



**Transnational Crime and
Corruption Center (TraCCC)
Georgia Office**



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CORRUPTION IN THE ROAD SECTOR OF GEORGIA

**TBILISI
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Corruption in the Road Sector of Georgia

This paper addresses the problem of corruption and poor public management in the road sector of Georgia. The poor condition of roads in Georgia costs the country millions of dollars in revenues from road taxes and fees, and impedes the development of the TRACECA project which Georgia committed to back in 1993. The general problem of insufficient financing, which largely accounts for the state of roads in Georgia, is further aggravated by endemic corruption, poor management, an ill-designed organizational structure of the state road administration, inefficient tax collection, and major distortions of revenue accumulation through the illegal practices of other agencies. The preservation of the centralized command system in the road sector has created grounds for corruption in the public procurement and quality control. Meanwhile, the state road administration's control over the accumulation of funds in the Road Fund provides room for the embezzlement of public funds. The study of legislation, economic situation, institutional structure and relations within the road sector of Georgia, as well as interactions with other sectors and agencies, has resulted in identifying the levels, methods and underlying reasons for corruption in the road sector of Georgia. The paper discusses the effects of corruption and mismanagement of public resources in the road sector on the overall economic situation in the country and provides recommendations for curtailing corruption and increasing efficiency in resource accumulation and public spending in the road sector of Georgia.

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Corruption in the Road Sector of Georgia

SUMMARY

The research on corruption in the road sector of Georgia was conducted by the American University's Transnational Crime and Corruption Center's Georgia Office, (TraCCC GO) April through October of 2003. The research pursued two principal goals:

1. To reveal the level and forms of corruption in the road sector of Georgia.
2. To provide an assessment of the impact of corruption in the road sector on the economic and social development of Georgia.

Due to the nature of the subject matter and the research objectives, a qualitative study was undertaken, which included the following techniques:

- An in-depth study of the official sources of data.
- Review of the relevant unofficial, Georgian and international materials.
- Interviews with government officials, construction companies and contractors.

The South Caucasus, consisting of Georgia, Armenia and Azerbaijan, lies at the intersection of a number of the world's trade and transport routes from the West to the East and from the South to the North. In view of this, Georgia has a very favorable location for involvement in international transportation as a transit country.

In 1993, Georgia joined the European Union sponsored Transport Corridor of Europe-Caucasus-Asia (TRACECA) project, which aims to develop a transport corridor aligned on a west - east axis from Europe, across the Black Sea, through the Caucasus and the Caspian Sea to Central Asia. This was a central step in Georgia fulfilling its perceived role as an international transit route. However, ten years of work on the Georgian section of the TRACECA corridor appears to be declining. One of the many reasons for this is the poor quality of roads in Georgia, which largely stems from corruption and poor management of the road sector.

Corruption in the road sector has been widely discussed in the Georgian mass media. However, exposing corruption and embezzlement by road sector authorities has so far failed to attract any serious attention from the law enforcement and anti-corruption bodies of Georgia.

In 1992, the Cabinet of Ministers of Georgia established the state enterprise, *Sakavtogza*. *Sakavtogza* was only engaged in economic activity and had no political or administrative functions. The Government of Georgia administered the road sector at that time. In 1995, under the "Law on the Structure and Activities of the Executive Branch" of Georgia, *Sakavtogza* was given administrative power. In 1997, *Sakavtogza* was reorganized into the State Department of Roads. Since 1997, the roads in Georgia have been the responsibility of a special road administration known as the State Department of Roads of Georgia (SDRG). SDRG owns and manages, on behalf of the state, international and intrastate roads in Georgia. The SDRG reports to the Government and Parliament of Georgia. In reality, it is accountable solely to the President.

Prior to 1996, the only source of financing for the road sector came from the central budget. In 1996, the State Road Fund (SRF) was established with road taxes introduced as the main source of revenue for the SRF. It is a tax collecting body within the SDRG, and is accountable to the SDRG management.

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The responsibilities of the SDRG included the regulation, development and control of long-term governmental programs, and financial analysis. So far it has failed to implement many of its core functions and responsibilities.

The legislative structure actually aids corruption in the road sector. A retrospective study of road sector related legislation included a total of 8 sector specific laws and 58 decrees, orders and resolutions relevant to the road sector. New laws are often introduced to address issues overlooked by earlier legislation, making for a confused and contradictory legislation, which is readily interpreted to benefit whoever wishes to gain advantage. The research summarizes the attitude to these laws and regulations as one of, “laws exist to be broken.” A similar “relaxed” attitude is rife with regard to tax collection, the handling of international grants, and long-term credits.

There are several organizations (governmental bodies and NGOs) that have reported on the levels of corruption in the Georgian road sector. However, the Government’s response has been predictably inept.

In 1996, a governmental commission was set up under Presidential Order No. 388, to develop and supervise the implementation of a long-term program aimed at the development of the road network of Georgia. Since then, only the text of the program has been prepared. Similarly, an advisory council set up at SRF, has produced no tangible outcomes, with council members meeting at best once a year. There is little coordination, if not open mistrust, jealousy and political in fighting, among the different departments, resulting in poor exchange of information and the withholding of finances between departments.

Often however, government initiatives have been unrealistic and unachievable. The proposed financing of the Presidential Program of 1996, which has never achieved its target investment levels, is a prime example of the widening gap between intention and reality..

The SRF has raised many questions, including: Is there a need in Georgia for the State Road Fund and for road taxes earmarked to finance the road sector? Who should be responsible for collecting road taxes? Should the SRF be a part of the SDRG structure?

The road construction and maintenance contractors are generally “very close” to individuals within the SDRG. The companies are ex-Soviet bodies, which have been “privatized” only to be dependent upon the SDRG as the only source of work and the SRF as the only internal source of funding. The tenders for contracts are not transparent and operate on a “kickback” system. No new road contractors can afford to enter the market as the system of kickbacks is too entrenched to make it profitable. Legislation has actually aided the aforementioned system.

In general, internationally financed road projects have enjoyed better oversight, with third parties contracted to conduct quality control. However, not all of them have resulted in good roads, often requiring repairs within two years of completion.

Tax collection has also been corrupt, especially in the Customs Department. Adjarian officials were singled out for not transferring collected fees and taxes to the central government. In addition, there are violations in the vehicle registration and technical examination processes, unregulated import and sale of petrol in the country. Additional problems include a lack of control over construction within the road sector, which in turn affects traffic safety, and the imperfect fee collection at the Rikoti Tunnel.

The effects are numerous and any realistic attempt to plan budgets is often meaningless, with expenditure plans rarely matching actual spending. This problem is further exacerbated by bad planning, changes in legislation, delegating finance collection processes, and the lack of

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information from other governmental departments. Meanwhile, the road haulage contractors are paying a substantial tax for very little return in terms of the quality of roads.

A question arises: “If quality service is not feasible because of the lack of financing, why spend what is available on poor services?” Is it a case of a little is better than nothing?

The Chamber of Control notes a number of “minor violations” in SDRG accounting practices. For example, numerous cases of “mistakenly” transferred funds later returned to SDRG accounts, poor tax payment practices, (e.g. nonpayment of taxes on special reserves, profit tax, income tax on physical persons, property tax, VAT, taxes to social security fund, taxes to healthcare fund), and the renting of equipment to private enterprises.

SDRG has used international financial aid and credit allocations in a “knee-jerk” fashion to meet what they believe are the current requirements of the road sector. But rarely are the opinions of Georgian and foreign experts sought. Thus, to quote Mr. Antti Talvitie (World Bank Program Team Leader), “it is not a wise strategy for any country to finance road maintenance using loans and credits; they should be reserved for network upgrading and clearance of the maintenance backlog”¹.

It can be concluded that corruption exists at all levels in the road sector, but this is as much a product of pursuit for personal profit by SDRG officials as it is poor performance and control from other government departments. Another factor is confusing and ever changing legislation open to different “interpretations” by officials.

¹ Mr. Antti Talvitie’s speech at the Joint Seminar on Transport Policies in the three South-Caucasus States, April 18 – 19, Tbilisi, Georgia

GLOSSARY

- TraCCC GO – Transnational Crime and Corruption Center – Georgia Office
- SDRG – State Department for Roads of Georgia
- SRF – State Road Fund
- SPA – State Procurement Agency
- TRACECA – Transport Corridor of Europe – Caucasus – Asia
- ECMT – European Conference of Ministers of Transport
- Public roads – general use roads owned and managed by the state
- Departmental roads – access roads to buildings and sites occupied by public or private organizations and roads within the area owned by public or private organizations
- International roads – roads connecting Georgia with administrative, industrial and cultural centers of other countries
- Intrastate roads – roads connecting administrative, industrial and cultural centers within Georgia, including the capital of Georgia, capitals of autonomous republics, “Rayon” administrative centers, and popular resorts; military roads and roads of special importance for the country
- Local roads – roads connecting smaller settlements with each other, administrative centers and international and intrastate roads
- Maintenance - routine or ongoing repairs, in many cases simply “patching” the road. It is performed on an ‘as needed’ basis.
- Periodical repair- preventive repair carried out on the regular basis (usually every 4 years) on all sections of the road to prevent its deterioration. In Georgia, it usually implies patching and a new layer of asphalt coating to cover the patches and level road surface.
- Rehabilitation - a series of measures to repair badly damaged roads, which is beyond the realm of standard maintenance, to bring them up to either their original condition or international standards. This may include the complete stripping and replacement of the road surface, replacement of the drainage system, etc.
- Modernization – increasing the carrying capacity of roads, including reconstruction of some sections and construction of access roads
- Reconstruction – the construction of a new road to replace the old one.
- *Sakavtogza* state concern – state enterprise responsible for management of the road sector of Georgia from 1992 – 1997, reorganized into SDRG in 1997

1 INTRODUCTION

The research on corruption in the road sector of Georgia was conducted by American University's Transnational Crime and Corruption Center – Georgia Office (TraCCC GO). The study lasted from April to October 2003. TraCCC GO is a research center established in January 2003 in association with American University's Transnational Crime and Corruption Center (TraCCC) – Washington, DC. It conducts extensive research on key areas of organized crime and corruption in Georgia. For additional information on TraCCC – GO activities visit our website at <http://www.traccc.cdn.ge>.

The research team was composed of TraCCC GO research fellows Ms. Eugenia Unanyants and Mr. Guram Svanidze, who wrote the State Procurement and Quality Control section of the report. Ms. Rusudan Dzigrashvili and Ms. Ketevan Chokheli assisted as volunteers. We express our gratitude to Ambassador Todd Stewart, Dr. Sally Stoecker and Dr. Ketevan Rostiashvili for their valuable and constructive comments on the report, Mrs. Johanna Dadiani for her edit of the report, and to the TraCCC project management for their assistance in the course of the research and report preparation.

2 GOALS AND OBJECTIVES OF THE RESEARCH

The research on corruption in the road sector of Georgia had two principal goals:

1. To reveal the level and forms of corruption in the road sector of Georgia.
2. To provide an assessment of the impact of the corruption in the road sector on the economic and social development of Georgia.

More specific objectives were pursued to meet the principal goals set forth above:

- To describe the existing status quo within the road sector.
- To reveal corrupt practices and instances of poor administration that affect the road sector, focusing on state management.
- To identify breaches of the law regulating the road sector of Georgia.
- To indicate where ambiguities within the legislation could be exploited for illegal gain.
- To identify possible shortcomings within state management of the road sector and other governmental bodies preventing efficient use of available resources.
- To explore whether corruption in the road sector affects the quality of the roads in Georgia, and to what extent.
- To offer recommendations on what could be done to improve the existing situation in the road sector of Georgia.

3 METHODOLOGY

The research on corruption in the road sector of Georgia is qualitative research due to the nature of the subject matter and the goals and objectives of the research. The core techniques used are:

1. In-depth study of official data sources.
2. Literature review of unofficial, Georgian, and international materials relevant to the research subject matter.
3. Primary data collection, including in-depth interviews with key stakeholders such as officials from the road sector administration, construction companies, the motor transport administration, road haulage contractors, and other state bodies.
4. Observation and survey of road surfaces, infrastructure, and road works.

Official data sources

The main sources of information used in the research are official documents, including laws and legal acts; published official documents and materials; and records obtained from state bodies. Despite the fact that the information received from official sources was of poor quality, in most cases it was the only source of information available. Unfortunately, it was rarely complete and often required verbal supplementation and clarification from responsible officials.

The main official data sources used in the research are the national legislation, documents from Parliament, Chamber of Control audit materials, and State Procurement Agency conclusions on SDRG purchasing practices. Additional sources were documentary information from the State Department for Roads of Georgia, National Anti-corruption Bureau resolutions, the Main Administration of the Traffic Police, World Bank study of the motor road sector of Georgia (provided by the State Department for Roads), statistical data from the State Department for Statistics, and data on the state budget from the Parliamentary Budgetary Office.

Literature review

The research team undertook a literature review which included previous studies of corruption in Georgia made by Georgian and international organizations, NGO and mass media reports relevant to the research subject matter, materials on the international experience of fighting corruption in general and, more specifically, on the prosecution of corruption cases in the field of road construction and maintenance.

The literature review provided a broad perspective on the problem of corruption both in Georgia and internationally, and more specifically on corruption in the road construction and maintenance industry. The materials on the prosecution of corruption cases in the field of road construction and maintenance in other countries helped to identify peculiarities of corruption in the road sector of Georgia. Newspaper articles and records of TV broadcasts provided initial information on some corrupt practices within this sector, which provided focus on many significant details throughout the research.

It should be noted that the situation in the road sector of Georgia is still unexplored territory and very little official and unofficial information is available. This is especially true when compared to other sectors of similar importance for the country.

Primary data collection

The choice of sampling used to select respondents for in-depth interviews was based upon the requirements of the research. The survey sample was made up of 32 respondents, who can be divided into three categories:

- respondents representing the road sector;
- respondents representing the motor transport sector;
- and Georgian experts in the areas related to the research subject matter.

The research sample was comprised of 6 officials of the State Department for Roads of Georgia (SDRG), 7 construction enterprises, 4 road haulage contractors, 6 cargo transport drivers, 3 transport NGO representatives, 2 officials of the Motor Transport Administration, and 4 experts in the areas related to the research subject matter. The respondents, with one exception, are middle-aged men with significant expertise in their business gained from years of working in the same field and often in the same organization.

Since the purpose of the interviews was to collection information and record opinions on the specific issues crucial to the research, structured interview guides were used. In many cases these were specially developed for individual respondents. The information obtained during the interviews was accurately recorded by interviewers and confidentiality was guaranteed.

Report preparation

Following the data collection stage, the information was collated and analyzed, conclusions were made and recommendations were developed upon which the present report has been prepared. The report is divided into three sections:

- The first section contains a glossary of terms used in the report, the executive summary, introduction, a description of the research goals and objectives, methodology, and background to the research providing a discussion of the role of Georgia as a transit country and basic characteristics of the road sector.
- The second section is devoted to research findings and analysis. These are presented under a number of headings dealing with specific subject areas. The background information obtained from the literature review and data collection is available in the appendices with corresponding references in the body text. This is useful in order to fully understand the research findings.
- Finally, the report includes conclusions on the level of corruption in the road sector of Georgia and the impact of corruption on the economic and social development of the country. It makes recommendations on curtailing corruption and improving the situation in the road sector.

4 BACKGROUND TO THE RESEARCH

4.1 GEORGIA AS A TRANSIT COUNTRY

4.1.1 *Regional characteristics*

Georgia is located at the eastern coast of the Black Sea. It covers an area of about 69,700 square kilometers and shares a border to the north with Russia, to the east with Azerbaijan, to the south with Armenia, and to the southwest with Turkey.

The South Caucasus region, consisting of Georgia, Armenia, and Azerbaijan, lies at the intersection of a number of global trade and transport routes. In view of this, Georgia has a very favorable location for involvement as a transit country.

The transport system of Georgia consists of air, rail, road, and maritime networks. The total length of the road network is 20,229 km. The rail network is 1,576 km, of which 974 km is used for cargo transportation. Georgia has two seaports in Poti and Batumi, and four airports in Tbilisi, Kutaisi, Batumi, and Senaki.

4.1.2 *Georgia and TRACECA*

In 1993, the Transport Corridor of Europe-Caucasus-Asia (TRACECA) project, also known as the "New Silk Road," was launched. This is a European Union-sponsored project involving Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan, Azerbaijan, Armenia, Georgia (since 1993), the Ukraine, and Mongolia (since 1996). The purpose of the project is to develop a transport corridor aligned on a west to east axis, stretching from Europe, across the Black Sea, through the Caucasus and the Caspian Sea to Central Asia².

Participation in the TRACECA project was a step towards Georgia's establishment as a transit country, as advocated by governmental policy. The development of the country's transit capacity was declared strategically important. Therefore, the rehabilitation and development of the transport sector was put forward as the priority for economic development. Since 1992, Georgia has received significant foreign aid for development of the transport system. The authors estimate that approximately \$342 million USD and 101 million Euros were allocated from 1992 – 2002. This was in the form of grants and loans to the transport sector, made by donor states and international financial organizations such as the World Bank, EBRD, Kuwait Fund, EU and Japan³. About \$82 million USD of this amount was allocated for the improvement of the road sector⁴. It should be noted, however, that although these numbers seem quite substantial, only a part of the foreign aid goes directly for infrastructure rehabilitation and development. The rest is used for the restructuring of public agencies, consultants, among other tasks.

² For detailed information on TRACECA project see www.traceca.org

³ Estimations were made based on the data provided in the publication "International Cooperation and Georgia 1992 – 2002" issued by the Foreign Investment Advisory Unit at the President of Georgia, 2002

⁴ Allocation of foreign aid to the government of Georgia is usually spread over years and based upon the performance under previous and/or ongoing projects. Therefore, previous delays or failures cause delays in the allocation of new grants and credits. Therefore, not all of the allocated funds have been disbursed yet. Funds for the rehabilitation of roads in Georgia have been allocated through different agencies and within different projects, i.e. SDRG is by no means the only recipient of road rehabilitation related foreign aid.

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4.1.3 *Road transport sector and road haulage business in Georgia*

In 2002, Georgia's motor vehicle fleet was comprised of 47,841 cars; 47,681 trucks and 22,738 passenger vehicles. Presently, 90% of the road transport industry is privately-owned, while 10% is still state-owned. The motor vehicle fleet is generally out-of-date and the number of vehicles does not meet actual demand⁵.

According to the Road Transport Administration, over 100 legal passenger transport enterprises operate on the Georgian intercity and international routes. Illegal transportation activities remain a substantial problem as the percentage of legal transport operators is only 50% - 60% of the total number⁶.

State policy on the creation of an international road haulage industry in Georgia includes intergovernmental agreements with over 20 countries and 14 international conventions, including the ECMT system⁷. Furthermore, provisions exist for the establishment of 18 large Georgian and international road haulage contractors and dozens of smaller units, to operate on international and domestic routes, freight forwarding agencies, professional associations and unions of passenger carriers and road haulage contractors⁸.

According to Georgian legislation, there are no constraints on the establishment of intercity and international transport enterprises. Under the "Law on Entrepreneurial Activity" adopted in 1999, no licensing is required for road transport activities. Fees for freight and passenger transportation are set by the carriers without state intervention. The Government regulates only intercity public transport tariffs, although all road transport enterprises have to pay regulatory fees to the Road Transport Administration⁹.

4.1.4 *The competitiveness of Georgia as a transit country*

The total volume of freight transported through the territory of Georgia between 1990 and 2002 was approximately 681.9 million tons, of which 426.5 million tons were transported by road. The largest volume of freight transportation was registered in 1990 – 1991. This can be explained primarily by the large amounts of humanitarian aid transported into and through Georgia. A downtrend began in 1992 and continued until 1997, when Georgia again experienced an increase in freight transportation. There has been a steady upward trend since then, with transport freight volume reaching 37.4 million tons in 2002. However, Georgia has never managed to restore freight volume to the 1990 – 1991 levels. Over the years, road haulage has remained the main means of passenger and freight transportation, totaling 22.5 million tons in 2002¹⁰ (see [Appendix 1](#) for the transport statistics).

However, regardless of the increase in freight traffic volumes through Georgia, the overall competitiveness of the Georgian section of the TRACECA corridor appears to be in decline. Field studies reveal that transit traffic seems to bypass Georgia, using alternative routes, such as Russia – Kazakhstan, and Turkey – Iran. The majority of external-source traffic in Georgia originates in neighboring countries and carries out either export/ import services for Georgia, or provides

⁵ Filled-in questionnaire on transport development submitted by the Government of Georgia to Inland Transport Committee of Economic Commission for Europe (Session 15, 2-4 September 2002, agenda item 5).

⁶ Extract from the speech of the Head of Road Transport Authority of Georgia (Mr. Dzotsenidze) at the Joint Seminar on Transport Policies in the three South Caucasus States, Tbilisi, 18-19 April 2002

⁷ ECMT – European Conference of Ministers of Transport

⁸ Extract from the speech of the Head of Road Transport Authority of Georgia (Mr. Dzotsenidze) at the Joint Seminar on Transport Policies in the three South Caucasus States, Tbilisi, 18-19 April 2002

⁹ Annex to the speech of the Head of Road Transport Authority of Georgia (Mr. Dzotsenidze) at the Joint Seminar on Transport Policies in the three South Caucasus States, Tbilisi, 18-19 April 2002

¹⁰ "Georgia - Statistical Review 2002", State Department for Statistics of Georgia

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transport to ports on the Georgian Black Sea coast. Other researchers have found that, “more than 95% of the transit cargo hauled across Georgia, both by motor vehicles and rail, originates in Azerbaijan and Armenia. The share of freight from Asian countries is insignificant and according to the data of recent years, is falling... Freight from Azerbaijan and Armenia accounts for a large part of the freight (54%) handled in Georgian ports. Asian cargo amounts to less than 3%.”¹¹

The Minister of Transport and Communications of Georgia stated that one of the main factors accounting for the decreasing competitiveness of the Georgian section of TRACECA was the insufficient capacity of the existing infrastructure. These lead to continuous standstills and financial losses¹². Motor transport authorities for their part repeatedly emphasize the importance of the rehabilitation and modernization of the roads for the successful functioning of the transport corridor. Other factors retarding TRACECA’s competitiveness and Georgia’s transit capacity development recognized by the governmental include:

- lack of a complete common legislative base;
- inadequate and unbalanced tariff policy of different governmental structures;
- lack of harmonized administrative procedures at the frontier points and customs check-points;
- illegal fees to customs and other officials;
- unreasonably complex customs and other controlling procedures;
- high transit fees, especially road taxes; and
- a low level of adherence to intergovernmental agreements.

The paper “Georgia’s Function as a Transit Country and Sustainable Development”¹³ explains the decline of TRACECA and its Georgian section by the following factors:

- A more flexible tariff policy exists in the corridors crossing Russia and Iran. For example, the transport cost of 1 ton of dry cargo per 1 km via one of the aforementioned corridors is 51.1% less than transporting it through Georgia. A similar situation applies to container shipments, where the price difference amounts to 63.3%;
- There are two ferry crossings on the route. The technical aspects related to ferry crossings diminish the comparative advantage of railroad transportation both in terms of speed and cost effectiveness;
- Unjustifiably high tariffs for port service, especially when compared to other, more competitive ports on the Black Sea;
- Complicated border crossing procedures and the illegal activities of the road police; and
- Safety standards have deteriorated and the traffic on Georgia’s highways has a low level of low cost-effectiveness. For example, it takes 4-5 days for vehicles to pass through the Georgian transit section (450 km) instead of 1 or 2 days on other routes. Taxes, including unofficial ones, amount to \$700-\$800 USD. Each kilometer of road costs

¹¹ Archil Gegeshidze: Georgia’s Function as a Transit Country and Sustainable Development (this paper is a part of the National Assessment Report on Sustainable Development of Georgia. The Report was submitted to the World Summit on Sustainable Development and is accessible on the web: http://www.johannesburgsummit.org/html/prep_process/natlassessment.html)

¹² Speech of M. Adeishvili at the Joint Seminar on Transport Policies in the three South Caucasus States, Tbilisi, 18-19 April 2002

¹³ Archil Gegeshidze: Georgia’s Function as a Transit Country and Sustainable Development (this paper is a part of the National Assessment Report on Sustainable Development of Georgia. The Report was submitted to the World Summit on Sustainable Development and is accessible on the web: http://www.johannesburgsummit.org/html/prep_process/natlassessment.html)

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almost \$2 USD. By contrast, in Europe, 1 kilometer of road costs only half as much. Consequently, Turkish companies prefer to use the route through Iran to reach destinations in Azerbaijan and Central Asia. Although this route is 500 km longer, it is 3 times cheaper.

The survey undertaken by the research team of road transport sector representatives identified and ranked the main impediments to the development of both the road transport sector and road haulage industry, as the front-line operators perceive them. They were the following:

1. Custom duties and procedures
2. Illegal payments to customs officials
3. Corruption in the traffic police
4. Poor state of roads
5. Excessive bureaucracy of public officials
6. Personal safety

Official data on how much Georgia loses in transit freight traffic due to problems encountered by cargo haulers is officially “confidential” and therefore unavailable to the research team. However, the overall volume of transit freight traffic lost by the entire TRACECA Corridor is estimated to be nearly 15 million tons per annum¹⁴.

Meanwhile, roads in Georgia are in extremely poor condition and the country appears unable to provide even the minimum amount of maintenance for the road network. Road authorities focus on the maintenance and rehabilitation of international routes, while many intrastate and local roads are in a neglected condition for the time being.

The result is a hampering of the overall development of the TRACECA corridor, freight forwarding, and passenger transportation activities decreasing Georgia’s role as a transit country. Moreover, the lack of a developed and well-maintained road network considerably impedes sustainable national economic growth and social cohesion, and integration into the world market and political processes. It also causes discontent with neighboring countries dependent upon Georgia in securing steady import/ export freight transportation.

4.2 ROAD SECTOR OF GEORGIA

4.2.1 *Road statistics*

There are two types of roads in Georgia: public/general use roads and departmental roads. The latter are access roads to buildings and sites occupied by public or private organizations. Public roads are managed by responsible state bodies, and departmental roads are managed by their owners.

The total length of public roads amounts to 20,229 km, including 1,474 km of international roads (connecting Georgia with other countries), 3,326 km of intrastate roads (connecting major cities and regional centers of Georgia) and 15,429 km of local roads (see [Appendix 2](#)).

¹⁴ Archil Gegeshidze: Georgia’s Function as a Transit Country and Sustainable Development (this paper is a part of the National Assessment Report on Sustainable Development of Georgia. The Report was submitted to the World Summit on Sustainable Development and is accessible on the web: http://www.johannesburgsummit.org/html/prep_process/natlassessmentrep.html)

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The five main roads used for international transportation include:

1. Poti – Tbilisi - Red Bridge (located on the border with Azerbaijan) - a 400 km international road connecting the Black Sea ports of Batumi and Poti with the Caspian Sea ports of Baku and Astara. This road bears a significant portion of the traffic from Europe, Azerbaijan, Armenia, and the Central Asian countries, as well as Iran, and to a lesser extent Afghanistan. It is considered to be the main international road in Georgia.
2. Mtskheta – Kazbegi – Larsi (Russian border), also called Georgian Military Highway - a 139 km road, which is one of the two main communication routes between Georgia and Russia. It is also one of the main economic links between Russia and the other South Caucasus countries of Armenia and Azerbaijan. This is especially true of Armenia, which has to use the territory of Georgia for all its communications with Russia, its main economic and strategic partner.
3. Sarpi – Batumi – Ureki - Samtredia (located at the junction with the Poti – Tbilisi - Red Bridge thoroughfare) - a 127 km road connecting Georgia with Turkey. This road is used to transport freight from Sarpi (a settlement on the Georgian - Turkish border) and the port of Batumi to Samtredia to their destinations along the main international roads and routes.
4. Khashuri – Akhaltsikhe - Turkish border - a 98 km road that has become an important route for freight transportation from Turkey since a new frontier admission point opened in the village Galesi on the Turkish border. This road leads to the Khashuri junction with the Poti – Tbilisi – Red Bridge main thoroughfare.
5. Tbilisi – Marneuli – Guguti (Armenian border) – a 97 km long road connecting Georgia with Armenia, which bears the majority of the transit traffic to Armenia.

Road construction varies considerably throughout Georgia: 9,073 km of roads have asphalt concrete, concrete or other type of hard surface; 9,417 km of roads have tarmac and gravel surfacing, while the remaining 1,379 km are unpaved dirt roads. The international roads are mostly two-way roads. Dual carriageways exist only at the access to big cities to handle higher density traffic flows at these sections.

The road infrastructure of Georgia also includes 4,077 road bridges with a total length of 86,919 m, 23,944 drainage channels, over 10 km of tunnels, and over 3 km of snow retention walls. The road network covers 16 important mountain passes, nine of which are closed in winter, while the use of the remaining seven highly depends upon weather conditions.

4.2.2 *State Management of Public Roads*

Georgia has a special road administration, the State Department for Roads of Georgia (SDRG), which owns and manages on behalf of the state the international and intrastate roads in Georgia. Local municipalities manage local roads. While the SDRG reports to the Government and Parliament, it is solely accountable to the President.

SDRG is responsible for planning, financing and providing technical supervision and quality control of road works. SDRG, the body is responsible for selecting private contractors for all road works. The selection procedures are regulated by the “Law on State Procurement” and other legal acts. With several exceptions, these allow the road works to be outsourced based on competitive bidding.

Before 1996, the only source of financing for the road sector of Georgia was the Central Budget. In 1996, the State Road Fund (SRF) was established, to create road taxes for revenues. The SRF was

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designed to be a tax collection body within SDRG, accountable to SDRG management. There are eight road taxes. However, the lion's share of SRF revenue comes from the *tax on the use of public roads*. This is a turnover tax on enterprises, with tax rates varying according to the type of enterprise. In addition to SRF revenues, since 1996 SDRG has received a number of grants and long-term credits from foreign countries and international financial organizations.

By 2002, 80% of road maintenance and 100% of road construction enterprises were privatized. According to Chamber of Control records, in 1997 there were 103 road construction and maintenance enterprises under the jurisdiction of SDRG. Privatization started in 1998 based on World Bank recommendations and reached its peak in 2000 and 2001. In 2001, the remaining enterprises with 100% state ownership were transferred to the jurisdiction of the Ministry of State Property Management, which has since been reorganized into a department wholly within the Ministry of Economy, Industry and Trade.

According to SDRG, there are approximately 60 road construction and maintenance enterprises in Georgia. The rate of development of the road construction and maintenance industry, which started after the privatization, is very slow. Of all the privatized state road enterprises only a dozen have grown into competitive companies, which have increased their production basis, purchased modern equipment, and are now able to compete for large road construction and maintenance projects. The rest have experienced a decline in growth, mostly caused by the deterioration of equipment and facilities inherited from Soviet times, and a lack of resources to replace them. It must also be noted that despite the privatization of the road construction and maintenance industry, SDRG remains a major, and often the sole, purchaser of road works in Georgia.

4.2.3 Soviet Legacy

Notwithstanding the privatization and reorganization efforts, the road sector of Georgia has mostly remained unchanged since Soviet times, when the whole territory of Georgia was divided into dozens of zones with each zone assigned a road maintenance, construction and management unit responsible for its roads. The planning, financing, technical supervision and approval of road works were performed according to an annual plan by the state road administration. The latter was also responsible for equipping road maintenance, construction and management units, providing them with construction materials and providing oversight to guarantee responsible use of public resources. The zonal principle of road works distribution has remained in place up to date, particularly since funding allocated for road works is small and a competitive bidding process is not required to select a contractor¹⁵.

SDRG, which has changed from the Ministry of Highways and later the state concern *Sakavtogza* into the present structure, has not experienced any major changes either. There were several reorganization attempts, initiated at the advice of World Bank experts, which resulted in moving some subdivisions out of the SDRG structure and a restructuring of others. However, the foundation of the organization, including top and mid-level management¹⁶, key technical personnel, remnants of the boss-subordinate relationships between SDRG and the now private road enterprises, have remained very much the same. This includes as well its functions, such as policy-making, financing, and exercising control over the road sector.

¹⁵ The state procurement principles are described in detail under Section 10

¹⁶ The "Velvet Revolution" of November 2003 has brought personnel changes to SDRG, notably at the top management level

Corruption in the Road Sector of Georgia

4.2.4 *Cost of proper roads*

“Roads are an expensive pleasure” is a typical response of road sector representatives whenever the state of roads in Georgia is discussed. It should be mentioned that the cost of road works in Georgia varies significantly according to both road parameters and terrain. According to World Bank estimates (which are widely used as a reference value), the average cost of road works in Georgia is as follows:

| Type of road | Maintenance works | Periodical repairs | Rehabilitation | Reconstruction |
|--|-------------------|--------------------|----------------|----------------|
| | USD per km | USD per km | USD per km | USD per km |
| International roads | 1,300 | 11,000 | 130,000 | 250,000 |
| Intrastate asphalt roads | 1,000 | 9,000 | 100,000 | 200,000 |
| Intrastate tarmacadam and gravel roads | 350 | 3,150 | 35,000 | 75,000 |
| Local asphalt roads | 400 | 3,000 | 25,000 | - |
| Local gravel roads | 200 | 1,000 | 10,000 | - |

Source: Chamber of Control, “State Department for Roads and Lower Organizations Inspection Act”, October 30, 2002

According to SDRG officials, the cost of reconstruction and construction of new roads in mountainous areas of Georgia could amount to 5 million USD per km.

For 1998, the total cost of maintenance and routine repairs of the entire road network of Georgia was estimated by a World Bank consultant at 100 million USD¹⁷. This would have been sufficient to maintain a good level of quality had the roads undergone periodic maintenance and rehabilitation.

Unfortunately, the roads have not undergone regular, suitable maintenance and rehabilitation in the past ten years due to lack of financing. Many roads deteriorated beyond repair in the economically depressed years from 1992-1995. Despite the fact that the situation has improved somewhat since 1996, in 2002 70% of international roads, 80% of intrastate roads and 90% of local roads still required rehabilitation. The cost of rehabilitating the entire road network was estimated at \$566 million USD¹⁸ – an astronomical sum when compared to SRF revenues. In 2002, SRF revenues amounted to 43,913 million GEL, which is equivalent to approximately \$20 million USD).

To help improve the situation in the road sector a 15-year program of rehabilitation and modernization of Georgia’s road network was launched in 1996 by order of the President. The total projected cost of the program constituted 2 billion USD; however, during the first 5 years the program deficit amounted to almost 200 million USD.

4.2.5 *Corruption in the road sector of Georgia*

Corruption in the road sector of Georgia has long been widely discussed in the Georgian mass media. However, despite numerous articles and some TV broadcasts exposing corruption and embezzlement by road sector authorities it has so far failed to attract any serious attention from law enforcement and anti-corruption bodies. Although regular audits are conducted and some violations

¹⁷ Chamber of Control, “State Department for Roads and Lower Organizations Inspection Act”, October 30, 2002

¹⁸ Chamber of Control, “State Department for Roads and Lower Organizations Inspection Act”, October 30, 2002

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have been revealed by the Chamber of Control, the main auditing establishment in Georgia, the Anti-corruption Bureau, Parliamentary investigation committees, and the State Prosecutor's Office have so far demonstrated little interest in the findings of these audits and no major violations of law, or signs of corruption, have been uncovered. Interest groups, non-governmental organizations, and individuals exercise practically no oversight over the government's activities in the road sector.

At the same time, there is a widespread perception in society of corruption in the road sector. Under President Shevardnadze, SDRG management was believed to be biased in favor of the ruling political forces and SRF was often called an election "money box" for the president and his party, which may partially explain the "immunity" from public monitoring the road sector enjoyed¹⁹.

5 NATIONAL LEGISLATION

The development of national legislation has been a continuous process in Georgia since the country proclaimed independence in 1991. The changing circumstances in the country, with new political and economic challenges, account for a large number of changes, amendments, and supplements to adopted legislation. In addition, due to a large number of issues requiring legislative regulation, the adoption of laws or issuance of legal acts by the executive branch has tended to be reactionary, appearing to address specific problems arising in different areas of the country's economic, social and political life. The frequent changes in the legislation have caused many problems for governmental bodies, often making it difficult to pursue consistent policies and forcing changes in their initial plans.

5.1 LAWS AND LEGAL ACTS REGULATING THE ROAD SECTOR OF GEORGIA

A retrospective study of developments in the road sector and of the main problems haunting the road sector over the years was undertaken based on existing legal documents such as laws, decrees, orders, and resolutions issued by the legislative and executive branches of the government. A total of eight sector specific laws and 58 decrees, orders, and resolutions were studied, and many more reviewed, for the purposes of the research. All the legal documents used for this report date from 1992 to the present.

According to SDRG, the main laws and legal acts (including amendments) regulating the road sector are as follows:

6. The Constitution of Georgia
7. The General Administrative Code
8. The "Law on Civil Service"
9. The "Law on Motor Roads"
10. The "Law on Legal Entities of Public Law"
11. The Charter of the State Department for Roads of Georgia

¹⁹ After the change of government in November 2003, the former Head of SDRG has left the country to avoid possible prosecution on corruption charges

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12. Decree No. 48 (April 9, 1999) of the President of Georgia on the “Regulations on the compensation for the damage to a worker’s health incurred during the implementation of his/her duties”
13. The “Law on Road Fund”
14. The Tax Code
15. The “Law on Traffic Safety”
16. The “Law on Construction Activity”
17. The “Law on Entrepreneurial Activity”
18. The “Law on Auditing Activity”
19. The “Law on Grants”
20. The “Law on Privatization of the State Property”
21. The Customs Code
22. The “Law on State Procurement”
23. Order No. 50 (July 22, 2002) from the Head of the State Department for Roads of Georgia on the “Approval of the program for competitive evaluation of the public servants of the central apparatus of the State Department for Roads of Georgia and its lower organizations: the Road Fund office and the Road - Taxation Office”.

As several of the aforementioned Acts cover the whole spectrum of public and private organizations in Georgia, we concentrated our assessment on the legislation specific to the road sector. Detailed descriptions of the main laws and legal acts regulating the road sector are presented in [Appendix 3](#).

5.2 BREACHES OF LAWS AND REGULATIONS

The central research finding regarding the legislation regulating the road sector can be summarized, as “laws exist to be broken”. This is especially true with regard to legal acts issued by the executive branch. Indeed, judging by the recurrence of similar provisions in decrees, resolutions and orders, the impression is that laws and legal acts are perceived by state authorities as something desirable but not mandatory for implementation. Presented below are several examples of violations of the law regulating the road sector.

Articles 16 and 22 of the “Law on Motor Roads” prohibit laying communications, performing construction of new facilities or repairing existing ones, placing filling stations, trade or catering facilities, and installing commercial stands within the road right-of-way without a corresponding permit from SDRG. Also introduced by Decision No. 6/14/39 of May 11, 1996 of the State Commission on the Use and Protection of Land and by Order No. 9 of March 29, 1996 of the Ministry for Urbanization and Construction, were temporary norms for locating filling stations along the roads. All applications for the location of facilities within the road right-of-way are considered by SDRG. The permits are issued free of charge. According to the “Law on Motor Roads”, to comply with traffic safety requirements, permits for locating services within the road right-of-way are granted only for international and intrastate roads. Responsible regional and municipal bodies take the final decision on this matter. Decisions on the location of services along local roads are taken by corresponding local government and traffic police divisions.

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According to the Chamber of Control of Georgia, there are numerous cases of illegal construction along roads in violation of existing norms and regulations. SDRG does not perform a systematic audit and registration of facilities built without official permission. If it did so, it would assist in the early identification of illegal construction, thereby making it easier to take law enforcement measures to stop it. No comprehensive list has been developed of facilities illegally located in the right-of-way and creating hazardous traffic conditions. No notices have been sent by SDRG to law enforcement bodies on the illegally located facilities. No cases have been brought to the courts on such illegal facilities, not even on the ones presenting a serious hazard to traffic safety.

Standards for the location of filling stations along the roads state that filling stations must be located at distance of 18 to 25m from the road axis, according to road category. The minimum distance between consecutive filling stations located along one side of the road must be 2 km²⁰. Mere observation of filling stations along the roads in Georgia provides an indication of the lack of adherence to these standards: in the majority of cases, filling stations are right at the road edge, sometimes as close as 10 – 15 meters to each other.

The illegal location of facilities along the roads is believed to be a significant source of illegal income for local authorities, the police, and SDRG.

Article 19 of the “Law on Motor Roads” determines responsibilities of the road authorities with respect to road accidents. By law, the road authorities must reimburse damage suffered by road users in traffic accidents caused by the bad state of the road, if the cause of the accident was a failure of the road authorities to implement their duties. The compensation is paid based on court decision. Documents on traffic accidents caused by the bad state of the road must be filled out by the traffic police together with a representative of the road authority responsible for that section of the road²¹.

