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November 2018

TECHNICAL ASSISTANCE REPORT—PUBLIC INVESTMENT MANAGEMENT ASSESSMENT

This Technical Assistance Paper on Georgia was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in May 2018.

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FISCAL AFFAIRS DEPARTMENT

Georgia

Public Investment Management Assessment

Isabel Rial, David Gentry, Katja Funke, Mary Betley, John Zohrab, Tanvir Hossain, Sandro Nosadze

Technical Assistance Report | May 2018

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F I S C A L   A F F A I R S   D E P A R T M E N T

Georgia

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GLOSSARY

BDD	Basic Data and Directions Document of Georgia
CG	Central Government
CMFD	Cash Management and Forecasting Department
EFF	Extended Fund Facility
ELA	Economic Liberty Act
EME	Emerging Market Economy
EU	European Union
FAD	Fiscal Affairs Department
GDP	Gross Domestic Product
GEL	Georgian Lari
GFS	Government Finance Statistics
GNERC	Georgian National Energy and Water Supply Regulatory Commission
IFI	International Financial Institution
LEPL	Legal Entities of Public Law
MOF	Ministry of Finance
MOESD	Ministry of Economy and Sustainable Development
MRDI	Ministry of Regional Development and Infrastructure
MTBF	Medium-Term Budget Framework
MTFF	Medium-Term Fiscal Framework
NASP	National Agency for State Property
OCDS	Open Contracting Data Standard
PC	Public Corporation
PDRB	Procurement Dispute Review Board
PIM	Public Investment Management
PIMA	Public Investment Management Assessment
PPA	Power Purchasing Agreement
PPP	Public-Private Partnership
PPP$	Purchasing Power Parity
RDF	Regional Development Fund
SAO	State Audit Office of Georgia
SFR	Statement of Fiscal Risk
SNG	Subnational Government
SOE	State-Owned Enterprise
SPA	State Procurement Agency
TSA	Treasury Single Account
WACC	Weighted Average Cost of Capital

PREFACE

In response to a request from the Ministry of Finance (MOF), an FAD mission visited Tbilisi, Georgia, from May 10 to 25, 2018, to provide TA on public financial management (PFM). The mission comprised Isabel Rial (FAD, head), David Gentry (FAD), John Zohrab (FAD regional PFM advisor), Mary Betley and Katja Funke (both FAD experts), and Sandro Nozadze (World Bank).

The tasks of the mission were to: (i) assess Georgia's public investment management framework; (ii) assist the authorities to prepare a reform strategy and prioritized action plan for strengthening the management of public investment; and (iv) recommend follow-up areas of technical assistance that could be provided by FAD or other development partners.

The mission met with Mr. N. Gagua (Deputy Minister of Finance), Mr. G. Kakauridze (Deputy Minister of Finance), Mr. T. Kavlashvili (Deputy Minister of Finance), Ms. E. Mikabadze (Deputy Minister of Economy and Sustainable Development), Mr. R. Mikautadze (Deputy Minister of Economy and Sustainable Development), Mr. I. Karseladze (Deputy Minister of Regional Development and Infrastructure), Mr. I. Begiashvili (Deputy Minister of Regional Development and Infrastructure), Ms. E. Ghazadze (Deputy Audit General), as well as with Ms. E. Guntsadze (Head of Budget Department) and Mr. P. Aslanikashvili (Acting Head of the Macroeconomic Analysis and Forecasting Department) from the Ministry of Finance, and officials from the Government Administration and from the Ministry of Education.

The mission also met: Ms. G. Boyreau and and Ms. M. Dolidze of the World Bank, and representatives from the donor community.

The mission is grateful to the authorities for the frank and open discussions and close cooperation. The mission also expresses its appreciation to Mr. F. Painchaud, IMF Resident Representative, and his staff, Ms. N. Sharashidze and Ms. K. Danelia, for their outstanding support; and to Ms. K. Avaliani, for her excellent translation assistance.

EXECUTIVE SUMMARY

The Government's decision to strengthen the infrastructure governance through improving the public investment management (PIM) and the public-private partnerships (PPPs) frameworks, is both timely and important. The government has an ambitious public investment agenda, to be implemented both through traditional public investment and with the help of private investors in the form of PPPs. Given the need to preserve fiscal sustainability in a context of limited fiscal space, avoiding inefficiencies and managing fiscal costs and risks arising from infrastructure projects will be crucial for advancing the government's public investment agenda. The authorities are working on a broad range of public financial management reforms, including improving the PIM framework and the legal and regulatory framework for PPPs and PPAs.

Over the last decade, public investment in Georgia has been similar to the average of emerging market economies (EMEs). Since the mid-2000s, public investment accounted, on average, for one third of total investment. Public investment remained volatile, reaching a peak of 8.6 percent of GDP in 2007, declining in the aftermath of large global and regional shocks, and stabilizing at about 5.5 percent of GDP in recent years.

Public infrastructure assets are increasingly procured off-budget, through complex governance and risk structures. The way public infrastructure assets are delivered in Georgia is changing. During the last decade, the decline in public investment (i.e., procured by central and subnational governments) has been mostly compensated by rising off-budget investment through PPPs, PPAs, and public corporations (PCs). Off -budget investment accounted for less than five percent of total public investment in the early 2000s, but increased to about one-third of total public investment in 2017. At the same time, the financing of public investment in Georgia is shifting towards domestic sources, with the share of domestically financed investment projects rising from 50 to 70 percent of total public investment, since 2009.

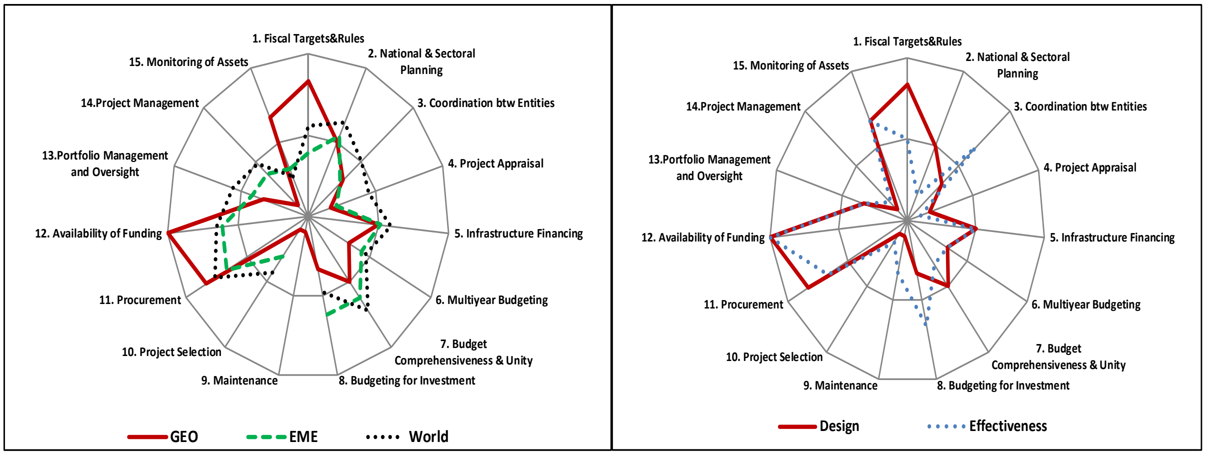
Going forward, authorities are planning to address large structural bottlenecks by scaling up public infrastructure. Notably, under the Extended Fund Facility (EFF) on-budget public investment spending is expected to increase from 6.1 percent of GDP in 2017 to 8 percent of GDP by 2023. Additionally, several projects in the in the energy and social infrastructure pipeline are expected to be implemented as PPPs and PPAs (e.g., power plants, schools). While Georgia compares favorably to the average of EMEs in terms of perceptions of infrastructure quality, indicators of quantity and/or access to infrastructure assets and services, such as roads and electricity, point to large bottlenecks. The estimated efficiency gap of 15–20 percent, though below that of EMEs, suggests that up to 20 percent of the public capital stock did not achieve its full potential.

Georgia faces challenges that reduce the efficiency of public investment, but there are also pockets of relatively good performance. Many of the country's policies and procedures governing public investment are either not or only partially aligned with good practices. Relative to the average of EMEs and the world, Georgia performs better in some PIM areas, while shares weaknesses in others (Figure 0.1.A). Most importantly, Georgia's PIM institutions perform different "in practice"—effectiveness— than "on paper"—institutional design (Figure 0.1.B).

Figure 0.1. Strength of Public Investment Management Institutions

A. Institutional Design
Comparing Georgia with EMEs

B. Georgia
Comparing Institutional Design vs. Effectiveness



The report evaluates the quality of Georgia's public investment institutions in three main phases of the investment cycle: planning, allocation, and implementation. Its assessment is summarized in Figure 0.1, and Table 0.1. Georgia's PIM perform well in some institutions. The fiscal rules in place give predictability of funding for public investment. During implementation, investment is appropriately funded, and nonfinancial assets including depreciation are reported in government consolidated financial statements. However, several challenges exist. Strategic planning is focused on new policy initiatives and does not provide a solid base for the budget process. Multiyear budgeting is not well implemented in practice, providing limited medium-term guidance for investment decisions. Project appraisal and selection are extremely weak. Whereas no standard methodology for determining maintenance needs, and weak project management do not facilitate lessons to be learnt from past experiences.

Given that several efforts to improve the PIM function are underway, risks of coordination failures are significant. Several initiatives are being implemented covering various aspects of the PIM framework. However, there is lack of clarity about the responsibilities of all entities involved in implementing the PIM framework. Notably, efforts to improve PIM should be fully integrated with the PPP legal and regulatory framework under preparation.

This report provides various options for strengthening the PIM framework, while integrating the PIM and PPPs processes, so that infrastructure projects are selected on their own merits as projects, and not by the way they are procured or financed. The mission recommendations are summarized in Table 0.2 and a proposed action plan is provided in Annex I. Recommendations linked to structural reforms currently underway are not included in the action plan.

Table 0.1. Georgia: Summary Assessment

Phase/Institution			Institutional Design	Effectiveness	Reform Priority
A. Planning	1	Fiscal principles or rules	**High:** There are permanent legal limits for general government fiscal aggregates.	**Medium:** Fiscal policy is insufficiently predictable. The expenditure ceiling has been breached 3 years out of 4.	Medium
A. Planning	2	National and sectoral plans	**Low:** The only national and sectoral strategies are not comprehensive and only cover new initiatives.	**Low:** The strategies' definitions of public investment objectives are not consistent with efficient investment.	High
A. Planning	3	Coordination between entities	**Medium:** Capital transfers from CG to SNGs are on a project-by-project basis, but with a high degree of co-ordination. No formal reporting process of contingent liabilities to central gov.	**Medium:** Estimated contingent liabilities are disclosed with central gov. budget documents. Contingent liabilities of PCs (20.6% GDP) and PPAs (33.7% GDP).	Low
A. Planning	4	Project appraisal	**Low:** Projects not funded by donors are not subject to a standard appraisal process or methodology.	**Low:** On average, 60% of projects are domestically funded. The new PIM methodology has not yet been implemented.	High
A. Planning	5	Alternative infrastructure financing	**Medium:** There is limited or no competition in most infrastructure markets. Monitoring of PCs fragmented.	**Medium: PPP law approved, but** regulatory framework not completed. PCs monitoring improving, but investment not addressed.	High
B. Allocation	6	Multi-year budgeting	**Medium:** Multi-year capital ceilings are not identified separately, and total construction costs are not published.	**Low:** Total construction costs beyond the BDD framework for major projects are not actively provided or updated in the system.	Medium
B. Allocation	7	Budget comprehensivenes s and unity	**Medium:** Investments undertaken through extra-budgetary entities without disclosure or legislative authorization.	**Medium:** Investments outside of the budget process are significant, but information reported in FRS.	Low
B. Allocation	8	Budgeting for investment	**Medium:** There are no mechanisms to give priority to on-going capital projects in the budget process.	**Medium:** informally, ministries inform MOF of on-going capital project expenditures for future budget years.	Medium
B. Allocation	9	Maintenance funding	**Low:** No standard methodology for maintenance requirements or to track maintenance funding.	**Medium**: Maintenance in the roads sector has a methodology, which has led to increased maintenance budgets.	High
B. Allocation	10	Project selection	**Low:** No standard project selection procedures and there is no project pipeline in place.	**Low:** there is no evidence that the new PIM selection procedures are getting ready to be implemented soon.	High
C. Implementation	11	Procurement	**High**: procurement system is open and transparent. E-procurement system enables monitoring and tracking of complaints.	**Medium**: Complaint review board not independent and analytical reports can be improved.	Medium
C. Implementation	12	Availability of funding	**High:** Flexible commitment rules and good cash management for domestic and donor funds.	**High:** No case in recent years of payments being delayed due to lack of funds.	Low
C. Implementation	13	Portfolio management and oversight	**Medium**: Physical and financial monitoring not performed systematically; no ex post reviews; flexible re-allocation.	**Medium**: Project reallocations of all types (incl. econ class) were 43 percent of MRDI's capital budget in 2016.	High
C. Implementation	14	Project implementation	**Low**: No implementation plans prepared; no guidance on project adjustments; ex-post audits irregular.	**Low**: No individual project audits were completed by SAO during 2015-2017.	High
C. Implementation	15	Management of public assets	**Medium**: Assets registered but without revaluation; non-financial assets and depreciation in financial statements.	**Medium**: SAO verifies ministry asset records on sample basis.	Medium

Table 0.2. Georgia: Summary of Recommendations

		Inst.	Priority	TA support
A. Planning Sustainable Levels of Investment				
1.	***Issue***: *The strategic planning of public investment is fragmented, lacks cohesiveness, only deals with new initiatives, and includes only some output and outcome indicators* **Improve national and sectoral planning by updating the public investment component of the national development strategy, including all sources of financing, levels of government, and procurement options**	2	Medium	FAD
2.	***Issue***: *The new PIM methodology has not yet been implemented, and the role of the MOF needs elaboration. Key economic assumptions of donor-funded projects are not reconciled centrally, and project appraisal discount rates are inconsistent and do not necessarily reflect the economy's opportunity cost of capital* **Improve project appraisal by implementing the new PIM methodology and ensuring that a dedicated team at the MOF is responsible for providing central support for line ministry project appraisal and for developing and maintaining the project appraisal methodology**	4	High	WB supported by FAD
3.	***Issue***: *The government has not yet decided on the deregulation of the electricity market, it has not yet considered the deregulation of the gas and water markets, and it has not addressed relative prices in land transport use.* **Improve competition in major infrastructure markets**	5	Structural reform	
4.	***Issue***: *The oversight of PCs investment is insufficiently focused* **Require PCs to undertake only those investments that comply with their Statements of Corporate Intent and are thereby commercially appropriate for them**	5	Structural reform (in progress with support of FAD)	
B. Allocating Investment				
5.	***Issue***: *The Basic Data and Directions Document (BDD) does not effectively guide multi-year capital spending* **Strengthen multi-year budgeting by improving the clarity and linkages in budget documents of annual and medium-term projections for public investment**	6	Medium	FAD
6.	***Issue***: *There are no formal mechanisms to give priority to on-going capital projects. Resources for new project could potentially crowd out on-going projects, leading to delays and increased project costs* **Implement mechanisms to prioritize the completion of on-going projects in the budget process**	8	Medium	FAD
7.	***Issue***: *There is currently no standard methodology to determine maintenance requirements or to track maintenance funding systematically.* **Develop a standardized methodology for estimating current and capital maintenance needs to be used by spending ministries over the rolling BDD/budget period**	9	High	FAD
8.	***Issue***: *The lack of standard project selection procedures and a list of approved projects potentially undermine the link between the PIM process and the budget* **Operationalize the project selection procedures in the PIM Guidelines/ Manual and incorporate them in the budget process applicable for all public investment projects, regardless of the funding source**	10	High	WB
C. Implementing Investment				
9.	***Issue***: *The effectiveness of the monitoring system is reduced because of lack of live, retrievable data, particularly for entities outside the government* **Introduce live machine-readable data, develop interface to improve data-sharing among different data users, and introduce contract implementation data in open format**	11	Medium	WB

Table 0.2. Georgia: Summary of Recommendations (Concluded)

	Inst.	Priority	TA support
Issue: *Project implementation progress is not reported systematically to MOF or related line ministries.* **10. Strengthen project implementation monitoring by issuing guidelines for implementing agencies to repare monitoring reports covering all budgeted projects**	13	High	FAD and/or other TA provider
Issue: *Project managers and procedures in place at implementing agencies, but lack formal implementation plans* **11. Strengthen project management by issuing guidelines to prepare project implementation plans for every investment project, regardless of financing source**	14	High	FAD and/or other TA provider
Issue: *MOF compiles limited information on the physical stock, condition, and value of fixed assets, but this information is not taken into account in planning and budgeting for maintenance, rehabilitation, and new infrastructure needs* **12. Link asset registry and accounting data with public investment planning and maintenance in the budget process**	15	Structural reform	
Cross cutting issues			
A. Legal and regulatory framework ***Issue***: *There is a need to better align the legal and regulatory frameworks supporting PIM and PPPs* • Ensure that all public investment projects are covered by the PIM process • Consider distinguishing between a regular PIM process for larger projects including all Public-Private Partnerships (PPPs), and a simplified procedure for smaller and highly standardized projects • Ensure, through the PIM Guidelines or the PIM Methodology, the alignment of the PIM process with the budget cycle • Review PIM Guidelines and the PIM Methodology to ensure consistency and to make them more user-friendly • Align, through the detailed provisions of the PPP implementing regulation, the PPP process with the PIM process • Clearly define roles and responsibilities for the various stakeholders and ensure consistency across procedures	Cross cutting	Structural reform supported by ADB and FAD	
B. IT systems and data management ***Issue***: *Information technology systems for PFM are fragmented, and none of them focus on PIM, hindering effective managerial decisions* • Ensure that the next phase of IT development supports the data management needs of the budget cycle as a whole. New elements should be actively designed and planned to work systematically and consistently across the related IT systems.	Cross cutting	Structural reform	

I. TRENDS IN PUBLIC INVESTMENT

A. Background

1. Georgian economy remains resilient to external shocks, with public finances stabilizing under the Extended Fund Facility (EFF). Georgia experimented higher growth than many of its peers since 2010. Despite the regional shock,[1] average annual growth amounted to 3.4 percent in 2015–17. At the same time, general government deficit and gross debt stabilized around 3.0 and 45 percent of GDP, respectively. For the medium term, the EFF envisages further fiscal consolidation, with deficit declining to 1.3 percent of GDP and gross debt to 40.3 percent of GDP by 2023.

