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Report No: 30746-GE

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 6.6 MILLION
(USD10.00 MILLION EQUIVALENT)

TO

GEORGIA

FOR A

RURAL DEVELOPMENT PROJECT

April 20, 2005

Environmentally and Socially Sustainable Development Unit
South Caucasus Country Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective April 2005)

Currency Unit	=	Lari (GEL)
1.82 Lari	=	US$1
US$	=	SDR 1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ACU	Association of Credit Unions
ADP	Agriculture Development Project
ARET	Agriculture, Research, Extension and Training Project
ASCDF	Agriculture Supply Chain Development Fund
BTI	Bureau of Technical Information
CERMA	Center for Enterprise Restructuring and Management Assistance
CUDC	Credit Union Development Center
DFID	Department for International Development
DICDP	Drainage and Irrigation Community Development Project
EBRD	European Bank for Reconstruction and Development
EPPO	European Plan Protection Organization
ERP	Enterprise Rehabilitation Project
EU	European Union
EBF	Extra Budgetary Funds
FDI	Foreign Direct Investment
FAC	ASCDF (Fund) Advisory Committee
FMR	Financial Management Report
FSP	Food Security Project
GEGI	Georgia Enterprise Growth Initiative
GMSE	Georgian Micro Finance Stabilization and Enhancement
IDCDP	Irrigation Drainage Community Development Project
IFAD	International Fund for Agriculture Development
IPPC	International Plant Protection Convention
ISTA	International Seed Testing Association
MOA	Ministry of Agriculture
MOF	Ministry of Finance
MOJ	Ministry of Justice
MFI	Micro Finance Institution
NAPR	National Agency of the Public Registry
NBFI	Non-Bank Financial Institution
NBG	National Bank of Georgia
PCB	Participating Commercial Banks
PCC	Project Coordination Center
PHRD	Japan's Policy and Human Resources Development Fund
PIU	Project Implementation Unit
PFI	Participating Financial Institution
PSC	Project Steering Committee
RAPA	Restructuring Assistance and Policy Advice for the MOA
RCG	Rural Credit Guidelines
RDP	Rural Development Project
SIDA	Swedish International Development Agency
SDLM	State Department of Land Management
SLAAR	Sustainable Livelihoods for Adigeni and Adjacent Rayons
SME	Small and Medium Enterprise

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WFF	Wholesale Finance Facility
UNDP	United Nations Development Program
UPOV	Union for Plant Variety Protection
USAID	United States Agency for International Development
WTO	World Trade Organization

Vice President:	Shigeo Katsu
Country Manager/Director:	Donna Dowsett-Coirolo
Sector Manager:	Juergen Voegele
Task Team Leader:	Rapeepun Jaisaard

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RURAL DEVELOPMENT PROJECT - GE

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RURAL DEVELOPMENT PROJECT - GE

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

ECSSD

Date: April 20, 2005 Country Director: D-M Dowsett-Coirolo Sector Manager/Director: Juergen Voegele	Team Leader: Rapeepun Jaisaard Sectors: Crops (50%); Agricultural marketing and trade (25%);Agro-industry (25%) Themes: Rural markets (P);Rural policies and institutions (S)
Project ID: P078544	Environmental screening category: Financial Intermediary Assessment
Lending Instrument: Specific Investment Loan	Safeguard screening category: Requires framework

Project Financing Data

[ ] Loan [X] Credit [X] Grant [ ] Guarantee [X] Other:

For Loans/Credits/Others:
Total Bank financing (US$m.): 10.00
Proposed terms: 40 years maturity including 10 years grace; service charge of 0.75% and commitment fee of 0.5%.

Financing Plan (US$m)

Source	Local	Foreign	Total
BORROWER/RECIPIENT	2.12	0.35	2.47
INTERNATIONAL DEVELOPMENT ASSOCIATION	9.12	0.88	10.00
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT	9.19	0.81	10.00
JAPAN: MINISTRY OF FINANCE - PHRD GRANTS	2.27	2.23	4.50
LOCAL SOURCES OF BORROWING COUNTRY	2.84	0.06	2.90
LOCAL FARMER ORGANIZATIONS	4.79	0.05	4.84
Total:	30.33	4.38	34.71

Borrower:
Government of Georgia
Georgia

Responsible Agency:
Ministry of Agriculture
41 Kostava Street
Tbilisi

Georgia
380062

Estimated disbursements (Bank FY/US$m)									
FY	2006	2007	2008	2009	2010				
Annual	1.05	2.67	3.18	2.33	0.77				
Cumulative	1.05	3.72	6.90	9.23	10.00				

Project implementation period: Start October 1, 2005 End: December 30, 2009
Expected effectiveness date: October 1, 2005
Expected closing date: June 30, 2010

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD A.3***	[ ]Yes [X] No
Does the project require any exceptions from Bank policies? ***Ref. PAD D.7***	[ ]Yes [X] No
Have these been approved by Bank management?	[ ]Yes [X] No
Is approval for any policy exception sought from the Board?	[ ]Yes [X] No
Does the project include any critical risks rated "substantial" or "high"? ***Ref. PAD C.5***	[ ]Yes [X] No
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD D.7***	[X]Yes [ ] No

Project development objective ***Ref. PAD B.2, Technical Annex 3***
The objective of the project is to develop the productivity and profitability of the private agriculture sector. This would be achieved by facilitating the access of Georgia's mainly small and medium-scale farmers to supply chains, improving the competitiveness of the supply chains and strengthening the capacity of selected agricultural and financial institutions to serve private-sector agricultural market activity. This would increase incomes and employment and reduce poverty in rural areas.

Project description *[one-sentence summary of each component]* ***Ref. PAD B.3.a, Technical Annex 4***
The proposed project has four components. The first component would strengthen the marketing/supply chains of high potential agricultural commodities through an integrated program of technical assistance to improve the efficiency of farm production, marketing and agri-business activity. The second component would improve the supply of financial services in rural areas, in part by strengthening rural finance credit institutions and the environment in which they operate. The third component would strengthen the capacity of key agriculture institutions with the view to facilitate the functioning of land, capital, input and output markets and food safety. The fourth component would support the management, monitoring and evaluation of project activities.

Which safeguard policies are triggered, if any? ***Ref. PAD D.6, Technical Annex 10***
Safeguard Policies Triggered by the Project:
Environmental Assessment (OP/BP/GP 4.01): Yes
Natural Habitats (OP/BP 4.04): No
Pest Management (OP 4.09): No
Cultural Property (OPN 11.03, being revised as OP 4.11): No
Involuntary Resettlement (OP/BP 4.12): No
Indigenous Peoples (OD 4.20, being revised as OP 4.10):No
Forests (OP/BP 4.36): No
Safety of Dams (OP/BP 4.37): No

Projects in Disputed Areas (OP/BP/GP 7.60): No
Projects on International Waterways (OP/BP/GP 7.50): No

Significant, non-standard conditions, **if any**, for:
Ref. PAD C.7

Loan/credit effectiveness:

(a) The project account has been opened by MOF and the initial amount of US$50,000 equivalent has been deposited.
(b) Appointment of a Project Steering Committee (PSC) satisfactory to IDA and
(c) Cross-effectiveness of DCA and IFAD's Project Financing Agreement.

Covenants applicable to project implementation:

At negotiations assurances have been obtained from the government as follows:

(a) An IDA special account would be established at a commercial bank acceptable to IDA.

(b) MOF would maintain a Project Account in a commercial bank on terms and conditions acceptable to IDA and shall replenish the Account quarterly in amounts sufficient as required for the Project during the next quarter.

(c) MOA agrees on the format of the quarterly financial management report (FMR).

(d) Maintain at all time during project implementation, the PSC and PCC (or an agreed successor) with staff with qualifications acceptable to IDA.

(e) Appointment of an ASCDF Advisory Committee (FAC) satisfactory to IDA no later than three months after project effective.

(f) FAC would carry out the ASCDP according to the ASCDF operational guidelines.

(g) The government would maintain the FAC until the completion of the ASCDF program with adequate qualified staff and resource required for implementation of the program.

(h) The PFI Subsidiary Loan Agreement has to be reviewed and is satisfactory to IDA.

(i) The government allows PFIs to set loan conditions according to best commercial and micro credit financing practices.

(j) All PFIs agree to provide sub-loans to eligible beneficiaries in accordance to Rural Credit Operational Guidelines.

(k) The government would establish and maintain a revolving fund into which all repayment of principal from credits extended to PFIs shall be deposited. The government would ensure that such revolving fund shall be used to provide rural credit on an on-going basis.

(l) The government would carry out the Rural Finance component in conformity with the Rural Credit Operational Guidelines and the Environmental Guidelines for loan activities.

(m) A mid-term review would be undertaken no later than (July 2007).

(n) Appointment of auditors satisfactory to IDA.

A. STRATEGIC CONTEXT AND RATIONALE

1. Country and sector issues

Georgia is a small Caucasus country with a population of 4.9 million people. The country relies heavily on agriculture, which provided 18% of Georgia's GDP and 56% of employment in 2003. Because of its relative size and role in employment, economic growth in the agriculture sector is critical to Georgia's overall economic growth and prosperity.

Georgia has the potential to significantly improve its agricultural production base and become a net exporter of a number of agricultural products. Recent International Fund for Agriculture Development (IFAD) and Japan's Policy and Human Resources Development Fund (PHRD) financed studies show that the wine, nut, mineral water, herb, citrus, fresh vegetable and livestock product industries all offer potential for incremental production and sales. This would lead to a significant reduction in rural poverty. For the most part, however, the country has been unable to produce the quality and quantity necessary to test its comparative advantage and gain secure and profitable access to export markets. Smallholders are constrained by limited access to essential inputs such as improved varieties, new technologies, modern inputs and working capital. Marketing infrastructure for most agriculture products is poorly developed, including assembly systems and little investment has been made to improve it. Similarly, many agro-processors are inefficient and unable to offer favorable prices, technology, quality control or credit to farmers.

The sources of credit for agriculture are limited. In general, banks and non-bank financial institutions (NBFIs) have weak capacity for agricultural lending. This lack of capacity is exacerbated by the small size of the financial sector as a whole and its limited capacity to provide medium and long-term credit, due, in turn, to the lack of term deposits. Small farmers are the main victims of this market failure, together with agricultural enterprises seeking medium- and long-term capital for investment. The NBFIs operating in Georgia, and the newly introduced commercial bank micro-credit programs have thus far focused on urban clients. Faced with increasing competition from commercial banks, the larger and more progressive NBFIs are now looking to expand their activities into rural areas. Progress is very slow, however, because they lack the financial resources to expand, adequate knowledge of agricultural lending and suitable loan products. The legislative and regulatory environment for NBFIs is also weak, which compromises their ability to expand in a sustainable manner. Detailed information of financial sector is in Annex 1.

Programs to expand the presence of NBFIs in rural areas are further constrained by the difficulties of building adequate institutional capacity, especially for village level NBFIs, which rely on poorly skilled local staff for operation and management. While locally based initiatives are close to rural people and highly accessible, their managers lack skills and experience and need time and strong support to acquire these attributes. Without this support, such NBFIs are unable to manage the problems and risks that all financial institutions face, and they often fail. The small-scale, rural credit unions (CU) established under the Agriculture Development Project (ADP) provides an example of these issues. Most grew rapidly and subsequently collapsed, illustrating both the strong demand for village-based NBFIs and the dangers and consequences of weak support. But the survival and continued activity of some of these CU's, in the face of considerable difficulty, indicates that sustainability can be achieved. The challenge now is to strengthen and extend this structure from its current base.

Secure land registration, which underpins investor confidence in long term agriculture investment and security for creditor is essential for successful rural and agri-business development. Equally, the secure registration of liabilities against moveable assets can underpin microfinance for agriculture. Several investments were made under the ADP to develop land registration and fee-management systems to generate income for partial self-financing of the registration agency. Substantial progress has been made and a new law was recently enacted to establish a National Agency of the Public Registry (NAPR) that will be responsible for land registration and cadastre and the registration of securities on moveable assets.

Farmers and agri-business enjoy little institutional support at present. In fact, most of the concerned government agencies are inefficient, under resourced and responsible for often archaic laws and regulations, thereby creating a serious impediment to rural growth. Effort to reorganize and restructure government institutions and legislation is only now being galvanized, but requires clear direction and significant financing if it is to be effective. Areas of particular concern to the commercial agriculture and agri-business communities include product standards and food safety, sanitary and phytosanitary regulation and technical support services.

2. Rationale for Bank involvement

The Bank and IFAD's continued involvement in the agriculture sector is crucial for the sustainability of investments in land registration and credit unions already made under existing ADP and for the further development of activities necessary for the growth of commercial agriculture and agricultural exports. The Bank and IFAD's role would be to directly support private sector actors in developing their businesses through technical assistance and training and the provision of investment directly and through financial intermediaries. As part of this approach, the Bank and IFAD could promote commercial agriculture by strengthening the legal and institutional framework of selected public institutions to provide improved services and regulation and by helping to create an enabling environment for private sector investment.

The Bank and IFAD have the capacity and expertise to strengthen agriculture value chains by reinforcing the concepts of supply chain development and demand-driven production and proven ability to assist the government in analyzing agricultural development policies, including institutional issues and leverage for policy reform in particular areas. It also has significant experience in promoting the development of rural financial institutions through measures to strengthen the legislative and regulatory environment, build institutional capacity and develop new loan products and financial services. IFAD has extensive experience in poverty alleviation in Georgia, associated with the development of upland areas. Because of their overall approach and position, the Bank and IFAD would be able to play a catalytic role in helping to coordinate donor activities in rural and commercial agriculture development in Georgia.

3. Higher level objectives to which the project contributes

The proposed project is consistent with the Bank's December 2003 Country Assistance Strategy(CAS) for Georgia which emphasizes the need for further support of the rural sector and describes strategies to promote export markets and provide an environment for private sector-led growth. This includes the need to remove constraints to private sector development, improve the institutional framework and complete the already initiated reforms supporting the restructuring of the economy. The project is included in the priority assistance program in the Reform Support Credit presented to the Board on June 24, 2004.

The ultimate goals of the Bank and IFAD involvement are sustainable rural income growth and poverty reduction, strong public institutions and good governance. This would be achieved through continued growth of private commercial agriculture and with a high level of participation in it by small-scale farmers and unemployed and under-employed rural people. Investments to develop strong rural institutions and to promote good governance would enhance the opportunities for employment creation and rural income growth.

The principles of supply chain development would be applied in a broad context and would be used to modernize production, increase productivity and reorient agriculture and agri-industry to meet the requirements of consumers in evolving domestic and international markets. As a successful result of the proposed project, financial institutions would expand coverage and outreach in rural areas, banks and micro-credit institutions would become more comfortable and competent in lending to agriculture and these financial institutions and credit unions would provide a sustainable platform for growth.

A sustainable public registry system would support an efficient land registration and cadastre system and a system for securing interests in moveable assets. This would have a major impact in providing acceptable collateral for PFIs to lend for capital investments in agriculture production and marketing, as well as for working capital. Action plans to reform sanitary and phytosanitary and veterinary institutions to meet World Trade Organization and European Union requirements would be developed and an effective food safety system established. Laws for plant, veterinary and sanitary control would also be modernized, with more transparent regulatory frameworks and improved monitoring systems.

B. PROJECT DESCRIPTION

1. Lending instrument

The lending instrument for Georgia would be mixed IDA Credit, Japanese PHRD Co-financing Grant and IFAD Loan and Grant. The Government of Georgia would borrow the IDA Credit on standard IDA terms, with a 40 year maturity and a 10 year grace period. The matching IFAD loan would be provided on standard highly concessional terms with a 40 year maturity and a 10 year grace period. In addition, the Government of Japan provides PHRD grant funds to co-finance the project's technical assistance and capacity building activities and IFAD provides grant fund for rural institutional development.

2. Project development objective and key indicators

The objective of the project is to develop the productivity and profitability of the private agriculture sector. This would be achieved by facilitating the access of Georgia's mainly small and medium-scale farmers to supply chains, improving the competitiveness of the supply chains and strengthening the capacity of selected agricultural and financial institutions to serve private-sector agricultural market activity. This would increase incomes and employment and reduce poverty in rural areas.

Key Indicators:

Outcome indicators:

The primary project outcome would be an increase in income of rural people. Contributions to this outcome would come from increases in the marketed output of competitive food and agricultural products and an associated increase in export earnings, farm household incomes, and employment in agro-processing and agri-business enterprises. This would be supported by improvement in the operational efficiency and sustainability of public and private institutions facilitating the operation of agricultural land, capital and product markets. The outcome indicators are:

- Incremental sales and profits of enterprises in the supply chains supported under the project
- Increase in the net income of farmers participating in project-enhanced marketing/supply chains
- Employment created in agriculture and agro-industry enterprises supported by the project
- Increase in agricultural lending by participating financial institutions, both in absolute terms and as a proportion of agricultural GDP
- An increase in the number of credit unions attaining operational and financial sustainability
- A substantial self-financed public registry for land and moveable property registration by the end of the project

Output Indicators:

- Number of commodity chains evaluated and supported

- Number of communities and producer groups supported
- Number of technology and market development programs funded
- Number of on-farm technology demonstration programs funded
- The number and volume of short- and medium-term loans to agricultural producers, agro-processors and agri-business
- Number of computerized land and moveable asset registration transactions conducted and level of cost recovery achieved by the NAPR
- The repayment performance of agricultural loans by banks and NBFIs
- The membership of the national system of rural credit unions
- The increase in marketed surplus, profit margin, and employment of the enterprises involved in supported commodity chains
- Veterinary, seed, sanitary, phytosanitary, and food safety laws and regulations enacted and an improved food safety systems

3. Project components

The proposed project has four components. Detailed descriptions of the four components can be found in Annex 4.

Component 1: Agricultural Supply Chain Development (*Estimated Cost US$ 4.27 million, of which IDA $0.58 million, IFAD $0.11 million, PHRD co-financing grant $2.17 million, IFAD Grant $0.2 million, Beneficiary $0.29 million and Government $0.92 million*)

The proposed project aims to support the efficient development of marketing/supply chains for commodities that have a demonstrated market potential, with the view to expand profitable domestic and export market opportunities. The proposed project would work with all agents in potentially profitable agricultural supply chains to develop and implement a holistic strategy for identifying and addressing weaknesses and bottlenecks. The project would support the following:

(a) **Supply Chain Analysis and Development** ***(Estimated cost US$0.82 million, of which PHRD co-financing grant $0.59 million and Government $0.23 million).*** Using CERMA and AgVANTAGE analysis of the production, processing and/or marketing of potentially profitable agricultural commodities, the objective of this sub-component is to develop a holistic strategy for the expansion of profitable sales in domestic and export markets. This would involve assistance in determining consumer demand, identifying technical, regulatory, institutional, contractual and financial constraints, developing a collaborative strategy for their redress, and analyzing sources of supply. The supply chain analysis would attempt to determine where commodity associations and other market participants could productively reinforce linkages among actors along a commodity chain both formally and informally. The project would coordinate with other parallel donor projects. In cases where parallel projects have not carried out a full analysis (e.g., the wine industry), the project would have the capability (with stakeholder participation) to initiate detailed studies of the sub-sectors. The project would finance for each project year, technical assistance, training, and studies in market and supply chain analysis and development. It would support agri-business firms in identifying regulatory, technological, contractual, and investment constraints and assist in the development of marketing plans, supply chain linkages, contractual agreements, and investment proposals.

(b) **Linkages to Farm Communities** ***(Estimated cost US$1.82 million, of which IFAD $0.11 million, IFAD $0.11 million, PHRD Co-financing grant $1.11 million and Government $0.40 million).*** The sub-component would pilot test a program to assist farmers and communities to engage with commodity supply chains in an equitable and profitable manner. Using field demonstrations, capacity building workshops and local study tours, the RDP would introduce farmers to more productive and profitable market-linked agricultural technology. Leadership training would also be emphasized, especially for younger members of rural communities. Farmer linkages to agri-businesses and markets would be strengthened and farmers would be empowered to develop marketing groups and associations with a view to growing product quantity and quality and, thereby, improving market access and price. The farmer groups themselves would largely be derived from existing informal groups where there is trust and familiarity. Provision would be made to support the development of business plans and proposals for loan applications to participating financial institutions (PFIs) and for activities supporting the initiation and development of enduring commercial relationships between farmers and key supply-chain entities. Local/international NGOs, employed under performance-linked contracts, would manage pilot programs in eastern, central and western Georgia, which would be reviewed after 15 months, leading to the identification of a longer-term project strategy for improved small-scale commercial farm productivity and market linkages.

Second, the project would also provide assistance both to the new and to existing farmer groups to link to commodity supply chains. For this, the project would finance technical assistance and training and partially support farmer group set-up costs and some equipment. In cases where groups desire to invest in facilities essential for participation in commodity supply chains, e.g. produce packing plants, the project would assist farmers (through the appropriate service providers) in developing business plans and proposals for loan applications to participating financial institutions (PFIs). Provision would also be made for the staging of regular discovery events to allow for initiation and development of enduring commercial relationships between farmers and key supply-chain entities.

(c) **Technology Transfer** (***Estimated cost US$1.63 million, of which IDA US$0.58 million, PHRD Co-financing grant $0.48 million, Beneficiary $0.29 million and Government $0.29 million***). The project would support small-scale farmers and farmer groups engaged in potentially profitable agricultural supply chains to develop appropriate, modern farm technology, crop and livestock management practices, and post-harvest technology and demonstration programs. Development of technology would be supported through the Agricultural Supply Chain Development Fund (ASCDF) and be coordinated by NGO and ASCDF advisory Committee (FAC). Farmer's access to support would be facilitated by the NGO team operating in each region. Management of this fund will be in accordance to the ASCDF operational guidelines.

Producers, processors and traders would be also encouraged to identify technology gaps and develop applied research and demonstration programs in collaboration with local and national research and extension institutions. The proposals would be submitted to the ASCDF Advisory Committee (FAC) for competitively selection.

Component 2. Rural Finance Services (*Estimated Cost US$ 25.76 million, of which IDA Credit $8.2 million, IFAD Loan $8.02 million, IFAD grant $ 0.47 million, PHRD Co-financing grant $1.16 million, Beneficiary $4.50 million, Government $0.51 million, Commercial Bank $2.7 million and NBFI $0.20 million*)

This component would improve the capacity of PFIs to lend to the farmers, processors and agri-business enterprises involved in the marketing/supply chains of marketed agricultural commodities. This would be achieved by (a) providing them with additional capital for lending to private entities in the agricultural sector, particularly medium and long-term loans for investment, and (b) strengthening their capacity for sustainable rural lending.

(a) Credit Lines for Commercial Banks (*Estimated cost US$16.10 million, of which IDA Credit $7.20 million, IFAD loan $3.20 million, Beneficiary $3.0 million and Commercial Bank $2.7 million*). This credit line would be made to eligible commercial banks to increase their capacity to make medium and long-term investment loans to eligible farmers, processors and agri-business enterprises. Loans to participating commercial banks (PCBs) would be either in US dollars or Euro or Lari, with a grace period of four years and repayment period of up to 10 years.

(b) Credit Lines for Non Bank Financial Institution ***(Estimated cost US$7.25 million, of which IDA Credit $1.0 million, IFAD loan $4.8 million and Beneficiary $1.45 million.)*** This credit line would be made to eligible non-bank financial institutions (including Credit Unions) to increase their capacity to make small investment and working capital loans to eligible farmers, processors and agri-business enterprises. Loans to NBFIs would be either in US dollars or Euro or Lari, with a grace period of two years and repayment period of up to 10 years.

PFIs would revolve these loans during the project. Interest rates charged by Government to PFIs on dollar and Euro loans would be determined on the basis of the corresponding 6 month LIBOR (US$ or Euro) plus a spread of 2%. Interest rates charged by Government to PFIs on Lari loans would be determined on the basis of the domestic inflation rate plus a spread sufficient to cover commitment fee, service charge, administrative cost and other costs. These rates will be revised semi-annually to reflect changes in costs and market conditions. PFIs would set their own interest and repayment terms to final beneficiaries and would bear the full risk of loan repayment. For the first year of their participation, commercial banks are required to contribute a minimum 10% to the loans and 20% for the subsequent years. In addition, the private applicants for loans would be expected to finance a minimum of 20% of the cost of each business venture from their own resources.

The PFIs would be selected on the basis of eligibility criteria, a summary of which is contained in Annex 4. 1. The PFIs would be responsible for identifying prospective borrowers and carrying out appraisals of the proposals submitted for financing. Appraisal of sub-loans would be according to procedures and criteria summarized in Annex 4.2. These would include compliance with environmental safeguards, which would be monitored throughout sub-loan implementation. The disbursement of loans to PFIs would be managed by a specialist unit within the PIU (see Annex 6). This unit would perform the functions of: (a) ensuring that PFIs meet eligibility criteria; (b) verifying proposed loans are eligible for financing under the project; (c) enabling rapid disbursement of loans to PFIs; and (d) monitoring the actual disbursement and utilization of loans. The PIU function in this respect would not include any discretionary functions; it would simply approve or reject applications made to it by the PFIs.

(c) Strengthening the Capacity of PFIs for Sustainable Rural Lending ***(Estimated cost US$2.41 million, of which IFAD loan US$0.02 million, IFAD grant $0.47 million, NBFIs $0.2 million, PHRD Co-financing grant $1.16 million, Beneficiary $0.04 million and Government $0.51 million).*** This component would strengthen the capacity of participating rural financial institutions to appraise and manage loans for production, agro-processing and agri-business; develop and promote appropriate loan products and collateral instruments; provide matching grants to selected NBFIs for the establishment of new rural branches; and develop sustainable rural credit unions. Support would be provided for training of bank and NBFI personnel, technical assistance to design, test and adopt more appropriate loan products, collateral instruments and financial services and matching grants of up to $10,000 to cover the costs of qualifying NBFIs of establishing new rural branches. Well-managed Credit Unions (CU) would be supported to expand and become financially sustainable. This would be achieved by focusing on a more savings driven approach to CU growth and extensive capacity building across the national CU movement in savings mobilization, credit administration, financial management, and overall governance. This would be facilitated by the establishment of a national association of CU that would progressively assume responsibility for the administration of the CU network. Project inputs would include national and international technical assistance, training and support for the establishment of the Association of Credit Unions.

Component 3: Institutional Modernization ***(Estimated Cost US$ 3.17 million, of which IDA Credit $0.68 million, IFAD loan $0.52 million, IFAD grant US$0.13 million, PHRD co-financing grant $1.05 million, Beneficiary $0.05 million and Government $0.74 million).***

This component would focus on specific, key legal and institutional reforms that impact directly on the competitiveness of Georgian agriculture and the safety and marketability of its products and enable Georgia to meet its international sanitary and phytosanitary obligations. Project interventions would be focused on:

(a) **Institutional and Legal Framework** ***(Estimated cost US$ 1.91 million, of which IDA Credit $ 0.68 million, PHRD co-financing grant $0.74 million, Beneficiary $0.01 million and Government $0.47 million)***. The project would work with relevant MOA staff to revise selected food, plant variety protection and veterinary laws and regulations to meet international trade and treaty requirements and support Georgian membership and participation in international standards organizations relevant to Georgian agricultural trade. Training and study tours would be provided, and operating manuals based on an EU compliant legislative framework would be developed. The project would also enable the Georgian government to establish a comprehensive, unitary food safety management and risk assessment system in line with the requirements of a draft Food Law. This would include the establishment of a Veterinary and Food Department within the MOA, the strengthening of domestic and border sanitary inspection capacity, the strengthening of laboratories for accredited food inspection, the development of a risk assessment capability and the establishment of the Food Safety Council proscribed under the draft law.

(b) **Support for Selected Commodity-Specific Programs** ***(Estimated cost US$0.15 million, of which PHRD Grant $0.1 million, Beneficiary $0.04 million and Government $0.02 million)***. Programs to support specific commodity chains supported by project under component one and consistent with strategies and actions plans for institutional development developed under sub-component 3 (b) would be identified. For example, the project might provide, based on the needs and proposals from the commodity chains, support for the development of product certification, quality testing and labeling standards. In the case where private services are not available and public services are not proficient, the project may consider strengthening these services.

(c) **Continuing Support for Property Registration** ***(Estimated cost US$1.11 million, of which IFAD loan $0.52 million, IFAD grant $0.13 million, PHRD co-financing grant $0.21 million and Government $0.25 million)***. Under the recently promulgated Law on Public Registries, the State Department for Land Management (SDLM) and the Bureau of Technical Information (BTI) were liquidated. Land registration and cadastre responsibilities have been transferred to a new National Agency for Public Registry (NAPR), which has been established as a Legal Entity under Public Law giving it substantial legal and financial independence. The NAPR would also be responsible for the registration of secured interests on moveable assets, which will be important to the development of rural financing. To ensure that the transition is smooth and original objectives are maintained, the project would, over a two-year period, complete the network of NAPR regional centers, develop systems for the integration of land and moveable property registry and land cadastre databases, establish a secure NAPR data management and transfer network and develop information programs on NAPR services. Project inputs would include training, equipment, information technology and national and international technical assistance.

