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ACRONYMS & ABBREVIATIONS

AoI	Agreement of Intention
ASYCUDA	Automated Systems for Customs Data
BER	Bid Evaluation Report
CAS	Country Assistance Strategy
CIS	Commonwealth of Independent States
COC	Chamber of Control
CPAR	Country Procurement Assessment Report
DP	Direct Procurement
DLC	Distance Learning Center
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia Region
EU	European Union
EU-TACIS	European Union Technical Assistance for CIS countries
GATT	General Agreement on Tariffs and Trade
GCC	General Conditions of Contract
GEL	Georgian Lari
GOG	Government of Georgia
GPA	Government Procurement Agreement of the WTO
IAPSO	Inter-Agency Procurement Services Office
IAS	International Accounting Standards
ICB	International Competitive Bidding
ICC	International Chamber of Commerce
IDF	International Development Fund
IFI	International Financial Institution
IMF	International Monetary Fund
IR	Regulations on Implementation of State Procurements
ISA	International Standards on Auditing
ISO	International Standards Organization
ISP	Internet Service Provider
ITB	Instructions to Bidders
L/C	Letter of Credit
LSP	Law on State Procurement
MEIT	Ministry of Economy, Industry and Trade
MOE	Ministry of Economy
MOD	Ministry of Defense
MOF	Ministry of Finance
MOIA	Ministry of Internal Affairs
MOSS	Ministry of State Security
NACP	National Anti-Corruption Program
NCB	National Competitive Bidding
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
OT	Open tendering
PRSP	Poverty Reduction Strategy Paper
RT	Restricted Tendering
SAC	Structural Adjustment Credit
SBD	Standard Bidding Documents
SCC	Special Conditions of Contract
SOE	State Owned Enterprise

SPA	State Procurement Agency
SPD	State Procurement Department
SRS	Structural Reform Support
SS	Single Source selection
TA	Technical Assistance
TACIS	Technical Assistance to the Commonwealth of Independent States
UNCITRAL	United Nations Commission for International Trade Law
WTO	World Trade Organization

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PREFACE

Basis of Report

This report was prepared on the basis of the findings of a World Bank mission to Georgia from February 20 to March 2, 2001 by a Task Team comprised of Ms. Els Hinderdael, Team Leader and Mr. Denis Robitaille, Senior Procurement Specialist, and Elene Imnadze, Public Sector Specialist. It also takes account of developments up to June 2002 when the SPA, with the support of the Bank, organized a workshop in Tbilisi to discuss the draft CPAR and develop a targeted action plan based on its findings. The Bank team represented at this workshop comprised Els Hinderdael, Pamela Bigart, Elene Imnadze and Peter Trepte (consultant).

The report is based on the results of interviews with more than 30 public and private institutions (see Annex 5), at the central and municipal levels of the Georgian public procurement system, as well as on detailed analysis of the laws, documents and other information collected.

On the part of the Government of Georgia (GOG), the Ministry of Economy, Industry and Trade (MOEIT) dedicated a high-level team to work alongside the Bank's mission on this assessment, headed by Mr. Temur Khomeriki, Head of the State Procurement Department and also comprising Mr. Giorgi Tvalavadze, Deputy Head, Legal Division of the State Procurement Department. The GOG counterpart team lent their full and proactive support to the CPAR mission and engaged with the Bank's team in a comprehensive dialogue about the issues identified by the assessment. The Bank is grateful to the Government of Georgia for this cooperation.

There has been strong support of the CPAR team's work, demonstrated by collaborative involvement during the preparation of this CPAR from the government, Parliament, the business community, and civil society. The CPAR findings and recommendations will also feed into the ongoing preparation of Georgia's Poverty Reduction Strategy Paper (PRSP), and thereby into the Country Assistance Strategy that is now being finalized.

Purpose of the Report

The Task Team focused on procurement systems at the Central and to a lesser extent at the Local Government level. The primary objectives of the CPAR are:

- to provide a comprehensive analysis of the country's public sector procurement structure, including the existing legal framework, organizational responsibilities and capabilities, and present procedures and practices, including how these may differ from the formal rules and procedures;
- to undertake a general assessment of the institutional, organizational and other risks associated with the procurement process;
- to establish the basis for dialogue between the country and donors on how to streamline and improve the economy, efficiency and transparency of public sector procurement;
- to develop a detailed action plan for reform to achieve institutional improvements, including interim modifications to existing practices in the country, so that contracts financed under current projects will meet the Bank's procurement standards, pending completion of the broader reform program; and
- to encourage better commercial practices in the private sector.

Acknowledgements

The mission members wish to acknowledge the extensive cooperation and assistance received from officials and staff of the public organizations, state agencies and private companies interviewed. Ms. Cheryl Martin, Country Officer of the Bank's Country Director's office for Georgia and Mr. Tevfik Yaprak, Chief of the Bank's Tbilisi office offered the mission invaluable assistance. The mission would also like to extend its thanks to Mr. Joel Turkewitz (Senior Public Sector Specialist, WBIGF) for his extensive assistance in the preparation of the strategic workshop held in Tbilisi in June 2002. Ms. Teona Yanghvelatze, Team Assistant in the Bank's Tbilisi Office, assisted with arrangements for the mission. Ms. Suzanne Snell (Consultant) assisted with the editing and formatting of the report. Ana Cristina Hirata also assisted in the formatting of the report.

Executive Summary

1. In light of its strategy for an accelerated transition to a market economy, Georgia has made tremendous efforts to provide a legal base for the required changes and has adopted a multitude of laws at a rapid pace, starting in 1993. In fact, Georgia's long-term visions and ambitions to integrate into European economic and political structures and the wider world economy provide a clear direction to its foreign policy.

2. With the notable exception of enforcement provisions, the scope of existing Georgian legal instruments would be adequate to control the procurement process in Georgia, if they were widely followed. The main issue is not the lack of legislation but rather the effective application of the legislation that is already in place. Part of the delay in implementing reform has been due to a radical reorganization involving the dissolution of the Ministries of Economy, Industry, Trade, and Foreign Economic Relations, and their consolidation into a single Ministry of Economy, Industry and Trade. Ministerial interference in procurement agency's decision-making, inadequate procurement agency budgets, and low levels of awareness of legal and regulatory provisions have slowed the reform process, despite strong top-level commitment. But possibly the most important underlying force that is slowing effective implementation is the persistence of traditional patterns of patronage that are nourished by and perpetuate non-competitive procurement procedures and practices.

Achievements to Date

3. As a result of the Government's determination and technical assistance provided under a World Bank Institutional Development Fund, public procurement is now guided by a single overarching law. The Law on State Procurement (LSP) was adopted in December 1998, enacted by Parliament in July 1999, and amended in March 2001. The LSP is modeled on the UNCITRAL Model Law and although it lacks enforcement clauses and a few other improvements are possible, by and large it forms a good basis for increased efficiency and transparency in public expenditures. An assessment of the LSP confirms that progress has been made in assimilating international standards and best practices.

The Need to Broaden Application and Scope of LSP

4. Despite an acceleration in establishing a sound legal framework, backed by donor funding and political will, the procurement reform agenda has not yet been completed, and procurement reform is going very slowly. Although in 2000, some 20 percent of the State budget of Georgia, representing 2.5 percent of GDP, was spent to procure goods, works and services, two years after the enactment of the Law, only 12 percent of public procurement has been conducted competitively in accordance with the LSP.

5. For one thing, a substantial volume of procurement using extra-budgetary funds was conducted beyond the reach of the LSP. For another, procurement by State Owned Enterprises (SOEs) was not subject to the LSP. In addition, procurement related to state security is excluded from the LSP and the largest procurers—Power Bodies in charge of defense and security—avoid application of the LSP by presenting general procurement as procurement related to state security. The March 2001 amendments to the LSP have now stipulated that off-budget funds and funds from SOEs shall be brought into the State budget and LSP, and this is a major step in the right direction. **The CPAR recommends** that the list of procurement identified as relating to national security be cleared by the SPA to ensure that Power Bodies procure general items in accordance with the LSP (section 1.7).

6. The regulations that implement the LSP also unnecessarily restrict competition in two respects. **The CPAR recommends** that foreign bidders be allowed greater access and that open and restricted bidding be more broadly applied (section 3.4.1, 3.4.2).

The Need for an Independent State Procurement Agency

7. An adequate governance structure is key to successful implementation of public procurement reform, and this requires that an independent and autonomous agency be created that reports to a level higher than ministerial level. While the original designation of the Ministry of Economy as the entity responsible for state procurement has been modified and a state procurement agency created, the Ministry still basically controls the agency. Whilst the creation of the State Procurement *Agency* (as opposed to the Department that it was) has improved the situation, the SPA is still subordinate to the MoE. During further discussions which took place on the occasion of the workshop held in Tbilisi in June 2002, it was clear that a further change in the SPA's status could not take place in the immediate future. However, the issue is recognized and the Minister of Economy undertook to reconsider the status of the SPA after one or two year's operation. **The CPAR continues to recommend** that the state procurement agency be given status that is truly independent and beyond the reach of influence of the Ministry of Economy, Industry and Trade. It needs to be free to implement its mandate of being a regulating and monitoring body that ensures compliance with the Law on State Procurement by all public entities and that provides the required oversight and coordination at the national level. In light of the recent political development to establish a Cabinet of Ministers, the CPAR recommends that the current governance structure be reconsidered and that the SPA be put under the Cabinet's control (section 2.3).

8. There has also been a chronic shortage of funds for implementing procurement reform and the situation has not improved between the date of the first CPAR missions and the date of this current CPAR. **The CPAR recommends** that SPA be given proper funding from the State budget, essential for it to implement its functions successfully (section 2.3).

The Need to Put Teeth into the Law

9. The limited application of the law and its regulations can be blamed on a lack of awareness of the law's provisions, a lack of enforcement measures, and a culture that is overwhelmingly fatalistic about, if not dependent on, patronage and corrupt behavior. Surveys have found that the public accurately perceives that the laws are fine but that executive implementation of them is weak, and that enforcement through the judiciary is not to be expected. All the incentives currently favor the perpetuation of vested interests and do not reward those who want to follow competitive procurement practices.

10. **The CPAR recommends** a full range of legal, regulatory, budgetary, training, dissemination, audit reform, and value-shifting measures to establish incentives for complying with the procurement law in particular, and to foster the growth of a culture of compliance in general. The key recommendations are:

- to introduce enforcement mechanisms into the LSP and amend the Criminal Code (the Administrative Code and Code on Administrative Violations have already been amended to this effect) to make procurement fraud a punishable crime (legal, section 1.7),
- to define State Procurement Agency authority to raise issues of non-compliance and wrongdoing with the respective authorities so they can initiate actions against offenders of the LSP and its regulatory provisions (regulatory, section 3.4.9),

- to establish checks and balances with budget information at the Ministry of Finance that will disclose non-compliant activities (budgetary, section 2.3),
- to develop a rolling multi-year budget allocation plan, that includes projections for the two years following its approval, so that long-term contracts can be planned for and efficiently executed (financial, section 2.5),
- to launch a procurement Web site with a full range of information and documentation, (dissemination, section 2.9),
- to develop a training strategy to build capacity within the procuring entities as it is not feasible for the SPA to train all entity staff. (training, section 2.7), and
- to publish procurement blacklists and procurement audit findings, and ensure that broader anti-corruption initiatives include procurement stories and hotlines for procurement complaints and whistle-blowing (shifting values, section 2.9, 4.4).

11. The public sector and business people who deal with procurement matters need training and accreditation programs to be made widely available within as short a timeframe as possible. **The CPAR recommends** that the Bank support development of a national training strategy for public procurement and auditing, development of curricula leading to certificate and degree programs, and recognition of the procurement profession through the roster of professions and accreditation (section 2.7, 2.9, 4.2).

The Need for Audit Reform and Anti-corruption Priorities

12. In order to establish an efficient system to audit public expenditures and to fight corruption, **the CPAR recommends** that Government consider development and implementation of a medium-term strategy for the reform of the country's supreme audit function which would

- Design and implement an effective system of internal audits within each procuring entity, coordinated possibly by an internal audit unit in the Ministry of Finance. The internal audit units would not be subordinate to the Chamber of Control. The units would have a wide mandate to supervise all budgetary expenditures in terms of strictly defined and uniform criteria (section 4.2).

13. The Government may consider the following recommendations in the finalization and implementation of the NACP:

- Prioritize public sector reforms proposed under the NACP in light of available resources. In the medium-term, priorities should be given to improving: (i) public expenditure sector management (budget, audit, procurement and finances); (ii) performance of revenue-collecting agencies; (iii) civil service employment requirements and conditions; and (iv) policymaking institutions (section 4.4).

A – SUMMARY OF FINDINGS

STRENGTHS AND WEAKNESSES OF THE PUBLIC PROCUREMENT SYSTEM

Public Sector: The Public Procurement Regime

1. Legal, Regulatory and Institutional Framework

1.1 Economic and Political Background

In 1783, Georgia signed a treaty with Russia in order to protect itself from attack by the Ottoman Empire. In 1801, Georgia became a province of Russian Empire and remained so until the 1917 Russian Revolution. On May 26, 1918 Georgia declared its independence and formed a democratic state. In 1921, the Russians annexed Georgia for the second time, this time under a Bolshevik government.

In 1922, Georgia became a member of the Trans-Caucasian Socialist Federation, and in 1936, a republic of the USSR. During the Soviet period, Georgia was one of the more prosperous republics. After the dissolution of the Soviet Union, there was a break of economic relations with other former Soviet republics. Georgia's re-declaration of its independence on April 9, 1991, was followed by two years of political instability. Separatist movements in the regions of Abkhazia and Tskinali (South Ossetia) created civil unrest and armed conflicts, with negative impacts on the economy.

The reestablishment of political stability in 1993 enabled the implementation of a program of structural macroeconomic reforms and a return to economic stability. The priorities have been addressing the enormous budget shortages and making the transition to a market economy.

The 1995 elections for president and parliament and adoption in the same year of a new constitution launched a process of internal political reform. The new constitution declared the wish of the Georgian people to live in compliance with the principles of democracy and the protection of human rights.

The focus of Georgia's foreign policy has been to foster cooperation with other countries and to integrate itself into regional and international structures. Georgia is diplomatically recognized by more than 100 countries and is a member of the CIS (1994), the European Council (1999), and the World Trade Organization (WTO) (2000, less than four years after applying for membership). Georgia is currently preparing to become a signatory to the WTO's Agreement on Government Procurement (GPA).

Against the backdrop of major reform requirements driven by fiscal considerations, Georgia has maintained its determination to make the transition to a market economy, and has initiated an impressive reform agenda covering such areas as budgeting, licensing, and procurement. Most subsidies have been abolished, taxation and banking control have been improved, prices and trade have been liberalized, state enterprises are being privatized, and a new legislative base has been established.

As a result of political stability and economic reform, foreign investors and international donors have been attracted to Georgia.

1.2 Government Structure

Georgia is a presidential republic. Political power is based on a classical democratic model with an executive (the president), a legislative body (the Parliament) and a judiciary. Although there is some influence from the Anglo-American Common Law on the Georgian Civil Code, specifically in the areas of economy and trade, Georgian Law finds its place in the legal family of Continental Europe. The historical background of Georgian legislation is rooted in Soviet Civil Law, which is mainly based on Roman-German legislation.

A review of the Law On the Structure and Activities of Executive Power (April 1997) reveals the complexity and multiplicity of central and local executive bodies in Georgia. The executive agencies of the Abkhazian and Ajarian Autonomous Republics are independent executive bodies of Georgia. There are over 2,000 bodies exercising executive power in Georgia. At the central level, there are more than 40 government agencies, including 20 ministries, 12 state departments (statistics, archives, veterans, roads, forestry, sports, youth, and others) and six state inspectorates.

Local government entities have executive power over matters of local jurisdiction, including local roads, water and sewerage infrastructure, education, health care, culture, and sports, and are regulated by the organic Law of Georgia on Local Self-Governance and Governance. The Law says that transfer of specific central functions to local governments is allowed only when accompanied by the transfer of corresponding material and financial resources. However, reality indicates that this transfer is the exception rather than a rule.

1.3 Public Procurement Policy

After the abolishment of the Soviet State Order system, which provided poor incentives for efficient use of resources, the first order regulating state procurement was a 1993 cabinet decree that was not based on the principles of competitive tendering (Decree No. 264 of the Cabinet of Ministers of Georgia on Supplying Production and Goods for the State Needs of the Georgian Republic, March 30, 1993). In the absence of supporting procurement regulation, some procuring entities continued to rely on their traditional supply sources, and many developed internal procurement procedures. Public procurement was conducted in an inefficient and non-transparent manner.

Public procurement practices evolved with the gradual realization that tendering should be competitive. A 1996 presidential decree addressed military procurement and a 1998 law covered civil works. Part III, Chapter One of the Civil Code (June 26, 1997) is completely devoted to Contract Law. The principle of fairness of agreements was introduced, along with the principle of contractual freedom.

In 1996, Georgia signed the Partnership and Cooperation Agreement (PCA). The PCA provides a framework for EU-Georgia relations, including political and trade cooperation, and aims at the approximation of Georgia's existing and future legislation with that of the EU, including laws governing public procurement. The agreement states that "the Parties shall cooperate to develop conditions for open and competitive award of contracts for goods and services in particular through calls for tenders" (art. 50).

The EU also made a commitment to provide technical assistance for legislative cooperation, related to implementing the approximation of laws. The World Bank made an IDF Grant available to Georgia in April 1998 to fund technical assistance in drafting public procurement legislation and implementing regulations for public and private sector use.

1.4 The Law on State Procurement (LSP)

The combined efforts of GOG and technical assistance resulted in the Law on State Procurement (LSP), adopted in December 1998 and enacted by Parliament on July 1, 1999. Although other related laws have contributed to the development of the public procurement system, the LSP is a major step towards real reform of the public procurement system. The LSP is modeled on the UNCITRAL Model Law and forms a good basis for increased efficiency and transparency of public expenditure. Its purpose is to ensure efficient spending of state resources through a competitive and transparent process that restores the public's confidence in the system

The LSP is an organic law that describes the general rules for state procurement and requires adoption of normative acts for its implementation. To date, normative acts have been adopted that

- provide implementing regulations (Regulations on Implementation of State Procurements (IR), August 1999),
- provide measures for public procurement reform (Presidential decree No. 403, On Measures for protection of rules, established by the Georgian Law on State Procurement and for the Implementation of the Reform of the State procurement system, May 7, 2000);
- regulate the collection of tender fees (Ministerial Order No. 84, Rules for payment and reimbursement of Tender Fees upon effecting the state procurement through resources from the state budget by means of tender).