According to the information of the Main Department of Traffic Police of the Ministry of Internal Affairs, the number of road accidents caused by unsatisfactory road conditions is very small. For example, from 1996 to 2003, only two cases of this kind were registered and compensation for damage paid. However, as discovered by the research team, the reason for the small number of such cases is not their absence, but poor record keeping.

Identifying causes of road accidents and reporting them was much easier then as traffic police investigators had full authority to investigate road accidents and determine the main and associated causes. However, the situation has changed significantly since 1994 when the Law on Motor Roads was enacted. According to Article 19 of this law, reports on traffic accidents associated with the bad state of public roads must be prepared by the traffic police in the presence of a representative of the road authority controlling that particular section of the road. This provision has significantly complicated registration of the causes of traffic accidents and further proceedings on such cases. Whenever traffic police investigators determine that road conditions were the main or associated cause of the accident s/he needs a road authority representative to sign the report, otherwise the case cannot be submitted to the court and compensation paid to the damaged party. As SDRG does not have official representatives to attend traffic accidents all over the country, this function is often delegated to the road enterprise responsible for the maintenance of that particular section of the road. For certain reasons (bad communication, unavailability of required person, night hours, etc.) it is impossible in most cases to contact local road authority representatives to call them to the scene of the accident. The police cannot officially report that the poor road condition is the main or

²⁰ Chamber of Control of Georgia: “Act of October 30, 2002 of the inspection in the State Department for Roads of Georgia and its lower organizations”

²¹ Article 19, Responsibility of the Road Authorities, “Law on Motor Roads” of Georgia, November 1994

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associated cause of the traffic accident without the agreement of road authorities; hence, such cases are not reported.

According to the traffic police, the main reason for the increasing number of traffic accidents on the main roads of Georgia is the inadequacy of the roads to handle the increase in traffic volume. Moreover, modern cars are able to reach speeds too high for Georgian roads. It should be specially noted, however, that this concerns only main roads, as according to traffic police data, traffic accident rates on local roads are decreasing almost proportionally to the deterioration of roads.

The traffic police have developed a list of road sections with high traffic accident rates and elaborated preventive measures, including measures aimed at improving road conditions at these sections. However, according to SDRG, the latter cannot be accomplished due to the lack of financing. The lack of cooperation between the traffic police and SDRG on this matter, and poor recording of the traffic accidents caused by poor road conditions represent a significant shortcoming for the development of state policy on road construction and maintenance. In light of insufficient funding, accurate statistics must be among the main factors to be considered when developing annual plans for priority road repair.

Another area notorious for breaches of resolutions, orders, and decrees issued by the executive branch is collection of road taxes. Several legal acts have been issued since the establishment of SRF in 1995 aiming to regulate the activities of several governmental bodies, which by the nature of their duties and responsibilities participate in the collection of road taxes.

Under Resolution No. 674 of the Cabinet of Ministers on October 18, 1995, the State Tax Service was obliged to provide, annually, a list of enterprises registered in Georgia to the state concern *Sakavtogza*. In addition, the Social and Economic Information Committee was to provide quarterly data on the output of the enterprises for tax collection on the use of public roads. The Traffic Police Department was to provide data on vehicle ownership for the collection of vehicle ownership taxes.

On June 13, 1996, a follow-up order²² was issued by *Sakavtogza* and the State Tax Service. The order states that the provisions of Resolution 674 are not being fulfilled. Namely the local tax inspections do not provide SRF tax services with the data on the output of local enterprises, frequently no information is provided on large tax-dodgers, road taxes are often not considered during inspections of enterprises by tax inspectors, and revenues from road taxes get transferred to the central budget instead of SRF, etc. The lack of cooperation between the local tax inspections and SRF tax service is cited as the main reason for significant shortages in SRF revenues and corresponding improvement measures are proposed.

This order is reinforced by Presidential Order No. 388 of June 14, 1996, which states that the State Tax Inspection must provide *Sakavtogza* with adequate assistance in the collection of road taxes as set forward in the previous legal acts.

Presidential Order No. 17 of January 12, 1998 once again sets forward requirements to improve collection of road taxes and obliges tax inspectors to assist SRF in the collection of road taxes. The order provides for the Department for Statistics to provide SDRG with the information on the production volume of the enterprises located in Georgia on a quarterly basis and the list of enterprises operating in Georgia on an annual basis.

These provisions are not being fulfilled according to 2002 evidence from the Chamber of Control. SDRG officials confirm that they do not receive data from the Department for Statistics and have to

²² Order #69 of the State Tax Service and the State Concern "Sakavtogza", June 13, 1996

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use data provided by the Tax Department and the “Statistical Yearbook of Georgia” (annually issued by the Department for Statistics) to prepare forecasts of SRF revenues.

Joint Order No. 109-30 of June 22, 2000 by the Ministry of Tax Revenues and SDRG, states that a great proportion of SRF revenues should be from the excise tax on imported petrol and fees for the entrance and transit of vehicles. To better control the performance of customs officials in collecting road taxes, a special commission was established to coordinate and control effective tax collection, and special reporting forms were created.

However, as stated in Presidential Decree No. 483 of November 28, 2001, which almost completely repeats the measures for improvement of the collection of road taxes set forward in the previous orders and resolutions, neither Order No. 109-30 of June 22, 2000 nor the provisions of other orders have been implemented.

The functioning of governmental commissions is a specific issue to be addressed when speculating on the implementation of legislation. It is a common practice in Georgia to establish governmental commissions to resolve problems in different areas of economic and political life. The commissions are usually established by legal acts and made up of heads or deputies of different governmental bodies, the responsibilities of each member are precisely defined and the schedule and agenda of meetings are set. However, the performance of such commissions is generally very poor. Often, only the very first items on the agenda are fulfilled (while public and government’s attention is still high) and the remaining objectives and tasks are left unaddressed.

Thus, Presidential Order No. 388 of June 14, 1996 established a governmental commission to develop a presidential program on the rehabilitation and modernization of roads in Georgia, to define sources of financing for the program, and to lead government policy in this field. The commission was further ordered²³ to report annually to the government on detailed plans for program implementation for the coming year and the evaluation of the outcomes of the previous year, to attract foreign investment to the program and to perform strict control to ensure that the provisions of Presidential Order No. 388 are efficiently implemented. Of all the duties imposed on the commission only the text of the program was developed. The research team applied to the State Chancellery of Georgia to obtain annual reports prepared by the commission and the minutes of the meetings, but no information has been provided. The anecdotal evidence received from the respondents suggests that after the first joint effort, which resulted in submitting the text of the program to the President, the commission remained only on paper. Interestingly, this commission has undergone several changes in composition since its establishment, with the same people removed from the commission several times by different presidential orders.

Another similar example is the advisory council at SRF. The advisory council was established at SRF in 2000 to ensure efficiency and transparency in SRF operations, but has never performed its functions. The meetings of the advisory council take place once a year and some discussions are held, but, according to SDRG, SRF and the council members themselves, no real outcomes are produced. To quote one member: “The Council exists only on paper. I attended first meetings, but I am a very busy person and can’t afford wasting time at the meetings, where nothing is done.” According to a SDRG official, “the Council was intended to function similar to a Board of Directors in Western companies; however it has not done so yet. Council members meet once a year, discuss SRF problems and listen to our reports. The World Bank mission should develop recommendations on increasing the effectiveness of the Advisory Council, maybe then something will change”.

²³ Presidential Order No. 837 of December 25, 1996

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The Chamber of Control and the Parliamentary commission on motor roads have detected significant violations of Chapter XII of the Tax Code of Georgia including the non-collection of taxes on vehicles with excessive axle loads. This is usually explained by the lack of necessary equipment. However, the proper equipment was purchased back in 2002 under World Bank credit, but has not yet been installed due to institutional misunderstandings between SDRG and the Customs Department²⁴.

Numerous violations of the “Law on the State Procurement” have also been identified by official control and auditing authorities²⁵.

5.3 REASONS FOR NON-IMPLEMENTATION OF LAWS AND REGULATIONS

The apparent non-implementation of actions required by law and executive branch orders is attributable mainly to:

- the unfeasible nature of the measures set forward in the legal acts,
- frequent changes to the legislation,
- negligence in law-making,
- inconsistent allocation of funds,
- lack of cooperation between governmental agencies,
- The of a rule-of-law culture in Georgia.

One of the most vivid examples of the unfeasible nature of the measures set forward in legal acts is Order No. 855 of the Government of Georgia “On the measures to improve the construction, reconstruction, repairing and maintenance of the public roads” of August 25, 1992. The order contains a crucial requirement, for the Ministry of Finance of Georgia to annually assign, from the state budget, the amount required for the maintenance, and periodic repairs of the roads; and, to provide as much financing as possible for the construction and reconstruction of the roads. Let alone construction and reconstruction, the economic conditions in Georgia in 1992 would not have satisfactorily allowed for even the most elementary requirements of the road sector. No wonder that the Ministry of Finance did not meet the Government’s requirements and the road sector received irregular and insufficient transfers from the state budget until the establishment of the Road Fund in 1995.

Another example is the “Presidential Program for Rehabilitation and Modernization of Roads in Georgia”. Developed under Presidential Order No. 388 of June 14, 1996, the program was approved on December 25, 1996. The estimated cost of the program was approximately 2 billion USD and its proposed duration was 15 years²⁶. Even being spread over 15 years, the cost of the program, equal to approximately 4 times the annual budget of Georgia, was unrealistic from the start²⁷.

Continuing changes to legislation are taken as a matter-of-fact in Georgia, so no one is surprised when laws are amended or replaced by new ones, but many cannot help being annoyed. According

²⁴ For detailed information see Section 8

²⁵ For detailed information see Section 10

²⁶ Detailed description and analysis of the presidential program is provided in Section 6

²⁷ See also “The Civil Monitoring of State Expenditures” by Georgian Young Economists’ Association, Georgian Young Lawyers’ Association, and Transparency International – Georgia, November 2002. The document is accessible at <http://www.transparency.ge>

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to SDRG, the road sector, being a very specialized field, is not affected by frequent changes in legislation to the extent other sectors are. However, introduction of amendments to the Tax Code or re-assignment of SRF funds by orders of top political officials (usually the President of Georgia) to activities not envisaged in SDRG annual plans have a significant negative impact on the road sector. As shown in Section 8, changes to either tax rates or tax administration mechanisms may profoundly affect SRF revenues and ruin SDRG annual road works programs. Similar problems are caused by the unplanned assignments of SRF resources to finance unplanned road activities, such as the rehabilitation of road sections destroyed by natural disasters. Meanwhile, SDRG has contingency funds for such cases and there should be no need for special presidential orders on the reallocation of funds within SRF.

The distortion of SDRG annual work plans is not the only consequence of such orders. They contradict the “Law on State Procurement”, which states that the purchase of goods and services by public bodies has to be implemented based on approved annual plans. Moreover, frequent changes to the legislation and inconsistent re-allocation of funds by orders of high-ranking authorities make long-term planning and development of the road sector impossible. Even with its own revenues generating body, SDRG finds itself in a situation where it has to, constantly adjust its annual road works program due to external interference. According to anecdotal evidence, the unplanned allocation of funds is a significant source of corruption in the road sector, as procedural shortcomings make it difficult to control the utilization of such funds²⁸.

Frequent and continuous amendments to adopted laws and legal acts are caused by negligence in the law-making process. Important phrases and entire paragraphs are sometimes omitted from the body text, which cause significant problems afterwards and require new legal acts to fix the problems. A striking example of such negligence is the omission of a paragraph in the published version of the “Law on Road Fund” of Georgia. Thus, Statement No. 03-5/7 of May 14, 1996 of the State Tax Inspection of Georgia indicates that paragraph 5 of Article 4 was omitted from the “Law on Road Fund” in the quarterly publication *sagadasakhado matsne* (Tax News) and the collection *gadasakhadebi sakartveloshi* (Taxes in Georgia). The omitted paragraph deals with the tax on the use of public roads and states, “entrepreneurs engaged in activities other than listed above pay 1% turnover tax from performed works or provided services”. Reportedly, this omission caused a lot of misunderstanding among taxpayers, who refused to pay the tax referring to this “version” of the “Law on Road Fund”.

Lack of cooperation between governmental agencies is a common problem for the entire public sector of Georgia. However, for the road sector of Georgia, the lack of cooperation between SDRG and other governmental agencies in collection of road taxes has particularly adverse consequences. The most plausible explanations of the existing situation are as follows:

- Tax authorities were originally against the establishment of SRF as a separate tax body and this institutional animosity is in place even today;
- The Tax Department and the Customs Department, which are responsible for helping SRF in collection of road taxes, have their own annual tax collection plans set by the Ministry of Finance. There have been cases when these agencies used road taxes to fulfill their annual obligations before the Ministry of Finance and the central budget. SRF revenues that had been illegally transferred to the central budget were later returned to SDRG by court decisions. However, it caused distortion of SDRG annual plans and, hence, serious damage to the whole road sector;

²⁸ See Section 10 for details.

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- And unwillingness on the part of the tax and customs authorities to provide SRF tax services with relevant tax information may stem from attempts to avoid any, even unintentional, cross-checks of their tax collection performance by other agencies. The plausibility of this explanation has roots in the perceived exceptionally high level of corruption in the tax and customs bodies.

It is obvious that each governmental agency strives for achieving its own objectives (which are not always consistent with the overall objectives of the government) thus getting acknowledged by political circles/elite and the financial incentives.

It is common knowledge that laws are effective only when they are effectively enforced, which is not the case in Georgia. The low level of law enforcement makes the issuance of legal acts a waste of time and paper. This problem is now well recognized in Georgian society owing to the efforts of non-governmental organizations, foreign experts, and some public officials. Nevertheless, it is law making, and not law enforcement, that remains the main preoccupation of many governmental bodies. Part of the reason is corruption in law enforcement bodies, which use their authority for personal, and not public, benefit.

With respect to law making and the road sector of Georgia, SDRG and independent experts believe that many laws and regulations are out-of-date in many respects and require serious amendments and improvements. The main concerns lie with the “Law on Motor Roads” and the “Law on Road Fund”. SDRG is currently working on a new draft of the “Law on Motor Roads”, which they intend to present to Parliament in 2004.

6 1996 PRESIDENTIAL PROGRAM

6.1 PROGRAM CONTENT

In 1996 the underdevelopment and poor maintenance of the road system in Georgia became a real concern for the government. It realized that the poor state of roads, including the main international routes, hampered Georgia’s potential for economic growth and development as a transit country. The problem was especially urgent as the development of the transportation corridor through Georgia was expected to become a major source of revenue for the State budget. Moreover, the revenues of (State Road Fund) SRF, established in 1995 to provide financing for the road sector of Georgia, proved to be much lower than anticipated.

To address these issues, the President of Georgia issued Order No. 388 “On the measures for rehabilitation and development of the motor roads in Georgia” on June 14, 1996²⁹. In accordance with this order, the Presidential Program for Rehabilitation and Modernization of Roads in Georgia was developed by a specially established governmental commission and approved by Presidential Decree No. 837 on December 25, 1996. Implementation of the program was included in the list of the State Department of Roads of Georgia (SDRG) principal objectives, as stated in SDRG Charter of 1997.

The program was slated to begin in 1997 and continue until 2010. The scope of work was immense: the program was supposed to cover the rehabilitation of nearly the entire road system of Georgia,

²⁹ The content of Order #388 is given in Appendix 3 (p. 127)

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excluding local roads, as well as its partial modernization³⁰. The rehabilitation project was to be completed within five years, by the year 2001. The rest of the works were planned to be carried out incrementally over 14 years as shown in Table 1, [Appendix 4](#).

The total cost of the programme was estimated at 2,306.8 million GEL (approximately 2 billion USD at 1996 exchange rate), which breaks down as follows:

| Activity | Cost over 14 years (in 1996 GEL) |
|--|-------------------------------------|
| Rehabilitation of priority routes | 214 million |
| Modernization of priority routes | 1,100 million |
| Partial rehabilitation of remaining international and intrastate roads | 459 million |
| Maintenance of international and intrastate roads | 285.7 million |
| Scientific and technical advancement | 56.8 million |
| Design and survey works | 88.4 million |
| Purchase of fixed assets | 102.9 million |
| Total cost | 2,306.8 million |

Source: Presidential Program for Rehabilitation and Modernization of Motor Roads

The proposed financing scheme for the works under the Presidential Program is presented in Table 2, [Appendix 4](#).

The priority transport routes, which were determined based on their historical and present-day economic and strategic importance, are the five main international roads in Georgia:

24. Poti – Tbilisi – Red Bridge (located on the border with Azerbaijan). The condition of this road in 1996 was assessed as extremely poor, with a completely deteriorated road surface in some sections, a mostly destroyed infrastructure and an absence of necessary road services.

The program provided for the immediate rehabilitation of this route to accommodate increasing traffic and freight flows (up to 10-15 millions tons of international freight per year), and to meet necessary traffic safety standards. The estimated cost of rehabilitation works was 66 million GEL. The programme also envisaged modernization works to increase the carrying capacity of this road, which included reconstruction of some road sections and construction of access roads. The estimated cost of these modernization works was 567 million GEL.

25. Mtskheta – Kazbegi – Larsi (located on the border with Russia). The estimated cost of the rehabilitation of this road was 98.5 million GEL. The estimated cost of modernization was 73 million GEL.
26. Sarpi – Batumi – Ureki – Samtredia. The estimated cost of rehabilitation was 20 million GEL. The estimated cost of modernization was 224 million GEL.
27. Khashuri – Akhaltsikhe (located on the border with Turkey). The estimated cost of rehabilitation was 15.5 million GEL and the estimated cost of modernization was 109 million GEL.

³⁰ As defined in the program, rehabilitation means “repairing damaged roads and bringing them up to the international standards”, while modernization means “increasing the carrying capacity of roads” including, the reconstruction of some sections and construction of access roads.

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28. Tbilisi – Marneuli – Guguti (located on the Armenian border). The estimated cost of rehabilitation was 12 million GEL and the estimated cost of modernization was 127 million GEL.

6.2 PROGRAM IMPLEMENTATION

The program turned out to be a failure from the very first year of operation. In 1997, instead of the projected 55.7 million GEL only 33.4 million GEL was mobilized to the program, creating a deficit of 22.3 million GEL. In 1998, the mobilized resources increased slightly to reach 36.4 million GEL. However, they remained far behind the projected funding of 73.4 million GEL. The highest level of financing directed to the program was in 1999 (43.2 million GEL), which is explained by higher revenues of SRF in 1998. Since 1999 the funding of the program has remained at a relatively stable level of 32 – 36 million GEL per year. However, the annual program deficit grew from 84.2 million GEL in 2000 to 112.6 million GEL in 2002. The total funding of the Presidential Program for the first six years was projected at 615.3 million GEL, while actual funding has amounted to only 215.3 million GEL. This is 35% of the projected amount. The total deficit of the first six years amounts to approximately 400 million GEL. The figures on the financial implementation of the Presidential Program are presented in the table below:

| # | Year | Projected funding (million GEL) | Actual funding (million GEL) | Implementation (%) | Deficit (million GEL) |
|---|--------------|------------------------------------|---------------------------------|-----------------------|--------------------------|
| 1 | 1997 | 55.7 | 33.4 | 60 | 22.3 |
| 2 | 1998 | 73.4 | 36.4 | 49.6 | 23.8 |
| 3 | 1999 | 90.4 | 43.2 | 47.8 | 47.2 |
| 4 | 2000 | 116.2 | 32.0 | 27.5 | 84.2 |
| 5 | 2001 | 132.7 | 36.0 | 28.8 | 96.7 |
| 6 | 2002 | 146.9 | 34.3 | 23.3 | 112.6 |
| | Total | 615.3 | 215.3 | 35.0 | 400.0 |

Source: State Department for Roads of Georgia; Reference for the Chamber of Control of Georgia

As stated above, the program envisaged the rehabilitation and partial modernization of the priority routes in the first five years of program implementation. However, no modernization works have been conducted in Georgia since independence, and of the five priority routes only the Poti – Tbilisi – Red Bridge route has received any significant attention in the past six years. The majority of rehabilitation works on this route have been done through the credits received from the World Bank and the Kuwait Fund. Some rehabilitation and maintenance works have been conducted on other routes too, with maintenance and periodic repairs prevailing. However, the overall volume of actual works does not even come close to the amount projected under the program.

The main reason behind the lack of implementation of the Presidential Program was the fact that it was essentially impractical. As shown in Table 2 ([Appendix 4](#)), the entire scheme was built upon the projected increase in the amount of funding from three main sources: SRF revenues, the central budget, and external credits and direct investments.

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The projected increase in SRF revenues was expected to come mainly from the expected increase in revenues from the tax on the use of motor roads, vehicle ownership taxes, and fees for entering the territory of Georgia. The tax on the use of motor roads is paid by enterprises operating on the territory of Georgia. Hence, the projected increase in the revenues from this tax in future years was to come from the expected increase in the number and output of private enterprises along with the economic development of the country.

The projected increase in revenues from the vehicle ownership tax was based on the estimate that the number of vehicles in Georgia in 1996 was significantly below actual consumer demand, and therefore would naturally increase. Finally, the increase in fees for entering and transiting through Georgia was primarily expected from the development of the TRACECA corridor. A result of this was to be higher volumes of transit traffic to Georgia. However, what resulted was actually a vicious circle. The Georgian section of TRACECA needed repairs and upgrades to attract transit cargo carriers, but at the same time required more transit traffic to be able to finance the repair and upgrades in the first place.

Moreover, at the time the program was launched, SRF was still a young bureaucracy and inexperienced in collecting road taxes. Therefore, SRF revenue forecasts relied largely upon expected improvements in its ability to collect taxes and cooperate with other tax agencies, namely the Tax Department and the Customs Department.

The second source of funding that the program heavily relied upon was appropriations from the central budget. These were to increase proportionally to the forecasted increase in the central budget funds. Increases in the latter were expected to come from the economic development of the country and the improvement in tax collection, as well as from the contraction of the shadow economy in the country's GDP.

The third major source, credits and investments through debt financing, was to be built upon the accomplishments of the previous points. At that time, the Government of Georgia was demonstrating its strong commitment to increasing Georgia's attractiveness to foreign investors. Simultaneously, economic stability and growth were expected to raise Georgia's credibility in the eyes of international financial organizations.

Unfortunately, none of the above forecasts were realized to any significant extent. SRF revenues did not increase in real terms and experienced a sharp decline in 2000. This was caused by the economic crisis in Russia of 1998, from which Georgia still has not completely recovered. Tax collection has even deteriorated, mainly due to the frequent changes in the legislation, continuing non-cooperation among the responsible agencies, and corruption in the tax collection and law enforcement departments. Constant non-implementation of the state budget has led to SDRG receiving only occasional allocations to help in restoration of roads either in the aftermath of natural disasters or if repairs are especially urgent.

The development of the TRACECA corridor is going much slower than expected. Georgia has not managed to attract large volumes of transit traffic, which is due to the poor state of the country's roads. Although several credits and grants were obtained from international organizations and donor states, the funding was far below the needs of the program. Both the government commission established to exercise control over program implementation, and other governmental bodies listed in Presidential Order No. 388 that laid a foundation for the program, have never functioned well throughout their existence.

Thus the failure of the Presidential Program is apparent. The enthusiasm of 1996 has long disappeared and SDRG officials only express disappointment when asked about the program implementation. However, similar to many other failed governmental programs in Georgia, the

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Presidential Program still remains in place and is often used to justify overall poor performance of the road sector. The program set unattainable goals and now responsibility for not achieving even smaller and more feasible objectives is often attributed to the general set of circumstances and conditions that were originally held as necessary for the implementation of the Presidential Program.

Overall, the Presidential Program for Rehabilitation and Modernization of Roads in Georgia provides another example of how decisions made at the highest levels are in reality often difficult to implement, despite being touted as priority items and involving high-ranking government officials.

7 STATE MANAGEMENT OF THE ROAD SECTOR

7.1 STATE DEPARTMENT FOR ROADS OF GEORGIA

Since the collapse of the Soviet Union, the state management structure in the road sector of Georgia has undergone a number of changes. In 1992, the state enterprise *Sakavtogza* was established by the Cabinet of Ministers of Georgia³¹. *Sakavtogza* was only engaged in economic activity and had no political or administrative functions. The Government of Georgia performed the administration of the road sector. In 1995, by the “Law on the Structure and Activities of the Executive Power” of Georgia³², *Sakavtogza* was given an administrative power and became the state concern *Sakavtogza*. Consequently, in 1997³³ *Sakavtogza* was reorganized into the State Department for Roads of Georgia.

The State Department for Roads of Georgia is an agency of the executive branch responsible for the management and regulation of the road sector of Georgia. SDRG also has enforcement functions in areas defined by State legislation. SDRG is accountable directly to the President of Georgia. In order to duly implement its functions, SDRG has to work closely with other governmental bodies, including the Ministry of Finance, Tax Department, Customs Department, Ministry of Internal Affairs, State Department for Statistics and the State Procurement Agency.

The organizational structure of SDRG is based on the “one-man management” principle. SDRG performs its functions through the following bodies:

- SDRG central apparatus;
- Lower organizations of Road Fund Office and Road-Taxation Office, which are the two constituent parts of the State Road Fund;
- Subordinate organizations, including the Department for Roads of the Autonomous Republic of Abkhazia, Department for Roads of the Autonomous Republic of Adjara, Communication and Information Office, and Expertise Office.

Further information on the SDRG structure, the responsibilities of subordinate departments and organizations, objectives, functions, rights and obligations is provided in [Appendix 5](#).

SDRG management consists of the Head of the Department and deputies, who are responsible for the overall management and supervision of SDRG apparatus and its subordinate organizations. According to SDRG, the central apparatus has 55 employees, the Road Taxation Office has 160

³¹ Order No. 681 of the Cabinet of Ministers of the Republic of Georgia, June 26, 1992

³² “Law on the Structure and Activities of the Executive Power” of Georgia, December 13, 1995

³³ “Law on the Structure and Activities of the Executive Power” of Georgia, April 15, 1997

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employees working mainly in the regions of Georgia, and the Road Fund Office has 187 full-time employees and 13 people working on a temporary contract basis. The majority of SDRG employees have been working there since Soviet times. Despite some reduction in employees during the process of reorganization, SDRG has retained its core technical and administrative personnel. Since turnover is practically non-existent, only 5 new employees were hired during the past few years to replace retirees. According to SDRG, the selection of new personnel takes place on a competitive basis in accordance with the “Law on Public Service”.

SDRG is concerned about conducting further training and upgrading of skills for its personnel. Such trainings are provided under World Bank and Kuwait Fund programs and by other governmental bodies. Occasionally, SDRG employees (mostly high-ranking officials) have the opportunity to undergo training courses abroad paid for by SDRG.

According to SDRG, the average salary in SDRG is 40 GEL (roughly 20 USD) per month for an ordinary employee and 90 GEL (roughly 45 USD) per month for a head of division. The situation is similar in the Road Fund Office and the Road Taxation Office. To compensate for such low wages³⁴, an incentive scheme has been developed based on the provisions of SDRG Charter, Order No. 7 of the State Department for Roads of Georgia, and Article 270 of the Tax Code of Georgia³⁵.

The amount of funds for the SDRG incentive scheme is determined by the SDRG Economic and Financial Affairs Office each month on the basis of the estimated fulfillment of monthly tax collection plans by the Road Fund Office and the Road Taxation Office. These calculations are submitted to SDRG management and the Treasury Department of the Ministry of Finance for approval.

The SDRG central apparatus receives 35% of the stimulation fund, while the remaining 65% is divided proportionally between the Road Fund Office and the Road Taxation Office. 80% of the central apparatus's share of the incentive fund is used for employee bonuses, and 20% is used for SDRG logistical support. The Chamber of Control data show that in 2001 the total SDRG annual incentive scheme amounted to 592 thousand GEL, of which 229.6 thousand GEL were transferred to the central apparatus, 279.8 thousand GEL to the Road Fund Office and 82.6 thousand GEL to the Road Taxation Office³⁶. According to SDRG, the incentive scheme raises the average salary of SDRG employees by 50% or more, while the employees of the tax collection units reportedly receive bonuses equal to 5-6 times the size of their salaries.

7.2 IMPLEMENTATION OF FUNCTIONS AND RESPONSIBILITIES

SDRG has so far failed to implement many of its core functions and responsibilities as assigned by the Government of Georgia and stated in the SDRG Charter. SDRG was established to implement regulatory functions, and develop and execute governmental policy in the road sector. This includes developing and managing the implementation of long-term governmental programs, performing a comprehensive analysis of the financial situation in the road sector, forecasting the main trends, finding solutions for urgent problems, and strengthening infrastructure capacity.

³⁴ The average subsistence level in Georgia in 2003 was estimated at 117.3 GEL (≈58 USD) by the State Department for Statistics.

³⁵ According to Article 270 of the Tax Code of Georgia, tax bodies have the right to create a financial stimulation and logistical support fund. The contributions to the fund depend on the fulfillment level of annual tax collection plans. Thus, if the plans are fulfilled up to 70% - 80%, the fund will receive 3% of the amount exceeding the 70% level; in case of 80 - 90% fulfillment – 5% of the amount exceeding the 80% level; 90 – 100% fulfillment – 10% of the amount exceeding the 90% level; and in case of 100% fulfillment – 15% of the amount exceeding the 100% level.

³⁶ The Chamber of Control indicates that incentive funds were only partially used for employees' bonuses, and certain amount remained on the accounts of SDRG, Road Fund and Road Taxation Offices. However, no information is provided on how the remaining sums were spent.

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The only long-term governmental program in the road sector has been the Presidential Program for the Rehabilitation and Modernization of Roads. The mere fact that after six years of non-implementation of the program SDRG has failed to publicly acknowledge that it is impractical, identify the reasons behind the failures and make adjustments, raises doubts as to SDRG's ability to perform its duties.

An additional duty the SDRG has failed to implement is a regular update on the status of the road sector. SDRG also has not provided other governmental bodies with reports, calculations, and statistical data on a timely basis and in the prescribed format. For example, SDRG has repeatedly failed to present reports to the State Procurement Agency (SPA) and the Department for Statistics. This is viewed by these agencies as a major impediment in processing and analyzing data on the performance of the public sector and on the overall economic situation in the country. In addition, the delay of reports on tender procedures and contracts from SDRG prevents SPA from taking action on violations of state procurement procedures in a timely manner. Furthermore it hampers the preparation of reports on government purchases.

SDRG is responsible for establishing close cooperation with other governmental agencies at all levels. Although SDRG has attempted to cooperate with some governmental bodies through the issuance of joint orders and regulations, the results have not been impressive. The long term lack of cooperation between SDRG, the Tax Department and the Customs Department has caused serious tax collection problems. It has on occasion even involved the courts in resolving misunderstandings between these bodies. Moreover, occasional friction between SDRG and the Ministry of Finance, SPA, the Traffic Police Department, Tbilisi Municipality and others, further hampers the development of the road sector. Complicated relationships between SDRG, the Ministry of Transport and Communications, and the Road Transport Administration have had a very negative impact on the development of Georgia as a transit country. A survey of transport sector representatives revealed that the Ministry of Transport and Communications, the Road Transport Administration, large freight-haulage companies, and transport NGOs are all consulted when annual work plans are developed by SDRG and priority road sections are determined for rehabilitation and maintenance works.

Taking into consideration the distressing road accident statistics³⁷, SDRG's failure to establish productive cooperation with the Traffic Police Department to ensure traffic safety is especially inexcusable. Although road conditions are rarely named as the main cause of traffic accidents, the traffic police frequently identify this as a contributing factor, which makes cooperation between the road authorities and the traffic police all the more important.

Moreover, very little has been done so far to establish collaboration in the field of road network development with other interested countries. Thus, close cooperation with the neighboring countries of Armenia, Azerbaijan and Russia would be very important. This is especially clear when considering that non-implementation of the agreements on road network rehabilitation by Georgian authorities has caused discontent among Georgia's neighbors, notably Armenia. To SDRG's credit, it must be mentioned that it managed to obtain several grants and credits from international donor organizations and foreign countries for the rehabilitation of roads in Georgia. However, investment attraction opportunities have yet to be explored.

Another function SDRG has still not implemented is the creation of a database on the road sector. SDRG officials recognize the necessity of this, and attribute its absence to a lack of resources. The computerization of SDRG started several years ago, and though there have been some achievements

³⁷ In 2002, there were 2011 traffic accidents registered in Georgia, in which 515 people were killed and 2509 people injured. ("Georgia – Statistical Review 2002", State Department for Statistics of Georgia).

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in this field, such as the computerization of the Road Fund Office, a large portion of the data still exist only in hardcopies. This seriously complicates management, analysis and distribution of information. Under-utilization of information technology by SDRG has caused serious communication problems between the head office and representatives, such as tax collectors and road works supervisors, in the provinces.

Finally and most importantly, SDRG has failed to achieve a decent level of quality control in road works, and has not introduced fair competitive bidding for road contracts in Georgia³⁸.

7.3 SDRG ORGANIZATION ISSUES AND STATE ROAD FUND OF GEORGIA

The existence of the State Road Fund (SRF) has been an issue under discussion since its establishment in 1995. The main concerns regarding SRF are the following:

- Is there a need in Georgia for the State Road Fund and road taxes earmarked to finance the road sector?
- Should SRF have been given the authority to collect road taxes?
- Should SRF be a part of SDRG structure?

In 1995, the International Monetary Fund presented a memo³⁹ on the tax policy in the state budget of 1996 and the draft Tax Code to the Cabinet of Ministers of Georgia. One section of the memo is devoted to the State Road Fund (SRF) of Georgia and addresses the aforementioned issues. The IMF believes that the earmarking of taxes can only be justified if the taxes are closely tied to the utilization of the collected revenues. Taxes specifically earmarked for one project give taxpayers an opportunity to compare the amount they pay in taxes with the received benefits. For example, many countries use a petrol tax to finance construction and maintenance of roads, which is more acceptable to the public since it is known beforehand how their tax money will be spent. In contrast, Georgian road taxes, which are a turnover tax on enterprises, are not always funneled back into programs benefiting public roads.

However, the IMF believes that the earmarking of taxes reduces the flexibility of the state budget and can prevent the efficient distribution of the revenues among competing targets. The demand for budgetary funds must be met by means of open distribution within the state budget. Consequently, designated taxes should be a part of the budget and not part of an extra-budgetary fund. In addition, according to the IMF, tax-collection functions of the SRF complicate the overall collection of taxes in Georgia. The SRF duplicates the functions of the Tax Department and, consequently, taxpayers have to deal with more than one tax-collecting body. The IMF recommended abolishing the existing road taxes and increasing the excise tax on petrol and diesel. This would raise more funds for the construction and maintenance of roads.

Similar recommendations were made by a World Bank consultant in 1998⁴⁰ in the final report on “Transport Rehabilitation Project”. It was proposed to abolish the tax on the use of public roads, modify the SRF and transfer it to the Ministry of Finance. Another alternative would be to develop a new independent off-budget entity that would be acceptable to the IMF, while reflecting the specific conditions in Georgia. To compensate for the abolishment of the turnover road tax on enterprises it was suggested to introduce an additional tax on fuel.

³⁸ See Section 10

³⁹ Georgia: Tax Policy in the Budget of 1996 and the Development of the Draft Tax Code, IMF, September 27, 1995

⁴⁰ Appendix 4: Financing Construction and Maintenance of Roads in Georgia – State Road Fund and Associated Laws; Final Report; Transport Rehabilitation Project; April 1998

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The proposed modification of SRF was to include the consolidation of its offices, outsourcing the collection of some taxes to other bodies (e.g. customs department, vehicle examination services) and the retention of enough personnel to collect the fuel tax. This would allow the increased productivity of the SRF staff by a factor of seven. Research revealed that public opinion on the status of SRF and road taxes vary significantly in Georgia. The majority of respondents recognize that SRF has had some positive effect on the road sector as compared to the situation in the early 1990s. However, its effect has been much smaller than anticipated.

Transport enterprises, which are the most heavily taxed businesses under the “Law on Road Fund”, demonstrate the most unfavorable attitude towards SRF. Transport enterprises pay 2% turnover tax, entrance and transit fees, vehicle ownership tax, and, indirectly, excise tax on imported petrol (see [Appendix 6](#) for detailed description of road taxes). At the same time, they suffer the most from the poor state of the roads. For example, according to estimates of one road haulage company in Georgia, they pay around 30,000 USD per year in road taxes. They would find this acceptable if they did not have to spend an additional 40,000 USD per year to repair damage to their equipment due to the poor state of the roads.

Transportation sector representatives generally believe that the SRF should be removed from State Department of Roads of Georgia (SDRG). They feel that whether road taxes are transferred to the central budget or collected in an independent off-budget fund, there would be more transparency and better control over road tax revenues and their utilization. They maintain that there would also be better chances for transport sector concerns and recommendations to be taken into consideration when preparing annual plans for road works.

The existence of high road taxes despite poor quality roads and a lack of confidence in appropriate expenditure of SRF funds by SDRG management accounts for the negative public attitude towards SRF’s status and road taxes. Private manufacturers, obliged to pay a 1% turnover tax, find it difficult to understand why they have to pay this tax, since road use is not always closely tied to their business operations. These complaints precisely reflect what the IMF advised the Georgian government back in 1995: if earmarked taxes are not associated with gained benefits, public opinion will be against them and incentives for tax evasion and illegal economic activity will increase.

This view is strongly contested by road construction and maintenance firms. Since these enterprises depend entirely on SDRG for road works contracts, SDRG’s control over SRF is the only guarantee that tax money will not be spent on general budget items unrelated to infrastructure.

Control over SRF remains a hot political topic. The review of literature and interviews conducted during our research reveal that many politicians, public officials and economists believe that the collection of taxes should be performed by a single tax body, namely the Tax Department. This would make it easier to exercise control over tax revenues in general and road tax revenues in particular. At the present, SRF revenues are recorded and reported to the government by SDRG. However, the possibility exists that the SDRG may be tempted to understate SRF revenues. The Chamber of Control, the main auditing body of Georgia, audits both the SDRG and SRF. However, the quality of these audits is not held in high esteem, and thus there is widespread support for more transparency in the management of the SRF.

Another concern is the concentration of planning, tax collection and spending functions within one organization. At the moment, SDRG forecasts SRF revenues and plans road works accordingly. It controls the collection of taxes by SRF units, spends SRF funds, and reports on both SRF revenues and its own expenditures. The arguments put forward by SDRG to justify the existing system include the present low rate of tax collection in the country, routine non-implementation of central

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budget items, and a high level of corruption in the tax-collecting bodies. SDRG likes to remind its opponents that before SRF, the road sector entirely depended on the central budget, which itself could not satisfy the fiscal needs of the country. The accumulation of road tax revenues in the Road Fund allowed the mobilization of at least some resources for the road sector. Furthermore, the SRF is the only tax-collection body in the country that regularly fulfills its tax collection quota. However, with regard to the latter point, it should be mentioned that fairly or not, the SRF tax collection quota is set by the SDRG. No other tax collection body in Georgia has the authority to set its own collection quota amounts.

Another reason for SDRG's resistance to the removal of SRF from its control is that this would not allow members of its bureaucracy to receive supplemental income. As explained previously, the existence of a tax-collection apparatus within its structure makes SDRG entitled to incentive schemes for tax-collection agencies. Thus SDRG is able to accumulate a large amount of funds through the financial incentive scheme.

Most of the interviewed SDRG and SRF officials recognize the frustration of road users with SDRG's performance and its monopoly over SRF funds. However, they believe that for the time being there is no viable alternative. Officials agree that in the future SRF should be removed from SDRG control and either operate as an independent body or have its functions transferred to the Tax Department. However, what criteria should be met in order for this to occur is unclear.

7.4 CORRUPTION AND TRANSPARENCY IN THE ROAD SECTOR OF GEORGIA

The arguments surrounding the State Road Fund's (SRF) status and SDRG's control over this body are fueled by a widespread perception of systemic corruption. According to the World Bank corruption survey of Georgia⁴¹, tax-collection bodies are perceived to be among the most corrupt public agencies. SRF has not escaped this negative perception. The primary difference between the SRF tax service and the Tax Department is that the former has no authority to check the reliability of financial statements of enterprises and has to rely on the data provided by the Tax Department. Corruption in the taxation authorities is believed to have a pyramid structure, beginning with tax inspectors at the base and extending up to the highest levels. It has been proven that bribery of tax inspectors has been common practice. Tax evasion in such cases is not reported and no punitive actions are taken.

According to the Chamber of Control and journalist investigations, there has not been widespread prosecution of those who have not paid the road tax. In fact, a number of large enterprises have significant tax debts. But since the majority of large tax-debtors are state-owned enterprises, the tax debts are either restructured or their payment is postponed by presidential orders and agreements with the Ministry of Finance.

The closed nature of SDRG's operations only serves to further widespread perception of corruption in the road sector. SDRG is responsible for planning SRF revenues and its own expenditures based on performance indicators of previous years. The Ministry of Finance must approve the annual plans. However, the road sector is financed from an off-budget fund and SDRG enjoys higher discretion in this matter than other budgetary organizations. SRF is responsible for fulfilling annual revenue plans. SDRG exercises absolute control over the accumulation of tax revenues in SRF and has discretionary decision-making power over expenditure items.

