Economic Policy Research Center

«Monitoring the Millennium Challenge Program»
V Stage Report

OPEN SOCIETY GEORGIA FOUNDATION
ფონდი ღია საზოგადოება საქართველო

The Project has been performed with support from the «Open Society Georgia Foundation»

The project has been performed within the scope of the coalition «Transparent Foreign Aid To Georgia»

December 2010

CONTENT

INTRODUCTION

Economic Policy Research Center (EPRC) has been monitoring the Millennium Challenge Georgia Program since January 2006. The project is supported by Open Society Georgia Foundation (OSGF). The Monitoring of Millennium Challenge Program is implemented within the scope of Transparent Foreign Aid to Georgia Coalition[1].

Over the period between 2006 and 2009, the EPRC published four monitoring reports. The current report deals with Stage V monitoring results.

This report covers the period from 1 December 2009 to 1 December 2010. The analyzed period is somewhat specific as there are four months left until the completion of the Compact. Therefore, some projects are supposed to be already completed by this stage or be in a final phase of their completion.

Let us recall that on 12 September 2005, Governments of Georgia and the USA signed an agreement - Millennium Challenge Compact which was ratified by the Parliament of Georgia on 28 October of the same year. The Millennium Challenge Georgia Program entered into force on 7 April 2006. The term of the Compact will expire on 7 April 2011.

It should be noted that the original Compact was amended once: on 20 November 2008, an amendment was made to the Compact signed between the Millennium Challenge Corporation and the Government of Georgia in 2005. This amendment envisaged granting an additional $100 million to the ongoing Millennium Challenge Georgia Program ($295.3 million), thus increasing the Millennium Challenge Corporation (MCC) development assistance to Georgia to $395.3 million. This additional aid, however, did not affect the completion date of the Compact.

This report, therefore, reviews not only the activities carried out throughout the analyzed year, but also the results achieved by 1 December 2010 and existing problems.

The report reflects the transformation of the entire design of the Program undergone from 1 December 2009 to 1 December 2010 as well as from the inception of the Compact to the present day.

The report discusses the dynamics of monetary parameters of the Program as a whole as well as its separate components; analyses whether or not the expended amounts meet the targets envisaged in a multi-year financial plan; overviews the progress of projects to be implemented under the Program, changes in internal designs of projects, conformity of results achieved through the implementation of projects with the goals declared in the Compact; and examines whether the current status of projects is conducive to the completion of the Compact on time, i.e. by 7 April 2011.

1 The Coalition member organizations are: Open Society Georgia Foundation, Economic Policy Research Center, Eurasia Partnership Foundation, Georgian Young Lawyers' Association, Green Alternative, Transparency International Georgia and Civitas Georgica.

I. KEY FINDINGS

- **A tendency of altering the main design of the Program continued in the monitoring period. This tendency, in fact, served the aim of mobilizing any resource available within projects for tackling problems in the Samtskhe-Javakheti Road Rehabilitation Project.** By the end of the analyzed period, the total cost of projects remained unchanged as compared to the corresponding period of the previous year, making up $395,3 million. At the same time, it became apparent that $100 million allocated to Millennium Challenge Georgia Program under the amendment #1 to the Compact in December 2008, as an additional aid in the aftermath of the August war, was entirely used up by the Samtskhe-Javakheti Road Rehabilitation Project (SJRR project). Besides, additional $10 million is to be reallocated from other projects for this Project. Originally, however, SJRR Project was to receive only $60 million out of that $100 million additional aid. Moreover, the comparison with the beginning of the 2009 analyzed period makes it clear that the SJRR Project will use 54 percent of the total amount instead of 52 percent as planned last year, while the Regional Infrastructure Development project and Administration and Control component will expend 14 percent and 5 percent of the total amount, respectively, instead of 15 percent and 6 percent.

- **The need to accelerate the rate of the use of amounts is still pressing.** Due to significant delays in previous years, only 76.5 percent of total amount had been spent by the beginning of the third quarter of the fifth Compact year. This means that the Program must expend 12 percent per quarter, on average, during the remaining period. Such an ambitious increase may endanger the quality of performed works. Special attention should be paid to the Regional Infrastructure Development Project (RID Project) which had only expended 62.1 percent of the total amount by the second quarter of the fifth Compact year. This means that the Program must expend 12.6 percent per quarter, on average, during the remaining period. This will be a difficult challenge as until now the Project expended 3.5 percent quarterly, on average. By the first quarter of the fifth Compact year, the Georgia Regional Development Fund (GRDF Project) spent 18.7 percent of the planned expenditure. During the fifth Compact year this component will expend 39 percent of the planned amount. The situation looks better in Enterprise Development and Administration and Control components with almost 80 percent of the planned amount been expended by the second quarter of the fifth Compact year.

- **The conformity of actual spending with financial plan has shown some improvement.** The total expended amounts in previous years did not exceed 50 percent of the planned one. In the following quarter 80 percent of the planned amount will be expended, which is a good indicator against the historical data, although still insufficient.

- **The SJRR project still remains the most problematic project of the Millennium Challenge Program. The cost of this Project increased again in the monitoring period** from $203,515 million to $212,615 million, or by about $9 million. However, the length of the rehabilitation road, as compared to the beginning of the analyzed period, has increased only by 3,52 km and comprised 222,72 km as of 1 December 2010.

  In the end, instead of $102 million as originally envisaged by the Compact, it is planned to spend $110,6 million more on the SJRR Project by the end of the analyzed period. The length of rehabilitation road, however, has decreased by about 22 km as compared to the original length of 245 km.

- **The SJRR project is again in emergency situation.** Although the problems related to improper performance of the company, Ashtrom International, had been identified by the beginning of the analyzed period, the program failed again to avoid emergency situation.

  The contract with Ashtrom International was terminated only in August 2010. MCG paid the company $37 938 632. The company was imposed a fine in the amount of $8,2 million.

  As a result, a $30 903 542 worth contract was awarded through price quoting, without competitive bidding, in the monitoring period.

In the EPRC's opinion, the emergency situation, the SJRR project found itself in, was caused by objective as well as subjective reasons. Among objective reasons are the provisions of the contract signed with Ashtrom International, which, despite identified problems, did not allow the state to terminate the contract without losses. Subjective reasons include half-measures undertaken against this company and the failure to timely use the preconditions for the termination of the contract, which existed in late April, and unjustified delay in doing so thereafter.

As a result, contracting companies had to perform works at an unprecedented speed which threatened the quality of performance. It should however be noted here that the scale of works promises that the Project will be completed on time.

- **During the monitoring period, proceeding from the interests of the project, ownership rights of three citizens of Georgia were violated. Their residential houses were expropriated.** The EPRC believes that the problem was the inadequacy of compensation in both cases – in case of the offer made by the state as well as in case of the amount requested by owners of houses. A fair decision was of utmost importance taking into account that the region is mostly inhabited with ethnic minorities. (See, details in section Implementation of Projects).

- **The monitoring period proved that the Energy Infrastructure Rehabilitation project is the most successful project of the Millennium Challenge Georgia Program. As of 1 December 2010, the budget of the Energy Project comprised $45,900 million** (less by $2,6 million as compared to the original budget envisaged in the Compact).

  Within the limits of existing funding, the Project managed to implement three phases of rehabilitation and an additional segment – pre-construction design study for an underground gas storage facility. However, with the savings made in the course of implementation, the Energy Project was not able to fully implement a new, fourth phase of rehabilitation. During the monitoring period, financial reserves of this Project were deliberately held on for needs of the SJRR Project. In the end, the fourth phase of rehabilitation was prevented from independent implementation, although in the second half of the analyzed period, the Energy Project purchased pipes and equipment, through international competitive bidding, worth $6 012 757 for the Georgian Oil and Gas Corporation to rehabilitate North-South gas main pipeline. The Corporation, i.e. the state, assumes the responsibility to implement these rehabilitation works.

- **The prospect of completing the Regional Infrastructure Development Project as scheduled raises questions.** The RID Project was allocated $60 million at the time of signing the Compact. After numerous modifications, the funding of this component, as of November 2010, stands at $54,735 million. Moreover, the number of originally envisaged projects has decreased. During the monitoring period – from 1 December 2009 to 1 December 2010, changes were made to the funding of internal projects under RID component. The MCG decreased its share in the projects. At the same time, the dynamics of the use of funds reveals that the completion of the RID projects in 2010, as it was planned, is unrealistic.

- **The funding of Georgia Regional Development Fund has decreased** by $2.5 million (from $32,5 million to $30 million). In the monitoring period, the GRDF was distinguished for its low activity rate. Within that period, a direction for spending GRDF amounts was determined: regional educational programs. However, although the MCC demands that this process be accelerated, the rule and the forms for distributing amounts had not been yet developed by 1 December 2010.

- **The Agribusiness Development Activity succeeded in observing the timeline**. Main activity in this project was seen in the first two months of the monitoring period. The remaining time was spent on the monitoring of projects and works for closing down the Project. The funding of ADA Project has been increased by $5 million as compared to original funding (from $15 million to $20 530 800). 286 projects were financed within the Project. As of 31 October 2010, the Project expended 93 percent of the amount allocated under the Compact. According to preliminary information, the Project was completed as scheduled. According to the information available to EPRC, as of 30 September 2010, only one project was deducted the amount - $19,320, for the failure to fulfill obligations.

- **The Millennium Challenge Georgia Program is in a final phase of its five-year implementation. A possibility of signing a new compact is on the agenda.** The MCC has already published the list of potential recipients of the aid in 2011, two groups of countries: low-income and lower middle income countries.

  A broad set of criteria has been developed which is divided into two groups – economic and political indicators (see, details in the section Prospects for extension of Millennium Challenge Program).

  Given the criteria, Georgia has good prospects for making it again into the list of countries funded within the framework of the Millennium Challenge Program. However, there has been no precedent so far of granting the Compact assistance to a country twice. The MCC Board of Directors will take a decision on a new program of assistance in mid December. It should be noted that the Government of Georgia has already expressed a desire to construct a university within the framework of a possible future compact. At this stage, the EPRC has no detailed information about any other priorities, identified by the Georgian government

II. PROGRAM TRANSPARENCY

Over the past few years, when implementing the Monitoring of Millennium Challenge Program, the EPRC has developed quite active cooperation with the new Millennium Challenge Georgia Fund (MCG) management. It should be noted that in some instances, the MCG management reacted to conclusions and recommendations of the EPRC. A decision taken by the MCG at the beginning of the monitoring period (December 2009) on the removal of a section of the road to be rehabilitated under the Samtskhe-Javakheti Road Rehabilitation Project (SJRR Project) from a contracting company, Ashtrom International, can be viewed as an example illustrating such a reaction (for detailed information see section Implementation of Projects).

It should hereby be noted that in the analyzed period the EPRC encountered problems in obtaining some information. In particular, **the EPRC received the Minutes of the Supervisory Board meeting #48, held on 5 August, only in October 2010, after repeated requests. Moreover, the EPRC never received the Minutes of the MCG Supervisory Board meeting #47, held on 6 July.** The excuse provided by the MCG's Public Outreach Office is that the above mentioned Minutes and the Resolution of the same meeting were not signed by Chairman of the Supervisory Board, although we consider this argument unconvincing. It is noteworthy that the Minutes of the Supervisory Board meeting #47, held on 6 July, was submitted to the Supervisory Board at its meeting #48. None of the Board members expressed their opinions regarding the Minutes and the Resolution and the Board members unanimously adopted both these documents. (See, Minutes of the MCG Supervisory Board meeting #48).

