation between the new road and development of trade in that region is somehow doubtful due to the following questions that need to be answered:

The presented Monitoring and Evaluation Plan doesn't provide arguments proving that the new road would encourage regional trade. If Samtskhe-Javakheti has already got export potential or problems with excessive products that need to be exported to other countries then how those products are being exported now? The management team of Millennium Challenge Georgia answered to this question in the following manner: “products are exported with land vehicles”.

Of course we understand that the products are exported with land vehicles. By asking the above-mentioned question we wanted the management team of Millennium Challenge Georgia to point out the mechanisms of positive influence of the new road on the regional trade in the document they presented. In particular, we want them to clearly indicate how the export of the regional products will be simplified by the construction of the new road. That would refine the document and the arguments of MCG would become more convincing. That way it'd become clearer why Samtskhe-Javakheti region was specifically chosen for the road rehabilitation project rather than any other region. Isn't it possible that the rehabilitation of the same number of roads in some other region would bring even more immediate benefits? Therefore, we believe that the groups of products (produced in the region), the export of which would significantly increase as a result of the new road, should be named.

Besides, we are talking about the development of trade in Samtskhe-Javakheti region we're not talking about benefiting international carriers. We would like to know where the export products produced in the region are exported to and how?

1. Which roads are used for that process and how much will the new road decrease the export problems?
2. What products are we talking about? Unfortunately, the presented document does not present any statistic materials containing that information.

⁴ http://mcg.ge/data/file_db/Monitoring/Plan_eng_dZFoZEZe6K.pdf

We believe that the export potential of such perishable goods as raspberries mentioned in the document is quite exaggerated. Such plants are widespread in west and east Georgia. We understand that there is some potential for growing the similar cultures in Samtskhe-Javakheti, but we believe that concentrating on that culture will not solve the poverty issue in the short-term time period; however, that can bring certain positive results. Samtskhe-Javakheti has already got a significant potential in such food products as meat, milk, potatoes, grain-crops etc. By increasing the effectiveness of production of the aforementioned products significant changes could be achieved in terms of improving the social conditions not only in that region but in the whole country. Therefore, the aforementioned directions had to be targeted first of all and raspberries should have been considered as one of the ways to diversify the range of food products produced in the region.

We are aware of the activities conducted by AgVantage⁵ in that direction, we also know that this program encourages the development of the similar cultures in several regions of Georgia, especially in west Georgia on the lands where tea is planted. In that case cultivation of berry crops is viewed as an alternative way to receive income. We know that AgVantage initiated the creation of Association of Berry Producers of Georgia the aim of which is the development of long-term and stable cultivation of berries in the country. That culture creates good opportunities for developing the small farms; however, there's only 150 hectares of lands in Georgia where the berry cultures are planted, while in Samtskhe-Javakheti we could harvest much more potatoes and grain-crops on tens of thousands of hectares. We maintain that along with stock-breeding the above-mentioned directions should be the first priority, because they have statistically proved competitive values. This is evidenced by the statistical data prepared by Ministry of Agriculture of Georgia. Besides, the main bulk of activities carried out by project AgVantage in that region is concentrated on livestock-breeding.

Based on the agricultural inventory conducted by State Department of Statistics in 2004 one can clearly see that Samtskhe-Javakheti specializes in one-year cultures and livestock-breeding. In particular: there are 0.28 hectares per capita and approximately 1.25 hectares of pasture lands per family in Samtskhe-Javakheti. By these indicators that region is a clear leader among the Georgian regions. According to the same data, there are 0.22 hectares of arable lands per capita and 0.98 hectares of arable lands per family – by these indicators the region holds the second place after the Kakheti Region.

After viewing these statistical data the following question can be asked: what's the use of expending resources on a perennial culture like raspberries if the region has a serious potential of replacing the import by farther developing wheat, potato, barley and other one year crop production as well as by increasing stock-breeding? Marketing raspberries will surely be connected with significant initial and long-term investments, which will also require the development of processing potential. If the authors of the Monitoring and Evaluation document still believe that this culture is a priority then they must present plausible materials based on facts indicating the prospects of employment and development for the local population.