2. To increase potential economic growth, authorities are planning to address large structural bottlenecks by scaling up infrastructure. Supported by the EFF, the authorities plan to implement measures to improve revenue mobilization and contain current expenditure, while making room for higher investment spending. Notably, general government investment spending is expected to increase from 6.1 percent of GDP in 2017 to 8 percent of the GDP by 2023.

3. The authorities are working on a broad range of public financial management reforms, including improving the public investment management (PIM) framework. Over the last decade, the Georgian authorities have implemented significant fiscal structural reforms to enhance fiscal institutions, improve fiscal transparency, and promote higher and more inclusive economic growth. Going forward, strengthening public investment management framework will be crucial, to ensure that the rising level of investment spending can promote higher and more inclusive growth while preserving long-term fiscal sustainability.

B. Trends in Total Public Investment and Capital Stock

4. In the last decade, total investment in Georgia has been mostly driven by the private sector. Total investment increased from its lowest level of 15 percent of GDP in 2009 to above 30 percent of GDP in 2017 (Figure 1). On average, public investment accounted for about one third of total investment, reaching a peak of 8.6 percent of GDP in 2007 and then stabilizing at 5.5 percent of GDP, on average, in the last three years. Declining and volatile public investment spending led to a deterioration of the public capital stock from about 130 percent of GDP in 2000 to 90 percent of GDP by 2017 (Figure 2). Yet, Georgia's public capital stock is in line with

[1] The Russo-Georgian War between Georgia, Russia and the Russian-backed self-proclaimed republics of South Ossetia and Abkhazia took place in August 2008 following a period of worsening relations between Russia and Georgia, both formerly constituent republics of the Soviet Union.

average levels observed in Emerging Market Economies (EMEs), as well as in peer countries (Figures 3 and 4).[2]

Figure 1. Total Investment
(% GDP)

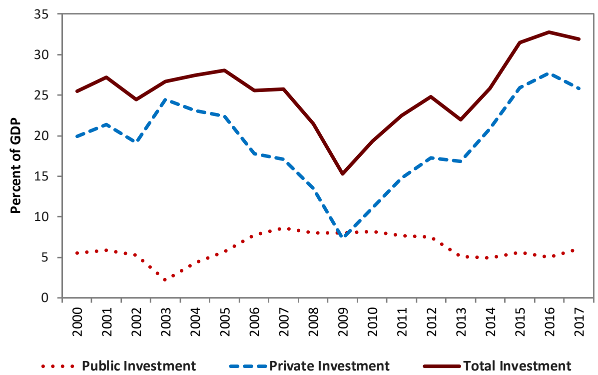


Figure 2. Public Investment and Capital Stock
(% GDP)

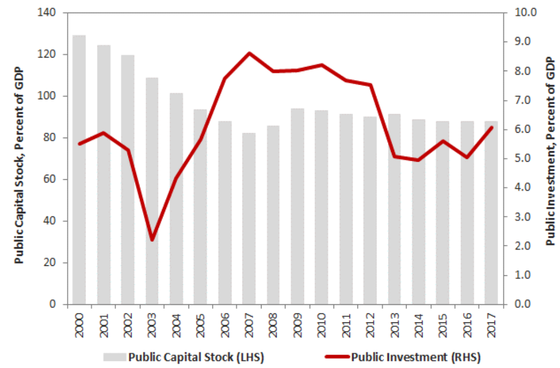


Figure 3. General Government Capital Stock
(% GDP)

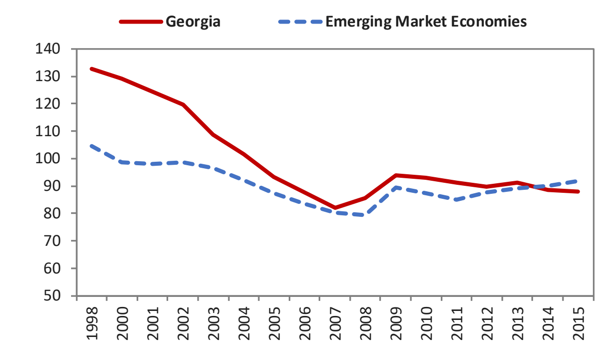
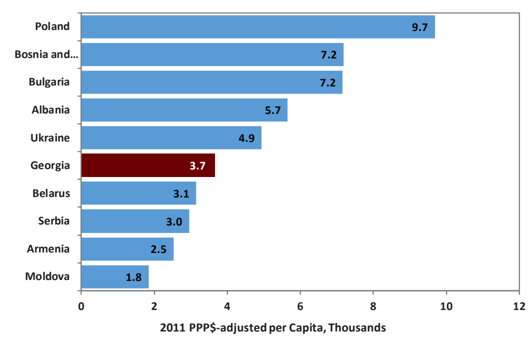


Figure 4. General Government Capital Stock per Capita 2011
(PPP$-adjusted)



Sources: Staff estimates based on official data.

5. Over the past 10 years, the share of public resources allocated to public investment remained largely stable despite significant consolidation efforts. After the global financial crisis, a sharp reduction in total public spending helped to reduce the general government deficit from its peak of 8.8 percent of GDP in 2009 to 1.2 percent of GDP in 2017 (Figure 5). Despite the sharp decline in public spending, the authorities managed to keep the composition of public spending largely stable, with capital expenditure accounting for about 20 percent of total expenditure since 2005 (Figure 6).[3] At the same time, volatility of investment has been reduced by half relative to that observed in the early 2000s (Figure 7).

[2] For this report Georgia's peer countries are: Albania, Armenia, Bosnia and Herzegovina, Bulgaria, Belarus, Moldova, Serbia, Poland and Ukraine.

[3] Fiscal figures in this report correspond to official national data. For the EFF purposes, total expenditures and deficit are adjusted to account for specific expenditures recorded below the line (e.g., transfers to PCs recorded as capital injections).

Figure 5. General Government Fiscal Balance
(% GDP)

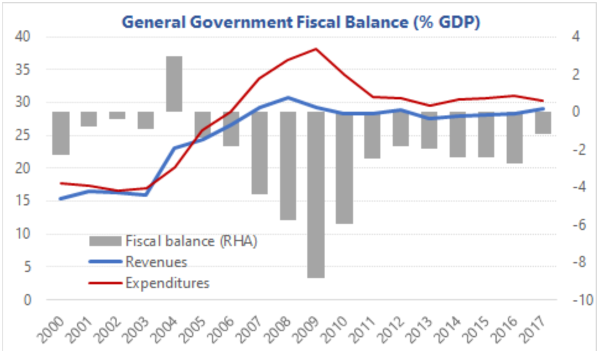


Figure 6. Composition of Public Spending
(in percent of total expenditures)

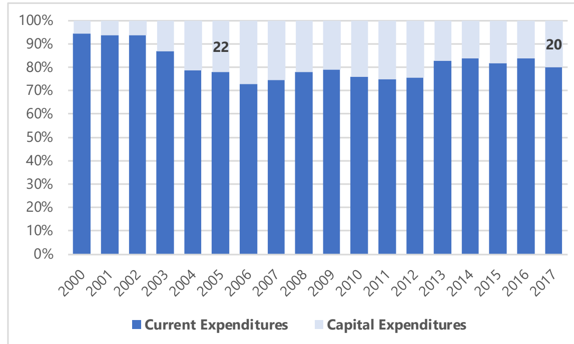


Figure 7. General Government Fiscal Balance
(% GDP)

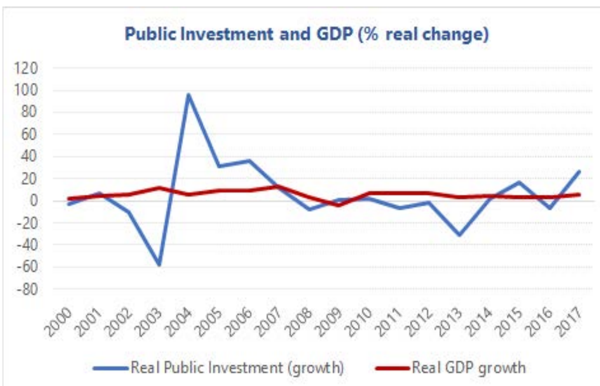
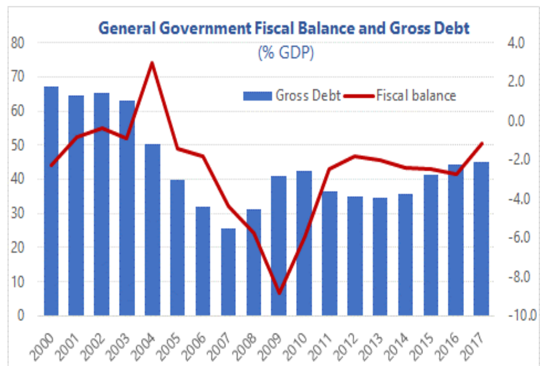


Figure 8. General Government Fiscal Balance and Gross Debt (% GDP)



Sources: Staff estimates based on official data.

6. **Private participation in the provision of public infrastructure assets and services started relatively late in Georgia, but has quickly reached EME levels.** The Government started using public-private partnerships (PPPs) later than the average of EMEs, with the larger projects procured in the electricity and, to a lesser extent, the transport sector. However, over the past decade, the pace of investment in PPPs has been remarkably fast. Particularly from 2015 onwards, a large number of power purchase agreements (PPAs) were contracted, with estimated total commitments for government of about 1.1 billion USD (7.7 percent of GDP).[4] By 2017, the stock of PPPs and PPAs is estimated at 5.1 percent of GDP, slightly above the average for EMEs of 4.5 percent of GDP, and above most of its regional peers (Figures 9 and 10).

[4] PPAs total commitment for government include capital spending (construction costs of the asset) and operational spending (government payments to private partner during contract operation). Capital stock on PPAs is estimated by accumulated construction costs of the PPA assets delivered up to each year.

Figure 9. PPP Capital Stock, Georgia and EMEs
(%GDP)

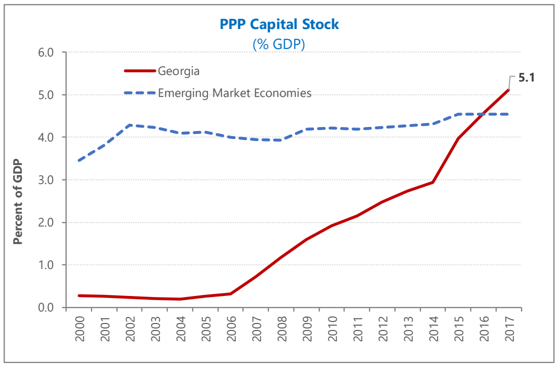
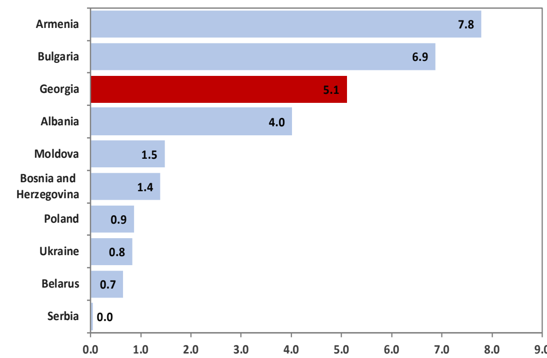


Figure 10. PPP Capital Stock, Comparing Georgia with Peer Countries 2015 (% GDP)



Sources: Staff estimates based on official data.

C. Composition and Financing of Public Investment

7. About two-thirds of Georgia's public investment is devoted to economic infrastructure. Compared to the average of EMEs, Georgia spends more on economic infrastructure (e.g., roads, ports, electricity) and less on social infrastructure (e.g., schools, hospitals). Economic infrastructure comprises a much larger share of total public capital spending (60 percent) than the average of EMEs (46 percent, on average) (Figures 11 and 12). At the same time, capital spending in social sectors is significantly lower than in EMEs, to a certain extent driven by the full privatization of the provision of capital assets in the health sector.

Figure 11. Georgia, Composition of Public Investment by Functional Classification
Average of last 5 years, % GDP

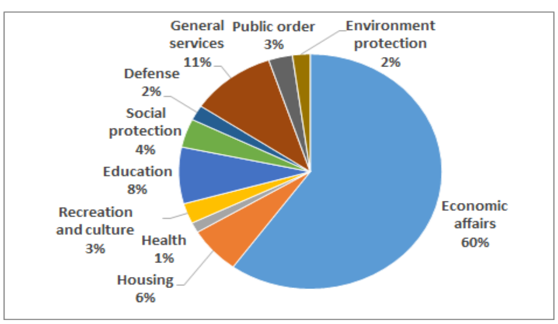
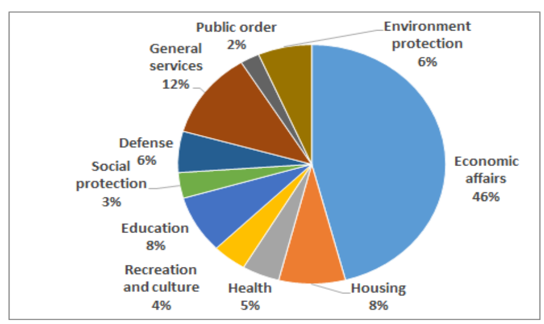


Figure 12. EMEs Composition of Public Investment by Functional Classification
Average of last 5 years, % GDP



Sources: Staff estimates based on official data.

8. In recent year, rising investment through PPPs, PPAs, and PCs has compensated for relatively lower general government investment. The importance of PPPs and PPAs in investment on public infrastructure assets and services in Georgia has grown dramatically in recent years, from an average of 0.5 percent of GDP between 2010–15 to about 2.0 percent of GDP by 2017. At the same time, public investment spending executed though PCs rose from around 1 percent of GDP between 2010–15 to 2.4 percent of GDP in 2017 (Figure 14). These developments more than compensated for the drop in public investment spending though the budget.

9. By 2017, general government accounted only for about two thirds of total investment spending, while public corporations, PPPs and PPAs contributed the remaining third (Figure 13). Within the general government, budgetary central government (BCG) and subnational governments (SNG) take most of the responsibility for infrastructure provision, while Legal Entities of Public Law (LEPLs) play a limited role. Public corporation's investment spending, estimated by the level of capital transfers received from the budgetary central government, contribute an additional 20 percent. The remainder of the total public investment portfolio[5] is delivered through PPPs and PPAs mostly in the electricity and transport sector.

