**Country and Sector Background**

1. Georgia is a country of 5.4 million people bounded by the black sea, Armenia, Azerbaijan, Turkey and Russia. It has played a historic role as a transit country between Asia and Europe and its independence in 1991 reopened the country’s transit possibilities. Until 1994, Georgia’s political instability did not allow the realization of that potential, but the conclusion of a cease-fire in the Abkhazian separatist dispute in that year marked a sharp improvement in the political and economic situation which has been sustained. This increased stability has focused attention on Georgia as one possible outlet for the huge oil reserves of the Caspian region.

2. On October 9, 1995, it was announced that Georgia would be one of two transit countries (along with Russia) for "Early Oil" from the first phase of exploitation of crude petroleum under the Caspian Sea by the Azerbaijan international operating company (AIOC), a consortium of 12 oil companies. The Georgian International Oil Corporation (GIOC) was created on November 11, 1995 as a state-owned enterprise to act as AIOC’s counterpart in Georgia.

3. AIOC will finance the investment in transit facilities for Early Oil through Georgia, which involves creating a continuous pipeline from Baku, Azerbaijan to Supsa (see 1/) on the Georgian Black Sea coast. This requires rehabilitation of existing pipelines, construction of some new stretches of pipeline, and construction of an oil storage depot and tanker terminal at Supsa. Early Oil is expected to begin flowing through the pipeline by end-1998. The
investment in early oil facilities is subject to a pipeline construction and operating agreement (PCOA) concluded between GIOC and the shareholders of AIOC (signed on March 8, 1996).

4 GIOC has been conceded the use of existing facilities, which it has in turn conceded to AIOC (under the PCOA). GIOC will also provide liaison services between AIOC and the government of Georgia. In return for conceding those facilities and providing those services, GIOC will receive tariff income from AIOC. GIOC is also obliged by the PCOA inter alia to participate in an environmental impact assessment, develop a safety monitoring system for the pipeline, and approve AIOC’s pipeline construction plans.

5 In the first year of its existence, GIOC has developed significant capacity, but much remains to be done if Georgia is to realize its full potential as a transit country. In particular, Georgia is one of the transit options for major export pipelines, i.e. Development of large-scale export from the Caspian region beyond Early Oil. AIOC is currently studying a number of major export pipeline routes and is expected to recommend a subset of these to its shareholders by mid-1997 for further analysis and possible negotiations. In addition, other oil developers in the region are considering Georgia as one of their transit options. However, substantial institution building will be needed if GIOC is to provide the government of Georgia the technical support it needs in any negotiations for a major export pipeline.

Objectives

6 The objective of the proposed project is to enhance the capacity of Georgia to undertake international negotiations in respect of oil pipeline transit. This will improve Georgia’s ability to benefit from oil development in the Caspian region by attracting private investment in the necessary transport infrastructure. Such capacity-building will include financial, commercial, engineering, environmental and legal aspects. This objective is to be achieved through on-the-job training, formal training courses, and advisory services.

Description

7 The project consists of four components:

(a) a feasibility study (by international consultants collaborating with Georgian counterparts) of a major oil export pipeline from Baku, Azerbaijan to Supsa, Georgia and of related terminal and storage facilities at Supsa. This study is intended to provide on-the-job training in project economics, pipeline tariff determination, environmental audit, legal review, project management and project financing, in order to enhance Georgian capacity to negotiate transit terms with private investors;

(b) a training fund to finance Georgian participation in formal training courses in Georgia and abroad, and on-the-job training in international companies in the oil industry. Such courses would
include: (i) pipeline transport economics (including principles of taxation); (ii) international contract negotiation skills; (iii) environmental impact assessment (including stakeholder analysis and public consultation); (iv) legal principles of transcountry pipeline construction & operation; (v) principles of oil accounting, general accounting and auditing; and (vi) project financing;

(c) negotiations advisors to provide specialized legal and financial advice prior to and during negotiations for oil transit, as well as to assist in preparing related contractual documents;

(d) project management services to be provided in kind by GIOC.

Financing

The total project cost is estimated at US$ 1.5 million, financed by the proposed credit of US$ 1.4 million equivalent and by a contribution in kind for project management from GIOC to an estimated value of US$ 100,000.

