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INTERNATIONAL FINANCE CORPORATION

AND

MULTILATERAL INVESTMENT GUARANTEE AGENCY

COUNTRY PARTNERSHIP FRAMEWORK

FOR

AZERBAIJAN

FOR THE PERIOD FY16-FY20

June 3, 2015

**South Caucasus Country Management Unit (ECCU3)
Europe and Central Asia Region**

International Finance Corporation (IFC)

Multilateral Investment Guarantee Agency (MIGA)

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CURRENCY EQUIVALENTS
(Exchange Rate Effective as of April 20, 2015)

| | |
|---------------|------------------|
| Currency Unit | Azerbaijan Manat |
| US\$1.00 | AZN 1.05 |

GOVERNMENT FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

| | | | |
|-------|--|-------|---|
| ACIP | Agricultural Competitiveness Improvement Project | KfW | German Development Bank |
| ADB | Asian Development Bank | LiTs | Life in Transition Survey |
| AF | Additional Financing | LPI | Logistics Performance Indicator |
| AML | Anti-Money Laundering | MIGA | Multilateral Investment Guarantee Agency |
| ASAN | Azerbaijani Service and Assessment Network | MFI | Microfinance Institution |
| AzRIP | Azerbaijan Rural Investment Project | MSME | Medium and Small Micro-Enterprises |
| B40 | Bottom 40 | NACP | National Anti-Corruption Plan |
| CBAR | Central Bank of the Republic of Azerbaijan | NWSSP | National Water and Supply Sanitation Project |
| CPF | Country Partnership Framework | OBI | Open Budget Index |
| CPS | Country Partnership Strategy | OGP | Open Government Partnership |
| CSO | Civil Society Organization | OOP | Out-of-pocket |
| CTF | Combating the Financing for Terrorism | OSCE | Organization for Security and Cooperation in Europe |
| DPO | Development Policy Operation | O&M | Operation and Maintenance |
| EBRD | European Bank for Reconstruction and Development | PEFA | Public Expenditure and Financial Accountability |
| EC | European Commission | PFM | Public financial management |
| ECA | Europe and Central Asia | PI | Permanent Income |
| EFO | External Financial Operation | PLR | Progress and learning review |
| EIB | European Investment Bank | POS | Points of Service |
| EITI | Extractive Industries Transparency Initiative | PPP | Public Private Partnership |
| EU | European Union | RAS | Reimbursable Advisory Services |
| FSAP | Financial Sector Assessment Project | SCD | Systematic Country Diagnostic |
| GDP | Gross Domestic Product | SDG | Sustainable Development Goals |
| GGFR | Global Gas Flaring Reduction | SECO | Swiss Economic Cooperation Organization |
| HBS | Household Budget Survey | SME | Small and medium enterprise |
| IBA | International Bank of Azerbaijan | SOE | State-owned enterprise |
| ICT | Information Communication Technologies | SOFAZ | State Oil Fund of Azerbaijan |
| IDA | International Development Association | T60 | Top 60 |
| IDP | Internally Displaced Person | TANAP | Trans-Anatolian Gas Pipeline |
| IFC | International Finance Corporation | UNDAF | UN Development Assistance Framework |
| IFI | International financial institutions | VAT | Value Added Tax |
| IMF | International Monetary Fund | WBG | World Bank Group |
| IT | Information Technology | WGI | World Governance Indicators |
| JICA | Japan International Cooperation Agency | WUAP | Water Users Association Project |
| JSSIP | Judicial Services and Smart Infrastructure Project | | |

| | IBRD | IFC | MIGA |
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EXECUTIVE SUMMARY

- i. **The Country Partnership Framework (CPF) for Azerbaijan covering the period FY16 - FY20, sets out the World Bank Group (WBG) support to the country on its path toward a sustainable, inclusive and private sector-led growth underpinned by a diversified asset base.** The country's strategic goals are laid out in its development strategy – *Azerbaijan 2020: Vision for the Future* (“*Vision 2020*”) and other strategic documents that aim at reducing Azerbaijan's dependence on oil and gas revenues and strengthening its resilience to external shocks through investments into diversified human capital, physical infrastructure and stronger institutions.
- ii. **The CPF builds on the WBG Systematic Country Diagnostic (SCD) for Azerbaijan¹ and aligns its objectives with the constraints and priorities identified in the SCD.** Following the findings and recommendations of the SCD, the CPF program *selectively* addresses a set of binding constraints defined by the SCD in order to support Azerbaijan in sustaining the progress made in eliminating extreme poverty and boosting shared prosperity. It will support the strategic goal of rebalancing the roles of the public and private sectors, with the former becoming a facilitator rather than the main driver of growth.
- iii. **Over the past decade, Azerbaijan has made remarkable progress toward reducing poverty and boosting shared prosperity.** According to the SCD, poverty incidence declined from close to 50 percent in the early 2000s to about 5 percent² in 2013. Consumption of households in the bottom 40 percent of the income distribution (B40) grew by over 2 percent per year between 2007 and 2012, which is twice the rate of the top 60 percent (T60). Improvements in living standards were accompanied by growth of the middle class from 4.3 to 28.9 percent of the population.³ The country's achievements on the WBG twin goals are largely accounted for by the stellar economic performance over the last decade with economic growth rate of 13 percent on average. Despite this good progress, a sizeable share of the population (65 percent in 2012), remains vulnerable and run the risk of relapsing into poverty in case economic conditions deteriorate.
- iv. **Azerbaijan's economy is facing strong headwinds from the dual challenges of lower oil prices and the uncertain regional economic environment.** The low oil prices, weak growth of the main trading partners and slow pace of structural transformation are now having an adverse impact on the Azerbaijan economy, which has led to lower exports, reduced oil revenues, and has curbed public investment. In 2015, Azerbaijan is expected to have its first fiscal deficit in over a decade. In the past, the country successfully weathered economic crises, including the 2008-2009 financial crisis. The substantial foreign currency reserves that Azerbaijan managed to accumulate despite an economic slowdown after oil production reached its peak in 2010, stand at 50 percent of the country's GDP. This will cushion the country from the immediate impacts of a sharp deterioration of the economic environment.

¹ The Systematic Country Diagnostic for Azerbaijan submitted to the Board on June 3, 2015.

² Data on poverty incidence for 2013 is being verified by the WBG.

³ The SCD defines the middle class as households with a per capita consumption above USD10 (PPP) per day

v. **In response to the emerging challenges and the mounting depreciation pressures, the government devalued the national currency⁴ and committed to fiscal consolidation.** The manat devaluation was undertaken to adjust relative prices and to prevent large rundowns on Azerbaijan’s foreign reserves. While the manat devaluation cushioned the impact of a shrinking revenue and lower transfers from the State Oil Fund of Azerbaijan (SOFAZ) to the budget in US dollar terms, it poses a risk of rising inflation and increased cost of servicing foreign currency denominated loans in the banking sector. The government is now committed to fiscal consolidation and plans to cut spending by 12-15 percent of its 2015 budget, mainly from public investments in roads and transport sector. However, given their high social value and to address the pressing needs of the vulnerable and marginalized population, the government is committed to keeping social expenditures at the same level as originally projected for 2015. The government will also explore other ways to strengthen spending efficiency, expand the coverage of social assistance, and improve targeting of social programs as part of its fiscal consolidation efforts.

vi. **The CPF takes into account the government’s intention to optimize the external borrowing over the medium term as part of the ongoing effort to maintain fiscal sustainability.** In particular, the government plans to refocus its foreign currency denominated borrowing, including loans from international financial institutions (IFIs), to support projects with a high economic rate of return where international expertise and technical assistance would justify potential exchange rate risks. Projects in this category include investments in: highways and other main transport corridors that will help integrate the economy into regional and global markets; the national water supply and sanitation systems; power distribution system; and other selected areas that the government identifies as priorities for external borrowing. The government is also keen on exploring more partnerships with the private sector—possibly through public-private partnerships (PPPs) or private management contracts—to deliver public services in some of these areas. The government has chosen to fund investments in social sectors (such as health, education and social protection) as well as local connectivity mainly from the state budget given that these investments typically involve less foreign currency expenditure and have longer pay back periods. Nonetheless, the government plans to seek support from development partners, in the form of technical assistance or limited co-financing depending on emerging demands. The WBG is considered as an important partner to support the government’s large investment programs, such as in power distribution system, highway network development, and water and sanitation services, in cooperation with the Asian Development Bank (ADB), European Investment Bank (EIB), and European Bank for Reconstruction and Development (EBRD), Swiss Economic Cooperation Organization (SECO), German Development Bank (KfW) and others.

vii. **The CPF lending program will help Azerbaijan in meeting its development objectives through engagement in priority areas where the country’s ownership is strong, where the WBG has a comparative advantage and where the potential impact on the WBG twin goals is substantial.** The CPF takes on board the SCD priorities and pursues a selective strategy focused on: (i) *strengthening governance* through better management of public resources, delivery of services, and institutions, including a more transparent and rules-based relationship between the public and the private sectors; (ii) *improving connectivity* through developing the country’s main transport networks, auxiliary infrastructure and broadband coverage as well as enhanced practices

⁴ The Central Bank of Azerbaijan (CBA) after defending the exchange rate from December 2014 till late February 2015 with a significant draw down on reserves, devalued the manat by 34 percent against the US dollar on February 21, 2015.

for operation and maintenance; and (iii) contributing to improved *human development outcomes* and increased prosperity through better access to water and sanitation, improved quality of the environment, and other health infrastructure and services, that have proven impact on health and social welfare outcomes. In addition advisory services will be provided to complement the lending activities in these areas.

viii. **The governance agenda will be supported in the CPF program by enhancing transparency and accountability in public sector management and service delivery, strengthening the rule of law, promoting financial inclusion, and creating a level playing field for businesses.** To that effect, the CPF program will contribute to: (i) implementation of a Public Expenditure and Financial Accountability (PEFA) follow-up action plan, and strengthening procurement practices under the National Anti-Corruption Plan (NACP); (ii) enhanced technical and administrative capacity of the judiciary and expansion of access to key services for all; (iii) enabling financial market infrastructure and regulatory frameworks, and assisting financial intermediaries to expand access to finance to underserved segments of population and corporate sector, which will help them grow, become more competitive and create jobs; (iv) reduced regulatory burden for SMEs and improved corporate governance practices in the private sector; and (v) strengthened capacity for data collection and analysis as a tool to ensure effective decision-making processes and citizen engagement. These measures will help the government to align better its public spending with strategic priorities of the new growth model, to open space for private investment, and to strengthen market institutions that in turn will contribute to a more conducive environment for private sector led growth.

ix. **The CPF will address the SCD connectivity agenda through investments into the development of the county's transport and transit corridors as well as improvement of local infrastructure at the community level.** The SCD highlights that *“the development of main transport corridors, along with relevant logistical services, will improve connectivity and open the way for producers to reach out to local and international markets in a faster and cheaper way.”* The CPF program in this area is guided by the well-articulated borrowing priorities of the government that is based on the accumulated experience and lessons from the long term presence of the WBG in the infrastructure sectors. The CPF program will also complement efforts by the government to improve local connectivity, which is key to increasing productivity in rural areas, and will be supported at the community level or through investments into the development of value chains. Other aspects of connectivity, such as telecommunications and broadband, may be addressed by the WBG interventions during the CPF period subject to client demand.

x. **The CPF considers human capital development as a long term strategic priority that will be supported through the ongoing investment operations and advisory services..** During the first half of the CPF implementation period, the WBG program in education is limited to the ongoing project in secondary education complemented by targeted technical assistance in tertiary education in partnership with the EC. Advisory services are included in the CPF program to support reforms in health and social protection, with a focus on improved financing mechanisms and efficiency of service delivery. These advisory services could pave the way for potential financial support in the outer years of the CPF program in response to evolving demands of the government in these areas. In the short and medium terms, the CPF will contribute to improved health outcomes and increased prosperity through targeting water and sanitation services, quality of environmental assets, and reforms in the delivery of social services.

xi. The CPF results are grouped around two Focus Areas and eight objectives that aim at improved Public Sector Management and Service Delivery, and enhanced Economic Competitiveness. The CPF strategic priorities were informed by consultations with the government, civil society (including local communities, the private sector, academia, and the general public), and with other development partners. The CPF objectives will be achieved through a number of ongoing operations (most of which were approved during the previous CPS for FY11-FY14) and new interventions in areas where strong implementation capacity and government ownership is already in place, and which are also closely linked to constraints identified in the SCD. The CPF will maximize the impact of the WBG program through a combination of IBRD and IFC investment and advisory services, and through leveraging resources of the country and other development partners. The advisory services and analytics (ASA) that the WBG plans to carry out under the CPF will buttress the proposed lending program as well as cater to the government's emerging needs. Following the successful experience of previous years, the CPF will continue to support government demand for "just-in-time" advisory services through timely policy notes, including in the form of externally funded operations (EFOs) or reimbursable advisory services (RAS). The indicative WB lending program is envisaged at around USD 300-500 million annually. The IFC indicative baseline investment program of long-term finance for FY2016-FY2020 will be in the range of USD 100-150 million.

xii. IFC's primary focus will be on supporting the economic competitiveness agenda of the CPF. In the first half of the CPF period, building on its existing portfolio of investments and advisory services, IFC operations will continue to prioritize support for greater financial inclusion and improvements in business environment. In parallel, IFC will seek opportunities in the real sector, including infrastructure, manufacturing, agribusiness and services, particularly aiming to support export-oriented sub-sectors. In the infrastructure space, IFC will be open to support PPP pilots as well as development of the regulatory framework. Expansion of IFC activities beyond the financial sector, and consequently larger than the baseline investment program, will be subject to the opening of the infrastructure sector for private sector participation and further progress with business climate reforms, which would continue to reduce regulatory burden for private businesses and encourage greater corporate transparency.

xiii. The CPF program will be underpinned by two cross cutting themes of Gender and Governance recognized by the SCD as critical for effective management of resources, social inclusion and accumulation of diversified assets. These themes are appropriately embedded into the WBG analytical work and investment operations under both focus areas of Public sector management and service delivery, and Economic competitiveness, also contributing to closing the regional disparities and rural /urban divide identified by the SCD.

xiv. The CPF identifies substantial risks that can affect the WBG program and proposes pragmatic mitigating measures. The substantial risks related to *governance* will be mitigated through strengthening institutional capacity in the areas of engagement and through enhanced monitoring of portfolio implementation. Progress with program implementation will be jointly monitored with the government, and adjustments will be made at the time of the progress and learning review (PLR). The other main risks stems from macroeconomic risks should the overall macroeconomic situation deteriorate. In this event, the CPF program can be adapted to incorporate a development policy operation subject to demand from the government and a robust reform program that would form appropriate basis for such an operation. This would direct financing into

budget support by adjusting the planned investment lending program or by extending the lending envelope. Actual lending will therefore depend on how government demand and portfolio performance evolve in the course of the CPF period, and on IBRD's lending capacity and demand from other borrowers.

I. INTRODUCTION

1. **The Country Partnership Framework (CPF) for Azerbaijan covers the five year period from FY16 to FY20.** The CPF is fully aligned with the objectives of the country's development strategy – *Azerbaijan 2020: Vision for the Future* (“*Vision 2020*”) – and is based on the findings and recommendations of the World Bank Group (WBG) Systematic Country Diagnostic (SCD) for Azerbaijan.⁵ The CPF supports the country in making further progress on the WBG twin goals of eliminating extreme poverty and boosting shared prosperity through a program that covers areas where the WBG can add value and builds on complementarities of IFC, IBRD and MIGA where relevant. The last Country Partnership Strategy (CPS) for Azerbaijan was discussed by the Board in September 2010 (Report No. 56246-AZ) and its progress report was discussed in May 2013 (Report No. 76826-AZ).

2. **The CPF is designed to support Azerbaijan in its efforts to sustain growth and the substantial progress on social and economic indicators in the face of regional economic uncertainties and volatile oil prices.** The CPF program will contribute to strengthening the country's public sector management, improving efficiency and inclusiveness of service delivery, and enhancing the competitiveness of the economy on the backdrop of fiscal adjustment and the acute need to reduce dependence on oil and gas revenues.

3. **The CPF objectives and priorities were discussed with various stakeholders and reflect the views and opinions expressed during the SCD consultations.** The CPF benefitted from a strategic workshop held in Baku to identify priorities and client demand, and from the WBG engagement with the government, the private sector, academia and other development partners. The feedback received from various stakeholders was duly reflected in the CPF and contributed to the formulation of strategic focus areas for WBG engagement and objectives that will help achieve the CPF outcomes.

II. COUNTRY CONTEXT AND DEVELOPMENT AGENDA

Political Context

4. **Azerbaijan has remained politically stable, pursuing a policy of pragmatic balance in the midst of regional turmoil and global power politics.** On the one hand, it aspires to Euro-Atlantic integration and plays an important role in Europe's energy security. On the other hand, it maintains good relations with its neighbors. The economic achievements of the past decade in reducing poverty and increasing incomes, combined with delivery of improved public and infrastructure services, have gained overall support for the government. In the aftermath of the Presidential elections of October 2013, the government triggered an acceleration of reforms in selected areas, such as education, social services, agriculture and e-government. In areas of openness and transparency, Azerbaijan has a considerable way to go to attain the level of its peers and needs to ensure that laws and regulations open up a level playing field and a conducive environment for civil society organizations (CSOs) to flourish as part of a true participatory development process. The recent introduction of stricter laws and regulations for the operations of civil society organizations went against this spirit; despite the justification given that it was a necessary step for harmonization and finalization of the legal framework.

⁵ The Systematic Country Diagnostic for Azerbaijan was submitted to the Board on June 3, 2015.

Growth, Poverty and Shared Prosperity

5. **Over the past decade, Azerbaijan’s economic advancement has been remarkable; it now faces the challenge of avoiding the middle income trap and sustaining the progress in future.** The oil windfall has helped the country to achieve high growth rates, accumulate large foreign exchange reserves, and reduce its debt levels. Economic growth averaged 13 percent per year during the period 2002-2013, as Azerbaijan transitioned into middle-income status, bolstered by high foreign direct investment in the oil sector and then by growing oil and gas production and exports, and prices. This has been accompanied by significant reductions in poverty as well as by rapid increases in the consumption of the bottom 40. Going forward, Azerbaijan now faces the challenge of how it can strengthen its capacity to tap into new, resilient and sustainable sources of growth and transition into upper income status without falling into what is often termed as the “middle income trap.”

6. **Alongside its economic advancement, Azerbaijan has experienced significant and steady poverty reduction and shared prosperity, which have contributed to the formation of the middle class.** Poverty headcount declined from 49.0 percent of the population in 2001 to 5.3 percent in 2013 (Figure 1)⁶ on the back of a steep rise in GDP per capita (Figure 2). In addition, extreme poverty fell significantly below three percent, as measured by the international poverty line of US\$1.25 per day (PPP). During 2007-2012, the consumption of the bottom 40 percent of the income distribution (B40) grew by more than two percent annually, two times faster than the consumption growth of the top 60 percent of the income distribution (T60). The positive trend in shared prosperity over the past decade has led to an increase in the share of the middle class, which grew from 4.3 to 28.9 percent of the population between 2007 and 2012.

Figure 1: Poverty headcount at the national poverty rate in Azerbaijan, 2001-2013

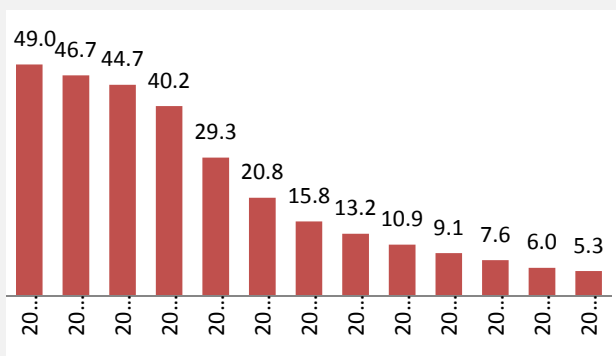
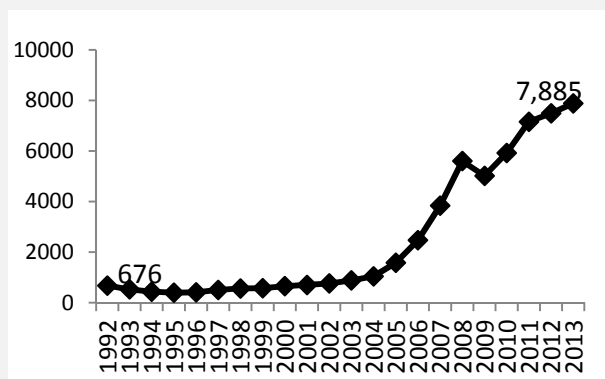


Figure 2: Evolution of GDP per capita



Source: Statistical Committee data as reported in the Systematic Country Diagnostic. Notes: Poverty lines are set each year through an administrative process. The nominal lines in 2007 and 2013 refer to AZN 64 and AZN 125 per month, respectively. Individuals with a per capita consumption below the poverty line are considered poor.

Source: Azerbaijan Systematic Country Diagnostic, 2015

⁶ Poverty figures for 2013 are being verified by the World Bank.

7. **Azerbaijan’s progress towards achieving the WBG twin goals has been brought about by public sector-driven growth, in combination with increases in wages and social transfers.**

The remarkable economic growth during 2002-2013 along with high wage increases and rising employment, were the main contributors to the drop in poverty and the expansion of the middle class. The minimum wage saw a 20-fold increase between 2000 and 2013, and real wages rose by 11 percent annually over the same period. Increased transfers from the budget (pensions and other social assistance) totaling 5.4 percent of GDP in 2013 had a lesser impact on progress on the twin goals, although they contributed a significant share of the non-market income of the B40.

8. **Despite the decline in poverty and positive dynamics on shared prosperity, a broad layer of the population still remains vulnerable to shocks.**

A substantial group of households graduated from poverty but did not reach the ranks of the middle class. These households belong to the group which is classified as *vulnerable* and accounted for 65 percent of the population in 2012. This means that the vulnerable exceeded the size of the B40. Within the B40 percent of the welfare distribution in Azerbaijan, more households are vulnerable (34 percent) than poor (5 percent). As noted in the SCD, an inadequate asset base including poor housing conditions, lack of education and relevant skills, limited employment and income generation opportunities have been impediments to the transition to higher income strata. In addition, B40 households show a higher dependency rate than the middle class, with more individuals either below 14 years or older than 65 years.

9. **Vulnerability and poverty incidence varies across regions of the country⁷ and the urban-rural divide is significant.**

National averages mask important welfare disparities between rural and urban areas as well as across regions and social groups. Although between 2007 and 2012 poverty declined in both rural and urban areas (by 10.8 and 8.5 percent, respectively), the majority of the poor (61.0 percent) live in rural areas. In 2012, the poverty rate in rural areas was nearly twice that in urban areas (8.0 percent vs. 4.5 percent). At the same time, poverty widely varies across regions: from over 14.0 percent in Lankaran to 2.0 percent or less in Baku and Nakchivan. Internally Displaced Persons (IDPs)⁸ are another “most vulnerable” group of the population particularly affected by circumstance-driven inequalities. The most recent government estimates show the IDP poverty rate to be around 18 percent. Despite the long-term investment made by Government to improve IDPs’ living conditions and their access to basic infrastructure and services, they remain a core stratum in the B40.

10. **Azerbaijan’s positive performance on the twin goals strengthened its resilience to the turbulent global economic environment in the aftermath of the 2008 crisis,**

which Azerbaijan weathered relatively well. The government’s prudent macro and fiscal policies, supported by accumulated foreign exchange reserves at the State Oil Fund of Azerbaijan cushioned the negative effects of the crisis. Higher consumption growth of the B40 relative to the entire population

⁷ The distribution of vulnerable households follows the regional pattern: the first and second quintiles of the welfare distribution concentrate in Shaki-Zagatala, Lankaran, Guba-Khachmaz, Aran, Yukhary Garabagh, Daghlig Shirvan and Kalbajor-Lachyn. At the same time, Baku and its surrounding regions of Absheron, as well as Nakhchyvan and Ganja-Gazakh report a share of households in the bottom 40 below the national average.

⁸ Approximately 7 percent of Azerbaijan’s population (around 595,000 persons) comprises internally displaced persons (IDPs), forced to leave their homes due to the political conflict with Armenia, making Azerbaijan a country with one of the highest number of IDPs per capita in the world.

allowed households in this category not to fall behind, evidenced by steady progress on poverty reduction and shared prosperity.

11. **While the country performed well on the macro and fiscal fronts, its incomplete institutional and structural reforms held it back from greater progress and impeded its vulnerable groups from joining the ranks of the growing middle class.** In resource-rich Azerbaijan, where reforms are often uneven, episodic and complex, improvements in the quality and relevance of education, affordable and quality healthcare, diversifying the economy away from natural resources, and creating better-paid jobs, have been inadequate. Data from the 2013 Caucasus Barometer survey suggest that only 65 per cent of the population ‘fully’ or ‘somewhat’ trust the education system.⁹

12. **The expansionary use of the oil windfall stimulated job creation but did not contribute to improving the quality of labor market engagement for the B40.** Overall unemployment rates declined in Azerbaijan from 11.8 percent in 2000 to 5.0 percent in 2013. However, B40 employment is mainly concentrated in low-quality sectors, about 18 per cent of B40 incomes are from agriculture, and they are most affected by the rural-urban divide. The B40 employment concentration in low-quality sectors is attributed to lower educational attainment, accompanied by growing labor informality: only 30 percent of wage-earners report having a formal contract.

13. **Labor income and public transfers have been central in lifting people out of monetary poverty and supporting shared prosperity.** Pensions and other social transfers made up 19 per cent of B40 income and about 16 per cent for the T60. Nearly two-thirds of Azerbaijan’s population received at least one category of public transfers or benefits, including pensions (which have steadily increased), imposing a significant burden on public finances. Increased efficiency calls for substantial policy and institutional changes for effective regulation of the labor market and better-targeted safety nets.

Recent Economic Developments and Medium Term Outlook

14. **Overall, oil wealth has served Azerbaijan well.** Azerbaijan prudently used hydrocarbon wealth to preserve macroeconomic stability, begin building a diverse asset base (especially in expanding and upgrading infrastructure), modernize public finance management and service delivery, broaden the use of information and communication technologies (ICT) and promoting e-government, reduce poverty and ensure social protection of the vulnerable. The country relied on oil revenues to accumulate large foreign exchange reserves and reduce debt levels. The government has been running twin surpluses on the fiscal and current accounts, averaging 4.7 percent of GDP and 10.3 percent of GDP, respectively over 2002-2013. Azerbaijan successfully reduced public debt from 21.7 percent of GDP in 2002 to 14.1 percent in 2013. In addition, foreign exchange reserves increased to 68 percent of GDP by end-2013, nearly 70 percent of which are accumulated at the SOFAZ. Sustained savings in SOFAZ reflected the authorities’ recognition of the importance of harnessing oil wealth for future generations and trying to contain real exchange rate appreciation.

15. **The remarkable oil-driven growth of 2002-2010 gave way to the economic slowdown in 2011-2012, which was followed by a modest recovery during 2013-2014.** Between 2002 and 2010, growth averaged 15.9 percent a year and was boosted by high foreign direct investment

⁹ Source: Azerbaijan Systematic Country Diagnostic, p.52

(FDI) in the oil sector and growing oil production and oil prices. As a result, per capita GDP nearly tripled over this period. In 2011, declining oil production was more than offset by high public spending and a continued construction boom that supported high non-oil growth. The non-oil sector grew at 9.4 percent in 2011 and 9.7 percent in 2012, mainly driven by a large public investment program. With the oil sector contracting by 9.3 percent in 2011 and 5.0 percent in 2012, real GDP grew by only 0.1 and 2.2 percent, respectively. As oil production temporarily stabilized in 2013, economic output expanded by 5.8 percent, responding to the continuous and sizable public investments that boosted growth in construction, manufacturing and non-tradable sectors. However, growth in 2014 decelerated to 2.8 percent as oil GDP contracted by nearly 3 percent.

16. Azerbaijan was hit by the spillover effects of the oil price decline and the ongoing regional crisis. Oil prices fell sharply from mid-2014 to mid-2015: the Brent spot price fell from its peak of US \$112 in mid-2014 to US \$53 in April 2015. During this period, real GDP grew by 2.8 percent, driven by non-oil GDP growth, which was solid at 6.9 percent albeit lower than the 10 percent growth achieved in 2013. The ongoing economic crisis hit Azerbaijan at a time when the country had developed an ambitious development program, with significant planned investments in infrastructure and expansion of public services.

17. The economy is now projected to grow on average at 2.3 percent annually over the medium-term, based on lower oil prices and constrained public investment. Going forward, the oil price per barrel is projected to remain low at US \$53 for 2015 and US \$59 for 2016-2017, which reflected a need for fiscal restraint. Public investment is projected to average 10.3 percent of GDP over 2015-2017, leading to lower non-oil sector growth.

Table 1: Macroeconomic Trends and Projections

(in percent of GDP, unless otherwise indicated)

| | 2010 | 2011 | 2012 | 2013 | 2014e | 2015p | 2016p | 2017p |
|---------------------------------------|---------|-------|-------|-------|-------------|-------|-------|-------|
| | Actuals | | | | Projections | | | |
| National Accounts | | | | | | | | |
| Real GDP growth (percent change) | 5.0 | 0.1 | 2.2 | 5.8 | 2.8 | 1.5 | 2.6 | 2.7 |
| Oil GDP | 1.8 | -9.3 | -5.0 | 0.9 | -1.5 | -1.5 | -1.0 | -1.0 |
| Non-oil GDP | 7.9 | 9.4 | 9.7 | 9.9 | 7.0 | 3.6 | 3.8 | 3.9 |
| Consumer Price Index (percent change) | 5.7 | 7.8 | 1.1 | 2.4 | 1.4 | 10.0 | 4.6 | 3.5 |
| GDP per capita (in U.S. dollars) | 5,922 | 7,285 | 7,285 | 7,997 | 7,938 | 5,447 | 5,778 | 6,094 |
| Gross investment | 18.5 | 21.2 | 23.8 | 25.6 | 21.2 | 21.3 | 20.8 | 22.3 |
| Public | 10.9 | 11.3 | 14.7 | 15.1 | 12.0 | 10.6 | 10.2 | 10.2 |
| Private | 7.6 | 9.9 | 9.0 | 10.5 | 9.2 | 10.7 | 10.7 | 12.0 |
| Gross national savings | 46.6 | 47.6 | 43.4 | 43.3 | 35.1 | 25.0 | 27.3 | 30.4 |
| General Government Operations | | | | | | | | |
| Revenues and grants | 45.8 | 45.4 | 41.4 | 39.7 | 38.9 | 39.6 | 38.6 | 38.2 |
| Non-oil revenues | 10.4 | 9.8 | 12.6 | 11.6 | 12.7 | 16.6 | 16.7 | 16.7 |
| Expenditure and net lending | 32.1 | 34.3 | 37.2 | 37.8 | 36.2 | 44.8 | 41.4 | 39.5 |
| Current expenditure | 21.2 | 23.0 | 22.5 | 22.7 | 24.2 | 34.2 | 31.2 | 29.2 |
| Capital expenditure and net lending | 10.9 | 11.3 | 14.7 | 15.1 | 12.0 | 10.6 | 10.2 | 10.2 |

| | 2010 | 2011 | 2012 | 2013 | 2014e | 2015p | 2016p | 2017p |
|-------------------------------|--------|---------|--------|--------|-------------|--------|--------|--------|
| | | Actuals | | | Projections | | | |
| Overall fiscal balance | 13.7 | 11.1 | 4.2 | 1.9 | 2.7 | -5.1 | -2.9 | -1.2 |
| Non-oil fiscal balance | -21.7 | -24.5 | -24.6 | -26.2 | -23.5 | -28.2 | -24.7 | -22.8 |
| External Sector | | | | | | | | |
| Current account balance | 28.4 | 26.5 | 21.4 | 16.6 | 14.2 | 3.8 | 6.5 | 8.1 |
| Exports of goods and services | 53.9 | 56.4 | 53.0 | 48.4 | 47.1 | 43.7 | 42.6 | 42.0 |
| Imports of goods and services | 19.8 | 24.0 | 25.3 | 26.3 | 26.8 | 34.2 | 30.7 | 28.7 |
| FDI (net) | 0.6 | 1.4 | 1.2 | 1.5 | 1.5 | 2.3 | 2.3 | 2.3 |
| Total public sector debt | 11.1 | 10.2 | 11.3 | 11.7 | 14.4 | 14.5 | 14.6 | 14.6 |
| <i>Memorandum items:</i> | | | | | | | | |
| Nominal GDP, billion AZN | 42.5 | 51.2 | 54.7 | 58.2 | 58.9 | 52.6 | 56.5 | 60.4 |
| Oil Fund assets, million USD | 22,767 | 29,800 | 34,129 | 35,878 | 37,104 | 34,813 | 33,595 | 33,172 |

Source: World Bank staff estimates based on data from the Azerbaijan authorities.

Note: Oil price is based on the projection in the GEP 2015 January report.

18. **The Central Bank of Azerbaijan (CBA) maintained a de-facto peg of the manat to the US Dollar (USD) until a sharp devaluation in February 2015.** There is no official exchange rate target that the CBA commits to defend. However, the value of the manat was pegged to USD in 2012-2014. Pressure on the currency had been building since the fourth quarter of 2014, stemming mainly from falling oil prices and currency depreciations by trading partners. The CBA lost 27 percent of its reserves between November 2014 (when reserves were close to USD 15 billion) and February 2015. On February 16, 2015 the CBA started pegging the manat to the USD and the Euro without disclosing the specific weights of the basket. Subsequently, on February 21, 2015 the CBA announced a 34 percent devaluation of the manat, referring to the need to ensure non-oil competitiveness.

19. **In 2015 Azerbaijan, will confront its first fiscal deficit in over a decade, albeit cushioned somewhat by the manat devaluation.** Assuming low oil prices and high spending pressures, the fiscal deficit is projected to deteriorate substantially to 5.1 percent of GDP in 2015 and to remain at 3 percent of GDP on average over the medium term. The main contributing factor behind the fiscal deficit is a large volume of committed public investments, including TANAP, the European Games and the second stage development of the Shah Deniz gas field. As new sources of revenue will take time to develop, fiscal consolidation over the medium term will help narrow the fiscal gap. Since Oil Fund reserves still remained at about 50 percent of GDP by 2014, financing annual fiscal deficits of 3 percent of GDP over the medium term is unlikely to risk depleting the Fund, but could significantly reduce it. The devaluation of the manat has protected the state budget somewhat in local currency terms – by about 2 billion AZN – and has reduced the need for transfers from the State Oil Fund.