It is noteworthy that transparency of Supervisory Board meetings is one of important factors in ensuring the transparency of Millennium Challenge Program. The Board is responsible, among other things, to discuss and approve changes to the Program, thus creating impression on the content of changes as well as attitudes of Board members to this content. Issues discussed and approved at Board meetings often require additional clarification, however, at the same time, as the monitoring practice has showed, they represent quite an interesting source for identifying problems.

In this regard, the period when the Board meeting #47 was held is of special interest. The Minutes of Supervisory Board meeting #46 reveals that at that time, or by June 2010, the prospects of the Samtskhe-Javakheti Road Rehabilitation was still unclear. This, in turn, was an impediment in expending amounts by other projects, for instance, the Energy Infrastructure Rehabilitation Project, because it was still unknown how the situation with a SJRR Project contractor, Ashtrom International, would develop and how much would be required to complete this project. (See, the review of dynamics of use of funds and the section Implementation of Projects).

However, the Minutes of Supervisory Board meeting #48 reveals that the decision to terminate the contract with Ashtrom International had already been taken, the price quoting carried out and an agreement prepared with another SJRR Project contractor, Black Sea Group, on the completion of rehabilitation of the Road sections that were not completed by Ashtrom.

The above said proves that the Supervisory Board Meeting #47 was held at a critical moment of the Program implementation. The refusal to provide the Minutes of that meeting (or even the delay in signing it) serves, in our view, the aim of thwarting a comprehensive monitoring and represents a step backward in ensuring transparency of the Millennium Challenge Georgia Program.

III. PROGRAM DESIGN

The total financial assistance allocated to the Millennium Challenge Georgia Program made up, including the 2008 amendment, $395.3 million. In the course of the implementation, the design of the entire Program as well as that of its separate projects has undergone changes. A permanent alteration of the design was mainly caused by problems emerging in the SJRR Project, also, by errors in preliminary estimates of the management for obtaining funding, flaws in the monitoring of works, conducted by contractors, lengthy response periods to these flaws, and other objective or subjective reasons. This report details causes, contents and results of these changes.

As of 1 December 2010, the design of the Millennium Challenge Georgia Program looks as follows:

1. **Samtskhe-Javakheti Road Rehabilitation Project (SJRR Project) - $212,615 million**;
2. **Energy Infrastructure Rehabilitation Project (Energy Project) - $45,900 million**;
3. **Regional Infrastructure Development Project (RID Project) - $54,735 million**.
4. **Georgia Regional Development Fund (GRDF Project) - $32 million;**
5. **Agribusiness Development Activity (ADA Project)- $20,530,800**.

To evaluate changes carried out in the analyzed period, the above presented design needs to be compared to the design in the corresponding period a year before. The previous stage of the Program monitoring, i.e. as of October 2009, the Millennium Challenge Georgia Program was as follows:

1. **Samtskhe-Javakheti Road Rehabilitation Project - $203,515 million** (the rehabilitation of 219,2 km road was under way in accordance with the contracts awarded under the project);

2. **Energy Infrastructure Rehabilitation Project - $49,5 million** (the rehabilitation of gas main pipeline and pre-construction design studies for the underground gas storage facility were in progress);

3. **Regional Infrastructure Development Project - $57,735 million** (five projects for the rehabilitation of water supply systems and sewage networks, feasibility studies for two projects and design works for one project were in progress under this component).

4. **Enterprise Development Component comprised the following projects:**

    - **Georgia Regional Development Fund - $32 million;**

    - **Agribusiness Development Activity - $20,2 million** ($15 million as of October 2008).

At that time, or by November 2009, a tendency was already apparent that the SJRR Project – one of the largest and most problematic projects in the Program, was mobilizing all the existing resources from other projects. In some cases this was adversely affecting these projects, in other cases, preventing them from a more successful and extensive development.

Indicators make it clear that this tendency persisted in the analyzed period – from 1 December 2009 to 1 December 2010.

A change in the Program design during the analyzed period was again made in favor of the SJRR Project – to the detriment of Energy Project and RID Project. Namely, as compared to the corresponding period of 2009, the SJRR Project financing has increased by $9,100 million. During the same period, the funding of RID Project decreased by $3,6 million and that of Energy Project by $3 million whereas the funding of ADA Project increased by $330 000. For the increase in the funding of SJRR Project, $6,6 million was mobilized from allocations to other projects of the Program. Moreover, amounts were redirected to SJRR Project from allocations for administrative costs as well. The information on how the mentioned changes affected the project implementation and how internal designs of projects changed thereafter is provided in the section Implementation of Projects.

As regards the change in the design of the Millennium Challenge Georgia Program – the comparison of the results for April 2006 and 1 December 2010 reveals the following alterations: $100 million additionally provided to the Program pursuant to the 2008 December amendment #1 to the Compact was fully expended by the SJRR Project. Moreover, an additional $10 million is envisaged for this project, to be reallocated from other projects. In particular:

The cost of **SJRR Project** increased by $110 million in the period between the signing of the Compact and 1 December 2010 (it first increased from $102 million to $212 million 615 thousand). At the same time, the length of the planned road rehabilitation decreased from 245 km to 222,72 km.

The Energy Project funding decreased by $2,6 million as compared to its initial funding, now standing at $45,9 million (instead of $49,5 million). Originally planned works and pre-construction design studies for the underground gas storage facility were carried out within the Project. But, the implementation of an additional phase of rehabilitation with the savings made in the course of implementation was rejected because of the SJRR Project.

The RID Project also saw a decrease in funding from the initial $60 million to $54,735 million as of November 2010. Moreover, the number of projects to be implemented within this component shrank.

The GRDF Project funding was cut by $2,5 million (from $32,5 million to $30 million).

The ADA Project funding, however, increased by $5 million as compared to its original funding under the Compact (from $15 million to $20 530 800).

IV. DYNAMICS OF USE OF FUNDS ALLOCATED TO MILLENNIUM CHALLENGE GEORGIA PROGRAM

This section analyses the dynamics of monetary parameters of the Program as a whole as well as its separate components to find out whether the amounts expended during the implementation of the Program conform to the indicators given in the multi-year financial plan. The analyzed period covers the activity of the Millennium Challenge Georgia Program from 30 September 2009 to 1 October 2010.

4.1. ADOPTED METHODOLOGY

This analysis is based on quarterly disbursement requests prepared by the MCG, detailed multi-year financial plans as well as the documents prepared by the MCG, defining **Economic Rate of Return** (ERR).

The efficiency of expenditure is evaluated by comparing actual quarterly expenditures, and constantly updating multi-year detailed financial plans.

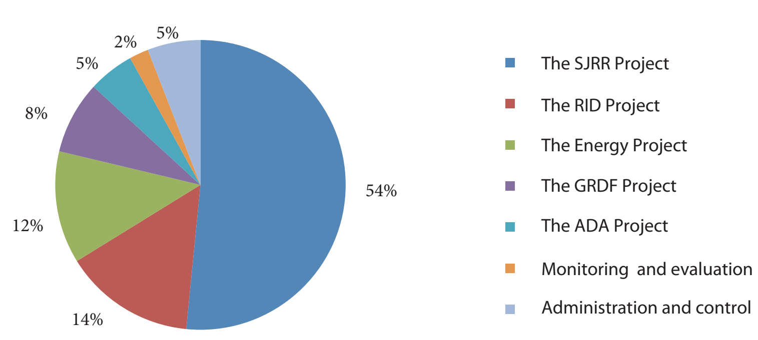
ERRs defined by the MCG are also used in the final part of the analysis to illustrate adverse effects of delays on spending program funds.

4.2 ANALYSIS OF DYNAMICS OF SPENDING

This analysis shows the actual aggregate spending from the first quarter of the fourth Compact year to October 1, 2010, which is taken from the quarterly disbursement requests. Since the third quarter of the fifth Compact year has not ended yet, the data presented for 1 January 2011 imply actual spending as of 31 October 2001, except the data for SJRR Project which reflects actual spending as of 29 November.

Before discussing the spending, it is interesting to see the distribution of the total amount of the Millennium Challenge Georgia Program by projects. See Diagram No1.

DIAGRAM N1 ILLUSTRATES THE DISTRIBUTION OF THE TOTAL AMOUNT BY PROJECTS.

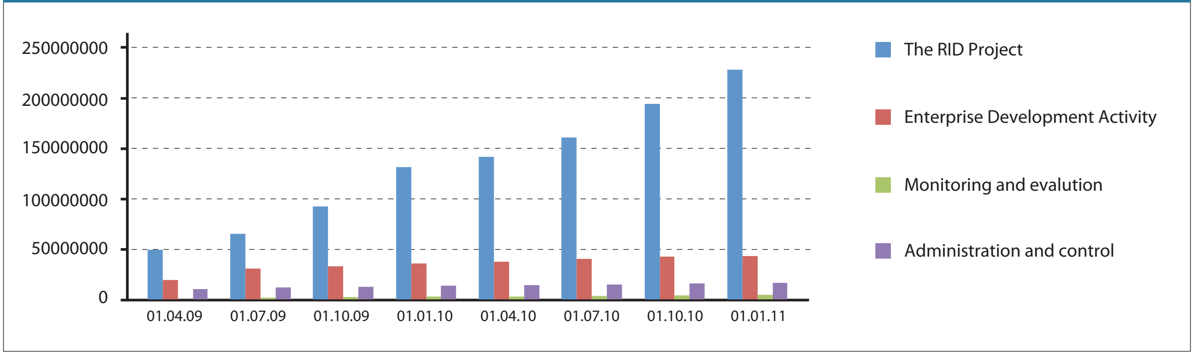


54 percent of the total amount will be spent for SJRR Project, instead of **52 percent** as planned last year, whereas **14 percent** and **5 percent** of the total amount will be spent for RID Project and administration and control component, instead of **15 per**cent and **6 percent**, respectively.

Diagram No2 shows the dynamics of actual aggregate spending from the first quarter of the fourth Compact year through the third quarter of the fifth Compact year (the data presented for 1 January 2011 imply only actual spending as of 31 October 2010, while in case of the SJRR Project – actual spending as of 29 November 2010, which is provided to show an existing trend, although the current quarter has not finished yet), which is taken from the quarterly disbursement requests.

An increase in the actual aggregate spending is obvious from the last quarter of the **fourth** Compact year – from 1 January 2010, when the aggregate spending for the largest component (RID Project) increased by 46 percent; however, the rate of increase significantly decreased thereafter. **For example, aggregate spending for the SJRR Project increased only by 7.7 percent (which is obvious from quarterly data on spending) for the first quarter of the fifth Compact year whereas this indicator comprised 62.5 percent in the previous period.**

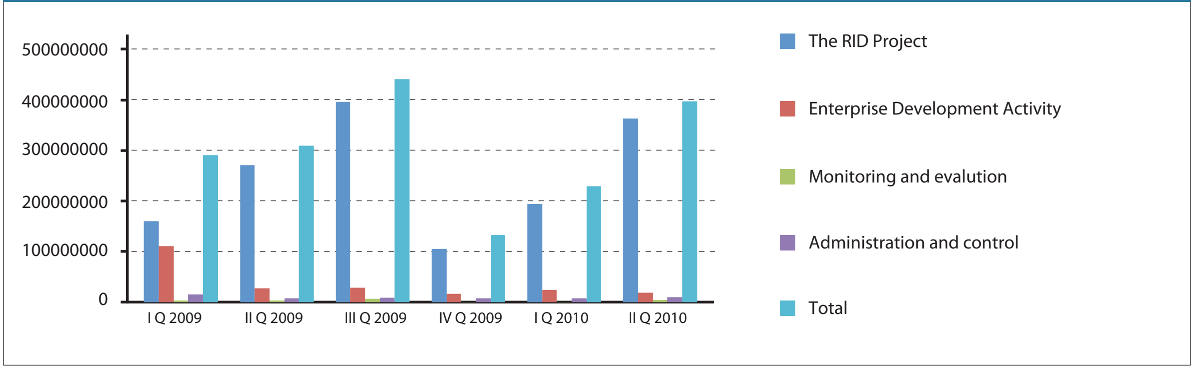
DIAGRAM 2.
AGREGATE SPENDING BY COMPONENTS BEGINING OF PERIOD (USD)



The Enterprise Development Component almost maintained its growth rate due to the increase in the ADA Project, and reached 5.7 percent, on average, by the analyzed period.

