EPRC
Economic Policy Research Center

«Monitoring the Millennium Challenge Program»
IV Stage Report

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

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CONTENT

I. FOREWORD

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

Over the period between 2006 and 2008, the EPRC published three monitoring reports. The current report deals with Stage IV monitoring results and covers the period from October 1, 2008 to October 1, 2009. The report discusses implementation of projects funded under the Millennium Challenge Program, use of additional $100 million granted in November 2008, dynamic of spending by projects, impediments in the implementation of the Program and appropriateness of decisions taken by the management.

By the end of monitoring period, as of October 2009, the Millennium Challenge Georgia Program looks as follows:

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

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

3. **Regional Infrastructure Development Project (RID 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 are in progress under this component).

Enterprise Development Component comprises the following projects:

1. **Georgia Regional Development Fund (GRDF Project) - $32 million;**

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

The Millennium Challenge Georgia Program underwent significant changes during the monitoring period. Changes were made to the Program as a whole as well as projects individually. Continuous alterations were prompted by problems that emerged in the implementation of the SJRR Project, errors in preliminary assessments prepared by the management to receive additional funding, as well as other objective or subjective reasons. This report provides a detailed review of reasons, content and outcome of these changes.

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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".

II. KEY FINDINGS

1. A low rate of spending by the Millennium Challenge Program remains a problem. It has led to the increase in the cost of projects and jeopardizes the timely and full completion of the projects. The step up in spending can be traced from the second quarter of the fourth program year. This trend, however, does not eliminate the fears about the completion of SJRR and RID Projects on time. General spending against the budget by projects is as follows:

As of the end of Q1, the SJRR and RID Projects spent each 10-12 percent of the total amounts on average. By the end of the second quarter this indicator will increase to 24.72 percent and 20.47 percent for SJRR and RID Projects, respectively.

A significant increase is seen in the use of amounts by the Energy Project with the actual spending at 53,75 percent of the total amount in Q1, program year 4, and predicted spending at 66,16 percent in the second quarter.

The Regional Infrastructure Fund used 59.1 percent of the total amount, according to the data of Q1, program year 4; the use of 72.02 percent of the total amount is planned in the second quarter.

By the end of Q1, 2009, the ADA Project spent 35.51 percent of the total mount and intends to increase spending to 54.39 percent in Q2, 2009. This means that during the remaining seven quarters before the Compact term expires, 64 percent of the total amount must be spent, which is 9 percent per quarter, on the average, whereas so far only 4 percent was used quarterly.

2. Overall, a significant difference is also observed with the financial plan: only 36.4 percent of the total amount is planned to be spent in the second quarter of the program year.

3. Gap between the financial plan and actual spending has widened in the reported period, having comprised 39.5 percent by the end of quarter 1, 2009, which is a matter of concern. Some improvement up to 47.76 percent is, however, expected in following quarter.

4. The main challenge to the Millennium Challenge Program yet again is the implementation of the SJRR project. Similarly to the previous year, the problems, which emerged in the implementation of this project during the monitoring period, caused the change in the entire arrangement of the Millennium Challenge Program and led to channeling the major part of additionally mobilized resources toward this project; more specifically, **$80 million, i.e. the bulk of additional $100 million granted to the Program in November 2008 goes to the SJRR Project** (against $60 million initially earmarked within the additional funding received in November 2008) **and only the remaining $20 million to the other four projects**.

5. **Frequent changes in project financing continue to be a problem of the Millennium Challenge Program.** For example, between November 2008 and October 2009, Energy Infrastructure Project was amended twice (first it was added, and then deducted $13 million); the RID Project was amended three times (the funding first increased by 26 million and then decreased on two occasions); the ADA Project was changed twice (toward the increase). The changes are practiced so often that in some cases they are not even reflected in the status of projects (see, the status of approved and identified projects for funding within the RID Project, as of August 2009, which does not reflect the change in funding under the disbursement request in June 2009). Needless to say that talks about the appropriateness of planning and accuracy of preliminary evaluations lack sense in such circumstances.

6. Despite the increase in the SJRR funding to $203,515 million, or doubling of the amount originally envisaged in the Compact (at the time of signing the Compact, funding of this project was estimated at $102 million, it increased to $123,6 million as of October 2008, and further to $183 million on the initial stage of additional funding), the project no longer includes the 245 km road for rehabilitation as initially intended under the project. **As of October 2009, according to the awarded contracts, the length of roads within the SJRR Project make up 219,2 km which is less by**

26 km (about 10 percent) than originally contemplated in the Compact. Even after the award of contract on the additional 3 km section which is planned under the project, the length of the road will reach 222,2 km, less by 23 km as compared to the initial Compact length.

7. The protraction of road works by the contractor Ashtrom International during the monitoring period extremely exacerbated the situation. The outcome of the MCG response to the situation was the acceleration of works (transfer of a road section to another company). However, the final result was also the increase in the cost of three lots in the project: **the rehabilitation works on 119,5 km road increased by $24,389 million (or, by 37 percent as compared to spring 2008)** over the period between spring 2008 and August 2009 (i.e. almost a year and a half), although the increase in cost of SJRR Project against the initial budget contemplated in the Compact was already apparent by 2008.

8. Due to the exacerbated situation the company Azerinsaatservice was awarded a $35 million worth direct contract for the 47,8 km road rehabilitation without a tender, through direct negotiations. The award of a direct contract of this value bypassing the tender, allowing a construction company to get it without competition, naturally, gives rise to questions and requires serious justification.

9. **The contractor company which caused this turmoil went unsanctioned.** It even gained from it as was released from the responsibility of rehabilitating the 47,8 long road and saw only $20 million decrease in its project budget. (See the details in the section Implementation of Projects, Samtskhe-Javakheti Road Rehabilitation Project).

10. **As of October 2009, some slowdown in the rehabilitation works on several sections of the Samtskhe-Javakheti road was still observed;** this may not only lead to the increase in price but also endanger its completion within the timeframe specified in the Compact.

11. The monitoring period saw the increase in the funding of the RID Project by $26 million first, and the decrease thereafter. As of October 2009, the budget of this project comprised $57,735 million, less by 2,205 million than originally envisaged in the Compact, although it was higher by $14,250 million than in October 2008. Nevertheless, **this change did not resulted in the increase of the number of projects, as compared to October 2008; it only caused internal modifications of the projects. The low rate in spending remained the problem,** threatening the timely and efficient implementation of the project.

12. During the monitoring period, the funding of the Energy Project increased by $13 million. This increase, according to the First Amendment to the Compact, was intended for the pre-construction studies of an underground gas storage facility - a relatively new component of the project; however after a while this amount was taken away from the project. **The management claims that the activities envisaged in the Compact will be completed within the scope of the existing budget; moreover, an additional fourth phase of the gas main pipeline rehabilitation is also planned, which is a positive factor indeed. However, the above developments indicate that the Project, in fact, did not need the $13 million that was envisaged and allocated for additional works in November 2008.** The MCG management provided the explanation of the above mentioned "error", which is given in the section Implementation of Projects.

13. The ADA Project funding increased by $15 million to $20,200 million, in the monitoring period. **The reported period saw an unprecedented speed-up in the implementation of the project as compared to previous years. From October 30, 2008 to October 1, 2009, two grant selection rounds were held and 133 grants with the total value of $7,394 million awarded. This means that twice the amount was used within the past year than over the first three years of the commencement of this project.** The ADA Project has moved up to a new stage and the threats here are not as much related to the low pace of the implementation and timely completion of the project but the quality of the implemented works.

14. Similarly to the ADA Project, the GRDF Project also spent funds at a higher speed during the monitoring period. **As of September 30, 2009, the GRDF Project invested $21 million in 10 Georgian companies, which is 84 percent of the amounts to be used for investing.** After investment projects have been funded, the focus will shift onto financial and operational conditions and the performance of portfolio companies as well as the financing of previously approved technical assistance projects. At that new stage of the GRDF Project one should pay a particular attention to the monitoring of the implementation of awarded contracts.

III. ADDITIONAL FINANCING

On November 20, 2009 the United States of America (acting through the Millennium Challenge Corporation) and the Government of Georgia signed the First Amendment to Compact granting an additional $100 million in assistance to the Millennium Challenge Georgia Program. However, the First Amendment to Compact of November 2008, i.e. the decision on granting additional $100 million, has been significantly changed by October 1, 2009, with $80 million channeling toward the SJRR Project and only $20 million, which 20 percent of the additional financing, going to the remaining four projects.

This means that by November 2008, i.e. when the additional $100 million was granted, the threats and risks as well as needs of the Millennium Challenge Program were not assessed properly. It should be noted that the redistribution of amounts among projects occurred several times during the monitoring period. Causes and outcomes of such changes as well as explanations thereof by the MCG will be discussed in detail below. Until then, we will review the information about the additional financing in a chronological order:

In November 2008, First Amendment to Compact which defines the purpose of the additional $100 million, reads: "MCC now desires to grant additional funding to the Government in an amount not to exceed One Hundred Million United States Dollars (US$ 100,000,000) to cover shortfalls in the original budget for the Projects and allow completion of the Projects as originally contemplated by the Compact" (see, First Amendment to Millennium Challenge Compact, p.1).

As the above quote shows, the purpose of the additional funding is to ensure completion of the Projects within the original budget and as originally contemplated.

To this end, according to First Amendment to Compact signed on November 20, 2008, the additional funding was distributed among Projects, as follows:

Regional infrastructure rehabilitation component:

1. **Samtskhe-Javakheti Road Rehabilitation Project - $183 million;** the initial budget of the project was $102 million; after the changes in 2008, the budget increased to $123,6 million by reallocating amounts from the RID Project. In November 2008, the project got an additional $60 million under **"the additional funding"**;

2. **Energy Infrastructure Rehabilitation Project - $62,5 million** (up from $49,5 million);

3. **Regional Infrastructure Development Project - $69,485 million.** The original budget comprised $60 million. In the third phase of the project implementation, funds were reallocated to the SJRR Project, thus cutting down the RID budget to $43,485 million and leaving several already agreed projects out. (As explained by the MCG management, under the additional funding the number of projects did not increase to its original amount not because of lack of financing but due to the reality that it would be impossible to complete them within the remaining period). Under "the additional funding" the RID Project increased by $26 million to $69,485 million;

Most of changes within the limits of additional $100 million funding which Millennium Challenge Program received late 2008, were made to the projects falling under the regional infrastructure rehabilitation component, as the information below shows. The table of additional funding provided in First Amendment to Compact looks as follows:

Table N1. First Amendment to Compact

Component	Year 1	Year 2	Year 3	Year 4	Year 5	Total
(USD $ million)						
1. Regional Infrastructure Rehabilitation Project						
(a) Road Rehabilitation Project Activity	N/A	N/A	3.00	18.00	39.00	60.00
(b) Regional Infrastructure Development Project Activity	N/A	N/A	1.30	7.80	16.90	26.00
(c) Energy Rehabilitation project Activity	N/A	N/A	0.65	3.90	8.45	13.00
Sub-Total	N/A	N/A	4.95	29.70	64.35	99.00
4. Program Administration and Control						
(c) Fiscal and Procurement Management	N/A	N/A	0.20	0.40	0.40	1.00
TOTAL ESTIMATED MCC CONTRIBUTION	N/A	N/A	5.15	30.10	64.75	100.00

By October 2009, however, funds were redistributed among the Projects as follows:

Samtskhe-Javakheti Road Rehabilitation Project - $203,515 million (the initial budget was $102 million; as of October 2008, the budget stood at $123,6 million and in November 2008, at $ 183 million)

Energy Infrastructure Rehabilitation Project - $49,5 million (it increased to $62,5 million under the additional funding but decreased again, as of October 1, 2009,).

Regional Infrastructure Development Project - $57,735 million (the original budget comprised $60 million; in October 2008 it was down to $43,485 million; after receiving the additional $100 million funding it went up to $69 million; as of June 2009, it stood at $64,535 million).

The enterprise development component includes the following projects:

Georgia Regional Development Fund - $32 million ($100 000 was taken away from the Project during 2009);

Agribusiness Development Activity- $20,2 million ($15 million as of October 2008, $19,840 million as of October 2009).

It should be noted here that although the first decision on increasing the ADA Project financing was taken in spring 2009, the table on the status of projects under the RID activity, as of August 2009, which can be accessed on the MCG webpage, does not reflect this change, showing again the RID Project funding of $69 million (see, MCG webpage, Status of approved and identified projects for funding within the RID Project, as of August 2009).

When reviewing the issue of additional funding one question inevitably arises: is the condition set forth in First Amendment to Compact, signed in November 2008, being implemented? In particular, whether the project will be completed under the additional funding ($100 million) in the form they were originally contemplated by the Compact, as it was implied in this Amendment (see, the quote above).

For this purpose, we will briefly review the projects which receive most of this "additional funding":

1. SAMTSKHE-JAVAKHETI ROAD REHABILITATION PROJECT (SJRR PROJECT)

Since April 2006, i.e. the moment when the Compact entered into force, the SJRR Project has been one of the most problematic activities in the Millennium Challenge Georgia Program. It is precisely the impediments in this project (discussed by the EPRC in its 2006-2008 reports) that has caused the change of the overall design of the Program. The year 2009 is not an exception in this regard as the SJRR Project remains the problem again.

As a result of the additional funding granted to the MCG within the framework of donors' aid in October 2008, the total budget of the SJRR Project now stands at **$203,515 million**. Contracts have already been awarded on the rehabilitation of 219,2 km road, which is less by almost 26 km than the length of the road (242km) originally envisaged (when the Program entered into force).

As we were told at the MCG, the decision on the rehabilitation of additional 3km long Sagharasheni-Partskhisi section may be taken in winter 2009 (see below, Implementation of Projects).

In October 2008, i.e. **by the moment the decision on allocating the additional funding was taken, contracts were signed on the rehabilitation of 170,9 km road**. These contracts were awarded in spring 2008. In particular:

On March 20, 2008, **the $65,467,530.16 worth contract was signed with the company Ashtrom, according to which the company would rehabilitate the following road sections: Partskhisi- Gokhnari (37,1 km), Gokhnari - Nardevani (34,6 km) and Nardevani - Satkhe (47,8 km)**.