20. **Inflation is likely to stabilize below 5 percent in the medium term.** Since 2009 inflation has been moderate, mainly tracking international food prices, and fell to 1.4 percent in 2014. Due to the manat devaluation, the World Bank projects a sharp rise in inflation above the CBA's indicative target of 5 percent in 2015, mainly because of higher prices of imported goods. Once the relative price adjustment has played out, inflation is projected to be lower than 5 percent in the

medium run. This may create space for monetary policy but transmission mechanisms are weak and undermined by fiscal dominance, the high share of cash in circulation, dollarization, underdeveloped capital markets and the absence of an interbank money market.

21. **The current account surplus is projected to fall to 6 percent of GDP over the medium term but the external sector will remain resilient.** The current account surplus has been declining since 2011. The oil price drop will exacerbate this further. The value of exports closely follows oil price movements since crude oil accounts for over 90 percent of goods exports from Azerbaijan. In addition, the weakening of the Russian economy poses a challenge for Azerbaijan's non-oil exports, as the Russian market alone accounts for over 60 percent of Azerbaijan's total non-oil exports. Although oil and gas exports to European countries will continue to dominate total exports, the fall in non-oil exports due to the deteriorating external environment will also adversely impact the current account surplus. FDI is expected to remain at 2.3 percent of GDP over the medium term and the majority of foreign investment will still concentrate in the oil and gas sector. In addition, with a smaller current account surplus going forward, the accumulation of reserves will also slow down.

22. **Public debt will remain sustainable over the medium term.** Despite a USD 1.25 billion Eurobond issuance in early 2014, the debt-to-GDP ratio stood at about 15 percent in 2014. Despite a low oil price outlook and risks from the recent devaluation, the overall default risk on Azerbaijan's public debt is quite low given the low level of public debt and relatively long debt maturities. Standard & Poor's rated the country's sovereign credit investment grade, citing low debt and high international reserves as favorable factors, but revised the outlook from stable to negative in early 2015, referring to possible fiscal challenges in the face of low oil prices. Over the medium term, as the Federal Reserve is expected to raise interest rates in the United States and the Azerbaijan economy faces high uncertainty, financing via bond issuance is likely to incur higher costs. Under this scenario, the government is expected to finance future budget deficits by transfers from the Oil Fund. According to the Debt Sustainability Analysis carried out by the IMF in 2013, the level of debt will slowly increase over the long term, but will remain low under different scenarios of large shocks.

23. **The government seeks to improve the performance of the non-oil economy from the current forecasts.** To do so, Azerbaijan needs to respond to existing and emerging challenges with effective management of fiscal shocks in the short run, scaled up implementation of the ongoing reforms in the medium term, and a new growth model based on a diverse asset base over the longer term.

Key Development Challenges

24. **The SCD presents a discussion of the binding constraints that need to be addressed to ensure shared, resilient and sustainable growth.** The SCD assumes that the overriding goal for Azerbaijan is moving toward an economy with a diversified asset base, with the poorest 40 percent strengthening their share and productive use of this asset base. To do so, Azerbaijan needs to respond to existing and emerging challenges with effective management of fiscal shocks in the short run, and better performance on public investment and scaled-up implementation of the ongoing reforms in the medium term. The current fiscal trends suggest that sustainable and resilient growth will have to come from new sources (mainly private investment and entrepreneurship) less

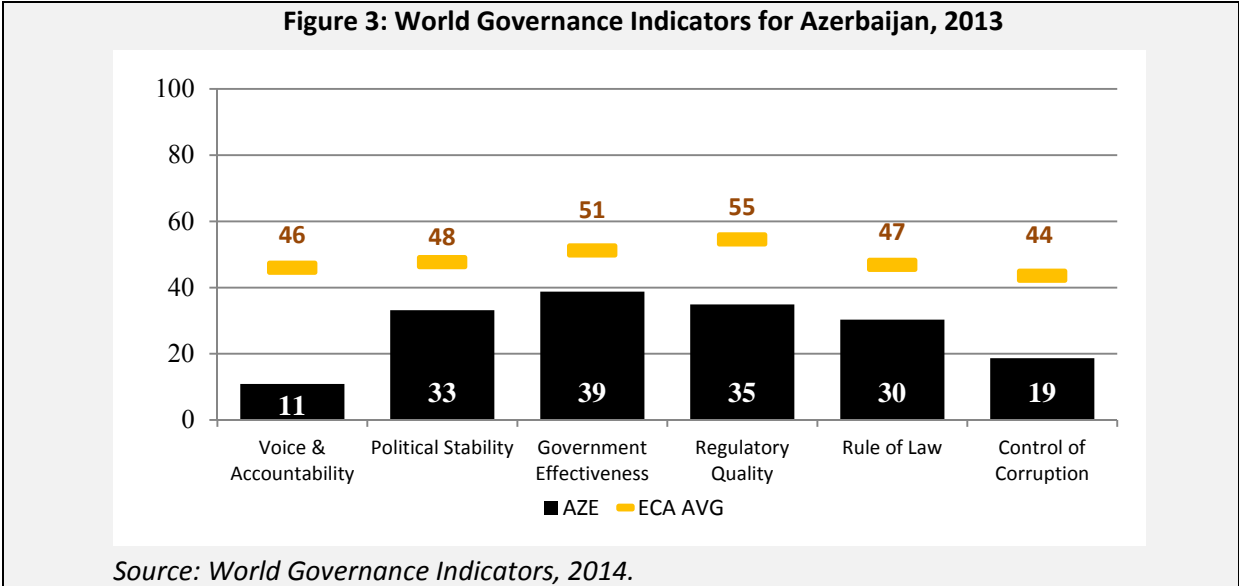
exposed to oil price volatility and more conducive to creating jobs and supporting greater demographic and geographic inclusion.

25. **The SCD suggests that Azerbaijan needs to address three core sets of binding constraints.** The first is *strengthening governance* pertinent to four themes: (i) macroeconomic and fiscal management; (ii) public service delivery; (iii) rule of law; and (iv) data collection, analysis and reporting. This would allow for a shift to a longer-term perspective on economic development that will be anchored in narrowed regional disparities, decentralization and local self-governance, greater transparency and accountability, more evidence-based decision making and a more dynamic private sector. Second, the best way to share oil wealth with future generations is through *investment in human capital*. Key healthcare priorities include ensuring access to and quality of healthcare, as well as investment in public health infrastructure, such as improved water and sanitation services and environmental assets. There is also a need for closing the gap in educational attainment across regions, between rural and urban areas, as well as across income groups and gender, for people to build their skills base and participate more actively and productively in the labor market. In addition, it is important to reduce a significant mismatch between the skills demanded by the market and the skills provided by the education system.. The third priority is *improving connectivity*, particularly in terms of developing networks of regional and local roads that can reduce transport costs for products and people. In addition, the development of main transport corridors, along with relevant logistical services, will improve connectivity and open the way for producers to reach local and international markets in a faster and cheaper way. These are key inputs required to promote private sector investment, rural productivity and access to economic opportunities.

26. **Strengthening institutional governance across sectors will support Azerbaijan's efforts to achieve its development goals.** Azerbaijan has made progress in a number of aspects of governance and needs to build further on this foundation by mainstreaming governance improvements in fiscal management, service delivery, and in supporting the enabling environment for the private sector. Governance challenges such as voice, accountability, and transparency impact quality and efficiency of service delivery. Despite these challenges, achievements have been made, most notably through the Azerbaijani Service and Assessment Network (ASAN), a “one-stop shop” for citizens to access a number of public services and provide transparent and efficient services with much reduced risk of corruption. The culture of measuring service delivery, efficiency, and satisfaction can be enhanced by applying the principles of citizen feedback developed by ASAN, which is widely perceived as a successful example of public sector reform. In 2013, Azerbaijan ranked in the 30th percentile on the World Governance Indicators (WGI) up from the 21st percentile in 2011 (Figure 3). However, it remains below the ECA average of 47 due to gaps in access to and quality of judicial services. The ongoing modernization of the judicial system, specifically through building smart court houses and providing access to information and judicial services, will play a critical role in ensuring legal space for incentives for increased economic activity of households and firms.

27. **There are opportunities for Azerbaijan to strengthen governance via participation in the Extractive Industries Transparency Initiative (EITI) and Open Government Partnerships (OGP).** Azerbaijan was the first EITI compliant country in 2009 against the original EITI rules and has been committed to increase the amount of information available to the public. The country has recently been validated under the 2013 EITI Standard Rules and changed its status

from “compliant” to “candidate” based on the outcomes of an early independent evaluation, which was carried out due to an increased concern over limited engagement of civil society in the EITI process. The country can benefit from an emerging opportunity to re-confirm its adherence to the fundamental principles of enhanced transparency in the extractive industries through implementation of the recommended measures ensuring civil society’s proficient participation in the EITI process. Subject to successful implementation of these measures, the country could regain its “compliant” status. Azerbaijan has also been a member of the OGP since 2011, and is currently developing its second OGP Action Plan. The previous Action Plan for 2012-2015 focused on the use of IT for public services, increasing transparency and increasing public participation. Future commitments will need to reflect Azerbaijan’s adherence to the principles of the OGP, specifically promoting transparency, and empowering citizens, fighting corruption, and harnessing new technologies to strengthen governance. These commitments will target key institutional governance gaps, and support openness of information, accountability, and public service delivery.



28. **Another important governance tool identified by the SCD is a strong and transparent system of data collection and dissemination that enables evidence-based policy decisions.** Azerbaijan’s national statistical system collects and produces a wide range of data and statistics, and provides access to published statistics through the website and statistical yearbooks and other reports produced by the State Statistics Committee (SSC). The value of the official data and statistics for public policy making can be raised through further enhancements in: (i) the systems of data dissemination and updating procedures, (ii) processing the Household Budget Survey (HBS) based on improved methodologies, and (iii) access to **anonymized**¹⁰ microdata on households (HBS) and firms collected by the SSC. Such enhancements can address the issue of discrepancies between data published by SSC and that used by other agencies; improve the quality

¹⁰ According to UNECE 2007, the term anonymized means that names and addresses removed and other steps are taken (e.g. collapsing of geographic details) to ensure that identification of individuals is highly unlikely.

of HBS analysis and poverty calculation; ensure accurate and timely publication of data; and facilitate more complex analysis by using anonymized microdata, including by independent policy researchers.

29. **Strategic use of oil revenues and effective fiscal management can help the country diversify assets and develop resilient and sustainable sources of growth.** Three priority lines of action are: (i) creating fiscal space through efficient public spending, particularly capital investment, which is performance-oriented and prioritized based on transparent monitoring, information sharing, and impact evaluation; (ii) strengthening governance by building credible and accountable institutions with the capacity to enforce fiscal rules and a medium term fiscal framework while planning for sustainability; and (iii) selectively leveraging the private sector through the introduction of public-private partnership mechanisms in service delivery.

30. **Azerbaijan has improved its fiscal institutions although more needs to be done.** Azerbaijan strengthened its public expenditure framework over the last six years by improving performance, scoring high on 17 indicators and performing better on an additional four, as identified by the 2015 PEFA Assessment.¹¹ Further improvements in three areas would lead to higher transparency, predictability and efficiency in the PFM system: (i) internal and external audit coverage could be expanded and international standards applied more comprehensively; (ii) comprehensive, integrated medium term budgeting; and (iii) consistency of functional classification with GFSM 2001¹² would serve better budget planning and execution.

31. **Given the sharp decline in oil revenues, prioritizing their strategic use and effective fiscal management is acutely necessary.** It will be desirable to re-program fiscal priorities with a focus on public investment programs, improved tax collection and broadened tax base, and increased expenditure efficiency. Government has taken the first steps with the proposed 2015 budget, which assumes fiscal consolidation by reducing capital spending, addressing allocative inefficiencies, and introducing changes to the taxation system to generate more revenues. Fiscal consolidation on the expenditure side will need to be driven by cuts (mainly in capital expenditures) and enhanced efficiency of recurrent spending. Government has already signalled that expenditures will be curtailed, stemming from the wide gap between the reference price of oil (set at USD 90) and actual prices, and the need to maintain SOFAZ reserves at a reasonable level. The Government has committed to keep social expenditures at the 2015 level and prioritize capital investments.

32. **Efficient use of public resources in health and education in combination with increased spending to ensure adequate level of service delivery will positively affect the B40.** Government health spending at around 1 percent of GDP is low in comparison with other countries in the region and is offset by out-of-pocket (OOP) spending which amounts to about 70 percent of total health expenditures and 10 percent of total household spending. In education, public spending has increased in nominal terms over the last decade but remained low as a share of GDP on the backdrop of unprecedented economic growth. In 2004, public spending on education was 13.3 percent of government expenditure and 3.4 percent of GDP while in 2013, it dropped to 7.0 percent and 2.7 percent, respectively. The 2.7 percent of GDP spent on education is well below

¹¹ The second PEFA assessment in Azerbaijan was conducted jointly by the World Bank, EU and SECO. The full PEFA report is published on the Ministry of Finance's web-site: <http://www.maliyye.gov.az/node/1780> (Azerbaijani); <http://www.maliyye.gov.az/en/node/1779> (English).

¹² Government Finance Statistics Manual of 2001

comparators in ECA. Effectiveness of the health and education systems was jeopardized by lack of transparency, misaligned incentives and informal payments, which imposed additional financial stress on poor and vulnerable households, depriving them from receiving higher quality services.

33. **Another structural challenge to accelerating and sustaining progress on achieving the development goals is bringing the private sector to center-stage as the main driver of growth.** Since growth over the past decade was largely driven by oil and non-tradable sectors, construction and services in particular, contribution of the tradable sectors to GDP has been below their potential with non-oil exports accounting for less than 5 percent of the total in 2013. Productivity levels have not been increasing, especially in the sectors that are the largest employers, for example in agriculture, which absorbs 37 per cent of the workforce while contributing only about 5 percent of GDP. The roles of the public and private sectors need to be rebalanced, with the former becoming a facilitator rather than the main driver of growth. This is also important to create budgetary space for more investment in priority areas while ensuring fiscal sustainability. In other words, attracting more private investment would take the pressure off the budget. These will be particularly important for large infrastructure projects. Developing the legal framework for public-private partnerships will be essential to attract private capital to such projects.

34. **Reforms are needed in a wide range of areas to spur private investment.** Specifically, a level playing field, a friendly business environment, well-regulated markets and adequate access to long term financing are needed to create incentives for increased private investment, innovation and entrepreneurship. Reforms which would encourage further rationalization in tax administration and customs, improved corporate transparency and financial disclosure practices, as well as sound environment for banking sector to lend and foreclose will be critical. In addition, productivity growth is negatively affected by the existing skills gap, limited labor mobility and labor market informality, which remains widely prevalent with only 30 percent of workers under formal contracts.

35. **Azerbaijan's shallow and bank centric financial sector hampers opportunities for diverting the economy away from oil.** Low financial sector intermediation negatively affects prospects for economic growth within the new private sector led growth model. The twin shock of an oil price drop and manat devaluation is challenging the financial sector resilience and sustainability, as devaluation and growing non-performing loans are eroding the banks' capital. The challenge today is to use this opportunity to address the structural deficiencies in the financial sector through robust reforms in governance, regulation, capital requirements. It is also necessary to introduce a level playing field between public and private banks to bring in new players that will offer access to finance to firms and households that have been excluded. Finally, expansion of the broadband networks and telecom, apart from facilitating communications and various economic activities, can also directly contribute to the economic growth and job creation.

36. **Along with institutional and social development, sustainable infrastructure is critical to maintaining and increasing productivity.** Irrigation and drainage infrastructure, especially that managed by farmers, needs rehabilitation to support rural incomes and create new business opportunities. The development of the main transport corridors, along with associated logistical services, will improve connectivity and open the way for producers to reach out to local and international markets in a faster and cheaper way, promote private sector investment and access to more economic opportunities. Modernization of key highways and railways infrastructure is

essential for the country to compete for more cargo transit in the region and capitalize on its strategic geographic position.

37. The sustainability of the significant public investment in construction and rehabilitation of infrastructure, particularly transport and energy, is undermined by ineffective maintenance systems, which are also important for modernization of the asset management system. In particular, a maintenance system for the main highways, which are to be completed over the next 5 years is urgently needed. Otherwise recently rehabilitated roads will fast deteriorate. If maintenance is neglected, Azerbaijan will start losing the benefits of ongoing investments while the current asset value of the main road network will decline by about 10 percent by 2020. Ongoing reforms in the railway sector need to be completed to improve its competitiveness, financial sustainability, and operational and cost efficiency. The construction of rural and regional roads, multi-modal corridors, railways, and inland waterways has great potential for alleviating poverty, boosting macro and micro economic activity and reducing income inequality. In addition, the large electricity distribution network constructed during the Soviet era has not been well maintained in rural areas and therefore supplies to rural communities are unreliable.

38. Inadequate supply of piped water and sanitation services is another constraint, especially in rural areas, with important implications for public health. Azerbaijan inherited a relatively extensive water supply system from the Soviet Union and at present about 95 percent of the population in Baku and about 83 percent of those living in secondary cities and small towns are connected to piped water. However, the quality of infrastructure and services has severely deteriorated since 1990 due to a lack of investment and deferred maintenance. Despite substantial public investment including through the Bank and other development partners' support, in many secondary and small towns, water treatment facilities remain largely dysfunctional or completely lacking, leaving the population in these towns without access to safe water and undermining public health outcomes. In many areas, the reliability of water supply is not assured, with piped water often available for less than 12 hours per day. Less than 33 percent of the population has access to a piped water supply in rural areas where centralized piped water supply systems are rare.

39. Poor connectivity and insufficient levels of financial inclusion and outreach limit opportunities for job creation and income generation. While the e-banking sector has improved on many outreach indicators in recent years, including in the number of non-branch based points of service (POS), the level of financial inclusion and outreach remains inadequate, especially among MSMEs and households, particularly in rural area. Access to financial services that comprise loans, deposits, e-services and payments, and infrastructure is below the ECA average. This constraint is also revealed in the WBG's recent survey on MSME Access to Finance Demand, according to which 51 percent of MSMEs report that access to finance is the most important obstacle that constrain their business growth. Financial inclusion of men and women and penetration can be increased through further development of modern financial infrastructure and financial services.

40. The MSME sector is small and the supply of entrepreneurs is low. Data from the 2010 Life in Transition Survey (LiTS) suggest that Azerbaijan compares unfavorably with other ECA countries on the size of the pool of potential or "latent" entrepreneurs. Only about 10 percent of the labor force and 5 percent of the wage-employed can be considered latent entrepreneurs, far below the ECA average of 27 percent of the labor force and 22 percent of the wage-employed.

There is also some evidence that the survival rate of new firms is low. According to the survey, only about a third of those who attempted to start a business succeeded in Azerbaijan, compared to about two-thirds in ECA as a whole, which also accounts for Azerbaijan's relatively small private sector. For instance, of the 106 countries included in the IFC database of MSMEs, Azerbaijan ranked a low 81 in the number of MSMEs per 1,000 people in 2008. In 2013, the state sector accounted for 26 percent of total employment (SSC, 2014).

41. **About 30 percent of the population in Azerbaijan lives in informal settlements, many of which are concentrated in the Greater Baku metropolitan area.** The lack of proper legislation and lax enforcement on one hand, and the artificial demand created by oil-driven growth coupled with the primacy of Baku as the unrivalled economic center of the country on the other, is fueling rural-urban migration. This is happening without the necessary housing or infrastructure to accommodate the burgeoning population. Bureaucratic red tape in acquiring permits and titles is the key reason of informalities in the housing market, enabling developers to construct and sell new houses without titles. This, and in some cases lack of connection to utilities, makes new houses unsuitable for habitation and exposes a household asset base to legal insecurity. Development of a mortgage market is critical to address the problem of affordable housing: this will require development of competitive interest rates, credit infrastructure and attractive capital market instruments for investors.

42. **The quality of environmental assets is a critical contributing factor to the well-being of people, affecting in particular their health and economic opportunities, especially for the B40.** If the depletion of resources continues at the rate of the last decade, and water and soil contamination is not properly addressed, Azerbaijan will be at a high risk of significant deterioration of its environmental assets with gloomy prospects for environmental sustainability. Government has been tackling environmental issues through improved legislation and supporting the global and regional initiatives. While the Greater Baku area has already benefitted from environmentally sensitive programs, including on contaminated soil rehabilitation, improved water supply and treatment, and solid waste management, there is more to be done for people to have access to clean air, soil and water. The task of improving the quality of environmental assets is of high relevance in rural areas and small towns where the majority of the poor live and remain underserved.

43. **Azerbaijan is in the middle of a demographic transition, which is also affected by the skewed sex ratio at birth.** The country's favorable demographic situation, characterized by a relatively high fertility rate and proportionately large working-age population, is changing. In addition, the elevated sex ratio at birth, whereby 115 boys are born per 100 girls, is a socio-cultural issue and will eventually have serious ramifications for fertility rate and population growth as well as labor market participation and economic performance in the long run.

44. **Azerbaijan faces the challenge of improving employment opportunities for all.** IDPs have lower employment rates and higher work inactivity than the non-displaced. The growing degree of labor informality, disproportionately affects the poor and lagging regions. Overall, women lag behind men in employment rates while a gender divide persists in terms of sectoral, occupational, and wage gap in the labor market. Access to productive opportunities is also influenced by social networks and access to markets. In this sense, the SCD analysis reveals high perception of the importance of having connections to obtain quality jobs in Azerbaijan, and

indicates that presence of an uneven playing field may be dampening expectations of future social mobility in the country.

III. WORLD BANK GROUP PARTNERSHIP STRATEGY

A. Government Program and Medium-term Strategy

45. **Azerbaijan’s development goals are reflected in the *Vision 2020* and other strategic documents.**¹³ The country’s long-term strategic priorities call for taking “*the current opportunities and resources to attain a stage characterized by sustainable economic growth and social welfare, effective state management and supremacy of the law*”¹⁴ and are codified in various strategic programs including the third Regional program on social and economic development, Agriculture and Education sector development strategies, Pension reform concept and others.

46. ***Vision 2020* provides clear anchors for setting a new post-oil growth model which will be supported by adequate institutions and developed infrastructure and human capital, essential elements of a modern state with high living standards, innovation and diversified asset base.** The government’s plan to move the country in this direction becomes imminent in the face of the recent sharp drop in oil price, which has brought to the fore the need to accelerate and implement critical reforms and programs. The new priorities of the Government therefore center on transferring the driving force behind the non-oil economic growth from the public to the private sector. The government strives to maintain the pace of the non-oil economy expansion that has been a major vehicle for employment generation and improved livelihoods of the B40. Through fiscal consolidation the Government seeks to reduce dependence on the State Oil Fund transfers to the budget and rely more on the collection of taxes. Concurrently, the government expects to continue implementing an inclusion agenda focused on improving services, and income and employment opportunities across the country with focus on poorer regions and vulnerable groups of the society.

47. **In the short- to medium term, the government commits to maintaining fiscal sustainability in an uncertain global environment through fiscal consolidation and optimization of public investment programs.** In particular, the government is focusing on integration of the economy into regional and global markets and creating more opportunities for jobs in the non-oil sector through investments in infrastructure, institutions and human capital to boost private sector growth and turn it into the main driver of economic development.

B. Proposed WBG Country Partnership Framework

48. **This CPF is designed to help the country respond to the short- to medium-term needs in the face of new regional and global challenges while sustaining progress on the WBG twin goals.** It encompasses the WBG’s ongoing program and new activities designed selectively to fit the SCD framework of long-and short-term priorities. The partnership framework builds on the lessons learned during implementation of the CPS for FY11-FY14, which, inter alia, emphasize

¹³ These include, *inter alia*, the Third State Program on Social and Economic Development of Regions, Agriculture Sector Strategy, Education Sector Strategy, the Concept Document on Pension Reform.

¹⁴ Azerbaijan 2020: Vision for the Future.

the importance of remaining flexible to accommodate evolving client demand and effectively adjust the program to the changing environment.

Lessons from CPS FY11-FY14 Completion and Learning Report (CPS CLR)

49. **Selectivity based on the cumulative experience from long-term engagements, applied to defining new operations underpinned by appropriate instruments for program delivery, ensured high program effectiveness.** Program selectivity was a strong feature of the CPS (FY11-14) period, and was largely carried out by scaling-up successful investment operations through Additional Financing or repeater projects. This resulted in greater impact on a larger number of beneficiaries. Although the bulk of the program focused on transport, water, social, urban and rural services, which together accounted for more than 93 percent of net commitments, it remained well-balanced with respect to social and institutional development impact, as these themes were embedded in the design of most projects.

50. **Increased complementarity between IBRD and IFC should be continued.** The CPS combined and leveraged IBRD's global knowledge of sector-specific issues and investments, with IFC's ability to mobilize financing and bring required expertise for the private sector. However, a more complementary program has the potential to further enhance impact, especially in infrastructure and public investment. Increased complementarity will need to start with closer, joint engagement at the CPF design stage, increasingly harmonized processes, with IFC's increased engagement in the real sector, through PPPs and sub-national finance.

51. **Flexibility is critical going forward, especially in a context such as that of Azerbaijan.** The WBG made effective use of the CPS Progress Report to introduce mid-course adjustments to the program, and to align it with the country's evolving priorities. Applying flexibility will be increasingly important: Azerbaijan is a sophisticated client that values careful partnership-building and WBG responsiveness. Its middle-income status and financing options also position it better to choose how to best leverage external funding and partners, resulting in changes to its own external financing options.

52. **Introducing innovative approaches requires a deep understanding of the political economy context, proper communication and flexibility.** The Reimbursable Advisory Services (RAS) program did not develop as originally envisaged due to the client's low appetite in the aftermath of IDA graduation and because the existing (at that time) relatively complicated procedures for approval of RAS and the legal framework were considered too complicated by the client. However, the WBG team was flexible in identifying and embracing alternative options, for example, by engaging in Externally Funded Operations (EFOs) with the CBA. This externally-funded engagement can have an important demonstration effect, and pave the way for a more robust RAS program in the future.

53. **When gender is appropriately embedded in project design, its impact is significant.** Most projects approved during the CPS period included gender-disaggregated data in their results frameworks. In cases where the WBG went beyond M&E and embedded gender in project design, for example, in the Azerbaijan Rural Investment Project II (AzRIP II) and the Water User Association Project, the impact was remarkable. Going forward, new operations will benefit from embedding gender into project design, implementation and evaluation in line with the corporate mandate.

54. **Projects need to be prepared carefully, with ownership built in from the beginning, and with a concerted effort to strengthen client management of projects.** In some hastily-designed projects in the past, Government ownership was not always visible: such projects had to be restructured. This lesson was built into the design of new projects during the CPS period, resulting in improved client engagement and greater client ownership. This was facilitated by a significant improvement in communication, as confirmed by the client. The program also put special focus on strengthening implementing agencies' capacity to manage WBG-supported projects and their products through capacity-building components.

55. **The IFC program's impact shows that a focused, targeted and incremental engagement can go a long way, even with relatively small resources.** The IFC program was designed to maximize its focus and impact. By building-up its program with small engagements, and tightly focusing on MSMEs and MFIs (micro finance institutions), the IFC program was able to achieve much with limited resources. For example, on the MSME lending front, a relatively small financing volume of US\$100 million was selectively targeted to MSMEs financing, resulting in the total number of MSME loans in their portfolio more than tripling.

56. **M&E quality should remain a priority from project design and throughout implementation, by taking a critical look at the results chain.** At the design stage, the CPS results framework included several indicators beyond the scope of the WBG program, which would have made it difficult to assess impact. The use of the Progress Report to streamline and re-align the CPS indicators allowed for more effective tracking of the program's contributions. However, stronger M&E requires good data quality and accessibility, both remaining issues to be addressed under the CPF.

Box 1. The WBG On-going Portfolio and Technical Assistance, as of May 2015

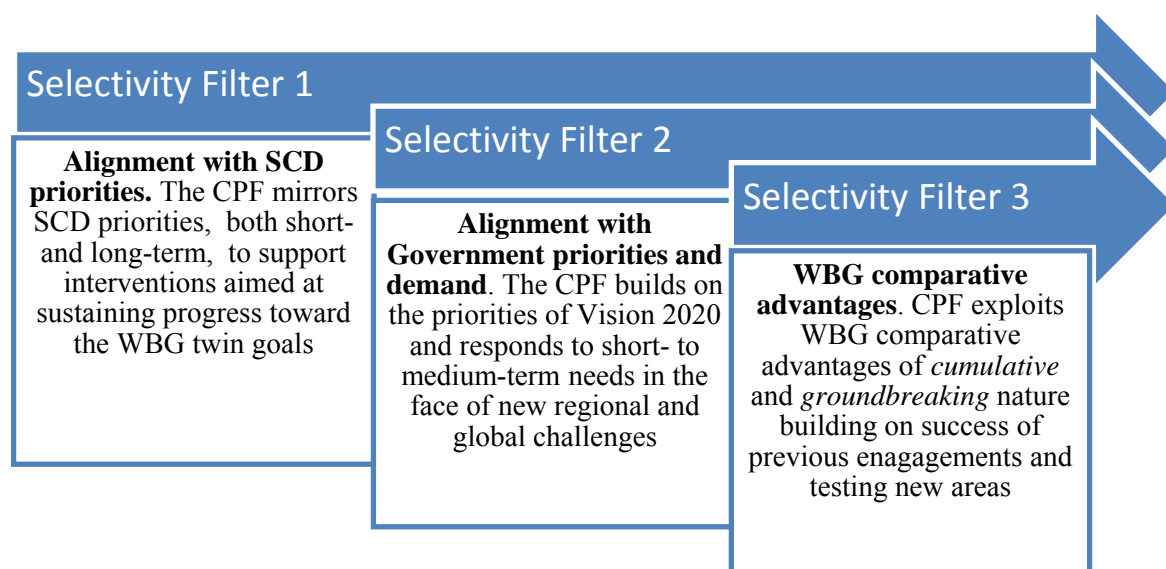
IBRD/IDA investment portfolio includes four IDA-financed and 13 IBRD projects with total commitment of USD 2.7 billion, covering a wide range of sectors. More than US\$2 billion of the investment portfolio comprise roads, railways, and water and sanitation projects. The remaining part of the portfolio includes operations in a broad set of areas from agriculture competitiveness, rural development, and support to IDPs, judicial reform, solid waste management, property rights registration, secondary education and social protection. After a substantial restructuring, portfolio performance improved as also manifested in the unprecedentedly high disbursement ratio of 32.0 percent as of mid- May 2015. Proactivity, following the restructuring of all problem projects, is now at 100 percent. The World Bank portfolio also comprises three recipient-executed Trust Funds in an amount of about US\$5.4 million. They support Supreme Audit institution development, the Corporate and Public Sector Accountability Project, and the Financial Sector Modernization Project.

IFC's committed portfolio totals US\$80 million, of which US\$71million is disbursed. It is dominated by the financial sector investments which account for about 80 percent and include MSME loans, sub-debt and equity investments, trade finance lines, and currency swaps. IFC advisory services program focuses on investment climate and financial market infrastructure. In addition to country specific advisory services, IFC's regional advisory projects - such as Corporate Governance, SME Banking Advisory, Resource Efficiency, Agribusiness Standards, and Sustainable Energy Finance - are available in Azerbaijan. IFC advisory programs are funded by donors, client fees and, in some cases, IFC budget. Donor funds in the amount of US\$3.4 million support implementation of Investment Climate and Financial Market Infrastructure projects. Swiss SECO accounts for 90 percent of these funds.

Overview of World Bank Group Strategy

57. **The overarching objective of the CPF is to support Azerbaijan toward sustainable, inclusive and resilient growth.** The CPF objective brings together the priorities of the government spelled out in the country’s national development programs and the recommendations of the SCD. Both emphasize continued attention to consolidating the gains in equity and inclusion, moving to a model of development where the private sector leads growth with support from strong institutions, and sustainable public finances under an effective and transparent government. The volatile economic environment calls for reforms and institutional changes that will make the economy resilient to external shocks. In line with this agenda, the CPF focuses on areas where the WBG has had strong engagement and explores new opportunities for productive partnerships based on areas with close links to the SCD and where there is a wealth of WBG global and regional knowledge and experience.

58. **The CPF cohesively synthesizes the SCD priorities and government’s strategic goals and further filters them through the prism of the WBG comparative advantages.** Thus, at the strategic level, the partnership framework applies three selectivity filters, namely: (i) alignment with SCD priorities; (ii) alignment with government priorities and demands; and (iii) WBG comparative advantages. The CPF objectives aim for a long term engagement from the outset assuming that adjustments will be made in the course of the WBG program implementation, subject to changing global and local environments. For example, due to the lack of government’s interest to borrow for social sector investments in the short run, the WBG indicative program for FY16-17 does not envisage any new lending in tertiary education, a priority area identified in the SCD to address the skills gap. However, the ongoing policy dialogue and technical support on education sector reforms, will help identify an appropriate instrument with the highest value addition to be offered in the outer years of the CPF. Furthermore, the government has given priority for its own public spending in this area, and also receives support from other development partners such as the EU and UN agencies in the education and health sectors. Hence, these sectors identified as priorities for human development in the SCD are funded under the government’s own spending programs.



59. **Selectivity Filter 1: Alignment with the SCD.** The CPF is informed by and builds on the findings of the SCD that has identified three broad priority areas: *governance and institutions*; *human capital*; and *connectivity*. In each of these areas, the SCD specifies a broad range of points for potential intervention as summarized in the challenges section of this CPF. In selecting the points of entry, the CPF will: (i) seek synergies between the ongoing and planned new interventions under each of the three broad SCD areas; and (ii) assess the potential for a small scale intervention in the short run to evolve into more substantial engagement in the longer run, either supported by the WBG or others, including the government.

60. **Selectivity Filter 2: Alignment with Government priorities and demand for WBG support.** The CPF builds on the priorities of the Vision 2020, the third State Program of Socio-Economic Development of Regions, and other sectoral development strategies. Falling oil prices have sharpened the government's strategic focus and influenced its borrowing plans. Consequently, the government has identified broad areas where it will welcome support of the WBG – primarily in infrastructure, economic diversification, institutional development, and public service delivery. These areas have the double benefit of addressing constraints to achieving the twin goals and making significant contributions to the government's own development program. These areas also support the government's emphasis on fiscal consolidation, which seeks to decrease the dependence on transfers to the budget from SOFAZ, raise more revenues from non-oil sectors, improve the efficiency and efficacy of public expenditure (including public investment and better procurement practices) and focus key government programs on reducing regional inequalities and increasing the quality of services available to all.

61. **In the short- to medium term, the WBG program will respond to the government's commitment of maintaining fiscal sustainability in an uncertain global environment through optimizing external borrowing.** In particular, the government plans to refocus its foreign currency denominated borrowing, including loans from international financial institutions (IFIs), to support projects with a high economic rate of return where international expertise and technical assistance would justify potential exchange rate risks. Projects in this category include investments in: highways and other main transport corridors that will help integrate the economy into regional and global markets; the national water supply and sanitation systems; power distribution system; and other selected areas that the government identifies as high priority for external borrowing. The government has chosen to fund investments in social sectors (such as health, education and social protection) as well as local connectivity (e.g. rural roads) mainly from the state budget while seeking support from development partners in the form of technical assistance or limited co-financing depending on emerging demands.

