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PUBLIC INVESTMENT POLICY PROJECT

Quarterly Performance Report

Period: October 1 – December 31, 2007

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The authors' views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

TABLE OF CONTENTS

ABBREVIATIONS

CBA	Cost-Benefit Analysis
CC	Call Circular
CIS	Commonwealth of Independent States
COM	Cabinet of Ministers
COP	Chief of Party (of a USAID project)
DAI	Development Alternatives, Inc.
ERSRI	Economic Reforms Scientific Research Institute
FY	Financial Year
GDP	Gross Domestic Product
GOAZ	Government of Azerbaijan
IFI	International Financial Institutions
IMF	International Monetary Fund
IT	Information Technology
LM	Line Ministry
LTTA	Long-term Technical Assistance
MOED	Ministry of Economic Development
MOA	Ministry of Agriculture
MOF	Ministry of Finance
MOT	Ministry of Transport
MTBF	Medium-term Budget Framework
MTDP	Medium-term Development Plan
MTMF	Medium-term Macroeconomic Framework
NBA	National Bank of Azerbaijan
NGO	Non-governmental Organization
PI	Public Investment
PIP-Project	Public Investment Policy Project (USAID/DAI)
PRGF	Poverty Reduction and Growth Facility
QAB	Quarterly Analytical Bulletin
RMSM-X model	Revised Minimum Standard Model – Extended of World Bank
SEDF	Socio-Economic Development Forecasts (of MOED)
SOW	Scope of Work
SPPRSD	State Program for Poverty Reduction and Sustainable Development
SPSEDR	State Program for Socio-Economic Development of Regions
SSDP	Sector Strategic Development Plan
STTA	Short-term Technical Assistance
TAMIS	Technical and Administrative Management Information System
TOR	Terms of Reference
USAID	United States Agency for International Development
WB	World Bank

I. Q4/2007 PROGRESS REPORT OVERVIEW

Responding to a request from the Government of the Azerbaijan Republic (GOAZ), USAID signed a contract with DAI on March 18, 2005 to implement the "Public Investment Policy" (PIP) project through December 2007, to work with the Ministry of Economic Development (MOED). The project has received an extension and will be ending February 29, 2008. The primary objective of this project is to help strengthen the Government of Azerbaijan's institutional capacity for: (a) long-term national and sector development and policy planning; (b) capital-budget formulation; and (c) investment project preparation, appraisal, and monitoring and evaluation. Throughout project implementation PIP-Project management and USAID have adjusted technical tasks so as to have maximum impact on the quality of capital investment in Azerbaijan. This Quarterly Performance Report presents an overview of progress achieved in Q4 2007 along with a detailed description of activities held during October-December 2007.

The PIP-Project provides assistance to the Government of Azerbaijan (GOAZ) to improve its capacity to make good public investment policy and management decisions in light of substantial increases of capital expenditures and medium-term plans[1]. In order to effectively use public resources for the long term development of Azerbaijan it is imperative that the GOAZ establish and enforce legal and regulatory procedures by which public investment projects and programs are selected. There need to be standards for prioritization that take into account the impact of projects and their soundness from social, economic and fiscal perspectives. Partly because Azerbaijan's huge oil windfall, which is able to finance public expenditures, is likely to be short-lived, it is particularly important that only the most productive and cost-effective investment projects be selected and financed. In the long run, Azerbaijan's economy should be driven by sectors other than oil and gas. Guiding principles throughout the life of the PIP-Project have been the need for:

(a) political will and determination in bringing consistency of various economic agencies[2] in macroeconomic policy formulation, using the unified statistical data; sector development priorities; medium-term budget framework; and based on these develop the National Development Framework with consequent capital expenditure priorities linked to budget limitations;

(b) establishment of a High Policy Planning Committee under the aegis of the President or Prime Minister to harmonize the economic planning, sector development planning and budget considerations, and providing the needed "top-down" direction that is obligatory for implementation and relevant accountability mechanism;

(c) establishment of "bottom up" project proposal initiatives, based on sector development plans (strategic, long-term; and operational, medium-term), priorities, sector budget limitations and measuring cross-sectoral impact from public investments;

[1] Allocations for PIP in FY2005 were AZN 164M, 882M in FY2006 and 1.92B in FY2007. PIP anticipated for 2008 and 2009 are AZN 2.84B and 3B, respectively.