In our opinion replacing the imported goods with the local produce is much easier and more profitable for the country and the region in terms of increasing employment and incomes and consequently decreasing the poverty rate. It will become even more evident if we take a look at the negative processes taking place in the Georgian agriculture during the last few years. The natural disasters that took place last year (droughts, floods etc.) and Russian embargo significantly limited the export potential of Georgian agricultural products. Georgia turned into a net importer of potatoes when there has never been a deficit in locally produced potatoes so far. Samtskhe-Javakheti region has a big potential in potato production, which also implies cultivation of ecologically clean potatoes in the high-mountainous zones. This is actually confirmed by researches conducted by international organizations and local experts.

We reiterate that unfortunately Georgia turned into a net importer of potatoes last year. As Samtskhe-Javakheti has a potential to provide a significant amount of potatoes to partly satisfy the country's demand for that product it would have been better to give priority to that sphere. As a

⁵ AgVantage – Maximizing Georgia's Agricultural Export- (formerly known as Support Added Value Enterprises) is a multi-year, multi-million Activity funded by the United States Agency for International Development (USAID) and implemented by ACDI/VOCA, a private, non-profit, U.S. international consulting and development organization

rule, the problems in the potato cultivation is mainly caused by climatic conditions, last year the potato production rate in Georgia went down to 164 thousand metric tons from 432 thousand metric tons harvested in 2005. The 40,000 hectares used for potato cultivation decreased down to 23 thousand hectares. Instead of 10.9 metric tons per hectare the country received an average of 7.4 metric tons per hectare. It all indicates that this sphere requires much more attention especially taking into account the fact that Samtskhe-Javakheti really has a serious competitive potential especially in production of early potatoes.

Besides, export of fruit and berries, in particular raspberries, is connected with food safety issues as without the documentation issued by state certification agency our products will not be received in European markets. Therefore, wouldn't it be much more profitable to direct our efforts on replacing the imported goods, which could yield even more income than the income generated through increasing export in the short-term period? Development of potato and other one year cultures in the region doesn't mean subsidies and direct intervention. It's necessary to settle the infrastructural and regulation issues on time and give substantial credits to the local farmers.

Unfortunately, the presented action plan doesn't mention the region's traditional competitive advantages in livestock-breeding sector, while an important part of the consolidation centers indicated in that part of the document were created in the livestock-breeding sector. According to 2004 agricultural inventory, there's 2.13 cows per capita in Samtskhe-Javakheti, according to that indicator, the region shares the first place with Adjara and is far ahead of the rest of the regions. Therefore, it'd be very appropriate to take into account the serious potential existing in that sphere as well while we talk about the development of local trade.

Despite the fact that decreasing the transportation expenses is very important for local farmers, overestimation of that factor is not desirable as besides the consolidation centers there are no agricultural enterprises left in the region and according to the inventory carried out by Department of Statistics in 2004 about 73% of the local farmers produce the products for self-consumption. Unlike other regions of Georgia where most of farmers earn their living by subsistence farming the situation in Samtskhe-Javakheti is relatively better in that respect, probably because the population has more livestock. Due to the general deficit of locally produced meat and milk products and also taking into account the fact that preservation and processing of such products at homes as well as their transportation is relatively easy due to the correlation of processing and transportation costs, some part of Samtskhe-Javakheti farmers probably already manages to sell their products. Authors of the document rightly believe that decreasing the transportation costs will increase the amount of products sold, but we don't think it will radically change the general situation as stimulating supply is more necessary in that case, which, in its turn, depends on other important factors (availability of capital, technologies, marketing, competition from importers etc.)

Besides, the traditional markets for livestock produced in Samtskhe-Javakheti need to be studied, are they situated along or near the new road that must be constructed under the project? Is the livestock sold for cash or is the trade barter-based? It's unclear what the authors of the document mean under "opening vast markets to the growers in the region" as Georgian agricultural potential is still quite weak. We believe that the "vast markets" mentioned in the document is an exaggeration and we hope the authors of the document will agree with us.

Besides, it's unclear what's meant by the "farther discussion of issues concerning the perishable goods", because one of the long-term goals of Millennium Challenge Program is encouragement of enterprise and production development. We think that if the main infrastructure rehabilitation activities of the project are successfully implemented the effective distribution of production resources through market mechanisms will be accelerated anyway. That will encourage the production of goods that have the biggest market potential.