62. **Selectivity Filter 3: WBG comparative advantage.** The WBG comparative advantages further narrow down potential areas of engagement. First, the WBG derives comparative advantage from the *cumulative* knowledge and experience gained from continued engagement in various sectors that places the WBG in a unique position to consolidate achievements and support reforms. This includes a rich stock of knowledge of the economy and the critical sector challenges, for instance in infrastructure and agriculture. Second, the WBG global knowledge can be leveraged and applied in Azerbaijan in new areas that respond to the government's evolving demand and have a potential to become an intervention of a *groundbreaking* nature with potential high impact. For example, the government has recently asked the WBG to collaborate with a number of development partners (ADB, EIB) in upgrading and rehabilitating the country's power distribution

system outside of the capital city of Baku along with improving corporate governance standards of the newly established power distribution company (Azerishiq). As a result, it is expected that delivery of this service to rural populations will become more reliable and efficient, positively impacted by reduced energy losses and by effective management of Azerishiq. This new area of engagement is highly relevant to the WBG twin goals as it directly targets poor areas of Azerbaijan. It also falls under the service delivery agenda within the SCD governance domain and will employ WBG global knowledge and expertise to the benefit of rural populations in the country.

63. **The CPF builds on a substantive portfolio of operations and knowledge base accumulated over more than two decades of productive partnership with Azerbaijan.** Over this time, the WBG has helped the country develop national systems of high order, such as in targeted social assistance, national water supply and sanitation, transport networks, building market institutions, and also address local needs at the community level, and also achieve certain progress towards creating more conducive environment for private businesses. Extensive experience that has been gained will serve as the basis for new interventions to maximize cohesiveness and impact of the CPF program in the long run. Learning from the lessons of the past and taking into account the current context, the CPF will remain *flexible* in choosing instruments to achieve the WBG twin goals and thereby contribute to the country's strategic development goals within two clearly defined focus areas. This will allow the CPF program to be adjusted to reflect emerging priorities and opportunities to respond to the changing environment.

CPF Focus Areas and Alignment with the SCD

64. **The CPF lending program will focus on priority areas where the country's ownership is strong, and the potential impact on the WBG twin goals and the country's development aspirations is substantial.** The CPF takes on board the SCD priorities and contributes to: (i) *strengthening governance* through better management of public resources, delivery of services, and institutions; (ii) *improving connectivity* through developing the country's main transport networks, auxiliary infrastructure and broadband coverage, as well as enhanced operational and maintenance practices; and (iii) contributing to *human development* and increased prosperity through better access to water and sanitation, improved quality of the environment, and other health infrastructure and services, that have proven impact on health and social welfare outcomes. In addition advisory services will be provided to complement the lending activities in these areas. Figure 4 illustrates the alignment of the WBG program with the SCD key priorities, which is explained in more detail in Annex 3.

65. **The CPF objectives and results are grouped around two focus areas in line with the SCD priorities, the government's strategic goals and borrowing plans, and the comparative advantages of the WBG:**

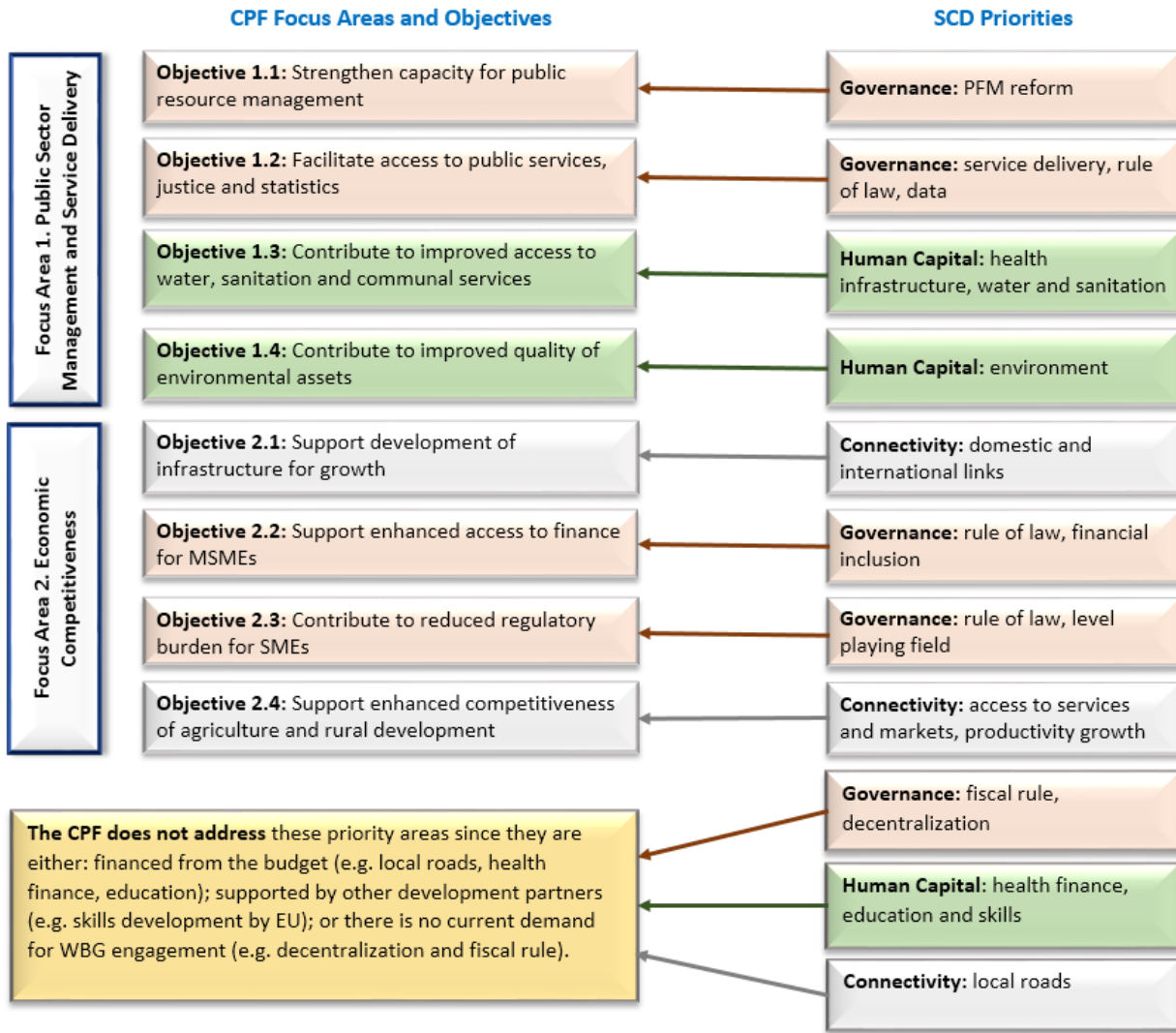
- Focus Area 1: Public sector management and service delivery
- Focus Area 2: Economic competitiveness

66. **The CPF focus areas and their objectives emerged from the application of the three selectivity filters.** The selected areas of WBG intervention were confirmed with the Government during the consultation process and were discussed with other stakeholders, including development partners, civil society and private sector. The first focus area – Public sector management and service delivery – is fundamental for maintaining the gains made by the B40. It

comprises objectives to strengthen capacity for public resource management, facilitate public service delivery and improve the quality of environmental assets. The second focus area – Economic competitiveness – incorporates objectives to improve selected infrastructure networks, enhance financial inclusion, reduce the regulatory burden on the private sector, and support economic activities in rural areas. The SCD emphasizes the need for changes to the governance environment in order to facilitate private sector led economic growth. The CPF in that regard focuses on access to finance and reduced regulatory burden for MSMEs as the mechanisms for creating a level playing field that will allow the private sector to contribute to growth. The CPF takes on board the SCD recommendation to prioritize connectivity by completing the government’s agenda of upgrading the core transport network to ensure smooth connectivity within the country and to international markets, as well as expanding auxiliary infrastructure. The CPF program includes support for fiscal management and expenditure efficiency to ensure the sustainability and resilience of the economy over the long term. The CPF results framework primarily builds on the ongoing portfolio with emphasis on areas that had shown success and where continued engagement is likely to deliver sustainable results within the CPF timespan.

67. The CPF program will support the government to enhance transparency and accountability in public sector management and service delivery, strengthen the rule of law, promote financial inclusion, and create a level playing field for businesses. To that effect, the CPF program will contribute to: (i) implementation of a Public Expenditure and Financial Accountability (PEFA) follow-up action plan, and strengthening procurement practices under the National Anti-Corruption Plan; (ii) enhanced technical and administrative capacity of the judiciary and expansion of access to key services for all; (iii) strengthened financial market infrastructure and regulatory frameworks, and increased access to finance for underserved segments of population and corporate sector, which will help them grow, become more competitive and create jobs; (iv) reduced regulatory burden for MSMEs and improved corporate governance practices in the private sector; and (v) strengthened capacity for data collection and analysis as a tool to ensure effective decision-making processes and citizen engagement.

Figure 4: Alignment between the CPF focus areas and objectives and the SCD priorities



68. **The CPF program will support connectivity through investments into the development of the transport and transit corridors, as well as improvement of local infrastructure at the community level.** The SCD highlights that *“the development of main transport corridors, along with relevant logistical services, will improve connectivity and open the way for producers to reach out to local and international markets in a faster and cheaper way.”* The CPF program in this area responds to the well-articulated borrowing priorities of the government and builds on the accumulated experience and lessons from the long term presence of the WBG in the infrastructure sectors. Sustainability of the substantial investments in the development of the main highways and rail networks will be enhanced through the introduction of modern operation and maintenance (O&M) management practices. The CPF program will complement government efforts to improve local connectivity, which is key to increasing productivity in rural areas, and will support investments at the community level, including the development of value chains. Other aspects of connectivity, such as telecommunications and broadband, may be addressed by the WBG interventions subject to the client demand.

69. **The CPF considers human capital development as a long term strategic priority that will be supported through the ongoing investment operations and advisory services..** During the first half of the CPF implementation period, the WBG program in education is limited to the ongoing project in secondary education complemented by targeted technical assistance in tertiary education in partnership with the EC. Advisory services are included in the CPF program to support reforms in health and social protection, with a focus on improved financing mechanisms and efficiency of service delivery. These advisory services could pave the way for potential financial support in the outer years of the CPF program in response to evolving demands of the government in these areas. In the short and medium terms, the CPF will contribute to improved health outcomes and increased prosperity through targeting water and sanitation services, quality of environmental assets, and reforms in the delivery of social services..

70. **The CPF will not address some of the priorities identified either by the SCD or by the government.** In particular, despite the volatile economic environment and uncertainties associated with low oil prices, the government has not expressed a clear interest in budget support. Therefore, the WBG will maintain its policy dialogue around macroeconomic and fiscal policy, through knowledge services rather than a particular lending instrument. However, the WBG stands ready to respond to any request for support to reforms in these areas through a general or sector-specific Development Policy Operation (DPO). Likewise, no specific intervention is proposed under the CPF on strengthening local authorities as part of the decentralization strategy – an area identified by the SCD as requiring improvement – due to the lack of a well-defined national strategy in this area. In the meantime, the Bank will continue to pursue citizen engagement and enhance the decision-making capacity of local communities which will, in the long run, contribute to strengthening demand-side initiatives for good governance at the local and municipal levels.

71. **However, the CPF program will also support critical public infrastructure improvements that were not specifically included among the list of SCD priorities.** In particular, the CPF program includes proposed support to improve the electricity distribution network in rural areas (outside Baku metropolitan area) in response to a specific request from the government. This will leverage various solutions available across the WBG and be implemented in partnership with other development partners, particularly the ADB, which carried out the preliminary needs assessments in this area. The rationale for WBG engagement in this area is based on the potentially significant impact of improved access to electricity in the regions on shared prosperity, and social and economic inclusion of the B40.. The CPF also views this engagement as an opportunity to achieve a multiplication effect of the potential power distribution operation in combination with other WBG supported projects, in particular with the operations in water and sanitation in selected rayons (districts).

72. **The CPF program will be underpinned by two cross-cutting themes of *Gender and Governance* recognized by the SCD as critical for effective management of resources, social inclusion and accumulation of diversified assets.** These cross-cutting themes will be embedded into the WBG analytical work and investment operations where applicable under both focus areas of Public sector management and service delivery, and Economic competitiveness, thereby also contributing to closing the regional disparities and the rural /urban divide identified by the SCD.

73. The *gender* dimension will be applied to the CPF program through: (i) analytical work that target knowledge gaps identified by the SCD, such as a labor force participation study; (ii) mainstreaming gender considerations in project design; (iii) disaggregation of results of investment

projects by gender, for example for customer access to services and borrowers of investment financing; (iv) awareness raising on the economic, demographic and social effects of the skewed sex ratio at birth; and (v) policy dialogue on a variety of aspects highlighted by the Azerbaijan Country Gender Assessment and the regional study on Missing Girls in the South Caucasus. New interventions will build on good practice to date in promoting women’s inclusion in the decision making process at the community level that proved an effective tool under the WBG ongoing CDD and IDPs projects. The WBG efforts will be aligned with and benefit from the strong presence of UN agencies and other development partners in this area.

74. While explicitly addressed within the public sector management, service delivery and private and financial sector development agenda, **governance** will cut across other areas of engagement to maximize the development impact of the WBG operations. In particular, the governance dimension will be integrated into the CPF program to promote transparent and accountable market institutions and feedback generation mechanisms, including through grievance redress instruments with a focus on facilitating service delivery at the community level. CPF also mainstreams governance in the connectivity agenda by aiming at effective corporate governance and financial management systems of relevant SOEs, and proper O&M in the main transport corridors and other infrastructure. Improved governance standards set for businesses are expected to contribute to non-oil sector growth, including through SMEs development and more favorable conditions for FDIs. The CPF supports development and application of ICT to areas with potentially high impact on transparency and accountability, in particular applying e-government elements in real estate and land registration as well as promoting information management systems.

Focus Area 1: Public sector management and service delivery

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| Country’s development goals: PFM reform, access to services and efficiency of service delivery, justice and market institutions |
| Demand for the WBG support: PFM and justice reform, public service delivery, including water and sanitation, ASAN scale-up, support to IDPs, environment management, statistics |
| SCD priorities: improved governance through strengthened fiscal management, PFM reform, enhanced capacity of the judiciary and improved delivery of services underpinned by reliable and timely data; improved water and sanitation, quality of environmental assets, develop health infrastructure |
| CPF Objectives: <ul style="list-style-type: none"> • <i>Strengthen capacity for public resource management</i> • <i>Support access to, and satisfaction with, public services</i> • <i>Contribute to improved access to water, sanitation and communal services</i> • <i>Contribute to improved quality of environmental assets</i> |

75. The SCD emphasizes the relevance of the governance agenda for sustainable and inclusive growth and prioritizes strengthening fiscal management to open fiscal space and lower the reliance on oil revenues. In addition, the SCD calls for improved service delivery in terms of access and quality as well as enhanced capacity of judiciary, with a focus on the B40 and underserved populations. It also stresses the need for reliable and timely data required for effective, evidence-based decision making.

76. The government's goal to improve public sector management and efficiency of service delivery under the ongoing fiscal consolidation effort resonates well with the SCD focus on governance. A process of fiscal consolidation is already underway. In this context, development and implementation of a PEFA follow-up Action Plan and the National Anti-Corruption Plan (NACP) will help enhance transparency and accountability in the use of public resources, including through strengthened procurement practices. The strategy to improve access and quality of service delivery is broad and aims at expanding coverage of social, communal and administrative services that range from water supply and sanitation, waste management, and housing to property rights registration, issuance of certificates, renewal of licenses, etc. It includes the use of IT technologies and other innovative approaches to bolster e-government capacity and bring a wide variety of services to all, making it easier to apply and collect benefits as well as to comply with processing requirements. Furthermore, the government is committed, despite the ongoing fiscal consolidation, to continue expanding physical infrastructure at the local and community levels to complete the agenda of supplying water and sanitation, electricity and improved environmental assets to underserved populations. Improved access to clean water and sanitation, proper management of waste are critical for improving health outcomes. The government will continue to invest in local roads to reduce the travel time to markets, service centers and social facilities. Improved communal infrastructure and utilities will positively impact quality of life and economic opportunities, in particular outside the capital city, where the majority of B40 reside. The government will track impact of all of these effort through the production of reliable and timely statistical data.

77. **The WBG program will help Azerbaijan improve: (a) public sector management; and (b) realize its service delivery transformation vision.** The first objective within this focus area will help build institutional capacity for public resource management while three others will support the transformation of public service delivery. The WBG will continue to provide technical assistance and financing to accompany the government in consolidating the current innovative initiatives for enhanced access to services that have strong impact on the livelihood of people in B40.

Objective 1.1: Strengthen capacity for public resource management

78. For the government, fiscal consolidation is a top priority under the current circumstances given their high dependence on SOFAZ transfers. Fiscal consolidation stresses improving efficiency of expenditures, shifting the investment leadership burden toward private sector and mobilizing more resources for the budget through an improved tax system, expansion of the tax base and stronger oversight over public expenditure. The ongoing process of fiscal consolidation implies a tighter fit between the current budget spending and medium term perspectives and priorities, better prioritization of investment projects, closer monitoring and evaluation, upgraded system of external and internal controls and a stronger public procurement system. The government is also exploring greater participation of private sector in delivery of public services through PPPs or similar arrangements.

79. The CPF seeks to contribute to fiscal consolidation and more transparent and efficient use of public resources through strengthening the PFM framework in line with the international good practice. CPF support will focus primarily on the implementation of the 2014 PEFA recommendations in partnership with the government, the EU and SECO. On procurement, the support will further rely on the implementation of the National Anti-corruption Plan. Support will

also be given to improving macroeconomic monitoring as an instrument to track progress in fiscal consolidation, to modernizing tax practices and building up external oversight.

80. The WBG Program will support strengthened capacity for public resource management. A joint WB-EU-SECO Technical Assistance activity will support implementation of the PEFA Follow-up Action Plan. The focus will be primarily on improving budgeting, resource allocation, internal and external controls and procurement practices. The WBG will continue the policy dialogue and provide advice to support the Public Procurement Agency in implementation of the eight (8) sub items under paragraph 14 of the National Anti-Corruption Plan in strengthening procurement practices, including through the introduction of e-procurement system. The WBG program will support the Chamber of Accounts in strengthening external audit capacity, and the Tax Administration on promoting cashless transactions through a targeted TA, including potential Trust Funded projects. The Bank will continue to provide advice through assessment and monitoring of the macroeconomic situation and stands ready to scale up engagement in support of fiscal consolidation. IFC will complement these activities through its engagement with SOFAZ, which will comprise continued asset management services and capacity-building efforts.

Objective 1.2: Support access to, and satisfaction with, public services

81. Effective service delivery is identified in the SCD as a key priority along with strengthened rule of law and reliable data on public service delivery. One of the strategies the Government has been using to realize its service delivery transformation vision is adapting global good practices and harnessing information and communications technologies, including electronic and mobile services and applications. Since 2012, an Agency for Public Service and Social Innovation (ASAN Xidmet or Easy Services) has piloted a customer-focused “one-stop shop” approach to service delivery. Some 107 administrative services in 30 categories are being successfully provided by the ASAN to citizens. Surveys show that citizens and firms are very satisfied with improved access, quality, transparency and integrity. Building on its success, the Government intends to broaden the functions of the ASAN agency, the menu of services included, and the mechanisms available to access the services, including engaging other agencies. An important complement of this initiative is the strengthening of the statistical capacity to track effective service on the ground. The universal access to a broad range of services will have transformational impact by reducing cost and facilitating access to all, especially to under-served areas and vulnerable groups.

82. The WBG will continue to work with the government in support of these initiatives, not only to bring access to all of the population, but also to broaden the scope of the service coverage and introducing similar methodologies in other institutions to complement the work of ASAN. Emphasis is also given to producing better statistics to track impact.

83. The WBG program will support the government in making services available to the entire population of Azerbaijan through a proposed ASAN Xidmet project and other mechanisms. The ongoing re-branding of the Azerbaijan Postal Service (AzerPost) supported by a SECO TF creates an opportunity for a potential project that will transform AzerPost into a service delivery centers reaching out to remote and underserved areas through its 1500 branches across the country. In addition, the ongoing IDPs Living Standards and Livelihood Project will be scaled up through a potential Additional Financing to increase coverage of IDPs by improving access to basic infrastructure and services as well as creating opportunities for skills development and, subsequently, income generation. IFC will explore opportunities to support expansion of ASAN’s

services to businesses across the country through piloting issuance of permits and licenses, and possibly through establishment of movable collateral registration services. E- and m-enabled services (e.g. notaries, bailiffs, registration and legal aid) as part of the implementation of the legal assistance model and ‘smart courts’ under the ongoing Judicial Services and Smart Infrastructure Project (JSSIP AF) will break barriers for the poor and B40 that today limit their access to justice. The WBG will help, through the ongoing Statistical Capacity Building TA, create a robust metadata system, data dissemination processes, update the household budget survey and develop technical protocols to support micro data access to users following internationally recommended procedures. Under the FY15 Programmatic Poverty Assessment (PPA) TA, the WBG program will support the SSC in addressing the issue of discrepancies between officially published indicators and those reported by international agencies.

Objective 1.3: Contribute to improved access to water, sanitation and communal services

84. Inadequate access to basic infrastructure and services are identified by the SCD as challenges that impede inclusive growth and asset accumulation, especially by the B40 who mostly reside outside the capital city and mainly in rural areas. In particular, the SCD highlights a need for investing in water and sanitation as part of the public health infrastructure as well as in connectivity as a way to influence people’s demand for health and education services. The Government is implementing the third State Program of Social and Economic Development of Regions for 2014-2018, which aims at reducing regional inequalities and providing households in all rayon centers with reliable basic services, such as water and sanitation, gas, electricity, heating, decent housing and solid waste collection.

85. The CPF will specifically contribute to : (i) improving access to utilities and local and community infrastructure through community-driven infrastructure investments in the poor communities; (ii) expanding coverage and accessibility of water and sanitation services; (iii) improving management of solid waste in Greater Baku Area and the development of a National Solid Waste Management Strategy; and (iv) developing institutional capacity of the state companies in charge of water and sanitation, as a key element of strengthening governance and ensuring sustainability of investments into the sectors. In particular, to address regional disparities, the program will continue to improve water supply and sanitation in rayons with a relatively higher level of poverty incidence, for example in the south (e.g. Masally, Lerik, Yardimly) and in the north (e.g. Siyazan, Shabran). The ongoing clean-up of informal dump sites will benefit the B40 by reducing environmental and health risks.

86. **The WBG program includes projects aimed at building infrastructure and upgrading the operational capacity of utility companies and service providers.** Two ongoing projects on water and sanitation – the National Water Supply and Sanitation Project (NWSSP) and the Second National Water Supply and Sanitation Project (NWSSP II) – cover 12 rayons of Azerbaijan including those where poverty rates are high. A proposed Additional Financing to the NWSSP will expand coverage to marginalized areas of rayon centers. The ongoing Solid Waste Management Project aims at improving the environment in the Greater Baku area but also contributes to generating opportunities for small businesses to engage in solid waste processing, specifically at the newly established industrial park. The CPF program will support infrastructure investments in poor communities through the ongoing community driven intervention under the ongoing Second Azerbaijan Rural Investment Project (AzRIP II), and will help improve connectivity to markets, health and education facilities. In addition, the CPF program includes

planned support for the improvement of power distribution systems in rural areas and the capacity of the newly established power distribution company, Azerishiq. IFC will explore PPP and investment opportunities in areas such as solid waste and power distribution, and will be open to provide advisory services on loss reduction and investment optimization to state utilities in the energy sector.

Objective 1.4: Contribute to improved quality of environmental assets

87. The long legacy of oil production and hazardous chemical waste in the town of Sumgayit, a satellite of Baku, have had negative environmental consequences that continue to haunt the country, particularly in the Absheron Peninsula and surrounding waters of the Caspian Sea. Furthermore, gas flaring remains an environmental concern also affecting economic efficiency. The SCD identifies the legacy pollution and governance gaps in environmental management as exposing the poorest to health risks – especially those who reside close to oil fields, abandoned industrial sites and in rural areas. Contamination and lack of a time bound strategy to promote environmental sustainability also limits opportunities for sustainable economic activities and entrepreneurship. Government is committed to achieve ambitious goals in: (i) cleaning up the polluted areas of Absheron, including lakes and contaminated areas around Sumgayit; (ii) achieving zero routine gas flaring by 2030; and (iii) addressing gaps in waste management and cleaning-up oil spills along the transport routes. The environmental and natural resource management objectives of the government comprise conservation of biodiversity and improving forest governance through strengthening the institutional capacity and regulatory framework. In order to clean up the polluted environment in the peninsula and surrounding sea, government needs to significantly improve institutional capacity for efficient management of resources.

88. **The WBG Program will seek to improve the quality of water in highly contaminated areas and reduce the number of people exposed to pollution hazards.** Given its global knowledge and expertise, the WBG will contribute to the Government’s ongoing Absheron Lakes Clean-Up Program aimed at mitigating the adverse impacts on health and economic opportunities through a proposed Lakes Clean-up project. The WBG will also continue supporting the State Oil Company of Azerbaijan (SOCAR) in implementing its commitment to reach zero gas flaring by 2030 through the Global Gas Flaring Reduction (GGFR) initiative. To make progress in reducing gas flaring, WBG will contribute to building partnerships with the government and oil companies operating in the country to implement the program. IFC engagement in this area can potentially be on developing opportunities in renewable energy – wind and solar in particular.

Focus Area 2: Economic competitiveness

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| Country's development goals: economic diversification, non-oil sector growth, improved business environment, financial inclusion, agriculture and agribusiness development |
| Demand for WBG engagement: economic diversification, business environment, access to finance, agriculture and rural development |
| SCD priorities: improved governance through creating a level playing field and financial inclusion to bring the private sector to the center stage, improved connectivity and increased productivity |
| CPF Objectives: <ul style="list-style-type: none">• <i>Contribute to the development of the main transport network for enhanced international and domestic connectivity</i>• <i>Support enhanced access to finance for MSMEs</i>• <i>Contribute to reduced regulatory burden for SMEs</i>• <i>Support enhanced competitiveness of agriculture and rural development</i> |

89. Bringing the private sector to the center stage as the main driver of growth is defined by the SCD as essential for accelerating and sustaining progress on the twin goals. To achieve this, the SCD identified the need to reduce regulatory burden on businesses, enhance financial inclusion, and support trade facilitation, including through improved connectivity for producers to reach local and international markets in a faster and cheaper way. The government is acting on a variety of fronts to position the non-oil private sector as the main driver of growth. This will be achieved through reforms to improve the business environment, reduce regulatory burden on SMEs, improved access to finance for MSMEs, increased investments in connectivity, and promoting competitiveness of selected sectors.

90. The WBG Program will contribute to achieving four objectives within this focus area. Specifically, it aims to: (i) ensure smooth connectivity within the country and strengthening international links, through investing in roads, railways and ICT broadband; (ii) strengthen the financial sector to support the private sector in general and MSMEs in particular in order to stimulate employment generation, financial inclusion and diversification; (iii) reduce regulatory burden for MSMEs with a focus on reducing regulatory constraints related to tax and customs administration, business inspections and permits, insolvency resolution, etc.; and (iv) upgrade agriculture and agro processing, which is critical for food security, jobs and enhanced export potential of the country. The WBG will contribute to strengthening the country's economic competitiveness and diversification agenda based on the comparative advantages of IBRD and IFC.

Objective 2.1: Contribute to the development of the main transport network for enhanced international and domestic connectivity

91. Azerbaijan has considerably advanced in addressing the significant infrastructure gaps that constrained the development of the non-oil sector. Still, the SCD highlights the need for completion of the connectivity agenda as fundamental for Azerbaijan's transformation into a diversified economy with significant value addition of a modern non-oil sector. The main transport corridors are important routes for producers to reach both local and international markets in a faster and cheaper way, while development of local roads is critical for increased access to markets for

producers in rural areas, where the majority of the B40 reside. The key challenge at present is to complete the core network of transport infrastructure of railways and highways as a backbone to the country's connectivity. The backbone will serve two purposes, specifically: (i) to connect Azerbaijan to regional and global markets; and (ii) serve as a platform for turning the country into a key logistics hub between the East and West. In the meantime, the Government has committed to improve the network of regional and local roads as part of its regional development program that falls under the mandate of the local executive authorities.

92. **The WBG program will support the Government to complete the development of the core transport infrastructure network of railways and highways** in cooperation with other development partners (ADB, EBRD, KfW, JICA). The ongoing Highway III project, the proposed AF and a new Highway IV project will support the rehabilitation and construction of the M2 highway that connects Baku and the Absheron Peninsula with Georgia, and the M3 highway that leads to the southern borders of Azerbaijan. The ongoing Rail, Trade and Transport Facilitation Project will provide alternative transport options to enhance resilience of the transport network and strengthen the country's strategic position. The government also expects the WBG to take the lead on ensuring sustainability of the high volume of investments by establishing proper maintenance systems for the highway network.

93. The Government, under increasing fiscal pressures, is also contemplating to leverage public-private infrastructure finance mechanisms. These would potentially include PPPs and outsourcing through performance-based contracts. IFC will explore opportunities to support this agenda through transaction advisory services, financing of pilot PPP projects and creditworthy SOEs, as well as advice on development of the regulatory framework for PPPs. IFC will be also interested to support critical private infrastructure projects, including those in the oil and gas sector and telecommunications, through debt and equity finance.

Objective 2.2: Support enhanced access to finance for MSMEs

94. The SCD points at enhanced financial inclusion as an important pre-requisite for private sector growth and job creation. A weakness of the financial sector is reflected in the very low financial inclusion indicators and consequently constrained financial access of MSMEs and entrepreneurs/micro enterprises. This constraint is also revealed in the WBG's recent survey on MSME Access to Finance Demand, according to which 51 percent of MSMEs report that access to finance is the most important obstacle that constrain their business growth. Increased financial inclusion and use of modern financial services (including e-payments, savings, insurance, and pension, SME, rural, mortgage and trade finance products) are important for reduction of cash and informal economy as well as strengthening of financial safety and equity, especially in rural areas with bigger reliance on remittances, higher incidence of poverty and subdued economic opportunities.

95. The government has tried to address the gaps in access to finance by creating state-owned intermediary agencies (Entrepreneurship Fund, Agricultural Credit Agency, IT Fund, and Mortgage Fund) and through significant influx of public funds. However, the changing macroeconomic landscape and the expected fiscal consolidation call for an enhanced role of the private sector for financial intermediation and savings mobilization. To move in this direction, however, it will be necessary to fill the considerable knowledge gaps due to the quality of the information available on the banking system.

96. **The WBG program will continue to help improve financial inclusion for MSMEs and the B40** through ongoing advisory services and TA on regulation and supervision of financial markets, the SECO funded TA on financial literacy and consumer protection, and TA on financial market infrastructure, including work on regulatory framework for credit bureaus, secured transactions and collateral registries, as well as credit underwriting policies and practices. New areas of engagement include development of financial services for AzerPost and a policy dialogue on longer-term finance, including affordable housing finance under the ongoing EFO with the Central Bank of Azerbaijan. Jointly with the IMF, the WBG will work with the government within the framework of the 2015 FSAP to assess the resilience and identify banking sector vulnerabilities and develop a road map for reforms to foster financial sector growth, soundness, efficiency, depth and breadth. The WBG is ready to support the country in addressing FSAP concerns and findings through Advisory and Technical Assistance programs. The WBG will continue to work on strengthening the transparency, soundness and reputability of the banking sector through the ongoing EFO on AML/CTF, bank corporate governance and Azerbaijan's compliance with the international financial regulation and supervision framework. IFC's engagement in the financial sector will remain a strategic priority and include a combination of investment and advisory services. Specifically, IFC will continue to (i) provide capital, liquidity and trade finance to well managed private banks, prioritizing MSME, gender and sustainable energy finance, (ii) build capacity within the banking sector to better manage risks and improve corporate governance, and (iii) support financial intermediaries in the introduction of the new customized products and services for MSMEs and farmers, and potentially mobile banking.

Objective 2.3: Contribute to reduced regulatory burden for SMEs

97. Azerbaijan has made progress in improving the business environment as measured by gains in the Doing Business scorecard and by the World Competitiveness Index. The SCD states that despite significant business climate reforms in recent years there is evidence that some parts of the regulatory regime continue to hurt incentives for entry and expansion in the private sector. Azerbaijan has adopted an active reform agenda and is expected to improve its position on the Ease of Doing Business. Some of the broader underlining constraints behind its ratings include (i) excessive burden of business regulations (e.g., permits, inspections, tax administration) resulting in red tape and high compliance costs for business, and (ii) low transparency of import-export customs operations which create opportunities for rent seeking and unequal treatment of businesses. SMEs face an uneven burden of these distortions vis-a-vis SOEs and large conglomerates. Therefore, the WBG interventions in this area will target SMEs.

98. **The WBG Program will aim to address some of the above constraints through the ongoing IFC advisory support and IBRD lending operations.** Specifically, IFC’s Investment Climate advisory will support: (i) the streamlining of business inspections and issuance of business permits (e.g., introduction of e-services and roll-out risk based inspections); and (ii) simplification of tax policies and administration procedures. These efforts will be complemented by the ongoing IBRD Judicial Services and Smart Infrastructure Project, which helps to improve access, transparency and efficiency of delivery of selected justice services including for businesses. In addition, the WBG will support improvements to the system of registering property rights through the ongoing Real Estate Registration Project and a potential repeater project to be prepared jointly with other development partners such as KfW. Should the opportunity arise, the WBG will be also open to help the government address other problematic areas of the regulatory environment, including ongoing efforts to improve customs procedures through the digitalization of trade processes.

Objective 2.4: Support enhanced competitiveness of agriculture and rural development

99. The government recognizes the agriculture sector’s high potential for boosting non-oil growth, ensuring food security, and providing jobs and income opportunities for about 40 percent of the country’s population who live in rural areas. The national Agriculture Sector Strategy outlines the main directions for unleashing this potential. The SCD also prioritizes agriculture and agribusinesses as a means to stimulate rural incomes and consumption growth and, thereby, boost shared prosperity. There is a need to fill in gaps in irrigation, introduce new technologies, improve access to finance and essential logistics, as well as develop a quality infrastructure to enhance the export potential of agricultural produce. To complete the circuit, the government continues to work on the protection of land property rights through expansion of the cadaster system and increased efficiency of services.