Component 4: Project Management ***(Estimated Cost US$ 1.51 million, of which IDA Credit $0.54 million, IFAD Loan $0.55 million, PHRD Grant $0.12 million and Government $0.54 million).***

The proposed project would be managed under the umbrella of the existing World Bank Project Coordination Center (PCC) or its agreed successor within the MOA. The PCC or its agreed successor would be responsible for all aspects of project administration, including overall project oversight, TA, goods and materials procurement, and financial control. The day-to-day management of the project would be with the technical Project Implementation Unit (PIU) within the PCC or its agreed successor. A Project Steering Committee (PSC) including representatives from government, private sector and donor agencies would provide project oversight and ensure national program integration. The project would finance technical assistance, training and study tour, office equipment and vehicles, staff salaries, auditing and other operating expenses related to the project. The structure of the PIU and its staff requirements are described in Annex 6.

4. Lessons learned and reflected in the project design

The main lesson learned during the last few years from Bank and IFAD-financed credit line operations in the ECA Region and elsewhere is that the project design should be kept as flexible as possible in order to allow for adjustments during project implementation. Considering the political and economic uncertainty in Georgia, it is critical to allow for adjustments during project implementation. To this end, 10% of project funding has been kept in unallocated category to further build on successful interventions as they are identified. It was further agreed at negotiations that up to US$3.0 million of funds allocated for agriculture credit could be reallocated, if required during project implementation. Lessons learned from ongoing projects, especially from the ADP, the Agriculture Research, Extension and Training Project (ARET), the Mountain Areas Development Project and the Irrigation and Drainage Community Development Project (IDCDP) show that it is important to create trust among all stakeholders before the project can enter the main implementation phase. Capacity building in all institutions dealing with the project as well as a step-by-step approach during project implementation is essential in order not to overwhelm the local authorities and institutions. The RDP would promote the development of self-financing institutions, specifically a national ACU and the NAPR, which are logical further steps beyond their development under the ADP to secure the sustainability of the post investment in these institutions.

The design of the supply chain development component would draw on experience from the USAID-funded AgVANTAGE project and CERMA-ERProject. AgVANTAGE has carried out extensive analysis of various supply chains, which the RDP would use in designing its support of supply chains. Experience provided by CERMA is especially useful for the design of the project in the areas of institutional arrangements with the authorities, the development of trust among partners, selection procedures for assisted companies and cost sharing between the project and beneficiaries.

Experience from the ADP shows that improved access to credit does make a difference to agricultural investment, output and rural livelihoods and that it can be done without distorting financial markets. Success or failure of the credit components of the ADP was highly correlated with the intensity and quality of project supervision and management. The performance of partner financial institutions depends on the ability of their staff to appraise loan proposals, particularly the ability to assess market prospects for the commodities to be produced and to develop repayment schedules consistent with income streams.

There is a strong demand for locally based credit facilities (such as credit unions) in rural villages, but these institutions need sustained, strong support in the form of training and supervision, if they are to evolve into viable financial institutions. Small village-based credit unions often lack the critical mass required for financial viability, hence the need to consolidate, particularly with a focus on rural towns. They also need to be savings-driven and encouraged to diversify their loan portfolio and loan products. This would enable them to expand to a wider membership base and generate a stronger member commitment to the organization – all of which would improve sustainability. These lessons learned from the ADP were used in the design of the credit component of the Rural Development Project (RDP).

5. Alternatives considered and reasons for rejection

The project team considered two different designs during project identification, which were rejected during project preparation. During the project identification stage, the project team considered focusing the project's implementation area on one specific location in the North West of Georgia, which has considerable potential for market-oriented and export-oriented agricultural development. In discussions with the Minister of Agriculture and PCC staff, it was concluded that this project approach would not be feasible for political reasons. The possibility of taking a more community driven development approach was also explored during project identification. The project team learned that the DFID-funded Sustainable Livelihood Project and the Bank-funded Social Investment Fund II follow exactly this approach. To avoid overlap, duplication and competition for clients, the team decided to exclusively pursue a market-oriented approach for the RDP.

As an alternative to PIU management and disbursement of the credit lines, consideration was given to establishing an autonomous Wholesale Finance Facility (WFF). Current law allows such a facility to operate as either a public or private non-commercial entity, based on government decree. Two advantages were seen for this facility. First, it would allow greater independence from public interference in the allocation of credit lines and greater protection from government appropriation of the credit lines themselves, both of which occurred in the ADP. Second, it would allow flexibility in the design of an exit strategy: i.e., the credit portfolio could be sold to a financial institution, the WFF could continue to serve as a disbursal mechanism for other credit lines, or the WFF could be transformed into an NBFI itself. PIU management of the credit lines, however, was ultimately preferred, because the additional complexity a WFF would add to project management and questions over its legal rights to profit were judged to be a greater cost to the project than these benefits. In any case, the creation of a new financial institution is beyond the scope of this project.

At the QER panel meeting, there was a suggestion that the land registration sub-component be carried out as a separate activity through a new WB project. Because of the need to continue support for this sub-component and the uncertainty of a new project, Bank management decided to support to the land registry component under this project through a targeted short-term investment in support of financial sustainability.

C. IMPLEMENTATION

1. Partnership arrangements (if applicable)

As part of both project preparation and implementation, the project would work with all agents and donor programs active in marketing/supply chain assistance. Since the project identification mission in June 2003, in which the Bank and IFAD's possible involvement in marketing/supply chain development was widely discussed with donors and project people in Georgia, a number of new programs in Georgia have established objectives similar to those of the Agriculture Supply Chain Development Component. This particularly applies to the USAID-financed AgVANTAGE project and ERP/CERMA. AgVANTAGE management confirmed their interest in identifying and preparing marketing/supply chains for further investment and technical development under the RDP project. CERMA experience would also be used for the new project.

Implementation co-financing has been developed with the Government of Japan and with IFAD. IFAD was a partner with the Bank in financing the ADP. Japanese Government funding under PHRD co-financing will finance technical assistance and training of all components. IFAD will finance land registration, credit unions and linkages to farm community sub-components and co-finance micro and commercial credit and project management costs. IFAD will also provide grant fund for rural institutional development.

For the implementation of the Rural Financial Services Component, the project would work in close collaboration with the Ministry of Finance. The National Bank of Georgia would provide regulatory oversight of the commercial banks and NBFIs in lending project funds, as well as the credit unions. The ADP PIU and the PCC would support the development of the ACU that would support the growth of credit unions.

In modernizing the legal framework and developing strategies and action plans for institutional development, the project would work with authorities in the Ministry of Health, the Center for Protection of Plant Variety Breeders Rights and several MOA departments, including the Department of Quality Inspection of Seeds and Plant Material, the State Commission for Testing and Protecting Selected Achievements, the Veterinary Department, the Department of Food and Processing Industry, and the Department of Plant Protection. The project would also coordinate with the RAPA project financed by USAID, the TACIS project financed by the EU, projects financed by FAO, dairy project financed by the SIDA, the pilot extension project financed by GTZ and possibly agencies receiving assistance from the WTO. The Project would seek additional co-financing for investments identified by action plans for institutional development.

For the Land Registration Sub component, the project would work closely with the NAPR in the Ministry of Justice and with the Ministry of Finance in establishing the new NAPR as an independent self-financing agency for land administration and moveable asset registration. In this process, the project would collaborate with KfW in implementing standard computer programs for centralized cadastre and land registration records, and with GTZ, which is working on property registration in Tbilisi. The USAID-Georgian Enterprise Growth Initiative (GEGI) project is working with the MOJ on a draft law on secured transaction. The MOJ would establish a working group to coordinate donor activities in land registration and cadastre management and moveable asset registration.

2. Institutional and implementation arrangements

The project would be managed by the Project Coordination Center (PCC) which is established by the joint order of Ministry of Agriculture and Ministry of Finance as a legal public entity according to the Presidential Decree number 149. While the government is planning to integrate project management unit into the structure of the MOA, it was agreed at negotiations that this existing PCC will continue to manage the project until MOA has formulated an alternative project management structure that is satisfactory to both IDA and IFAD. The PCC has an overall management and supervision responsibility of World Bank-financed projects. The PCC is supported by a core service team, which provides centralized procurement and disbursement services to all agriculture projects and project management units responsible for technical management and supervision of each project. The RDP Project Implementation Unit (PIU) would be responsible for the whole project implementation, day-to-day management of all components including planning and budgeting of project activities, preparation of procurement plan, preparation of progress and project management reports, staff management and project monitoring and evaluation. The PIU will be managed by a project manager, who has overall responsible for all components of the project. Since the PIU is a unit in the PCC and is not an independent legal entity, the project manager will report directly to the Director of PCC.

The PIU would include professional staff and administrative and support staff. Professional staff positions would include a project manager, a senior finance and banking specialist, two PFI finance supervisors (including one specialized in CUs and MFIs), a Secretariat to the FAC, a linkages to farm community coordinator a monitoring and evaluation officer. The PIU would be supported administratively by an administrative officer and drivers.

The PIU will work with (a) an Agricultural Supply Chain Development Fund (ASCDF) Advisory Committee (FAC), which would manage the award of competitive grants supporting commodity, technology and supply chain development (b) a group of NGOs who would coordinate the linkages to farm communities programs, (c) the Credit Union Development Center (CUDC) which would provide technical services to credit unions, (d) an Association of Credit Unions (ACU) which would manage the development of a national rural credit union program, (e) participating commercial banks and NBFIs through subsidiary loan agreements between the Ministry of Finance and PFIs, following the rural credit guidelines, (f) the responsible government agencies for each institutional reform sub-component, and (g) the NAPR which will implement the land registration, cadastre management and moveable asset registration programs.

The Project Steering Committee (PSC) would be chaired by the Minister of Agriculture and include the relevant Vice-ministers of Finance (MOF), a Vice-President of the National Bank of Georgia, the chairperson of the Parliamentary Agrarian Committee, the RDP PIU Manager and PCC Director and representatives of the donors, international and domestic NGOs engaged in agricultural and rural development and a private sector representative. The RDP PIU would provide secretarial support to the PSC. The PSC would meet half yearly to review the RDP semi-annual and annual reports and annual work program with a view to ensuring the closest possible alignment of RDP activities with government financial control and economic growth policies and to capture synergies with other donor and international financial institution funded projects. The PSC members would inform the Minister of Agriculture of their opinion on these matters, but would have no jurisdiction over the program or budget of the RDP.

The Linkages to Farm Communities program would be managed by a group of NGOs selected on a competitive basis, following TA procurement procedures. The successful NGOs would be responsible for staffing and managing the three field teams (one per region) that would implement a pilot program for farmer training and technology testing and demonstration programs. The field teams would assist farmers to prepare applications for grants for technology testing and demonstration programs and for market linkage activities. Grant applications for less than US$5,000 would be awarded by the PIU on the recommendation of NGO management committee that would oversee the pilot Linkages to Farm Communities Program. Grant applications for larger amounts would be screened by the NGO review committee with short-listed proposals forwarded to the FAC for final approval.

The ASCDF Advisory Committee (FAC) would include one representative from each of the MOF, Parliamentary Agrarian Committee, MOA and Academy of Agricultural Sciences, together with two representatives respectively of the Linkages to Farm Communities NGO management committee and the farming and agri-industry communities. The Minister of Agriculture would nominate private sector FAC members on the advice of the PCC Director. This 10-person committee would elect an independent person of high standing in Georgian agriculture as its chairperson. The Committee could invite tenders for the Chairperson position if preferred. Committee members would be appointed for two-year terms with staggered replacement to ensure continuity of knowledge of FAC operations. The RDP PIU would provide a Secretariat to support the FAC, which would meet quarterly to review funding proposals and progress reports and to select applications for ASCDF grant funding. The detailed operation of the FAC is described in the ASCDF Operational Guidelines.

3. Monitoring and evaluation of outcomes/results

In pursuing its major developmental objectives, the project would target an increase in the access of Georgia's mainly smallholder farmers to marketing/supply chains. This would be measured through the number of farmers dealing with supported supply chains and size of those supply chains. It would also be measured through the increase of aggregate sales and exports of the enterprises financed under project credit lines and the number of farmers and enterprises benefiting from improved access to financial and marketing services.

Baseline data would be collected at the beginning of the implementation of each sub-component. The follow-up data collection and reporting format would be developed during the first supervision mission. Progress would be monitored through regular reporting by the PCC/PIU and through project supervision missions. It is envisaged that reporting under the RDP would be done through quarterly progress reports. Project reporting would be done by the PIU in agreed formats.

The monitoring of credit lines would occur at two levels, on-going review of the financial soundness and viability of the PFIs and simultaneous review of the way that beneficiary loans are being used and managed. Financial institution monitoring would be based on quarterly reports (as submitted to the National Bank of Georgia), together with audited annual accounts. Monitoring of credit use would be based on quarterly reports of disbursements and repayments, and periodic visits to the financial institutions and project beneficiaries by PIU staff; plus the use of standard World Bank monitoring indicators for PCBs and NBFIs. The quality of technical assistance inputs would be reviewed on an on-going basis in co-operation with the beneficiaries of this assistance.

4. Sustainability

Sustainability beyond the implementation period of the increased production, profitability and productivity resulting from the project is considered likely because the project is specifically designed to support and improve only profitable private production of commodities. In terms of actual implementation, the project would help participants in supported supply chains to increase their adaptability to respond to the constantly changing market demand of globalized internal and external markets. Thus, the sustainability of project interventions would be the improved commercial sustainability of the already viable private industries supported under the project. Anything that improved the general sustainability and profitability of business activity in Georgia would be positive for the sustainability of project interventions. Conversely, a declining business environment would be a negative factor and a non-favorable aspect of the project's orientation to let the market rather than the project "pick winners". Sustainability would be enhanced by project action to mitigate commercial risk by (a) relying on matching-grant from private sector beneficiaries; (b) reliance on commercial banks/NBFIs for taking commercial risk and partial loan financing; and (c) avoiding non-competitive agricultural commodities.

In the case of legal regulatory and institutional modernization, the project aims to modernize certain aspects of the legal framework, secure supply chain-specific regulatory improvements, particularly food safety and quality and complete the development of the land registration and cadastre system. Only the land sub-component raises significant sustainability issues and these are in fact the focus of the intervention, which aims to create a financially and institutionally sustainable land and moveable property registration system based on the successful interventions under ADP and an appropriate legal framework, which has now be established (Law of Georgia On State Registry, June 1 2004)). Mindful of the MOA's limited recurrent budget, the Project, in developing a modern legal and regulatory framework for the sector would actively pursue least cost options consistent with a modern administrative, regulatory and support service.

The project would enhance the capacity of PFIs to continue agricultural lending on a sustainable basis in two ways: (a) by providing credit lines to allow PCBs to strengthen and diversify their portfolios and by enabling NBFIs to attain the critical mass needed to achieve economies of scale and improve their access to private capital; and (b) by increasing the capacity of banks and NBFIs to make well-informed decisions about agricultural lending and to better manage agricultural loan portfolios. Moreover, the more profitable agriculture-related lending expected as a result of these interventions is also likely to raise PFI interest in such lending. That is, after project credits have been repaid, banks and NBFIs are expected to continue to allocate a greater share of their resources than pre-project to the rural and agricultural sectors. Project interventions are also designed to enhance the capacity of PFIs to repay subsidiary loans received from the MOF (discussed under risk). The investments made by project sub-borrowers would be sustainable, for the reasons outlined in the previous paragraph. The sustainability of participating NBFIs would be further enhanced by project measures to build a national ACU structure for rural credit unions to strengthen training and supervision and increase deposit mobilization; to strengthen the legal basis for MFI activity; and to strengthen the capacity of the NBG to regulate and supervise NBFIs.

5. Critical risks and possible controversial aspects

Potential risks are related to commercial risk, financial risk, potential political instability, the current relatively unfavorable business environment and possible lack of counterpart funding. Commercial risk would be minimized by the demand-driven and private co-financing approach, which would only support commodities that have clear market demand and profitable production operations. Risk is also reduced by holistic support for complete supply/marketing chains. Concerning financial risk, the risk of default by PFIs has fallen substantially as a result of the on-going reform and strengthening of the financial sector and the stronger supervision by the NBG. The default risk for sub-loan beneficiaries would be moderate, as the project would reduce commercial risk for all elements in agricultural supply chains. Potential and existing problems would be identified early in the project cycle and solutions found as an integral part of project implementation. Sub-borrowers without access to foreign exchange have the option to borrow and repay their loans in Lari. Directing project support mainly to the private sector and grassroots organizations, which would develop strong ownership, would minimize the impact of potential political risk. Commodities would not be considered for project support if the political willingness to make essential legal and institutional reforms is lacking. Delay in providing or non-availability of counterpart funds would be a major risk and would be likely to delay project implementation. The problem, related to government budgeting, could be mitigated by the project carrying out proper planning for each implementation year and MOF following through in putting the required lines in the budget.

6. Loan/credit conditions and covenants

Effectiveness Conditions

(a) The project account has been opened by MOF and the initial amount of US$50,000 equivalent has been deposited.
(b) Appointment of a Project Steering Committee (PSC) satisfactory to IDA.

(c) Cross-effectiveness of DCA and IFAD's Project Financing Agreement.

At negotiations assurances have been obtained from the government as follows:

(a) An IDA special account would be established at a commercial bank acceptable to IDA.

(b) MOF would maintain a Project Account in a commercial bank on terms and conditions acceptable to IDA and shall replenish the Account quarterly in amounts sufficient as required for the Project during the next quarter.

(c) MOA agrees on the format of the quarterly financial management report (FMR).

(d) Maintain at all time during project implementation, the PSC and PCC (or an agreed successor) with staff with qualifications acceptable to IDA.

(e) Appointment of an ASCDF Advisory Committee (FAC) satisfactory to IDA no later than three months after project effective.

(f) FAC would carry out the ASCDP according to the ASCDF operational guidelines.

(g) The government would maintain the FAC until the completion of the ASCDF program with adequate qualified staff and resource required for implementation of the program.

(h) The PFI Subsidiary Loan Agreement has to be reviewed and is satisfactory to IDA.

(i) The government allows PFIs to set loan conditions according to best commercial and micro credit financing practices.

(j) All PFIs agree to provide sub-loans to eligible beneficiaries in accordance to Rural Credit Operational Guidelines.

(k) The government would establish and maintain a revolving fund into which all repayment of principal from credits extended to PFIs shall be deposited. The government would ensure that such revolving fund shall be used to provide rural credit on an on-going basis.

(l) The government would carry out the Rural Finance component in conformity with the Rural Credit Operational Guidelines and the Environmental Guidelines for loan activities.

(m) A mid-term review would be undertaken no later than (July 2007).

(n) Appointment of auditors satisfactory to IDA.

D. APPRAISAL SUMMARY

1. Economic and financial analyses

Financial analysis. Farm modeling was carried out to analyze profitability at the farm level for the key potential crops in the project area. The analysis is based on the assumption that, with technology development, improved association, better market information and strengthened linkages to supply chains under the project, farmers would expand their farming activities. The models are based on individual borrowing for investment in Saperavi vineyards, apple orchards, hazelnut orchards, tea acreage, greenhouse vegetables and dairy cows. Financial data used in the analysis includes: (i) investment costs, (ii) operating costs, (iii) net income before financing, and (iv) net income after financing. It was assumed that farmers would borrow at most 80% of total investment at the prevailing rate of interest (which was about 20% in June 2004) and would have grace periods of 1-2 years and repayment periods of 1-4 years, depending on the investment. Farmers would contribute 20% of the total cost, typically to cover operating costs. For each production system, the Financial Rate of Return (FRR), Net Present Value (NPV) and net annual income after loan repayment (net return) were calculated. The results of the analysis show that investments in the analyzed crops have FRRs of 12-46%, except for tea, which has a negative FRR. NPVs range from 814 Lari to 34,954 Lari per ha. Greenhouse vegetables have the highest net return - 16,000 Lari per 0.2 ha - and also the highest FRR at 46%. (Annex 9). While this analysis shows substantial incremental family income per hectare for a number of different investments, the actual profitability and cash flow of individual borrowers would of course need to be evaluated by PFIs on a case-by-case basis.

Economic Analysis. The Nominal Protection Coefficient (NPC) and the Domestic Resource Cost (DRC) ratio were used to determine whether Georgia has comparative advantage in the production of major commodities such as hazelnuts, apples, greenhouse vegetables, milk and tea. These ratios were not calculated for Saperavi grapes, since it is an intermediate product. The 2004 border prices of traded goods were determined using domestic prices minus conversion factors calculated on the basis of import tariffs, export subsidies, excise duties and VAT charges. International price projections were used to estimate farmgate economic prices in 2004 constant terms for international traded inputs and outputs. For most of the analyzed commodities, both the NPCs and DRCs indicate that Georgia has comparative advantages in their production. The indicators for these commodities are below 1, ranging from 0.61 to 0.89 for NPCs and from 0.20 to 0.96 for DRCs. The DRCs show comparative advantage to be very marginal in the case of tea and milk, while the NPCs are 1.07 and 1.29, respectively.

Hazelnut has the highest comparative advantage (DRC of 0.11 and NPC of 0.71). At present, being superior quality than Turkish hazelnut, Georgian production cannot satisfy the demand of the processing sector. With growing demand, hazelnut production looks likely to have a reliable future, provided farmers can access good quality planting material and agro-chemicals and the existing hazelnut growers association expands its membership and services to meet farmer needs. Greenhouse vegetables have an NCP of 0.74 and a DRC of 0.27. The analysis is based on a greenhouse industry that produces parsley, dill and caraway in the winter and tomatoes, salad greens and cucumbers in the early summer. These products go to the Moscow market and have the potential to expand their share in that market. Apples have an NCP of 0.61 and a DRC of 0.48. Apple production has potential for both domestic and export markets. First grade apples (45%) would be washed, graded, boxed and exported to Moscow. Second grade apples (30%) would go to Georgian urban markets and third grade apples (25%) would be used to produce apple juice concentrate. There is high potential to increase production of first grade apples. Milk has an NPC of 1.07 and a DRC of 0.89. With prevailing dairy industry productivity and at present world market prices, milk production in Georgia is just viable financially, but economically marginal. With improved animal genetics and feed resources, however, Georgian farmers would have the potential to achieve much higher levels of productivity and improved comparative advantage. Tea provides poor returns to investment and labor and unfavorable economic results. Its NCP is 1.29 and its DRC is 0.96. The government is attempting to revive the tea industry, but with strong competition from international suppliers, there is little likelihood of a return to anywhere near the scale of its past operations, which engaged 167 processing factories. Hand rolled tea and brick tea may offer some opportunity for growth, but on a relatively small scale.

Economic analysis of Saperavi grapes, a major input into wine making was not possible due to grapes being an intermediate product. It should be noted, however, that the financial analysis of grape production was favorable (Annex 9) and that there is currently a strong export market for Saperavi wines, particularly in Russia.

2. Technical

Funding of agricultural research in Georgia is negligible and research institutes have lost a substantial proportion of their infrastructure and staff capacity, however, a core capacity remains in export commodities and there is strong interest amongst the research institutes to collaborate to meet the new market opportunities. Through the ASCDF, the researchers and agricultural extension staff would have the opportunities to work with farmers in developing and testing innovative technologies.

3. Fiduciary

(a) **Procurement**. An assessment of PCC capacity to implement procurement actions for the project has been carried out in June 2004. The assessment reviewed the organizational structure for implementing the project and the interaction between the PCC's project staff responsible for the procurement, MOA and the PIU, the legal status and procurement capacity. There are three procurement officers in the PCC's Core Service Team. Three of them attended different procurement training courses and had an intensive experience in different Procurement and Selection procedures. Each procurement specialist is responsible for his/her designated project with necessary back up function. One of them would be in charge of the procurement under the RDP. Although the overall procurement capacity could be considered satisfactory, there is some room for improvement.

The CPAR has assessed Georgia as a high-risk country. Therefore the prior review thresholds are those applicable to a high-risk country. The corrective measures which have been agreed are: (i) provide additional training to the PCC procurement staff on the application of the current procurement and selection guidelines and the respective documents; (ii) provide training to the PCC and PIU staff on the preparation of the technical parts of the bidding documents (technical specifications, bill of quantities or schedule of activities/requirements etc. particularly in the procurement of works and IT equipment, etc.) and requests for proposals (TOR's); (iii) conduct a comprehensive procurement training for all project related staff as part of the project launch workshop; and (iv) the Bank's Standard Bidding Documents and Requests for Proposals and ECA's sample formats for small procurement would be used. In addition, the bank would monitor procurement activities and the procurement specialist would conduct post reviews and would provide guidance in all procurement-related activities.

(b) **Financial Management Review**. As of October 2004 PCC has acceptable financial management arrangements in place to meet the current Bank requirements in respect of the quality of accounting, reporting and internal controls system and also in respect of the audit arrangements, and is ready to start the project implementation.

4. Social

The results of the study on "Constraints and Opportunities for Rural Growth" have been used as a basis for social assessment in this project. The preliminary findings of this study have generally been used in the designing the project. The study has been done in consultation with stakeholders, the government and NGOs. A social assessment summary is contained in Annex 10.

5. Environment

Since this project has been classified as an FI project, an operations manual entitled "Environmental Management Plan and Environmental Guidelines for Project Loan Activities" has been prepared. The document includes a description of the project, a description of possible activities that the project might finance, potential environmental issues for each type of activity the project could finance, a description of the guidelines the financial institutions would follow in evaluating the impacts of each sub-project, a description of the World Bank and Georgian safeguards and EIA systems and sample forms to be used in environmental monitoring. The document has been reviewed and cleared by an ECSSD environment specialist. It has been translated into Georgian and discussed with the staff of Georgian commercial banks and the Georgian Environmental Department, whose recommendations have been incorporated in the manual. The environmental report has been distributed in Georgia and sent to the Info Shop on July 9, 2004.

The project would not finance any major infrastructure and sub-projects are unlikely to involve the acquisition of land through eminent domain. The project would not directly finance purchases of fertilizer and chemicals. Farmers are able, of course, to purchase them in the market or through farmer groups. Training and field demonstration would be provided for farmers under the project in appropriate application techniques and timing for fertilizers and pesticides, as well as handling of residues. This would be expected to contribute to reducing the negative impact of increased input use.

6. Safeguard policies

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[X]	[]
Natural Habitats (OP/BP 4.04)	[]	[X]
Pest Management (OP 4.09)	[]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[]	[X]

Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OD 4.20, being revised as OP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

7. Policy Exceptions and Readiness

The project complied with all applicable Bank policies and is ready for implementation.

* *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*

Annex 1: Country and Sector Background

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

Macro-Economic Situation

1. Georgia's economy grew by 8.6% in 2003, up from 5.6% in 2002. This is the highest growth rate since 1997, and continues a period of strong growth (> 5% per annum) that began in 2001. Construction activity related to the Baku-Tbilisi-Ceyhan (BTC) pipeline contributed heavily to growth in 2003, together with a rebound of industry and increased output in the agriculture and service sectors. Improved economic stability further enhanced growth, with 2% nominal appreciation of the Lari against the Dollar, and inflation of 4.8% (year-on-year), down from 5.6% in 2002.

2. These favorable trends were not matched by progress on Georgia's longstanding structural problems: weak governance, deep-seated corruption, poor fiscal management, and very high levels of external debt. The IMF suspended its Poverty Reduction and Growth Facility (PRGF) in September 2003, due to government's inability to enact a fiscally responsible budget; and disappointing overall progress with reform. This in turn compromised Georgia's ability to negotiate a re-scheduling of its external debt with the Paris Club. These factors, combined with growing donor fatigue, resulted in a pessimistic view of Georgia's prospects for continued economic growth, prior to the "Rose Revolution" in November 2003.

3. Current prospects are more positive. The new government is revising the budget, in consultation with the IMF, based on higher tax revenue and a lower budget deficit. Success on this front has opened the way to reinstatement of the PRGF, negotiation with the Paris Club, and continued donor support, clearly expressed through the June 2004 Donor's Conference. Many of the factors that underpinned recent economic growth are also likely to continue during the next two years, including good prospects for economic growth in Russia, Turkey and the EU (Georgia's main export markets), and buoyant markets for minerals and agricultural products. The prospect of continued support from the donor community, and increased confidence in the new government also presage well for increased private investment.

4. A cautious stance towards future growth prospects is necessary nevertheless. There is still considerable uncertainty surrounding the path to be followed by the new government, both internally and externally. Domestically, the government may find it difficult to balance its populist promises to eradicate corruption and reduce poverty with the IMF's demands for improved tax collection and fiscal rigor. Externally, the need to maintain good relations with Russia and other CIS countries would need to be balanced against measures to re-unite Georgia. Irrespective of any domestic or regional political instability, medium-term growth prospects would depend heavily on the ability of government and donors to implement civil service reform, improve tax collection and budget management, accelerate privatization and reduce corruption and smuggling. The initial combination of budgetary restrictions and increased tax collection would thus be a stern first test of the ability and commitment of the new government to reform. Without continued reform, confidence in government would remain low and the private sector would lack the incentives to invest and modernize.