On 14 May 2008, **the $33,100,683.20 worth contract was signed with a joint company Papenburg/Ostash (later, Papenburg/Black Sea Group) to implement the road rehabilitation works on the following road sections: Satkhe-Ninotsminda-Amenian border (31,4km) and Akhalkalaki-Sulda road sections (20km).**

The rehabilitation works started in spring 2008 and were scheduled to be completed by the end of 2010 (see the Monitoring of Millennium Challenge Program, III Stage Report).

As of October 2009, the following contracts had been signed under the SJRR Project:

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)** - $15,73 million worth contract; **Nardevani-Satkhe (47,8km)** - $35,194 million; **Akhalkalaki bypass (2,3 km)** - $4 540 972; - contractor Azerinsaatservice Ltd.

It is interesting that the company Azerinsaatservice is a new contractor of the MCG. This company entered the Georgian market at the time when tenders were announced for the purpose of using the additional funding; by October 2009, it is already the largest contractor among the Samtskhe-Javakheti road construction companies. As of October 2009, the company has contracts with the total value of $63, 207 million. The road to be rehabilitated by the company is 85,1 km long in total. The largest contract (worth $35,194 million) on the rehabilitation of 47,8km long road has been awarded to the company without a tender. (This road section (lot #4) was taken out of the contract with Ashtrom International, another contractor. Reasons, conditions, justification and evaluation of this transfer can be seen below in the section Implementation of Projects).

To sum up, through the additional funding, the contracts were awarded on the rehabilitation of 219,2 km long road (i.e. less by 26 km than originally envisaged in the Compact). The decision on the rehabilitation of additional 3km long Sagharasheni-Partskhisi section may be taken in winter 2009. As of now, it is pending. If the decision is taken, the total length of the road under the SJRR Project will make up 222,2 km (less by 23 km than the 245 km as originally envisaged in the Compact).

2. REGIONAL INFRASTRUCTURE DEVELOPMENT PROJECT (RID PROJECT)

Like the SJRR Project, the RID Project also received additional funding of $26 million out from the $100 million pledged by MCC as the international aid at the donors' conference in October 2008. Later, the funding of this project was downsized and as of 1 October 2009, comprised $57,735 million. (According to the MCG management, the funding was cut not because of problems in the SJRR Project but to make some savings within the RID Project. It is the fact, however, that all the savings almost entirely went to the SJRR Project).

Unlike the SJRR Project, the total value of the RID Project does not differ significantly from the original one. **The Compact originally envisaged $60 million for the RID Project, according to First Amendment to Millennium Challenge Compact (Compact), signed on 20 November 2008, the budget of the Project increased to $69,485 million (up by $9 million). As of 1 October 2009, however, it is less by $2,205 million than originally contemplated.**

Let me recall that in 2008, due to the problems in the SJRR Project, additional funds to this Project were redirected from the RID Project, according to the amendment to the Compact, which resulted in the decrease of the MCG share in the RID Project funding from $60 million to $43,485 million.

As said above, under the amendment signed in November 2008, the value of the Project increased by $26 million as compared to that in October 2008.

As of October 2009, however, the Project funding comprised $57,735 million, i.e. less by $2.2 million than originally envisaged in the Compact.

Due to the reduction in the funding to $43,485 million, as compared to October 2008, the list of projects identified as potential recipients of funding, comprising seven water supply and three irrigation systems projects, was slimmed down with five out of seven water projects left. This means that in 2008, two projects – Rustavi water supply system rehabilitation and Tskaltubo water supply and sewage system rehabilitation projects removed from the list of approved potential recipients of funding.

What happened after the Compact was amended in November 2008 and the budget increased to $69 million?

According to the information published on the MCG webpage, the additional funding ($26 million was supplemented to the RID Project under First Amendment to Millennium Challenge Compact (Compact) signed on November 20, 2008) envisages a full completion of previously approved municipal projects. See webpage: www.mcg.ge

Moreover, the MCG quarterly progress report (Compact year 3, Quarter 3; October 1 – December 31, 2008) notes: "In November 2008, consistent with the Compact amendment, 26 million has been added to RID project. These funds are divided as follows: Kutaisi municipal water supply project – 6 million; Kobuleti water supply and sewage rehabilitation project – 8 million; Borjomi sewage rehabilitation project – 12 million. The process of preparation and approval of relevant documents has started". Which means that **the additional funding will be used not for completing municipal projects approved earlier (which implied seven water supply and three irrigation projects) but for the implementation of works for five water supply projects selected in 2008, with some modification**. Thereafter, as of 31 September 2009, the project funding shrank but the number of projects did not. As the management explained, the decision not to increase the number of projects within the additional funding received in November 2008, and spend available funds for the internal modification of projects was prompted by the fact that irrespective of the increase in funding there was little time left before the completion of the term of the Project. (see details in the section Implementation of Projects).

3 ENERGY INFRASTRUCTURE REHABILITATION PROJECT (ENERGY PROJECT)

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

In 2008, within the component of support to the energy ministry, a decision was reached to add a component to the original Compact, namely, the component of a feasibility study of the construction of gas storage facility and channel all the ministry support funds toward it. (See the details on the implementation of this component in the section Implementation of Projects).

The change to the activities under the Millennium Challenge Georgia Program before 2008, did not affect the funding of the Energy Project - either upward or downward. The Project underwent changes only after the decision was taken regarding the additional funding in November 2008.

Pursuant to Amendment of Millennium Challenge Compact signed on 20 November 2008, the budget of the Energy Project increased to $62,5 million. According to the MCG management, **the additional $13 million funding envisages the conduct of necessary studies in the energy sphere, which includes comprehensive economic, geological and environmental analysis, pre-construction design and public/private financial plan for the construction of gas storage facility and related infrastructure.** (See details about the progress of this project in the section Implementation of Projects). By 1 October 2009, however, the $13 million supplement to the project allocated within the framework of the additional funding was taken away from the project again (in accordance with the request for money reallocation). As the management claims, this decrease will not affect the accomplishment of the project goals. (See details in the section Implementation of Projects).

4. AGRIBUSINESS DEVELOPMENT ACTIVITY (ADA PROJECT)

The ADA Project became a recipient of the additional funding on the second stage. First Amendment to Compact signed in November 2008, envisaging the distribution of the additional $100 million granted to the Millennium Challenge Program in October 2008, did not include this project. The disbursement request of June, however, already reflects the change implying the allocation of additional funds to the ADA Project.

As of October 2009, the budget of the ADA Project stood at **$20,200 million**. Such a change was probably prompted by an increased rate of spending of project funds since it was precisely the low speed of spending that represented the problem of the Project by October 2008. (See details about the progress of this project in the section Implementation of Projects).

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

The present analysis aims at illustrating the compliance of the amounts expended during the implementation of the Millennium Challenge Program with the indicators of multi-year financial plan. To this end, we provide the overview of dynamics of monetary parameters of the entire Program and its components. The analyzed period covers the period from September 30, 2008 to October 1, 2009.

1. ADOPTED METHODOLOGY

This analysis is based on quarterly disbursement requests prepared by the MCG, detailed multi-year financial plans, the program monitoring and evaluation plan which was revised in September 2008, and First Amendment to Millennium Challenge Program signed by and between the Government of Georgia and the United States of America acting through Millennium Challenge Corporation. It also uses the documents prepared by the MCG, defining **Economic Rate of Return** (ERR). The efficiency of expenditure is evaluated by means of comparing actual quarterly spending and constantly updating multi-year detailed financial plans.

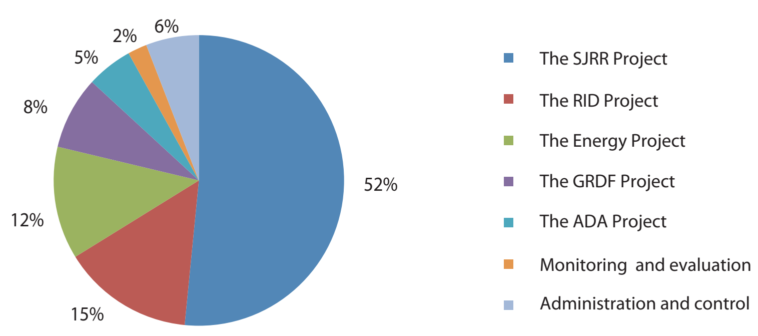
ERRs defined by the MCG are also used in the final part of the analysis to illustrate adverse effects of delays in spending program funds.

2. AN ANALYSIS OF DYNAMICS OF SPENDING

This analysis shows actual aggregate spending from the second quarter of the third program year to October 1, 2009, which is taken from the quarterly disbursement requests. As the second quarter of the fourth program year is yet to end, amounts to be spent by October 1, 2009 according to the disbursement request prepared on 1 July 2009 and the financial report, are indicated here as planned spending (estimates) in order to show an expected trend.

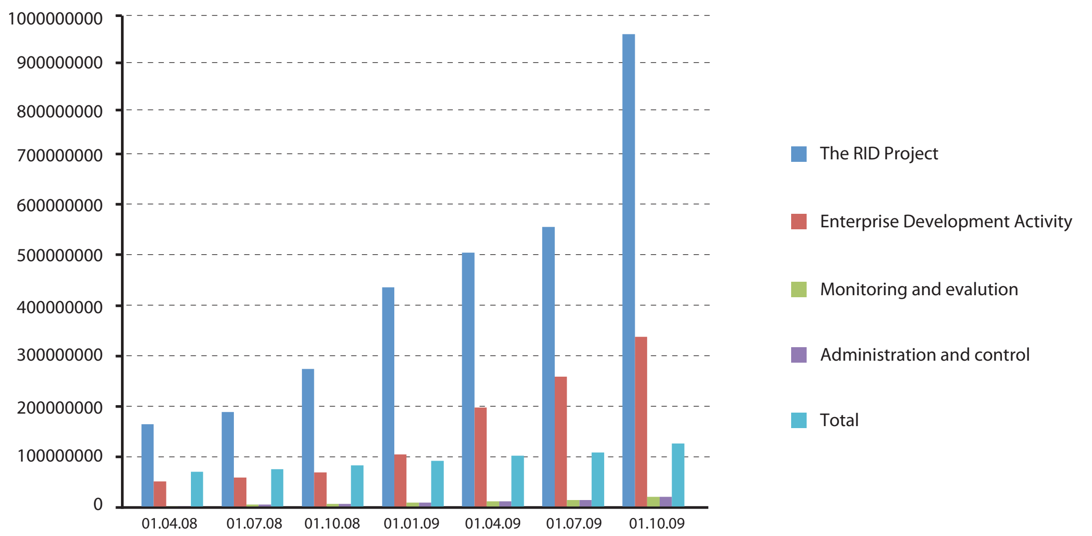
Before discussing the spending, it would be interesting to show the distribution of the total Millennium Challenge Program amount by projects. See Diagram N1.

DIAGRAM 1. ILLUSTRATES THE DISTRIBUTION OF THE TOTAL AMOUNT BY PROJECTS.



To discuss the dynamics of spending, Diagram No2 shows actual aggregate spending from the first quarter of the first program year to 1 October 2009, which is taken from the quarterly disbursement requests. Despite some increase observed in the current year, the spending is still in small amounts.

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



For instance, the dynamics of quarterly spending, shown in Table No1, deserves attention.

Table N1. Increase in spending by quarters

	II.Q.2008	III.Q.2008	IV.Q.2008	I.Q.2009	II.Q.2009*
Regional Infrastructure Rehabilitation	**265,02%**	**88,93%**	**-57,99%**	**-24,90%**	**647,59%**
Samtskhe-Javakheti Road Rehabilitation	2312,29%	52,59%	-72,02%	-28,13%	1247,56%
Regional Infrastructure Development	19,03%	256,66%	83,89%	-44,61%	298,67%
Energy Infrastructure Rehabilitation	-11,58%	207,11%	-61,78%	1,98%	217,27%
Enterprise Development Component	**30,79%**	**228,49%**	**168,39%**	**-34,33%**	**28,90%**
Georgia Regional development Fund	3,85%	634,21%	244,40%	-36,61%	-17,39%
Agribusiness Development Activity	46,66%	59,34%	22,37%	-21,95%	232,15%
Monitoring and Evaluation	**560,03%**	**-9,82%**	**106,11%**	**-45,78%**	**250,89%**
Administration and Control	**99,28%**	**2,14%**	**8,36%**	**-24,42%**	**142,11%**
Program administration	31,73%	9,09%	7,85%	-33,25%	184,38%
Audit	300,00%	-75,00%	300,00%	-75,00%	446,25%
Fiscal and procurement management	1019,98%	0,00%	0,00%	0,00%	75,00%
Total	**195,59%**	**94,07%**	**-15,96%**	**-30,34%**	**300,00%**

Similarly to the previous year, the rate of spending is low again. One should note a quarterly increase in spending in the second quarter of the fourth program year, but this is an estimated target. The Q1, 2009 saw the decrease in the spending in all the components save the Energy Project which showed almost 2 percent increase.

To illustrate the above said, table No2 shows the dynamics of actual spending against the total amounts by quarters. Since it shows the dynamics of the ratio between aggregate amounts, this indicator, naturally, is characterized with an upward trend. More interesting for us, however, is the speed of increase, which is rather low as it can be seen from the table.

For example, the aggregate spending of the largest SJRR Project increased by 1.9 percent, on the average, from January through July, 2009. The speed of spending of RID and Energy Projects increased by 3-4 percent, on the average, as compared to the aggregate amounts. The situation is somewhat better in case of enterprise development component, in particular, the GRDF Project which shows the spending at 59.1 percent of the total amount in Q1, Program Year 4, and estimated 72.02 percent in the following quarter.

In general, a huge lag behind the financial plan is easily noticeable: only 36.4 percent spending of the total amount is planned in Q2, Program Year 4.