Diagram No3 shows quarterly amounts in absolute terms by components, which clearly shows significant decline in the spending of above mentioned amounts from the end of the fourth Compact year.

DIAGRAM 3.
ACTUAL SPENDING BY QUARTERS AND COMPONENTS (USD)



The dynamics can be more clearly seen in quarterly spending data (since the third quarter haa not ended yet, the use of available actual data (for October-November) in this type of table would have given a distorted picture).

Table N1. Increase in spending by quarters

	II.Q.2009	III.Q.2009	IV.Q.2009	I.Q.2010	II.Q.2010
Regional Infrastructure Rehabilitation	**69.03%**	**46.09%**	**-73.36%**	**84.06%**	**72.79%**
Samtskhe-Javakheti Road Rehabilitation	141.27%	48.42%	-79.95%	155.37%	73.10%
Regional Infrastructure Development	-17.64%	152.47%	-42.58%	-6.01%	55.80%
Energy Infrastructure Rehabilitation	-10.77%	-39.34%	-74.01%	-74.78%	438.93%
Enterprise Development Component	**-75.44%**	**4.87%**	**-39.97%**	**42.58%**	**-5.97%**
Georgia Regional development Fund	-92.87%	16.80%	-61.47%	27.16%	93.23%
Agribusiness Development Activity	-21.56%	1.51%	-33.02%	45.46%	-22.11%
Monitoring and Evaluation	**-13.14%**	**108.52%**	**-66.58%**	**5.60%**	**115.22%**
Administration and Control	**-47.97%**	**14.13%**	**-17.10%**	**2.36%**	**1.25%**
Program administration	-43.95%	23.38%	-39.84%	21.48%	1.22%
Audit	-70.75%	-100.00%	-	-75.00%	0.00%
Fiscal and procurement management	-53.33%	0.00%	22.81%	-9.41%	1.37%
Total	**6.39%**	**42.30%**	**-69.87%**	**72.44%**	**62.34%**

The last quarter of the fourth Compact year clearly shows the decrease in spent amounts, especially in case of Regional Infrastructure Rehabilitation - the largest project of the period, with its spending seeing an almost 80 percent decrease. In the first quarter of the fifth Compact year, however, the spending increased sharply, although, within the same period, a quarterly spending in the Energy Project decreased.

Despite the above mentioned decline in quarterly spending, one should view an upward trend in the total spending in the first two quarters of the fifth Compact year as a promising development. This is a relatively good indicator against the previous Compact year where the rate of spending was somewhat slow.

Table No2 shows the dynamics of actual spending against the total amounts of the Millennium Challenge Georgia Program.

Table N2. Share of aggregate spending in total amounts as of beginning of the period (%)

	01.04.09	01.07.09	01.10.09	01.01.10	01.04.10	01.07.10	01.10.10	01.01.11*
Regional Infrastructure Development Project:	16.3%	21.5%	30.4%	43.4%	46.8%	53.2%	64.2%	75.5%
SJRR Project	9.6%	13.7%	23.7%	38.4%	41.4%	49.0%	62.1%	76.8%
RID Project	10.9%	16.9%	21.8%	34.2%	41.3%	48.0%	58.4%	65.8%
Energy Project	53.7%	63.3%	71.9%	77.1%	78.4%	78.8%	80.6%	81.0%
Enterprise Development Project:	37.8%	59.5%	64.9%	70.5%	73.8%	78.6%	83.1%	84.9%
GRDF Project	43.3%	70.2%	72.1%	74.4%	75.2%	76.3%	78.4%	79.6%
ADA Project	29.3%	42.9%	53.6%	64.4%	71.6%	82.2%	90.4%	93.1%
Monitoring and Evaluation	13.3%	18.2%	22.4%	31.2%	34.2%	37.3%	44.0%	49.5%
Administration and Control:	49.7%	57.7%	61.9%	66.6%	70.6%	74.6%	78.6%	81.1%
Program administration	47.6%	56.0%	60.6%	66.4%	69.9%	74.1%	78.3%	80.0%
Audit	42.2%	48.5%	50.3%	50.3%	57.7%	59.5%	61.4%	61.4%
Fiscal and procurement management	54.0%	61.6%	65.1%	68.7%	73.0%	76.9%	80.9%	84.8%
Total	20.8%	28.4%	36.4%	47.9%	51.4%	57.3%	67.0%	76.5%

Despite a faster rate of spending observed in the first two quarters of the fifth Compact year, the ratio of actually spent amounts and total amounts is still low because of a sharp lag in the previous period. In particular, **of the total RID Project funding only 62.1 percent was expended by the second quarter of the fifth Compact year. This means that the Project will have to spend 12.6 percent of the total amount per quarter, on average, during the remaining three quarters, which is a serious challenge as until now an average quarterly spending has comprised 3.5 percent.** The situation looks better in regards to Enterprise Development and Administration and Control components, with almost 80 percent of the total amounts expended by the second quarter of the fifth Compact year.

According to preliminary data, a spending rate is higher in the third quarter of the fifth Compact year. The data available for this quarter, which includes all the indicators for October and only the SJRR Project data for November, shows that the share of aggregate spending of the largest SJRR Project in the total amount increased by 14.7 percent, while this increase in case of the Enterprise Development project reached almost 2 percent.

In general, as a result of a huge delay in previous years, only 76.5 percent of the total amount had been expended by the third quarter of the fifth Compact year. This means that 12 percent of the total amount must be spent per quarter, on average, during the remaining two quarters. Such an ambitious increase may endanger the quality of performed works.

CHART 1.
SPENDING AS OF BEGINNING OF PERIOD AGAINST THE TOTAL AMOUNT

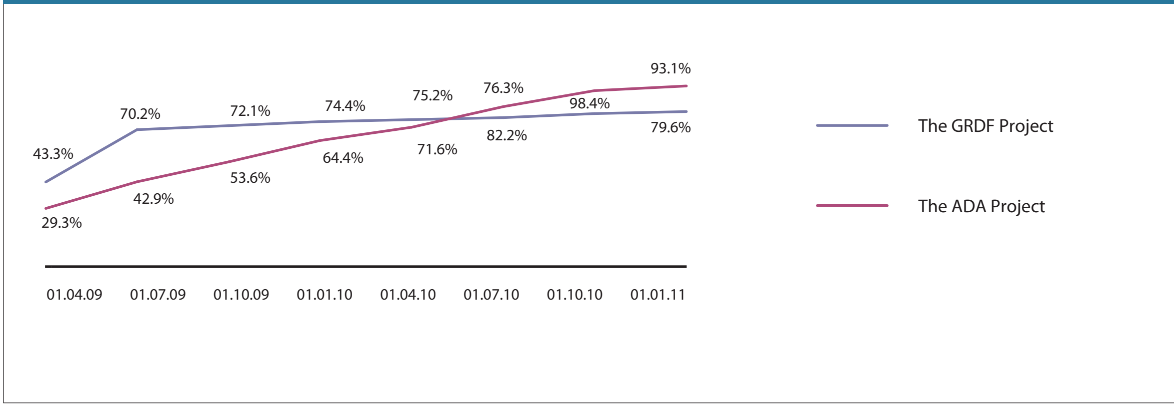
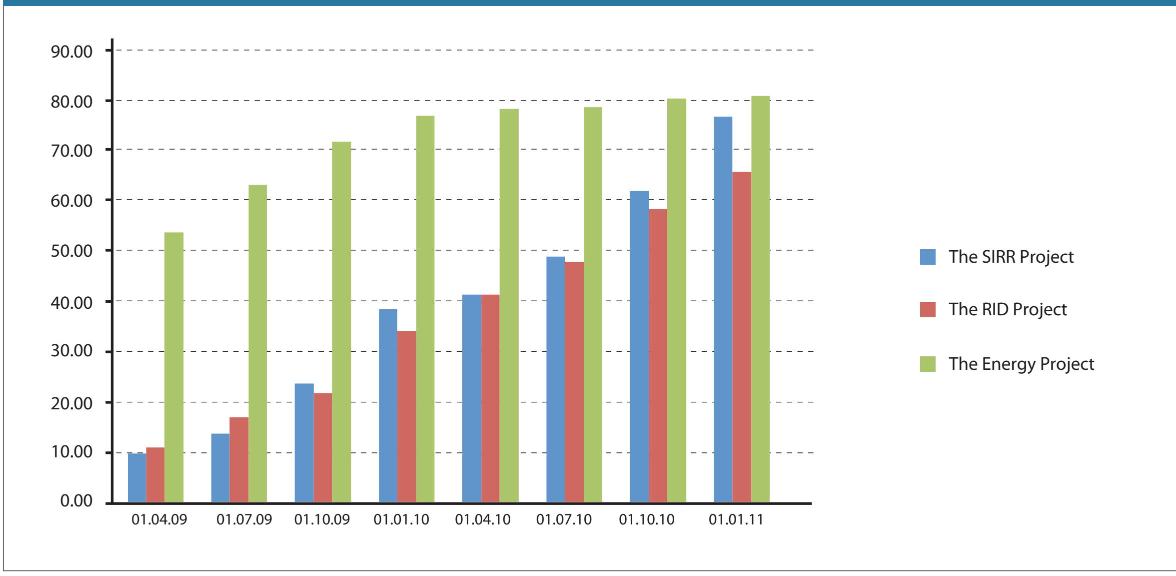


Chart No1 shows the dynamics of aggregate spending of two Program activities, namely, the GRDF and ADA Projects (comprising 8.1 percent and 5.2 percent of the total amount, respectively), as of beginning of analyzed period. A sharp upward trend can be observed as compared to the previous year, especially in the ADA Project: the project shows the spending of 90.4 percent of the total amount in the second quarter of current Compact year and 93.1 percent at the end of October, which is a good sign. As regards the GRDF Project, the dynamic reveals some slowdown, with the share of spending in the total amount standing at 79.6 percent, as of October of the fifth Compact year.

The ADA Project dynamics has significantly improved in contrast to that of the GRDF Project which will need a sharp increase in spending to be completed successfully.

Diagram No4 shows the dynamics of spending against the total amount within the frameworks of three RID projects. The ratio between the actual spending and the total amount of the RID Project is rather low - 53.4 percent on average, by the fifth Compact year, which comprises 14 percent of the total Project. The spending in Energy Project and SJRR Project reaches 57.3 percent and 79.9 percent of the total amount, respectively. The indicators show improvement as compared to a year before.

DIAGRAM 4.
SPENDING AS OF BEGINNING OF PERIOD AGAINST THE TOTAL AMOUNT (%)



Despite the above noted positive tendencies, the lag is still observed in comparison with the targets of detailed financial plan. Table No3 provides the dynamics of actual quarterly spending against the indicators in the financial plan (according to the detailed financial plan). The given table clearly illustrates that the spending of program components is well short of the planned targets.