The law was amended in March 2001 to extend its applicability to off-budget funds (see 1.5) and to give the implementing agency, the State Procurement Agency, increased autonomy (see 2.2). The Amendments were adopted by Parliament on March 30, 2001. The Charters of the Board and of the SPA were approved by the President on June 5, 2001 as Presidential Decrees No. 224 and No. 223 respectively.

1.5 Scope and Applicability of LSP

The Law applies to the procurement of all goods, works and services funded from the State and local budgetary resources, the budgets of the Abkhazian and Adjarian Autonomous Republics, and the budgets of other Georgian local units. The March 2001 Amendments also make funds received as international assistance and loans extended under the GOG's guarantee subject to the LSP, along with funds of public or private legal entities wholly or partially government owned (with the exception of the National Bank of Georgia). With regard to international funds, Article 3 of the LSP provides that if the LSP is in conflict with the provisions of the international agreements, the latter shall prevail.

Although the LSP does not apply to procurements financed from funds from the National Bank of Georgia, on May 31, 2001, the Board of the National Bank of Georgia approved procurement guidelines by the NBG in their board decree No. 19. These regulations make no reference to the LSP but are generally in line with it (for example, same thresholds).

There were two important exceptions to the applicability of the law as originally adopted that undermined its effectiveness. First, until the March 2001 enactment of the Amendments to the LSP, procurement from extra-budgetary funds was not subject to the LSP. Procurement funded from the extra-budgetary funds was not transparent and did not follow competitive procedures, resulting in arbitrary, non-competitive award of contracts and inefficient use of funds. A large amount of procurement is financed from extra-budgetary funds, collected by the government bodies as monetary penalties, income from sale of state property, as well as other sources, and mostly used at their own discretion.

The other exception is state procurement related to state secrets, for which the “power ministries”—Ministry of Defense (MOD), the Ministry of Internal Affairs (MOIA) and the Ministry of State Security (MOSS)—are responsible. The Georgian Law on State Secrets specifies that such confidential procurements are to be conducted in accordance with Presidential Order No. 11, (January 14, 1999) which provides the rules for conducting tenders to procure and order goods for military and defense purposes. This order specifically states that ordinary goods and food items are not subject to the special rules and would therefore fall under the LSP. A list of eligible state secret items is published and updated every three years, including ammunition, strategic raw materials, military infrastructure, technology, research and development; and production of bank notes and securities.

However, in practice, the power ministries, who are the largest procurers, often present general procurement as state secret procurement, thereby avoiding application of the LSP. This practice is a major impediment to ensuring efficient use of a large percentage of the state funds. This loophole is addressed in the March 2001 Amendments to the LSP, which require implementing regulations for such procurements to be developed by the National Security Council (NSC) and approved by the President of Georgia by June 1, 2001 (art. 26 [5]). But the NSC has responded that there is no need to do this because the existing Order No. 11 sufficiently regulates procurement of items related to national security.

1.6 Slow Pace and Lack of Enforcement

At the time of the CPAR mission’s February 2001 visit, the reform did not yet seem to be working well. More than eighteen months after the enactment of the Law, only 12 percent of public procurements had been conducted based on competitive procedures in accordance with the LSP. Eleven percent were conducted by open tendering, 1 percent by restricted tendering, and the rest of procurement was conducted on a sole source basis (see 5.1, 5.2).

In 1999, only 144 procuring entities (60 central budget and 84 local budget entities) had reported at least one procurement that followed methods provided for in the LSP. This represents only a small fraction of the 2,000 central budget and of the more than 6,000 local budget entities that conduct procurement.

It is not unusual to see a gap between the intended procurement reform and actual progress made. While the CPAR mission found strong commitment to procurement reform in the president’s office and among some top officials, there are also competing interests at the ministerial level that are less supportive. For this reason, it is important for the Bank to maintain pressure through the stringent conditions regarding procurement reform included in the Third Structural Adjustment Credit (SAC III, May 1999). These include agreement on indicators to measure progress and on performance benchmarks for central and local agencies with large procurement budgets. SAC was paired with a Structural Reform Support (SRS) project (June 1999) that includes technical assistance, equipment, and training to strengthen the State Procurement Department (SPD), recently strengthened and renamed the State Procurement Agency (SPA; see 2.2).

The March 2001 amendments to the LSP close, or provide for the closure of, the largest loopholes in applicability of the LSP (see 2.2). But the LSP also fails to provide for disciplinary actions against officials of procuring entities who fail to follow LSP provisions or normative regulations. This lack of enforcement mechanisms seriously weakens the law’s effectiveness.

1.7 Recommendations for Adjusting the Legal Framework

Whilst the National Security Council has already prepared a list of products attracting the use of confidential procurement procedures, **the CPAR recommends** that the NSC provide for implementation of regulations for confidential procurements of the law enforcement agencies (the “power ministries”), and that the list of procurement identified as relating to national security, is cleared by the SPA to ensure that Power Bodies procure general items in accordance with the LSP. The LSP should also be further amended to provide for effective enforcement and penalties for ignoring LSP and normative regulation provisions. The implementing regulations for the LSP should also be amended to fully reflect the amended law. The Administrative Code and the Code on Administrative Violations have been amended to provide for such penalties but the proposed amendment to the Criminal Code is still under discussion by the Georgian Parliament. These amendments must be made as soon as possible.

2. Organization And Resources

2.1 Procurement and Contracting Authority

Central government procurement functions are restricted to policymaking and monitoring. The responsibility for policymaking in procurement rests with the executive. The Ministry of Economy (MOE), now merged into the Ministry of Economy, Industry and Trade (MEIT), was the main executive body responsible for initiating procurement laws, prior to the establishment of the State Procurement Department (SPD). However, SPD’s continued dominance by MEIT limited the autonomy that SPD was intended to enjoy under the LSP. SPD also held responsibility for monitoring compliance with the LSP and procuring entities were required to report to the SPD on the use of state funds. Even with the creation of the new SPA, it is still dependent, at least administratively, on the MEIT.

The authority to conduct procurement is totally decentralized to the procuring entities, which number about 2,000 on the central and 6,000 on the local level. Each of the 8,000 entities has its own budget line in the state budget and receives an allocation for its procurement needs and has the authority to conduct procurement. There are more entities authorized to conduct procurement than there are state bodies because, for example, the Ministry of Education has several procuring entities, one in the Ministry and others in research institutes, musical boarding schools, libraries and so forth.

The rights and obligations of the procuring entities are defined by article 5 of the LSP and article 4 of the Implementing Regulations. They are responsible for the efficient implementation of state procurement activities. Their capacity varies widely from entity to entity (see 2.7).

The authority to contract belongs to the procuring entity. Normally, the head of the entity signs the contract and there are no unnecessary levels of approvals or cumbersome procedures for conclusion of a contract.

2.2 Role of the State Procurement Agency

The LSP as originally enacted assigned responsibility for coordinating state procurement to the Ministry of Economy (MOE). The State Procurement Department (SPD) was established as a structural unit within MOE. The Minister of Economy nominated the head of the SPD, who served at the pleasure of the President of Georgia. The SPD was staffed and a few of the staff

went on short study tours in 1999, financed by IDF. Further needed dissemination and training efforts are described below (see 2.6 and 2.7).

However, most procuring entities basically chose to ignore the new mechanisms established by the LSP, as well as SPD's efforts to implement them. SPD's status as a structural unit within MOE did not give it the standing it required to ensure proper oversight and to enforce compliance by other state agencies.

Following the April 2000 Presidential elections, the Ministry of Economy was merged with the Ministries of Industry and Trade, and a new minister was appointed. In July of 2000, the SPD head and its staff were replaced, despite the clear objections of the Bank, which viewed such a move as a waste of the capacity that had been built up in the unit. The new head established a unit with 15 specialists with education in engineering, law, and business administration. They are, however, not sufficiently trained.

Under pressure to meet the conditions of SAC III, the new MEIT management drafted amendments to LSP that would establish SPD as an independent public entity and rename it the State Procurement Agency (SPA). SPA would have authority to develop normative regulations and standard bidding documents and would be responsible for training and dissemination of information about procurement, and for monitoring, supervision, and conducting administrative reviews.

A new Supervisory Board would be established to ensure transparency in the public procurement system and SPA's activities. The board would consist of seven members, to be appointed by the President of Georgia, of which four are expected to be the representatives of the Chamber of Control, Ministries of Finance, Justice, and Economy, Industry and Trade, and the remaining three would represent mass media and civil society.

2.3 Recommendations on Proposed State Procurement Agency

The draft amendments to the LSP were reviewed by the CPAR mission, which found that while most of the Bank's recommendations on other matters had been incorporated, the proposed amendments would not substantially change the position of the procurement agency. Subsequent review of the draft charters of the SPA and its Board confirmed that the proposed governance structure would maintain strong links with MEIT, assign extended authority to the chairman of the SPA, and weaken the oversight role of the Supervisory Board. Hence, the new SPA would become de facto an entity under the MEIT, which would contradict the main purpose of the amendments.

The new SPA was established by amendments to the LSP in March 2001 and a Supervisory Board established by Decree No, 224 in June 2001. Notwithstanding the Bank's recommendations, the newly established SPA is indeed closely linked with the MEIT, although this is apparently more in the nature of an administrative arrangement and does not necessarily imply direct functional control by MEIT. Following further discussions with the Minister during the workshop held in June 2002, it is understood that the status of the SPA will be reviewed after some two years of operation because, now that it has been established as a separate Agency, no immediate change in its status can be contemplated.

Based on the CPAR mission's discussions and further follow-up, the Bank sent letters dated March 7, 2001, and May 2 and 17, 2001, that highlighted the Bank's concerns about the SPA's independence. The Bank wrote that an adequate governance structure is key to successful implementation of public procurement reform, and this means that the agency should report to a

level higher than ministerial level. Ensuring independence and autonomy would further require that:

- the Supervisory Board, not the chairman, should be the primary decision-making authority,
- a competitive and transparent method be adopted for selecting the nominee for chairman, in order to strengthen the independence of his position,
- MEIT's control function be narrowly defined to include review and advice, and not extend to overruling SPA decisions,
- new provisions be included in SPA's charter to establish a system of checks and balances through close coordination and information exchange with the Ministry of Finance (MOF), especially regarding non-compliance with LSP and its regulations (IR). These are contained in a new Decree No. 85 of July 1, 2002.

The Bank also strongly recommended that the SPA be properly funded from the State budget so that it does not need to charge fees for additional services that are not within its area of responsibility, as proposed in the draft charter. Although such revenue collection is permitted by the Georgian legislation, establishing such extra-budgetary funds is not a good practice. If sufficient allocations cannot be guaranteed, the type of services to be provided by the SPA for fees should be explicitly defined within a fairly narrow scope in order not to allow the SPA to divert its resources and attention to non-core functions.

With exception of the competitive selection of the chairman of the SPA and the provision of a list of fee-based services that could be offered by the SPA, the above Bank concerns have been addressed in the Amendments adopted in March and in the Charters of the Agency and the Board approved in June 2001.

The CPAR recommends initiation of efforts to build SPA staff capacity through intensive procurement training in specialized international institutes (see 2.7).

2.4 Technical and Financial Planning

Each procuring entity implements public procurements in accordance with an annual procurement plan developed and approved in advance. Each entity develops a draft of the general annual program describing the scope and justification of the planned procurements. This plan is to be coordinated with the corresponding budgets (state or local), in accordance with the laws on the Budgetary System and Budgetary Authorities and the Principles of the Georgia Economic and Social Development Indicative Planning. Therefore, the draft plan is submitted to the Ministries of Finance of Georgia, Abkhazia and Adjara and the SPA. They review the plan and harmonize the procurement needs with the available budgets and the overall economic strategy.

The respective Ministries of Finance clear the respective budgets for the annual program and send it to the Parliament for approval. Based on the approved State and other budgets for the general program, the head of the procuring entity prepares a detailed state procurement plan, within 20 days after adoption of the State and other Budgets. The state procurement plan details what will be procured, when it will be procured and how much the estimated value of the contracts is. It is submitted to the SPA for information.

In the event a contract is valid for several fiscal years, the procuring entities shall reflect financial resources to be allocated for implementation of procurement in the budget for the next fiscal year. In this case, the procuring entity obtains budgetary authorizations for contract payments due beyond the current fiscal year. If there are budget constraints and as a result, payments cannot be made, the contractual conditions allow for the procuring entity to annul the contract.

In the event of a delay in the approval of the state or local budgets or when an entity is planning a procurement that is not budgeted for, the procuring entity shall conduct procurement in accordance with article 15 par. 6 of the Law on Budget Systems and Budget Authority, which defines the minimum/maximum allocation.

The insufficient, unpredictable and fragmented financing of procuring entities due to severe budget constraints has for several years impeded or prevented proper procurement planning and results in splitting of large value contracts in small value packages. Delays in the approval of allocations have been an ongoing problem. The budget for FY 01 was the first one approved in the year preceding the procurements.

There are no procedures to ensure that the procuring entity obtains budget authorization prior to inviting bids. Article 6, paragraph 7 of the IR stipulates that for procurements estimated to cost more than GEL250 000 (US\$ 0.5 million), the procuring entity must notify the SPA and Ministry of Finance of any procurement procedure initiated, prior to distribution of notification, in the event of a tender, and prior to the negotiations, in the case of negotiations with one supplier. The SPA must also be notified about the type and method of procurement.

In December 2000, a Presidential resolution was adopted on Restructuring of The Treasury of the Ministry of Finance and Measures Aimed at Improvement of its Activities (No. 523, December 12, 2000). The resolution establishes that contracts concluded by procuring entities must not exceed the amount shown in the pertinent budget line. Registration of all contracts above GEL 5,000 is mandatory only for goods and services (excluding communal services); For subsidies and capital expenditures, entities must inform MOF on commitments made against the state budget.

2.5 Recommendations on Procurement Planning and Organization

Although a substantial effort has been made to improve and formalize the planning process in order to maximize the benefits of competitive tendering, the planning process is often ineffective, due to inaccurate cost estimates included in the plan and the fragmented release of funds. The results are inefficient packaging and inappropriate and non-competitive procurement methods, and the procurements cannot be executed as planned. **The CPAR recommends** the development of a rolling multi-year allocation plan, which includes projections for the two years following its approval, so that long-term contracts can be planned for and efficiently executed. There is a new draft Budget Law under consideration which may assist in this regard although its precise details and status are unknown, even by the SPA.

The current organizational arrangement of having procurement conducted by 8,000 entities is complex and not cost effective. **The CPAR recommends** that GOG, under SPA's lead, reassess this arrangement in light of the savings that would be possible by simplifying and consolidating entities and their budget allocations. One of the suggestions made by the Bank and taken up by the GOG was the creation of procurement units within certain procuring entities. A Decree was adopted to this effect although it has not yet been implemented, mainly due, it would seem, to a shortage of funds. The CPAR team will explore opportunities on the Bank side, for sectoral project teams to include simplification of procurement arrangements within the scope of broad restructuring of ministries receiving Bank project support.

2.6 Dissemination of Procurement Knowledge

The SPA's annual report has highlighted that, despite the existence of a good framework law, most heads of local governments are not aware of the adoption of the LSP or have an incorrect understanding of the purpose of the procurement reform process. Some heads are procuring in

accordance with the non-competitive Soviet system and do not consider local funds subject to the public procurement law. Therefore, implementation of the law on the local level is poor.

The problem is not confined to local government officials. There is insufficient understanding of the basic concepts of public procurement based on market economy principles among public sector officials generally. The inadequate level of dissemination of knowledge stems from the assumption that information about the new LSP could be disseminated at a cost that the system could bear. SAC III requires measures to carry out dissemination, including preparation and distribution of a set of country-specific standard documents and manuals.

The problem of information dissemination is most acute in the provinces. One of the results of the workshop held in June 2002 was a suggestion by the delegates that regional information centers be created. Clearly, the absence of funds precludes the creation of new centers but, given that the central administration has representations in each of the regions, it was thought possible that departments or individuals could be identified who would be able to hold and disseminate information and act as a contact point for local enquiries. The **CPAR recommends and encourages** the creation/use of such cost-effective local resource centers.

2.7 Training and Professional Development

Procurement-related tasks are performed by public officials in addition to their official functions and not by trained procurement specialists. A formal position of procurement specialist does not exist. Although some entities may have a department in charge of purchasing the necessary supplies (usually called Material-Technical or Supply Departments), these departments would not automatically be responsible for conducting a tender. The head of the entity would create a tender committee and an ad hoc apparatus to the committee for each case, which might or might not include staff from the supply department. The CPAR mission is aware that some entity heads do try to build on the existing departments and staff, but it is difficult to judge whether such cases are more the exception than the rule. Limited budget allocations to each entity contribute to the difficulties of improving procurement capacity.

The level of knowledge of procurement rules and principles varies from entity to entity. Existing public and private training institutions do not yet offer procurement as a subject matter in their curricula, and in-country capacity to provide public procurement training for government officials has yet to be established. Nor is there any formal mechanism to provide public procurement training for respective government officials.

While Bank funds have financed the training of local staff of Bank project implementation units (PIU), the implementation of the new procurement law will require major training efforts to be undertaken in all public organizations and to some extent in the private sector. As an initial step, the SPD organized a two-day introductory seminar in 2000 for senior central and local government officials, financed by IDF. A series of seminars is being planned for the heads and experts of central and local public procuring entities, representatives of executive and legislative branches, NGOs and business associations, and the general public. Such training efforts are required under SAC III, along with training of trainers from the SPA.

GOG urgently needs to develop a training strategy to build capacity within the entities, as it is not feasible for the SPA to train all entity staff. Such a plan could provide for training of staff at the largest procuring ministries through courses established at existing institutes identified by the SPA. These staff could then in turn train their subordinate entities. GOG should also provide for secondment of entity staff to the SPA, once SPA staff has been trained as recommended.

2.8 Information Technology and E-Procurement

The application of information technology, including the use of the Internet, has been severely limited due to poor telecommunications infrastructure, high costs of equipment and connectivity compared to average wages, shortage of system administrators and qualified engineers, and frequent power outages. In particular, the government does not possess advanced information systems and only about 0.2 percent of the population uses the Internet. However, progress is being made, guided by the GPA requirement to hold regular consultations regarding developments in the use of information technology in public procurement (Article XXIV of the GPA).

First, the government recently created the State Department of Information Technology and the State Commission for the Development of Information Society. Its main objectives are to introduce and promote the use of the latest information technologies in the public and private sectors. It has prepared a draft law to regulate electronic commerce and authorize electronic signatures.

Second, the recently initiated privatization of the two important telecommunications companies should result in substantial upgrades to the communications networks. The soon-to-be-completed installation of an optical cable to connect 15 major cities will provide access to better connections for about 20 percent of the population.

Third, access to the Internet has improved with the launch of several Internet Service Providers (ISPs). Competition is fierce and prices are dropping dramatically. As of May 2001, unlimited access is available for a fixed rate of about \$40 per month, compared to \$150 for two hours per month in 1996.