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

	01.04.08	01.07.08	01.10.08	01.01.09	01.04.09	01.07.09	01.10.09*
Regional Infrastructure Development Project:	5.34	6.10	8.90	14.19	16.41	18.08	30,54
SJRR Project	0.06	0.20	3.51	8.58	9.99	11.01	24,72
RID Project	3.65	4.12	4.68	6.67	10.34	12.37	20,47
Energy Project	28.99	32.69	35.96	46.00	49.83	53.75	66,16
Enterprise Development Project:	9.65	11.21	13.25	19.97	37.99	49.82	65,08
GRDF Project	9.26	10.20	11.19	18.40	43.25	59.01	72,02
ADA Project	10.32	12.86	16.60	22.55	29.83	35.51	54,39
Monitoring and Evaluation	4.25	4.60	6.91	8.99	13.28	15.61	23,78
Administration and Control:	30.34	32.19	35.86	39.62	43.69	46.77	54,22
Program administration	27.34	30.20	33.96	38.07	42.51	45.46	53,88
Audit	17.36	18.10	21.05	21.79	24.75	25.49	29,53
Fiscal and procurement management	37.41	37.74	41.38	45.03	48.67	52.31	58,69
Total	7.36	8.29	11.03	16.34	20.81	23.92	36,37

Diagram No3 shows quarterly amounts in absolute terms by components. From the fourth quarter of the third program year, the dynamics of aggregate spending clearly shows some stagnation and even further decrease. Similarly to the previous year, this is especially the case with the spending of amounts of the largest regional infrastructure rehabilitation project.

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

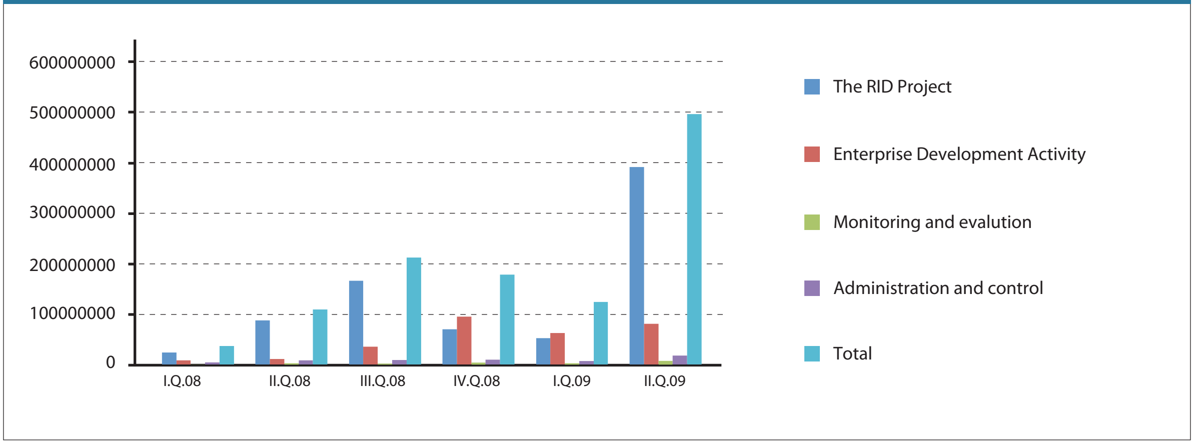


CHART 1.
SPENDING AS OF BEGINNING OF PERIOD AGAINST THE TOTAL AMOUNT

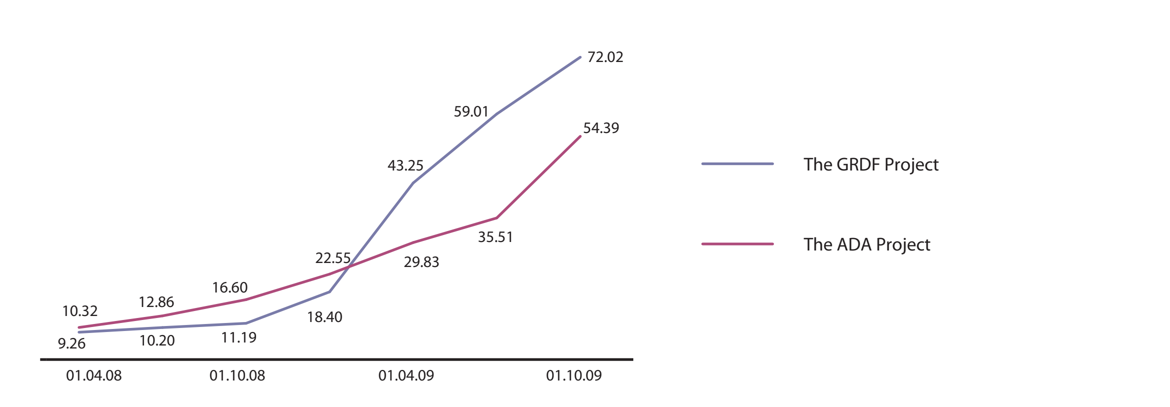


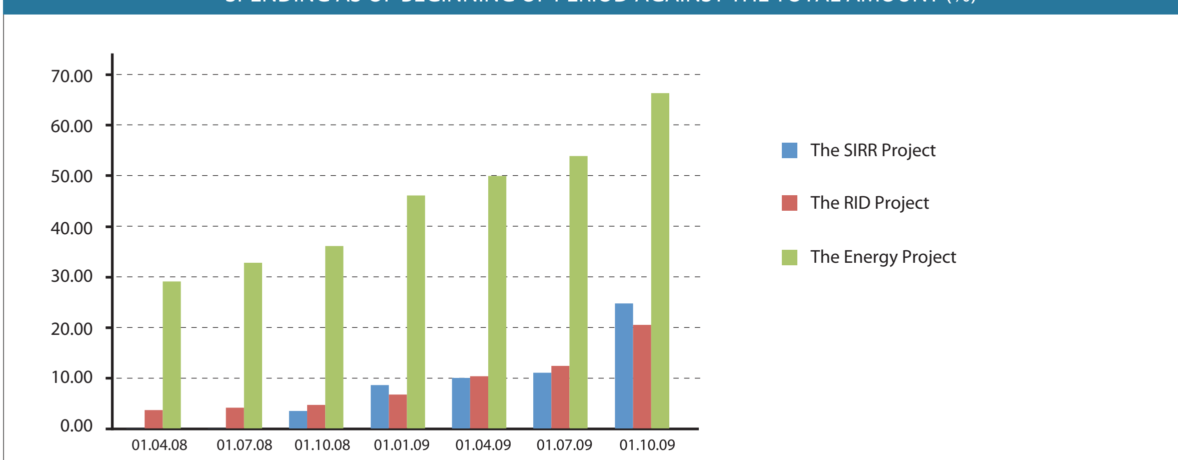
Chart No1 shows the dynamics of aggregate spending of two Program activities, namely, the GRDF and ADA Projects (comprising 8.1 and 5.1 percent of the total amount, respectively), as of beginning of corresponding period. It is marked with a sharp upward trend, as compared to the previous year, but this trend can be traced since the last quarter of the third program year. The spending within the ADA project is estimated at 54.39 percent by the end of Q2, 2009, whereas by the end of Q1, 2009, the actual spending comprised 35.51 percent. This means that during the remaining seven quarters before the Compact term expires, the Project must use 64 percent of the total amount, i.e. 9 percent per quarter, on the average, whereas so far it only used 4 percent quarterly. At the stage when the emphasis is placed on the acceleration of works under the project, attention should be paid to the control over the quality of performed works.

A sharp increase in spending is observed within the GRDF Project from the last quarter of the third program year. To offset the delays in the previous period, however, 5 percent of total amount needs to be spent quarterly, on the average, whereas this indicator managed to exceed 3 percent only at the end of the third program year.

Diagram No4 shows the dynamics of spending against the total amount under three projects of the regional infrastructure development component. A sharp increase in the spending of Energy Project is remarkable but it should be noted here as well that it comprises only 12 percent of the total component and cannot change a general picture. The SJRR and RID Projects' spending is somewhere near 10-12 percent of the total amount, on average, by the end of Q1, 2009.

The ratio between spending and total amounts in Q2, 2009, stands at 24.72 percent for the SJRR Project and at 20.47 percent for the RID Project.

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



At the same time, a disturbing difference is observed from the indicators of the detailed multi-year financial plan. Table No3 provides the dynamics of actual spending against indicators in the financial plan (according to the detailed financial plan). The given table clearly illustrates how far the program components' spending lags behind the estimates of the multiyear financial plan.

Table N3. Comparison of actual aggregate spending with financial plan estimates

	01.04.08	01.07.08	01.10.08	01.01.09	01.04.09	01.07.09	01.10.09*
Regional Infrastructure Development Project:	69.0%	32.7%	39.5%	57.5%	44.0%	36.5%	46,14%
SJRR Project	1.5%	2.8%	39.7%	86.2%	39.5%	28.7%	42,97%
RID Project	111.9%	11.7%	11.7%	15.3%	20.7%	20.1%	26,29%
Energy Project	101.3%	69.2%	61.6%	73.0%	69.6%	65.8%	75,07%
Enterprise Development Project:	42.2%	37.6%	30.0%	29.1%	38.2%	42.8%	49,99%
GRDF Project	49.4%	43.8%	35.7%	29.1%	41.5%	49.2%	56,64%
ADA Project	35.0%	32.0%	25.7%	29.0%	32.3%	31.7%	40,11%
Monitoring and Evaluation	59.6%	17.0%	15.7%	13.7%	17.7%	19.1%	24,72%
Administration and Control:	116.9%	95.4%	82.1%	75.4%	69.1%	64.0%	67,60%
Program administration	95.8%	77.0%	63.4%	57.5%	53.1%	49.3%	52,96%
Audit	216.0%	154.3%	150.9%	134.8%	112.1%	56.4%	59,64%
Fiscal and procurement management	152.9%	134.2%	130.3%	127.2%	116.5%	115.4%	119,62%
Total	68.2%	39.1%	40.7%	49.5%	43.5%	39.5%	47,76%

Since October 2008, a significant progress has been observed in spending within the regional infrastructure rehabilitation component, namely, the SJRR and Energy Projects, whilst since January 2009, a positive trend was also seen in the RID Project. In particular, the spending by the end of Q1, 2009, was only 20.1 percent but the estimated target for the second quarter is 26.46 percent. The spending for the largest SJRR Project comprised 28.7 percent, whereas the estimated spending for the end of Q2, 2009 is 42.97 percent.

As regards the second, enterprise development component, a positive development was observed in the GRDF Project from October 2008. This promising trend, however, reversed. Only 32 percent of the planned spending was used for the ADA Project in the first quarter of the fourth program year, whereas the corresponding indicator for the GRDF Project stood at 49.2 percent. As regards Q2, 2009, which is presented here as prediction, the improvement is expected in the Energy Project alone with the spending at 75.1 percent.

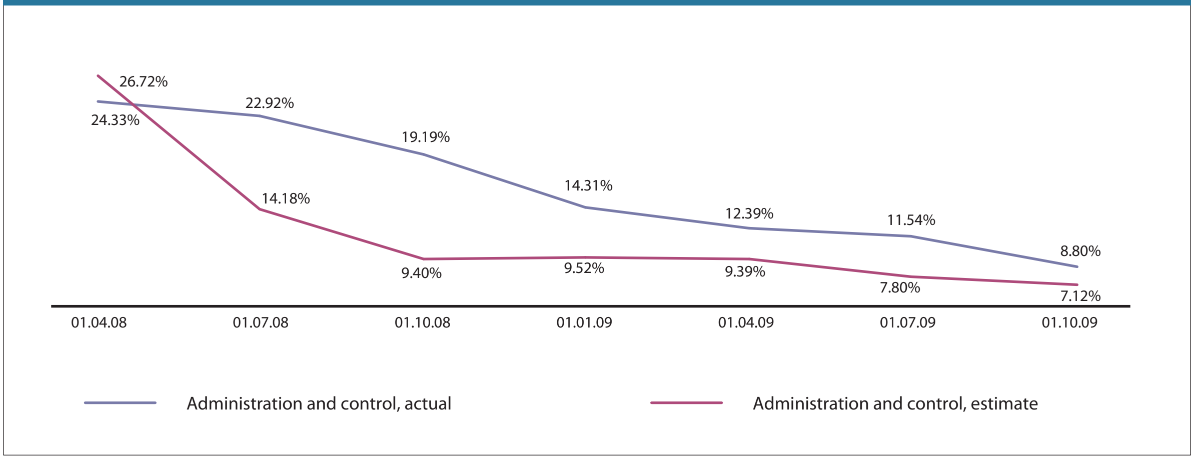
Overall, by the end of Q1, 2009, only 39.5 percent of the planned spending was used and the 48 percent target in the following quarter cannot change the general picture.

As it could be easily discerned in the previous reported period, the gap between the actual and planned spending of the monitoring and evaluation component is quite wide. The actual spending reached 19 percent only at the end of Q1, 2009. This can be explained by the delays in the implementation of works under other components and therefore, is less worrying.

Overall, the actual spending increasingly lagged behind the financial plan and at the end of Q1, 2009 comprised 39.5 percent, a notably bad indicator. Some improvement - up to 47.76 percent, is however expected in the following quarter.

Chart No2 shows the ratio of actual and planned administration and control spending with the total amounts

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



Actual spending of the administration and control component is the closest to the corresponding multiyear plan indicator. By the end of Q1, 2009, this indicator was at 64 percent, whilst for the second quarter it is expected to go up to 67.60 percent.

The reported period saw an undesirable increase of the ratio between administrative spending and the total spending as compared to the planned one. This fact would not have been alarming had the works envisaged in the Compact been duly implemented; however, particular attention needs to be paid to it, especially in light of significant delays in the fulfillment of program projects.

3. POSSIBLE NEGATIVE IMPACT OF DELAYS IN SPENDING

Table No4 provides some calculation to illustrate possible negative impact of delays in spending originally envisaged in the program. It is acknowledged that a project is profitable when its discounted revenue exceeds expenditure.