Table N3. Comparison of quarterly spending with financial plan estimates

	I Q 2009	II Q 2009	III Q 2009	IV Q 2009	I Q 2010	II Q 2010
Regional Infrastructure Development Project:	83.8%	69.8%	101.7%	66.3%	61.9%	80.5%
SJRR Project	56.2%	75.7%	105.9%	98.4%	73.2%	82.0%
RID Project	174.6%	43.1%	89.2%	44.8%	39.1%	62.2%
Energy Project	206.3%	70.1%	90.8%	50.7%	19.9%	194.4%
Enterprise Development Project:	141.9%	61.8%	90.7%	56.0%	55.7%	59.9%
GRDF Project	131.5%	21.5%	101.3%	58.3%	18.7%	39.0%
ADA Project	188.0%	130.9%	87.7%	55.6%	82.3%	87.2%
Monitoring and Evaluation	100.0%	60.2%	149.1%	46.7%	44.6%	53.2%
Administration and Control:	131.0%	69.8%	97.8%	73.0%	81.6%	110.1%
Program administration	108.1%	63.3%	97.0%	58.9%	79.9%	94.6%
Audit	125.0%	29.3%	-	100.0%	20.0%	-
Fiscal and procurement management	214.3%	100.0%	100.0%	100.0%	100.0%	100.0%
Total	102.0%	68.9%	101.4%	64.6%	61.5%	79.3%

Since January 2009, the spending of the regional infrastructure development component was brought in line with the targets envisaged in the financial plan. To offset an earlier lag, the SJRR Project of this component expended amounts in excess of the planned by 6 percent. In that period all the components well conformed with the financial plan estimates and the total expended amount exceeded the financial plan by 1.4 percent. However, the delay was observed again in the following periods. In particular, although the SJRR Project spending stood at 98.4 percent, the RID Project expended only 66.3 percent of the planned funds in the final quarter of the fourth Compact year. This delay was the result of a 44.8 percent performance against the planned regional infrastructure development component and 50.7 percent performance against the planned Energy Project. A delay occurred in the following quarter again, though in a sharper form. By the second quarter of the fifth Compact year these indicators look better, giving hopes for offsetting earlier delays.

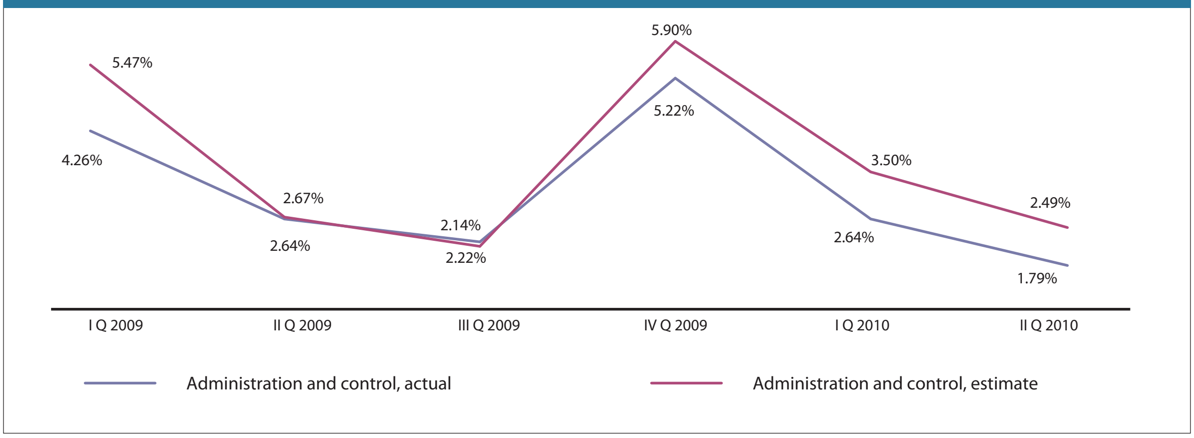
As regards the Enterprise Development Project, a quarterly spending in the analyzed period did not exceeded 60 percent of the planned one. It is noteworthy that **in the first quarter of the fifth Compact year, the GRDF Project spent only 18.7 percent of the planned expenditure. This component will expend 39 percent of the amounts planned for the fifth Compact year.**

The situation in the Administration and Control component has improved with its target for the end of October comprising 110 percent. Similarly to the previous analyzed period, the lag in case of the Monitoring and Evaluation component from the planned indicator is rather large and reaches 50 percent, on average. This, however, can be explained by delays in the performance of works under other components and is, therefore, less alarming.

Overall, the improvement is observed in terms of bringing actual expenditure in conformity with the financial plan. Whereas the amounts spent did not exceed 50 percent of planned expenditure in previous years, the forthcoming quarter envisages the spending of 80 percent of the planned amount, which is a good indicator against a historical data.

Chart No2 shows the share of actual spending of administration and control component against the total amounts.

CHART 2.
ACTUAL AND PLANNED ADMINISTRATION AND CONTROL AMOUNTS AGAINST THE TOTAL AMOUNT



Actual spending of the administration and control component is in conformity with the multiyear plan. During the analyzed period, however, the ratio between actual and total administrative costs exceeded the planned indicator (Chart No2). The actual and planned indicators of this component were almost identical in the third quarter of the fourth Compact year, but the increase in the actual indicator is still observed in the analyzed period. However, against a relatively timely progress of works envisaged in the Compact, this no longer seems alarming.

4.3. POSSIBLE NEGATIVE IMPACT OF DELAYS IN SPENDING

As in the report for the last year, Table No4 reflects relevant calculation to illustrate possible negative impact of delays in the initially envisaged spending of the Program. As it is acknowledged, a project is profitable when its discounted revenue exceeds its expenditure.

The calculations in the table are based on a simple assumption that expenditures of projects must generate revenues of at least similar amount in future; otherwise the implementation of a project would make no sense. Bearing this in mind, one should assume that a delay in spending in a certain year would most likely cause delay in revenues of at least the same amount in consecutive periods. To arrive at a present value, the expenditure and the revenue of a project are discounted at a discount rate of the relevant period. The discount rate used in the calculation is the ERR defined by the MCG itself. This parameter is given in the second column of the below Table, next to corresponding projects. The delay in the first Compact year, shown in the third column, is not discounted as it is assumed that expenditure would immediately generate the return. The delay in spending in the second Compact year as compared to financial plan target, which is shown in the fourth column, is recalculated at a discount rate for the first period, whereas delays in the third and fourth Compact years, provided in the fifth and sixth columns, respectively, are recalculated at discount rates for the second and third periods. The seventh column shows the aggregated discounted loss derived as the discounted loss caused by the delays in planned spending for four years.

An optimistic assumption is that the losses in the first four years will be entirely offset in the fifth, sixth and seventh years. Hence, the sum of figures in the eights, ninth and tenth columns (representing discounted value of the figures in the third, fourth, fifth and sixth columns for the third, fourth, fifth and sixth periods, respectively) shall be deducted from the sum of columns three, four, five and six in order to arrive at the final discounted loss caused by the delays in planned spending over the first four years. The final result is given in the column “discounted margin”. Even following the optimistic scenario, the loss caused by the lag between the actual and planned spending of the program exceeds $31 million.

This shortfall can theoretically be compensated by a sharp increase in the program spending in the remaining period. It should also be taken into account that the improvement in the Program implementation, observed in the fifth Compact year, has yet to be reflected in this indicator.

Table N4.

	Discount (%)	Year I	Year II	Year III	Year IV	Total	Year V	Year VI	Year VII	Year VIII	Total	Dis-counted margin
SJRR Project	17.8	0	21135889	-174533	7333197	28294552	0	12929587	-106768	4485981	17308800	10985752
RID Project	11.6	231700	2742671	16669466	5589949	25233786	166699	1973246	11993035	4021752	18154732	7079054
Energy Project	11.7	2095052	9060808	10159681	181531	21497071	1503264	6501407	7289883	130254	15424808	6072263
GRDF Project	26	74312	1467654	5455796	185344	7183106	37149	733689	2727385	92654	3590878	3592228
ADA Project	12	1066728	3596368.75	7904437.18	-228885.75	12338648	759275.92	2559824.24	5626222.26	-162916.36	8782406	3556242
Total		3467792	38003390.2	40014846.6	13061134.7	94547163	2466388.2	24697753.1	27529756.9	8567725.3	63261624	31285540

A great improvement has been observed in the fifth year of the Millennium Challenge Georgia Program against the delay of the previous period. Timely performance of works in the following period will be critical for a successful completion of the Program.

V. IMPLEMENTATION OF PROJECTS

1. SAMTSKHE-JAVAKHETI ROAD REHABILITATION

DURING THE MONITORING PERIOD, THE COST OF THIS PROJECT HAS INCREASED AGAIN FROM $203,515 MILLION TO $212,615 MILLION; THE LENGTH OF THE ROAD FOR REHABILITATION INCREASED IN THIS PERIOD BY 3,52 KM AND COMPRISED 222,72 KM BY 1 DECEMBER 2010.

A $30 903 542 WORTH CONTRACT WAS AWARDED WITHOUT A COMPETITIVE BIDDING, THROUGH PRICE QUOTING. DESPITE THE EXPERIENCE OF THE PREVIOUS YEAR AND EXISTING PRECONDITIONS, THE PROJECT IS STILL IN AN EMERGENCY SITUATION.

THE CONTRACT WITH ASHTROM INTERNATIONAL, WHOM THE MCG PAID THE TOTAL OF $37 938 632 MILLION, WAS TERMINATED. THE COMPANY WAS IMPOSED FINES IN THE AMOUNT OF $8,2 MILLION.

INSTEAD OF $102 MILLION AS ORIGINALLY ENVISAGED BY THE COMPACT, AT THIS STAGE IT IS PLANNED TO SPEND $110,6 MILLION MORE ON THE SJRR PROJECT; HOWEVER, THE LENGTH OF REHABILITATION ROAD HAS DECREASED FROM THE ORIGINAL 245 KM TO 222,72 KM, I.E. BY ABOUT 22 KM.

DURING THE MONITORING PERIOD, THE PROJECT VIOLATED THE OWNERSHIP RIGHT OF THREE CITIZENS – THEIR HOUSES, I.E. PROPERTY, WERE EXPROPRIATED.

During the monitoring period, the SJRR remained to be the most problematic project of the Millennium Challenge Georgia Program.

Over the period between 1 December 2010 and 1 December 2010, the cost of the project increased again from $203,515 million to $212,615 million.

Within the same period, the length of the rehabilitation road (219,2 km) that was contracted as of 1 December 2009, increased by 3,52 km to 222,72 km. The cost of rehabilitation of the additional section of the road stands at $3 033 000. This means that **the cost of rehabilitation roads, envisaged in the contracts signed last year, increased by $6 067 000.**

One of the reasons causing this increase was the problems associated with Ashtrom International.

During the monitoring period, however, unexpected obstacles emerged some of which, in the EPRC's view, were indeed of a force-majeure type (for example, results of flooding) whereas others could have been predicted (problem of resettlement, condition of road sections needing reinforcement).

At the beginning of the analyzed period, by 1 December 2009, the status of contracts in the SJRR Project was as follows:

Partskhisi- Gokhnari (37,1 km), Gokhnari - Nardevani (34,6 km) - contractor **the company Ashtrom International,** cost of the contract 54,659 million.

Satkhe-Ninotsminda-Armenian border (31,4km) and Akhalkalaki-Sulda road sections (20km) – a $33,1 million worth contract; **Khertvisi-Vardzia (about 11 km)** – $13,4 million worth contract; - contractor Papenburg/Black Sea Group.

Rehabilitation of the Sulda-Kartsakhi-Turkish border (about 16km) road section – $8.4 million worth contract; **Teleti-Koda-Asureti (19 km)** - $15,073 million worth contract; **Nardevani-Satkhe (47,8km)** - $35,194 million; **Akhalkalaki bypass (2,3 km)** - $4 540 972; - contractor Azerinsaatservice Ltd.