We also believe that one more argument supplied by the authors of the document: getting foreign investors interested, is quite doubtful. Unfortunately, the foreign investments in Georgian industry are scarce (except for the energy sector). As far as agriculture sector is not sufficiently developed in Georgia and we don't think the foreign investors will be interested in financing that sector of economy, which constantly experiences serious problems. There can be no talk about foreign investment before the infrastructure is not rehabilitated and local capital is not invested in the sector, local capital must be invested both on regional and national levels. Under the present

conditions we believe that attracting the foreign investment, especially in such a remote region, is unlikely.

We want to note some questionable opinions and factual inaccuracies mentioned in the document. According to that part of the document, the region is exporting its products to Turkey, Armenia, France and UK. We repeat that unfortunately, the region can't export its products to France and UK and it won't be able to do so in the foreseeable future. However, the situation is different as far as Turkey and Armenia are concerned. It's unclear what products are the authors of the document talking about as Georgian export statistics clearly don't confirm the above-mentioned statement. Exporting the products to such different countries requires developed production and marketing facilities as well as effective legislation, which is not the case in that region, where capital and human resources are quite scarce.

We share the authors' opinion about the certain tourism potential existing in Samtskhe-Javakheti region, we also think that Vardzia as a tourist attraction will help increase the number of tourists in that region. At the same time we must bear in mind that preservation of that monument requires immediate state intervention and it still remains to be seen whether mass tourism may harm it. There are many other tourist and cultural attractions along or near the Tbilisi-Vale road. Therefore, how can we be sure that the development of tourism will be encouraged by the construction of the new road rather than rehabilitation of the already existing one? Unfortunately, quite a large tourism potential of Borjomi and Bakuriani is not discussed in the document. We think that consistent activities near these resorts will pave the way for successful implementation of the goals indicated in the Millennium Challenge compact.

1. The excessive products produced in the region could be supplied to those resorts. These two famous resorts could create additional demand on the agricultural products both in winter and summer seasons if the number of tourists will increase. It will help decrease the poverty rate too.

2. Easy access to those resorts will increase employment and get more foreign tourists and investors interested.

We agree with the authors of the document that the main road will increase transport flows, but at the same time we must take into account the benefits of decreasing the expenses on public health, education and other services in that high-mountainous zone: development of infrastructure and roads essentially decreases the cost of public health and education as well as other services. The final portion of the document mentions this issue, but we believe that this should be more clearly underlined in the main part of the document as well.

4.1.2. Reliable Supply of Energy (Energy Rehabilitation)

Description of the component

We completely agree with the authors of the document that rehabilitation of energy sector will decrease the cost of energy carriers for the population. But we need to take into account the following detail: while improving the effectiveness of the energy infrastructure will decrease the certain costs will it help decrease the price of natural gas, whereas the world prices of natural gas are constantly increasing? Besides, need for natural gas will probably increase as the environmental legislation is enforced and as the price of other energy carriers increases. We'd like to know how the sums saved as a result of decreased costs (due to the rehabilitation of the natural gas pipeline) will be expended. If those amounts will be spent for gasification of the settlements near the gas pipeline the final results will be much more beneficial and the government will be able to save the amounts that needed to be allocated for this purpose and social welfare programs.

We think that along with accenting the decrease in greenhouse natural gas emission, more attention should be paid to the potential benefits received as a result of preserving the forests. It can be calculated, it's even more important as the synergy effect caused by preserving forests and decreasing the greenhouse gas emission exceeds the simple arithmetic sum total of those two factors. By that we mean that preservation of forests is connected with various kinds of direct and indirect benefits such as: preservation of forest, flora and fauna, improving recreational resources and tourist resources as well as other factors.

4.1.3. Improved Local Services (Regional Infrastructure Development)

Description of the component

Development of regional infrastructure plays an essential role in successful development of economy of any country. We believe that \$60 million allocated by Millennium Challenge Program for that purpose will help the country achieve that goal. That part of the Georgian compact is the component that is directly connected with the long-term goal of eradication of poverty in Georgia. It's because, as a rule, private capitals are rarely invested in that sector for long-term and risky projects, private investors are more oriented towards concrete customers. Infrastructure serves the interests of all economic agents operating near it; therefore its development has an essential role in improving the quality of education and public health as well as increasing investments and developing enterprises and transportation. All the above-mentioned factors are the main components for improving the welfare of population.

That part of the document accurately analyses the important role that main infrastructure plays in raising the effectiveness of educational and public health systems. Solving the infrastructure problems at local levels allows the authorities to decrease the costs on education, public health, transportation and administration. It would be highly advisable to work out an effective method for calculating the benefits received as a result of improving these important economic parameters under the monitoring and evaluation plan, that would become a mechanism for planning and development of farther researches in that direction as well as identifying new important projects.