The calculations in the table are based on the assumption that expenditures of projects will generate revenues of at least similar amount in future; otherwise the implementation of projects makes no sense. Bearing this in mind, the delay in spending in a certain year will most likely cause delay in revenues of at least same size in following periods. To arrive at a present value, the expenditure and the revenue of the 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 delays in the first program year, which are provided in the third column, are not discounted as it is assumed that expenditure would immediately generate the return. Delays in spending in the second program year, as compared to financial plan targets, reflected in the fourth column, are recalculated at a discount rate for the first period, whereas delays in the third year, provided in the fourth column are recalculated at a discount rate for the second period. The sixth column shows aggregated discounted losses derived as a discounted loss caused by the delays in spending planned for the first, second and third years. An optimistic assumption is that the losses in the first three years will be entirely offset in the fourth, fifth and sixth years. Hence, the sum of figures in the sevenths, eights and ninth columns (representing discounted value of the figures in the third, fourth and fifth columns for the third, fourth and fifth periods, respectively) shall be deducted from the sum of columns two, three and four in order to arrive at the final discounted loss caused by the delays in planned spending over the first three years. The final result is given in the column "discounted margin". Even under the above described optimistic scenario the loss caused by the gap between the actual and planned spending of the program exceeds $26 million. This shortfall can theoretically be compensated by a sharp increase in the program spending in subsequent periods; however, in reality it is not likely as less than two years are left before the end of the program.

Table N4.

	Discount (%)	Year I	Year II	Year III	Total	Year IV	Year V	Year VI	Total	Discounted margin
SJRR Project	17.8	0	21135889	-174533	20961356	0	12929587	-106768	12822818	8138537
RID Project	11.6	231700	2742671	16669466	19643837	166699	1973246	11993035	14132980	5510857
Energy Project	11.7	2095052	9060808	10159681	21315540	1503264	6501407	7289883	15294554	6020986
GRDF Project	26	74312	1467654	5455796	6997762	37149	733689	2727385	3498223	3499539
ADA Project	12	1066728	3596368.75	7904437.18	12567534	759275.92	2559824	5626222.256	8945322.416	3622211.515
Total		3467792	38003390.18	40014846.6	81486029	2466388.22	24697753	27529756.89	54693898.24	267921130.5

As it was predicted in the Monitoring of Millennium Challenge Program, III Stage Report, prepared by the EPRC, an ambitious increase in spending, planned by the MCG, proved to be impossible against the background of the past year events. A speedy expenditure of increased funds requires much more administrative and institutional resources than it was envisaged; therefore, one of the reasons of the failure to achieve set goals is the shortage of administrative and institutional resources, as it was explained in the above mentioned report.

As noted above, in November 2008, in the aftermath of military actions in Georgia, the United State of America, acting through Millennium Challenge Corporation, granted the additional $100 million in assistance to the Government of Georgia to cover shortfall in the original budget for the projects and allow completion of the projects as originally contemplated by the Compact. It is however obvious that without eliminating above mentioned shortcomings in the efficiency of the program, it will be difficult to use these funds, which will jeopardize the completion of the works under the Compact.

V. IMPLEMENTATION OF PROJECTS

1. SAMTSKHE-JAVAKHETI ROAD REHABILITATION

ALTHOUGH THE INITIAL FUNDING OF THE SJRR PROJECT ALMOST DOUBLED FROM $102 MILLION TO $203, 515 MILLION, THE ROAD UNDER THE REHABILITATION WITHIN THIS PROJECT IS SHORTER BY APPROXIMATELY 26 KM, I.E. 10 PERCENT, THAN IT WAS ORIGINALLY CONTEMPLATED BY THE COMPACT;

DURING THE MONITORING PERIOD, THE SITUATION EXTREMELY EXACERBATED DUE TO THE SLOWDOWN IN THE PACE OF ROAD REHABILITATION WORKS;

DURING THE MONITORING PERIOD, A CONTRACT WITH THE TOTAL VALUE OF $35 MILLION WAS AWARDED THROUGH DIRECT NEGOTIATIONS WITH A SINGLE PERSON, WITHOUT CONDUCTING A TENDER;

DURING THE MONITORING PERIOD, IRRESPECTIVE OF THE CONTRACT SIGNED WITH ASHTROM INTERNATIONAL ON THE REHABILITATION OF THREE LOTS (THE TOTAL OF 119,5 KM ROAD), THE REHABILITATION COST OF THIS ROAD INCREASED BY $24,389 MILLION (THAT IS 37 PERCENT AS COMPARED TO SPRING 2008). NONE OF THE COMPANIES THAT CAUSED THE RISE IN THE PRICE OF WORKS WAS HELD ACCOUNTABLE.

The SJRR Project is the largest project of the Millennium Challenge Program. Originally, the project was allocated $102 million out from the $295,3 million granted to the MCG under the Compact. By October 2009, after the project budget had been corrected three times, the SJRR Project funding stood at $203, 515 million.

As of now, contracts are awarded on the rehabilitation of 219,2 km road which is shorter by about 26 km as compared to the length of the road (245 km) intended for the rehabilitation when the Compact entered into force.

In particular:

According to the information published on the MCG webpage, the total value of the project is $203, 515 million. The project envisages the rehabilitation of 223,9 km road. As mentioned above, however, the contracts are signed for the rehabilitation of 219,2 km. (As it was explained at the MCG, the decision on the rehabilitation of the additional 3km long Sagharasheni-Partskhisi section will be taken in winter 2009).

The status of the contracts signed within the scope of the SJRR Project as of October 2009 looks 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 (20km) – a $33,1 million worth contract; **Khertvisi-Vardzia (approximately 11 km)** – $13,4 million worth contract; - contractor Papenburg/Black Sea Group.

Rehabilitation of the Sulda-Kartsakhi-Turkish border (about 16km) road section – a $8.4 million worth contract; **Teleti-Koda-Asureti (19 km)** - $15,73 million worth contract; **Nardevani-Satkhe (47,8km)** - $35,194 million; **Akhalkalaki bypass (2,3 km)** - $4 540 972; - contractor Azerinsaatservice.

These contracts also envisage the spending of allocations under the additional funding, also, as the result of the "revision" of the contracts in early 2008, the transfer of a road section from one contractor to another. These issues will be separately discussed in detail.

a) Additional funding:

It should be noted that in the current reporting period, contracts were awarded for the works to be implemented within the additional funding (i.e. the additional $100 million), more specifically:

Within the initially allocated additional funding ($60 million for the SJRR Project), the $13,4 million worth contract was signed with Paperburg/Black Sea Group, which envisaged rehabilitation works on the Khertvisi-Vardzia road section (about 11 km).

The Sulda-Kartsakhi-Turkish border (about 16km) road section will also be rehabilitated within the limits of additional funding. The works will be carried out by Azerinshaatservis, an Azerbaijani company selected through a competitive tender. The $8.4 million worth contract was signed with this company on 22 April 2009.

On 11 June 2009, the contract was awarded on the rehabilitation of Teleti-Koda-Asureti road section (19 km). A contract with the total value of $15 073 148,22 (fifteen million seventy-three thousand one hundred and forty-eight USD and twenty-two cents) was awarded to Azerinshaatservis Ltd (Azerbaijan). Total duration of works is 18 months and it consists of road works including earth works, rehabilitation of culverts and drainage, pavement, road furniture and marking, retaining walls, and bridges, and other.

An interesting detail: the MCG's general procurement notice of October 27, 2008, regarding the SJRR Project, reads:

"The MCG intends to apply a portion of the proceeds of the MCC Funding to the Samtskhe - Javakheti Roads Rehabilitation Project ("SJRRP") and to eligible payments under contract(s) for works to be awarded under International Competitive Bidding (ICB) procedures. During the next 2 months MCG plans to begin procedures to procure the rehabilitation works of following sections of the Samtskhe-Javakheti Road:

1. *Sulda – Kartskhaki - Turkish Border (Approximately 16 km)*
2. *Khertvisi – Vardzia (Approximately 11 km)*
3. *Teleti – Koda – Asureti (Approximately 18 km)*

Procurements will be conducted according to the principles, rules and procedures set out in the Procurement Agreement between the GoG and MCC. Contractors and consultants from eligible source countries as defined in the Procurement Agreement are invited to participate".

The procurement plan published in December 2008, however, notes that for the rehabilitation of the additional sections of the Samtskhe-Javakheti road, the international competitive biddings will be announced for: lot #1 – Sulda-Kartsakhi-Turkish border and lot #2 – Khertvisi-Vardzia, together and also, for Teleti-Koda-**Partskhisi** road rehabilitation (see, the MCG's procurement plan December 2008 – May 2009).

What's interesting is that Teleti-Koda-Partskhisi section is about 8 km longer than the Teleti-Koda-Asureti road section (i.e. 27 km). The rehabilitation of this section was originally envisaged in the Compact within the cope of lot #1. Due to the problems having emerged in the implementation of the SJRR Project (which was discussed in detail in the Monitoring of Millennium Challenge Program Stage II and III Reports), it was decided to fund the rehabilitation of the above section from the state budget. According to the decision taken in March 2008, this road was to be financed from state budget allocations to the Roads Department of Georgia in 2008-2010. The Roads Department of Georgia was tasked with the performance of construction works (see, Decree #0150, dated 24 March 2008, of the Government of Georgia). The responsibility for the rehabilitation of this road was accordingly assumed by the Roads Department of Georgia.

After granting the additional $100 million to the MCG within the scope of the donors' pledge of October 2008, the above mentioned road section made it into the Millennium Challenge Program again, however, the length of the road is shorter by 8 km.

The EPRC sent a letter to the MCG for explanations and got the following response:

"In response to your letter of 16/06/09, we would like to inform that it is planned to construct the Akhalkalaki bypass and Sagharasheni-Partskhisi road sections, which will be transferred to companies upon the basis of change order. As regards the rehabilitation of the Teleti-Koda-Asureti road section, initially the project envisaged the rehabilitation of the Teleti-Koda- Partskhisi section. But since the funding of $123,6 million no longer included the Teleti-Koda- Partskhisi section, the Roads Department of Georgia rehabilitated the 5km long Asureti-Sagharasheni section in 2008. The MCG, therefore, funds only the Teleti-Koda-Asureti section, whilst the 3km long Sagharasheni-Partskhisi section will be transferred on the basis of the change order".

As of now the rehabilitation of these sections has not been transferred to construction organizations on the basis of the change order. As the MCG management explained later, the decision on the transfer of this section will be taken by the end of 2009.

If the decision on the rehabilitation of these section is taken and relevant documentation drawn up and registered, the total value of the project, $203,515 million, will include the rehabilitation of 222,2 km long road. Thus, while the original design of the Millennium Challenge Georgia Program envisaged the rehabilitation of 245km long road with $102 million, today, the funding of the rehabilitation of shorter 219,2km road (less by 26 km, or 10 percent) is almost doubled.

b) Rate of project implementation and exacerbated situation

Let me recall that during the initial years of the Millennium Challenge Program, the implementation of the project was lagging far behind the schedule, which resulted in the extension of works under the project and, among other factors, a significant rise in price of the project.

During the period of current monitoring it was precisely the pace and the failure of contractor to fulfill its obligations that caused the management to take an unprecedented decision of awarding the $35 million worth contract on the rehabilitation of 47 km long road section without a tender, through direct negotiation with a sole person. This decision will be analyzed below; until then, we will provide the information preceding this decision.

The first mention of problems related to the completion terms can be found in the quarterly progress report, dated 30 April 2009, which we studied during the monitoring period. According to the information of the MCG management:

"According to the Amendment to Compact approved in November of 2008, USD 60 mln were additionally contributed to the Samtskhe-Javakheti Road Rehabilitation Project budget. Bidding was announced for the implementation of construction works on additional road sections. ICB # SJRRP/CW/05 contained two lots for implementation of rehabilitation works on the following sections:

- Lot # 5.01 road section: Sulda-Kartsakhi-Turkish Border (16km)
- Lot # 5.02 road section: Khertvisi – Vardzia (11km)

ICB # SJRRP/CW/06 contained one lot, under which rhabilitation works will be carried out on the Teleti-Koda-Asureti section with the length of 19km.

At section 2 of the road, certain obstructions were created due to prolonged procedure of obtaining the necessary permits by Ashtrom International for allocating areas for forest use purposes crossing Algeti national park and for cutting existing plants at Gokhnari-Nardevani section between 50-53km and 57-59km markings.

In order to timely solve this problem the Environmental Protection Team of the SJRR Project together with the representatives of MCC developed a plan which excludes the necessity of cutting the trees entered in the red book". (See, Quarterly Progress Report, Compact Year 3, Quarter 4; January 1, 2009 – March 31, 2009).

As a result, the contract on the rehabilitation of the road sections included in two lots was signed on April 24, 2009, whilst the contract on the Teleti-Koda-Asrueti road section - on June 12. The MCG management then claimed that a-month-and-a-half delay would not affect the completion of the contract.

At a later stage, however, it transpired that the terms were already violated in that period, which already became quite a concern in April 2009. According to the information provided by the MCG at a working meeting with the EPRC (which took place at the MCG office in October 2009), Ashtrom International was expected to mobilize technique for the road rehabilitation works by April 15, 2009.

As the process with Ashtrom protracted, by 1 July the decision was made on the basis of negotiations with the company (after taking all the procedural steps) to take the fourth lot (**Nadrevani-Satkhe, 47,8km**) away from the company. On 31 July, through the negotiations with a sole person, this lot was awarded to Azerinsaatservis (the $35, 194 million contract worth); in August, on the basis of change order, the same company was awarded the contract of $4 540 972 for the rehabilitation of the **Akhalkalaki bypass (2,3 km)**.

The situation after the above decision looked as follows:

Pursuant to the contract executed with Ashtrom in spring 2008, the company was to carry out the **rehabilitation** of three lots – **Partskhisi-Gokhnari (37,1km); Gokhnari-Nardevani (34,6 km), Nardevani-Satkhe (47,8 km)**. The cost of contract at the time of signing stood at $65,467 million. After the negotiations which resulted in taking the 47,8km long Nadrevani-Satkhe section (i.e. the longest section) out, the value of a corrected contract with Ashtrom International comprised $54 659 059 (See, the second amendment to the contract #SJRRP-CW-04, agreement of 31 July 2009).