During the monitoring period of 1 December 2009 -1 December 2010, the SJRR Project was entered by a new actor – an **Azerbaijani company, OJSC Akkord Inshaat Senaye**. Through a competitive bidding this company was awarded a contract on the rehabilitation of Tsalka-Nardevani 15 km road section (in April 2010); **the value of the contract totals $6 115 739** (see, Award Notice #SJRRP/CW/08).

On 30 August 2010, the rehabilitation of 53,1km long Partskhisi-Tsalka road section was awarded through direct contracting to **Papenburg/Black Sea Group. The cost of contract is $30 903 542**. (See, Award Notice #03-DC-SJRRP-CW).

Both the above mentioned sections were among those to be rehabilitates by Ashtrom International. According to the MCG, it paid $37 938 632 million to Ashtrom International and the company was fined with $8,2 million.

Nevertheless, as stated above, the rehabilitation cost of the 119,2 km section, which was envisaged in contracts signed back in 2009, increased by $6 115 739 as of 1 December 2010.

Moreover, it was decided to rehabilitate an additional 3,52 km within the framework of the Project. We will discuss this in more detail later in this section.

In the end, as of 1 December 2010, the SJRR Project is to rehabilitate 222,72 km of road and the total cost of this works is $212,615 million.

Instead of $102 million as originally envisaged by the Compact, at this stage it is planned to spend $110,6 million more for the SJRR Project, whereas the length of the road decreased from the original 245 km to 222,72 km, i.e. by about 22 km.

1. DETAILS OF RELATIONSHIP WITH ASHTROM INTERNATIONAL

In its Stage IV Monitoring report the EPRC emphasized oroblems and threats in relation to Ashtrom International, the SJRR Project contractor, posed by slow pace of rehab works by the company. The recommendations submitted by the EPRC on 11 December 2009, suggested the need for revising relations with the contractor. In particular, EPRC recommended that "A particular attention again should be paid to the rehabilitation works under the SJRR Project. The status of the rehabilitation works on several sites as of October 2009 indicates that the threat still remains and the situation may exacerbate in the spring of 2010. Therefore, to avoid this threat, the completed works should be evaluated in the nearest future and preventive measures taken in advance by the contracting companies in order to save the contract from breaching."

It should be noted that the MCG reacted to the recommendations, although we believe that the response was not fully sufficient. In particular: an issue of "taking a decision concerning Ashtrom International (amendment to contract) and future strategy" was put on the agenda of the nearest Supervisory Board meeting. However, the discussion at the meeting and the decision taken by Supervisory Board in this regard proved that the Board and especially, the MCC were not prepared for radical steps. One of the reasons was such approach was some provisions in the contract with Ashtrom International that made the termination procedure too complicated, even in the middle of contract violations by the company.

We would recall that at that stage, rehabilitation works were already lagging behind the schedule due to Ashtrom's improper performance and inadequate monitoring of the performed works; all this led to an emergency situation.

Because of created emergency, a $35 million worth contract was already awarded through direct contracting, bypassing a competitive bidding. Moreover, the cost of rehabilitation was already increased at that stage, namely:

in the spring of 2008, despite the contract with Ashtrom International on the rehabilitation of three lots, the cost of road rehabilitation increased by almost $24,389 million (that is by 37 percent as of spring 2008). None of the companies the performance of which led to the increase in the price of the works was held responsible.

The total price of the SJRR Project, as compared to that in the Compact, had almost doubled - from $102 million to $203,515 million - by the beginning of the analyzed period, i.e. by 1 December 2009. It should however be noted that it was not the blame of Ashtrom International alone. Reasons of increase in the cost of Project were already discussed in detail in the previous Monitoring Report of EPRC.

Given the circumstances, the MCG Supervisory Board discussed the termination of the contract with Ashtrom at its meeting on 21-23 December, 2010. The MCC representative stated that the MCC was ready to consider the termination of the contract with Ashtrom if the Board takes a less risky solution by removing part of the Project from Ashtrom International. According to the explanation by MCC, such a suggestion on its part was prompted by financial and legal risks, posed by the contract termination, which were to be taken by the Georgian side. In particular, according to the MCC information, although Ashtrom had every possibility to fulfill obligations, the company still had a chance to win $10 million in arbitration. Moreover, the shortage of time would increase the cost of remaining works. (See Minutes of the MCG Supervisory Board meeting #44, 21-23 December 2009).

Although the sides were sure that Ashtrom would not be able to perform works, as the minutes of the meeting proves, an interim decision was taken. In particular: a decision was made to remove a 15km long section under the Lot 3 from Ashtrom and to proceed with the remaining works on the bases of regular, two-weekly aims, the accomplishment of which would be inspected by a technical consultant. The decision also noted that if the timeline were violation, Ashtrom would be penalized and in this case, the Georgian side would have the right to terminate the contract without any fears of losing a possible dispute at the arbitration. (See Minutes of the MCG Supervisory Board meeting #44, 21-23 December 2009).

It should be noted that this decision was interim. The refusal to take radical decisions was prompted by the fact that **at the time of signing the contract between Ashtrom and MCG, the contract did not contain enough leverage allowing the Georgian government to terminate the contract without any losses.**

Moreover, the Supervisory Board refrained from placing the responsibility on the state for those financial and legal risks that were pointed out by the MCC.

As a result, the interim decision has, on the one hand, corrected the process positively in this regard but on the other hand, retained the threats which in June-July 2010, once again endangered the completion of the SJRR Project on time and led the Project to other emergency decisions.

It should also be noted that by that period, the situation in regards to the implementation of SJRR Project was critical:

According to the data of December 2009, the total amount left to be spent under the SJRR Project and other projects comprised $45 million. By technical calculations, however, the completion of the works under Lots 2 and 3 would require about $46 million. The Supervisory Board meeting of 21-23 December evidenced that the management had already realized that any saving made by projects in the course of implementation should be channeled toward the SJRR Project. (See Minutes of the MCG Supervisory Board meeting #44, 21-23 December 2009).

Thereafter, the analysis of the use of funds (see, the fourth section of the report) also revealed that the management made saving purposefully and refused to make additional spending in other projects (for example, in the Energy Project) in order to overcome problems in the SJRR Project.

Although the decision taken in December 2009 was rather cautious and controversial, a positive development of that meeting was that the Supervisory Board tasked the MCG management to prepare bid documentation in advance. Namely, a decision was made to have the bid documentation prepared for those road sections which

Ashtrom was still in charge for, in case Ashtom failed to accomplish aims set for 10 January and the Georgian side terminated the contract. Moreover, it was decided to prepare letters which, been signed by the Prime-Minister, would be sent to international organizations with the request to put Ashtrom International on the black list. (See Minutes of the MCG Supervisory Board meeting #44, 21-23 December 2009).

As a result of a competitive bid held on the bases of these decisions, the Azerbaijani Company OJSC Akkord Inshaat Senaye was awarded a contract on the rehabilitation of 15 km Tsalka-Nadrevani section in April 2010.

Although the problems had been understood and, at first blush, measures taken, the monitoring period showed that the MCG and Government of Georgia failed to settle the problems with Ashtrom in due time. Although the delays in the performance of works by Ashtrom were apparent at the Supervisory Board meeting of 7 April 2010, leading to penalizing the company with $5000 per overdue day, they were not regarded as a ground for the termination of the contract. (See Minutes of the MCG Supervisory Board meeting #45, 7 April 2010).

Delays in performance were not discussed in quarterly progress reports of the MCG either, nor at the Supervisory Board meeting of 11 June, which, we believe, speaks of the inability of the Fund to react on time.

It was only in August 2010 when the most of sections to be rehabilitated by Ashtrom was handed over to a new contractor. Timeline-related problems again influenced the award of contract through direct contracting, based on price quoting, instead of holding a competitive bidding. **Similarly to the previous monitoring period, this time again a contract with the total value of $30 903 542 was awarded without a competitive bidding.**

The EPRC agrees that the SJRR Project was indeed in emergency in August 2010, i.e. eight months earlier to the completion of the Compact; however, it believes that had the MCG and the government taken strict and adequate measures right at the beginning of the year, that sort of situation would have been averted.

Especially, considering the fact that the ground for the termination of the contract with Ashtrom International in August 2010, indicates that "the situation at this stage is different from that in December, namely, it was rather difficult to announce Ashtrom a defaulted party then while now chances have well increased for such a step. Works were to be completed by 27 April this year and therefore, Ashtrom is clearly facing a threat of breaching the contract. Also, Ashtrom was supposed to complete the construction of one of bridges by 26 August and we have a conclusion of an engineer saying that this work cannot be completed by that date." (See Minutes of the MCG Supervisory Board meeting #48, 5 August 2010). This information provided to the meeting by the Project's lawyer proves that a precondition for terminating the contract already existed on 17 April 2010. Nevertheless, this issue was not discussed at the Board meeting in June. As for the July meeting, we have no information whether the issue was raised or not as the MCG did not supply us with the minutes of that meeting. Still, it is a fact that the decision was taken only in August, jeopardizing the prospect of completing the Project on time.

Especially, considering the fact that in August 2010, in parallel to signing a contract, the state made a pledge to the MCC that the Georgian government would assume the responsibility for the decision. (See Minutes of the MCG Supervisory Board meeting #48, 5 August 2010).

Despite the above said, one should single out one aspect which, as compared to the previous monitoring period, speaks of some progress in this area: during the analyzed period Ashtrom International, after the termination of contract, was fined with the total amount of $8, 200 million, thus sparing the Project from a further much higher rise in its cost.

Moreover, the scale of rehab works carried out in autumn of 2010, proved that the Project could have been completed within the Compact term. According to the data as of 31 October 2010, the Project expended 77 percent of the total budget, which, according to available information, increased further in November.

2. OBSTACLES IN THE REHABILITATION

a) Resettlement problem: One of the challenges to the SJRR Project was a decision to be taken on the resettlement of houses situated along the road. Obviously, a proper preliminary study would have taken into consideration these obstacles. But, apart from this, there is one more thing interesting in this issue - the way of solving the problem.

During the road construction process, on the basis of requests of the local municipality and population, MCG requested the Levan Samkharauli National Forensic Bureau to conduct a survey to determine the engineering-technical condition of the houses located in the villages of Kartsakhi, Sulda and Bozali, which are situated up to a distance of 25 meters from the edge of the road. This study was conducted on the 72 structure-buildings. As a result of studies conducted by the mentioned Forensic Bureau and Tbilisi Title Company, additional 44 structure-buildings were included in a resettlement area.

Of these 44 buildings, three houses with its auxiliary facilities were to be purchased as they might ruin; out of remaining buildings 23 were assessed as damaged, 17 as non-damaged that might be damaged. According to the available information, of 23 buildings 10 were occupied while of 17 non-damaged ones – 9 buildings were occupied. According to the expert opinion, a temporary relocation from all these buildings for six months was necessary. According to the information of the MCG manager, each relocated family would receive a compensation of GEL 1900 (rent for house six months – GEL 1500,or GEL 250 per month; rent for cowshed for six months – GEL 300, or GEL 50 per month; transportation – the total of GEL 100). (See Minutes of the MCG Supervisory Board meeting #45, 7 April 2010).

This obstacle which has emerged in the implementation of the SJRR project belongs to an unforeseen category.

In April-May, the MCG held negotiations with the owners of houses and decided to pay to 19 families to be temporarily relocated, GEL 3700 instead of originally envisaged GEL 1900, almost twice as much as the amount calculated in agreement with the Forensic Bureau.

However, an agreement was not reached in regard to those three houses, which were to be left forever and under the decision of the MCG Supervisory Board, these houses were expropriated. (See Minutes of the MCG Supervisory Board meeting #46).

Indeed, the Georgian legislation provides for expropriation if state interests require so, however, until this action is taken the owners shall be offered adequate compensation.

In the case of the SJRR Project, while state interests are not arguable, the size of offered compensation is.