⁴¹ Corruption in Georgia: Survey Evidence, World Bank, June 2000

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Based on this scenario, many politicians, public officials, journalists and taxpayers call into question SRF's claims of maximum efficiency in the collection of road taxes. They either suspect that annual plans underestimate the actual capacity of the existing tax base or that not all revenues are officially reported. This is a well-known corruption scheme. Revenue mobilization targets are set at lower levels than anticipated. At the end of the year when revenue targets are met, the tax-collection body receives pay bonuses according to the incentive plan. In addition, the difference between the planned and collected revenues is misappropriated. The state body authorized to conduct an audit of SRF and SDRG finances is the Chamber of Control of Georgia. However, its audit reports mainly focus on SDRG expenditures and the variations in the volume of tax revenues. They do not evaluate the revenue-generating capacity of the existing tax base as compared with actual SRF revenues.

It is in SDRG's interest to have SRF removed from its jurisdiction. SDRG would then not be responsible for SRF's performance and could set higher tax revenue targets for SRF. It could also demand more efficient service and require strict punitive measures against tax evaders and SRF officials failing to meet tax revenue targets. Therefore, by having discretionary power over SRF funds, SDRG is not able to pursue the public interest.

The strong perception of corruption in SDRG also stems from the relationship between SDRG and road enterprises, which has changed little since Soviet times. An additional factor is the role that favoritism plays in how SDRG contracts out road works. In Soviet times, the road sector developed as a very specialized area with a limited number of enterprises engaged in road works under the control of the state road administration. Every year these enterprises would receive fixed work plans and payment from the state road administration. In emergencies additional financing was solicited from the central budget. There was no competition and all the enterprises were accountable to the state road administration, which in turn had to ensure responsible spending of state funds by those enterprises. The turnover of employees was extremely low. These factors led to very close professional and personal relations between road enterprises and the state road administration. Overall, this system could be described clannish in nature, with very few outsiders admitted to it over the years.

Reports on corruption in the post-communist countries often describe Soviet legacy as the main cause of continuing corruption despite proclaimed adherence to the principles of democracy and a market economy. This has proven to be true with respect to the road sector of Georgia. The majority of interviewed representatives from the road sector, including some SDRG officials, admit that corruption flourished in this sector during Soviet times. Stealing state property (e.g. construction materials) and selling it on the spot, embezzlement of state funds and bribery of supervisory officials was commonplace. The only explanation for the relatively good quality of Georgian roads was the abundance of centrally provided funds. According to SDRG officials, in Soviet times the road sector received about 200 million rubles per year, which is very close to current estimates of the 100 million USD⁴² required for annual maintenance of public roads

Although generous Soviet funding is no longer available the relationships remained, as did the principles and methods of doing business. Privatization of the road enterprises as conducted under World Bank recommendations has not created a competitive market in the road sector. Although there was both consolidation and some elimination of firms in the road sector, the majority remained small Soviet-style road enterprises. These have constantly struggled for survival. In addition, no new road enterprises have been able to enter the market. This can be explained by the fact that SDRG remains the main client for road works in Georgia and has discretionary power

⁴² Chamber of Control, "State Department for Roads and Lower Organizations Inspection Act", October 30, 2002

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through sole-source procurement. It also has a decisive role via open and restricted tenders in selecting contractors for road works.

There is a deeply rooted belief in society and governmental and political circles that personal relationships between SDRG and various road enterprises strongly influence the selection of contractors. This belief is partially supported by the fact that no new construction firm which was not part of the road sector in Soviet times has ever received a contract. Surveyed respondents claim that it is impossible for a new company to enter the road construction market unless they pay officials more than SDRG's favorite firms do. These large kick-backs make it unprofitable for these companies to operate. Hence, very few independent enterprises participate in SDRG tenders.

The "Law on State Procurement" created fertile ground for the development of kick-backs. The definition of this is where a successful contractor pays a certain share of the contract value back to the authorities responsible for the contract award. Apart from kick-backs in open and restricted tenders, SDRG has used another procurement method, called sole-source procurement, to maintain this corrupt system. This makes it difficult to control SDRG expenditures.

Under the "Law on State Procurement", small contracts are awarded without competitive bidding to enterprises located near the planned road works. Such contracts account for the majority of road works. The usual practice is to sign a contract for maintenance work with a road enterprise without specifying the volume of work entailed in the contract. The implication is that the company should ensure efficient spending and provide for the best possible maintenance within the available resources. In reality, the lack of specification on the type and volume of work to be undertaken makes it impossible to control the company's performance. This allows enterprises divert the received financing for personal gain. Therefore, many non-competitive enterprises with obsolete equipment and insufficient resources are artificially kept in business by SDRG. As a result, the quality of roads decreases.

Because there is no external quality control, these companies usually get away with defects and poor maintenance of roads. Due to the lack of collaboration between governmental bodies, it is very difficult track payments between SDRG and its contractors. This facilitates almost risk-free embezzlement of state funds by SDRG officials. It is likely that the maximum allowed payment for small contracts is actually not sufficient with what is required to properly maintain roads, but this is difficult to say since such a study has never been conducted.

Thus, SDRG policy on the distribution of road works contracts encourages corruption on the part of road enterprises hoping to secure state contracts. Firms are forced to compensating themselves for the cost of kickbacks by reducing the quality of the work performed. The widespread perception of the high level of corruption in SDRG and the road sector is fueled by the lack of transparency in SDRG, including the lack of published information on SRF and SDRG activities and difficulties in obtaining public information from SDRG.

Article 2 of the "Law on Road Fund" obliges SDRG to publish annual plans for the utilization of SRF resources and report through the press on actual expenditures. Moreover, according to World Bank recommendations, SDRG should pursue a well-planned public relations strategy. This should include monthly press releases and articles on the problems in the road sector of Georgia, SDRG activities, revenues and expenditures, and gains and losses. The purpose of such publications is to attract public attention to road sector problems. Very little of the above has been done by SDRG.

A report on SDRG expenditures was published once. Press releases are issued only on an occasion basis to outline major events in the road sector, or more frequently in response to the sharp criticism against SDRG. However, there are no signs of a consistent public relations policy. The information on SDRG and the road sector that appears in the mass media is mostly negative and contains either

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criticism of the bad roads in Georgia or “exposures” of corrupt practices in the road sector. Unfortunately, information provided in such publications is often unsubstantiated and can easily be refuted by knowledgeable people. This benefits SDRG and distracts public attention from the problems in the road sector of Georgia.

The law on the freedom of information⁴³ provides for the openness, accessibility and availability of public information⁴⁴ to all interested parties. The relevant authority must respond to a request for public information within ten days. Moreover, Article 36 of the Administrative Code of Georgia provides for each public body to appoint a person responsible for the provision of public information. According to the author’s experience, SDRG’s compliance with these standards is mixed.

Initially, the author had to wait for more than a month and make dozens of phone calls to different offices within SDRG to get the requested information. Moreover, SDRG went beyond their authority in asking how the requested information was to be used. However, subsequent attempts by the author to receive information and interview SDRG officials were not difficult. Reportedly, other organizations and journalists have more difficulties in acquiring public information from SDRG. On a positive note, it is clear that the vigilant monitoring by Georgian and foreign NGOs of government adherence to the law on the freedom of information is having a positive effect and enhancing the transparency of their activities.

Profound public mistrust towards SDRG is a result of scant publicity of SDRG and SRF activities, their achievements and problems they face, as well as the difficulty in obtaining information. Comments made during interviews reflect general public opinion on this matter:

- “SRF has not yet demonstrated good performance, which causes significant resistance among tax-payers to pay road taxes”,
- “If SRF made the first step and demonstrated that the tax money is not wasted or spent improperly, taxpayers would be more willing to pay road taxes”,
- “The problem with SDRG and SRF is that very few improvements can be seen on most of the roads”,
- “The structure is extremely non-transparent, there is no information on SRF revenues and SDRG expenses, that is why all the judgments about their performance are made on the basis of observations, which make them much less favorable than they could have been had the system been more transparent”.

According to Minister of Finance Zurab Nogaideli, “SDRG expenditures must be more transparent; more precise statements should be made on what will be done and when, so after a certain period of time the results could be made known to the public”⁴⁵.

Another area of concern is the complete exclusion of the transport sector from policymaking, planning and decision-making processes in the road sector. Reportedly, there is no working relationship between the Road Transport Administration and SDRG. Transport sector representatives believe that the reluctance to cooperate comes from SDRG management. SDRG officials counter that there is no law obliging them to hold consultations with transport sector officials on matters concerning roads in Georgia.

⁴³ Administrative Code of Georgia, Chapter 3 as of June 25, 1999

⁴⁴ Under Georgian legislation, financial information of public agencies is public and must be available to all interested parties

⁴⁵ “Road Fund – an Instrument for Rehabilitation of Roads or Emergency Aid for the President”, 24 Saati, May 22, 2003

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The frustration of the transport sector is understandable. They suffer losses due to the poorly maintained road network and are banned from influencing the processes that could reduce the negative effect on the transport sector. The areas where the transport sector could make a positive contribution include road works planning and the supervision of tender procedures to ensure merit-based selection. They might even be able to supervise the performance of selected contractors.

Transport NGOs and road haulage contractors are the most active proponents of the TRACECA corridor development and Georgia's involvement in the international transportation. They view the underdevelopment and poor maintenance of the road network as a major impediment to the development of Georgia as a transit country and the growth of their businesses. They attribute this situation mainly to corruption in SDRG and the road sector. These parties form a strong interest group prepared to exercise vigilant monitoring over SDRG and road enterprises in order to ensure the efficient spending of funds and reduction of corruption. Few of them claim to want direct participation in decision-making over road construction and maintenance issues. The majority of these interested parties would like SDRG's consideration of their proposals on the priority sections to be repaired. They would also appreciate the right to observe SDRG tenders and site works, and the opportunity to proffer claims against contractors failing to fulfill their contractual obligations.

SDRG is strongly opposed to these proposals and is supported by the lack of legislative provisions on this matter. However, the call for external control over SDRG activities expressed by politicians, public officials, journalists and interest groups is strong and should be taken into consideration by the Government of Georgia.

Under the Shevardnadze administration, these claims were largely prompted by the perceived political bias of SDRG management towards the ruling political forces. The former Head of SDRG was viewed as a close friend and supporter of President Shevardnadze. Sharp criticism was leveled at SDRG management in the media and from "political tribunes" of the opposition parties. They blamed SDRG for using SRF funds to sponsor the election campaigns of the president and political parties loyal to his regime. SDRG management's loyalty to the ruling political forces was often suggested as the main reason for the anti-corruption, law enforcement and auditing bodies' apparent lack of interest in SDRG and SRF. However, no substantiated evidence has ever been uncovered to support these claims.

Based on the situation described, it would seem prudent to make SDRG and SRF activities more transparent and better reported in the media. When a system is closed and information is not available, there is more ground for suspicion and negative assessment of the performance of responsible authorities. More importantly, public participation and oversight over the government's activities are one of the most effective anti-corruption instruments. This is especially true when law enforcement and government anti-corruption bodies do not have enough resources to effectively enforce the law in different economic sectors. Moreover, exposure of road sector problems to the public would stimulate responsible payment of road taxes. In particular, it could help change the attitude of the transport sector and private businesses obliged to pay the tax on the use of public roads. These share in SRF revenues of these entities is too large to be neglected.

8 FINANCES

8.1 SDRG REVENUES AND ROAD TAXES

According to the information of SDRG and the Chamber of Control of Georgia, SDRG revenue sources are as follows:

- SRF revenues, including road taxes and fees;
- Appropriations from the central budget;
- Directed allocations from other sources based on presidential orders and decrees;
- Foreign credits, investments and grants.

SDRG revenues from 1996 to 2003 (5 months) broken down by revenue sources are presented in [Appendix 7](#). In 2003, SRF revenues originated from the following eight sources:

- Excise tax on imported petrol;
- Tax on the use of public roads;
- Vehicle ownership tax;
- Fees for entering the territory of Georgia;
- Tax on weight infringement and extra axle load;
- Tax on the sale of fuel;
- Tax for using underground communication facilities located in the road right-of-way and for the placement of commercial stands and signs along public roads;
- Fees for using Rikoti tunnel.

The number and rates of road taxes have constantly changed since the establishment of the Road Fund in 1995. The rates of road taxes and fees are determined by the “Law on State Road Fund”, the Tax Code of Georgia, and other legal acts, including presidential and SDRG orders and regulations. The rates and mechanisms for collection of road taxes and fees are given in [Appendix 6](#).

Each fiscal year, appropriations from the central budget are determined by the “Law on State Budget”. According to SDRG, the volume of funding envisaged for the road sector in the central budget depends on annual SRF revenue plans. Thus, as SRF revenues increase, appropriations from the central budget decrease. However, due to chronic non-implementation of the budget, SDRG has never received the fully envisaged amount of financing from the central budget either before or after the establishment of SRF. Since 1998, potential budgetary appropriations have not been counted when planning SDRG expenditures for the next fiscal year. This is due to the unreliability of financing from the central budget, according to SDRG. Whenever budgetary assignments are available, they are used for covering contingency expenses and co-financing of projects implemented under credits from international financial organizations.

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Contingency expenses are also covered by purpose allocations from the Presidential Fund and other sources based on corresponding presidential orders. The purpose allocations mainly occur in the aftermath of natural disasters (e.g. landslides, mudslides, flooding, etc.) or to finance urgent road works not planned by SDRG.

Foreign credits and grants have played a significant role in the rehabilitation of the road network in Georgia. SDRG has so far received two purpose grants from the EU and the government of Japan and two purpose credits from the World Bank and the Kuwait Fund. Foreign assistance has otherwise been provided to SDRG indirectly, within other projects aimed at the development of the transport sector of Georgia⁴⁶.

Road taxes represent the main source of revenue for SDRG. Hence, their efficient collection is extremely important for the road sector and the country as a whole. The dynamics of total SDRG revenues compared to SRF tax revenues show the important role SRF plays in financing SDRG activity. However, the data on road tax revenues provided by SDRG and the Chamber of Control are not adjusted for inflation and therefore do not allow comparison of the real value of SRF tax revenues over years. At an average inflation rate of 7% from 1998 – 2002 (based on Department for Statistics information), presenting SDRG revenues in real terms would be more useful to reveal an accurate picture of SRF cumulative revenues.

Moreover, there appears to be no official assessment of the revenue-generating capacity of the SRF tax base, which makes it impossible to assess the efficiency of the tax collection units. Normally, SRF performance in tax collection is assessed relative to the anticipated SRF revenues. However, the concentration of planning and implementation responsibilities within one body – SDRG – means that this method of assessment may not reflect the real situation.

Of particular concern are inaccuracies and discrepancies, often significant in nature, in the financial data provided by SDRG, found in the Chamber of Control reports and literature review. The authors verified the data wherever possible, and tried to fill in the gaps through discussions with SDRG, SRF and independent experts. However, we cannot guarantee the accurateness of the data on SDRG revenues and expenditures provided in this report.

In 1997, SRF revenues were planned at 20 million GEL⁴⁷, while the actual revenue level exceeded the planned amount by 6.9 million GEL, or 34%. The significant increase in the Road Fund revenue that year was primarily due to the almost twofold increase in the collection of tax on the use of public roads compared to 1996 (see [Appendix 7](#) for reference). As compared with the previous year's achievement, the anticipated level of SRF revenues increased in 1998 to 25 million GEL. However, actual SRF revenues that year reached 39.4 million GEL, considerably exceeding the anticipated amount. The primary reason for the sharp increase was Parliament's decision to transfer part of the revenues from the excise tax on imported petrol to SRF. Supplemented by the relatively high transfers from the central budget, and international assistance, total SDRG revenues in 1998 reached the highest level ever at 46.890 million GEL.

In 1999, anticipated SRF revenues amounted to 35.1 million GEL, while the reported collected revenues increased to 42.463 million GEL. However, despite the small increment in the collection of road taxes, total SDRG revenues decreased compared to the previous year. This was due in part to the lack of transfers from the state budget and the modest amount of international assistance. In 2000, there was a sharp decrease in SRF revenues due to the amendments of July 13, 2000, in the "Law on the Budget System and Budget Authorities" and to the Tax Code of Georgia. Starting in July 2000, revenues from the excise tax on petrol were transferred in full to the central budget. This

⁴⁶ Foreign assistance is discussed in Section 9

⁴⁷ Data on anticipated tax revenues is obtained from the Chamber of Control inspection reports

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reduced SRF revenues by almost 9.3 million GEL compared to the previous year. In addition, because of a reduction in the rate of the vehicle ownership tax, SRF received approximately 1.3 million GEL less than expected. As a result, total SDRG revenues in 2000 came to only 32.3 million GEL.

The situation improved in 2001 when a share of the excise tax on petrol was returned to SRF, and there was a significant increase in the collection of tax on the use of public roads from enterprises. Although the new rates for the vehicle ownership tax caused more than a twofold decrease in the revenues from this tax compared to the previous year, and more than 2.5 times less than in 1999, it was offset by greater transfers from the central budget and increases in revenues from the tax on the sale of fuel and fees for using Rikoti tunnel. As a result, total SDRG revenues in 2001 amounted to 40.3 million GEL. That year SDRG also received an additional 25.9 million GEL in the form of international assistance raising its total budget to 66.2 million GEL.

In 2002, SDRG again experienced an increase in revenues from the majority of its revenue sources. The exceptions were the vehicle ownership tax, the tax on the sale of fuel, and transfers from the state budget. Total SDRG revenues amounted to 43.9 million GEL. A significant supplement to SDRG revenues in 2002 was the nearly 44.8 million GEL in the form of international assistance. As a result, the total amount available to SDRG in 2002 was 88.7 million GEL. However, the apparent improvement in SDRG revenues since 2000 is not sufficient to become optimistic about future SRF revenues. Although some improvements are apparent, many problems remain and often threaten the entire road sector of Georgia.

The most significant SRF achievement by far is the rate of tax collection on the use of public roads. Introduced in 1995 by the “Law on Road Fund”, this tax caused great discontent in the private sector of Georgia, with some resistance remaining up to date. Reportedly, however, the majority of enterprises in Georgia now pay this tax. According to SDRG, the increase in the tax payment rate was achieved by explaining to the enterprises that this tax is included in production costs. This significantly diminishes its burden on taxpayers.

Nonetheless, tax debts from the previous years remain. This complicates the work of SRF taxation units, since tax debts are usually included in SRF revenue plans for the next fiscal year. According to the Chamber of Control, in July 2002 more than 80 companies had tax debts to SRF, amounting to a total of 14.8 million GEL. Individual tax debts of enterprises ranged from 10 thousand GEL to 5.6 millions GEL. The majority of these debts are from 2000 and 2001. According to SDRG, more than 15 million worth of tax debt from previous years has been restructured based on presidential orders and agreements with the Ministry of Finance. However, a large part of the restructured debt has not been paid either.

SRF, despite being a tax-collection body, does not have enforcement authority other than to seize non-payers' bank accounts. This practice, however, has not been particularly effective. One of the reasons is that many private enterprises in Georgia still prefer cash settlements to bank transactions. Another reason, emphasized by SDRG, is that before 2000, private enterprises in Georgia could only have one bank account and report it to the tax service, while now they are allowed to open as many accounts as they wish in any bank. As a result, in anticipation of the seizure of accounts known to the tax service, private companies open new ones, which are not reported to either the tax service or SRF.

Another problem with the collection of the tax on the use of public roads, as perceived by SDRG and SRF, is the lack of accurate information on the production volume of the enterprises in Georgia. To estimate next year's revenues, SRF has to use the data provided by the Tax Department and the Department for Statistics. The latter, according to evidence from both SDRG and the Chamber of Control, does not provide SDRG with corresponding information, thus violating Presidential Order

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No. 17 of 1998. Information from the Tax Department is not considered reliable. This is due to the high level of corruption within this structure and the frequent understatement of private companies' output data, which affects SRF revenues from this tax.

SDRG estimates the potential revenue-generating capacity of the tax on the use of public roads at approximately 25 million GEL. Improvements could potentially raise an additional ten more million GEL per year for the road sector of Georgia, a 20% increase in SDRG revenues. These include improvements in tax collection and enforcement mechanisms, along with better communication between the responsible governmental bodies.

A similar situation exists with tax collection on the sale of fuel. The revenues from this tax have been steadily growing since 1995 and amounted to 1.5 million GEL in 2002. According to SDRG estimations, this tax should raise at least 2 million GEL more. The uncertainty about the revenue generating capacity of this tax is explained by the fact that a vast portion of fuel production and trade activity belongs to the shadow economy. According to the Chamber of Control, the majority of businesses producing and selling fuel in Georgia either evade taxes or report unrealistically small taxable profits. In 2002, tax debts in this industry were estimated at approximately 1.3 million GEL and 44 enterprises did not declare taxable income to SRF. Again, the problem is that SRF does not have the ability to survey its tax base and is entirely reliant upon the data provided by the tax services. By Presidential Order No. 483 in November 2001, tax inspectors must check for the payment of road taxes when auditing private enterprises and provide SRF with information on the financial status of organizations that allegedly evade road taxes after each inspection. According to the Chamber of Control, tax inspectors do not sufficiently fulfill these provisions. Moreover, taxable profits declared by businesses are often believed to be understated. However, SRF is powerless to take measures unless the tax inspectors confirm the understated profit. Another important factor complicating proper estimation of the taxable capacity of the enterprises is a large volume of smuggled or illegally produced petrol on the market.

The smuggling of petrol in Georgia represents a huge problem with regard to another significant SRF income item – the percentage of revenues derived from the excise tax on imported petrol. This accounted for more than 30% of all SRF revenues in 2002. As mentioned previously, SRF's share in the revenues from the excise tax on imported petrol has varied since 1998.

According to SDRG, when the excise tax on imported petrol was introduced in 1998, Parliament supported the transfer of the total amount of tax revenues to SRF. However, due to problems with the implementation of the central budget revenue plans, Parliament passed a temporary provision reducing SRF share in the tax revenues to 50%. This provision remained in force until mid 1999, when it was decided to transfer 100% of the tax revenues to the central budget. This resulted in a tremendous decrease in SRF revenues in 2000. The disastrous lack of resources SDRG suffered in 2000 led to the reinstatement of SRF's share at the 30% level, which has been in place ever since.

As the excise tax on imported petrol is collected by the Customs Department, SRF has no control over the revenues from this tax. The only method of verifying the accuracy of the amounts transferred to SRF is to compare the reported volume of imported petrol and calculate what 30% of the tax revenues at the existing excise tax rate should be. The problem is that reported statistics on imported petrol are extremely inaccurate due to the large quantities of smuggled petrol.

According to official statistics, the volume of imported petrol has varied from 441,000 tons in 1998 to 331,000 tons in 1999, 117,000 tons in 2000, 261,000 tons in 2001 and 270,000 tons in 2002. At the same time, experts estimate the consumption of petrol in Georgia to range from 450 to 600

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thousand tons per year⁴⁸. With domestic production of oil amounting to approximately 74,000 tons per year, which is used to produce a number of petroleum products (e.g. petrol, kerosene, etc.), a large portion of the difference between the reported import and consumption data is attributed to the illegal import of petrol into Georgia.

Large volumes of illegally imported petrol are believed to originate from two sources: corruption in the Customs Department and corruption in the top political and governmental circles indirectly involved in the country's fuel business. According to expert estimates⁴⁹, 140 – 202 million USD could be mobilized from taxes on imported petroleum products if smuggling were prevented. Given a revenue mobilization level of 46 million USD in 2002, it is clear that effective anti-smuggling measures would yield a substantial increase in SRF revenues.

In addition to the above, irresponsible conduct by the Customs Department frequently impedes effective performance of SRF and SDRG. Thus, the revenues from the excise tax on imported petrol, including SRF share, are transferred by the Customs Department to the central budget. SDRG has to fight to get back SRF's share, sometimes through the courts. For example, based upon Chamber of Control data, the following amounts were transferred to the central budget instead of SRF:

- June 2002 - 1,448,118 GEL
- January 2003 - 2,652,636 GEL
- April 2003 - 3,262,067 GEL.

SDRG explains such conduct by the Customs Department by the fact that the latter has to fulfill tax collection plans set by the Ministry of Finance. Whenever customs officials are unable to fulfill their plans, they fill the gaps by using SRF's share of tax revenues.

Another road tax administered by the Customs Department is fees for the entrance and transit through the territory of Georgia. The actual revenues from this tax transferred to SRF are always below anticipated levels. For example, in 2002, actual revenues came to only 7.8 million GEL as compared to projected revenues of 12 million GEL. SDRG believes the difference is due to the corrupt practices of customs officials, which is confirmed by transport sector representatives. The number of vehicles entering or passing through the territory of Georgia is usually understated. Also, vehicle dimensions and cargo weight are falsified in the official reports, significantly affecting SRF revenues. The authority to collect the tax was transferred to the Customs Department in 1998. SRF cannot verify the data on the number of vehicles crossing Georgian borders reported by the Customs Department, and hence, cannot control the amount of revenues from this tax.

The steady decrease in revenues from the fees for the entrance and transit through the territory of Georgia since 1999, however, can be explained by the reduction in the volume of cargo and passenger vehicles. As revealed by our road user survey, complicated customs duties and procedures, and illegal payments to customs officials, constitute the two main reasons for transit vehicles to avoid passing through the country whenever possible.

⁴⁸ Conference Recommendations on Mobilization of Budget Revenues from Petroleum Products; USAID, AmCham, Ministry of Finance of Georgia, May 2003

⁴⁹ Conference Recommendations on Mobilization of Budget Revenues from Petroleum Products; USAID, AmCham, Ministry of Finance of Georgia, May 2003

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Since a large portion of the transit and import transportation crosses the Georgian – Turkish border, the performance of Adjarian customs offices⁵⁰ is particularly important in the collection of entrance and transit fees. The Chamber of Control discovered significant violations with transfers of tax revenues collected at the Sarpi customs office, in a total disregard for legislation. The figures in the table below show the amounts deposited and transferred to various destinations from a special account at Batumi Maritime Bank by Sarpi customs officials:

| Year | Amount deposited into account (GEL) | Amount transferred (GEL) | | | Amount paid for bank services (GEL) | Amount left in account (GEL) |
|-----------------------------|-------------------------------------|--------------------------|-----------------|------------------------|-------------------------------------|------------------------------|
| | | to SRF | to Acharavtogza | to unknown destination | | |
| 1998 | 1,565,800 | --- | 629,700 | --- | 3,800 | 930,300 |
| 1999 | 4,605,800 | 735,700 | 2,424,700 | 2,318,600 | 14,600 | 44,500 |
| 2000 | 5,222,600 | --- | 2,625,700 | 2,625,700 | 15,700 | --- |
| 2001 and first half of 2002 | 6,566,100 | --- | 3,275,200 | 3,275,200 | 15,700 | --- |

Source: Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 2002

As shown in the table, of the total revenue of 17,960,200 million GEL collected at the Sarpi customs office, SRF received 735,700 GEL. “Acharavtogza” received 8,955,200 GEL and 8,219,500 GEL disappeared, with no subsequent investigation. This data was revealed to the Chamber of Control by SDRG. However, the Chamber could not do an ‘on-the-spot’ check due to the failure to obtain the necessary permits for inspection in Adjaria. All SDRG requests for investigation of this case filed with the Supreme Council, the Cabinet of Ministers and other governmental bodies of Adjaria, have gone unanswered. It remains to be seen what changes will occur with the recent change in regime in this province.

As shown in [Appendix 7](#), the tax for weight infringements and extra axle load introduced by the “Law on State Road Fund” of Georgia in 1995 was not collected until 2003. The Customs Department is responsible for collecting the tax for weight infringements, while SRF is supposed to collect the tax on extra axle load. According to SDRG and other respondents, the non-collection of the tax on weight infringements is attributable mostly to the corrupt practices of customs officials and the absence of equipment to determine cargo weight. The standard practice to calculate the tax for extra weight is to compare the weight of cargo stated in the waybill and the load-carrying capacity of the vehicle. However, this method is not effective for two reasons:

- Many waybills are falsified, understating the actual weight of the cargo;
- In order to avoid unloading the truck and weighing the cargo to check the accuracy of the waybill, many drivers prefer to bribe customs officials. This is due to the fact that the procedure is time-consuming and costly in terms of parking and down-time.

Until 2002, the non-collection of tax on extra axle load was due to the absence of necessary equipment. According to Chamber of Control evidence, the equipment could not be purchased for a

⁵⁰ Relationship between SDRG and “Acharavtogza” – the Adjarian road administration - are very much alike the relationship between the Adjaria’s government and the government of Georgia. In line with policy of the Adjaria’s government towards the government of Georgia, “Acharavtogza” reports to SRF on the taxes collected in Ajaria, but does not transfer the revenues to SRF.

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long time due to a disagreement between the Customs Department and SDRG on whether it should be installed inside or outside the customs zones. Finally, in 2001, the Ministry for Tax Revenues of Georgia agreed on the installation of gauges for the measurement of extra axle load inside the customs zones. Five pieces of vehicle weighing equipment costing a total of 535 thousand GEL were brought into Georgia in June 2002, but have not yet been installed. According to SDRG, the reason is resistance on the part of the Customs Department, which is unwilling to let SRF tax collectors into the customs zones.

According to transport sector representatives, the result is that SRF is losing substantial income as the majority of trucks entering or passing through Georgia are overloaded. More importantly, the tax on weight infringements and extra axle roads are aimed at discouraging road haulers from overloading trucks because of the damage to roads caused by such overloaded vehicles. Non-enforcement of these two taxes contributes to the poor state of Georgia's roads.

SRF revenues from the vehicle ownership tax have been decreasing since 1996 and hit extremely low levels in 2001 and 2002. It seems paradoxical that tax revenues are decreasing while the number of vehicle owners has increased significantly over the years. There are two explanations of this downtrend. Under amendments to the Tax Code in 2000, the tax rate was decreased almost fourfold, by replacing tax rates based on engine horsepower with a fixed tax rate based on vehicle dimensions and load-carrying capacity. The second reason is that a large portion of vehicle owners evades this tax. According to Chamber of Control data for Tbilisi and Adjara, in 2001, only 87% of vehicle owners in Tbilisi and 28% of vehicle owners in Adjara paid the vehicle ownership tax.

This tax is collected during the registration, re-registration and annual technical examination of vehicles. Vehicle owners have to deposit the tax fee to SRF bank account and show bank receipts during the registration and/or technical examination of vehicles. Traffic police must submit a report on the number of registered or examined vehicles to SRF by the end of the reporting period (calendar month). SRF compares the traffic police data with the amount accumulated on the SRF bank account.

The main reason for tax evasion is corruption in the traffic police. According to the Anti-Corruption Bureau of Georgia, half of the vehicles imported to Georgia in 2002 were registered illegally, without customs clearance and corresponding taxes. The evidence of corruption by the traffic police in the vehicle registration process provides grounds for questioning traffic police vigilance in checking for the payment of vehicle ownership tax. Tax evasion by the owners of light vehicles is highly unlikely due to the small tax rate, but can present quite a problem with owners of trucks and buses.

Moreover, according to SDRG, only half of the registered vehicles regularly pass technical examination. This is especially true in the provinces, where the traffic police pay less attention to the lack of a technical examination certificate and the fines (usually bribes) are smaller. Furthermore, many truck owners prefer to pay 5 GEL in bribes to the traffic police rather than the 50 - 100 GEL vehicle ownership tax and the cost of the technical examination. These owners inherited their vehicles from the Soviet system during the processes of privatization, but rarely use their trucks now. Based on all these facts, SDRG estimates the capacity of the vehicle ownership tax base to be at least twice as high as the current revenues from this tax.

The most ineffective Road Fund tax is the levy for using underground communication facilities located in the road right-of-way and for the placement of commercial stands and signs along the public roads. According to SDRG, the revenues from this tax are so small (6 thousand GEL in 2001 instead of the projected 100 thousand GEL) that they do not even cover tax collection costs. According to SDRG, this tax should either be abolished or transferred to local authorities.

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The collection of fees for using Rikoti Tunnel – the only toll road in Georgia – has been under close observation by the supervisory bodies and mass media since tunnel tolls were introduced. As the revenues are earmarked for the maintenance of the tunnel, it now depends solely on these revenues. The tunnel is located at the Rikoti Pass on the Poti – Red Bridge main trunk. There is an alternative free road bypassing the tunnel. However, the tunnel is especially used intensively by heavy trucks. There is no accurate information on the average daily rate of vehicles passing through the tunnel, but based on the Chamber of Control data it can be estimated at more than 2000 vehicles per day⁵¹.

A number of official and journalistic investigations have been undertaken to reveal whether there is a difference between reported and actual revenues from the tunnel tolls. From 1999 to 2001, the Chamber of Control undertook inspections of the checkpoints at Rikoti Tunnel. The inspection conducted on December 8 - 9, 1999, revealed a gap of 308 GEL between the actual (1456 GEL) and projected (1764 GEL) revenues, a 17.46% difference. This calculation was made by comparing the number and dimensions of vehicles that passed through the tunnel and the amount in the checkpoint till⁵². The difference was explained by the unwillingness of some drivers to pay tunnel tolls.

A covert inspection conducted between 9 A.M. and 3 P.M. on December 22, 1999, revealed a difference of 235 GEL between the actual and owed revenues⁵³. The explanation put forward by the checkpoint officials, and accepted by the Chamber of Control inspectors, was the same as above. The inspections conducted in 2000 and 2001 did not disclose any discrepancies between the actual and owed revenues. According to the investigation in 2001 by the popular TV program “60 Minutes”, the minimum revenues from the toll at Rikoti Tunnel amount to 6 million GEL per year. Thus, the embezzlement of 5.4 million GEL took place in 2001. Another journalistic investigation by the newspaper *Alia*’s investigation team concluded that at least 180 thousand GEL every year are not accounted for⁵⁴.

Another ground for questioning the honesty of checkpoint officials is the token system. Even though special equipment was installed at the tollgate in 2002, the tokens are not placed into the automatic collection system by the drivers, but instead by checkpoint employees. Many journalists have suggested that not all the collected tokens are put into the automatic device to be registered, but instead are returned to the cash desk and sold again. Taking into consideration the number of checkpoint employees - 28 persons working in 2 shifts at each end of the tunnel – with an average salary of 36 GEL (roughly 18 USD) per month, the scenario seems rather plausible.

It is possible to calculate approximate annual revenues using the following formula. If the average number of vehicles per day is 2000 and the minimum toll rate is 1 GEL per vehicle, yearly revenue would be 730 thousand GEL. This is 80.8 thousand GEL more than the highest reported revenues from Rikoti Tunnel. According to estimates of World Bank consultants, the cost of maintaining Rikoti Tunnel is approximately 1 million GEL per year⁵⁵. The present condition of the tunnel, including road surface, lighting, and ventilation is far from satisfactory. This is recognized by SDRG authorities, but attributed to lack of financing. The above evidence demonstrates that if all the revenues generated at Rikoti Tunnel were used for its maintenance, it would be in much better condition.

Although the small tax base is a frequent excuse for insufficient SRF revenues put forward by SDRG and SRF officials, the above evidence shows that this is not the case. If road taxes were fully collected in the country, SRF revenues, by even the most modest estimations, would increase by

⁵¹ Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 2001

⁵² Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 1999

⁵³ Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 1999

⁵⁴ “How and how much is misappropriated from the Rikoti tunnel revenues”, *Alia* #75, July 1-2, 2003

⁵⁵ Appendix 4: Financing the construction and maintenance of roads in Georgia – State Road Fund and associated laws, Final Report, Transport Rehabilitation Project, April 1998

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more than 50 million GEL, an approximately 116% increase compared to current SRF revenue levels.

The author would like to emphasize that counter to popular perception, SRF tax-collection units are not solely responsible for the low tax-collection rates. Other governmental agencies also significantly contribute to the low level of revenues accumulated at SRF. Therefore, it can be said that the poor condition of the road sector of Georgia is due to the corruption and malfunction of other, seemingly unrelated, governmental structures.

8.2 SDRG EXPENDITURES

The main expenditure item for SDRG is the construction, rehabilitation, periodic repair and maintenance of public roads in Georgia. These types of expenditures account for 60% - 95% of SDRG total annual expenditures. Until 2001, the expenditures on road network maintenance and the operation of SDRG and its departments were the only permanent items on the SDRG expenditure plan. Since 2001, other significant expenditures have emerged in relation to the credits from international financial organizations that SDRG has been receiving since the late 1990s. These include co-financing of the works financed by international credits and repayment of the principal and interest on loans. Apart from being an additional “burden” on SDRG and SRF resources, these expenditures caused a heated debate between SDRG and the Ministry of Finance on which body should be responsible for the repayment of loans that benefit the road sector.

Moreover, although the President approved such a policy back in 1997, SDRG’s payment of the previous years’ arrears from the current year’s budget started only in 2001. This also formed another substantial expenditure item. In addition, in 2001 contingency reserves were included in the SDRG expenditure plan. This resulted in fewer emergency allocations from the central budget, the Presidential Fund, and other sources in subsequent years. Furthermore, SDRG expenditures on facilities maintenance and personnel have increased by 64% over the years from, 1.17 million GEL in 1996 to 1.8 million GEL in 2002. The increase in cost of SDRG main expenditure items and the appearance of new items in the SDRG expenditure plan explain the decrease in the share of road works in overall SDRG expenditures. They went from a high of more than 90% in 1996 – 2000, to around 60% in 2001 – 2003. The data on SDRG expenditures from 1996 – 2003, broken down by expenditure items, are given in [Appendix 8](#).

The dynamics of SDRG revenues and expenditures are influenced by a large number of factors of both domestic and external origin, which are not always controllable by SDRG. SDRG expenditures must be planned for each fiscal year. The expenditures related to the purchase of goods and services must be approved by the State Procurement Agency. According to the Chamber of Control, SDRG regularly fails to keep its expenditures within the approved plans. For example, in 2001⁵⁶:

- Planned expenditures on the sustenance of SDRG personnel and the maintenance of facilities was exceeded by 9%;
- Expenditure plans for road works were exceeded by 9%;
- Debt servicing expenditure plans were unfulfilled by 27%;
- Arrears payments exceeded planned amounts by 28%;
- Contingency expenditure plans were exceeded by 27%;

⁵⁶ Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 2002

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- Transfers to Tbilisi municipality were exceeded by 78%;
- Overall fulfillment of the annual expenditure plan for 2001 amounted to 97%.

The discrepancies between the expenditure plans and actual spending are largely explained by the changes in the revenue plans. They are due in part to contingencies, problems caused by other governmental structures, and poor planning by SDRG because of a lack of reliable forecasts on the economic situation in the country. Other reasons include a poor exchange of information among governmental agencies and frequent amendments to the legislation, notably the Tax Code of Georgia. One should note that the non-fulfillment of expenditure plans is typical for the majority of governmental agencies in Georgia. The lack of an adequate response from the controlling bodies makes such failures a routine matter. However, aside from this, there is another important problem related to the expenditure of public funds – the inefficient use of public money.

It is difficult to evaluate the efficiency of SDRG spending on road works without a thorough audit of design and financial documentation. However, based on the evidence from the Chamber of Control, SPA, and a joint report by Transparency International - Georgia, Georgian Young Lawyers Association and Association of Young Economists of Georgia⁵⁷, numerous violations have been detected in the procurement and quality control practices of SDRG.

Of specific concern is the non-transparency of tender procedures within SDRG and violations of the “Law on State Procurement”, primarily in the discretionary selection of contractors when the contract value exceeds limits for the use of discretion authority. Moreover, the practice of establishing lump sum contracts for a set volume of work has not found broad application in Georgia. The main method of contract payment is payment based on monthly output. There is nothing wrong with this method, provided field inspection data and analysis are accurate and reliable. However, the long-established close relationships among private contractors, quality control organizations (which are privatized former SDRG units) and SDRG management, combined with the discovered violations in SDRG contracting practices and the general poor quality of repaired roads, provide sufficient grounds for questioning the reliability of the field inspection reports.

The method of contract payment based on monthly output is also considered the main reason for the extensive arrears SDRG has accumulated in previous years. The authority to cover the previous year’s debts in the current budget was given to SDRG by the President of Georgia in 1996 and the practice has since become widespread. The problem is that, in view of the numerous violations in the contracts established between SDRG and private companies, it becomes practically impossible to accurately estimate the arrears to be covered. Among the violations discovered by controlling bodies and NGOs are:

- No indication of who the contract parties are;
- Lack of a defined scope of work;
- No indication of the total cost;
- No provision for start and completion dates;
- No indication of the rights and obligations of the contract parties.

⁵⁷ “Civil Monitoring of the State Department of Automobile Roads”, Transparency International – Georgia, Georgian Young Lawyers’ Association, Georgian Young Economists’ Association, November 2002

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Moreover, it is often difficult for accurate planning to take place due to insufficient contingency reserves and the routine non-implementation of annual revenue plans, often for reasons beyond SDRG control. As a result, the amounts owed to private contractors accumulate, reducing the volume of work to be carried out in the upcoming year.