Distribution of the sums for various sub-goals under the component largely depends on the priorities defined by the state and their changes. The rehabilitation of irrigation and drainage systems requires special attention, because the export potential of our country largely depends on this issue. Therefore, the methodology of selection of infrastructure projects, their priorities and implementation means must be clearly defined.

Meeting the deadlines will be especially important during the monitoring process. It's especially important for irrigation and drainage systems as the delays in rehabilitation works will cause permanent increase of the project costs due to depreciation of the systems. Generally speaking we completely agree with the goals and tasks indicated in the Regional Infrastructure Development component.

4.1.4. Increased Investment in Small and Medium Enterprises (Georgia Regional Development Fund)

Description of the component

That part of the compact implies achieving a very important goal. Generally, the program components and mission directed at increasing investments in small and medium enterprises are written quite well. While the rural enterprises don't have any means for attracting financial resources, \$30 million allocated for creation of stock fund is a good start for investing in the rural areas. At the same time it's necessary to clearly define the target groups of the program, in particular, who and how will become direct and indirect beneficiaries of the program? How will the beneficiaries be affected and when will the poverty reduction process start to take place? As the other four programs this program is also a part of the plan directed at eradication of poverty.

Therefore, we need to ask the following questions: will this component be coincided with Regional Infrastructure Development and Regional Trade Development components? In other words will the synchronous implementation of the components of Georgian compact be given priority? We also imply geographic aspects of the simultaneous implementation of various components. If the certain activities will be conducted in similar geographic regions or some activities of several components will be carried out in one and the same or neighboring regions how will the benefits of the various components be calculated in relation with other components and general economic development of the country? What are the concrete reasons to believe that helping the enterprises that require \$1.5 million will help overcome the poverty problem? There's a danger that such enterprises that can be considered quite big for Georgian standards will try to attain their private goals while failing to significantly contribute to the general goal of poverty reduction.

4.1.5. Improved Economic Performance in Agribusiness (Agribusiness Development)

Description of the component

The so-called field shop approach and the fact that the activities will be conducted in the following three directions are to be welcomed: 1) Production of raw materials and farmers' partnerships; 2) Commercialization of service providers; 3) Encouragement of development of value added enterprises.

Despite these ambitious plans, the flexibility of the mechanisms of those components needs to be guaranteed, that will allow them to adapt to the negative processes taking place in the agriculture sector during the recent years (climatic complications, deficit of capital, animal and plant diseases, competition with importers, inconsistent state policy). Unfortunately, so far the donor projects that funded farmers' partnerships were not successful. What was the reason of the failure: traditional fear of cooperation or the imperfect design of the program? This question still remains unanswered. Taking that into account what's the guarantee that this progressive goal set under Millennium Challenge Program will be successfully realized? What are those concrete innovative mechanisms that make this new initiative different from its predecessors?

Commercialization of suppliers will be complicated if the state policy in agricultural sector doesn't change. Without speeding up the process of land consolidation and rehabilitation of irrigation and drainage infrastructure this task will be extremely complicated. In our opinion development of the country's agrarian potential (farmers' cooperative farms, increased productivity) depends on creation of jobs in towns, because the excessive labor force in villages must be employed in other sectors and demand on agricultural products must be created, otherwise competing with import will be impossible and irreversible processes will start in the agrarian sector.

The approach towards the activities under the third subcomponent – identification of enterprises with confirmed commercial capabilities is to be welcomed as well. Probably this is the most effective way to achieve progress as assisting small enterprises and family-based farms worsens their conditions in the long-term period because the family farms belong to the sphere where investments are extremely scarce. Here we have the following question: do we help the family farms, which is nothing but a short-term social (often quite effective) benefit, but in the long run it's an ineffective distribution of resources or do we help those who have already showed their market potential (we should note that by distributing the incomes generated by them the poverty is reduced)?

The activities directed at spreading the information on the projects planned under the Program can be positively evaluated. When there's total deficit of information on prices of agricultural products, technologies, good production practices etc. this initiative can yield only positive results.