Finally, several international organizations are supporting the use of information technologies. The World Bank has supported the creation of a website to assist the privatization program under the responsibility of the Ministry of State Property Management¹ and the launch of the Georgian Development Gateway², with cooperation of by the State Department of Information Technology. The Gateway presents local content from all levels of government, from communities, from civil society and from the business community.

Participants at the workshop held in June 2002 were largely in favor of creating an information website under the aegis of the SPA, especially given the difficulties of disseminating information throughout the country in a comprehensive and timely manner.

2.9 Recommendations for Training and Information Technology

The CPAR recommends that SPA be given a mandate to identify capable training institutes that can partner with them, to coordinate training activities at central and regional levels, and to develop programs with the institutes to train all public central and local agencies and any interested private parties. SPA could also assist in developing a procurement curriculum that would lead to a recognized procurement certification. It is also recommended that SPA continue to work with the Training and Research Center of Regional Policy and Administration, with whom SPA cosponsored in 2000 a training program designed for local government heads, as the

¹ The website may be found at <http://web.sanet.ge/mospm/>

² The Georgian Development Gateway website may be found at <http://georgia-gateway.org/>. Additional information regarding the Development Gateway initiative may be found at <http://www.developmentgateway.org/>

center is an important tool for disseminating knowledge about public procurements to local officials.

As a first step towards the use of information technology for public procurement in Georgia, **the CPAR recommends** that SPA launch a website, linked to the Georgian Development Gateway or considers setting up a procurement sub-site of the Development Gateway, where it would promote and coordinate the advertisement of public procurement opportunities, publish contract awards, dispute decisions, criminal actions, blacklists of contractors, and SPA's annual report, and promulgate standard procurement documents and examples of best procurement practices. As long as easy and affordable access to Internet is not a reality for all regions, paper advertisement will have to be maintained in parallel.

The CPAR further recommends that SPA assess the possibility of linking the training requirements with IT opportunities becoming available through the use of the Distance Learning Centers (DLCs) being established with Bank support. The Global Distance Learning Network (GDLN) is growing by leaps and bounds since its launch in 1999. The Ministry of Education could designate a training institution to become the DLC in order to join the GDLN. The Bank and external partners could assist in developing content for the training courses.

3. Procedures and Practices

This section describes the procedures and practices in accordance with the LSP and its implementing regulations (IR). At the present time, these are followed for only a small fraction of public procurement (see 5.1, 5.2)

3.1 Domestic Preference and Foreign Bidders

The LSP does not include provisions that would limit the participation of foreign bidders in open tenders per se. To promote the development of domestic contracting and manufacturing industries, a 15 percent margin of preference is granted in the evaluation of bids offering inputs (material and labor) from Georgia when foreign and domestic bidders participate in the tender (LSP art.13). In theory, this approach is acceptable. However, based on the interviews conducted for the CPAR, it is evident that the majority of OT tenders are conducted among local bidders. One reason for this practice may be that political pressure is being applied by local manufacturers on public officials to spend public money locally, not on foreign bidders.

Another reason could be that international advertising for OT, in one of the most accepted foreign languages, is only required for very high-value contracts (above GEL 600,000 for goods and services and GEL 8,000,000 for works) foreign bidder participation is limited for the majority of tenders of relatively low value which are currently conducted in Georgia. In addition, procurements are sliced into small packages because of the fragmented budgetary resources, which does not attract participation by foreign bidders (see 5.0).

The **CPAR recommends** that these thresholds for publication in international newspapers be reduced. They will need to be once Georgia has become a party to the WTO's GPA but there is no reason why these thresholds should not already be lowered to encourage and take account of more effective competition.

3.2 Conduct of Procurement Proceedings

3.2.1 Methods of Procurement

In accordance with the LSP, public procurement may be conducted on the basis of open tendering (OT), restricted tendering (RT), or single source selection (SS)

In cases justified by the LSP, open and restricted tenders can be carried out in two stages. The conditions for use of each procurement method is explicitly prescribed in the LSP. The IR clearly state that it is not permitted to artificially divide procurements in order to avoid the monetary threshold specified in the LSP for specific procurement methods.

The most recent Amendments to LSP introduced two additional procurement methods, Request for Price Quotations and Method for Procuring Intellectual Services. The IR will need to be adjusted to include provisions for these two procurement methods.

Table 1. Current Thresholds for Procurement Methods.

	Mandatory for goods and services when contract estimate ...	Mandatory for works when contract estimate...
Open tendering	Exceeds GEL 70,000 (USD 35,000 equivalent)	Exceeds GEL 230,000 (USD 120,000 equivalent)
Restricted tendering	Exceeds GEL 25,000 (USD 13,000 equivalent) but is less than GEL 70,000	Exceeds GEL 120,000 (USD 60,000 equivalent) but is less than GEL 230,000

The procedures for OT apply to **restricted tendering**, with the exception that in RT, the invitation to bid is sent to a minimum of five bidders selected by the Tender Committee. In certain instances, not clearly defined in the LSP, the number of bidders invited to bid may be restricted to less than five. If the required minimum number of three qualification packages or three bids is not received, the procuring entity shall agree with the SPA on an alternative procurement method.

Restricted tendering is permitted where the value of the contract falls between two financial levels. There is, however, no possibility either in the LSP or IR for restricted tendering to be used above the upper limit in cases, for example, of complex equipment available only from a limited number of suppliers.

A two-stage tender may be held when, due to the complexity of the subject of the procurement, the procuring entity has difficulty in clearly defining the specific requirements of the procurement (e.g., for procurement of complex consultant services, complex information technology equipment, etc.). In the first stage, technical proposals, including qualification information are submitted without indication of the price. Following a review of the technical proposal, the Tender Committee is authorized to negotiate with bidders in order to clarify/elaborate their proposals and to define the requirements of the second stage bidding documents. The second stage documents are only issued to those bidders who satisfy the requirements of the first stage and only upon payment of a tender fee. Nevertheless, Article 20(3) of the IR is unclear in the sense that it does not appear to require submission of a complete technical bid during the first stage.

Single source procurement is based on direct negotiations with one contractor and is justified, according to Article 22 of the LSP, when:

- the estimated value of the procurement does not exceed GEL 25,000 (for construction works GEL 120,000);
- the supply or implementation of the works or services is the exclusive right of a single natural or legal person;
- procurement is needed on an urgent basis or as a result of force majeure;
- it is necessary to procure goods or technology equipment, works and services from the original supplier in order to ensure compatibility with and prevent deterioration of the quality of the original supplies. The procuring entity may extend the original contract or sign a new contract with the original supplier, except when the estimated value of the procurement to be carried out exceeds the initial contract amount.

For contracts estimated to cost less than GEL 10,000 (GEL 50,000 for Works), the procuring entity may select any contractor of its choice to negotiate with. For contracts estimated to cost between GEL 10,000 and GEL 25,000 (between GEL 50,000 and GEL 120,000 for Works), the procuring entity shall request quotations from a minimum of three suppliers and the supplier who offers the most favorable bid that best satisfies the requirements shall be invited to negotiate. Notwithstanding the above provisions, the IR stipulate that SS may be applied for procurements above the thresholds of the LSP.

Request for Quotation is a simplified method of procuring readily available goods and services for which there is an established market and that are estimated to cost more than 10,000 GEL but less than 25,000GEL for goods and services and more than 50,000 GEL but less than 120,000GEL for minor works. As this method was introduced in the most recent amendments of March 30, 2001, the specifics of this procurement method have still to be introduced in the regulations.

3.2.2 Tender Committees

If procurement is conducted on the basis of either open or restricted tendering, the head of the procuring entity is required to appoint a Tender Committee of no fewer than five members of the senior management of the entity (the head of the procuring entity, the deputy heads and/or heads of the entity departments). The conflict-of-interest provision of the LSP applies to all members of the Tender Committee. Each Tender Committee is chaired either by the head of the entity or by his authorized representative. In addition to the Tender Committee, an ad hoc Tender Committee Apparatus is established by the head of the procuring entity for each procurement. He delegates to this unit the authority to conduct and organize state procurements and provide technical and administrative support to the Tender Committee. The Apparatus is headed by the Tender Committee Chair and is composed of a number of the procuring entity staff.

The Tender Committee (based on information from the technical staff of the entity) prepares the advertisement, identifies the procurement method and sends this information to the SPA for comments. Further, it reviews and approves the tender documents, announces the tender on behalf of the procuring entity, carries out qualification and receives and evaluates the bids. In the case of two-stage open or restricted tendering, the Tender Committee also holds direct negotiations with bidders to verify any issues of the initial tender proposal, as well as to define the final parameters for tender documentation.

3.2.3 Bidding Documentation

The typical timetable for carrying out state procurement is presented in Annex 1, which lists each step in the procurement process and indicates its duration. The LSP requires the Tender Committee to approve the tender documentation prior to publication/distribution of the invitation to tender. In accordance with the LSP and the Implementing Regulations, tender documentation is required to include: (i) the agreement of intention (AoI); (ii) the instructions to bidders (ITB) which contain all information necessary to prepare responsive bids; (iii) the quantity of goods, works, services to be procured and required delivery schedule, (iv) the technical specifications including reference to Georgian and international standards and description of any alternatives, if required; (v) general contract conditions and form of contract.

The adoption of good quality standard bidding documents for all major types of procurement will undoubtedly make a valuable contribution not only to improving the procurement process but also to better protecting the contractual risks and obligations of purchasers and sellers. As the development of standard documents is a SAC III condition, the SPA prepared draft standard documents which were reviewed and commented upon by consultants funded from the World Bank's IDF grant. The SPA adopted the finalized documents by order N1 of 15 October 2001.

Article 11(3) of the IR maintains a provision enabling procuring entities to charge a tender "fee" for the purchase of bidding documentation. This leaves open the possibility of charging more for the documents than the costs of producing them, though the applicable rates appear to be set by Article 19 of the LSP. Both the SPA and the Supervisory Board accepted the Bank's recommendation that the cost of purchasing the documentation should be limited to the costs of production but, in amending the LSP, the Parliament appears to have overlooked the proposed amendment. Since the IR must be compatible with the LSP, they also include reference to the tender fee. The **CPAR recommends** that these provisions be removed.

3.2.4 Notification and Advertising

Because every procurement based on open and closed tendering is subject to pre-qualification, the invitation to tender, as provided for in the LSP, in essence combines the invitation to pre-qualify and the invitation to bid into one single announcement. The invitation to tender is approved by the Tender Committee. For contracts that are to be procured following OT or RT, the Tender Committee is required to notify the SPA and the corresponding Ministries of Finance about the initiation of the procurement procedure. Any amendment to the announcement shall be advertised through the same channels as the original publication. The rules for advertisement are provided for in the LSP and the Regulations.

For **open tendering**, the Tender Committee is required to announce the bid as follows:

- mandatory publication of the invitation to tender in a local newspaper, and
- mandatory publication in a wide-spread international newspaper or specialized trade journal, in one of the internationally most accepted foreign languages, and distribution to foreign diplomatic representations, for all procurements estimated to cost more than GEL 600,000 (USD 300,000 equivalent) for goods and services - GEL 8,000,000 (USD 4,000,000 equivalent) for works. The local newspaper is published bi-weekly and weekly. As above (3.1), it is recommended that these thresholds be lowered, even before possible accession to the GPA.

For **restricted tendering** the procuring entity sends the invitation to bid to the selected bidders.

The LSP provides specific guidance on the contents of the announcement. The information provided is comprehensive and covers

- qualification criteria and deadline for submission of the qualification data;
- description and method of delivery of the goods, works or services to be procured;
- bid submission deadline, amount of the required bid fee, bid evaluation criteria;
- eligibility criteria for domestic preference;
- acceptability of alternative proposals;
- right to appeal violations of the procurement proceedings.

3.2.5 Qualification of Bidders

In accordance with articles 10 and 11 of the LSP, every procurement is subject to a pre-qualification exercise in order to identify a list of bidders qualified to participate.

Qualification criteria relate to financial and legal standing and to requirements for licenses, registration or other authorizations, and other criteria such as specific experience that the Tender Committee may wish to add. There is no standard pre-qualification document available.

Late submissions are rejected. Only pre-qualified bidders are eligible to purchase the bidding documents. Pre-qualified bidders have the opportunity to review the tender documents prior to purchasing. Upon payment of the tender fee, the tender documents are issued to the bidders. The tender fee of GEL 500 (\$250) for open tender and GEL 150 (\$75) for restricted tender is set by law. The bidder has 30 days to prepare his bid.

3.2.6 Cancellation of Tenders

Article 23(1)(b) IR, entitled Revoking State Procurement procedures, appears to allow the cancellation of all procurements if less than 3 proposals or 3 qualified proposals are received. The Bank strongly opposes this possibility because even a single bid could be received as a result of competitive bidding, be responsive and acceptable for award. The fact that only one bid is received does not make the procedure uncompetitive. It may merely demonstrate that only one bidder is interested in supplying a particular good or service under the terms and conditions offered at that particular point in time.

3.2.7 Agreement on Intention (AoI)

The LSP/IR require the procuring entity to enter into an Agreement of Intention with each participating bidder at the time of bid submission. Each bidder undertakes to sign a contract agreement, if offered the contract, and each procuring entity undertakes to enter into a contract with the winning bidder based on the terms and conditions of the bidding documents. The terms of the AoI correspond broadly to those of a bid security. It makes the bid binding for a specified validity period. However, there is no cost involved to the bidder at the time of submission of the bids. Costs may only be incurred upon default of the obligations of the agreement.

The AoI form, signed by the head of the procuring entity, is included in the bidding documents. The bidder signs the AoI and submits it together with his bid. Failure to submit the AoI or submission of an unsigned AoI results in rejection of the bid.

3.2.8 Tender and Performance Securities

The LSP has no provisions requiring a bid security. The IR, however, stipulate that a tender security is mandatory for high-value contracts, estimated to cost more than GEL 600,000 for goods and services (GEL 800,000 for works); for complex or urgent procurements. The security,

in the form of a money transfer or bank guarantee, is expressed in the bidding documents as a fixed amount and by Law, limited to 1 percent of the estimated contract cost. The securities are to be sealed in the bid envelope. The tender committee can reject tender securities if the authenticity of the security is questionable or if it is confirmed that the issuing bank is insolvent.

The bid security may be forfeited (i) if the bidder withdraws or modifies his bid after bid submission deadline; (ii) if the successful bidder refuses to sign the contract agreement within the bid validity period; or (iii) if a bidder is disqualified for serious violation of the procurement procedures. The bidder has the right to appeal the decision to forfeit his bid security.

Article 30 of the IR makes it mandatory for the successful bidder to furnish a **performance security** in cases of high value contracts (600,000 GEL for goods and 8m GEL for works). The amount of the guarantee will be between 2 and 5 percent of the contract value. However, it appears that there is a choice between securities or insurance cover. This does not sufficiently protect the procuring entity because in most contracts there will be a need for both a performance security (protecting the procuring entity against non-performance by the seller/contractor) and for insurance to be taken out by the seller/contractor against various risks, e.g., loss or damage during transportation, damage caused by the seller/contractor during contract execution, etc. Thus, the provision should be changed to say that for all contracts above a threshold there would be a requirement for both a performance security and for insurance appropriate under the circumstances.

In practice, performance securities are rarely required by tender committees, thereby exposing the procuring entity to risks of non-performing contractors and suppliers. For any type of security, banks typically demand 100 percent cash cover for the amount of the security throughout the period of its validity, plus a monthly commission charge ranging from 0.3 percent to 0.5 percent of the amount of the security. Based on information received from the SPA, this translates into a cost to the contractor/supplier of 12-16 percent of the contract price. As a result, domestic bidders have difficulty in raising such securities and many, especially works contractors, prefer to bid as subcontractors to foreign bidders, particularly on high-value contracts.

3.2.9 Submission and Opening of Bids

Bidders have a minimum of 30 days, counted from the date of issuance of the bidding documents, to prepare and submit their bids. Bids are to be signed by authorized representatives and are to be received in sealed envelopes by the bid submission deadline. The LSP requires that late bids be returned unopened. A bidder may modify or withdraw its bid prior to the deadline for bid submission. After the deadline, a tender committee meeting convenes to open the bids publicly. There is no requirement that the bid opening immediately follows the bid submission deadline. The bidders' names, the bid prices and alternative prices, if any, shall be read aloud and recorded in the tender committee meeting minutes.

3.2.10 Evaluation of Bids

After bid opening, the tender committee establishes the completion time for bid evaluation. A bid may be considered responsive even if it contains minor deviations that do not materially alter or depart from the main requirements of the bidding documents.

During the preliminary examination the tender committee is authorized to check bids for arithmetical errors. The method of correcting errors is specified in the LSP and is in accordance with internationally accepted practice.

Substantially responsive and corrected bids are subject to detailed evaluation by the tender committee, following the criteria and weights outlined in the bidding documents. The evaluation criteria listed in the IR are: Price, Delivery Schedule, Technical Quality and functional requirements of goods works and services, Payment Schedule, Operating and Maintenance Costs, Responsiveness to the interests of the country and the Region (including factor of use of local labor, materials etc; environmental, national and security interests; etc.). The IR suggest that all criteria must be applied for each procurement and that the maximum score for each criteria is 10. Each evaluator scores each bid and the bid ranked highest by him receives his vote. The successful bid is the bid that has collected the majority of votes. In the event of a tied vote, the head of the tender committee casts the deciding vote. The tender committee ensures confidentiality of the process and records the evaluation procedure in writing.

Re-confirmation of the qualification requirements may be requested from bidders at any stage of the bidding process. Sub-contractors' qualifications may be evaluated at the time of award.

3.2.11 Award and Contract Effectiveness

Bid evaluation reports are prepared in the form of a protocol, which is attached to conclusions of the tender committee members. The protocol shall contain information such as a summary of the bidders' proposals, a clear and complete description of the evaluation process, including the reasons for rejecting of any bid as non-responsive, how the stated evaluation criteria were applied, and how the successful bidder's qualifications were verified. The protocol is binding.

Negotiations with the winning bidder are strictly prohibited by Law. Based on the limited number of procurements that have followed the LSP, it is difficult to say whether this provision of the Law is adhered to at all times.

Contract conditions are not covered in the LSP. Within 10 days of the notification to award, the winning bidder is required to sign the contract agreement with the procuring entity. No additional government approvals are required before contracts can be made effective.

Procuring entities are required to publish the result of the tender procedure and the name of the contractor selected in the local gazette, *Sakartvelos Respublika*.

3.2.12 Record Keeping and Monitoring

Procedures and practices regarding maintenance of records of public procurement proceedings are found both in Article 24 of the LSP and Article 32 of the IR. They define in a very detailed manner which information is to be included in the State procurement records in order to allow verification that the legislative requirements have been fulfilled.