Another problem with SDRG expenditures on road works is the lack of quality control. In accordance with SDRG priorities for road works and in view of the scarcity of resources available to the road sector, the largest portion of the budget is assigned to the rehabilitation and maintenance of international roads. The contracts for road works on international roads are relatively large and attract construction companies with higher production capacity and commitment to quality. Moreover, as large contracts receive more attention from state controlling agencies and NGOs, the terms and conditions of such contracts are usually more concrete.

However, the situation of intrastate and local roads is much worse due to smaller funding. Consequently, contracts are given to smaller companies that do not have adequate resources or the capacity to provide high quality services. The lack of interest on the part of larger companies towards small contracts is explained by high mobilization costs, which naturally leads to provision of contracts to local enterprises that are close to the work sites – a zonal principle of work distribution. Quality control of site work by SDRG inspectors is poor due to the high cost of keeping full-time inspectors on dozens of sites, and SDRG management tends to overlook quality defects. To quote one SDRG official, “What quality can we expect for the money we are paying them? It is simply impossible to do a quality job under such financing. But we can’t afford to pay more.”

In 2002, maintenance work on international roads was performed by eight road construction enterprises at an average cost per company of 499.5 thousand GEL. Maintenance work on intrastate roads by 63 road enterprises cost an average per company of 79.6 thousand GEL while maintenance work on local roads by 61 road enterprises cost an average per company of 61.4 thousand GEL⁵⁸.

A question arises- if quality work cannot be contracted due to insufficient funding, why spend taxpayer money on the provision of poor quality work? In addition, instead of encouraging quality performance, SDRG actually encourages small enterprises to do a poor job thanks to insufficient financing. For small enterprises, next year’s contract (which they will inevitably receive under the zonal work distribution principle) depends to a great extent on the condition of the road. The worse the road is, the higher the probability of a new contract. SDRG responds to this charge saying that roads require periodic maintenance, and without such, future rehabilitation will be required which will entail much greater expense. However, higher rehabilitation costs could be offset by properly rehabilitated, high quality roads, and, hence, lower maintenance costs after rehabilitation. Moreover, instead of spending millions on poor maintenance over years, the money could be accumulated and used for proper, high-quality rehabilitation works. It would also cut down prevention and contingency expenditures. In 2002 the expenditures on this type of work amounted to approximately 8.4 million GEL, which is 4.6 times more than contingency reserves envisaged in the SDRG budget.

The conclusion can be made that although SDRG expenditures focus mainly on road works, efficiency of spending and received benefits are much lower than they could have been. This is especially true given the limited resources of the road sector in Georgia. Moreover, a well-known method of hiding illegal gains is to make it difficult to exercise oversight over public expenditures by external auditors or observers. Therefore, SDRG persists in giving preference to numerous small contractors, whose performance is more difficult to oversee than that of companies involved in

⁵⁸ Estimations are made based on the data provided by SDRG.

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larger projects. This is viewed as complicating the oversight over the efficiency and effectiveness of SDRG expenditures.

SDRG expenditures for personnel and facilities are also considered inefficient. The increase in personnel and facilities maintenance expenditures is attributed to both the increased collection of SRF taxes requiring more personnel, and the additional cost of inflation. However, if the latter cannot be prevented by internal measures, tax-collection costs could be decreased by computerization of tax-collection units, especially SRF field branches. In addition, broader application of IC technologies would significantly cut the communication expenses of both SRF and SDRG. Moreover, computerization of SDRG facilities and appropriate training for SDRG personnel would yield higher labor productivity making it possible to cut SDRG and SRF operational costs and personnel.

Co-financing of work performed with foreign credit and debt servicing has become an important expenditure item for SDRG since 2001. According to the credit agreement with the World Bank, 72.7% of project costs are covered by World Bank credit, while 27.3% is to be provided by the Government of Georgia. By agreement between SDRG and the Ministry of Finance, the latter should cover 16.67% (VAT portion) of the Georgian co-financing share, while SDRG should cover the remaining 13.33%.⁵⁹ Under the credit agreement with the Kuwait Fund, the Georgian party assumed responsibility for the co-financing of 32% of the obtained credit, for which the Ministry of Finance is responsible for the VAT portion and the rest is to be covered by SRF funds.⁶⁰ Moreover, SDRG is responsible for servicing the debt under the previous and on-going credits. According to Chamber of Control evidence, SDRG has failed to fulfill its responsibilities several times already, which has resulted in penalty interest, an obviously unaffordable practice due to the scarcity of SDRG resources.⁶¹

The Chamber of Control audits have revealed occasional violations in accounting procedures at SDRG, namely incorrect accounting records, untimely and incomplete assignments to the central budget and special government funds and untimely payments. The Chamber of Control has also detected numerous cases of erroneously transferred sums from SDRG accounts. Such transfers are generally explained by routine mistakes in accounting, and returned to SDRG accounts after a certain period. This could be an example of a well-known practice of “borrowing” state funds for personal use (flourishing in the 1990s in the majority of post-communist countries, including Georgia). Typically, the “borrowed” amounts are used for short-term investments with a high rate of return, while profits are divided between the “borrower” and public officials who “lent” the money. The restitution of erroneously transferred money appears to set the state auditing bodies at rest and does not cause further investigation. However, in conditions of significant scarcity of resources, such a “drain” cannot but cause certain disruptions in SDRG operations and have a negative effect on the road sector of Georgia.

Among other “minor violations”⁶² discovered by Chamber of Control audits were poor tax payment practices at SDRG (i.e. nonpayment of taxes on special reserves, profit tax, income tax on physical persons, property tax, VAT, taxes to social security fund, taxes to healthcare fund, etc.).

Many violations were detected in the renting of equipment and facilities to private organizations by SDRG, namely non-payment of rent by private enterprises and lack of enforcement measures on the part of SDRG. SDRG officials explained the lack of enforcement measures as follows: in a case of non-payment, the amount owed to SDRG in rent is subtracted from the value of the non-payers’

⁵⁹ Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 2002 and SDRG data.

⁶⁰ Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 2002 and SDRG data.

⁶¹ See Section 9 for more details.

⁶² The term used in the Chamber of Control reports.

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contracts with SDRG. However, the lack of written agreements on this kind of deal between SDRG and private contractors, and the lack of corresponding provisions in the contracts for road works, provide grounds for speculation on how, and for whose benefit, the money due in rent is actually used. Moreover, it seems that private companies may be using their debt to SDRG to secure future contracts.

The plausibility of the above is reinforced by violations in the process of privatization of state property in the late 1990s. According to the Chamber of Control, several organizations now possess previously state-owned equipment, which they had rented or leased from SDRG prior to privatization, apparently without raising any discontent on the part of SDRG. According to anecdotal evidence, some of the today's large road construction companies significantly benefited from such privatization, with the benevolence of SDRG management, thereby obtaining the best available equipment illegally.

SDRG does not appear to be properly fulfilling its responsibility of representing the state interests in the road sector of Georgia. By inefficient spending and mismanagement of capital and financial assets, SDRG wastes public money, where a more effective application of these resources in other sectors could be more useful. SDRG's excuse of being unable to improve the situation until sufficient financing is provided demonstrates that SDRG management has not been capable of taking up the challenge of introducing qualitative changes into SDRG operations. Moreover, allocation of resources in the road sector clearly points to the prevalence of personal and crony interests over the interests of the state.

9 INTERNATIONAL ASSISTANCE

Since 1992 the major donors providing grants and credits for the rehabilitation and development of the road network in Georgia include: the European Community, the Government of Japan, the World Bank and the Kuwait Fund for Arab Economic Development. The total amount allocated to the road sector of Georgia, in grants and credits from these four organizations amounts to approximately 67.5 million USD.⁶³ However, these funds have not yet been fully disbursed. The road sector of Georgia has also received international assistance within other projects, without direct involvement of SDRG. Information on the European Community grant, the grant from the Government of Japan, and the World Bank and Kuwait Fund credits is provided in [Appendix 9](#).

The main issues of concern with regard to the international assistance for the road sector of Georgia can be summarized as follows:

- non-implementation by the Government of Georgia of its responsibilities under international agreements;
- conflicts between the responsible governmental agencies with respect to co-financing of the projects undertaken under credit agreements with international donor organizations;
- lack of efficiency and effectiveness in the utilization of the international aid;
- lack of fairness and objectivity in tender procedures; and,
- lack of transparency in the utilization of foreign aid.

⁶³ Estimated by the research team based on the Chamber of Control reports.

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The issues of concern listed above are related to the credits received by the Government of Georgia for road network development. The reason is that it is much easier to control the utilization of grants, as these are purpose grants relatively small and thoroughly monitored by donor countries or organizations. Still, once the projects financed by foreign grants are complete, the subsequent benefits are generally used at the discretion of Georgian beneficiary organizations, which provides the latter with the opportunity of turning benefits to their personal advantage.

The machinery purchased under the Government of Japan's grant serves as a good example of the above. The grant was provided at the request of the President of Georgia and supported by studies from Japanese experts about the situation in the road sector of Georgia. The studies confirmed that the low productivity of the road enterprises was largely due to the lack of modern road building-machinery and equipment. The purchased machinery transferred to SDRG to rent out to private companies that needed it to perform road works. SDRG turned out to be incapable of providing the necessary storage and maintenance for the machinery, and a decision was made to announce a tender to select a firm capable of providing the corresponding services. However, the next day the machinery transferred for "temporary" storage to a firm selected at SDRG's discretion. It is believed that the machinery is still held by that firm and no tender for the storage and maintenance has been announced. Moreover, no tenders have been announced to rent out the machinery.

According to the research evidence, the machinery is loaned to private enterprises at SDRG's discretion and, in the majority of cases, SDRG does not receive any rent. According to SDRG, the amounts due in rent are later deducted from the value of the contract between SDRG and a specific company. However, no documentary evidence proving SDRG statements could be found. Therefore, the assumption is that SDRG management receives personal benefits from renting out the machinery. Meanwhile, SDRG could have used the revenues from renting out the machinery to improve its technical capacity, or to develop its own capacity to store and maintain the expensive, and unique machinery. Instead, they paid at least 81,864 GEL per year for these services.

Furthermore, the main objective of conducting open and fair tenders for renting out state-owned equipment and facilities is to identify the bidder with the highest anticipated return on capital, who, therefore, is willing to offer a higher price. Consequently, by conducting open and fair tenders for renting out the machinery SDRG could have ensured economic efficiency of the allocation of state-owned resources and the highest possible revenues for itself. The funds could have been used to address SDRG's immediate and urgent needs and to improve the work conditions of SDRG employees.

One of the important issues related to the World Bank credit proves to be the co-financing of the World Bank's Road Project for Georgia. In the Georgian hierarchy of laws and legal acts, international agreements come immediately after the Constitution – the supreme law of the country. This means that the provisions of international agreements cannot be overruled by legal acts issued by Georgian governmental agencies or by internal agreements among governmental agencies. According to the agreement between the World Bank and the Government of Georgia, the co-financing funds must be provided from the central budget rather than SRF. Therefore, the subsequent agreement between the Ministry of Finance and SDRG on the division of responsibility for the co-financing of the World Bank Road Project is a gross violation of the law (see [Appendix 9](#) for details). According to SDRG, they realized the seriousness of the liabilities they assumed by entering into the agreement with the Ministry of Finance; however, it was the only way they could get the credit agreement ratified by Parliament. Indeed, only after the sub-agreement between the Ministry of Finance and SDRG was established did the Parliament of Georgia find it possible to ratify the credit agreement between the World Bank and the Government of Georgia.

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Moreover, neither the Ministry of Finance nor SDRG is meeting deadlines for the payment of their share of the co-financing part of the agreement. According to the World Bank Supervisory Mission's memorandum of June 2003, the Ministry of Finance has been chronically late with covering the VAT part of the co-financing amount. At the same time, the Ministry of Finance had to apply to the court to force SDRG into fulfilling the co-financing responsibilities it assumed under the credit agreements with the World Bank and the Kuwait Fund. Thus, by June 2003 SDRG owed the Ministry of Finance a total of 3,133,900 USD and 59,145 Kuwaiti dinars in payments under the above credit agreements.⁶⁴

SDRG explained the non-payments to the Ministry of Finance by the lack of corresponding funds in SRF due to the violations committed by the Customs Department, namely the illegal transfer of SRF share of the revenues from the excise tax on petrol to the central budget. This dispute was settled by a court decision on June 13, 2003, obligating SDRG to pay the amount owed to the Ministry of Finance, less the amount owed to SDRG by the Customs Department.

This is just one of many cases when, in conditions of severe scarcity of resources, non-fulfillment of obligations by one governmental agency causes poor performance on the part of another one. However, it becomes particularly problematic when the terms of international agreements are not observed. As a result, not only does the country lose credibility with international donors, but also expensive international projects are not completed according to proper standards. The consequence is that the cost of Georgia's external debt exceeds the benefits received from international credits, placing an increasingly heavy burden on future generations.

Another violation of the credit agreement between the World Bank and the Government of Georgia is the non-implementation of the following condition⁶⁵: "The Government of Georgia shall provide funds required for the maintenance of the roads, which shall not be below the SDRG budget of 1999 and shall be adjusted annually in proportion to the increase or decrease of the revenues of the credit recipient body."⁶⁶ According to the estimates of the World Bank Supervisory Mission, the dynamics of the financing of the road sector of Georgia compared to the financing envisaged in the credit agreement is as follows (in million GEL):

| | 1999 (actual) | 2000 (actual) | 2001 (actual) | 2002 (actual) | 2003 (anticipated) |
|--|--------------------------|--------------------------|--------------------------|--------------------------|-------------------------------|
| SRF revenues | 42,592 | 32,200 | 38,756 | 42,300 | 50,2* |
| Liabilities (co-financing, repayment of credit) | - | - | 5,475 | 14,203 | 15,3 |
| Road maintenance financing | 42,592 | 32,200 | 33,281 | 28,097 | 34,9 |
| Financing envisaged in the project | 42,592 | 46,340 | 52,178 | 57,395 | 62,7 |
| Deficit | - | 14,140 | 18,897 | 29,298 | 27,8 |

Source: State Department for Roads of Georgia.

The funds available for the maintenance of the roads in Georgia have been decreasing since 1999 rather than increasing, as originally envisaged in the credit agreement. The concern is not only that the Government of Georgia fails to fulfill yet another condition of the agreement, but that the

⁶⁴ Tbilisi Circuit Court Decision of June 13, 2003 (Case #31a-90).

⁶⁵ Quotation from the Memorandum by the World Bank Supervisory Mission, Road Project, Georgia, June 6-14, 2003.

⁶⁶ The credit recipient body under the given credit agreement was the Ministry of Finance on behalf of the Government of Georgia.

* check digit of the draft budget for 2003.

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volume, location, and parameters of the projected road works were developed under the assumption that adequate maintenance and periodic repairs would be provided for the road network at the expense of SRF resources at 1999 levels. Unfortunately, it becomes increasingly obvious that because of the significant deficits in SDRG resources, the ultimate project goals are hardly achievable.

The interviewed experts also expressed concern regarding the type of the works financed by international credits. The scope of works includes a large volume of surface treatment works; however, experts consider it more expedient to substitute surface treatment with rehabilitation works. The argument is that the lifetime of the surface treatment is only 4-5 years, after which a new treatment will be required, while the lifetime of rehabilitated sections is much longer. Moreover, rehabilitation of road sections should significantly decrease future maintenance costs, which would increase the benefits from international credits. Another argument for increasing the share of rehabilitation works, set forth in the report to the Parliament of Georgia on the progress of the works under the World Bank credit,⁶⁷ is that the surface treatment works are actually monopolized by one road enterprise, which has the necessary machinery and equipment. In view of the lack of competition, the price for surface treatment works is believed to be inflated and differ significantly from the market price.

SDRG, however, believes that the projected scope and types of works are correct and meet the current requirements of the road sector of Georgia. Surely, SDRG has full authority to decide how to use credit allocations, but it would seem sensible to consider the opinion of Georgian and foreign experts. Thus, according to Mr. Antti Talvitie (World Bank Program Team Leader), “it is not a wise strategy for any country to finance road maintenance using loans and credits; they should be reserved for network upgrading and clearance of the maintenance backlog.”⁶⁸

Georgian experts, mass media, NGOs and transport sector representatives all raise the question of the fairness and objectivity of the tenders under the World Bank and Kuwait Fund credits. According to the research evidence, although bidding for the contracts under the World Bank credits are considered more transparent and competitive, full objectivity has yet to be achieved. The tenders are said to be “objective in form, but not in content.” The comments mainly refer to the:

- structure of the tender commission (the commission is made up of SDRG employees and presided over by the Head of SDRG or a person appointed by him);
- non-involvement of other governmental bodies, NGOs and media representatives;
- lack of transparency in the tender procedures;
- SDRG failure to ensure the provision of works and services at market prices; and,
- overpricing of vehicles, equipment and construction materials in tender proposals resulting in higher value of contracts.

The lack of transparency and objectivity were noticeable in contracting out works under the Kuwait Fund credit. Contracts worth of millions of USD were awarded based on restricted tenders, where parties to Kuwaiti–Georgian joint ventures were proposed by the Kuwait Fund and SDRG respectively. Because it was a condition of the international agreement that the Government of Georgia had agreed upon, there was nothing unlawful about SDRG conduct in this case, although it

⁶⁷ Report on the Progress in the Implementation of the Agreement on the Development Credit #3357-GE (Roads Project) between the Government of Georgia and International Development Association as of March 31, 2002.

⁶⁸ Mr. Antti Talvitie’s speech at the Joint Seminar on Transport Policies in the three South-Caucasus States, April 18 – 19, Tbilisi, Georgia

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did violate the “Law on State Procurement,” as the contract value significantly exceeded the limits set by the law for restricted tenders.

It must be mentioned that in 1999, SDRG strongly resisted the involvement of foreign companies to undertake road works under international credits. The argument was that involvement of foreign contractors would impede the development of the local road construction and maintenance industry. The World Bank accepted this argument at the time, with the reservation that procurement methods should be determined based on the volume of tender packages. It was emphasized that certain privileges to local companies could be considered; however, the main objective should be the maximum economic effectiveness of the project for the credit recipient. Whether SDRG was right in this matter can be judged by the quality of the road works.

The quality of work under the World Bank and Kuwait Fund credits is generally assessed as substantially higher than under other SDRG projects, although many minor defects have been detected. According to the research evidence, the difference in quality is partially explained by the fact that priority routes, which are rehabilitated and maintained using international credits, have always been in better condition than other sections of the road network of Georgia less important for international transportation purposes.

Another factor contributing to the higher quality of road works under the World Bank and Kuwait Fund credits is better quality control. The quality of road works is controlled by Georgian companies selected on a tender basis, whose performance is then monitored by foreign contractors responsible for the supervision of road works. Georgian contractors are well aware that their chances to get another contract with an international project depend on their performance; hence, there is better enforcement of the quality requirements. Moreover, to quote one of the respondents, “financing under World Bank credit is better, so it is easier to demand high quality performance from contractors.” However, as revealed by visual observation, some of the road sections that were reportedly repaired under the World Bank credit in 2001 – 2002 need repair again already, which suggests that the quality of road works even under international projects leaves much to be desired.

The lack of information on the implementation of road works, and the goals and objectives of the projects financed by international donor organizations, adds to the lack of transparency in the utilization of credit funding. Thus, the Chamber of Control provides only descriptions of the projects and the resources disbursed and utilized. Audit reports do not provide any analysis of the efficiency and effectiveness of the utilization of foreign credits. Moreover, according to SPA, which has demonstrated vigilance and rapid response to violations in state procurement procedures under domestically funded projects, they are not empowered to monitor tenders under international agreements. This is, undoubtedly, a significant shortcoming, as SPA has the necessary resources and expertise to ensure openness and fairness of the tenders financed by international donors.

Corruption in road projects financed by international credit is believed to be lower than in domestically funded projects. The main forms of corruption in international projects are the overpricing of tender proposals and “kick-backs” for contract awards. Moreover, the monopolistic power of some companies that stems from exclusive possession of certain equipment or previous participation in projects of similar or larger scope (required by the “Law on state procurement”) prevents the creation of a competitive environment for certain works, which allows the companies that enjoy market power to dictate their conditions and prices.

10 STATE PROCUREMENT AND QUALITY CONTROL

10.1 STATE PROCUREMENT

10.1.1 *Potential for Corruption Problems in the Procurement Process*

Because of various reasons, procurement provides a certain potential for corruption. If during communist times, bribes were paid for covering illegal activities or soliciting additional financing, in the present-day these have been replaced by a “kickback” system. This is when successful contractors pay a certain share of the contract value back to the authorities responsible for the contract award. This system undermines sound public sector procurement and asset disposal practices that should ensure an efficient use of fiscal resources. As it follows from the data of one study, over half of the enterprises surveyed said that the necessity of unofficial payments was a very important reason for not participating in procurement (see Appendix 11). It appears that unofficial payments are perceived by enterprises as a larger problem than the official costs and complexity of procedures.⁶⁹

Procurement should be considered in a broader context. It should not be isolated from the processes that take place both in society as a whole and in the sector of road construction and maintenance. SDRG’s relations with other institutions inevitably affect the sector as a whole and procurement in particular.

Namely, the shortcomings of the legislation on procurement issues negatively affect its implementation in practice. The usual disorder of SDRG relationships with the Ministry of Finance, the Customs Department, and others, inevitably creates problems for the sector as a whole and for the procurement sphere. Officials with whom we spoke said that the sector could not afford to be “a happy island in a sea of problems.”

For example, representatives of enterprises interviewed by our team witness that unstable financing is a cause of the irregular fulfillment of procurements. When issues concerning sequestration of the budget were considered in Parliament last year, the whole sector was paralyzed, and procurement procedures were stopped.

Other factors could influence procurement. Excessive cost of the procurement object could be a prerequisite for unofficial payment (kickbacks). The corruptive chain could be continued during quality control procedures. All of these reduce the quality of the assets or materials purchased with public money. In the long run, a reputation for corruption in tenders narrows the pool of bidding companies, allowing illegal bargains with procurement agencies, falsifications during fieldwork, etc.

Here we would like to stress a circumstance that is of crucial importance for procurement; namely, for transparency and opportunities for fair competition. It is a commonly shared opinion that SDRG is something like a small State inside the State, that it is a closed sphere (historical, political, leadership factors as mentioned above). However, there were no serious barriers in arranging meetings with SDRG officials in spite of a wide spread idea that the sector is notoriously non-transparent. On the contrary, SDRG officials declared many times that they had nothing against public monitoring, but they were against amateurs meddling. We do not hold prejudices against our

⁶⁹ Corruption in Georgia: Survey Evidence. Report prepared by the World Bank Based on a Survey Conducted by Georgian Opinion Research Bureau International with funding from the World Bank and US AID and with the Collaboration and Support of the Government of Georgia (June 2000).

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respondents from SDRG and private companies, but it would be naïve to expect them to be fully sincere.

The enterprises survey proved to be less informative than expected. Hypothetically, road companies should be the victims of the corruption that takes place in tender practice. However, their representatives were as reserved as officials from SDRG. It also took a lot of time and effort to arrange interviews with representatives of private companies. Taking into account that some of them were extremely busy, we can also assume that they were unwilling to make time for an interview. In one case, a representative refused to cooperate with us in order to avoid problems. Others did not refuse, but they did their best to avoid an interview. One moment that attracted our attention occurred when officials from SDRG emphasized that they had detailed information about our meetings with representatives of other enterprises.

It proved to be problematic to find independent experts because of the absence of such institutions in this sector.⁷⁰ Some experts from other construction sectors were also interviewed. They were more critical in their evaluations than their colleagues from the road maintenance and construction sector.

10.1.2 *Acclimation to the New Procurement System*

As it follows from our survey, adjusting to new procurement procedures has proved to be rather complex for the road construction and maintenance sector. It took time for road enterprises to get used to this innovation. That is why there have been many violations of the Law on State Procurement and Regulations on Implementation of State Procurement.⁷¹ The SPA, State Chamber of Control, mass media and others, have all registered these violations.

There were initial relationship problems between SDRG and the Department of State Procurement, later the SPA. It took a certain amount of time to establish appropriate structural unity within SDRG that would be responsible for the fulfillment of the State procurement practice in this sphere. Such a structure had to be established in July 1999 in accordance with the Law on State Procurement, which came into effect at that time. SDRG should cooperate with the Department on the State Procurement that was established under the Ministry of Economy. There was a delay in implementing the Law on State Procurement.

The same can be noted about the practice of submitting plans and reports. For example, at the request of SPA, in accordance with Article 24 of the Georgian “Law on State Procurement,” SDRG was required to submit its annual report on purchases made during 2001. Instead, SDRG presented an account on purchases made only in the framework of the realization of World Bank and Kuwait Fund credits.

SDRG did not submit the 2001 plan to SPA at all and the plan for 2002 was approved on 14 February 2002 and sent to SPA in June. Therefore, the requirement of Article 5² was violated. At the same time, it did not meet other requirements. The plan did not contain many issues provided by Article 3 (item 7) of the Regulations on Implementation of State Procurement, including: source of financing, the volume/scope of goods, works and services to be produced, procurement method, procurement time frame, long-term contracts or quarterly financial obligations in a given year for contracts signed during the previous year, etc.

⁷⁰ When familiarizing ourselves with similar materials from Kazakhstan we saw that experts there did not hide their names and were rather severe in their estimations. It could be explained with a peculiar detail that it was a President of the country who initiated the criticism of the road sector.

⁷¹ Regulations on Implementation of State Procurement, October 15, 2001.

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There are many instances of violations of the Law on State Procurement and Regulations on Implementation of State Procurement registered by the Chamber of Control and the State Procurement Agency with respect to the fulfillment of procedural requirements of tenders. The following is an example of the general violations that occurred during one of the tenders held by SDRG in 2003 and those in the report on the tender submitted to SPA:

1. One of the companies submitted out-of-date data; but, the commission did not implement the right entitled by Article 9 (item 9) of Regulations on Implementation of State Procurement to demand from the bidder a presentation of documents confirming their updated qualifications.
 - a.) Three companies were disqualified because of defects in their submitted documents. It was done in violation of a provision of Article 10 (item 6) of the Law on State Procurement. The agency did not give the bidders an opportunity to correct a mistake or inconsistency, which should be fulfilled before the end of the qualification selection. At the same time, there were inconsistencies in other company's documents. However, the commission did not take notice of this fact.
 - b.) One bidder did not submit some required information (Article 10) (such as its property not seized, no bankruptcy declaration, or sanitation proceedings have been commenced against it, etc.). In spite of this, the commission considered its documents to be complete. In the commission's report, there was no qualification data for one of the bidders in spite of the fact that this one was disqualified.
 - c.) Some companies submitted documents that showed they would be paired with other companies in order to bolster their qualifications. However, the documents lacked a clear division of labor among the partners. In the final proposal for the tender there was no documentation that the partners would work together.
 - d.) There were no minutes of the tender commission meetings or commission members' evaluations on the bids considered and tender documentation (Article 32, item 8,"d" of the Regulations on Implementation of State Procurement) which hindered SPA in making a conclusion on the compliance of the procedure with legislation.
2. Inconsistencies were detected in the work completion dates as stated in the tender announcement and the tender documentation in spite of the provision of Article 12 (item 1) of the Law on State Procurement. The law states that the announcement of a tender, tender documentation, and any procurement-related documentation should have a clear and comprehensive description of goods, works, services to be procured etc.

As it follows from the Law on State Procurement (Article 6-7) and Regulations on Implementation of State Procurement (Article 5), there are four methods of state procurement, which depend on the estimated value of the procurement:

- An open tender is held when procurements exceed 230,000 GEL;
- A closed tender is held when procurements are less than 230,000 GEL and exceed 120,000 GEL;
- A price quotation is held when procurements are above 50,000 GEL and below 120,000 GEL; and,
- A sole-source (direct negotiations with a single entity) tender is held when procurements are less than 50,000 GEL.

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It is important to mention the last method because provisions on its use are often violated. Purchases on significant amount (10,481,432 GEL) were done with implementation of this method in 2002. This method can only be used in cases when the estimated cost of the unit under procurement does not exceed 10,000 GEL or 50,000 GEL when construction works are procured. It is also implemented in the force majeure situation (Article 22 of the Law on State Procurement), etc. This latter method is used when it is necessary to implement a state procurement from the same supplier for the purpose of further application and prevention of deterioration of the quality of works, except in cases when the initial supply cost exceeds the amount of the procurement.

Several of these violations have been registered by the SPA and the Chamber of Control in 2001 and 2002. For example, direct negotiation with a single person was used instead of closed tendering in one case. The value of procurement was 170,400 GEL, thus significantly exceeding the monetary limits of the single-source procurement. The improper use of this method occurred when a contract with one private company was signed. The value of procurement was 112,800 GEL. In this case, the price quotation method should have been used.

Another violation of this provision occurred when the single-source method was applied instead of open tendering in Zestaphoni in 2002. The total value of procurement was 309,000 GEL. The list of such violations could go on indefinitely.

Last case was reported in the mass media (*Alia* 6-7 March 2003). The journalist put the question to the representative of SDRG whether a certain supplier is usually chosen when the method of single-source procurement is used. SDRG official in his interview with journalist did not exclude possibility of such a situation. He also explained why the monetary limits within which the given method can be used were exceeded. He said that these works were carried out at the expense of the local budgets and it was always difficult to predict the amount of budget revenues. For example, they planned to get 30-40 thousand GEL, but unexpectedly, more taxes were collected. The company got an opportunity to go on with its work though it did not inform the Procurement Agency about the beginning of procurement proceedings and thus, the procedural requirements were broken. On the question whether it was a violation of Law on State Procurement, this official simple-heartedly answered that they always did their work before the Law on State Procurement was in force and no matter who did this work. The main thing is that the work was done.

Regulations on Implementation of State Procurement state: "In the event, when the estimated value of a given procurement contract exceeds 50,000 GEL, upon conclusion of procurement preparation activities (in the event of single-source procurement – prior to beginning of negotiations) a procuring entity shall inform SPA and etc. about the beginning of procurement proceedings. In addition, the State Procurement Agency shall receive an explanation on the selection of procurement method applied."

Suppliers are required to report changes in their quarterly reports. However, they do not do it and present SPA with a *fait accompli* at the end of the year. It is beyond SPA's mandate to undertake an investigation and that represents one of the shortcomings of the Law on State Procurement.

On the other hand, there were interviewees' complaints that the Law on State Procurement and Regulations on Implementation of State Procurement are excessively detailed, that it takes time to write numerous reports, and that due to the specificity of the sector it is difficult to provide for everything that could potentially cause inconsistency in implementation of plans and reports. "They're better to trust us than to make us write reports on each occasion when something occurs unexpectedly," said one interviewee.

SPA actively cooperates with SDRG. This could be the result that in May 2002 at SDRG a special decree was issued which aimed to strengthen control over procurement procedures. Another decree

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aimed to improve the situation in the contract arrangements in order to meet all the requirements of the Law on State Procurement. Some specialists have undertaken special trainings focused on the management of the procurement process.

It should be noted that the decree (28.01.2002, #5) of the Head of SDRG on the results of the Chamber of Control's audit was not severe because no critical violations were detected. In this respect, the report on monitoring of the SDRG of the international organization Transparency International that was produced in 2002 is interesting. The excessively categorical tone of the report is obvious. However, the report expresses the idea of "immunity" that this sector receives from public monitoring as well as from State control agencies. The same idea was also developed by those representatives of the mass media who carried out their own investigations of the situation in the sector.

So, in material published 1-2 July 2003 in the newspaper *Alia*, instances of bribery by representatives of the Chamber of Control were described (they took place in 1998). Journalists also reported on a common Georgian temptation that officials of SDRG engaged in - invitations of the representatives of control bodies to restaurants. It is usually difficult to decipher whether this is something like bribery or simply hospitality. Foreign specialists who carry out audits constantly face the pressure of such hospitality, reported one of the journalists.

We do not underestimate or overestimate the significance of these journalistic investigations. More over, journalists in some instances made serious mistakes.⁷²

10.1.3 *Reforms: real or imaginary?*

It should be noted that no complaints on the infringement of bidders' rights were registered with the SPA. Its hot-line is silent.⁷³ Does this mean that reforms in SDRG, especially in procurement practices, have developed smoothly?

The main preconditions for sound procurement practices are effective reforms inside the system. They should contribute to the development of market relations in the sector. In accordance with presidential decrees some SDRG subdivisions were conferred the status of "Legal Entity of Public Law," that entitled them a certain degree of independence from SDRG. Furthermore, 80% of road maintenance and 100% of the road construction industries were privatized.

What do respondents think about reforms and process of privatization in this sector? All of the interviewees-representatives of enterprises welcomed innovations in SDRG activities. However, some of them did not express enthusiasm when answering the question about reforms stating, "Nothing special took place," "Enterprises are still dependent on SDRG," "This was done under pressure of creditors who preferred to deal with independent entities." There is widespread opinion that the road construction and maintenance sector is still highly centralized.

Some interviewees expressed nostalgia for the past when the State financed the road maintenance sector rather generously, supplying it with material and equipment. Now, they must take care of themselves. Prices of materials have risen drastically. In Soviet times asphalt cost 34 rubles per ton, and now it costs 50 USD per ton (or about 5-6 times more). There are huge problems with spare parts for equipment. Sometimes road builders find themselves in an urgent situation where they have no choice but to purchase uncertified spares.

⁷² The case of Ogaini road sector reconstruction is most odious. Journalists from the newspaper *Alia* accused the road-builders of misappropriating 17 million GEL when the whole value of reconstruction was about 14 million GEL. They cited a former SDRG official who had emigrated by that time.

⁷³ The hotline at SPA is (+995 32) 93 21 08. Source: State Procurement Agency: Bulletin #1, 2002.

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All enterprises had to acquire bitumen (an important component of chemical compounds used in road works) from Iran and Azerbaijan. This makes them more vulnerable because of complicated relations with the Customs Department (the most corrupt structure). The same is true about enterprises that import cement. “I import cement from Russia, said one, and my enterprise suffers from the downtime at checkpoints at terminals because of the bureaucratic abuse.” As usual, relations with the corrupt Tax Department are exhausting.

As mentioned previously, the field of road construction/ maintenance is a closed, clannish type system so it may be considered to have a high potential for corruption. On the other hand, one can admit that there are deeply rooted traditions that have contributed to the formation of sound and strong corporate tendencies in this sector. During interviews, in various contexts, a similar detail was stressed, “We are a family. We solve our problems within our sphere not bothering those outside our family. We are colleagues for many, many years.”

These sentiments do not necessarily diminish the role of professional ethics and principles of fair competition at tenders. On the other hand, one can suppose that such a “community like” system, in which personal relations have acquired such importance, is a fertile ground for violations of the law.

The other characteristic is that this community-like system is oriented on the equalizing principle. It could be functional in a situation in which the whole sector found itself. It is rational to support everybody equally when the whole sector is on the verge of catastrophe. (“We should help each other” were typical answers.)

The current situation in the sector is a good precondition for the realization of this principle. There are only about 10-12 large and efficient companies in Georgia and no real competitive environment. As all the road works in Soviet times were distributed on a regional basis, the road companies have construction bases in each particular region where equipment and warehouses for construction materials are located, which makes it cheaper for them to conduct mobilization of equipment and personnel and to deliver construction materials to the work sites. These factors make their tender bids cheaper and demonstrate their advantageous position.

The implication of these practices is that non-competitive enterprises with obsolete equipment and insufficient resources are artificially kept in business by SDRG. They usually receive small contracts. These companies are specialized on the current maintenance of certain sectors of the roads in regions and they employ the local population.

Experts from other construction sectors are of the opinion that nepotism is more possible in such companies. If a certain amount of money is assigned for the road maintenance to a small company without specifying the exact volume of works under the contract, the probability of corruption rises. Due to the irregularity of such small contracts, the majority of contracted small road enterprises try to “make the most” of the financing.

Experts from other construction sectors emphasized other negative aspects of corporate relations in the sector. As was mentioned above, no new road enterprise has entered the road works market since its decentralization. Those experts explain this by the fact that SDRG remains the main procuring entity for road works in Georgia and has discretionary power of selecting contractors for road works.

At the same time, interviewed representatives of the road construction sector are of the opinion that it is difficult for new companies to enter the market. The cause is the strict requirements of companies involved in the tender process to have 5-years experience in the road construction and maintenance sector. It is also required that a bidding company have previously performed works of approximately the same cost as the tender bid. The interviewees consider this a fair requirement.

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Whereas experts from other construction sectors think that this requirement is an artificial obstacle that impedes development of sound competition among bidders.

The issue as to why foreign construction companies do not wish to participate in international and national tenders in road works was also raised. As interviewees said, the main reason is the small value of the tenders. At the same time it was assumed by respondents that foreign enterprises were much better equipped than Georgian ones, the exception being a Russian company, which won a tender in 2001. Many foreigners purchased tender packets but did not participate in tenders. Foreign companies are mostly active in the spheres of design, consulting and oversight.

Our interviews were something considerable to the monitoring of the tender process, during which questions on issues concerning tender committee activities were raised. Detailed questions about all stages of the tender process were raised, but detailed answers were not received. Respondent-official who is responsible for the organization of tenders enumerated some cases of the violation of Law on State Procurement and Regulations on Implementation of State Procurement, but this enumeration was not nearly as complete as it was in documents that we received from the SPA and Chamber of Control. He denied any possibility that pressure on the bidders' part could have any effect. On the question of to what degree interviewees trust the fairness of tenders and the tender committee, almost all interviewees from the road construction sector were quite satisfied with it.

They are satisfied with the transparency of tender procedures and availability all necessary information for bidders. Interviewees shared the opinion that no bidders were discriminated against. Respondent are not against broadening the circle of Committee members, "But they must be professionals." The opinion that, "Unfortunately, amateurs are usually most active," was often expressed. Notably, not all respondents knew about the number of Committee members, in spite of the fact that their companies won serious tenders.

The managers of enterprises admitted that there is corruption in their sphere but they do not overestimate its significance. "It is much less here than in other spheres," was a common answer. One interviewee said how his colleagues were amazed after hearing foreign consultants' stories about corruption in countries that are more civilized than Georgia. On the question concerning possible kickbacks, the respondents answered that bidders try to include in their proposals the lowest bid possible in order to have more chances to win a bid. Otherwise, it makes no sense to participate in tenders.

At the same time, according to experts from outside the road construction sector tender, procedures (especially national) are formal. It seems to be that everything is all right and all requirements are observed. Nevertheless, there are stipulations for everything. All important and profitable road contracts are distributed on pre-discussed conditions. Road-builders themselves are not experienced in the participation in tenders. They openly talk about details of their proposals that usually are kept in secret. It is not free and fair competition, but various types of bargaining among them that often takes place (especially between contractors and sub-contractors).

It was mentioned by experts that there are no mechanisms for the control of procurement processes in force majeure situations.⁷⁴ With kickbacks for contract ranging from 10% to 40%, enterprises have to survive and cannot afford to think about the quality of performance. Inclusion is more preferable for them than exclusion in spite of the poor benefits of such a choice.

As it follows from unofficial information, Georgian companies from other construction sectors attempted to enter the road construction market. Later they refused to enter the market and not

⁷⁴ Due to geographical location of Georgia, there is a high possibility of *force majeure* on the roads, especially in mountainous regions in winter. Therefore, rather significant sums are allotted for such cases (for example, 2919000 GEL in 2002).

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because of strict requirements of tenders, but because the kickback is so much higher for them as "newcomers."

Foreign investment could contribute to the development and revival of the market and therefore the procurement system as the credits from the World Bank and Kuwait Fund did. However, foreign private investors were frightened by the corruption of Georgian officials. This is also unofficial information.

Heads of companies and SDRG officials emphasized that international tenders contributed to formation of the national procurement practice in the sphere of the road construction and maintenance. However, an independent expert expressed some criticism towards international tenders that were held in the framework of the credit agreement with the World Bank. In his opinion, the tender commission was comprised of the head of SDRG and its subdivisions. There are no representatives of other State organizations or NGOs. He and his colleagues were present at the final stage of the tenders when the results were announced. Therefore, transparency of the credit realization process is rather poor.

An independent expert stressed another point. It was unnecessary to submit a tender proposal in the Georgian language. This provoked some discomfort for the Georgian part of Commission. The outside expert felt that a Georgian version of proposals should be attached to the English version.

He mentioned that the tender that was carried out within the framework of the credit realization in 2001 in which some violations took place, specifically a tender on the purchase of 15 automobiles. The Commission did not manage to develop sound competition among suppliers, on the one hand, or to establish market prices. In some cases, the proposed prices exceeded the current market prices. There was the possibility to reduce proposed expenditures and save about USD 1.2 - 1.5 million. This amount is enough to rehabilitate 10-11 kilometers of the road.