100. **The WBG Program in agriculture and rural development, largely built on the ongoing program, will focus on improving selected value chains, expanding access to investment financing, and strengthening animal health and phyto-sanitary services** as key elements of the quality infrastructure through the ongoing Agricultural Competitiveness Improvement Project (ACIP). With other development partners (e.g. KfW), the WBG will help improve the system of property rights registration through a potential Real Estate Registration repeater project. To enable better access to markets and more productive use of assets by rural population, the WBG program will also contribute to the development of auxiliary infrastructure, such as local roads, irrigation systems, storage facilities and extension services through the ongoing AzRIP II. The ongoing ACIP will provide lending to support access to finance for farmers and agro businesses. Through a capacity building program, it will also help improve skills of financial institutions in administering investment loans and new financial products for farmers and agribusiness. In parallel, the IFC Agri Insurance and Agri Finance advisory projects will complement the access to rural finance agenda, while IFC finance will be available for competitive private agribusiness companies. The ongoing Water Users Associations Project (WUAP) will help develop irrigation systems in areas that have high potential for agriculture growth but depend on sustainable water supply. In addition, the WBG will help develop other facilities in line with value chain analyses and respond to potential needs of agro processing and delivery to market.

C. Implementing the FY16-FY20 Country Partnership Framework

101. This CPF will be implemented for five years covering FY 2016 through FY 2020. During this period, it will be reviewed and adjusted in the mid-term to respond to the changing environment and evolving needs of the client and reflect progress of program implementation. The impact of the devaluation of the manat as well as structural reforms on the poor and the B40 will be monitored and assessed in the course of the CPF implementation to inform the progress review.

102. The IBRD indicative financing program for FY2016-2017 will be in the range of US\$300-500 million per annum (Table 2). Lending volume and composition of projects will depend on country demand, global economic developments, and portfolio performance as well as IBRD's lending capacity and demand from other borrowers. IFC indicative baseline investment program of long-term finance for FY2016-2020 will be in the range of US\$100-150 million, mostly in the financial sector, plus additional trade finance guarantees. Larger and more diversified IFC support across sectors will be subject to opening of the infrastructure sector for the private investments and further progress with investment climate reforms, which would encourage greater corporate transparency, further rationalization of customs and tax administration, and sound environment for banks to lend and foreclose.

103. The WBG will further strengthen its productive cooperation with other development partners. Building on the successful cooperation with the European Union through SECO financing, for example on PEFA, and IFC advisory services in the areas of business enabling reforms and developing financial market infrastructure, opportunities will be explored for more EFOs and innovative ASA engagement. Dialogue and coordination with the EU will continue on financial sector modernization, including strengthening the capacity of AzerPost, and financial literacy and consumer protection, as well as on justice and education reform, agriculture and agribusiness development. In infrastructure development, especially roads, and water and sanitation, the WBG will coordinate and closely cooperate with ADB, EBRD, KfW, EIB and JICA. The WBG will participate in the work of the UN family, in particular on SDGs and UNDAF implementation, as well as on gender, health and labor market reforms.

IV. MANAGING RISKS TO THE CPF PROGRAM

104. **Overall Risk in Azerbaijan is assessed as Moderate.** Two key potential risks may impact the achievement of the CPF results, particularly, macroeconomic stability, and institutional and governance challenges.

Table 2: Risks to the WBG Program in Azerbaijan

| Risk Categories | Rating (H, S, M or L) |
|---|------------------------------|
| 1. Political and governance | Substantial |
| 2. Macroeconomic | Substantial |
| 3. Sector strategies and policies | Moderate |
| 4. Technical design of project or program | Moderate |
| 5. Institutional capacity for implementation and sustainability | Moderate |
| 6. Fiduciary | Moderate |
| 7. Environment and social | Moderate |
| 8. Stakeholders | Moderate |
| Overall | Moderate |

105. **Continued weakness in political and governance is a key risk factor.** Institutional and governance challenges erode the efficiency of public expenditures and slow down private sector growth, which may impact the outcomes of the CPF program related to the growing role of the private sector. The WBG recognizes the complex country context and has elevated governance and institution building to a cross-cutting theme that needs to be taken into consideration in every WBG activity. The WBG will also use the recently completed PEFA assessment to follow-up on implementation of some major reforms in public financial management system, while IFC will continue to promote better governance of the corporate sector through its advisory services to individual clients as well as to the domestic providers of such services will increase the scale and impact. The substantial risks of governance that may also affect the WBG program are related to implementation capacity weaknesses of certain agencies. This will be mitigated through thorough analysis of implementation arrangements at project preparation and enhanced joint monitoring of portfolio implementation.

106. **The volatile global and regional economic environment poses a substantial macroeconomic risk that could affect the WBG program.** After many years of significant growth rates led by increasing oil and gas exports, future growth in Azerbaijan is expected to fall to more modest levels and be increasingly dependent on progress in making the non-oil economy more competitive. Azerbaijan has successfully built the State Oil Fund, which had accumulated over US\$40 billion by the end of 2014. However, economic strains may develop if oil and gas prices stay low for a prolonged period. Even if there are political and economic difficulties, Azerbaijan will be in a position to provide counterpart funds and service its debts. Should the macroeconomic situation further deteriorate, the CPF program can be adapted to incorporate a development policy operation, subject to demand from the government. This would redirect financing into budget support by diverting resources from the planned investment lending program. Flexibility of the strategic framework would allow to mitigate this risk by adjusting the program in a timely manner.

ANNEX 1. CPF Results Monitoring Matrix

Focus Area 1: Public sector management and service delivery

The government's goal to improve public sector management and efficiency of service delivery under the ongoing fiscal consolidation effort resonates with the SCD's focus on governance. In this context, development and implementation of a PEFA Follow-Up Action Plan and the National Anti-Corruption Plan (NACP) will help enhance transparency and accountability in the use of public resources, including through strengthened procurement practices. Improved governance also implies effective decision making process which in its turn requires reliable and timely statistical data.

Building on the success of ASAN Xidmet, Government intends to broaden its functions and apply e-services applications to increase access to a broader range of public services across the country. The effectiveness of public service delivery will be enhanced by investments in physical infrastructure at local and community levels. Improved communal infrastructure and utilities will positively impact quality of life and economic opportunities, in particular outside the capital city, where the majority of B40 reside.

The ongoing judicial system modernization will increase access to justice and amplify the impact of the government's program of improved service delivery by expanding access to key justice sector services (such as notaries, bailiffs, registration and legal aid), targeting the needs of vulnerable groups - such as IDPs, refugees, women, minorities and low income households - as identified by the SCD. The government also aims to maintain and, if possible, to enhance the quality of environmental assets, which still remain under threat and put development outcomes at risk.

The WBG program will help Azerbaijan improve public sector management and realize its service delivery transformation vision by contributing to strengthening public institutions and the efficiency of, and access to key public services. During the CPF period, the Bank will work with the State Statistics Committee (SSC) on the area of strengthening data dissemination systems and enhancing metadata. The WBG will also support the government in addressing environmental damage that is detrimental to the health of the population, especially of the B40.

Objective 1.1: Strengthen capacity for public resource management

Intervention logic: The 2014 PEFA identified critical priorities for improving Azerbaijan's public financial management systems. These include further aligning budget classification with GFSM 2014; linking medium term planning and budgeting; strengthening tax compliance; preparing annual financial reports under international standards; improving internal and external audit capacity; and enhancing independent and credible procurement complaint mechanisms. The PEFA agenda complements the National Anti-corruption Plan, in particular on public procurement.

These measures will contribute to a more transparent and efficient use of public resources by strengthening the PFM framework and moving to a higher standard in terms of international good practice. Efficiency gains will help open fiscal space for better targeting public resources to support pro-poor policies.

The WBG, jointly with the EU and SECO, will further support the development and implementation of the PEFA Follow-up Action Plan with a strong focus on capacity building. The WBG interventions are expected to improve budgeting, resource allocation, internal and

external controls. In addition, the WBG will support implementation of the NACP in strengthening procurement practices, including through the introduction of e-procurement system.

IFC will complement these activities through its engagement with SOFAZ which will comprise continued asset management services and capacity-building efforts.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|--|--|
| <p><i>Indicator 1:</i> PEFA demonstrates improvement in external and internal audit</p> <p>Baseline: PEFA PI-21(i) = C in 2014; PEFA PI-26(i) =D in 2014 [<i>based on 2011 PEFA Methodology</i>] Target: PEFA PI-21(i) = B and PEFA PI-26(i) =B in 2017 (*)</p> <p><i>Indicator 2:</i> Progress in implementation of the NACP under item 14 on Procurement Baseline: 0 items implemented (2013) Target: at least 8 sub-items implemented (2019)</p> | <p><i>Milestone 1:</i> An Action Plan on PEFA follow-up approved and under implementation (2016)</p> <p><i>Milestone 2:</i> The internal audit framework based on international standards (ISAs) is piloted in at least 5 central government agencies (2015)</p> <p><i>Milestone 3:</i> The international standards in internal audit are implemented by the majority of central government bodies (2017)</p> <p><i>Milestone 4:</i> The coverage of the central government expenditure by external audit reached 75% of expenditures (2017)</p> <p><i>Milestone 5:</i> Amendment to Public Procurement Law approved by Government (2016)</p> <p><i>Milestone 6:</i> E-procurement system operational (2018)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> •PEFA Follow up TA •ROSC on accounting and audit •Fiscal incidence analysis/Assessment of equity implications of fiscal consolidation • Corporate Governance ROSC • SOE CG assessments <p><i>On-going</i></p> <ul style="list-style-type: none"> •PEFA Follow up •Macro monitoring •Country Economic Memorandum (CEM) • IFC AMC capacity building for SOFAZ •Judicial Services and Smart Infrastructure Project |

Objective 1.2: Support access to, and satisfaction with, public services

Intervention logic: Effective service delivery is identified by the SCD as a key priority along with strengthened rule of law and reliable data on public service delivery. Building on its continued successful engagement in selected areas of public services and applying global knowledge and expertise, the WBG will contribute to the agenda of improved service delivery through support to the ASAN Xidmet, and increased coverage of the most vulnerable, specifically IDPs to sustain their livelihoods.

The WBG program will help extend the reach and delivery capabilities of ASAN, especially to under-served areas and vulnerable groups. IFC will explore opportunities to support expansion of ASAN’s services to businesses across the country through piloting issuance of permits and licenses, and possibly through establishment of movable collateral registration services.

Building on the cumulative effects and impact of the ongoing program for supporting IDPs, a targeted operation will contribute to reducing poverty among this most vulnerable group of the society through improved access to basic infrastructure and services as well as through creating opportunities for skills development and, subsequently, income generation.

Improved access and efficiency through e- and m-enabled services (e.g. notaries, bailiffs, registration and legal aid) and ‘smart courts’ will also underpin the WBG-financed Judicial Services and Smart Infrastructure Project (JSSIP AF). The WBG program will also strengthen, through a technical assistance intervention, the capacity of the State Statistics Committee to produce and publish key data on public service delivery. The WBG program will also strengthen, through a technical assistance, the capacity of the State Statistics Committee to collect publish and make accessible data needed for evidence based decision making especially to enhance service delivery.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|--|--|---|
| <p><i>Indicator 1:</i> Increased number of customers annually using ASAN’s service centers, mobile units and e- and m-enabled services and applications to access selected public services</p> <p>Baseline: 2 million (2015)¹⁵ Target: 5 million (of whom at least 30 percent comprise women, IDPs, refugees and minorities) (2018)</p> | <p><i>Milestone 1:</i> ASAN services cover 100 percent of the country’s territory (2018)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • Possible ASAN Public Services Project (FY17) • Possible AF Judicial Services and Smart Infrastructure Project (FY18) • A possible IDPs project • Potential IFC regulatory environment project <p><i>On-going</i></p> <ul style="list-style-type: none"> • Judicial Services and Smart Infrastructure Project • Pilot Justice Sector PEFA (jointly with EU) |

¹⁵ Based on ASAN report that (a) 3 million users accessed services at ASAN service centers in 18 months, (b) 100,000 users accessed ASAN mobile centers in 12 months, (c) 2,000 users on average are served daily by each ASAN service center and (d) currently 10 state entities and some private companies provide over 237 different services to citizens and firms. The indicator wording and baseline and target values will be verified with ASAN.

| | | |
|---|---|---|
| <p><i>Indicator 2:</i> Increase in percentage of vulnerable groups (including 20 percent of women) among legal aid beneficiaries Baseline: 0 percent (2015) Target: 25 percent (2018)</p> <p><i>Indicator 3</i> Increased number of IDPs (in WBG program affected areas) satisfied with improved access to services/utilities/infrastructure as good Baseline: 6 percent (2014) Target: 90 percent (2018)</p> <p><i>Indicator 4:</i> Improved statistical data presentation and end-users' satisfaction increased Baseline: No meta-data system in SSC (2014) Target: Meta-data system established and fully operational (2018)</p> <p><i>Indicator 5:</i> World Bank's Statistical Capacity Indicator for Azerbaijan (covering methodology, source data, periodicity of statistics) Baseline: Statistical capacity score is 74.33 (2013) Target: Statistical capacity score is 77 (2019)</p> | <p><i>Milestone 2:</i> Justice Sector Gender Strategy and Action Plan prepared and publicly disclosed (2017)</p> <p><i>Milestone 3:</i> Legal aid procedures and access streamlined (including e-access through legal aid portal) (2018)</p> <p><i>Milestone 4:</i> Number of IDPs directly benefiting from WBG program exceed 30 percent of total number of IDPs including 50 percent women (185,000 out of 595,000) (2017)</p> <p><i>Milestone 5</i> The meta-data system is established, staff trained and software operational in test mode (2016)</p> <p><i>Milestone 6</i> Azerbaijan subscribes to IMF's Special Data Dissemination Standards</p> | <ul style="list-style-type: none"> • Poverty and Social Impact Analysis (ASAN and Justice) • IDPs Living Standards and Livelihoods project • South Caucasus Poverty TA • TF Statistical Capacity Building grant • IFC Azerbaijan and Central Asia Financial Infrastructure Project |
|---|---|---|

Objective 1.3: Contribute to improve access to water, sanitation and communal services

Intervention logic: The Government is implementing the third State Program of Social and Economic Development of Regions for 2014-2018 which aims at reducing regional inequalities and providing households in all rayon centers with reliable basic services, such as water and sanitation, gas, electricity, heating, decent housing and waste collection. Inadequate access to basic infrastructure and services are also identified by the SCD as challenges that impede inclusive growth and asset accumulation, especially by Bottom-40 who mostly reside outside the capital city and mainly in rural area. In particular, the SCD highlights a need for investing in water and sanitation as part of the public health infrastructure as well as in connectivity as a way to influence people’s demand for health and education services.

The WBG will maximize impact of its intervention using the accumulated experience and lessons of the long term engagement in infrastructure.

Applying the selectivity filters, the WBG program will contribute to: i) improving access to utilities and local and community infrastructure through community-driven infrastructure investments in the poor communities, ii) expanding coverage and accessibility of water and sanitation services, iii) improving management of solid waste in Greater Baku Area and the development of a National Solid Waste Management Strategy, and iv) developing institutional capacity of the state companies in charge of water and sanitation, as key element of strengthening governance and ensuring sustainability of investments into the sectors. In particular, to address regional disparities, the program will continue improve water supply and sanitation in rayons with a relatively higher level of poverty incidence, for example in the south (e.g. Masally, Lerik, Yardimly) and in the north (e.g. Siyazan, Shabran) of Azerbaijan. Through infrastructure investments in poor communities, program will help improve connectivity which eventually would connect people to markets, health and education facilities, and markets to markets.

IFC will explore PPP and investment opportunities in areas such as solid waste and power distribution, and will be open to provide advisory services on loss reduction and investment optimization to state utilities in the energy sector.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|---|--|
| <p><i>Indicator 1:</i> Increased number of households in WBG program areas receiving potable water and sanitation services</p> <p>Baseline: 40000 (2014) Target: 60000 (2017)</p> <p><i>Indicator 2:</i> Number of rayons in WBG program areas with adequate Operational and Maintenance (O&M) capacity</p> | <p><i>Milestone 1:</i> Water supply and sanitation services system commissioned in 12 rayons in project areas (2018)</p> <p><i>Milestone 2:</i> O&M personnel in water and sewerage project areas trained and maintenance equipment in place (2018)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • National Water Supply and Sanitation Project (NWSSP) AF (2016) • Potential IFC PPP transaction advisory • Potential IFC investments in solid waste and power distribution <p><i>On-going</i></p> <ul style="list-style-type: none"> • NWSSP • Second NWSSP • Solid Waste Management Project • AzRIP II |

| | | |
|--|---|---|
| <p>Baseline: 5 (2014) Target: 12 (2017)</p> <p><i>Indicator 3:</i> Waste management in Greater Baku (landfilling and recycling) in line with EU waste management and landfilling directives</p> <p>Baseline: Not in line with EU directives (2015)</p> <p>Target: Fully in line with EU directives (2020)</p> <p><i>Indicator 4:</i> Improved access to key facilities as measured by reduced time spent by beneficiaries in supported communities to reach the market, hospital, school, safe water source, etc.</p> <p>Baseline: 15% on average (2014) Target: 48% on average (2018)</p> | <p><i>Milestone 3:</i> Industrial and municipal waste disposal capacity created under the project (2017)</p> <p><i>Milestone 4:</i> Gas and leachate collection systems are operational at Balakhani landfill (2017)</p> <p><i>Milestone 5:</i> National Solid Waste Management Strategy and Legal framework are prepared and implementation started (2018)</p> <p><i>Milestone 6:</i> 1,270 community micro-projects completed successfully (2018)</p> | <ul style="list-style-type: none"> • South Caucasus Poverty TA • IFC Central Asia and South Caucasus Energy Infrastructure advisory program |
|--|---|---|

Objective 1.4: Contribute to improved quality of environmental assets

Intervention logic: SCD defines the legacy pollution and governance gaps in environmental management as exposing the poorest - especially those who reside close to oil fields, abandoned industrial sites and rural areas- to health risks. Land and water contamination and lack of a time bound strategy to promote environmental sustainability also limits opportunities for sustainable economic activities and entrepreneurship. Government pursues the following goals: (i) to clean-up the polluted areas of the Absheron peninsula, including lakes and contaminated areas around Sumgayit; (ii) achieve zero routine flaring by 2030; and (iii) address gaps in waste management and clean-up oil spills along the transport routes.

The WBG supports the Government’s efforts in reducing gas flaring in partnership with government and oil companies operating in the country. Given its global knowledge and expertise, the WBG will contribute to the Government’s ongoing Absheron Lake Clean-Up Program aimed at mitigating the adverse impact on health and economic opportunities. IFC engagement in this area can potentially be on developing opportunities in renewable energy – wind and solar in particular.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|--|--|
| <p><i>Indicator 1:</i> Improved quality of water in selected lakes (monitored by measuring fixed parameters) as measured by ha of cleaned soil Baseline: 0 (2020) Target: TBD under the project during its preparation</p> <p><i>Indicator 2:</i> Reduced number of people exposed to pollution hazards caused by industrial and domestic contamination of Absheron lakes and their surroundings</p> <p>Baseline: Will be established during project preparation Target: TBD under the project during its preparation <i>(Note: The CPF Program & Learning Review will have available the specific baseline and target)</i></p> | <p><i>Milestone 1:</i> Lake Clean-up Program under implementation (2017)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • Lake Clean-up Investment Program • Potential IFC ECA Resource Efficiency advisory program <p><i>On-going</i></p> <ul style="list-style-type: none"> • TA/AAA on development of phased investment program • GGFR Phase 4 • IFC Central Asia and South Caucasus Energy Infrastructure advisory program |

Focus Area 2: Economic Competitiveness

The Government seeks to open space for private sector to lead the growth of the non-oil economy and increase productivity. Roles of the public and private sectors need to be rebalanced so that the former facilitates economic competitiveness through strengthened governance, developed infrastructure and market institutions while the latter plays a stronger role in job creation, productivity growth and income generation. Bringing the private sector to the center stage as the main driver of growth is defined by the SCD as essential for accelerating and sustaining progress on the twin goals. To achieve this, the SCD identifies the need to reduce regulatory burden on businesses, enhance financial inclusion, and support trade facilitation, including through improved connectivity for producers to reach out to local and international markets in a faster and cheaper way.

The WBG will maximize impact of its intervention using the accumulated experience of the long term engagement in infrastructure as well as on selective basis continue to address business regulatory and financial sector constraints subject to the Government’s commitment to reform in these areas.

Applying the selectivity filters, the WBG program will help: i) ensure smooth connectivity within the country and strengthening international links, through investing in roads, railways and potentially ICT broadband, ii) strengthen financial sector to support the private sector in general and SMEs in particular in order to stimulate employment generation, inclusion and diversification, iii) reduce regulatory burden for SMEs

with focus on identified regulatory constraints related to tax and customs administration, business inspections and permits, insolvency resolution, etc., and iv) upgrade agriculture and agro processing which is critical for food security, jobs and enhanced export potential of the country.

The WBG will contribute to strengthening the country’s economic competitiveness and diversification agenda based on the comparative advantages of IBRD and IFC.

Objective 2.1: Contribute to the development of the main transport network for enhanced international and domestic connectivity

Intervention logic: The SCD highlights the need for improved connectivity as fundamental for Azerbaijan’s transformation into a diversified economy with significant value addition of a modern non-oil sector. The main transport corridors are important routes for producers to reach out to both local and international markets in a faster and cheaper way while development of local roads is critical for increased access to markets for producers in rural areas, where majority of Bottom-40 reside.

With the support of development partners (ADB, EBRD, KfW, JICA), the country has considerably invested in the development of road infrastructure, mainly highways and international transport corridors and intends to complete this agenda with their participation in the medium term. It also wants to ensure sustainability of the high volume investments by establishing a proper maintenance systems to be expectedly led by the WBG. In the meantime, the Government committed to improve the network of regional and local roads as part of its regional development program and as falling under the mandate of the local executive authorities.

The WBG, based on its long term productive engagement, will support the Government develop the core network of transport infrastructure of railways and highways as a backbone of the country’s connectivity in order to (i) link Azerbaijan to regional and global markets, and (ii) serve as a platform for turning the country into a key logistics hub between the East and West. Development of proper maintenance systems for the transport corridors will be at the core of the WBG new interventions.

The Government, under increasing fiscal pressures, is also contemplating to leverage public-private infrastructure finance mechanisms. They would potentially include PPPs and outsourcing through performance-based contracts. IFC will explore opportunities to support this agenda through the transaction advisory, financing of pilot PPP projects and creditworthy SOEs, and advice on development of the regulatory framework for PPPs. IFC will be also interested to support critical private infrastructure projects, including in the oil and gas sector and telecommunications through debt and equity finance. Specific results indicators will be added during the CPF mid-term review if any of these opportunities materialize.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|--|---|
| <p><i>Indicator 1:</i> Road user costs on M4 Baku-Shamakhi and M3 Alat-Yenikend highways reduced Baseline: 100% (2014) Target: 90% (2020)</p> | <p><i>Milestone 1:</i> 75 km upgraded for M4 Baku – Shamakhi highway (2017) and 45 km upgraded for M3 Alat-Yenikend highway (2017)</p> <p><i>Milestone 2:</i> Modern road maintenance system established in one-two selected highways corridors (2018)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • Highway III AF (2016) • Highway IV (2017) • Transport Connectivity TA • Potential IFC PPP transaction advisory • Potential IFC investments <p><i>On-going</i></p> |

| | | |
|---|---|---|
| <p><i>Indicator 2:</i> Train E-W transit time reduced Baseline: 23 hrs (2014) Target: 12 hrs (2018)</p> | <p><i>Milestone 3:</i> Modern axle load control system implemented on the key road network (2018)</p> <p><i>Milestone 4:</i> Rail infrastructure at E-W fully rehabilitated, including signaling, power supply and track (2018)</p> <p><i>Milestone 5:</i> Computerized IFRS accounting system of Railways fully operational (2016)</p> <p><i>Milestone 6:</i> Business Plan on ADY operations developed, approved and under implementation (2017)</p> <p><i>Milestone 7:</i> At least one pilot PPP project reached financial closure in line with recognized international practices (2018)</p> | <ul style="list-style-type: none"> • Highway II • Highway III • Rail, Trade and Transport Facilitation Project with AF • IFC Central Asia and South Caucasus Energy Infrastructure Advisory program |
| <p>Objective 2.2: Support enhanced access to finance for MSMEs</p> | | |
| <p>Intervention logic: The Government’s goal is to facilitate growth of the private sector, especially MSMEs as part of a strategy to reduce an overreliance on public sector as a driver of growth. In this regard, the government places high importance on channeling resources through the financial intermediaries to eligible MSMEs in the short run. In medium to long run, the aim of the government is to increase the soundness of the entire financial system to increase availability of finance to boost investment.</p> <p>The WBG will continue its efforts to improve financial inclusion for MSMEs and Bottom-40 through: (i) its work on legal and regulatory framework for financial literacy and consumer protection, financial markets regulation, supervision and resolution, financial market infrastructure, capital and long term finance markets, including mortgage/affordable housing finance, (ii) expanding access to finance for MSMEs, (iii) building capacity within the banking sector to better manage risks and improve corporate governance, and (iv) developing financial institutions and products, enhancing efficiency and building capacity of financial institutions and AzerPost in financial services delivery, including longer term finance and other new financial products for MSMEs.</p> | | |

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|--|---|
| <p><i>Indicator 1:</i> Increased number of loans to MSMEs through the IFC client banks</p> <p>Baseline: 317,000 (2013) Target: 600,000 (2018)</p> <p><i>Indicator 2:</i> Number of security interest notices created in the registry</p> <p>Baseline: 0 (2014) Target: 5000 (2020)</p> <p><i>Indicator 3:</i> Increased number of rebranded AzerPost points to facilitate access to financial services in rural areas</p> <p>Baseline: 5 rebranded access points (2014) Target: 150 rebranded access points (2020)</p> | <p><i>Milestone 1:</i> New private credit bureau is operational in line with the international practices (2017)</p> <p><i>Milestone 2:</i> New legislation on secured transactions enacted (2017)</p> <p><i>Milestone 3:</i> On-line registry of security interests in movable assets established (2017)</p> <p><i>Milestone 4:</i> CBAR regulations for responsible lending and information disclosure issued (2017)</p> <p><i>Milestones 5:</i> AzerPost pilot rebranding program under implementation with a new marketing strategy for financial services delivery approved (2018)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • AzerPost Reform Project (FY2016-2017) • FSAP Follow- up TA (2016-2019) • Financial Inclusion and Stability TA (SECO) (2016-2020) • Potential IFC Mobile Banking advisory program • IFC debt and equity investments in the financial sector • IFC trade finance guarantees <p><i>On-going</i></p> <ul style="list-style-type: none"> • Consumer protection and Financial literacy TF • FSAP • Financial Sector Modernization TF (AzerPost and Capital Markets Modernization TA) • Mortgage financing TA/EFO • AML TA/EFO • IFC outstanding investment projects with 9 financial intermediaries • IFC ECA SME Banking advisory program • IFC Azerbaijan and Central Asia Financial Markets Infrastructure advisory project • IFC ECA Corporate Governance Program |
| <p>Objective 2.3: Contribute to reduced regulatory burden for SMEs</p> | | |
| <p>Intervention logic: The Government aspires to create an environment conducive for the private sector development as measured by gains in the Doing Business scorecard and World Competitiveness Index. The most problematic areas as per the Doing Business rating include Dealing with Construction Permits, Getting Electricity and Trading across Borders. Some of the broader underlining constraints behind these poor ratings include (i) excessive burden of business regulations (e.g., permits, inspections, tax administration), and (ii) low transparency of import-export customs operations. SMEs face an uneven burden of these distortions vis a vis SOEs and large conglomerates. Therefore, the WBG interventions in this area will target SMEs.</p> | | |

The WBG program will aim to address some of the above constraints through the ongoing IFC’s advisory support and IBRD investment operations. IFC will continue efforts aimed at (i) the streamlining business inspections and issuance of business permits (e.g., introduction of e-services and roll-out risk based inspections), and (ii) simplification of tax policies and administration procedures. These efforts will be complemented by the ongoing IBRD Judicial Services and Smart Infrastructure Project which helps improve access, transparency and efficiency of delivery of selected justice services including for businesses. Should the opportunity arise, the WBG will be open to help the government address other problematic areas of the regulatory environment, including ongoing efforts to improve customs procedures through the digitalization of trade processes.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|--|---|--|
| <p><i>Indicator 1:</i> Simplified process of business permits issuance as measured by the decreased number of days to receive construction permits and get access to electricity</p> <p><i>Constriction permits</i> Baseline: 151 day (Doing Business, 2015) Target: 115 days or less, 25% less (Doing Business, 2019)</p> <p><i>Getting electricity</i> Baseline: 164 days (Doing Business, 2015) Target: 125 days or less, 25% less (Doing Business, 2019)</p> <p><i>Indicator 2:</i> Compliance cost savings from reduced administrative and compliance burden of business inspections Baseline: USD 0 million (2015) Target: USD 30 million (2018)</p> | <p><i>Milestone 1:</i> New Law on permits approved and enacted (2016)</p> <p><i>Milestone 2:</i> An Action Plan for reducing SMEs’ administrative and compliance burden of business inspections in place (2017)</p> <p><i>Milestone 3:</i> Risk based approach for inspections is rolled out which would reduce the frequency of inspections for businesses with low risk</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • Potential Doing Business Reform Advisory (2016-2017) • Potential IFC regulatory reform advisory project <p><i>On-going</i></p> <ul style="list-style-type: none"> • Judicial Services and Smart Infrastructure Project • IFC Azerbaijan Investment Climate Advisory (Phase II) • IFC ECA Corporate Governance advisory program |

Objective 2.4: Support enhanced competitiveness of agriculture and rural development

Intervention logic: The government recognizes agriculture sector’s high potential for boosting non-oil growth, ensuring food security and providing jobs and income opportunities for about 40 percent of the country’s population who live in rural areas. The national Strategy for Agriculture Development outlines the main directions for unleashing this potential. The SCD also prioritizes agriculture and agribusinesses as a means to stimulate rural incomes and consumption growth and, thereby, boost shared prosperity. There is a need to fill in gaps in irrigation, introduce new technologies, improve access to finance and essential logistics, as well as develop a quality infrastructure to enhance the export potential of agricultural produce. To complete the circuit, the government continues to work on protection of land property rights through expansion of the cadaster system and increased efficiency of services.

The WBG will continue to contribute to the sector development by focusing on selected value chains, expanding access to investment financing, and strengthening animal health and phytosanitary services as key elements of the quality infrastructure. With other development partners (KfW), the WBG will help improve the system of property rights registration. To enable better access to markets and more productive use of assets by rural population, the WBG program will also contribute to the development of auxiliary infrastructure, such as local roads, irrigation systems, storage facilities and extension services.

| CPF Objective Indicators | Supplementary Progress Indicators | WBG Program |
|---|--|--|
| <p><i>Indicator 1:</i> Increase in marketed output of the targeted value chains and agribusinesses</p> <p>Baseline: N/A Target: 20% increase in 60% of the targeted value chains and agro businesses</p> <p><i>Indicator 2:</i> Increase in number of irrigations according to crop water norms in the rehabilitated irrigation systems</p> <p>Baseline: Typically two irrigations per farmer Target: At least four irrigations applied by 80% of water users in rehabilitated schemes</p> <p><i>Indicator 3:</i> Number of rural poor, including women, benefiting the WBG program supported economic activities at community level</p> <p>Baseline: 0 (2014) Target: 250000, including 50%women (2018)</p> <p><i>Indicator 4:</i> Coverage of the digital cadaster map to allow more citizens and businesses benefit from online services increased</p> <p>Baseline: 1.5 mln ha (2015) Target: 3.5 mln ha(2020)</p> | <p><i>Milestone 1:</i> Productive partnerships established as planned, 30 agribusinesses received investment financing (2017)</p> <p><i>Milestone 2:</i> Rehabilitation works on project irrigation schemes completed (2019)</p> <p><i>Milestone 3:</i> Implementation of community livelihood micro projects underway (2017)</p> <p><i>Milestone 4:</i> Technical works for expanding coverage and quality of data completed. (area covered by digital cadaster maps)</p> | <p><i>New</i></p> <ul style="list-style-type: none"> • Real Estate Registration repeater project (2016-17) • IFC Business Taxation and Agriculture Competitiveness Advisory project <p><i>On-going</i></p> <ul style="list-style-type: none"> •ACIP •Real Estate Registration Project •AzRIP II •WUAP •IFC Agri Insurance and Agri Finance Advisory project |

| | | |
|---|---|--|
| <p><i>Indicator 5:</i> Increase in number of agribusinesses – borrowers of investment financing in ACIP participating banks Baseline: 0 (as of end of 2014) Target: 100 more agribusiness received investment lending (2018)</p> | <p><i>Milestone 5:</i> Implementation of capacity building program in appraisal of agribusiness investment proposals underway (2018)</p> | |
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ANNEX 2. CPS Completion and Learning Report

| | |
|---|----------------------------|
| CPS Board Discussion: | October 21, 2010 |
| CPS Progress Report (Board Presentation): | May 28, 2013 |
| Period Covered by CPS Completion and Learning Review: | July 1, 2010-June 30, 2014 |

1. SUMMARY OF KEY FINDINGS

1. ***The FY11-14 CPS was prepared in the aftermath of the global economic and financial crisis, which Azerbaijan weathered relatively well.*** The objectives of the CPS were to: (i) build a competitive non-oil economy; and (ii) strengthen social and municipal services. In addition, the CPS included a cross-cutting filter on strengthening governance and institutions. The Government's development program, which provided the strategic underpinning of the CPS, was anchored in the *State Program on Poverty Reduction and Sustainable Development 2006-2015* and in the *Azerbaijan 2020: Vision for Future (Vision 2020)*, adopted at the end of 2012. The objectives of the State Program included macroeconomic stability, improved quality and access to basic health and education services, improved infrastructure, and a strengthened social protection system (see Annex 5). *Vision 2020* confirmed these objectives, and put increased emphasis on economic diversification as a means to achieve sustainable social outcomes and economic growth, as well as on governance, as it relates to transparency and public service delivery.

2. ***The CPS Development Outcome is rated Satisfactory.***¹⁶ The World Bank Group (WBG) delivered a program of support to Azerbaijan's development strategy through a financing envelope of US\$807 million¹⁷ from IBRD (US\$721 million) and IDA (US\$86 million),¹⁸ above the envisaged CPS envelope, which ranged from US\$612 million to US\$762 million. IFC invested about US\$100 million from its own account, including trade finance of US\$40 million.¹⁹ IFC's lower than expected investment program is explained by the fact that envisaged investment opportunities in the real sectors did not materialize. This is mainly due to remaining corporate governance issues and inadequate level of transparency of private companies in the real sector, as well as limited progress in engaging with the government on PPPs and sub-national finance. The WBG program supported reforms and activities which led, inter alia, to improvements in the business enabling environment, expanded and faster access to services in rural areas, lower transportation costs, improved livelihoods, and reforms in public investment management. More broadly, the WBG supported Azerbaijan in building a base for economic diversification and improved quality of non-oil growth. Although non-oil sector growth was strong in the years previous to the CPS period, overall growth was largely driven by oil. During this period, the share of oil sector in GDP steadily increased, along with the economy's dependence on oil (see Annex 4). In 2014, on the other hand, the share of non-oil sector to GDP reached 60 percent (vs. an average of 53 percent between 2002 and 2010), and GDP growth has been driven by the non-oil sector since 2010, albeit financed by oil-funded public capital investments. The WBG

¹⁶ Both CPS objective were Mostly Achieved. Out of 11 CPS outcomes, eight (73 percent of the total) were Achieved or Mostly Achieved, one was Partially Achieved, and two were Not Verified, although good progress was made under their respective indicators. Of the 30 primary indicators, 9 were surpassed, 12 were achieved or mostly achieved, four were partially achieved, 3 were not verified, one is on track based on a revised baseline and target as a result of AF, and one was not achieved.