Post Review: For each procurement, a report shall be submitted to the SPA within 10 days from the contract signing for procurements following tender procedures and for single source procurements for which the contract amount exceeds GEL 25,000. For all other procurements, the reports are due on a quarterly basis. To promote transparency in state procurement procedures, a summary of the reports is published at least twice a year. The reports are also available to stakeholders upon their request. All reports are kept for a period of three years.

In addition, each procuring entity is required to prepare an annual report. As a minimum, the annual report must contain the number and amount of all contracts signed in the fiscal year, per procurement type (works, goods and services), the number and contract amount of the completed and ongoing contracts, a quarterly overview of the projected and actual disbursements made, and

data on the debt accumulated due to delayed payment and other unsettled contract issues. These reports form the basis for the SPA's annual report, which is submitted to the President, together with the SPA's recommendations for improvement of the public procurement system.

Unfortunately, despite the SPA's numerous appeals, there is ample evidence that most entities do not submit the required reports or submit them incompletely. It is hoped that the revised status of the SPA will allow for a reversal of this trend. Nor does the MOF provide the SPA with data on flow of funds disbursed for procurements, even though this information is needed to assess the accuracy of reports received from the procuring entities..

Based on the need to ensure a system of checks and balances and consultations between the procurement entity and the MoF, the recent amendments to the LSP added the requirement that the central MoF, finance ministries of the republics of Abkhazia and Adjara, and local finance departments provide the SPA with data on actual disbursements on a monthly basis.

The Amendments also stipulate that the chairman of the tender committee shall report on the procurement process to the President of Georgia at the government meeting, when the tender exceeds GEL 2 million (USD 1 million equivalent). The requirement for prior review by the SPA of contracts estimated to cost more than GEL 50,000 has been abolished in the Amendments.

3.3 Contract Implementation

3.3.1 Contract Administration

A small cadre of specialists in contract administration and contract management is currently being developed, in particular through the PIUs that administer IDA-funded projects. However, their numbers are tiny, in comparison with the large number of public officials involved in public procurement at various levels of the Government. For the most part, effective contract administration is lacking. In the development of human resources for public procurement, emphasis should be placed on building capacity for contract administration and management in the public sector.

3.3.2 Administrative Review

The recent amendments introduced article 24.1 to the LSP, which establishes a procedure largely following, at least in principle, the UNCITRAL model law, for any bidder to seek review of an action of a procuring entity or tender committee that he believes is in breach of the LSP/IR or that he believes has violated his rights. Unless a contract has entered into force, a complaint shall in the first instance be submitted in writing to the procuring entity. The entity shall not entertain a complaint unless it was submitted within 20 days from the day when the bidder became aware of the circumstances giving rise to his complaint, or 20 days from the date when that complainant should have become aware of those circumstances, whichever is earlier. A bidder may also file his complaint directly with the SPA. The LSP sets no limitation on the time allotted the entity to provide a decision.

If the bidder is dissatisfied with the entity's response, he may appeal to the SPA. The SPA however has a deadline of 10 days to provide a final decision in writing. If the SPA considers the claim justified, it is authorized to call on the entity to observe the LSP, to demand the procuring entity to cancel improper decisions or bring them into conformity with the established rules, and to advise the appropriate bodies if a bidder has failed to comply with the provisions of the LSP.

It is to be noted that, unlike the provisions of UNCITRAL, the SPA does not have the power to make a fully binding decision on the basis of a complaint from a bidder. Once a complaint is lodged, the SPA will enter into discussions with the parties and will seek to resolve the dispute by mutual agreement. It may make a “reasonably justified decision” which will consist of warnings or recommendations to a defaulting procuring entity but this will not be binding on the procuring entity in the sense that it is obliged to comply. Indeed, evidence from the SPA suggests that many Ministries do not accept its “decisions” which is, of course, one of the main reasons why the SPA needs a greater and more independent status enabling it to make proper and effective decisions where the LSP has been infringed. As it stands, the negotiations between the parties would appear often to descend to the level of horse-trading with much pressure put on the SPA.

The only possibility open to the SPA is, in the event of a failure of the procuring entity to respond appropriately to one of its decisions, to prepare a “Protocol” (minutes of the process) which it will send to the Court for decision, after having consulted with the Chamber of Control. The SPA will also send such a Protocol to the administrative court where, during the negotiations, it establishes infringements of the LSP. It is the Court and only the Court which has the power to impose the penalties foreseen in the amended Administrative Code and Code on Administrative Violations.

If a bidder wishes to appeal the “decision” of the SPA, or if the 20-day deadline has expired or if he wants to file a complaint after contract signing, complaints can only be filed and settled in court.

For any claim submitted to the entity, the SPA or court, prior to contract signing, the entity shall suspend the procurement procedures for a period of 10 days, which can be extended to maximum of 30 days. Again, the SPA rather depends on the willingness of the procuring entity to comply with its decisions.

As it stands, therefore, the administrative review before the SPA lacks teeth. The procedure resembles the UNCITRAL model but the SPA lacks the real powers to make it an effective and efficient review mechanism. It would seem that this has a lot to do with the status of the SPA since procuring entities do not feel the need to comply with its decisions.

3.3.3 Payment

Letters of Credit (L/C) are used frequently. Most banks issue confirmed L/C's. The commission charge for an L/C amounts to about 14 percent.

Several banks in Georgia participate in a trade support program initiated by the (European Bank for Reconstruction and Development) EBRD, with the purpose of promoting and expanding documentary operations. The EBRD confirms a limit to carry out credit and security operations, which are guaranteed to be confirmed by foreign banks participating in the EBRD project.

Procuring entities do not submit timely withdrawal applications to the Treasury, which therefore is unable to anticipate the necessary reallocation of funds to meet contractual payment requirements. As a result, delays in payment are endemic in Georgia and entities become liable for interest on delayed payments.

3.3.4 Price Adjustment

The State Department of Statistics publishes a monthly Consumer Price Index (CPI) and a Producer Price Index (PPI). It does not publish construction or labor indices. To date however, the common practice in contracts of long duration has been that the procuring entity awards a fixed price contract, regardless of the duration of the contract. Price increases during contract

execution are generally agreed through ad hoc negotiations between the procuring entity and the supplier/contractor, and have no basis in the terms of the contract itself. This practice fails to afford adequate protection of the contractual rights to either party and may facilitate corrupt collusion between the employer and the supplier/contractor during execution of the contract.

3.4 Recommendations on Procedures and Practices

3.4.1 Domestic Preference and Foreign Bidders

As the provisions for domestic preference spelled out in the LSP/IR are not clear, **the CPAR recommends** that a clear description of the eligibility criteria for the preference as well as the procedure to apply the margin of preference during evaluation of bids be included in the LSP/IR. The CPAR also recommends that the threshold for mandatory publication of invitation to bid in international newspapers be lowered in order to increase foreign bidders' participation in open tendering.

3.4.2 Methods of Procurement

The law implies that restricted tendering is mandatory if the contract estimate falls between the financial thresholds specified by law (see Table 1, page 13). **The CPAR recommends** that RT may also be applied for contracts above the threshold, for procurement of specialized items that are only available from a limited number of bidders. To ensure transparency of the process, the decision whether or not RT is fully justified for contract amounts above the threshold should not be left to the discretion of the Tender Committee but should be subject to approval by the SPA. This should be a transitional arrangement only and once the practice is established, the procuring entities should make the decision based on the conditions to be set out in the LSP.

Where RT is used, there is a lack of transparency in selecting the five potential bidders. This leaves room for corrupt practices and possible collusion among bidders. To this effect, **the CPAR recommends** the introduction of a fair process of establishing a list of suppliers and contractors qualified for a specific procurement. Although it is difficult to define a process that guarantees a fair selection, one approach might be a random selection from a list of qualified suppliers. Another approach might be a systematic rotation from that same list.

In two stage tendering, the **CPAR recommends** further clarity in the IR. The provisions in Article 20 IR should require a complete technical bid (subject to technical as well as commercial qualifications and adjustments), but without a price bid and without a bid security. It should also be made clear that the bidder has no obligation to submit a second stage bid, i.e., that he may drop out after the first stage.

SS procurement is allowed (but not mandated) for procurement of small contracts estimated to cost less than GEL 25,000 (GEL 120,000 for works) or if justified in accordance with the criteria in the LSP. This approach has led to heavy overuse of SS, which has been especially open to corrupt practices. In 2000 about 53 percent of state expenditures were procured following SS (see section 5). Therefore, **the CPAR recommends** that for larger contracts above the SS threshold, all applications for SS should be made subject to prior approval of the SPA in order to regain control over the use of this method. Again, this should be only a transitional arrangement and procuring entities must learn to apply the conditions of the LSP correctly. In addition, the provisions of Article 5(7) of the IR concerning the prohibition against splitting contracts to avoid the threshold values of the LSP should be properly enforced

The rules for negotiations under SS are not specified and are left to the discretion of the head of the entity. **The CPAR recommends** that rules be established in order to provide the basis for a fair and transparent process.

SS based on negotiations with the most favorable bidder selected following comparison of price quotations is cumbersome and allows for manipulation of the SS method. **The CPAR therefore recommends** that it be deleted.

The CPAR further recommends that the upper threshold for contracts to be procured based on comparing price quotations obtained from at least three suppliers, be set at GEL 25,000 for goods and services (GEL 120,000 for works).

The definition of "goods" in the LSP includes the procurement of buildings and thereby brings real estate acquisition within the scope of the law. As it is unique to cover acquisition of real estate property in a procurement law, **the CPAR recommends** that this reference be removed from the law. Alternatively, the implementing regulations may need to introduce special procedures to cover the unique circumstances associated with purchasing real estate property.

3.4.3 Tender Committees

The composition of the Tender Committees as provided by the LSP does not guarantee inclusion of specific technical expertise. The latter is left up to the discretion of the committee chairman. As a result, the quality of technical evaluation of proposals may suffer. The ad hoc nature of the Tender Committee Apparatus does not provide for continuity in development of specific procurement-related knowledge and skills that could contribute to improved adherence to procedures as more experience is gained. SPA's Action Plan includes capacity building of procurement units. **The CPAR recommends** the consolidation of the number of procuring entities where possible to simplify the complexity of the institutional setup and to establish permanent procurement units within at each procuring entity. Notwithstanding the existence of a Decree to this effect, little has been done actually to create these units. It is, therefore, an ongoing commitment.

The CPAR further recommends to limit the number of Committee members to five as a large number does not add value and affects the quality and the timeliness of the decision making.

3.4.4 Bidding Documents

Technical Specifications mostly provide design specifications, which describe in detail the materials and the methods to be followed. **The CPAR recommends** the introduction of functional and performance specifications to describe the object to be procured.

3.4.5 Notification

Although the notification requirements in the LSP are in line with international practices, it must be stated that publication of announcements in international newspapers is costly, and often unaffordable to procuring entities. As a result, advertisements are often not properly disseminated. **The CPAR recommends** (i) that all tender announcements be published in Georgian and a major foreign language such as English, on SPA's website once the website has been established; and (ii) that procuring entities be required to advertise an annual overview of the large procurements scheduled for each fiscal year, to alert the business community of upcoming pre-qualification/bidding opportunities;

3.4.6 Prequalification and Use of Registry

Pre-qualification adds substantial time and administrative burden to the procurement process and is only justified for large complex contracts. In addition, the pre-qualification requirements for licenses, registration and other authorizations are not always clear, and too many requirements from government agencies may increase the opportunity for bribes and corruption. **The CPAR recommends** that a registry of qualified suppliers/contractor be established and maintained for small-value contracts that could substitute for the lengthy procedure of pre-qualification. In addition, supplier and contractor performance should be routinely evaluated and any standing lists of pre-qualified suppliers and contractors updated based on this information. It should be ensured that newcomers can readily apply to be qualified. For non-complex, larger value contracts for which a large number of contractors is available to bid, pre-qualification could be substituted, with post-qualification of the bidder proposed for award.

The CPAR recommends that the tender fee be adjusted to represent the costs of preparation and dispatching of tender documents.

3.4.7 Cancellation of Tenders

Since competitive procedures may legitimately result in the receipt of a limited number of bidders, often less than 3, there is no reason why a competitive procedure should be cancelled where fewer than 3 bids are received. The CPAR recommends therefore the deletion of Article 23(1)(b) of the IR.

3.4.8 Use of AoI and Performance Securities

In transition countries where bidders' financial capacity is limited, the use of an Agreement of Intention (AoI) in lieu of more costly bid security provisions is acceptable for small value contracts, because it affords the entity reasonable protection against irresponsible bids without discouraging bidders. **The CPAR recommends** deletion of the provision that allows AoI terms and conditions to be negotiated, and that instead, the actions in case of default should be clearly defined. It is further recommended that bidders who do not meet the commitment of their AoI be blacklisted.

The CPAR recommends that the provisions relating to performance securities be clarified making sure that *both* performance securities and insurance cover may be available to procuring entities. As an additional point, the reference in Article 22(4) of the IR is incorrect (although this may be a translation error): *bid* security should read *performance* security.

3.4.9 Bid Opening and Evaluation

There is no requirement that the bid opening immediately follow the bid submission deadline. **The CPAR recommends** that bids be opened immediately after the deadline for submission because this is a fundamental prerequisite for transparent procurement. While the notification period may be acceptable for domestic bidders, it is not adequate for international bidders. In order to promote international as well as domestic participation, a minimum bid preparation period of 45 days is recommended for all tenders.

In order to allow bidders to compete on a level playing field, **the CPAR recommends** that the evaluation criteria and the evaluation methodology be clearly spelled out in the bidding documents, and that all evaluation criteria be expressed in monetary terms. Given that pre-qualification is mandatory for every procurement, the tender committee should only verify the

qualification of the successful bidder. The CPAR also recommends to do away with the point system for evaluation of goods and works. Each bid should be evaluated on its merit as compared to the criteria in the bidding documents.

3.4.10 Administrative Review

The CPAR recommends that each complaint first be submitted to the entity, and to the SPA only in case of appeal. It may also be acceptable to state that complaints forwarded directly to the SPA will be dealt with in consultation with the relevant procuring entity. Otherwise it is likely that bidders will take their claims directly to the SPA, thereby missing the opportunity to resolve the claim quickly with the entity.

It should be made clear which means the SPA has to enforce compliance by entities. This is a problem in many laws that do not state what happens when the procuring entities disregard the LSP. However, it is not clear whether the solution to such a problem lies with the procurement law. The SPA not only reports to the President in an annual report but also should presumably be able to raise complaints about a non-compliant entity to those arms of Government that can take action. **The CPAR recommends** that the LSP define the authority of the SPA to raise issues of non-compliance and/or wrongdoing with the respective departments and authorities, so that they can initiate disciplinary actions against offenders. Any actions will be determined in accordance with the administrative Code and Criminal Codes. Amendments have been made to the Administrative Code and to the Code for Administrative Violations. However, amendments to the Criminal Code are still under discussion by the Georgian Parliament. **The CPAR therefore recommends** that the Criminal Code be amended as a matter of urgency both to identify appropriate disciplinary actions for infringement of the LSP and to ensure completeness and compatibility with the amendments to the Administrative Codes.

In particular, the **CPAR recommends** that any powers the SPA is given to act on complaints of bidders and correct infringements of the LSP should be sufficient to allow it perform its duties. In addition to endowing the SPA with sufficient authority, the means of correcting infringements should be made clear and explicit.

The LSP (Article 24) sets out detailed procedures for administrative review of complaints by the SPA but it does not describe the institutional structure within the SPA for hearing complaints. The SPA has a set of internal procedures which it uses to hear complaints but these are not collected into a single text and are not available to third parties. **The CPAR recommends that** formal and fair procedures be established for considering claims. The existing procedures should be consolidated into a single and coherent text, published and made available to all interested parties, notably bidders wishing to complain. Once a website has been established, these procedures and any required forms should be made available on-line. In order to avoid even the appearance of a conflict of interest, the SPA staff hearing complaints should be different from those who are providing guidance and advice to procuring entities in the conduct of procurements. On the recommendation of the Bank, a specialized unit has been established within SPA for conducting administrative reviews. This "Legal Department", however, is not staffed by specially trained personnel but, rather, depends on existing capacity. **The CPAR recommends** that proper and specialized training be provided to the new Legal Department.

3.4.11 Price Adjustment

The CPAR recommends that the implementing regulations be amended to require the use of price adjustment formulae in contracts of long duration (more than 18 months) and that the CPI

published by the State Department of Statistics be used to calculate price adjustments for this purpose.

4. Audit And Anti-Corruption Measures

4.1 Auditing Performance

4.1.1 Auditing of Public Expenditures

The Law on the Chamber of Control (COC) of Georgia of April 15, 1997, created the country's supreme audit institution. Its mandate is to review how budget expenditures are being made on a *post factum* basis. The Chamber of Control reports to the Parliament and comprises about 770 staff. Despite the fact that the Chamber enjoys an acceptable level of independence, its impact has been limited so far mainly because its management and staff have very limited experience and few resources. In addition, the fact that part of the Chamber operations are financed through off-budget penalties, applied for irregularities discovered by its staff, seriously affects its credibility. Moreover the Chamber lacks modern management tools.

4.1.2 Auditing of Private Expenditures

The Law of Georgia On Auditing Activities (1995, amended in 1997 and 1998) defines the state regulations of auditing activities, the subjects of audit, the rules of conducting audit, and the rights and obligations of the parties in the audit. According to the Law, all audits of legal entities in Georgia are to be carried out according to the International Standards on Auditing (ISA).

By law, the Council for Audit Activities of the Parliament of Georgia is the state body designated to regulate the audit activities. The Council works out the standards and recommendations for conducting audit, issues certificates to auditors and licenses for audit services, keeps records of auditors and audit firms in the state register. Since 1995, the Council has been providing training and advice on professional development of auditors to universities and business schools. However, compliance with the Law is extremely limited because the accounting and auditing professions are just beginning to develop and because the enterprises, mostly small and medium-sized, have no incentive to comply.

4.2 Recommendations for Reforming Audit

In order to establish an efficient system to audit public expenditures and to fight corruption, **the CPAR recommends** that Government consider development and implementation of a medium-term strategy for the reform of the country's supreme audit function, which would

- Clarify the mandate of the COC and upgrade related legislation (including review of division of responsibilities between the executive and the supreme audit institution);
- Provide training to staff to upgrade and maintain their skills;
- Channel all monetary penalties through the general consolidated fund;
- Finance staff salary and operating expenses through regular budget appropriation;
- Design and implement an effective system of internal audits within each procuring entity, coordinated possibly by an internal audit unit in the Ministry of Finance. The internal audit units would not be subordinate to the Chamber of Control. The units would have a wide mandate to supervise all budgetary expenditures in terms of strictly defined and uniform criteria;

- Mandatory regular publishing and detailed financial reporting, accessible to the public, for every budget organization.