The expert also highlighted one peculiar instance concerning all tenders on the performance of surface treatment in April 2002. Only one proposal was considered which was submitted by the same company. This is the only company that had the necessary equipment for this type of work. In fact, it holds a monopoly in this sphere, and was able to manipulate the bidding such that the costs proposed and considered were artificial and fell short of market prices. In such a situation a conflict of interest can occur.

As mentioned, there are preparatory stages that precede the tender procedure and which could facilitate corrupt dealings. It may take place at the stages of design and elaboration of requirement specifications, and could result in the excessive value of the procurement. We spoke with an SDRG official who is responsible for such works. One of the main impressions was that there is a very narrow circle of organizations that carry out these works and all of them were previously substructures of SDRG. We asked whether there were other more independent organizations. The answer was that these organizations engaged have the most skilled staff and they have the best reputation. That is why foreign partners trust them.⁷⁵

The given situation is similar to one in the procurement practice. Of similar importance for both stages is the fact that, as follows from materials of the Chamber of Control, in the statute of the legal entity bodies in sector, there are no provisions on the forms and limits of state control and the basis of financial activities of these bodies. It is a violation of the requirements of Article 6 of the "Law on Legal Entities of Public Law."

⁷⁵ Interviewee rejected any possibility of excessive values of procurement objects. "At the meetings of SDRG's Council, that confirms projects and their estimates, the only requirement, that is set, is to provide minimal costs of procurement. "I do all my best in this respect, but Saralidze is always dissatisfied and insists on reducing the price – said an interviewee.

10.2 QUALITY CONTROL

As road users stated during interviews, one could hardly suppose that someone would find Georgian roads as meeting international standards. “The state of roads in Georgia does not comply with the European standards by any characteristic (whether carrying capacity, carriageway, etc.). Therefore, Georgia cannot function within the European Transport Corridor successfully.” It is an opinion, expressed in a relatively neutral way by road users. In another case, even before the interview started, the respondent declared that regardless of what questions would be put, his final statement would be, “Everybody from the President of Georgia to the driver should be ashamed by the state of Georgian roads.”

How do road builders themselves assess the quality of Georgian roads? When assessing the condition of the roads of international significance almost all respondents were satisfied with the quality of roads. However, they were much more severe when assessing the quality of the intrastate and local roads. An exception is the state of the roads in such districts as Bolnisi, which can afford to maintain the roads in normal conditions. This district possesses a gold mine and a gold processing factory.⁷⁶

Interviewees said that current situation was much worse than it was 5 years ago, and much better than it was 10 years ago. It deteriorated because of the absence of financing. Now there are signs of progress that became possible mostly by virtue of international aid and not by Georgian means.

It was not difficult to find people with an opinion on the quality roads assessment. Not only road users from the transport sphere, but journalists and ordinary people were eager to express their opinion. Most of them showed knowledge of details, especially about the opportunities to steal materials. One journalist recounted how road workers patched the surface of a road without tar. (Kviris palitra, 4-10 June, 2001). Later he asked an engineer whether it was possible for him to buy a truck with asphalt for his own private use. “No problem,” was the answer. The engineer quoted a price, but did not ask the journalist why he wanted to buy asphalt. This is a typical example of how materials are stolen, which of course negatively affects the quality of the works performed.

The case of Rikoti tunnel is noteworthy in this respect. As mentioned above, special automatic devices were set to get payments for the use of the tunnel that should be used for its maintenance and that of its infrastructure. Journalists and MPs have tried to count the profits that SDRG could obtain from this procedure. One politician brought up this case in discussions with Boris Saralidze during the Parliamentary election. Mr. Saralidze was asked how these payments disappeared. The actual amount of money was in dispute, but one thing became obvious – the tunnel was still in a deplorable state and poorly paid state employees have continued to steal toll revenues.

Those interviewed from the road construction sector expressed an interest in cooperating with international consultants. These foreigners work under the framework of a credit agreement. Foreign monitors are perceived to be principled, possibly due to the fact that their high salaries are actually ten times more than the Head of SDRG.

However, the situation is not so idyllic, as an independent expert noted. The quality of work does for the most part meet the requirements mandated in credit realization agreements. Nevertheless,

⁷⁶ The other thing is that road builders and road users talk about different road sectors that is why there is a drastic dissonance in their assessment. Road builders prefer to analyze situation on the roads of the international significance maintenance of which is considered priority for SDRG; ordinary road users made accent on the state of municipal and intrastate roads that are much worse.

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there are sections that are absolutely deplorable, especially the 2-kilometer section near Kutaisi. Defects in the road quality were explained by poor climatic conditions during the time of work.

Below is an example of how kickbacks force a company to illegally shortcut or otherwise cut costs during the construction process.

- Replacing the materials indicated in the technical specifications of the contract with lower quality, cheaper substitutes or with old materials;
- Reducing the real costs of materials in financial documents to avoid taxes; and,
- Reducing personnel salaries in financial documents to avoid corresponding taxes, for example the 53% tax the company pays on the personnel's wages.

Furthermore, the illegal actions listed below artificially increase profit margins. However, a higher profit tax is still cheaper than paying taxes on materials and payroll taxes.

- Organization of construction operations. For example, a bidder indicates that the nearest quarry is 80 km away of the work site, but in fact it is only 10 km away. This allows the bidder to cut work costs and steal money from the state.
- Increasing the bid costs by including costs for temporary facilities, such as workers' accommodations, which either already exist or are not required.
- Road construction to restore temporary transportation. This type of construction would occur in the event of destruction from natural disasters, such as rebuilding roads after landslides, avalanches, flooding, etc. The purpose is to restore the pathway for transport as soon as possible to help people in the disaster areas. The money is allocated from the budget and the construction company does the minimum work necessary since they know that it is a temporary measure. As a result, the road is usually destroyed by traffic in about a month and needs again to be rehabilitated, often by the same company.

Quality control companies are charged with ensuring that road-work construction complies with design requirements. Up until recently, these companies were a subdivision of SDRG. However, in accordance with recommendations from foreign creditors, this was also privatized to guarantee the independence of the quality control procedures.

Fifteen inspectorates were established. Their activities cover the whole territory of the country. Engineer inspectors are responsible for monitoring and reviewing whether projects satisfy their design specifications and cost estimates. They are required to be at the work site, and confirm the completion of each stage of the work. Once a month, the inspector must certify a statement of work, in order to pay the contractor. Furthermore, engineers are responsible for performing field tests that are later analyzed at laboratories, and drafting procedures for regulating work standards.

The other monitoring bodies that take part in quality control procedures include the Commission on Quality, Anti-corruption Commission and control bodies from outside the system. As a rule, high-ranking officials of SDRG, international consultants (in case of works performed under credits), and local self-government are also responsible for review and certification.

The Chamber of Control regularly checks up on the quality of the road works. As it follows from its materials, there are no serious defects. Contracts contain a special mechanism. A supplier is responsible for remedying defects at his own expense for a certain period. One respondent (the director of company) told that the local population stole traffic signs. Only when the company had replaced the signs did the Chamber certify the completion of contract.

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The Director of one of the companies specializing in quality control stated, “How do you assess the quality of the road works in Georgia in general? As for compliance standards in our sphere, we attained the 90% level. Overall compliance in the road construction sphere is much higher than in other spheres,” He excluded possibility of corruption in his sphere because engineers have relatively high salaries (300-500 GEL). Therefore, there is less of a motive for them to take part in corruption. “We have never had magnates in the sphere,” the Director stated.

The establishment of such companies should have an effect. However, it is in the similar dependent position as other private companies operating in the sector. Moreover, during the interview the Director did not express enthusiasm with respect to the establishment of his LTD and considered it a forced measure. The Director sometimes demonstrated the difficulty in adjusting to his new independence: when speaking he often used the term “we”, unwittingly still identifying himself with SDRG.

Management based on the corporate relations could have both negative and positive sides. It may be functional as a coping strategy in a situation when the collapse of the sector is real. Its aim is to freeze a process of degradation, but it is a bar for the development of sound competitive relations. In fact, the sphere of road construction and maintenance managed to preserve itself from the turbulent 1990’s, but did so at the expense of adhering to the old system of management. Only because of the impetus that came from the international organizations, did the restructuring of the sphere became possible. It is clear that the sector needs comprehensive reforms.

11 CONCLUSIONS

11.1 CORRUPTION, STATE PROCUREMENT, AND EXTERNAL CONTROL

The road sector of Georgia is one of the most closed and opaque sectors of the Georgian economy. The concentration of all decision-making and controlling powers in the hands of one governmental agency has established fertile ground for corruption in the road sector of Georgia.

Currently SDRG is empowered to develop revenue plans for SRF, exercise control over the collection of road taxes by means of SRF tax-collection units, and develop expenditure plans and allocate SRF revenues at its own discretion. Furthermore, they can select contractors for road works, supervise contractors’ performance and exercise quality control, and approve road works. These state-granted powers, combined with the lack of alternative clients for medium to large-scale road works in Georgia, has made the road construction and maintenance enterprises entirely dependent upon SDRG.

In addition, the extreme loyalty of these road enterprises towards SDRG is rooted in the Soviet legacy. This is characterized by the narrow specialization of construction enterprises in Soviet times. This resulted in close relations between enterprises involved in road construction and maintenance and the State Road Administration, which was later transformed into SDRG. These relations endure to this day in spite of the formal privatization process. The term “*formal*” is used because although the privatization of the road construction/maintenance industry has occurred, the absence of private investment in the road sector of Georgia has made the industry dependent upon state contracts, which are solicited through “good relations” with SDRG. As a result, a competitive environment has not been created in the road construction and maintenance industry and the centralized command system has virtually been preserved. This allowed the development of a corruption scheme based on a “kick-back” system, with kickbacks ranging from 10% - 40% of the

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contract value. Moreover there is an uncontrolled discharge of SRF funds through small contracts to road construction and maintenance enterprises.

Numerous breaches of law in the state procurement practices reveal that SDRG largely ignores the existing legislation and uses old methods of distributing work (zonal principle). This entails allocating contracts based on sole-source negotiations even when the contract value exceeds the limits set by the “Law on State Procurement of Georgia.” Even when licit procurement principles are observed, it is almost unfeasible to control the cost-effectiveness of small projects assigned on the basis of the zonal principle and sole-source negotiations. In the majority of cases, the contractual value of such projects is insufficient to implement the projected works. As a result, contractors are expected to “do what they can” with the funds provided. Unless a thorough inspection is carried out, it is impossible to determine how much was really spent on the implementation of contractual obligations. Such projects are of particular concern, as they are assigned on the basis of sole-source negotiations with loyal enterprises, which make it particularly difficult to trace kickbacks to SDRG.

The introduction of competitive bidding under the “Law on State Procurement” was to serve as a mechanism of creating a competitive environment in the road construction and maintenance industry. However, the research shows that the principles of competitive tendering have not taken root in SDRG procurement practices, and tenders at SDRG are competitive in form rather than in content. This is largely due to imperfections in Georgian legislation that regulate state procurement practices.

First, the provision of the “Law on State Procurement” on the composition of tender commissions among officials and employees of the public agency that carries out the bidding creates fertile ground for corruption and a flourishing “kickback” system. The legalized “in-house” decision-making process regarding the selection of contractors makes it easy and risk-free to offer and accept kickbacks for state contracts. This provision especially plays into the hands of SDRG, since the road construction and maintenance industry comprises loyal road enterprises entirely dependent upon SDRG.

Second, the law does not oblige public agencies carrying out the bidding to invite outside experts or civil society representatives to observe tender procedures. Rather, it leaves it to their discretion. This is a significant shortcoming, as SDRG often explains the lack of transparency and external control over tender procedures by the lack of a mandate of corresponding legal provisions.

Third, the State Procurement Agency is only granted the authority of *post facto* assessment of the bidding process based on the documentation provided by the public agency that carried out the bidding. The State Procurement Agency established to exercise monitoring over tender procedures and procurement related decision-making processes. Restrictions on SPA control does not allow SPA to exercise immediate monitoring over tender procedures to identify and respond to violations in a timely manner. It also does not facilitate the establishment of effective governmental control over public expenditures in Georgia.

Attempts to establish public control over SRF and SDRG through the creation of an advisory council at SRF, and attempts to establish a governmental commission within the Presidential Program to facilitate road sector development have proved unsuccessful. The council and the commission exist only formally and, although meetings of the council/ commission members are held occasionally, they have not produced any tangible outcomes. This proves that for effective external monitoring and assistance in the road sector of Georgia, involvement of interested parties, including other governmental agencies, transport sector representatives, and NGOs, is indispensable.

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The problem with external control over SDRG is aggravated by the fact that state controlling and auditing bodies either do not properly perform their functions, such as the Chamber of Control, or do not have the legal mechanisms to do so, such as in the SPA. Thus, in the majority of cases, the Chamber of Control inspection reports lack analysis and conclusions on the lawfulness of SDRG and SRF actions. Moreover, the measures taken by the controlling bodies against detected violations of law and legal practices by SDRG generally take the form of notifications on the detected violations to SDRG with no follow-up action. These measures are not effective against the abuse of power and illegal activities of government officials. No wonder the SDRG response to such notifications has so far been limited to reprimands and promises of stricter punishment for responsible officials. The immunity of SDRG and SRF from external monitoring and control was largely due to close links between SDRG management, namely the former head of SDRG, and the ruling political forces under Shevardnadze's presidency. Hopefully, the situation will change under the new government and the new Head of SDRG.

It is worth noting that the scale of corruption in foreign-financed projects appears to be lower than in SDRG-financed projects. This is due to increased transparency in the procurement procedures and better quality control performed by private contractors. According to the research information, corruption in donor-financed projects mainly takes the form of overpricing of tender proposals and kick-backs for contract awards.

11.2 FINANCES AND TAX COLLECTION

Since 1992, the financing for the road sector of Georgia has been insufficient to meet the needs of the sector. According to the estimate of a World Bank consultant, 560 million USD is required to rehabilitate the road network of Georgia (excluding local roads), and an additional 100 million USD per year to provide proper maintenance of rehabilitated roads. SDRG revenues have been significantly lower than the estimated requirements, reaching a peak (exclusive of foreign assistance) in 1998 at the level of 46.89 million GEL (approximately 23.4 million USD).

Despite the fact that SDRG controls the State Road Fund and the road taxes, there is no real discernable benefit to the road sector. Although there have been certain achievements and SDRG now has stabilized income, the tax revenues of SRF are not sufficient. Research has shown that this is due to a number of reasons.

First, SRF is the only tax-collection body in Georgia not subordinate to the Ministry of Finance, but to the end user of the collected tax revenues, namely the SDRG. This means that SDRG sets revenue mobilization targets for SRF, which are approved by the Ministry of Finance and based on the previous year's performance. It is also charged with reporting on actual SRF performance. Moreover, by having a tax-collection body in its structure, SDRG is the beneficiary of a financial incentive scheme. This is tied to the fulfillment of the tax-collection plans by SRF. Such conditions create fertile ground for corruption and are likely a strong disincentive for SDRG in setting higher revenue mobilization targets for SRF. Thus, by setting lower revenue mobilization targets, SDRG can easily achieve the fulfillment of revenue plans. Furthermore, the financial incentive scheme for the employees allows the SDRG to claim any revenues collected in excess to the planned amount, which in turn is set at SDRG's discretion. Of particular concern is the fact that there is no estimate of the feasible revenue generating capacity of the SRF tax base.

If SRF were a separate taxation body under the jurisdiction of the Ministry of Finance, the accumulation of tax revenues in SRF would be more transparent. The performance of the SRF tax-collection units would also be easier to assess. Another possible option is for road taxes to be collected by the Tax Department and earmarked for SDRG in the central budget. It is important,

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however, that SDRG is granted primary authority to use revenues from the road taxes to manage and finance the road sector of Georgia. A strong argument for transferring the tax collection authority to the Tax Department is that the latter has legal right to audit private companies and take enforcement measures in the case of non-payment. SRF lacks this ability. Moreover, the Tax Department has better resources, including access to databases with more accurate statistics, networks of offices covering all of Georgia and the required equipment. Today, SRF has to apply to the Tax Department for statistical data and auditing of seemingly unreliable enterprises. This creates additional paperwork, reduces cost-efficiency of tax collection, and forces businesses to deal with two tax collection units instead of one.

Second, as Georgian and international experts have pointed out, the earmarking of road taxes is justified only when they are closely tied to road usage. A turnover tax is one with rates that vary according to the type of enterprise. This turnover tax on the use of public roads is unpopular with taxpayers and has even led to tax evasion. Moreover, a turnover tax is very difficult and inefficient to administer in Georgia, where reliable statistics on the turnover of enterprises is unavailable and the share of the shadow economy in the country's GDP is enormous. It is plausible that SRF revenues would be higher if the tax on the use of public roads were replaced by a more straightforward and economically justifiable tax, one that is less prone to abuse. A good example of this would be an increased tax on petrol and diesel.

Third, the lack of collaboration among SRF, the Tax Department, and the Customs Department has a significant negative impact upon SRF revenues. These are the bodies involved in the collection of road taxes. Reluctance to cooperate stems largely from the fact that SRF and the Tax and Customs Departments are accountable to different governmental bodies and have their own revenue mobilization targets. With the generally poor administration of taxes in Georgia and higher governmental and public pressure on the Tax and Customs Departments, the latter will always pursue their own goals. This is true even when it comes down to undercutting SRF. In addition, corruption in the Tax and Customs Departments is a major factor contributing to SRF low revenue levels. This is the result of the transfer of inaccurate data to SRF and a reluctance to take measures against tax violations identified by SRF.

Frequent and inconsistent changes in the legislation, especially the Tax Code, makes it difficult to plan SRF revenues and, hence, the scope of work for the next year. It undermines the SDRG financial base, and creates inconsistencies and contradictions in regulations. Furthermore, there are often irregularities in the enforcement of legal provisions and numerous "loopholes" open for illegal exploitation.

The use of road tolls is a commonly accepted practice the world over, and might be of use to Georgia. It could be instrumental for the generation of revenue for road maintenance. However, the road toll pilot project at the Rikoti Tunnel has not been a success. Despite the installation of toll equipment, numerous violations during the collection of tolls have been detected by various inspections and individuals. The violations themselves have actually allowed the tolls to become another source of illegal revenue. Meanwhile, the tunnel remains poorly maintained due to the lack of resources. Therefore, the introduction of public toll roads in Georgia probably should be postponed until honest fee collection and effective control can be guaranteed.

11.3 IMPLEMENTATION OF SDRG FUNCTIONS

SDRG has proved ineffective in implementing its core functions and objectives. At this time, SDRG has focused on the regulation of the road sector and the provision of a certain level of maintenance to the country's road network. However, SDRG has ignored its main function as a top

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governmental authority: the development and pursuance of governmental policy in the sector. There are no signs of a strategy for the development and maintenance of the road network in Georgia, integrated socio-economic, scientific and technical policy, or an outlook for future developments in the road sector. Meanwhile, in order to achieve sustainable development of the road sector, a long-term program of action is required with continual analysis of the program's implementation, its failures, successes and development prospects, and procedures for program adjustment and modification.

The only attempt to establish a long-term program for the road sector was the Presidential Program for Rehabilitation and Modernization of Roads in Georgia of 1996. This program became ineffectual in the very first year of its implementation. However, the unrealistic goals of the program have not been adjusted to fit real circumstances. The failure of the program, with a deficit of 400 million GEL in the first six years, has not been recognized by SDRG or the government. Moreover, the impracticability of the program goals is often used as an excuse for not attaining even smaller and more feasible objectives.

Among other important responsibilities SDRG has failed to implement are: securing road communication for the people and the economy, cooperating with the Traffic Police to ensure traffic safety on the roads, introducing modern production methods into the road sector, and regulating infrastructure development along roads in accordance with the "Law on Motor Roads" of Georgia.

11.4 CONDITION OF ROADS IN GEORGIA AND QUALITY CONTROL

The poor condition of the road network in Georgia can be explained by the lack of resources to rehabilitate and maintain roads. The situation is much better on the international roads, compared to the intrastate and local roads. Better maintenance of international roads – main trunks connecting Georgia with neighboring countries – is stipulated by the international commitment Georgia has assumed as a part of TRACECA transportation corridor and by the fact that Georgia's development as a transit country has long been among the policy priorities of the Georgian government. Moreover, international roads have undergone extensive maintenance and even rehabilitation on certain sections in the last few years. The condition of the intrastate roads is much worse, and only periodic maintenance is provided on an irregular basis. The condition of local roads is extremely poor and, on many occasions, the roads that connected smaller settlements in Soviet times have turned into earthen roads or ceased to exist at all.

Given the extreme scarcity of resources available to SDRG, reasonable selection of the types of work to be undertaken on particular road sections and rigorous quality control is required. Of special importance is the utilization of foreign aid obtained by SDRG in the form of grants and credits. Both Georgian and foreign experts have criticized the fact that a large portion of foreign aid is used for periodic maintenance, rather than rehabilitation. The lifetime of maintenance work is much shorter than that of rehabilitation work, and once the roads are rehabilitated, further maintenance is much cheaper. The results of SDRG's "pro-maintenance" approach in foreign aid utilization can already be observed. Many road sections, where maintenance works were conducted under World Bank credits in 2001-2002, are already close to the condition they were before the treatment. Therefore, spending borrowed money on short-term improvements seems unreasonable and a waste of money that places heavier burden of external debt repayment on future generations of Georgians.

The frequently cited reasons for SDRG's preference for maintenance works over rehabilitation works with foreign credit are corruption and nepotism. The expenditures on maintenance works are

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more difficult to control, which leaves contractors room for making illegal profits. In addition, the issue of monopolization of certain types of road works by individual companies, which have the necessary equipment and consequently can set higher prices, was even raised before Parliament as an example of inefficient utilization of foreign credits by SDRG.

Quality control on projects funded under foreign credit tends to be better than that on domestically funded projects. This is explained by healthier competition for contracts, and importantly, project supervision implemented by foreign contractors. The quality control on such projects is performed by Georgian sub-contractors reporting to foreign project supervisors. Although many minor defects have also been detected on the repaired sections, the scale of fraud in the quality and volume of construction materials is significantly lower.

With violations of law in the procurement practices at SDRG and strong dependence of road construction and maintenance enterprises upon state contracts, it would be unreasonable to leave quality control and approval of completed works solely in the hands of SDRG. The research evidence shows that SDRG has not been vigilant in quality control, especially over work implemented under small contracts, where quality control frequently does not exist. As a result, Georgian roads are often coated with asphalt of such poor quality that numerous cracks appear and grass starts growing through after the first rain.

This is not to say that SDRG should not be able to control the quality of road works. As a client, SDRG must have the right to check the progress and quality of contractors' work, but the practice of hiring a third party – a private company specializing in quality control and supervision of construction works or a not-for-profit organization capable of doing the job – needs to be introduced. Such contracts should be hired on the basis of open tender and carry legal liability in case of overlooked or concealed defects. Moreover, there is strong demand on the part of the Georgian transport sector for the mandatory involvement of outside experts or organizations to exercise monitoring over the quality of road works. Transport enterprises even expressed readiness to hire qualified specialists to observe road works and report on the non-compliance with standards and other possible violations, if there are legal provisions allowing external monitoring. The Ministry of Urbanization and Construction could also be involved as an external monitoring and control body.

Taking measures to ensure high quality implementation of road works and compliance with corresponding standards is essential for Georgia, where scarce public resources are often used to benefit a small group of people, while economic efficiency of public projects and public benefit is largely neglected. Undoubtedly, Georgia could have a much better road network within existing resources if rigorous quality control of road works were implemented.

11.5 CONSEQUENCES OF POOR ROADS

It is difficult to present exact figures on Georgian economic losses due to the poor state of the roads because this data is often confidential, and not available to researchers. Moreover, the negative consequences of poor roadways are not always quantifiable in a presentable fashion.

At the international level, the poor state of the road network and inadequate development of the road infrastructure impedes the development of the Georgian part of TRACECA corridor and the TRACECA project as a whole. Although there are other factors (unbalanced tariff policy, corruption at customs, political instability, personal safety of drivers, etc.) contributing to the low competitiveness of Georgia as a transit country, bad roads remain a serious disincentive for those who can choose between alternative routes. Moreover, the slow pace of improvement of road

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conditions causes discontent among neighbor states, which are dependent upon Georgia for their import and export transportation.

At the domestic level, the underdevelopment of the road network in Georgia impedes the development of transportation markets, including road haulage and passenger transportation. Transport businesses incur significant losses every year due to the bad state of the roads, which prevents their growth and entrance into the international transportation market. Meanwhile, road transport is the main means of transportation within Georgia. The damage to transport businesses is especially significant as they pay proportionally more in road taxes than any other business in the country.

The poor state of the road network in Georgia, most notably intrastate and local roads, represents a major obstacle for the integrity of the country. The communication between the capital, economic, and cultural centers of the country and other settlements, and even entire regions, is extremely difficult due to the bad state of the roads. Furthermore, some areas are completely isolated from the rest of the country. Because of the impeded movement within the country, there are serious problems with trade, distribution of manufactured goods and agricultural products and labor migration. The inadequate development of the road network has serious political implications, as inhabitants of the areas that are difficult to access feel isolated from the cultural and economic core, while the central government does not have necessary control over these areas.

Poor roads and the lack of road infrastructure hampers the development of the tourism industry, including auto-tourism, since many cultural monuments and attractions for tourists are located all over the country and often in places difficult to access.

According to the traffic police, the inadequate state of the roads is often an accompanying cause of traffic accidents in Georgia. Though official traffic police statistics do not reflect this fact, the inadequate state of the roads can be counted as the main or accompanying cause of a traffic accident only in the presence of SDRG representatives, which rarely occurs. However, the lack of reporting does not eliminate the problem, which has extremely bad consequences. First, because of the absence of the corresponding statistics it is impossible to determine the most dangerous sections of roads by high traffic accident rates and take preventive measures. Second, many people are killed or injured in traffic accidents, and road authorities get away with it even when the traffic police can prove their culpability. Third, no compensation is paid to the damaged party by road authorities because of the lack of evidence owing to the provision in the “Law on Motor Roads.” Meanwhile, if the compensation for damage were paid by SDRG and other responsible authorities it would be a good incentive for improving the quality of roads in Georgia.

Proceeding from the above, the economic and political losses Georgia incurs as a result of the poor development of the road network are too large to be ignored. Tax revenues of the State Road Fund and the state budget could be increased significantly if the condition of the road network is improved. The increase in public revenues would come from both the development of certain industries (e.g. road haulage and passenger transportation, tourism, transit, etc.) and the overall economic growth normally resulting from the improvement of communication infrastructure in a country. Moreover, it would be easier to remove many political constraints caused by the undeveloped communication infrastructure.

12 RECOMMENDATIONS

In order to increase the funds available for the road sector of Georgia and to improve the collection of road taxes we recommend the following:

The State Road Fund should either be removed from SDRG and exist as an independent taxation body under the Ministry of Finance's jurisdiction, or the authority to collect road taxes should be transferred to the Tax Department (except those currently collected by the Customs Department). The revenues from road taxes should be earmarked for the rehabilitation and maintenance of the road network in Georgia, and effective administration of road taxes should be ensured. In this way, SDRG will have no control over the collection of taxes, but will be provided with at least the same level of financing. At the same time, SDRG would have an incentive to conduct a thorough analysis of the revenue-generating potential of the Road Fund tax base and raise concerns over the performance of tax collection units before the government, Parliament and the people of Georgia.

As the "tax on the use of public roads" is very inefficient to administer, regardless of whether the responsible authority is SRF or the Tax Department and is not closely tied to road usage, it would be more efficient to discard the tax. In its place should be an increased tax on petrol and diesel. It would be the most straightforward, most economically defensible, and least corruption-prone method.

It is necessary to stop the practice of frequent amendments to existing legislation, notably the Tax Code of Georgia and other laws effecting revenues from road taxes. This is a particular problem for Georgia as the road sector suffers from the inability to predict the level of revenues for the next fiscal year stemming from amendments to taxation and budget related legislation.

Foreign investment should be solicited for the road sector of Georgia. To attract investment, whether credit or private, it is important that the Government of Georgia fulfill its commitments under international agreements.

The creation of private toll roads should be considered as an alternative option to secure road network development and increase the funds available for the road sector of Georgia. Foreign or domestic investors could be attracted by long-term contracts on preferential terms to construct alternative toll roads with ownership rights for the constructed roads over the duration of the contract. Apart from better quality of roads, it would serve to fight corruption by establishing alternative demand for road construction and maintenance services.

The collection of tunnel tolls at Rikoti Tunnel should be outsourced to a private enterprise, with the revenues earmarked for the maintenance of the tunnel. In addition, granting ownership concession of intrastate and local roads that are in danger of complete deterioration to private parties or community-based organizations could be another possible method of ensuring better maintenance of the roads.

To reduce corruption in SDRG and the road sector of Georgia, increase the level of transparency, and create a competitive environment it is necessary to introduce healthy procurement practices and external monitoring and control over the tender procedures and quality of road works.

Serious amendments are required to the "Law on State Procurement" of Georgia. Firstly, the provision on the composition of tender commissions should be amended and the involvement of outside experts, transport sector, and civil society representatives made obligatory. In addition, bids could be presented in two volumes: a technical bid and a financial bid, with different and independent bodies assessing the respective volumes, with a predetermined formula used to assess the best bid from the two submissions - a common practice on large projects in the West.

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The State Procurement Agency should be given the authority to exercise immediate control over tender procedures in order to take timely action in case of violations. It should also act as the auditing and law enforcement authority within its area of specialization.

The zonal principle of contracting out road works should be reduced to the minimum. We recommend that small maintenance contracts be consolidated into larger contracts (e.g. maintenance of roads in one or several districts, rather than on certain road sections) and put on open tenders, so that only companies that have an adequate technical base and experience be offered long-term maintenance contracts. Moreover, these procedures will make performance and quality control much easier and cost-effective.

Quality control functions should be removed from SDRG and granted to private enterprises or not-for-profit organizations selected on the basis of open tenders, similar to those methods employed for projects operating using foreign credit. Independent monitoring of road works should be allowed, and the results of such monitoring given serious consideration by road authorities. The Ministry of Urbanization and Construction could be involved as external monitoring and control body.

The Chamber of Control and other auditing bodies should not limit their functions to detecting violations, but take further steps to ensure that corresponding measures are taken and the responsible authorities are punished as provided for in Georgian legislation.

Recruitment of specialists with the necessary technical and administrative skills would be useful to raise the performance level of SDRG personnel and break the long-standing links between SDRG officials and private enterprises. It is possible that preference should be made for people with either a Western education or experience working in Western companies in key positions in the financial, procurement, and performance management and quality control departments.

Advisory councils or governmental commissions guiding and controlling the processes in the road sector of Georgia should be granted authority to have a real impact upon these processes. Moreover, they must be composed of people who have a strong and well-grounded interest in ensuring the proper functioning of the road sector.

To provide sustainable development of the road sector of Georgia, the failure of the Presidential Program for Rehabilitation and Modernization of Roads in Georgia of 1996 must be publicly recognized. A realistic long-term program must be developed containing inherent mechanisms for continual analysis of program implementation, program failures, successes and development prospects, and procedures for program adjustment and modification. SDRG should focus on development, coordination, and implementation of the national policy in the road sector of Georgia, rather than the day-to-day working relationship with road enterprises.

Special efforts should be made to establish collaborative relationships with other governmental agencies, including the Ministry of Transport and Communications, the State Road Administration, the Traffic Police, the Department for Statistics, the Customs Department, the Tax Department, the Ministry of Finance and local government bodies to ensure the effective and timely solution of emerging problems.

To ensure traffic safety, mechanisms for calling SDRG to account for traffic accidents caused by inadequate conditions of the road should be elaborated upon and enforced. Corresponding amendments should be introduced to the “Law on Motor Roads” of Georgia to transfer complete authority to investigate the causes of traffic accidents to the traffic police or an otherwise independent investigative body.

The creation of independent non-governmental organizations would ensure a higher degree of accountability of the road authorities – e.g., an association for the protection of road users’ rights -

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that would advocate road users' rights, including: demanding adequate preventive measures on dangerous road sections, conducting independent investigation of traffic accidents, and bringing corresponding matters into court to solicit compensation for inflicted damage from the responsible authorities.

AFTERWORD

In the aftermath of the Georgian “Rose Revolution” of November 23, 2003, profound changes are underway in the government structures of Georgia, including SDRG and SRF.

A new Head of SDRG was appointed on December 16, 2003,⁷⁷ with a subsequent change of the top level of SDRG management. New professionals were hired to replace deputies and many chiefs of divisions, although the technical and support personnel have generally remained the same. The SDRG organizational structure is also under review and is likely to be modified in the near future.

The new “Law on the Structure, Authorities and Activity Rule of the Government of Georgia” of February 11, 2004 resulted in SDRG being transferred to the jurisdiction of the newly established Ministry of Infrastructure and Development. Further changes in SDRG’s legal status, including SDRG transformation into a “legal entity of public law,” are also being considered. Its possible status as a “legal entity of public law” would give SDRG more flexibility regarding its structure, number of employees, remuneration policies, the purchase of equipment and facilities, and obtaining grants and credits. It would also allow SDRG to focus on the implementation, rather than the development, of state road sector policy by transferring certain functions (e.g. policy development, foreign relations, technical standards development and approval, etc.) to the Ministry of Infrastructure and Development.

Amendments to the “Law on State Road Fund of Georgia” of December 31, 2003⁷⁸ have reduced the number of road taxes. Beginning January 1, 2004 there are only four road taxes: a tax on the use of public roads, a vehicle ownership tax, a tax for entering the territory of Georgia, and a tax on weight infringement and extra axle load.

Since March 1, 2004 SRF has been deprived of its former tax collection duties, which have been transferred to the Tax Department at the Ministry of Finance. SDRG has only retained the collection of tolls at Rikoti Tunnel. All road taxes are earmarked for SDRG and the road sector.

SDRG’s total budget in 2003 amounted to 50.2 million GEL, compared to SDRG revenue in January – March 2004⁷⁹ that reached 12.398 million GEL. During 2003, the total revenue from the tax on the use of public roads reached 18.75 million GEL, an average of 1.563 million GEL per month. The first few months under the new administration have seen an increase in revenue from this tax to 2.303 million GEL per month in January – February. Although, there was a decrease to 704.4 thousand GEL in March – the first month after the transfer of tax collection function to the Tax Department - the tax revenues are expected to increase again as the Tax Department’s inspections grow into collection of road taxes. The revenues at Rikoti Tunnel have increased by 60% since January 2004, which supports the view that the low levels of SRF revenue under the previous SDRG administration were due to inefficient tax collection and the non-disclosure of all SRF incomes.

SDRG has managed to cover all the arrears accumulated by the previous administration, including liabilities to road construction firms for works completed in previous years, SDRG’s share in the co-financing of projects under the World Bank and Kuwait Fund credits, and the repayment of interest, principal and penalties on loans from international financial organizations.

⁷⁷ Acting President’s Order No. 1620 of December 16, 2003.

⁷⁸ Amendment #3179 – “Law on Amendments to the Law on State Road Fund of Georgia”, December 31, 2003.

⁷⁹ As fiscal year in Georgia starts on January 1, first quarter of a year is normally a low period for tax revenues.

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SDRG's approach to procurement practices has also changed. Since January 1, 2004 SDRG has conducted 18 open tenders. However, only 7 contracts were awarded and 11 tenders failed due to the lack of competition and overpricing of bids – an outcome previously unheard-of. The SDRG administration seems determined to eradicate the corrupt procurement practices that have existed in the road sector for decades, while introducing competitive bidding principles even if it involves additional expense for repeated tenders.

Some 55 contracts for the treatment of local and intrastate roads (where the contract values are set within the limits prescribed by the Law on State Procurement) were provided on the sole-source procurement basis. According to SDRG officials, they started verifying estimates presented by potential contractors, which surprised many road construction firms accustomed to overpricing their services to compensate for kickbacks. Moreover, advance payments are now made under bank guarantees and on terms set forward in contracts.

Several improvements have been introduced to the quality control system. Each contract for road works now incorporates a one-year guarantee period, within which contractors are obliged to repair all faults at their own expense. A special quality control commission has been established at SDRG to control the quality of road works. Quality control on large projects is maintained by private companies selected on a tender basis. According to SDRG, now that all payments to contractors are made on time, it is much easier to enforce quality requirements that were largely neglected before.

Another SDRG success (in cooperation with the Transport Reform and Rehabilitation Center) is the preliminary agreement on a new World Bank credit for "Intrastate and Local Roads Project," scheduled to start in January 2005. The credit is likely to be equivalent to 30 million USD and the anticipated project duration is 3 years (2005 - 2008). The credit is to fund a project for the rehabilitation of 300 – 350 km of intrastate and local roads. Three companies have been awarded contracts to develop tender documentation for works under the new credit.

The new SDRG administration has demonstrated an understanding of and adherence to the principles of transparency and public accountability, which has resulted in a strengthening of the public and media relations division at SDRG. SDRG now responds to enquiries within days. The Georgian press has produced 18 publications on SDRG in the past three months including financial reports, press releases, articles on road sector problems, tender announcements and reports on tender outcomes including disclosures on the value of awarded contracts, contract recipients, road sections to be treated and reasons for not awarding specific contracts. SDRG has also arranged several media and television trips to areas with notoriously bad roads to raise public awareness on the road sector.

SDRG intends to establish a supervisory board composed of government and transport sector representatives (public officials, road haulage contractors and transport NGOs), to increase the transparency of SDRG activities. The Supervisory Board will monitor the efficiency and effectiveness of SDRG expenditures, determine development priorities and help solve road sector problems. However, as experience with the Advisory Council at SRF shows, ensuring the effective functioning of the Board will be a major challenge.

SDRG has announced a contest for innovative cost-efficient solutions for addressing lighting, air-conditioning and fee collection at Rikoti Tunnel. Several proposals have already been received from private companies, which will significantly reduce tunnel maintenance expenses. The SDRG administration seems determined to focus on the total rehabilitation of Georgia's road network, in contrast to the past practice of extensive patchwork repair. This has resulted in the planning of a series of rehabilitation works for 2004 funded by the SDRG budget, including the rehabilitation of bridges, most of which need emergency repair.

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It would appear that some of the recommendations in the report have already received recognition by SDRG administration and their implementation has started. However, it is too early to judge whether current improvements are a short-term response to the strong political pressure of the time, or signs of positive trends in the road sector of Georgia. One thing is certain though: if SDRG administration pursues its current course, Georgia has a chance of enjoying better roads and therefore developing into an effective transit country.

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APPENDIX 1 - TRANSPORT STATISTICS

Freight carried by general purpose transport types (thsd. tons)

| Years | Total | Type | | | |
|-------|----------|----------|----------------|---------|------|
| | | railroad | motor vehicles | marine | air |
| 1980 | 239977,7 | 86528,7 | 147348,0 | 6091,0 | 10,0 |
| 1985 | 276273,9 | 91258,9 | 175915,0 | 9084,0 | 16,0 |
| 1990 | 253074,9 | 76860,9 | 167070,0 | 9127,0 | 17,0 |
| 1991 | 182020,9 | 56709,9 | 115032,0 | 10267,0 | 12,0 |
| 1992 | 47106,8 | 14633,4 | 26545,0 | 5921,4 | 7,0 |
| 1993 | 23049,8 | 7965,9 | 10416,0 | 4662,9 | 5,0 |
| 1994 | 14567,1 | 3173,4 | 8168,0 | 3224,2 | 1,5 |
| 1995 | 14985,1 | 4656,4 | 8690,0 | 1636,6 | 2,1 |
| 1996 | 14149,0 | 4783,7 | 8800,0 | 561,8 | 3,5 |
| 1997 | 19703,0 | 7200,0 | 12200,0 | 300,0 | 3,0 |
| 1998 | 24124,1 | 8494,9 | 15000,0 | 625,0 | 4,2 |
| 1999 | 25913,4 | 9492,0 | 16000,0 | 419,1 | 2,3 |
| 2000 | 30060,0 | 11496,1 | 18500,0 | 62,6 | 1,3 |
| 2001 | 33168,7 | 13137,0 | 20000,0 | 30,5 | 1,2 |
| 2002 | 37400,0 | 14900,0 | 22500,0 | - | 1,3 |

Source: State Department for Statistics of Georgia.

Freight turnover by general-purpose transport types (million of tons/km)

| Years | Total | Type | | | |
|-------|---------|----------|----------------|---------|------|
| | | railroad | motor vehicles | marine | air |
| 1980 | 74281,6 | 19639,7 | 2355,0 | 52261,8 | 25,1 |
| 1985 | 74915,6 | 17829,4 | 3017,5 | 54041,4 | 27,3 |
| 1990 | 79937,6 | 15476,7 | 2577,6 | 61854,9 | 28,4 |
| 1991 | 66584,8 | 12116,7 | 1652,5 | 52788,7 | 26,9 |
| 1992 | 40927,7 | 3511,9 | 387,7 | 37018,9 | 9,2 |
| 1993 | 34611,2 | 1553,6 | 121,4 | 32931,5 | 4,7 |
| 1994 | 26680,2 | 954,8 | 83,6 | 25637,8 | 4,0 |
| 1995 | 15519,3 | 1246,0 | 130,0 | 14138,3 | 5,0 |
| 1996 | 7412,7 | 1141,4 | 131,3 | 6132,0 | 8,0 |
| 1997 | 5987,7 | 2006,2 | 303,5 | 3671,4 | 6,6 |
| 1998 | 10390,0 | 2573,7 | 385,0 | 7421,9 | 9,4 |
| 1999 | 9045,8 | 3160,4 | 420,0 | 5460,3 | 5,1 |
| 2000 | 5001,7 | 3192,1 | 475,0 | 611,7 | 2,9 |
| 2001 | 5156,8 | 4473,0 | 520,0 | 161,1 | 2,7 |
| 2002 | 5710,6 | 5057,5 | 543,0 | - | 3,17 |

Source: State Department for Statistics of Georgia.