Figure 13. Composition of Public Investment Portfolio 2015–17, % of total

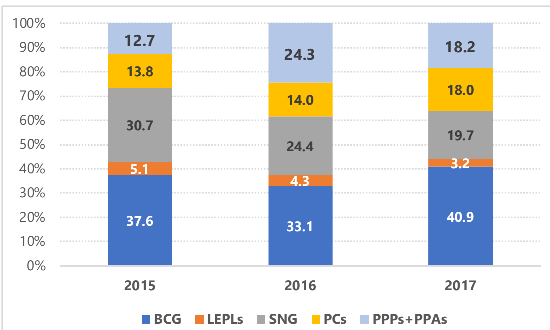
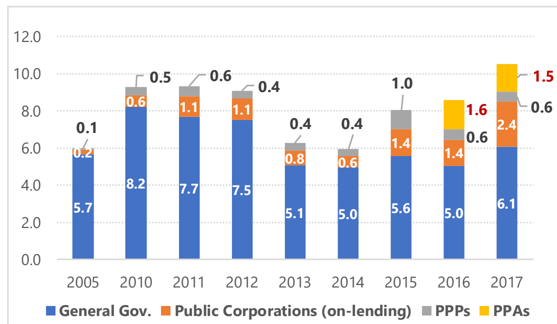


Figure 14. Investment in Public Infrastructure Assets 2005–17, % GDP

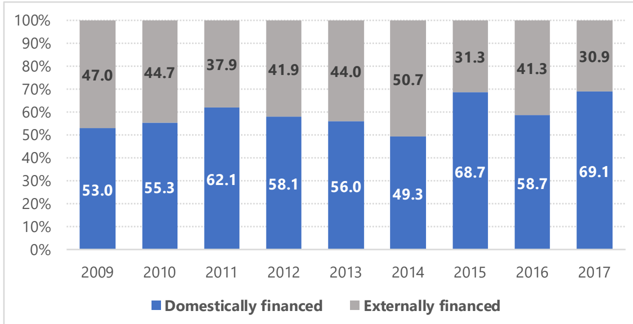


Sources: Staff estimates based on official data.

10. Financing of public investment in Georgia is shifting towards domestic sources. In 2017, domestic financing represented about 70 percent of total financing, the highest level in the last three years, compared to an average of 55 percent between 2009 and 2014 (Figure 15). Foreign concessional loans comprise the bulk of external financing sources, while external grants are marginal.

[5] Public investment is a statistical concept that refers to the net acquisition of non-financial assets by general government units (i.e., SNG, SNG and LEPLs in case of Georgia). The net acquisition of non-financial assets done by PCs is accounted as private investment according to the 2008 System of National Accounts (SNA). In turn, PPPs and PPAs related assets can be accounted either as public or private investment in statistics, depending whether certain conditions are met. Yet, in practice most countries account PPPs and PPAs related assets outside the public sector accounts. In this report, public investment portfolio is defined as total public-sector spending in the acquisition of nonfinancial assets, regardless of how they are procured (traditionally or as PPPs or PPAs) and which entities undertake them (central, subnational, or public corporations).

Figure 15. Financing of Investment Spending by General Government 2009–17
(composition in percentage)



Sources: Staff estimates based on official data.

II. EFFICIENCY AND IMPACT OF PUBLIC INVESTMENT

11. Georgia compares favorably to EMEs and peers in terms of perception of infrastructure quality. According to the World Economic Forum surveys, infrastructure quality in Georgia is perceived largely as better than the average of EMEs (Figure 16). Looking at the component of the infrastructure quality index, the significant improvement observed from the mid-2000s is supported by improvements in all infrastructure sectors, notably in electricity supply. However, since 2014 perception indicators suggest a deterioration in infrastructure quality in almost all subsectors (Figure 17).

Figure 16. Perception of Infrastructure Quality, Comparison with Peers

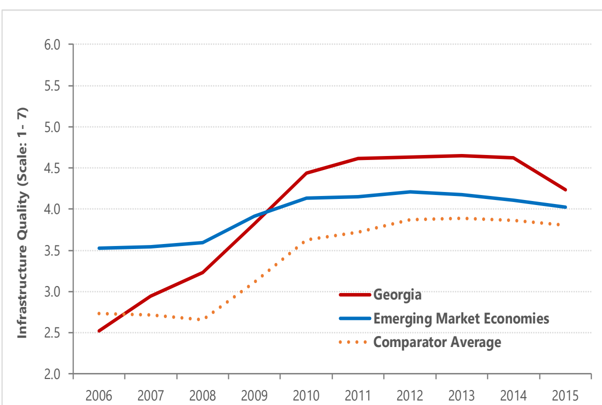
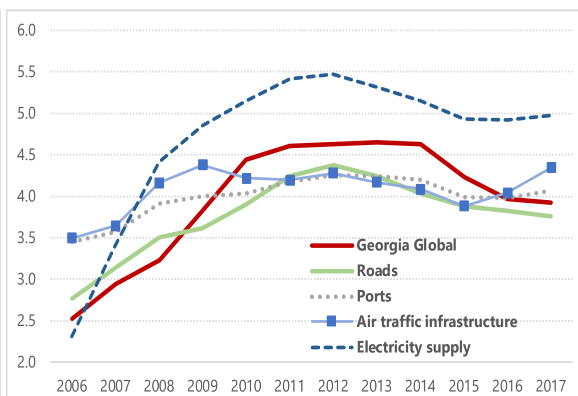


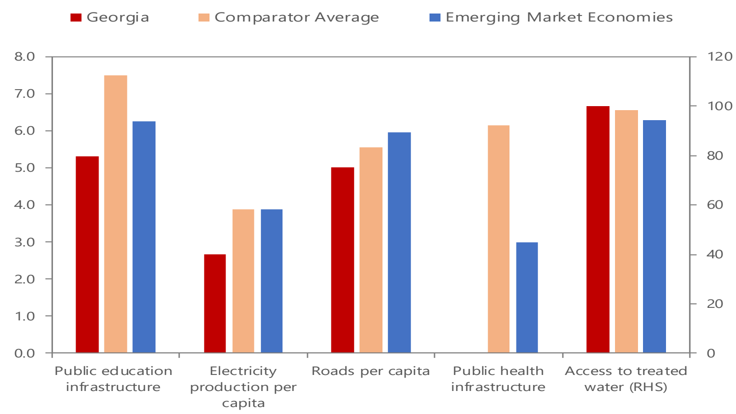
Figure 17. Perception of Infrastructure Quality, Components for Georgia



Sources: World Bank, World Economic Forum, Global Competitiveness Index, and staff estimates.

12. On the other hand, physical measures of access to public infrastructure and service delivery suggest that Georgia still lags in several sectors. Georgia performs better than the average of EMEs and peer countries in access to treated water. However, indicators suggest that there are significant gaps in roads, electricity, and education infrastructure compared to EMEs and peer countries. In the road sector, despite the substantial increase in the length of the road network in recent years, the increase in the demand for transport has resulted in a worsening of road congestion. Similarly, the energy sector remains vulnerable. First, production per capita is lower than comparators. Second, the reliance on imported fossil fuels can lead to higher market prices or subsidies from government (Figure 18).

Figure 18. Measures of Infrastructure Access, Index (LHS) and Percent (RHS)



Sources: World Bank, World Economic Forum, Global Competitiveness Index, and staff estimates.

13. The IMF has developed a methodology for estimating the efficiency of public investment.[6] This is detailed in the 2015 paper "Making Public Investment More Efficient."[7] A "frontier" is estimated, consisting of the countries achieving the highest "output" (i.e., quality and access of infrastructure) per unit of "input" (capital spending for similar income level). Using a consistent set of data, the performance of a total of 128 countries is compared against the frontier.

14. There is scope to improve Georgia's PIM framework to help reduce inefficiencies in the provision of public infrastructure assets. Based on the IMF's methodology for estimating the efficiency of public investment, Georgia compares well to the average of EMEs, although there is significant room for improvement.[8] Using physical indicators of quantity and access to infrastructure, the estimated efficiency gap between Georgia and the most efficient countries with comparable levels of public capital stock per capita is 21 percent, significantly lower than the average efficiency gap for EMEs of 44 percent (Figure 20). On the other hand, based on survey indicators of perception of quality of infrastructure, the efficiency gap is estimated at 14 percent, closer to the average of EMEs of 20 percent (Figure 19). These results suggest that

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[6] Efficiency of public investment is defined as the relationship between the value of the public capital stock and the measure coverages and quality and quantity of infrastructure assets.

[7] See http://www.imf.org/external/np/pp/eng/2015/061115.pdf

[8] The IMF's methodology for estimating the efficiency of public investment is detailed in the 2015 paper "Making Public Investment More Efficient". A "frontier" is estimated, consisting of the countries achieving the highest "output" (i.e., quality and access of infrastructure) per unit of "input" (capital spending for similar income level). Using a consistent set of data, the performance of a total of 128 countries is compared against the frontier.

between 15 to 20 percent of public investment spending did not result in the increase in the level or quality of infrastructure that would have been achieved by the most efficient country.

Figure 19. Indicators of Quality of Infrastructure

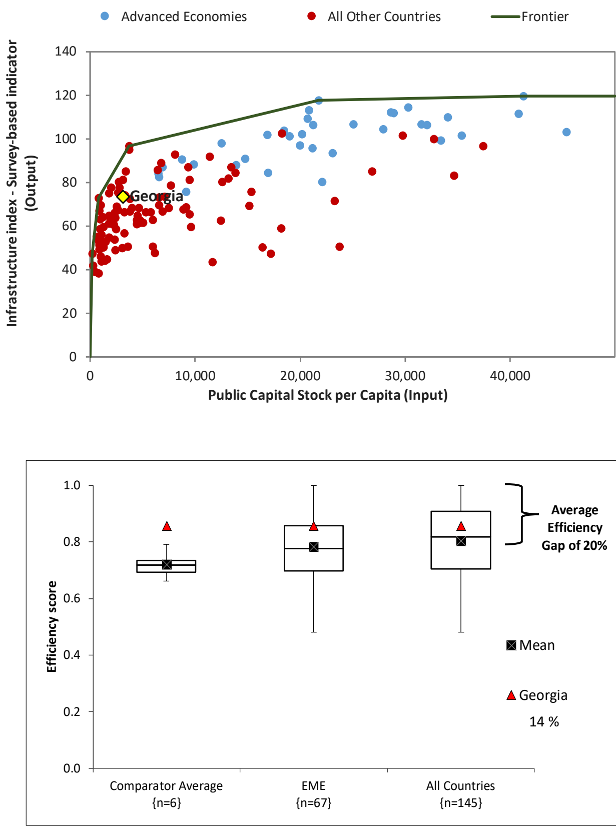
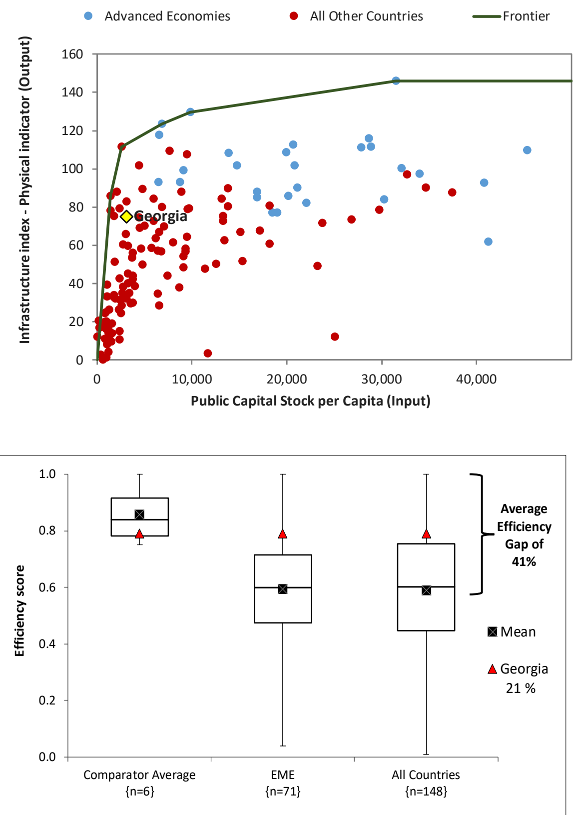


Figure 20. Physical Indicators of Quantity and Access of Infrastructure Assets and Services



Sources: Staff estimates.

15. Given the need to ensure medium-term fiscal sustainability, Georgia's public investment strategy needs to rely increasingly on a more efficient provision of infrastructure. Achieving efficiency in the allocation and management of public resources is critical in an environment where public investment spending is expanding towards more complex and risky projects, procured increasingly outside the budget.

III. PUBLIC INVESTMENT MANAGEMENT INSTITUTIONS

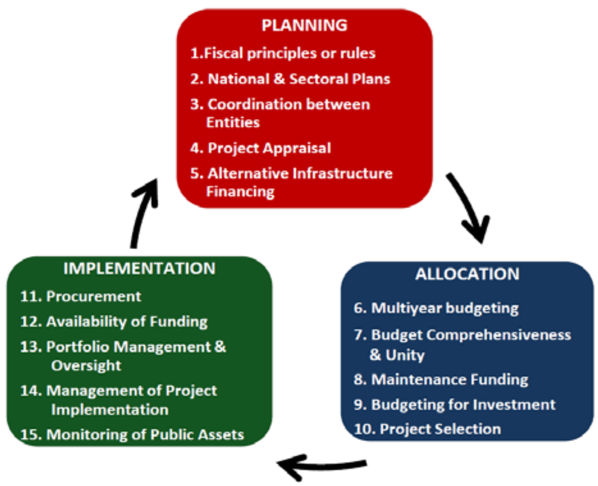
A. The PIMA Framework

16. The IMF has developed the Public Investment Management Assessment (PIMA) framework to assess the quality of the public investment management of a country. It identifies the strengths and weaknesses of institutions and is accompanied by practical recommendations to strengthen them and increase the efficiency of public investment.

17. The tool evaluates 15 set of policies and procedures (called "institutions") that are involved in the three major stages of the public investment cycle (Figure 21):

- Planning of investment levels for all public-sector entities to ensure sustainable levels of public investment;
- Allocation of investments to appropriate sectors and projects;
- Delivering productive and durable public assets

Figure 21. PIMA Framework Diagram



Sources: Public Investment Management Assessment: Review and Update, April 2018, IMF.
http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/05/10/pp042518public-investment-management-assessment-review-and-update

18. For each of these 15 institutions, three indicators are analyzed and scored, according to a scale that determines whether the criterion is met in full, in part, or not met (see Appendix I for the PIMA Questionnaire). Each dimension is scored on three aspects: institutional design, effectiveness, and reform priority:

- Institutional design refers to objective facts indicating that appropriate organizations, policies, rules and procedures are in place. The average score of the institutional design of three dimensions provide the score for the institution, which may be high, medium, or low.
- Effectiveness refers to the degree to which the intended purpose is being achieved or there is a clear impact. The average score of the effectiveness of three dimensions provides the effectiveness score for the institution, which may be high, medium, or low.
- Reform priority refers to how important improving the issues contained within the institution are for the specific conditions faced by Georgia.

The following sections provide the detailed assessment for Georgia according to the PIMA framework.

B. Investment Planning

1. Fiscal Principles or Rules (Design— High; Effectiveness—Medium)

19. Fiscal policy in Georgia is guided by the Economic Liberty Act (ELA), the government's national development strategy *Georgia 2020*,[9] and the *Government Platform 2016-20.*[10] The ELA, which was adopted in 2011 and came into force in 2014, limits: (i) the ratio of budgetary central government (state) debt to GDP to 60 percent; (ii) the ratio of the consolidated budget (central and local government) deficit to GDP to 3 percent; (iii) the ratio of expenses plus the increase in non-financial assets of the consolidated budget to GDP to 30 percent; and (iv) new general state taxes or increases in the top rate of such taxes, to those approved by referendum, with the exception of excises. The *Georgia 2020* and the *Government Platform* prescribe a stable ratio of state debt to GDP of about 40 percent as a medium to long-term target. The ceiling on state debt to GDP ratio of 60 percent operationalized the long-term target, including a buffer of 20 percent of GDP to account for the impact of macroeconomic risks. Current estimates based on standard shocks modelled by the debt sustainability analyses (DSAs) suggest that, within a 10-year time horizon, projected state debt would be unlikely to exceed the 60 percent of GDP ceiling.

20. Authorities introduced a medium-term fiscal framework (MTFF) in 2004, but implementation falls short from good practices. The MTFF does not distinguish between recurrent and capital spending, or between ongoing and new capital projects. This limits the ability of the MTFF to support predictability in PIM.

