1. Georgia is a relatively small country with a population of 5.4 million situated in the southern part of the Caucasus region. It was the first of the non-Baltic states to declare independence from the former Soviet Union (FSU), on April 9, 1991. Formal contacts between the World Bank and the Republic of Georgia (hereinafter referred to as Georgia) began in March 1992, and the country joined the World Bank in August 1992. A Country Economic Memorandum, entitled "Georgia, From Crisis to Recovery: A Blueprint for Reforms" (Report No. 11275-GZ) was distributed to the Board in May 1993.

2. Soon after its independence Georgia became embroiled in political and civil strife which had a devastating effect on the economy. The armed conflict abated in late 1993, and the government has since refocused its attention on establishing law and order and rebuilding and reforming the economy. The government has requested IDA support in its efforts to design and implement stabilization and market reforms. The proposed operation is in response to that request. It would constitute the first operation by the World Bank Group in Georgia.

3. Background. Prior to the breakup of the FSU, Georgia was a relatively well-off state with a strong tradition of entrepreneurship. The Georgian economy’s sources of strength included agriculture (citrus, tea, wines) and agro-industries (processed food, fertilizers), tourism (the Black Sea coast), and natural resources (e.g., manganese). Georgia was also a relatively large producer of steel pipes, electric motors, synthetic fibers, roofing materials, textiles, and shoes. Furthermore, the country’s location made it a primary transit conduit for goods shipped elsewhere in the Caucasus. External trade, largely with the republics of the FSU, played a large role in the economy. Georgia relied heavily on imports of energy from other republics, notably Russia (electricity, crude oil) and Turkmenistan (natural gas). Imported energy amounted to about 95 percent of the total energy supply in 1992-93. Wheat, sugar, and some heavy machinery were the other major imports. Georgia’s main exports included citrus, tea, tobacco, wine, and mineral water.

4. Since independence, Georgia has suffered from intense civil conflict in Abkhazia and elsewhere which resulted in a large influx of
refugees to the other parts of Georgia, worsening the economic plight of the country. A ceasefire is now in effect and negotiations are underway to resolve the dispute. The war had a devastating effect on the Georgian economy. It directly affected Georgia’s main exports of tea and citrus and cost wiped out earnings from tourism. In addition, recession in the FSU, adverse terms of trade movements, the breakdown of marketing channels and trade, an earthquake, and strikes and political violence accelerated the economic decline. The per capita GNP is estimated to have declined from US$1,640 in 1991 to US$850 in 1992; output declined further by 40 percent in 1993. Not surprisingly, the economic decline has resulted in a sharp deterioration of social conditions. Living standards have plummeted. Rationing for basic commodities was introduced in December 1993. Central heating in Tbilisi was discontinued for the winter, and electric power has been rationed -- with more than 12 hours of daily power shutdowns. The shortage of fuel and electricity has forced cuts in public transport, and the influx of refugees from Abkhazia and western Georgia has aggravated the housing situation.

5. Since the beginning of 1994, the government has begun to consolidate its control over the country. There is an improvement in the law and order situation, and a new team is in place which has renewed efforts to rebuild the economy through market oriented reforms. Already progress has been made in implementing structural reforms in several areas: virtually all housing has been privatized; progress has been made in privatizing agricultural land; small-scale enterprise privatization has been initiated; and most prices (except energy and food products) have been liberalized. However, Georgia’s transition to a stable market economy will require strong monetary and fiscal measures to ensure macroeconomic stability, further price and trade liberalization, deeper structural changes in the enterprise and banking sector, including acceleration of medium-scale and large-scale enterprise privatization and financial sector reform. Better means to protect the most vulnerable population during the transition period will be necessary.

6. Project Objectives. The Government of Georgia has requested the World Bank’s support to develop and help finance an Institution Building Project to facilitate the design and implementation of reforms, establish the institutional framework for the effective management of a private market economy, and to develop a framework for coordination of technical assistance.