4.2 Results Expected According to Monitoring and Evaluation Plan

Poverty reduction indicators mentioned in the expected results of Millennium Challenge Program must be analyzed in two directions: 1) will the evaluation method of those parameters be modified? (State Department of Statistics is already working on it); 2) Compact's connection with macroeconomic parameters. As far as the second direction is concerned we should bear in mind that the demographic situation in Georgian regions is worsening as the population that is able to work is migrating. Besides, the changes in social inequality are unknown. Due to this and other exogenous factors, the modification of indicators may become necessary so that the positive results that may be more modest than the planned ones are not considered unsuccessful. Besides, local authorities may not be able to participate in the infrastructural projects as it's envisioned by the plan due to the delay in institutional reforms.

We recommend adding to the program the following parameters components as new indicators:

Improvement of transportation for regional trade (Samtskhe-Javakheti Road)

- Changes in the number of vehicles in the country and region must be taken into account in indicators; evaluation of the changes in the number of vehicles is desirable due to the following reasons: the increased number of vehicles caused by improved infrastructure must be differentiated from the increased number of vehicles caused by general increase in vehicle

numbers in the country. Besides, we'd like to note that the number of vehicles is steadily and quickly increasing in the country;

- Changes in transit movement; (according to management of MCG, this indicator is going to be calculated within program monitoring plan and program impact evaluation design);
- Changes in cargo transportation; (according to MCG Management team, this indicator is going to be calculated within program monitoring plan and program impact evaluation design);
- Changes in the number of road accidents;
- Decreased price of public health and education services (due to the significant value of that indicator).

Management team of Millennium Challenge Georgia can't understand why decreasing? They think that decreasing the price of public health and education services is not always the best option. Improved communication can become a guarantee of a better quality and therefore more expensive service.

Economic Policy Research Center notes that in this case decreasing the price of public health and education services is used as an equivalent of reducing the costs. If other variables remain unchanged the best option automatically implies the reduction in prices of public health and education services.

Rehabilitation of Energy Sector

- Benefits connected with decreased logging;

According to management team of Millennium Challenge Georgia: "Rehabilitation of gas pipeline doesn't directly mean that the logging process will be slowed down; however, energy balance is the basis for calculating these indicators".

EPRC believes that there is no direct connection; we're talking about identifying the benefits, establishing their possible connection with rehabilitation of the energy sector and calculation of those benefits. We believe it's quite possible.

- Reinvestment in local networks.

Improvement of local service (Regional Infrastructure Development)

- Public health and education indicators;
- Increasing the size of enterprises

Increasing investment in small and medium enterprises

- Increasing the size of enterprises;
- Comparison with the enterprises where such investments have not been made.

Improved economic indicators in agribusiness sector

- Comparison with the enterprises where such investments have not been made;
- Indicators for evaluation of beneficiaries' conditions.

According to MCG, the list of indicators included in the program monitoring and evaluation plan was drawn up in 2005 and they contain only several main directions. More detailed indicators in monitoring and evaluation plan are not required as the main objective of that document is definition of the main directions of monitoring and evaluation – the so-called vectors. Basic, interim and final reports will include quite a wide range of indicators featuring the above-mentioned indicators named by the Center and indicators of other many groups.

4.3 Assumptions and Risks of Monitoring and Evaluation Plan

Improvement of transportation for regional trade (Samtskhe-Javakheti Road)

The assumptions indicated in connection with this component are quite doubtful, namely we believe the assumption that the farmers will quickly establish contacts with wholesale traders and supermarkets is quite questionable. There is no supermarket network in Georgia and the extreme

fragmentation of producers will not allow them to compete with major distributors. A more realistic assumption would be as follows: the production basis will be preserved and even slightly increased and a steady, long-term development will be commenced.

The degrading pasture lands may become a serious problem for Samtskhe-Javakheti as that region is primarily known for its livestock-breeding. As the number of livestock is slowly growing in the country while industry is stagnating the pasture lands become overloaded. However, on the other hand, certain development of tourism potential of the region can really take place and that can help the farmers improve their standard of living. There is a risk that for some exogenous reasons the new road will not be utilized as actively as desired.

According to MCG: "Road is the basic element of infrastructure, which is the basis for establishment of trade relations. The question on how, when and with whom the relations mentioned in the commentary will be established will be answered by the data collected as a result of activities conducted under program impact evaluation".

We'd like to repeat that such an ambitious and large scale program should take into account the widest possible range of risks due to two main reasons: 1) Taking into account those risks in the beginning of the project will allow the project to adapt to the reality and existing circumstances more easily; 2) Monitoring and evaluation process will be much simplified, which is a precondition for more effective conduction of farther activities.

