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Report No: 45632-GE

PROJECT PAPER

ON A

PROPOSED ADDITIONAL FINANCING CREDIT

IN THE AMOUNT OF SDR 12.8 MILLION

(US\$20.0 MILLION EQUIVALENT)

TO

GEORGIA

FOR THE

SECOND EAST-WEST HIGHWAY IMPROVEMENT PROJECT (CREDIT NO.4373-GE)

October 1, 2008

**Sustainable Development Department
South Caucasus Country Unit
Europe and Central Asia Region**

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CURRENCY EQUIVALENTS

(Exchange Rate Effective September 30, 2008)

Currency Unit = GEL
1.40 GEL = US\$1
1 GEL = US\$0.71
US\$1.57 = SDR1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
CPS	Country Partnership Strategy
CY	Calendar Year
EBRD	European Bank for Reconstruction and Development
EDPRP	Economic Development and Poverty Reduction Program
EIB	European Bank of Investment
EIRR	Economic Internal Rate of Return
EMP	Environmental Management Plan
FM	Financial Management
FMR	Financial Monitoring Report
GDP	Gross Domestic Product
GEL	Georgian Lari (Currency Unit)
GNI	Gross National Income
IDA	International Development Association
IFR	Interim Unaudited Financial Report
JBIC	Japanese Bank for International Cooperation
MoED	Ministry of Economic Development
PRSP	Poverty Reduction Strategy
RDMED	Road Department of the Ministry of Economic Development
SDR	Special Drawing Rights (Currency Unit)
SEWHIP	Second East West Highway Improvement Project
TRRC	Transport Reform and Rehabilitation Center

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**GEORGIA
SECOND EAST-WEST HIGHWAY IMPROVEMENT PROJECT
ADDITIONAL FINANCING
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Project Paper Data Sheet

Date: October 1, 2008 Country: Georgia Project Name: Second East-West Highway Improvement Additional Financing (SEWHIPAF) Project ID: P107610	Task Team Leader: Olivier Le Ber Sector Manager: Motoo Konishi Country Director: Donna Dowsett-Coirolo Environmental category: A							
Borrower: Georgia Responsible agency: Roads Department of the Ministry of Economic Development (RDMED) 12 Kazbegi Avenue 0160 Tbilisi Georgia Tel: (+995 32) 38 16 33 Fax: (+995 32) 31 30 52								
Revised estimated disbursements (Bank FY/US\$m) ¹								
FY	2008	2009	2010	2011	2012			
Annual	12.3	15.9	26.3	0.5	0.0			
Cumulative	12.3	28.2	54.5	55.0	55.0			
Current closing date: February 29, 2012 Revised closing date: February 29, 2012.								
Does the restructured or scaled-up project require any exceptions from Bank policies? Have these been approved by Bank management? Is approval for any policy exception sought from the Board?							<input type="radio"/> Yes <input checked="" type="radio"/> No <input type="radio"/> Yes <input type="radio"/> No <input type="radio"/> Yes <input type="radio"/> No	
Revised project development objectives/outcomes <i>[If applicable]</i> There is no change in the Project's Development Objectives or expected outcomes.								
Does the scaled-up or restructured project trigger any new safeguard policies? Not applicable								
For Additional Financing								
<input type="checkbox"/> Loan <input checked="" type="checkbox"/> Credit <input type="checkbox"/> Grant For Loans/Credits/Grants: Total IDA financing (US\$m.): \$20.0 million Proposed Terms: IDA terms of 20 years maturity with 10 years grace.								
Financing Plan (US\$m.) ²								
	Source	Local	Foreign	Total				
	Borrower	10.0	0.0	10.0				
	IDA	14.0	6.0	20.0				
	Others	0	0	0				
	Total	24.0	6.0	30.0				

¹ The disbursement for FY08 was faster than the original projection. The revised disbursement schedule reflects the actual disbursement and incorporates the disbursement from additional financing.

² Additional financing only.

I. Introduction

1. This Project Paper seeks the approval of the Executive Directors to provide an additional credit in an amount of US\$20.0 million equivalent to Georgia for the Second East-West Highway Improvement Project (SEWHIP, Credit: IDA-4373 GE). The Additional Financing would contribute to cover a financing gap which was anticipated during the preparation of SEWHIP, due to limitations on the amount of IDA funding which Georgia was able to access at that time. About 40% of the original Credit has already been disbursed; the Additional Financing is needed during the first quarter of CY2009 to maintain the pace of implementation and achieve seamless disbursements.

2. There will be no change to SEWHIP activities. While there is no co-financing from other donors for this project *per se*, there is close coordination among the various donors supporting (or willing to support) upgrading of the East-West transit corridor in Georgia (of which SEWHIP is an important part), including with the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Bank of Investment (EIB) and the Japanese Bank for International Cooperation (JBIC).