¹⁷ Formally, only one project (ACIP) was approved in FY14. However, three more projects were ready to be delivered in FY14, but a decision was made to postpone them to early July 2015. With the inclusion of these projects, the CPS envelope amounts to \$807 million, of which \$721 from IBRD and \$86 million from IDA.

¹⁸ Azerbaijan graduated from IDA in 2011.

¹⁹ MIGA did not have an active program.

contributions in the area of economic diversification and non-oil growth came from multiple fronts, including AAA and lending in infrastructure and connectivity, agriculture and irrigation, health and education, as well as strengthening institutions in public finance management (Corporate and Public Sector Accountability Project, Public Investment Capacity Building Project), in the financial sector (Capital Markets Modernization Project and Financial Sector advisory), property rights (Real Estate Registration Project) and judiciary (Judicial Modernization Project). Although not an explicit objective of the CPS, poverty rates in Azerbaijan saw a remarkable improvement during the CPS period, decreasing from 9.1 percent in 2010 to 5.3 percent in 2013.

3. ***Performance of the WBG in designing and supporting the implementation of the CPS Program is rated Good.*** The assessment is based on several factors, including: (i) high relevance of the CPS objectives to the country's development priorities; (ii) flexibility in the engagement with the client; (iii) effective implementation of the program, resulting in improved performance; (iv) good use of lending instruments, and a strong AAA program; and (v) Improved M&E framework of the CPS and portfolio.

2. CPS DEVELOPMENT OUTCOME

4. ***The CPS Development Outcome is rated Satisfactory.*** The Program revolved around two strategic objectives, four results areas, and eleven outcomes. Both CPS Objectives are assessed as having been Mostly Achieved, with important development impacts in specific areas, including the expansion of the Targeted Social Assistance (TSA), which has had a significant contribution to poverty reduction, and access to services in rural areas, resulting in remarkable improvements in beneficiaries' livelihoods.

(I) First Strategic Objective: Building a Competitive Non-Oil Economy.

5. ***The first objective is rated Mostly Achieved.*** The government has made significant strategic progress on diversification, away from reliance on oil. Macro data show positive initial signs with a strong non-oil GDP growth that averaged over 9 percent per year from 2010 to 2013, an expansion of non-oil GDP in overall GDP from 48 percent to 56 percent in the same period, and double-digit growth in construction, hotel and restaurant, and information and communication industries. The *Vision 2020* strategy, which provides a clear line of sight to a new development model based on asset diversification, was informed by a significant body of WBG analytical and advisory services. In addition, the WBG contributed to improvements in the business environment; increased access to finance to businesses and individuals, and improved corporate governance practices. Transparency and efficiency of public institutions also improved, although reform implementation, especially in public investment management, is still ongoing.

Results Area 1: Enhancing Macro-Economic Stability and Growth Policies.

6. ***The two outcomes under the first Results Area were Achieved and Mostly Achieved, respectively.*** IBRD supported these outcomes through the Capital Markets Modernization Project, the Public Investment Capacity Building Project (PICBP), the Real Estate Registration Project, the Corporate and Public Sector Accountability Project (CAPSAP), the Judicial Modernization Project, and a robust advisory program, consisting of a Country Economic Memorandum (CEM) on export-led diversification, two High Level Policy Forums on economic diversification, an

Economic Diversification and Growth Technical Assistance (TA), a Programmatic Public Expenditure Review (PPER), a Public Expenditure and Financial Accountability Assessment (PEFA), a Trust Fund on Supreme Audit Institution Development, a study on Fostering Entrepreneurship in Azerbaijan, and the Development of Supervision Framework for Operational TA. IFC advisory work included a Business Enabling Environment project, a follow-up Investment Climate project, a Europe and Central Asia (ECA) Governance project, and advice on Doing Business reforms. IFC also introduced a new dimension of asset management in its cooperation with the Government, by mobilizing US\$350 million from the State Oil Fund of Azerbaijan for IFC Asset Management Company Funds.

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| <i>Results Area 1: Outcome 1</i> | <i>Status</i> |
| Improved Investment Climate and Institutions | Achieved |

7. ***The IFC program was effective at supporting improvements in the business-enabling environment and in delivering a multi-faceted program of support in this area. The engagement was designed with careful phasing of projects and their areas of focus in a building-block approach.*** The IFC Business Enabling Environment Project and IFC Investment Climate Project aimed to eliminate discretionary regulatory practices and to simplify business regulations in order to reduce the cost of doing business and informality, and ultimately foster SME sector development. One-stop-shop and on-line business registration system became fully operational under the first project. Implementation of the regulatory reforms launched during the first project was supported by the second project, which also prioritized two new areas: (i) transfer pricing and exchange of tax information mechanisms, and (ii) regulatory reforms for agribusiness. While activities in these newer areas provide the base for future reforms, significant progress has been achieved with regard to inspections reform. One of the major achievements is the new *Business Inspections Law*, which was adopted in 2013 and became effective in 2014. The law and supporting regulation, policies and procedures, as well as IT-solutions for inspections were developed by the project. This law includes essential provisions for increased transparency and accountability of inspections, such as the introduction of inspection check lists; a requirement to upload the inspection results to the e-registry of inspections; a requirement to register every inspection in the e-registry and present an extract from e-registry to an entrepreneur, to prevent illegal inspections and make the system more predictable; and introduction of a risk-based approach to reduce the frequency of inspections for businesses regarded as low risk. At the same time, the law affects financial sector regulation, specifically the supervisory functions of the Central Bank of Azerbaijan (CBA). This aspect is being addressed as part of the Financial Sector Advisory Program conducted jointly by IBRD and the IMF.

8. ***Important progress was made towards decreasing the incidence of discretionary regulatory payments.*** IFC's Business Inspection Survey shows that incidence of unofficial payments during inspections went down from 47 percent in 2008 to 20 percent in 2012. The declining trend is supported by the WBG Enterprise Survey (BEEPS) which indicates that the percentage of firms recognizing unofficial payments to tax inspectors declined from 31 percent in 2009 to 11.7 percent in 2013. The cost of registering business also continued to decline. As a result of reforms supported by two sequenced IFC advisory projects, the cost of business registration decreased from an estimated US\$340 per business in 2008 to US\$65 in 2014. The annual direct compliance cost savings from business registration reforms is estimated by IFC to be about US\$15 million. Although the total number of inspections per business per year remained almost unchanged from 2008 to 2012 (11 and 12, respectively), these indicators are expected to improve

now that the Business Inspections Law is effective. A decrease in the number of visits by tax officials per year from 3.2 in 2009 to 1.7 in 2013 suggests that progress is on the right track.

9. ***In spite of relatively small investment volumes, a combination of IFC investments and advisory services resulted in more than three times as many loans to MSMEs than targeted under the CPS.*** During the CPS, IFC worked with leading private banks and microfinance institutions (MFIs) to improve their business models while building capacity within the sector to increase lending to underserved firms in terms of access to finance for MSMEs, including those in rural areas. During FY11-FY14, IFC invested about US\$100 million from its own account, including about US\$40 million of trade finance, in the financial sector. Approximately 90 percent of debt and equity investments, as well as trade finance lines, had a MSME focus. In spite of relatively modest investment volumes, IFC's client banks and microfinance organizations significantly expanded on-lending to MSMEs, so that the total number of outstanding MSME loans in their portfolio more than tripled in the course of the CPS, reaching 317,000 MSMEs at the end of 2013, from a baseline of 57,000 and a target of 85,000. Significant contribution to this success can be attributed to the IFC advisory engagements which prioritized support for (i) helping MFIs build sustainable business models, (ii) improving risk management practices within the banking sector, (iii) promoting new financial products for SMEs, and (iv) strengthening financial market infrastructure. The *IFC Transformation of Microfinance Institutions project* strengthened risk management capacity and governance of one of the leading MFIs in the country, and supported its successful transformation into a commercial entity. It was the first successful MFI transformation example in Azerbaijan which helped to test the regulatory framework and had a significant demonstration effect in the microfinance industry. *IFC SME Banking Services project* helped one of the leading microfinance players build sustainable and profitable SME banking business, and ultimately facilitated access to finance for underserved MSMEs. An Access to Finance note and a Fostering Entrepreneurship Study led by IBRD provided insights on financial sector development challenges and constraints, especially with regard to MSMEs growth, and contributed to accelerated reforms toward the creation of credit bureau and secured transactions legislation to facilitate access to finance for MSMEs, and in an increased appetite for private sector reforms, as reflected in the April 2014 Presidential Decree on Entrepreneurship and Private sector development. The *IFC Banking Crisis Management Project* aimed to build capacity of risk and NPLs management within the banking sector by working with three client banks. The project helped these banks mitigate the effects of the economic crisis and successfully recover. Post implementation, their lending on average increased by about 30 percent, compared to a static growth in the sector, indicating management comfort that poor decisions will not be repeated. The banks now have appropriate early warning systems to identify upcoming risks and the tools to withstand future economic turmoil. The ongoing *IFC Financial Market Infrastructure project* aims to improve the financial infrastructure and regulatory environment related to credit bureaus, movable collateral registries, and secured transactions. While private credit bureaus are yet to be established, good progress has been archived on putting the regulatory framework in place. The coverage of the public credit registry also increased from 7 to 23 percent, while the price of the report of the credit registry declined by 50 percent. In parallel, the ongoing IBRD Capital Markets Modernization Project initiated fundamental reforms of the securities markets. It supported the development of a new draft legal and regulatory framework leading to relicensing of market participants, increased transparency and price discovery, strengthened securities markets infrastructure the settlement, clearance, and depository of securities.

10. ***Support from the IBRD Real Estate Registration Project led to enhanced efficiency gains in the real estate sector.*** Part of a broader effort, supported under the Project, to develop a transparent and efficient real estate registration system, the average number of days to register property purchase or sale transactions decreased from 30 to 12, exceeding the second Primary Indicator of 15 days. Under Primary Indicator 4, the number of transactions registered at the Service for Registration of Real Estate in 2014 reached 256,357, exceeding the target and against a baseline of 87,461. In addition, about 1.3 million ha of digital cadastral map have been produced, the State Committee for Property Issues²⁰ now offers 18 e-services to the public and, since March 2014, new online services to notaries have been introduced nationwide. Almost 75 percent of customers declare being satisfied with the registration services, against a baseline of 50 percent.

11. ***Though not a formal CPS indicator, improvements in corporate governance were effectively supported by the IFC Corporate Governance project.*** The aim of this support was to help corporate banks and corporates improve performance and gain easier access to capital, as well as improve overall transparency of the corporate sector. This was tackled via a number of interventions. At the firm level, these included corporate governance assessments, implementation support, consultations and trainings. Consequently, ten investors and banks introduced corporate governance screening of their clients in the investment decision process, encouraging smaller firms to adopt good practices. Most of the clients reported reduced cost of capital, improved loan terms and higher valuations as a result of demonstrated improved transparency of operations and clearer corporate roles. Private sector clients of the Project reported that improvements in corporate governance practices helped them mobilize financing from third parties in the amount of US\$138 million. At the policy level, the Project helped implementation of reforms that strengthened the legal environment for corporate governance, including the introduction of the Corporate Governance Code. The code introduced important provisions which help assure better investor protection, including on internal controls and risk management, improved operation of the board and shareholders protection. IFC remains engaged in this area through its *ECA Regional Corporate Governance Platform*.

Results Area 1: Outcome 2
**More Transparency and Efficiency in
 Public Institutions**

Status
 Mostly Achieved

12. ***Transparency and efficiency of public institutions has improved.*** Under Primary Indicator 1, specific data on the percentage of projects which complete economic appraisal is not available. However, the approval, in 2010, of new Regulations on Preparation, Implementation and Monitoring of Public Investment Projects and their adoption by the Ministry of Economy and Industry since 2011, represents a significant step. Approval of these rules set a framework for all major public investment projects to be justified based on economic and efficiency considerations. PICBP supported the Ministry of Economy and Industry in the application of the new rules to further improve the public investment management, including (i) assessment of the existing regulatory framework and recommendations to improve quality and efficiency of the PIM system,

²⁰ The SCPI is composed of the Service for Registration of Real Estate (SRRE), the Real Estate Cadastre and Technical Information Centre (RECTIC), the Information technology and Data Management Centre (ITDMC) and SCPI Apparatus. The SSRRE is a service within the SCPI responsible for registration of property rights.

(ii) preparation of detailed instructions on the application of economic analysis for the assessment of public investment projects, and (iii) capacity building of the respective Government agencies.

13. ***The WBG program contributed to important steps towards increased transparency and governance in the public sector, which complemented IFC's efforts in the banking and corporate sectors.*** With support from the Corporate and Public Sector Accountability Project (CAPSAP), the number of key budget organizations and higher education institutions using unified accounting and financial reporting systems increased from 0 to 59 at the end of 2014, exceeding the target of 25. As envisaged by the program, the number of SOEs adopting International Financial Reporting Standards (IFRS) increased from two to five, including three large SOEs, namely, Azerenerji, Azersu and Azerbaijan Railways (ADY).

14. ***Positive corporate and public sector governance changes happened on the backdrop of a comprehensive judicial system modernization effort which resulted in enhanced transparency and improved access to information.*** The Judicial Modernization Project (JMP) pioneered the concept of user-oriented 'smart courts' for more accessible and transparent judicial service delivery, and Legal Information Centers were piloted, providing free legal aid to about 4,300 users and enabling the Ministry of Justice to test cost-effective approaches to legal aid for the vulnerable. More than 70 percent of judges in first instance courts were recruited through competitive and transparent procedures, with results accessible to the public in real time. The court network was expanded and an independent body, the Judicial Legal Council, was empowered to manage the judiciary, handle judicial discipline, and strengthen judicial independence. A 'hot line' to the Council to report judicial corruption is now functional. A 2014 judicial perception survey, conducted as part of the JMP, shows significant improvements on several dimensions of the court and judicial system, including courts conditions and accessibility, and quality and accessibility of government-paid legal services. The responses from the surveyed users about various aspects of the court system all exceed the targeted 5 percentage improvement under Primary Indicator 4.

Results Area 2: Upgrading Key Growth Supporting Infrastructure.

15. ***The two outcomes under the second Results Area were Partially Achieved and Achieved, respectively.*** The IBRD support consisted of the Highway II (plus two AFs) and Highway III projects; the Rail, Trade and Transport Facilitation Project (including one AF); the Agricultural Development and Credit Project (ADCP) II, the Agricultural Competitiveness Improvement Project (ACIP); the Water Users Association Project (WUAP); the Azerbaijan Rural Investment Project (AzRIP) I and II; the IDP Economic Development Support Project (EDSP); and the ongoing IDP Living Standards and Livelihoods (L&L) project. The AAA program comprised a study on Improving the Sustainability of Road Management and Financing, an Institutional Development Fund (IDF) grant on Quality Management in the Road Sector Projects, and an Agriculture Sector Note.

| <i>Results Area 2: Outcome 1</i> | <i>Status</i> |
|---|--------------------|
| Transport vehicle operating costs reduced, road safety improved and rail transit traffic increased | Partially Achieved |

16. ***IBRD support for the transport sector resulted in reduced vehicle operating costs, and improved road safety. However, rail transit traffic did not increase as originally anticipated.*** IBRD financed the construction and rehabilitation of 216 km of two-lane highway roads,

connecting the country's strategic destinations in the southern and western directions. Primary Indicator 1, related to reduction in road user costs, was partially met. Road user costs dropped from US\$0.40 per vehicle km to \$0.35 on the M6 Hajiqabul- Bahramtapa road, and to \$0.34 on the R6 Tagiyev-Sahil road, against a target of \$0.32. Transit times under these segments decreased by 17 percent and 75 percent, respectively. Works in the existing M4 Baku-Shamakhi lanes are nearing completion, while construction on two additional lanes is completed but with the lanes not yet open to traffic. In parallel, despite a rapid and drastic increase in the number of motorized vehicles,²¹ road traffic deaths per 10,000 vehicles dropped from 10 to 8.6, corresponding to a 14 percent decrease and surpassing the CPS target of 10 percent under the second primary indicator. The anticipated approval of a Road Safety Strategy, which was prepared under the Highway II project, is expected to have a far-reaching impact on increased awareness and implementation of road safety measures nationwide. IBRD also financed rural roads rehabilitation and small road works in regions with higher relative incidence of poverty and in IDP communities. Under the first AzRIP project, 1.2 million people in 431 communities benefited from approximately 1,300 kilometers of new or reconstructed roads. People in villages targeted under AzRIP save between a quarter and a third of their time going to a primary school, a secondary school, or a clinic. Time taken going to a hospital, a transportation hub, or a marketing point was reduced by half. In villages where roads have been rehabilitated, 78 percent of farm products are brought to markets by farmers themselves, as opposed to 18 percent in non-project areas. Under AzRIP II, 325 Community Projects were completed, of which more than 60 percent financing road rehabilitation. As a result, the time to reach the nearest social infrastructure decreased between 9 percent and 32 percent, while access to and use of rural infrastructure increased by 25 percent. Under the IDP EDSP project, 116 access roads to IDP settlements were built or repaired, resulting in 631 km of rural road surface installed. Beneficiary surveys conducted under the project indicate that some of the main outcomes include improved accessibility to schools and between the community and regional centers; saved time; increased safety; improved agricultural marketing; and reduced car maintenance costs.

17. ***The WBG also made contributions to the policy and institutional development of the Transport sector.*** The findings of the study on Improving the Sustainability of Road Management and Financing were used in the policy dialogue with the Government, and contributed to the preparation of a proposed Regional Roads Development Project. The IDF Grant on Quality Management in the Road Sector Projects supported the Government in developing an implementation action plan to introduce quality management practices into policies and procedures for the road administration. The action plan encompassed introduction of a set of quality principles based on International Organization for Standardization (ISO) standards, the establishment of an organizational framework for quality management, the development of a uniform supervision system for road works, and capacity building activities for Azer Road Services (ARS). The organizational function of ARS for quality management was reviewed and reformed within the Grant activities. The Grant went further by supporting the establishment of a Quality Management Unit within the road administration, and contributed to the development of the legislative framework for establishment of the quality management system, which was non-existent before.

18. ***The WBG support to the railways program was adjusted at mid-course, to reflect the Government's shift to a more strategic approach and a longer-term engagement in the sector. However, the expected results have not yet materialized.*** The Rail Trade and Transport Facilitation (RTTF) Project was originally designed as part of a broader program of transport

²¹ In 2013, the number of motorized vehicles increased by 102,000 or 10 percent, and reached 1.246 million.

sector modernization and, as such, covered a few segments of the country's railways that were assessed to become a critical bottleneck to the system as a whole. In response to the Government's decision to address the railway challenges more comprehensively, the RTTF was restructured through an Additional Financing, to focus on upgrading the whole signaling system and power conversion and on improving the operational efficiency of Azerbaijan Railways. The reduction in the volume of rail transit to 4.3 million tons, against a baseline of 11 million tons and a target of 23 million tons, reflects a few factors: a) ongoing rehabilitation of the entire East-West rail infrastructure, including the tracks, and signaling and power supply systems; b) savings connected to shipping domestic oil via the existing oil pipeline network rather than through the railways, which are likely to become even more important against the overall drop in oil prices and c) volatile regional geopolitical situation resulting in less transit of crude oil via Azerbaijan from Central Asian countries. The downward trend in freight transit is expected to continue until the new infrastructure becomes operational in 2017. On the other hand, the non-oil domestic freight volume has seen a stable increase,²² reflecting an increasing contribution of rail transport to Azerbaijan's non-oil economy.

Results Area 2: Outcome 2
**Increased coverage of agriculture irrigation,
 marketed production and farmers' income**

Status
 Achieved

19. ***WBG support for the agriculture sector resulted in increased agricultural marketed production, higher net income of participating farmers, expanded irrigation and higher agricultural productivity.*** The Agricultural Development and Credit Project (ADCP), the second of two Adaptable Program Loans, supported rural businesses to improve the linkages between their production and markets, and to help farmers improve their productivity. Under the project, the production marketed for cash by farmers increased by 27 percent, almost three times the first Primary Indicator target of 10 percent. The average net income of participating farmers increased by nearly 30 percent from agricultural activities, and by 39.5 percent from all activities, exceeding the second Primary Indicator of 20 percent. ACIP, the ongoing, follow-up operation, aims to further facilitate the access of agricultural producers to markets. In rehabilitated schemes under WUAP, at least four irrigations are now applied by 80 percent of participating farmers in line with crop water norms, meeting Primary Indicator 3. Rehabilitation works were completed in 14 Water Users Associations (WUA) and 9 are ongoing, with early survey data indications that crop water requirements are substantially met, that around 1,200 ha has been returned to full productivity, and overall agricultural productivity in rehabilitated WUAs is around 15 percent higher than in previous years. Under the micro-projects supported under AzRIP, 700,000 people benefitted from rehabilitated irrigation systems. The average agriculture productivity increased by about 30 percent and added more than US\$ 1 million to the value of production in project areas. AzRIP also enhanced the capacity of local stakeholders in micro-project program development and management, including contracting, procurement, financial management, and participatory monitoring and evaluation. Women's empowerment through incubating leadership and participation in decision-making has been a prominent feature of AzRIP's results narrative and a strong gender focus continues under AzRIP II (see Annex 6). The Agriculture Sector Note helped inform the design of ACIP, and its recommendations were considered by the Government for the preparation of the new Agricultural Strategy for Azerbaijan which is, however, still ongoing at the time of the CLR.

²² The volume of non-oil domestic freight was 10.5 million tons in 2014, from 7.5 million tons in 2011.

(II) Second Strategic Objective: Strengthening Social and Municipal Services.

20. *The second CPS objective is rated Mostly Achieved.* Five of the seven outcomes were achieved or mostly achieved. Under these, the program brought about remarkable advancements in the coverage and targeting of Targeted Social Assistance (TSA), and livelihood improvements of rural, IDP, and farming populations, including women. While there was fulfillment of many of the indicators in the CPS results matrix, the choice of indicators was not always optimal. In these cases, a lack of additional data did not allow to adequately assess whether the respective outcomes were met, and these were thus assessed as Not Verified.

Results Area 3: Improving Social Services.

21. *One outcome was Achieved, one was Mostly Achieved, and two were Not Verified.* The WBG support comprised the Pension and Social Assistance Project, the Social Protection Development Project, the Health Sector Reform Project, the Education Sector Development Project, CAPSAP, the IDP Economic Development Support Project (EDSP); and the ongoing IDP Living Standards and Livelihoods (L&L) project. Analytical support was provided through a Health PER.

| <i>Results Area 3: Outcome 1</i> | <i>Status</i> |
|---|-----------------|
| Increased coverage and efficiency of social protection and employment services | Mostly Achieved |

22. *The WBG program supported the introduction and targeting efficiency of the TSA, contributing to remarkable progress on poverty reduction.* The ongoing Social Protection Development Project builds on the previous Pension and Social Assistance project (PSAP), and finances further improvements in the targeting mechanism of TSA. The extent to which the CPS target of increasing the coverage of the poorest segments was achieved will only be available as part of the planned Azerbaijan Monitoring Survey of Social Welfare scheduled for April, 2015. However, significant progress in strengthening the targeting of social protection was achieved under the PSAP. It was under PSAP support, in 2006, that Azerbaijan introduced TSA, which consolidated the state-provided basic pension for the uninsured as well as several child and family benefits, thereby decreasing fragmentation and securing efficiency gains. As a result of this support, 100 percent of TSA beneficiaries receive TSA monthly benefits through an automated system. A TSA centralized database was also established, providing information on the TSA recipients, applicants and resources spent on the program. Support from the project strengthened the poverty focus of social protection thanks to better targeting. With PSAP support, the targeting error for social assistance payments decreased to 31 percent, from a baseline of 50 percent.²³ Social transfers, which include transfers through the TSA program, provide an important source of income for poor households in Azerbaijan. The most recent Household Budget Survey illustrates that pensions and social transfers accounted for 20 percent of poor households' income, as well as for households just above the poverty line. According to World Bank estimates, the national poverty rate in 2012 would have been considerably higher in the absence of transfers, at 25 percent without pensions, and at 30 percent without any social benefits in 2012 (vis-à-vis the observed 6 percent for that year).²⁴

²³ Based on a 2008 survey. More recent data are expected at the time of the Azerbaijan Monitoring Survey of Social Welfare 2015.

²⁴ Source: World Bank staff calculations.

23. ***Employment services benefitted from new training modules and occupational standards.*** Primary Indicator 2 was mostly achieved. With the support of the Social Protection Development Project: (i) 43 modular training programs were developed and are in use, vs. a target of 30; (ii) two sites are functional and the third one is expected to become functional by mid-2015; (iii) 210 occupational standards and 200 training standards were developed and are in use, exceeding the target. Newly designed career counseling and improved employment services have been tested across the country and are being implemented in the Ismayilli employment center. The Ministry of Labor and Social Protection has taken steps to establish a new labor resource function around the Occupational Standards Group, which will be charged with further development of occupational standards. The Ministry has also implemented a new activity on labor market record keeping, in line with the State Labor Inspectorate Service upgrade initiated under the project.

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| <i>Results Area 3: Outcome 2</i> | <i>Status</i> |
| Wider access to health services | Indicators achieved although impact is not verified |

24. ***The CPS Primary Indicators measuring the time to reach health care facilities and hospital rationalizations were achieved.*** Under Primary Indicator 1, the average time to reach Primary Healthcare (PHC) and secondary healthcare facilities was met, at 15 minutes and 45 minutes, respectively. However, because no baseline was set, it is difficult to assess whether and to what extent this indicator has improved. In parallel, under Primary Indicator 2, the health care network was rationalized extensively as a result of the Ministry’s Master Plan implementation. In 65 districts, the number of hospitals was reduced from 413 in 2009 to 214 in 2013, exceeding the target of 220, and that of PHC facilities increased from 543 to 782. Rationalization resulted in a reduction of the number of beds by 36 percent, and in an increase of occupancy rate from 47 percent in 2008 to 60 percent in 2014, in line with the CPS targets. Utilization improved substantially in two pilot districts where the number of outpatient visits to PHC more than doubled, but other districts did not show similar improvements. In parallel, rehabilitated facilities also received training in hospital management and IT, and all health workers were re-trained to provide better quality services, especially in the area of maternal and child health. A critical aspect connected to healthcare access was highlighted in the 2013 Health PER, which noted that Government health spending, at around 1 percent of GDP, remains one of the lowest in the ECA region. This has resulted in high out-of-pocket spending by the population which amounts to nearly 70 percent of household health expenditures and 10 percent of total household spending, suggesting a significant burden on the poor as households in Azerbaijan face much higher risks of impoverishment from out-of-pocket payments for health care than in most other countries in the ECA region. One of the PER’s policy recommendations was to raise government health spending, with appropriate safeguards, to help reduce dependence on out-of-pocket (OOP) spending.²⁵ Other indicators of access were not monitored under the Health Reform Project, and thus a conclusive assessment cannot be made as to whether wider access has been achieved through the WBG-supported program.

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| <i>Results Area 3: Outcome 3</i> | <i>Status</i> |
| Improved quality of basic and higher education | Progress made on indicators but impact is not verified |

²⁵ According to Ministry of Finance data provided as part of its review of the CPS CLR, healthcare spending in the public budget increased from AZN 68.9 million in 2010 to a forecasted AZN 106.1 million in 2014.

25. ***Progress was made under most of the Primary Indicators, but improvements in the quality of basic and higher education could not be adequately measured.*** Primary Indicator 1, related to improved test scores, was dropped as part of a restructuring of the Education Sector Development Project. The project originally envisaged covering the costs for Azerbaijan to participate in the Program for International Student Assessment (PISA) in 2012. However, the government decided to drop this activity given the fact that curriculum reform introduced did not at the time cover 15-year old students. Data from the 2009 PISA test for 15-year olds, indicate that Azerbaijan ranked 64th out of 65 countries in reading, 63rd in science, and 45th in mathematics. The PISA scores on reading and science show that Azerbaijan lags behind countries with similar levels of GDP per capita, and are only internationally competitive in the area of mathematics. Azerbaijan registered for the Trends in International Mathematics and Science Study (TIMSS) 2015 and in the Progress in International Reading Literacy Study (PIRLS) 2016 to test Grade 4 students reading comprehension. Results from these tests are not yet available and may help evaluate more recent reforms. Primary Indicator 2, measuring the proportion of teachers using active methodologies under the new curriculum, saw progress, with 71 percent of teachers reporting the use of mixed methodologies, vs. a baseline of 64 percent and a target of 80 percent.²⁶ The contributions towards institution and capacity building through the project are nonetheless significant, as it helped the government revamp the curriculum from Grade 1-8 with a focus on competency, which in itself was a major endeavor. All teachers are trained and sensitized on the new curriculum, while principals, teachers and parents, are actively engaged in the reform process, as reflected by an attitude survey conducted under the Project. Although considerably more progress is needed, these are good starting points toward building good governance. With respect to higher education, the two Primary Indicators focused on national accounting qualification (NAQ). The first one was surpassed, with 50 students achieving NAQ for budgeting, against a target of 25. Progress is ongoing on the adoption of new accounting and audit textbooks and syllabi, both of which are awaiting approval by the Ministry of Education before they are formally integrated in the academic programs, expected for the 2015-16 academic year. At the policy level, a Strategy for Development of Education was approved at the end of 2013, with the aim to further modernize the Education sector, and to make it a primary element of economic growth and a more knowledge-based economy.

Results Area 3: Outcome 4
Improved living conditions of IDPs

Status
 Achieved

26. ***The WBG, in close partnership with the Government, contributed significantly to improvements in the living standards of Internally Displaced Persons (IDP).*** The Government of Azerbaijan and the World Bank have a long history of partnership in addressing the needs of IDPs in the country. One lasting outcome of this work was the creation, financed by the World Bank, of the Social Fund for the Development of Internally Displaced Persons in 1999. The Fund's objective is to raise the living standards of IDP communities by providing funding for the rehabilitation of small-scale social infrastructure, job creation for IDPs, and income-generating activities. As the partnership moved into its second decade, the Government and the Bank shifted their focus on IDPs' outstanding needs, including the improvement of economic self-reliance. The

²⁶ The percentage figure in 2013 is calculated on a larger teacher base since the new curriculum and related teacher training rolled out beyond the baseline of grades 1-2 to higher grades and, subsequently, the tracking expanded the teacher sample to 1-5 in 2013.

BAPS study served as the basis for the design of the Living Standards and Livelihood Project, which continues ongoing investments in housing and micro-project infrastructure, with an enhanced focus in improving livelihoods for IDPs. Under the project, 200 targeted communities, representing more than 2,200 people, received training and developed business plans. Beneficiaries included about 1,300 youth. Of the 240 youth that have already received training and equipment, 64 percent opened their own small business and 36 percent gained employment typically in the businesses via which they were trained. Sixty percent of participating communities lived in remote rural areas, representing some of the most vulnerable people. Female participation exceeded 70 percent. A 2014 Beneficiary Survey showed that more than 77,800 IDPs gained access to improved infrastructure. Under Primary Indicator 1, the percentage of respondents indicating that micro-projects had achieved their expected results was 12.5 percent in 2009. A 2014 Beneficiary Survey indicates that 95 percent of surveyed beneficiaries rated the services and/or infrastructure as “good”, while the quality of the micro-projects financed under the L&L was rated as “good” by 93 percent of the surveyed beneficiaries. Under Primary Indicator 2, the percentage of female membership in micro-project committees reached 47 percent, close to the target of 50 percent.

Results Area 4: Improved Municipal and Rural Services.

27. ***All the outcomes under the fourth Results Area were Achieved.*** They were supported through the National Water Supply and Sanitation Project I and II, including an AF, the Integrated Solid Waste Management Project, including AF, and the Rural Investment Project (AzRIP) I and II. The analytical program comprised a National Solid Waste Management Performance Improvement and Private Sector Participation Strategy, a Solid Waste Strategy, an Integrated Urban Water Resources Management (IUWRM) Study for the Greater Baku Area, and an Agriculture Sector Note.

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| <i>Results Area 4: Outcome 1</i> | <i>Status</i> |
| More reliable water supply and sanitation | Achieved |

28. ***Availability, reliability and quality of water supply improved in targeted areas.*** Under Primary Indicator 1, with the support of the two National Water Supply and Sanitation Projects, 220,000 people benefitted from access to improved water supply, exceeding the target of 200,000. Of these, 135,000 were women. Under Primary Indicator 2, daily average availability of water improved from 3 to 10 hours.²⁷ Although this was short of the target of 15 hours, the increase, together with a larger than expected number of beneficiaries, represented significant achievements. Quality of water also improved, as reflected in an increase in the percentage of drinking water samples in project areas meeting Azeri water quality standards from 0 in 2012 to 60 percent in 2014.

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| <i>Results Area 4: Outcome 2</i> | <i>Status</i> |
| Improved reliability of solid waste management services | Achieved |

29. ***Solid waste disposal management recorded impressive progress.*** With support from the Integrated Solid Waste Management Project, 527,000 people gained access to waste collection

²⁷ The target of 24 hours under Primary Indicator 1 is a duplication of the CPS results matrix. Water supply availability was thus measured against the target of a 15 hour average.

services, surpassing the Primary Indicator 1 target of 400,000. Under Primary Indicator 2, the closure of 67 percent of informal dump sites, against a target of 60 percent, brought improvements not only in terms of waste management, but likely in terms of safety and health as well, as all cleaned dump sites are located in close proximity to high density urban areas. The investment program benefitted from the IUWRM study, which analyzed conditions and trends in water resources management in the Greater Baku Area, and whose findings and recommendations informed extensively the recent update of the Greater Baku Water and Sanitation Master Plan, and the preparation of the Greater Baku Regional Development Plan. Both activities are supported by the National Water Supply and Sanitation Project.

| | |
|--|---------------|
| <i>Results Area 4: Outcome 3</i> | <i>Status</i> |
| Improved access to rural infrastructure | Achieved |

30. ***Access to Rural Infrastructure exceeded expectations in several areas*** (see also paragraph 16). With respect to Primary Indicator 1, there was strong progress made towards increasing access to rural roads, with the AzRIP II project reaching 800,007 beneficiaries, of which 412,000 women, against a baseline of 523,206. As regards Primary Indicator 2, there was also good progress recorded as the time spent to reach the nearest social infrastructure points has decreased significantly, between 9 percent and 32 percent, depending on the type of infrastructure.