Rehabilitation of Energy Sector

Selling of carbon credits, in other words selling the pollution permits mentioned among the assumptions doesn't seem likely to take place in Georgia in the near future. Currently the country's financial infrastructure is being formed and selling the environment financial instruments (for example carbon credits) is possible only in countries with highly refined financial markets and even in such countries it's not always possible.

Selling the pollution permits is the complex financial mechanism and government's willingness is not the only factor necessary for doing it. There's lots of materials and literature that prove that such schemes were not very successful in countries of Eastern Europe, China etc. which are far more developed than Georgia. Georgia still doesn't have effective equity market and successful functioning of that sphere based on market mechanisms in our country will be extremely difficult. Being part of Kyoto Protocol doesn't necessarily mean that the country has effective mechanisms for selling pollution permits. For example the attitude shown by United States towards Kyoto Protocol is known all over the world; however, carbon credit system is developed best of all in that country. Besides, intervention of donors and governments in that sphere doesn't necessarily mean the effective, market-oriented use of that mechanism.

The global rise in natural gas prices will have to be taken into account as one of the risks, because the price hike is not caused only by Gazprom's policies. The developing countries of the world (China, India, countries of South-East Asia) have a growing need for energy carriers, while the providers of energy carriers have been experiencing the investment deficit for the last several decades. Due to those factors and the political difficulties existing in the countries that have large energy resources, we believe the price of energy carriers will increase even more in the near future and that factor needs to be regarded as one of the risks. This is even more relevant if we take into account the fact that the price of energy carriers directly influences the welfare of population.

Improvement of Local Service (Regional Infrastructure Development)

We think that **the assumptions** and risks indicated in connection with that component (in other words evaluation of the actually existing situation and assumptions about the situation that will exist after the program components are implemented) are well-documented. One can even say that some of the risks indicated in connection with that component have already taken place.

Increasing investments in small and medium enterprises

In our opinion the assumptions indicated in this case are too optimistic, this can be proved by analyzing the existing situation. Unfortunately, Georgian industry is still weak and the country's export nomenclature has not been increased for years. This is demonstrated by the long-term failure to produce competitive products that could be exported to international markets. Besides, it's highly improbable that even the success of small and medium enterprises will encourage the quick growth of foreign investments. In our opinion, in case of small and medium enterprises, concentration on foreign investment is not justified as: 1) It's unlikely that the foreign high-tech companies will invest in such enterprises; 2) In this case the foreign capital is not more effective than the local one; 3) Foreign investments are usually made in the beneficiary countries where there's confirmed sustainable development during at least several years. Therefore, we don't presume that even the successful implementation of this component of the compact will significantly increase the amount of foreign investments. It should happen at the expense of macroeconomic changes.

It's noteworthy that while there's certain optimism in the assumptions expressed in connection with that component, the risks are quite feasible. We believe that it would be better to modify the assumptions based on those realistic risks. In particular, we think that it's better to replace the words: "increased diversity of industry and financially profitable intensity" with the following: the enterprises will become relatively more attractive for investment and their capacities will increase.

In its comments MCG notes that: "We should point out to the authors that the assumptions clearly indicated that "information about the successes will attract more investments", which means that investment fund must create preconditions for attracting foreign investment in a few years. Of course this may not happen in the first few years".

In answer to the above-mentioned comments we still consider that attracting foreign investment in the regional enterprises will be extremely difficult in the following few years. We believe that increasing the capacities of enterprises through local investments is more realistic.

Improved economic indicators in agribusiness sector

Unfortunately, the second phase of land privatization process, even according to the assumptions indicated in the document, is not carried out as quickly as desired. Unfortunately, there are only several thousand farms in Georgia, which have a total of 4 hectares of land; this is a very small amount of land for creating a modern-type enterprise. The privatization rate is not reflected in the official documents yet. It's not easy to say how much land exactly is owned by the state, how much land is neglected and untended and how adequate is the price of land. Besides, even successful privatization process will not solve the problems concerning fragmentation of land plots and lack of development of land market in the medium-term period. Rehabilitation of irrigation systems is at best postponed due to inconsistent approach of government and deficit of capital. Price hikes of interim products (fuel, herbicides, pesticides, fertilizers) and unfavorable conditions must also be included in the list of risks. As a result of decreased international prices on agrarian products and increase of import it will be extremely difficult to achieve satisfactory results in Georgian agribusiness without fundamental changes. Therefore, all these factors need to be taken into consideration as assumptions and risks of the given component.