21. While the fiscal rules have been successful from several perspectives, they have not effectively provided a stable environment for public investment. A recent FAD technical assistance report[11] highlighted several weaknesses of current set fiscal targets and rules, notably: the expenditure limit is procyclical; there are gaps in coverage; there are weaknesses in measurement, reporting, and oversight; and the budgetary process, including its medium-term budget framework (MTBF), is looser than desirable. Moreover, the limits on taxes reduce revenue flexibility. As shown in Table 1: (i) aggregate expenditure has been above the ELA limit; and (ii) there have been large deviations between forecast and actual aggregate expenditure. These are symptoms of an expenditure rule under pressure, which would tend to undermine the orderly planning and execution of public expenditure, given the higher discretion associated with capital expenditure.

[9] Government Ordinance No. 400 of June 17, 2014 o*n approving the Socio-economic Development Strategy of Georgia - "Georgia 2020" and Associated Activities.*

[10] Every new government, shortly after its formation, is required to present to parliament its platform for the remainder of the parliamentary term. The *Government Platform 2016-2020* was presented in November 2016.

[11] T. Hansen, S. Farrington, J. Jalles, I. Rial and S. Yläoutinen, *Georgia. Enhancing the Fiscal Framework,* November 2017.

Table 1. Fiscal Forecasts and Outturns in Georgia (percent of GDP)

Fiscal Outturns and Projections

	2014	2015	2016	2017	2018*	2019*	2020*	2021
Expenditures	30.2	30.4	30.9	29.9	29.9	29.9	29.4	28.8
Of which capital	*4.6*	*4.5*	*4.0*	*4.1*	*6.1*	*6.4*	*6.7*	*7.4*
Deficit	-2.0	-1.1	-1.4	-0.5	-1.3	-1.4	-1.4	-1.3
Debt	35.4	41.3	44.4	42.9	43.1	42.8	42.4	41.3

a. Vintages of Total Expenditure Forecasts & Compliance with Expenditure Rule

(percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
BDD 2014					30.2	29.8	29.7	29.6				
BDD 2015						29.9	30.2	29.6	28.8			
BDD 2016							30.0	28.7	28.5	27.9		
BDD 2017								29.9	29.7	29.5	28.9	
BDD 2018									29.9	29.9	29.4	28.8
Execution	33.9	30.7	30.6	29.3	30.2	30.4	30.9	29.9				
Ceiling	30	30	30	30	30	30	30	30				

b. Vintages of Capital Expenditure Forecasts and Actual (percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
2014					5.4	5.1	5.0	4.9				
2015						5.5	6.1	6.0	5.7			
2016							4.0	5.1	5.4	5.5		
2017								4.2	5.4	6.6	7.2	
2018									6.1	6.4	6.7	7.4
Execution	6.4	6.1	6.3	4.7	4.6	4.5	4.0	5.0				

Source: IMF staff based on official data. Figures in red corresponds to years where limits were bridged.

22. The authorities are gradually implementing the recommendations and action plan of the recent FAD's technical assistance mission report. From a PIM standpoint, priority should be given to improving the link between the Basic Data and Directions Document (BDD) and annual budget preparation, and hence the orderly planning of public investment. Efforts should be focused in the following areas: (i) a reconciliation and explanation of forecast changes for capital expenditure in successive vintages of Georgia BDD; (ii) distinguish between baseline estimates and new policy initiatives in preparing capital expenditure budgets; and (iii) gradually extend the MTBF's binding nature for capital expenditure. Further details are discussed in institution 6 (Multiyear Budgeting).

2. National and Sectoral Plans (Design - Low; Effectiveness - Low)

23. Georgia does not have a national public investment strategy or infrastructure plan.[12] The authorities prepare and publish three national planning documents, one set of sector planning documents, and one set of ministerial planning documents. The three national documents are: (i) *Georgia 2020* (see Footnote 1), which was prepared in 2014 and sets national development goals to be achieved by 2017 and 2020; (ii) the *Government Platform* (see Footnote 2), which sets out the government's reform plans for its expected term of office; i.e., between 2016 and 2020; and (iii) BDD, which each year covers fiscal plans for the forthcoming budget year and the following three years. The set of sector planning documents consists of about 60 sector strategies, and the set of ministerial planning documents consists of one action plan per central government ministry.

24. The economic vision of *Georgia 2020 document* is to create the foundations for long-term inclusive economic growth and improve the welfare of the population. It does not have a separate public investment component per se, but includes extensive discussion of the need for improved infrastructure to support economic development and improved economic competitiveness in many sectors. Its coverage in terms of projects is limited and ad hoc; it discusses types of new projects and mentions some of them individually: East-West Highway, Anaklia port, the Georgian section of the Baku-Tbilisi-Kars railway, and Kutaisi airport. It includes some key output and outcome indicators, for electricity and transport (Table 2).

Table 2. Georgia: 2020 Infrastructure Development Targets

Target	Baseline	2017	2020
Total annual production of electricity (TW*h)	9.7	12	14
Access to electricity (Doing Business rank)	50	45	35
Logistics Performance Index (score)	2.77	3.1	3.3
Roads percentage surfaced	39	42	45

Source: Georgia 2020.

25. *Georgia 2020* is not costed and does not cover public investment distinctly or comprehensively. It only covers a selection of public investments and does not address systematically the existing public capital stock. Its implementation is not fully reflected in practice; notably, the implementation framework omits reference to sectoral strategies, and the output and outcome indicators are not carried forward into the *Government Platform*. There is no updating of *Georgia 2020* during its term.

26. The *Government Platform* is focused on planned and ongoing reform activities. While it is generally consistent with the vision of *Georgia 2020*, it does not map its activities to

[12] The planning framework is prescribed in *Policy Planning System Reform Strategy 2015-2017*, Decree of the Government of Georgia N427 of August 19, 2015. The *Policy Planning Manual,* approved by Decree of the Government of Georgia N629 of December 30, 2016, is a handbook explaining the framework for ministries.

the results expected in *Georgia 2020*. It is also not costed, does not cover public investment distinctly or comprehensively, and does not address the existing public capital stock. However, it does provide additional details on selected public investment projects; Box 1 shows the investments with quantified indicators included in this document.

Box 1. Government Platform 2016–20 Infrastructure Investments

- Construction of the 800km East -West Highway, with a total cost of USD 3.5 billion USD, to be finalized by 2020
- Almost 360,000 people to be provided with 24 hours a day drinking water by 2020
- 8000km of internet infrastructure to be provided and 90percent of the country's population to have access to the internet
- In 2017 – 2020, at least 500 MW installed capacity to be provided, and an infrastructural investment of 3 billion GEL to be implemented in energy sector
- A gas storage project of 210–280 million cubic meters

Source: Government Platform 2016–2020.

27. Each BDD document includes: (i) the *Government Platform*; (ii) expenditure forecasts by ministry for the forecast period; and (iii) a summary of each ministry's action plan for the forecast period. Measurable output or outcome indicators of each action plan, as well as assessments of risks, are included in the ministry action plans. Strategic goals are linked to costs via the action plans. At this level, however, the coverage of strategic planning is limited to the state budget. The action plans are also focused on ministries' new activities or projects rather than their full scope of activities. They do not have distinct components for public investment, and do not address directly the existing capital stock under ministries' management.

28. The sector strategies are fragmented, and the quality of costing in them varies greatly. Some strategies cover several ministries and some ministries have several strategies. Although about 60 sectoral strategies exist, they do not cover the full scope of government activities, and often are only concerned with new activities. Some have output and outcome indicators, but many do not. They are often motivated by donors or the aim to attract donor support, as many sector strategies are structured to conform with donor approaches. They are often also motivated by ministries needing government endorsement of their strategies to a greater level of detail than is in *Georgia 2020* or *the Government Platform*, in order to justify their action plans and funding. Another motivation is the need to unify the conceptual and technical framework for policy involving several ministries and agencies, e.g. the *National Road Safety Strategy*. They typically do not have distinct public investment components, and do not address the existing public capital stock.

29. To ensure the effectiveness of public investment planning, sectoral strategies and ministry action plans need to be closer linked to the budget process. To achieve this goal, sectoral strategies should be: (i) consistent with the resource framework of the BDD and annual budget; (ii) updated regularly; and (iii) internally consistent between them and with the ministry accountability framework.

30. It is important for public investment strategic planning to be a distinct component of national, sector and ministerial strategic planning. This helps to ensure that the public capital stock, and not just new public investment, is analyzed, and strategic planning takes full advantage of the information generated by audits of project and portfolio performance, so that the investment cycle is closed. A systematic and comprehensive approach to the strategic planning of public investment would help to ensure that outcome indicators are comprehensive and thereby increase the focus on economic efficiency in, and hence economic growth enhancement of, public investment.

3. Coordination Between Entities (Design—Medium; Effectiveness—Medium)

31. There is substantial coordination between central government and municipal governments on municipal capital expenditure. Most capital transfers between central and municipal governments are decided by a special commission under the Ministry of Regional Development and Infrastructure (MRDI) that also includes representatives of the Ministry of Finance (MoF). The commission uses a formula based on population, except with respect to Tbilisi and Adjara which comprise about half of the population, to determine annual indicative allocations for capital transfers to each municipality. It then notifies the municipalities of the indicative allocations—although not necessarily six months before the start of each fiscal year—and the municipalities submit capital projects to the commission for approval within these allocations. The commission approves the projects individually and makes the transfers on a per-project basis, to match the contractual requirements for payment, so that municipalities are notified about expected transfers as soon as the projects are approved. Resulting from this process, the commission has comprehensive information about the central government's commitments to fund these projects. The criteria applied by the commission to approve projects are defined by government decree. There is no coordination between municipalities and central government on projects funded by municipalities' own resources.

32. Table 3 shows the amount of capital transfers from central to municipal government relative to total municipal capital expenditure. The annual state budget does not show the individual municipal capital projects, irrespective of whether they were financed by capital transfers from central government.

Table 3. Capital Transfers from Central to Municipal Government

GEL million unless otherwise stated

	2014	2015	2016	2017
Capital transfers approved by the MRDI commission	135.7	174.5	183.0	195.8
Other capital transfers	81.8	93.0	60.4	21.8
Total capital transfers	217.5	267.5	243.4	217.8
Share of total municipal capital expenditure	28 percent	36 percent	33 percent	34 percent

Source: MoF.

33. The annual budget documentation discloses information on many of the contingent liabilities associated with the capital projects of Public Corporation (PCs). Although there are no standard mechanisms for SNGs and PCs to report contingent liabilities to the central government, the latter compiles, estimates, and publish data on contingent liabilities on a regular basis. A table in the state budget documentation discloses the capital projects of PCs that are funded by loans from central government and that in turn are funded by matching loans from donors (i.e., on-lending). Contingent liabilities for the state arise from these projects in the sense that PCs might not be able to service the loans that funded them, and so a fiscal risk materializes. Most major capital projects of PCs are funded in this way. The Statement of Fiscal Risks (SFR), which is included in the annual budget documentation, includes discussion of: the magnitudes and risks of the largest projects; and the risks of financial distress of the PCs which would cause contingent liabilities to the state to materialize. The SFR suggests, in particular, that a major source of financial problems in PCs and related materialization of contingent liabilities for the state, is linked to inefficient and poorly planned investment projects. Table 4 below shows net lending from central government to PCs for capital expenditure.

Table 4. Net Lending from Central Government to PCs for Capital Expenditure

GEL million

	2013	2014	2015	2016	2017
Central government net lending to PCs for capital expenditure	180.3	222.6	360.0	422.5	764.0

Source: MoF.

34. The SFR also discloses extensive information on the contingent liabilities associated with electricity generation PPPs. This mainly consists of an analysis of scenarios in which the fiscal risks of the PPAs supporting most of these PPPs could materialize. It also discusses other contingent liabilities of some large PPPs, notably the Nenskra hydro project and the Gardabani I thermal project. Information about two large PPPs the Tbilisi airport and the Anaklia port concession, is not yet disclosed, given that the agreements have not yet concluded.

4. Project Appraisal (Design—Low; Effectiveness—Low)

35. Capital projects not funded by donors are not subject to a standard methodology or central support for project appraisal. As donors on average fund around 40 percent of capital expenditure of the general government (Figure 15), many projects are not subject to rigorous technical, economic and financial analysis, including risk assessment. The authorities have approved a new PIM framework for such projects, developed with the assistance of the World Bank, which should remedy this deficiency.[13] However, it has not yet been implemented, in part because it requires a significant improvement in the capacity and resource allocations in line

[13] Government Decree N191 of April 22, 2016 *On Approval of Roadmap for Investment Projects Management* and Minister of Finance Order N165 of July 22, 2016 *On Amendments to the Order N385 of the Minister of Finance of Georgia dated July 8, 2011 on Adoption of Methodology for Program Budgeting*.

ministries and at the MoF.[14] In addition, it is not clear that a new PIM unit in the MoF required by the new framework will be established and will be responsible, in respect of all projects, for providing central support for line ministry project appraisal and for developing and maintaining the project appraisal methodology. The mission was advised that the MoF currently intends to distribute the functions envisaged for the PIM unit between the Budget department, the fiscal risks division and a working group.

36. The newly approved PIM framework could be improved in several areas. In particular, it includes a 5 percent real discount rate, to be used uniformly for all projects. The World Bank advised that this rate should only apply on a temporary basis and that research be undertaken to determine a discount rate that is appropriate for Georgia. This analysis has not yet been done. On the face of it, a 5 percent real discount rate could be too low for Georgia for the foreseeable future, which could result in a significant misallocation of capital with negative implications for the country's economic growth. By comparison, which does not seem fully explainable by inflation expectations, the nominal pre-tax weighted average cost of capital (WACC) used by the Georgian National Energy and Water Supply Regulatory Commission (GNERC) for regulated tariff approval purposes is 16.4 percent. The inputs into GNERC's calculation are set out in Box 2.

Box 2. GNERC WACC Calculation Inputs

- Risk-free rate (rf):12.22 percent (weighted average yield to maturity of 10-year Treasury bonds issued in 2016
- Default spread: 4.16 percent (country default risk from Damodaran, data as at January 2017)
- Return on debt (rd):12.93 percent (weighted average interest rate on loans, more than 5 years, provided in 2016 to the energy sector, data from the National Bank of Georgia)
- Equity beta (β): 0.8 (average for comparable countries: Albania, Bulgaria, Croatia, Macedonia, Montenegro, Serbia)
- Mature market premium: 6.17 percent (market risk premium average 6.2 percent for 2016 from Damodaran)
- Country risk premium: 5.12 percent (country risk premium from Damodaran, data as at January 2017)

Post-tax cost of equity = (rf – default spread)
= β * mature market risk + country risk premium
= 18.36 percent

Given a tax rate of 15 percent, the pre-tax cost of equity (re) = 21.6 percent

The WACC is derived applying: a 60 percent weighting of debt to rd (return on debt) and a 40 percent weighting of equity to re (return on equity).

Source: MoNE.

37. Capital projects funded by donors, which are mostly large, are subject to rigorous technical, economic and financial analysis, including risk assessment. However, while the appraisal processes are similar across donors, there is not necessarily consistency in key

[14] Piloting of this new PIM framework is under way.

assumptions across donors or projects. In particular, discount rates differ and market assumptions are not necessarily reconciled with the authorities' economic forecasts.

5. Alternative Infrastructure Financing (Design—Medium; Effectiveness—Medium)

38. Regulation of infrastructure companies aims at promoting open and competitive markets for the provision of infrastructure assets and services. In this context, PCs should be subjected to effective oversight of their investment plans, to allow for objective pricing of infrastructure outputs. In Georgia, there is limited competition in markets for infrastructure provision, and incentives for private companies to participate in these markets is variable. As a result, investments are being made in some sectors without facing efficient relative prices. This likely results in a distorted allocation of capital in the economy, with negative implications for economic growth. In particular:

- In the telecommunications sector, producers and consumers face market prices, there are no PCs, the public asset (the spectrum) is auctioned transparently, and the role of the regulator, the Georgia National Communications Commission, is mainly to solve disputes.
- In the electricity sector, the authorities are planning to deregulate the market progressively, but the specifics of the transition and end-state have not yet been decided. In the meantime, the market framework is prone to a significant amount of inefficient investment in the sector. Notably, electricity consumers are facing a single price which reflects the cross-subsidization between low-cost and high-cost generators, reducing their incentive to improve efficiency in consumption. Moreover, distribution network provision and trading are bundled, further reducing incentives to improve consumption efficiency. Generators do not face the risks of high-cost provision because of cross-subsidization and PPAs arranged by the state. In addition, there are PCs in the sector which do not act commercially, taking excessive risks and over-investing.
- In the gas sector, the authorities have only just started to consider deregulation. In the meantime, gas purchase and distribution are monopolized by the government and an SOE, reducing incentives for efficiency in supply and distribution; and households receive subsidized gas, reducing incentives for efficiency in consumption.
- In the water sector, the authorities have not yet considered how it could be deregulated. In addition, the pipeline network, which is a natural monopoly, might need to be fully rehabilitated before it is attractive for private operators to use in a deregulated market. Until consumers face economic prices, the extent to which investment is inefficient will not be known with confidence.
- In the transport sector, there is no regulatory framework covering the sector holistically, and investment is occurring without apparent regard for efficient relative prices between the transport modes. Rail is losing market share to road, which might be caused in part by road transport not being efficiently priced.

