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INDEPENDENT EVALUATION GROUP
GEORGIA COUNTRY ASSISTANCE EVALUATION
APPROACH PAPER

Country Background

1. Georgia is a small country of 4.6 million people located on the southern flanks of the Caucasus Mountains with a land area of 69,700 square kilometers (slightly smaller than South Carolina). It borders Russia in the north, Turkey and Armenia in the south, Azerbaijan in the east and has a coastline on the Black Sea in the west. The population is ethnically diverse, and this diversity has in the past fueled inter-ethnic violence. Territorial disputes and civil unrest in the early 90s led to de facto loss of control over some regions.

2. Georgia declared independence from the Soviet Union in April 1991 and elected Zviad Gamsakhurdia as its first post-Soviet President. In January 1992, Mr. Gamsakhurdia was ousted in a coup and was supplanted by Mr. Shevardnadze, a former Georgian Communist Party leader and a high-ranking Soviet official (Minister of Foreign Affairs) under Gorbachev. With time, widespread corruption, recurrent internal strife and deepening economic crisis put the Georgian state on the verge of collapse. After the parliamentary elections of November 2003, results of which were by many accounts falsified by the ruling party, a mass uprising known as the "Rose Revolution" forced the resignation of Mr. Shevardnadze. Shortly thereafter, in January 2004, the leader of the revolution, Mr. Saakashvili, swept the presidential election with 96 percent of the vote. Since 2004, the country has made visible progress on market reforms and governance, but this progress has been marred by unresolved civil conflicts in the breakaway regions of Abkhazia and South Ossetia, and uneasy relations with Russia, one of Georgia's main trading partners.

3. The per capita income of Georgia was about US$1320 (Atlas method) in 2005. Despite sustained economic growth over the last few years, overall poverty has remained high, with the overall incidence of poverty reaching 39.4 percent in 2005.[1] The income distribution is relatively uneven with the Gini coefficients hovering around 0.35 for consumption and 0.45 for income. Non-income poverty indicators also show little improvement. The current population of 4.6 million (July 2007 est.) has fallen from 5.4 million in 1989 – a decline of nearly 20 percent reflecting the falling birth rate and massive migration due to economic and social hardship.

4. Georgia's output contracted sharply at the beginning of its transition in 1991 from a centrally-planned to market economy. By the end of 1994, Georgia's economy had shriveled to around one-third of its size in 1990. The fiscal base collapsed as the ratio of total public revenues to GDP decreased from 15 percent in 1992 to only 2.3 percent by 1993. Hyperinflation of over 15,000 percent per annum was observed in 1994.

[1] Source: IMF Country Report No. 06/361, 2006.

5. Economic recovery began in 1995 when Georgia started to adopt a wide range of fundamental economic reforms, including stabilization, structural adjustments and fiscal decentralization. The economy registered a strong rebound with modest inflation in the mid-1990s, and real GDP growing around 10 percent between 1996 and October 1998. The positive trends were set back by the Russian crisis in 1998, with real GDP growth slowing to 2.9 percent in 1999. The economy has recovered since then, registering a real GDP growth rate of 9.3 percent in 2005. Total government revenue to GDP ratio increased approximately by 30 percent while total nominal tax revenue grew by more than 45 percent in 2004 due to the authorities' drive to curb tax evasion. Inflows of foreign direct investment exceeded the current account deficit in 2004 for the first time in several years. Expanding general economic activity fueled growth in 2005 which was very different from the previously witnessed growth, driven by investment in the oil and gas pipeline construction.