7. Project Description. On the basis of the economic and sector work already completed, further work undertaken in preparing the project, and in agreement with the government, this Institution Building Project would assist in the following areas.

   a. Financial Sector Reform

   Financial Sector Infrastructure: The institution building and technical assistance program will focus on preparing the institutional framework for financial sector reforms. The IDA project will finance consulting services and equipment to: (1) introduce and implement Broadly Adapted Financial Statements...
(BAFS), an internationally acceptable accounting and auditing system; (ii) conduct diagnostic studies of five state-owned banks and make recommendations for further actions; and (iii) review existing payment system and make recommendations for steps to streamline the system. In addition, within the framework of the proposed project, the Central Bank of the Netherlands has agreed to provide technical assistance on a grant basis for strengthening the banking supervision system and the development of a legal framework for the banking sector, and the IMF will provide a senior level advisor to the President of the NBG. The project will be coordinated with the on-going activities of the other donors: the EU is conducting training seminars for banking and accounting professionals; and USAID is developing a training program for commercial bankers.

b. Economic Management

Economic Policy Formulation: Support will be provided to the Office of the Deputy Prime Minister (responsible for economic reforms) to design a strategy for the restructuring and reform of the government’s economic management agencies, particularly the Ministries of Finance and Economy, and to strengthen economic policy formulation and analysis. The British Know-How Fund has agreed to finance a short-term adviser to provide an initial assessment for this restructuring. In addition, the Government of the Netherlands has agreed to provide grant funds to finance a sectoral economist to work as an adviser to the Deputy Prime Minister. This adviser will be in addition to the macroeconomist who was originally envisaged under the proposed IDA project, and who has already been in place under grant funding from USAID.

Statistical Services: The government has requested assistance to strengthen its capacity for data collection and analysis. The project will support consulting services, training, and equipment to assist the Committee for Social and Economic Information (CSEI) in (i) reviewing the methodology used for generating and maintaining national accounts and initiating steps to introduce the internationally acceptable System of National Accounts (SNA); and (ii) designing and conducting an improved household survey in the city of Tbilisi.

Tax Administration: Technical assistance is needed to help the government design the tax modernization program, the computerization of the tax offices and the training of the State Tax Inspectorate (STI) staff. The project is expected to be completed in two phases: a pilot project for the modernization and computerization of the central STI and the Tbilisi City Inspectorate; and extension of the computerization and training to the rest of Georgia. The IMF is helping to streamline the tax administration system, develop a computerization plan, and oversee the implementation of the modernization in the first phase, and is expected to continue its support to the second phase as well. The IDA
The government has decided to establish a modern Treasury which will provide better expenditure management and will also consolidate currently idle government balances with the banks into a single Treasury account with the NBG. The Ministry of Finance has been working with the IMF on the design of the treasury system. The project is expected to be carried out in two phases: in the first phase, a central treasury function will be established in the Ministry of Finance and a regional branch in the city of Tbilisi; in the second phase, regional treasuries will be established throughout Georgia. The IMF will oversee the initial work. The IDA project will finance computers for the establishment of the central Treasury office and the regional office in the city of Tbilisi.

Debt Management and Economic Analysis: The Ministry of Finance has requested assistance in strengthening its debt management and economic analysis capacity. The project will finance short-term advisers and equipment to assist the Ministry of Finance in (i) setting up a debt management system, and (ii) training the staff of the Department for Macroeconomic Analysis. UNCTAD is expected to execute the debt management component of the project: a computerized system will be installed in the Ministry of Finance, and hands-on training will be conducted in maintaining a modern debt management system. For the macroeconomic analysis, experts will assist the Ministry staff in developing computer-based economic models, streamline data collection and analysis tools, and prepare economic projections.

Strengthening of Customs Administration: This component will assist in the establishment of a customs administration suitable for a private, market economy. Support will be provided to the Customs Committee in (i) simplifying and reforming the organization and procedures of customs operations; (ii) modernizing customs management; (iii) training the customs staff in the customs management and the computerization; and (iv) computerizing customs clearance procedures, accounts, and statistics at Tbilisi headquarters and at the Tbilisi airport as the first pilot site. This component has been prepared with the assistance of and would be executed by UNCTAD.

Aid Coordination: The government has decided that the newly established Secretariat to the government’s Aid Management Commission will work as the Aid Management Unit (AMU) of the country. The project will finance a long-term external adviser and equipment to assist and train the staff of the AMU in carrying out its functions. The adviser(s) will assist the AMU in maintaining donor information, understanding donor procedures, coordinating country’s external aid priorities consistent with the national development objectives, and communicating those with the external aid agencies. Also, the
project will finance experts to assist the government staff in analyzing sectoral information with an objective to design and develop projects that will be acceptable to the donor community. Both the EU and the UNDP have expressed interest in supporting the initial establishment and functioning of the AMU on a grant basis.

