

CONFORMED COPY

CREDIT NUMBER 3615 AZ

Development Credit Agreement

(Second Structural Adjustment Credit)

between

AZERBAIJAN REPUBLIC

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated March 13, 2002

CREDIT NUMBER 3615 AZ

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated March 13, 2002, between Azerbaijan Republic (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Association has received from the Borrower a letter dated February 12, 2002, describing a program of actions, objectives and policies designed to achieve structural adjustment of the Borrower's economy (hereinafter called the Program), declaring the Borrower's commitment to the execution of the Program, and requesting assistance from the Association in support of the Program during the execution thereof; and

(B) on the basis, inter alia, of the foregoing, the Association has decided in support of the Program to provide such assistance to the Borrower by making the Credit in two tranches as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985, (as amended through October 6, 1999) with the modifications thereof set forth below (the General Conditions) constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 12, is modified to read:

"'Project' means the program, referred to in the Preamble to the Development Credit Agreement, in support of which the Credit is made.";

(b) Section 4.01 is modified to read:

"Except as the Borrower and the Association shall otherwise agree, withdrawals from the Credit Account shall be made in the currency of the deposit account specified in Section 2.02 of the Development Credit Agreement.";

(c) Section 5.01 is modified to read:

"The Borrower shall be entitled to withdraw the proceeds of the Credit from the Credit Account in accordance with the provisions of the Development Credit Agreement and of these General Conditions";

(d) The last sentence of Section 5.03 is deleted;

(e) Section 9.06 (c) is modified to read:

"(c) Not later than six months after the Closing Date or such later date as may be

“(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, the Borrower shall prepare and furnish to the Association a report, of such scope and in such detail as the Association shall reasonably request, on the execution of the program referred to in the Preamble to the Development Credit Agreement, the performance by the Borrower and the Association of their respective obligations under the Development Credit Agreement and the accomplishment of the purposes of the Credit.”; and

(f) Section 9.04 is deleted and Sections 9.05, 9.06 (as modified above), 9.07 and 9.08 are renumbered, respectively, Sections 9.04, 9.05, 9.06 and 9.07.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “ARWC” means Aspheron Regional Joint-Stock Water Company of the Borrower, established as a joint-stock company pursuant to Decision No. 1038 of the Parliament, dated May 12, 1995, and includes any successor thereto acceptable to the Association;

(b) “Azerenergy” means the power company of the Borrower, established as a joint-stock company established pursuant to Presidential Decree No. 423, dated September 17, 1996, and includes any successor thereto acceptable to the Association;

(c) “Azerigas” means the joint-stock company of the Borrower, established pursuant to Presidential Decree No. 328, dated May 31, 1996, and includes any successor thereto acceptable to the Association;

(d) “Chamber of Accounts” means the Borrower’s supreme audit institution, responsible for auditing the government income and expenditure, assessing the financial integrity and performance of government operations and the credibility of reported information;

(e) ”CoM” means the Cabinet of Ministers of the Government of the Borrower;

(f) “Deposit Account” means the account referred to in Section 2.02 (b) of this Agreement;

(g) “FY” means the fiscal year of the Borrower beginning on January 1 and ending December 31 of each year;

(h) “MTEF” means the Medium Term Expenditure Framework for the state budget and the budget of each state extrabudgetary fund together with details of major investments and other projects, adopted by the Borrower;

(i) “Oil Fund” means the State Oil Fund of the Borrower as established in accordance with Presidential Decree No. 240, dated December 29, 1999;

(j) “PIP” means the Public Investment Program adopted by the Borrower;

(k) “Public Procurement” means the Borrower’s public procurement procedure;

(l) “Public Procurement Implementation Plan” means an implementation plan for the Borrower’s Public Procurement;

(m) “SOCAR” means the State Oil Company of the Borrower, and includes any successor thereto acceptable to the Association; and

(n) “State Social Protection Fund” means the Social Protection Fund of the Borrower, established in accordance with Presidential Decree No. 233, dated September 30, 1992.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to forty-eight million four hundred thousand Special Drawing Rights (SDR 48,400,000).

Section 2.02. (a) Subject to the provisions of paragraphs (b), (c) and (d) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Credit from the Credit Account in support of the Program.

(b) The Borrower shall open, prior to furnishing to the Association the first request for withdrawal from the Credit Account, and thereafter maintain in the National Bank of Azerbaijan, a deposit account in Dollars on terms and conditions satisfactory to the Association. All withdrawals from the Credit Account shall be deposited by the Association into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Credit shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Association shall have determined at any time that any proceeds of the Credit shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Association, (i) deposit into the Deposit Account an amount equal to the amount of said payment, or (ii) if the Association shall so request, refund such amount to the Association. Amounts refunded to the Association upon such request shall be credited to the Credit Account for cancellation.