Agriculture Sector

5. Georgia is a small Caucasus country with a population of 4.9 million people. Agriculture, which is mainly composed of small-scale, subsistence farmers producing small surpluses for the market, provided 18% of Georgia's GDP and 56% of employment in 2003 and is critical to the success of Georgia's overall economic growth and prosperity. The costs and risks associated with high input agriculture limit small-scale farmer adoption of improved technology and consequently, their penetration of commercial markets. Poorly developed marketing infrastructure, assembly systems and inefficient

agro-processing further constrain competitive agriculture despite a clear potential for domestic market growth and high value exports. Government and donor efforts to support the agriculture sector have successfully focused on supply side investments (e.g., irrigation, land privatization and agriculture technology), with limited attention to measures to orient this supply to demand in domestic and international markets.

6. **Agricultural Production:** Growth in agricultural production and agricultural sector services is, in the short-term, the most viable option for sustainably increasing the livelihoods of rural populations in Georgia. Georgia has the potential to be a net food exporter. Given the low domestic demand, most growth in the medium term is likely to come from agricultural export, particularly of high-value horticultural and agricultural products in which Georgia has a comparative advantage. This includes grapes, fruits, citrus and vegetables, as well as some aromatic and medicinal plants.

7. Yields for some economically important crops for the domestic market such as wheat, maize, sunflower and potato are low to very low, however, with appropriate technology, they could potentially be doubled in a short period. Deciduous and citrus fruit production has declined precipitously since independence as a result of neglect, weak markets, the breakdown of irrigation systems, aging trees, fuel wood demand and the lack of new varieties and sufficient new planting material. Yields have also fallen from already low pre-independence levels due the lack of inputs and husbandry. The viticulture industry has also declined in area and yield for similar reasons, although, recent foreign direct investment (FDI) has catalyzed some growth in this sub-sector. Tea, which is marginally profitable at these latitudes, has experienced the greatest proportional decline in production.

8. Major economic constraints to increased productivity include lack of access to working capital, unavailability and/or low quality of machinery services and agro-chemicals, poor terms of agricultural trade and inadequate upstream and downstream technical and commercial farm services. Total fertilizer use in the country in pure nutrients has undergone a dramatic decrease since the mid-1980s. As an example, Georgian agriculture used almost 250,000 tons of nutrients in 1985, but 4,000 tons were applied in 1994, rising to 32,000 tons in 1998 – almost exclusively nitrogen based products. The low use of fertilizer aside, until quite recently, the almost total absence of phosphors from the market and the marginal supply of potassium has been a major constraint to improved annual and perennial crop production. Similar scenarios exist for pesticides, herbicides, improved varieties and planting material, irrigation water and mechanization services.

9. Crop production would improve with better access to working capital for agriculture production, competitive market access to a balanced set of fertilizers, the liberalization of the seed sector including the acceptance of the EU Vegetable Seed Catalogue and maintenance of an open policy on seedlings, the registration and training of input suppliers, increased attention to IPM, investment in post-harvest quality control and storage, a focus on whole chain management for key commodities and the re-establishment of traditional markets in the region.

10. The national livestock population is mostly privately owned, with animals spread across several hundreds of thousands of households. Livestock populations (excluding horses) have also seen a massive decline that started even before independence, due to policies intended to penalize Georgia's independence ambitions. Despite a long-standing program of genetic improvement (that has now collapsed), most livestock are from indigenous breeds or their crosses rather than higher yielding imported breeds and productivity is correspondingly low. Insufficient feed grain supply and the lack of appropriate fodder technology mean that most animals are reared under extensive rather than intensive husbandry systems.

11. Livestock production will improve with demand driven by rising consumer incomes. This process will be facilitated by the privatization of State breeding and clinical veterinary services, improved access to medium term credit, the establishment of a reputable national feed industry, community management of natural pasture, additional research into feed and fodder production and the establishment of an effective disease epidemiology and associated control program.

12. **Agro-Processing:** The food-processing sector has yet to emerge from its post-independence depression. There are innumerable food processing and storage plants throughout the country that have collapsed into skeletal structures and vast cold storage chambers that are no longer operational. Others have been taken over for alternative uses. Many food processing plants are outdated in terms of their infrastructure, machinery and scale of operation[1]. There are a few modern processing plants, but not all of them are in use. For instance, two modern facilities in the Kelvachauri District, the Beltus[2] and the Agordzineba[3] fruit processing factories, are only in partial production and exporting their products, but the industry faces increasingly stiff competition in export markets and needs to modernize its processes, products, and marketing techniques. Considerable investment is needed in upgrading the processes and equipment. Processors should be linked with commercial banks to tackle the urgent need for credit.

13. **Agriculture Institutions:** Georgia cannot develop a competitive agricultural economy as a whole or in individual sub-sectors, particularly export-oriented ones, under its present sanitary/phytosanitary (SPS), food safety and testing regimes. There is insufficient knowledge of disease prevalence in crop and animal production systems, agricultural seed is largely uncertified and not subject to variety protection, imported and exported agricultural commodities are not effectively tested for pests or disease; and some foods in Georgian markets are manifestly unsafe. The agricultural processing sector is nevertheless subjected to largely irrelevant food sampling and testing programs and mandatory certification procedures at both production and market levels. Both domestic and export agricultural industries are further disadvantaged by the lack of any specific institution responsible for sanitary or phytosanitary risk assessment [as required by World Trade Organization (WTO) rules], while risk management is conducted on an *ad hoc* basis.

14. Georgia is yet to meet its WTO treaty commitment to base its SPS measures on international standards, guidelines and recommendations; to recognize the equivalency of measures applied by other member states (Georgia still operates a compulsory standards system); or to establish a science-based food safety risk assessment and management system. This situation is aggravated by weak inspection and laboratory services. In this environment it is difficult to invest with confidence in the agriculture sector, secure high quality seed or breeding stock, reliably estimate or mitigate against risk, or build consumer and market confidence in product safety and quality.

15. **Food Safety.** Food safety control in Georgia is weakly developed, with food borne diseases causing extensive illness and death. There is insufficient epidemiological data collected to direct food safety controls and supporting inspection and laboratory services are inefficient, under resourced and

[1] For example, the Gorkone Food Processing Kombinat in Gori had 17ha of buildings on one site.
[2] The Beltus Fruit Processing Plant was constructed in the late 1980's with state of the art equipment from Germany and Italy, much of which was automated or electronically controlled. The plant has lines to sort, wash, wax, grade and package fruit and also has fruit juice and jam-making lines. Products were clearly intended for export and the plant would have been to ISO and HACCP standards enabling export into the EU and other international markets. The cold store was still covered with the protective materials in which it was transported to the site. The plant has been unused since 1990 and has been partially vandalized, but it could be rehabilitated without excessive cost. This plant probably has the best processing equipment in Georgia.
[3] The Agordzineba Processing Plant at Batumi, was constructed in 1998 and had been little used. It has a fully automatic sorting, washing, waxing, grading and packaging line manufactured by Tarim-Sanay of Turkey. There appears to be no damage to the plant, and it could be put into operation without further investment.

largely ineffective. There is no specific institution concerned with risk assessment and risk management, so that when it is conducted, it is on an *ad hoc* basis. Too many inspection bodies, with lawful but overlapping responsibilities result in multiple inspections of enterprises. Routine and often meaningless sampling and testing, including mandatory certification of foodstuffs at producer and market levels, substitute for a focus on core problems. Among other things, food standards fail to distinguish between food safety and commercial quality. Inspectors' technical knowledge and skills are outdated; they have little experience of hazard-based process-control approaches to food safety management; and food safety decisions are prone to corruption. Supporting laboratories lack equipment and adequately trained staff, and the laboratory accreditation system does not meet international standards.

16. **Phytosanitary and Seeds.** The Georgian seed industry is in disarray. Seed breeding is at an ebb, with no new varieties released since 2000. Seed multiplication is limited to a few scientific organizations and one private seed company, with little officially certified seed available to farmers. The seed certification system[4], with its multitude of rayon-level centers, is grossly overstaffed and resourced, yet offers no formal seed certification service. The variety testing commission's[5] VCU (value for cultivation and use) trials do not meet internationally accepted standards and the commission is unable to conduct DUS (distinctiveness, uniformity and stability) testing. As a result, it is not possible to formally register new Georgian varieties in the common seed catalogue, which is in a state of suspension, having last been published in 2000. Georgia has no plant variety protection legislation, and existing seed sector legislation would require extensive revision to meet international best practice. This should include reducing mandatory varietal testing from 3 to a maximum of 2 years and the cessation of testing of vegetable varieties registered in the EU vegetable common catalogue.

17. Phytosanitary inspection is largely ineffective due to the lack of resources for physical inspection and testing at border points and the low capacity and lack of mobility of domestic field inspectors. Overstaffing, the multiplicity of border crossings, a weak regulatory base and the unnecessary "inspection" of many imported products compound these problems. The national phytosanitary laboratory is poorly equipped and unable to conduct mandatory tests. Plant protection services are equally overstaffed and under resourced. Additionally, they are burdened with ineffective testing and registration procedures for imported agricultural chemicals.

18. The RDP project would start addressing the complex issues facing Georgia, many of which are endemic to the Georgian public sector and need to be addressed through high-level policy choices. The project would focus on those key legal and institutional reforms that impact directly on the competitiveness of Georgian agriculture and the marketability of its products and enable Georgia to meet its international SPS and trade obligations. Project interventions would be strategically focused on (a) modernizing the legal framework, (b) strengthening food safety, and (c) supporting selected programs that fit specific needs of the selected commodity chains.

19. Land registration, cadastre management and moveable asset registration is presently implemented through Rayon-based registration offices, mostly operating with paper rather than electronic data management systems. The Bank has supported the establishment of this system through investment in staff capacity building, the development and piloting of an electronic rural land registration system and the establishment of 11 territorial land registration centers. Other donors have supported land surveys, cadastre management, training and land registration in urban centers.

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[4] Managed by the MAF Seeds and Seedling Variety Control Inspection, which has 155 staff.

[5] Managed by the MAF State Commission of Testing and Protecting Selection Achievement, which has 53 MAF staff and 50 field staff at 36 field stations.

20. The recent passage of the Law of Georgia on State Registry has established a new framework for the development of an independent and eventually self-financing public registry responsible for land registration, cadastre management and a national registry of liens on moveable asset. This would be implemented through about 25 State territorial registry offices, including those already established under the ADP, which would replace the former rayon-based registry offices. This new network would use land registration software built of that developed under the ADP, together with land cadastre and moveable asset registration systems under development by other donors. The RDP would support the development of the NAPR administration and its financial control systems, build associated staff capacity, implement a new electronic land registration system and establish an associated secure national digital communications system.

Financial Sector

21. **Commercial Banks**: Over 100 new banks sprang from the ashes of the former Soviet Union following Georgia's independence. However, these were largely tiny, undercapitalized, poorly managed, and inadequately-supervised institutions, several of which have since collapsed, severely denting the public's faith in the entire banking sector. Consolidation within the banking sector is still ongoing, albeit at a reduced pace. For example, licenses for 4 banks were revoked in 2004. As at end December, 2004, the number of commercial banking institutions was down to 21, namely: 19 resident banks, and 2 branches of foreign registered banks – with a combined 162 branches. However, some 85.4 percent of total banking assets are owned by 6 banks, indicating how small several of the banks are. It is also important to note that 12 banks now have foreign shareholders, including EBRD, IFC, DEG, and IMI, and have benefited, and continue to benefit from, significant capacity building[6].

22. Despite continuing weaknesses, there is some semblance of growth and a gradual restoration of public confidence in the industry. Total banking assets, while still very small, at approximately US$931 million as at end December 2004, and only around 17.2 percent of GDP, marked a slight increase from the previous year's 15.7 percent[7]. Total commercial bank lending, which amounted to about US$528.7 million, or about 56.8 percent of total assets and approximately 9.8 percent of GDP, grew slightly from the previous year's 9.2 percent of GDP.

23. Similarly, depositors have been making a gingerly return, with total banking sector deposits growing to some US$ 538.6 million by end December 2004, corresponding to about 10 percent of GDP, up from 8.5 percent of GDP the previous year, and a mere 2 percent of GDP in 1995. In fact, there has, of late, been a rise in household deposits, which jumped by 46 percent in 2003 and 27.4 percent in 2004 and accounted for some 50.2 percent of total deposits, reflecting growing confidence in the financial sector, particularly in Tbilisi.

24. These deposits, however, remain in the short term market. Although the proportion of time deposits above one year is growing, it still hovers around 2.7% of GDP. In the absence of a meaningful insurance and pension fund sector, this is way too small to fund long term capital needs of an economy that is beginning to show strong signs of recovery and sustained growth. And virtually none of these deposits exceed 2 years. Consequently, almost 100 percent of all long term lending of maturities above 2 years is financed with long term borrowings from international financial institutions, principally EBRD, IFC, DEG, KfW, and others – including IDA and Commercial Bank of Greece, which account for 15 percent of total liabilities (see further down for details). However, banks closed the year with, and

[6] EBRD has shares in 4 banks, IFC in 2 banks, DEG in 2 banks, IMI in 1 bank, Commercial Bank of Greece in 1 bank, Commerzbank in 1 bank. Their combined shares amount to approximately 17 percent of the total banking sector capital.

[7] According to un-audited figures as at end of December 2004

continue to be characterized by, excess liquidity in the short term market, largely due to an unstable business and political environment, particularly during 2003, as well as lending saturation in the short term, urban market. Thus, whereas there is increasing availability of short-term funds in the banking system, medium to long term funds remain a serious challenge, and external assistance in this area remains key.

25. As indicated earlier, there is some modicum of growth and profitability in the industry. As at end 2003, ROA for the banking sector stood at 4 percent and ROE at 15 percent. In fact, banking sector equity increased by 10 percent in 2003, principally from the banks' net incomes, which grew by 14 percent over the previous year. The average capital adequacy ratio of the entire banking system closed at 20.3 percent last year, over and above the statutory 12 percent.

26. More than four fifths of these earnings are coming from interest on loans. The interest rate averaged 4.9 percent on Lari deposits[8], and 9.1 percent on rate-bearing foreign currency deposits, which constituted 86 percent of total deposits. During the same period, loan interest rates averaged 25.4 percent on Lari loans and 19.1 percent on foreign currency loans. Foreign currency assets constituted some 68 percent of total assets. It is interesting to note that despite the political challenges of the past year, including the "Rose Revolution" of November 2003, the country maintained a reasonably stable macro-economic environment, including a 4.8 percent inflation rate. The budget deficit has been tamed, leading to a drastic drop in Treasury Bill rates, which made them less lucrative investments for financial institutions, thus releasing funds for lending. Banking supervision has also improved, thanks, in part, to NBG's adoption of international policies and practices in banking supervision, capital requirements, financial reporting, and corporate governance.

27. In summary, Georgian commercial banks, while still undergoing consolidation and still generally weak, seem to have put the worst behind them, and are beginning to experience growth and profitability. Public confidence is gradually being restored, and deposits are beginning to build up, but largely in the short-term market. Long term lending continues to be supported by foreign lines of credit, and this is likely to continue for the foreseeable future.

28. **Microfinance Institutions**. There are half a dozen main micro finance institutions in the country, with a combined US$7 million in assets, mainly in form of loans. As they don't take deposits, their loan portfolios are largely financed by grants from international organizations, including UNDP, CIDA, and ACDI/VOCA, among others. They also rely on retained earnings to grow their loan portfolio, which is made possible, in part, by the high interest rates charged. However, donations and retained earnings are not sufficient to finance the ambitious growth program envisaged by some of them.

29. They generally give out small loans, ranging from US$ 500 to US$ 5,000. Together, they serve a clientele of about 30,000 borrowers, predominantly urban. Their interest rates range from 2 – 4 percent flat per month on group loans, to 1.5 – 2 percent per month on declining balances on individual loans. For most MFIs, non-performing loans range from 2-3 percent of the outstanding loan portfolio. One MFI (Constanta) has attained operational and financial sustainability.

30. The legislative and regulatory framework for NBFI activity is also weak, particularly for MFIs. Other than credit unions, MFIs, currently operate under the Georgian civil code as non-profit, charitable organizations. They are allowed to make loans under this law, provided that they do not make a profit and that lending is not a major part of their overall activity. Whereas this legal framework was not much of an issue during the early, formative stages of MFI development, it has now become a major constraint to their expansion. Government has also begun to question the legality of the larger MFIs operating under

[8] It averaged 2.7 percent on demand deposits, and 10.2 percent on time deposits.

this law. The USAID funded GMSE project to support MFIs has responded to this issue by seeking amendments to the civil code as a short-term measure to allow MFIs to continue operating. Together with the main MFIs, GMSE is also drafting a new MFI law to provide a sound legislative basis for MFIs to operate as commercial entities, thus creating a legal environment conducive to the expansion of MFI activity. It is expected to be adopted during 2005.

31. **Credit Unions**. As of December 31, 2004, there were 53 licensed credit unions operating in Georgia, with total assets of US$ 1,203,000, most of it in loans (90.1% of total assets), and total liabilities of US$ 1,072,500. Some US$505,732 of these liabilities was medium term loans from the World Bank-financed Agriculture Development Project, and US$ 529,800 from member deposits. Member capital amounted to some US$ 130,572, approximately 11 percent of total assets.

32. Credit unions charge in the range of 3-5 percent per month on a declining balance on loan sized averaging $230. Their cost of funds in year 2004 was primarily the 17.6 percent (annual average) interest on borrowings under the World Bank financed Agriculture Development Project (ADP). Although CUs are paying interest of 18-36 (annual) percent on deposits, the amount of deposit-taking remains very small.

33. Their financial performance remains generally poor as they continue to be beset by inadequate institutional capacity, largely due to their reliance on poorly skilled local staff for operation and management. While locally based initiatives are close to rural people and highly accessible, their managers lack skills and experience, and need time and strong support to acquire these attributes. Without this support such institutions are unable to manage the problems and risks that all financial institutions face, and they quickly fail. But the resilience and continued activity of these CU's, in the face of considerable difficulty, indicates that sustainability is indeed possible. The challenge is how to consolidate these gains, including strengthening their capacity and extending their outreach.

34. **Rural Financial Services**. Agriculture, which constitutes some 18 percent of GDP, is beginning to show strong signs of recovery. Indeed, the initial sharp decline in agricultural output of the post Soviet era has been firmly arrested, and a pro-growth environment put in place, including complete dismantling of inefficient collective farms and distribution of land, full price and trade liberation, and removal of all subsidies. However, credit – which is essential for renewing the dilapidated stock of farm equipment, increasing the use of improved seed and livestock genetic material, accelerating soil nutrient supplementation, and improving processing and marketing capacity – remains one of the key constraints to generating a veritable supply response. Agricultural lending by commercial banks, NGOs and MFIs of a combined total of US$ 15 million, is still only equal to 0.4 percent of total GDP and a mere 1.2 percent of agriculture GDP. This is extremely low, and deprives the sector of investment and working capital for farmers, agro-processors and agri-business enterprises that are essential to its sustained growth, as emphasized in the CAS. It is projected that in order to facilitate the expected growth in the sector, and to fully harness the potential from other ongoing investments in the rural sector, including infrastructure, agricultural extension, and rural business advisory services, agricultural lending would have to increase to about 10 percent of agricultural GDP in the medium term, corresponding to about US$130 million per year.

35. This limited agricultural lending is in part due to the small size of the financial sector, which leads to a shortage of medium to long term investment capital for all economic sectors. It is also due to factors peculiar to agriculture – the cyclical nature of its activities, the paucity of suitable collateral, and the type and scope of its risks, and correspondingly – the unique lending skills it demands, the risk management strategies it imposes, the lending methodologies it requires, and the appropriateness of the financial products it entails.

36. Indeed, some financial institutions have developed the required deeper understanding of the rural milieu and the lending opportunities it offers, and are successfully making some inroads, a trend that needs to be encouraged and facilitated. For example, Bank Republic has 2 percent of its loan portfolio in agriculture (some US$450,000), financed mainly from its short term deposits. This is down from 12 percent four years ago when it had access to external lines of credit and could extend medium term loans to its agricultural clients. Nevertheless, it intends to rebuild its agricultural portfolio to $6 million over the next 5 years, and sees growth opportunities in wine production, nut production and livestock. The availability of long term funds remains a major impediment.

37. Another Bank, ProCreditBank, which continues to enjoy significant access to medium/long term resources from partner international financial institutions, has 10 percent of its loan portfolio in agriculture (some US$ 5 million). It relies heavily on extending credit to farmers through processors, particularly those involved in milk processing, hazelnuts, fruit juices and pulp, wine production, egg and broiler production, and tomatoes for export. It also extends seasonal credit directly to farmers through its rural outlets for livestock, potatoes, cucumbers and wheat production. Similarly, United Bank of Georgia has since February 2004 initiated an agricultural lending pilot. Whereas agricultural lending is still a mere 0.7 percent of its total loan portfolio (some US$ 300,000), the bank projects a build up to around US$ 5 million over the next five years, corresponding to around 5 percent of its outstanding loan portfolio. There is a similar experience with Bank of Georgia, where agricultural lending is still a paltry 2 percent of its loan portfolio (corresponding to about US$ 1.5 million), much of it to wineries, which frequently on-lend to their suppliers (the small farmers). It too has expressed interest in growing its agricultural loan portfolio, long term resources permitting.

38. Similarly, some NGOs/MFIs have also been making inroads into the agricultural sector. World Vision started agricultural lending in November 2003, with loans of up to US$ 5,000 and loan terms of up to 18 months, and an agricultural loan portfolio of about 5 percent (some US$ 54,000). Constanta is also moving into the agricultural sector. The Georgia Rural Development Foundation (GDRF)[9] has the largest agricultural loan portfolio among the NGOs (about US$ 2 million). In general, the larger and more progressive NBFIs are now seeking to expand their activities into rural areas as they face increasing competition from commercial banks in urban areas. Progress is very slow, however, because they lack the financial resources to expand and of an adequate knowledge of agricultural lending and suitable loan products. As stated earlier, current laws also limit the ability of NBFIs to function as commercial enterprises, which further limits their ability to expand and, while credit unions remain very weak, the more progressive ones have demonstrated the power and potential of grassroots organizations in the transformation of the rural economy.

39. There is, therefore, an unmistakable bout of enthusiasm and exuberance in rural/agricultural lending, and an undoubtedly growing body of knowledge and valuable experience, albeit nascent, in successful rural/agricultural lending in Georgia that needs to be harnessed and disseminated throughout the industry in a more systematic manner. Assessments during project preparation also clearly pointed to the need for improved skills in agricultural investment appraisal, and portfolio risk management. There is mounting demand for improved proficiency in structured financing, leasing, and other innovative financial products in order to enrich the product offering. There is also a knowledge gap as regards successful commercial bank downscaling and effective MFI capacity building for rural finance, including knowledge sharing, and fostering linkages between the formal and informal sectors. Amidst this zeal, there is a real danger of financial institutions embarking on agricultural lending unprepared in terms skills and appropriate lending instruments, and encountering dreadful experiences and shunning the sector for a long time to come. It has happened elsewhere. Secondly, it is also abundantly clear that fuelling this gathering momentum for rural lending will require availing additional medium/long term loanable funds.

[9] GRDF had arrears of 12 percent of its loan portfolio in 2003, although its reporting improvements in 2004.

This is in full recognition that whereas confidence in the banking sector, and the expected improvement in other aspects of the financial sector (e.g. pension funds, and insurance companies) will lead to a gradual accumulation of long term savings, we are just not there yet.

40. Three new projects are now responding to some of these constraints. The USAID-financed GEGI Project consists of a series of initiatives to strengthen the enabling environment for credit provision and private investment. These initiatives include measures to strengthen the current system for moveable asset registration and the establishment of a credit bureau[10]. Other activities include the establishment for NBFIs of a wholesale finance window among commercial banks and the promotion of leasing. A second USAID initiative, the Georgian Micro-Finance Stabilization and Enhancement (GMSE), is providing training and capital to selected NBFIs and strengthening the legislative basis for MFI activity. KfW is planning a program to provide deposit insurance and micro-insurance, although details of this program have yet to be worked out.

41. All of these initiatives are generally pertinent and will go a long way in providing a conducive environment for small scale lending. What is now needed is build on this foundation with specific capacity building activities aimed at enabling financial institutions to take advantage of this atmosphere and engage the small rural borrower in earnest. It will take sector-specific skills, and the appropriate lending instruments. It will take creating linkages between lending, market development, and on-farm technology adoption. It will take removing debilitating chokepoints in the production-processing-marketing commodity chain by supporting commercial bank lending to the larger agro-processing and agri-business enterprises that are essential to the development of commercial agriculture. It will take providing the badly needed medium to long term resources, but doing so in a manner that does not create disincentives for continued domestic resource mobilization, and overall financial sector development. These are the basic tenets of the proposed Rural Development Project.

42. **Previous World Bank-funded Projects and Other International Financial Institutions.** Two of the World Bank-supported projects offer valuable lessons for the RDP, namely: the Agricultural Development Project, and the Agricultural Research, Extension, and Training Project. In addition, and as stated above, the RDP complements other international financial institutions that are providing technical assistance and financial resources to the banking sector.

Agricultural Development Project (ADP)

43. The ADP became effective on August 21, 1997 and is expected to close on June 30th, 2005. ADP's overall objective is to improve productivity and access to credit by (i) availing working and investment capital to private farms and agri-businesses; (ii) developing a network of rural credit unions to provide financial services to small farmers and rural micro-enterprises; (iii) supporting an institutional framework and implementation capacity for land registry; and (iv) identifying an agricultural development and investment program to address other major constraints to increasing agricultural productivity. As of November 29, 2004, US$ 13.85 million of the original US$ 14.06 million equivalent (i.e. 98.5%) had been disbursed (see table below). The next paragraphs present a succinct summary of the project's outcome.

44. <u>Enterprise Credit</u>. Credit disbursements to enterprises through participating financial institutions (PFIs) started in November 1997. Loans were made to 48 agribusiness enterprises serving rural areas for a total amount of US$ 8.56 million (US$ 7.47 million from the original IDA Credit and US$ 1.09 million from the reflows). By March 2001, all disbursements of the initial credit line and the reflows had been made (see annual breakdown in the table below). Revolving the reflows from the PFIs was minimal as

[10] These initiatives are considered premature given current conditions in the banking and business environment.

this was not part of the Development Credit Agreement and its introduction during project implementation was unsuccessful, partly due to Government's own budgetary needs.

ADP Disbursement Status, November 30, 2004

Component	Allocation (US$ millions)	Disbursement (US$ millions)
Credit to Enterprises	8.70	7.92[11]
Credit Unions	2.00	1.08
Land Registration	3.50	2.92
Agricultural Services	0.50	0.24
Project Management	0.30	1.44
Special Account Advance		0.27
TOTAL	**15.00 (now: 14.06)**[12]	**13.86**

45. Repayment from PFIs was completed in March 2004, whereupon a total of US$ 7.69 million was returned to the State Budget: US$ 7.47 million corresponding to the original credit line amount, and US$ 0.22 million being the net balance from the spread charged to PFIs, after applying part of the spread to the defaulted loan amount. Except for one PFI (Tbilcredit) which was liquidated before paying off its loan amount of US$ 1.47 million, the repayment rate by all the other PFIs was 100%. However, when this loss is factored in, the overall principal repayment rate by the PFIs back to Government drops to 82.4%. The US$ 1.47 million loss was made up for by the spread attached by Government to the on-lending rates, which brought in a total of US$ 1.72 million.

ADP Annual Disbursements

Year	Amount disbursed (incl. orig. IDA and credit reflows), US$	Percentage of total disbursement
1997	160,000	1.87%
1998	3,957,086	46.22%
1999	2,110,327	24.65%
2000	2,274,398	26.56%
2001	60,000	0.70%
Total	**8,561,811**	**100.00%**

46. The interest rate charged to PFIs by the Ministry of Finance on US$-denominated loans (adjusted semi-annually) consisted of 6-month LIBOR + 3%. At the beginning of the project, this rate averaged around 8.86%, but had declined to 4.26% by July-December, 2003, averaging 7.59% over the project period (November 1997 – January 2004).

47. The interest rate on GEL-denominated loans was initially linked to the average-weighted interest rate of 30-day funds auctioned by the National Bank of Georgia (NBG) (adjusted quarterly). The resulting rate (30 – 60%) was very high, and consequently, there was no demand for LARI-denominated loans. In order to bring it more in line with the general cost funds for PFIs, the interest rate base for Lari

[11] This includes US$7.47 for the credit line, and US$0.45 million for capacity building.

[12] At Board approval, this SDR-denominated credit was equivalent to US$ 15.0 million. Currently, it's equivalent to US$ 14.1 million due to exchange rate movements.

loans was changed in May 2000 and linked to the average-weighted interest rate of the NBG payable on reserve requirements plus 7% (adjusted semi-annually). In 2000, the resulting interest rate was 15% but dropped to approximately the 11-12% range in 2002 and 2003. From January- June 2004 it was 12.25%.and averaged 12.22% for the whole 2000-June 2004 period. In fact, only 4.5% of the entire credit line was disbursed in GEL.

48. The interest rate for final sub-borrowers on US$-denominated loans varied from 16% to 24% annually, averaging 20%. The interest rates for final sub-borrowers on the two GEL-denominated loans, made during the latter part of the project, were 16% and 21%, respectively.