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Average length of transportation of 1-ton freight by general transport types (km)

| Years | Railroad | Motor vehicles | Marine | Air |
|-------|----------|----------------|--------|------|
| 1980 | 227 | 16 | 8580 | 2510 |
| 1985 | 195 | 17 | 5949 | 1706 |
| 1990 | 201 | 15 | 6777 | 1671 |
| 1991 | 214 | 14 | 5142 | 2242 |
| 1992 | 240 | 15 | 6252 | 1314 |
| 1993 | 195 | 12 | 7062 | 940 |
| 1994 | 301 | 10 | 7952 | 2667 |
| 1995 | 268 | 15 | 8639 | 2381 |
| 1996 | 239 | 15 | 10915 | 2286 |
| 1997 | 277 | 25 | 13828 | 2357 |
| 1998 | 303 | 26 | 11875 | 2238 |
| 1999 | 333 | 26 | 13029 | 2217 |
| 2000 | 340 | 26 | 9772 | 2231 |
| 2001 | 340 | 26 | 5282 | 2250 |
| 2002 | - | - | - | - |

Source: State Department for Statistics of Georgia.

Passengers carried by general purpose transport types (million persons)

| Years | Total | Type | | | | | | |
|-------|--------|----------|-------|------------|----------------|------|--------|--------|
| | | railroad | bus | trolleybus | metro (subway) | tram | marine | air |
| 1980 | 984,0 | 31,0 | 643,8 | 123,7 | 142,5 | 39,4 | 1,2 | 2,4 |
| 1985 | 1138,4 | 25,6 | 804,2 | 112,7 | 144,8 | 47,3 | 1,3 | 2,5 |
| 1990 | 1043,9 | 14,8 | 735,2 | 77,5 | 183,4 | 29,5 | 0,8 | 2,7 |
| 1991 | 870,5 | 11,0 | 613,3 | 56,1 | 167,3 | 20,1 | 0,3 | 2,4 |
| 1992 | 354,9 | 7,6 | 149,9 | 27,1 | 157,8 | 11,8 | 0,01 | 0,7 |
| 1993 | 311,9 | 7,3 | 81,5 | 28,6 | 182,2 | 11,7 | - | 0,6 |
| 1994 | 246,4 | 9,8 | 87,6 | 7,8 | 138,0 | 2,9 | 0,01 | 0,3 |
| 1995 | 277,7 | 3,1 | 116,2 | 9,7 | 142,2 | 6,2 | - | 0,3 |
| 1996 | 320,3 | 3,0 | 141,0 | 13,8 | 155,2 | 7,0 | 0,002 | 0,3 |
| 1997 | 318,7 | 1,9 | 176,0 | 18,8 | 114,0 | 7,8 | 0,01 | 0,2 |
| 1998 | 326,3 | 2,3 | 205,0 | 15,8 | 96,4 | 6,6 | - | 0,2 |
| 1999 | 340,9 | 1,9 | 226,0 | 15,8 | 89,8 | 7,2 | - | 0,2 |
| 2000 | 366,7 | 2,3 | 235,0 | 16,2 | 105,4 | 7,7 | - | 0,1 |
| 2001 | 364,0 | 2,1 | 240,0 | 15,7 | 97,3 | 8,8 | - | 0,1 |
| 2002 | 373,84 | 2,1 | 249,5 | 122,1 | | | - | 0,1375 |

Source: State Department for Statistics of Georgia.

Corruption in the Road Sector of Georgia

Passenger turnover by general-purpose transport types (million of passengers/km)

| Years | Total | Type | | | | | | |
|-------|---------|----------|--------|-----------------------|----------------|-------|--------|--------|
| | | railroad | bus | trolleybus | metro (subway) | tram | marine | air |
| 1980 | 15500,6 | 3622,0 | 6134,0 | 606,1 | 912,0 | 208,8 | 36,7 | 3981,0 |
| 1985 | 18349,6 | 3724,0 | 8169,0 | 552,2 | 926,7 | 250,7 | 41,0 | 4686,0 |
| 1990 | 17823,0 | 2457,0 | 8335,0 | 379,8 | 1173,8 | 156,4 | 24,0 | 5297,0 |
| 1991 | 15176,1 | 2135,0 | 7110,0 | 274,9 | 1070,7 | 106,5 | 6,0 | 4473,0 |
| 1992 | 5793,2 | 1210,0 | 2147,0 | 132,8 | 1009,9 | 62,5 | 3,0 | 1228,0 |
| 1993 | 4062,5 | 916,9 | 1204,4 | 140,1 | 1166,1 | 62,0 | - | 573,0 |
| 1994 | 4035,1 | 1164,5 | 1463,5 | 38,2 | 883,2 | 15,4 | 2,6 | 467,7 |
| 1995 | 4035,6 | 371,1 | 1907,3 | 47,5 | 910,1 | 32,9 | - | 766,7 |
| 1996 | 4053,9 | 380,3 | 2049,9 | 67,2 | 993,0 | 36,9 | 0,2 | 526,2 |
| 1997 | 5015,7 | 293,7 | 3400,0 | 93,9 | 729,4 | 50,5 | 1,2 | 447,0 |
| 1998 | 5523,6 | 396,9 | 3910,0 | 85,7 | 616,9 | 43,1 | - | 471,0 |
| 1999 | 5722,9 | 355,1 | 4310,0 | 92,0 | 574,8 | 45,1 | - | 345,9 |
| 2000 | 6002,0 | 452,9 | 4500,0 | 90,5 | 674,6 | 46,2 | - | 237,8 |
| 2001 | 6122,6 | 398,0 | 4700,0 | 106,0 | 622,7 | 55,4 | - | 240,5 |
| 2002 | 5676,9 | 392,3 | 4987,3 | not included in total | | | - | 297,3 |

Source: State Department for Statistics of Georgia.

Average length of transportation of 1 passenger by general transport types (km)

| Years | Railroad | Bus | Trolleybus | Metro (subway) | Tram | Marine | Air |
|-------|----------|------|------------|----------------|------|--------|--------|
| 1980 | 116,8 | 9,5 | 4,9 | 6,4 | 5,3 | 30,6 | 1658,9 |
| 1985 | 145,5 | 10,2 | 4,9 | 6,4 | 5,3 | 31,5 | 1874,4 |
| 1990 | 166,0 | 11,3 | 4,9 | 6,4 | 5,3 | 30,0 | 1961,9 |
| 1991 | 194,1 | 11,6 | 4,9 | 6,4 | 5,3 | 20,0 | 1863,8 |
| 1992 | 159,2 | 14,3 | 4,9 | 6,4 | 5,3 | 300,0 | 1754,3 |
| 1993 | 125,6 | 14,8 | 4,9 | 6,4 | 5,3 | - | 955 |
| 1994 | 118,8 | 16,7 | 4,9 | 6,4 | 5,3 | 259,0 | 1559,0 |
| 1995 | 119,7 | 16,4 | 4,9 | 6,4 | 5,3 | - | 2555,6 |
| 1996 | 126,8 | 19,3 | 5,0 | 6,4 | 5,3 | 120,0 | 1754,0 |
| 1997 | 154,6 | 19,3 | 5,0 | 6,4 | 5,3 | 120,0 | 2235,0 |
| 1998 | 172,6 | 19,1 | 5,4 | 6,4 | 6,5 | - | 2355,0 |
| 1999 | 186,9 | 19,1 | 5,8 | 6,4 | 6,3 | - | 1730,0 |
| 2000 | 196,6 | 19,1 | 5,6 | 6,4 | 6,0 | - | 2378,0 |
| 2001 | 189,5 | 19,6 | 6,7 | 6,4 | 6,3 | - | 2405,0 |
| 2002 | - | - | - | - | - | - | - |

Source: State Department for Statistics of Georgia.

APPENDIX 2 - TRANSPORT WAY STATISTICS

Operational length of transport ways (km)

| Years | Railway tracks | Metro (subway) tracks (two-way) | Tramway (two-way) | Trolleybus (two-way) | General purpose motor roads |
|-------|----------------|---------------------------------|-------------------|----------------------|-----------------------------|
| 1980 | 1420 | 19 | 50 | 160 | 22196 |
| 1985 | 1465 | 23 | 50 | 215 | 21334 |
| 1990 | 1586 | 25 | 43 | 300 | 21599 |
| 1991 | 1586 | 25- | 43 | 337 | 21651 |
| 1992 | 1586 | 25 | 43 | 289 | 21601 |
| 1993 | 1586 | 25 | 43 | 281 | 21094 |
| 1994 | 1586 | 25 | 43 | 213 | 20738 |
| 1995 | 1586 | 25 | 41 | 289 | 20970 |
| 1996 | 1586 | 25 | 41 | 284 | 20298 |
| 1997 | 1586 | 25 | 36 | 311 | 20120 |
| 1998 | 1586 | 25 | 36 | 311 | 20215 |
| 1999 | 1576 | 25 | 36 | 311 | 20215 |
| 2000 | 1562 | 27 | 36 | 270 | 20362 |
| 2001 | 1565 | 27 | 36 | 272 | 20229 |
| 2002 | - | - | - | - | - |

Source: State Department for Statistics of Georgia (2002).

Length and parameters of road network

| Roads | Total length (km) | Category ⁸⁰ | | | | |
|---------------|-------------------|------------------------|------------|------------|-------------|--------------|
| | | I | II | III | IV | V |
| | | km | km | km | km | km |
| International | 1474 | 13 | 765 | 180 | 422 | 94 |
| Intrastate | 3326 | 0 | 33 | 266 | 1839 | 1188 |
| Local | 15429 | 0 | 0 | 0 | 3310 | 12119 |
| Total | 20229 | 13 | 798 | 446 | 5571 | 13401 |

Source: Documents of the Joint Seminar on Transport Policies in the three South Caucasus States, April 2002.

⁸⁰ Road category is determined by GOST standards (old soviet standards still used in Georgia). Depending on road parameters (composition and carrying capacity), there are 5 categories of roads, where I category is the highest and V category is the lowest one.

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Bridges

| Type of road | Number | Length (m) | Average length (m) |
|---------------|-------------|---------------|--------------------|
| International | 609 | 24646 | 40 |
| Intrastate | 1191 | 28536 | 24 |
| Local | 2227 | 33737 | 15 |
| Total | 4077 | 86,919 | |

Source: Final Report, SDRG and Transport Rehabilitation Project, financed IDA – World Bank (April 1998).

Drainpipes

| Type of road | Number | Length (m) | Average length (m) |
|---------------|--------------|---------------|--------------------|
| International | 2909 | 55321 | 19 |
| Intrastate | 5936 | 77862 | 13 |
| Local | 15099 | 117573 | 8 |
| Total | 23944 | 250756 | |

Source: Final Report, SDRG and Transport Rehabilitation Project, financed IDA – World Bank (April 1998).

Tunnels and snow retention walls

| Type of road | Tunnels | | Snow retention walls | |
|---------------|-----------|--------------|----------------------|-------------|
| | Number | Length (m) | Number | Length (m) |
| International | 9 | 8879 | 7 | 1115 |
| Intrastate | 7 | 2695 | 4 | 469 |
| Total | 16 | 11574 | 11 | 1584 |

Source: Final Report, SDRG and Transport Rehabilitation Project, financed IDA – World Bank (April 1998).

Mountain passes

| Type of road | Number | Winter state |
|---------------|-----------|-----------------------|
| International | 3 | open most of the time |
| Intrastate | 11 | 4 – open, 7 – closed |
| Local | 2 | Closed |
| Total | 16 | |

Source: Final Report, SDRG and Transport Rehabilitation Project, financed IDA – World Bank (April 1998).

APPENDIX 3 - LEGISLATIVE MILESTONES

Law on Motor Roads

On November 11, 1994 the “Law on Motor Roads” was adopted by the Parliament of Georgia. It was the first significant step since 1991 towards the establishment of new regulations for the road sector of Georgia.

The “Law on Motor Roads” provides and establishes the following:

- legal definitions for a motor road, its components and infrastructure;
- types and the classification of roads;
- road administration structure and the related rights and responsibilities of the state authorities;
- mechanisms for financing and providing logistical support to the road sector;
- rules for the use of roads and road infrastructure, and for the state control over the road network of Georgia;
- provisions for traffic safety and medical aid on the roads;
- rights of the road administration employees; and,
- road work standards

Under the law, the definition of a motor road includes: the traffic area, bridges (including trestle bridges), tunnels, road junctions, drainage facilities, abutments, hard shoulders, bicycle lanes and sidewalks, the right-of-ways and facilities located within the right-of-ways, as well as other road facilities. It also includes the road infrastructure (e.g. communications, lighting, road signs, etc.), the air space above the road within the standard vehicle dimensions, and various protective facilities.

The roads in Georgia are divided into public roads and departmental roads. Departmental roads are the roads located on the territory of public or private organizations, which are in charge of those roads. Roads are classified according to their importance as international, intrastate and local roads:

- International roads connect Georgia with administrative, industrial and cultural centers of other countries;
- Intrastate roads connect administrative, industrial and cultural centers within Georgia and may also include roads of military or strategic importance; and,
- Local roads connect villages and other settlements with each other and with administrative, industrial and cultural centers within Georgia.

The list of international and intrastate roads should be reviewed every 5 years by SDRG and approved by the president of Georgia. The list of local roads should be reviewed every 3 years and approved by the local government bodies.

Initially, the Cabinet of Ministers of the Republic of Georgia was responsible for pursuing an integral policy in the road sector. This responsibility was granted to SDRG by the amendment of

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October 16, 1997. Since July 20, 2001 all the issues regarding road network development must be resolved in cooperation with the Ministry of Transport and Communication.

By law, roads are managed by their owner, who is responsible for construction, reconstruction, repair and maintenance of the roads. Accordingly, international and intrastate public roads in Georgia are managed by SDRG - the owner of public roads on behalf of the state. Local roads are managed by local authorities. Traffic police and local government authorities are responsible for controlling traffic safety and its compliance with the corresponding standards.

The law obliges road authorities to reimburse the damage suffered by road users in traffic accidents caused by the poor state of the road, if the cause of the accident was a full or partial failure of the road authorities to implement their duties.⁸¹ At the same time, damage to the road surface inflicted by road users must be reimbursed by the responsible party.

The road sector and road works on the public roads are financed from the state budget and other sources. In 1995, the State Road Fund was established for the specific purpose of collecting and providing funds for the road sector of Georgia.

Toll roads can be established in Georgia only if there is an alternative free road. By the amendment of October 16, 1997, revenues collected from toll roads must be used on the maintenance of these roads.

The “Law on Motor Roads” of Georgia contains 17 restrictions and prohibitions of certain activities, the most significant of which are:

- use of roads by vehicles, whose dimensions, weight or axle load exceed the standard determined by Georgian legislation;
- installation of commercial stands along the roads without a permit issued the road authorities;
- trading within the traffic area;
- construction and agricultural activities, as well as geological surveys and other specified activities in the right-of-way (which extends 100m to each side from the road) without the permit of the road authorities; and,
- installation of kiosks and other movable facilities within the road right-of-way without the permit of the road authorities.

The “Law on Motor Roads” was amended twice,, in 1997⁸² and 2001.⁸³ These amendments have been incorporated into the description of the main provisions of the law.

The Law on the Road Fund

The second major legislative event for the road sector was the adoption of the “Law on Road Fund” on September 2, 1995. This law provides for the allocation of necessary financial resources for the development and maintenance of roads, and creates a legal foundation for the establishment of the State Road Fund. It determines the objectives of the Road Fund and establishes rules for utilizing its resources.

⁸¹ Article 19, Responsibility of Road Authorities, “Law on Motor Roads” of Georgia.

⁸² “Law on amendments and supplements to the “Law on Motor Roads” of Georgia”, October 16, 1997.

⁸³ “Law on supplements to the “Law on Motor Roads” of Georgia”, July 20, 2001.

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Since its adoption in 1995, many amendments and supplements have been made to the “Law on Road Fund,” for example, in 1996⁸⁴, 1997⁸⁵, 1999⁸⁶, 2001⁸⁷ and 2002⁸⁸, the most important of which have been incorporated in this review. The majority of the amendments are related to tax rates, expansion of the tax base, and tax payment procedures.

SRF was created as an off-budget establishment for the specific purpose of financing the maintenance, repair, reconstruction and construction of the roads in Georgia, as well as other activities related to technical and scientific progress, development and management of the road sector. The law forbids the use of SRF resources for purposes not related to the abovementioned..

As of October 16, 1997 SRF is managed by SDRG,⁸⁹ which determines the procedures for the collection of road taxes and manages the SRF resources. Every year SDRG should publish plans for the utilization of SRF resources in the upcoming year and actual expenditures of the previous year in the Georgian press.

The law identifies sources of revenue for SRF:

- tax on the use of public roads;
- tax for the sale of fuel and lubricants;
- vehicle ownership tax;
- fees for entering the territory of Georgia and transit fees;
- tax for using underground communication facilities located in the road right-of-way and for the placement of commercial stands along the public roads;
- road administration revenues from lotteries, interest on lending, sale of shares and collected fines; and,
- other sources as determined by the law.

The administration of road taxes is carried out in accordance with Chapter XIV of the Tax Code of Georgia. The collection of taxes for the Road Fund, the registration and control of revenues is implemented by SRF tax inspections, the State Tax Inspection and the Customs Department, as provided by the legislation.

Taxes paid by enterprises and other organizations under this law are included in the production costs. Recovered tax payment shortfalls and revenues from fines are transferred to SRF minus the fees to the organization, which detected the violations.

The law also provides for the creation of a special fund for the incentive scheme for SRF and SDRG employees in accordance with Article 270 of the Tax Code.

Rules and procedures for the collection of taxes, registration of revenues, control and use of the resources of the Road Fund of Georgia

⁸⁴ “Law on supplements to the “Law on Road Fund” of Georgia”, June 27, 1996.

⁸⁵ “Law on amendments and supplements to the “Law on Road Fund” of Georgia”, October 16, 1997.

⁸⁶ “Law on amendments and supplements to the General legislative Act of Georgia, April 16, 1999; “Law on supplements to the “Law on Road Fund” of Georgia,” June 9, 1999.

⁸⁷ “Law on amendments to the “Law on Road Fund” of Georgia,” June 5, 2001.

⁸⁸ “Law on supplements to the “Law on Road Fund” of Georgia,” June 7, 2002.

⁸⁹ In the original text SRF was under the jurisdiction of the Cabinet of Ministers. By the resolution # 674 of October 18, 1995 SRF management authority was transferred to the state concern “Sakavtogza,” which was transformed into SDRG in 1997.

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On October 18, 1995 a resolution was issued by the Cabinet of Ministers on the “Rules and Procedures for the Collection of Taxes, Registration of Revenues, Control and Purposive Use of the Resources of the Road Fund of the Republic of Georgia.”⁹⁰ This resolution included:

- provisions for the transfer of SRF management authority to the state concern Sakavtogza;
- approval of the “Regulations on the collection of taxes, registration of revenues, control and purposive use of the resources of the Road Fund;” and,
- specific requirements, including providing specific data to Sakavtogza and assistance in tax collection to different authorities, such as the Ministry of Finance, the State Tax Service, the Social and Economic Information Committee, the Ministry of Internal Affairs (Traffic Police Department), and Tbilisi Municipality.

The “Regulations on the Collection of Taxes, Registration of Revenues, Control and Purposive Use of the Resources of the Road Fund” set the road tax rates, procedures and due dates for tax payments, enforcement procedures in case of non-payment, and reporting forms.

Presidential Program for Rehabilitation and Modernization of Roads in Georgia

On June 14, 1996 the President of Georgia issued the Order “On the Measures for Rehabilitation and Development of the Motor Roads in Georgia.”⁹¹ The order contains a forthright statement on the problems in the road sector of Georgia and assigns top priority to the rehabilitation of roads. A great emphasis is placed on the development of the TRACECA transportation corridor, which should promote Georgia’s role as a transit country and facilitate its integration into the world economy. The order contains detailed guidelines for improving the situation in the road sector of Georgia, including the establishment of a governmental commission to develop a presidential program on the road system rehabilitation and modernization, and on the mobilization of financial resources necessary for the program’s implementation.

Among specific issues addressed in the order was the development of the Presidential Program for Rehabilitation and Modernization of Roads in Georgia. It was proposed that the following measures be undertaken:

3. Making the rehabilitation and development of roads a top priority issue for the country’s economic development.
4. The creation of a report by *Sakavtogza* on the status of the road network in Georgia and its capacity for future development.
5. The establishment of a governmental commission for the elaboration of the Presidential Program for Rehabilitation and Modernization of Roads and mobilization of financial resources. The commission was to carry out state policy in this field, to ensure the effective development of the TRACECA corridor, and to promote Georgia’s role as a transit country. The commission was made up of representatives from the following establishments: State Minister of Georgia, Faculty of the Georgian Technical University (motor road and aerodrome design and construction departments), *Sakavtogza* (later SDRG), State Department for Motor Transport of Georgia, Ministry of Trade and Foreign Economic Relations (later the Ministry of Economy, Industry and Trade), Ministry of Justice, Ministry of Finance, Ministry

⁹⁰ Resolution #674 of the Cabinet of Ministers of the Republic of Georgia, October 18, 1995

⁹¹ Order #388 of the President of Georgia, June 14, 1996

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of Internal Affairs (Traffic Police Department), State Chancellery of Georgia (Office of Economy and Communication), Transport Coordination Council of Georgia, Institute *Saksakhgzaproekti* (road design institute); Ministry of Defense, Eurasia Transport Corridor Problems Center, Ministry of State Property, Presidential Office of Local Government Policy Coordination, Institute of Transport Problems, Parliamentary sub-committee on construction and municipal economy.

6. The program was to be developed by the governmental commission in order to examine the following measures:

- Determining priority routes and developing a program for their rehabilitation;
- Developing a winter maintenance program;
- Creating an infrastructure development program;
- Mobilizing finances from governmental reserves, large investment projects, SRF resources, permits for the use of roads by heavy vehicles, resources of the central and local budgets, and foreign investments;
- Creating a subcommission to develop scientific recommendations on the development of the road infrastructure and land acquisition policy to meet the requirements of *Sakavtogza* and other organizations involved in road rehabilitation and construction;
- Developing a taxation system for enterprises involved in fuel sales, in accordance with “Law on State Road Fund” and taking into consideration recommendations of international organizations. Amending the existing “Law on the Road Fund” before June 30, 1996.

In addition, special instructions were given to several top governmental officials:

- The Minister of Foreign Affairs and the Minister of Foreign Economic Relations and Trade were instructed to provide Asian and European countries with the information on the TRACECA corridor, its capacity and the opportunities it provides; to start actively seeking relationships and negotiations with other countries, especially CIS members, that could be interested in investing and participation in the development of the Eurasian Corridor; and, to report annually their achievements and the estimated amount of investments to the President;
- The Minister of Urbanization and Construction, in cooperation with the Ministry of Economics and the Ministry of Finance, was instructed to develop a regulation on the mandatory financial contribution to the rehabilitation of roads in Georgia from all the large investment projects on the territory of Georgia, and to present it to the governmental commission;
- The Ministry of Finance was instructed to consider, on an annual basis, the largest possible assignments from the central and local budgets to finance the development of the road system; to assist *Sakavtogza* in collection of road taxes, their control and responsible spending; and, to develop legislation against tax evasion; and,
- The *Sakavtogza* was instructed to develop and present to the State Chancellery the following: a classification of roads; a project for the management of the road system in the new economic conditions, taking into consideration the future reconstruction of the road system; mechanisms for controlling the weight and dimensions of heavy vehicles using interstate roads and their licensing by SRF tax inspection units; technical documentation

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on the right-of-ways of the major roads and adjacent areas to be used for the construction of access roads; and, a new system for planning and implementing road works on the basis of new technological developments in compliance with world standards.

On December 25, 1996, Presidential Order No. 837 approved the Presidential Program for the Rehabilitation and Modernization of Roads in Georgia. The proposed duration of the program is 15 years, the first 5 years of which are given for the rehabilitation of the priority routes. The implementation of the program was to become a priority for the economic development of the country. The Order contained guidelines for the responsible authorities and the members of the governmental commission, emphasizing that the commission should present reports on the fulfillment of the annual plans as well as detailed plans for the coming year to the government.

Classification of international, intrastate and local roads

On December 25, 1996 Presidential Order No. 834 approved the list of international, intrastate, and local roads and their classification.⁹² According to the new classification, Georgia had 1,581 km of international roads, and 3,392.3 km of intrastate roads, a total of 4,973.3 km, of which 4803.1 km of roads were *Sakavtogza*'s responsibility, while the remaining 170.2 km were under the control of the regional municipalities.

Law on the State Purchase of Construction Works

On February 6, 1998, the "Law on the State Purchase of Construction Works" was adopted. The purpose of the law was to ensure rational allocation, by state organizations, of resources for the purchase of construction works; thus, endeavoring to raise the quality of construction works and stimulate competition in the wide spectrum of construction activities, including the construction of roads and road facilities.

The Law introduced to Georgia the principle of competitive bidding for construction works exceeding 100 thousand GEL, and survey activities exceeding 10 thousand GEL. The placement of state orders was to be based on the outcome of tenders. To enter the construction market in Georgia, the company (either Georgian or foreign) had to obtain a license from the Ministry of Urbanization and Construction. The Ministry of Urbanization and Construction was responsible for the development of additional regulations on: tender procedures, supervision of tender procedures, implementation of the placed state orders, and resolution of complaints from tender participants prior to transferring them to the courts.

The "Law on the State Purchase of Construction Works" was annulled, when the "Law on State Procurement" was adopted. However, the main principles are still relevant under the new law.

Law on Licensing Design and Construction Works

On September 9, 1999 the "Law on Licensing Design and Construction Works" was adopted. The law regulates the licensing of design and construction works, determines the types of works that need licensing and provides a description of the conditions to be met, the documents required to

⁹² Order #834 of the President of Georgia on "Approval of the list and classification of international, intrastate and local roads", December 25, 1996

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receive a license, and details the whole licensing procedure. Licenses for design and construction works are issued by the Ministry of Urbanization and Construction.

The First Toll Road

On January 25, 1999 the first tunnel tolls were introduced, by Order No. 6 of the Head of SDRG.⁹³ The tariffs were imposed on the use of the Rikoti Tunnel. The revenues are to be used for rehabilitation and maintenance of the tunnel.

SDRG Reorganization

On February 3, 2000, by Presidential Order No. 32⁹⁴ the two main public bodies of the SDRG, the Road Rehabilitation and Modernization Office and the Road Rehabilitation and Maintenance Office, were restructured into legal entities of private law.

Establishment of a Special Commission

On June 22, 2000, Joint Order No. 109-30 of SDRG and the Ministry for Tax Revenues⁹⁵ was issued, which established a special commission to check the collection of entrance and transit fees from foreign vehicles and the transfer of the collected revenues to the corresponding bank accounts. Also, the Customs Department was obliged to report monthly to SDRG on the collected excise taxes on imported petrol and entrance/transit fees from foreign vehicles, using special forms attached to the order.

Advisory Council at SRF

On September 24, 2000, an advisory council was created at SRF by Presidential Order No. 419.⁹⁶ The council was charged with analyzing SRF revenues, expenditures and the transparency of SRF management, and with ensuring wide participation of road users in SRF management. The council was created to meet the requirements of the World Bank pre-project assessment mission ("Road Rehabilitation Project"). The advisory council was made up of 14 members, including representatives from: SDRG, the Ministry for Economy, Industry and Trade, the Technical University of Georgia, the Ministry for Tax Revenues, the State Chancellery of Georgia, the Traffic Police Department, the Ministry of Finance, the Design Institute *Sakgzametsniereba*, the Ministry for Transport and Communications, and members of transport NGOs.

Law on Construction Activities

On October 27, 2000, the "Law on Construction Activities" was adopted. The law determines the legal, economic, and organizational sides of the relationships between parties involved in construction activities on the territory of Georgia, and mechanisms of protection and regulation of the norms related to construction activities. The purpose of this law is to ensure the effective

⁹³ Order #6 of the Head of the State Department for Roads of Georgia "On the rates for using the tunnel at Rikoti Pass", January 25, 1999

⁹⁴ Order #32 of the President of Georgia, February 3, 2000

⁹⁵ Joint order # 109-30 by the Minister of Tax Revenues of Georgia and the Head of the State Department for Roads of Georgia "On the Measures to increase control over the revenues from the Road taxes"

⁹⁶ Order #419 of the President of Georgia, September 24, 2000 "On the establishment of the Advisory Council at the State Road Fund"

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operation of the construction industry, promote the country's social, cultural and economic development, create a competitive environment in this field, and ensure the high quality of construction works.

All the parties involved in construction works must comply with construction rules, standards and norms. The proponent of the construction works must select the contractors, ensure a suitable level of expertise on the construction project, obtain a permit for construction from the relevant authorities, and ensure payment for the completed works. The financial aspects are regulated by the contract between the parties. No state authorities, except those for auditing and control, are allowed to engage in the financial and economic relationships between the parties involved in the construction projects.

Arkmsheninspektsia (a division within the Ministry for Urbanization and Construction) can suspend construction works, and the construction parties, for any violation of standards, rules, norms, and contractual obligations.

The state policy in the field of construction is carried out by the Ministry of Urbanization and Constructions and other relevant local authorities. The Ministry for Urbanization and Construction is responsible for the approval of the completed construction projects.

Any disputes (either legal, financial, contractual or otherwise) between participants are resolved by the courts.

Regulations on the collection of Road taxes, revenue registration, control and the purposeful use of Road Fund revenues

On November 28, 2001 “Regulations on the collection of Road taxes, revenue registration, control and the purposeful use of Road Fund revenues” were issued.

SDRG are obliged to prepare annual plans on the utilization of the SRF resources, and submit them to the Ministry of Finance, during the process of the state budget formation.

The revenues collected from the tax on the use of public roads, the tax for using underground communication facilities in the road right-of-ways and fees for the placement of commercial stands along the local roads in the regions should be transferred to SRF and used for the maintenance of the roads, as well as other activities planned by SDRG, in those regions in accordance with the approved annual plan.

Law on State Procurement

On March 30, 2001, significant amendments and supplements were made to the “Law on State Procurement” of December 9, 1998.⁹⁷ The amendments to the old law were so substantial that in effect a new law was adopted.

The law determines general legal and economic principles for the purchase of goods, works and services using public funds. The purpose of the law is to ensure rational use of the resources allocated for state procurement, to develop a competitive environment in the supply of goods and services to the state bodies, provide a non-discriminative approach towards the participants of

⁹⁷ See [Appendix 12](#) for the full text of the “Law on State Procurement” with incorporated amendments and supplements.

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procurement procedures, ensure transparency and public participation, and create an integrated procurement system.

The law provides for the establishment of the State Procurement Agency (SPA) with its chair to be appointed and dismissed by the President upon the recommendation of the Ministry of Economy, Trade and Industry. Also the law creates a Board of Supervisors at SPA to ensure transparency in public procurement.

The purchasing organization is responsible for, selecting suppliers, supervision and exercising of control to ensure the fulfillment of contract obligations, carrying out state procurement in a rational manner, paying the suppliers on time, avoiding possible conflicts of interest, submitting reports on the performed purchases to the Ministry of Economy, Industry and Trade and the Department for Statistics. All the purchases of goods, works or services by the state bodies must be made in accordance with the annual procurement plans.

The legally adopted methods of state procurement are as follows:

- open tender;
- restricted tender;
- price quotation; and,
- sole-source procurement.

The selection of a procurement method depends on the value of the contract.⁹⁸

Open and restricted tenders are administered by the tender committee, which is established by the head of the purchasing organization and consists of 5 members – employees of the purchasing organization. The tender committee makes its decision by majority vote. The minutes of the tender committee meetings must be prepared and signed by all members of the committee.

In open tenders, the tender committee announces the tender through the mass media. After analyzing the qualification data provided by each potential bidder, the list of bidders is composed. Prior to the evaluation of tender proposals an “Agreement on Intention” is signed between the purchasing organization and each bidder. The tender committee considers the proposals of only those bidders that have entered the “Agreement on Intention.” Tender proposals are evaluated by the criteria and priorities stated in the tender documentation. In restricted tenders, the invitation for tender proposals is sent to no less than five selected organizations. The number of bidders should not be less than three.

The detailed description of the state procurement process should be provided in the report on state purchases, which must be submitted to the Ministry of Economy within the stated period. All the interested parties must have access to the reports on state purchases and their summary must be made public on a regular basis, at least once a year. To ensure the transparency of the state procurement process, SPA must monitor the transparency of the tender procedures, reporting, open competition, and the opportunity for rational and free choices in the process of state procurement.

Competitive evaluation program

⁹⁸ For in-depth discussion of the state procurement issues see Section 10

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On July 22, 2002 the Head of State Department for Roads of Georgia, issued an order ⁹⁹ according to which all employees of the SDRG and its satellite organizations should pass a competitive evaluation on a regular basis.

⁹⁹ Order #50 by the Head of the State Department for Roads of Georgia “On the approval of the competitive evaluation program for the public officials of the central apparatus of the State Department for Roads and its lower organizations: the Road Fund office and the Road - Taxation Office”, July 22, 2002.

APPENDIX 4 – PRESIDENTIAL PROGRAM: WORK SCHEDULE AND FINANCING

Table 1. Projected schedule of the rehabilitation, modernization and maintenance works¹⁰⁰

| # | Restoration and development activities | Length (km) | Cost (million GEL) | Estimated costs (million GEL) and periods | | | | | | | | | | | | | |
|---|--|-------------|--------------------|---|------|------|------|------|------|------|------|-------|-------|-------|-------|-------|-------|
| | | | | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| 1 | Rehabilitation of priority routes | 833 | 214 | 19.6 | 29.4 | 42.6 | 57.8 | 64.6 | - | - | - | - | - | - | - | - | - |
| 2 | Modernization of priority routes | 626 | 1100 | 8.5 | 9.7 | 10 | 13.9 | 18.8 | 79.9 | 86 | 96.5 | 106.3 | 116.1 | 125.1 | 135.4 | 145.7 | 148.1 |
| 3 | Partial rehabilitation of remaining international and intrastate roads | 5180 | 459 | 7.8 | 10.2 | 10.6 | 13.1 | 14 | 27.7 | 32 | 33.4 | 37.1 | 42.7 | 48.8 | 53.3 | 60.7 | 67.6 |
| 4 | Maintenance of international and intrastate roads | 6013 | 285.7 | 11 | 12 | 12 | 13 | 14 | 16 | 20 | 22 | 23 | 24 | 25 | 28 | 31.7 | 34 |
| 5 | Scientific and technical advancement | | 56.8 | 1.2 | 1.6 | 2.1 | 2.7 | 3.1 | 3.4 | 3.8 | 4.2 | 4.6 | 5.1 | 5.5 | 6 | 6.5 | 7 |
| 6 | Design and survey works | | 88.4 | 1.6 | 2.3 | 3.2 | 4.1 | 4.9 | 5.4 | 5.9 | 6.5 | 7.2 | 7.9 | 8.6 | 9.3 | 10.3 | 11.2 |

¹⁰⁰ Source: Presidential Program for Rehabilitation and Modernization of Motor Roads.

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| | | | | | | | | | | | | | | | | | |
|---|--------------------------|--|---------------|-----------|-----------|-------------|--------------|------------|--------------|--------------|--------------|--------------|--------------|------------|--------------|--------------|--------------|
| 7 | Purchase of fixed assets | | 102.9 | 2.3 | 2.8 | 3.8 | 4.7 | 5.6 | 6.1 | 6.9 | 7.7 | 8.3 | 9.1 | 10 | 10.8 | 11.9 | 12.9 |
| 8 | Total | | 2306.8 | 52 | 68 | 84.3 | 109.3 | 125 | 138.5 | 154.6 | 170.3 | 186.5 | 204.9 | 223 | 242.8 | 266.8 | 280.8 |

Table 2. Financial provisions (revenues and costs estimated at 1996 prices (million GEL))¹⁰¹

| # | Tax | 1996 forecast | Average annual growth rate 1996 – 2000 (%) | 1997 | 1998 | 1999 | 2000 | Average annual growth rate 2000 - 2010 (%) | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|----|---|---------------|--|------|------|------|------|--|------|------|------|------|------|------|------|------|------|------|
| 1. | Tax on usage of automobile roads* | 5.0 | 9 | 8.6 | 9.4 | 10.2 | 11.1 | 9 | 12.1 | 13.2 | 14.4 | 15.7 | 17.1 | 18.6 | 20.3 | 22.1 | 24.1 | 26.3 |
| | Including regions | 1.0 | - | 3.0 | 3.3 | 3.6 | 3.9 | - | 4.2 | 4.6 | 5.0 | 5.4 | 5.9 | 6.4 | 7.0 | 7.6 | 8.3 | 9.0 |
| 2. | Tax on fuel and lubricants sales | 0.5 | 0.76 | 1.0 | 1.0 | 1.0 | 1.0 | - | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 1.2 |
| 3. | Car ownership tax | 5.0 | 7.5 | 5.3 | 5.8 | 6.2 | 6.7 | 15 | 7.7 | 8.9 | 10.2 | 11.7 | 13.5 | 15.5 | 17.8 | 20.5 | 23.6 | 27.1 |
| 4. | Tax on communications located in road right-of-ways** | 0.2 | - | 0.3 | 0.3 | 0.3 | 0.3 | - | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| 5. | Tax on advertisements | 0.08 | 9 | 0.1 | 0.1 | 0.1 | 0.1 | 5 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |

¹⁰¹ Source: Presidential Program for Rehabilitation and Modernization of Motor Roads.

* All the revenues from this tax collected in the regions will be used for the maintenance of local roads in those regions.

** All the revenues collected from local roads will be used for the maintenance of local roads in those regions.

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| | | | | | | | | | | | | | | | | | | |
|-----|--|------|---|------|------|------|------|----|------|------|-------|-------|-------|-------|-------|-------|-------|-------|
| | stands located along the roads** | | | | | | | | | | | | | | | | | |
| 6. | Fees for entering the territory of Georgia | 7.0 | 9 | 12.5 | 13.6 | 14.8 | 16.1 | 15 | 18.5 | 21.3 | 24.5 | 28.2 | 32.4 | 37.3 | 42.9 | 49.3 | 56.7 | 65.2 |
| 7. | Fees for use of certain road sections and payments for permits for works in road right-off-way zones | 0.1 | 9 | 0.3 | 0.3 | 0.4 | 0.4 | 5 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 | 0.6 | 0.7 | 0.7 |
| 8. | Total State Road Fund revenues | 17.9 | - | 28.1 | 30.5 | 33 | 35.7 | - | 39.8 | 45.4 | 51.2 | 57.7 | 65.1 | 73.6 | 83.2 | 94.1 | 106.8 | 121 |
| 9. | Including regions | 1.0 | - | 3.0 | 3.3 | 3.6 | 3.9 | - | 4.2 | 4.6 | 5 | 5.4 | 5.9 | 6.4 | 6.8 | 7.6 | 8.3 | 9 |
| 10. | Assignments from the state budget | 6.0 | - | 12.3 | 18 | 27 | 40.5 | 10 | 44.6 | 49 | 53.9 | 59.3 | 65.2 | 71.7 | 78.9 | 86.8 | 95.5 | 105 |
| 11. | Total financial resources (8 + 10) | 28.9 | - | 40.4 | 48.5 | 60 | 76.2 | - | 80.4 | 94.4 | 105.1 | 117 | 130.3 | 145.3 | 162.1 | 180.9 | 202.3 | 226 |
| 12. | Subsidies for local roads maintenance to low-income regions | - | - | 0.7 | 2.2 | 2.5 | 3 | - | 3.5 | 3.8 | 3.5 | 4.1 | 4.4 | 4.8 | 5.5 | 5.5 | 6.3 | 7.1 |
| 13. | Financial resources used to finance presidential program (11 – 9 - | - | - | 36.7 | 43 | 53.9 | 71.3 | - | 72.7 | 86 | 96.6 | 107.5 | 120 | 134.1 | 151.8 | 167.8 | 187.7 | 209.9 |

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| | | | | | | | | | | | | | | | | | | |
|-----|--|---|---|------|------|------|-------|---|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 12) | | | | | | | | | | | | | | | | | |
| 14. | Total required resources, including: | - | - | 52 | 68 | 84.3 | 109.3 | - | 125 | 138.5 | 154.6 | 170.3 | 186.5 | 204.9 | 223.0 | 242.8 | 266.8 | 280.8 |
| | Modernization of priority routes | - | - | 8.5 | 9.7 | 10 | 13.9 | - | 18.8 | 79.9 | 86 | 96.5 | 106.3 | 116.1 | 125.1 | 135.4 | 145.7 | 148.1 |
| | Rehabilitation of priority routes | - | - | 19.6 | 29.4 | 42.6 | 57.8 | - | 64.6 | - | - | - | - | - | - | - | - | - |
| | Partial rehabilitation of remaining international and intrastate roads | - | - | 7.8 | 10.2 | 10.6 | 13.1 | - | 14 | 27.7 | 32 | 33.4 | 37.1 | 42.7 | 48.8 | 53.3 | 60.7 | 67.6 |
| | Maintenance of international and intrastate roads | - | - | 11 | 12 | 12 | 13 | - | 14 | 16 | 20 | 22 | 23 | 24 | 25 | 28 | 31.7 | 34 |
| | Scientific and technical advancement | - | - | 1.2 | 1.6 | 2.1 | 2.7 | - | 3.1 | 3.4 | 3.8 | 4.2 | 4.6 | 5.1 | 5.5 | 6 | 6.5 | 7 |
| | Design and survey works | - | - | 1.6 | 2.3 | 3.2 | 4.1 | - | 4.9 | 5.4 | 5.9 | 6.5 | 7.2 | 7.9 | 8.6 | 9.3 | 10.3 | 11.2 |
| | Purchase of fixed assets | - | - | 2.3 | 2.8 | 3.8 | 4.7 | - | 5.6 | 6.1 | 6.9 | 7.7 | 8.3 | 9.1 | 10 | 10.8 | 11.9 | 12.9 |
| 15. | Deficit to be filled by credits and investments | - | - | 15.3 | 25 | 30.4 | 38 | - | 52.3 | 52.8 | 58 | 62.8 | 66.5 | 70.8 | 71.2 | 75 | 79.1 | 70.9 |

APPENDIX 5 – SDRG STRUCTURE AND RESPONSIBILITIES¹⁰²

SDRG Structure and Responsibilities of SDRG Constituents

SDRG structure comprises the Central Apparatus, lower organizations and subordinate organizations (legal entities of public law).