6. In 2006, Russia restricted access to its markets for some Georgian products. In addition, the cost of natural gas imported from Russia increased by 70 percent.[2] Nevertheless, despite a difficult external environment, real GDP grew by 9 percent in 2006. Prior to the economic embargo, real GDP growth rate was projected to be 10 percent in 2007. Due to loss of the export markets combined with the increase in the price of natural gas, the projected growth rate in 2007 has been revised to 7.5 percent.[3]

7. Overall, Georgia has made significant progress since the 2003 "Rose Revolution" in the quality of governance and business environment,[4] large-scale infrastructure rehabilitation programs, an overhaul of the education system, and new legislation intended to liberalize the economy and create favorable conditions for private sector development. Yet, Georgia's economy still has not caught up to the pre-transition period: real GDP in 2006 was still below the 1989 level. Industrial output remains heavily dependent on the activity of a small number of firms, with about 50 industrial enterprises (out of 2,800) accounting for over 75 percent of total output. Official statistics indicate that at least 30 percent of economic activity still takes place in the shadow economy.[5]

Bank Strategy and Program

8. Georgia became a member of International Bank for Reconstruction and Development (IBRD) in August 1992 and (International Development Association (IDA) in August 1993. In 1995 Georgia joined International Finance Corporation (IFC). During the first two years of Georgia's membership, development of an assistance program was hindered by civil conflicts and the Bank focused on building macroeconomic and sector knowledge and providing limited technical assistance. Stabilization of the political situation and a new emphasis on economic reform in late 1993-early 1994 opened the

[2] The prices for natural gas were increased for all recipient countries, including Georgia.
[3] Source: IMF Country Report No. 07/107, 2007.
[4] Overall improvements across several indices (World Bank CPIA, Doing Business, Index of Economic Freedom, TI Corruption Perception Index, WBI Governance Indicators, others) attest to positive trends in the perception of governance situation and the overall business environment in the country.
[5] Source: The Economist Intelligence Unit, Georgia Country Profile, 2006.

way for dialogue and broader assistance program. The first loan agreement[6] was signed in July 1994. The first "limited" country assistance strategy was discussed by the Board in the mid-1990s. Its objectives were to help reverse the economic decline, to assist the transition to a market economy and alleviate poverty. Assistance was to a large extent of an "emergency" nature, designed to prevent irreversible degradation of infrastructure and deterioration of the health system and bring about improvements in basic health indicators.

9. Since then, Bank management has presented two country assistance strategies for Georgia to the Board: the first full country assistance strategy in late-1990s (covering FY98-00) and a Joint IDA-IFC Country Partnership Strategy (CPS) in September 2005 (covering FY06-09). There was a period between FY01 and FY06 when the country was not formally under a country assistance strategy. Among the main reasons for this were: (i) postponement of country assistance strategy preparation in FY01 as the country started work on its Poverty Reduction Strategy Paper (PRSP);[7] (ii) significant reduction of Bank lending in response to a worsening governance environment after FY01;[8] (iii) suspension of country assistance strategy preparations in FY02 over concerns about political developments; and (iv) a withdrawal of country assistance strategy document in late 2003 due to change in government after the Rose Revolution. In the immediate aftermath of the revolution, the Bank engaged in several shorter-term transitional support activities, including quick-disbursing development policy lending (DPL), some investment lending and enhanced analytical and advisory assistance (AAA).

10. Total lending commitments during the period under review amounted to US$885 million vs. US$1,008 million planned, with US$561 million of investment lending and US$324 million of adjustment/development policy lending. The Bank's portfolio in Georgia was quite diverse: lending sectors included urban development, transport, energy, rural, public sector governance, social protection and social development, health, education, private sector development and environment. The lending program was supported by extensive AAA work.

11. The late-1990's country assistance strategy supported the Government's development agenda with the following main themes: (i) strengthening public finance; (ii) deepening and diversifying sources of growth; (iii) protecting the environment; and (iv) reducing poverty and improving social service delivery. Following issuance of the I-PRSP in 2000, the Bank introduced several new elements to its strategy – governance and anti-corruption, civil service reform, and building a greater role for civil society. After an independent portfolio review in early FY03, in the continuing poor governance environment, the Bank made governance and anti-corruption the highest priority objectives, and lending was temporarily confined to social sectors.

[6] Institution Building Loan (P008413).
[7] The final PRSP (EDPRP in Georgia – Economic Development and Poverty Reduction Paper) was issued in FY03. A Progress Report was issued in January 2005, forming the base for the FY06-09 country assistance strategy.
[8] No Bank loans were made in FY02.