4.4 Evaluation Methodology

Our assessment of the evaluation methodology is based on the materials indicated in Monitoring and Evaluation Plan. We just review these materials and present our additional recommendations. More detailed analysis of evaluation methodology is possible through quality and quantity-based study of the models used in it, which is a matter of additional research.

Samtskhe-Javakheti Road

The need to use **random selection** method is justified in this case; however, the criteria for establishing the homogeneity of the selection group must be clearly defined; besides, it needs to be farther studied how justified it is to extend the results of research of a particular group over the whole population.

Georgian Development Fund (stock fund)

The danger of investment dislocation must be taken into account during the evaluation of that component. In particular that means that there's a possibility that an enterprise or service can be financed with this activity, which wouldn't even exist under market competition conditions. In order to evaluate the impact of tourism and agribusiness on environment time lags need to be taken into consideration, because investment activities may not impact those parameters promptly and it may happen in a non-linear fashion. Combination of the two methodologies or simple comparison of their results will present quite a clear picture for evaluating general results. If comparison of control and research groups through some other **variable instrument** (for example geography, distance from Tbilisi, local characteristic etc.) becomes possible the results will be far more convincing.

According to management team of Millennium Challenge Georgia, the above-mentioned issues were included in the existing design of program impact evaluation. That design guarantees the generation of multidimensional models.

Agribusiness Development Activity

The methodology of the evaluation of that component due to its ambiguous connection with many factors of agricultural industry (exogenous natural factors and their variations, macroeconomic indicators, existing situation) is probably the most difficult one. We must take into account the fact that due to the extreme fragmentation of Georgian agrarian industry, identification of homogenous control and research groups and their comparison with each other in time and space will be very difficult. We believe that studying this methodology needs thorough thinking and detailed research, which will be possible after part of the activities included in this component is finished and the evaluation of the results is done.

4.5. Conclusions

In conclusion we can say that implementation of complex tasks set by Millennium Challenge Compact and their evaluation methodology will largely depend on research of interim results, which will reveal the accuracy of initial assumptions and risks. The most important thing will be meeting the deadlines; otherwise the objective evaluation of final results will be extremely difficult.

Besides, we have difference of opinions with the authors of the document concerning with factual materials, assumptions and risks indicated in certain program components. In particular under factual inaccuracies we mean the following: the authors of the document state that Samtskhe-Javakheti products are exported to France and UK, which, in our opinion, is not true. Besides, the potential of perishable goods in the region needs to be farther studied. Perishable goods are not produced in such numbers to say that the only problem hindering their exporting is the bad condition of the roads. This information can easily be checked. This is essential to understand the region's economic prospects completely. Besides, the region won't be able to gain access to huge markets. We believe that the economic potential of Samtskhe-Javakheti is not fully reflected in the monitoring and evaluation document.

More attention should have been paid to potato and one-year cultures production as well as livestock-breeding. The document should have focused on how the Millennium Challenge Program will increase the effectiveness of those parts of economy and therefore contribute to poverty reduction goal. We agree with the authors of monitoring and evaluation plan as far as risks and assumptions of improvement of local service are concerned, as for other four directions we have a difference of opinions with MCG and we've already reviewed.

Final Conclusions and Recommendations

We'd like to point out our conclusions once again that were made during the monitoring process:

Conclusion/recommendation I:

The detailed analysis of the reporting period indicates that a very small portion of the preliminarily planned sums are actually expended. That's an indication of incorrect planning; besides, the management of MCG is not able to timely spend the amounts, which endangers the project implementation to some extent. The following factors intensify this danger:

- Gradual fall in the US dollar exchange rate, which in reality decreases the compact budget, especially if the activities are not carried out on time. This will create problems in procurement as well if the procurements are made in hard currency.
- Inflation factors both inside and outside the country, which will surely make the implementation process more expensive (see Samtskhe-Javakheti Roads Rehabilitation Program). The longer the implementation process is delayed the harder the planning will be because if, for example, the activities that need to be conducted now are postponed then the inflation prognosis must be done for later periods of time, which will surely increase risks.
- Changes in macroeconomic parameters, both internal and external changes, which will influence the IRR and ERR parameters.