Central Apparatus of SDRG is comprised of the following units:

- SDRG Management;
- Apparatus of the Head of the State Department for Roads of Georgia;
- General Office;
- Personnel and Legal Affairs Office;
- Technical Affairs Office;
- Road management Office;
- Economic and Financial Affairs Office;
- Tender Office;
- Special Affairs Office;
- Foreign Affairs Office; and,
- Public and Media Relations Office.

Prior to February 3, 2000, SDRG had two other units, the Road Rehabilitation and Modernization Office and the Road Rehabilitation and Maintenance Office, which were reorganized into private organizations (legal entities of private law) by Presidential Order No. 32¹⁰³.

Apparatus of the Head of the Department provides support to the SDRG management.

The General Office performs clerical work and recordkeeping for the Central Apparatus.

The Personnel and Legal Affairs Office: provides legal services to the Central Apparatus, its lower organizations and the subordinate organizations; prepares drafts of the legal acts; ensures law and order in the activities of the SDRG system; represents SDRG in court, in case of legal proceedings; and, manages human resources.

The Technical Affairs Office is mainly responsible for: development of the scientific and technical advancement strategy for the road sector; identification and introduction of advanced work methods and technologies in the road sector of Georgia; and, preparation of project proposals on engineering works for both roads and road facilities which are submitted and approved by SDRG management and other relevant bodies.

¹⁰² Charter of the State Department for Roads of Georgia, September 22 1997; Presidential Order #235, May 7, 1999; Presidential Order #426, July 7, 1999; Presidential Order #32, February 3, 2000; Presidential Order #177, May 2, 2003

¹⁰³ Order #32 of the President of Georgia, February 3, 2000.

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The Road Management Office is responsible for the preservation and development of the public roads and road facilities, the systematic improvement of their parameters, the coordination of both road maintenance and construction works, the development, in cooperation with other SDRG offices, of prospective plans for construction, maintenance, periodic repairs, rehabilitation and reconstruction of the public roads.

The Economic and Financial Affairs Office is responsible for: identifying prospective directions for the economic and financial development of the road sector; providing analysis of the economic activities and accounting practices in the sector and forecasting of the sector's short and long term development; controlling, analyzing, and forecasting SRF revenues; providing analysis of the reorganization processes and economic reforms in the sector and developing proposals for the required adjustments and corrections in this field; preparing annual plans for road construction, reconstruction and maintenance works and the required amounts of Road Fund revenues; assigning resources from the state budget, credits, grants and other sources; protecting SDRG interests during the preparation of the state budget; obtaining and processing information on accounting, economic and financial performance of the lower and subordinate organizations; and, presenting reports to the relevant governmental bodies.

The Tender Office is responsible for organizing and conducting the tendering process for road works, as financed by the Road Fund resources; making assignments from the state budget, grants and credits; and, for preparing quarterly and annual reports on the purchases made by the SDRG.

The Special Affairs Office is responsible for: the special and confidential affairs of SDRG; developing and presenting proposals on the range and volume of the available reserves to the relevant governmental bodies; and, the control, preservation, renewal and replenishment of the available reserves of the subordinate and lower organizations.

The Foreign Affairs Office is responsible for establishing business relations with foreign countries.

The Public and Media Relations Office is responsible for establishing and keeping relations with the public and mass media.

Lower Organizations:

The SDRG lower organizations, namely the Road Fund Office and the Road Taxation Office, are responsible for the collection of the Road taxes as provided for in the "Law on State Road Fund."

The Road Fund Office is responsible for collecting the tax on the use of public roads, the tax for the use of underground communication facilities within the right-of-ways and for placing commercial stands along public roads.

The Road Taxation Office is responsible for collecting the tax from the sale of fuel and lubricants, the vehicle ownership tax, and fees for using the Rikoti Tunnel.

Subordinate Organizations:

The Department for Roads of the Autonomous Republic of Abkhazia is responsible for identifying potential developments in the road network within the Republic of Abkhazia and the submission of the prepared proposals to SDRG for the purpose of developing an integrated policy in the road sector of Georgia.

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The Department for Roads of the Autonomous Republic of Adjara is responsible for identifying potential developments in the road network in the Republic of Adjara; the submission of the prepared proposals to SDRG for the purpose of developing an integrated policy in the road sector of Georgia; and, the coordination of construction, reconstruction and maintenance works on the local roads of Adjara.

The Communication and Information Office is responsible for the operation and maintenance of the electronic communication and radio communication facilities within the SDRG system.

The Project Expertise Office: performs design estimates and provides expert conclusions on technical documentation; develops and approves technical documents for SDRG; provides assessments of the work-improvement suggestions and innovations proposed by SDRG; and, participates in the discussions of the complicated project designs and decision-making on the principal design issues.

The charters of the subordinate organizations were approved by the State Department for Roads of Georgia. However, according to evidence from the Chamber of Control, the charters of these organizations do not contain the description of the mechanisms for the state control over these organizations and the grounds for their financial activity, which is in violation of the “Law on Legal Entities of Public Law.”

SDRG Objectives, Functions, Rights and Responsibilities

SDRG Charter includes among its objectives to:

- Develop and pursue the integrated socio-economic, scientific and technical policy of the road sector;
- Manage the state-owned road network of Georgia and provide the governmental regulation of the sector’s activities;
- Develop and implement the strategy for the road sector’s development;
- Secure road communication for the people and the economy of Georgia;
- Prepare drafts of legislative acts for the regulation of the road sector;
- Develop and introduce technical and economic standards, norms and regulations for the road sector;
- Determine and control the strategic directions of foreign economic relations;
- Establish relationships and cooperate with neighboring and other countries;
- Prepare well reasoned proposals and carry out corresponding measures to obtain credits and attract foreign investments;
- Identify, select and introduce advanced technologies and production methods into the road sector;
- Provide assistance to the local government bodies in the areas related to its activities;
- Ensure law and order in the SDRG integrated system; and,
- Implement the Presidential Program of the road sector development.

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As provided for in the SDRG Charter, the main SDRG functions are to:

- Analyze the situation in the road sector and provide both short- and long-term forecasts of the sector's development;
- Develop a long-term governmental program for the road sector development, based on which annual programs should be prepared and implemented;
- Prepare conclusions and recommendations on the proposed legal acts;
- Develop and introduce an integrated system of terms and conditions for licensing road construction enterprises;
- Provide expertise on design estimates, and ensure quality control of road works;
- Perform periodic analyses and introduce changes to the reorganization processes and economic reforms in the road sector;
- Exercise control over the utilization of the state budget assignments, Road Fund resources and other resources allocated for road construction, reconstruction and maintenance works;
- Be a single purchaser of the construction, reconstruction and maintenance works on public roads;
- Introduce the practice of competitive tendering to road construction and maintenance contracts;
- Create and develop databases on the road sector;
- Develop and introduce a policy for human resource management;
- Provide financial, legal and organizational services to SDRG lower and subordinate organizations, and to protect their interests;
- Organize and coordinate activities related to the creation and development of TRACECA, to work with the countries interested in TRACECA development, to obtain credits from international financial organizations and to attract investments to the road sector;
- Provide analysis and assessment of the possible consequences of emergency situations and natural disasters, to develop preventive measures and coordinate responsive measures;
- Cooperate with the Main Traffic Department of the Ministry of Internal Affairs to ensure traffic safety on the roads;
- Make provisions for raising the level of skills of the personnel of the central apparatus, lower and subordinate organizations; and,
- Regulate the development of infrastructure, in accordance with the "Law on Motor Roads," and issue permits for construction and development activities in the right-of-ways.

According to the SDRG Charter, SDRG may:

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- Take part in the implementation of the social and economic policy of the country, development and discussion of the drafts of legislative acts and the state budget of Georgia;
- Possess and use the state-owned property in the road sector as provided for in the legislation;
- Obtain information, from both governmental and private organizations, that is required to implement SDRG functions;
- Establish legal entities of public law and lower organizations, and assist in implementing their reorganization and liquidation;
- Issue orders, instructions, methodological guidelines and other documents mandatory for implementation for other ministries and departments, as well as private organizations and natural persons;
- Establish contracts with legal and natural persons and to execute payments for their services;
- Establish contracts with employees;
- Invite experts and specialists for consultancy services;
- Send employees abroad to participate in training, workshops and conferences;
- Submit well reasoned proposals on the projects of special importance for the operation and development of the road sector, and on the required additional budget allocations, to the President of Georgia.
- Establish fees for certain sections of public roads in conjunction with the Ministry for Economy;
- Establish relationships and sign agreements, within the granted competence, with the corresponding foreign organizations;
- Create incentive scheme for the SDRG employees, in accordance with Chapter XV of the Tax Code; and,
- Delegate its rights and responsibilities to other governmental and non-governmental institutions, if not otherwise stated in the legislation.

SDRG responsibilities include:

- Informing the President on the achievement of set objectives and the implementation of duties and responsibilities;
- Ensuring close cooperation with other governmental organizations at all levels;
- Providing corresponding governmental bodies with reports, calculations and statistical data on scheduled dates and in agreed formats;
- Systematically publishing information on activities in the road sector;
- Ensuring, within its authority, traffic safety and free movement on the roads;
- Protecting the interests of its employees, employees of lower organizations and subordinate bodies, and others employed in the road sector; and,

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- Assuming responsibility for issues within its competence.

APPENDIX 6 – ROAD TAXES AND FEES

Road taxes and fees currently in force in Georgia are as follows:

1. Excise tax on imported petrol

According to the Excise Service of the Customs Department of Georgia, the excise tax on imported petrol, regardless of the type of petrol, is 200 GEL (≈100 USD) per ton. The excise tax on petrol is collected by the Customs Department of Georgia. Based on amendments to the Tax Code of Georgia, the “Law on the State Budget” of 1998 and Order No. 383 of the President of Georgia, dated June 22, 1998, part of the revenues from the excise tax on imported petrol are transferred to SRF. SRF’s share in the revenues from the excise tax on petrol has varied from 100% to 30% since 1998.

a.) Tax on the use of public roads

The tax on the use of public roads, as determined by the “Law on Road Fund”, is imposed on the organizations engaged in production activity on the territory of Georgia. The tax rates ¹⁰⁴ are as follows:

- Every company involved in road haulage or passenger transportation activities pay 2% of the income from the use of motor vehicles;
- Commercial banks pay 0.5% of the income from provided services;
- Entrepreneurs involved in trading and brokerage activities pay 0.1% of the income from provided services;
- Enterprises involved in production activity other than indicated under the previous items pay 1% of the income from produced goods or provided services; and,
- Entrepreneurs, whose production or commercial facilities are located in the right-of-ways, pay double rates of the tax according to the type of activity.

The tax is collected by the Road Fund Office of SRF. By law, taxpayers must present a tax declaration to the corresponding SRF service by the end of the reporting period (quarter of a year) and transfer the appropriate amount to the bank account designated by SRF. The tax on the use of public roads is included in the production costs.

b.) Vehicle ownership tax

Vehicle ownership tax is determined by Chapter 7 of the Tax Code of Georgia. The tax rates are as follows¹⁰⁵:

Cars: - 5 GEL per year (≈2.5 USD)

Trucks:

¹⁰⁴ Article 4, Law on the Road Fund of Georgia

¹⁰⁵ Article 161, Tax Code of Georgia (as of February 2003)

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| | | |
|---|---|----------------------------|
| Load-carrying capacity of up to 3 tons | - | 10 GEL per year (~5 USD) |
| Load-carrying capacity of 3 to 10 tons | - | 50 GEL per year (~25 USD) |
| Load-carrying capacity of 10 to 20 tons | - | 80 GEL per year (~40 USD) |
| Load-carrying capacity of more than 20 tons | - | 100 GEL per year (~50 USD) |

Buses:

| | | |
|--------------------|---|----------------------------|
| Up to 12 seats | - | 50 GEL per year (~25 USD) |
| 13 – 30 seats | - | 70 GEL per year (~35 USD) |
| More than 30 seats | - | 100 GEL per year (~50 USD) |

Vehicle ownership tax is paid during the registration of a vehicle and annual technical examinations. The registration, re-registration and technical examination of vehicles cannot be undertaken unless the vehicle ownership tax has been paid. The tax revenues are transferred to SRF. The tax is collected by the Road-Taxation Office of the State Road Fund of Georgia in cooperation with the Traffic Police Department of the Ministry of Internal Affairs.

c.) Fees for entering the territory of Georgia

Fees for entering and transit through Georgia are determined by the Tax Code. The taxpayers are owners or drivers of the foreign vehicles entering Georgia, as well as owners or drivers of the vehicles registered in Georgia if they execute transit through the territory of Georgia. The fees for entering and transit through Georgia, which are paid in addition to customs fees ¹⁰⁶ are as follows:

Cars: - 60 GEL (~30 USD)

Trucks and other vehicles:

| | | |
|---|---|--------------------|
| Load-carrying capacity of up to 3 tons | - | 230 GEL (~115 USD) |
| Load-carrying capacity of 3 to 10 tons | - | 380 GEL (~190 USD) |
| Load-carrying capacity of 10 to 20 tons | - | 480 GEL (~240 USD) |
| Load-carrying capacity of 20 to 40 tons | - | 650 GEL (~325 USD) |
| Load-carrying capacity of more than 40 tons | - | 880 GEL (~440 USD) |

Buses:

| | | |
|--------------------|---|--------------------|
| Up to 12 seats | - | 115 GEL (~57 USD) |
| 13 – 30 seats | - | 230 GEL (~115 USD) |
| More than 30 seats | - | 380 GEL (~190 USD) |

¹⁰⁶ Article 205, Tax Code of Georgia (as of February 2003)

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The entrance and transit fees are paid on crossing the Georgian border. The fees are collected by the Customs Department and transferred to SRF bank accounts. Certain privileges in paying transit and entrance fees were granted to the owners and drivers of the cars registered in several regions of Armenia and Azerbaijan adjacent to the border with Georgia.

d.) Tax on weight infringement and extra axle load

The tax on weight infringement and extra axle load is determined by the Tax Code of Georgia. The taxpayers are owners or drivers of the foreign vehicles entering Georgia, as well as owners or drivers of the vehicles registered in the country. If the actual cargo weight exceeds the load-carrying capacity of the vehicle, the driver or the owner of that vehicle pays the following tax rates on each 1 ton of the extra load¹⁰⁷:

Vehicles with load-carrying capacity of up to 20 tons – 10% of the entrance fee;

Vehicles with load-carrying capacity of more than 20 tons – 5% of the entrance fee.

The limit for axle load in Georgia is 10 tons per axle. The tax rates for extra axle load¹⁰⁸ are as follows:

| | | | |
|----------------------|---|---------|------------|
| ≤0.5 ton on an axle | – | 50 GEL | (~25 USD) |
| 0.5 – 1.0 on an axle | – | 80 GEL | (~40 USD) |
| 1.0 - 1.5 on an axle | – | 100 GEL | (~50 USD) |
| 1.5 - 2.0 on an axle | – | 125 GEL | (~62 USD) |
| 2.0 - 2.5 on an axle | – | 170 GEL | (~85 USD) |
| 2.5 - 3.0 on an axle | – | 250 GEL | (~125 USD) |

Vehicles with an axle load exceeding 13 tons per axle are not allowed in Georgia.

The tax on weight infringement is collected from vehicles at the Georgian border, while extra axle load tax is collected in locations selected by SDRG. The taxes are collected by the Customs Department and SRF officials and transferred to SRF bank accounts.

e.) Tax on the sale of fuel

The tax on the sale of fuel is determined by the “Law on Road Fund.” The tax is collected by the Road Fund Office of SRF. The tax on the sale of fuel is paid by the producers of fuel at the rate of 5% of the income from the sold products after excise and VAT taxes and by the sellers of these products and intermediary firms at the rate of 5% from the difference between the purchasing and selling prices after excise and VAT taxes.¹⁰⁹ By law, taxpayers must present a tax declaration to the corresponding SRF service by the end of the reporting period (one month) and transfer the appropriate amount to the bank account as indicated by SRF officials.

¹⁰⁷ Article 205, Tax Code of Georgia (as of February 2003).

¹⁰⁸ Article 205, Tax Code of Georgia (as of February 2003).

¹⁰⁹ Article 5, Law on the Road Fund of Georgia.

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- f.) Tax for using underground communication facilities located in the right-of-way and for the placement of commercial stands and signs along the public roads.

The tax for using underground communication facilities located in the road right-of-way and for the placement of commercial stands and signs along the public roads is determined by the “Law on Road Fund.” The tax is collected by the Road Fund Office of the State Road Fund. The tax for using underground communication facilities located in the road right-of-way is paid by the owners of underground communications at the rate of 0.15 GEL per running meter.¹¹⁰ The tax for the placement of commercial stands and signs along the public roads is paid by the owners of the commercial stands and signs at the following rates¹¹¹:

- 26 GEL per square meter for stands and signs along international roads;
- 20 GEL per square meter for stands and signs along intrastate roads; and,
- 6.5 GEL per square meter for stands and signs along local roads.

By law, taxpayers must present a tax declaration to the corresponding SRF service by the end of the reporting period (one year) and transfer the appropriate amount to the bank account indicated by SRF.

g.) Fees for using Rikoti Tunnel

The fees for using Rikoti Tunnel are determined by Order No. 6 of the Head of SDRG of January 25, 1999. The fees are paid by all the vehicles passing through Rikoti Tunnel in both directions at the following rates¹¹²:

- Cars and buses (up to 30 seats) – 1 GEL
- Trucks up to 10 tons – 2 GEL
- Trucks of more than 10 tons and buses with more than 30 seats – 3 GEL

The fees are collected by the Road Taxation office of SRF and are earmarked for maintenance of the tunnel.

¹¹⁰ Article 8, Law on the Road Fund of Georgia.

¹¹¹ Article 8, Law on the Road Fund of Georgia.

¹¹² Order No. 6 of the Head of SDRG of January 25, 1999.

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APPENDIX 7 - SDRG REVENUES IN 1996 – 2003

SDRG revenues in 1996 – 2003 (first 5 months) in thousands of GEL¹¹³

| # | Source | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|----|--|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| 1 | Excise tax on imported petrol | - | - | 11,724.0 | 13,591.4 | 4,319.1 | 11,298.3 | 13,652.9 | 4,200.0 |
| 2 | Tax for use of public roads | 5,906.0 | 11,719.9 | 11,010.2 | 10,816.1 | 11,741.0 | 15,500.0 | 16,224.2 | 7,796.1 |
| 3 | Vehicle ownership tax | 5,914.0 | 5,252.5 | 5,541.1 | 5,618.4 | 4,374.3 | 2,044.7 | 1,879.4 | 838.3 |
| 4 | Entrance and transit fees | 7,169.0 | 8,563.0 | 9,855.3 | 10,646.6 | 9,935.0 | 7,782.3 | 8,985.4 | 3,271.5 |
| 5 | Tax on weight infringement and extra axle load | - | - | - | - | - | - | - | 32.5 |
| 6 | Tax on the sale of fuel | 585.0 | 996.8 | 1,279.1 | 1,293.9 | 1,421.9 | 1,566.1 | 1,521.9 | 542.0 |
| 7 | Fees for using Rikoti Tunnel | 274.0 | 407.3 | 451.4 | 496.7 | 184.0 | 624.4 | 649.2 | 239.0 |
| 8 | Budgetary assignments and transfers from Presidential Fund | 7,295.0 | 8,868.0 | 3,527.2 | 300.0 | 300.0 | 1,500.0 | 1,000.0 | 200.0 |
| 9 | Foreign grants and credits | - | 3,177.5 | 3,502.1 | 626.9 | - | 25,930.0 | 44,771.0 | - |
| 10 | Revenues from lottery | - | - | - | 113.7 | - | - | - | - |
| 11 | Balance | | | | | | | | 1,705.5 |
| | Total | 27,143.0 | 38,985.0 | 46,890.4 | 43,503.7 | 32,275.3 | 66,245.8 | 88,684.0 | 18,824.9 |

Source: State Department for Roads of Georgia.¹¹⁴

¹¹³ All values are given in nominal terms. The average rate of inflation in 1996 – 2003 was 7%.

¹¹⁴ The data presented in the table was provided by SDRG. The comparison with other sources (Chamber of Control, World Bank report, literature review) revealed discrepancies between data on SDRG revenues and expenditures reported by different sources.

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APPENDIX 8 - SDRG EXPENDITURES IN 1996 – 2003

SDRG expenditures in 1996 – 2003 (first 5 months) in thousands of GEL¹¹⁵

| # | Type of Expenditure | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|----|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| 1 | Road construction, rehabilitation, periodic repairs and maintenance | 27,570.9 | 35,252.1 | 43,282.3 | 39,941.7 | 26,492.9 | 48,472.6 | 75,009.1 | 11,057.0 |
| 2 | Co-financing of World Bank and Kuwait Fund credits | - | - | - | - | - | 2,215.0 | 6,804.3 | 1,535.0 |
| 3 | Repayment of principal and interest on the obtained credits | - | - | - | - | - | 3,259.7 | 1,141.6 | - |
| 4 | Payment of arrears for works performed in the previous year | - | - | - | - | - | 3,860.0 | 5,819.6 | 3,918.8 |
| 5 | SDRG operating expenses (including lower organizations) | 1,169.8 | 1,485.5 | 1,426.9 | 1,393.8 | 1,391.0 | 1,792.9 | 1,817.6 | 573.9 |
| 6 | Contingency funds | - | - | - | - | - | 1,912.0 | 1,788.0 | 912.2 |
| 7 | Loan and grant servicing | - | - | - | - | - | - | 149.5 | 16.5 |
| 8 | Transfers to Tbilisi municipality | - | - | 1,271.0 | 1,704.5 | 1,226.6 | 536.2 | - | - |
| 9 | Returning extra sums erroneously paid in taxes to SRF | - | - | - | - | 313.9 | 521.9 | 4.3 | - |
| 10 | Improvement of material and technical base | - | 208.4 | 70.5 | 19.9 | - | 18.6 | - | - |
| 11 | Lottery | - | - | - | 115.8 | - | - | - | - |
| 12 | Payments made on the basis of court decision | - | - | - | - | - | - | - | 400.0 |
| | Total | 28,740.7 | 36,946.0 | 46,050.7 | 43,175.7 | 29,424.4 | 62,588.9 | 92,534.0 | 18,413.4 |

Source: State Department for Roads of Georgia.

¹¹⁵ All values are given in nominal terms. The average rate of inflation in 1996 – 2003 was 7%.

APPENDIX 9 – FOREIGN GRANTS AND CREDITS

European Community Grant¹¹⁶

In March 1997, financial agreement No. 197/202 was established between the Government of Georgia and European Community on the allocation of 2 million ECU for:

- the completion of construction works on the bridge across the River Khrami and the construction of access roads;
- restoration and repair works on the Red Bridge; and,
- the arrangement of the Red Bridge frontier checkpoint.

The grant was allocated within the TACIS program of 1996. The anticipated project duration was 12 months. The project started in September 1997 and was completed in October 1998.

According to the agreement, payments for the completed works were made by European Community directly to the accounts of the contractor. The advance payment comprised 35% with intermediary payments every 3 months. The payments were made for the completed works on the basis of the joint estimation of the volume and cost of works by the European Community monitor, and SDRG and the contractor's representatives. However, 5% of the contract value was to be paid after a guarantee period of one year. Three Georgian contractors were involved in the works under the European Community grant.

The total cost of works, except for the frontier checkpoint, amounted to 1,858,600 ECU (2,826,900 GEL). However, due to the fall in the exchange rate between GEL and ECU, an additional 650 thousand GEL were allocated from the central budget to fill the deficit created by ECU depreciation, increasing the cost of the project to 3,477,000 GEL.

It should be mentioned that the frontier checkpoint was not completed under the European Community grant, as the works were stopped due to the frontier demilitarization process and the European Community refused to bear the cost of uncompleted works, which had to be covered by SDRG.

Grant from the Government of Japan¹¹⁷

At the request of the President of Georgia, the Government of Japan considered the possibility of providing Georgia with a grant in the form of road-building machinery under Japan's official development assistance program.

In June 1998, SDRG submitted a road rehabilitation project to the Japanese Embassy. In February 2001, the Government of Japan sent its mission to Georgia for the purpose of project development. The project was submitted to the Japan International Cooperation Agency (JICA). A Japanese company CPC was selected to develop a list of the required machinery, upon which an agreement was established between SDRG and the Japanese Embassy in Georgia whereby 304 million Japanese yen was allocated to Georgia. The supplier ("Mitsubishi") was selected by tender and, according to the invoice of October 30, 2001 and the customs declaration of December 29, 2001, 16 units of road building-machinery and 8 sets of spare parts were imported into Georgia. The machinery included:

¹¹⁶ Chamber of Control: "Report on Inspection of the State Department for Roads of Georgia", 1999 and SDRG evidence.

¹¹⁷ Chamber of Control: "Report on Inspection of the State Department for Roads of Georgia", 2002 and SDRG evidence.

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- an asphalt paver;
- a bulldozer;
- 4 motor graders;
- 4 loaders;
- 4 compactors;
- a trailer; and,
- a patrol vehicle.

The total cost of equipment amounted to 266.9 million yen, i.e. 4,263,500 million GEL or 2,300,000 USD.

The machinery was handed over to SDRG. According to the instructions of April 2, 2002 from the Head of SDRG, a special tender commission was to be created to develop terms and conditions for renting out the equipment, as well as to conduct a tender for the storage and maintenance of the machinery. On April 3, 2002, the machinery was handed over to JSC “Graal 92” for temporary storage at the rate of 6,822 GEL per month, until a company responsible for the storage and maintenance of the machines was selected. According to the Chamber of Control, in September 2002, 7 out of 16 machines were still on “Graal 92” premises, while nine machines had been rented out based on agreements between private contractors and SDRG.

World Bank Credits

On January 31, 1996, agreement No. 2809¹¹⁸ was established between the Government of Georgia and the International Development Agency (IDA) on the allocation of credit for the rehabilitation of the railway and road systems in Georgia, to a total amount of 12 million USD. Some 8.75 million USD were assigned to the rehabilitation of roads, broken down as follows:

- 2.4 million USD to engineering works;
- 3.1 million USD to the purchase of equipment and materials;
- 1.3 million USD for consultancy services and studies; and,
- 1.95 million USD to a reserve fund (these funds were later used for road construction works).

According to the agreement, the IDA share in the financing of engineering - road construction and repair works - was determined at 57% of the total cost of these works, while Georgia had to provide the remaining 43% of the required amount in form of co-financing, increasing the funds available for the work to 4.21 million USD. The project was to be completed between 1996 and 1998.

According to the Chamber of Control, road works contractors and suppliers of equipment and materials were selected on a tender basis. The terms and conditions were agreed with IDA and

¹¹⁸ Data on credit agreement #2809 – GE were obtained from the Chamber of Control “Report on Inspection of the State Department for Roads of Georgia”, 1999 and SDRG evidence.

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EBRD. The representative of the Problem Center on Eurasian Transport Corridor (PCETC) was a member of the tender commission. The tender results were submitted to PCETC and the World Bank. Following the World Bank's approval of the selected candidates, the contracts were established between SDRG and private contractors. The completed works were approved by a special commission, which contained a PCETC representative. The commission conclusions were sent by PCETC to the World Bank and the financing was allocated following the receipt of the co-financing share from the Georgian party. The payments for services and supplies were made directly by PCETC without SDRG involvement.

The credit enabled SDRG to conduct repair and maintenance works on 1300 km of international and intrastate roads, and purchase the necessary equipment and materials. 1.2 million cubic meters of earthworks were conducted; approximately 77 thousand m² of road surface were repaired and covered with a two-layer asphalt coating; and, maintenance works were conducted on 110,597 m² of road surface; two bridges were constructed; 1320 m³ of retaining walls were reinstated. Nearly 2,015,100 USD was spent on construction materials, vehicles, equipment, and spare parts. Among the important purchases were an environmental laboratory and a testing laboratory for bridges.

The total expenditures, under the credit agreement No. 2809 of January 31, 1996 between IDA and the Government of Georgia, amounted to 9,408,200 USD, of which IDA's share comprised 6,796,900 USD.

During the implementation of the works under the first World Bank credit for the rehabilitation of the road system in Georgia, the discussion began about the second credit for the rehabilitation and reconstruction of the road system. Following extensive work in Georgia of World Bank consultants in 1998, the credit agreement No. 3357 – GE¹¹⁹ was signed on July 26, 2000 between the World Bank and the Government of Georgia on 29.8 million SDR or 40 million USD (72.7%) in IDA financing for a 55 million USD project for rehabilitation and construction of roads – Road Project for Georgia. Under the credit agreement, the Government of Georgia was to provide the remaining 15 million USD (27.3%). The credit is repayable over 35 years, including a 10-year grace period at 0.75% interest per year. The credit recipient is the Ministry of Finance of Georgia, which, in turn, re-loaned it on the same conditions to SDRG. The works started in 2001 and are to be completed in 2004.

In the process of the ratification of the credit agreement by Parliament of Georgia, the co-financing of 15 million USD that Georgia agreed to provide became a controversial issue. The World Bank mission insisted that co-financing should be provided from the central budget and not SRF funds – the provision recorded in the agreement. However, the Ministry of Finance suggested that, due to the lack of budgetary resources, the co-financing should be divided in two parts: the VAT part and the project co-participation part. The Ministry of Finance agreed to pay the VAT part (55% of the total co-financing amount) from the central budget, while under the sub-agreement of November 7, 2000 between the Ministry of Finance and SDRG, the latter assumed responsibility for financing the project co-participation part (45% of the total co-financing amount) from SRF funds*. The credit agreement was ratified with corresponding amendments on November 10, 2000.

¹¹⁹ Data on credit agreement #3357 – GE were obtained from the Chamber of Control "Report on Inspection of the State Department for Roads of Georgia", 2002 and SDRG evidence.

* Under Georgian legislation, violation of the international agreement is the violation of the upper level law.

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By the agreement, the project is implemented by SDRG with the support of the Investment Center for Eurasian Transport Corridor (ICETC). SDRG and ICETC functions were determined as follows:

- SDRG is responsible for the planning and management of the works within the project, preparation of the tender documentation, approval of completed works and quality control, and preparation of invoices for completed works and their submission to ICETC; and,
- ICETC is responsible for coordination of SDRG activities within the project, conducting all financial operations at SDRG assignment and preparation of progress reports on the project.

According to the World Bank, 50 million USD were to go towards road rehabilitation, focusing on repairs, modernization of highway design and safety improvements by means of road signs and markings. The project targeted three major roads: Poti – Red Bridge, Tbilisi -- Armenia, and Tbilisi -- Russia. The remaining project funds were to be allocated for improving institutional and professional management within the road sector, by increasing the institutional capacity of SDRG, modernizing SRF and road taxes, developing a traffic safety program, and introducing international standards to the road sector.

The Roads Project for Georgia has three aims:

- to reduce road transportation costs and improve access to Georgia's major traffic corridors;
- to provide a steady and adequate level of funding for road maintenance based on charges related to the use of roads; and,
- to improve management and effectiveness of the entire road network including local roads by strengthening SDRG and developing private road construction industry.

There are two main project components:

- The first component includes periodic maintenance and repair of priority sections of the main road network including drainage upgrading (470 km) and surface treatment (282 km); rehabilitation of priority road sections (159 km) and related improvements in hard-shoulders, road marking, and signs; and reconstruction of bridges over the River Tsivi and the River Sondiskhevi (173.7m); and,
- The second component includes strengthening of SDRG institutional capacity; modernization of SRF and road taxes; development of a traffic safety program; installation of a pavement management system; development of roads database; upgrading of technical specifications to international standards; introduction of the financial management system; improvement of contract management; planning of the sector's performance indicators; provision of trainings and funding for financial audits and equipment.

The credit's breakdown by expenditure type is as follows:

| Type of expenditure | Amount (SDR) |
|----------------------|--------------|
| Road works | 22,900,000 |
| Materials | 600,000 |
| Consultancy services | 2,300,000 |

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| | |
|---|-------------------|
| Additional operating costs | 500,000 |
| Repayment of advance payment at the project preparation stage | 500,000 |
| Reserve | 3,000,000 |
| Total | 29,800,000 |

Source: Extract from the Agreement on the Development Credit between Georgia and the International Development Organization, Tbilisi, July 26, 2000 attached to the Chamber of Control "Report on Inspection of the State Department for Roads of Georgia", 2001.

The agreement envisaged the purchase of machinery and equipment, including:

- 13 off-road vehicles;
- 4 vehicle weighing systems;
- 1 deflectometer system;
- 1 geological field laboratory;
- 1 drilling rig;
- 20 traffic intensity measuring gauges;
- 40 computer sets, including printers and software;
- 12 copiers;
- 22 fax-machines; and,
- other equipment for an information center.

The road works to be performed under the Road Project in 2001 – 2004 are as follows:

| Type of work | 2001 | 2002 | 2003 | 2004 | Total |
|---|-------------|-------------|--------------|--------------|----------------|
| Rehabilitation (km) | 58.0 | 25.0 | 49.0 | 39.0 | 171.0 |
| Periodic repairs and maintenance (km) | - | 64.0 | 68.0 | 125.5 | 257.5 |
| Bridge over River Tsivi (run. m.) | - | - | 87.0 | - | 0.087 |
| Bridge over River Sondiskhevi (run. m.) | - | - | 62.0 | - | 0.062 |
| Total | 58.0 | 89.0 | 117.0 | 164.5 | 428,649 |

Source: State Department for Roads of Georgia.

A series of international tenders were conducted in 2001 – 2003 to select contractors for consultancy, road maintenance and rehabilitation, technical assistance and supervision, design and bidding documents preparation, procurement assistance and other works. A total of 30 contracts have so far been awarded within the World Bank Road Project, of which 22 contracts were given to Georgian companies and eight contracts to foreign companies. The technical assistance and work supervision services contract was awarded to Louis Berger International.

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Kuwait Fund Credit

On March 7, 2000, a credit agreement¹²⁰ was established between the Government of Georgia and the Kuwait Fund for Arab Economic Development, for a total amount of 5 million Kuwaiti dinars (16,249,000 USD). The agreement was ratified by the Parliament of Georgia on June 27, 2000.

The credit is repayable over 20 years, including a 4-year grace period, at the annual interest rate of 3%. The repayment of the principle should be performed in 32 payments at half-a-year intervals. Georgia assumed responsibility for the co-financing of 32% (7,639,000 USD) of the credit amount, including the VAT part paid from the central budget and project co-participation part paid from SRF funds. Consequently, the project cost increased to 23,888,000 USD. The duration of the project was 2 years (2002 – 2003).

The project objectives are as follows:

- to ensure that current and future traffic requirements are met to a satisfactory level;
- to diminish traveling time;
- to improve traffic safety; and,
- to increase road-building capacity through introduction of new technologies and equipment.

The scope of work comprises rehabilitation, renovation, improvement and partial reconstruction and up-grade of 100 km road section, related improvements in drainage system, road marking, and signs, and consultancy services in project design and supervision.

The breakdown of the credit amount by the type of works is as follows:

| Type of work | Credit amount (Kuwait dinars) | Credit amount and Georgian co- financing (USD) |
|-------------------------|----------------------------------|---|
| Road works | 3,850,000 | 15,638,000 |
| Consulting services | 400,000 | 1,614,000 |
| Road building-machinery | 300,000 | 975,000 |
| Contingencies | 450,000 | 1,842,000 |

Source: Extract from the Credit Agreement between Georgia and the Kuwait Fund for Arab Economic Development attached to the Chamber of Control "Report on Inspection of the State Department for Roads of Georgia", 2001.

The road works under the Kuwait Fund in 2002 – 2003 are as follows:

| Location | 2002 | 2003 | Total |
|---|------|------|-------|
| Marneuli - Sadakhlo (km) | 10.0 | - | 10.0 |
| Samtredia – Lanchkhuti - Grigoleti (km) | 18.0 | 39.3 | 57.3 |
| Poti access road (km) | 2.0 | 2.8 | 4.8 |

¹²⁰ Data obtained from the Chamber of Control "Report on Inspection of the State Department for Roads of Georgia", 2002 and SDRG evidence.

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| | | | |
|--------------------------------------|-------------|-------------|---------------|
| Bridge over River Kaparcha (run. m.) | - | 222.0 | 0.222 |
| Total | 30.0 | 42.1 | 72.322 |

Source: State Department for Roads of Georgia.

According to the terms of the agreement, the selection of contractors was performed on the basis of restricted tenders with participation of Georgian and Kuwait companies. The contract for consulting services was awarded to the Kuwaiti company “Pan Arab Consulting Engineers.” One of the main requirements of the agreement was the subcontracting of Georgian companies. The tender for road works was conducted among seven Kuwaiti-Georgian joint ventures, where the Kuwaiti companies were proposed by the Kuwait Fund and Georgian companies – by SDRG, of which one joint venture was selected. The contract value amounted to 18,493,100 USD.

SDRG’s special approval commission performs the approval of completed works where 2.5% of the contract value is retained for 1-year guarantee period and will be repaid to the contractors if no defects are exposed within one year after the completion of works.