II. Background and Rationale for Additional Financing

3. **Original Project:** SEWHIP was approved by the Board on November 15, 2007 for SDR 22.4 million (US\$35 million equivalent) and became effective on March 10, 2008. The Project's development objectives are (i) to contribute to the gradual reduction of road transport costs and improve ease of transit and safety along the central part of Georgia's East-West corridor through upgrading a segment of the East-West Highway (E60) from Tbilisi to Rikoti, and (ii) to strengthen the capacity of government agencies (particularly RDMED) to develop and implement a traffic safety program. The Additional Financing involves no change of the project's original objectives, design or scope.

4. The SEWHIP consists of (i): the upgrading of the Igoeti to Sveneti section of the E60 Highway from two to four lanes including the construction of four bridges at Igoeti bypass, (ii) a road safety component and (iii) project implementation. The Government wanted IDA to process the upgrade from Igoeti to Sveneti as one operation, but due to phasing of Georgia's access to IDA, which extended across two replenishment periods, this was not possible. To meet the Government's project implementation timeframe, however, the SEWHIP was designed as a single operation with an IDA credit of US\$35 million in FY08 and the remaining US\$20 million to be financed in FY09 through additional financing, subject to IDA availability, good project performance, and progress in implementing a National Traffic Safety Strategy. In July, the Government sent a formal request to IDA for the Additional Financing.

5. **Financing gap and cost overrun:** The original total cost of the project was estimated at US\$80 million, but this has since been revised upward to US\$90 million mainly due to the depreciation of 18% of the US\$ against the GEL.

6. **Project performance:** The implementation of SEWHIP is well managed and ratings in all the Implementation Supervision Reports have been satisfactory or better. The main contract for the highway upgrade is under implementation; earthworks have started. The implementation

of the road safety component is also progressing at a good pace. Of the US\$35 million credit amount for SEWHIP, about US\$14 million has been disbursed and disbursement is ahead of original projection.

7. **Traffic Safety:** When the SEWHIP project was being finalized, the Government requested more time to develop its comprehensive traffic safety strategy³ IDA and the Government agreed during SEWHIP's negotiations that for IDA to proceed with the additional financing, the Government would need to show "good progress" in the implementation of the National Traffic Safety Strategy, and this would be demonstrated by:

- (i) A National Traffic Safety Strategy having been adopted by the Government;
- (ii) Instructions having been given to the line ministries to implement the strategy; and
- (iii) A high level coordinating body operating to oversee implementation of the strategy.

8. In July, the Cabinet of Ministers endorsed the National Traffic Safety Strategy presented by the Ministry of Economic Development (MoED). The Cabinet also approved the amendment to the charter of the Transport Commission to cover traffic safety issues. The Transport Commission is a high level inter-ministerial coordinating body which meets regularly to discuss transport related matters.

9. **Country Context:** In the last four years macroeconomic management in Georgia has been solid and able to mitigate internal and external shocks. GDP growth averaged 10.5% during 2005-2007 led by selected sectors, including trade services, construction, financial intermediation, and manufacturing industry. Strong economic growth and appreciation of national currency vis-à-vis SDR and US\$ has resulted in a substantial increase of dollar denominated per capita income. The Gross National Income (GNI) per capita increased from US\$680 in 2001 to US\$1,990 in 2007. Georgia became a 'blend' country eligible for IBRD resources as of FY09.

10. The recent August conflict has resulted in shocks to the key pillars of economic development of Georgia. These shocks have included weakening investor and consumer confidence, physical and infrastructure damage and other infrastructure bottlenecks, increased numbers of internally displaced persons, and liquidity pressures in the banking system. A joint multi-donor needs assessment led by the World Bank will be completed in early October. The preliminary assessment is that direct damages to international, main, secondary, local and community roads are not very extensive and can be handled in the context of planned donor post-conflict support to Georgia, as well as through regular periodic and routine maintenance activities of the network.

III. Proposed changes

11. There are no changes of the project's original objectives, design, scope or components.

³ The traffic safety component in SEWHIP was scaled back from a multi-sector pilot program for the E60 Highway to one focusing on RDMED and comprised of works, specialized consultancy services, training and equipment to increase RDMED's traffic safety capacity.

IV. Consistency with CPS

12. The SEWHIP is the second of a series of sequential upgrades of the E60 East-West Highway in Georgia. The E60 upgrade was agreed as part of the FY06-09 Country Partnership Strategy (CPS), which focuses new lending on economic and social policy reforms, infrastructure and education, as key pillars of Georgia's sustainable development strategy. The first of the E60 series, EWHIP (from Agaiani to Igoeti) was approved on December 5, 2006 for SDR 12.9 million (US\$19 million equivalent) and became effective on March 5, 2007. The SEWHIP, from Igoeti to Sveneti, was approved on November 15, 2007 for SDR 22.4 million (US\$35 million equivalent) and became effective on March 10, 2008.