[2] Primarily, the Ministry of Economic Development, the Ministry of Finance, and the National Bank of Azerbaijan and involving the State Oil Fund and Milli Mejlis

(d) harmonization of sector planning (strategic long-term and operational medium-term) with the national development priorities and budget ceilings, and establishment of quantifiable performance measures that sectors aim at achieving in the medium-term perspective;

(e) development, approval and enforcement of the national PIP "rules of law": regulations, procedures for project preparation and linking PIP preparation to the project cycle; introduce a discipline and sequence in project ideas review at very early stages and verify whether capital expenditures will yield the necessary returns over time and spur non-oil sector development, employment and regional economic growth; and

(f) development and implementation of a program of sustainable staff competence building across agencies in planning, budgeting, and project preparation using cost-benefit analysis techniques.

In 2007 the MOED, following the Presidential Decree of December 26, 2006, which provided it with a governance role in PIP management, has demonstrated leadership and determination to: (a) develop the PIP Regulations, operational instructions and forms that bring discipline and rigor into capital investment project preparation; (b) improve sector development planning; (c) make operational the newly established PIP Department; (d) improve national economic development forecast methodologies; and (e) facilitate training of the core staff in central and sector ministries in project preparation and appraisal.

During the first three quarters of 2007 the PIP-Project tasks were grouped as identified below to best support the needs of the MOED's increased role in PIP governance:

- Macroeconomic policy
- National Budget
- Sectors/Projects
- Institutions and Regulatory Reform
- Training and capacity building
- Data Management, and
- Communications.

Following the technical staff reduction (departure of PIP-Project COP Dr. Janusz Szymer in early October), and technical guidance from USAID, the PIP-Project focused its efforts in the following three major tasks. These tasks reflect the main focus of technical assistance in establishing an effective legal and regulatory framework in PIP governance and increasing institutional capacity of MOED and sector ministries in planning, budgeting, project preparation and appraisal. The core tasks of the PIP-Project activities in Q4/07 were:

Task 1. Facilitate the establishment of a sound Public Investment Policy legal and regulatory framework, and improve state budget expenditures

Task 2. Improve selected sector strategic and operational planning to better address sector capital investment needs

Task 3. Provide cost benefit analysis training, including a Training of Trainers course

Task 4. Strengthen of the institutional and technical capacity of economic planning organizations to improve the quality and consistency of macro-level forecasting and analysis.

The narrative below provides the summary of objectives and accomplishments by tasks.

Task 1. *Facilitate establishment of a sound Public Investment Policy legal and regulatory framework, and improve state budget expenditures*

Objective: Strengthen Public Investment Program (PIP) – related regulation to ensure a) sound sector development planning; b) mandatory use of cost-benefit project analysis; and c) positive impact on the fiscal year budget and MTEF planning. The regulation will be supported through the procedural/operational instructions that provide requirements and sequence for project preparation, appraisal, execution, and monitoring for results.

Expected results: PIP regulation and underlying instructions finalized and approved by MOED by December 2007; linkages between the content of PIP and MTEF strengthened and the FY2009 budget is prepared in line with the new requirements.

Accomplishments in Q4: The PIP-Project worked closely with the MOED PIP Department and prepared the draft PIP Regulations providing the framework for Public Investment Program formulation and project validation. The draft PIP regulations also link PIP to medium-term budget planning and project preparation at sector level, and require extensively involvement of MOED experts; and appraisal at MOED, using CBA techniques. The project recommended that a High Commission be established under the Cabinet of Ministers to review individual large-scale and costly projects for their economic significance and returns, social necessity and fiscal sustainability. Under this recommendation, MOED would serve as secretariat/advisor to the High Commission, producing recommendations and the list of recommended projects.