39. There is an independent regulator for the energy and water sectors. The GNERC was established in 2007 by the Law of Georgia on Electricity and Natural Gas. There have been issues with the implementation of the regulatory regime. Regulated companies have argued that tariff structures have sometimes been too low to support commercial viability, e.g., for the state-owned electricity transmission company Georgia State Electro system and the major publicly-owned water company, the state-owned United Water Supply Company. On the other hand, the GNERC has sometimes considered that the companies have over-invested, and its mandate is only to approve tariffs that grant a commercial return for the minimum reasonable levels of investment. GNERC has recently approved significant increases in tariffs, which could mean that the implementation of the regulatory regime and its effect on investment behavior are achieving a better balance between these perspectives.

40. The *Government Platform 2016–20* summarizes the authorities' policy on PPPs,[15] **and parliament has recently approved a PPP Law.**[16] A comprehensive legal framework for the preparation, selection, and management of PPPs according to good international practice, in almost all respects, is provided in the Law. Before its approval, some PPPs were established according to previous legal and administrative frameworks. These were not sufficiently clear or strong, legally or administratively, to support the substantial expansion of the role of PPPs in the economy that the authorities envisaged in their strategy in order to enable a larger quantity of public infrastructure to be provided to the public at lower cost and/or lower fiscal risk. Box 3 identifies some of the Law's key features.

Box 3. Key Features of the PPP Law

- Broad coverage, in terms of sectors, public institutions, and types of services delivered
- Principle of optimal risk transfer allocation between the private and public partners
- Competition and non-discrimination in selection of PPP projects – direct negotiations limited to the energy sector, and apart from national security for projects publicly initiated (i.e., excluding non-solicited proposals)
- Requirement for ceilings on PPP exposures
- Requirement for fiscal affordability, fiscal risks and value-for-money assessments
- Gatekeeping role of the MoF

41. However, the new PPP Law is not yet operational. This will require a government decree and methodological guidelines to be approved. In addition, the PIM framework needs to be brought in line with the PPP Law, and harmonized with the PPP decree; this is discussed in Section IV.A below. The authorities hope that they will be approved by end-2018. However, the authorities will face a major challenge in implementing the complete regulatory framework, as

[15] It specifically mentions PPPs in the energy, transport, education, and housing sectors.

[16] Law of Georgia on Public-Private Partnership.

the increase in capacity requirements will be substantial. Moreover, the PPP Law requires the establishment of a PPP database. However, given that the regulatory decree has not yet been approved to operationalize the database, information on PPPs operations remains limited. Current available data on estimated investment costs is shown in Table 5.[17]

Table 5. Georgia: PPP and PPA Project Values

Project	Percent GDP
Hydro projects subject to PPAs [1/]	32.0
Anaklia port	4.5
Gardabani II	1.6
Gardabani I	1.5
Batumi Port	0.6
Tbilisi Airport	0.5
Batumi Container Terminal	0.2
Batumi Airport	0.2
Total	**41.1**

Source: MoNE, World Bank PPP database and staff estimates.
1/ Only the 72 PPAs for which: (i) a PPA agreement has been signed; (ii) a construction permit has been issued; and (iii) there has been financial closure. It should be noted that, given current export prices, it would be likely that some of these 72 projects will not proceed. Another 82 PPAs are under negotiation.

42. The government publishes a consolidated report on the financial performance of all significant PCs, but it does not disclose investment plans in a systematic manner. The SFR included in the annual state budget documentation includes a discussion on an individual basis of the financial condition of several large PCs, but it does not focus on investment plans systematically.

43. The monitoring of PCs is fragmented, and the existing monitoring framework is not designed to ensure efficient investment. Large PCs in the energy sector are monitored by the Ministry of Economy and Sustainable Development (MOESD), most other PCs by the National Agency for State Property (NASP) under the MOESD, the Partnership Fund by the MOESD and MoF, and other PCs by line ministries. The SFR has introduced a degree of consolidated monitoring; however, it is at an early stage and the authorities are considering strengthening the PC monitoring framework. Key features of a desirable monitoring framework are set out in Box 4.

[17] Although these initial asset values are neither depreciated nor revalued, they give some indication of the associated liabilities that the state might have to assume if the projects experienced financial distress.

Box 4. Desirable Features of PC Monitoring

The government should set transparent, quantitative and solely commercial goals for PCs, and hold their supervisory boards accountable for achieving them.

Any non-commercial goals that the government wishes PCs to execute should be funded separately by the government under separate and transparent contracts.

PCs should trade competitively and should not enjoy any commercial advantages or suffer any commercial disadvantages by virtue of their public ownership. In particular, they should not receive any explicit or implicit guarantees from the government and should be subject to a competitive cost of capital, both equity and debt.

PCs should produce and publish statements of corporate intent (SCIs) that are agreed with the government's monitoring representative. SCIs should include the scope of the PCs' businesses, risk limits, expected financial returns, major transactions that should be approved by the government's representatives, and requirements for the production and publication annual reports that disclose performance against SCIs.

PC supervisory board members should have private sector commercial skills and experience. They should not be government ministers or officials as this would create conflicts of interest and limit the ability to hold the boards accountable.

The PC monitoring framework should be centralized. The MoF should be the shareholder of large PCs in order not to diffuse the monitoring responsibility among different government representatives. The NASP should be the shareholder of smaller PCs. Line ministries should not be shareholders of PCs or be responsible for their monitoring, in order to avoid conflicts of interest with their sectoral public policy responsibilities.

Sources: FAD technical assistance reports, and *How to Improve the Financial Oversight of Public Corporations*, 2016, IMF. https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/ Issues/ 2016/ 12/31/How-to-Improve-the-Financial-Oversight-of-Public-Corporations-44373

Recommendations

Based on the assessment provided in this section, the following recommendations to improve the planning of sustainable levels of investment are suggested. A detailed action plan is included in Annex I.

Issue 1: The strategic planning of public investment is fragmented, lacks cohesiveness, only deals with new initiatives, and is limited to only some output and outcome indicators

Recommendation 1: Improve national and sectoral planning by updating the public investment component of the national development strategy, including all sources of financing, levels of government, and procurement options.

Issue 2: The new PIM methodology has not yet been implemented, and the role of the MoF needs elaboration. Key economic assumptions of donor-funded projects are not reconciled centrally, project appraisal discount rates are inconsistent and do not necessarily reflect the economy's opportunity cost of capital.

Recommendation 2: Improve project appraisal by implementing the new PIM methodology and ensuring that a dedicated team at the MoF is responsible for providing central support for line ministry project appraisal and for developing and maintaining the project appraisal methodology.

Issue 3: The government has not yet decided on the deregulation of the electricity market, it has not yet considered the deregulation of the gas and water markets, and it has not addressed relative prices in land transport use.

Recommendation 3: Improve competition in major infrastructure markets.

Issue 4: The oversight of PCs investment is insufficiently focused

Recommendation 4: Require PCs to undertake only those investments that comply with their Statements of Corporate Intent and are thereby commercially appropriate for them.

C. Investment Allocation

6. Multi-year Budgeting (Design—Medium; Effectiveness—Low)

44. Since investment projects are medium-term in nature, effective planning of projects by spending ministries requires budgetary mechanisms which facilitate medium-term budgetary planning, and provide greater predictability of funding over the medium term. A medium-term perspective for multi-year projects also provides a framework for planning future current spending requirements related to existing projects. These mechanisms help improve the efficiency of spending on investment projects.

45. Total multi-year expenditure ceilings are provided to ministries by programs in the BDD document, but these are not disaggregated into current and capital. In the budget documentation, the capital projects annex sets out four-year spending projections for capital projects by ministry and program/sub-program. Using the ministry and program codes, it is possible to identify the acquisition of non-financial assets in these projections by ministry and program (Chapter VI of the budget document) (Figure 22). However, since not all capital projects are included in the capital projects annex, it is not easy to assess the full picture on capital projects by ministry (Box 5).[18]

46. Neither the full cost of major capital projects over their expected life-cycle nor the related future operating costs are published systematically in the budget documentation. Projections are shown only for the budget year and three following years. Nonetheless, the e-Budget system has the functionality to provide for the cost profile of capital projects beyond the four-year period, but in practice this functionality is not used regularly by spending ministries. This leads to weaknesses in projections of capital expenditures over time. Figure 23 shows forecasting errors for capital spending.

[18] This point is also made in the State Audit Office's 2016 report on its performance audit of capital projects management.

Box 5. Definition of Capital Project Used in the Capital Projects Annex to the Budget

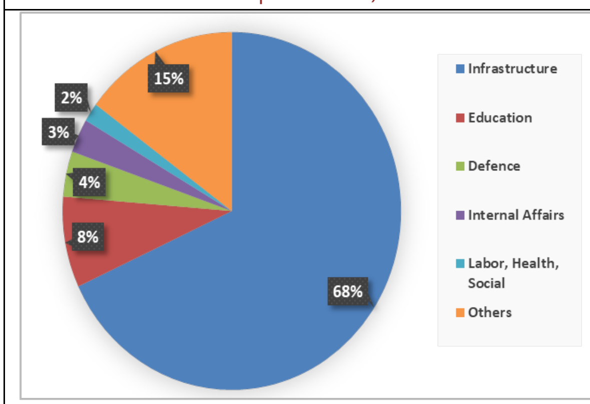
The Ministry of Finance Order 385 defines a capital project for inclusion in the capital projects annex to include:

- For construction/rehabilitation projects, projects with a project value of GEL 50 Million or more, with a post-construction term of use of at least 5 years; and
- For purchases of software, machinery and other equipment (except military technique, weapons and other military equipment), projects with a separate/total project value of GEL 0.150 Million with a post-purchase term of use of at least 3 years.
- Projects which do not meet the above criteria but "due to their importance" should be included in annex.

The Order specifies that the cost of the project should contain all the expenses linked to project implementation.

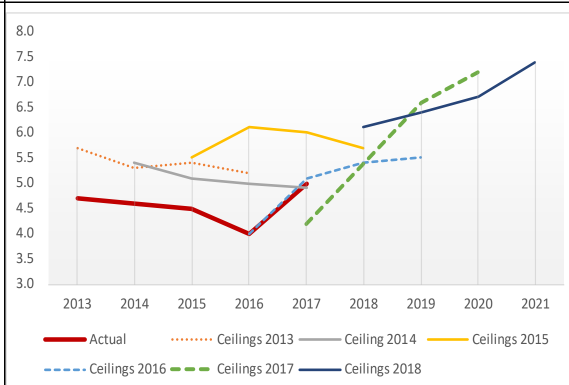
Source: Order of the Ministry of Finance of Georgia N385 "On the Approval of Methodology of Creation of Program Budgeting."

Figure 22. Distribution of Appropriated Capital Spending by Ministry, 2017 (% of total capital expenditures)



Sources: Staff estimates based on official data.

Figure 23. Differences Between Forecast and Actual Capital Expenditures across 4-year BDD Period (% GDP)



47. The medium-term BDD process could more effectively guide multi-year capital spending. At the beginning of the budget process, spending ministries start their calculations from a zero base each year and focus primarily on the coming budget year, which undermines the potential value of a rolling medium-term framework and the effectiveness of capital budgetary planning over the medium term.

7. Budget Comprehensiveness and Unity (Design —Medium; Effectiveness—Medium)

48. Effective public investment management requires comprehensive information on capital spending, regardless of how the investments are financed. Budget comprehensiveness ensures that decision-makers and those tasked with oversight are able to assess all proposed investment allocations relative to the overall resources envelope when they make decisions, supporting overall fiscal sustainability.

49. The processes for preparing capital and current budgets are integrated, and current and capital expenditures are included in the budget documentation. Budget aggregates by ministry and program are prepared by the MoF Budget Department and presented together by main economic category in Chapter VI of the budget document. While capital spending by budgetary central government (including externally-financed spending) is undertaken through the budget, those undertaken by PCs' own resources, some LEPLs' own resources, by Partnership Fund, and PPPs are not. While these expenditures are not disclosed in the budget main presentation, and are not subject to separate Parliament authorization, the FRS includes considerable information about PCs including the Partnerships Fund and PPP. The amounts undertaken outside of the budget are relatively significant, with, for example, capital investment by the Partnership Fund equivalent to 20 percent of total capital appropriations in the budget.

50. Capital spending authorized outside the budget process undermines comparable analysis and the setting of priorities. Greater capture of this information would support better fiscal management.

8. Budgeting for Investment (Design – Medium; Effectiveness – Medium)

51. Funding should be available to complete projects as planned once they are started. Good practices suggest that medium-term costs should be clear at the time a project is first approved, and on-going projects should be given priority for funding in the annual budget process. During budget execution, limits should be placed on transferring money from capital to recurrent budget.

52. Allocations for capital projects are appropriated on an annual basis, and there is no formal mechanism for protecting the funding of on-going projects. For multi-year projects, there is an informal agreement on funding requirements during budget negotiations between the MOF and the spending ministry about the allocation of resources for the following year's budget; however, total multi-year commitments are not included in the budget document. The BDD is supposed to take these into account in setting the ministry's ceilings. In addition, for multi-year projects about to be tendered, the MOF gives a certificate of confirmation of funding, which includes the provision that the ministry cannot apply for funding for additional new projects in place of the agreed funding for the current project. In practice, funding of on-going projects is adequate.

53. All requests for in-year reallocations of budgetary appropriations, including those from capital to current lines, are required to be approved by MoF. The Budget Code does not specifically restrict in-year reallocations of appropriations from capital to current, but there is a cap on total reallocations between programs of 5 percent of the budget agency's appropriation, while changes between programs and sub-program require the agreement of the Ministry of Finance. Chapter VIII of the Annual Budget Law goes further in stating that all requests for reallocations involving appropriations earmarked for investment/capital projects must be approved by the government (the MoF, in practice). In fact, reallocations from capital to current appropriations take place only rarely.

54. The budget process for public investment requires appropriate information for decision-making in order to ensure smooth and efficient funding allocations. Data on projects in the budget do not distinguish between on-going and new projects and, in the absence of clear total project costs and expected project timelines, as well as the practice of changing project codes, it is thus difficult to analyze the balance of on-going projects versus new projects over time.

9. Maintenance Funding (Design —Low; Effectiveness—Medium)

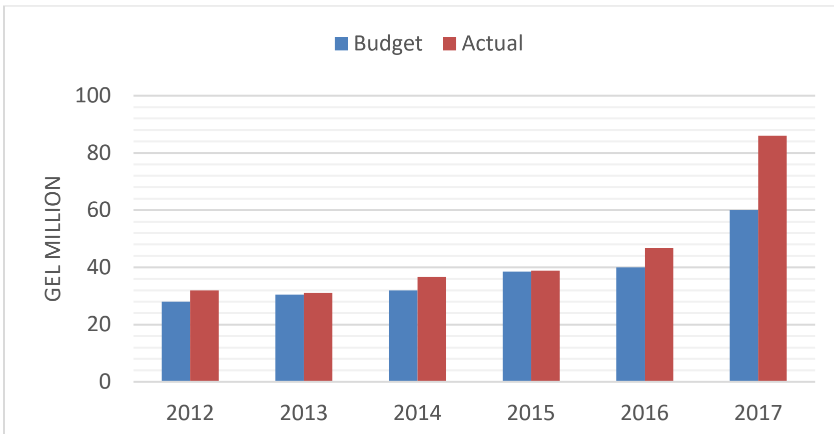
55. In order to protect the quality and condition of a public asset and ensure its maximum use through its intended life-cycle, adequate maintenance of the asset is essential. This requires that adequate maintenance allocations be provided in the budget, including both regular (annual routine and periodic) maintenance to ensure that assets achieve their expected productive life-span; and major improvements, e.g., rehabilitation, to increase an existing asset's productive capacity or serviceable length. Inadequate spending on maintenance can lead to faster-than-planned degradation of fixed assets and consequently higher operating costs (e.g., for vehicles operating on poorly-maintained roads) and the higher cost of more frequent major rehabilitation works or replacement of assets. However, maintenance spending is in practice often the area of expenditure which tends to suffer relatively more from either under-investment or in-year spending cuts than other types of spending.