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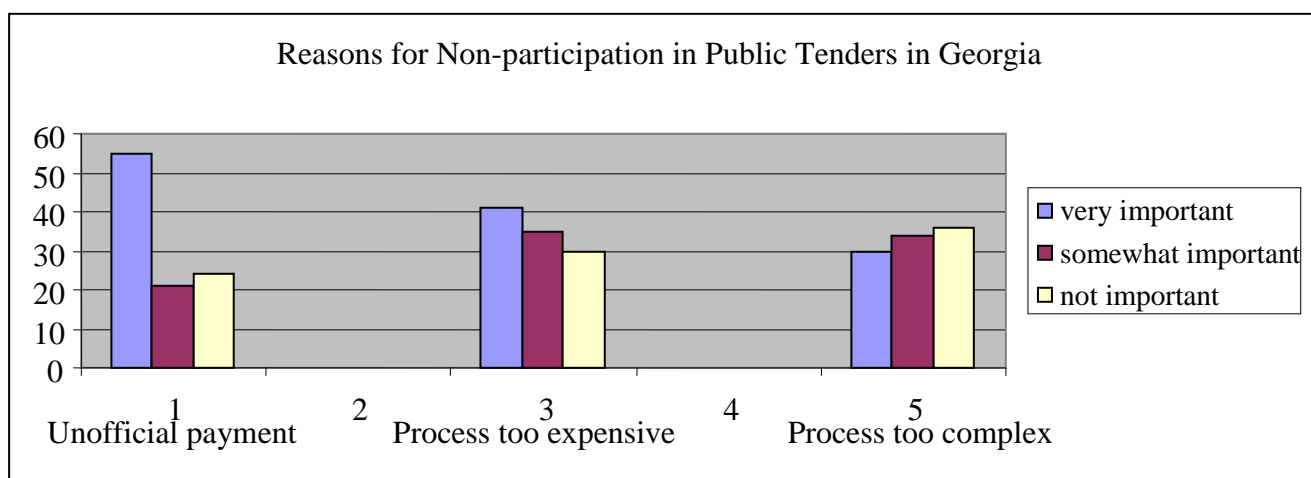
APPENDIX 10 – SDRG TENDERS IN 1996 – 2003

International and domestic tenders conducted by SDRG in 1996 – 2003

| # | Source of Financing | Years | | | | | | | | Total |
|---|---------------------------------------|-------|------|------|------|------|------|------|------|-------|
| | | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | |
| A | State Road Fund | | | | | | | | | |
| 1 | Closed tendering on the road works | | 13 | 4 | 1 | | 1 | | | 19 |
| 2 | Open tendering on the roads works | | | | 10 | | 3 | 19 | 19 | 51 |
| 3 | Total number of bidders | | 43 | 12 | 12 | | 12 | 19 | 24 | 122 |
| 4 | The number of repeated tender-winners | | 2 | 1 | | | | 1 | | 4 |
| B | Kuwait Fund Credit | | | | | | | | | |
| 1 | Closed tendering on the road works | | | | | | | | | |
| 2 | Open tendering on the roads works | | | | | | 1 | | | 1 |
| 3 | Total number of bidders | | | | | | 14 | | | 14 |
| 4 | The number of repeated tender-winners | | | | | | | | | |
| C | IDA credit #2809 GE | | | | | | | | | |
| 1 | Closed tendering on the road works | | | | | | | | | |
| 2 | Open tendering on the roads works | 1 | 1 | | | | | | | 2 |
| 3 | Total number of bidders | 76 | 18 | | | | | | | 94 |
| 4 | The number of repeated tender-winners | 1 | 1 | | | | | | | 2 |
| D | IDA credit #3357-GE | | | | | | | | | |
| 1 | Closed tendering on the road works | | | | | | | | | |
| 2 | Open tendering on the roads works | | | | | | 1 | 5 | 3 | 9 |
| 3 | Total number of bidders | | | | | | 8 | 11 | 13 | 32 |
| 4 | The number of repeated tender-winner | | | | | | 4 | 1 | 3 | 8 |

Source: State Department for Roads of Georgia.

APPENDIX 11 – REASONS FOR NON-PARTICIPATION IN PUBLIC TENDERS



Source: Corruption in Georgia: Survey Evidence. Report prepared by the World Bank Based on a Survey Conducted by Georgian Opinion Research Bureau International with funding from the World Bank and USAID and with the Collaboration and Support of the Government of Georgia (June 2000).

APPENDIX 12 - LAW ON STATE PROCUREMENT OF GEORGIA

GEORGIAN LAW ON STATE PROCUREMENT¹²¹

As it is by 20 April, 2001 (Published: in the Legislative Bulletin of Georgia /'Sakartvelos sakanonmdablo matsne'/ N7, 1998 and N10 2001)

Chapter 1. General Provisions

Article 1. Scope of Application of Law

1. This Law states the general legislative and economic principles governing State procurement.
2. The regulations determined by the present Law apply to any State procurements except the State procurement related to State secrets as defined by the Georgian Law “on State Secrets”.
3. Regulations for implementation of State procurement connected to State secrets defined in the Georgia Law “on State Secrets” is developed by the National Security Council and approved by the President of Georgia.

Article 2. Purpose of the Law

The purpose of the Law is to:

- a) Provide rational and economical expenditure of financial resources allocated for State procurement;
- b) Develop sound competition between suppliers producing goods, works and services meeting State needs;
- c) Provide just and non-discriminative approach towards participants of procurement proceedings;
- d) Achieve transparency and publicity in the State procurement;
- e) Create a single, integrate procurement system and promote public confidence in the mentioned system.

Article 3. Definition of Concepts and Terms Used in the Law

- a.) “State procurement” - acquisition of any goods, works or services in order to meet State needs and by utilizing funds from:
 - a.a. Georgian State budget and means consolidated in the State budget;
 - a.b. Budgets of the Abkhazian Autonomous Republic and the Adjarian Autonomous Republic;

¹²¹ The English version of the “Law on State Procurement” of Georgia was provided by the State Procurement Agency

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- a.c. Budgets of other Georgian local units determined by Georgian legislation.
 - a.d. Special funds of all those organizations and institutions which are funded out of the resources of the State Budget of Georgia, budgets of Autonomous Republics of Abkhazia and Adjara and local budgetary resources specified by law;
 - a.e. Funds extended by other countries and international organizations either as an international assistance or lending on the basis of international agreements (except the cases when the given Law is in conflict with the respective international agreement or if respective credit or grant agreements provide for internationally accepted procurement rules different from the rules established by this Law);
 - a.f. Loans extended under the government's guarantee;
 - a.g. Funds of public or private legal entities, (except of National Bank of Georgia) established based on the State property, irrespective of sources of such funds.
- b.) Procuring agency – any executive governmental body of Georgia, or Autonomous Republics of Abkhazia and Adjara, budgetary agency or organization, local self-governance and governance bodies as well as any other institution or company that is procuring goods, works and services by the funds specified in paragraph a) of this Article.
- c.) “Object of Procurement” – particular types of goods, works, and services purchased by the procuring organization.
- d.) “Bidder” - any physical or legal body in Georgia, or in foreign countries, that passed through the qualification procedure.
- e.) “Supplier” - any physical or legal body in Georgia, or a foreign country, that concluded a contract with a procuring organization on implementing State procurement.
- f.) For the purpose of the present Law, the term “construction works” means works that are carried out for construction of an entity or its parts, as well as repair, reconstruction, and rehabilitation of the entity (except design related activity).
- g.) For the purpose of the present Law, the term “preference” means the acceptable difference between the values of the bid submitted by the national bidder and that of the foreign bidder in which case upon the evaluation by price factor the preference will be given to the national bidder.
- h.) Price quotation – a simplified method of procurement of goods, services, and minor works the estimated value of which is above 10,000 GEL and below 25,000GEL, and of minor works at estimated value above 50000 GEL and below 120,000GEL.
- i.) Procurement of intellectual services – a special type of procurement, of intellectual and other consulting services, scientific research works and experiments, construction designs, and government's orders in the education sphere;
- j.) Goods – any types of goods (including raw materials, manufactured goods, equipment, buildings, etc.) being in solid, liquid or gas condition, also electrical

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power; this will also include services associated with the goods if the cost of these services is not higher than that of the goods;

k.) Services – any subject of procurement except goods and civil works.”

Article 4. Public Procurement Agency

1. With the purpose of coordinating and monitoring all public procurement activities, under the guidance of the Law on Public Legal Entities, a permanent-operating-independent agency, to be referred to as the Public Procurement Agency (hereinafter the “Agency”), shall be established. The chair of which, shall be appointed and dismissed by the President of Georgia at the proposal of the Ministry of Economy, Trade and Industry.
2. The Constitution of Georgia, international covenants and agreements, this Law and the Agency’s charter, to be adopted based on the above-mentioned documents, shall constitute a legal base of the Agency operations.
3. With the purpose of ensuring transparency in the public procurement system and publicity in the activities of the Agency, a Board of Supervisors shall be established with the Agency, which shall consist of 7 members (including Chairman of the Board of Supervisors), to be appointed by the President of Georgia. The Charter of the Board of Supervisors shall be approved by the President of Georgia. The staff of the Board of the Supervisors: officials from ruling and controlling bodies (representatives of the Chamber of Control, Ministries of Finance, Justice and Economy, Industry and Trade); Representatives of Mass media and Public organizations. The Board of Supervisors works on the public basis.
4. The Charter and the structure of the Agency shall be based on this Law and shall be approved by the President of Georgia. A state body carrying out control of the activities of the Agency shall also be specified by the Charter of the Agency in compliance with the legislation of Georgia.
5. The Agency Funding:
 - a.) Funds earmarked from the State Budgets;
 - b.) Revenues received for the work carried out on the basis of the agreement;
 - c.) Revenues consistent with Georgian legislation.
6. The main functions of the Agency shall be as follows:
 - a.) To develop and make public any normative acts required for the implementation of this Law and standard bidding documents and to harmonize them with international norms;
 - b.) On the basis of reports received from procurement agencies, to implement systematical studies and analyses of situation existing in the country’s procurement system and to provide recommendations to the President of Georgia to enable him to make appropriate decisions;
 - c.) To develop model teaching programs and methodological materials and documentation, to hold seminars and training sessions for central and local governmental bodies, law-enforcement agencies, mass media and other interested parties;

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- d.) To develop and improve an integrated public procurement data base;
- e.) To provide expertise, recommendations and consulting services to procurement agencies;
- f.) To maintain the register of suppliers
- g.) To support the establishing of modern informational and communications technologies in the public procurement system;
- h.) To make public any normative acts and reports for ensuring publicity of public procurement and to publish a special periodical newsletter;
- i.) On the basis of administrative procedures to adjudicate any disputes emerged in the course of public procurement activities;
- j.) To oversee the lawfulness of state procurement procedures and define the state policy regulating a procurement process.

New 4¹, and 4² articles shall be added to the Law to read as follows:

Article 4¹. Duties and Responsibilities of the Agency Chairman

1. The Agency Chairman shall:

- a.) In agreement with the Board of Supervisors established at the Agency issue normative acts – orders – specified in this Law and mandatory for all the agencies involved in the state procurement;
- b.) Make orders and instructions on internal organizational matters;
- c.) Regulate any issues which are within the Agency's jurisdiction;
- d.) Monitor the Agency's structural units to ensure that they perform their functions in proper manner; supervise the Agency staff according to the established procedures.
- e.) Within the limits of its competence appoint and dismiss the Agency staff;
- f.) Manage the Agency's funds and control the spending;
- g.) Make suggestions according to the established procedures on such decisions which should be made on any matter over which the Agency has jurisdiction;

2. The Chairman of the Agency is responsible for the Agency's activities in accordance with law.

Article 4². Duties, Responsibilities and Operational procedures of the Board of Supervisors

1. The Agency's Board of Supervisors shall

- a.) Review at its meetings normative acts to be issued by the Chairman of the Agency, and the by-laws of the Agency's structural units and results of their activities;
- b.) In its operations the Agency's Board of Supervisors shall be guided by the key directions of the government's public procurement policy and at its meetings shall give the participants in the public procurement activities possibility to freely defend their respective interests;

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- c.) Prepare annual reports about its activity and submit it to the President of Georgia. The reports should be open to public.
2. Agency's Board of Supervisors within the limits of its competence, shall have the right to request procurement agencies to provide it with any information related to the public procurement activities and to examine correctness of such data and information.
3. The meetings of the Agency's Board of Supervisors shall be open to public and all its decisions shall be published in accordance with the existing procedures. Confidentiality of any information considered by the Board of Supervisors shall be preserved in accordance of applicable law.

Article 5. Rights and Obligations of procuring organizations

1. A procuring organization has the right:
 - a.) To select a supplier according to this Law and bylaws and conclude a contract with the supplier;
 - b.) To disqualify a person according this Law;
 - c.) To terminate procurement proceedings at any time before a contract is signed if such a decision stems from an objective necessity that is beyond the control of the procuring organization and can not be foreseen, also based on state or public interests;
 - d.) To supervise and exercise control over the fulfillment of the contract;
 - e.) According to the effective legislation suspend or terminate the realization of the contract if the supplier submits false qualification documents, also in other cases determined by the legislation.
2. A procuring organization is obliged:
 - a.) To carry out State procurement in a rational manner within the limits of the allocated assigned budget allocations and stemming from the country's interests and according to the rules stated by this Law and the by-laws;
 - b.) To keep confidential the information provided by bidders to the procuring organization before the contract on state procurement is signed.
 - c.) Submit to the Georgian Ministry of Economy reports on the realized State procurements according the format and within the terms set forth by the Article 24 of the present Law.
 - d.) Immediately submit to the Georgian State Department of Statistics statistical reports on the realized State procurements according the format developed and approved by the Georgian State Department of Statistics.
 - e.) Pay the supplier the cost of works and/or services immediately upon goods, works, and services are delivered, unless otherwise stated in the contract.
 - f.) In case if state procurement is canceled according to the Article 5 (2) (c) implement this procurement only by resuming the terminated procedures.
 - g.) In the cases provided by the Article 5 (2) (c) notify the Georgian Ministry of Economy and parties participating in the procurement process about its

decision and the grounds for such a decision within the three (three) days upon the decision is made. Meanwhile, procuring organization is not obliged to provide the participants of the procurement process with the evidence or give the detailed information that made basis for the above-mentioned decision, as well as reimburse the bidders' costs related to the participation in the proceedings, except tender fees.

Article 5¹. Terms and Procedures for Avoiding Conflict of Interests

1. These procedures which are aimed at avoiding conflict of interests shall apply to the following activities related to public procurement:
 - a. Conducting any operations required for preparing public procurement, including those aimed at identifying both characteristics and estimated costs of objects to be procured;
 - b. Selecting members of tender committees and any other persons responsible for implementing public procurement;
 - c. Preparing tender application forms, tender documents and other required materials;
 - d. Reviewing and evaluating qualifications materials and bids;
 - e. Under the conditions envisaged in this law, holding technical discussions and negotiations;
 - f. Under the conditions of closed tender, selecting potential bidders;
 - g. Overseeing and monitoring the implementation of the public procurement contracts;
 - h. Conducting any other activities aimed at implementing public procurement.
2. No person willing to take part in the public procurement activities and/or actually participating in such activities shall have the right to apply any procuring agency (its managers or employees) or any governmental agency with a request to assist him, or by using all means and methods to put any direct or indirect pressure on such agencies in order to win the right to enter into any public procurement contract, which may be beneficial to such a person.
3. No procuring agency shall assign any person to the duty of organizing and managing the public procurement activities or overseeing such activities and no procuring agency shall invite any person as a consultant (or expert), if such a person:
 - a.) Is closely related to any managerial staff of a legal entity involved in the public procurement activities or to a direct party to such activities if the latter is an individual;
 - b.) For the last three years has worked for any agency involved in the public procurement activities;
 - c.) Has a personal or business relationship or has conducted negotiations with the purpose of establishing such relationship with any individual or legal entity that is involved in the public procurement activities.

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4. No individuals and legal entities that had been involved in the public procurement preparatory operations shall have the right to take part in the public procurement activities.
5. All provisions prescribed in paragraphs 3 and 4 of this Article shall also apply
 - a.) In cases of overseeing the implementation of public procurement contracts;
 - b.) To all parties to any state procurement conducted through negotiations with one person.
6. In cases of open or closed tenders, immediately after the qualifications materials submission deadline, all members of the tender committee, all invited consultants (experts), and all those employees of the procuring agency that have anything to do with the public procurement activities, shall be required to certify in written that his or her involvement in this particular public procurement activity is not in conflict with any of the above requirements.
7. Whenever consulting services are to be procured, the following conditions shall be met:
 - a.) No consultant or any affiliated person thereof (whether individual or entity) shall take part in any public procurement activity, which given the nature of such activity may be in conflict with any other responsibilities of such consultant;
 - b.) All consultants (both individuals and entities) shall be required to give the procuring agency a professional, objective and unbiased advice based on the interests of the procuring agency.

Article 5². Public Procurement Planning

1. Any procurement agency shall implement public procurements in accordance with an annual procurement plan developed and approved in advance. In the case of multiple year procurement, planning is conducted by a pertinent procuring body in compliance with the Georgian legislation. State procurement planning is regulated by the Decree of the Chairperson of the Agency.
2. Each annual procurement plan shall be developed in accordance with the procedures of developing and reviewing the drafts of appropriate (State or local) budgets, as set out in the laws on the Budgetary System and Budgetary Authorities and the Principles of the Georgia Economic and Social Development Indicative Planning.
3. Procurement of homogeneous goods, services and work conducted by a pertinent procurement agency during a year is considered as one procurement if it is financed out of one source.
4. Not later than 20 days following the approving of the State Budget, or those of the Autonomous Republics, or local budgets, the head of a pertinent procurement agency shall approve and provide to the Agency the revised procurement plan

Chapter 2. Methods of State Procurement

Article 6. Methods of State Procurement

1. Methods of State procurement are as follows:
 - a.) Open tendering
 - b.) Closed tendering
 - c.) Single-source procurement
2. In cases justified by the present Law, open and close tenders can be carried put in two stages.
3. Principles for the use of procurement methods are determined by the present Law and by-laws adopted by the Georgian Ministry of Economy;
4. The quotation and the intellectual services procurement methods shall be defined in a special normative act.

Chapter 3. Tender

Article 7. Basic Principles Governing the Choice of Type of Tender

1. Open tender is held in cases when the estimated value of the subject to procurement exceeds the amount of 70.000 LARI, while in the case of procurements of construction works – 230.000 LARI.
2. Closed tender is held in the cases when the estimated value of the subject to procurement is less then the amount of 70.000 LARI (while in the case of procurements of construction works – 230.000 LARI), but exceeds the amount of 25.000 LARI (while in the case of procurements of construction works –120.000 LARI)

Article 8. Grounds for Establishing and Functioning of Tender Committee

1. Both, open and closed tenders are held by Tender Committee which is established by the Head of the procuring organization and consists of at least 5 members;
2. Head of procuring organizations and/or deputies, as well as heads of structural subdivisions of procuring organizations are appointed as members of Tender Committee;
3. It is prohibited for a close relative of the head of bidder (physical or legal body); a founder or member of bidding organization that has a status of legal body and exists as a Fund or a Union; or has a share in the bidder enterprise equity; to be a member of the Tender Committee;
4. Pursuant to the decision of the Tender Committee, specialists from corresponding fields and representatives of other treasury organizations can be invited to the Tender Committee as experts and consultants, with voting right;
5. The Tender Committee will be chaired by the head of the procuring organization or the person appointed by him (her);
6. Pursuant to the order of the Head of the procuring organization with the purpose of proving organizational-technical activities of the Tender Committee, there will be

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established apparatus, manned by the staff members of the procuring organization and headed by the Chairman of the Tender Committee;

7. The Tender Committee takes decisions by the simple majority of the Committee members. The member of the Committee, that disagrees with the decision of the Committee has right to submit his own viewpoint, that should be attached to the decision of the Tender Committee. In the case of equal votes, the Chairman has the casting vote;
8. The minutes of meetings of the Tender Committee shall be signed by the members of the Committee.

Article 9. Tender announcement

1. In an open tender the Tender Committee on the behalf of a procuring organization:
 - a.) Shall make an announcement about the tender via the Mass Media, defined in the by-laws;
 - b.) When the estimated value of the State procurement exceeds the amount of 600.000 LARI, while in the case of the construction work procurement – 8.000.000 LARI notification shall be also placed in an widespread international periodical or specialized printing organ, on one of the languages most accepted in the international trade practices. The notification shall also be sent to the foreign diplomatic and consular institutions based in Georgia;
2. If necessary shall define additional means, other than the ones defined in the sub-unit (a) and sub-unit (b) of the Unit, for tender announcement
3. In the case of closed tender the procuring organization, sends to the bidders selected in advance subject to this Law (no less than five bidders) an official notification of holding the tender.
4. In the tender announcement there should be indicated:
 - a.) Contact details of the procuring organization;
 - b.) The type, quality and quantity, the point and form of supply of the procured goods; the essence and the place of implementation of the work or service to be implemented; all other details, that the procuring organization considers necessary as connected with the description of the objects to be procured;
 - c.) The desire to supply of the goods, to implement the work, to render the service to be procured, and the obligatory terms;
 - d.) Criteria and rule for estimation of qualification data;
 - e.) The terms, place and language for submission of the qualification data;
 - f.) Request for the documentation proving the qualification data;
 - g.) The rules, terms, place and language for submission of tender documents payment rate for acceptance of tender documents.

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5. The Tender Committee approves the tender announcement.
6. The Tender Committee publishes and, correspondingly distributes tender announcements no later, than 15 calendar days before the collection of the qualification data starts. In the case of closed tender, the Tender Committee should select the mean of distribution of tender announcement that will enable the selected persons to receive the announcement in the shortest possible term.
7. The Tender Committee might amend the information mentioned in the announcement, notice of which shall be made through mass media, the same way the announcement had been published, and in the case of closed tender the notice should be distributed to all the persons, whom the Committee addressed initially.
8. Amendment of the announcement and the publication (distribution) of these amendments should occur no later, than five calendar days before end of the submission term.

Article 10. Qualification data

1. The qualification data of the legal entities bidding for State procurements should meet the following requirements:
 - a.) Their property should not be arrested; no bankruptcy or sanction proceedings should be commenced against them, they should not be under re-organization or liquidation process;
 - b.) Within the last 5 years period their heads should not had been sentenced or no criminal proceedings, connected with their duties at job, should be instituted against them by the moment the State procurements start.
2. The qualification data of the physical person bidding for State procurements should meet the following requirements:
 - a.) They should be capable of functioning;
 - b.) No bankruptcy proceedings should be commenced against them;
 - c.) Within the last 5 years period their heads should not had been sentenced for economic activities or activities connected with their duties at job, or no criminal proceedings should be instituted against them by the moment the State procurements start;
3. In case if supply of goods, implementation of works or rendering of service subject to the legislation requires license, certificate or other types of permission, the bidder for the State procurements should have such license, certificate or permission.
4. In case if the documentation submitted by person as proof for the qualification, data is not valid or it does not meet the qualification requirements, the procuring organization can disqualify the person at any stage of procurement procedure, before entering the agreement on State procurement.
5. The disqualified person can sue the decision on disqualification;
6. In case if the documentation reflecting the qualification data is not correct or complete, or if it contains any technical mistake the procuring organization gives the

bidder opportunity to correct the mistake or inconsistency, or to fill in the documentation with the necessary information. The process of correction or filling of the qualification documentation should be fulfilled before the end of the qualification selection.

7. The detailed rule for estimation of qualification data is defined by by-law.

Article 11. Qualification selection

1. The purpose of the qualification selection is to define the list of bidders, by comparing the submitted data with the qualification data.
2. The qualification selection should be ended no later, than in 10 days after the procedure for the submission of qualification data stops.
3. The results of the qualification selection shall be registered under the decision of the Tender Committee and it will reflect the reasons and basis for disqualification of corresponding person(s) and approves the list of bidders.
4. All the persons, that had submitted their qualification data on due time shall be informed about the decision of the Tender Committee on the qualification selection. In the case of disqualification, they will also be informed about the basis for disqualification. The Tender Committee should choose the most efficient and quick way of delivery of the information.

Article 12. Tender documentation

1. The Tender Committee approves the tender documentation before publication (distribution) of the tender announcement.
2. After payment of the fees defined in this Article 19 of the Law, if there is such, the Tender Committee is obliged to issue tender documentation upon the request from the bidder.
3. The tender documentation should include:
 - a.) Instructions for development of the bidders tender proposals;
 - b.) Prioritized the procedures and criteria for estimation of the bidders' proposals;
 - c.) The quantity of the goods to be procured, obligatory or desirable terms and place for supply of goods, implementation of work and rendering of service, and other details, that the procurement organization will consider important in connection with the object to be procured;
 - d.) Full description of the technical and qualitative data of the object to be procured, including relevant technical specifications, plans, schemes and sketches, also the reasonable alternative technical and qualitative specifications to the object of procurement, if permitted by the procuring organization;
 - e.) The necessary conditions for the agreement on State procurements, that are known to the procuring organizations in advance, including the instructions for the form of the agreement;
 - f.) The methodology for calculation of the price of tender proposal, also the information whether the price should include other elements, besides the goods, work or service (e.g. transportation, insurance, taxes, etc);

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- g.) instructions for the currency, that the amount for the tender proposal should be stated in;
 - h.) The term, place and language for submission of the tender proposal;
 - i.) Description of the means and procedures for requirement of additional information or explanation, connected with the tender documentation by the bidder. While in case of two-stage tender – also the opportunity to hold direct negotiations with the bidders;
 - j.) Time, place and rule of tender proposals disclosure;
 - k.) The names and contact details of the officers of the Tender Committee apparatus, that are entitled to have direct contact with the bidders and provide them with the information and explanations on the procurement procedures;
- 4. The textual materials, specifications, plans, schemes, sketches and other materials used for the technical and qualitative parameters of the object to be procured should correspond to the current standards of international and Georgian standards, technical specifications, terminology and conventional definitions. It is forbidden to include the trademark, patent, model, source and producer in the description of goods to be procured.
 - 5. The Tender Committee, pursuant to the written request of bidder, or at its own discretion, shall explain or verify the information connected with the tender documentation, which shall be attached to the tender documentation in the form of appendices and shall be distributed to all the bidders 15 calendar days before the end of submission of tender proposals. The appendices or verification should not change the essence of the tender documentation.

Article 13. Preferences

In the case of participation of both local and foreign bidders 15 % preference is granted in respect of the tender proposal price, which should be submitted by the local bidder.

Article 14. Agreement on Intention

- 1. The procuring organization, prior to review of tender proposals enters agreement on intention with each bidder. Under the agreement:
 - a.) In case of winning the tender the bidder undertakes the obligation to enter agreement with the procuring organization on goods supply or, correspondingly implementation of work, or rendering services;
 - b.) Except for the case envisaged in Article 5.2.(c) of the Law or the event of disqualification, the procuring organization undertakes obligation to enter agreement with the bidder on goods supply or, correspondingly implementation of work, or rendering services in case of winning the tender by the latter, on the terms defined in the tender proposal;
- 2. Agreement on intention shall include term of the agreement on State procurement, the term of validity of the bidders tender proposals, also the responsibilities of parties in the event of default on the liabilities assumed under the agreement on intention.
- 3. The rules for definition of the forms of responsibility for breaching the form and conditions of the agreement on intention are defined by by-laws.

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Article 15. The procedure for submission and review of tender proposals

1. Tender proposals are submitted to the Tender Committee in sealed envelopes and the envelopes are opened at a Tender Committee meeting upon the expiration of their submission period and in the presence of the bidders. After opening the envelopes, the committee determines the deadline for the reviewing of received proposals and taking a final decision.
2. Before the disclosure of the tender proposals bidders have right to withdraw or change the tender proposal any time;
3. The Tender Committee only reviews the proposals of the bidders, which entered the agreement, envisaged by the Article 14 of the Law with the procuring organization.
4. Tender proposals are assessed in accordance with the criteria and priorities defined in the tender documentation. In case if the tender proposal submitted by bidder is not consistent with the requirements of tender documentation, the Tender Committee, at its own discretion, takes decision on disqualification.
5. The Tender Committee does not disqualify tender proposal, in case it includes inconsistencies, that do not materially change or contradict the essence of the requirements stated in the tender documentation or correction of which does not affect the essence of the tender documentation.
6. In the case defined in unit 5 of this Article, the Tender Committee addresses the corresponding bidder with the request to verify the tender proposal.
7. Tender winner is determined based on written conclusions submitted by Tender Committee members, in accordance with the estimation criteria and prioritization stated in the tender documentation.
8. The conclusion of Tender Committee member there should indicate the name of the preferred bidder, and also the basis and arguments for such preference.
9. The absolute majority of conclusions of Tender Committee members decide winner. In the case of equal votes, the chair of Tender Committee has the casting vote.
10. The decision of Tender Committee, stated in unit 7 of the Article is registered in minutes, with the conclusions of Committee members attached to it. Minutes should include information on the persons participating in the review of tender proposals, on bidders and summary of the submitted proposals.
11. Bidder can sue for any issues connected with the tender procedures.

Article 16. Signing a Letter of Agreement with the winner

1. Subject to the current law and based on the agreement defined in the Article 14 of the law, as well as tender proposal conditions of the winner, agreement on State procurement is made between procuring organization and the winner.
2. The conditions of agreement are defined by by-laws.
3. In the case that construction works are procured, if the construction site is located in the Georgian territory, no less than 70 % of the engineering-technical personnel and laborers and other support staff engaged in the procured works shall be citizens of Georgia.

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4. In the case of disqualification of the winner, or in case, if the winner refuses to enter the agreement the Tender Commission addresses other bidders for participation in the renewed review process of tender proposals, and if necessary, on prolongation of the term of the agreement on intention. In case, if non-of the bidders express desire to participate in the renewed review process new tender is held.

Article 17. Re-announcement of tender

1. In case if no winner was declare pursuant to tender process and renewed review-assessment of tender proposals, or despite tender announcement no tender proposals had been submitted or non of the submitted proposals was consistent with the conditions of Tender documentation, than Tender Committee elaborates new tender documentation and announces new tender.
2. Subject to the unit one of the Article the procuring organization can change the tender Committee, or appoint new members.

Article 18. Prohibition of negotiations with the bidders during the tender process

Tender Committee is not entitled to negotiate with the persons desiring to take part in tender and bidders, except of the event of two-stage tender.

Article 19. Tender fee

2. The following rates are set for tender fee in the case of State procurement from the State budget resources of Georgia, special funds of the organizations and agencies funded from the State budget, with funds received as assistance or credits from foreign countries and international organizations on the basis of international treaties, credits received with the state guarantee, with funds of legal public entities established with state property (except the National bank of Georgia):
 - a.) In the case of open tender – 500 LARI.
 - b.) In the case of closed tender – 150 LARI.
3. In the case of State procurement from Abkhazian, Adjarian or local budget resources, budgets of Autonomous Republics of Abkhazia and Ajara, special funds of organizations and agencies funded from the local budgets as defined by the legislation of Georgia, subject to the Law there can be set local tender fee, which should not exceed the amount defined in the unit 1 of the Article.

Article 20. Candidate selection during closed tender

1. In the case defined in the Article 7.2 of the Law tender announcement will be sent to the selected persons;
2. In case the closed tender is conducted the number of bidders shall not be less than 3, otherwise the procuring entity has the right either to continue the begun tender or terminate it and announce an open tender (after the agreement with the agency).
3. Besides the rules defined in the unit 1 and the unit two of the Article other rules determined for open tender is also used for closed tender.

Article 21. Two-stage tender

1. Two-stage tender is held if:

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- a.) Given the peculiarity of the object to be procured, it is impossible to determine all the technical and economic conditions of the object in advance and the procuring organization considers it necessary to hold negotiation with bidders at the first tender stage, in order to determine technical, economic and other aspects;
- b.) The object of State procurement is consultancy, scientific research, experimental, investigative or consultation-projecting works, and it is impossible to determine their results and price in advance;
2. At the first stage of two-stage tender the bidders shall submit their free Initial tender proposals, (“initial tender proposal”);
3. At the first stage Tender Committee can hold direct negotiations with bidders, with the purpose to verify any issues of the initial tender proposal, as well as define the final parameters for tender documentation;
4. Pursuant to review of the initial tender proposal the Tender Committee determines the final version of tender documentation that shall be distributed among all the bidders in case of payment of tender fee.
5. Besides the rules defined in the units 2,3 and 4 of the Article, the rules for one-state tender are also applicable to the two-stage tender.

Chapter 4. The method of holding Negotiation with One Bidder

Article 22. The method of direct negotiation with a single person

1. The procuring organization may chose to use the method of holding direct negotiations on State procurement with a single person, in case:
 - a. The estimated cost of the unit under procurement shall not exceed 10 000 GEL and in the case of procuring construction works – 50 000 GEL;
 - b. Supply or implementation of the State procurement object is the exclusive right of a single person;
 - c. As a result of Force Majeure the State procurement can not be postponed;
 - d. It is necessary to implement State procurement from the same supplier with the purpose of further application and prevention of deterioration of qualitative feature of goods, technology or equipment received from the supplier, except for the case when the initial supply cost exceeds the assumed amount of the State procurement to be implemented;
2. In the case of application of the method of holding direct negotiations on State procurements the head of the procuring organization or the authorized person appointed by him (her) subject to legislation.

Chapter 5. Review of the Conditions of Agreement on Implementation of State Procurement

Article 23. Review of the conditions of agreement on Implementation of State procurement

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1. It is not permitted to change the conditions of the agreement entered with the supplier if it causes increase in the price of the agreement and adversely affects the conditions of the agreement referring to the procuring organization, except for the case envisaged by the Article 398 of the Civil Code;
2. The procedures and rules for review of the conditions of agreement on implementation of State procurements are defined by the Georgian Legislation.

Chapter 6. Control and Monitoring of State Procurements

Article 24. State procurement account

1. The State procurement process is reflected in the State procurement account and the rule for its elaboration and keeping is defined by the by-law, adopted by the Ministry of Economy.
2. After tender is held minutes of Tender Committee meeting, decisions taken, conclusions of the experts and consultants participating in the tender, also other documents defined in the by-law referred to in the unit 1 of the Article should be attached to the account.
3. The State procurement accounts shall be submitted to the Ministry of Economy of Georgia within the following terms:
 - a. In the case of tender no later, than 10 days after agreement is executed;
 - b. In the case of holding negotiations with a single person, if the amount of State procurements exceed 25.000 LARI -no later, than 10 days after agreement is executed;
 - c. In the case the amount of State procurements is less than 25.000 LARI - on quarterly basis, no later, than the 10th day of the first month of the following quarter;
4. All the interested persons shall have access to the State procurement accounts if requested, and their summary should be made public on regular basis through the State procurement bulletins, founded by the Ministry of Economy of Georgia.
5. If the volume of public procurements conducted through a tender exceeds 32 million GEL, the chairman of the tender committee shall report on the procurement process to the President of Georgia at the government meeting”.
6. The Ministry of Finance of Georgia, those of the Autonomous Republics of Abkhazia and Adjara, and local finance departments shall be obligated to regularly (on a monthly basis) provide the Agency with information about actual disbursements to the budgetary agencies.”
7. The Agency is authorized to request any documents and information on state procurement from procuring organizations and bidders at any stage of state procurement implementation, including the information on implementation of agreements.”
8. In order to ensure transparency of the procurement process the agency’s obliged to carry out monitoring of the protecting of such principles during the state procurement

process as publicity, fairness, proper fulfillment of the determined procedures, reporting open and efficient competition, an opportunity of rational and free choice.

Chapter 6¹. Adjudicating Disputes and Bringing Claims in Relation to Public Procurement

Article 24¹. Bringing of Claims

1. All persons willing to participate or actually participating in the public procurement activities, all bidders and suppliers, whether being individuals or entities, shall have the right to contest any action of procuring agencies (or tender committees), if they believe that in the course of the public procurement activities any rules or procedures, established by the Public Procurement Law or any other applicable legal act, and/or their rights have been violated.
2. If any claim emerges before the conclusion of a public procurement contract, the person who has such a claim may request directly the procuring agency to reconsider the decision of the relevant officer of the tender committee or procuring agency or to review the dispute.
3. In cases envisaged in paragraph 2 of this Article, any person who has a claim may apply to the procuring agency with this claim no later than 20 calendar days after the receipt of information about the conditions or the making of that decision which caused the emergence of such a claim or dispute. All such persons whose interests actually are or can be affected by such claim shall have the power to take part in the review of that claim.
4. Before a public procurement contract is made, any individual or legal entity that is willing to take part or is actually participating in the public procurement procedure, or is a bidder or supplier, may appeal to the Agency with a claim to review any dispute, which may arise in relation to public procurement.
5. Any individual or legal entity that is willing to take part or is actually participating in the public procurement activities, or is a bidder or supplier, may appeal to the Agency also in case that such individual or entity is not satisfied with the decision of the procuring agency.
6. In cases envisaged in paragraphs 4 and 5 of this Article, the Agency, no later than 10 days after the receipt of a claim, shall make in written a reasonably justified decision, which shall be communicated to those persons, and the procuring agency that has submitted the claim.
7. If as a result of thorough scrutiny of the claim itself, as well as all related conditions, the Agency finds that the claim is reasonably justified, then the Agency shall have the power to:
 - a. Warn the procuring agency that it has committed an incorrect action and call on it to implement the public procurement activities in accordance with the requirements of law;
 - b. Require that the procuring agency review or cancel its decision(s);

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- c. In case that it finds that any participant in the public procurement activities has failed to comply with the provisions of this Law, to require the appropriate agencies to hold such a participant responsible for such a breach.
8. After the deadline specified in paragraph 3 of this Article, as well as after the public procurement contract has been entered into effect, all claims and appeals may be heard by courts only.
9. No claim may be considered if it refers to:
 - a. The selection of a public procurement method, if the same has already been selected in accordance with the procedures established by this law and other applicable legal acts;
 - b. The decision of the procuring agency on the cancellation of public procurement activities, if such a decision has been made in accordance with the procedures established by this law and other applicable legal acts.
10. Any claim or appeal shall be based on a reasonable ground and shall be supported by a reasonable evidence that in case of withholding the claim or appeal the person in question will suffer serious losses.
11. In case that any claim is submitted to the procuring agency, or the Agency, or court before the relevant public procurement contract has been effected, the procuring agency shall suspend all public procurement activities for the period of 10 days. By the decision of the manager of the procuring agency, or the Agency, or court the suspension period may be extended, provided that under no circumstances shall the whole suspension period exceed 30 days.
12. With the agreement of the Agency, the procuring agency may decide not to suspend the public procurement activities, if delay in public procurement is impossible or is not justified in view of national or public interests.
13. Any individual or legal entity that is willing to take part or is actually participating in the public procurement activities, or is a bidder or supplier, may take legal action against the decision of the procuring agency or the Agency with respect to the claim of such an individual or entity.
14. Any damages which as a result of reviews and hearings provided in this Article may be payable to the person that has initiated claims, shall be limited to those costs which have been incurred in relation to the participation of such a person in the public procurement activities and shall not include any indemnification for the expected revenues.

Chapter 7. Transitional Provisions

Article 25. Procurement rule for goods until January 1, 2000, subject to the Presidential Ordinance N317, dated June 20 1997.

The Law is not applicable to the goods envisaged by the Ordinance of the President of Georgia “ on Certain Urgent Measures for the Optimal Use of Budgetary Appropriations for the Country’s Law Enforcement Bodies and Some Urgent Measures Fostering the Operation of Local Enterprises at a Maximum Capacity” dated June 20, 1997.

Chapter 8. Final Provisions

Article 26. Establishment of State Procurement Department and adoption of by-laws.

1. The president of Georgia shall appoint the Chairman of the State Procurement Department prior to June 1 1999.
2. The Ministry of Economy of Georgia shall establish the State Procurement Department prior to June 1, 1999.
3. The Ministry of Economy of Georgia shall adopt the by-laws, necessary for enactment of the Law prior to June 1, 1999.
4. The State Department of Statistics of Georgia, in coordination with the Ministry of Economy of Georgia shall approve the form of the account, defined in the Article 5.1.(d) of the Law prior to June 1, 1999.
5. The expenses of the State Procurement Department of the Ministry of Economy of Georgia shall be included into the State budget of Georgia.

Article 26¹. Creation of an Agency for Public Procurement and Normative Acts to be issued in connection with the implementation of this Law

1. In relation to the reorganization of the Public Procurement Department of the Ministry of Economy, Industry and Trade into the Public Procurement Agency, by May 1, 2001 the following regulations shall be issued:
 - a. Decree of the President of Georgia on “Establishment of the State Procurement Agency and Transfer of State Property Thereto”;
 - b. Decree of the President of Georgia on “Approving the Charter of the Supervisory Board attached to the State Procurement Agency.”
2. The Agency shall start fulfillment of its functions and the Agency’s Supervisory Board in its initial composition shall be constituted as of May 1, 2001.
3. By June 1, 2001, the Parliament of Georgia, by making appropriate amendments to the Code of Administrative Offenses and the Criminal Code of Georgia, shall define the forms of responsibility for the violation of the legislation regulating public procurement.
4. By June 1, 2001 the Chairman of the Agency shall issue a Decree approving the Regulations on the Implementation of State Procurements.
5. By June 1, 2001 the President of Georgia shall approve the implementing regulations for confidential procurements as defined by Georgian Law on State Secrets.
6. By June 1, 2001 the Board of the national Bank of Georgia shall approve the implementing regulations for the National Bank.

Article 27. Annulled by-laws

1. The Presidential Ordinance #612, dated October 28, 1998 shall be considered invalid upon adoption of the Law.
2. Starting from June 1, 1999 the following shall be considered invalid:

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- a. The decree of the Cabinet of Ministers of Georgia #264 “On Supplying Production and Goods for the State Needs of the Georgian Republic”, dated March 30, 1993;
 - b. The Presidential decree # 244 “On Some Measures Ensuring Maximum Efficiency of the Country’s Industrial Potential in Material and Technical Support of Georgia’s Military Forces”, dated March 31, 1996;
 - c. The Law of Georgia “on State Orders in the Construction Sector” (06.02.98)
3. On January 1, 2000 the Ordinance of the President of Georgia “ on Certain Urgent Measures for the Optimal Use of Budgetary Appropriations for the Country’s Law Enforcement Bodies and Some Urgent Measures Fostering the Operation of Local Enterprises at a Maximum Capacity” dated June 20, 1997 will become invalid;

Article 28. Enactment of the Law.

Article VII and VIII of this Law shall enter into force immediately upon publication, while other Articles -only after July 1, 1999.

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