If approved soon, the legal and regulatory framework combined with the increased competency and proficiency of sector experts (project preparation) and MOED staff (project appraisal) will lay the foundation for sound planning and decision-making in project selection for FY2009 and the rolling three-year PIP.

Task 2. *Improve selected sector strategic and operational planning to better address sector capital investment needs*

Objectives: Pursuant to the agreement with the leadership in the Ministry of Transportation and Ministry of Agriculture help improve sector strategic plans, help prepare operational plans and prepare case studies and conduct trainings in topics of project preparation and appraisal.

Expected results: improved sector strategic plans, draft sector operational plans and on-the-job trainings using project cost-benefit analysis techniques.

Accomplishments: The PIP-Project mobilized two experienced sector experts to address sector strategic and operational plan preparation in two sectors key to Azerbaijan's development (transportation and agriculture). The transportation sector strategy document satisfactorily set goals yet requires further determination on mechanisms and reforms required to achieve goals.. The agriculture sector strategy, on the other hand, lacked consistency and definitive benchmarks. It also was inconsistent with agriculture sector competitiveness initiatives. The latter activity was closely coordinated with another USAID-funded Project (Trade and Investment Project).

Task 3. *CBA Training and the Training of Trainers' (TOT)*

Objective: Strengthen the GOAZ capacity to use cost-benefit analysis (CBA) techniques preparing and appraisal of public investment projects. The training program targets: a) training expert trainers in topics of CBA; b) development of training materials and formats for project preparation and appraisal; and d) facilitating demand in preparation of quality project pre-and feasibility studies.

Expected results: Establishment of a group of trainers from the selected GOAZ agencies (central ministries: MOED and MOF and designated line ministries: MOE, MOA, COIWS and MOT/MOIE) and train them on topics of CBA. Key staff is trained and able to train others in the use of CBA in project selection, preparation and appraisal.

Accomplishments: The PIP-Project, in cooperation with the staff of the Cambridge Resources Inc. team, led by Prof. Glenn Jenkins, successfully organized and conducted the Training Program on Investment Appraisal and Risk Analysis (held in Baku on December 3-14). Two week course included 23 participants from 10 state economic and sector agencies who successfully graduated from the training program. It provided best-practice techniques for project preparation, appraisal and risk analysis and included hands-on calculation of financial and economic net present values and internal rates of return, using practical case studies (a power project), performing practical assignments in adjusting cash (resource) flow to market distortions and running risk analysis. The new skills can practically be applied to the preparation and appraisal of individual public projects and should improve public investment planning and the use of limited public investment resources.

Task 4. *Strengthen of the institutional and technical capacity of economic planning organizations to improve the quality and consistency of macro-level forecasting and analysis.*

Objective: Develop a financial consistency model for producing internally-consistent medium-term macroeconomic framework (forecast) which will guide economic development planning, budgeting and public investment planning.

Expected results: Preparation of a reliable and consistent macroeconomic outlook for FY2008-2011; improved medium-term expenditures framework based on the macroeconomic framework; MOED's economic modeling capacity strengthened; medium-term macroeconomic framework for FY2009-2012 developed in line with the improved financial consistency model.

Accomplishments: The PIP-Project mobilized an Financial Programming Specialist, who performed the first phase of the assignment, but whose assignment was suspended because of different expectations about the needs and type of practitioner required for the assignment for the next phase.

In addition to addressing core technical areas in Q4/07 the PIP-Project staff cooperated with the World Bank in analyzing the draft Budget Manual, and offered recommendations. The PIP-Project staff also analyzed the draft PIP 2008-11 and provided analysis, identifying issues and offering recommendations to improve the process. Finally, the project staff facilitated the study tour of the MOED delegation to Kazakhstan in October.

Details of each of these activities are provided below. Further detailed reports and deliverables, as well as referenced materials, are enclosed in annexes to this quarterly performance report.