56. Maintenance expenditures are not separately identified in budget documents, except for roads. Maintenance expenditures in all sectors other than roads are combined with other goods and services items for programs in these sectors. In the road sector, both current and capital maintenance are provided in the budget through specifically-designated program/sub-programs. The Roads Department uses its own methodology for determining the physical maintenance requirements for roads using a multi-criteria analysis, and their associated expenditure requirements on the basis of maintaining a specific level of road condition, as measured by the international roughness index (IRI). Road infrastructure is significant, with annual investments representing around 68percent of total capital spending in the budget. Figure 24 sets out planned and actual routine and periodic maintenance spending by the Roads Department over the last six years.

57. There is no standard methodology for estimating routine or more extensive maintenance needs and required budget funding. Funding amounts are determined largely incrementally, based on the likely resources available. Analysis of maintenance expenditures (planned and actual) is made more difficult by the lack of specific identification of maintenance in the budget and in execution reports. Routine maintenance spending is identified in the budget for roads projects and for machinery and equipment but not systematically beyond these broad classes, and actual spending on capital maintenance spending is not separately analyzed in budget reports.

58. The lack of a systematic mechanism for budgeting and reporting on maintenance needs for all types of public assets risks deterioration of the stock of public capital and increased operating and eventual replacement costs. In the preparation of new projects, spending ministries do not routinely include estimates of future required maintenance spending, and, with the budget process' relative emphasis on the coming year, there is no incentive in the existing budget process to do so.

Figure 24. Routine/Periodic Maintenance Spending on Roads 2012–17 (GEL Million)



Source: MoF and Roads Department of MRDI.

10. Project Selection (Design—Low; Effectiveness—Low)

59. Formal, transparent, and effective project selection procedures help guide a government to identify and prioritize projects for inclusion in the budget, in line with government priorities. Such procedures should be based on clear and well-specified criteria and help adjudicate between competing well-prepared projects which have been appropriately assessed as part of project preparation. The independent review of proposed project assessments helps ensure that only high-quality proposals are considered for project selection. The lack of a rigorous and transparent process to ensure that similar major investment projects compete on an equal footing, or enabling projects to bypass these procedures, potentially undermine the efficiency and productivity of capital investment. Given the size of major investments, the potential costs of poor selection in terms of efficiency losses are high.

60. Domestically-financed capital projects in the budget are not selected according to standardized selection criteria or formalized selection procedures, and no pipeline of appraised investment projects is maintained. The MoF is currently not applying standard project selection criteria. Projects are selected by spending ministries and agreed with the MoF during budget negotiations, but selection is not undertaken on the basis of standard and consistent selection criteria. The selection process for projects at municipal level financed by transfers from central government budget through the Regional Development Fund (RDF) is more transparent, with projects assessed against specified criteria. Nonetheless, while the RDF is one of the main sources of infrastructure projects in municipalities, the total amounts of the transfer represent around 20 percent of central government capital expenditures. While project selection procedures and criteria are contained in the new PIM methodology, this has not been implemented yet. Major externally-financed projects are subject to project appraisal; however, there is not a systematic review by a central agency before it is included in the budget. There is no project pipeline currently, but the new PIM procedures include a stage of appraising projects to go into a list of projects intended for inclusion in the budget.

61. Applying a more rigorous approach to selecting capital projects, such as those set out in the PIM manual, would improve the efficiency and outcomes from public investment. The government's new project selection procedures, when applied to all public investment regardless of the funding source, provide a framework to improve the quality of the stock and flow of public investment projects for greater impact on economic growth. Key to these improvements are the gatekeeping role of MoF to prevent projects from being in the budget without undergoing customary appraisal and subject to selection criteria. A clear documentation trail for selection decisions contributes to accountability and a credible budget.

Recommendations

Based on the assessment provided in this section, the following recommendations for allocating investment are suggested. A detailed action plan is included in Annex I.

Issue 5: The Basic Data and Directions Document of Georgia (BDD) does not effectively guide multi-year capital spending.

Recommendation 5: Strengthen multi-year budgeting by improving the clarity and linkages in budget documents of annual and medium-term projections for public investment.

Issue 6: There are no formal mechanisms to give priority to on-going capital projects. Resources for new projects could potentially crowd out on-going projects, leading to delays and increased project costs.

Recommendation 6: Implement formal mechanisms to prioritize the completion of on-going projects in the budget process.

Issue 7: There is currently no standard methodology to determine maintenance requirements or to track maintenance funding systematically.

Recommendation 7: Develop a standardized methodology for estimating current and capital maintenance needs to be used by spending ministries over the rolling BDD/budget period.

Issue 8: The lack of standard project selection procedures and a list of approved projects potentially undermine the link between the PIM process and the budget.

Recommendation 8: Operationalize the project selection procedures in the PIM Guidelines/ Manual and incorporate them in the budget process applicable for all public investment projects, regardless of the funding source.

D. Investment Implementation

11. Procurement (Design—High; Effectiveness—Medium)

62. **Good procurement procedures are necessary to purchase quality products at the lowest reasonable price.** This aim is achieved through an open and competitive bidding process, information systems covering the full procurement process, and independent review of complaints. These features of the procurement system also contribute substantially to transparency and perceived fairness.

63. **More than three-quarters of capital projects are procured competitively using a modern web-based procurement information system.** The Law on State Procurement was passed in 2005. Procurements are made through the e-Procurement system (Ge-GP;www.spa.ge), which became operational in 2011. The system is used for tender announcements, bid submissions, evaluation, contract awarding, and all decisions of the tender commission. The procurement system is managed by the State Procurement Agency (SPA), whose current structure results from the 2014 reforms. The total value of goods, works and services procured through open competitive procurement methods has gradually increased. Between 2013 and 2017, the value of direct contracting was halved, from 48.7 percent of the value of all procurements in 2013 to 24 percent in 2017. However, a significant number of PPA agreements have been procured through direct contracting. The number of bids for open tenders is fairly low, averaging about 3 percent in recent years. Spending agencies prepare 12-month procurement plans covering the budget year.

64. **The e-Procurement system is used actively for monitoring purposes, but analytical reporting can be improved.** Procurement is monitored by the respective line ministry, the SPA as well as the State Audit Office (SAO). The procurement database is quite complete and is available in the public procurement portal. Elements of the procurement information available to the public has been designed in line with the Open Contracting Data Standard (OCDS). Standard analytical reports are produced using the information in the system, including quarterly updates on published tenders, the value of tenders and the average number of bidders (www.stats.spa.ge). However, the effectiveness of the system for monitoring, particularly by those not directly involved (e.g. by those outside of government), is reduced because of lack of live, retrievable data. While the e-Procurement system is quite good, planning for some enhancements should go forward. For example, greater control over the value of contracts could be enhanced through a direct link between the e-Procurement and the e-Budget systems.

65. **The number of failed tenders and the procurement complaints procedures raise some concerns.** The number of tenders that have not resulted in a signed contract has reached

29 percent, on average between 2013–16. This number is high, and the cause is not clear. The complaint procedures vary based on the size of the contract.[19] Generally, complaints procedures follow several good practices, including clearly-defined processes for submitting and resolving complaints; the role and responsibilities of the Procurement Dispute Review Board (PDRB)[20], which handles complaints, to suspend the procurement process; the ability for complainants to lodge a complaint without a fee; and that PDRB decisions are binding for all parties. Procedures for handling procurement-related complaints are open to the public and the decisions of the PDRB are made publicly available. Time periods allowed to complete complaint review are reasonable. For example, for relatively large contracts, as defined in the procedures, the complaints review period should be completed within 5 days. The PDRB is not fully independent because its Chair (who has the deciding vote) plus 3 of the 6 members are from the SPA.

12. Availability of Funding (Design – High; Effectiveness - High)

66. Public investment is more efficient when project implementation is consistent with budget appropriations and is not constrained by cash availability. Good cash management and flexible procedures for commitment of funds are required to achieve this goal. The benefit is removal of financial uncertainty from the list of possible causes of project implementation delays and cost increases.

67. Spending units have considerable flexibility to commit funds during budget execution. While quarterly budget allocations are recorded in the e-Treasury, these may be adjusted to allow for commitment of funds in amounts up to the annual appropriation, if needed. Commitment of funds beyond the fiscal year (e.g., multiyear contracts) is possible with the permission of the MoF Budget Department. Substantial cash management reforms were introduced in 2015, including creation of the Cash Management and Forecasting Department (CMFD) in the MoF. The CMFD prepares daily cash forecasts for the current month and monthly forecasts for all full months remaining in the fiscal year. Forecasts are based on analysis of historical cash flow and surveys of spending units focusing on planned expenditures outside of historical patterns, such as payments due under large construction contracts. The coverage of spending units in the Treasury Single Account (TSA) and the e-Treasury system was expanded in 2015 to include all municipalities and LEPLs,[21] in addition to the State Budget.

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[19] For contracts under the thresholds defined by EU procurement directives (EUR 5,548,000, equivalent to GEL 15.8 Mill), the Decree №1 of February 27, 2015 of the Chairman of the State Procurement Agency on Dispute Review Board applies. For contracts equal to, or greater than, Order N1 of the Chairman of the State Procurement agency for the Dispute Review Council, dated 08 Feb 2018, applies.

[20] Established by an Executive Order in 2015.

[21] LEPLs are required to use the TSA and the e-Treasury system for the purposes of recording revenue and expenditure. However, the e-Treasury system is not used by MoF to control LEPL spending. LEPLs may independently invest their funds outside the TSA but must transfer funds back to the TSA before spending, which permits the recording of all LEPL expenditures through the e-Treasury system.

68. A substantial proportion of donor funds flow through the e-Treasury system. For example, in 2017, approximately 48 percent of payments financed by International financial institutions (IFI) loans and grants were channeled through the treasury. In such circumstances, typically a foreign currency account is created in the TSA for each IFI agreement, into which the IFI deposits funds. The responsible implementing spending unit spends GEL from the State Budget account, which is reimbursed within days by converting foreign currency from the agreement account and depositing GEL to the State Budget account. The agreement account has overdraft rights. IFIs are notified of overdrafts, which are monitored by MoF until sufficient funds are deposited to eliminate the overdraft. Information on payments made directly by IFIs are recorded in the e-Treasury system.

69. Systems affecting cash availability are working well in Georgia. This is reflected in the fact that there has been no instance in at least several years of funding being unavailable to make payments when needed, either for budget-funded or IFI-funded projects.

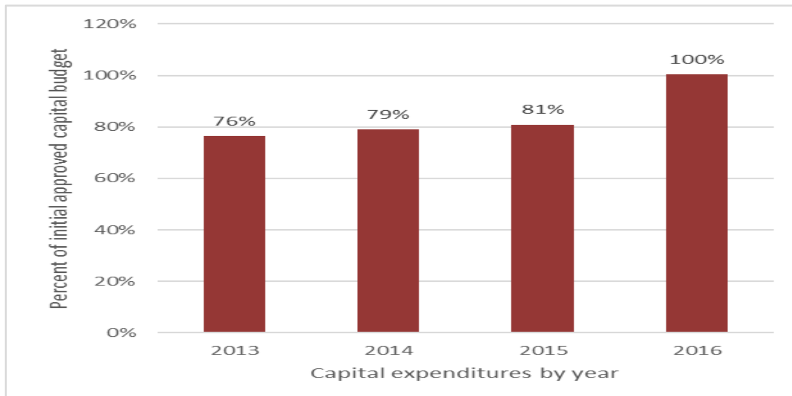
13. Portfolio Management and Oversight (Design – Medium; Effectiveness - Medium)

70. Project monitoring is necessary for managing the progress in implementing the portfolio of ongoing projects. There are significant benefits to portfolio management and monitoring. First, monitoring provides in-year accountability for the progress made in implementing the approved budget. Second, it identifies emerging portfolio-wide implementation problems, such as material shortages or price increases. Third, it systematically screens individual projects being implemented to identify those that may require assistance. For example, if a project is proceeding at a better than expected pace, or faces unexpected costs, funds can be shifted in-year to that project from one that is experiencing delays, rather than waiting for the next annual budget. In extreme cases, both during a budget year and between them, a project may be delayed, face additional costs, or become obsolete to the extent that it should be canceled before completion. It should be noted that reporting on implementation in the annual budget process or in the Annual Budget Execution Report is not a substitute for timely in-year monitoring.

71. Project implementation progress is currently not reported systematically to MoF or the respective line ministers. Regular reporting to IFIs on the financial and physical progress of specific projects funded by them is made by the MoF Public Debt and External Financing Department, based on standard reports submitted by implementing agencies. Reporting by supervising engineers to implementing agencies is not standardized, which prevents easy consolidation. Regular reporting on spending across the entire range of budget-approved projects occurs through the Quarterly Budget Execution Reports, but such reports do not include physical progress. Serious implementation problems are raised to higher levels by project managers, but only on a case-by-case basis. Thus, existing reporting on project implementation cannot be described as a system of monitoring aiming at maximizing the benefits of project monitoring.

72. When implementation problems arise during budget execution, spending units have considerable flexibility to re-allocate funds between projects. Article 31 of the Budget Code prescribes the rules for re-allocating funds between projects. Notably, ministries may, under their own authority, re-allocate authority to spend between projects under a program for which the ministry is responsible. In 2017, MRDI shifted between projects approximately 43 percent of the total value of its capital budget between projects and project economic classes. This number is high, raising issues about the credibility of initial budget projections, and may also reflect issues associated with project planning and implementation. This flexibility contributes to high rates capital budget execution, increasing from 73 percent of initial approved budgets in 2013 to 100 percent in 2016 (Figure 25). Change notices are submitted to the MoF Budget Department through the e-Budget system and recorded, with limitations described in Institution 8 above.

Figure 25. Rate of Capital Budget Execution
(percent of budgeted capital expenditure)



Source: MoF.

73. Ex post evaluations of completed major projects do not occur systematically. Such reviews are intended to identify, after a project has been completed, challenges experienced regarding costs, deliverables, and outputs. The results of the evaluations can be used to adjust project design, appraisal, and general procedures for implementation. While ex post evaluation of projects is required by most IFI agreements, no ex post evaluations are conducted on budget-funded projects. A chapter is devoted to ex post evaluation in the PIM Guidelines,[22] but implementation of this aspect of the Guidelines has not begun. The State Audit Office, in its review of the Annual Budget Execution Report, highlights cases where project spending deviates by more than 15 percent from initial appropriation, and provides an explanation for the deviation. But this does not have a measurable effect on the system of project implementation, in large part because the PIM Methodology Manual and the PIM Guidelines have not yet been applied in practice.

14. Management of Project Implementation (Design – Low; Effectiveness – Low)

74. The aim of project management is to ensure that approved projects are implemented with minimum deviation from expected schedule, funding, and functional scope. Ideally, project implementation issues should be anticipated in the project profile specified before a project is selected for budget funding. This helps set realistic expectations

[22] Chapter VI.

during budget discussions. Project implementation plans are prepared based on the project profile to identify specific tasks to be carried out, dates for completion, and parties responsible for carrying out those tasks. If there are significant deviations from project implementation plans, procedures should be in place to revise the project profile, including the possibility of canceling the project before completion in extreme cases. Ex post audits of individual projects can help to identify the causes of project implementation difficulties and responsibilities for managing them.

75. Implementing agencies have project management staff and procedures in place but often lack formal implementation plans. Formal implementation plans are typically required by IFIs but implementing agencies generally do not prepare them for budget-funded projects. Heads of divisions are assigned responsibilities for managing several projects, rather than individual staff under their direction, and thus there are no project managers as the term is commonly understood. For example, the MRDI Roads Department has four project management divisions under it, but no staff under the division head is assigned primary responsibility for oversight of individual projects. Project management is viewed narrowly as contract oversight. Projects are nearly always implemented by private contractors, selected through competitive bidding. Third party consulting engineers or supervisory engineering firms are used to oversee construction contractors, in line with customary practice internationally.