3. WORLD BANK GROUP PERFORMANCE

31. **The World Bank Group’s overall performance is rated *Good*.** The assessment is based, *inter alia*, on: (i) High relevance of the CPS objectives. From the start, the CPS was closely aligned with the national development strategies in place and effective use was made of the CPS Progress Report to introduce mid-course corrections to the program, and to align it with the country’s evolving needs and priorities; (ii) Effective implementation of the program, including a pro-active and extensive restructuring of projects²⁸ to respond to changing circumstances and implementation issues; and (iii) Improved results frameworks, through a concerted effort by the Bank’s team to revise and update the results matrix of projects during restructurings and to revise the CPS results matrix at the time of the Progress Report.

Design

- (i) ***The CPS objectives remained highly relevant to Azerbaijan’s development goals.*** The CPS was prepared under the circumstances of a rapid increase in income and decrease in poverty, but also the global economic crisis. The drivers of growth and poverty reduction that had served the country well were vulnerable, and the post-crisis world offered new challenges. The CPS thus proposed a two pillar strategy of: (i) building a competitive non-oil economy; and (ii) strengthening social and municipal services, with a cross-cutting theme of governance and anti-corruption. These were in line with Azerbaijan development goals outlined in the *State Program on Poverty Reduction and Sustainable Development* and the *Azerbaijan 2020 Vision*.
- (ii) ***The WBG engagement was flexible, adapting to country circumstances and evolving financing needs.*** The CPS program delivered on almost all of the planned operations (Annex 2) although

²⁸ Second Education Sector Development Project, CAPSAP, Health Sector Reform Project, Social Protection Development Project, Highway II and III, Public Investment Capacity Building Project, National Water Supply and Sanitation I and II, Rail Trade and Transport Facilitation.

there were some evolutions in the size of financing of certain projects. Additional Financings were also added to the program to respond to changing circumstances (notably the Rail Trade and Transport Facilitation Project) and to scale up well-performing projects (AzRIP, National Water Supply and Sanitation 2).

- (iii) ***The program maintained focus and selectivity.*** The lending and AAA programs were closely aligned with the CPS objectives. The use of instruments itself was selective and efficient, as the program was built on repeater or follow-up projects (Judicial Services and Smart Infrastructure, AzRIP II, IDP LS&L, and ACIP) and AFs (Railway Trade and Transport Facilitation, Integrated Solid Waste Management, Judicial Modernization, AzRIP II, NWSSP II) to enhance the impact on existing successful operations. New approvals were nearly all in infrastructure, with institutional building dimensions, in line with the Government's priorities and own investments, but in areas where it sought the Bank's technical expertise, policy advice, and financial support. The portfolio composition reflects such selective approach, as the transport, water, social, urban and rural services, accounted for more than 90 percent of net-commitments at the end of FY14. At the same time, the program had important social and institutional development impacts, as these aspects were embedded in the project design.
- (iv) ***The AAA program provided analytical underpinning to the CPS program, while also becoming increasingly responsive to client needs.*** The AAA program's contribution to the CPS objectives was twofold: (i) it provided analysis and policy recommendations to the economic diversification agenda; and (ii) it informed and complemented the lending program through advisory work and sector studies. In parallel, the WBG has increasingly responded to emerging government requests for technical advice on specific issues, in the form of short notes, such as on best practices for storm water management systems. These were prepared in a speedy manner and highly appreciated by the client, contributing to further strengthening the partnership. Part of the AAA program comprised South Caucasus regional tasks, including Skills, Pension Reform, and Gender Reports. The extent to which Azerbaijan benefitted from these varied, partly because the pace of reforms in some of these areas did not always lead to a sufficiently robust level of engagement, and because adequate data was not always available.
- (v) ***Lessons from the previous CPS were well reflected in the design of the new program.*** All the lessons from the CPS Completion Report for the FY07-10 CPS were reflected in the CPS design and implementation. These included: (i) the need for selectivity and prioritization; (ii) designing a balanced program of lending and AAA operations;²⁹ (iii) focusing on portfolio implementation; and (iv) increased attention to M&E.
- (vi) ***The original CPS results framework had some important weaknesses, most of which were addressed at the time of the Progress Report.*** The original CPS results framework included several indicators that were overly ambitious and outside the scope of the WBG program, such as increases in the volume of non-oil exports, or the reduction in non-oil primary deficit. The CPS Progress Report streamlined the results framework, and while some issues related to the relevance and measurability of some indicators remained – such as those related to quality and access to education and health - they were relatively few and did not significantly affect the ability to evaluate the program's outcome as a whole.

²⁹ The FY07-10 CR suggested the use of development policy lending. This was not considered appropriate in the context of budget surpluses.

Implementation

- (i) **Portfolio performance improved significantly as a result of a comprehensive restructuring effort, that covered 10 operations and \$2.3 billion in net commitments** (see Annex 3). Several projects in the WBG portfolio had been prepared hastily in 2009 to respond to the global financial crisis. The Government and the Bank collectively recognized that the design of these projects needed strengthening and better targeting, and in some cases also needed additional financing to align better the financial envelope with the scope of the projects and ensure that the projects would achieve their development objectives. This proactive portfolio management resulted in a significant turnaround in portfolio quality and implementation pace as reflected in an increase in disbursement ratio from 10 percent in FY10 to 27 percent in FY14, and a decrease in net commitments at risk from 22 percent to 1 percent (see Table 1). IFC's level of non-performing loans has been relatively high throughout the CPS period, averaging about 30 percent of the total outstanding loan portfolio. Two out of three NPLs were successfully restructured in FY13 and FY14, and one is expected to be resolved in FY15.

Table 1: FY10-14: Selected IBRD Portfolio Indicators for Azerbaijan FY10-14

| FY | No. Projects | Net Commitment (\$US ml) | Disbursement Ratio | Commitment At Risk (US\$ ml) | % Commitment At Risk | No. Problem Projects | % Problem Projects | % Realism Index | % Proactivity |
|------|--------------|--------------------------|--------------------|------------------------------|----------------------|----------------------|--------------------|-----------------|---------------|
| FY10 | 19 | 2,237 | 10% | 501 | 22% | 3 | 16 | 100 | 100 |
| FY11 | 19 | 2,317 | 9% | 501 | 22% | 3 | 16 | 100 | |
| FY12 | 16 | 2,211 | 14% | 956 | 43% | 5 | 31 | 100 | 100 |
| FY13 | 17 | 2,503 | 23% | 982 | 39% | 4 | 24 | 100 | 60 |
| FY14 | 17 | 2,487 | 27% | 21 | 1% | 1 | 6 | | 75 |

- (ii) **The WBG team used the CPS Progress Report and project restructuring as opportunities to revise the CPS and projects' results frameworks.** The Progress Report was used as an opportunity to streamline the CPS results framework, by dropping indicators that were considered unrealistic and outside of the program's scope, although some issues related to relevance and measurement (for example, in the case of the Health and Education-related outcomes) persisted. The portfolio restructuring, part of an overall focus on implementation and performance, was also used as an opportunity to revise and improve the results frameworks of individual operations. Five of the seven projects that closed during the CPS period had M&E quality rated as Substantial by IEG.
- (iii) **The Reimbursable Advisory Program (RAS) did not materialize as expected.** The Progress Report envisaged a RAS program that would prepare the ground for investment projects in new areas, such as renewable energy or regional development; respond to emerging demand in priority areas; and serve as an advocacy tool, in areas such as inclusive growth, macro-fiscal management, and governance. In hindsight, it was premature to plan for a RAS engagement with a client that had only just graduated from IDA and was inappropriate to expect a client that was repaying nearly all of its loans to the WBG on an accelerated basis to shift immediately into a RAS payment mode. The focus, scope and format of the RAS, which was initially envisaged under a comprehensive Joint Economic Research Program (JERP) similar to that in Kazakhstan, shifted to a case-by-case engagement, which started in the ICT sector and is currently under discussion. Although not formally considered a RAS, Externally-Funded Operations (EFO) were signed in 2014 with the Central Bank of Azerbaijan to support its Anti-Money laundering work and to support the development of a Mortgage Funds. Joint preparation of the PEFA with the European Commission

through SECO grant-financing, is also an example of an innovative AAA engagement through an EFO.

- (iv) ***Division of work between IBRD and IFC was driven by strategic and comparative advantage considerations, but complementarity could be strengthened.*** The IFC program, which was relatively small, directed its focus on business environment, corporate governance, and MSMEs financing. The IBRD program focused on the high-level diversification policy dialogue, and on specific investments and analytical work in the identified key areas of social and municipal services, growth-supporting infrastructure, public sector delivery and governance, IDPs, and health and education. Although the program focus was well distributed and complementary, joint programs were limited, especially in areas with potential for more synergy, such as transport infrastructure projects.
- (v) ***Effective donor coordination.*** In the area of infrastructure development, especially roads and water and sanitation, the WBG closely cooperated with ADB, EBRD, KfW, and JICA. Dialogue and coordination with the EU was strong in the areas of judicial and education reform, and in supporting agriculture and agri-business development. In the area of governance, private and financial sector development, the WBG coordinated with GIZ and USAID. The WBG played an active role as a member of the UN family, such as joint consultations on MDG/SDG in 2013-14, joint work on the development of UNDAF, juvenile justice and nutrition with UNICEF, and on gender, health and labor market reforms with relevant UN agencies.
- (vi) ***Risks to the implementation of the CPS program were adequately identified and mitigated:*** (i) The risk of a slow pace of reforms was addressed through a solid policy dialogue and a solid AAA program; (ii) Weaknesses in governance and institutional capacity were addressed through a focus on public service delivery, including the CAPSAP, PICBP, and Judicial Modernization projects, as well as IFC advisory work on corporate governance and business environment; (iii) The threat of the ongoing portfolio's performance to the delivery of CPS results was addressed through a comprehensive restructuring of the portfolio; (iv) Economic vulnerability, accentuated by high reliance on oil revenues, was mitigated by the design of the CPS and its objectives, one of them explicitly addressing economic diversification; and (v) The risk related to regional security remained relevant, but did not affect program implementation.

4. ALIGNMENT WITH CORPORATE GOALS

32. ***Although the CPS was prepared before the adoption of the WBG Twin Goals, the program was closely aligned with ending extreme poverty and boosting shared prosperity.*** The CPS objectives of building a competitive non-oil economy and of strengthening social and municipal services targeted the need for sustainable, inclusive growth. A robust set of analytical work informed the Government's *Vision 2020*, which places emphasis on economic diversification and sustainable growth. The lending program was selective and promoted inclusiveness and lifting the livelihoods of the more vulnerable segments of the population. Poverty rates in Azerbaijan saw a remarkable improvement during the CPS period, decreasing from 9.1 percent in 2010 to 5.3 percent in 2013. The introduction and expansion of the TSA, achieved through the support of the WBG program, played a key role towards poverty reduction. Based on World Bank estimates, the national poverty rate in 2012 is estimated to have been considerably higher in the absence of social transfers, reaching 25 percent in the absence of pensions, and 30 percent in the absence of any social benefits, vis-à-vis the actual 6 percent for that year. The impact of the CPS program was

particularly significant for rural and poorer segments of the population, which benefitted from increased access to municipal and social services, irrigation, higher productivity of agriculture products, net income increases, and increased capacity in the preparation and implementation of micro projects. The gender impact was significant, as women constituted a large portion of beneficiaries and active participants at the community level. Much of IFC work focused on building capacity within the banking and microfinance sectors, to increase lending to under-served MSMEs, including those in rural areas.

5. MAIN LESSONS

33. ***Selective scaling-up of the program through Additional Financing and repeater projects contributed to enhancing its impact and sustainability of investment.*** Scaling-up successful investment operations through Additional Financing or repeater projects resulted in greater impact and reaching a larger number of beneficiaries. At the same time, although the bulk of the program focused on transport, water, social, urban and rural services, which together accounted for more than 90 percent of net commitments, it remained well-balanced with respect to social and institutional development impact, as these areas were embedded in most of the projects' design.

34. ***The extent and modality of IFC and IBRD cooperation and complementarity should be driven by business and development needs.*** IFC's engagement in Azerbaijan was limited, due to specific sector constraints (see paragraph 2). In response to such business context, IFC focused on areas where it had a comparative advantage and could bring value-added, namely the financial sector and the overall country's investment climate. The IBRD program, on the other hand, leveraged its global knowledge of sector-specific issues and investments, as well as of the strategic diversification agenda. These efforts were complementary and well-coordinated. Recently, due to the decline in oil prices, the Government has expressed an increased interest to leverage the private sector in their efforts to diversify the economy and to finance infrastructure investments (e.g., energy, rail, roads). This calls for a stronger cooperation between IBRD and IFC in the next strategy cycle as it will require (i) a tangible progress with more comprehensive policy actions to improve business climate (e.g., improving the rule of law, protecting investors, improving the skills of the labor force, etc.), and (ii) an introduction of the regulatory framework and building capacity within the public sector for public-private partnerships. Examples of joint IFC and IBRD work may include joint AAAs and joint identification and supervision support missions of specific operations and AAAs.

35. ***Flexibility is critical going forward, especially in a context such as that of Azerbaijan.*** The WBG made effective use of the CPS Progress Report to introduce mid-course corrections to the program, and to align it with the country's evolving priorities. Applying flexibility will be increasingly important, as Azerbaijan is a sophisticated client that values careful partnership-building and responsiveness on the part of the WBG. Its middle-income status and financing options also position it to better choose how to best leverage external funding and partners, resulting in changes to its own external financing options.

36. ***Introducing innovative approaches requires a good understanding of the political economy context, proper communication, and flexibility.*** The RAS program did not develop as originally envisaged due to the client's low appetite in the aftermath of IDA graduation, a lack of consistent and clear communication from the WBG about the value-added and objective of the RAS instrument, and a lack of established procedures for approval of such products. However,

the WBG team in the country was flexible in identifying and embracing alternative options, for example, by engaging in Externally Funded Operations (EFO) with the Central Bank of Azerbaijan. These externally-funded engagements can have an important demonstrative effect, and pave the way to a more robust RAS program in the future.

37. ***When Gender is embedded in project design and implementation, its impact is significant.*** Most projects approved during the CPS period included gender disaggregated data in their results frameworks. In cases where the WBG fully embedded gender in the project design and implementation, as was the case in AzRIP, the impact was remarkable (see Annex 6). This type of gender operationalization should be, to the extent possible, applied to all new operations going forward.

38. ***Projects must be prepared with ownership built in from the beginning and with a concerted effort to strengthen the client's management of the projects.*** In some projects that had been hastily designed, the Government's ownership was not always visible so these had to be restructured. The lesson from this was built into the design of new projects during the CPS period, resulting in improved engagement with the client and in greater ownership. This was also facilitated by a significant improvement in communication, as confirmed by the client. The program also put special focus on strengthening the capacity of implementing agencies to manage the WBG supported projects and their products through capacity building components.

39. ***IFC program's impact shows that a focused, targeted and incremental engagement can go a long way, even with relatively small resource.*** The IFC program was designed to maximize its focus and impact. By building-up its program with small incremental engagements, and tightly focusing on MSMEs and MFIs, the IFC program was able to achieve much with limited resources. On the MSME lending front, a relatively small financing volume of US\$100 million was selectively targeted to MSMEs financing, resulting in the total number of MSME loans in their portfolio more than tripling.

40. ***M&E quality should remain a priority at the design stage and throughout implementation, by taking a critical look at the results chain.*** At the design stage, the CPS results framework included several indicators that were beyond the scope of the WBG program, and which would have made it difficult to assess its impact. The WBG team's use of the Progress Report to streamline and re-align the CPS indicators has allowed a much more effective tracking of the program's contributions. However, a stronger M&E requires good data quality and accessibility, both still relevant issues to be addressed under the CPF.

CPSCLR Attachment 1

Status of Azerbaijan FY11-14 CPS CLR Results Matrix

| <i>CPS Objective 1: BUILDING A COMPETITIVE NON-OIL ECONOMY</i> | | | |
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| <p>Key Government Goals: Prudent macro-economic management and improved trade policies and institutions Strengthen Azerbaijan’s role as a regional transport corridor and improve connectivity within Azerbaijan (<i>to be measured by increased transit traffic</i>) Improve the business environment for higher non-oil growth (<i>to be measured by the level of growth of SMEs, non-oil exports</i>). Build a more efficient and productive rural sector. (<i>to be measured by increase in agriculture exports, farm income</i>)</p> <p>Key Issues and Obstacles: Macro-economic management will require careful balancing of expenditure, exchange rate, and inflation in light oil revenues. Trade policies and institutions need to relax the current “control oriented” approach. Transport: Roads need improvement and widening. Port and Rail need modernization, intermodal / interoperability. Business environment needs strengthening in several areas (tax, customs, licensing, etc.) The financial system remains shallow. The largest bank is state-owned and SMEs have limited credit access Agriculture – need to improve agriculture productivity, food certification and processing, irrigation framework, crop and livestock disease risk</p> | | | |
| CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR | MILESTONES UPDATE | PROGRESS TO DATE ON OUTCOMES AND INDICATORS | WORLD BANK GROUP PROGRAM THAT CONTRIBUTED TO THE OUTCOME |
| <i>Results Area 1: Enhancing macro-economic stability and growth policies</i> | | | |
| Outcome 1: Improved investment climate and institutions | | Achieved | |
| <p>--<i>Primary Indicator 1:</i> Improvement in business permits and inspections regime measured by reduction in direct cost to comply with business regulation.</p> | <p>Milestone 1: Streamline business registration. ➤ Milestone Met: Number of days to open business: Baseline: 10 (Doing Business, 2009)</p> | <p>Mostly Achieved: Business registration costs were reduced: Baseline: US\$340 per business (2008); Actual: US\$65 per business (2014). Annual direct compliance cost savings from the business registration reforms (e.g.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Capital Markets Modernization Project (Approved: FY11; Closing: FY16); |

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| <ul style="list-style-type: none"> • <i>Baseline:</i> According to the SME survey 29 % of individual entrepreneurs and 38% of SMEs admits paying unofficial fees to obtain permits. • <i>Target:</i> reduced incidents of unofficial payment to below 30% on average for obtaining 3-5 selected permits • <i>Baseline:</i> 80% of businesses inspected, with average 11 inspections per year per business (SME Survey). • <i>Target:</i> less than 10 inspections on average per year per business. | <ul style="list-style-type: none"> ➤ - Actual: 5 (Doing Business, 2014). Number of days to get a construction permit: Baseline: 200 (Doing Business, 2009) – Actual: 151 (Doing Business, 2014). ➤ Milestone: Improvement in transparency of business permits and inspections. ➤ Milestone Met: Inspections Law was passed in the Fall of 2013, and became effective in March 2014. The Law includes important provisions for increased transparency of inspections: ➤ Introduction of inspection check lists ➤ Requirement to upload the inspection results to the e-registry of inspections so that every entrepreneur can track the history of inspections conducted in the company. ➤ Requirement to register every inspection in the e-registry and present an extract from e-registry | <p>introduction of one-stop-shop and online registration mechanisms) is estimated by IFC to be about US\$15 million.</p> <p>The incidence of unofficial payments was reduced: Baseline: 47% (Inspection Survey, 2008) Actual: 20% (Inspection Survey, 2012*)</p> <p>The percentage of firms recognizing unofficial payments to tax inspectors/officials declined: Baseline: 31 percent (BEEPS, 2009) Actual: 11.7 percent (BEEPS, 2013).</p> <p>Average number of visits by tax officials per year went down: Baseline: 3.2 (BEEPS, 2009) Actual: 1.7 (BEEPS, 2013)</p> <p>Total number of inspections per business per year remained almost unchanged: Baseline: 11 (IFC SME Survey, 2008) Actual: 12 (Inspections survey 2012*)</p> <hr/> <p><i>* The survey was conducted before the effectiveness of the Inspections Law, and thus does not capture the Law's impact.</i></p> | <ul style="list-style-type: none"> • Real Estate Registration Project (Approved: FY07; Closing: FY16 - IBRD). • IBRD AAA and TFs: • Country Economic Memorandum on export-led diversification (FY10); • High Level Policy Forum (October, 2009, 2012), to support the Government in developing a strategy for economic diversification; • Programmatic Public Expenditure Review ESW on expenditure Policy (FY13); • Economic Diversification and Growth TA (FY14); • Financial Advisory Note under South Caucasus Advisory TA • SECO Trust Fund on Financial Sector Modernization (ongoing) • Azerbaijan Development of Supervision Framework for Operational Risk TA (FY14) to support the development of a comprehensive framework for effective supervision of operational risk in the banking system. • Fostering Entrepreneurship in Azerbaijan (FY14). |
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| | <p>to an entrepreneur; this prevents businesses from illegal visits and makes the system more predictable.</p> <p>➤ Introduction of the risk based approach which reduces the frequency of inspections for businesses with low risk.</p> | | <ul style="list-style-type: none"> • IFC Advisory: • Azerbaijan Business Enabling Environment project (FY08-FY13); • Azerbaijan Investment climate project, Phase II of the project above (FY14-FY15); • Azerbaijan Corporate Governance project (FY03-FY12); • ECA Corporate Governance Project. • Advice on DB reforms. |
| <p>-- <i>Primary Indicator 2:</i> Average number of days taken to register a property transaction at the State Service for the Registration of Real Estate:</p> <ul style="list-style-type: none"> • <i>Baseline (2007):</i> 30 days • <i>Target (2014):</i> 15 days | | <p>Surpassed. The average number of days to complete a record of purchase/sale of property in the land administration system (both Urban and Rural) is 12 days. The average time to register a property transaction at the State Service for the Registration of Real Estate is also 12 days.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Real Estate Registration Project (Approved: FY07; Closing: FY16 - IBRD); <p>IFC Investments:</p> <p>10 active outstanding loans to private banks and MFIs 5 loans to the banks matured during the CPS period 8 outstanding equity investments in private banks and MFIs 4 active trade finance lines at private banks</p> <p>IFC Advisory:</p> <p>Financial market infrastructure project (FY10-15) SME banking advisory services to Turan Bank (FY12-FY13)</p> |

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| | | | <p>Mortgage project (FY07-FY12) MFI transformation project (FY09-FY12) Banking crisis management project (FY10-FY12)</p> <p>Key international partners: SECO, the Netherlands, Austria, and BP.</p> |
| <p>-- <i>Primary Indicator 3:</i> Increased number of loans provided to MSMEs through IFC client banks</p> <ul style="list-style-type: none"> • <i>Baseline (2009):</i> 57,000 • <i>Target (2014):</i> 85,000 | | <p>Surpassed. As of 2013, 317,000 loans were provided to MSMEs through IFC client banks.</p> | |
| <p>-- <i>Primary Indicator 4:</i> Number of transactions registered annually at the State Service for Registration to increase:</p> <ul style="list-style-type: none"> • <i>Baseline (2005):</i> 87,461 • <i>Target (end of 2012):</i> 250,000 | | <p>Surpassed. The total number of transactions registered at the State Service for Registration in 2014 is 256,357.</p> | |
| <p>Outcome 2: More Transparency and Efficiency in Public Institutions</p> | | <p>Mostly Achieved.</p> | |
| <p>-- <i>Primary Indicator 1:</i> Improvement of the quality of preparation of infrastructure projects through application of economic appraisal on Government financed infrastructure projects.</p> <ul style="list-style-type: none"> • <i>Baseline:</i> no requirement on economic appraisal for Government financed infrastructure projects | | <p>Actual Target Not Verified, but significant progress made towards it. New Regulations on Preparation, Implementation and Monitoring of Public Investment Projects were approved by the President in 2010 and has been applied by the Ministry of Economy and Industry since 2011. This was an important development for enhancing the efficiency and quality of</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Judicial Modernization Project + AF (Approved: FY06; Closing: FY15- IBRD/IDA) • Corporate and Public Sector Accountability Project (Approved: FY08; Closing: FY15 - IDA) • Public Investment Capacity Building Project (Approved: FY09; Closing: FY15 - IDA) |

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| <ul style="list-style-type: none"> • <i>Target:</i> 80% of the Government financed infrastructure projects from roads, water and sanitation and energy sectors with project costs above USD15 million have completed a type of economic appraisal for requesting state funding | | <p>Government financed infrastructure projects as the new Rules set a specific requirement (the baseline was “no requirement”) for all major public investment projects to be appraised based on economic considerations. Economic analysis is now presumably applied to all major infrastructure projects due to the formal requirement; however, specific data on percentage of projects which complete economic appraisal is not available.</p> | <p>AAA and TFs:</p> <ul style="list-style-type: none"> • Public Expenditure and Financial Accountability Assessment (PEFA) conducted between February-July, 2014 and covering the period 2011-2013 in cooperation with the European Union (EU) and the Swiss State Secretariat for Economic Affairs (SECO). • SECO TF on Supreme Audit Institution Development Trust Fund (Approved: FY11; Closing: FY15), under CAPSAP <p>IFC Advisory:</p> <ul style="list-style-type: none"> • Azerbaijan Business Enabling Environment project (FY08-FY13) • Azerbaijan Investment climate project, Phase II of the project above (FY14-FY15) <p>Key international partners: EU, USAID, SECO</p> |
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| <p>-- <i>Primary Indicator 2:</i> number of SOEs using International financial standards</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 2 • <i>Target:</i> 5 | <p>Milestone: Number of ISA based audits conducted by Chamber of Accounts increases from 0 to 5.</p> <p>➤ Milestone not measured: This milestone was not measured because the ISA audits do not fall under the Chamber of Accounts responsibility.</p> | <p>Achieved. Five SOE, including Azerenerji, Azersu, and ADY transitioned to International Financial Reporting Standards (IFRS) in their reporting.</p> | |
| <p>-- <i>Primary Indicator 3:</i> number of public and higher education institutions that have introduced the automated Unified Account and Financial Reporting System.</p> <ul style="list-style-type: none"> • <i>Baseline – 0 (2010)</i> • <i>Target - 25 (2014)</i> | <p>Milestone: System deployment in progress.</p> <p>➤ Milestone met: system deployed, and 59 budget organizations and line ministries adopted UAFRS.</p> | <p>Achieved. 59 key budget organizations (including 11 higher education institutions) and Line Ministries use the Unified Account and Financial Reporting System. Use of UAFRS is expected to be implemented in 99 public and higher education institutions by the end of the CAPSAP project (June, 2015).</p> | |
| <p>-- <i>Primary Indicator 4:</i> User satisfaction with court system in targeted areas increased:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 60% (2009) • <i>Target:</i> 5% points (2014) | <p>Milestone: 4 or more court houses built, 150 new judges selected and trained.</p> <p>➤ Milestone met:</p> <ul style="list-style-type: none"> - Construction of 4 court houses completed (Gandja, Gedabek, Yasamal and Oguz). - 235 judges (i.e., 50% out of 466 existing judicial posts) were appointed according to the new procedures and passed all relevant professional training courses | <p>Surpassed. A Judicial Perception Survey (2014) indicates a significant improvement in court users' satisfaction with the court system, including:</p> <ul style="list-style-type: none"> 91% consider conditions in the court rooms to be “normal” (baseline: 57%); 67% are able to file a lawsuit independently without a lawyer (baseline: 32%); 55% consider government-paid legal aid to be “quality service” (baseline: 40%); | |

| | <p>at the Justice Academy and abroad (Turkey & Germany). 76 candidates for judge also passed continued professional training courses within the Justice Academy and abroad (Turkey). In total, 67% of judges/candidate judges (311 out of 466) passed professional courses.</p> | <p>79% say they have no problem with receiving government-paid legal aid (baseline: 65%); 81% say that means for investigating video, photo evidence, and electronic evidence are available during case proceedings (baseline: 39%); 91% obtain information about laws from the internet (baseline: 55%); 72% obtain information about cases currently considered in court (baseline: 11%); 88% say that courts have rooms available for holding meetings and discussions with lawyers (baseline: 60%); 90% say that court houses have rooms or seats intended for those awaiting court sessions (baseline: 60%). 25% percent of the general population said that conditions were created to allow access to disabled persons to court houses (baseline: 3%).</p> | |
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| CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR | MILESTONES | PROGRESS TO DATE | WORLD BANK GROUP PROGRAM AND PARTNERS |
| <i>Results Area 2: Upgrading Key Growth Supporting Infrastructure</i> | | | |
| Outcome 1: Transport vehicle operating costs reduced, road safety improved and rail transit traffic increased | | Partially Achieved | |
| -- <i>Primary Indicator 1:</i> Reduction in road user costs. | Milestone: Reduction in road user costs by 20% on the Baku - Shamakhi road between km | Partially Achieved. | |

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| <ul style="list-style-type: none"> • <i>Baseline:</i> \$0.40/vehicle km • <i>Target:</i> \$0.32/vehicle km in M4 Baku – Shamakhi road between km 15 – km 45, M6 Hajigabul – Bahramtapa road, and R6 Tagiyev – Sahil road | <p>15 – km 116 (baseline is \$0.40/vehicle km).</p> <p>➤ Milestone Partially Met (see outcome progress to date, column 3)</p> <p>Milestone: Upgrade 200 km of highways.</p> <p>Milestone Met: 216 km of two-lane highway roads have been rehabilitated during 2011-2014 so the target is met.</p> <p>Milestone: Traffic Safety Strategy implemented.</p> <p>Milestone partially met: Strategy was developed, agreed with all key government agencies and submitted to the Cabinet of Ministries for approval. The milestone was not very realistic as the strategy is a ten-year strategy whose implementation could not have been completed under the CPS period.</p> <p>Milestone: Adopt new Motor Code.</p> <p>Milestone Partially Met: The new Motor Code was developed but was not adopted yet as the implementation of the associated road management reforms has not yet started.</p> | <p>M4Baku-Shamakhi road: works are nearing completion (paving expected by the Spring of 2015) on existing lanes; construction of two additional lanes is completed but not opened to traffic.</p> <p>M6 Hajigabul-Bahramtapa road: \$0.35/vehicle km</p> <p>R6Tagiyev-Sahil road: \$0.34/vehicle km</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Highways II Project + 2 AF (Approved: FY06; Closing: FY15 – IBRD/IDA); • Highways III Project (Approved: FY10; Closing: FY17 – IBRD/IDA); • Rail Trade and Transport Facilitation Project + AF (Approved: FY08; Closing: FY18 - IBRD). • Rural Investment Project (AzRIP) (Approved: FY04; Closed: FY12 - IDA); • AzRIP2 (Approved: FY13; Closing: FY19 – IBRD. An AF was approved in early FY15). • IDP Economic Development Support Project (Approved: FY05; Closed: FY12 - IDA); • IDP Living Standards and Livelihoods Project (Approved: FY12; Closing: FY16 – IBRD). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • ESW on Improving the Sustainability of Road Management and Financing in Azerbaijan (FY12); • PHRD grant on Baku Urban Transport (Approved: FY07; Closed: FY11) |
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| | | | <ul style="list-style-type: none"> • IDF grant on Quality Management in the Road Sector (Approved: FY11; Closed: FY14). <p>Key international partners: ADB</p> |
| -- <i>Primary Indicator 2</i> : Reduction in road traffic deaths per 10,000 vehicles | | Achieved. At the end of 2014, road traffic deaths reached 8.6 per 10,000 vehicles, corresponding to a 14% reduction. | |
| <ul style="list-style-type: none"> • <i>Baseline (2009)</i>: 10 road traffic deaths per 10,000 vehicles • <i>Target</i>: 9 road traffic death per 10,000 vehicles (10% reduction) | | | |
| -- <i>Primary Indicator 3</i> : Volume of rail transit traffic on East-West rail corridor. <ul style="list-style-type: none"> • <i>Baseline</i>: 11 million tons • <i>Target</i>: 23 million tons | | Not Achieved. The Government expects the volume of rail transit to be 4.3 million tons in 2014. The reduction in the volume of rail transit to 4.3 million tons, against a baseline of 11 million tons and a target of 23 million tons, reflects few factors: a) ongoing rehabilitation of the entire East-West rail infrastructure, including the tracks, signaling and power supply systems; b) savings connected to shipping domestic oil via the existing oil pipeline network rather than through the railways, which are likely to become even more important against the overall drop in oil prices and c) volatile regional geopolitical situation resulting in less transit of crude oil via | |

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| | | Azerbaijan from Central Asian countries. The downward trend in freight transit is expected to continue until the new infrastructure becomes operational in 2017. On the other hand non-oil domestic freight volume saw a stable increase, from 7.5 million tons in 2011 to 10.5 million tons in 2014. | |
| Outcome 2: Increased coverage of agriculture irrigation, marketed production and farmers' income | | Achieved. | |
| <p>-- <i>Primary Indicator 1:</i> Production marketed for cash:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 60% • <i>Target:</i> increase by 10% | <i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i> | Surpassed. Production marketed for cash by participating farmers has increased by 27 percent. | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Agricultural Development and Credit Project II (Approved: FY06; Closed: FY12 – IDA); • Water Users Association Project (Approved: FY11; Closing: FY16 – IDA/IBRD); • Agricultural Competitiveness Improvement Project (Approved: FY14; Closing: FY19 – IBRD). • Azerbaijan Rural Investment Project (Approved: FY13; Closing: FY19-IBRD). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • Agriculture Sector Note KP (FY12). <p>IFC Advisory:</p> <ul style="list-style-type: none"> • Azerbaijan Investment Climate Project (FY14-FY15) |

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| | | | Key international partners: USAID |
| <p>-- <i>Primary Indicator 2:</i> Incomes of participating farmers and rural entrepreneurs:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> annual income of AZN 11,000 • <i>Target:</i> increase by 20% | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Surpassed. Average net income of participating farmers from agricultural activities has increased by 30 percent over the 11,000 AZN baseline.</p> | |
| <p>-<i>Primary Indicator 3:</i> Increase in number of irrigations according to crop water norms in the rehabilitated irrigation systems.</p> <ul style="list-style-type: none"> • <i>Baseline:</i> Typically two irrigations per farmer • <i>Target:</i> At least four irrigations applied by 80% of water users in rehabilitated schemes | <p>Milestone: Collection percentage of Irrigation Fees in supported area to increase substantially (baseline: 10-20%)</p> <p>Milestone met: WUAP Project WUA collection rates are at least 65%.</p> | <p>Achieved. Four irrigations are applied by 80% of the farmers in rehabilitated schemes.</p> | |
| CPS OBJECTIVE 2: STRENGTHENING SOCIAL AND MUNICIPAL SERVICES | | | |
| <p>Key Government Goals:</p> <p>Poverty declined to 16% in 2008, but continued progress needed (both urban and rural)</p> <p>Health indicators are worse than for other CIS countries, and need improvement</p> <p>Basic education coverage is good, but the quality needs improvement</p> <p>Higher education coverage (17%) and quality is low and needs improvement</p> <p>IDP conditions and livelihood remain poor</p> <p>Full coverage of the population to reliable and high quality water supply is a top government priority</p> <p>Water and solid waste removal services also in significant need of improvement</p> <p>There is a particular need to improve rural services where the need is more pressing</p> <p>The Government has declared its interest in the environment agenda</p> | | | |

Key Issues and Obstacles:

Further improvements in social assistance and employment services coverage possible
 Health facilities need to be upgraded and run in a more effective manner
 Basic education continues to need curriculum reform and streamline the number of schools
 Higher education needs reduced restrictions on entry, merit based entrance, and improved quality
 IDPs not well integrated into society. Need more permanent approach
 The state of the water pipes has significantly deteriorated and need major overhaul
 Waste removal services both limited and informal. Need to formalize approach and bring technology to support.
 Inter-government budget and administrative processes for strengthening rural investment still weak

Real commitment to the environmental agenda unclear. Calls for greater consensus building before can move forward on pressing issues.

| CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR | MILESTONES | PROGRESS TO DATE | WORLD BANK GROUP PROGRAM AND PARTNERS |
|--|------------|---|---|
| <i>Results Area 3: Improving Social Services</i> | | | |
| <p>Outcome 1: Increased coverage and efficiency of social protection and employment services</p> | | <p>Mostly Achieved.</p> | |
| <p>-- <i>Primary Indicator 1</i>: Percentage of the poorest decile that is covered by targeted social assistance:</p> <ul style="list-style-type: none"> • <i>Baseline (2008)</i>: 14.3% • <i>Target (2014)</i>: 20% | | <p>Target Not Verified, but significant progress made on TSA coverage. A precise assessment of the poorest decile to be covered by TSA will be available after the Azerbaijan Monitoring Survey of Social Welfare 2015 is conducted in April 2015. However, significant progress was made in strengthening the targeting of social protection under the PSAP. It was under PSAP support, in 2006, that Azerbaijan introduced TSA, which consolidated the state-provided basic pension for the uninsured as well as several child and family benefits. As a</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Pension and Social Assistance Project (Approved: FY04; Closed: FY11 – IDA); • Social Protection Development Project (Approved: FY08; Closing: FY16 – IDA). |

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| | | result of this support, 100% of TSA beneficiaries receive TSA monthly benefits through an automated system. | |
| <p>-- <i>Primary Indicator 2:</i> Labor market interventions improved as measured by:</p> <p>(i) new module training programs developed and in use:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 22 (2009) • <i>Target:</i> 30 (2014) <p>(ii) new module training centers fully functional:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 0 (2009) • <i>Target:</i> 3 (2014) <p>(iii) new occupational standards developed based on ISCO-88/ISCO-08:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 52 (2009) • <i>Target:</i> 200 (2014) | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Mostly Achieved.</p> <p>43 modular training programs developed and in use in the existing training centers.</p> <p>Two (out of three) new modular training centers are fully functional. The third one is expected to become fully functional by April, 2015.</p> <p>210 occupational and 200 training standards developed and in use.</p> | |
| <p>Outcome 2: Wider access to health services</p> | | <p>Indicators achieved although impact is not verified.</p> | |
| <p>-- <i>Primary Indicator 1:</i> Improved access to health services through upgraded health facilities as measured by average time to reach regional and village hospitals and PHC:</p> | <p>Milestone: Health facilities upgraded including 2 new hospitals, 3 village hospitals, 9 PHCs.</p> <p>➤ Milestone met: New health facilities were constructed and equipped in pilot districts (2013) in line</p> | <p>Achieved. On average, it takes about 15 minutes to reach a Primary Healthcare (PHC) facility and 45 minutes to reach a secondary healthcare facility in targeted areas. No baseline is available.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Health Sector Reform Project (Approved: FY06; Closed: FY14 - IDA). |

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| <ul style="list-style-type: none"> • <i>Baseline:</i> N/A • <i>Target:</i> 15 minutes to reach PHC, 45 minutes to secondary health care facilities | <p>with modern standards and according to the master plan.</p> | | <p>AAA and TFs:</p> <ul style="list-style-type: none"> • Health PER (June, 2013); Health Policy Note (June, 2013). |
| <p>--<i>Primary Indicator 2:</i> Rationalized health care network as measured by:</p> <p>1) Reduced number of hospitals:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 413 hospitals(2009) • <i>Target:</i> 220 hospitals(2014) <p>2) Increased bed occupancy rate:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 46.9% (2008) • <i>Target:</i> 60% (2014) | <p>Milestone: Master plan for restructuring health services network developed.</p> <p>➤ Milestone met: Implementation of the Master plan nationwide.</p> <p>Milestone: New Human Resources and financing policies adopted.</p> <p>➤ Milestone met: Health workers planning and human resource strategy was developed and ratified by the MOH in September 2008 (note: milestone already met before CPS period).</p> <p>Milestone: Health MIS Prototype developed and tested</p> <p>➤ Milestone met: Health MIS developed and piloted in hospitals nationwide by the end of 2013.</p> | <p>Achieved.</p> <ul style="list-style-type: none"> - In 65 districts, the number of hospitals was reduced from 413 in 2009 to 214 in 2013. - Occupancy rate increased to 60 % in 2014. Rationalization resulted in a reduction of the number of beds by 36 percent - per 10,000 population, i.e. from 67.4 (2010) to 43.2 (2013). | |
| <p>Outcome 3: Improved quality of basic and higher education</p> | | <p>Not Verified.</p> | |
| <p>-- <i>Primary Indicator 1:</i> Improved test scores in basic education in rural areas for grade 4:</p> | <p>Milestone: Sample based national assessment in grades 4 and 9 introduced in 2010.</p> | <p>Not Verified. Data will not be available before Spring 2015. This indicator was dropped from the Education Project's</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Education Sector Development Project II (Approved: FY08; Closing: FY16 – IDA); |

| | | | |
|---|--|---|---|
| <ul style="list-style-type: none"> • <i>Baseline:</i> Math, Azeri language scores (2011) • <i>Target:</i> at least two scores improved (2014) | <p>➤ <i>Milestone Met:</i> - Sample-based student assessment implemented.</p> <p>Milestone: New curriculum adopted for grades 1-6 by 2014.</p> <p>➤ <i>Milestone Met:</i> - New curriculum for grades 1-6 adopted.</p> <p>Milestone: Number of schools streamlined/merged.</p> <p>➤ <i>Milestone Not Met:</i> - This milestone corresponds to a dropped activity during the Education Sector Development Project's restructuring. School rationalization is not being implemented during the project time frame. This is largely due to the consideration that its effect on school access needs to be fully assessed and comprehensive consultations with school communities need to take place first.</p> <p>Milestone: # of innovation grants supported.</p> <p>➤ <i>Milestone no longer under the scope of the CPS period:</i> This milestone relates to the planned Higher Education</p> | <p>results framework, as part of a Level I restructuring.</p> | <ul style="list-style-type: none"> • Corporate and Public Sector Accountability Project (Approved: FY08; Closing: FY15 - IDA). |
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| | Project, whose approval was envisaged during the CPS period, but which has been postponed. | | |
| <p>-- <i>Primary Indicator 2</i>: Increased proportion of teachers using active methodologies in the context of the new curriculum:</p> <ul style="list-style-type: none"> • <i>Baseline (2010)</i>: 11% of teachers used new active learning methods, 64% used a mix of old and new, and 26% used old methods in grades 1-2, where the introduction of new curricula started. • <i>Target</i>: Classroom observations in grades 1-2 will show 80% teachers using mix and new active learning methods (and no more than 20% will be using only old methods). | | <p>Partially Achieved. The Observational Study carried out by MoE in 2011-2013 shows that 17.8% of teachers used new active learning methodologies in 2013 compared to the baseline of 10.6 per cent in 2010 and that 70.7% of teachers/classes (one teacher per class observed) report using mixed (active + traditional) teaching methodologies. The percentage figure in 2013 is calculated on a larger teacher base since the new curriculum and related teacher training rolled out beyond the baseline of grades 1-2 to higher grades and, subsequently, the tracking expanded teacher sample to 1-5 in 2013. A new survey is to be completed in May, 2015, to track progress specifically on grade 1-2.</p> | |
| <p>--<i>Primary Indicator 3</i>: Number of students having achieved National Accounting Qualification for Budget Sector:</p> | <p>Milestone: The National Accounting Qualification for Budget Sector training program launched and attended by more than 300 students.</p> | <p>Surpassed. 50 students achieved National Accounting Qualification for the Budget Sector.</p> | |

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| <ul style="list-style-type: none"> • <i>Baseline:</i> 0 (2010) • <i>Target:</i> 25 (2014) | <p>➤ Milestone surpassed: 507 students attended NAQ for the Budget Sector training.</p> | | |
| <p>--<i>Primary Indicator 4:</i> Number of higher education institutions that have introduced new syllabi and textbooks for accounting and audit:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 0 (2010) • <i>Target:</i> 5 (2014) | <p>Milestone: All 7 textbooks and syllabi have been prepared and are ready for publication.</p> <p>➤ Milestone surpassed: 11 new accounting and audit, tax related textbooks have been introduced at higher education institutes. 9 of them are audit, accounting and tax related, the remaining 2 are MIS and Economics.</p> | <p>Partially Achieved, with ongoing progress. The Ministry of Education (MoE) distributed the new textbooks to 25 higher education institutions. They are used as recommended additional study materials. In order to include them in the program they need to be approved by the MoE. The Economic University was tasked with reviewing the books, and it will provide its inputs recommendation for their inclusion in the program. The Ministry of Finance, as an entity responsible for financial accounting policy in the country, will update the existing syllabus and submit the updated one to the MoE for further approval. Once the syllabus is approved, it will be valid for all state universities. The PIU plans to complete this part of work by September 2015.</p> | |
| <p>Outcome 4: Improved living conditions for IDPs</p> | | <p>Achieved.</p> | |

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| <p>-- <i>Primary Indicator 1:</i> Micro-projects achieve their expected results for improvement in living conditions, as rated by community members:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 12.5% (2009) • <i>Target:</i> 94.5% (2014) | | <p>Achieved. As of September 30, 2014, the Beneficiary Survey conducted before and after micro-projects were completed showed the following: Number of people provided access to (micro-project) service/ utility/ infrastructure: 77,827 Surveyed beneficiaries rating access to (micro-project) service/ utility/ infrastructure as good: 95% Surveyed beneficiaries rating quality of (micro-project) service/ utility/ infrastructure as good: 93%</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • IDP Economic Development Support Project (Approved: FY05; Closed: FY12 - IDA); • IDP Living Standards and Livelihoods Project (Approved: FY12; Closing: FY16 – IBRD). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • Azerbaijan: Building Assets and Promoting Self Reliance: The Livelihoods of Internally Displaced Persons Report (FY12) |
| <p>-- <i>Primary Indicator 2:</i> Percentage of women in micro-project committees:</p> <ul style="list-style-type: none"> • <i>Baseline:</i> 0 (2009) • <i>Target:</i> 50% (2014) | | <p>Mostly Achieved. 47% female membership in micro-project and housing renovation committees.</p> | <p>Key international partners: UNHCR</p> |
| <p>CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR</p> | <p>MILESTONES</p> | <p>PROGRESS TO DATE</p> | <p>WORLD BANK GROUP PROGRAM AND PARTNERS</p> |
| <p><i>Results Area 4: Improved Municipal and Rural Services</i></p> | | | |
| <p>Outcome 1: More reliable water supply and sanitation</p> | | <p>Achieved.</p> | |

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| <p>-- <i>Primary Indicator 1:</i> Number of people with improved water supply and sanitation in targeted areas:</p> <ul style="list-style-type: none"> • <i>Baseline (2009):</i> 0 □ <i>Baseline (2009):</i> 0 • <i>Target:</i> 200,000 people, 24 hours (2014) | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Surpassed. 220,000 people have access to improved water supply and sanitation in targeted areas, under the support of the two National Water Supply and Sanitation Projects (NWSSP) and related additional financing. Of these, 135,000 are women. Sixty percent of the beneficiaries have 24-hour access to water supply.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • National Water Supply & Sanitation (NWSSP) Project (Approved: FY07; Closing: FY17 - IBRD); • Second National Water Supply & Sanitation (SNWSSP) Project + AF (Approved: FY08; Closing: FY18 – IBRD/IDA). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • National Solid Waste Management Performance Improvement and Private Sector Participation Strategy EW (FY12); • Solid Waste Strategy EW (FY12); • Integrated Urban Water Resources Management Study for Greater Baku Area, financed through grant funds leveraged by the Bank from the donor funded Water Partnership Program (FY12). |
| <p>-- <i>Primary Indicator 2:</i> Number of hours of available water service per day in targeted areas:</p> <ul style="list-style-type: none"> • <i>Baseline (2009):</i> 3 hours • <i>Target:</i> over 15 hours (2014) | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Partially Achieved. Daily availability increased by 233%, from 3 to 10 hours. The current average is 10 hours of water service per day. Most beneficiaries in targeted areas are benefiting from new water intakes and transmission lines feeding existing water supply networks, which resulted in an improved supply of piped water service per day (i.e. 10 hours of daily service on</p> | |

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|---|--|---|---|
| | | average). The target is on track but not fully met due to the fact that new water supply and sanitation networks in targeted areas are not yet put into full operation due to on-going and expected extension of referred networks being implemented under the on-going Additional Financing to SNWSSP and planned AF to NWSSP. | |
| Outcome 2: Improved reliability of solid waste management services | | Achieved. | |
| <p>-- <i>Primary Indicator 1:</i> Extend waste collection services to unserved population of Greater Baku:</p> <ul style="list-style-type: none"> • Baseline: 0 • <i>Target:</i> about 400,000 people | <p>Milestone: Rehabilitate Balakhani landfill (the largest formal waste dump in Baku)</p> <p>Milestone Partially Met: Rehabilitation is on-going</p> | <p>Surpassed. As of November, 2014 about 527,000 people who have been underserved benefit from waste collection.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Integrated Solid Waste Management Project + AF (Approved: FY08; Closing: FY17 - IBRD). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • National Solid Waste Management Performance Improvement and Private Sector Participation Strategy EW (FY12); • Solid Waste Strategy EW (FY12). <p>Key international partners: ADB, JBIC, KfW, IDB, EU, UNDP</p> |
| <p>-- <i>Primary Indicator 2:</i> Improved solid waste disposal management</p> <ul style="list-style-type: none"> • Baseline: 0 • <i>Target:</i> Closure of 60% of informal dump sites | <p>Milestone: Closure of 60% of informal dump sites.</p> <p>Milestone Overly Met: 67% of informal dump sites were closed.</p> | <p>Achieved. As of November, 2014, 44 informal dump sites (corresponding to 67% of all informal dump sites) have been closed.</p> | |

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| Outcome 3: Improved access to rural infrastructure | | Achieved. | |
| <p>-- <i>Primary Indicator 1:</i> Number of beneficiaries in supported communities with improved access to rural roads, including women:</p> <p><i>Baseline (2012):</i> 523,206 including 257,834 women</p> <ul style="list-style-type: none"> • <i>Target (2014):</i> 800,000 including 350,000 women | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Achieved. The number on beneficiaries with improved access to rural roads is 800,007. Of these, 412,000 (51%) are women.</p> | <p>IBRD/IDA:</p> <ul style="list-style-type: none"> • Rural Investment Project (AzRIP) (Approved: FY04; Closed: FY12 - IDA); • AzRIP2 (Approved: FY13; Closing: FY19 – IBRD. An AF was approved in early FY15). <p>AAA and TFs:</p> <ul style="list-style-type: none"> • Agriculture Sector Note KP (FY12). |
| <p>-- <i>Primary Indicator 2:</i> Improved use of infrastructure services in supported communities as measured by reduced time spent by beneficiaries to reach key infrastructure (market, hospital, school, safe water source):</p> <ul style="list-style-type: none"> • <i>Baseline (2011):</i> 43% • <i>Target (2014):</i> 50% | <p><i>The original milestone was the outcome indicator; hence, it has been moved to Column I</i></p> | <p>Progress made and indicator on track, based on revised baseline of 0 and a target of 50% by 2017, for new communities targeted under AzRIP II. There are measuring difficulties from using the CPS baseline and target. The CPS baseline refers to the actual reduction in time spent by the communities as a result of the AzRIP AF (2009-11). The target of 50% was set for the 90 new communities targeted under AzRIP 2, and is to be achieved by 2017. According to the results of the Midterm Survey for the AzRIP 2 communities in which</p> | |

infrastructure projects have been completed, significant progress has been made to date. The time spent to reach the nearest social infrastructure points has decreased significantly, varying 9% up to 32% with “with an average decrease of 15% (see table below). The percentage increase in access to and use of rural infrastructure is currently at 25%. This measures access to fifteen infrastructure types, including roads, bridge, public transport, market, health care facilities, community centers, kindergartens, schools, primary and secondary, potable water, water supply, electricity, gas and heating.

| Infrastructure Type | Baseline Survey (minutes) | Midterm Survey (minutes) | R |
|---------------------------------|---------------------------|--------------------------|---|
| 1. Paved Access Road (route) | 14,1 | 10,9 | |
| 2. Pre-School/kindergarten | 13,2 | 11,3 | |
| 3. Secondary School | 14,9 | 10,1 | |
| 4. Community Center | 16,2 | 11,7 | |
| 5. Village Clinic | 14,9 | 12,3 | |
| 6. District Hospital | 37,4 | 32,1 | |
| 7. Central Transportation Point | 33,0 | 29,9 | |
| 8. Domestic Water Supply Point | 8,1 | 6,7 | |
| 9. Parks | 30,5 | 25,9 | |
| 10. Market | 34,1 | 30,5 | |

CPSCLR Attachment 2

Azerbaijan: WBG Portfolio Evolution, FY11-14 (US\$ Million)

| FY | IBRD/IDA Planned Operations | | | | IBRD/IDA Approved Operations | | | | IFC Investment 3/ | | WB G Total |
|----------------------|-----------------------------|----------------|----------------|----------------------|--|-------------|--------------|----------------------|---|-----------|------------------|
| | Operations | IDA | IBRD | Total | Operations | IDA | IBRD | Total | Operations | Amount | |
| FY11-12 | Capital Markets | 80 | 100-150 | 180-230 | Capital Markets | | 12 | 12 | Trade finance lines to Demirbank, Unibank and Turan bank | 13 | |
| | Judicial AF | | | | Judicial Modernization AF | 9.2 | 24.2 | 33.4 | MSME Loan to Unibank | 10 | |
| | Irrigation II | | | | Water Users Association | 76.8 | 3.2 | 80 | MSME Loan to Turan Bank | 7 | |
| | | | | | | | | | Loan to FINCA | 7 | |
| | | | | | | | | | Equity in Rabitabank | 2 | |
| | | | | | | | | | Azerigazbank rights issue | 1 | |
| | ADCP III | | | | Total FY11 | | | 125.4 | Total FY11 | 40 | 165.4 |
| | Higher Education | | 150-250 | 150-250 | | | | | Trade finance lines to Demirbank, Unibank, Respublika bank and Turan bank | 8 | |
| | IDP II | | | | IDP Living Standards | | 50 | 50 | | | |
| | AZRIP II | | | | | | | | | | |
| | Hovsan Outfall | | | | | | | | | | |
| | | | | | Total FY12 | | | 50 | Total FY12 | 8 | 58 |
| Total FY11-12 | 80 | 250-400 | 330-480 | Total FY11-12 | 86 | 89.4 | 175.4 | Total FY11-12 | | | |
| FY13 | AzRIP II | | 30 | 30 | AzRIP II | | 30 | 30 | MSME Loan to Accessbank | 15 | |
| | Solid Waste Management AF | | 47 | 47 | Integrated Solid Waste Management AF | | 47.1 | 47.1 | SME and RE/EE loan to Respublika bank | 14 | |
| | | | | | Rail Trade and Transport Facilitation AF | | 220 | 220 | Trade finance lines to Demirbank and Azerigazbank | 14 | |
| | | | | | | | | | Azerigazbank rights issue | 1 | |

| FY | IBRD/IDA Planned Operations | | | | IBRD/IDA Approved Operations | | | | IFC Investment 3/ | | WB G Total I |
|----------------|--|-----------|----------------|----------------|---|-----------|--------------|--------------|------------------------------------|-----------|-----------------------|
| | Operations | IDA | IBRD | Total | Operations | IDA | IBRD | Total | Operations | Amount | |
| | Total FY13 | | 77 | 77 | Total FY13 | | 297.1 | 297.1 | Total FY13 | 44 | |
| FY14 | National Water and Sanitation | | 50 | 50 | | | | | Trade finance line to Azerigazbank | 6 | |
| | National Water Supply and Sanitation II AF | | 40 | 40 | National Water Supply & Sanitation Project II AF | | 150 | 150 | | | |
| | Agricultural Competitiveness Improvement | | 35 | 35 | Agriculture Competitiveness and Innovation (ACIP) | | 34.5 | 34.5 | | | |
| | Judicial Modernization | | 50 | 50 | Judicial Services and Smart Infrastructure | | 100 | 100 | | | |
| | Health Sector Reform | | 30 | 30 | AzRIP II AF | | 50 | 50 | | | |
| | Total FY14 | | 205 | 205 | Total FY14 | | 334.5 | 334.5 | Total FY14 | 6 | 340.5 |
| FY11-14 | TOTAL FY11-14 | 80 | 532-682 | 612-762 | TOTAL FY11-14 a/ | 86 | 721 | 807 | TOTAL FY11-14 | 98 | 905 |

CPSCLR Attachment 3
List of Restructured Projects during the CPS Period

| Global Practice | Project ID | Project Name | Net Commitments (US\$ ml) | Restructuring Level | DO Change | Restructuring Date |
|-----------------------------------|------------|--|------------------------------|--------------------------------------|--------------|-----------------------|
| Education | P102117 | Second Education Sector Development Project | 25 | 1 | Y | 02/24/2014 |
| Governance | P099924 | Corporate and Public Sector Accountability Project | 11 | 2 | | 11/19/2013 |
| Health, Nutrition & Population | P094220 | Health Sector Reform Project | 34 | 2 | | 06/28/2013 |
| Social Protection & Labor | P105116 | Social Protection Project | 20.82 | 2 | | 04/04/2014 |
| Transport & ICT | P094488 | Highway 2 | 675 | 2 | | 03/15/2013 |
| Transport & ICT | P094488 | Highway 2 | 675 | 2 | | 10/18/2013 |
| Transport & ICT | P115396 | Public Investment Capacity Building Project | 8 | 2 | | 09/23/2013 |
| Transport & ICT | P083108 | Rail Trade and Transport Facilitation | 670 | 2 (but Board-approved through AF) | | 06/27/2013 |
| Transport & ICT | P118023 | Third Highway Project | 241.6 | 1 | Y | 12/04/2013 |
| Water | P096213 | National Water Supply & Sanitation | 207.58 | 1 | Y | 11/18/2011 |
| Water | P096213 | National Water Supply & Sanitation | 207.58 | 2 | | 02/28/2013 |
| Water | P109961 | National Water Supply & Sanitation II | 410 | 1 | Y | 11/18/2011 |
| Water | P109961 | National Water Supply & Sanitation II | 410 | 2 | | 02/26/2013 |
| Water | P109961 | National Water Supply & Sanitation II | 410 | 2 (but Board-approved through AF) | | 06/11/2014 |
| Total | 10 | | 2,303 | | | |

CPSCLR Attachment 4

Azerbaijan: Selected Macroeconomic and Financial Indicators 2010-2014

| Indicators | U/A | Baseline | | End-Program Results | |
|--|-----------------|----------|-------|---------------------|---------|
| | | Year | Value | Achieved | |
| | | | | Period | Results |
| Real GDP growth | % per annum | 2010 | 5 | 2011-14 | 2.7 |
| Non-oil GDP growth | % per annum | 2010 | 7.9 | 2011-14 | 9 |
| Export growth ³⁰ | % per annum | 2010 | 24.7e | 2011-14 | 4.7 |
| Current account balance* | % of GDP | 2010 | 28 | 2014 | 16 |
| Non-oil current account balance* | % of nonoil GDP | 2010 | -18 | 2014 | -14 |
| Fiscal balance | % of GDP | 2010 | 13.7 | 2014 | 2.9 |
| Non-oil fiscal balance | % of nonoil GDP | 2010 | 44 | 2014 | 50 |
| Inflation ³¹ | % year-end | 2010 | 7.8 | 2014 | -0.1 |
| External debt ratio to GDP* | % | 2010 | 7.4 | 2014 | 8.5 |
| External debt ratio to exports ³² | % | 2010 | 18 | 2014 | 20 |
| Oil Fund reserves | % of GDP | 2010 | 42.8 | 2014 | 49 |
| Commercial banks capital adequacy ratio | year-end | 2010 | 16.9 | 2014 | 18.65 |
| Commercial banks loan to deposit ratio | year-end | 2010 | 1.17 | 2014 | 1.19 |
| Commercial banks non-performing loans | year-end | 2010 | 4.7 | 2014 | 5.4 |
| Commercial banks liquidity ratio | year-end | 2010 | 19 | 2014 | 12.2 |

* Q3 2014

Source: IMF/World Bank

GDP Growth 2006-14

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|--------------------|------|------|------|------|------|------|------|------|------|
| Real GDP growth | 34.5 | 25.0 | 10.8 | 9.3 | 5.0 | 0.1 | 2.2 | 5.8 | 2.8 |
| Oil GDP growth | 63.2 | 36.8 | 6.8 | 14.0 | 1.8 | -9.8 | -5.0 | 0.9 | -1.5 |
| Non-oil GDP growth | 11.9 | 11.4 | 15.9 | 3.7 | 7.9 | 9.4 | 9.7 | 9.9 | 7.0 |

Share of Oil and Non-Oil Sector to GDP 2002-14

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Share of oil sector in GDP, percent | 34 | 33 | 34 | 48 | 57 | 60 | 59 | 49 | 52 | 53 | 48 | 44 | 40 |
| Share of non-oil sector in GDP, percent | 66 | 67 | 66 | 52 | 43 | 40 | 41 | 51 | 48 | 47 | 52 | 56 | 60 |

³⁰ Export growth assumes the growth rate of export of goods and services from balance of Payments published by CBA. Export numbers according to Statistics Committee is different from BOP numbers and reflect only goods export. According to Statistical committee data exports increased by 45.3 percent in 2010 and during 2011-2014 average export growth was 1.4 percent.

³¹ Average inflation rate was 5.7 percent in 2010 and 1.4 percent in 2014.

³² Exports data is the exports of goods and services based on Balance of Payments data of CBA.

CPSCLR Attachment 5

SUMMARY OF COUNTRY GOALS

Azerbaijan made significant gains towards the medium-term objectives outlined in its strategic programs, most recently in the *Azerbaijan 2020 Strategy*:

- ***The macroeconomic framework during the CPS period has remained positive.*** Economic growth averaged 2.7 percent a year during 2011-14, with non-oil GDP growth reaching an average of 9 percent during the same period (see Annex 4). The government has been running twin surpluses on the fiscal and current account, and reduced public debt from 21.7 percent of GDP in 2002 to 14.1 percent in 2013. In addition, foreign exchange reserves increased to 68 percent of GDP by the end of 2013 –nearly 70 percent of these held by the State Oil Fund. The WBG supported Azerbaijan in building a base for economic diversification and improved quality of non-oil growth. Between 2002 and 2010, growth averaged 13 percent a year and was boosted by high foreign direct investment in the oil sector and growing oil production and oil prices. As a result, per capita GDP nearly tripled over this period. In 2011, declining oil production was more than offset by high public spending and a continued construction boom that supported high non-oil growth. As oil production stabilized temporarily in 2013, economic output expanded by 5.8 percent, responding to the continuous and sizable public investments that boosted growth in construction, manufacturing and non-tradable sectors. Although non-oil sector was strong in the years previous to the CPS period, overall GDP growth during that time was largely driven by the oil sector (see Annex 4). The share of oil sector in GDP increased, along with the economy’s dependence on it. In 2014, on the other hand, the share of non-oil sector to GDP reached 60% (vs. an average of 53% between 2002 and 2010) and GDP growth has been driven by the non-oil sector since 2010, albeit financed by oil-funded public capital investments.
- ***Strong economic performance has been matched by a positive track-record in terms of poverty reduction, shared prosperity and, ultimately, middle class growth.*** Poverty rates in Azerbaijan saw a remarkable improvement during the CPS period, decreasing from 9.1 percent in 2010 to 5.3 percent in 2013. At the same time, households in the bottom two quintiles of the distribution (i.e. the bottom 40 percent or b40) experienced income (consumption) growth of 2.09 percent per year between 2007 and 2012. However, although poverty declined in both rural and urban areas, it is significantly higher in rural areas (nearly twice that of urban areas in 2012, at 8 percent vs. 4.5 percent, respectively). In addition, poverty varies widely across regions: from over 14 percent in Lankaran to 2 percent or less in Baku and Nakchivan.
- ***Rapid economic growth has been accompanied by increased social spending, without which poverty rates would have been considerably higher.*** Total expenditures on social transfers accounted for 4.8 percent of GDP in 2008. This non-market income played a key role for individuals, particularly those in the bottom 40. Nearly two-thirds of the population receive at least one kind of public transfer, and benefits, especially pensions, have been increasing steadily (imposing a non-negligible burden on public finances). Pensions, representing 75 percent of public spending on social protection, have played an important part in reducing poverty, as their amount increased to 95 percent of the minimum subsistence level. According to World Bank estimates,

the poverty rate in 2012 would have been considerably higher, at 25 percent, without pensions, and at 30 percent in the absence of any social benefits.³³

- ***More progress is needed in the areas of access and quality of education and health.*** Azerbaijan has achieved universal access to basic education. However, while primary and secondary enrollment rates are high and in line with ECA averages, Azerbaijan has the second lowest enrollment rate in tertiary education in the ECA region, second only to Uzbekistan. The gross enrollment rate for tertiary education in 2012 was 20.4 percent, significantly below the ECA average of 55.6 percent. Although access to basic education (grades 1st-9th) is near universal, student performance has not improved. In the 2009 Program for International Student Assessment (PISA) test for 15-year olds, the latest in which it participated, Azerbaijan ranked 64th out of 65 countries in reading, 63rd in science, and 45th in mathematics. Azerbaijan has made significant progress towards improving health outcomes in recent years. Over the period 2006-2012, the infant mortality rate decreased from 11.9 to 10.8 per 1,000 live births; and the under-5 mortality rate decreased by 20 percent, from 16.2 to 13.9 over the period. Maternal mortality rate decreased by about 56 percent, from 34.2 per 100,000 live births in 2006 to 14.9 in 2012. However, limited awareness of good health behavior results in a fast rise of non-communicable diseases (NCD) and a reduced life expectancy (59 for men and 63 for women). A persistently heavy reliance on secondary health care units instead of primary care, with a focus on treatment vs. prevention, has led to an inefficient allocation of resources. Nearly half of the population seeks assistance from a hospital doctor as the first point of care, as primary care services are, although available, often not considered of good quality.
- ***Business environment registered some improvements:*** Azerbaijan is one of the top 10 global improvers according to the 2015 Doing Business report, with its ranking improved from 88th to 80th (out of 189). In 2013-2014, Azerbaijan recorded three reforms easing the regulatory framework: It made starting a business easier by reducing the time to obtain an electronic signature for online tax registration; it made transferring property easier by introducing an online procedure for obtaining the non-encumbrance certificate; and it made paying taxes easier for companies by introducing an electronic system for filing and paying social insurance contributions. Reforms in Azerbaijan have targeted both legal institutions and regulatory processes, translating into considerable time gains for entrepreneurs. For example, in 2005, it took 113 days for an entrepreneur in Azerbaijan to start his business. Today it takes only 5 days. Paying taxes takes 195 hours days for a budding entrepreneur in Azerbaijan today, compared to 756 hours 10 years ago. Evidence also suggests that the incidence of discretionary regulatory practices has declined (see paragraph 8) and that the cost of business registration decreased by an estimated 60 percent since 2008. Nonetheless, while Azerbaijan continues to improve regulatory practices, more remains to be done. Its ranking in the Global Competitiveness Index (GCI) has remained substantially unvaried, with a ranking of 38 (out of 144) from 39 in 2013-14 (out of 148). According to the GCI, the most problematic factors for doing business are corruption, access to finance, tax rates, inadequately educated workforce, and inadequate supply of infrastructure. On the latter, Azerbaijan's ranking improved 51st (out of 133) in 2009-10 to 47th (out of 143) in 2014-15 for overall infrastructure. According to Doing Business 2015, Azerbaijan also ranked 10th in property registration out of 189 countries, as a result of reforms implemented in this area. At the same time,

³³ Source: Azerbaijan Systematic Country Diagnostic.

the rankings for quality of roads and railroad infrastructure deteriorated from 58th to 69h and from 31st to 37th, respectively.

- ***Governance challenges continue to constrain access to public services, but the Government of Azerbaijan recognizes that service delivery is in need of improvement.*** The Life in Transition Survey (LiTS) in 2010 showed that Azerbaijan was the only country where citizen satisfaction with service delivery for most public services declined from 2006. In response, Azerbaijan has formulated strategies for development (the most recent being the *Azerbaijan 2020 Vision*), which highlight the importance of strengthening citizen’s rights, improving service delivery and continued institutional reform. Azerbaijan has taken steps to adopt international good practices in service delivery and these national-level efforts have yielded improvements. In recent years, the government has taken several initiatives to reduce corruption and improve access to key public services. Presidential Decrees have mandated ICT development, electronic access to services, mobile service delivery units, improvement of courts’ functioning and the establishment of special agencies under the President to overcome service delivery inefficiencies. One such special agency is the ASAN initiative, a “one-stop shop” for citizens to access a number of public services. ASAN is already delivering impressive results: public satisfaction with ASAN is high and ASAN is widely perceived as a successful example of reform in Azerbaijan.

CPSCLR Attachment 6

EMBEDDING GENDER IN PROJECT DESIGN AND IMPLEMENTATION: Lessons from Azerbaijan Rural Investment Project (AzRIP)

1. Rural community infrastructure provision through AzRIP is supported through the provision of grants to finance demand-driven micro-projects and the provision of training and complementary services to enhance the capacity of participating communities and stakeholders. AzRIP's Regional Operations Offices (ROO) and in particular its Project Assistance Teams (PAT) provide management, implementation support through technical guidance, facilitation and training and monitoring and evaluation of Project activities and the number of female staff in the ROOs and PATs has been increasing steadily over the life of the Project.. Women's participation has been consistently recorded as high in all activities and currently approximately 50 percent of active project participants are women. This has been spurred by the intense gender awareness embedded in the PAT teams' operational approach, manifested in the gender seminars convened to raise awareness of the role of women in AzRIP and to discuss strategies for fostering and sustaining women's participation. These gender sessions provide a forum for disseminating information about how women have benefitted from the project. Participation guidelines that govern AzRIP's community engagement approach embody this: there is a quota for women's representation in local Community Groups (the primary institution at community level for project governance), with at least half of the 8 required group members mandated as to be occupied by women).
2. For the livelihoods pilots, now being scaled up under the Additional Financing for AzRIP-2, fostering women's empowerment and agency has been a central focus of supported activities and women are the prime beneficiaries of livelihood initiatives. Mobilization and organization of Common Interest Groups includes a participatory diagnosis of a community's livelihood challenges and existing and potential on-farm and off-farm income generating activities, and opportunities and constraints to realizing those opportunities. A particular emphasis has been placed on supporting CIGs that include or are exclusively composed of women and youth. Mobilization teams provide training on group dynamics, and facilitate the process of identifying income generating activities.
3. Key principles underlying the selection of income generating activities include their potential to be people centered and participatory, be socially, environmentally and economically sustainable in the long term and their transformational potential to empower vulnerable community members, especially women.
4. AzRIP staff workshops have benefited from drawing upon the expertise of national gender specialists. In the most recent staff retreat, in June, 2014, two gender experts discussed the status of women's leadership in Azerbaijan and the rates of women's participation in elected office and in high level government positions.
5. Building awareness, active and intense learning and knowledge sharing and most importantly, peer-to-peer learning of women in leadership in AzRIP communities through the Community Leadership Exchange Network, the regular community investment conferences and formalized Cross Visit Sessions during which community representatives from across the country

exchange experiences and engage in active learning are critical ingredients of a successful gender strategy in AzRIP. Through its media communications and advocacy, AzRIP consistently promotes women's leadership. Success stories around women leaders regularly feature in AzRIP's quarterly newsletter and serve to encourage newly engaged communities. Gender analysis is furthermore integrated into the comprehensive M&E plan for the Project.