12. The goals of the 2005 joint IDA-IFC Country Partnership Strategy (CPS) are: (i) generating growth and job creation by removing barriers to private sector development and improving infrastructure, finance and markets; (ii) enhancing human development and social protection through improved education, health, social protection, and community services; and (iii) strengthening public sector management and budgetary processes. The key component of the CPS is a series of Poverty Reduction Support Operations (PRSOs), complemented by a Public Sector Reform Support Program (PSRSP). The CPS seeks to catalyze and complement efforts of other donors: the proposed PSRSP would catalyze twice as much funding from other donors; IDA and the US Millennium Challenge Corporation (MCC) have agreed to an arrangement whereby IDA is assisting in the supervision of MCC financing of municipal infrastructure, to be implemented in collaboration with the Municipal Development Fund (MDF) financed by IDA.

13. *The overall priority objectives of Bank assistance throughout the review period (1993-2007) can be summarized as: (a) strengthening governance and improving quality of public sector management; (b) generating growth and employment by creating favorable conditions for and removing impediments to private sector development; and (c) reducing poverty and improving quality of social services by investing in infrastructure and supporting institutional reform in relevant public sector entities*.

<u>Country Assistance Evaluation (CAE): General Approach and Methodology</u>

14. A Country Assistance Strategy Completion Report (CASCR), prepared in 2005 by the Region and covering FY98-05, rated the overall outcome of the Bank's assistance to Georgia as moderately satisfactory. A subsequent internal review of the CASCR by the IEG rated the outcome as moderately unsatisfactory, arguing that program objectives were partially achieved because: (i) the political conditions for their success did not exist; and (ii) the Bank program covered more areas and institutions than could be handled effectively. IEG stressed the need to identify a few areas critical for good economic performance, assess carefully the political support for change, and concentrate resources in achieving meaningful outcomes.

15. The planned Country Assistance Evaluation (CAE) will provide an opportunity to revisit the above assessments in a more in-depth manner, covering the entire fourteen-year period from FY93 to FY07. The evaluation will entail a review of all project and program documents and ESW since FY93, as well as past and ongoing IEG evaluations, including country, sector and thematic work.

16. The CAE will evaluate the relevance of each of the objectives and the strategy, including the balance between adjustment and non-adjustment lending and between lending and non-lending instruments, the efficacy of the Bank's program and the efficiency with which the results were achieved. The ultimate goal is to assess whether the Bank's program achieved its objectives and had a substantive impact on the country's development. The evaluation will examine whether the selection of sectors, lending instruments and analytical products comprised the right mix under the country circumstances, including the periods when the Bank was operating in the country without

a formal country assistance strategy. The CAE will also assess the Bank's contribution to the results in light of other donors' work, the Government and exogenous factors.

17. The CAE team will closely coordinate with and receive input from other parts of the IEG, including the ongoing and planned Project Performance Assessment Reports (PPARs) for Georgia, relevant thematic evaluations and the work on the overall approach to the CAE methodology.

Main Issues: Focus of the Evaluation

18. In accordance with the main directions of the Bank assistance throughout the review period, the evaluation will examine the progress in achieving the following objectives:

a. ***Public sector governance and capacity building***: establishing and sustaining stable macroeconomic environment; strengthening capacity at the central and local government levels; improving governance and reducing corruption; strengthening public sector management; improving management of public finances; and developing functional judiciary.

- Was the Bank successful in helping to establish a stable macroeconomic framework and improving the capacity to manage public resources at the center of government? Did the Bank analyze and take into account the social and political economy factors, including the capacity and willingness of the authorities to carry out reforms?
- Did the Bank program help to improve the governance environment in the country? Was the Bank's assistance in governance and public sector reform areas adequate to country conditions? Did the Bank help to put in place a credible and efficient monitoring and evaluation system to track progress in governance and accountability? Was the quality of dialogue with the authorities appropriate to carry on Bank assistance in the public sector governance area? Did the overall performance of targeted public sector entities and the quality of management therein improve as a result of the Bank's interventions? Did the Bank's continuous work on the sub-national level have an impact on the quality of local governance?
- Did the Bank's adjustment (development policy) lending program help the government to achieve the results sought, including advancing policy reform agenda and maintaining the level of critical public expenditures? Did it result in better sectoral governance? Was the overall political-economic environment in the country conducive to Bank budget support? Was the Bank lending justified in the environment of poor governance and absence of a formal country assistance strategy from FY01 to FY06?
- Did the Bank's financing of sector institutional reform (transport, education, health and judiciary) help to achieve the outcomes sought in terms of long-term systemic institutional impact and sustainability of

change? Did the overall performance of selected public sector entities and the quality of management improve?