76. There are no government-wide guidelines for adjusting approved projects during execution. Such adjustments would be made following a review of the project, and may address funding, scheduling, functional scope, and even cancelation. Managers and engineers currently use professional judgment to bring project-related problems to the attention of higher levels in its respective line ministry, and if necessary to the MoF. Adjustments to project profiles can be made after these discussions. A more systematic approach is to define criteria to trigger a review, such as contracts not being signed within 9 months of the fiscal year, or estimated total project costs increasing by 15 percent or more of the original estimated total project cost. Such guidelines are currently absent. Development of criteria to trigger a review, which would be one component of the suggested guidelines, should be aligned with the monitoring system, and thus likely would be implemented only after a monitoring system was in place. Project modifications in practice are significant. The State Audit Office of Georgia (SAO) noted[23] that for projects completed in 2016 there were material cost differences between originally planned and actual in 84 percent of projects, and material changes in the time to completion in 42 percent of projects, with 33 percent taking longer to implement than originally planned. These summary statistics cover changes made in-year and between years.

77. The SAO audits projects selectively. IFI-funded projects are audited by contracted private firms, not by the SAO. Routinely, ongoing budget-funded projects and budget-funded projects completed within a fiscal year are audited by SAO superficially as part of the annual audit of the spending unit. In-depth audits of budget-funded projects are done only when

[23] State Audit Office, Report on the Government's Report on the Annual Execution of the 2016 State Budget.

information is uncovered in the spending unit audit, or from other sources, that raises concerns. Given limited resources, SAO employs a risk-based framework for selecting what to audit. But the bar is high; in the period 2015–17 SAO did not perform any audits targeting individual projects.[24]

15. Monitoring of Public Assets (Design – Medium; Effectiveness – Medium)

78. Information on the stock, condition, and value of public assets is a key element of an efficient PIM framework. It establishes accountability of a spending unit for safekeeping and maintenance of assets purchased with public funds. Asset valuation provides the basis for preparation of financial statements, including the balance sheet (non-financial assets) and operations statement (depreciation expense). Information on asset age, value, and condition provide an approximate measure of the need for routine maintenance, rehabilitation, and replacement of the asset. The nature of the existing stock of assets is essential to understanding what new infrastructure is necessary to support economic development strategies. In this way, good practices suggest that data on assets are important information inputs to accounting, planning, and budgeting.

79. Responsibility for asset record keeping is decentralized in line ministries, which follow guidelines issued by the MoF. Assets currently are defined as any single object costing more than 500 GEL and having a life greater than one year (short-term) or three years (long-term). Assets are recorded at their historical cost, and are not revalued. Ministries submit a list of major assets to MoF, which is published on July 1 annually on the Treasury Department website along with historical cost, accumulated depreciation, and use, among other data, since 2013. Ministry-level financial statements are submitted in Excel spreadsheets to the MoF Treasury Department, which consolidates them (unofficially, at present). Oversight by the Treasury Department of spending unit-prepared financial statements indirectly assures a degree of quality control over asset records. Some spending units are making very serious efforts to document fixed assets—for example, the United Water Supply Company is using geographic information software to catalogue the location and condition of its fixed assets, and is using this information to plan major replacements and upgrades. The SAO audits spending units annually, and in doing so conducts spot checks on the accuracy of asset records.

80. MoF reflects non-financial assets in the balance sheet and depreciation expense in the operating statement. This has been done since 2010 for budgetary central government. Depreciation is calculated using straight-line methods consistent with Government Finance Statistics (GFS) 2001 and IPSAS.

81. Treasury currently is engaged in two major reforms that will affect standards and procedures relating to assets. First, MoF plans to introduce all IPSAS standards, including full accrual. It began this effort in 2012, and hopes to complete introduction by 2020, with an

[24] The State Audit Office did complete in this period two major audits involving large groups of capital projects: Capital Project Management Performance Audit in 2016, and Management of Regional Development Fund Projects Performance Audit in 2016.

additional transition period of two–three years for full application of the standards. Second, the e-Treasury budget execution information system will be expanded in 2020 to include accounting. Currently, accounting records are prepared outside the e-Treasury system. While both reforms are highly labor intensive, it is reasonable that supporting information systems would be updated in coordination with introduction of new accounting standards. An asset registration component will be included in the e-Treasury upgrade. Entering data on all existing assets and verifying their accuracy is likely to take up to two years. Due to the centralization of asset records, and linking asset records with procurement, cash expenditures, and accounting, asset records will become more comprehensive and accurate. While the initial focus is to improve asset records for accounting purposes, the challenge thereafter will be how best to use the balance sheet information for other purposes, such as infrastructure planning, maintenance budgeting, and assessment of fiscal risks.

Recommendations

Based on the assessment provided in this section, the following recommendations for investment implementation are suggested. A detailed action plan is included in Annex I.

Issue 9: The effectiveness of the monitoring system is reduced because of lack of live, retrievable data, particularly for entities outside the government.

Recommendation 9: Introduce live machine-readable data, develop interface to improve data-sharing among different data users, and introduce contract implementation data in open format. Develop an application programming interface (API) tool for "receiving from/sending data to" the SPA's new OCDS portal to allow and facilitate different types of users to access and analyze procurement data.[25]

Issue 10: Project implementation progress is not reported systematically to MoF or related line ministries.

Recommendation 10: Strengthen project implementation monitoring by issuing guidelines for implementing agencies to prepare monitoring reports covering all budgeted projects.

Issue 11: Project managers and procedures are in place at Implementing agencies, but they not project specific and there are no formal implementation plans.

Recommendation 11: Strengthen project management by issuing guidelines to prepare project implementation plans for every investment projects, regardless of financing source.

Issue 12: MoF compiles limited information on the physical stock, condition, and value of fixed assets, but this information is not taken into account in planning and budgeting for maintenance, rehabilitation, and new infrastructure needs.

[25] The types of users could be i) citizens interested in public procurement, ii) public officials interested in the management of public contracting, iii) citizens with technological skills and with the ability to reuse data to create added value. (iv) private sector representatives.

Recommendation 12: Link asset registry and accounting data with public investment planning and maintenance in the budget process.

IV. CROSSCUTTING ISSUES

A. Legal and Regulatory Framework

82. Several specific laws and regulations cover important aspects of PIM in Georgia. The PIM Methodology (issued in 2015 and developed with TA of the World Bank) contains the instruction for implementing the PIM Guidelines. It includes technical details for undertaking the procedures prescribed in the Guidelines. The PIMG Guidelines (Decree 191) were issued in 2016 to assist budgetary organizations in evaluating capital investment proposals in a consistent and comprehensive manner and in prioritizing competing projects. They provide consistent and standardized procedures for pre-selection, appraisal, and selection of public investment projects. The PPP Law (2018) provides the legal framework for developing, selecting and implementing PPP projects. It includes rules and procedures and defines the institutional framework. [26]

83. The legal and regulatory framework supporting PIM is still evolving, underscoring the need to ensure consistency among the several laws and regulations. Good practices suggest that PPPs should be regarded simply as an alternative way to procure public infrastructure. This means that PPPs should be embedded in the PIM framework. In countries that developed PIM and the PPP frameworks independently, ensuring consistency among them is imperative. In the case of Georgia, there is a need to ensure that the legal and regulatory frameworks regulating PIM and PPPs are consistent.[27] First, the PIM guidelines could be improved to provide clearer and more balanced guidelines for the various stages of the project cycle. Second, the link between PIM Guidelines and Methodology and the budget cycle can be strengthened. Annex II includes a proposal to achieve these two objectives. Third, there is room for better aligning the legal and regulatory frameworks supporting the PIM and PPPs. The secondary legislation of the PPP Law, currently being prepared, provides the opportunity to work in this direction.

[26] At the request of the authorities, the mission team met with the authorities' advisory team currently drafting the regulations of the PPP law (ADB), and with the WB's team assisting the authorities in implementing the PIM framework. Both ADB and the WB teams concurred with the need to ensure consistency between the overall PIM and PPP frameworks, and in particular in their underlying legal frameworks. The mission team shared the preliminary findings and recommendations with both teams, and agreed in further follow-up to support the authorities structural reform in this area.

[27] PIM and PPP frameworks comprise four main components: legal and regulatory framework, institutional governance structure, management processes and procedures, and accounting and reporting framework.

Improving Consistency Between PIM and PPP Legal and Regulatory Framework

84. The PPP laws and regulations for PIM are not fully consistent.

- **Timing of procurement decision**. The PIM Guidelines foresee that the decision on the procurement method—i.e., whether a project may be undertaken as a PPP, is only considered after a project has received a favourable appraisal. This is in line with good international practice as it provides for an integrated public investment process that assesses and decides on all projects independent of the method of implementation. The PPP Law allows for the identification of investment projects as PPP, deciding on the procurement method at project initiation. The implementing regulations for the PPP Law should clarify that only projects with a favourable appraisal can be considered for implementation as PPP, i.e., move to the Value for Money assessment.
- **Integration in the budget process**. According to the PPP Law, following the approval by the Government of Georgia, budgetary entities my implement a PPP project. An inclusion in and approval through the budget process is not explicitly required. PPPs often come with substantial fiscal risks and may require budget funding in the implementation phase. Thus, when the Government enters a PPP, it commits public resources to cover the fiscal risks or to be paid from future budgets. While the annual budget process does not cover the approval of future commitments under PPPs, it would be important that comprehensive information on such commitments is provided as part of the budget documents. This would allow the Parliament to approve the budget taken into consideration the magnitude of future PPP commitments, before launching the PPP procurement process.
- **Institutional arrangements**. The PIM Guidelines mandate the Economic Council with deciding on which projects may be included in the investment project list and it maintains the list, which included those projects that have been appraised favourably and which may be included in the budget entities action plans. The PPP Law mandates the Government of Georgia to authorise projects for implementation as PPP. The mission was informed that the Economic Council has been abolished. All approvals related to public investment projects, including PPPs, which have been assigned to the Government of Georgia, should be taken by a single body. The PIM Guidelines and the PPP legislation should reflect this.

85. The role and responsibilities of the MoF in the PIM and the PPP process are not clearly defined. The MoF does not have a clear and strong enough role to guard public finances –ensure viability and affordability of public investment projects.

- **The criteria for the MoF assessment of projects at the different project stages are not clear in the PIM or the PPP legal framework.** For example, in the PIM process (Article 10, 9.), the MoF assesses projects for its economic and social value. It is not clear what is meant by economic value and what the competence of the MoF is in assessing the social value. In addition, key concepts for the assessment, including economic value, budget implication, affordability, or viability are discussed but not clearly defined in the Guidelines nor the Methodology. The regulatory framework should clearly state the MoFs responsibility for assessing viability, affordability and Value for Money. The respective concepts and the assessment criteria should be clearly defined in the legal framework.

- **It is not clear whether the MoF has the power to stop a project at key decision points in case a project is not affordability, viability, and/or does not deliver value for money.** To ensure accountability, it would be good international practice, that the MOF has veto power at these decision points (gateways)—i.e., at project selection, decision on procurement method, tendering, contract negotiation, and in case of changes to the contract—to stop projects that are not affordable, not viable or that do not deliver Value for Money. If the MoF is only given an advisory role, the MoF's assessment and recommendations should be published together with the approval of the decision-making body, i.e., the Government of Georgia. The MoF would then be responsible for its recommendations and the Government of Georgia for its decision to approve any projects against the MoF's recommendations.

B. IT Systems and Data Management

86. Information technology (IT) systems for PFM consist of several sub-systems, although none of them focused on public investment management. These include: the e-Budget, e-Treasury, and e-Procurement systems, as well as e-DMS (debt management), e-HRMS (Human Resource Management System), RS.GE (revenues for tax and customs) and e-auction (sale of state-owned goods). Table 6 provides an overview of the first three of these systems.

Table 6. Georgia: Overview of Core PFM-related IT Architecture

System	When became operational	Coverage	Functions
e-Budget	2012, in conjunction with reforms to program budgeting	Used by 51 budget spending units (including. ministries and LEPLs), for budgeting for more than 900 organizations	Budget preparation (revenues and expenditures), compilation of consolidated State Budget documentation, cashflow planning, quarterly in-year budget allocations, virements (reallocations)
e-Treasury	2010	Central government spending units, LEPLs and municipalities.	Payment systems (e-payments), budget execution, expenditure control, commitment of funds, reporting on budget execution, management of spending units' personnel database (payroll module)
e-Procurement	2010, in conjunction with procurement reforms	All government contracts, including for some externally-financed projects	Procurement of government contracts and related information, including tender announcements, tender documents, decisions of tender commission, signed contracts

Source: MoF.

87. The systems are considered to support PFM procedures relatively effectively, in term of their coverage, integration, ease-of-use, and flexibility

- **Coverage**: Systems cover all central government budget entities, autonomous bodies, self-governing bodies, and LEPLs;
- **Integration**: Budget planning and execution processes use integrated e-Budget and e-Treasury systems to share information and establish controls and data verification using common classifications and real-time exchange of data. The linking of line ministries' cashflow forecasts with commitment authorization enables line ministries to plan and commit funds for the entire budget year directly through the system.
- **Ease-of-use**: The systems are used widely and appear to be well-understood.
- **Flexibility**: These systems have been developed in house, based on the needs of local PFM technical staff. Therefore, systems can be adjusted evolve over time in response to changing requirements.

88. However, the systems do not currently provide full information required for managerial decisions in a number of key areas, and in particular in PIM.

- Financial planning at the BDD and action plan stage remain outside of the system, which prevents the rolling over of information already in the system, not allowing to ensure systematically that ongoing projects are taken into account in the planning and undermining the effectiveness of the MTBF;
- The system does not capture capital project information in an accessible way. For example, initial project costs are not included in the project profile and would have to be retrieved from the first year in which the project was included in the budget. This also prevents the integration of future projected current costs arising from investment activity in the e-Budget system, which could lead to an omission of future costs in the planning and thus an under-provision for operation or maintenance;
- The system does not provide for an asset register, which would include information on the condition of the asset and thus guide maintenance planning. In addition, an asset register would be the basis for generating balance sheets as part of the financial statements;
- There is still room for improving access to procurement information for analytical purposes, including providing machine-readable information, and tools to facilitate receiving and sending data to the OCDS portal.

C. Capacity Building

89. The authorities recognized that improving public investment management will require efforts in capacity building, particularly at the MoF. While capacity constraints exist for certain skill niches in large line ministries and public corporations, overall their capacity to identify, assess, procure, and monitor investment projects is broadly adequate. The mission met with the main public investors (i.e., Ministry of Regional Development and Infrastructure, Ministry of Health, and many of the main public corporations) and all the counterparts interviewed showed significant capacity for project development, monitoring and trouble-shooting. However, the MoF seems to have large skills gaps in areas such as CBA, financial analysis, engineering, project monitoring and accounting.

90. Staff noted that the MoF overall staffing levels are inadequate, and the roles and responsibilities regarding public investment management are somehow unclear. For example, despite the current MoF organigram provides for a Public Investment Unit, it has never been functional. The Budget Department has been in practice executing PIM-related functions without additional resource allocations. The authorities informed the mission that they plan to eliminate this unit and distribute roles and responsibilities among other departments in the MoF.

91. The PIMA reinforces the need for a capacity building strategy. The PIM challenges and recommendations made in previous sections underscore the need for strengthening staffing and skill sets mainly in the MoF, but also in executing agencies. The mission did not undertake a detailed assessment in this area. Yet, experience suggest that strengthening capacity will require complementary organizational reforms including some structural staffing changes, and substantial skills development. Increase staffing and capacity are specifically required to:

- Develop strategies that link national and sectoral development objectives to specific public investment projects;
- Support preparation of more comprehensive and credible project proposals, in accordance with new PIM guidelines. This will entail improving capacity to utilize project preparation methodologies and techniques (e.g., needs analysis, project costing, cost benefit analysis, prioritization, risk analysis);
- Undertake more thorough project appraisals, particularly in the case of large, complex projects where specialist knowledge is needed or innovative financing methods, are proposed;
- Oversee experts/consultants contracted to provide technical support for feasibility, project design and appraisal studies; and
- Secure effective programming and prioritization of projects within overall constraints (sector strategies, resources, financing, etc.).
- Secure more effective project management including oversight of experts/consultants, monitoring of project progress, problem resolution, reporting, quality assurance and ex post evaluation;
- Consolidated monitoring, analysis and reporting;
- Develop incentives for optimizing the pace of implementation or re-allocating resources to other priority areas, where necessary; and
- Audit and conduct an ex post evaluation of project outputs and outcomes

Recommendations

Based on the assessment provided in this section, the following recommendations regarding cross cutting issues are suggested. A detailed action plan is included in Annex I.