Project Administration: The project will finance: (i) an external procurement consulting firm to assist the PIU with the preparation of procurement and disbursement documents under this project, and to ensure that all procurement under the project follow the World Bank’s procurement guidelines; and (ii) a computerization expert to assist and train the government staff in developing detailed computerization plans, and implementing the equipment purchased under this project.

c. Privatization and Enterprise Reform

Support for Privatization: The credit will finance activities which will help accelerate implementation of privatization in Georgia. Since the government has already made significant progress on small-scale privatization, this project will focus on the development of a broad privatization strategy and on initiating mass privatization. The project will finance: (i) one short-term senior level adviser to assist the Ministry of the State Property Management (SPM) and the Office of the Deputy Prime Minister in reviewing the current privatization plan, and in identifying impediments to its progress; and (ii) experts and equipment to (a) assist in formulating the mass privatization program and the voucher scheme; (b) assist in the design and implementation of a public information campaign to support the mass privatization campaign; (c) assist in the development of a privatization methodology and implementation through a pilot privatization of selected large enterprises; (d) provide training aimed at strengthening the institutional capabilities of SPM in carrying out privatization and enterprise diagnostics; and (e) review and further develop a legislative framework for privatization. The privatization component will be coordinated with the already on-going activities of the EU and the German Government. In addition, equipment will be provided to both the SPM and the Ministry of Industry to facilitate their work in the privatization process.

8. Financing Plan: (US$ Million)

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9. Project Implementation. This credit will be administered in Georgia by the Institution Building PIU, comprising a project manager and two specialists -- one on procurement and another on disbursements.
In addition, the project will finance an experienced procurement consulting firm to assist the PIU for the first 12 months of the project. The administrative burden placed on government staff has been minimized to the extent possible by packaging the operation into as few contracts as possible. The project has provided extensive funding to conduct in-country training as well as external training of the government staff from all the beneficiary agencies. Two project components will be executed under directed-source arrangements with a UN specialized agency (customs administration and Debt Management: UNCTAD), in accordance with World Bank guidelines, thereby further reducing the administrative burden on the government.

10. Parallel financing will be provided by the Government of the Netherlands for a sector economist to support the Office of the Deputy Prime Minister. The British Know-How Fund will finance a short-term adviser for restructuring of the government economic management agencies. Technical assistance has been arranged on a grant basis from the Central Bank of the Netherlands for banking supervision and legal infrastructure. The IMF will provide technical assistance for three areas in the economic management component (Tax, Treasury, and adviser for the NBG). The project will be coordinated with the on-going activities of the USAID, Germany, and the EU in the areas of economic analysis, bankers’ training, and privatization. Further donor coordination efforts will continue.

11. Project Sustainability. The assistance provided through this project will train the government staff in the design and implementation of stabilization policies and market reforms. It would thus strengthen the institutional framework for managing a private market economy. It would also provide a vehicle for coordinating technical assistance and, through that assistance, accelerate the process of reform in Georgia.

12. The risks relate to the possible consequences of a renewal of armed conflict, political instability, and of implementation difficulties. The government is still in the process of consolidating its power and determining institutional responsibilities. To minimize potential problems, the project has been kept small, focused on most important needs, and concentrated on central institutions. Possible implementation delays are being minimized by reducing the number of contracts as much as possible, initiating procurement activities very early in the project cycle, focusing on those core activities that can have a demonstrable impact in a short time, and defining the program as fully as possible prior to its initiation.

13. Poverty Category. Not Applicable

14. Environmental aspects. As this project is not expected to have any significant negative environmental impact, it has been placed in category C for the purposes of OD 4.01 on Environmental Assessment and does not require an environmental assessment. Recognizing the importance of environmental issues with respect to the process of privatization, the operation would finance environmental audits for early candidates for privatization as required. In addition, under the privatization component, assistance would be provided to help the government develop a strategy for settling environmental liability
questions.

15. Program Objective Category. Economic Management (EA) category.

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