49. All in all, the project financed 48 sub-loans covering a wide range of activities, including: hazelnut production, crop production, livestock breeding, wheat processing, wine production, spring water bottling, canning, tea processing, and meat processing. The post-loan average sales of the enterprises increased by 64%, and average export sales increased by 81%. The average number of employees in the enterprises financed under the ADP increased by 41% and average salaries by 16%. The impact would have been even more if the reflows had been used for relending to additional enterprises.

ADP Participating Financial Institutions – Loan disbursements and repayments

Bank Name	**Number of Loans Issued**	**Amount Received (US$)**			**Amount Repaid by PFIs to ADP (US$)**	**Percentage Repaid**
		Working Capital	Investment Capital	Total Received		
1) Bank of Georgia	2	-	310,000	310,000	310,000	100.0%
2) TBC	9	875,000	389,553	1,264,553	1,264,553	100.0%
3) Republic Bank	16	1,460,000	1,017,560	2,477,560	2,477,560	100.0%
4) Intellect Bank	9	570,000	1,022,198	1,592,198	1,581,960[13]	99.4%
5) Tbiluniversalbank	2	45,000	50,000	95,000	95,000	100.0%
6) Tbilcredit	1	160,000	-	160,000	160,000	100.0%
7) Tbilcom	4	1,312,500	230,000	1,542,500	44,633	2.9%
8) Absolute	5	950,000	170,000	1,120,000	1,120,000	100.0%
	48	**5,372,500**	**3,189,311**	**8,561,811**	**7,053,706**	**82.4%**

*Including both the original credit line and the reflows.

50. Credit Union Development. The purpose of the component was to establish a rural credit union system with mechanisms for monitoring and enforcing prudential standards, mobilizing savings, and providing loan capital to its membership. An appropriate legal and regulatory environment for credit unions was established: a credit union law was passed, and a supervision department for non-bank depository institutions was established in the National Bank of Georgia. Some 55 credit unions were established, serving over 13,000 people, and with member savings of Lari 3 million.[14] These funds were leveraged with project funds, permitting to make over Lari 12.6 million in rural lending in areas of agriculture, trade, medical services, education, and housing, among other things. RDP will consolidate these gains by addressing current weaknesses in governance and other areas, as discussed in Annex 4.3.

[13] The difference is due to sub-projects financed in GEL. Since GOG took the currency exchange risk on Lari loans, this exchange rate loss was borne by GOG.

[14] As stated earlier, the number of *licensed* credit unions as at then end of 2003, was 42 (National Bank of Georgia Bulletin).

51. Land Registration and Titling. A registration system has been successfully piloted in two districts, and as a result, there has been a noticeable increase in land transactions in these areas. This model is being replicated in the rest of the country, the details of which are described elsewhere in this PAD.

52. Development of Agricultural Services. The first two studies have been completed and have resulted in the development of investment projects. A third study of the assets and liabilities of the Ministry of Agriculture and Food has been completed and is expected to serve as a basis for restructuring the Ministry. The fourth activity is the computerized accounting training for Ministry accountants, which was completed in January 2005.

53. Lessons learned. The ADP experience offers many valuable lessons for the RDP, including:

- *Improving effectiveness of avoiding/handling bankruptcy situations.* As stated earlier, the banking situation has greatly stabilized in recent years, although further consolidation is likely, mainly through mergers and acquisitions. However, bankruptcy of some PFIs, although increasingly less likely, remains a distinct possibility. ADP showed that reliance on periodic Central Bank and external audits wasn't sufficient. Consequently, not only have RDP's selection criteria for PFIs been tightened, but the selected PFIs will be subjected to stricter monitoring as well. In addition, Assignment Agreements will be signed with all non-CAMEL-1 rated PFIs, whereby the project/Government will take over its portfolio within a PFI that is at risk of bankruptcy, a practice that is gaining prominence in Georgia, and a feature that wasn't available in ADP.

- *Mainstreaming the use of reflows.* In order to maximize the impact of the credit line, provisions to re-lend reflows from PFIs will be codified in the DCA to avoid any ambiguity. These reflows will be recycled for up to 10 years, a period during which locally sourced medium/long term funds are expected to grow to sufficient levels for financing domestic medium/long term investment needs.

- *Extended Maturity.* In keeping with the increasingly common practice, PFIs will receive the credit line funds for up to 10 years, to allow them to extend medium and long term loans multiple times before fully repaying the money back to Government.

Agricultural Research, Extension, and Training (ARET) Project

54. ARET's overall objective is to assist Government in developing an efficient and cost-effective agricultural knowledge system, and in demonstrating, disseminating and promoting the adoption of appropriate technologies that increase sustainable agricultural production and reduce pollution of natural resources. The project, which became effective in May 2001 and is expected to close in December 2005, is achieving its objective through: (i) small competitive grants for demonstrating these technologies; (ii) reforming the Agricultural Research System; and (iii) investing in Environmental Pollution protection measures. Thus far, US$ 2.9 million has been disbursed for the Adaptive Research and Technology Dissemination component, of which US$ 2.5 million in competitive grants, averaging US$20,000 per farmer. Areas covered under these demonstrations include fruit production, vegetables, cereals, animal husbandry, and beekeeping.

ARET Disbursements To-Date.

Component	Allocation (US$ millions)	Disbursement (US$ millions)
Adaptive Research and technology Dissemination[15]	4.070	2.856
Reform of the Agricultural research System	2.760	.514
Pilot Environmental Pollution Control Program	-	.005
Project management Unit	.710	.298
Advance for Special Account	-	.750
Total	**7.540**	**4.423**

International Finance Corporation (IFC)

55. Georgia joined the IFC in 1995, and during the last 9 years, IFC has been involved in: (i) technical assistance work; (ii) support to local companies; (iii) private advisory service; and (iv) investment in the Baku-Tbilisi-Ceyhan pipeline. The technical assistance focuses on developing the Leasing sector (further improvement of the legislative and regulatory environment and training of existing and potential leasing companies and their clients), and on improving Corporate Governance practices. In addition, an SME survey was conducted to identify key obstacles to this sector's development and recommend specific improvements in the regulatory and administrative environment. IFC has also undertaken equity participation in, and provided direct financing to, several investments including mineral water, glass, power distribution, and an oil pipeline. In the financial sector, IFC has focused on supporting the development of the housing finance market: providing credit lines and technical assistance to the leading banks in this sector, namely TBC Bank and Bank of Georgia. In 1999, IFC also helped establish the ProCredit Bank - the first bank dedicated to lending to micro and small enterprises for working capital and equipment acquisition.

56. IFC's country strategy for Georgia envisages continued support to SME development. This includes continued involvement in mortgage financing and leasing. It is also interested in supporting the transport sector, as well as Government's privatization efforts. Other possible areas include mining, education, and the wine sector. The RDP complements IFC's efforts by focusing more broadly on agribusiness through a holistic "commodity chain" approach. This project was prepared in close collaboration with IFC, which was regularly consulted during the preparation missions and was copied on other internal distributions (decision meeting package, etc.).

Other International Financial Institutions

57. Several other international financial institutions have responded to the lack of long term credit by availing resources in the form of credit lines through various participating financial institutions. Currently, there is about US$ 78 million disbursed and outstanding. Most of the financing is for construction, industry, and trade/exports. Only one credit line of US$ 4.8 million (funded by KfW), and which is already fully disbursed, is for agriculture. Secondly most of the other credit lines are fully disbursed as well. With long term savings still very low, banks still report a high demand for medium/long term loanable funds, and are still in need of external support in this area.

Outstanding credit lines by international financial institutions in local financial institutions (September, 2004; US$ Millions)

	Procredit	UGB	TUB	BOG	Intellect	TBC	TOTAL

[15] Of the US$ 2.9 million, US$ 2.5 million was in form of small grants to farmers.

EBRD	10.7	3.1	1.1	6.5	0.9	1.0	**23.3**
KFW	3.5	4.1					**7.6**
DEG	0.8			6.5		2.7	**10.0**
IFC	7.7			6.7		3.0	**17.4**
FMO	1.3						**1.3**
IMI-AG	2.5						**2.5**
BSTDB		13.2		2.5			**15.7**
Total	**26.5**	**20.3**	**1.1**	**22.1**	**0.9**	**6.7**	**77.7**

EBRD = European Bank for Reconstruction and Development; IFC = International Finance Corporation; KfW = Kreditanstalt für Wiederaufbau; DEG = Deutsche Investitions und Entwicklungsgesellschaft (subsidiary of KfW); BSTDB = Black Sea Trade and Development Bank; FMO = Netherlands Development Finance Company; IMI-AG = Internationale Micro Investitionen Aktiengesellschaft; UGB = United Georgian Bank; TUB = TbiliUniversalBank; BOG = Bank of Georgia; TBC (no known expanded form).

58. These credit lines come under various terms and conditions, with majority of them extended to participating financial institutions in the range of 6-Month Libor + 4%, to 6-Month Libor + 6%, with a few at either side of the range. Participating financial institutions keep these funds for 5 – 12 years.

The terms and conditions of the credit lines from International Financial Institutions

Bank name	EBRD		IFC		KfW		DEG		BSTDB		EBG		FMO	
	Int. rate	*Term*	*Int. rate*	*Term*	*Int. rate*	*Term*	*Int. rate*	*Term*	*Int rate*	*Term*	*Int. rate*	*Term*	*Int. rate*	*Term*
TBC Bank	Lib+6%	12 yrs	Lib+4%	8 yrs			9.30%	7 yrs						
Bank of Georgia	Lib+4%	6 yrs/Rev.	Lib+5.25% Lib+4%	7 yrs 7 yrs			EurLib+6% EurLib+4.5% EurLib+4.25%	6 yrs 8 yrs 7 yrs	Lib+4.75%	Rev.				
Untd Georgian Bank	Lib+4.75%	10 yrs			0.75%	40 yrs					Lib+2%	12 yrs		
Procredit Bank	5%	6 yrs	5%	5 yrs	5% 9%	8 yrs 6 yrs	7%	6 yrs					5%	6 yrs
Republic Bank														
Intellectbank	Lib+7%	10 yrs												
Tbiluniversalbank	Lib+7% Lib+7%	10 yrs 5 yrs												

EBG = Emporiki Bank of Greece; the other abbreviations as previously defined

59. **Financial Institutions Expected to Participate in the Project.** Based on Expressions of Interest formally received from commercial banks, and on the basis of the proposed selection criteria, up to seven banks are likely to participate in the project. Together, these banks own 77.4% of the total banking sector assets, indicating significant numeric and substantive participation by all the major banks in the country. Together, they have a network of 55 rural branches, which augurs well with creating a competitive environment in rural areas.

60. They expressed their interest to participate on the basis of their projected demand for agricultural and agribusiness credit as contained in their business plans. This demand by commercial banks was analyzed in order to assess their capacity to grow the projected portfolio, as well as detect any possible overlap over intended clients among financial institutions. Subsequent to this analysis, net demand by

commercial banks was established to be in excess of US$50 million. Similarly, the NBFIs intend to double their portfolios over the next five years. In view of their recent rapid growth, this was deemed feasible. NBFIs face serious funding constraints given the level of capital market development in Georgia. Their primary source of funds is bilateral and multilateral organizations. The project aims to expand the resource base of these NBFIs as well as their client base and capacity.

61. These projected demand estimations from both banks and NBFIs were in line with a recent assessment, which projected very strong effective borrower demand in this market segment of small and medium enterprises, including agriculture. Two very detailed analyses were conducted, one by KfW, and another by USAID. The USAID study, which is the most recent, estimated the gap between effective demand and existing supply for this market segment at US$ 238 million.[16]

62. The amount in this credit line is not meant by itself to meet this demand gap in its entirety. Rather, it is designed to consolidate the gains made during the ADP and serve as a catalyst to stimulate financial institutions to lend the required blend and amounts of short and long term resources to the rural sector. In other words, the credit line is designed to induce mainstream commercial banks to engage more in the agricultural sector, and help them to build a healthy loan book in this sector. It is also meant to expand the resource base of the smaller non-bank financial institutions.

63. The amount of US$ 14.4 million in the credit line is in line with the absorptive capacity of the expected participating financial institutions. The average annual disbursements of about US$ 3 million constitute less than 1% of the loan portfolio of financial intuitions expected to participate in the project, well within their absorptive capacity. Yet, it will go a long way in inducing the desired change within these institutions.

[16] US Agency for International Development, 2004

Un-audited/Preliminary Financial Data of Commercial Banks expected to participate in the new Rural Development Project as of September 30, 2004 – *(US$ Millions)*

	Name of the Bank	Total Assets	Loan Portfolio	Total Liabilities	Total Deposits	Equity	Net Income of 9 months, 2004	ROA	ROE	Branches in Rural Areas	CAMEL Rating
1	TBC Bank	190.9	111.2	162.7	147.0	28.2	4.1	3.1%	20.5%	19	1
2	Bank of Georgia [17]	151.8	93.3	125.4	96.4	26.4	1.6	1.5%	7.3%	6	1
3	United Georgian Bank	92.2	53.3	79.3	53.3	12.9	0.8	1.1%	8.9%	13	2
4	Procredit Bank	88.0	65.3	69.6	29.1	18.4	1.0	1.8%	8.7%	4	2
5	Republic Bank	60.7	35.6	47.0	44.2	13.7	2.9	7.8%	32.3%	1	2
6	Intellectbank	25.5	14.1	19.5	17.2	6.0	0.4	1.9%	7.9%	11	2
7	Tbiluniversalbank	20.9	10.0	16.0	14.5	4.9	0.9	6.1%	29.0%	1	2
8	Basisbank	15.6	8.5	10.8	10.6	4.9	0.3	2.4%	7.0%	0	2
	Total	**645.6**	**391.3**	**530.2**	**412.3**	115.4	**11.9**	**2.1%**	**8.5%**	**55**	

Financial Data of NBFIs expected to participate in the new Rural Development Project as of September 30, 2004

Name of NBFI	Total Assets (US$ Mill.)	Total Equity (US$ Mill.)	Loan Portfolio (US$ Mill.)	Number of Active Clients	Portfolio at Risk
Constanta Foundation	10.2	10.1	6.7	16,587	5.89%
Crystal Fund	0.5	0.5	0.4	1,134	5.87%
World Vision	1.5	1.3	1.3	1,498	2.30%
Georgian Rural Development Fund	1.8	1.7	1.8	910	N/A*
Total	**14.1**	**13.6**	**10.2**	**20,129**	--

*Most recent data not available, but at end 2003, PAR was less than 5.0%.

[17] In November 2004. the Bank of Georgia and Tbiluniversalbank signed a Merger Agreement. Thus, in essence, there will be seven banks.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

1. Experience from Other Projects

The World Bank ECSSD is financing three existing projects in the rural sector in Georgia: the Irrigation and Drainage Community Development Project (IDCDP), the Agriculture Research Extension and Training Project (ARET) and the Agriculture Development Project (ADP). The Private/Financial Sector Development Department (ECSPF) is financing the Enterprise Rehabilitation Project (ERP). Experience from these projects, IFAD's Mountain Area Development Project and other donor projects would be used in the design of the RDP.

Project Name	Date of Approval	Closing Date	IDA financing/ Project costs (in US$)	IP and DO Rating
IDCDP	June 28, 2001	December 31, 2005	27 million/ 32.8 million	satisfactory
ARET	May 11, 2000	December 31, 2005	7.6 million/ 10.1 million	satisfactory
ADP	March 25, 1997	June 30, 2005	15 million/ 26.4 million	satisfactory
ERP	December 17, 1998	December 31, 2004	15 million/ 21 million	satisfactory

2. **IDCDP.** This US$32.8 million project, of which US$27 million IDA financing, aims to reduce reliable water supply constraints in Georgia by rehabilitation of irrigation and drainage facilities for 110,000 ha. The project also supports the development and strengthening of the Amelioration Associations (AA), to enable them to operate and maintain the irrigation systems after rehabilitation. Progress is satisfactory despite being constrained by the shortage of counterpart funds. Two drainage rehabilitation sub-projects have been substantially completed, and two other sub-projects for the rehabilitation of major irrigation infrastructure have started. Four new sub-projects would soon be awarded. The rehabilitation of Khashuri Irrigation Canal, which has been recently completed, provides irrigation for 12,000 ha. This canal is much appreciated by farmers and the government. The project is also working with a total of 71 AAs, of which 28 have been established and have applied for registration. Eighteen of these AAs are legally registered, two have already had the infrastructure transferred to them under a usufruct arrangement and another two expect the transfer very soon. This project is providing the main production infrastructure necessary for the development of intensive agriculture in rural Georgia. The Project's IP as well as DO were rated Satisfactory in the latest Project Status Report. The project was approved on June 28, 2001 and is scheduled to close on December 31, 2005.

3. **ARET**. This US$10.1 million project, of which US$7.6 million IDA financing, provides good examples of the implementation of a competitive grant scheme (CGS), the reform of the agriculture research system and environmental pollution control programs. The research and extension linkages under the CGS support the development of agricultural technologies (crop, livestock, horticulture, viticulture, wine and dairy) in the current situation where research and extension systems are not well developed. It provides a low cost avenue to provide support to researchers, extension officers and farmers. The program also covers environmental protection sub-projects and has recently been extended to support the linking of primary producers, processing facilities and markets. The reform component of the project is designed to be a pilot program dealing with only one institute, the Institute of Viticulture and

Horticulture. The reform program in this institute has progressed well, albeit with delays. The program has reduced staff by about 50% under the agreed restructuring plan and now works on strengthening agricultural research output. The Project's IP as well as DO were rated Satisfactory in the latest Project Status Report. The project was approved on May 11, 2000 and is scheduled to close on December 31, 2005.

4. **ADP**. This US$26.4 million project, of which US$15 million IDA financing and US$ 6.8 million is IFAD financing has provided investment funds to enterprises through commercial banks, developed credit unions to provide small loans for small farmers and has supported reform of the land cadastre and registration system. A credit line for commercial agriculture financed 48 loans for working capital and investment in production and processing, for a total of US$8.5 million. Rural Credit Unions (CUs) were established to provide micro-credit for low-income farmers. About 55 small well-managed CU's has made a significant difference in their local rural economies. They have typically provided small working capital loans of 300-500 Lari to farmers, at interest rates of 3%-5% per month for periods up to 12 months. Repayment rates exceed 95% for well-managed CUs. The Project's IP as well as DO were rated Satisfactory in the latest Project Status Report. The project was approved on March 25, 1997 and is scheduled to close on June 30, 2005.

5. **Enterprise Rehabilitation Project (ERP).** The US $21 million project, of which US $15 million is IDA financing, supports enterprise rehabilitation through a management group provided by CERMA. A cluster approach is being used to develop commodity supply chains. This approach involves working with groups of related enterprises or producers to identify business opportunities for specific commodities and then pulling them into related up-and down-stream organizations involved in the supply chain. The experience of CERMA has been useful in the design of the RDP project. Two important lessons learned from CERMA's experience are (a) successful intervention comes not only from providing effective technical assistance in management and marketing, but crucially also from establishing trust with the beneficiaries through close and personal interaction and (b) project managers and the design of the assistance scheme need to be protected from political interference. The Project's IP as well as DO were rated Satisfactory in the latest Project Status Report. The project was approved on December 17, 1998 and is scheduled to close on December 31, 2004.

6. **Other Donor Programs**. DFID is funding the SLAAR program (Sustainable Livelihoods in Adigeni and adjacent rayons). The objectives of SLAAR, which is implemented by CARE, are to improve rural livelihoods and reduce poverty by improving access by farmers, small rural businesses and community groups to resources and markets and increasing skills. The program team has assisted local governments in forming rayon working groups to discuss priorities for rayon development, developed four community initiative projects, established a Third Party Arbitration Court, set up on-farm demonstration programs, established service centers, and supported off-farm income-generation activities. All these activities appear to be well conceived and implemented.

7. The USAID funded AgVANTAGE project (formerly called SAVE) has the objective of increasing the productivity and income of the Georgian agriculture sector through a supply-chain approach extending from input supply, through production to post-harvesting and marketing. The first phase was to identify constraints and establish priorities for developing legitimate agri-business and has been completed. The second phase concentrates on creating a market brokerage capacity to attract private investment, sponsor pilot processing plants with improved technologies and develop agriculture services enterprises. The RDP and AgVANTAGE would coordinate their efforts through the Project Steering Committee.

8. IFAD's Rural Development Project for Mountain Areas (RDPMA) has financed the development of poor mountainous communities in four areas: Ducheti, Aspinclrce, Sleceakouri and Ambrolouri, all above 1,000 meters altitude. RDPMA aims to develop self-help societies to improve crop and livestock

production and generate increased income from farm products. The project has assisted farmers in improving varieties of potatoes, pasture, feed and breeds and developing infrastructure including small-scale irrigation and power generation. Income generating activities involve making cow and sheep cheese and knitting apparel from wool yarn. This project concluded that pasture and feed development are important for animal production, that integrated production and processing can add value to the primary products and that communities working together are more efficient than individuals in managing public resources such as pastures, roads, irrigation and hydro-electric facilities.

Annex 3: Results Framework and Monitoring

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

Results Framework

PDO	Outcome Indicators	Use of Outcome Information
Georgia's private agriculture sector mainly small and medium-scale farmers and processors are developed and have access to competitive agricultural market supply chains. Operation efficiency of public and private institutions increased.	• Increase in sales and profits of enterprises in the supply chains supported under the project. • Increase in net income of farmers participating in project-enhanced marketing/supply chains. • Amount of employment created in agriculture and agro-industry enterprises supported by the project. • A sustainable system of rural credit cooperatives. • A substantial self-financed public registry for land registration. • Seed, sanitary and phytosanitary, and food safety laws enacted and food safety system upgraded. • Strategies and action plans for institutional development completed.	PY1-4. Ensure quality of implementation and implementation impact. PY1-2 Evaluate the direction and assistance needs for works in the area of rural credit, land registry and SPS. PY2. Ensure the process of market chain development is robust and sustainable. Review evidence of economic, social and environmental impacts and their sustainability and revalidate project programs and prospects to achieve expected results. Otherwise re-orient project to remove policy/social and institutional roadblocks to market driven agricultural growth. End-PY4. Provide evaluation of project results in strategies and actions plans to Government for assessing need and design of future investment.
Intermediate Results One per Component	**Results Indicators for Each Component**	**Use of Results Monitoring**
Component One: **Agriculture Supply Chain Development** Agricultural supply chains that add consumer value and provide a sustainable competitive advantage to their members developed.	**Component One:** • Number of commodity chains evaluated and supported. • Number of communities and producer groups supported. • Number of technology and market development programs funded. • Number of on-farm technology demonstration programs funded. • FAC activities transparent and competitive. • Increased capacity in agriculture marketing and supply chain development.	**Component One:** PY1-4. Ensure the ASCDF is used effectively to bridge public goods supply gaps. Close monitoring of supporting field services and financial, social and institutional outcomes of ASCDF activities. Audit the grants and grant process for corruption. If not positive, revise ASCDF procedures and evaluate field staff skill base and selection. PY2. Evaluate the Linkages to farm Communities Program after 15 months if successful, continue the program and if not, review alternative options. PY1. Ensure strong collaboration with AGVANTAGE and CERMA and fair and orderly engagement of all participants along project supported

PDO	Outcome Indicators	Use of Outcome Information
		supply chains. Take corrective action to deal with any institutional constraints and with corruption or monopolistic behavior in supply chains. Evaluate beneficiary assessment of the NGO supported Linkages to Farm Communities program to evaluate effectiveness. Take corrective action with contracted NGOs. PY3-4. Evaluate impact of supply chain development program and reallocate resources if required to achieve market objectives.
Component Two: **Rural Finance Services.** A sustainable increase in agricultural lending by Banks and Non-Bank Financial Institutions.	**Component Two :** • Agriculture lending as a proportion of total lending. • Repayment performance of agricultural loans. • Expansion of NBFI lending into rural areas. • Number of viable rural credit unions in operation.	**Component Two:** PY1. Ensure that training of PFI staff is adequate for sustainable rural lending. PY2. Review initial loan portfolios and determine the need for new loan procedures, products and collateral instruments. PY3. Evaluate the effectiveness and sustainability of the Association of CUs. If positive, continue to expand, but if unsuccessful, implement exit strategy for this component. PY3. Review relative success of commercial bank and NBFI loan portfolios and reallocate resources between these institutions if required.
Component Three: **Legal and Institutional Framework.** Modernized legal framework and development plans for seed, SPS, food safety and land and moveable asset registration institutions. Strengthen food safety management including WTO compliant risk assessment systems.	**Component Three:** • Plant industry regulation developed and meeting international requirements. • Veterinary laws for disease control meet international standards. • Food laws to support risk assessment at national and enterprise levels. • Public Registry established and largely self-sufficient.	**Component Three:** PY1. Ensure that legislation is comprehensively revised to meet international treaty and trade requirements. Take issue to Cabinet level if progress is unsatisfactory. PY2. Review progress with food safety and public registry institutional development, identify constraints and discuss them with the Government. PY3. Review technical, institutional and financial sustainability of the Public Registry and take corrective action if unsatisfactory. Ensure that a

PDO	Outcome Indicators	Use of Outcome Information
		food safety system having a unified inspection service and WTO compliant risk management system is operational. If not review institutional arrangement and training needs for adjustment..
Component Four: **Project Management** PCC/PIU facilitating adoption and institutionalization of project products and providing progress and financial reports and annual plans and budgets in a timely manner.	**Component Four:** • Project progress and financial reports are initiated and submitted in a timely manner; • Project audits and procurement and financial supervision missions report uniformly good results; • Technical leadership of PIU recognized by institutional counterparts.	**Component Four:** PY1. PCC is fulfilling procurement and financial management responsibilities. If not, apply corrective measures. PY2. PIU, including supporting TA and the ACU organization are providing technical leadership. If not, apply corrective measures. End of PY2. Ensure timely preparation of mid-term review inputs. PY4. Ensure timely transfer of responsibilities to various project supported institutions before project closure.

Arrangements for results monitoring

		Data Collection and Reporting						
Outcome Indicators	**Baseline**	**YR1**	**YR2**	**YR3**	**YR4**	**Frequency and Reports**	**Data Collection Instruments**	**Responsibility for Data Collection**
Increase in - sales and profit of enterprises supported by the project.		5%	10%	15%	25%	Annually	-Report to PIU by enterprise.	Enterprise and PIU
- net income of participating farmers.		10%	20%	30%	50%	Annually	-Baseline data plus household survey.	PIU and survey team.
- employment		5%	10%	15%	25%	Annually	-Baseline data plus enterprise survey.	PIU and survey team.
Results Indicators for Each Component								
Component One : -Number of commodity chain supported.		3	6	10	14	Quarterly	RDP Monitoring System Business plan reviewed.	PIU and commercial banks
-Number of communities and/or producer group supported.		2	4	6	8	Quarterly	FAC minutes, Secretariat and NGO's reports.	NGOs, ASCDF AC and PIU.
-Number of technology and market development programs funded.		10	20	30	40	Quarterly	Technology and market development sub-project reports.	PIU secretariats and ASCDFAC.
-Number of on-farm technology demonstration programs funded.		15	30	45	60	Quarterly	Technology evaluation and demonstration reports.	PIU secretariats and ASCDFAC
Component Two : -Agriculture lending as percentage of agriculture GDP	1.2%	1.5%	2.0%	3.0%	4%	Semi-annually	Participating Commercial Banks, NBFI and Credit Union records and reports.	PFIs and PIU.
-Repayment performance of agricultural loans.		91%	92%	93%	94%	Semi-annually	PFI balance sheets, report and survey.	PFIs and PIU.
-Number of NBFIs lending to rural areas.		3	4	5	6	Semi-annually	PFI annual reports and supervision mission reports.	PFIs and PIU
Component Three: -Number of legal framework developed.			1	3	4	Annually	National Gazette, Progress report, supervision report.	PIU and Parliament Committee.
-Percentage of Action plan for MOA accomplished.		30%	60%	100%		Annually	MOA progress report and annual report.	MOA and PIU
-Percentage of NAPR self-sufficiency.		5%	10%	30%	50%	Annually	NAPR transaction records, account and budget. Customer survey, project M&E and NAPR annual reports.	NAPR and PIU.

Annex 4: Detailed Project Description

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

1. The proposed project, to be implemented over 4 years, has four components. The first component would strengthen the marketing/supply chains of high potential agricultural commodities through an integrated program of technical assistance to improve the efficiency of farm production, marketing and agri-business activity. The second component would improve the supply of financial services in rural areas, in part by strengthening rural finance credit institutions and the environment in which they operate. The third component would strengthen the capacity of key agriculture institutions with the view to facilitate the functioning of land, capital, input and output markets and food safety. The fourth component would support the management, monitoring and evaluation of project activities.