4.3 National Anti-Corruption Program

There is resistance to the principle of audit from many interest groups. The traditional trade links within the CIS are to some extent maintained by government organizations and the industry, which results in the continuous use of direct contracting. Nationwide surveys have established that corruption permeates Georgian society, undermining the credibility of the State and its officials.

4.3.1 Survey on Corruption

In 1997, Georgia accepted the Bank's offer to conduct surveys on corruption. The results were published in the report "Corruption in Georgia – Survey Evidence" in June 2000. The main findings of the surveys, targeted at households, enterprises and public officials, were that

- Corruption is significant and increasing;
- The customs services, tax authorities, police, traffic police and energy companies are perceived to be the most corrupt;
- The main causes of corruption are:
 - the existence of large rents due to loopholes in laws and regulations;
 - the high degree of discretion of public officials;
 - the extremely low official salaries of public officials; and
 - the low degree of accountability, which limits the probability that corrupt officials will be detected and prosecuted.

The survey confirmed that corruption literally permeates Georgian society, undermining the credibility of the state, impeding its economic development and stifling its ability to reduce poverty. Fortunately, political leaders have recognized the critical need for the State to undertake serious and immediate action to combat corruption. President Shevardnadze has declared:

"If we fail to avoid this national disaster, if we fail to cure the nation, public and state from the horrible, poisoning malady of corruption, Georgians as a civilized nation and Georgia as an independent, democratic state will have no future."

4.3.2 Working Group and Program Launch

Following the publication of the survey, Presidential Decree No. 296 of July 9, 2000, established a working group to elaborate a National Anti-Corruption Program (NACP). In November 2000, the working group presented interim NACP guidelines with the objective of initiating a broad public debate that would create political and social consensus in support of the NACP and its implementation. The proposed NACP guidelines presented a thorough diagnosis and excellent strategy that covers all relevant areas. The guidelines underscored the need for a balance between prevention, detection, prosecution and education, and the need for broad-based civil society oversight and monitoring. Key policies included amending the Criminal Code to impose stricter sanctions for illegal actions, a review of the tax system, introduction of transparent procedures for issuing business licenses and permits, and establishment of effective public procurement and of internal and external audit mechanisms.

Based on these guidelines, the working group submitted to the President a final draft NACP at the end of March 2001. Having completed its mandate, the working group was disbanded.

Simultaneously, the National Security Council reviewed and cleared a draft Decree on the establishment of an Anti-Corruption Agency and recommended it to the President for signature.

While reviewing the draft decree to establish an anti-corruption agency, the President issued Decree No. 95 of March 15, 2001, requiring the implementation of a set of preliminary anti-corruption measures that include setting up a Civil Monitoring System to review activities carried out by the Customs Department the elimination of most of police posts on highways, and the submission by all Ministries and State Departments of licensing activities. Although these measures are very limited in scale compared to the NACP proposed agenda and do not address the causes of corruption, the President indicated that he wanted to demonstrate his commitment towards the fight against corruption and to spur civil society involvement. For many observers, failure to implement the decree satisfactorily could seriously compromise the credibility of the Government and the support of the civil society towards the full-fledged implementation of the NACP.

Then on May 8, 2001, the Anti-corruption coordination Bureau was established by Presidential Decree No. 187. However, as of May 2001, the approval of the NAC program by the President was still pending.

The launch and implementation of the proposed NACP clearly represents a daunting task that will require consistent and concerted efforts by government, civil society and the international community to curb the influence of corruption on Georgia's political, economic and social life. Nevertheless, the struggle against corruption rests upon continuing strong political will and a consistent strategy.

4.4 Recommendations for Anti-Corruption Measures

The Government may consider the following recommendations in the finalization and implementation of the NACP:

- Finalize and adopt the NACP urgently in order not to break the momentum;
- Ensure that the new Anti-Corruption Agency can function as an independent body reporting to the President as the head of executive and comprising respected individuals from civil society and government agencies;
- Prioritize public sector reforms proposed under the NACP in light of available resources. In the medium-term, priorities should be given to improving: (i) public expenditure sector management (budget, audit, procurement and finances); (ii) performance of revenue-collecting agencies; (iii) civil service employment requirements and conditions; and (iv) policymaking institutions;
- Set up benchmarks by which success of the NACP can be assessed over time; and
- Seek support from multi- and bi-lateral donors and coordinate their actions.

5. Public Sector Management Performance

5.1 Extent and Composition of Procurement under LSP

The data collected by the SPD for 1999 and 2000 only partially reflect the magnitude of public procurement because they do not include procurement from off-budgetary funds, which are not subject to the LSP and therefore not reported to the SPD. For example, the Ministry of Tax Revenues reported GEL 281,200 spent from their extra-budgetary funds on procurements in 2000, while their allocation from the central budget for procurement amounts to GEL 121,335.

The following data obtained from the Ministry of Finance indicate that despite the slight increase in total revenues and total expenditures, public funds available for expenditures on works, goods and services have decreased drastically.

Government Spending from the State Budget, 1998-2000 *

	1998		1999		2000	
	Planned	Actual	Planned	Actual	Planned	Actual
Total Revenues and Grants	752,147.2	621,886	922,500	650,164	695,115.5	640,256.3
Total Expenditures and Net Lending	930,546.8	797,251.3	1,231,900	904,837.2	992,567.1	833,870.1
Current Expenditures	845,406.5	721,005.1	963,717	757,969.3	798,618.2	724,136.4
Goods and Services	282,600	233,670	313,187.7	208,934.8	124,660.4	111,483.8
Capital expenditures	47,771.8	40,508.2	25,046.3	20,653.5	17,610.9	13,646

* All figures in thousand GEL

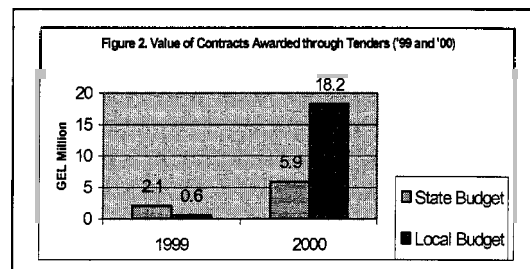
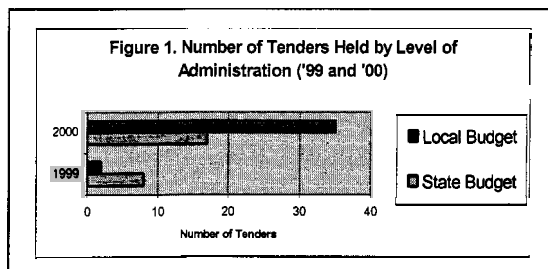
** Excluding Interest Payment and Subsidies and other current transfers

*** Goods and Services category also includes expenditures for utilities.

Based on SPD data for 2000, GEL 114.1 million from the state budget was allocated to central procurement and GEL 96.1 million (84 percent) was actually disbursed. The local budgets were allocated GEL 142.2 million for procurement out of which GEL 126,000 (88 percent) was disbursed.

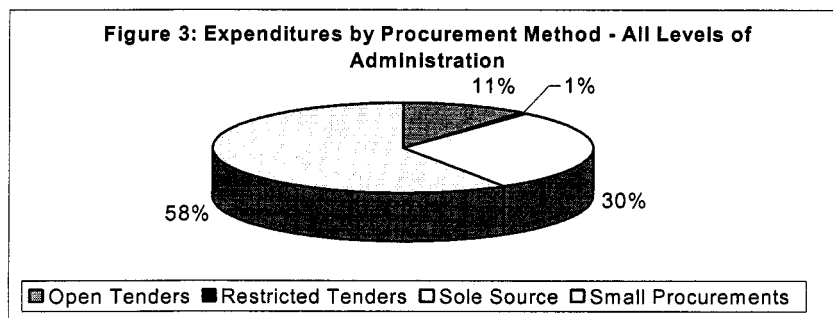
The share of contracts awarded following competitive tendering procedures in accordance with the LSP is small (Figures 1 and 2). During 1999, a total of 10 tenders were carried out resulting in a total contracted amount of GEL 2.7 million. Central purchasing accounts for 77 percent of the total contracted amount (GEL 2.1 million, 8 out of 10 tenders through 21 contracts; multiple contracts were awarded per bid, to implement different portions of the procurement.).

In 2000, there was an increase in the number of tenders. A total of 52 tenders were carried out, resulting in a total contracted amount of GEL 24.1 million. While in 1999 central purchasing accounted for 77 percent of the total contracted value, in 2000 municipalities handled a larger share of transactions. Thirty-five tenders were held at the local level with contracts totaling GEL 18.2 million, 75 percent of the total contracted value, while 17 tenders were conducted (39 contracts) at the central level, amounting to a total contracted value of GEL 5.9 million. Interestingly, average contract value is higher for municipal than for central purchasing (GEL 537,000 as compared to GEL 150,000).



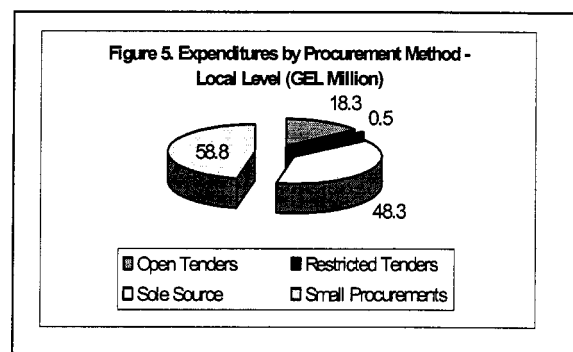
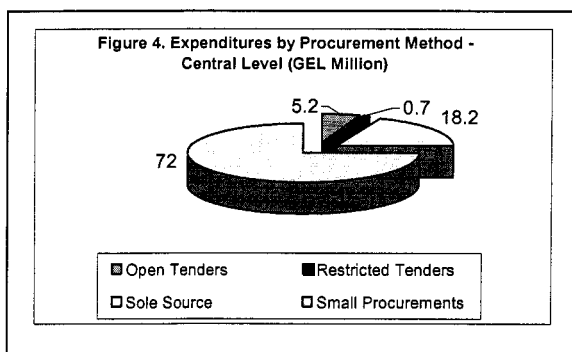
5.2 Competitiveness of Public Procurement

Looking at both levels of administration, competitiveness of public procurement appears to be rather poor, with most procurement expenditure being done through sole source (30 percent) or following “small procurements” (60 percent), leaving few expenditures handled following open (11 percent) and restricted (1 percent) tendering (Figure 3).



Total disbursements for procurements in 2000 amount to GEL 222.1 million (GEL 96.1 million central and GEL 126 million local). According to SPD, almost GEL 131 million is spent on so-called small procurements that are described as operating expenditures (small office supplies, fuel, etc.) purchased from any supplier of the procuring entity's choice and without benefit of contractual arrangements. These are low-value transactions below GEL 10,000 for goods and services and below GEL 50,000 for works. Sole source contracts amount to GEL 66.3 million. Most of these contracts are below GEL 25,000 for goods and services and below GEL 120,000 for works, although some larger value sole source contracts have been awarded.

Unstable and unpredictable availability and disbursement of funds, coupled with a lack of proper planning by the procuring entities, could be possible explanation for such a phenomenon, along with absence of enforcement of the LSP. The extent of expenditures through small procurements and sole sourcing is however alarming. Figures 4 and 5 demonstrate that the problem exists at both the central and local levels, with competitiveness being slightly higher at the municipal level.



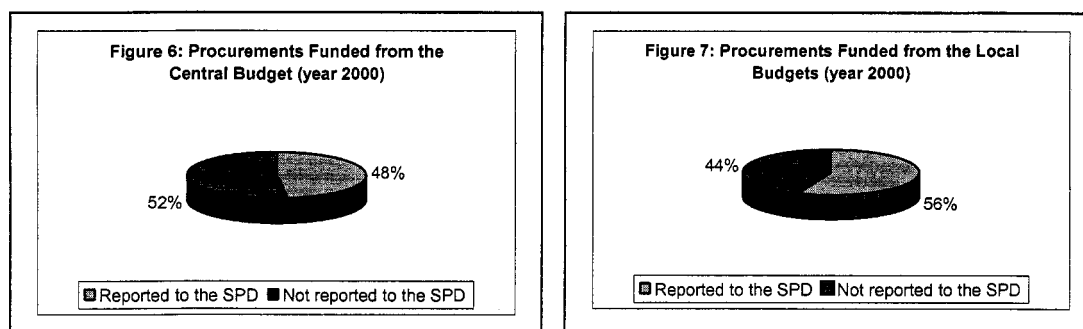
5.3 Impact of Budgetary Constraints

Due to the irregular availability of State funds, procuring entities are frequently unable to fulfill their contractual payment obligations and are forced to terminate contracts. This has resulted in claims from suppliers and contractors and an increasing number of arbitration cases and penalties,

which in turn worsen the already critical budget situation and result in a loss of confidence in the GOG by the private sector.

5.4 SPA Database and Registry

The State Procurement Implementing Regulations of August 1999 obliged the MOE to create and maintain a uniform database for state procurement-related information. In the draft of the March 2001 amendments to the LSP, this function was shifted to the State Procurement Agency. Such a database has already been set up by the SPD. Currently it embraces about 144 procuring entities (of which 60 are funded from the central budget and the rest from the local budgets) that have at least once reported their procurement to the SPD (see Figures 6 and 7). The information in the contracts database is classified by method of procurement, item of procurement, estimated and actual values of contracts, duration of contracts, and provider of services/goods.



The database also contains the “blacklist” of providers who failed to discharge their contract obligations. Its purpose is solely informative. The firms on the blacklist are not banned from participating in future procurements. The SPA may notify the procuring entity regarding the unreliability of such firms, but the final decision to invite the firm to bid is the decision of the procuring entity.

In addition to the database, the SPD and now the SPA has established and maintains a registry of suppliers that have supplied a state entity on at least one occasion. The registry currently counts 500 suppliers, who are considered to be qualified and need not prequalify.

6. Performance of Bank-Assisted Projects

6.1 Nature of the Portfolio

Georgia joined the World Bank in 1992 and IDA in 1993. So far, the objectives of the Bank’s assistance have been to reverse economic decline, assist the transition to a market economy, and alleviate poverty. Twenty-four IDA credits totaling US\$557 million have been approved with specific focus on (i) improving public management; (ii) developing human resources; (iii) building institutional capacities; (iv) strengthening safety nets; (v) promoting regional environmental initiatives; (vi) rehabilitating infrastructure; and (vii) promoting private sector development. As of March 2001, eight IDA-financed projects totaling US\$244 million have been completed satisfactorily and 16 totaling \$313 million are under implementation. Six projects are under preparation.

Of the 24 IDA-financed operations, five were adjustments credits for US\$ 280 million and 19 were investment or technical assistance credits for US\$ 277 million. Such an important volume

of adjustment lending fully justifies a close look at public expenditures management systems and procurement regimes. Regarding investment and technical assistance operations, the Bank's procurement guidelines and standard bidding documents have been applied, including ECA sample standard bidding documents for NCB works, NCB goods, IS for goods and minor works.

6.2 Performance of the Bank-assisted Portfolio

The overall performance of the portfolio has returned to a satisfactory status after a worrisome performance during FY 2000. The March 2000 CPPR indicated that portfolio performance had seriously deteriorated, with five projects with unsatisfactory development objectives or implementation performance. Since then, performance has improved, with only one project rated unsatisfactory. As of May 1, 2001, ratings given to the Procurement category by the Bank's supervising team are satisfactory for all projects.

The main problems that have recently affected the portfolio involved the lack of counterpart funds, the unclear taxation policy and regulations applying to contracts, the ambiguous operation of special accounts, and variations in the roles, organizational structure, and accountability frameworks of different project implementation units (PIUs). Following the recent decentralization of portfolio management responsibilities to the Bank's Office in Tbilisi and the pro-active collaboration of the Government, these problems are being satisfactorily addressed.

- Counterpart funds. Government has made adequate provision of counterpart funds a priority.
- Taxation. The Government's decision to impose taxes on all contracts has led to a review of financing arrangements for existing projects. Future project cost estimates and financing will take the new taxes into account.
- Special Accounts. Interim arrangements have been made to open new SAs in commercial banks.
- PIUs. Steps are being taken to clarify PIUs' legal status and standardize their employment conditions.

6.3 Procurement Performance

6.3.1 Procurement Strengths

Most PIUs are staffed with relatively well-paid local consultants and include at least one procurement specialist with a good knowledge of the Bank's guidelines and procedures. Most projects provide for formal procurement training, and procurement plans are regularly updated. Although the Bank's Office in Tbilisi does not include a procurement advisor or specialist, an internationally recruited financial management specialist has recently been assigned to the office in order to strengthen the financial management of the portfolio and improve auditing and oversight capacity in Georgia, Armenia and Azerbaijan.

6.3.2 Procurement Weaknesses

In November 1999, the World Bank commissioned a specialized and independent consultant firm (Global Procurement Consultants Limited) to carry out a procurement audit of two WB-assisted projects. Under these two projects, a total of 52 contracts were reviewed, of which 38 had been below the prior review threshold. The auditor concluded that the procurement processing of 11 contracts valued at US\$4.1 did not meet the requirements of the Credit Agreements. These cases are currently being reviewed by the Bank. Several minor deficiencies were also detected in several other contracts.

The main findings, which were made available in June 2000, revealed the following weaknesses:

1. Weak contract administration (poor planning, poor documentation, no cost estimate);
2. Too short a period allowed to prepare and submit bids;
3. Inadequate specifications, including use of brand names;
4. Use of procurement methods not included in Credit Agreement;
5. Slicing of contracts to bring procurement within financial threshold of national shopping;
6. Modifications of contract specifications, scope, quantities and unit prices after bid submission;
7. Contracts signed at higher amount than evaluated without justification;
8. Inadequate justification for bid rejection; and
9. Poor quality of works executed and use of purchased equipment.

It is true that most of the contracts reviewed were initiated four to six years ago, at a time when the PIUs had limited experience with Bank's procurement requirements. In addition, it was underlined in the auditor's report that project financial audits failed to uncover any wrongdoing with regard to contracting activities. But it was the government's own conclusion, through its working group on anticorruption, that foreign-assisted projects are not exempt from corrupt and fraudulent practices. The fact that the Bank supervising teams rated the two audited projects satisfactory—and even highly satisfactory at one stage—with regards to procurement activities indicates that the limited time available for project supervision may not be sufficient for the sort of detailed post-review work that would be required to detect and correct project-specific deviations, especially in an environment where corruption is endemic.