Conclusion/recommendation II:

Failure to meet the deadlines was not the only problem. There were problems not only with timely allocation of the monetary funds, but also with timely expenditure of the amounts and their timely inclusion in the State Budget.

Despite the assumed obligations the 2006 and 2007 Laws on State Budget didn't describe in detail the categories for which the amounts received from Millennium Challenge Corporation were to be expended, this is an indication of ineffective work of both the management of the Millennium Challenge Georgia and Ministry of Finance of Georgia.

This is farther evidenced by the fact that the Millennium Challenge amounts were changed in the Law on State Budget several times during the year - in September 2007 the new, third draft amendments to the State Budget were sent to the Parliament. Therefore, the planning process must be improved, because the difference between planned and expended amounts is approaching a dangerous limit. Besides, MCG and the Ministry must cooperate more actively so that the sums reflected in the State Budget correspond to the amounts planned and expended by MCG.

Conclusion/recommendation III:

During the monitoring period MCG presented imperfect 6 month procurement plans – they didn't include the starting point of the 6 month period and besides, the document didn't show on what stage each procurement transaction was made. Therefore, monitoring was complicated; besides, the organizations that wished to participate in the procurement process didn't know how to plan their activities. According to MCG, the new procurement plans don't contain information on completed procurements; however, the new 6 month procurement plans still don't include the expected dates of announcement of biddings, which, in our opinion, is also necessary.

Conclusion/recommendation IV:

The deadlines set for implementation of Energy Rehabilitation Project as well as other projects were not met. The delay in project implementation from the very early stages caused the following: the rehabilitation works started in winter and they coincided with floods, which, together with delayed deliver of pipes caused by Russian embargo (that circumstance was called a force majeure by the MCG), farther delayed the project implementation process. Therefore, we think that MCG must try to take into account the reasons for failure to meet the deadlines and political risks during the planning stage.

Conclusion/recommendation V:

The program encountered the huge problems during the implementation of Samtskhe-Javakheti Project. In the initial stages of the project implementation, according to the minutes of the meetings of the MCG Supervisory Board due to uncoordinated work with state agencies, failure to take into account the necessity to get various permits (in other words due to certain management problems) the project implementation was delayed – this is admitted by MCG too.

As a result, the bidding proposals were opened on June 7, 2007, these proposals were presented by construction companies selected as a result of pre-qualification selection process. The quotations presented by the companies taking part in the bidding process significantly exceeded the budget of the project. Due to that and based on the analysis of bidding proposals, the bidding was terminated. At the moment new bidding is being prepared for the construction companies.

Of course it will cause a significant delay in the implementation of Samtskhe-Javakheti Roads Rehabilitation Project – according to optimistic estimates, the procurement process will be finished by spring 2008, and in other words the commencement of the construction works has been postponed for one more year. That will most probably make the project implementation even more expensive. Why wasn't the preliminary evaluation of activities done adequately? Or why the quotations presented by the companies were too high? Was the bidding unprepared and how much more will the Fund had to pay in case of a new bidding? – These issues need to be specifically studied.

Conclusion/recommendation VI:

As far as Monitoring and Evaluation Plan of Millennium Challenge Georgia is concerned, the fulfillment of complex tasks indicated in the Millennium Challenge Compact and their evaluation methodology will largely depend on the research of the interim results, which will reveal the accuracy of initial assumptions and risks. The strict adherence to schedules will bear an essential importance; otherwise the objective evaluation of final results will be extremely difficult.

We have significant difference of opinions with the authors of monitoring and evaluation plan in connection with factual materials, assumptions and risks of certain program components of the compact. In particular, under the factual inaccuracy we mean the following: the authors of the document state that Samtskhe-Javakheti products are exported to France and UK, which, in our opinion, is not true. Besides, the potential of perishable goods in the region needs to be farther studied. Perishable goods are not produced in such numbers to say that the only problem hindering their export is the bad condition of the roads. This information can easily be checked. This is essential for the understanding of the region's economic prospects. Besides, the region won't be able to gain access to vast markets.

More attention should have been paid to potato and one-year cultures production as well as livestock-breeding. The document should have focused on how the Millennium Challenge Program will increase the effectiveness of those parts of economy and therefore contribute to poverty reduction goal.

We believe that taking into account the existing problems and recommendations by Millennium Challenge Georgia will make the program's goals more coherent and the chances of ultimate success feasible.



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