II. ACTIVITIES ACCOMPLISHED IN Q4/2007

Task 1: Facilitate the establishment of a sound Public Investment Policy legal and regulatory framework, and improve state budget expenditures *(See Annexes 1.1 – 1.3).*

During the reporting period the PIP-Project staff intensified work in strengthening the legal and regulatory framework in support of the PIP policy and programming. The absence of effective PIP Regulations has been one of the impediments to introducing and enforcing discipline in project preparation under the Public Investment Program. Therefore, PIP-Project activities were aimed at rendering technical assistance to MOED to develop and adopt effective legislation to ensure: a) sound sector development planning; b) mandatory use of cost-benefit project analysis; and c) make positive impact on the fiscal year budget and MTEF.

Since Q2/07 the project has been working with its counterparts to develop effective PIP Regulations to link investment policy and programming with sector development planning and budget limitations. The PIP-Project staff prepared the draft PIP Regulations and on October 23, 2007 made a presentation to the senior staff of MOED (chaired by the Deputy Minister Sevinj Hasanova) providing a rationale for the regulations that would bring the PIP policy and programming in conformity with the project cycle **(Annex 1.1)**. MOED staff voiced concerns that several provisions (in particular, establishment at the MOED sector work groups for project formulation at sector and rayon levels) may not be possible due to institutional constraints. In order to address both the regulatory and capacity sides, the project has worked with our counterpart in defining the scope of authority of the MOED-established sector working groups and provide leadership in project preparations at early stages (project ideas, project concept papers) and then lead sectoral experts through preparation of project pre-feasibility and feasibility studies. The PIP-Project offered a number of comments to the draft PIP Regulations, specifically:

- Establishment of the PIP High Commission, under the auspices of the Cabinet of Ministers, to review and approve annual and rolling three-year Public Investment Program therefore establishing a high-level collegial decision-making body to govern project selection for the Public Investment Program

- Establishment of the PIP Review Committee, within MOED, to validate the finalist projects for submission to the annual and rolling three-year Public Investment Program

- Creation of the Sector Work Groups, led by MOED, to review and coordinate preparation of sector strategic and operational plans, and jointly review project ideas as well as prepare project documentation (proposal; pre-feasibility; and feasibility studies) by sector agencies for submission to MOED. The latter agency is tasked then to appraise project submissions for their economic efficiency, social significance and fiscal sustainability

- Setting up the relevant project preparation units at sector agencies, in charge for project preparation as well as monitoring and evaluation.

During the period of September-November the project continued to work with our counterparts in preparing PIP Regulations through regular meetings and consultations. The final draft PIP Regulations, incorporating suggestions expressed by the MOED Deputy Minister Sevinj Hasanova was prepared and submitted to MOED on November 30 **(Annex 1.2).** Due to the preparations with the state budget formulation for FY2008 MOED requested to resume the work on the PIP Regulations in January and finalize by February 2008.

Overview of the draft Public Investment Program 2008-11

This section provides the summary of analysis of the draft Public Investment Program for 2008 and the rolling tree-year period.

The Public Investment (PI) Program constitutes a significant portion in Azerbaijan public expenditures and plays a major role in Azerbaijan. The economic justification for the allocation of public funds is usually that certain strategic purposes are not adequately provisioned for by the private sector (for example, the maintenance of remote regions), or public goods need to be provided, so that it becomes economically rational to use public funding. The challenge for the government is not so much over the quantity of public investment but over its quality in terms of the allocative efficiency of investment expenditures across sectors, projects, and regions. Total public investment in Azerbaijan for 2008 is estimated at about 11 percent of forecasted GDP and about one-third of government expenditures. The level of public investment is thus comparable with most OECD countries, where it ranges from 3 to 5 percent. This highlights the need for the investment budget to be based on objective criteria in the context of a national economic or investment policy which reflects the inter-sector and inter-regional priorities for investment. The Azerbaijan Government has embarked upon this path to improve the efficiency of public investments.

There has been considerable improvement the past few years in the preparation of Public Investment Program by MOED. This brief note makes an overview of the PI Program preparation process, impact of improved requirements of Call Circular and provides the analysis of Public Investment Program for 2008-2011 by size, sector scope, financial sources and beneficiaries.