Implementation

9. The ministry of Finance will represent the borrower, the Republic of Georgia, and will onlend the proceeds of the credit to GIOC. The project will be implemented by GIOC. Include names and responsibilities of agencies charged with implementing individual components, expected participation of stakeholders and NGOs, and incentives to the participation of such groups. In its function as technical support agency for the government in its negotiations for oil transit through Georgia. The executive director of GIOC, as project manager, will oversee project implementation; procurement and management of consultants will be his direct responsibility, while disbursement, accounting, and loan repayment will be managed by the finance department of GIOC.

10. Terms of reference for the feasibility study have been prepared by GIOC (with the assistance of bank staff). The terms of reference emphasize the need for close involvement by GIOC counterparts in the work of the consultants, in order that the primary objective of on-the-job training is achieved. Terms of reference for the negotiations advisors have been drafted, and will be finalized once the scope of the negotiations becomes clear. An indicative training program has been prepared for financing from the training fund, and will be finalized after the consultants conducting the feasibility study have undertaken a detailed training needs assessment of GIOC.

11. The selection process for all consulting, advisory and training services will be in accordance with the bank’s "guidelines for use of consultants by world bank borrowers and by the world bank as executing agency" (August 1981). No goods procurement is provided for under the credit. All letters of invitation and all contracts will be subject to prior review by IDA. The letter of invitation for the consultants to undertake the feasibility study
has already been issued in view of the need for expeditious preparation for oil transit negotiations, which is associated with the pace of oil development in the region.

12 The project manager will be responsible for ensuring that the finance department of GIOC maintains project accounts in accordance with bank guidelines on financial reporting. The special account, project accounts, SOEs and GIOC’s company accounts will be audited by suitably qualified independent auditors acceptable to IDA; audit reports will be submitted to IDA within six months of the end of each financial year. The audit reports will include a statement verifying that the amounts disbursed against SOEs have been used for the purpose intended.

Sustainability

13 The proposed project is intended primarily to build capacity to undertake negotiations related to a major oil export pipeline from Baku to Supsa. However, Early Oil agreements contain periodic renegotiation clauses, and other oil and gas transit projects through Georgia are under consideration; the capacity built by the proposed project would therefore have spinoffs for later negotiations. The identification of a key counterpart institution, GIOC, for the project will increase the sustainability of the proposed project.

Lessons learned from past Operations in the Country/Sector

14 The implementation experience of the Georgia Institution Building and Structural Adjustment Technical Assistance Credits (Credit No. 2641 and 2847, approved July 5, 1994 and April 18, 1996 respectively) shows the value of timely institution building assistance in Georgia. However, experience of advisory services provided at very short notice for Early Oil negotiations under the Institution Building Credit suggests that sustained involvement of advisors at all stages of preparation and actual conduct of negotiations is desirable. Lessons learned from comparable projects elsewhere demonstrate the importance of selecting internationally-reputable consultants using bank competitive procedures and of the implementing agency being fully committed to the project.

Environmental aspects and participatory approach

15 In accordance with OD 4.01, the proposed project has been classified as category c, since it involves only institution building. However, the project places strong emphasis on building capacity in environmental analysis and dissemination of environmental information. The feasibility study includes an environmental audit to identify the key environmental issues in Georgia in order that GIOC can evaluate the environmental impact assessment that any pipeline investors would be required to undertake. It also places emphasis on assessing market potential in Black Sea countries, in view of the environmental constraints on shipping oil through the Bosphorus (see 2/). The training fund supplements the on-the-job training of the feasibility study with formal education.
training in environmental impact assessment, and provides for training in stakeholder analysis and public consultation in order to maximize public participation in environmental decision-making. In addition, the feasibility study provides for a review of the legal and regulatory issues pertaining to environmental considerations, and such issues will be included within the terms of reference of the negotiations advisors.

Program objective categories

16 The proposed project would contribute to the development of Georgia through its potential impact on fiscal revenues and private participation in infrastructure investment. Its emphasis on capacity building in environmental analysis with public participation will enhance the sustainability of that development.

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Note: This is information on an evolving project. Certain components may not necessarily be included in the final project.

Processed by the Public Information Center week ending April 11, 1997.

1/ An environmental impact assessment is underway. Once it has been completed, the design of the pipeline, Supsa terminal and environmental mitigation systems will be subject to Georgian Government approval.

2/ The Government of Turkey has repeatedly expressed concerns over the environmental implications of increasing volumes of oil shipped through the Bosphorus.