A number of short-term measures to improve procurement oversight in the field are being implemented or considered:

- (1) Hold pre-bid conference for NCB contracts to educate contractors;
- (2) Conduct a specific audit of shopping procedures for the entire portfolio and compare price obtained with local markets;
- (3) Limit use of shopping procedures to a strict minimum;
- (4) Promote the utilization of the UN IAPSO services for the procurement of off-the-shelf goods such as vehicles, office equipment, furniture, computer hardware and software;
- (5) Provide procurement training to all Operations Officers based at the WB office in Tbilisi;
- (6) Assign a Bank Procurement Accredited Staff from a resident mission in the Caucasus to provide regional services;
- (7) Define composition of selection/evaluation committees prior to project negotiations, limit number to a maximum of five specialists with composition subject to prior review, and provide training to committee members.

Private Sector: Regulation and Practices

7. Commercial Regulation

In the aftermath of independence in 1991, the economic situation in Georgia became unstable. This was manifested by a reduction in personal incomes, devaluation of the national currency, a dramatic reduction in industrial and agricultural production, weakening of the tourist industry and an increase in unemployment. Since 1994, Georgia has begun the implementation of an economic stability program involving improvement of the taxation and bank surveillance systems, abolition of state orders, liberalization of trade and currency exchange and a privatization policy. In September, 1995 a national currency was introduced. As a result of the economic stability program, a process of economic growth began in Georgia. In parallel, a new market economy

oriented legislative base was established. It includes a Civil Code, a Tax Code, a Law on Promotion and Guarantees of Investment Activities, a Law on Entrepreneurs and a Law on Privatization of State Property.

7.1 Law on Entrepreneurs (1994)

The Law on Entrepreneurs sets forth the organizational and legal forms for participants in commercial activities. These are Individual Enterprise, Solidarity Liability Company, Commandite Company, Limited Liability Company, Joint-Stock Company and Co-operative. Limited liability companies, joint-stock companies and individual enterprises account for the greatest portion of enterprises registered in Georgia. An enterprise of any organizational form becomes a legal private entity only from the moment it is entered into the Company Register. The law covers financial accounting and reporting, minimum mandatory amount of a Charter Fund, and stipulates that annual accounts, financial accounting registers and business reports are subject to mandatory checking by independent auditors.

7.2 Law on Supporting Small Enterprises (1999)

The Law on Supporting Small Enterprises defines the economic and legal basis for the development of small business enterprises in Georgia. According to the Law, a small enterprise may exist in any form determined by the Law on Entrepreneurs. Small enterprises are those companies in which the number of employees and amount of annual turnover do not exceed fixed amounts ranging from 10 to 40 employees and GEL 50,000-500,000 depending on the sector. The law also defines special measures to stimulate their development, including financial support programs, financial and consulting services, training of small enterprises employees, and leasing services. Small business development and support centers and small business coordination councils have been established to promote small business development.

7.3 Law on Promoting Investments and Guarantees (1996)

The Law on Promoting Investments and Guarantees defines the legal basis both for foreign and local investments and investment guarantees. The Law aims to restore a legal environment that promotes investments. Revocation of an investment is allowed only in special cases and only by paying an appropriate amount of compensation. The investment regime applies equally to foreign and local investors. Foreign investors are free to repatriate their profits. Disputes may be resolved by mutual agreement, in Georgian Court, through the International Center for the Resolution of Investment Disputes, or any international arbitration court that is established according to UNCITRAL regulations.

7.4 Law on Licensing Entrepreneurial Activities (1999)

The Law on Licensing governs licensing of entrepreneurial activities. Licensing is required only for 12 types of entrepreneurial activities that may create a certain danger to human health, life, state security or public order. The license is issued for an indefinite period of time and is not transferable.

7.5 Civil Code and Civil Procedural Code (1997)

The Civil Code comprises legal norms and principles governing contractual relationships between legal private entities. Chapter One of the Code is devoted to Contract Law. It defines general norms for concluding contracts involving property, purchase, and lease. Chapter 5 (article 65) stipulates that in a private law relationship, administrative bodies acting as legal bodies under

Public Law shall be guided by relevant norms of the Civil Code when entering into contracts (including State Procurement Contracts).

In Georgia, civil cases may be heard by courts of common law. The Courts of Primary Jurisdiction for the courts of common law are the Regional and District courts, whose rulings may be appealed to the Appeal Chamber of the District Court. That court's ruling may be appealed to the Cassation Court. Courts of Common Law consider cases whose parties are citizens, enterprises and organizations. Parties can also agree to submit a property dispute to a private arbitration court.

7.6 Private Arbitration Law (1997)

The Private Arbitration Law provides regulations for considering civil disputes by permanent or ad hoc private arbitration panels. The arbitrator's decision is binding on the parties in dispute and when not implemented, forcible implementation is mandated. Procedural norms in Georgia are broadly consistent with internationally recognized rules for arbitration e.g. UNCITRAL

In Georgia economic (business) disputes are mainly resolved by the Common Law Courts of general jurisdiction or informally rather than by court. Recently there have been some precedents of using private arbitration panels and it is expected that they will be more broadly used in the near future. This is because after the abolishment of arbitration courts, arbitration institutions did not exist in the country. Recently some permanent arbitration courts have been established and it is likely that in the near future they will be more broadly used.

7.7 Tax Code (1997)

In its foreign economic relations, Georgia does not apply any restriction or banning that would conflict with international practice. The Georgian Tax Code identifies 15 types of customs regimes and defines issues related to the functioning of the customs department. It is within the competence of the customs regime to collect from entrepreneurs all taxes (duties) that fall due when goods or transportation vehicles cross Georgia's borders. The rates are determined by other laws such as the Law on Customs Duties.

During times of civil conflict, Georgian customs borders can not be fully controlled. This results in a rather heavy volume of smuggling, which complicates tax collection.

8. Commercial Practices

8.1 Private Sector Development

The most important sectors of the Georgian economy are: agriculture (21 percent of GDP), industry (13 percent), trade (12 percent) and transport (12 percent). The main exports are ferro-alloys, wine and fertilizers. The main imports are commodities such as oil, sugar, electricity, wheat and flour. The high share of trade and communication is to a certain extent a result of Georgia's geopolitical location. Trade and cargo haulage operations occupy a major place in Georgian business activities.

Agriculture accounts for almost a third of the GDP, with half of the population living in rural areas. To assist the revival of the sector the Government undertook to transfer the land to private hands and to provide better access to credit through credit unions.

Following independence, the manufacturing sector was hit hard by the disintegration of the soviet industrial system and the shift to market-based energy prices and lack of access to investment. By 1996, Georgia's industrial output was estimated at 14 percent of its 1989 level. Privatization of the sector was then undertaken. Construction is rebounding after an almost complete collapse. Currently, most construction is private and carried out by small-scale firms. Very few projects are financed by the state. Reconstruction and modernization of existing tourism facilities, along with the design and implementation of publicity campaigns, are top priorities. In addition, the government seeks cooperation with WTO and UNESCO in the framework of the Big Silk Road Project.

The reform of the banking sector began in 1995 with the National Bank of Georgia (NBG) as supervisory body. The NGB instituted bank consolidation and reform, imposing stringent reporting requirements and progressively increasing the minimum capital requirements. As a result, the number of banks fell from 247 in 1995 to 33 in 2001. The remaining banks are still small and undercapitalized and further consolidation is expected. Still, the financial sector plays very little part in the economy.

8.2 Foreign Trade and WTO

Immediately after the dissolution of the Soviet Union, Georgia started preparation for membership in GATT and then WTO. Assisted by multi- and bilateral donors, Georgia became a full member of WTO on June 14, 2000. Negotiations to become a signatory to the GPA are scheduled to start in August 2001. Membership of WTO allows Georgia to get Most Favored Nation status in trade with the 134 WTO member countries. The main benefits expected include increased efficiency of local industry, increased foreign investment, increased exports; increased transparency; and reduced prices. In addition, Georgia has signed free trade agreements with eight CIS countries.

8.3 Constraints and Opportunities

Although Georgia has made substantial progress in establishing the legal and regulatory framework for a market economy, a number of obstacles hamper a faster pace of private sector growth: corruption, smuggling, bureaucracy, ambiguous legislation and lack of access to affordable credit. Most of these issues would be addressed under the umbrella of the proposed anti-corruption program.

Standards. Georgia is in the process of replacing 21,000 soviet-type standards with internationally recognized standards, to be completed within three years. However, the responsible agency GeoStandard has so far struggled to meet WTO regulations. Although Georgia takes standards from the International Organization on Standards (ISO), the question of whether to take the U.S. or EU approach to standards is still debated. A decision should be made and implemented as quickly as possible.

Legislative Environment. The enforcement of all legislation would be facilitated by eliminating ambiguity in legal texts. In part, this ambiguity reflects outdated legislation still in effect, the rapid pace of the legislative drafting process and lack of familiarity with new laws. In parallel with the elimination of ambiguities, the Government should also focus on enforcement and information.

The business community claims that one of the main reasons why foreign investments are very limited is the weak rule of law prevailing in Georgia. For example, court rulings have sometimes led to unjustified changes of enterprise control that avoided desirable restructuring of enterprises

in line with the bankruptcy laws. Moreover, prosecutions of corrupt judges, as well as other government officials, should lead to stronger penalties than simple loss of position or reassignment, as it is the case now. The judiciary system could enjoy broader public support if it would apply impartially the legislative base. Recent progress towards establishing a stronger rule of law includes the recent law that requires judges to pass an examination to retain their seats.

Banking Sector. The commercial banking system has substantially improved in recent years but remains weak, with a majority of small and under-capitalized commercial banks. Most of the loans are small, short-term and expensive. However, the National Central Bank has tightened supervision and encouraged consolidation by progressively raising the minimum capital requirement. Over the past two years, the total number of commercial banks shrunk from 294 to 33. Further consolidation is expected.

Civil Service. It is believed that Georgia's heavily corrupt civil service is a major obstacle to the development of the private sector. The survey on corruption of June 2000, doing business in Georgia is difficult and expensive. The system of extortion used by public servants when dealing with entrepreneurs has created an informal tax chain where unofficial payments received exceed the revenues of the State. This shadow economy is estimated by some at 50 percent of all activities.

Arbitration. The international business community was pleased to learn that the International Chamber of Commerce inaugurated in December 2000 a Court of Arbitration, which is based on the recent Laws on Private Arbitration, and on Private International Law. Court decisions will be binding in countries that signed the 1958 New York Convention, including Georgia. The parties are allowed to choose who will be the judge from a list of twelve candidates.

Energy Crisis. In order to attract major foreign investments and sustain economic development, the Government will have to resolve the energy crisis that has affected the country during the past eight years despite major investments in the sector.

8.4 Privatization

Georgia made the privatization of state property an important part of its economic reforms. The strategy and mechanisms of the privatization process are stipulated by the Constitution of Georgia, the Civil Code and the Law on Privatization of State Property of May 30, 1997. The Ministry of State Property Management (MSPM) is responsible for carrying out the privatization of state property and for controlling related organizational issues. The purchaser of any state property may be an individual or legal person, either a resident or non-resident of Georgia. The law stipulates that the state's share in the property after the purchase of the state property should be less than 25 percent.

The privatization of state enterprises is being carried out in two distinct phases. The first phase saw the successful privatization of about 15,000 small and medium-sized enterprises in the trade and service sectors between 1993 and 2000. The second phase, which is assisted by the World Bank, was initiated in 1997 for the privatization of industrial, energy and communications enterprises, and ports and public services facilities such as water supply and sewerage, through international tender. For this purpose a Case-By-Case unit was created within the MSPM to carry out the large enterprise privatization program³. The MSPM has encountered difficulties in this

³ With Bank assistance MSPM created an Internet-based privatization marketing website. This website provides information on investment opportunities arising from privatization to potential worldwide

second stage, mainly because the targeted enterprises are large, more expensive, equipped with outdated technologies, have weak management, are not competitive, are heavily indebted and in need of major investments. So far, several large entities in the energy, communication and transport sector have been privatized.

In addition, the entire process is plagued with allegations of fraud and corruption. Public opinion towards privatization is largely negative, as many feel that the political leaders and bureaucrats are selling what not so long ago were called the country's jewels for discounted prices in exchange for bribes. While it is difficult to assess the extent to which this type of transaction occurs, certainly the process is ripe with rich incentives. Where the Bank has a place at the table, it has sought to support open, competitive, and strategic privatization, restructuring of newly privatized entities, and improving the corporate management of the privatized enterprises (power rehabilitation, enterprise rehabilitation, private and financial sector projects). Bank project funds have also given concrete support, as for outside financial, legal, and technical advisory services during the privatization process. The international donor community should continue to assist the privatization process and support the privatized enterprises, as this is the best way to set a standard and bring outside eyes into the process.

8.5 Commercial Procurement

The private sector is still in a nascent state, struggling to meet the challenges of a market economy. For a multitude of reasons, the majority prefers to continue to do business the old way, which is characterized by ad hoc decisions, absence of market analysis and surveys, cash transactions, personal relationships, absence of a formal contract, smuggling to avoid taxes and duties, low quality products, no respect for deadlines, and delayed payments. Disputes that arise between the parties are often resolved through informal mediators and negotiations. At all cost, the parties try to avoid legal recourse due to the weak rule of law.

With regard to procurement, the private sector rarely applies competitive procedures for procuring goods, works and services. Direct purchase is the main method of procurement and it is done based on personal or traditional contacts. Contractors' representatives interviewed for the CPAR report indicated their strong objection to awarding contracts to the lowest bidder, which in their view always results in low quality products. Their preference is for the old system, where contracts are awarded to the bidders that are the closest to the cost estimate. In order to convince the industry of the advantage of open competition based on price, a major effort will have to be undertaken to make sure that the contractors that do not deliver in accordance with the terms of their contracts would be penalized as specified in the contracts or have their contracts terminated and their performance security forfeited. Training should also be provided to project supervisors in contract management.

Considering that competition is rarely encountered in the private sector and that smuggling, fraud and corruption are rampant, thresholds for commercial practices under Bank-financed operations should be kept low, with some variations depending on the sector. Considering the increasing participation of foreign investors in the power and telecommunications sectors, slightly higher thresholds could be justified in those sectors. In other sectors that are still struggling to adjust to a market economy, the thresholds should be kept low.

8.6 Customs

Customs procedures are complex, time-consuming and often applied arbitrarily. The share of illegal imports in the overall volume is estimated at more than 40 percent of the total imports. One of the main reasons is the complexity of the custom tariff system, which has several thousand classifications and custom rates. A customs duty of 12 percent is levied on most non-CIS imports. As of January 1, 1997, certain goods, including specific capital goods, electricity, natural gas, and equipment previously taxed at 12 percent, were made subject to a customs duty of 5 percent. All imports are subject to a general customs processing fee of 0.2 percent. Georgia will benefit from slight tariff reductions negotiated within the framework of the WTO. The agreement requires Georgia to reduce its import tariffs over a period of 5 to 7 years.

The level of computerization of Customs operations is low. Common Customs abuses include:

- under-invoicing to lower the assessed import duties;
- mis-description of goods to place them into a lower-rated Customs classification category;
- bribery of Customs officers, reported to be commonplace; Customs officers use incorrect or incomplete import documentation as an opportunity to demand bribes.

To avoid or minimize exposure to these abuses, many importers employ specialist logistics companies to handle Customs formalities and documentation on their behalf. Theft of goods during inland transport is commonplace. Many importers hire armed guards to accompany their shipments.

To attack the above listed abuses, the Customs Department competitively selected a private pre-shipment inspection company and signed a two-year contract in 2000. All goods valued at more than \$2,500 equivalent are subject to the pre-shipment inspection.

In addition, the Customs Department has developed an action plan for customs reform, with technical assistance from EU-TACIS and Eurocustoms. The action plan aims at improved relations and coordination with government agencies and the business community, at establishing improved mechanisms of control and enforcement of the Customs Code, at recruitment and training of personnel, and at a structural re-organization of the Customs Department. Eurocustoms is currently providing TA for the recruitment and training of new staff. EU-TACIS assisted in the drafting of normative acts for the Customs Code. In addition, the Customs Department has established a working group with the State IT department to prepare a plan to expand customs infrastructure and install a communications network in all regions of Georgia (ASYCUDA was installed three years ago in some regional and Tbilisi offices).

B – STRATEGIC MEASURES AND ACTION PLAN

9. General Risk Assessment

9.1 The Letter vs. the Spirit of the Law: Early Days

Georgia's experience with formulation and implementation of a unified public procurement policy has been brief. Increasing attention has been directed at public procurement reform since 1997. The reform efforts concentrated as a first step, on preparing a solid legal framework to form the basis for launching procurement reform. But it is barely two years since the Law on State procurement came into effect in July 1, 1999, with passage of implementing regulations the

following month. Prior to enactment of the LSP, many entities had developed their own internal procurement procedures and procurement was conducted in an inefficient and non-transparent way.

The LSP is modeled on the UNCITRAL Model Law and although improvements are required, especially concerning enforcement provisions, it forms a good basis for increased efficiency and transparency in public expenditures.

Despite strong top-level commitment within the executive and the legislature, problems with implementation have slowed down the reform. There is very little evidence of adherence to the legislation. In monetary terms, only 1 percent of the annual value of contracts entered into in 2000 has been procured through open tendering. As a result, the public has no trust in the system and the private sector is not interested in business deals with GOG.

The GOG is aware of the implementation problems, and in response to pressure to meet SAC III conditionalities, has made substantive changes to the legislative instruments to improve monitoring of the operations and enforcement by the executive. But satisfying the SAC conditionalities will not be enough. For one thing, there are additional changes in the current draft amendments to the LSP recommended by the CPAR mission that will also be required, in particular concerning removal of the heavy hand of MEIT and establishing the independence of the state procurement agency. The LSP also further needs to be amended to incorporate enforcement measures.

Moreover, while inclusion of provisions and measures in the text of laws and regulation are important, they are not the only, or even the main, obstacles to effective implementation. SPA also desperately needs to receive the funding it requires to do its job. It also needs to set up structures and procedures for enforcing the law and its regulations, without which they remain comprehensive, but toothless, documents. Expecting compliance without enforcement measures is unrealistic, even where good law has been in effect for a long time.

Making compliance with procurement regulations non-voluntary and attaching a price to non-compliance is essential, particularly in Georgia, where (as in other former Soviet republics), possibly the largest obstacle to implementation of procurement reform is the persistence of the old patterns of supply. Weakening the power of omnipresent vested interests will require investment in enforcement and in training. Building the capacity of staff at Georgian procuring entities at all levels of the administration is a massive challenge that has just gotten underway. While the initial steps taken by GOG are encouraging, including holding training seminars for senior officials on central and local level, several thousands of officials are yet to be trained.

9.2 Procurement Reform Tied to Larger Anti-Corruption Efforts

Measures that target changes in procurement behavior do not impact in a vacuum. They will succeed or fail as a function of what is going on in the larger context. They will succeed faster, the faster goes the fundamental shift in the attitudes and behavior of politicians and civil servants in the wider environment. The pervasive nature of old attitudes is thus an aspect in the risk of procurement reform process, and the success of procurement reform will rely heavily on the success of the implementation of the GOG's anti-corruption strategy.