2. **Component 1: Agricultural Supply Chain Development** ***(Estimated Cost US$ 4.27 million, of which IDA $0.58 million, IFAD $0.11 million, PHRD co-financing grant $2.17 million, IFAD Grant $0.2 million, Beneficiary $0.29 million and Government $0.92 million)***

With the agriculture supply chain development component, the proposed project aims to support the efficient development of marketing/supply chains for commodities that have a demonstrated market potential, with the view to expand profitable domestic and export market opportunities. The proposed project would, through a competitively allocated Agricultural Supply Chain Development Fund (ASCDF), work with all agents in selected, potentially profitable agricultural supply chains to develop and implement a holistic strategy for identifying and addressing weaknesses and bottlenecks. Marketing/supply chains under consideration at present are (a) wine and grape production; (b) hazelnut production and processing; (c) cheese and dairy production; (d) juice, jam and other processed fruit items and fruit production, (e) processed vegetables production, (f) fresh fruits and vegetables with packaging, and (g) honey and bee keeping. In this component the project would support the following:

(a) **Supply Chain Analysis and Development** ***(Estimated cost US$0.82 million, of which PHRD co-financing grant $0.59 million and Government $0.23 million)***. Work would be conducted with the existing World Bank Enterprise Rehabilitation (ERP) and USAID AgVANTAGE projects to identify commodities and supply chains that have demonstrated market potential. Using CERMA, the ERP project management unit and AgVANTAGE analysis of the production, processing or marketing of potentially profitable agricultural commodities, the project would work at all points and with all agents in the supply chain (processors, traders and farmers) to develop a holistic strategy for the expansion of profitable sales in domestic and export markets. This would involve assistance in determining consumer demand, identifying technical, regulatory, institutional, contractual and financial constraints and developing a collaborative strategy for their redress. The supply chain analysis would attempt to determine where commodity associations and other market participants could productively reinforce linkages among actors along a commodity chain both formally and informally. In cases where the parallel CERMA and AgVANTAGE projects have not carried out any full analysis (e.g., the wine industry), the project would have the capability (with stakeholder participation) to initiate a detailed study of the sub-sector.

The project would finance technical assistance, training and studies in market and supply chain analysis and development. It would support agri-business in identifying regulatory, technological, contractual and investment constraints and assist in the development of marketing plans, supply chain linkages and contractual agreements and investment proposals. The investment and working capital would come from credit lines provided through participating commercial banks and micro-finance institutions.

(b) **Linkages to Farm Communities** ***(Estimated cost US$1.82 million, of which IFAD US$0.11 million, IFAD grant $0.2 million, PHRD Co-financing grant $1.11 million and Government $0.40 million)***. The sub-component would, initially, pilot test a program to assist farmers and communities to engage with commodity supply chains in an equitable and profitable manner. Using field demonstrations, capacity building workshops and local study tours, the RDP would introduce farmers to more productive and profitable market-linked agricultural technology. Leadership training would also be emphasized, especially for younger members of rural communities. Farmer linkages to agri-businesses and markets would be strengthened and farmers would be empowered to develop marketing groups and associations with a view to growing product quantity and quality and, thereby, improving market access and price. The farmer groups themselves would largely be derived from existing informal groups where there is trust and familiarity. Provision would be made to support the development of business plans and proposals for loan applications to participating financial institutions (PFIs) and for activities supporting the initiation and development of enduring commercial relationships between farmers and key supply-chain entities. Local/international NGOs, employed under performance-linked contracts, would manage pilot programs in eastern, central and western Georgia, which would be reviewed after 15 months, leading to the identification of a longer-term project strategy for improved small-scale commercial farm productivity and market linkages.

Second, the project would also provide assistance both to the new and to existing farmer groups to link to commodity supply chains. For this, the project would finance technical assistance and training and partially support farmer group set-up costs and some equipment. In cases where groups desire to invest in facilities essential for participation in commodity supply chains, e.g. produce packing plants, the project would assist farmers (through the appropriate service providers) in developing business plans and proposals for loan applications to participating financial institutions (PFIs). Provision would also be made for the staging of regular discovery events to allow for initiation and development of enduring commercial relationships between farmers and key supply-chain entities.

The project would introduce an approach to farmer integration that would address the *functional* needs of delivering suitable, adoptable technologies with the social, economic and political *empowerment* requirements of disadvantaged and marginalized farmers and farming communities. This process would build on an understanding of gender, institutional, political and economic roles and change processes at the local level and of indigenous knowledge in agriculture. In particular, the project would endeavor to pilot sustainable approaches to technology and market development that blends participatory group-based approaches with broader-based farmer-to-farmer and mass media and audio-visual approaches to information dissemination and capacity building.

Approaches. The Linkages to Farmers and Communities Program would pilot a multi-pronged approach to achieving greater grassroots participation of men and women in agriculture and market development. This would include:

- strengthening resource and institutional capacities, based on clearly defined development objectives and associated skill gap analysis;
- identifying key stakeholders and ensuring effective participation;
- assisting farmers to build effective organizations, supported by leadership and management training and adequate resources;
- identifying market opportunities and building appropriate supply chains involving farmer organizations.

Specifically, the project would aim to:

- build the capacity needed for local stakeholders (government agencies, communities and private operators) to adjust to changing socio-economic and institutional circumstances, including both adverse events and opportunities for livelihood improvement. This would focus on the Resource Capacities (RCs) and Institutional Capacities (ICs) of local stakeholders. *Resource capacities (RCs)* refer to *adequacy of resources* in terms of "hardware" (funds, equipment, material and infrastructure) and "software" (information, knowledge and skills). *Institutional capacities (ICs)* relate to the enabling institutional environment, which allows for a cost effective use of RCs. ICs encompass the concept of 'good governance', including adequate information, competent, transparent and accountable management, and stakeholder inclusion in decision making.

- conduct stakeholder analysis addressing issues of "representativeness", philosophy, image, power and current linkage mechanisms to develop an effective linkage strategy for any particular technology or market development program. Given the need for partnerships between different stakeholder groups along the market chain, this would also require that the project tackle the issues of power disparity between these groups, and the capacities to deal with it. The project would address this issue by establishing common goals, clarifying responsibilities, identifying and redressing weaknesses and developing meaningful business relationships and processes with which to pursue common goals.

- develop training and information packages for farmer associations and local administrations, in the fields of, *inter alia,* effective communication and group organization and management; government roles and regulations; strategic planning; financial, business and change management; gender and development, investment planning and participatory monitoring and evaluation; facilitate community empowerment through farmer and processor driven association formation, training, planning and linkage to project and ex-project development resources, including rural credit and social infrastructure development programs. Farmer and producer organizations that wish to play a continuing role in technology and marketing arenas, need to think strategically, to increase their professionalism and to focus on a limited number of commodities. Successful community empowerment programs would be used as role models for other communities.

- develop leadership skills among highly motivated community members. A distinction would be made between traditional community leaders and the "motivators" the project is aiming to target.

(c) **Technology Transfer (*Estimated cost US$1.63 million, of which IDA US$0.58 million, PHRD Co-financing grant $0.48 million, Beneficiary $0.29 million and Government $0.29 million*)**. The project would support small-scale farmers and farmer groups engaged in potentially profitable agricultural supply chains to develop appropriate, modern farm technology, crop and livestock management practices, and post-harvest technology and demonstration programs. Development of technology would be supported through the Agricultural Supply Chain Development Fund (ASCDF) and be coordinated by a NGO and industry led on-farm technology testing and development committee. Farmer's access to support would be facilitated by the NGO team operating in each region. Management of this fund will be in accordance to the ASCDF operational guidelines.

The ASCDF program would fund a series of technology and market development and technology demonstration programs on farmers fields and in assembly markets and processing industries, aimed at raising the competitiveness of agricultural commodities and processed products in Georgian and international markets. The program, which would focus on market chains that have invested in growth and value-added production, would fund at least 50 applied market and technology development grants valued at up to US$40,000 each. Farmer groups would be eligible to apply for up to 80 ASCDF financed technology testing and development grants of up to US$5,000 each. Applications would be evaluated by the participating NGOs and successful applications forwarded to the PIU ASCDF Secretariat for approval and funding. Applications for grants greater than US$5,000 would be short-listed by the participating NGOs and forwarded to the FAC for consideration and possible approval. In addition to the on-farm technology development, industry and farmer based groups and associations, working, when appropriate, in collaboration with public or private science, technology or advisory groups, would be invited semi-annually to submit proposals (valued up to US$40,000) that would improve competitiveness and are linked to clearly defined market opportunities. ASCDF funding would cover operating expenses, materials, field labor, fuel and supplies. Participating groups or associations would be required to contribute 30 percent of the cost of applied research programs and technology demonstrations, up to half of which could be contribution in kind. Capital expenditures would be kept to a minimum, however, expenditure up to 20% of the grant may be incurred for capital items such as laboratory equipment, field equipment for small plots, new processing technology, technical bibliographic material and extension material. Training costs for participating farmers and industry, scientific and extension staff could be supported up to 15% of the total project budget. The costs of staff salaries, large-scale capital equipment or civil works would not be covered under the program.

Component 2. Rural Finance Services *(Estimated Cost US$ 25.76 million, of which IDA Credit $8.20 million, IFAD Loan $8.02 million, IFAD grant $ 0.47 million, PHRD Co-financing grant $1.16 million, Beneficiary $4.50 million, Government $0.51 million, Commercial Bank $2.70 million and NBFI $0.20 million*).

This component aims to increase the capacity of PCBs and NBFIs to lend to the farmers, processors and agri-business enterprises involved in the marketing/supply chains of various agricultural commodities by (a) providing PCBs and NBFIs with additional capital for lending to agriculture, particularly medium- and long-term loans for investment and (b) strengthening the capacity of PCBs and NBFIs for sustainable rural lending.

(a) Credit Lines for Participated Commercial Banks *(Estimated cost US$16.10 million of which IDA Credit $7.20 million, IFAD loan $3.20 million, Beneficiary $3.0 million and Commercial Bank $2.70 million*). This credit line would be made to eligible commercial banks to increase their capacity to make medium and long-term investment loans to eligible farmers, processors and agri-business enterprises. Loans to PCBs would be in either US dollars or Euros or lari, with a grace period of four years and repayment period of up to 10 years.

(b) Credit Lines for Non Bank Financial Institution *(Estimated cost US$7.25 million of which IDA Credit $1.0 million, IFAD loan $4.80 million and beneficiary $1.45 million.*) This credit line would be made to eligible NBFIs to increase their capacity to make small investment and working capital loans to eligible farmers, processors and agri-business enterprises. Loans to NBFIs would be either in US dollars or Euros or Lari, with a grace period of two years and repayment period of up to 10 years.

PFIs would revolve these loans during the project. Interest rates charged by Government to PFIs on dollar and Euro loans would be determined on the basis of the corresponding 6 month LIBOR (US$ or Euro) plus a spread of 2%. As of March 2005, LIBOR plus 2 percent is below the rate paid on six month to one year deposits by Georgian banks. With LIBOR continuing to rise, and long-term rates continuing to decline due to the increasing confidence in the financial sector and other macroeconomic factors, these two rates (i.e., the proposed refinancing rate and the weighted average of six months to one year deposit rates) are expected to converge over time. However, in order not to create disincentives for domestic saving mobilization, there will be a semi-annual adjustment of the refinancing rate such that the refinancing rate will be at least as high as the weighted average (from the preceding 6 months) of the deposit rate paid by the Georgian banks on the corresponding deposit of six months to one year. The first semi-annual adjustment of interest rates will take place 12 month after the first Subsidiary Loan Agreement has been signed with the PFI.

Interest rates charged by Government to PFIs on Lari loans would be determined on the basis of the domestic inflation rate plus a spread sufficient to cover commitment fee, service charge, administrative cost and a default risk premium. These rates will be revised semi-annually to reflect changes in costs and market conditions. PFIs would set their own interest and repayment terms to final beneficiaries and would bear the full risk of loan repayment. For the first year of their participation, commercial banks are required to contribute a minimum 10% to the loans and 20% for the subsequent years. In addition, the private applicants for loans would be expected to finance a minimum of 20% of the cost of each business venture from their own resources.

The PFIs would be selected on the basis of eligibility criteria, a summary of which is contained in Annex 4. 1. The PFIs would be responsible for identifying prospective borrowers and carrying out appraisals of the proposals submitted for financing. Appraisal of sub-loans would be according to procedures and criteria summarized in Annex 4.2. These would include compliance with environmental safeguards, which would be monitored throughout sub-loan implementation. The disbursement of loans to PFIs would be managed by a specialist unit within the PIU (see Annex 6). This unit would perform the functions of: (a) ensuring that PFIs meet eligibility criteria; (b) verifying proposed loans are eligible for financing under the project; (c) enabling rapid disbursement of loans to PFIs; and (d) monitoring the actual disbursement and utilization of loans. The PIU function in this respect would not include any discretionary functions; it would simply approve or reject applications made to it by the PFIs.

(c) Strengthening the Capacity of PFIs for Sustainable Rural Lending (*Estimated Cost US$2.41 million, of which IFAD loan $0.02 million, IFAD grant $0.47 million, NBFIs $0.20 million, PHRD Co-financing grant $1.16 million, Beneficiaries $0.04 million and government $0.51 million*). The proposed project would strengthen: (i) the NBFIs to increase their financial and managerial performance, and expand their outreach; (ii) both banks and NBFIs in agricultural financial product development and the specifics of agricultural lending; (iii) the NBG for more effective oversight; and (iv) credit unions to consolidate their operations and establish a national union of credit unions, as follows:

i) Support specific to NBFIs

- institutional development technical assistance for selected MFIs to strengthen their financial management, accounting, risk management, credit analysis, governance and reporting capacities, supervision procedures, including encouraging the use of MFI rating agencies to enhance their credibility and ability to tap into commercial sources of funding;
- matching grants of up to $10,000, to cover the costs of establishing of new branches in order to facilitate their expansion into, and/or increase their outreach in, rural areas.

ii) TA for all PFIs (both PCBs and NBFIs)

- training of bank and NBFI personnel to appraise and manage lending to agricultural producers, agro-processors and agri-businesses;
- product development technical assistance to design, test and adopt more appropriate loan products, collateral instruments and financial services;

iii) TA for NBG

- technical assistance to develop an appropriate legislative basis for NBFI activity;
- technical assistance to strengthen the capacity of the NBG to supervise and regulate the activities of NBFIs (including micro-finance institutions and credit unions).

iv) Strengthening Credit Unions

The project would strengthen at least a core of 50 small, but well-run credit unions that currently lack the human and capital resources to be financially self-sustainable. This would be achieved through technical assistance, training, and study tours aimed at: (i) strengthening the individual CUs in savings mobilization, credit administration, financial management, and overall governance; (ii) facilitating the consolidation of some of the smaller CUs into larger, more viable units; and (iii) developing a national Association of Credit Union (ACU) for, among other things: a) coordinating the CU system's training and other capacity building programs; b) facilitating cross-fertilization and knowledge sharing within the system; c) consolidating, analyzing and disseminating key industry data for mutual comparison; d) elaborating and disseminating industry standards, and promoting self-regulation, in conjunction with the National Bank of Georgia; e) carrying out advocacy; f) advising Government on relevant legislative and regulatory issues; and g) liaising with various stakeholders, including other members of the financial sector, donors, government (see Annex4.3).

Low-income rural borrowers would remain the focus of credit union activity, and small loans and deposits would remain the basis for service delivery. Existing IFAD funds would be used to capitalize this new structure. Project funds would be used to strengthen individual CUs, as well as facilitate CU consolidation, including identifying strategically located well managed CUs around which existing CUs that are interested in consolidating can coalesce[18]. They would also be used to establish a national ACU structure (including MIS) that could overtime mature into a financial Apex organization. Once operational, the ACU would progressively assume responsibilities for training credit union staff, monitoring credit union performance, working with the National Bank of Georgia in particular on the protocol for the supervision of CUs, and developing specialized financial services (e.g., inter-branch intermediation, insurance, etc.) see Annex 4.3.

Component 3: Institutional Modernization *(Estimated Cost US$3.17 million, of which IDA Credit $0.68 million, IFAD loan $0.52 million, IFAD grant US$ 0.13 million, PHRD co-financing grant $1.05 million, Beneficiary $0.05 million and Government $0.74 million)*

This component would focus on key legal and institutional reforms that impact directly on the competitiveness of Georgian agriculture and the marketability and safety of its products and enable Georgia to meet its international SPS and trade obligations. Project interventions would be strategically focused on (a) essential the legal and institutional reform, (b) supporting selected programs that fit specific needs of the selected commodity chains, and (c) continuing to support the land cadastre and registration, as follows:

(a) **Institutional and Legal Framework *(Estimated cost US$1.91 million, US$ 2.29 million, of which IDA Credit $ 0.68 million, PHRD co-financing grant $0.74 million, Beneficiary contribution $0.01 million and Government $0.47 million)***. Georgia has outdated food, seed and plant variety protection and veterinary laws and institutional framework. The project would assist government departments in reviewing these laws, with the objective of modernizing them to be compatible with WTO commitments, EU directives and commercial agriculture needs. The project would provide technical experts to advise and interact with the management staff of the relevant departments on the revision of these laws and also assist government legal staff in drafting pertinent legislation. Training and study tours would be provided, and operating manuals based on an EU compliant legislative framework would be developed. The project would support Georgian membership in IPPC, EPPO, UPOV and ISTA, provide training for seed department staff to international standards in seed testing and certification, and introduce ISTA seed certification laboratory procedures. The project would also assist government to establish a functional food safety and risk assessment system through the development of a unified inspection service, establishment of a food safety management and risk

[18] Of course, where such a suitable candidate already exists, no new one would be needed. Such an already existing CU would be strengthened in light of its new responsibilities.

assessment system and the strengthening of laboratory services including laboratory accreditation. The improvement of legal & regulatory framework for the privatization of veterinary services has been addressed through the PHRD project preparation grant with the redrafting of the Veterinary Law, which is now before the Parliament. The project would also enable the Georgian government to establish a comprehensive, unitary food safety management and risk assessment system in line with the requirements of a new Food Law, developed with the support of the PHRD grant and soon to be presented to government for review and legislation.

(b) **Support for Selected Commodity-Specific Programs** ***(Estimate cost US$0.15 million, of which PHRD co-financing grant $0.1 million, Beneficiary contribution $0.04 million and Government $0.02 million)***. Programs to support specific commodity chains supported by the project under component one and consistent with strategies and action plans for institutional development developed under sub-component 3, would be identified. For example, the project might provide, based on the needs and proposals from the commodity chains, support for the development of product certification, quality testing and labeling standards. In the case where private services are not available and public services are not proficient, the project may consider strengthening these services.

(c) **Continuing Support for Land Registration** ***(Estimated cost US$1.11 million, of which IFAD loan $0.52 million, IFAD grant $0.13 million, PHRD co-financing grant $0.21 million and Government $0.25 million)***. Under the recently promulgated Law on Public Registries, the State Department for Land Management (SDLM) and the Bureau of Technical Information (BTI) were liquidated. Land registration and cadastre responsibilities have been transferred to a new National Agency for Public Registry (NAPR), which has been established as a Legal Entity under Public Law giving it substantial legal and financial independence. The NAPR would also be responsible for the registration of secured interests on moveable assets, which will be important to the development of rural financing. To ensure that the transition is smooth and original objectives are maintained, the project would, over a two-year period, complete the network of NAPR regional centers, develop systems for the integration of land and moveable property registry and land cadastre databases, establish a secure NAPR data management and transfer network and develop information programs on NAPR services. Project inputs would include training, equipment, information technology and national and international technical assistance.

Component 4: Project Implementation. ***(Estimated Cost US$ 1.51 million, of which IDA Credit $0.54 million, PHRD Grant US$ 0.12 million, IFAD Loan $0.55 million and Government $0.30 million).***

The proposed project would be managed under the umbrella of the existing World Bank Project Coordination Center (PCC) or an agreed successor within the MOA. The PCC would be responsible for all aspects of project administration, including program oversight, TA, goods and materials procurement, and financial control. The day-to-day management of the project would be with the technical Project Implementation Unit (PIU) within the PCC. A Project Steering Committee (PSC) including representatives from government, private sector and donor agencies would provide project oversight and ensure national program integration. The project would finance technical assistance, training and study tour, auditing, office equipment and vehicles, staff salaries and other operating expenses related to the project. The structure of the PCC, PIU and its staff requirements are described in Annex 6.

Appendix 4-1

Participating Financial Institutions and Subsidiary Loan Agreements

I. Eligibility Criteria

In order to be a Participating Financial Institution (PFI), commercial banks and non-bank financial institutions (NBFIs) must undergo due diligence by the World Bank, and if judged acceptable, must meet at all times a set of financial and management criteria and have signed a Subsidiary Loan Agreement (SLA) with the Ministry of Finance (MOF).

Commercial Banks

To participate in the Project, a commercial bank would be required to meet criteria which require, among other things, that such an institution:

A. General Standards:

(i) Is legally registered as a commercial bank and is in compliance with all banking laws and prudential regulations of the National Bank of Georgia (NBG) acceptable to IDA;
(ii) Is deemed to have "fit and proper" ownership and management; and
(iii) Maintains its records in accordance with International Financial Reporting Standards (IFRS) and undergoes an annual, external audit, conducted in accordance with the International Standards on Auditing (ISA) by independent, internationally recognized auditors acceptable to IDA and PIU, and has no material qualification by auditors for each of the 3 preceding years or since inception, whichever is less.

B. Other Standards:

(i) Has an established history of successful lending for agriculture, agro-processing, or agri-business; and/or plans to expand this component of its portfolio in conjunction with broader, strategic objectives;

(ii) Has an adequate network of branch or service points in rural areas, or plans to expand this network into rural areas in the immediate future; and

(iii) Has the necessary staff, knowledge, physical and other resources to implement the credit line under the Project; or has made clear plans to strengthen these elements of its capacity.

C. Recognition of Eligibility:

Each commercial bank that meets the above criteria for project participation would be issued a formal acknowledgement to this effect, in the form of a Side Letter, which would form an integral part of the Subsidiary Loan Agreement. This side letter would specify the upper limit to the credit that can be accessed by each bank and the general conditions for project participation, including reporting and monitoring procedures and participation in technical assistance programs.

D. Credit Line Allocation for Eligible PFIs

The project would select 4-5 commercial banks to work with.

Non-Bank Financial Institutions

To participate in the Project, a non-bank financial institution (NBFI) would be required to meet criteria which require, among other things, that such an institution:

A. General Standards:

(i) Is legally registered as a non-government organization or when the legal framework is established, a non-bank financial institution, according to Georgian Law;

(ii) Is in compliance with all relevant laws and regulations;

(iii) Maintains its records in accordance with International Financial Reporting Standards, and undergoes an annual audit of its financial statements, conducted in accordance with the International Standards on Auditing (ISA), and International Accounting Standards by independent external auditors acceptable to IDA and PIU, and has no material qualification by auditors for at least one preceding year;

(iv) Has a demonstrated commitment to serve those who have no access to formal financial institutions, as specified in the statutes and business plan and carried out in operations;

(v) Has the necessary staff, knowledge, physical and other resources to operate viably and satisfy its stated objectives; and

(vi) Has been in operation for at least three years and has total assets of at least US$ 300,000.

B. Other Standards:

(i) Has an established history of successful lending for agriculture, agro-processing, or agri-business; and/or plans to expand this component of its portfolio in conjunction with broader, strategic objectives;

(ii) Has an adequate network of branch or service points in rural areas, or plans to expand this network into rural areas in the immediate future;

(iii) Has the necessary staff, knowledge, physical and other resources to implement the credit line under the Project; or has made clear plans to strengthen these elements of its capacity; and

(iv) Has the capacity to take environmental impact analysis and environmental monitoring or would develop this capacity.

C. Recognition of Eligibility:

Each NBFI that meets the above criteria for project participation would be issued a formal acknowledgement to this effect, in the form of a Letter of Agreement which would form an integral part of the Subsidiary Loan Agreement. This Letter of Agreement would specify the upper limit to the credit that can be accessed by each NBFI and the general conditions for project participation, including reporting and monitoring procedures and participation in technical assistance programs.

D. Credit Line Allocation for Eligible NBFIs

The project would select 3-4 NBFIs to work with.

II. Principal Terms and Conditions of Subsidiary Loan Agreement

The Credit Line would be divided into two sub-components, namely:

(i) **Sub-component A** - a commercial credit line to commercial Banks;
(ii) **Sub-component B** – a credit line for non-bank financial institutions.

Principal Amount. The principal amount of a Subsidiary Loan which shall be due and repayable by a PFI shall be equivalent, in US$ or Euro or Lari, as the case may be, of the aggregate amount of withdrawals made by the PFI in the respective currencies from the Credit Line.

Loan Repayment. The principal amount of a Subsidiary Loan, in US$, Euro or Lari, as the case may be, shall be repaid by the PFI over a period of 10 (ten) years, with equal installments to be repaid at the end of years 4 through 10 for commercial banks and at the end of year 2 through 10 for NBFIs. Repayment would be for the full amount advanced with interest payable on a declining balance.

Interest Rate and Repayment Terms. The Subsidiary Loan shall be charged, on the principal amount thereof, withdrawn and outstanding from time to time, an interest rate calculated as follows:

(i) The interest rate on a Subsidiary Loan denominated in US$ on dollar loans or Euro loans would be set on the basis of US$ LIBOR or Euro LIBOR (6 month) plus a 2 percent spread.

(ii) The interest rate on a Subsidiary Loan denominated in Lari would be set on the basis of the domestic inflation rate plus a spread sufficient to cover commitment fee, service charge, administrative cost and a default risk.

(iii) In each case, the rate shall be revised semi-annually, on February 1 and August 1 of each year.

The PFIs would assume the full credit risk on all sub-loans financed under the project.

Maximum Loan Size. The maximum initial allocation for any single commercial bank will not be more than US$ 1.0 million and the maximum initial allocation for any single NBFI will not be more than US$ 0.5 million. The maximum (cumulative) loan limit could be increased if the PFI demonstrates proper use and recovery of the initially provided funds according to the Project's RCG. However, the maximum (cumulative) allocation for the any single commercial bank shall not be more than 25% of its Net Capital. Similarly, the maximum (cumulative) allocation for the any single NBFI shall not be more than 50% of its Net Capital.

Revolving of Project Funds. Any amount of principal repaid by sub-borrowers on account of sub-loans made under the Project, which is not immediately needed for repayment of the Subsidiary Loan to MOF, shall be kept by PFIs in separate revolving accounts (for each currency). The funds accumulating in these revolving accounts should be utilized by PFIs to finance additional sub-projects aimed at pursuing the objectives of the Project, and which conform to the agreed terms, conditions and eligibility criteria for the Project as detailed in the Subsidiary Loan Agreements and the Rural Credit Guidelines. The status of utilization of the revolving account would be monitored by the PIU at the end of each quarter (March 31, June 30, August 30, and December 31).

Maximum Financing Share. For sub-component A, the maximum amount to be made available by the Borrower to each PFI out of the proceeds of the Credit Line would be equivalent to 90% of sub-loan disbursements made by the PFI and withdrawn from the Credit Account during the first 12 months of project implementation and 80% of aggregate sub-loan disbursements thereafter.

Agricultural Portfolio Expansion Targets for Non-Bank PFIs under Sub-Component B. For sub-component B, allocations from the credit line would be based on agreed targets for expanding agricultural lending (measured in terms of portfolio share, total amount lent or a combination of both), to be assessed on a case-by-case basis. Annual allocations made after year one, would be adjusted to reflect progress towards these targets, but would be contingent on a substantial allocation of non-project resources to the client group.

Applications and Withdrawals from the Credit Line. Periodically, as stipulated in the Subsidiary Loan Agreement and agreed between the PFI and the PIU, PFIs would prepare Requests for Disbursement (RFD) as the basis for drawing on the credit line as stipulated in the RCG.

Requests for Disbursement from the Sub-Component A should be by each sub-loan, accompanied by Sub-project Information Sheets, which describe in detailed the sub-loan proposal.

Disbursements to participating NBFIs from the Sub-Component B credit line would be made by tranche according to agreements between the PIU and the NBFI. The amount and timing of the tranches would be based on the estimated demand and seasonal pattern of agricultural credit.

Where appropriate, the PIU may also request additional information. On receipt of the Request for Disbursement and accompanying documentation, the PIU shall promptly review the request and accompanying documentation to ensure that it complies with project guidelines.

Where the request complies with project guidelines, the PIU shall inform the PFI in writing of its approval and arrange for transfer from the Credit Line to the account of the PFI, the funds eligible for withdrawal and disbursement.

Accounts. MOF and the PFIs would maintain separate subsidiary loan accounts in the respective currencies (US$ or Euro or GEL) for each portion of the Credit Line (sub-components A and B) withdrawn by the PFIs.

Each participating financial institution would designate an authorized representative to work with the Project, and to authorize relevant transactions.

Appendix 4-2

Approval Procedures and Principal Terms and Conditions of Sub-Loans

A. Sub-component A - Commercial Bank Credit Line

Maximum Loan Amount. The maximum single loan to any borrower would be $500,000 for investment and $200,000 for working capital. The maximum cumulative loan to any single borrower (for all purposes) would be $1 million, or no higher than single exposure limits set by NBG.

Free Loan Limits and World Bank No-Objection. The first three sub-loans made to each of the PCBs in sub-component A, irrespective of the amount of the loan, would be subject to World Bank review. All loans above $300,000, plus any loans where cumulative borrowing exceeds $500,000, would also require a World Bank no objection. Subsequent loans below $300,000 would be screened by the PIU to ensure they meet project criteria, but would not be subject to World Bank no objection unless specifically requested by the PIU.

The PCBs would assume the full credit risk on all sub-loans financed under the project.