13. In January 2008, Georgia's Parliament approved a five year economic program for 2008-2012, "Georgia without Poverty". *Inter alia*, the program emphasizes targeted infrastructure development, particularly in transport infrastructure and logistics. The Government plans to complete the rehabilitation of a significant part of the country's road infrastructure.

V. Appraisal of Additional Financing

14. **Economic and financial:** The expected economic impact of SEWHIP with the Additional Financing is not material because the proposed financing does not amend the original project scope. The limited cost variation does not impact the economics of the project because the price increase in US\$ term is due mostly to inflation in the construction sector and US\$ depreciation. It is marginally due to the modification of the bridge design and not due to underestimating of the works (or the quantities). While costs (expressed in US\$) are increasing, so is the value of the benefits (whether it is value of time or vehicle operating costs). Furthermore, the original economic analysis included an EIRR sensitivity analysis for a 20% cost increase of the civil works, which indicated that even at that level of increase the resultant EIRRs would be respectively 15.2% for the 23 km Igoeti-Sveneti road and 10.9% for the construction of the Igoeti bypass⁴. The impact of the conflict on future traffic growth cannot be determined with precision at this time. However, until August, the traffic growth on the E 60 highway had been much faster than initially projected (an increase of 30% in one year instead of the 7% assumed in the economic evaluation). Taken together, the team considers that the economic (cost-benefit) analysis is marginally affected and should thus remain substantially unchanged or even show improved results if the traffic growth is not too much affected by the conflict.

15. **Technical:** The main contract for the highway upgrade is under implementation. The works involve the construction of two new lanes and the rehabilitation of two existing lanes from Igoeti to Sveneti section of the E60 Highway. The works are being implemented in two stages; the first beginning with the construction of the new lanes to be followed by the rehabilitation. The works contract has been awarded to the lowest evaluated bidder and earthworks have already started. The section of the SEWHIP improvement that is near Gori did not sustain material damage during the recent events. The second works contract involves the construction of 4 bridges to allow for the crossing of a small and narrow valley and the Lekhura River near Igoeti. RDMED has already started the designing process and has launched the prequalification process.

⁴ SEWHP, Project Appraisal Document Annex 9 (E)

16. **Procurement:** Procurement and consultant guidelines for World Bank loans and IDA credits, dated May 2004 and revised October 2006, are applicable to both the SEWHIP and the Additional Financing. The procurement capacity of RDMED has improved since the appraisal of SEWHIP. The procurement activities under the First East-West Highway Improvement Project were carried out by RDMED, assisted by the Transport Reform and Rehabilitation Center (TRRC). For the SEWHIP, RDMED has assigned a group of staff to assume procurement responsibilities for IDA sponsored projects. These staff report to the Deputy Chairman in charge of all international investment projects, and they have become more familiar with procurement policies and procedures for World Bank loans and IDA credits. Also, the offices of RDMED and TRRC have been consolidated into one building which has improved communication. These developments have resulted in more effective implementation, including procurement activities. The additional financing would not change SEWHIP's original procurement plan. Since the main contract representing 75% of the project is procured under satisfactory conditions, the residual procurement risk remains limited and manageable.

17. **Financial and disbursement:** The financial management functions of the additional financing including the flow of funds, staffing, accounting, reporting, and auditing will be handled by RDMED through TRRC as set in the Implementation Support Agreement spelling out their respective roles and responsibilities. There will be no changes in financial management arrangements. The financial management function of TRRC has been reviewed regularly by the Bank as TRRC is responsible for a number of on-going IDA financed projects and has been found satisfactory. The latest financial management supervision report (April 2008) concludes that financial management arrangements of the project continue to be satisfactory and the internal control procedures are in place. The overall FM risk for the project is moderate and the financial management arrangements of the project are acceptable to IDA. There is no audit of the project since it started to disburse in 2008 (it is already 40% disbursed). The client is in compliance with audit covenants regarding all other projects implemented by the TRRC. Similar audit arrangements will be adopted for the additional financing. The project audit will be conducted by independent private auditors under terms of reference acceptable to the Bank. The annual audited project financial statements will be submitted to the Bank within six months of the end of each fiscal year and also at the closing of the project. The cost of the audit will be financed from the proceeds of the credit. Project management-oriented Interim Un-audited Financial Reports⁵ (IFRs) will be used for the additional financing monitoring and supervision. The existing formats of the IFRs will be used and the TRRC will produce a full set of IFRs every quarter throughout the life of the project and will submit them to the Bank no later than 45 days after the calendar quarter end. There are no changes in the disbursement arrangements.