Thus, according to the contract signed in spring 2008, the cost of **rehabilitation** of three lots – **Partskhisi-Gokhnari (37,1km); Gokhnari-Nardevani (34,6 km), Nardevani-Satkhe (47,8 km)** stood at **$65,467 million**; in August 2009, the contracts with the total value of $89,853 million were signed for the rehabilitation of the same sections. **This means that from spring 2008 to August 2009 (i.e. about during a year and a half) the cost of rehabilitation of the 119,5km long road increased by $24,389 million (or by 37 percent as compared to spring 2008).** And this happened when by 2008 already the cost of the SJRR Project was already increased as compared to the cost originally envisaged by the Compact. (See, the Monitoring of Millennium Challenge Program, III Stage Report).

Justification of emergency decision

The result which was received by October 1, 2009 (increased cost of rehabilitation works, contract awarded bypassing the bidding), naturally, gives rise to questions. The answers to these questions were provided to the EPRC by the MCG management at a working meeting; these issues are also discussed in MCG's progress reports and minutes of the MCG Supervisory Board. We systematized our questions and arguments, which are provide below:

Was it possible to avoid the exacerbation of the situation?

As the MCG management stated, Ashtrom International was to mobilize equipment for the road rehabilitation works in April 2009. After the company failed to mobilize the equipment on the Nadrevani-Satkhe road section, the Project management sent a notification to the company. In total three notifications were sent in accordance with the procedures, following which negotiations were launched with the company about the removal and transfer of this section to other company. The negotiations ended on 1 July and the above mentioned decision was taken, however, a corresponding contract was only signed on 30 July, 2009.

The construction works were supervised by the company Finnroad. It should be noted that the issue of the responsibility of this company for the failure to timely provide the information was raised at the meeting of the MCG Supervisory Board held on 31 July 2009 (meeting #39); in particular, the chairman of the meeting, Kakha Baindurashvili inquired when would Finnroad submit its performance report.

Aleko Khetaguri, the minister of energy and member of the Supervisory Board, suggested that since Finnroad failed to carry out effective monitoring and supervision and ensure the control over the timely implementation of the contract, it would be better to sever contractual relations with the company by decreasing the amount of works. The MCG lawyer, Lasha Mgeladze, however, explained that the FIDIC standard conditions require the involvement of an engineer in the capacity of a supervisor, as it personally accepts notifications from a contractor and conducts a methodological supervision of the construction. The downsizing of the works, Mgeladze added, would paralyze the implementation of the contract, especially taking into account that the construction season was under way.

The chairman of the meeting, Kakha Baindurashvili, tasked the MCG with providing the information on the strengths and weaknesses of Finnroad activity and scrutinizing the resumes of 37 employees of the supervisory company.

The member of the Supervisory Board, Aleko Khetaguri, made a suggestion of transferring the functions of the supervisory company to the Roads Department of Georgia, but as I. Eloshvili explained to the Board members, the contract could be impossible to transfer without the termination of the contract on legal basis with the existing contractor and moreover, this would need the approval from the MCC. The MCG CEO George Abdushelishvili promised the Board to ensure the fulfillment of the task given by the Board concerning the supervisory company in the shortest possible time. (See, Minutes of the Supervisory Board Meeting #39).

On 4 September 2009, the MCG Supervisory Board meeting was held, at which the issue SJRR Project was discussed but the issue of Finnroad was not.

Why was not the issue of responsibility of Ashtrom Internationa raised? Or, why were not the sanctions applied when the violation of rehabilitation schedule caused the increase in the cost of the project?

In this regard, the MCG management explained that the terms of the contract with Ashtrom International had not expired either by April or by July 2009. The company could insist that it would be able to fulfill the obligation and consequently, there was no legal ground to penalize the company at that stage. The management went on to explain that even if the contract with the company was annulled and sanctions applied, the amount of these sanctions would not have compensated for the losses resulting from the difference in prices after the announcement of a new tender on all the three lots that had been awarded to Ashrtom for rehabilitation. Moreover, in case of announcing a new tender, the summer-autumn season in 2009 would be lost for road rehabilitation works and this would endanger the completion of the entire SJRR Project.

According to the MCG management, the decision to conduct negotiations with Ashtrom International on the removal of one lot as well as any subsequent decision was agreed both with the MCG Supervisory Board and MCC.

Against this background, naturally, another question arises: Why was the cost of contract set at $54,659 million after the correction when the cost of contract awarded in 2008 for the rehabilitation of three sections , including the longest and most difficult road section which had been removed, comprised $65,467 million?

As explained by the MCG lawyer, the cost of contract at the times of negotiations was already increased up to $74 million on the basis of change order. This means that the cost of contract signed with the company increased by almost 15 percent during a year, which again gives rise to additional questions. As it is well known, on the basis of change orders the MCG management can decide on the increase of the cost of contract in the range of 10 percent alone, whereas any decision beyond this range require additional approvals. The MCG management explained that it received such approvals. Nevertheless, the issue of the expedience of the price increase still lingers. At a working meeting with the EPRC, the MCG management quoted two examples to explain objective reasons behind the rise in the contract price:

The first was about the increase in the number of trees to be cut down within the Project, as compared to pre-project evaluation. As the MCG management recounted, according to the preliminary assessment conducted by the company Kocks Consulting, 300 trees were to be cut and then "recovered" along the road sections to be rehabilitated by Ashtrom International. In reality the number of trees subject to cutting (and accordingly, recovering) comprised 30 000, which necessitated the increase in the initially planned funding. (True, the company Kocks Consulting considered a provisional number of trees, subject to revision in the course of the project implementation, but in the EPRC's opinion, the error in the provisional number is unacceptably large).

The second example was about the rehabilitation works in Tsalka. According to the information by the MCG, in the course of rehabilitation it turned out that the water main pipeline of surrounding villages, which ran under the road, was damaged. It was therefore decided to "relocate" the pipeline, which required additional means.

Moreover, the MCG management talked about other specific reasons (for example, condition of soil layers), which also caused the increase in funding.

In the EPRC's opinion, the consulting company conducted an unqualified and improper assessment of works. We believe that the difference between 300 and 30 000 trees is beyond any acceptable margin of error. On the one hand, this illustrates incompetence in evaluation and on the other hand, indicates to the lack of proper cooperation between the project management and various state bodies during the implementation of the Project. The EPRC believes, should this cooperation be conducted at a proper level, the information about the water main pipeline running under the road would have been possible to receive at the time of pre-evaluation of the Project cost.

Given the above said, the EPRC concludes that the consulting company failed to properly fulfill its task and actually, no reaction followed.

Moreover, in the EPRC's view, even if the grounds for the increase of the contract cost to $74 million are **objective**, the cost of contract on the rehabilitation of the remaining two sections with Ashtrom International, **set at $54,659,59 still gives rise to question**. This amount is less by just $20 million than the increased contract price, whereas the objective rehabilitation price of the section removed from the contract (at least, the MCG employed a number of arguments to prove the objectivity of this price, which will be provided below) was determined as **$35, 194 million**. It means that after Ashtrom International, in fact, failed to fulfill assumed obligations and the issue of revising the contract was put on the agenda, as a result of the contract revision the company relinquished the $35 million worth rehabilitation works for which it was deducted only $20 million. Consequently, as of August 2009, it was Ashtrom International which gained from the situation.

Why was the decision taken on awarding a 35 million worth contract to a new contractor through a direct negotiation and not bidding process?

The answer to this question was already provided above; we would recall that the announcement of a tender would paralyze the summer-autumn rehabilitation season in 2009, causing a further increase in the contract price and endangering the completion of the entire project. This explanation does reflect the reality but does not neutralize the questions raised in relation to the emergence of exacerbated situation, in general. Among these questions, for example, is the following one:

How and why was the cost of contract with Azerinsaatservice set at $35,194 million?

The MCG management's letter sent to the EPRC in response to this question reads:

"Unit rates of bill of quantities were evaluated by comparing them to similar rates of those contracts which the MCG has recently procured through tender for the SJRR Project as well as the rates submitted by the joint company Papenburg/Ostash (another contender with the lowest price offer, which submitted its proposal for # SJRRP-CW-04 contract in January 2008).

The prices and unit rates of the contracts # SJRRP/CW/05 – 01 (Sulda-Kartsakhi_Turkish border) and # SJRRP/CW/06 (lot #1) were considered the most relevant for the comparison.

The contract # SJRRP/CW/05 - 02, Khertsvisi-Vardzia (the joint company Papenburg/Black Sea Group), awarded in April 2009, was considered inappropriate for the comparison with the third section works (lot #4) because of the nature of rehabilitation works needed in mountainous terrain.

Hence, it was deemed reasonable to evaluate the cost of remaining works on the third section (lot #4) by comparing them with those rates of works of similar amount and technical complexity, which the MCG accepted recently within the contracts awarded for the SJRR Project through international bidding.

Azerinsaatsevice Ltd informed us that the unit rates which served as a basis for the finally offered price for the remaining works on the third section (lot #4), largely relied on the rates submitted for the #SJRRP/CW/06 contract (lot #1). This contract was awarded to the company in June 2009 through competitive bidding conducted in accordance with the procurement procedures.

Azerinsaatsevice Ltd also informed us that for those cases which were not envisaged in the above mentioned contract, it used the identical unit rates from # SJRRP/CW/05 – 01 contract. The comparative analysis of common units from both above mentioned contracts proved the approach of Azerinsaatsevice Ltd and since these rates were based on the rates of contracts procured through competition, they were deemed reasonable for the works needed to complete the third section (lot #4).

In the process of comparing, it was decided that a relatively high price of mobilization reflected a commercial evaluation by the Azerinsaatsevice Ltd leadership of the purchase of machinery (asphalt mixing and concrete batching plants, also concrete and road crushing machines) and equipment (transport means and road construction devices) needed for the contract, in particular, very significant risks related to the essential need of completing a major part of works within the current construction season in order to ensure the completion of entire works by November 2010.

Program of works and timeline for the delivery of machinery and equipment

In addition to the evaluation of commercial aspects of the Azerinsaatsevice Ltd proposal we deemed it important to evaluate the feasibility of the use of resources, planned by the company, and the sequence and length of individual unit of works.

Within its proposal, Azerinsaatsevice Ltd submitted a detailed program of works which was thoroughly discussed and examined based on the schedule of technical and logistic issues presented by the MCG technical consultants. The program of works was also supported by a detailed timeline for the delivery of key machinery and construction equipment that were necessary for the completion of the program.

The amount of these machinery and equipment, which must be mobilized, far exceeds those currently used under the #SJRRP/CW/04 contract. It is implied that Azerinsaatsevice Ltd must purchase this machinery for this contract.

We considered that the works described in the program are logically successive and can be completed within the terms allocated for separate construction or installation works. The program of works also envisages strict weather conditions characteristic for the territory of lot#4.

The study of each unit rates in the bill of quantities proposed by Azerinsaatsevice Ltd was primarily conducted for the aim to understand the approach employed by Azerinsaatsevice Ltd in matching costs and risks of each work.

In 16 months of the 30-month long contract period, Ashtrom completed about 10 percent of the lot 4 works, whereas Azerinsaatsevice Ltd is required to complete the most of originally planned works within 15 months and the working period, when it will be able to work, is potentially limited to about 9 months.

The MCG, therefore, resolved that the proposal submitted by Azerinsaatsevice Ltd for the completion of lot #4 works by November 2010, was realistic and fair".

Is the experience gained from problems with Ashtrom International considered in a contract with a new contractor?

This issue was raised at the 39th meeting of the MCG Supervisory Board, where the MCG management talked about the details of the contract signed with Azerinsaatsevice Ltd.

1. The advance payment will be 20 percent of the total contract price and shall be issued upon the submission of a bank guarantee for that amount and performance guarantee.

2. The construction company shall submit a performance guarantee in the amount of 20 percent of the total contract value, regardless of the fact that the maximum amount of the performance guarantee under FIDIC is 10 percent.

3. The MCG retains 10 percent of the amount payable each month. This amount will be paid to the company after the full completion of works.

4. If the completion term is violated the construction company is penalized in the amount of $10 000 per overdue day. The maximum amount of the fine shall be 10 percent of the contract value.

The Supervisory Board approved the contract with Azerinsaatservice Ltd with the additional changes ensuring against the above mentioned risks.

What is the current status of the rehabilitation of the above mentioned section? Has the decision to increase the cost of project helped speed up the project implementation?

Given the urgency and problematic nature of the issue, at a meeting of the Supervisory Board on 4 October 2009, the Board heard the information about ongoing rehabilitation works on the Samtskhe-Javakehti roads. According to the information communicated by the MCG management to the meeting participants:

"After relinquishing the lot #4, Ashtrom mobilized its technique on the lots # 2 and #3. The changes were made in the management as well, which had a positive impact on the performance of the company.

In July, 140 units of equipment were mobilized at 71,7km, which was not enough for an efficient implementation of works. In August, Ashtrom mobilized additional 60 units of equipment.

An asphalt plant has been delivered and assembled and will be up and running by the end of September.

Works for the fortification of weak sections of the ground and leveling are basically carried out on the lot #2. Parallel to arranging a gravel layer Ashtrom International started production of the materials needed for the gravel layer as well as purchasing from Marneuli querries.

During the rehabilitation works on the lot #3 it appeared that the water main pipeline running under the road was outdated. In agreement with Tsalka municipality, a project has been drawn up, after completion of which the villages allocated at Tsalka-Nardevani section will benefit from the improved water supply".

The Board was provided the following information with regard to the lot #4 (i.e. the lot which was awarded to Azerinsaatsevice Ltd on the basis of the contract on 31 July):

"In August the construction company was holding survey of land cover and preparing drawings. Also, construction company started arrangement of the construction base and leveling works at 6 km. The cost of performed works comprised USD 7,666,934.60, out of which USD 7,038,934.60 is the advance payment.