Eligibility Criteria for Sub-projects:

All proposed sub-projects should be supported by sound business plans, demonstrating technical and financial viability, satisfactory cash flows and loan repayment capacity.

Withdrawals from the credit line may only be made for expenditures made by the beneficiaries not earlier than 120 days prior to the date when the expenses are submitted to the PIU.

Eligible Beneficiaries: Eligible beneficiaries would include private farmers, producer organizations and private businesses involved in agricultural production, processing, and marketing, operating as joint stock companies, limited liability companies, farmers' associations, cooperatives, partnerships, or any other legal or natural form. All applicants would need to demonstrate operation or intention to engage in the relevant activity in the rural areas.

Criteria for Selection and Appraisal of Sub-projects. PCBs are responsible for identifying prospective sub-borrowers, and for following the eligibility criteria for investments and sub-loan beneficiaries described in the Subsidiary Loan Agreements and the RCG.

Sub-loans shall be made for sub-projects, selected by PCBs on the basis of detailed feasibility studies and careful appraisal by the PFI, which would cover the following:

(i) technical feasibility, financial and commercial viability, and designed with appropriate health and safety standards, in full compliance with all laws and regulations of the Government of Georgia;
(ii) economic justification of the proposed investment, including an assessment of the competitiveness of the end-product;
(iii) an evaluation of the proposed scale of the sub-project, the need and adequacy of the civil works and equipment to be procured, location of the enterprise, its layout and design, the estimated costs in domestic and foreign currencies;
(iv) an assessment to ensure that no safety hazards or environmental deterioration would result, directly or indirectly, from the sub-project to be financed;
(v) an evaluation of the borrower's ownership structure, creditworthiness, organization, management and financial position, and an evaluation of the technical staff and know-how available for implementing the sub-project and its operation.

(vi) appraisal projections made by the PCB should ensure that the project complies with a projected debt service coverage ratio of no less than 1.3 over the life of the sub-project, calculated on the basis of the borrower's total debt outstanding (calculated annually); a debt-equity ratio of no more than 3:1 and an annual net cash flow no less than 120% of the annual debt servicing requirement.

Sub-borrower's Participation. Sub-borrowers shall be required to contribute towards sub-project costs, from their own resources, in cash or in kind, no less than 20% co-financing of the total project cost. This contribution must be in addition to any grants received.

Repayment Terms of Sub-loans. Repayment schedules of sub-loans financed under sub-component A would be based on projected cash-flows and repayment capacity of sub-borrowers, and would include a grace period as and when required and justified. Grace and amortization periods would be based on the type of investment financed and the projected (estimated) cash flow, and would be commensurate with the repayment capacity of the borrower. However, in no case would repayment periods exceed the useful life of the investment financed. Sub-borrowers are expected to repay the sub-loans (principal and interest) in the currency in which it was denominated.

Interest Rates of Sub-loans. PCBs should charge interest on the principal amounts of sub-loans outstanding from time to time at the prevailing commercial interest rate under the Subsidiary Loan Agreement and a spread determined by the PCB which would be based in each case on PCB's risk assessment, administrative costs and other banking margins.

Choice of Currency of Sub-loans. Sub-loans to beneficiaries would be denominated and repayable in either US$ or Euro or GEL, as determined by each sub-borrower at the time of signature of the sub-loan agreement with the PCB.

B. Sub-component B – Non-Bank Financial Institution Credit Line

NBFIs are responsible for identifying prospective sub-borrowers. NBFIs would have full autonomy in sub-loan approval and would bear the lending risks. NBFIs would be required to carefully appraise sub-projects prepared by the sub-borrowers, in accordance with accepted procedures for this type of lending and loan size.

Eligibility Criteria for Sub-projects. Sub-loans should be used to finance investment and provide working capital in order to increase production and sales of food and agricultural products and commodities. In addition to on-farm production, eligible activities include, *inter alia*, credit for sorting, grading and packing; storage and cold storage; agro-processing; and marketing.

The sub-project should be commercially and financially viable, technically feasible, and, on the basis of the projected cash flow, demonstrate the ability of the sub-borrower to service the sub-loan according to the repayment terms agreed between the NBFI and the sub-borrower.

Eligible Beneficiaries for sub-component B include, *inter alia*, private farmers, farmers associations, producer organizations or private businesses involved in agricultural production, processing, and marketing; and operating in any legal or natural form.

Beneficiary Participation. The Beneficiaries shall be required to make a cash and/or in-kind contribution in the amount of 20% of the estimated cost of the sub-project. This contribution must be in addition to any grants received.

Repayment Terms and Interest Rates of Subsidiary Loans. The subsidiary loan would bear regular prevailing commercial interest rates, as determined by the NBFI. The repayment period of the subsidiary loan shall be based on the projected cash flow, and should be commensurate with the type of beneficiaries financed and their repayment capacity. Sub-borrowers are expected to repay the sub-loans (principal and interest) in the currency in which it was denominated.

Currency of Subsidiary Loans. All subsidiary loans under sub-component B would be denominated and repayable in US$ or Euro or GEL, as determined by each NBFI at the time of signature of the subsidiary loan agreement.

Loan Limits: NBFI sub-loans will not exceed US$5,000 or the Lari 10,000 equivalent, the present legal limit which may be revised from time to time. Sub-Loans of more than $5,000, or Lari equivalent, will be subject to a prior review by the PIU, plus any sub-loans to a single borrower where cumulative borrowing exceeds $10,000. There would be no requirement for World Bank no-objection for NBFI sub-loans.

C. General Conditions Applicable to all RDP Sub-loans and Sub-loan Agreements

Approval Procedures for Sub-loans above the Free-limit for Sub-Component A. PFIs would furnish to the PIU for review and submission to the IDA, an application, which would include (i) a description of the Beneficiary including financial information, (ii) information on the appraisal of the sub-project, including a detailed description of the expenditures proposed to be financed out of the proceeds of the credit line, (iii) the proposed terms and conditions of the sub-loan, and (iv) any other information that the PFI considers useful for the review of the sub-project proposal. PIU and IDA reserves the right to request the PFI to furnish additional explanations and clarifications in case the information contained in the Summary Report is not adequate for decision-making.

Sub-project Information Sheet. PFIs would prepare for each approved sub-project for sub-component A, an Information Sheet and submit one copy to the PIU prior to PFI's request for withdrawal of funds from the Credit Line. One copy of the Information Sheet would be kept in the Project File in PFI's head office and one copy would be filed in the beneficiary's document file kept in the PFI branch office responsible for servicing the sub-loan, and one copy would be retained by PIU.

Accounts and Record-keeping. PFIs have to establish in their accounting systems appropriate accounting codes to permit identification of sub-loans made under the Project. Separate codes should be used for sub-loans according to the currency of denomination. PFIs would retain, until at least one year after the IDA has received the audit report for the fiscal year in which the last withdrawal from the Credit Line account was made, all records pertaining to the subsidiary loans and sub-loans made by each PFI including accounts, contracts, orders, invoices, bills, receipts and other documents evidencing sub-loan expenditures.

Reporting. Each PFI shall be required to submit to the PIU all reports and information as prescribed in RCGs, including access to the NBG's onsite inspection reports and shall make available to the PIU all other information which IDA and PIU shall reasonably request.

Audit. The accounts and any additional records to be maintained by the PFIs should be adequate to reflect, in accordance with sound accounting practices, the operations, resources and expenditures in respect of the Credit Line operations under the Project.

In compliance with the terms and conditions of the Subsidiary Loan Agreement, the PFIs shall ensure the audit of the PFIs financial statements for each fiscal year and their external auditors would furnish a separate auditors' report on the accounts and records relating to the Project, including a separate opinion by said auditors as to whether the statements of expenditure submitted during such financial year, together with the procedures and internal control involved in their preparation can be relied upon to support the related withdrawals from the Credit Line.

Environmental Standards. During sub-project appraisal PFIs have to ensure that proposed sub-projects are in compliance with all environmental laws and standards of the Government of Georgia, and the Environmental Guidelines of the RDP Credit Component. All relevant documents and permits should be kept in each beneficiary's document file maintained by the PFI, and be made available for review by PIU, IDA representatives and PFI auditors.

Annex 4.3

Strengthening existing rural credit unions and establishing a self-sustainable Association of Credit Unions

A program to re-orient and strengthen the ADP credit unions is planned, with the aim of establishing a viable, national system of rural credit unions through technical assistance and improved oversight. Program design and implementation would be guided by the need to:

(a) strengthen their financial management, including credit administration, and overall governance;

(b) emphasize savings mobilization as the basis for sustainable operation and growth, including a stronger linkage between savings deposits and access to loans by individual borrowers, and increased participation of urban members from small rural towns;

(c) expand membership including developing strategies and diverse financial products (savings, credit and insurance) that are more suited for low-income rural people. Membership is expected to increase from an initial base of 5,000 to 12,000 within 3 years, and to 20,000 within 5 years; with a continued focus on serving low-income rural people (recall that membership of the first CUs increased from zero to 12,200 from 1995-2000);

(d) consolidate some of the smaller rural village credit unions into bigger, more viable entities, with current outlets serving as branches of the larger structures; and

(e) establish an association of credit union with a view to eventually establishing an apex framework for economies of scale in capacity building and information sharing and in pursuing matters of common interest.

These issues would be dealt with under the following three initiatives:

(a) *Re-orientation and Strengthening of the Credit Union Culture*:

Many of the existing credit unions are still led and managed by people who regard the CUs as vehicles for furthering their own interests. Until the end of June 2005, the ongoing Agricultural Development Project would continue to support the members of these CUs to enhance their empowerment and involvement capacity building. Where acceptable management and governance already exists or is installed, the CUs would receive strong capacity building support. Where acceptable management and governance is not installed, the credit union would be excluded from all future project activity, although it would retain the right to revolve its existing portfolio.

All credit unions included in the follow-on project would receive intensive training directed towards members, managers and Board of Directors; to ensure that they understand and apply the principles of cooperative and credit union governance and management. The training program would cover not only the basic tenets and the philosophy underlying cooperative organization including good governance, but would also cover the more technical aspects, e.g. proper book keeping and accounting, financial management, outreach and expansion strategies, different financial products, and savings mobilization. They would be provided with operational procedures manuals which are currently under revision. A computer software for improved accounting and financial management would be installed and the related training provided.

b) *Consolidation of Small Rural Credit Unions*

Some CUs are too small to be viable. There is, therefore, a need to promote voluntary consolidation among numerous such CUs. Work is ongoing to identify such CUs. This entails identifying optimal locations for the Principal CUs as well as identifying the smaller CUs to be brought under their respective ambits. Where there are no obvious candidates for a Principal CU among the existing ones where demand for consolidation has been expressed, plans would be made to facilitate the emergence of one such CU. Project support would be provided to that effect. Due consideration would be given not only to the potential to mobilize savings, but also to the need for ensuring that the principal of full participation of CU members in the life of the CU, which is required for strong ownership and accountability, is upheld, and is not compromised by the expanded distances and membership, and by lack of homogeneity and social cohesion of the resulting large entities. A pilot project to establish three of these regional credit union centers has been initiated under the ADP.

(c) *Establishing an Association of Credit Unions*

The objective is to have a national ACU as a precursor to the formation of an apex framework, which would start off simple in design and financial requirements, and progressively take on more responsibilities over time as the CU system grows and matures. Initially, this ACU would have a **small one-person secretariat** whose principal functions would at the beginning be weighed very heavily toward coordinating the much needed capacity program, in close collaboration with the Credit Union Development Center (CDCU). As the CU system grows, the secretariat would progressively expand and take on more complex functions, in tandem with the growing scope and complexity of the CU system's needs: from overseeing the capacity building program in its early stages, to assisting the National Bank of Georgia in industry monitoring and supervision further down the road, to facilitating the provision of specialized financial services (e.g. deposit guarantee facilities, financial intermediation, insurance, etc.) in its mature phase.

In addition to coordinating the CU system's training and other capacity building programs, the ACU initial responsibilities would progressively cover: i) facilitating cross-fertilization and knowledge sharing within the system; ii) consolidating, analyzing and disseminating key industry data for mutual comparison; iii) elaborating and disseminating industry standards, and promoting self-regulation, in conjunction with the National Bank of Georgia; iv) carrying out advocacy; v) advising Government on relevant legislative and regulatory issues; and vi) liaising with various stakeholders, including other members of the financial sector, donors and government. As stated above, it would take on even more complex activities further down the road as its own capacity is up to the challenge, and the industry has sufficiently developed to warrant such innovations.

It would be legally constituted as an Association, with individual branches or regional centers as determined in its business plan. In the initial stages, it would receive strong backstop support from the CUDC.

Immediate policy and legislative issues to work on include: rationalization of the regulatory process (by the National Bank of Georgia); the basis for setting and collecting membership fees; involvement in the development of new legislation for non-bank financial institutions; and modifications to the current system of taxation of CUs (including profits, and provisions for loan losses).

The project would finance technical assistance and training and initial recurrent costs for the first three years, with full self-funding expected thereafter.

Annex 5: Project Costs

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Project Cost By Component and/or Activity	Local US$ million	Foreign US $million	Total US $million
Agricultural Supply Chain Development	2.6	1.3	4.0
Rural Finance Services	24.6	1.1	25.6
Institutional Modernization	1.3	1.5	2.9
Project Management	1.1	0.2	1.3
Total Baseline Cost	29.6	4.2	33.8
Physical Contingencies	0.2	0.1	0.3
Price Contingencies	0.5	0.1	0.6
Total Project Costs[1]	30.3	4.4	34.7
Interest during construction			
Front-end Fee			
Total Financing Required	30.3	4.4	34.7

[1]Identifiable taxes and duties are US$1.7 million, and the total project cost, net of taxes, is US$33.0 million. Therefore, the share of project cost net of taxes is 95 %.

Sources of funds are as follows:

Component Finance US$ million	IDA Credit	IFAD Loan	IFAD Grant	PHRD Co-Financing	Com Banks	NBFIs	Bene-ficiaries	Govern ment	Total
A. Ag Supply Chain Dev.	0.58	0.11	0.20	2.17	0.00	0.00	0.29	0.92	4.27
B. Rural Finance	8.20	8.02	0.47	1.16	2.70	0.20	4.50	0.51	25.76
C. Institution	0.68	0.52	0.13	1.05	0.00	0.00	0.05	0.74	3.17
E. Project Management	0.54	0.55	0.00	0.12	0.00	0.00	0.00	0.30	1.51
Total	10.00	9.20	0.80	4.50	2.70	0.20	4.84	2.47	34.71

Annex 6: Implementation Arrangements

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1. The project would be managed by the Project Coordination Center (PCC), established by the joint order of Ministry of Agriculture and Ministry of Finance as a legal public entity according to the Residential Decree number 149. While the government is planning to integrate project management unit into the structure of the MOA, it was agreed at negotiations that this existing PCC will continue to manage the project until MOA has formulated an alternative project management structure that is satisfactory to both IDA and IFAD. The PCC has an overall management and supervision responsibility of donor-financed projects. The PCC is supported by a core service team which provides centralized procurement and disbursement services to all projects and a Project Management Unit (PIU), a unit within PPC, which is responsible for technical management and supervision for each project.

2. The RDP PIU would be responsible for the whole project implementation, day-to-day management of all components including planning and budgeting of project activities, preparation for procurement plan, preparation of progress and project management reports, staff management and project monitoring and evaluation. The PIU will be managed by a project manager, who has overall responsible for all components of the project. Since the PIU is a unit in the PCC and it is not an independent legal entity, the project manager will report directly to the director of PCC.

3. The PIU would include professional staff and administrative and support staff. Professional staff positions would include a project manager, a senior finance and banking specialist, two PFI finance supervisors (including one specialized in CUs and MFIs), a Secretariat to the FAC, a training and communications specialist and a monitoring and evaluation officer. The PIU would be supported administratively by an administrative officer and drivers.

4. The PIU will work with (a) an Agricultural Supply Chain Development Fund (ASCDF) Advisory Committee (FAC), which would manage the award of competitive grants supporting commodity, technology and supply chain development (b) a group of NGOs who would coordinate the linkages to farm communities programs, (c) Credit Union Development Unit (CUDC) which would provide technical services to credit unions, (d) an Association of Credit Unions (ACU) which would manage the development of a national rural credit union program, (e) participating commercial banks and NBFI through subsidiary loan agreements between the Ministry of Finance and PFIs, following the rural credit guidelines, (f) the responsible government agencies for each institutional reform sub-component, and (f) the NAPR which will implement the land registration, cadastre management and moveable asset registration programs.

5. The Project Steering Committee (PSC) would be chaired by the Minister of Agriculture and include the relevant Vice-ministers of Finance (MOF), a Vice-President of the National Bank of Georgia, the chairperson of the parliamentary Agrarian Committee, the RDP PIU manager and PCC director and representatives of the donors and international and domestic NGOs engaged in agricultural and rural development and a private sector representative. The RDP PIU would provide secretarial support to the PSC. The PSC would meet half yearly to review the RDP semi-annual and annual reports and annual work program with a view to ensuring the closest possible alignment of RDP activities with government financial control and economic growth policies and to capture synergies with other donor and international financial institution funded projects. The PSC members would inform the Minister of Agriculture of their opinion on these matters, but would have no jurisdiction over the program or budget of the RDP.

6. The ASCDF Advisory Committee (FAC) would include representatives of the MOF, Agrarian Parliamentary Committee, Academy of Agricultural Sciences and MOA together with two representatives respectively of civil society, and the farming and agri-industry communities. The Minster of Agriculture would nominate non-government FAC members on the advice of the PCC Director. This 10-person

committee would elect an independent person of high standing in Georgian agriculture as its chairperson. Committee members would be appointed for two-year terms with staggered replacement to ensure continuity of knowledge of FAC operations. The RDP PIU would provide a one-person Secretariat to support the FAC, which would meet quarterly to review funding proposals and progress reports and to select applications for ASCDF grant funding. The detailed operation of the FAC is described in the ASCDF Operational Guidelines.

7. One or more NGOs would be recruited on a competitive basis, following TA procurement procedures. The successful NGOs would be responsible for staffing and managing three field teams (one per region) that would pilot test a program for farmer training and technology testing and demonstration programs. The field teams would assist farmers to prepare applications for grants for technology testing and demonstration programs and for market linkage activities. Grant applications for less than US$5,000 would be awarded by the PIU on the recommendation of NGO management committee that would oversee the Linkages to Farm Communities Program. Grant applications for larger amounts would be screened by the review committee with short-listed proposals forwarded to the FAC for final approval. NGOs would report to the PIU. The pilot program will be evaluated 15 months after its establishment and a decision made whether to expand or modify the program.

8. The CUDC will animate and facilitate the process of helping participating CUs to develop a national association of credit unions. Once formed, the association would then elect from its ranks a Board of Directors of 5 – 7 members. The Association's day-to-day activities would be initially carried out by a one-person Secretariat. It is understood that the whole process of CU sensitization, leading to the formation of an association, will take time. During this time, the CUDC will, in partnership with the ACU be coordinating the implementation of the capacity building program for the individual credit unions that is planned under the project. It is also understood that the ACU will need extensive technical support before it can fully assume all its functions. Thus, the CUDC will continue exercising these functions, while at the same time coaching and offering technical support to the ACU.

9. The participation of PFIs in the rural credit component of the RDP is defined in the RDP Rural Credit Guidelines (RCG). Following a request for expressions of interest, applicant PFIs would be individually reviewed by IDA and the Borrower, in conjunction with the PIU, with particular attention to their overall lending capabilities, and financial and portfolio performance. To be eligible for selection the PFI must have a satisfactory financial and management structure, satisfactory risk-based capital adequacy, acceptable asset quality and lending performance, adequate liquidity, and the organization, management, technical staff and other resources necessary for the efficient carrying out of its operations. These attributes, plus a demonstrated commitment to expand agricultural lending would be the basis for final selection, after undergoing a through due diligence. The same standards shall be used by the PIU to monitor the continued eligibility of currently operating PFIs.

10. Approved PFIs would be issued a formal acknowledgement to this effect, in the form of a Letter of Agreement, which would form an integral part of the subsequent Subsidiary Loan Agreement with the MOF. Subsequent utilization of financial resources provided under the Project should comply with the terms and conditions described in the RCG, which constitute an integral part of the Credit Agreement and the Subsidiary Loan Agreement. PFIs would be responsible for identifying prospective sub-borrowers and for following the eligibility criteria for investments and sub-loan beneficiaries described in the Subsidiary Loan Agreement and the RCG. PFIs would charge interest on the principal amounts of sub-loans outstanding from time to time at the prevailing interest rate under the Subsidiary Loan Agreement and a spread determined by the PFI which would be based in each case on PFI's risk assessment, administrative costs and other banking margins. The PFIs would assume the full credit risk on all sub-loans financed under the project, for loans in both Lari and US dollars.

11. Each participating commercial bank is required to submit to the IDA, through the PIU, the first three sub-project proposals under the commercial bank credit line, irrespective of the amount of the proposed sub-loan, and any sub-loan proposal in an amount exceeding US$ 300,000 equivalent. This limit would also apply whenever the outstanding balance(s) of sub-loans to one borrower financed under the Credit Line when added to the amount of the proposed sub-loan exceeds the limit of US$500,000 equivalent.

12. Eligible sub-borrowers shall include, *inter alia*, private farmers, private agro-processing, agri-business or agricultural marketing companies, and producer associations and organizations in whatever legal form. They must be engaged in farming, agro-processing, agri-business or agricultural marketing. Sub-borrowers shall be required to contribute towards sub-project costs, from their own resources, in cash or in kind, no less than 20% co-financing of the total project cost. This contribution must be in addition to any grants received.

13. The PIU would have day to day responsibility for overseeing and monitoring the implementation of the Credit Line of the Project and for ensuring that intended beneficiaries are indeed receiving support.

14. The institutional reform component of the RDP would be implemented by the responsible government agencies under the supervision of the PIU, which would retain responsibility for the related procurement and financial management. The program for the modernization of sanitary, phytosanitary and seed and seedling legal frameworks and food safety management would be implemented respectively by the veterinary, plant protection and seed related departments of MOA and, the Ministry of Health (MOH) for sanitary matters. Ad hoc support for selected commodity specific programs would evolve with project implementation and be implemented by the PIU in close collaboration with the FAC.

15. The newly established National Agency of the Public Registry would, with international TA support, implement the land registration, cadastre management and liens on moveable asset registration programs. The KfW financed Cadastre and Land Registration Project would support the land related program under the RDP, while the Georgian Enterprise Growth Initiative (GEGI) and the MOJ would support the NAPR in the development of a law on security interests in moveable assets and the identification of software, hardware and staff capacity for its implementation.

16. The PIU M&E officer would coordinate project monitoring. In pursuing its major developmental objectives, the project would target an increase in the income of Georgia's mainly small farmers and their access to marketing/supply chains. This would be measured through the number and size of commodity chains supported and the incomes of participating farmers. It would also be measured through the increase of aggregate sales and exports of the enterprises financed under project credit lines and the number of farmers and enterprises benefiting from improved access to financial and marketing services. The monitoring of credit lines would occur at two levels, on-going review of the financial soundness and viability of the PFIs and simultaneous review of the way that beneficiary loans are being used and managed. The quality of technical assistance inputs would be reviewed on an on-going basis in co-operation with the beneficiaries of this assistance. Provision has been made for the assessment and monitoring of environmental impact with all RDP investment activities.

Annex 7: Financial Management and Disbursement Arrangements

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Country Issues.

The most recent CFAA was conducted in September 2003 and updated in March 2004. The CFAA assessed each component of the public expenditure management framework throughout the report and analyzed the fiduciary risks in the system of internal controls. The individual assessments took account of the level and magnitude of risk presented in each component. The CFAA team adopted the European Union's Public Internal Financial Control Systems (PIFCS) model of internal control as the basis for its analysis of the Government's internal control framework. While the Government is taking action to improve its systems of financial management, significant and serious weaknesses remain in many parts of its expenditure management system. Based on this analysis, the overall fiduciary risk of the Government's public expenditure management framework is rated as HIGH. The high fiduciary risk rating is based on the following assessments:

Public enterprises: While progress is being made in bringing into the budget preparation process the extra-budgetary funds (EBF) and special revenues, EBFs remain outside of the Treasury spending controls and public enterprises remain outside of the Government reporting entity. These enterprises do not provide the Government with timely and accurate financial statements of their financial position and results of operations; nor does the Government exercise appropriate oversight over their operations. Public enterprises represent a potentially high risk to the Government because of their potential for large actual and contingent liabilities.

Local governments: The large amount of the budget spent by local governments, coupled with the inadequate legal and operating framework for budget planning and execution by local governments, represents a moderate-high fiduciary risk.

Budgeting: The absence of a medium-term expenditure framework[19] and related budget ceilings, large variances in budget/actual revenues, EBFs operating outside of Treasury spending controls and arrears at approximately 3 percent of GDP indicate that significant work continues to be required to make improvements to the budgeting process. This is a moderate/high risk for the Government.

Accounting and Reporting: The Government does not follow the International Public Sector Accounting Standards (IPSAS) cash-based accounting standards for its budget entities, and the law does not require strict adherence to it. Because reliable and consistent financial information is a cornerstone of financial management and control, this is rated as a moderate fiduciary risk.

Internal Controls: If the EU's internal control system model and criteria were applied to the Government, their current controls would indicate a high level of fiduciary risk. The organizational values of the civil service are not conducive to effective internal control. The existing legislative base does not address a number of key control requirements; internal audit has not been implemented and financial management systems and staff financial skills are weak. A major program for financial capacity development is essential. While the Government partially satisfies the criteria for an effective external audit function, with regard to its basic ex ante and ex post controls over spending and creation of an anti-corruption program, the weak state of internal controls constitutes a high risk for the Government.

The CFAA team provided the following recommendations for the Bank-financed projects:

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[19] The 2004 Budget is to some extent based on the preliminary forecasts of the main medium term macroeconomic and fiscal parameters for 2004-2006. More robust linkages are required in future fiscal years.

- Additional training should be provided to the staff of the relevant MOF unit and to the PIU staff in World Bank financial management, disbursement, and procurement procedures, and in International Financial Reporting Standards.

- The Government should complete the development of the standard framework for PIUs. This framework would include standardized job descriptions, staffing levels, compensation arrangements and hiring guidelines. These standards are useful tools to ensure that the PIU staff, especially the financial management staff, have job descriptions that cover all essential tasks necessary for effective management and control.

- The NBG should continue its work on consolidation of the commercial banks, and on introduction of regulatory mechanism following the best practices and recommendations provided by international banking community, most importantly in respect of the minimum capital of commercial banks (five million Euros).

- In preparing future adjustment operations, fiduciary arrangements should be reviewed and reflected in credit agreements in more detail, particularly in respect of ring-fencing of the deposit account into which adjustment proceeds are paid and in respect of arrangements for auditing of the deposit account. The CFAA also recommends as part of its due diligence that the Bank receive copies of the audited financial statements and management letters of the NBG. The CFAA also recommends that the NBG comply fully with the proper flow of funds for all adjustment operations.

Risk Analysis.

The risk analysis from the Financial Management Questionnaire is as presented below. (Note: The project's financial management risks are not considered to be significant enough to warrant inclusion in section C5 of the PAD).

	Risk Rating	**Risk Mitigation Measures**
Inherent Risk		
1. Country Financial Management Issues	S	Not applicable
2. Project Financial Management Issues	M	Not applicable
3. Weak Banking Sector Issue in RS	S	Project Special Account (USD) is going to be opened in the commercial bank.
4. Perceived Corruptions	S	Ring fencing of projects
Overall Inherent Risk	S	Significant
Control Risk		
1. Implementing Entity	L	
2. Funds Flow	L	
3. Staffing	L	
4. Accounting Policies and Procedures	L	
5. Internal Audit	N/A	Not applicable

6. External Audit	M	The PCC should select audit company form the list of WB qualified auditors
7. Reporting and Monitoring	L	
8. Information Systems	L	
OVERALL CONTROL RISK	L	

Strengths and Weaknesses.

The significant strengths that provide a basis of reliance on the project financial management system include: (i) significant experience of PCC in implementing Bank-financed projects for past several years; (ii) the good quality of audit reports issued by PCC's project auditors for the past years; (iii) highly qualified and trained staff, and (iv) automated accounting system in place.