The major objective of the GOAZ in launching its Public Investment Program initiative was to establish an appropriate review and selection process that: (1) provided clear statements of project and program priorities; (2) linked those priorities to both available domestic and external finances and macro-economic strategies and socio-economic policy; and (3) concentrated budgetary resources on selected critical investments. Other important objectives were to develop a PI Program formulation process that: (1) facilitated the capacity of line ministries and agencies to prepare strategies, build consensus around them, and use them to guide project and program selection; and (2) resulted in a document that assists in guiding GOAZ decision making.

The PIP Call Circular forms for 2008-2011 were improved significantly[3] based on the observations from previous years' experience and numbers of changes that were introduced:

- PIP CC were redesigned and simplified to provide sufficient information on sector, plans and a project.

[3] In collaboration with the PIP-Project

- An instructions booklet that explains each Form in the CC and how to fill each line to accompany the CC forms were prepared and attached to PIP CC.

- Electronic version of PIP CC forms were placed at the official web-site of MOED and floppy disks were attached to the hardcopy of PIP CC sent in total to 132 line ministries/agencies.

- Technical training on completing the PIP CC 2008-2011 forms was conducted jointly by PIP-Project, PI Department and Economic Reforms Scientific Research Institute (ERSRI) for selected line ministries and state agencies during Q2-2007.

As a result of joint PIP-Project and MOED staff work, the PIP Call Circular 2008-11, were issued on March 19, 2007 and sent in 132 copies to line ministries, state agencies and regional executive governments. Considering the second year of introduced PIP CC practice and formal technical training provided, the staff of the line ministries realized the need to strengthen strategic and medium-term sector planning and justify requests for public investment projects. There was notable progress in quality of responses from those agencies/line ministries who participated at the technical training on completing the PIP Call Circular 2008-11 forms, namely, the Ministry of Youth and Sport, the Ministry of Transport, the Ministry of Culture and Tourism, the Ministry of Education, the "Azersu" Open JSC Azerbaijan Melioration and Irrigation Open JSC, "Azerigaz" Open JSC, the "Azerenerji" Open JSC.

Despite the availability of electronic version of PIP CC forms at the official web-site of MOED and floppy disks attached to the hardcopy of PIP CC sent to 132 line ministries/state agencies, the most of the responses were in hard copy format. Though, the electronic version responses were more completely and qualitatively better prepared than the hard copy responses.

PIP-Project staff actively participated in providing assistance in preparation of PI Program, namely, by helping to answer to queries on requirements on PIP CC from line ministries and committees, by entering the project data to the newly created PI projects database and providing recommendations on the content of PI Program itself. For more information on the PIP 2008-11 analyses please refer to the **Annex 1.3.**

Task 2: Improve selected sector strategic and operational planning to better address sector capital investment needs (See Annexes 2.1 and 2.2)

The PIP-Project activities under this task focused on improving the institutional capacity of the selected sector line agencies with their strategic (long-term) development plans, operational (medium-term) plans and PI project preparation and improving their understanding and utilization of cost-benefit analysis techniques for project preparation and appraisal. Pursuant to the stated objectives, the main areas of the technical assistance in Q4/2007 included:

2.1. Technical assistance to the Ministry of Agriculture (Annex 2.1)

Pursuant to the comments and suggestions provided to the Ministry of Agriculture (MOA) and the Ministry of Economic Development (MOED), on November 26 the PIP-Project brought R. Anson, an agricultural sector economist who had previously worked with the project and MOA, to continue a dialogue and facilitate a major review of the MOA strategy. Mr. Anson conducted a series of meetings at MOA, MOED (involving Deputy Minister S. Hasanova), senior officials in the Cabinet of Ministers in charge of agriculture policy, and extensively coordinated activities with the USAID-funded Trade and

Investment Project staff, and their agriculture economist (R. Burkoff). As a result of his two-week assignment, the PIP-Project consultant prepared: a) an updated technical note with comments and suggestions on the GOAZ's latest draft of the Agriculture Strategy document; b) an updated framework for the agriculture sector operational, in line with our suggested strategy recommendations; and c) an updated note on the recommended framework for MOA's Improved PIP Procedures and Guidelines.