Recommendations Legal and Regulatory Framework

Issue: There is a need to better align the legal and regulatory frameworks supporting PIM and PPPs

- Ensure that all public investment projects are covered by the PIM process.
- Consider distinguishing between a regular PIM process for larger projects including all PPPs, and a simplified procedure for smaller and highly standardized projects.
- Ensure, through the PIM Guidelines or in the PIM Methodology, the alignment of the PIM process with the budget cycle.
- Review PIM Guidelines and the PIM Methodology to ensure consistency and to make them more user-friendly.
- Align, through the detailed provisions of the PPP implementing regulation, the PPP process with the PIM process.
- Clearly define roles and responsibilities for the various stakeholders and ensure consistency across procedures.

Recommendations in IT systems and data management

Issue: Information technology systems for PFM are fragmented, and none of them focus on PIM, hindering effective managerial decisions.

- Ensure that the next phase of IT development supports the data management needs of the budget cycle as a whole. New elements should be actively designed and planned to work systematically and consistently across the related IT systems.

Annex I. Proposed Action Plan[1]

Action	2018	2019	2020	2021	Responsible agency
Recommendation 1: Improve national and sectoral planning					
Update the public investment component of the national development strategy, including all sources of financing, all levels of government and all procurement options.	Obtain government approval for modification to the planning framework	Design new framework. Conduct training in new framework	Implement new framework in: (i) new national development strategy; (ii) new government platform;		Government administration and MOF
Ensure that sectoral strategies: distinguish public investment; are comprehensive in coverage; include existing projects and new initiatives; include a clear resource envelop and clear definition of economic efficiency objectives; and are updated for new investment plans	Obtain government approval for modification to the planning framework	Design new framework. Conduct training in new framework	Implement new framework in sector strategies		Government administration and MOF
Ensure that the ministry action plans: are aligned with the sectoral strategies; and are fully coordinated to avoid fragmentation of PIM	Obtain government approval for modification to the planning framework	Design new framework. Conduct training in new framework	Implement new framework in BDD and ministry action plans		MOF

[1] Recommendations linked to structural reforms are not included in the action plan.

Action	2018	2019	2020	2021	Responsible agency
Recommendation 2. Improve project appraisal processes					
Implement the new PIM methodology	Review PIM methodology on basis of pilots and need to harmonize with PPP framework	Approve timeline of extending mandatory coverage of PIM methodology	Review implementation	Review implementation	MOF and line ministries
Ensure that the MOF will be responsible, in respect of all projects, for providing central support for line ministry project appraisal and for developing and maintaining the project appraisal methodology.	Approve MOF Order to allocate PIM responsibilities to different units of the MOF	Provide workshops for line ministries			MOF
Ensure that key economic assumptions in donor-funded public investment projects are consistent with the assumptions used for projects not funded by donors and by the MOF and MOESD in their economic forecasting and risk assessments.	Include in PIM Methodology approved by the order of Minister of Finance	Establish regular communication channels with line ministries			MOF
Approve a discount rate methodology and specific discount rates, reflecting the economy's opportunity cost of capital, to be applied	Undertake research (TA support needed)	Include new discount rate methodology and new discount rates in draft amended decree on PIM methodology			MOF

Action	2018	2019	2020	2021	Responsible agency
to all public investment.					
Recommendation 5. Strengthen multi-year budgeting					
Introduce a rolling baseline in the budget process		Develop methodology and simple model for ministries to prepare their baselines for each program.	Train MOF and spending ministry staff in the methodology and model.	Incorporate preparation of the baseline projections into the budget process	MOF
Strengthen the credibility of outer-year capital projections	Design reconciliation tables to be used in the BDD/budget documents for capital spending projections over the medium-term.	Use e-budget system functionality to fill in ministries' medium-term capital projections as base for their preparation of BDD/budget submissions. Include in budget instructions that ministries should provide reconciliations of their medium-term capital spending projections on a rolling basis and explanations of significant changes.	As part of the training on the rolling baseline discuss its role in strengthening the credibility of medium-term capital projections.		MOF
Improve the clarity and linkage between different parts of the budget documentation	Include in Chapter VIII of the budget document the agreed definitions of capital/investment and capital/investment projects.	Include in the budget document additions to existing and new tables to consistency and enable linkages to be made between chapters III, VI and the capital projects annex			MOF
Recommendation 6. Implement mechanisms to prioritize the completion of on-going projects in the budget process					
Facilitate and improve transparency for the prioritization of on-going projects in the budget process	Specify in BDD/budget instructions that spending ministries should prioritize the completion of on-going projects over new projects in their budget	Use the e-Budget system to pre-fill ministries' existing project commitments for the coming budget year and medium-term period.	E-Budget system to include realistic total project costs, disaggregated by main category of costs.		MOF

Action	2018	2019	2020	2021	Responsible agency
	submissions.	Focus on status of on-going projects during budget negotiations with ministries; require them to provide clear justification for beginning new projects alongside their on-going project portfolio.			
Recommendation 7.	**Develop standardized methodology for estimating maintenance needs**				
Develop a standardized methodology for estimating current and capital maintenance needs Incorporate a review of the adequacy of planned maintenance expenditures in budget negotiations		Approve timeline for developing the methodology for particular asset classes, based on relevant international experience.	Develop a methodology for particular asset classes, based on relevant international experience. maintenance.	Include a review of planned maintenance expenditures in MOF's templates for its review of ministry submissions. Enable IT systems to link data on asset conditions from asset registers into planning and budgeting systems.	MOF
Ensure future maintenance spending is captured in the full life-cycle costing and analysis of new projects			In line with the new PIM procedures, ensure that the documentation required for the analyses of the project includes the preparation of full life-cycle costs	Training for MOF and spending ministry staff on preparing life-cycle project costs	MOF
Ensure maintenance spending is explicitly budgeted and reported for all relevant assets			Provide in the budget documentation for an annex on annual and medium-term allocations and projections for maintenance spending	Ensure budget execution reports include comparisons by ministry of planned and actual maintenance expenditures	MOF

Action	2018	2019	2020	2021	Responsible agency
Recommendation 8.	**Operationalize the project selection procedures in the PIM Guidelines/ Manual and incorporate in the budget process**				
Apply project selection procedures to all public investment, regardless of the funding source Formalize and incorporate new PIM procedures in annual budget calendar/process	Devise an implementation plan for the new procedures, including overall timetable and setting out specific activities and timing for operation of the new procedures for each type of stakeholder	Adopt a timeline for procedures to be covering all projects regardless the funding source.	Implementation of the plan.	Implementation of the plan.	MOF, new PIM co-ordinating body
Take decisions on key outstanding PIM procedures			Decide on thresholds of project to determine extent of project appraisal to be undertaken; criteria for independent review of appraisals by MOF; and the criteria (checklist) for Government to approve projects for inclusion in the list of approved projects		MOF, new PIM co-ordinating body
Enforce gatekeeping role by MOF	Work with the PIM co-ordinating body to ensure the effectiveness of the gatekeeping role	Prevent projects from bypassing the procedures and being parachuted into the selection process			MOF, PIM co-ordinating body
Set out a clear documentation trail for selection decisions at two key stages: for entry into the approved list of projects (pipeline); and for final inclusion in the budget (accountability)	Incorporate in the new procedures the documented steps which will be required for recording selection decisions and how they will be documented	Implement the documentation/ recording procedures.			MOF, new PIM co-ordinating body

Action	2018	2019	2020	2021	Responsible agency
Recommendation 9:	**Strengthens procurement practices**				
Introduce live machine-readable data		Improve current systems to introduce live machine-readable data			SPA
Develop an application programming interface (API) tool for "receiving from/sending data to" the SPA's new OCDS portal to allow and facilitate different types of users to access and analyze procurement data.			Develop the application	Test and improve the application.	SPA
Recommendation 10:	**Strengthen project implementation monitoring**				
Issue guidelines for preparation of capital project monitoring reports		Design monitoring and reporting system. Align with standard project profile and implementation plan. Align with new FMC system.	Pilot in two ministries with significant capital project implementation responsibility, e.g. Ministry of Regional Development and Infrastructure (MRDI).	Revise design on basis of pilot, if needed, and expand to other implementing agencies	MOF MRDI
Recommendation 11.	**Strengthen project management**				
Issues guidelines for preparation of project implementation plans		Design project management data and forms. Standardize to enable consolidation and reporting; more detail can be added for specific project / agency requirements. Align with monitoring system.	Pilot in same ministries as project monitoring / reporting system	Expand to other implementing agencies in coordination with new monitoring / reporting system	MOF MRDI

Annex II. Making PIM Guidelines Clearer and Balanced

1. **Presentation and clarity of the PIM Guidelines could be improved.** The Guidelines cover the entire project-cycle, i.e., project screening and pre-selection, project appraisal, project selection and budgeting, project implementation, project monitoring and ex-post evaluation.

2. **The PIM Guidelines:**

- **Are not easy to follow because of its complex structure.** The separation of process and roles and responsibilities makes it very difficult to see how the different actors are fulfilling their responsibilities within the process and might have caused some gaps and inconsistencies in the processes. For example, Article 12 covers the roles and responsibilities in the project selection process without referring to the role of the MoF or to the project list, which is an essential input to the process. Also, Article 14 defines the roles and responsibilities for project monitoring without mentioning the role of the budgetary (implementing) entity, or the need for preparing a project implementation plan against which progress would be monitored. A clear presentation of the process together with the actors and their responsibilities would be helpful to ensure a comprehensive and consistent design of procedures and clear accountability of actors. This would be a precondition for the effective implementation of PIM.
- **Are overburdened with details on project appraisal.** The project appraisal methodology (Article 9) is covered in greater detail than the other stages of the project cycle. About half of the guidelines related to the project cycle are devoted to project appraisal, discussing for example how to assess the value of relevant costs and benefits and how to calculate a present value. Such detail would be better suited for a methodological manual.
- **Interfere with the organization and management of economic entities.** Article 6 provides for how the economic entity organizes the preparation of the project concept note. To ensure clear responsibility and accountability, the guidelines could focus on the responsibility of the head of the entity to submit a Project Concept Note and on the criteria that should be considered when proposing a project.
- **But do not clarify PIM related organizational structures in the MoF.** There is no detail being provided on what structures in the MoF would undertake the MoF's tasks and on how these would interact, e.g., whether the budget directorate or the Fiscal Risk Unit would assess Project Concept Notes. Such detail is not necessarily needed in the Guidelines but could be provided in the Methodological Manual (this is not the case in the existing Methodology).

3. **Improving the link between PIM guidelines and the budget process would require paying attention to the following issues**:

- **The coverage of PIM guidelines and methodology is partial.** The Guidelines and procedures do not apply to projects financed by donors. While the donors' project appraisal and project implementation practices might be consistent with the methodologies under the

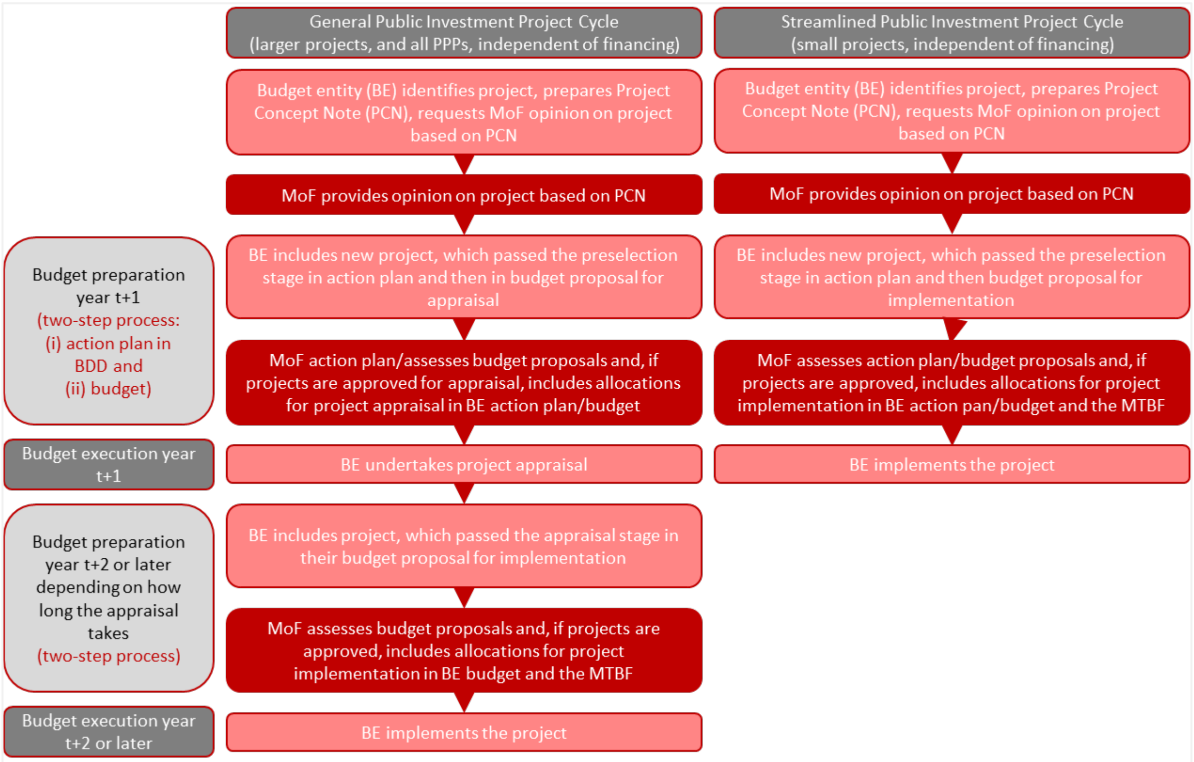
PIM Guidelines and Methodology, excluding donor financed projects from the PIM process creates a parallel selection process and thus a parallel project pipeline. Thereby, projects might be selected based on financing considerations and not based on political priorities. However, donor financed projects absorb fiscal resources that could otherwise be used for projects financed though other channels, or other projects financed by the same source (e.g., road A instead of road B). To ensure that public resources are allocated in line with policy priorities across various spending needs—i.e., across different projects independent of their financing—all project selection should be done in a single process.

- **The PIM process is not fully aligned with the budget process.** The Government of Georgia cannot stop the development of projects that would not be considered a priority or that would not receive budget funding. Budget entities develop projects and may take projects through the appraisal stage after receiving a non-binding opinion from the MOF. Project appraisal, in particular for large projects, requires significant resources. These resources should only be made available for appraising projects that are a Government of Georgia priority and that may thus receive funding in case of a favourable appraisal. This allocation of resources should be done through the budget process where pre-selected projects can be suggested as part of the budget entity's action plan to receiving allocations for appraisal. Figure 27 shows the integration of the project cycle with the budget process. In the first budget year, resources would be allocated for project appraisal and after a favourable appraisal, in a later budget year, resources for project implementation. There could be a streamlined process for small and highly standardized projects, which would not require a full appraisal as the basis for the resource allocation decision.

4. The coverage and the substance of the PIM Methodology is not consistent with the PIM Guidelines.

- **The Guidelines and the Methodology seem to apply to a different set of public investment projects.** While the Guidelines explicitly exclude projects financed by donors under the ratified agreements through observing the basic principles of investment project management, the Methodology applies to all public investment projects independent of their functional nature or funding source. It would be important to make these consistent, expanding the coverage under the Guidelines to all public investment projects as discussed above.
- **The Methodology covers only part of the process laid out in the Guidelines.** The PIM Methodology covers only pre-selection, project appraisal, and project selection and budgeting, with major emphasis on project appraisal. Project implementation, project monitoring and ex-post evaluation are not covered by the Methodology. These phases are important and have not received a lot of intention in current practices (see Section III.D). It would be important to provide more support for these phases in the Methodology.

Figure II.1. Alignment of PIM and Budget Process



Source: Staff.

- **The roles and responsibilities are not fully consistent between the Guidelines and the Methodology.** For example, according to the Guidelines, the MOF, after examining the project appraisal prepared by the budgetary entity, submits the project together with its conclusions to the Economic Council for further discussion and the Economic Council draws up the list of projects. According to the Methodology, the MOF submits a list of eligible projects to the Economic Council of Ministers for final approval. To ensure accountability in the PIM process, roles and responsibilities should be assigned clearly and consistently.
- **The Guidelines and the Methodology overlap in coverage as details on the project appraisal methodology are included in both.** To make the documents more user-friendly, it would be preferable to consolidate the details on the appraisal in the Methodology. This would also make the Guidelines more balanced in terms of weight given to provisions for the various stages of the project cycle.
- **The Methodology repeats parts of the Guidelines.** For example, the definitions provided in the Guidelines and the Methodology are largely overlapping. This can lead to inconsistencies, especially if one document is updated without making the same changes to the other. For things covered in the Guidelines, it would be preferable to have a reference in the Methodology to the relevant provisions.

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