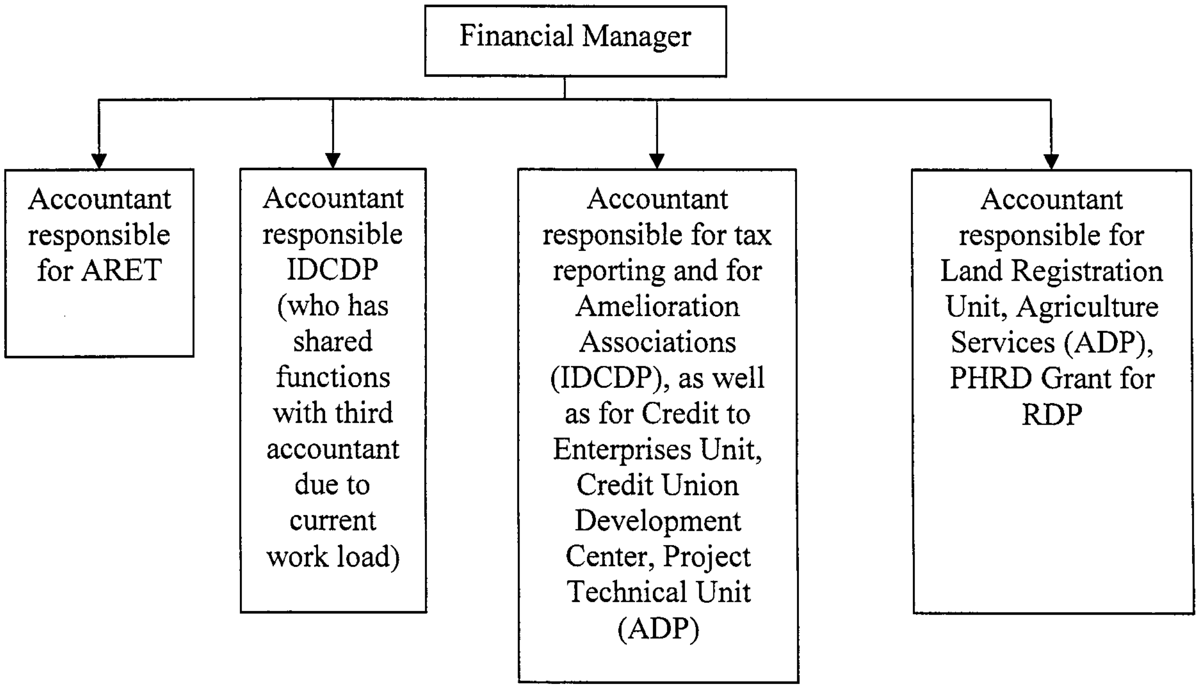
There are no significant weaknesses identified in the PCC, and several recommendations provided as a result of pre-assessment to further improve the internal controls of the PCC, the project reporting and the job description of the staff, have been properly addressed by the final assessment. The only matter which needs to be addressed by all PIUs including the PCC is the recent change in the legislation and adoption of the new Chart of Accounts for all Public Legal Entities (all PIUs legal status is PLE). Currently, the study is conducted by PIUs to evaluate and provide comments on the applicability of the new Chart of Accounts developed for all PLEs.

Funds Flow.

Project funds will flow from (i) the Bank, either via a single Special Account which will be replenished on the basis of SOEs or by direct payment on the basis of direct payment withdrawal applications, and (ii) the Government, via the Treasury account at the National Bank of Georgia on the basis of payment requests of PCC.

Staffing.

The organizational structure of PCC provides for one General Director, a finance team comprising a Financial Manager and five assistants (the majority of them passed training ILO in Turin in 2003 including the accountant who is going to deal with RDP), a procurement team and other various teams to lead and implement the three projects and their components. The PCC's financial team has considerable experience of implementing Bank-financed projects and has demonstrated that it is fully capable of satisfying the financial accounting and reporting requirements of the project. The organization chart of the Financial Management department is presented below:



Accounting Policies and Procedures.

The accounting books and records are maintained on a cash basis (with the exception of those relating to the CUDC and CEU components which are maintained on a modified cash basis) and project financial statements, including FMRs, are presented in United States dollars. The PCC's accounting procedures and internal controls appear capable of recording correctly all transactions to-date, supporting the preparation of regular and reliable financial statements, and safeguarding the entity's assets. The PCC probably would be required to implement new chart of accounts recently adopted for all PLEs, in case this change covers WB PIUs as well (now in the negotiation stage with MOF to clarify the coverage of the minister's instruction), and make relevant modifications in the accounting policy/financial management manual.

Internal Audit.

PCC has no internal audit function and none is considered necessary given the size of the PIU.

External Audit.

The auditing arrangements for the project will follow the standard procedures adopted for ECA, and, more specifically, for its Hub-North part (comprising CIS countries).

The audit of the project will be conducted by independent private auditors acceptable to the Bank and on terms of reference (TOR) acceptable to the Bank. There is a List of audit firms eligible to perform audits of World Bank financed projects in CIS countries, which is updated regularly, and there is a standard audit TOR applicable for ECA, which is also updated regularly to take account of the developments in the overall Bank audit policy. The project will choose the auditor from the above-mentioned List and will use the ECA standard audit TOR as a basis for preparation of its own audit TOR, which is to be cleared with the project FMS annually irregardless of the term of contracts concluded with the auditors (one year contract or several year contracts).

The annual audited project financial statements will be provided to the Bank within six months of the end of each fiscal year and also at the closing of the project. The project financial statements will be based on the quarterly FMRs and will include: (i) Summary of sources and uses of funds; (ii) Summary of uses of funds by project components; (iii) SOE summary schedule, (iv) Statement of the Special Account, and (v) notes to the financial statements. Single audit opinion is required on all the above listed financial statements.

The contract for the audit awarded during the first year of project implementation may be extended from year-to-year with the same auditor, subject to satisfactory performance. The cost of the audit will be financed from the proceeds of the credit.

Audit Report	*Due Date*
Financial statements – continuing entity	Not applicable
Financial statements – PCC are based on the quarterly FMRs and include balance sheet, summary of sources and uses of funds, summary of uses of funds by project components, SOE summary schedule, statement of Special Account and notes to financial statements	Within six months of the end of each fiscal year and also at the closing of the project
Other (specify)	None

The External auditor will be selected to audit the above financial statements by September 2005 based on the TOR cleared by Country FMS, and the audit will be conducted and audit report on the project issued by June 30, 2006.

Reporting and Monitoring.

Project management-oriented Financial Monitoring Reports (FMRs) will be used for project monitoring and supervision and the indicative formats of these have already been discussed and agreed with the Bank.

Information Systems.

PCC uses in-house developed "Coppers" accounting package and for salaries accounting, another "Payroll" in-house developed software. Both of them have been functioning for a number of years already, and no major problems have been noted so far. For "Coppers", a very good comprehensive user manual has been developed and distributed to all accounting staff. Several reports are prepared in MS Excel after being exported from the accounting software. The accounting software is installed on computers linked via LAN separate from PCC network. Each accounting staff has his/her specific module installed on the computer.

Disbursement Arrangements.

Special Account

To facilitate disbursements against eligible expenditures, the Government of Georgia will establish the Special Account in a commercial bank acceptable to the Association, under terms and conditions satisfactory to IDA. Each source of funds for this project will have its own Special Account and will be governed by the relevant provisions of the Disbursement Handbook. The Special Account will be denominated in US dollars with an authorized allocation of US$1.0 million for the credit. Initially, the allocation will be limited to US$500,000 until total disbursements (expenses) have reached SDR 1.5

million, at which time the full authorized allocation can be claimed. Applications for the replenishment of the SA will be submitted at monthly intervals (or when 20 percent of the initial deposit has been utilized, whichever occurs earlier). The replenishment application would be supported by the necessary documentation, the SA bank statement and a reconciliation of this bank statement. Exchange gains and losses will not be financed by credit; these will be financed by the PFI for the dollar subsidiary loans and by the Borrower for Lari denominated subsidiary loans.

Proceeds of the credit and other sources of funds will be allocated as follows:

Disbursement Table

	US$ million					Disbursement
Expenditure Categories	**IDA**	**IFAD Loan**	**IFAD Grant**	**Japan Co-finance**	**Total**	**Percentages**
1. Civil Works	0.10	0.12			0.22	80% of eligible expenditures
2. Goods	1.07	0.51	0.27		1.85	100% of foreign expenditures, 100% of local expenditures (ex factory costs) and 80% of local expenditures for other items procured locally.
3. PCB Sub-Loans	6.48	2.88			9.36	90% of loan (net of beneficiary contribution) disbursed by PCBs in year 1 and 80% thereafter.
4. NBF Sub-Loan	0.90	4.32			5.22	100% net of beneficiary contribution
5. Consultant Services, studies and Workshops			0.45	4.05	4.50	80% for local firms and individuals, 90% for foreign firms and individuals and 100% for eligible social charges.
6. Operating Costs	0.45	0.45			0.90	80%
7. Unallocated	1.00	0.92	0.08	0.45	2.45	
Total	**10.00**	**9.20**	**0.80**	**4.50**	**24.50**	

Operating costs include staff salaries, communication, office supplies, utilities, operation and maintenance of office equipment, vehicles and offices, project monitoring studies, project report and publications.

Statement of Expenditure

IDA funds would be disbursed under transaction-based procedures including SOEs and direct payments. Supporting documentation for SOEs, including completion reports and certificates, would be retained by the Borrower and made available to the Bank during project supervision and external audit purposes. All disbursements would be made on the basis of full documentation for (a) contracts for goods or works costing more than the equivalent of US$100,000 each; and (b) services under contracts of more than the equivalent of US$100,000 for each consulting firm and more than the equivalent of US$50,000 each for individual consultants. Disbursements below these thresholds, as well as for training, operating costs and sub-loans would be made according to certified Statement of Expenditure (SOEs). This documentation would be retained by PCC/PIU for at least one year after receipt by the World Bank of the audit report for the year in which the last disbursement was made. Disbursements of sub-loans to commercial banks would be made upon the submission of approved proposals evaluated according to Rural Credit Operational Guidelines. Disbursement to NBFIs would be based on estimated demand and seasonal pattern of agricultural credit, as agreed with the PIU. Disbursements for expenditures above the SOE thresholds would be made against presentation of full supporting documentation relating to those expenditures.

Supervision Plan.

During project implementation, the Bank will supervise the project's financial management arrangements in two main ways: (i) review the project's quarterly FMRs and six-monthly management reports as well as the project's annual audited financial statements and auditor's management letter; and (ii) during the Bank's supervision missions, review the project's financial management and disbursement arrangements (including a review of a sample of SOEs and movements on the Special Account) to ensure compliance with the Bank's minimum requirements. As required by the Bank and ECA guidelines, Country Financial Management Specialist for Armenia and Georgia will carry out regular FM supervisions of the project.

Annex 8: Procurement

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

A. General

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Legal Agreement. The general descriptions of various items under different expenditure category are described below. For each contract to be financed by the Loan/Credit, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank project team in the Procurement Plan. The Procurement Plan would be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

Procurement of Works: Works procured under this project, would include rehabilitation of the Credit Union offices and upgrading of about 10 regional NAPR offices. The procurement would be done using the Bank's, ECA sample NCB bidding documents and shopping proposal document for inviting price quotations for shopping of works agreed with the Bank.

Procurement of Goods: Goods procured under this project would include: office equipment; data network equipment; office furniture, generators, vehicles. The procurement would be done using Bank's SBD for all ICB and ECA regional bidding documents and sample format for inviting price quotations for shopping of goods agreed with the Bank.

Selection of Consultants: International and local consultants would be selected to provide: technical assistance, training and studies in all components. In the market and supply chain development TA and training would be for the analysis and development of agriculture supply chains, for the assistance to rural communities and for innovative technology development. In the rural finance component, TA would be used to train bank and NBFI personnel to appraise and manage agriculture lending; to design, test and adopt more appropriate loan products, collateral instruments and financial services; In the institution development component, TA would be used to advise project staff in legal framework analysis; in institutional development need analysis and in industry-specific regulatory support identification and in issues concerning animal and plant diseases, laboratory service and inspection, food inspection and control and product certification. Land specialists would be used for registration, cadastre, information technologies and land registry development. In addition, the project would provide specific membership fees, contract for public awareness program, audit services; design and supervision etc.

Short lists of consultants for services estimated to cost less than US$ 100,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Operational Costs: The project would finance operating costs for the PCC and PIU for salaries; field allowances, communications, office supplies and utilities, operation and maintenance costs of equipment, vehicles and offices, project report and publication and other costs incurred as a result of project implementation. These costs would be procured using the implementing agency's administrative procedures, which would be reviewed and agreed with the Association.

Others:

Procurement under Credit lines and Agriculture Supply Chain Development Fund (ASCDF). The proposed credit would provide funds to commercial banks and non-bank financial institutions to be on-lent to private sector enterprises and farmers for production, processing and trading of agriculture products. Procurement of goods, equipment and works under the credit line, excluding the consultation services, would be the responsibility of the sub-borrowers as beneficiaries. All of the procurement by sub-borrowers would be minimal in the maximum value (limited to US$300,000 per sub-loan), covering numerous items at each site and all such procurement would be at the discretion of the sub-borrower. Procurement of goods and works financed by sub-loans relent by commercial banks or micro-credit institutions would be conducted by commercial practices, in accordance with paragraph 3.12 of the Guidelines.

The project would also finance development of new and innovative production and processing technologies through an Agriculture Supply Chain Development Fund to be managed by ASCDF Advisory Committee (FAC). It is planned to fund at least 50 applied market and technology development grants valued at up to US$40,000 each and 80 technology testing and demonstration of up to US$5,000 each. The FAC would establish priority areas, the procedures for applying for the grant and the criteria for review of the proposals. Funds would be approved for projects based on pre-determined criteria outlined in the ASCDF Operation Manuals and would be directly given to successful applicants.

Goods and works procured by beneficiaries of grants under ASCDF shall be procured competitively in accordance to paragraph 3.17 of the Guidelines. To the extent possible beneficiaries shall obtain competitive price quotations from at least three suppliers and, in awarding contracts, shall take into account other relevant factors, such as time of delivery, efficiency and reliability of the goods and availability of maintenance facilities and spare parts. The supply of goods, works or services from the beneficiary itself or from affiliated entities shall not be eligible for financing under the credit.

Training: Training and study tours would be carried out according to a training plan, which the PCC would revise semi-annually and submit to the IDA for approval prior to implementation.

B. Assessment of the agency's capacity to implement procurement

An assessment of PCC capacity to implement procurement actions for the project has been carried out by Plamen Kirov (ECSPS) in June 2004. The assessment reviewed the organizational structure for implementing the project and the interaction between the PCC's project staff responsible for the procurement MOA and the PIU, the legal status and procurement capacity.

The project would be implemented by the Project Coordination Center (PCC) which is a legal entity under public law that was established according to presidential decree based on joint order issued by the Ministry of Finance and Ministry of Agriculture. The PCC is supported by a Core Service Team which provides centralized procurement and disbursement services and a project implementation unit (PIU) that is in charge of technical aspects of the implementation of projects. The PCC will submit the annual work plan to Project Steering Committee (PSC) for its review. (Annex 6).

The PIU would be responsible for day-to-day project management including work programming and financial management, project procurement, progress and financial reporting, staff appointment and management and project monitoring and evaluation. The PIU would include 7 professional staff and 4 administrative and support staff. Professional staff positions would include a project manager, a senior finance and banking specialist, two PFI finance supervisors, a one-person Secretariat to the FAC, a training and communications specialist and a monitoring and evaluation officer. The FAC Secretariat would include an experienced agriculturist and an agricultural marketing specialist. The PIU would be supported administratively by an assistant to the project manager and a procurement officer.

There are three procurement officers in the PCC's Core Service Team. Three of them attended different procurement trainings and had an intensive experience in different Procurement and Selection procedures. Each procurement specialist is responsible for his/her designated project with necessary back up function. One of them would be in charge of the procurement under the RDP. Although the overall procurement capacity could be considered satisfactory, there is some room for improvement.

The community participation and technology development grant components of the project would be linked through an Agricultural Supply Chain Development Fund (ASCDF) Advisory Committee (FAC), which would manage the award of competitive grants supporting technology and supply chain development. An Association for Credit Unions (ACUs) would be established, with member CU support, to manage the development of a national rural credit union program. Commercial credit disbursement would be managed through subsidiary loan agreements between the Ministry of Finance and participating banks and non-bank financial institutions (NBFIs).

The CPAR has assessed the risks (institutional, political, procedural, etc.) that may negatively affect the ability of the implementing agency to carry out procurement process and has rated it a high risk country. Therefore the prior review thresholds are those applicable to a high risk country. The corrective measures which have been agreed are: (i) provide additional training to the PCC procurement staff on the application of the current procurement and selection guidelines and the respective documents; (ii) provide training to the PCC and PIU staff on the preparation of the technical parts of the bidding documents (technical specifications, bill of quantities or schedule of activities/requirements etc. particularly in the procurement of works and IT equipment, etc.) and requests for proposals (TOR's); (iii) conduct a comprehensive procurement training for all project related staff as part of the project launch workshop; (iv) the Bank's Standard Bidding Documents and Requests for Proposals and ECA's sample formats for small procurement would be used.

The Bank would monitor procurement activities. The Bank procurement specialist would conduct post reviews and would provide guidance in all procurement related activities.

C. Procurement Plan

The Borrower, at appraisal, developed a Procurement Plan for project implementation which provides the basis for the procurement methods. This plan has been agreed between the Borrower and the Project Team during negotiations in April 2005 and is available at the PCC at the MAF. It would also be available in the Project's database and in the Bank's external website. The Procurement Plan would be updated in agreement with the Project Team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

D. Frequency of Procurement Supervision

In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended one supervision mission per six months to visit the field to carry out post review of procurement actions. The procurement staff would properly collect and maintain the procurement documentation.

Attachment 1

Details of the Procurement Arrangement involving international competition.

1. **Goods and Works and non consulting services.**

(a) List of contract Packages which would be procured following ICB and Direct contracting:

Contract (description)	Estimated cost (US$)	Procurement method	P-Q	Domestic preference (Yes/no)	Review by Bank (prior/post)	Expected Bid Opening Date	Comments
Goods							
Office equipment (desktop computers, laptop computers, photo copiers, fascimiles, etc)	509,600	**ICB**	1		Prior	TBD	
Data network equipment	420,053	**ICB**	2		Prior	TBD	
4WD station Wagon (2) Compact 4WD (39)	331,680	**ICB**	1		Prior	TBD	One package with several lots

(b) ICB Goods Contracts estimated to cost above US$ 100,000 per contract would be subject to prior review by the Bank.

2. **Consulting Services.**

(a) List of Consulting Assignments with short-list of international firms.

Ref.#	Contract (description)	Estimated cost (US$)	Procurement method	P-Q	Review by Bank (prior/post)	Expected Bid Opening Date	Comments
1	International Consultants	2,393,806	QCBS	6	Prior	Through life of the project	
2	International Consultants	499,127	IND	5	Prior	Through life of the project	

(b) Consultancy services estimated to cost above US$ 100,000 per contract would be subject to prior review by the Bank.

(c) **Short lists composed entirely of national consultants**: Short lists of consultants for services estimated to cost less than US$ 100,000 equivalent per contract, may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Annex 9: Economic and Financial Analysis

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

1. **Production models** have been developed based on a range of agricultural production activities existing in Georgia and likely to be eligible for PFI support under the proposed RDP. These production models are based on discussions with farmers, agricultural extension workers, input dealers, commodity traders and others with a detailed knowledge of Georgian agriculture. Models are included for red Saperavi grape vineyards, apple orchards, hazelnut orchards, tea, and winter herbs grown in plastic houses. A single livestock model for dairy production from which farmers sell milk, culled livestock and manure was prepared. The livestock model was built to reflect pasture grazing and hay as the main feed bases. The mission also relied on a recent IFAD-financed study of agricultural comparative advantage and marketing in Georgia. Additional financial and economic studies are in progress and would be included in updated economic and financial analyses at project appraisal.

2. **Financial and economic analysis** has been carried out for the key potential crops and livestock products in the project area. Tea was included, as it is the subject of much conjecture as to its future in Georgian agriculture. The analysis is based on the assumption that, with technology development, improved association, better market information and strengthened linkages under the project, farmers would expand their farming activities. The analysis models the investment decisions of individual borrowers, which would be based on a range of financial data including: (i) investment costs, (ii) operating costs, (iii) net income before financing, and (iv) net income after financing. Investment costs and operating costs vary by type of investment and include costs for orchard rehabilitation, new seedlings, concrete posts, trellis wire, land treatment, initial fertilizer for planting, plastic tunnels, drip irrigation, fertilizer, livestock and livestock buildings. Operating costs are normally for feed, agro-chemicals, equipment operation, irrigation, utilities and labor. It is assumed that farmers would borrow at most 80 percent of total investment at the prevailing rate of interest (which was about 20 percent in June 2004) and would have grace periods of 1-2 years and repayment periods of 1-4 years depending on the investment. Farmers would contribute 20 percent of total cost, typically to cover operating costs. For each production system, net annual income after loan repayment, the internal rate of return (IRR) and net present value (NPV) are calculated. The opportunity cost of capital was set at 12 percent. The results are summarized in Table 1 below. They provide an indication of the costs and returns to alternative agricultural investments the RDP might support. While this analysis shows substantial incremental family income per hectare for a number of different investments, the actual profitability and cash flow of individual borrowers would of course need to be evaluated by PFIs on a case-by-case basis.

3. Nominal Protection Coefficient (NCP)[20] and Domestic Resource Cost (DRC)[21] ratio were used to determine whether Georgia has comparative advantage in the production of major commodities such as hazelnuts, apples, greenhouse vegetables, dairy cattle, Saperavi grapes and tea. The 2004 border prices of traded goods were determined using domestic prices minus conversion factors calculated on the basis of import tariffs, export subsidies, excise duties and VAT charges. International price projections were used to estimate farmgate economic prices in 2004 constant terms for international traded-inputs and-outputs.

[20] Nominal Protection Coefficient are the ratio of domestic price to boarder price.
[21] Domestic Resource Cost ratio is defined as the ratio of the opportunity cost of domestic factor of production per unit of output to the foreign exchange earned reduced by the cost of tradable input.

Table 1. Financial Returns to Various Family-Farm Investments

Loan Category	Net Annual Income after Loan Repayment (Lari)	Net Present Value (NPV) (Lari)	Internal Rate of Return (IRR)
Vineyards (Saperavi red grape)	24,140 / ha	4,790 /ha	20%
Apple Orchards	6,302 / ha	5,904 /ha	26%
Hazelnut Orchard	2,287 / ha	814 /ha	15%
Tea	296 / ha	(12,423) /ha	Neg.
Greenhouse Vegetables	16,068 / 0.2 ha	34,954 /0.2 ha	46%
Dairy Cows – natural pasture base	3,201 / 3 cows	1,157 /3 cows	12%

Commodity Models

4. **Red Saperavi grapes.** The model assumes 2,500 vines per ha, three years between establishment and first production and a rise in grape production from 3,000kg/ha in the third year to a peak 7,000 kg/ha in Year 8, which would be maintained to Year 25. Investment costs per ha would include 2,500 grafted vines, 20 tons of cow manure and 600 kg of NPK fertilizer. Annual inputs include 300 kg of NPK and one herbicide and up to six fungicide applications applied with a knapsack sprayer. A rented tractor would apply two inter-row cultivations annually. Strategic irrigation would be applied using surface irrigation. The labor input is estimated at 84-person days/ha at full production. It is assumed that a PFI would finance 80% of the investment, equal to 5,280 Lari. The financial net present value (NPV) and internal rate of return (IRR) on the investment are detailed below. As the wine grape is an intermediate product, no attempt was made to determine its economic benefit; however, it should be noted that there is a strong export market for Saperavi wines, particularly in Russia.

Table 2. Financial Returns to Saperavi Grape Production

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Family Labor Day (Lari)
	19	4,564	5,910	88

5. **Hazelnut production**. The model assumes 400 trees per ha, three years between establishment and first production and a rise in nut production from 800kg/ha in the third year to a peak 2,200 kg/ha in Year 7, which would be maintained to Year 15. Investment costs per ha would include land preparation, 400 grafted seedlings, 20 tons of cow manure and 200 kg of superphosphate, 100 kg of urea and 200 kg of potash. Annual inputs include 200 kg of superphosphate, 100 kg of urea and 200 kg of potash, 1 insecticide spray, 2 fungicide sprays and 1 herbicide spay for weed control. A tractor would provide inter row cultivation twice yearly. The labor input is estimated at 66-person days/ha at full production.

Table 3. Economic and Financial Analysis of Hazelnut Production

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Family Labor Day (Lari)
	15	814	2,287	37
Economic Indicators	Domestic Resource Cost (DRC)		Nominal Protection Coefficient (NPC)	
	0.20		0.71	

6. The analysis shows reasonable financial returns and economic benefits. With an under supplied processing sector and growing export demand, hazelnut production is likely to have a reliable future, provided farmers can access good quality planting material and agro-chemicals and the existing Hazelnut Growers Association expands membership and services to meet farmer needs. Investment costs at 1,790 Lari per ha are reasonable. The crop provides its first return in 3 years and shows a profit in Year 4. Hazelnuts can be grown across a broad swath of western and central Georgia and suitable varieties are available for most locations with production potential.

7. **Apple production**. The apple used for this financial and economic analysis is based on red delicious apples, the predominant crop in central Georgia and assumes high input irrigated production. Apple orchards are established at 1,200 trees per hectare and produce their first harvest of 4.25 ton/ha of in the 3rd year after establishment. A high level of inputs is assumed, including 10 tons of manure every third year, 200 kg of superphosphate, 200 kg of urea and 150 kg of potash annually. Spraying would include 4 insecticide sprays, 6 fungicide sprays and 1 herbicide spay for weed control. Irrigation would include 3,000 m^3 of surface irrigation water per ha per year. A tractor would provide inter-row cultivation twice yearly. Yield is assumed to peak at 30 tons per ha in Year 9 and continue at this level for a further 6 years. Good private apple farmers in central Georgia regularly achieve this yield.

8. Production would include 45% of first grade, 30% of second grade and 25% of third grade apples giving an aggregate price of 0.28 Lari/kg. First grade apples would be washed, graded, boxed and exported to Moscow. Second grade apples would go to Georgian urban markets and third grade apples would be used to produce apple juice concentrate. The price in the Moscow market for first grade Georgian apples is approximately 800 Lari (US$400) per ton.

Table 4. Economic and Financial Analysis of High Input Apple Production

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Family Labor Day (Lari)
	26	5,904	6,302	41
Economic Indicators	Domestic Resource Cost (DRC)		Nominal Protection Coefficient (NPC)	
	0.48		0.61	

9. The analysis shows good financial returns and economic benefits. With a stable apple juice concentrate processing capacity and growing domestic and international (Russian) markets, prospects for growth of high quality apple production are reasonably good. Varieties do have to change, however, with the modeled red delicious variety likely to find less favor in the future. Investment costs at 1,740 Lari per ha are reasonable, with the crop providing its first return in 3 years and a profit in Year 4. Apples are grown mainly in central Georgia, where they play an important role in local farming systems.

10. **Greenhouse production.** Winter-grown parsley was used for the greenhouse model. It is produced between November and April and is in strong demand in the Moscow market. The model assumes the use of a locally manufactured, plastic covered greenhouse without supplementary heating (though there is evidence that an even higher return can be obtained from heated, glass greenhouses). The investment includes a 0.2 ha greenhouse, a motor cultivator, a pump and drip irrigation equipment and various tools including a knapsack sprayer at a total cost of 31,000 Lari, representing an annualized investment cost (for parsley) of 2,450 Lari per annum (50% of total annualized cost, as production takes only 6 months). Parsley is sown in September using locally available seed, with the first harvest in November and the last cut in April. Animal manure is the main fertilizer, with additional phosphate applied at establishment and nitrogen between cuts. Weeds are controlled with herbicide applications and hand tillage and the crop requires up to 5 insecticide sprays. Irrigation occurs 8-10 times during the season. The crop is cut once monthly between November and March and twice in April, yielding 4,000 kg of parsley. The product is packed with ice in chilled 30-kg boxes and either trucked or air-freighted to Moscow. Transport costs by road from Kutaisi to Moscow including official and unofficial charges amount to 1.40 Lari per kg. The Kutaisi greenhouse industry produces parsley, dill and caraway in winter and tomatoes, salad greens and cucumbers in early summer. The parsley sale price to intermediaries in Moscow is 8-10 Lari per kg. The financial and economic analysis of parsley production is detailed below.

Table 5. Economic and Financial Analysis of Greenhouse Parsley Production

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Total Labor Day (Lari)
	39	28,927	15,000	32
Economic Indicators	Domestic Resource Cost (DRC)		Nominal Protection Coefficient (NPC)	
	0.27		0.74	

11. The analysis shows high financial returns and good economic benefits, however, it has a high labor requirement resulting in lower returns per person day than some other crops. The Kutaisi region, with its benign winter climate has potential to expand its share of the Moscow winter herb market, however this requires much higher levels of farmer organization and better integration into supply chains, particularly linking the region to Russian supermarkets. AgVANTAGE has made some initial exploration of this market; however, additional investment in the factors of production, farmer association and value adding processing is required for potential long-term benefits to be realized.

12. **Tea** provides poor returns to investment and labor and unfavorable economic results. The model assumes a one-hectare tea plantation in the Guria region established from seed and coming into production in Year 5, with 0.1 ton/ha of green tea, of which 80 per cent is second grade and 20 per cent is

third grade. Production rises to 6 tons/ha by Year 9, with annual applications of 3 tons of mineral fertilizer per ha, well above the regional average. While government holds onto the hope of the revival of the tea industry, there is little likelihood of its return to anywhere near the scale of its past operations, which engaged 167 processing factories. Hand rolled tea offers some opportunity for growth, but only on a relatively small scale.