ANNEX 3. Alignment of CPF Focus Areas and Objectives and SCD Priorities

The CPF program will help the country in meeting its development objectives through engagement in priority areas where the country's ownership is strong, and the potential impact on the WBG twin goals and the country's development aspirations is substantial. The CPF takes on board the SCD priorities and contributes to: (i) *strengthening governance* through better management of public resources, delivery of services, and institutions; (ii) *improving connectivity* through developing the country's main roads networks, auxiliary infrastructure and broadband coverage as well as enhanced operational and maintenance practices; and (iii) *developing the country's human capital* through better access to water and sanitation, improved quality of the environment, and other health infrastructure and services, that have proven impact on health and social welfare outcomes. The table below³⁴ demonstrates how the CPF program aligns with the SCD short- and long-term priorities.

| Timeline | SCD Priorities | CPF Focus Areas and Objectives |
|--|---|--|
| <p>Short-term (<math>\leq 3</math> years)</p> <p>Challenges:</p> <p>Top-down</p> <p><i>Ensuring fiscal trends are sustainable and growth is stable, sustainable and shared</i></p> <p>Sustainable asset diversification and productive use at the macro-level through</p> <p>1) Strategic use of oil rents and effective fiscal management;</p> | <p>1. Creating fiscal space through strengthened <i>accountability, transparency and efficiency of public spending</i> by instituting credible fiscal rules of the game, implementing <i>PEFA recommendations, the Government's own national anti-corruption strategy</i>, and developing the institutional capacity and mechanisms needed for results-based programmatic budgeting</p> | <p>1. The CPF program will address the set of issues under Focus Area 1: Public sector management and services, Objective 1.1: Strengthen capacity for public resource management. To meet the objective, the WBG program will help the government implement the <i>PEFA follow-up</i> PFM Action Plan. The program will cover critical priorities identified by 2014 PEFA - a joint product of the WB, EU, SECO and the government - for improving Azerbaijan's public financial management systems. These include further aligning <i>budget classification</i> with GFSM 2014; linking medium term planning and budgeting; strengthening tax compliance; preparing annual financial reports under international standards; improving internal and external audit capacity; and enhancing independent and credible procurement complaint mechanisms. The WBG program will also support <i>implementation of the National Anti-corruption Plan</i>, in particular on improving public procurement. These measures will contribute to a more transparent and efficient use of public resources by strengthening the PFM framework and</p> |

³⁴ The table combines a summary of priorities as given in the SCD Executive Summary (p.18) and a corresponding CPF program description.

| | | |
|---|--|---|
| <p>2) Unleashing Productivity Growth (Private Sector Including Agriculture); Trade and Trade Facilitation</p> | <p>2. Strengthening of local authorities as a decentralization strategy established and implemented;</p> <p>3. Strengthening governance of private sector to ensure even playing field, well defined property rights, facilitate financial inclusion, and support integration and trade facilitation.</p> | <p>moving to a higher standard in terms of international good practice. Efficiency gains will help open fiscal space for better targeting the public resources to support pro-poor policies.</p> <p>2. While the WBG will continue engage local authorities and municipalities in various ways, including through building their capacity to implement and manage public facilities, e.g. water and sanitation or solid waste, the Bank does not plan for any specific intervention to support the decentralization agenda. Selectivity Filter 2, which stipulates alignment with the government’s own priorities, is applied in this case in view of the absence of a decentralization strategy and low demand for the WBG support in this area. However, the WBG will continue the policy dialogue with a focus on fiscal decentralization and identify an appropriate WBG instrument for that, including through TA of tax authorities. Meanwhile CPF program supports <i>citizen engagement</i> and <i>enhance the capacity of communities in decision-making process</i>, which will, in the long run, contribute to strengthening demand-side initiatives for good governance at the local level.</p> <p>3. The SCD’s priority area of strengthening governance of private sector translates prominently into CPF program under Focus Area 2: Economic Competitiveness, Objectives 2.2: Support enhanced access to finance for MSMEs and Objective 2.3: Contribute to reduced regulatory burden for SMEs. In particular, the CFP facilitates financial inclusion by helping improve <i>access to finance</i> -- a key binding constraint for business development - through enhanced financial market regulations, supervision and resolution; developed financial infrastructure, advanced financial institutions and products etc. IFC program will contribute to creating a level playing field through improved</p> |
|---|--|---|

| | | |
|--|--|--|
| | <p>4. Completing <i>roll-out of ASAN</i>, review and evaluation to ensure governance accountable of the program, customs reforms completed and customs services integrated into ASAN; tax administration integrated into ASAN;</p> | <p>taxation practices and modern corporate practices as well as support the realization of cost savings to private sector from the reduced administrative and compliance burden of business inspections. Property rights protection will be provided for through cadaster map coverage and online services in agriculture and agribusinesses development The trade facilitation agenda will be tackled through improved international connectivity, in particular construction and rehabilitation of Highways and Railways as well as improved access to internet/broadband under both ongoing and new operations.</p> <p>4. The CPF will address this priority area under Focus Area 1, Objective 1.2: Support access to, and satisfaction with, public services through expansion of coverage and content of ASAN services which also caters to the needs of the private sector. The ongoing PSIA for ASAN will evaluate adequacy, inclusiveness and quality of its services and impact on the poor and marginalized. Building on the success and utilizing the capacity of the ICT intensive ASAN, the CPF program will explore ways of enhancing interconnectivity and data exchange with more agencies, including with the high technology based tax administration for the benefit of tax payers.</p> <p>CPF contributes to the customs reform through a dialogue around issues related to trading across borders, one of the of DB indicator where Azerbaijan is lagging behind. The government is committed to improve on this from which will pave the way to deepening the regional integration on in line with the country’s strategy plan to become a regional transport and transit hub.</p> |
|--|--|--|

| | | |
|--|--|--|
| <p>Bottom-up: <i>Sustainable accumulation of human, physical and financial capital</i></p> | <p>5. Continued investment in irrigation, boosting agricultural productivity to address rural income inequality and roads infrastructure; other key public services including housing, water and sanitation, and social services, particularly targeting IDP communities.</p> <p>6. Capacity building and autonomy of judiciary</p> <p>7. Strengthening data collection and use relating to public spending, especially public investment, and</p> | <p>5. Under Focus Areas 1 and 2, CPS promotes investments into infrastructure for better access to public services and infrastructure for growth. These are two ingredients for improved <i>connectivity</i> and <i>productivity growth</i> defined by the SCD as a key constraint to the country's inclusive growth. Applying the filter of its long term successful engagement in the sector, the WBG program will help improve access to <i>water and sanitation</i> and other <i>public services</i>, through the ongoing and proposed new operations, including those targeted at IDPs. Through infrastructure investments in the poor communities, the program will help improve <i>local roads</i> to connect to markets and social services.</p> <p>Following the SCD recommendations, CPF puts a special focus on agriculture and rural development (Focus Area 2 Objective 2.4) through investments in irrigation, value chains development, increased access to finance and quality infrastructure (standardization and accreditation agencies, veterinary services, etc.), that will contribute to enhanced sector competitiveness and promotion of SME development.</p> <p>6. CPS program is well aligned with the SCD priority of enhanced capacity and autonomy of judiciary as part of addressing the <i>governance</i> constraint. Under Pillar 1 Objective 2, the WBG will support modernization of the sector, building on the substantial ongoing program which will provide: (i) better quality of judicial services and their delivery, using the most advanced IT based facilities,(ii) free legal aid to particularly benefit the poor and marginalized groups; and (iii) better access to information.</p> <p>7. CPF is aligned with SCD and recognizes critical importance of strengthening the system of data collection, analysis and</p> |
|--|--|--|

| | | |
|--|---|---|
| | <p>public services with a view to strengthening monitoring and evaluation of impact on b40 and facilitating evidence based decision making and course correction where needed.</p> <p>8. Education policy established and implementation initiated for quality improvement at secondary level and strengthened access and coverage at tertiary level;</p> <p>9. Risk pooling in health care and reforms to support autonomy, standards and quality; establish protection against impoverishing health expenditures by strengthening access and quality.</p> | <p>publishing for supporting evidence-based decision making, especially for assessing distributional effects of policy reforms (Focus Area 1, Objective 1.2: Support access to, and satisfaction with, public services). CPF program will help improve capacity of the State Statistics Agency (SSC) through establishing a statistical meta-data system based on international best practices and professional training of staff. The WBG will coordinate with other development partners, including the UN agencies, to address the issue of discrepancies and reconcile methodical differences to unify databases.</p> <p>8. The WBG has been long engaged in the development of the country' education systems, supporting the reform in general education and formulation of the country's education sector development strategy. The government has already implemented several important reforms, in particular by introducing per capita financing in the tertiary, and a new remuneration and quality assurance system in the secondary education. The WBG will continue to support reforms through the ongoing policy dialogue, current operation in the secondary education and a potential Higher Education project. The current interventions on skills development (Social protection development project, Public investment capacity building project) are limited and target specific sector needs. However, in case the government expresses strong interest, the engagement will be broadened to cover the skills agenda, most probably in the outer years.</p> <p>9. The CPF does not include any investment operation on health care due to the shift in the government's borrowing priorities. The WBG engagement will, however, continue through a policy dialogue and technical assistance/ advisory</p> |
|--|---|---|

| | | |
|--|---|---|
| | <p>10. Programmatic budgeting established and disaggregated data published; preliminary performance indicators established;</p> <p>11. Review of data management and publication practices completed at both macro and micro level and reforms implemented</p> <p>12. Drafting of PPP framework, public investment management methodology and piloting</p> <p>13. Time-bound strategy for environmental sustainability incorporating integrated landscape management and cleanup of contaminated land; wastewater management and improved local environmental services established.</p> | <p>services that will underpin the ongoing discussion on health financing reform and a potential investment operation should government's demand and ownership is there. Meanwhile the CPF will address the issue of improved health outcomes through investing into water supply and sanitation as part of the health system infrastructure. A potential Lake clean-up operation will also have a positive impact on health, especially on marginalized people residing in the highly contaminated areas of the Absheron Peninsula.</p> <p>10. This priority area falls under a longer term PFM reform agenda and is not included in the CPF program at this point in time but will be considered at the PLR stage.</p> <p>11. This priority area falls under a longer term and broader agenda of improving the quality of and public access to information. This issue will be part of the policy dialogue within the ongoing TA for SSC.</p> <p>12. IFC will explore PPP and investment opportunities in infrastructure as well as loss reduction and investment optimization advisory service to state utilities in the energy sector.</p> <p>13. The CPF will only address part of these challenges focusing on areas where the government's commitment and ownership is strong. In particular, the program envisages an operation as part of the government's ongoing program on cleaning up contaminated lakes on the Absheron Peninsula. This in its turn is part of broader plans on addressing environmental challenges across the country, which may be a basis for an evolving engagement. A proposed operation will contribute to improved health outcomes within the objective</p> |
|--|---|---|

| | | |
|-------------------------------|--|--|
| | | (Pillar1, Objective 1) of facilitating the delivery of public services. |
| | <p>The CPF assumes that the two strategic focus areas of improved public sector management and service delivery, and economic competitiveness and the eight objectives will remain relevant throughout the CPF lifetime of five years. This is accounted for by the long term nature of the objectives and instruments that are defined through a strict process of applying the selectivity filters. Most of the longer term priorities identified by the SCD will be addressed dependent on the government’s evolving needs and demands for the WBG engagement as well as contingent upon the pace of reform and transformation in the priority areas. For example, the WBG engagement in health, education, environmental strategy development, and local connectivity will be limited if the government’s demand remains unchanged. In the current economic and financial environment, the government prefers to invest into these areas from the state budget and tap into the WBGs global knowledge and advisory services, while using the WBG and other IFIs funding for the large and transformational projects, where it is justified to take foreign currency exchange rate risks.</p> | |
| Longer-term (3+ years) | <p>Overhaul local connectivity; Implement education policy focused on access to tertiary and quality of secondary; Continue to strengthen access and quality of health care while ensuring adequate financing mechanisms; Performance-based programmatic budget established and implemented; Capital budgeting methodology established and implemented; PPP framework established and functional, both in terms of financing of and provision of infrastructure and social services; Irrigation overhauled; First phase of strategic plan for environmental sustainability implemented; with next phases for medium and long term actions defined.</p> | <p>These SCD longer term priority areas fall into the above referred category and will be considered for potential investment lending in the outer years and adjusted for at the PLR time. For example, rural roads, tertiary education, health financing, program budgeting, PPPs are among medium to long term priorities, hence warrant less detailed discussion within this strategic framework. More specifically: Since the government addresses the challenge of “overhauling the local connectivity” as part of its public investment program, the CPF program will mainly focus on <i>highways and main transport corridors</i> – government’s borrowing priority – to complete the country’s integration into the regional transport network, which will help Azerbaijan to become a transit and logistics hub. At the same, the CPF envisaged investments into the local connectivity through community driven development projects. The road network database developed under the WB financed projects will be used as a tool to help the government define priorities for long term investments in local and regional roads.</p> |

| | | |
|--|--|--|
| | | <p>In the long term, the Bank is prepared to support Azerbaijan in implementing policies on improved access to and relevance of tertiary education, in line with the Education Reform Strategy implementation. In the meantime the ongoing project on secondary education helps to build a foundation for improved quality of secondary education as a prerequisite for effective reforms in the tertiary education, as it is also stipulated in the SCD (Executive Summary, para 28). To build a pipeline of future interventions in this area, the WBG will carry on policy dialogue and provide TA/advisory services.</p> <p>The WBG will continue to provide TA support and share knowledge on the health care financing mechanisms and best global practices, which has a potential for an investment operation in the outer years.</p> |
|--|--|--|

ANNEX 4. Selected Indicators of Bank Portfolio Performance and Management

As Of Date
05/27/2015

| Indicator | 2012 | 2013 | 2014 | 2015 |
|---|------|------|------|------|
| Portfolio Assessment | | | | |
| Number of Projects Under Implementation ^a | 16 | 17 | 17 | 17 |
| Average Implementation Period (years) ^b | 3.9 | 4.6 | 5.2 | 5.7 |
| Percent of Problem Projects by Number ^{a, c} | 31.3 | 23.5 | 5.9 | 5.9 |
| Percent of Problem Projects by Amount ^{a, c} | 43.2 | 39.3 | 0.8 | 8.8 |
| Percent of Projects at Risk by Number ^{a, d} | 31.3 | 23.5 | 5.9 | 5.9 |
| Percent of Projects at Risk by Amount ^{a, d} | 43.2 | 39.3 | 0.8 | 8.8 |
| Disbursement Ratio (%) ^e | 14.2 | 23.4 | 26.6 | 34.3 |
| Portfolio Management | | | | |
| CPPR during the year (yes/no) | | | | |
| Supervision Resources (total US\$) | | | | |
| Average Supervision (US\$/project) | | | | |

| Memorandum Item | Since FY 80 | Last Five FYs |
|---|-------------|---------------|
| Proj Eval by OED by Number | 29 | 7 |
| Proj Eval by OED by Amt (US\$ millions) | 815.8 | 234.4 |
| % of OED Projects Rated U or HU by Number | 24.1 | 14.3 |
| % of OED Projects Rated U or HU by Amt | 21.9 | 21.9 |

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank's country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

ANNEX 5. Operations Portfolio (IBRD/IDA and Grants)

As Of Date 4/30/2015

| Closed Projects | | 34 | |
|-------------------------------------|--|-----------|--|
| <u>IBRD/IDA *</u> | | | |
| Total Disbursed (Active) | | 1,656.96 | |
| of which has been repaid | | 128.22 | |
| Total Disbursed (Closed) | | 571.52 | |
| of which has been repaid | | 429.47 | |
| Total Disbursed (Active + Closed) | | 2,228.49 | |
| of which has been repaid | | 557.69 | |
| Total Undisbursed (Active) | | 1,042.15 | |
| Total Undisbursed (Closed) | | 0.00 | |
| Total Undisbursed (Active + Closed) | | 1,042.15 | |

| <u>Active Projects</u> | <u>Project Name</u> | <u>Last PSR</u> | | | <u>Original Amount in US\$ Millions</u> | | | | | <u>Difference Between Expected and Actual Disbursements^{a/}</u> | |
|-------------------------------|---|--------------------------------------|---------------------------------------|---------------------------|--|-------------------|---------------------|-----------------------|-----------------------|---|-------------------------|
| | | <u>Supervision Rating</u> | | <u>Fiscal Year</u> | <u>IBRD</u> | <u>IDA</u> | <u>GRANT</u> | <u>Cancel.</u> | <u>Undisb.</u> | <u>Orig.</u> | <u>Frm Rev'd</u> |
| | | <u>Development Objectives</u> | <u>Implementation Progress</u> | | | | | | | | |
| P122812 | ACIP | S | MS | 2014 | 34.5 | 0.0 | | | 32.2 | 2.9 | 0.0 |
| P110679 | ARP II-INTEGRAT'D SOLID WASTE MGT | S | S | 2008 | 76.6 | 0.0 | | | 35.1 | -12.0 | 3.8 |
| P120321 | AZ Capital Markets Modernization | S | MS | 2011 | 12 | 0.0 | | | 5.3 | 5.3 | 0.4 |
| P118023 | AZ HIGHWAY 3 | MS | MU | 2010 | 171.6 | 70 | | | 145.2 | 141.8 | 45.7 |
| P099924 | CAPSAP | S | S | 2008 | 0.0 | 11 | | | 0.6 | 1.0 | -7.2 |
| P102117 | EDUC SECT DEVT 2 | MS | S | 2008 | 0.0 | 25 | | | 2.5 | 3.6 | 1.1 |
| P094488 | HIGHWAY 2 | MS | MS | 2006 | 613 | 62 | | | 11.3 | -465.3 | 9.7 |
| P122943 | IDP Living Standards and Livelihoods | S | S | 2012 | 50 | 0.0 | | | 15.5 | -34.5 | 0.0 |
| P144700 | Judicial Services & Smart Infrastr Proj | S | HS | 2015 | 100 | 0.0 | | | 89.5 | -7.6 | 0.0 |
| P096213 | NAT'L WATER SUPPLY & SAN | S | MS | 2007 | 230 | 0.0 | | 22.4 | 45.6 | 68.1 | 45.6 |
| P109961 | NAT'L WATER SUPPLY & SAN II | S | MS | 2008 | 380 | 30 | | | 182.5 | -118.9 | 34.8 |
| P115396 | PUB INVST CAP BLDG | MS | S | 2009 | 0.0 | 8 | | | 0.5 | 0.2 | 0.0 |
| P083108 | RAIL TRADE & TRNSPT FACIL | MS | MS | 2008 | 670 | 0.0 | | | 413.6 | 193.6 | -5.8 |
| P100582 | REAL ESTATE REG. | MS | MS | 2007 | 30 | 0.0 | | | 7.3 | 7.3 | 7.3 |
| P122944 | RURAL INVSMT (AZRIP) 2 | S | HS | 2013 | 80 | 0.0 | | | 39.7 | 0.0 | 0.0 |
| P105116 | SOCIAL PROT DEV | MS | MS | 2008 | 0.0 | 26.7 | | 5.9 | 0.0 | 7.6 | 1.3 |
| P107617 | WUAP | S | S | 2011 | 3.2 | 76.8 | | 0.0 | 15.6 | 1.8 | 0.0 |
| Overall Result | | | | | 2450.9 | 309.5 | | 28.3 | 1042.1 | -205.2 | 136.6 |

ANNEX 6. Statement of IFC's Held and Disbursed Portfolio

As of 04/30/2015

(In USD Millions)

| FY Approval | Company | Committed | | | | | Disbursed Outstanding | | | | |
|-------------------------|------------------|--------------|-------------|---------------------------|---------------|-------------------------|-----------------------|-------------|---------------------------|---------------|-------------|
| | | Loan | Equity | <u>**Quasi Equity</u> | <u>*GT/RM</u> | <u>Partici pant</u> | Loan | Equity | <u>**Quasi Equity</u> | <u>*GT/RM</u> | Participant |
| FY02 | ACCESSBANK | 0.00 | 1.60 | 0.00 | 0.00 | 0.00 | 0.00 | 1.60 | 0.00 | 0.00 | 0.00 |
| FY07 | ACCESSBANK | 0.00 | 0.56 | 0.00 | 0.00 | 0.00 | 0.00 | 0.56 | 0.00 | 0.00 | 0.00 |
| FY08 | ACCESSBANK | 0.00 | 2.25 | 0.00 | 0.00 | 0.00 | 0.00 | 2.21 | 0.00 | 0.00 | 0.00 |
| FY13 | ACCESSBANK | 9.00 | 0.00 | 0.00 | 0.00 | 0.00 | 9.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY14 | ACCESSBANK | 0.00 | 0.00 | 0.00 | 0.18 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY15 | ACCESSBANK | 0.00 | 0.00 | 0.00 | 5.32 | 0.00 | 0.00 | 0.00 | 0.00 | 1.53 | 0.00 |
| FY07 | ADA-TICARET | 10.91 | 0.00 | 5.97 | 0.00 | 0.00 | 10.91 | 0.00 | 5.97 | 0.00 | 0.00 |
| FY09 | AZERIGAZBANK | 0.00 | 0.00 | 3.33 | 0.00 | 0.00 | 0.00 | 0.00 | 3.33 | 0.00 | 0.00 |
| FY08 | CREDAGRO | 0.00 | 0.00 | 1.71 | 0.00 | 0.00 | 0.00 | 0.00 | 1.71 | 0.00 | 0.00 |
| FY11 | FINCA AZERBAIJAN | 0.88 | 0.00 | 0.00 | 0.00 | 0.00 | 0.88 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY13 | FINCA AZERBAIJAN | 0.00 | 0.00 | 0.00 | 0.35 | 0.00 | 0.00 | 0.00 | 0.00 | 0.30 | 0.00 |
| FY14 | FINCA AZERBAIJAN | 0.00 | 0.00 | 0.00 | 0.22 | 0.00 | 0.00 | 0.00 | 0.00 | 0.22 | 0.00 |
| FY15 | FINCA AZERBAIJAN | 0.00 | 0.00 | 0.00 | 1.25 | 0.00 | 0.00 | 0.00 | 0.00 | 0.95 | 0.00 |
| FY13 | RESPUBLIKA | 14.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY11 | TURAN BANK | 2.33 | 0.00 | 0.00 | 0.00 | 0.00 | 2.33 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY15 | TURAN BANK | 7.00 | 0.00 | 0.00 | 0.00 | 0.00 | 3.50 | 0.00 | 0.00 | 0.00 | 0.00 |
| FY11 | UNIBANK OJSC | 3.33 | 0.00 | 0.00 | 0.00 | 0.00 | 3.33 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Portfolio: | | 47.45 | 4.41 | 11.01 | 7.32 | 0 | 29.95 | 0.00 | 1.60 | 0.00 | 0.00 |

* Denotes Guarantee and Risk Management Products.

** Quasi Equity includes both loan and equity types.

ANNEX 7. Gender Indicators

March/2015
EUROPE AND CENTRAL ASIA

GENDER AT A GLANCE AZERBAIJAN

| | |
|---|--------------|
| GNI per capita (Atlas Method, US\$) ¹ | 7,350 (2013) |
| Population living below US\$2.50 ² | |
| Population living below US\$5.00 ² | |
| GNI per capita loss due to gender gaps in the labor market ³ | 4% (2008) |

Most recent...

| | |
|--|---------------|
| Government Gender Action Plan | Not available |
| Country Gender Assessment ⁴ | 2014 |

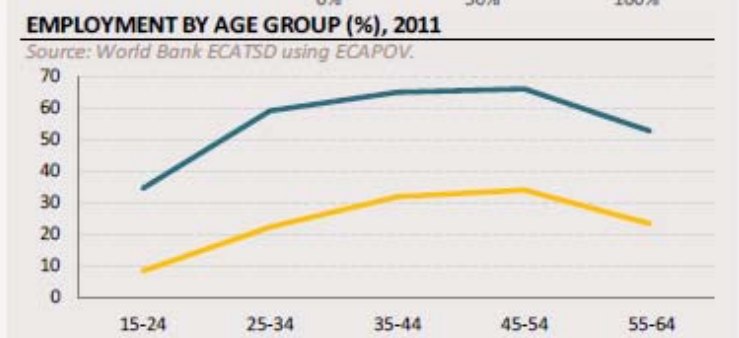
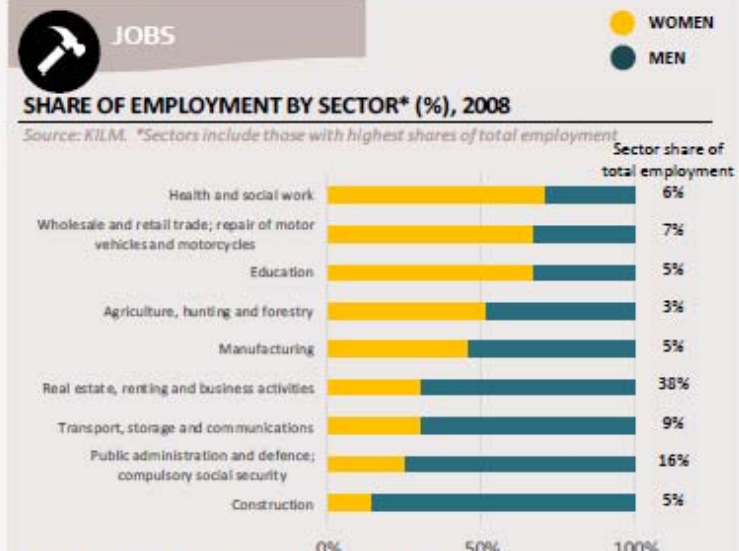
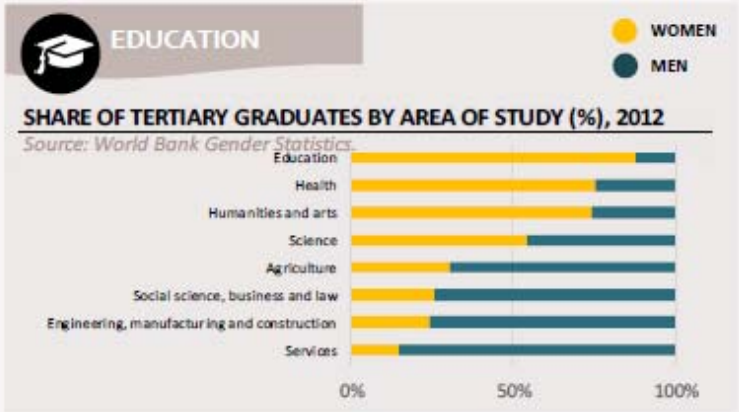
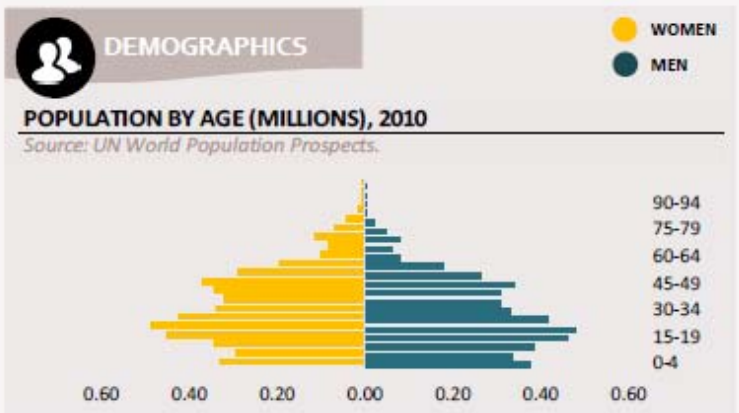
Source: ¹ WDI. ² World Bank ECATSD using ECAPOV.
³ Teignier, Marc and David Cuberes (2014). "Aggregate Costs of Gender Gaps in the Labor Market: A Quantitative Estimate." Universitat de Barcelona Economics Working Papers 2014/308.
⁴ World Bank.

MILLENNIUM DEVELOPMENT GOAL PROGRESS

| | | |
|--|------------|------------|
| Ratio of girls to boys in primary education | 98 (2002) | 98 (2012) |
| Ratio of girls to boys in secondary education | | 99 (2012) |
| Ratio of girls to boys in tertiary education | | 105 (2012) |
| Share of women in wage employment in the non-agricultural sector | 47% (2002) | 43% (2012) |
| Proportion of seats held by women in national parliament | 11% (2002) | 16% (2015) |

Source: World Bank Gender Statistics, Inter Parliamentary Union.

| GLOBAL INDICES | Score | Max | Rank | Year |
|------------------------------------|--------|-----|--------|------|
| WORLD ECONOMIC FORUM | | | | |
| Global Gender Gap Index | 0.6753 | 1 | 94/142 | 2014 |
| UNDP | | | | |
| Gender Inequality Index | 0.3400 | 0 | 62/152 | 2013 |
| OECD | | | | |
| Social Institutions & Gender Index | 0.2403 | 0 | 71/108 | 2014 |
| EU | | | | |
| Gender Equality Index | - | 100 | - | 2013 |





LEGAL FRAMEWORK

The constitution of Azerbaijan guarantees equality for men and women before the law. Men and women have equal ownership and inheritance rights to property. The default marital property regime is partial community of property. There are laws restricting the industries in which women may work. More specifically, there are restrictions regarding the employment of women in the areas of mining, construction, metalworking, factories, jobs requiring lifting weights above a threshold, and work deemed hazardous or arduous. Women are entitled to 126 calendar days of maternity leave with 100% of wages paid and 14 days of unpaid maternity leave. Men are entitled to 14 days of unpaid paternity leave. Parents are entitled to an additional 1,039 days of partially paid parental leave. The law guarantees pregnant and nursing women workplace protections from dismissal, placement in an equivalent position when they return from maternity leave, and rights to a flexible schedule. The law stipulates public provision of childcare for children under the age of primary education. The age at which men and women can retire and receive full benefits is 63 and 58.5, respectively. There is legislation specifically addressing domestic violence that includes emotional, financial, physical, and sexual abuse.

Source: *Women, Business, and the Law (2013)*.

KEY INDICATORS

| | Azerbaijan | | Europe & Central Asia | | OECD | | Upper Middle Income | | Year* |
|---|------------|--------|-----------------------|--------|------|--------|---------------------|--------|-------|
| | Male | Female | Male | Female | Male | Female | Male | Female | |
| Endowments: Education, Health, and Demographics | | | | | | | | | |
| Gross pre primary enrollment (% of relevant age group) ¹ | 25 | 25 | 78 | 77 | | | 69 | 69 | 2012 |
| Gross primary enrollment (% of relevant age group) ¹ | 99 | 97 | 102 | 102 | 102 | 101 | 119 | 115 | 2012 |
| Gross secondary enrollment (% of relevant age group) ¹ | 101 | 100 | 100 | 98 | 98 | 98 | 87 | 89 | 2012 |
| Gross tertiary enrollment (% of relevant age group) ¹ | 20 | 21 | 57 | 69 | 65 | 77 | 31 | 37 | 2012 |
| Adult literacy rate (% aged 15 and above) ¹ | 100 | 100 | 99 | 99 | | | 96 | 92 | 2012 |
| Labor force with tertiary education (% of relevant group) ¹ | 19 | 13 | 26 | 32 | 26 | 31 | | | 2012 |
| Life expectancy at birth (years) ¹ | 68 | 74 | 73 | 80 | 77 | 83 | 72 | 76 | 2012 |
| Maternal mortality rate (per 100,000 live births) ¹ | - | 26 | - | 18 | - | 21 | - | 57 | 2013 |
| Fertility rate (births per woman) ¹ | - | 2.0 | - | 1.7 | - | 1.8 | - | 1.9 | 2012 |
| Access to Economic Opportunity | | | | | | | | | |
| Labor participation rate (% of population ages 15-64) ¹ | 73 | 68 | 78 | 63 | 79 | 62 | 82 | 62 | 2013 |
| Unemployment (% of labor force) ¹ | 4.4 | 6.6 | 9.7 | 9.5 | 8.0 | 8.0 | 6.0 | 5.7 | 2013 |
| Youth unemployment (% of population ages 15-24) ¹ | 13.3 | 15.8 | 21.7 | 22.4 | 17.5 | 17.2 | 14.2 | 16.0 | 2013 |
| Self-employed (% of employed men/women) ¹ | 52 | 63 | 22 | 16 | 18 | 13 | | | 2008 |
| Employment rate of persons ages 25-49 with a child under 3 living in household ² | | | | | | | | | |
| Firms with female participation in ownership (% of firms) ¹ | - | 4 | - | | - | | - | | 2013 |
| Gender pay gap (in average monthly earnings, % of men's wages, unadjusted) ² | - | 53 | - | 23 | - | | - | | 2013 |
| Account at a formal financial institution (% age 15+) ¹ | 16 | 14 | 73 | 66 | 86 | 80 | 62 | 53 | 2011 |
| Land owners (% of adult population) ¹ | | | | | | | | | |
| Agency | | | | | | | | | |
| Proportion of seats held by women in national parliaments (%) ³ | - | 16 | - | 20 | - | | - | | 2015 |
| Share of women among members of municipal councils or other local area governing bodies ² | - | | - | 31 | - | | - | | |
| Firms with female top managers (%) ¹ | - | 2 | - | | - | | - | | 2013 |
| Proportion of women in ministerial level positions (%) ¹ | - | 3 | - | 21 | - | 27 | - | 15 | 2014 |
| Percentage agreeing that a husband is justified in hitting or beating his wife ⁴ | 57 | 49 | | | | | | | 2006 |
| Women who have experienced physical and/or sexual violence by a partner and/or non-partner since the age of 15 ⁵ | - | | - | | - | | - | | |

*Indicates year of country data. All benchmarking data is from the most recent available year.

Source: ¹ World Bank Gender Statistics. ² UNECE. ³ Inter-Parliamentary Union (as of 1/1/2015). ⁴ Demographic and Health Survey. ⁵ EU Violence Against Women Survey.