NGOs and the media have been involved in monitoring the application of the procurement law and the GOG is encouraged to continue information sharing in the interest of transparency. The CPAR recommends a number of ways in which this sharing can be expanded with regard to procurement and business regulations generally, including creation of information centers, a

distance learning center, and a website. It is also in the interest of those backing procurement reform to ensure that procurement stories are part of the larger anti-corruption effort.

9.3 High Risk

At this time, the CPAR ranks Georgia as a high-risk country in respect of its public procurement system. Further removing the obstacles to successful implementation should be one of the GOG's top priorities. However, this assessment should not detract from nor diminish the recognition deserved for having created a strong legal and regulatory foundation in a short space of time. In this respect, Georgia stands at the head of some of its former sister republics and can be taken as a model. The example of other transition economies in the region further suggest that with steady progress in the larger anti-corruption effort, and by following the road map offered by the CPAR Action Plan for Georgia, the savings realized from competitive procurement reform can be tripled in 2 years time. Literature suggests that savings can amount to 15 percent of the State Budget. The CPAR report estimates that coverage of LSP/IR-compliant competitive procurement procedures can increase from the current 12 percent to 50 percent within five years.

10. Strategic Workshop of June 2002

From June 3-5, 2002 the GOG and SPA with the support of the Bank organized a strategic workshop to consider procurement issues raised in the CPAR, discuss general issues of procurement policy and to devise a strategy to take forward the development of procurement law and implementation in Georgia. The full program for this workshop is attached in Annex 6.

All interested Ministries and departments, representatives from the private sector, civil society and the donor community had been invited to attend the workshop and a number did. Obviously, the SPA was in attendance as well as representatives of the Ministry of Finance and the MEIT. However, the spread of procuring Ministries and departments who attended was disappointing and demonstrated a certain lack of commitment on the part of the Government as a whole to procurement reform. Likewise, private sector, civil society and donors were poorly represented. This may have something to do with lack of awareness and there is little doubt that the SPA has insufficient funds to disseminate information on procurement reform as widely as it should. Without high visibility and status, there is little more that the SPA can do. This may account for the comparatively narrow turnout but is nonetheless of concern.

Despite the narrow representation, the number of participants was encouraging and, although there was a slow start to the proceedings, the audience actively participated in the discussions. The workshop included, as well as a number of presentations by local officials, Bank staff and invited guests with international procurement experience, a series of break-out sessions in which the participants were encouraged to discuss and debate the current problem areas of procurement reform in Georgia as identified in the CPAR and to offer solutions and recommendations for the way forward. The intention was to come up with a blueprint for future reform based on the input of the participants.

This intention was amply fulfilled and the results of the discussions in the break-out sessions were debated in the plenary sessions. Based on these discussions, the SPA was able to design a framework for ongoing reform which received the support of the stakeholders present. The objectives and means of implementation of these reforms were discussed subsequently with the Minister of Economy and with the Vice Minister at the State Chancellery. They have both pledged their support to the continuing reform. In particular, it is anticipated that the blueprint or business plan for continuing reform prepared by the SPA based on the outcome of the workshop will be forwarded to the State Chancellery and to the President and then incorporated into a

Presidential Decree. This Decree will set up a working group of defined key officials who will be assigned specific tasks related to the blueprint. In this way, the reforms will not only bear the seal of approval of the President but will also identify key steps to be taken by senior officials. The task of monitoring the progress of the reforms will thus be made easier and more transparent and will have an accordingly higher probability of success.

The detailed SPA work program resulting from the workshop is set out in Annex 3A. However, some of the main themes (not all of which are new) to emerge were:

- 1) The need to ensure effective coordinating units in each procuring entity;
- 2) The desirability of creating regional structures for the dissemination of information on the LSP and IR and to provide basic guidance;
- 3) The desirability of creating an information website operated and maintained by the SPA. The regional structures could also provide access to the website in the provinces where access is otherwise limited;
- 4) Improved transparency and dissemination of appropriate information;
- 5) The importance of increasing the status and authority of the SPA;
- 6) Improved monitoring based on measurable qualitative and quantitative indicators;
- 7) Improved remedial powers for the SPA;
- 8) The need to ensure proper training and to develop a body of procurement professionals.

Before final adoption into a decree, the SPA work program still requires some more detail to set out precisely the extent and form of some of its components, notably the regional and international training. Although not currently covered in the SPA work program, the Bank would actively encourage and support assistance from appropriate international consultants to assist the government with the design of its training strategy and programs, which should form one of the key tasks in the anticipated Presidential Decree, in order to ensure a comprehensive and sustainable approach.

11. Strategic Measures

11.1 Objectives

This report recommends that an appropriate strategy for advancing the ongoing public procurement reform would focus on removing the obstacles that are slowing down the implementation of the reform.

The main objectives are:

- to increase the scope for competitive procurement in the public sector by completing the legislation and regulation to extend the law's applicability, extend eligibility of foreign bidders, and include enforcement;
- to create real institutional capacity to apply the law and regulations by amending the law to ensure the independence of the state procurement agency, by providing adequate funding, by building capacity of procuring entities at all levels of the administration, and by creating enforcement structures;
- to weaken existing incentives for non-compliance by creating penalties and enforcing them, and by fostering a broader culture of compliance.

11.2 Complementary CPAR and SPA Action Plans

The strategy recognizes that changing rules within the public administration is not enough. To be effective, the Bank must work with its partners to understand and address a broader range of incentives and pressures, both inside and outside of government, that affect public sector performance. A broad framework is thus required, one that addresses competition, having a “voice,” and building of partnerships, in addition to internal rules and incentives. A successful outcome will include restoring the confidence of the public and the business community in the fairness of the procurement system.

A clear agenda of achievable reforms exists. They are set forth in complementary action plans adopted by the state procurement agency and the Bank (see Annexes 2 and 3). The actions that the SPA has been pursuing are linked to the SAC III conditionalities and the signing of the GPA. The CPAR recommendations take a longer view of what is required that goes beyond changes in the law and regulations. Not only the content, but sequencing of the actions has been carefully designed.

These actions plans (Annexes 2 and 3) should now be read in conjunction with Annex 3A which contains the SPA’s Working Program for 2002 based on the outcome of the strategic workshop. This plan will be submitted to the State Chancellery and incorporated into a Presidential Decree setting up a working group to implement the program.

11.3 Sequencing in the Short- and Medium Term

The CPAR Action Plan, and the document as a whole, are intended to act as a unifying tool to bring the GOG, the Bank, and the donors around the table to design a medium-term program and assign funding and support responsibilities. Several donors were consulted during the collection of data and opinions, but none participated in developing the recommendations.

Sequencing will need to take into account what is achievable in the short term, without adversely affecting the realization of the longer-term measures. Comparative advantage in parceling out donor responsibilities can usefully build on current areas of involvement. The Bank can usefully continue to assist GOG in perfecting procurement policy and developing standard bidding documents. The Bank could also assist the Government in developing a training strategy that could have multiple sources of support at the implementation stage.

Short-term priorities include passing the amendments to the Criminal Code to allow the SPA to instigate penalties for breach of the provisions of the LSP, revisions to the Law on Chamber of Control, reducing MEIT’s control function over SPA, and moving to the next phase of anti-corruption activities.

The other immediate priority is to ensure the adoption of the Presidential Decree which puts into effect the working plan devised by the SPA as a result of the strategic workshop and appended in Annex 3A.

Within the current favorable environment for cooperation between GOG and Bank, the Bank would continue its financial support. Good governance and procurement reform fit well into the country assistance strategy and the Bank assistance program under the SRS project. The SRS task team has confirmed that the actions identified as needing support from the Bank could be eligible for financing from the ongoing SRS project. Another opportunity for Bank support for longer term actions rests within planned Public Sector Reform Credit (PSRC) and SATAC III.

12. Recommended Bank Approach for Supervision

12.1 Thresholds and NCB

The following financial thresholds for procurement methods are recommended for Bank financed procurements:

Thresholds by Procurement Method

Procurement Method	Threshold
ICB: Works	>US\$ 600,000
NCB: Works	<US\$ 600,000
Minor Works	<US\$ 100,000
ICB: Goods	>US\$ 100,000
International Shopping: Goods	<US\$ 100,000
National Shopping: Goods	<US\$ 50,000

For the future, in regard to goods for which a sufficiently competitive supply market exists in Georgia and for which foreign firms would not be interested in bidding, the Bank may consider, on a project-by-project basis, the procurement of goods by NCB below a threshold of US\$100,000; above this threshold, ICB would apply for such goods.

Based on the relatively low level of development of the Georgian consulting industry, it is recommended to establish \$100,000 as the national threshold below which shortlists for consulting firms may consist entirely of national firms.

12.2 Prior and Post Review

The Bank should conduct prior review on:

- all contracts for goods and works procured by ICB;
- the first 2-5 contracts for goods and works procured by NCB (may be modified depending on the nature, number and size of contracts);
- contracts with consulting firms >US\$100,000; and
- contracts with individual consultants >US\$50,000.

The Bank should also conduct post review on at least one in five of contracts that are subject to post review.

12.3 Strategy for Fiduciary Safeguards - Action Plan

The fiduciary risk for Bank portfolio in Georgia continues to be high. The overall weak procurement environment raises concerns about the value of money and accountability for public funds, especially because practices vary widely from the formal rules and enforcement is weak. The increasing shift in the World Bank's new lending to social sector projects, which involve thousands of small-value contracts at the sub-national government level that are generally not subject to prior review by Bank staff, and where capacity for implementation and monitoring is generally weak, would further increase fiduciary risks in Bank-financed projects.

Despite the Bank's best efforts, it is simply not possible to fully insulate Bank-financed projects from the systemic problems of the environment in which they are implemented. The Bank's strategy to help reduce opportunities for corruption and thereby help ensure that proceeds of Bank loans are used for their intended purposes with due attention to economy and efficiency, will include the following:

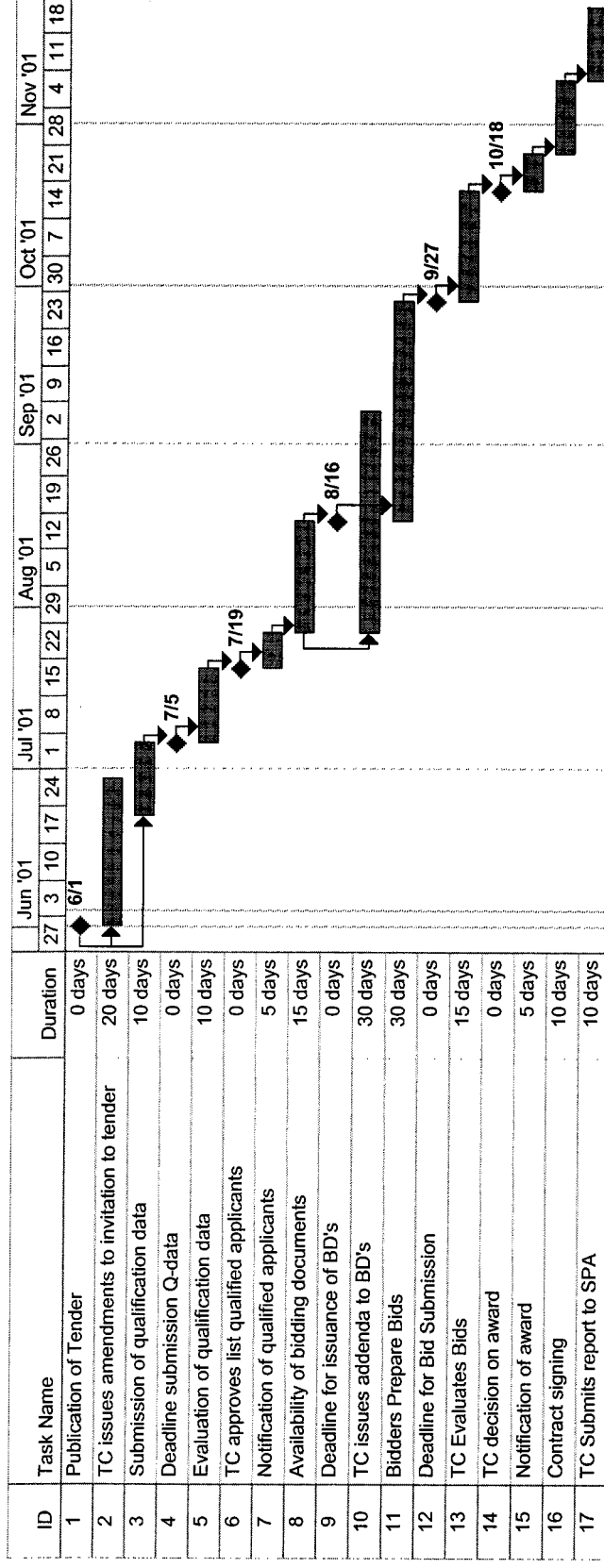
- Building of adequate safeguards for fiduciary risks including actions to strengthen capacity and finalize procurement arrangements at an early stage, in the design of new projects.
- Installation of planning, budgeting, and project management reporting systems at an early stage and requiring updated and satisfactory annual procurement and financial plans and use of these plans for guiding implementation and supervision.
- Additional legal provisions to make the National Competitive Bidding (NCB) procedures acceptable to the World Bank. The current side letter on the acceptability of NCB procedures is being substantially strengthened based on findings of this report, for use in all future projects (see Annex 4)
- Follow up on procurement complaints and audit findings.
- Relying on Corruption and Fraud Investigation Unit (CFIU) to investigate cases of alleged fraud and corruption, and apply sanctions where called for.
- Bank procurement staff should exercise particular vigilance to prevent discrimination by Georgian implementing agencies against foreign bidders under all procurement methods, but especially NCB.
- Given the high level of corruption in the country, Bank staff should exercise particular diligence in reviewing requests received from Georgian implementing agencies to award contracts on a Single Source basis;
- Also as an anti-corruption measure, Bank teams should make sure that procurement post reviews are conducted by every supervision mission and that the Back-To-Office report of every supervision mission contains a specific annex dealing with procurement post review, which should be sent promptly to the Regional Procurement Adviser;
- The Bank should support organization of business seminars to encourage Georgian industry to participate as bidders in Bank-financed projects;

13. Action Plan

The time-based Action Plan, appended to this Report as Annex 2, proposes detailed steps for implementing recommendations made in this report, along with priorities and time periods in which they might be achieved. Annex 3 is the Public Procurement Reform Action Plan prepared by SPD in December 2000 and last updated in April 2001. This SPD action plan is now complemented by a Working Program appended in Annex 3A which is based on the results of the strategic workshop held in Tbilisi in June 2002.

Annex 1

Timetable for Conducting State Procurement



*TC = Tender Committee

Annex 2

CPAR Action Plan for Implementation of Key Recommendations

Objectives/Actions	Responsibility	Year 1	Year 2	Year 3
Completing Legislation & Regulation				
1. Ensure application of enforcement mechanisms in State Procurement Law. Continue to work to amend Criminal Code to identify actions for infringement of LSP (section 1.7, 3.4.9).	SPA/GOG		X	
2. Empower SPA with authority to raise issues of non-compliance and wrongdoing with respective authorities so they can initiate disciplinary actions against offenders of LSP/IR provisions (section 3.4.9).	SPA/GOG	X		
3. In the longer term, reconsider current governance structure of SPA in order to endow it with independence and authority (section 2.3).	SPA			X
4. Ensure that law enforcement (security) agencies provide for implementation of regulations for confidential procurements and mandate SPA clearance of the list of confidential procurements (section 1.7).	SPA/GOG/ NSC		X	
5. Develop a rolling multi-year budget allocation plan and ensure that this is compatible with the new draft Budget Law (section 2.5)	GOG		X	
6. Establish and produce in a transparent manner, fair procedures for addressing complaints through administrative reviews at the SPA (section 3.4.8).	SPA		X	
7. At the latest when GPA membership is assured but preferably before, lower threshold for mandatory publication of invitation to bid in international newspaper to increase foreign bidders' participation in open tendering (3.2.4).	SPA		X	
8. Continue to control the overuse of Direct Contracting and expand the application of Restricted Tendering for procurement of specialized items and requiring SPA to grant waivers for use of both methods if above the threshold established in the LSP (3.4.2).	SPA	X	X	X
Creating Institutional Capacity				
9. Establish and strengthen a specialized and functionally independent unit within SPA for conducting administrative reviews (section 3.4.9)	SPA		X	
10. Provide adequate funding to SPA through State budget that will allow it to carry out its mandate of policy formulation, oversight, and enforcement (section 2.3).	GOG	X		
11. Initiate efforts to build SPA staff capacity through procurement training in specialized institutes (section 2.3, 2.7).	SPA/GOG		X	
12. Assess the possibility to consolidate 8000 procuring entities and their budget	MOF/MOE/	X	X	

Objectives/Actions	Responsibility	Year 1	Year 2	Year 3
allocations to simplify the complex and not cost efficient institutional set-up and develop training strategy to build capacity within the entities (section 2.5, 2.7, 3.4.3).	SPA			
13. Establish permanent procurement units within each procuring entity to provide for continuity and development of procurement related experience and skills (to replace ad hoc Tender Committee Apparatus)(section 3.4.3).	GOG	X	X	X
Building Professional Capacity				
14. Add procurement profession to National Roster of Professions (section 2.9)	GOG			X
15. Introduce accreditation scheme for procurement officers (section 2.9).	GOG		X	
16. Develop national training strategy for public procurement and auditing professionals, entity staff, and business professionals (section 2.9, 4.2).	GOG		X	
17. Nominate training institute to become Distance Learning Center (WBI) to implement procurement training (section 2.9).	SPA			X
Fostering Culture of Compliance				
18. Launch SPA Web site, linked to the Georgian Gateway or set up as a procurement sub-site of the Global Gateway, to disseminate bidding opportunities, announce contract awards and dispute decisions, publish blacklists, publish SPA annual report, promulgate standard documents, guidelines and best practices (section 2.9).	SPA	X		
19. Introduce Code of Ethics for government agencies. Introduce into the LSP control and incentives measures to encourage compliance and discourage avoidance of LSP/TR.	GOG		X	
20. Establish fair and transparent administrative procedures for blacklisting companies and individuals found to have engaged in procurement fraud and corruption.	SPA	X		
21. Strengthen internal and external auditing and publish audit findings and ensure that the obligation on every entity to hire an independent auditor each year is enforced (section 4.2).	GOG		X	
22. Establish public information center for business community and public to disseminate new anti-corruption initiatives	GOG		X	
23. Simplify rules and reduce arbitrary and unnecessary control of government bureaucracy at all levels of administration (licensing, registration). Provide easy access to information required to set up business (licensing, taxation).	GOG		X	X
24. Continue information sharing with NGOs and media.	SPA/GOG	X	X	X