- Did the Bank assistance improve the country's capacity to benefit from Caspian oil exploration and transit, and minimize the related environmental and social costs? Did the Bank assistance help to improve the reliability, efficiency and financial sustainability of the energy sector?

b. ***Private sector development:*** achieving sustainable growth rates and generating new jobs by removing barriers to private sector development; privatization of state-owned assets; establishment of an appropriate legal and regulatory framework; improving access to finance and improving infrastructure.

- Did the Bank's assistance help to improve the competitiveness of the private sector and facilitating job creation? Did the Bank assistance help to facilitate private sector-generated growth?
- Did the Bank assistance help to remove barriers for private sector development? Did the Bank assistance help to establish appropriate legal and regulatory framework, conducive for private sector development and growth? Did the business climate in the country improve as a result of those changes? Was the country able to increase the levels of foreign direct investment?
- Did the privatization of state-owned enterprises and the Bank-supported non-investment restructuring of privatized enterprises produce expected results in terms of increasing their effectiveness, efficiency and productivity?
- Did the Bank lending in infrastructure help to improve the conditions for the private sector development? Did the Bank-supported reforms and lending for irrigation rehabilitation help to increase productivity of private farms in the agriculture sector? Were the road transport costs reduced and access in major traffic corridors improved as a result of the Bank's lending for roads rehabilitation? Did the Bank intervention help to improve the reliability and efficiency of electricity supply?

c. ***Enhancing human development and reducing poverty***: improving delivery of public services; rehabilitating basic infrastructure; and enabling sustainable use of environmental resources.

- Did the Bank's assistance help to reduce poverty levels in the country? Did the Bank's assistance in establishing social safety nets and pension reform help to create a targeted social assistance system?
- Did the Bank lending in infrastructure rehabilitation (roads, energy network, rural sector, and municipal development financing through social investment and municipal development funds) help to improve provision of basic public services to the population? Did the Bank assistance help in mitigating the adverse social impacts of energy sector reform on the most vulnerable groups?

- Did the Bank's financing of institutional reform in health and education sectors help to achieve the outcomes sought? Did the Bank support in education lead to better learning outcomes? Did secondary school enrollment rates improve? Did the Bank support in health sector help to improve health indicators? Did the health finance reforms supported by the Bank help to improve access for the lowest income groups to a minimum package of publicly provided basic health care?
- What was the impact of the Bank's lending on improving environmental sustainability? Did the Bank's support help to mitigate the consequences of improving the preparedness for natural calamities and pandemics?
- Did the Bank financing of municipal projects through the Social Investment and Municipal Development Funds help to improve local infrastructure and access for vulnerable groups to basic social services? Was the capacity of local communities to manage projects improved as a result?

<u>CAE Outputs, Budget and Timetable</u>

19. The CAE will be carried out under the general supervision of Ali Khadr (Senior Manager, IEGCR). The task team includes Konstantin Atanesyan (Task Team Leader, IEGCR), Jorge Garcia-Garcia (macro economy, governance and private sector development, co-TTL), Vicente Ferrer-Andreu (rural sector and environment), Denzel Hankinson (energy), Thomas Kennedy (transport and urban development) and Ronald Ridker (human development). Sarwat Jahan will provide input to the macro economic section, as well as data and research support, and Janice Joshi will provide administrative support. Peer reviewers are Alma Kanani (SASPR), Cory Welt, Deputy Director and Fellow, Russia and Eurasia Program at the Center for Strategic and International Studies (CSIS) and Dusan Vujovic (IEGCR, internal reviewer). The team will visit the country in the September-October 2007. The CAE is expected to be delivered to CODE in June 2008.