Before the end of this year, the construction company intends to perform the following works: land excavation, leveling, change of culverts, fixing the freeze-resistant layer, preparation of inert materials and storing. Before the end of this year, during the following months the construction company intends to utilize about USD11,000,000.

Main risk is the delay of equipment from the supplier of the construction company. In this regard, we were promised that on October 1 the contractor shall finish mobilization completely and shall start full scale works. The weather factor may be risky, but both constructor and the engineering company assure us that projected works can be performed in winter conditions as well". **(See, Minutes of the Millennium Challenge Georgia Fund Supervisory Board Meeting N 40)**.

To evaluate ongoing works on the roads, the EPRC, together with the MCG representatives, visited the road under rehabilitation. The following can be said after a visual inspection: Azerinsaatsevice Ltd had the technique mobilized on the fourth – Nadrevani-Satkhe 47,8km section and the rehabilitation works were in progress.

The technique was mobilized on the second section – Partskhisi-Gokhnari road, which falls under the lot to be rehabilitated by Ashtrom International.

No technique was seen on another section of this company – Gokhnari-Nadrevani road.

Given that Partskhisi-Gokhnari and Gokhnari-Nadrevani road sections are within quite a strict climate zone, the EPRC reckons that the threat of delays in the rehabilitation of this road still lingers. Ashtrom International may again fail to fulfill the requirements of a renewed contract. We believe, it is necessary to accurately evaluate the amount of works and define the prospects in the forthcoming months, before the spring 2010, otherwise the completion of the SJRR Project will be jeopardized and the working (rehabilitation) season in 2010 may fall through; If in April 2010 the situation exacerbates again, the signs of which, in the EPRC's view, are already looming, this will cause the failure of obligations under the Compact and accordingly , the failure of the entire SJRR Project, i.e., the largest project of the Millennium Challenge Georgia Program. In this case, the responsibility of the MCG management will also be raised as given the existing situation, it is necessary to predict risks to the road rehabilitation and take corresponding measures in winter 2009-2010 in order to make a full use of the 2010 working season.

PRIVATIZATION OF THE STRIP ALONG THE SAMTSKHE-JAVAKHETI ROAD

Another interesting detail which has outlined during the monitoring period is related to the privatization of the territory adjacent to the Samtskhe-Javakheti road.

Pursuant to the minutes of the meeting of the MCG Supervisory Board #35, "Although the Ministry of Economic Development of Georgia suspended privatization of lands within the zone of Samtskhe-Javakheti road and right of way, certain lands were privatized in the above mentioned zone". According to the minutes, the materials were forwarded to the Prosecutor's Office of Georgia for investigation. (See, minutes of the Supervisory Board meeting of 18 February, 2009).

As the MCG informed the EPRC: "thirteen plots of land have been privatized within the right of way and project impact area, with the total space of 296,8 ha, Out from the indicated total space, 3585 square meters of land fall under the SJRR Project's right of way and impact area" (See, the MCG's letter, dated 11 June 2009, sent in response to the EPRC letter of 29/05/09).

To clarify the issue, the EPRC sent a letter to the Ministry of Economic Development of Georgia, asking "to provide information when and which state agency carried out the privatization of these plots; What is the decision taken with regard to the legality of this privatization and will it impede the process of the Samtskhe-Javakheti road rehabilitation?"

The explanation sent by the Public Relations Department of the ministry states:

"Based on the letter #1711, 16.12.08, from MCG concerning the privatization of plots within the SJRR Project area, the General Inspection of the Ministry of Economic Development of Georgia conducted a working investigation and established that in 2007-2008, on the basis of lease agreements executed earlier, the regional administration of the State Management Policy and Privatization Department of the ministry carried out the privatization of 11 plots with the total area of 316,97ha, in Tetritskaro district.

Based on the findings of 27.01.09 of the General Inspection, the Kvemo Kartli Regional Administration of the State Management Policy and Privatization Department was tasked under the letter #213651/9-8 of 23.02.09, from the ministry of economy, with investigating into the circumstances of the case and discussing with interested parties the legality of the privatization of the mentioned plots.

At a public hearing, held in the Kvemo Kartli Regional Administration on 31 March 2009, the representative of the MCG, Lasha Mgeladze, declared that he was representing neither complaining nor competent party and had no claims in regards to privatization protocols. The representative was only interested in the issue whether the plots which fell under the construction corridor were eligible to monetary compensation.

Since the issue was not resolved by an administrative procedure, the ministry sent a letter #30/274/11-9, 08.06.09, with the privatization materials enclosed, to Prosecutor General's Office of Georgia which, on its part, sent the materials for further study to Kvemo Kartli Division of the Prosecutor General of Georgia".

The MCG project management explained to the EPRC at the working meeting that the mentioned plots were assumedly privatized at the stage when certain sections of the road were removed from the list of rehabilitation due to the lack of funding. As the management went on explaining, the additional funding allowed for the inclusion of extra road sections, which brought about the mentioned problem. The management said that the Millennium Challenge Program envisaged compensations for the owners of these lands but this compensation would not be in the amount that could significantly affect the implementation of the project.

2. REGIONAL INFRASTRUCTURE DEVELOPMENT

DURING THE MONITORING PERIOD, THE FUNDING OF RID PROJECT FIRST INCREASED BY $26 MILLION, THEN DECREASED AGAIN AND AS OF 1 OCTOBER 2009 COMPRISED $57,735 MILLION WHICH IS LESS BY $2,205 MILLION THAN ORIGINALLY ENVISAGED IN THE COMPACT, ALTHOUGH IS MORE BY 14,250 MILLION THAN IN OCTOBER 2008.

NEVERTHELESS, THE LIST OF PROJECTS TO BE IMPLEMENTED HAS NOT BEEN EXTENDED AS COMPARED TO THE OCTOBER 2008 STATUS; ONLY INTERNAL MODIFICATIONS OF THE PROJECTS WERE ALTERED.

THE LOW PACE OF SPENDING REMAINS THE PROBLEM AND ENDANGERS THE TIMELY AND EFFICIENT COMPLETION OF THE PROJECT.

The RID Project is among those which receive the means from granted additional funding. However, no increase as compared to the original Compact allocation takes place any longer. Within the additional funding the project was allocated $26 million as per First Amendment to Compact but this amount was cut down thereafter.

Consequently, as of October 2009, the funding was reduced by $2,2 million as compared to the original funding under the Compact. The RID Project does not implement the activities as originally designed. The number of projects is downsized and the remaining ones are "modified" in accordance with the new funding.

I would recall that in 2008, largely due to the problems created in the SJRR Project, on the basis of the amendment to the Compact, the SJRR Project received additional funds from the RID Project which resulted in cutting the MCG funding in this project from $60 million to $43,485 million.

As a result of this decision, the number of potential projects identified for funding at the first stage, comprising seven water supply and three irrigation systems projects, shrank, leaving only five out of seven water projects: in 2008, two activities – Rustavi water supply system and Tskaltubo water supply and sewage system rehabilitation projects were removed from the list of recipients. In November 2008, a new amendment was made to the project which led to the increase in the Budget of the Project to $69,485 million this time.

According to the information published on the MCG webpage, the additional funding ($26 million was supplemented to the RID Project under the Amendment to Millennium Challenge Compact (Compact) signed on November 20, 2008) envisages the full completion of previously approved municipal projects. See webpage: www.mcg.ge

Moreover, the MCG quarterly progress report (Compact year 3, Quarter 3; October 1 – December 31, 2008) notes: "In November 2008, consistent with the Compact amendment, 26 million has been added to RID project. These funds are divided as follows: Kutaisi municipal water supply project – 6 million; Kobuleti water supply and sewage rehabilitation project – 8 million; Borjomi sewage rehabilitation project – 12 million. The process of preparation and approval of relevant documents has started". This means that **the additional funding will be used not for the full completion of previously approved municipal projects** but for the implementation of works for five water supply system projects selected in 2008, with some modification. (Let me recall that according to the project management the key reason for this is the limited time left before the completion of the Project).

The **disbursement request** of June 2009 already envisages a new modification of projects whilst the money reallocation request indicates the RID Project funding as $57,735 million and, according to the information available to us, the funds were reduced mainly for Borjomi sewage system rehabilitation. But let us track events in a chronological order.

The rationale for the decrease in the number of previously approved projects in 2008 explained that "in the process of initial identification the decision was made in favour of the projects the preparation of which had been already started due 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). But the identified projects also included such projects, the preparation of which was yet to be launched.

Although the MCG financed the feasibility studies for those projects, their completion within the Compact terms, i.e. in five years, seemed unrealistic. The Municipal Development Fund is in negotiations with donors to attract financing for the Tskaltubo project. The Government of Georgia decided to include the Zemo Samgori irrigation rehabilitation project into a World Bank irrigation project whilst the MCG has been tasked with funding the preparation of engineering design". (See, the MCG's response to the EPRC'letter of 21/10/08. Monitoring of Millennium Challenge Program III Stage Report).

Despite the increase in funding, the Tskaltubo project is currently not included in the MCG RID Project (the sole completed activity is the feasibility studies). As regards the Rustavi water supply system, the fate of this project was decided much earlier, at the end of 2007, when the Government of Georgia took a decision to put it up for privatization. Consequently, the Rustavi water supply system is removed from the list of projects for funding. (See, Monitoring of Millennium Challenge Program III Stage Report).

Let us recall here that at the time of signing the Compact it was stated that the funds available for the MCG RID Project would not be enough to tackle all problems existing in this sector. Therefore, from the inception of the Project the

MCG is cooperating with the European Bank of Reconstruction and Development (EBRD), the Swedish International Development Agency (SIDA), EC Delegation to Georgia and other donors for the purpose of joint financing, thus making it possible to implement larger-scale projects.

After the amendment signed in 2008 November, the RID Project included the following activities:

“Poti municipal water supply project is aimed at rehabilitation of the water supply system in Poti. As a result of the project implementation, the population of Poti and adjacent villages (about 50 000 persons) will receive safe potable water, the local water supply system will benefit from the improved system, technical assistance and reduced maintenance costs. The project is implemented with co-funding of MCG, EBRD, SIDA, EU and the local government. The project is implemented in three phases. The initial phase – construction of the new headworks and pipe from Grouli spring to Nosiri is funded by EBRD, construction of 7 km pipeline is funded by MCG.

Kutaisi municipal water supply project is aimed at improvement of the water supply system for Kutaisi and adjacent villages (about 175 000 persons). The project is implemented in the parallel funding scheme, with co-participation of EBRD, SIDA and the local government.

Kobuleti municipal water supply and sewage rehabilitation project is aimed at improvement of municipal water supply service in Kobuleti. Population of Kobuleti and Choloki is about 42 000 persons, during the tourism season this number increases up to 150 000. The project is fully funded by MCG.

Bakuriani municipal water supply project is aimed at improving municipal water supply service at Bakuriani (population – 2 000 persons, during tourism season – 40 000). The project is fully funded by MCG.

Borjomi municipal water supply project is aimed at improving municipal water supply service in Borjomi (population about 15,000 persons)”. See, MCG Quarterly Progress Report Compact Year 3, Quarter 3. October 1, 2008 – December 31).

As regards the status of funding of activities under the RID Project, as of August 2009, it looks as follows:

1. **Poti municipal water supply project** – the total cost of the project is $15,870 million of which the MCG’s share comprises $4,550 million. The first and second phases of the project were completed by April. The third phase works - metering, was under way. As of August, construction works within this project were completed.

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. Works are in progress.

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. The project is in the implementation phase.

4. **Bakuriani municipal water supply project** - the total cost of the project is $9,086 million of which the MCG’s share comprises $7,7 million. Water supply and sewage system rehabilitation is under way.

5. **Borjomi municipal water supply project** - the total cost of the project is $26,098 million of which the MCG’s share comprises $20,800 million. Works of phase I and phase II are in progress. (See, the MCG webpage: Status of projects as of August 2009. It should however be noted here that the MCG’s share in funding Bojomi municipal water supply rehabilitation project has been decreased by $4,9 million and is now about $15 million).

6. **Preparation of engineering design for Zemo Samgori Irrigation Scheme** - the total cost of the project is $1 million. The contract has been awarded to the winning company. Construction works has not started yet.

7. **Feasibility Study of Tskaltubo Water Supply and Sewage Systems Rehabilitation Project** - the total cost of the project is $250 000; study has been completed.

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

A detailed information of the status of projects as of August 2009 is available at the MCG webpage. However, this table does not reflect the change made to the project funding in June and, of course, it cannot reflect the change made by September 29, 2009.

Moreover, according to the MCG information, this data reflects the amounts earmarked for the projects by the MCG; however, the tenders allowed to make some savings as well. (Let me recall that these savings were later channeled to the SJRR Project).

As the table about the status of projects posted on the MCG webpage shows, much of the rehabilitation works has begun in autumn 2009. It is noteworthy that as of October 2008 one of the major problems in the RID Project was its low speed of implementation, endangering the timely completion of the projects. The speed of the project implementation can be clearly seen from the dynamics of spending which is still low in this project. (See the section, **Dynamics of use of funds allocated to Millennium Challenge Georgia Program**). Consequently, the low implementation rate remains the problem as well as the threat that project may not be completed within the defined timeframe or the acceleration of the implementation may happen at the detriment to quality and the scale. (In particular, as the year 2009 showed, neither increase nor decrease in the funding affects the number of rehabilitation projects; it is the amount of works to be implemented within the project that undergoes changes through internal modifications).

I would recall that the implementing entity of the RID Project is the Georgia Regional Development Fund (www.mdf.org.ge). The relationship between the MCG and MDF is regulated by the Collaboration Agreement.

The MCG has also signed the Service Agreement with the World Bank. According to this Agreement World Bank supervises MDF activities in technical, procurement and environmental issues. EBRD also carries out such supervision for projects implemented under EBRD parallel financing scheme.