Table 6. Economic and Financial Analysis of Tea Production Guria Region

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Total Labor Day (Lari)
	neg.	(12,423)	297	12
Economic Indicators	Domestic Resource Cost (DRC)		Nominal Protection Coefficient (NPC)	
	0.96		1.29	

13. Smallholder tea production is clearly both unprofitable and uneconomic, although it does provide a high level of family employment. Rather than prohibiting the replacement of tea crops, the government would better invest in strategies for rehabilitating former tea land and encouraging farmers to diversify production in this potentially profitable agricultural region.

14. **Dairy Cattle**. With prevailing dairy industry productivity, at present world market prices milk production in Georgia is just viable financially, but economically marginal. The model used to determine this outcome, summarized in Table 7, assumes a 3 cow herd averaging 3,600 litters per cow per year and a 15 month calving interval. Animal feed is based predominantly on grazed and conserved natural pasture, which is consistent with the production level. Housing costs have been kept to a minimum, but still represent the greatest cost of the investment. Returns to capital are markedly higher (40%) if no investment in buildings is required.

Table 7. Economic and Financial Analysis of Milk Production in Emereti Region

Financial Indicators	Internal Rate of Return (%)	Net Present Value (Lari)	Profit/ha (Full Production) (Lari)	Return per Total Labor Day (Lari)
	12%	1,157	4,176	3.0
Economic Indicators	Domestic Resource Cost (DRC)		Nominal Protection Coefficient (NPC)	
	0.89		1.07	

Clearly Georgian dairy farmers have the potential to achieve much higher levels of production; however, with current animal genetics and feed resources, the model of this analysis is a high output scenario. The project should work with existing dairy farmers and the SIDA-funded dairy development project to identify the opportunities in the industry that offer profitable returns.

Annex 10: Safeguard Policy Issues

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

Environmental Guidelines
Summary

THE PROJECT

1. Limited access to credit is a major impediment to the growth of commercial agriculture in Georgia. Financial institutions have a limited presence in rural areas and a weak capacity for agricultural lending. Agro-processors, agri-businesses and small scale producers thus lack the means to modernize their plant, improve product quality, finance the acquisition of raw materials and invest in new production technology. To overcome existing constraints the project would provide credit lines to bank and non-bank financial institution for on lending for investment and working capital.

POTENTIAL ENVIRONMENTAL ISSUES

2. Environmental and safeguard issues are foreseen in the investments in agro-processing and public sector infrastructure (such as storage facilities, collection points, wholesale markets and possibly feeder roads), some of which are likely to be Environmental Category B and others Category C. **There would be no Environmental Category A sub-projects financed under the project.** Agro-processors would have potential environmental impacts from solid and liquid waste emissions, smoke, airborne particles and gaseous discharges, transport, and machinery noise that would need to be mitigated to National and Bank Standards. Also National safety measures for personnel in the vicinity of operating machinery would have to be incorporated. Some investment may also involve minor environmental issues related to the use and storage of agricultural chemicals, waste management at farms, site preparation for facilities and natural resources management in rural areas, including forests, biodiversity, soil and water.

RESPONSIBILITY

3. Sub-projects financed through project credit lines must be in compliance with the environmental laws and regulations of Georgia and with World Bank safeguard policies. Environmental risk management of sub-loans would become a part of sub-loan and micro-loan appraisal by the participating financial intermediaries (PFI's). Loan officers should be able to verify that sub-loan and micro-loan applications are in compliance with Georgian laws and regulations and would not cause enduring harm to the Georgian natural environment. The Bank environmental guidelines require financial intermediaries to undertake environmental screening of sub-projects. Loan officers (or environmental specialists employed by the PFI) would make decisions on environmental and safeguard compliance, providing that there are no complex environmental issues involved in the proposal. The Environmental Chapter of the OM provides guidelines that would assist PFIs to determine to what extent various project activities would affect the environment and to ensure that sub-loan applicants have incorporated all necessary measures to keep their proposed sub-projects compliant with Bank safeguard policies and Georgian environmental law.

SELECTED SAFEGUARD AND ENVIRONMENTAL CATEGORIES

4. Environmental category 'FI' and safeguards category 'SF' have been allocated to the project (See OM Environmental Chapter for details). The World Bank's ten safeguard policies are tabulated below together with their relevance to the project.

Table-1 : Bank Safeguard Policies	
Policies	**Relevance to this project**
Environmental Assessment	Highly likely
Natural Habitats	Possible
Forests (rain forests)	None
Pest Management	Likely
Involuntary Resettlement	Possible
Indigenous Peoples	Unlikely
Cultural Property	Unlikely
Safety of Dams	None
Projects on international waterways	Unlikely
Projects in Disputed Areas	Possible

5. Sub-projects may be defined as Category A, B or C within the FI Category, but none of the sub-projects in Georgia RDP would be Category A. For Category B sub-projects the PFI would provide to the Bank a written assessment of the institutional mechanisms for sub-project EIA and if the Bank is not satisfied that adequate EIA capacity exists within the PFI, all Category B sub-project EIA reports would be subject to prior review by the Bank. Sub-project environmental categories are detailed in the Environmental Chapter.

GEORGIAN ENVIRONMENTAL LAWS AND REGULATIONS

6. Georgian policy on environmental protection requires that economic development should not have negative impact on the environment. Under RDP, therefore, PFI's would be required to ensure that sub-loan activities comply with Georgian laws. See Environmental Chapter for details of relevant laws.

7. Georgian environmental categories: Under Georgian law EA is grouped in four environmental categories (1, 2 ,3 or 4), the first three of which are approximately equivalent to Bank environmental categories A, B and C. Georgian Category 4 relates to project activities that have no environmental impact but may need some form of permit. This Environmental Chapter uses Bank categories, but expands into detail using data from Georgian Laws.

8. All sub-projects would be screened for environmental issues by the PFI, based on data provided by the sub-borrower, and an environmental category allocated to the sub-project. In all cases, where an environmental assessment report or environmental monitoring plan is required, these are to be prepared by the sub-borrower and, where relevant, submitted to the Ministry (or its Agents). The EIA report, monitoring plans and permits are to be provided to the PFI with the sub-project proposal.

PROBABLE SUB-PROJECT ACTIVITIES

9. It is not possible to determine the various activities for which loan funds would be requested, but current and traditional agricultural activities in the Project region reflect the probable application to which loan funds would be designated. These would probably include production, processing and/or marketing of wine, fruit, vegetables, nuts, milk, milk products, tea, meat and meat products. Small-scale loans are probable for agricultural and horticultural production activities, including orchards and livestock, but are likely also to include inputs and services to these industries. Guidelines for the use and storage of fertilizer and pesticides would be provided by the PIU, and farmers would be trained under the project.

ENVIRONMENTAL SCREENING OF SUB-PROJECTS

10. Loan officers or the environmental specialist in the PFI would be required to screen each sub-project to define the Environmental Category and the required Environment Management Plan (EMP).

> **Preliminary Screening** - to establish the Environmental Category and relevant EMP associated with the activities of the proposed sub-project and compare this with the mitigation and management proposals of the sub-project proponent. Check lists and guidance are provided in the Environmental Chapter to assist loan officers with the preliminary screening.
>
> **Secondary Screening**. If Preliminary Screening is successful, field visits would be required to establish the veracity of the environmental data provided by the sub-project proponent. This is a physical check executed by the PFI loan officer or environmental specialist as part of sub-project appraisal.

11. In cases where Secondary Screening finds substantial errors or changes to Preliminary Screening data, the Environmental Screening Category and the Environmental Management Plan may need to be revised. The sub-project must not be financed by the PFI until the revisions have been accepted and checked by the PFI.

12. **Sub-projects assessed as Category B (lower environmental risk)** would require Secondary Screening during appraisal excepting small scale production activities such as agriculture, orchards, horticulture and vineyards or small scale processing, storage and marketing activities. Also minor upgrades to existing processing plants are excepted. Low risk sub-projects may be visited and screened during project supervision. An EIA may be required for some Category B sub-projects. For expansion of existing facilities or where change of technology is proposed at an existing plant, an environmental audit may be required, depending on the nature of the sub-project.

13. **Sub-projects assessed as Category C (sub-projects having no environmental issues)** require no Secondary Screening but the completed Preliminary Environmental Screening report should be entered in the project file.

14. **If the sub-project is rejected** on environmental grounds during Preliminary Screening, an improved environmental proposal may be submitted by the proponent, and re-considered as above. This decision is at the discretion of the PFI.

Environmental Monitoring

15. If the sub-project is accepted for funding and implementation under the project, following full appraisal by the PFI, environmental monitoring would be required in compliance with the EMP agreed in the screening procedure. The extent of project monitoring would be dependent on the nature, scale and potential impact of the sub-project. Monitoring may require the services of environmental specialists or a company with laboratory and analytical facilities (for complex environmental problems) or inspection by the local government environmental officer (See Environmental Chapter - Monitoring and Reporting).

Project Supervision (Environmental)

16. Likewise, the extent of Bank and PFI Supervision would be dependent on the nature of the sub-project. Monitoring reports should be available before each supervision mission and any anomalies or concerns investigated during supervision. The supervision missions should check the physical activities of the sub-project against the Secondary Screening Report and establish that mitigation and monitoring

measures are functioning as designed and are adequately controlling any pollutants or environmental issues within the law and regulations. In cases of unsatisfactory performance, an environmental audit and revised environmental management plan may be required.

Annual Environmental Reporting by the PFI to the Bank.

17. PFI's are required to submit annual reports on the environmental performance of the loans financed using WB funds. This should include a list of monitoring reports from sub-project borrowers and a list of reports from the Ministry or its agents. Annual Environmental Reports are to be provided to the Bank before each project supervision mission, and the latest Report is to be included as an attachment to the PFI's annual report to the Bank. The Banks reporting requirements for PFI's are detailed in the Environmental Chapter, including the format for the Annual Report. This is a compilation of all sub-projects under the control of the PFI.

B. Social Assessment

18. This social assessment (SA) is based on the recent ESW on constraints and opportunities to rural growth. The study was designed to provide analysis to support the preparation of this project. The main aim of the study was to provide a qualitative understanding of the constraints affecting rural growth. Employing mixed methods, the empirical aspect of the study was based on i) a qualitative in-depth survey of 20 rural enterprises and their communities, ii) a rapid quantitative survey of 106 rural enterprises, iii) a GIS-based analysis of the Survey of Georgia Household data, iv) a domestic agricultural market study, and v) interviews with development practitioners in Georgia. Since the study covered an extensive area of Georgia, it was found to be appropriate for the purposes of a social assessment for this project and the majority of the findings have been incorporated in the design of the RDP.

19. Rural Georgia has been affected by rising poverty and weak economic growth. Supporting more than 2 million people, or about 40% of the country's total population, poverty in rural Georgia grew by a staggering 16 percent a year, rising from 13.4 percent in 1997 to 20.9 percent in 2000. In some regions, more than 50 percent of rural households live below the official poverty line. Against this background, the Rural Development Project is designed to develop the private agriculture sector by facilitating the access of Georgia's mainly small and medium-scale farmers to supply chains, improve the competitiveness of the supply chains and strengthen the capacity of selected agricultural and financial institutions serving private-sector agricultural market activity. It is anticipated that the project activities would increase incomes and employment of the rural population and reduce poverty in rural areas.

20. The main social development issue relevant to this project is the potential for **elite capture** of project benefits. There is a significant risk that project benefits would be captured by particular interest groups due to the prevailing weak governance environment, significant inequality within the agricultural zones of rural Georgia, and strong social networks rural space.

a. **Weak governance environment.** The weak governance environment afflicting rural Georgia is a key constraint on development and is well described in the ESW. Local economic activities are commonly subject to capture by organized criminal elements (mafia) or rogue government officials. The study found that local enterprises that appear successful frequently enjoy the support of the mafia or influential government officials. These enterprises, through indebtedness or threat of force, often get caught in patron-client relations that exact a heavy toll on their independence and profitability. The resulting weak business environment has forced many local enterprises to impose a ceiling on their own growth to avoid attracting attention.

b. **Inequality.** The likelihood of elite capture is also high due to the marked inequality found within important agricultural regions such as Kolkheti, Kakheti or Kartli. These are areas of high population density in which poverty and affluence exist in marked juxtaposition. In Inner Kartli, for example, about 23 percent of the rural population constitute the poorest category (1^{st} quintile) while the least poor category makes up about 24 percent (5^{th} quintile). A significant portion of the poor are IDPs and economic migrants from the mountainous regions.

c. **Social networks.** The ESW describes the important role played by social networks in the coping strategies of rural farmers and enterprises alike. This ranged from obtaining economic inputs from family and friends (labor, capital), to leveraging support for strategic inputs (electricity) and problem solving (protection against the law or mafia). There is a high likelihood that the rural groups that the project will engage with are made up of members that belong to particular social networks. This has a positive effect when the strong social capital ensures high trust between members and the group is better able to cooperate and focus their energies on undertaking project activities. It may have a negative effect when more vulnerable groups who do not belong to strong social networks are excluded from project activities.

21. Mitigating Measures. The findings of the social assessment have helped to shape the final design of the project. The project places emphasis on grassroots participation and adopts a community-focused approach through its Linkages to Farmers and Communities Program and the formation of three regional farmer/community linkage teams. Specifically, the project has adopted a strategy to avoid capture of project benefits based on: (a) careful on-site analysis of stakeholders, (b) high level of transparency in project transaction, and (c) implementation of activities that support the empowerment of local farmers and communities. These approaches are described further below:

Stakeholder analysis. The project will undertake detailed local level stakeholder analysis that would enable the project implementers to better ensure the participation of legitimate project beneficiaries, and avoiding local enterprises or groups that are entrenched in patron-client relations. The presence of the three regional farmer/community linkage teams would ensure that local knowledge (especially the power disparity between groups) is adequately captured in project analytical work.

Community empowerment. The project will provide training and access to information aimed at empowering rural farmers and producers. Based on the results of the local stakeholder analysis, target groups and communities will be encouraged to participate in the Linkages to Farmers and Communities Program. The project will facilitate community empowerment by helping farmer and rural groups in association formation and the strengthening of organizational capacities. The development of stronger grassroots organizations will strengthen the voice of the rural population especially in improving their bargaining power. In addition, the project will identify highly motivated community members and provide them with leadership training.

Transparency. The project places a heavy emphasis on transparency in project activities. In all project sites there will be notice boards placed in publicly accessible areas where the most recent project information is available. There will also be an ongoing public information campaign. The project will put in place a social monitoring system through which issues of elite capture, corruption and inclusion can be closely monitored and acted upon. On an annual basis the project will conduct a social survey to gauge the level of beneficiary satisfaction and identify, early on, potential social development issues.

Annex 11: Project Preparation and Supervision

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

	Planned	Actual
PCN review	September 30, 2003	September 30, 2003
Initial PID to PIC		November 16, 2003
Initial ISDS to PIC		November 16, 2003
Appraisal	July 2004	October 31, 2004
Negotiations	October 2004	March 28, 2005
Board/RVP approval	December 2004	
Planned date of effectiveness	October 1, 2005	
Planned date of mid-term review	July 31, 2007	
Planned closing date	June 30, 2010	

Key institutions responsible for preparation of the project:

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Rapeepun Jaisaard	Sr. Agriculture Economist	ECSSD
Juergen Venema	JPA: Agribusiness Specialist	ECSSD
Ilia Kvitaishvili	Rural Development Specialist	ECSSD
Tatyana Kandelaki	Financial Specialist	ECSPF
Eustacius Betubiza	Sr. Micro Finance Specialist	ECSSD
Friedrich Peloschek	Lead Council	LEGEC
Rohit R. Mehta	Sr. Financial Officer	LOAG1
Garry Smith	Institution Specialist	Consultant
Garry Christensen	Rural Finance Specialist	Consultant
David Gue	Agro processing Specialist	Consultant
Plamen Stoyanov Kirov	Procurement Specialist	ECSPS
Arman Vatyan	Financial Management Specialist	ECSPS
Koshie Michel	Program Assistant	ECSSD

Bank funds expended to date on project preparation:

1. Bank resources: US$308,350
2. Trust funds: FAO US$65,800
3. Total: US$374,150

Estimated Approval and Supervision costs:

1. Remaining costs to approval: US$20,000
2. Estimated annual supervision cost: US$100,000

Annex 12: Documents in the Project File

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

A. Technical Reports

- World Bank/GEF financed Georgia Integrated Coastal Management Project: Review of Livelihood Security by CARE-International in the Caucasus, September 2001.
- Growth and Rural Poverty in the CIS7, Case Studies of Georgia, the Kyrgyz Republic, and Georgia by The World, Bank , June 2004.
- The Georgian Agriculture and Food Products Market by Zurab Liluashvili, September 2003.
- Georgia Country Report by The Economist Intelligence Unit, May 2003.
- Georgia Microfinance Feasibility Study by Business and Finance Consulting GmbH, November 2003.
- Central and Eastern Europe and the Newly Independent States – Thematic Study on Comparative Advantage and Agricultural by The International Fund for Agriculture Development (IFAD) March 2004,
- Georgia Trade Diagnostic Study by Poverty Reduction and Economic Management Unit Europe and Central Asia Unit – The World Bank, June 2003.
- Georgia Agricultural/ Agribusiness Sector Assessment, USAID, March 2001.
- Wine Sector Competitiveness in Georgia, The World Bank, November 2002.
- Georgia: An Update of Agricultural Developments by Iain Shuker, The World Bank, July 2000.
- Restructuring Assistance and Policy Advice for the Ministry of Agriculture and Food of Georgia – An Overview of the Georgian Tea Sector, USAID, November 2002.
- From Subsistence to Markets: Overcoming constraints to Rural Growth in Georgia by Sharidan Faiez, The World Bank, May 2004.
- Assessment of Specific Constraints to Agribusiness in Georgia and Methodology for Prioritization ,Support of Added-Value Enterprises - ACDI/VOCA – USAID, Georgia 2003.
- Export and National Marketing Development for Horticultural Products in Georgia, FAO, 2002)
- Assessment of the Competitiveness of Georgian Agriculture, Agrisystem Ltd, September 2004.

B. Project Preparation Documents

- Procurement Assessment (by Procurement Specialist, November, 2003 – updated March 2004);
- Financial Assessment Report (by the Financial Management Specialist, 2004);
- Procurement Review Report
- Project Costs
- Financial and Economic Analysis.

Annex 13: Statement of Loans and Credits

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

			Original Amount in US$ Millions						Difference between expected and actual disbursements	
Project ID	FY	Purpose	IBRD	IDA	SF	GEF	Cancel.	Undisb.	Orig.	Frm. Rev'd
P074361	2003	SIF 2	0.00	15.00	0.00	0.00	0.00	15.82	0.00	0.00
P040555	2003	PRIM HEALTH CARE DEVT	0.00	20.30	0.00	0.00	0.00	22.87	-0.27	0.00
P044800	2003	FORESTRY	0.00	15.70	0.00	0.00	0.00	16.60	0.03	0.00
P077368	2003	MUNI DEVT & DECENTRLZN 2	0.00	19.41	0.00	0.00	0.00	21.71	5.68	0.00
P072394	2001	ENERGY TRANSIT INST BLDG	0.00	9.63	0.00	0.00	0.00	7.34	3.10	0.00
P055173	2001	EDUC I (APL)	0.00	25.90	0.00	0.00	0.00	20.67	7.39	0.00
P055068	2001	IRR/DRAIN REHAB (APL #1)	0.00	27.00	0.00	0.00	0.00	24.56	4.65	0.00
P054886	2001	ELEC MRKT SUPPORT	0.00	27.37	0.00	0.00	0.00	26.44	-2.58	0.00
P048791	2001	PROT AREAS DEV (GEF)	0.00	0.00	0.00	8.70	0.00	9.16	3.27	0.00
P040556	2000	ROADS Project	0.00	40.00	0.00	0.00	0.00	13.22	-27.45	0.00
P064091	2000	AGRIC RES EXT TRG (GEF)	0.00	0.00	0.00	2.48	0.00	2.01	0.97	0.00
P065715	2000	AGR RES EXT & TRG	0.00	7.60	0.00	0.00	0.00	4.91	3.23	0.00
P008416	1999	ENT REHAB	0.00	15.00	0.00	0.00	0.00	4.73	4.87	0.00
P050911	1999	INTG COASTAL MGT	0.00	4.40	0.00	1.30	0.00	3.07	2.75	0.80
P052154	1999	STRUCT REF SUPPORT	0.00	16.50	0.00	0.00	0.00	7.56	7.37	3.54
P057813	1999	JUDICIAL REFORM	0.00	13.40	0.00	0.00	0.00	3.26	-10.01	0.00
P060009	1999	INTG'D COASTAL MGMT (GEF)	0.00	0.00	0.00	1.30	0.00	1.13	0.90	0.46
P039929	1998	SIF	0.00	20.00	0.00	0.00	0.00	5.15	0.78	0.00
P008415	1997	AGRIC DEVT	0.00	15.00	0.00	0.00	0.00	0.68	1.60	0.00
		Total:	0.00	292.21	0.00	13.78	0.00	210.89	6.28	4.80

GEORGIA
STATEMENT OF IFC's
Held and Disbursed Portfolio
In Millions of US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
2000/03	Bank of Georgia	5.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
0/97	Georgia G&MW Co.	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1999/01/02	Georgia M-F Bank	6.00	0.00	0.00	0.00	4.00	0.00	0.00	0.00
1998	Ksani	6.32	2.50	0.00	0.00	6.32	2.50	0.00	0.00
1998/02	TBC Bank	3.00	0.00	0.00	0.00	3.00	0.00	0.00	0.00
1999	TbilComBank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Total portfolio:	20.32	2.50	0.00	0.00	15.32	2.50	0.00	0.00

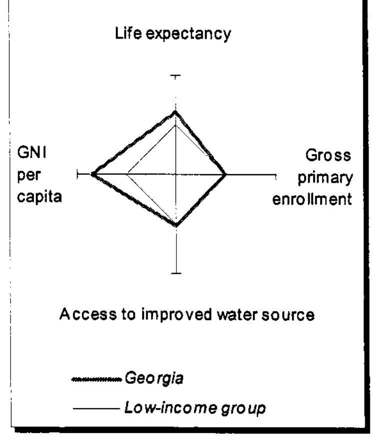
		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic.
1997	GGMW	0.00	0.00	0.00	0.00
	Total pending commitment:	0.00	0.00	0.00	0.00

Annex 14: Country at a Glance

GEORGIA: RURAL DEVELOPMENT PROJECT - GE

POVERTY and SOCIAL	Georgia	Europe & Central Asia	Low-income
2002			
Population, mid-year *(millions)*	5.2	476	2,495
GNI per capita *(Atlas method, US$)*	730	2,160	430
GNI *(Atlas method, US$ billions)*	3.8	1,030	1,072
Average annual growth, 1996-02			
Population *(%)*	-0.5	0.1	1.9
Labor force *(%)*	0.5	0.4	2.3
Most recent estimate (latest year available, 1996-02)			
Poverty *(% of population below national poverty line)*	11	..	..
Urban population *(% of total population)*	57	63	30
Life expectancy at birth *(years)*	73	69	59
Infant mortality *(per 1,000 live births)*	24	25	81
Child malnutrition *(% of children under 5)*	3	..	..
Access to an improved water source *(% of population)*	79	91	76
Illiteracy *(% of population age 15+)*	..	3	37
Gross primary enrollment *(% of school-age population)*	95	102	95
Male	95	103	103
Female	96	101	87

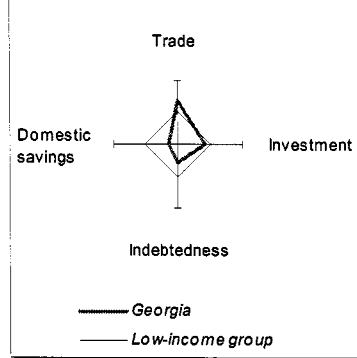
Development diamond*



KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1982	1992	2001	2002
GDP *(US$ billions)*	..	4.5	3.2	3.3
Gross domestic investment/GDP	26.4	23.4	18.5	18.0
Exports of goods and services/GDP	..	35.7	23.0	27.1
Gross domestic savings/GDP	34.5	-7.2	2.7	5.9
Gross national savings/GDP	..	..	6.7	10.6
Current account balance/GDP	..	..	..	..
Interest payments/GDP	..	0.0	0.9	1.2
Total debt/GDP	..	1.8	54.0	54.9
Total debt service/exports	..	..	6.2	9.5
Present value of debt/GDP	..	..	33.3	..
Present value of debt/exports	..	..	85.4	..

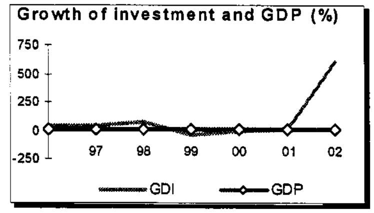
	1982-92	1992-02	2001	2002	2002-06
(average annual growth)					
GDP	-6.2	2.1	4.7	5.4	..
GDP per capita	-6.7	2.6	5.5	6.4	..

Economic ratios*



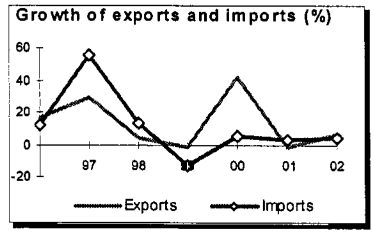
STRUCTURE of the ECONOMY	1982	1992	2001	2002
(% of GDP)				
Agriculture	23.0	52.9	22.1	19.6
Industry	38.2	23.9	21.9	23.1
Manufacturing	30.5	17.7	..	..
Services	38.8	23.2	56.0	57.3
Private consumption	53.3	97.8	87.6	84.3
General government consumption	12.2	9.4	9.7	9.8
Imports of goods and services	..	66.3	38.8	39.2

Growth of investment and GDP (%)



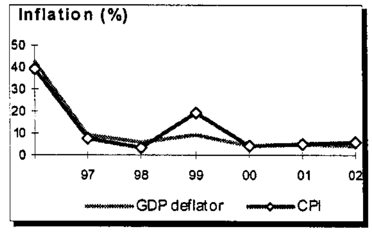
	1982-92	1992-02	2001	2002
(average annual growth)				
Agriculture	..	..	..	..
Industry	..	..	3.0	3.0
Manufacturing	..	3.3	4.0	4.0
Services	..	..	..	..
Private consumption	..	2.4	8.7	-24.8
General government consumption	..	4.3	-13.9	4.7
Gross domestic investment	..	11.4	10.3	608.5
Imports of goods and services	..	8.4	2.9	4.2

Growth of exports and imports (%)



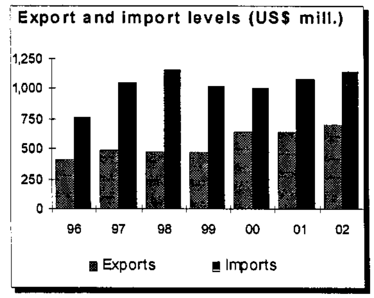
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices				
(% change)				
Consumer prices	..	887.4	4.7	5.6
Implicit GDP deflator	3.5	1,314.2	5.3	4.4
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	12.6	16.5	16.9
Current budget balance	..	-21.6	0.4	0.6
Overall surplus/deficit	..	-35.6	-1.4	-0.7



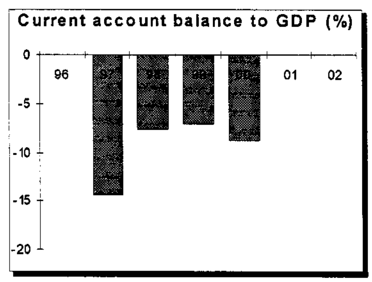
TRADE

	1982	1992	2001	2002
(US$ millions)				
Total exports (fob)	..	267	639	695
Black metal	..	..	42	46
Tea	..	..	62	70
Manufactures	..	..	273	288
Total imports (cif)	..	645	1,078	1,146
Food	..	..	143	153
Fuel and energy	..	..	176	185
Capital goods	..	..	470	489
Export price index *(1995=100)*	..	..	98	101
Import price index *(1995=100)*	..	..	97	99
Terms of trade *(1995=100)*	..	..	101	102



BALANCE of PAYMENTS

	1982	1992	2001	2002
(US$ millions)				
Exports of goods and services	..	..	1,153	1,249
Imports of goods and services	..	..	1,490	1,583
Resource balance	..	..	-336	-334
Net income	..	..	20	33
Net current transfers	..	..	108	122
Current account balance	..	..	..	..
Financing items (net)	..	..	..	..
Changes in net reserves	..	..	-19	-26
Memo:				
Reserves including gold *(US$ millions)*	..	..	149	193
Conversion rate *(DEC, local/US$)*	..	3.30E-5	2.1	2.2



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
(US$ millions)				
Total debt outstanding and disbursed	..	79	1,729	1,825
IBRD	..	0	0	0
IDA	..	0	396	478
Total debt service	..	0	77	129
IBRD	..	0	0	0
IDA	..	0	3	3
Composition of net resource flows				
Official grants	..	5	69	..
Official creditors	..	0	64	57
Private creditors	..	22	13	-17
Foreign direct investment	..	0	160	..
Portfolio equity	..	0	0	..
World Bank program				
Commitments	..	0	90	55
Disbursements	..	0	63	59
Principal repayments	..	0	0	0