The minutes of the MCG Supervisory Board meeting reveals that the Levan Samkharauli National Forensic Bureau defined the following property prices: a residential house owned by Seda Mosoyan – GEL 8,140 (approximately $4500); the house and auxiliary construction of Galust Dukhoiyan – GEL 11,602 (approx. $6,500) and the house and auxiliary construction of Khachatur Keiyan - GEL 6,320 (approx. $3,500). The residential houses were situated in the villages of Kartsakhi, Sulda and Bozali.

It is noteworthy that the owners of the houses, who refused to agree to the above quoted amounts, demanded that new residential buildings of the same size be constructed. Finally, agreement was reached on the following amounts: Seda Mosoyan – GEL 40,000, Galust Dukhoiyan – GEL 110,000 and Khachatur Keiyan again demanded the construction of a house.

The Supervisory Board deemed the requested compensation inadequate. (See Minutes of the MCG Supervisory Board meeting #46).

The EPRC believes that compensations were inadequate in both cases – as offered by the state and as demanded by the owners.

We can quote as an example costs of cottages of 55,9 square meters, built for refugees, which according to the calculation provided by the Georgian government, comprised GEL 26,700 on average (in some cases, even $20 000 is quoted). This SJRR Project case, however, involved houses as well as auxiliary structures and the prices quoted above can by no means be regarded as market price. Especially, given that those who were to be relocated only for six months, were given a compensation totaling half of those amounts which the state intended to pay for the purchase of the property (houses and auxiliary structures).

As regards the amounts demanded by the villagers, we assume that they were not properly explained what the consequences could be in case of disagreement over the price.

We think that in this case, the expropriation of houses served the interests of the Project but an adequate offer was not made, which resulted in the violation of ownership right of the citizens of Georgia. One should also consider the importance and subtlety of the region mostly inhabited with ethnic minorities. We think that more efforts should have been taken to achieve agreement. However, it is apparent that the shortage of time again had a negative impact – the SJRR was already operating in a real emergency mode and an additional unforeseen obstacle to it urged for finding a quick solution. In the end, ownership rights of three citizens were infringed, which in EPRC's opinion is a negative side of the Project.

b) Unforeseen costs: the need for unforeseen spending in the SJRR Project arose during the monitoring period. According to the MCG manager, heavy rains resulted in flooding of the Mtkvari river, eroding an embankment and causing a landslide on the section under the existing bridge in Vardzia. To avoid further damage to the bridge and the road, the construction supervising company Finnroad issued a variation order #9, according to which the cost of reinforcement works for the embankment and the bridge comprised almost half a million USD - $430 481.

The above mentioned variation was incorporated in the contract on the rehabilitation of Khertvisi-Vardzia road section. Such changes to the contract are necessary do not enable us to positively assess the management of this Project and quality of preliminary desing studies.

The MCG management openly criticized a poor quality of preliminary design studies. According to the MCG CEO, Giorgi Abdushelishvili, weak spots of the road were not identified properly and therefore, not reflected in the cost-estimate. Therefore, it was precisely due to inadequacy of preliminary assessment that the engineer allowed the contractor to reinforce the road with rocky material instead of local material. In the end, the cost of rocky material was estimated at $2, 058 million. (See Minutes of the MCG Supervisory Board meeting #46).

c) Additional section: to achieve the wholeness of the rehabilitation road, a decision was taken in the monitoring period to rehabilitate an additional section despite the problems existing in the SJRR Project. In particular:

To maintain a uniform standard along the entire length of the rehabilitated Samtskhe-Javakheti road, it was decided to rehabilitate an additional 3,2 km long Bogvi-Portskhisi section. To this end, the contract with Azerinsaatservice was amended for the first time, setting a price for that section on the basis of a unit price offered by Azerinsaatservice for Teleti-Koda-Asureti contract. The cost of variation order comprised $3 033 185. The decision was approved on 7 April 2010.

The EPRC believes that the taking of such risks within the SJRR Project with the cost of its works already increased and operating in an emergency mode, was justified given the aim of the wholeness of the rehabilitation road.

As regards the price, we would recall that the Teleti-Koda-Asureti contract was awarded to Azerinsaatservice through direct contracting during the fourth stage of monitoring, when the completion of the road was endangered by the performance of Ashtrom International. At that stage the price offered by Azerinsaatservice was considered acceptable due to shortage of time. It is obvious that in the Bogvi-Portskhisi case the above argument was more valid. Moreover, works near that section were performed by this company and therefore, awarding it Bogvi-Portskhisi section rehabilitation seems logical.

2. ENERGY INFRASTRUCTURE REHABILITATION

THE ENERGY INFRASTRUCTURE REHABILITATION PROJECT IS ONE OF THE MOST SUCCESSFUL PROJECTS OF THE MILLENNIUM CHALLENGE GEORGIA PROGRAM. WITHIN THE EXISTING FINANCING THE PROJECT IMPLEMENTED THREE PHASES OF PLANNED REHABILITATION AND FUNDED PRE-CONSTRUCTION DESIGN STUDIES FOR THE UNDERGROUND GAS STORAGE FACILITY. HOWEVER, THE PROJECT WAS NOT ABLE TO FULLY IMPLEMENT THE FOURTH PHASE OF GAS MAIN PIPELINE REHABILITATION WITH THE SAVINGS MADE IN THE COURSE OF IMPLEMENTATION OF THE PROJECT.

The Energy Project was, in fact, the only project that had its main component 100 percent completed by 31 October 2010.

The original budget of this project totaled $49,5 million and comprised two components: (1) the rehabilitation of damaged sites of the North-South gas main pipeline (the rehabilitation of 22 sections in total was envisaged) – $44,5 million and (2) support to the Ministry of Energy in further improvement and implementation of energy sector strategy - $5 million.

Let us recall that one of the condition precedents for the disbursement of the grant within the Millennium Challenge Georgia Program was the refusal on the part of the Government of Georgia to privatize the gas main pipeline, the move regarded as a significant component for the energy security of the country.

In the analyzed period, however, the topic of gas pipeline privatization and placement of its shares on international exchanges was actively discussed.

It should be noted here that the reservation that restricts the right of the Government of Georgia to privatize the gas pipeline is valid until the completion of the Compact. After the Compact has been completed, this obligation assumed under the Millennium Challenge Program will no longer stay in force.

However, it is also noteworthy that the security concerns that prompted the inclusion of the pipeline rehabilitation component in the Program are still in place. The transfer of gas main pipeline natural monopoly into private hands threatens the security of the country. Moreover, the rationale behind a possible sale of rehabilitated pipeline is more than unclear. Especially, considering that a new component that has been added to the Energy Project is again directed toward ensuring the energy security of the country. In this regard a relatively new component – a feasibility study of gas storage facility, is rather interesting.

The feasibility study for the construction of gas storage facility was a new component of the Energy Project and it was introduced in 2008, before the additional funding was granted. The decision to fund this component was taken in spring 2008 within a $5 million assistance to the Energy Ministry, which was indeed a positive development as the construction of a gas storage facility is a very important step for the country's energy security.

This project, in agreement with the Ministry of Energy of Georgia, envisages the pre-construction design studies of the underground gas storage facility in Georgia with the aim to create strategic stocks of natural gas. The pre-construction design studies involve a full engineering-technical, economic, geological, financial and environmental studies, as well as evaluations related to the construction of a gas storage facility and associated infrastructure.

During the monitoring period, on 29 December 2009, a contract was signed a $3.36-million contract with the Danish consulting company, Ramboll Oil & Gas A/S to perform the above mentioned works. The company was selected through international bidding. Pre-construction feasibility study is planned to be completed by the end of 2010. It should be noted here that after a number of changes in the funding of this project, which initially stood at $49,5 million, the funding of the Project as of today comprises $45,900 million.

Moreover, the following works have been implemented within this amount: the rehabilitation of 22 sections of the gas main pipeline, which has already been completed and was carried out in three phases.

One should also note one additional detail – as a result of a successful implementation of the Project, the management of the Project saved some amounts and last October, developed a proposal to implement the fourth phase of the Project.

In its report published last year, the EPRC wrote that according to the Energy Project management, both components (the rehabilitation of the gas main pipeline and pre-construction design study of underground gas storage facility) would be completed within the limits of 85 percent of the allocated funding. The preparation of a so-called additional project was in progress at that time (within the limits of remaining 15 percent of the funding), envisaging the implementation of the fourth phase of gas main pipeline rehabilitation. That project required the approval from the MCG Supervisory Board and the MCC.

As the analyzed period proved, the fourth phase of rehabilitation within the framework of the Project never materialized. The main reason of that was the necessity to mobilize additional funds for other projects of the Program – primarily, for the SJRR Project. The issue of the implementation of the fourth phase was discussed at the MSG Supervisory Board Meeting #44, held on 21-23 December, 2009. Due to threats existing in SJRR Project, it was decided to refrain from implementing this phase.

In particular, at the meeting "Chairman of the Meeting asked whether or not it will be possible to reallocate $8 million from the Energy Infrastructure Rehabilitation Project to the SJRR Project, to which Ilia Eloshvili have a positive answer. The Chairman also asked how this $8 million would be spent, to which Ilia Eloshvili responded that this amount could be spent on the implementation of the fourth phase of the Energy Project. With regard to this issue all the Board members unanimously stated that the road construction was a higher priority than the construction of the fourth phase. (See, Minutes of the MSG Supervisory Board meeting #44, 21-23 December, 2009).

As the monitoring revealed, $3,6 million was finally reallocated from the Energy Project to the SJRR Project.

Obstacles that emerged in the implementation of SJRR Project and efforts to obtain amounts to overcome these obstacles must be an explanation to the delay in the spending of funds observed in the Energy Project in the first half of the analyzed period. (This is extensively discussed in the section on the dynamics of use of funds). Discussion of a new procurement plan at the 11 July 2010 meeting of the Supervisory Board can serve as a proof of intentional delay in the spending. It was noted at the above mentioned meeting that the procedure for the procurement of pipes for the Georgian Oil and Gas Corporation (GOGC) would begin and a condition would be incorporated that a contract could be signed provided that funds were available and would not be reallocated for the SJRR Project. (See, Minutes of the MSG Supervisory Board meeting #46).

It should be noted that in the second half of the analyzed period, after details of the SJRR Project had become known, the Energy Project purchased pipes and equipment, through international competitive bidding, worth $6 012 757 for the GOGC to rehabilitate North-South gas main pipeline. As the Project management explained to the EPRC, the MCG, or the Government of Georgia, commited itself to perform rehabilitation works. The Energy Infrastructure Rehabilitation Project contributed to these works only in the form of purchased technical equipment. Thus, it can be said that the fourth phase of the Project was partially funded.

3. REGIONAL INFRASTRUCTURE DEVELOPMENT PROJECT

DURING THE MONITORING PERIOD – FROM 1 DECEMBER 2009 TO 1 DECEMBER 2010, CHANGES HAVE BEEN MADE TO FUNDING OF INTERNAL PROJECTS UNDER THE RID PROJECT. THE MCG HAS DECREASED ITS SHARE OF FUNDING IN PROJECTS AND SHARED ITS FINANCING BURDEN WITH OTHER DONORS AND THE STATE. THE DYNAMICS OF AMOUNTS TO BE EXPENDED REVEALS, HOWEVER, THAT THE COMPLETION OF RID PROJECTS THAT WERE SCHEDULED TO BE ACCOMPLISHED THROUGHOUT 2010, IS LESS LIKELY.