3. ENERGY INFRASTRUCTURE REHABILITATION

DURING THE MONITORING PERIOD, THE FUNDING OF THE ENERGY PROJECT FIRST INCREASED BY $13 MILLION. ACCORDING TO FIRST AMENDMENT TO COMPACT, THE INCREASE WAS TO BE USED FOR PRE-CONSTRUCTION STUDIES OF A GAS STORAGE FACILITY – A RELATIVELY NEW COMPONENT OF THE PROJECT; HOWEVER, LATER ON, THIS ADDITIONAL FUNDING WAS TAKEN AWAY FROM THE PROJECT. THE MCG MANAGEMENT CLAIMS THAT THE ACTIVITIES ENVISAGED IN THE COMPACT WILL BE COMPLETED WITHIN THE EXISTING BUDGET.

AS OF OCTOBER 1, 2009, THE DEGREE OF SPENDING WITHIN THE PROJECT IS HIGHER THAN THAT OF OTHER PROJECTS AND THE SPENDING TARGET FOR THE END OF THE SECOND QUARTER, FOURTH PROGRAM YEAR, STANDS AT 66,16 PERCENT.

BESIDES, ACCORDING TO THE ENERGY PROJECT MANAGEMENT, BOTH COMPONENTS (GAS MAIN PIPELINE REHABILITATION AND PRE-CONSTRUCTION STUDIES OF GAS STORAGE FACILITY) WILL BE COMPLETED WITHIN THE LIMITS OF 85 PERCENT OF THE ALLOCATED FUNDING. THE PREPARATION OF A SO-CALLED ADDITIONAL PROJECT IS NOW UNDER WAY (WITHIN THE LIMITS OF THE 15 PERCENT OF FUNDING SAVED UNDER THE PROJECT), WHICH INVOLVES THE IMPLEMENTATION OF THE PHASE IV OF THE GAS MAIN PIPELINE PROJECT. THIS DECISION, HOWEVER, REQUIRES APPROVAL FROM THE MCG SUPERVISORY BOARD AND THE MCC.

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

Let me 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. A relatively new component of the Energy Project – feasibility study of gas storage facility, is rather interesting in terms of energy security.

Before 2008, although the Millennium Challenge Georgia Program underwent some changes in its design, the Energy Project funding remained unaltered - either toward increase of decrease. Changes were made only in November 2008 after the decision regarding the additional funding.

Pursuant to the amendment to the Compact, signed on November 20, 2008, the total budget of the Energy Infrastructure Rehabilitation project increased to $62,5 million. According to the MCG management, **the additional $13 million funding was to be spent for the conduct of necessary studies in the energy sphere, which included comprehensive economic, geological and environmental analysis, pre-construction design and public/private financial plan for the construction of gas storage facility and related infrastructure.**

The feasibility study for the construction of the gas storage facility was a new component of the Energy Project and it was introduced in 2008, before the additional funding was received. At the time of signing the Compact, this activity was not envisaged. The decision in this regard was taken in spring 2008 within the $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 ensuring the energy security of the country.

It is noteworthy that the issue of delivery terms of this component was first raised on the MCG Supervisory Board meeting on 22 July 2008, where "the Chairman of the meeting Nika Gilauri reminded the Board members that MCG received an assignment for the selection of consultant as early as two months ago and he enquired about the results. In response Giorgi Abdushelishvili advised the Board that selection among experienced companies had already been conducted through open tender for the preparation of Terms of Reference for the feasibility study of gas storage, though only two companies responded with applications, which was stipulated by the fact that if a company took part in the Terms of Reference for the preparation of the scope of works, it could no longer be involved in the feasibility study of the underground gas storage (the execution of which is more attractive for companies due to much greater volume of works), taking conflict of interests into consideration" (See, Minutes of Supervisory Board Meeting #30).

On 6 September 2008, the MCG awarded the $136,967 worth contract to Gustavson Associates, the company selected through the international competitive bidding.

At the above mentioned meeting, the Supervisory Board determined the date of submission of the scope of works – 1 October 2008, and resolved that the scope of works should cover conducting feasibility study of underground gas storage, preparation of the design of project works and environmental impact assessment. (See, Minutes of Supervisory Board Meeting #30).

The scope of works, however, was not submitted by 1 October. Moreover, at the meeting of the Supervisory Board on 2 December 2008, the MCG management tabled a motion to make the first amendment to the Contract No CQ 09 with Gustavson Associates regarding the increase in funding. In particular:

Giorgi Abdushelishvili submitted the document to the Board and reported that during the visit of Gustavson Associates to Georgia to conduct a fact finding mission, it transpired that there were additional works which needed to be carried out at the initial stage for the further development of the gas storage project and the company requested an additional $45 000 for these works. At the same time, the company took the obligation to complete the works by the end of January 2009.

The Ministry of Energy was against such an amendment, stating that if works under the agreement were completed in a qualified and timely manner, the Georgian side would have enough information to select itself the best location for the gas storage among from possible oil and gas fields within 2-3 months after the submission of a final report. (See, Minutes of Supervisory Board Meeting #33, December 2, 2008).

Accordingly, the Supervisory Board rejected the change to the contract. Nevertheless, the company violated the deadline and delivered its final report in March 2009. Thereafter, however, the terms were never violated. In the end, the situation as of September 2009 looked as follows:

A US company - Gustavson Associates completed the initial stage of implementation of the underground gas storage project in Georgia which encompasses TORs of pre-construction studies and the detailed program of gas storage project development in Georgia. Based on the Report, the Ministry of Energy and Fuel selected the Ninotsminda Oil Field as an optimal location for the construction of an underground gas storage facility in Georgia.

The Ninotsminda oil field, Rustavi gas condensate field and Samgori south dome field have been considered as three options for the gas storage construction. As already noted above, the Ministry of Energy and Fuel of Georgia worked on selection of the storage location and relevant studies. Based on these studies, on 12 June 2009, the Ministry officially addressed the Millennium Challenge Georgia Fund to finance the pre-construction studies for the Ninotsminda oil field.

The bidding was announced on 16 July for the conduct of pre-construction studies for the gas storage facility, with the deadline for the delivery of applications determined as 28.09.2009. According to the MCG, the winner will be selected and corresponding contract awarded in December 2009.

In accordance with the amount reallocation request of the Millennium Challenge Georgia Program, the Energy Project was deprived of $13 million granted to it under the November 2008 contract, which went to the SJRR project.

The MCG management claims that despite this decision, the pre-construction studies and design works of the underground gas storage facility will still be implemented. The $13 million "saving" made in the project is explained as follows:

By November 2008, when the decision on allocation of additional $13 million to the project was taken, it was not determined which of the three possible locations for the underground gas storage facility would be selected. The MCG management said that the selection of Ninotsminda Oil Field (which we discussed above) cut out the need of additional researches (drillings had been carried out by the state on this field). Hence, the reallocation of $13 million to other MCG project was a painless move.

It is obvious that the objectivity of this argument can be judged only after the engineering design, prepared within the existing funding, has been submitted. The results of 16 July tender are also of certain interest in this respect; the contract awarded on the basis of these results as well as its price will provide us with a better insight into the works to be performed under the project.

As regards the progress of the second, major component of the project, the MCG says that Phase III of the gas main pipeline rehabilitation works was implemented in the reported period. In particular, on February 18, 2009, with the aim of procuring necessary pipes and other equipment for the Phase III rehabilitation works on the North-South Gas Main Pipeline, MCG signed a $2.8 million contract with the Azerbaijani Company - Oil and Gas Construction Trust.

On July 15, 2009, MCG signed contracts with the four international bidding winner companies: Seacor Environmental Services Ltd - contract value - $215,948.78; JSC Hydroenergomontaji - contract value - GEL 2,102,987; Peri Ltd - contract value - GEL 942,097; and JV New Energy-Tbilisi - contract value - $703,620.

All necessary permits for gas pipeline rehabilitation were obtained.

Phase II construction works of the gas main pipeline rehabilitation project, envisaging the rehabilitation of nine sections, commenced in September 2008 and are scheduled to end early September 2009.

Under the Phase III of pipeline rehabilitation project, seven additional sections were rehabilitated with these worked started in spring 2009. (According to the project management, the Phase III has already completed in October 2009).

Phase III of North-South Gas Main Pipeline Rehabilitation envisaged the rehabilitation of seven sites with the majority of them in Kazbegi district. In particular

- construction of river Tertri Aragvi bank protection structures to protect the gas pipeline from erosion at KP119+750 and KP191+700.

- replacement and strengthening of existing 1200 and 700 mm pipeline sections at river Kabarjino and river Belaia crossings.

- protection of a section of the gas pipeline along the river Baidara, as well as arranging interconnections and valves between different diameter pipelines at the site.

- replacement of an existing 700mm gas pipeline section at river Snostskali crossing.

Thus, a relatively new but very important component – underground gas storage project, will be implemented within the framework of the Project.

Besides, as the Energy Project management states, above mentioned both components will be completed within the limits of 85 percent of the allocated funding. The preparation of a so-called additional project is now under way (within the limits of remaining 15 percent of the funding), which involves the implementation of the Phase IV of the gas main pipeline project. This decision, however, requires approval from the MCG Supervisory Board and the MCC.

4. AGRIBUSINESS DEVELOPMENT ACTIVITY

THE ADA PROJECT FUNDING INCREASED BY $15 MILLION TO $20,200 MILLION DURING THE MONITORING PERIOD.

THE REPORTED PERIOD SAW AN UNPRECEDENTED SPEED-UP IN THE IMPLEMENTATION OF THE PROJECT AS COMPARED TO PREVIOUS YEARS. FROM OCTOBER 30, 2008 TO OCTOBER 1, 2009 TWO ROUNDS OF GRANT SELECTION PROCESS WERE HELD AND 133 GRANTS WITH THE TOTAL VALUE OF $7,394 MILLION WERE AWARDED. THIS MEANS THAT TWICE THE AMOUNT WAS USED WITHIN THE PAST YEAR THAN DURING THE FIRST THREE YEARS OF THE INCEPTION OF THIS PROJECT.

THE ADA PROJECT HAS MOVED UP TO A NEW STAGE AND HERE THE THREATS ARE RELATED NOT AS MUCH TO THE LOW PACE OF THE IMPLEMENTATION AND TERMS OF THE COMPLETION OF THE PROJECT BUT THE QUALITY OF THE IMPLEMENTATION. THE EXECUTION OF MANY CONTRACTS AT ONCE CREATES THE THREAT TO PURPOSEFULNESS AND COMPLETION OF THE CONTRACTS AND CALLS FOR A STRICT MONITORING OVER THE PERFORMANCE OF CONTRACTS.

The ADA Project is part of the enterprise development component of the Millennium Challenge Georgia Program. The original budget of the Project, when the Compact was signed, stood at $15 million whereas now (as of 29 August) it comprises $20,200 million. The decision about increasing the funding of the Project was taken not in November 2008, when the additional $100 million was granted to the MCG, but in spring 2009, after the indicator of spending by the project showed an upward trend.

Let me recall that the ADA Project awards 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, 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). Typical example for value-adding enterprises are dairy processing enterprise, small cannery and similar.

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). Typical examples of value chain projects are small dairy production factory, cannery production from its own collecting centers where raw materials from small farmers are consolidated, processed, packed and sold.

By 2011, it is planned to finance up to 300 projects under the Agribusiness Development Activity, which will create approximately 2,934 new jobs and will provide an indirect benefit to more than 70,000 local farmers (see, MCG webpage, Agribusiness Development Activity). The pace which the ADA Project set during 2009 is a pre-requisite for the achievement of set goals. However, the accelerated pace creates threats with regard to the quality of implementation and performance of obligations by grantees. Before discussing these threats we should first review the changes implemented during the monitoring period.

As of October 20, 2008, there were seven rounds of grant selection process and two tenders held resulting in the award of 103 grant agreement with the total value of $4 605 328 (see, Monitoring of Millennium Challenge Program III Stage Report). By that time, however, more than two years had passed from the launch of the project. (In 2006, a contract was signed with the American company, CNFA selected on the basis of the international bidding, which is in charge of administration of grants competition, perfection of project proposals, monitoring of the grants projects. The ADA project was officially inaugurated on August 2, 2006).

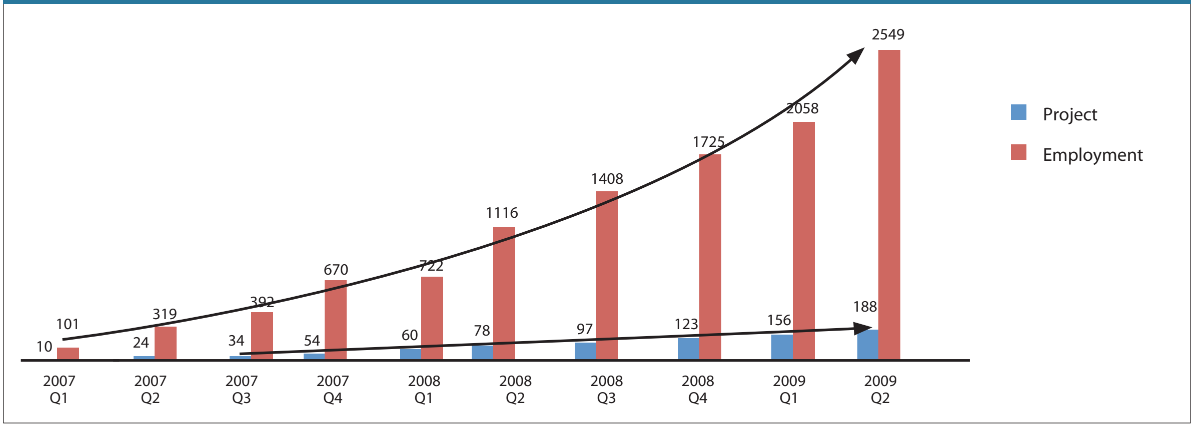
During this period, the low pace of the project implementation was complemented with the increase of the administration price; the MCG explained the slow rate of the project, among other objective factors, with “a shortage of specialized staff” in CNFA, the project implementing entity. (See, Quarterly Progress Report, Compact Year 2, Quarter 4; p.27). To resolve the problem, CNFA Georgia was allocated an additional $290 696; this amendment to the project management contract with this company was approved by the Supervisory Board on 13 December 2007. (See, Quarterly Progress Report, Compact Year 2, Quarter 4).