(d) No withdrawals shall be made from the Credit Account after the aggregate of the proceeds of the Credit withdrawn from the Credit Account shall have reached the equivalent of SDR 24,200,000, unless the Association shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Association:

- (i) with the progress achieved by the Borrower in the carrying out of the Program;
- (ii) that the macroeconomic policy framework of the Borrower is satisfactory, as measured on the basis of indicators agreed between the Borrower and the Association; and
- (iii) that the actions described in Schedule 2 to this Agreement have been taken satisfactory to the Association. If, after said exchange of views, the Association is not so satisfied, the Association may give notice to the Borrower to that effect and, if within 90 days after such notice, the Borrower shall not have taken steps satisfactory to the Association, in respect of (i), (ii) and (iii) above, then the Association may, by notice to the Borrower, cancel the unwithdrawn amount of the Credit or any part thereof.

Section 2.03. The Closing Date shall be December 31, 2003 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or cancelled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on January 1 and July 1 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each January 1 and July 1 commencing July 1, 2012 and ending January 1, 2037. Each installment to and including the installment payable on January 1, 2022 shall be one and one-fourth percent (1-1/4%) of such principal amount, and each installment thereafter shall be two and one half percent (2-1/2%) of such principal amount.

(b) Whenever (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by the Association of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and

the actions specified in Schedule 2 to this Agreement.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request.

(c) Without limitation upon the provisions of paragraph (a) of this Section, the Borrower shall exchange views with the Association on any proposed action to be taken after the disbursement of the Credit which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program, including any action specified in Schedule 2 to this Agreement.

Section 3.02. Upon the Association's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

(b) furnish to the Association as soon as available, but in any case not later than six (6) months after the date of the Association's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and

(c) furnish to the Association such other information concerning the Deposit Account and the audit thereof as the Association shall have reasonably requested.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (1) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Termination

Section 5.01. The date sixty (60) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as the representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
83 Samed Vurgun Street
Baku 370022
Azerbaijan Republic

Telex:

142116 BNKSL

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INDEVAS
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

Facsimile:

(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

AZERBAIJAN REPUBLIC

By: /s/ Hafiz Pashayev

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By: /s/ Judy O'Connor

Country Director
South Caucasus Country Unit
Europe and Central Asia

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Credit shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another credit or a loan;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Association by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semiprecious stones, unworked or worked

718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party);

6. expenditures (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Association determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Credit during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Association to remedy the situation.

SCHEDULE 2

Actions Referred to in Section 2.02 (d) of this Agreement

1. The MTEF for FY 2003-2005 and the PIP for FY 2003-2005, consistent with the MTEF, have been approved.
2. (a) The Budget Systems Law of the Borrower has been enacted; and
(b) the budget for FY 2003, consistent with the MTEF and the Borrower's Budget Systems Law, has been approved by the Borrower's cabinet of ministers, integrating all remaining state extrabudgetary resources into the state budget with the exception of the Oil Fund.
3. The Borrower has: (a) provided evidence of satisfactory implementation of its Public Procurement Implementation Plan; (b) implemented a process of Public Procurement review by independent procurement auditors commencing with pilot audits in FY 2002; and (c) published the results of the pilot audits as well as the plans for any remedial actions.
4. The Borrower has: (a) appointed at least five auditors for the Chamber of Accounts; (b) developed a satisfactory organizational structure; (c) created staff grades with acceptable job descriptions and recruitment criteria; (d) installed appropriate equipment with the Chamber of Accounts; (e) prepared the Chamber of Accounts' work plan for FY 2003; and (f) submitted the financial plan for the Chamber of Accounts for FY 2003 to the Parliament.
5. The Borrower has implemented a satisfactory public financial accountability action plan.
6. The Borrower has adopted a satisfactory medium-term strategy for enhancing targeting of social assistance and reducing the impact on the poor of new public utility policies.
7. The Borrower has: (a) published the audited accounts of the Oil Fund in FY 2001; (b) published financial and budget execution statements quarterly; and (c) completed a review of the Oil Fund's governance arrangement.
8. The Borrower has: (a) reduced by 30% of the subsidies in the electricity, gas, and water sectors through a combination of better cash collection, tariff adjustments and increased efficiency; and (b) provided evidence that budgetary institutions have been current with utility payments for at least six months.
9. The Borrower has caused SOCAR, Azerenergy, Azerigaz and ARWC to complete: (a) monthly financial and operational management information in order to monitor subsidies; (b) annual audited financial statements; and (c) a time-bound action plan in order to upgrade their financial management arrangements.
10. The Borrower has approved satisfactory draft regulations for electricity, gas and water sectors in order to ensure fair and competitive behavior.
11. The Borrower has: (a) determined appropriate economic prices for electricity, gas, water, wastewater and solid waste treatment; and (b) approved and published a time-bound action plan to adjust tariffs to economic prices along with required actions to mitigate social consequences.

12. The Borrower has introduced a system to monitor and publish progress in the reduction of barriers to private investment through annual firm-level surveys by an independent research organization.