The RID Project is aimed at improving municipal service delivery. The Project provides grants to eligible government entities (local self-government, municipal enterprise and central government) for the development of infrastructure. The Project involves the rehabilitation of water supply systems in Poti, Kobuleti, Kutaisi, Bakuriani and Borjomi. Moreover, for the purpose of joint financing, MCG is cooperating with the European Bank of Reconstruction and Development, the Swedish International Development Agency, EC Delegation to Georgia and other donors, thus making it possible to implement larger-scale projects. The Municipal Development Fund of Georgia is the entity implementing the Project.

At the time of signing the Compact the RID Project was planned to receive $60 million. After numerous modifications, the funding of this component, as of November 2010, stands at $54,735 million. Moreover, the number of originally envisaged projects decreased, which the EPRC indicated in its previous report as well.

It should be recalled that in 2008, mainly due to problems in the SJRR Project, additional funds were reallocated to this Project from the RID Project, according to the amendment to Compact, thus decreasing the MCG share in the RID Project funding from $60 million to $43,485 million. This decision led to slim-down of the list of projects identified as potential recipients of funding – out of seven water supply and three irrigation systems rehab projects two water projects were removed. This means that in 2008, two projects – Rustavi water supply system rehabilitation and Tskaltubo water supply and sewage system rehabilitation - were removed from the list of approved potential recipients. A new amendment to the Compact in November 2008, increased the Project budget to $69,485 million, though it again decreased thereafter to $57,735 million. As of November 2010, the budget of the Project stood at $57,735 million.

The slim-down in the list of projects in 2008 was explained with the following arguments: “During the initial identification of projects the preference was given to those ones with some preparation for investments already under way owing to the involvement of other donors (with the financial aid of the EU feasibility studies were either completed or in progress for Poti, Kutaisi, Kobuleti, Rustavi, Borjomi and Bakuariani water supply systems. The World Bank and the BP expressed their readiness to fund the design works). However, the identified projects also included such projects, the preparation of which was yet to be launched: Zemo Samgori, Kbemo Samgoti and Tbisi-Kumisi irrigation projects and Tskaltubo water supply and sewerage system rehabilitation project. Although the MCG financed the feasibility studies for those projects, their completion within the Compact terms, i.e. in five years, seemed unrealistic.” (See, MCG’s response to the EPRC letter of 21/10/08).

Because of the above cited argument and despite the increased funding, the number of projects to be implemented under the RID Project has not changed and as of December 2010, it again includes five water supply system rehabilitation projects, feasibility studies for two projects and the preparation of a construction design project for one irrigation system.

According to the information on the status of the Project, it will be completed by the end of 2010.

It is also interesting that during the monitoring period - from 1 December 2009 to 1 December 2010, changes were made to the funding of projects to be implemented within the framework of this Project. In particular:

1. **Poti municipal water supply project** – out of total cost of the project of $15,870 million, $4.550 million was an MCG share which has been decreased to $3,852 million as of today.

2. **Kutaisi municipal water supply project** - the total cost of the project is $20,499 million of which the MCG's share comprises $11,970 million. This share of MCG is decreased to $10,419 million as of today.

3. **Kobuleti municipal water supply and sewage rehabilitation project** - the total cost of the project is $22,180 million of which the MCG's share comprises $18,800 million. This share is down to $18,424 million.

4. **Bakuriani municipal water supply project** - the total cost of the project is $9,086 million; the MCG's share of $7,7 million is increased to $8,7 million.

5. **Borjomi municipal water supply project** - the total cost of the project is $26,098 million. The MCG share has increased from $15 million last year to $16,625 million.

6. **Preparation of engineering design for Zemo Samgori Irrigation Scheme** - the total cost of the project is $1 million.

7. **Feasibility Study for Tskaltubo Water Supply and Sewage Systems Rehabilitation Project** - the total cost of the project is $250 000.

8. **Feasibility study for Zemo and Kvemo Samgori and Tbisi-Kumisi Irrigation Schemes Rehabilitation** - the total cost of the project is $229 000.

The above changes indicate that by decreasing its own share, the MCG, in fact, redistributed its burden of funding to other donors and the state.

There is also another interesting factor. At the beginning of the monitoring period, the Poti water supply systems rehabilitation project and feasibility studies for Tskaltubo and Zemo Samgori projects had been already completed. The completion of all the other projects was planned in the fourth quarter of 2010 (See 2010 status of the RID Projects).

Moreover, the progress of projects is described in current activities as follows:

"Rehabilitation works within the frameworks of the Kutaisi Municipal Water Supply System Rehabilitation Project started in autumn of 2008. The Project aims at improving water supply system and services in Kutaisi. Rehabilitation of existing city network (30 streets) is funded by MCG. Construction works also include repair of wells, reservoirs and pumping stations, also, installation of new pumps and water meters. Completion of works is anticipated by the end of 2010. Rehabilitation of the city network on two streets (Chavchavadze and Akhalgazrdoba streets) is now completed. Works on the remaining 28 streets and auto-factory district are performed in accordance with the workplan.

The bidding procedures for the Kutaisi Gora District Settlement Water Supply System rehabilitation are completed. Works include restoration of reservoirs, purchasing and installation of water meters and pumps. Contracts have been signed and the mobilization is underway. Rehab works are planned to start in May 2010.

Construction works are underway on water reservoir, main pipeline and water supply and sewage system networks within the frameworks of the Kobuleti Municipal Water Supply and Sewage Systems Rehabilitation Project.

Construction works are underway on construction of reservoirs and rehabilitation of water supply/sewage networks within the frameworks of the Bakuriani Water Supply and Sewage Network Rehabilitation Project. Construction works are planned to be completed by end of 2010.

The bidding procedures for the Bakuriani water treatment plant construction has completed. Contract negotiations are currently in progress with a winning company. The works will start in May 2010 and will be completed in December 2010.

Construction works for the first (rehabilitation of headwork and main pipe), the second (rehabilitation of water supply and sewage systems) and the third (construction of Gujareti and Sadgeri water intake and main pipeline to the water treatment plant) stages within the frameworks of the Borjomi Water Supply and Sewage Network Rehabilitation Project are underway. The works will be completed in November 2010."

However, according to data of 31 October 2010 (i.e. maximum two months earlier before the completion of projects and at the moment of the completion of the Borjomi project), the indicator of spending is quite low, in particular:

By 31 October 2010, 66 percent of the total funding, envisaged for the RID Project in the Compact, is to be expended, which means that within the remaining two months the Project must expend 34 percent of the funding, i.e. one fifth of the amount that was to be spent during five years. Moreover, delays are observed not only against Compact amounts but also against the expenditure planned in advance for this period (for 31 October 2010, the management planned the expenditure of 93 percent of the total funding envisaged by the Compact, but this plan is not followed either and the performance indicator stands at 71 percent).

The amounts to be expended by Bakuriani Water Supply and Sewage Network Rehabilitation Project is worth special mentioning – as of 31 October 2010, only 40 percent is spent of the total funding that was planned and envisaged under the Compact. The Kobuleti project spent 63 percent against the Compact amount and 76 percent against the planned amount, by the indicated time; the Kutaisi project spent 69 percent and 70 percent, respectively; as for the Borjomi project, which was planned to be completed end of November, the corresponding indicators comprised 75 percent and 78 percent, respectively, as of 31 October 2010. The only project that has fully expended allocated funding is the Poti municipal water supply project. (However, as we have already noted, the works in this project was declared completed last year, in August 2009).

In the EPRC's opinion, these indicators suggest that the completion of the projects in 2010 is highly unlikely. A proof of it is the Borjomi municipal water supply project.

Besides, the problems regarding the observance of terms are further complicated by the policy of the RID partners. As noted above, for the purpose of joint financing, MCG is cooperating with the EBRD. In case of two projects, one of the reasons impeding the works was the change to reporting manner, required by the EBRD. According to current information, the EBRD itself does not envisage the completion of its part of the project until the end of 2011.

4. REGIONAL DEVELOPMENT FUND

IN THE MONITORING PERIOD, THE GRDF WAS DISTINGUISHED FOR ITS LOW ACTIVITY RATE. WITHIN THAT PERIOD, A DIRECTION WAS DETERMINED FOR SPENDING GRDF AMOUNTS: REGIONAL EDUCATIONAL PROGRAMS. HOWEVER, ALTHOUGH THE MCC DEMANDS THAT THIS PROCESS BE ACCELERATED, THE RULE AND THE FORMS FOR DISTRIBUTING AMOUNTS HAD NOT BEEN YET DEVELOPED BY 1 DECEMBER 2010.

A distinguishing feature of the GRDF among the Millennium Challenge Georgia Program projects is that it is a ten-year project. As compared to other projects (their duration is five years), the Fund has twice as much time to achieve set goals.

It should be noted that where the GRDF was marked with the highest increase in spending in the previous monitoring period – throughout 2009, in the period between 31 September 2009 and 31 October 2010, the rate of its spending was low. As of Quarter 1, Compact Year 4 (by 1 March 2009), the Board of Directors of the Fund had already approved 10 investment projects with the total value of $21 million which comprised 84 percent of the GRDF investment budget. (See, Quarterly Progress Report, Compact Year 4, Quarter 1).

Moreover, we would recall that a webpage of a project implementing entity: www.seaf.ge was created only in the fourth year of the enactment of Compact, in 2009, which displayed the information about accomplished activities. **However, this webpage posts only the information as of 31 September 2009, which means that it has not been updated since then and that the issue of transparency is not taken seriously.**

According to the MCG quarterly report, the investment portfolio of the GRDF comprised 10 companies as of 30 September 2010. Investments to these companies made up $21,88 million, which is about 85 percent of the total investment budget of the GRDF. (See, Quarterly Progress Report of MCG, Compact year V, Quarter II).

This means that during the monitoring period, or during one year, the GDRF used a mere 1 percent of its investment portfolio.

As regards the scale of reinvestment – by the end of September 2010, the total revenues transferred to the GRDF account by the investment portfolio companies made up $5,7 million of which $1,89 million has been reinvested.

Thus, the list of investment projects approved as of September, 2010, looks as follows:

Company	Business	Location
Doki	Construction materials retailer and wholesaler	Tbilisi
Bazi	Food canning, jarring and concentrate producer	Saguramo
Rcheuli	Hotel chain	Telavii, Sighnagi, Batumi, Kutaisi
Piunik	Integrated poultry business	Kaspi
Tetnuldi	Mountain hotel	Mestia
Ecopex	Hazelnut processing and export	Mtskheta
Prime Concrete	Concrete production	Poti
Madai	Black Sea fishing and processing	Poti
Dogan	Animal feed and pet food producer	Marneuli
Delta Comm	Development of fiber optic internet cable infrastructure	Throughout

See: www.seaf.ge

As the EPRC wrote in the Stage IV Monitoring Report, the GRDF was supposed to focus its activity on the projects of technical assistance in 2010.

According to quarterly results, by 30 September 2010, there were 21 technical assistance projects approved of which nine projects were completed. (See, Quarterly Progress Report of MCG, Compact year V, Quarter II).

Moreover, the analyzed period saw the step-up in the discussion of the form of post-Compact existence of the GRDF. This issue was debated at the MCG Supervisory Board meeting #46. The issue addressed was about a farther placement of GRDF revenues. The GRDF will receive revenues from existing portfolio companies and new investments of existing portfolio companies and through collecting interest and principal of loans for new investments, as well as the sale of its own share in these companies until April 2010 (the date of GRDF closure).

Two alternative options of placing revenues were outlined, of which one should be selected:

The GRDF revenues will be used to support educational programs primarily in Georgia's regions;

A new investment fund will be set up, to be financed from the GRDF revenues. (See the Minutes of the MCG Supervisory Board meeting #47).

The Supervisory Board members find it difficult to take a decision on this issue. The participants in the meeting stated about the necessity for a broader involvement in the decision making process.