Moreover, the problem also was the low quality of grant applications. To resolve this problem, CNFA Georgia, in the fourth quarter of the compact year 2, contracted three local organizations to assist “promising applicants”, i.e. those who scored 60-69 points in the previous rounds, to reapply.

As regards the current status, as of October 1, 2009, nine rounds of grant selection and two tenders have been carried out. As a result, MCG signed 236 grant agreements worth $12 million. These projects will create about 3,057 new jobs and bring indirect benefit to more than 97,000 local farmers. (See, the MCG webpage).

This means that over the period between 30 October 2008 and 1 October 2009, two rounds of grant selection were carried out. In the reporting period, 133 grants were awarded worth $7,394 million. This is almost twice as many as during the first three years of the project. (See. the diagram below).

SIGNED GRANT AND EMPLOYMENT BY QUATER (CUMULATIVE SUM)



One should also note here that the data reflects the contracts awarded as of 1 October 2009 whereas the award of contracts will continue through November, according to preliminary information. By that period all the grant amounts will likely be fully expended.

Looking at the spending dynamics of the ADA Project, one can see that this Project has the best indicator in 2009. On the other hand, however, the speed-up in the spending gives rise to questions regarding the purposefulness of the grants, or, the achievement of declared goals. We believe that in the forthcoming year a special attention should be paid to the control over the progress of contracts funded under the ADA Project and the economic efficiency of these grants. (In this regard the MCG management explained that the MCG is aware of this threat and envisages the employment of three specialists to pay particular attention to purposefulness of the projects).

5. REGIONAL DEVELOPMENT FUND

SIMILARLY TO THE ADA PROJECT, THE GRDF PROJECT ALSO USED FUNDS AT A HIGHER SPEED DURING THE REPORTED PERIOD. AS OF SEPTEMBER 30, 2009, THE GRDF PROJECT INVESTED $21 MILLION IN 10 GEORGIAN COMPANIES, WHICH COMPRISES 84 PERCENT OF THE AMOUNTS TO BE USED FOR INVESTING.

AFTER INVESTMENT PROJECTS HAVE BEEN FINANCED, THE FOCUS WILL BE MADE ON THE FINANCIAL AND OPERATIONAL CONDITIONS AND PERFORMANCE OF PORTFOLIO COMPANIES AS WELL AS THE FUNDING OF PREVIOUSLY APPROVED TECHNICAL ASSISTANCE PROJECTS.

AT THE NEW STAGE OF THE GRDF PROJECT A PARTICULAR ATTENTION SHOULD BE PAID TO

THE MONITORING OF THE IMPLEMENTATION OF AWARDED CONTRACTS.

The Regional Development Fund is a ten-year project. As compared to other Millennium Challenge Georgia projects (their duration is five years), the Fund has twice as much time to achieve set goals. As of 1 October 2008, similarly to other projects, the problem of the Fund was low spending rate and small size of implemented works. In particular, as of 1 October 2008, the Fund financed only two companies.

On 23 May 2008 an investment agreement was signed with the company “Rcheuli”, which aims at expanding the hotel network in the regions of Georgia. In addition to the investment the company was provided with technical assistance in issues of development of hotel management standards and design. Funds were also provided to conduct a marketing survey. On 26 May 2008 a new hotel of the “Rcheuli” hotel chain - “Rcheuli Pirosmani” was opened in Sighnaghi. (See, www.mcg.ge Georgia Regional Development Fund).

Over the period between 1 October 2008 and 1 October 2009, i.e. during the monitoring period, the spending indicator - and accordingly the number of invested projects, showed increase.

As of Quarter 1, Compact Year 4 (as of 1 March 2009), the board of directors of the Fund had already approved 10 investment projects with the total value of $21 million which comprises 84 percent of the Fund's investment budget. More than 80 percent of these amounts are invested in regional projects, primarily in agribusiness and tourism sectors. (See, Quarterly Progress Report, Compact Year 4, Quarter 1).

Only in the fourth year of the enactment of Compact, i.e. in 2009, the project managing company created a webpage: www.seaf.ge displaying the information about accomplished activities.

According to the webpage, the situation as of 31 March 2009 had not changed by 30 September and looks as follows:

As of September 30, 2009, GRDF has invested $21 million into 10 Georgian businesses:

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	mefrinveleoba da sainkubacio kvercxis warmoeba	kaspi
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

Profiles of investments of each company are presented below:

1. Madai
Business: Black Sea Anchovy Fishing
Use of Funds: Purchase of ship and equipment and processing plant upgrades
Opportunity: First Georgian company to utilize fishing license rather than leasing out to Turkish ships

2. Prime Concrete
Business: Concrete production, transport and pumping services
Use of Funds: Mobile factory equipment, pumps and mixers
Opportunity: First large scale production facility in Western Georgia, to meet upcoming demand for Poti port and other developments

3. Piunik
Business: Integrated poultry business
Use of Funds: Equipment, hatching hens, working capital
Opportunity: Expansion from a small poultry importer into a large enterprise involved in production of eggs, incubation and feed. The company is engaged in a limited import from Armenia and is already strong enough to meet growing demand in Georgia.

4. Tetnuldi
Business: Mountain Hotel
Use of Funds: Construction and working capital (start-up)
Opportunity: First major private tourism investment in Svaneti, one of Georgia's strongest tourism assets, offering quality accommodations and complete "tourism experience".

5. BAZI
Business: Food canning/jarring and concentrate production
Use of Funds: Apple and tomato concentrate production equipment
Opportunity: Cannery with largest distribution in Georgia entering apple concentrate production, which is in high demand in Europe and globally.

6. Rcheuli
Business: Georgian hotel chain
Use of Funds: Construction of hotels
Opportunity: First company to develop hotel chain outside of Tbilisi, addressing lack of any comfortable accommodations other than guest houses in key tourism locations.

7. Dogan
Business: Animal Feed and Pet Food Producer
Use of Funds: Equipment, facility improvements, working capital
Opportunity: Compound and extruded feed producer with opportunity to expand sales in Georgia, Armenia and Azerbaijan through import-substitution. Currently is the only producer of extruded feed (feed for fish, early stage poultry and pet food) in the Caucasus.

8. Delta Comm
Business: Fiber Optic Internet Cable Infrastructure Development
Use of Funds: Equipment to expedite construction of infrastructure, and working capital
Opportunity: To be the first nationwide fiber-optic network in Georgia, providing important back-up systems to Internet Service Providers and existing Georgian telecoms.

9. Ecopex
Business: Hazelnut processing/export
Use of Funds: Purchase of land, processing equipment, and working capital
Opportunity: Opportunity to enable capacity increase for a smaller but technically capable player, which will execute agreement and contracts in advance allowing to expand its business and secure its place on the world market.

10. Doki
Business: Residential and commercial furnishings and construction materials retailer/wholesaler
Use of Funds: working capital
Opportunity: Expansion of existing business to be first to provide full range of products, to develop advantages of "chain" structure and complete warehouse with real time inventory information.

Given the purposefulness of the implemented investments, they comply with the declared goals of the GDRF Project. Let me remind that the GDRF Project aims at supporting the development of small and medium enterprise through investments. The Fund will operate 10 years. Its budget comprises $32 million (according to the change made on 29 September 2009, it was deducted $100 000). **Commercial investment fund** - (budget USD 30 million) makes long-term investments in rapidly growing Georgian SMEs. **Technical assistance for SMEs** - (budget USD 2 million) will be applied to improve the performance of portfolio companies following investment or to assist prospective portfolio companies to become qualified for GRDF investments.

Moreover, according to the information of the Fund management, after the funding of the above investment projects, the focus will shift onto the financial and operational conditions and performance of portfolio companies as well as funding of earlier approved technical assistance projects.

The EPRC believes that the monitoring of the fulfillment of obligations by companies and the achievement of declared aims of the investments are of particular importance at this stage. The results of the monitoring to be carried out over the forthcoming year will definitely provide answers to the question as to how targeted and economically efficient were the investments implemented within the GRDF Project.

VI. CONCLUSIONS

The Millennium Challenge Georgia Program has been implemented for about three and a half years now. A trend of lagging well behind the originally planned spending was clearly observed on every stage of the implementation. While the dynamics of spending improved since the second quarter of the fourth Compact year, the full completion of SJRR and RID Projects is still at risk, according to their spending indicators. In particular:

Amounts spent under the SJRR and RID Projects comprise, on average, 10-12 percent each of the total amounts, as of end of Q1, 2009. By the end of the second quarter this ratio will increase to 24.72 percent and 20.47 percent for SJRR and RID Projects, respectively.

This is especially important given that less than a year and a half is left before the full completion of the most of the works and an unprecedented rise of spending indicator is required to ensure their completion.

Danger remains in relation to the ADA Project as well. By the end of Q1, 2009, the ADA Project spent 35.51 percent of the total mount and intends to increase spending to 54.39 percent in Q2, 2009. The above said means that during the seven quarters that are left before the Compact terms expires, 64 percent of the total amount must be used, which is 9 percent per quarter, on the average, whereas only 4 percent was used quarterly until now.

Against this background, the Energy Project indicator is remarkable with the actual spending at 53,75 percent of the total amounts in Q1, and spending target at 66,16 percent in the second quarter. The Project envisages the implementation of a new component (not considered in the Compact), pre-construction studies of the underground gas storage facility and, according to the preliminary information, of the fourth phase of the gas main pipeline rehabilitation, which is indeed a remarkable fact.

Overall, however, the Millennium Challenge Program is well short of the financial plan: the spending target for Q2, Compact Year 4, stands just at 36.4 percent of the total amount.

The gap between the financial plan and actual spending widened in the reported period and by the end of Q1, 2009, comprised 39.5 percent – an alarming indicator indeed. In the following quarter, though, some improvement is expected up to 47.76 percent.

At the same time, frequent changes continue to be a problem of the Millennium Challenge Program. Over the period between November 2008 and 1 October 2009, for example, the Energy Project was changed twice, RID Project - three times, and the ADA Project – twice. Clearly, this creates problems in the consistency of the program development.

During the monitoring period, the cost of SJRR Project increased to $203 million, i.e. almost twice as compared to $102 million envisaged originally under the Compact. Moreover, this amount is used to rehabilitate 26km, or 10 percent shorter road than initially intended. This is the result of shortcomings of the management, especially at the initial stage, which protracted and accordingly, increased the cost of the project.

The monitoring of the SJRR implementation also revealed the shortcomings in the operation of both the consulting company Kocks Conslting and supervising company Finnroad.

In the reported period – during 2009, three lots to be rehabilitated under the SJRR Project implying the rehabilitation of 119,5 km road, increased in price by $24,389 million (or, by 37 percent as compared to the price as in spring 2008).

The monitoring period and the outcome of negotiations with Ashtrom International proved that the capacities of the companies were over-valuated during the conduct of tenders for construction works, which created problems in their performance. This process also made apparent that the mechanisms which would prevent the situation from extreme exacerbation in spring 2009 and ensure that the contractor perform obligations or risk being held responsible, were insufficient. Hence, the company Ashtrom International, underperformance of which led to the increase in the cost of the project by $20 million, escaped unscathed, even gaining from the situation.

It should also be noted that in the agreement with a new contractor, the MCG included more guarantees, which can be assessed as a positive move indeed, although it cannot compensate for the result – the increased cost of the project. Neither did the taken decisions fully eliminate the threats related to a timely completion of the road works within the Compact term.

The ADA and GRDF Projects show acceleration in spending as compared to the previous year. The Projects are moving up to a new stage where a particular emphasis should be placed on the compliance of funded projects with the targets and economic efficiency.

VII. RECOMMENDATIONS

Bearing in mind the above presented review and conclusions, the project management shall pay particular attention to the following factors:

Throughout the remaining seven months before the expiry of the Compact term, and with the new obligations assumed when $100 million was added to the entire budget, the MCG management shall work under a special regime in order to ensure effective implementation of huge amount of works and full and timely spending of the remaining amounts;

A proper planning of expenditure requires a particular attention as the experience with the delays in SJRR Project illustrated. Erroneous planning of spending largely impedes and consequently, increases the cost of works. Attention should be paid to the increasing loss in terms of the economic rate of return, which was presented above on the basis of simple assumptions;

The fast implementation of the Compact components which fall behind the schedule should not happen to the detriment of efficient and timely implementation of other components;

Original project plans will probably need to be revised and brought in line with real possibilities as the ambitious estimates of growth in the coming quarters, as the MCG intends, is less likely to be met without strengthening institutional and human resources. This may lead to the problems regarding the quality of works;

Monitoring on the road rehabilitation works needs to be intensified, the results of which should be used to detect and quickly react to any delays in the works during the winter period as to avoid another loss of the working season as it happened in 2009. Especially considering that the loss of 2010 working season would inevitable lead to the failure of the entire project;

The quality of works performed by contractors – be they construction companies or supervising and consulting firms - needs to be evaluated and when needed, the issue of their responsibility raised;

An intensive monitoring should be carried out over the grants and investments implemented under the enterprise development component of the program in order to timely define the compliance of spending of these amounts and evaluate their economic efficiency;

In general, given the acceleration of the rate of implementation of projects, the qualitative control needs to be toughened as to ensure that the program results match the set goals.

A particular attention should be paid to the SJRR Project. The status of the rehabilitation works on several sites as of October 2009 (see the details in section Implementation of Projects) indicates that the threat still remains that the situation may exacerbate again by the spring 2010. Therefore to avoid this, 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.

VIII. ABBREVIATIONS AND TERMS USED IN THE TEXT

MCG	Millennium Challenge Georgia Fund
MCC	Millennium Challenge Corporation
Compact	Grant agreement betweenthe United State of America and the Government of 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

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