Annex 3

SPA Action Plan for Public Procurement Reform

Original Action Plan from Draft CPAR June 2001				Updated Action Plan as of June 2002	
No.	Actions	Status	Implementing Agency	Priority	Remaining to be done
1	Establish the SPD as an independent Public Procurement Agency (SPA) following adoption of the Charters for the Agency and its Supervisory Board	The Charters have been drafted in consultation with the WB, have been approved by parliament and have been submitted to the President for signature	SPD	(1)	SPA has been established as a separate Agency under the direct control of MEIT. With MEIT's concurrence, consideration will be given after an initial 2 years to making the SPA more independent.
2	Amend the Implementing Regulations to fully reflect the amended LSP	Amendments have been drafted in consultations with IDF financed expert; to be adopted as soon as the SPA is legally established	SPA and its Supervisory Board	(1)	Completed Dissemination and implementation
3	Develop, promulgate and disseminate standard bidding documents (SBD) and sample contract agreements	SBD's are being prepared in consultations with IDF financed expert; to be approved and disseminated as soon as the SPA is legally established	SPA	(2)	Completed Dissemination and implementation
4	Elaborate and publish guidelines and instructions for conducting State procurement	Respective documents are being drafted	SPA	(1)	Completed Dissemination and implementation
5	Develop and approve templates to be used by entities for reporting of public procurements	templates are drafted and cleared with the State Department of Statistics; to be approved as soon as the SPA is legally established	SPA and its Supervisory Board	(1)	To be completed
6	Develop guidelines on procurement planning principles for procuring entities	In the process of drafting	SPA	(2)	To be completed
7	Establish and maintain a registry of providers of goods, works and services for State needs; specify	Registry has been established. Rules are to be prepared	SPA	(2)	Ongoing Incorporation into website

	rules on the use of the registry (e.g., blacklisting)	Database has been established and is updated on a regular base	SPA	(2)	Ongoing	Incorporation into website
8	Establish and maintain a database with procurement/contract data per procuring entity		SPA	(2)	Decree has been adopted but not yet implemented	Decree must be implemented
9	Assist in setting up specialized procurement units in the procuring entities; strengthen respective staff capacity	To be initiated	SPA	(2)	Ongoing	Training of trainers
10	Establish a unit within the SPA to consult/advice procuring entities as needed	Unit established but requires further strengthening of staff of the unit	SPA	(1)	No change: ongoing	
11	Prepare proposals to improvement mechanisms of accountability and enforcement	Ongoing	Government committee (including SPA chairman)	(1)	WTO questionnaire completed	Assistance needed to negotiate country and coverage annexes in preparation for accession
12	Prepare draft addenda to GPA agreement (list of major procuring organizations, list of types of procurements, monetary thresholds on goods, works and services etc.)	Government committee on cooperation with WTO was established in March of 2001 and has met to discuss completion of the draft addenda to GPA agreement prior to negotiations in August, 2001				

Priority: (1) implement immediately and maximum within 3 months

(2) important but can be implemented within 6 months to 1 year

Annex 3A

SPA Working Program for 2002

Task 1	Measure 2	Time sheet 3
1. Organization of business visit of the collaborators of the State Procurement Agency in order to share international experience in the sphere of State Procurement and to establish the horizontal communications with the Public Procurement Agencies of other countries.	To organize Study Tours in Slovak Republic, Poland and Bulgaria by the SRS Credit means	The third and fourth Quarter
2. Working out the appropriate documentation, which is necessary for negotiations about Georgia's accession in WTO Government Procurement Agreement (GPA)	a) To work out answers on questioner of WTO GPA committee and member states and to prepare Georgian Annexes by the assistance of the International Consultant; b) To develop eternally updated register of suppliers In conformity with Annexes of WTO GPA and to ensure its transparency	Up to September
3. Organization of Training-Seminars in order to retrain State Procurement Specialists	To organize the training-seminars by the assistance of the World Bank and other international organizations: a) For collaborators of Ministries and Central Entities (Borjomi); b) For procuring entities of Tbilisi (Tbilisi); c) Regional Training-seminar for the local procuring entities of western Georgia (Kutaisi); d) Regional Training-seminar for procuring organizations of autonomous republics (Batumi); e) Regional Training-seminar for the local procuring entities of eastern Georgia (Telavi)	July July August August September
4. Participation in the international workshops On a theme of state procurements	Participation of the representatives of State Procurement Agency in the conferences organized by aegis of World Bank, WTO, UN and EU	Fourth Quarter
5. Organization of trainings for SPA staff	Retraining of SPA staff by the means of SRS credit: a) In the International Training Centers of Washington and Turin; b) Training of SPA staff in English language	Fourth Quarter
6. Distribution of information about the State Procurement System of Georgia in the international information networks	To establish the Web site of the Agency in the Internet (On the Web site will be published: tender announcements; Information about contracts and their execution; Annual reports of the Agency; Review of the facts of an offence, Methodological and Normative documentation on State Procurement and etc.)	August
7. Institutional improvement of the State Procurement System	a) To provide organizational and methodological support for raising knowledge and experience in the sphere of state procurement in order to establish structural units of procurement in each state procuring organization; b) To establish the structural unit of	Up to August 1

	<p>administrative resolution in the Agency and supply it by appropriate conditions by the SRS credit means (designing of electronic program "Kodeqsi", providing by communication means, establishment of the center of administrative resolution and etc);</p> <p>c) To strengthen the Advisory center.</p>	
8. Working out the rule of State Procurement Specialist's certification and conditions of accreditation	To present suggestions in the Government in cooperation with the Ministry of Education about entering of State Procurement specialist in the national list of professions	Up to September 1
9. Ensuring of transparency and publicity of State Procurements	<p>a) To organize the briefing for media and nongovernmental organizations;</p> <p>b) To establish the Regional informational and methodological centers;</p> <p>c) To organize cycle of television programs about urgent problems of State Procurement reform;</p> <p>d) To publish periodical bulletin of the Agency;</p> <p>e) To distribute information about the state procurements (In case of an opportunity to establish the special publication or to publish the weekly addition of newspaper).</p>	<p>Monthly</p> <p>Fourth Quarter</p> <p>September</p> <p>Quarterly</p> <p>Weekly</p>
10. Ensuring of revealing of State Procurement Legislation's offenses and using of compulsory mechanisms of performance of the requirements of the law Against the infringers of Legislation	<p>a) Strengthening of Monitoring on state procurement implementation and implementing of appropriate measures on the facts of infringement, by the cooperation with appropriate bodies;</p> <p>b) To increase the work ability of contract implementation's inspecting groups and publishing of information which they will present to the Agency;</p> <p>c) To organize the meeting in procuring entities for coordinators which are responsible on state procurements;</p> <p>d) To implement the comparative analysis of information presented by the Ministry of Finance about actual allocation of means and received reports on procurement implementations.</p>	<p>Constantly</p> <p>Constantly</p> <p>September</p> <p>Constantly</p>
11. Improvement of planning, implementation and report of State Procurements	<p>a) To work out the form which will show the actual allocation of means for procuring entities, in order to ensure the checking of rational usage of means;</p> <p>b) To improve the structure of an account part of the budget together with the Ministry of Finance in order to improve state procurement planning;</p> <p>c) To publish the detailed instructions of dispute resolution procedures between the parties;</p> <p>d) To publish the common instructions of using standard forms of state procurement implementation and report.</p>	<p>Up to August 1</p> <p>Third Quarter</p> <p>Up to September 1</p> <p>Fourth Quarter</p>
12. Ensuring of financial support of State Procurement Reform	a) Ensuring of appropriate financing of the Agency from the State budget of Georgia (Increasing of salaries for SPA staff; Foreseeing the necessary financing in the state	Constantly

	<p>budget of 2003; Financing of the Agency fully and timely within the means stipulated in the budget for the Agency) in order to fully implement its functions;</p> <p>b) Presentation of an appropriate projects to the International Donor Organizations on each direction of reform;</p> <p>c) To implement Joint projects with the beneficients interested in reform.</p>	<p>Constantly</p> <p>Fourth Quarter</p>
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Annex 4**ACCEPTABILITY OF NATIONAL COMPETITIVE BIDDING**
(Supplemental Letter)

1. We represent that the procedures to be followed for national competitive bidding under the Loan/Credit Agreement shall be those set forth in the Law on State Procurement of Georgia, its Amendments and Implementing Regulations, provided however that the following requirements are met for compliance with the provisions of the “Guidelines for Procurement under IBRD Loans and IDA Credits” (the Guidelines) published by the Bank in January 1995 and revised in January and August 1996, September 1997 and January 1999.

- (a) the bidding period should not be less than 30 days from the date of publication of the Invitation to Bid or the date of issuance of the bidding documents to the bidders, whichever is later;
- (b) pre-qualification shall not be used for simple goods and works but shall be conducted for large and complex works;
- (c) bidding shall not be restricted to pre-registered firms. If registration is required, it shall not be denied to eligible bidders for reasons unrelated to their capacity and resources to successfully perform the contract (e.g., mandatory membership in professional organizations, classification, etc). Post-qualification shall be conducted to verify that the bidder has the capability and resources to successfully perform the contract;
- (d) bidding documents shall be made available to all bidders who are willing to pay the required fee;
- (e) state-owned enterprises in Georgia shall be permitted to bid only if they are legally and financially autonomous and operate under commercial law;
- (f) the opening of bids shall follow immediately after the deadline for bid submission and bidders' representatives should be permitted to attend;
- (g) a single envelope procedure shall be used for the submission of bids for goods and works;
- (h) procuring entities shall use the Bank's regional standard NCB documents, which shall be satisfactory to the Bank prior to their issuance to bidders;
- (i) bidders shall be required to submit bid and performance securities in an amount appropriate to the estimated value of the contract and in a form acceptable to the government;
- (j) evaluation of bids shall be based on quantifiable criteria, clearly defined in the bidding documents. Responsiveness of the bid to the interests of the country, the region or the procuring entity is not an acceptable criteria;
- (k) contracts for long duration (more than 18 months) shall contain appropriate price adjustment provisions;
- (l) Rebidding shall not be carried out without the Bank's prior concurrence;
- (m) Contracts shall be awarded to the lowest evaluated bidder.

2. Unless otherwise agreed to in writing between the Government of Georgia and the Bank, these representations and assurances form an integral part of said Bank/Credit Agreement.

3. It is our understanding that in signing the Bank/Credit, the Bank may rely on the statements set forth in this letter.

Annex 5

List of People Interviewed for CPAR, Georgia
February 20 – March , 2001

Organization	Person	Title
State Chancellery	George Isakadze	Deputy State Minister
	Levan Dzeladze	Former Deputy State Minister
	Temur Basilia	Advisor to the President on Economic Policy Reforms
Parliament	Vano Merabishvili	Chairman of Parliamentary Committee on Economic Policy Reforms
	Gia Siradze	Parliamentary Committee on Economic Policy Reforms, member
	Suliko Pavliashvili	1 st Deputy Chairman of Parliamentary Committee on Budget Control
	Temur Giorkhelidze	Head of Subcommittee on Budget Control
	Zurab Adeishvili	Chairman, Parliamentary Committee on legal issues
Ministry of Economy, Industry and Trade	George Gachechiladze	Minister
	Gela Charkviani	Deputy Minister
	Vano Chkhartishvili	Former Minister
State Procurement Agency	Temur Khomeriki	Chairman of the State Procurement Agency
Ministry of Finance	Levan Chrdileli	Head of Budget Department
	David Ramishvili	Head of Treasury Department
Chamber of Commerce	Guram Akhvlediani	Head of Chamber of Commerce
	Fady Asli	Head of American Chamber of Commerce
	Pier Orlov	Head of International Chamber of Commerce
National Bank of Georgia	Levan Kistauri	Macroeconomic Department
Commercial Banks	Vakhtang Butskhiridze	Director of TBC Bank

Organization	Person	Title
	Alexander Von Gleich	Head of Microfinance Bank of Georgia
EU Delegation	Jacques Vantomme	Active Ambassador of EU Delegation
	Mike Masbaum	Legal Team Leader, GEPLAC
United Nations	Marco Borsotti	UN Resident Coordinator and UNDP Resident Representative
Ministry of Justice	Kote Kublashvili	1 st Deputy Minister
Ministry of Urban Development and Construction	Beso Tulashvili	Head of Department on Economic Policy Reforms
Project Implementation Units	Alex Sikharulidze	Head of Institutional Building Project
	Gia Tsagareli	Head of Transport Project
	Paata Bolashvili	Head of Municipal Projects
	George Nikolaishvili	Implementation and Coordination Center Head of Health Project
	Gigi Maglakeidze	Director of Agricultural Projects Coordination Unit
	Shalva Kokochashvili	Deputy Executive Director, Georgian Social Investment Fund
	David Ninidze	Director, Fund for Cultural Heritage Preservation
State Department of Statistics	Nana Adeishvili	Director of CERMA
	Tamaz Ozbetelashvili	Price Statistics Division
	Revaz Tsakadze	National Accounts and Macroeconomic Analysis Division
Private Businesses	Michael Scoley	Head of AES Telasi
State Customs Department	George Gachechiladze	Head of Customs Department
Anti Corruption Working Group	David Usupashvili	Secretary of Working Group
Chamber of Control	Tamriko Bichikashvili	Deputy Head
Large Tax Payers Department	Vakhtang Chakhnashvili	Head of Large Taxpayers Inspection
State Information Technology Department	Davit Tarkhan-Mouravi	Head of State Information Technology
Institute of Public Administration	George Margvelashvili	Director of Institute of Public Administration

ANNEX 6

Workshop on
Improving Procurement in Georgia

June 4-6, 2002
Location: Tbilisi

Agenda

Day 1: June 4

09:00 – 09:30 Registration

09:30 – 09:45 Opening of the Workshop

Mr. George Gachechiladze, Minister of Economy, Industry, and Trade

09:45 – 10:00	The Importance of Improving Procurement in Georgia
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This presentation will discuss the importance for economic growth and development of an effective procurement system in Georgia. The discussion will explore the manner in which procurement can save scarce revenues and serve to spur on private sector expansion. Key issues in the development of an effective procurement system will be identified

Mr. Tevfik M. Yaprak, Georgia Country Manager, World Bank

10:00 – 10:30	The Challenge of Improving Procurement in Georgia
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This presentation will examine the current situation in procurement in Georgia, and highlight the key challenges for improving the performance of the system.

Mr. Temur Khomeriki, Chairman, State Procurement Agency

10:30 – 11:00 Discussion

11:00 – 11:15 Break

Session I

Establishing New Procurement Practices

This session will focus on strategies for implementing new procurement practices, including dissemination of information, establishment of clear procedural guidelines and development of a plan to train staff in new procedures. Special attention will be given to approaches to phasing in new practices.

Chair: *Els Hinderdael, World Bank*

- | | |
|---------------|---|
| 11:15 – 11:45 | Lessons from International Experience
<i>Mr. Peter Trepte, World Bank</i> |
| 11:45 – 12:30 | Implementing a new Procurement Law: The Case of Kazakhstan and Poland
<i>Mr. Madi Duisembaev, General Director, Association “Procurement”</i>
<i>Mr. Marian Lemke, Representative from Poland</i> |
| 12:30 – 13:00 | Discussion |
| 13:00 – 14:00 | Lunch |

Session II

How to improve performance in the new Georgia procurement system

This session will focus on strategies for improving procurement effectiveness. The session will include a discussion of the authority and functions of the Ministry of Finance and purchasing ministries and subnational governments in a well-designed decentralized procurement system. Strategies for involving the private sector in calling attention to misbehavior on the part of government officials or competitors will be reviewed. The role of the Procurement Agency in the performance of the procurement system will also be explored

Chair: *Mr. Gela Charkviani, Deputy Minister of Economy, Industry, and Trade*

- 14:00 – 14:30 International Experience with making decentralized procurement systems work effectively
Mr. Peter Trepte, World Bank
- 14:30 – 15:15 Country Example: Establishing Effective Incentives in Procurement: The Case of Kazakhstan and Poland
Mr. Madi Duisembaev, General Director, Association “Procurement”
Mr. Marian Lemke, Representative form Poland
- 15:15 – 15:45 Discussion
- 15:45 – 16:00 Break
- 16:00 – 17:45 Break out session: Establishing effective procedures and practices in the Georgia procurement system.

Day 2: June 5

- 09:00 – 10:00 Report to the Plenary from the Working Groups
- 10:00 – 10:30 Discussion
- 10:30 – 10:45 Break

Session III

Monitoring of Procurement

This session considers the fundamental components of an effective system for monitoring and evaluating procurement. The session includes a discussion of the information that is critical to monitor, as well as the role of different groups in monitoring and evaluation. The session concludes with an examination of strategies for prioritizing monitoring resources and using monitoring and evaluation data to change procurement practices.

Chair: *Mr. Vladimer Ugulava, Anti-corruption Bureau, Director*

- 10:45 – 11:15 Principles of Monitoring and Evaluation of Procurement: Lessons from International Experience
Ms. Els Hinderdael, World Bank
Mr. Joel Turkewitz, World Bank

11:15 – 11:35	Implementing Changes in Monitoring: The Case of the Philippines <i>Ms. Kristina Pimentel, Program Director, Procurement Watch</i>
11:35 – 12:05	Discussion
12:05 – 13:45	Lunch

Session IV

Establishing Effective Oversight of the Procurement System

This session examines the role of different institutions in establishing effective oversight of the Procurement System. Particular attention will be placed on the establishing effective collaboration among the main oversight bodies, including: the Procurement Agency, the State Chancellery, the Ministry of Finance, the Chamber of Control, Parliament, the Anti-Corruption Bureau, business associations, the media, and civil society

Chair: *Mr. Malkhaz Shubitidze, Chairman of the SPA
Supervisory Board*

13:45 – 14:15	International Experience with Oversight of Procurement <i>Pamela Bigart, World Bank</i>
14:15 – 14:45	Establishing Effective Oversight: The Case of the Philippines <i>Ms. Kristina Pimentel, Program Director, Procurement Watch</i>
14:45 – 15:15	Discussion
15:15 – 15:30	Break
15:30 – 17:15	Break-out Groups – Improving the Monitoring and Oversight of Procurement
17:15 – 18:00	Report back to the plenary from break-out groups
18:00 – 18:30	Closing of the Workshop
18:30 – 19:30	Cocktail

Session V**Building Capacity in Procurement**

09:00 – 11:30	Building Capacity in Procurement – priorities and the sequencing of reform Discussion with the group of officials and representatives of donor community
11:30 - 12:00	Summing up the outcomes and agreements reached
12:00 – 12:30	Press Conference