It is noteworthy that the above mentioned meeting of the Supervisory Board is dated 11 June 2010. It is important to note that at that meeting an MCC representative pointed to the need for speeding up the decision-making process. As the MCC representative stated, this decision, in MCC's view, had to be part of a closure plan of the Millennium Challenge Georgia Program and therefore, the Government must take a timely decision. (See the Minutes of the MCG Supervisory Board meeting #47).

According to the information provided to the EPRC by the MCG, by 1 December 2010 the decision had been taken that the GRDF revenues would be directed toward regional educational programs. However, the rule and mechanism of expending these amounts have not been developed yet.

5. AGRIBUSINESS DEVELOPMENT ACTIVITY

MAIN ACTIVITIES IN THE ADA PROJECT WERE PERFORMED IN THE FIRST TWO MONTHS OF THE MONITORING PERIOD. THE REMAINING TIME WAS SPENT ON THE MONITORING OF PROJECTS AND WORKS FOR THE COMPLETION OF THE PROJECT. 286 PROJECTS WERE FINANCED WITHIN THE PROJECT. AS OF 31 OCTOBER 2010, THE PROJECT EXPENDED 93 PERCENT OF THE AMOUNT ALLOCATED UNDER THE COMPACT. ACCORDING TO PRELIMINARY INFORMATION, THE PROJECT WAS COMPLETED AS SCHEDULED. ACCORDING TO THE INFORMATION AVAILABLE TO EPRC, AS OF 30 SEPTEMBER 2010, ONLY ONE PROJECT WAS DEDUCTED THE AMOUNT - $19,320, FOR THE FAILURE TO FULFILL OBLIGATIONS.

The ADA Project is a project under the Enterprise Development component of the Millennium Challenge Georgia Program. Its initial funding was $15 million whereas as of 31 October, it stood at $20,530 million. The duration of the Project is 4,5 years.

The decision on increasing the funding of the Project was first taken in spring 2009, after the indicator of spending by the project showed an upward trend. Similarly to the SJRR Project, the ADA Project also received additional funding in the monitoring period (1 December 2009 – 31 October 2010), though the increase was insignificant. In particular, according to the data of 31 August 2009, the ADA Project funding comprised $20,200 million which was topped up by $330,000 before 31 October 2010.

Let us recall that the ADA Project awarded grants on a co-financing basis for the support of primary production, establishment of farm service centers, development of value-adding enterprises and value chains in any of the regions in Georgia. The ADA Project comprises two components - Enterprise Initiative and Value Chain Initiative. Grants are awarded for the following activities:

Primary Production - the maximum amount of the grant is $50,000; the minimum rate of co-financing is 1:0.5 (for each USD 1, farmers shall provide USD 0.5 co-financing). Typical examples of primary production project are nurseries, cattle breeding farms, bee-keeping farms and similar.

Establishment of Farm Service Centers – a farmer service center is a sort of agribusiness-store where farmers can purchase all necessary products (planting materials, fertilizers, chemicals), receive advice or benefit from agriculture equipment services. The maximum amount of the grant is USD 50,000; the minimum rate of co-financing is 1:0.75 of the requested amount (for each USD 1, farmers shall provide USD 0.75 co-financing).

Value-adding enterprises - the maximum amount of the grant is USD 50,000; the minimum rate of co-financing is 1:1 of the requested amount (for each USD 1, farmers shall provide USD 1 co-financing).

Value Chain - the complete production cycle including growing, storing, processing and rendering marketable state and quality assurance of the products. The maximum amount of the grant is USD 150,000; the minimum rate of co-financing is 1:1 of the requested amount (for each USD 1, farmers shall provide USD 0.5 co-financing).

It is noteworthy that similarly to the Stage IV monitoring, the Stage V monitoring also witnessed a high spending rate in the first months of the analyzed period.

In December, 2009, agreements were signed within a new Machinery Rings initiative, envisaging grants of up to $150,000 to already funded and successful Farm Service Centers, on the co-financing basis (50%). Within this initiative about 30 units of tractors with tillage and two harvesters have been purchased. It was anticipated that the Machinery Rings initiative would create about 70 new jobs and provide indirect benefit to tentatively 3,000 local farmers in need of quality machinery service.

As of April 2010, nine rounds of grant selection and two tenders had been carried out. As a result, MCG signed 286 grant agreements worth $16 million. (See, www.mcg.ge).

Since April, the number of funded projects has not increased.

According to most recent information, by the end of the second quarter of the fifth Compact year, i.e. 30 September, the total budget of 286 grant agreements signed by MCG and CNFA, made up $16,114,598, of which $19,320 was deducted from one of the projects due to the failure to fulfill obligations. At this stage, about $1,500,000 was issued from the grants fund, which in total made up $14,540,368. (See, Quarterly Progress Report of MCG, Compact year V, Quarter II).

It should be noted that of signed 286 agreements ($16,114,698) 238 projects belong to Enterprise Development component and their budget reached $9,418,224. 38 projects belong to Value Chain component, with the total budget of $5,197,124. Ten projects are signed within a new Machinery Rings initiative, with a total amount of $1,499,250.

It is important to note that as a result of the ADA Project implementation, by 2011, it was planned to finance up to 300 projects, which would create approximately 2,934 new jobs and provide an indirect benefit to more than 70,000 local farmers.

As the report provided on 30 September 2010 states, at this stage 286 projects were finances under the ADA Project. Moreover, as of 31 October 2010, the Project had already expended 93 percent of the amount envisaged in the Compact. By the end of November 2010, a closing ceremony of the Project was held, at which it was stated that the amount of investment in the agriculture, including the co-financing, made up $32 million.

VI. PROSPECTS FOR EXTENSION OF MILLENNIUM CHALLENGE PROGRAM

In January 2004, the Government of the United States of America, having developed a completely new mechanism for providing aid to countries in transition, created Millennium Challenge Account to support the financing of this mechanism and established Millennium Challenge Corporation to implement and administer the project.

We would recall that the Millennium Challenge Compact signed by the Governments of Georgia and the USA will end on 7 April 2011. 120 days are envisaged for the Program closure works.

The MCC has already published the list of potential recipients of the aid in 2011, two groups of countries: low-income category and lower middle income category.

At this stage, Georgia falls under a lower middle income country category. When developing conditions for awarding grants, the MCC did not limit itself to satisfactory economic indicators. To determine whether or not countries willing to receive the financing meet the MCC requirements, a broad set of criteria was developed.

First group of criteria include the degree of economic freedom and such factors as liberal trade regime, fiscal policy, main macroeconomic aggregates: acceptable inflation rate, stability and general climate for business.

According to the second group of criteria, it is necessary for a country to be promoting civil liberties, rule of law, political rights, increasing government effectiveness and control of corruption.

Other requirements include support to the development of health and education sectors and public expenditure on these sectors. Moreover, according to MCC criteria, the GNI per capita for low-income countries must be $1,905 for the year 2011, while that for a lower middle income country must range between $1,906 and $3,945.

At present, the GNI per capita in Georgia comprises $2,530 and by its income level, Georgia fits in a group with Angola, Armenia, Bhutan, Ecuador, Guatemala, Jordan, Paraguay, Turkmenistan, Ukraine and others, 29 countries in total.

Given the above quoted criteria, Georgia has good prospects for making it again into the list of countries funded within the framework of the Millennium Challenge Program. However, there has been no precedent so far of granting the Compact assistance to a country twice.

The MCC Board of Directors will take a decision on a new program of assistance in mid December. It should be noted that the Government of Georgia has already expressed a desire to construct a university within the framework of a possible future compact. This desire was articulated by the Georgian President during his visit to the USA. At this stage, the EPRC has no detailed information about any other priorities, identified by the Georgian government.

VII. CONCLUSIONS AND RECOMMENDATIONS

The Millennium Challenge Georgia Program is already in its final phase of implementation. Today, one can already say that one of the main problems of the Program was the lack of experience in project management and mistakes made on the initial stages of Program implementation. Mistakes were made on actually every stage of management. It is especially true in case of the SJRR project which caused the change of the entire design of the program.

Initial cost estimates of projects were very optimistic, which became a key reason for the increase in already planned financing thereafter.

Tender results that were too high against the optimistic estimates led to annulment of tender results by project managers, thus creating not only financial problems but also the problem of meeting timelines.

Problems with violating timelines were complemented with increased service prices that further led to emergency situations.

Poor quality of pre-construction designs, inadequacy of cost estimates, omission of a number of environmental or standardization and other issues at times of signing contracts with contractors led to repeated changes to contracts and rise in the cost of works thereafter.

Due to signing improper contracts at the initial stage, the termination of the contract with Ashtrom International without damaging the state proved to be a problem. The company, in fact, withdrew from the contract with minimal losses.

The monitoring period and the result of negotiations with Ashtrom International revealed that during tenders held for the road rehabilitation works, the capacity of the company was over-valuated, which gave rise to problems in the performance of obligations by the company. This period also revealed the lack of mechanisms that would have helped avert the emergency situation created in the spring of 2009 and the summer of 2010 and ensured the proper performance of obligations by the company or imposition of adequate financial responsibility on the company.

In the final stages of the Project implementation, including in the monitoring period, delayed and cautious decisions of the management endangered a timely and quality completion of the SJRR Project. Moreover, during two years it led to emergency situations in the implementation and awarding through direct contracting contracts worth $35 million and $30 million.

However, it should be noted here that unlike in 2009, the MCG management managed to impose $8.2 million fine on the company in 2010. It should also be noted that in new contracts MCG incorporated additional guarantees, which is a welcoming development indeed.

It should be noted also that limited timeline and resettlement issues that were not envisaged in preliminary design studies caused the infringement on ownership rights of three citizens of Georgia, which casts shadow on the Project.

Moreover, sharp delays in expending amounts in all the projects led to the situation when the pace of using funds at the final stage of the program is extremely accelerated, raising concerns about the quality of performed works. Besides, the indicator of spending in projects under the RID threatens the timely completion of the Project.

The completion of the Energy Project proved that the energy sector has more positive experience in project management than in case of roads and other infrastructure projects.

The monitoring period also revealed that the completion of projects under the RID component within the Compact term is less likely. At the same time, the government is dragging on the decision on farther structural arrangement of the GRDF.

The EPRC believes that against these identified problems with only four months remaining until the completion of the Compact, it is necessary for the MCG management to work under a special regime in order to ensure effective implementation of large amount of works and accordingly, the use of remaining funds on time.

The speed-up in works must not come at an expense of quality. Therefore, the monitoring of the quality of road rehabilitation should be enhanced. In general, the acceleration in the pace of project implementation calls for strengthening quality control in order to ensure that the results of the Program conform to its aims.

Apart from the SJRR project, a special attention in this regard should be paid to the RID Project, as well as to GRDF Project with its return on investments indicator to be assessed in five years (let us recall that this project is 10 year long).

Besides, if the MCC takes a decision on awarding a new compact to Georgia, we deem it necessary to ensure a broader public involvement in identifying the priorities. This should be achieved through better transparency and employing consultation mechanisms.

Moreover, in planning future funding it is necessary to ensure accuracy of estimates and to take into account threats related to awarding contracts and improper planning.

VIII. ABBREVIATIONS AND DEFINITION OF TERMS

MCG	**Millennium Challenge Georgia Fund**
MCC	**Millennium Challenge Corporation**
Compact	**Grant agreement between the governments of the U.S and Georgia within the Millennium Challenge Program.**
Monitoring/working Group	**A working group comprising representative of Economic Policy Research Center and Open Society Georgia Foundation**
Program	**Millennium Challenge Program**

EPRC
Economic Policy Research Center

71, Vazha-Pshavela ave. Tbilisi, Georgia.
Block VIII, Floor II, Sector VII, Office VII.
Tel: (995 32) 207 305
Fax: (995 32) 207 305
info@eprc.ge
www.eprc.ge