18. **Social:** The Resettlement Action Plan has been submitted to and cleared by IDA. Some minor adjustments have been introduced because of a slight modification in the alignment. Once the new alignment is determined, the revised list of land owners and associated impacts would be submitted to IDA prior to the initiation of negotiation with land owners. Based on RDMED's good track record in implementing the resettlement plan for the FEWHIP and its demonstrated commitment to comply with IDA social safeguards, the risk of non-compliance is low.

⁵ Previously known as Financial Monitoring Reports (FMRs).

19. **Environment:** SEWHIP is rated Category A for the purposes of environmental assessment because some significant environmental issues are anticipated in accordance with the World Bank's safeguard policies and procedures, including OP/BP/GP 4.01 *Environmental Assessment*. A framework assessment was first conducted, followed by a full scale Environmental Impact Assessment and an Environmental Management Plan (EMP). RDMED has a satisfactory capacity to supervise implementation of the EMP and ensure contractors' compliance. RDMED's staff responsible for environment and social safeguards received technical assistance from IDA aimed at enhancing the agency's capacity in environmental and social management of roads rehabilitation and construction operations. This included on-the-job training and the provision of an operational manual to guide RDMED's field work. Three RDMED staff participated in the regional Safeguards Training Workshop offered in April 2008 by the Bank in Tbilisi.

VI. Expected Outcomes

20. There is no change to the Results Framework with the exception of three Intermediate Outcome Indicators about traffic safety for which no target value were not originally set, pending the adoption of the Traffic Safety Strategy by the Government. These three Intermediate Outcome Indicators have since been agreed upon. The revised "Arrangements for Results Monitoring" is attached as an Annex.

VII. Benefits and Risks

21. Until the recent conflict, no new sector risks had developed since SEWHIP's approval. The risk profile of the original project has decreased as the institutional capacity of RDMED has improved⁶, the principal works contract has been procured, and RDMED is more aware of road safety issues. Despite the recent August events, there is no lasting damage to the E-60 highway, generally, or to the ongoing works financed under the SEWHIP in particular. The only new risk for the project is that the remainder of implementation will take place in a post-conflict setting during which economic slowdown is anticipated. However, the international community is providing substantial financial and technical support to Georgia. The additional financing will be helpful to the economic recovery process by freeing budgetary resources which can be used elsewhere for reconstruction purposes.

VIII. Financial Terms and Conditions for the Additional Financing

22. The existing SEWHIP Financing Agreement will be amended to reflect the terms and conditions for the Additional Credit (Article II and amortization provisions) and the disbursement table/schedule has been revised accordingly. The additional credit has a final maturity of 20 years including a grace period of 10 years.

⁶ There is demonstrated desire to modernize and the organizational structure of RDMED is such that there is now a core management team that has experience working with IDA and is familiar with IDA policies and procedures. Also the working relationship of TRRC and RDMED is closer as they are housed in one building.

**Second East West Highway Improvement Project – Additional Financing
Project Paper**
Arrangements for results monitoring

Project Outcome Indicators	Target Values				Data Collection and Reporting			Responsibility for Data Collection
	Baseline	2008	2009	2010	2011	Frequency and Reports	Data Collection Instruments	
Transit time from Igoeti to Sveneti	19'	17'	12'	12'	12'	Every year	Technical reports	RDMED and TRRC
Vehicle operating cost from Igoeti to Sveneti (cars in US\$/km)	0.20	0.19	0.18	0.18	0.18	Every year	Road databank	
Vehicle operating cost from Igoeti to Sveneti (trucks in US\$/km)	0.76	0.74	0.72	0.72	0.72	Every year	Road databank	
National road safety action plan with targets and monitoring indicators devised	No	Yes				Every year	Project Monitoring Reports (PMR)	
National road safety action plan with targets and monitoring indicators under implementation	No	Yes				Every year	Project Monitoring Reports	
Intermediate Outcome Indicators								
Component 1								
Number of km upgraded (2 lanes)	0	24	48	48	48	Every 6 months		RDMED and TRRC
Igoeti-Sveneti built incorporating safety specifications	No		Yes			Every 6 months		
Component 2								
New accident data system in place and data available and in use by key agencies to develop safety interventions in each sector	No	No	Yes	*	*	Every 6 months	Project Monitoring Reports (PMR)	RDMED and TRRC
Number of fatalities per 10,000 cars	14.5	13.9	13.2	12.6	12	Every year	Police statistics	
Percentage of vehicle occupants wearing seat belts on E60	60%	65%	70%	75%	85%	Every year	PMR	
RDMED road safety unit strengthened (staff number)	3	5	5	5	5	Every 6 months	PMR	
Number of hazardous locations improved per year	0	0	10	15	20	Every 6 months	PMR	
High level multi agency coordination body operating		Yes				Every 6 months	PMR	