One of the main recommendations made by the project, and supported by many government officials, was to establish an inter-ministerial Working Group, under the auspices of the Cabinet of Ministers, to coordinate improvements to the agriculture strategy, including additional issues (e.g., food security strategy). It would also establish measurable performance indicators the agriculture sector would aim to achieve over time. The Working Group was recommended to include representatives from the Cabinet of Ministers, the President's Office, MOED, MOF and stakeholder state agencies. Another key recommendation, which was endorsed by the MOA Minister I. Abbasov, was to consider restructuring the MOA Investment Department into the new Strategy, Investment Planning and Performance Monitoring Department. The new department, if established, would de facto serve as a technical secretariat for the inter-ministerial Working Group and coordinate the preparation of not only strategy documents but operational plans as well.

The PIP-Project consultant, jointly with the USAID-funded Trade and Investment Project, co-moderated a seminar (December 5) at MOED on food security and food stabilization, reviewing international experience.

2.2. Technical assistance to the Ministry of Transport (MOT) (Annex 2.2)

The PIP-Project has endeavored to develop a relationship and assist the Ministry of Transportation with technical assistance, in a similar spirit as was done with other counterparts and line ministries. Despite an earlier invitation for technical assistance from MOT Deputy Minister M. Panahov to review sector strategic plans (overall, for the sector, and for railroad modernization), as well as conduct a series of trainings reviewing case studies, the work did not proceed as expected (despite the fact that SOW and CV of a highly experienced transport economist, H. Kurzman, was approved by the Ministry counterparts). The PIP-Project mobilized Dr. Kurzman who ended up reviewing the sector strategy document and supporting documentation available from international organizations, to arrive at recommendations on sector strategy improvements and areas for collaboration in future. Mr. Kurzman also held meetings with MOT subordinate organizations, MOED transport expert, international lender organizations, and private transport freight forwarding operators. Several project proposal preparation trainings were discussed and the one scheduled for December 7 was later cancelled by MOT officials.

2.3. Technical assistance to the Ministry of Education (MOE)

The PIP-Project conducted a series of work meetings with MOE staff to make a presentation of the "Allocation Management System for Education Sector" model.

The PIP-Project staff presented the narrative of the scope and structure of the training, and short overview of the Allocation Management System (AMS), the tool that was designed to help to make cost-effective decisions on resource allocation between new school construction and rehabilitation. The counterparts became genuinely interested with the opportunities the AMS provides, including facilitation of the ministry's work in sector diagnostics and needs' analysis, investment project identification, cost benefit analysis and budget allocation and overall budgeting process.

Furthermore, the ministry officials expressed satisfaction that this tool could be later integrated with the ministry's existing Management Information System that had been developed with the support of the World Bank. The training materials and AMS were also presented to Mr. Bakhish Ahmadov, expert in PIP from the Economic Reform Scientific Research Institute. The PIP-Project staff also held a meeting with Mr. Jemaleddin Gulaliyev, the Head of Social Sector at MOED, on November 22, 2007 and presented AMS as well as recommendations for project preparation for school construction and rehabilitation projects.

Task 3: Implementation of the CBA Training and the Training of Trainers' (TOT) Program (Annex 3)

Since 2005 the Public Investment Policy Project, in collaboration with the Ministry of Economic Development of Azerbaijan, has been facilitating the reform of capital investment management through long-term planning, capital budget formation, preparation and appraisal of public investment projects. To achieve efficiency and effectiveness from the Public Investment Program it is imperative to appraise project proposals early, and consider potentially viable projects for their net present value over time, economic rate of return, social-economic development necessity, and fiscal sustainability.

In order to effectively manage national resources, projects to be funded by the government must be appraised and evaluated for their merits and demerits, and priority. This task focuses upon building the capacity of government counterparts to use techniques, such as cost benefit analysis, when doing project appraisal and evaluation. Fortunately, Azerbaijan has a high level of readiness to improve project appraisal capacity. This is because Azerbaijan has a better quality of technical personnel (currently doing feasibility studies and cost assessment) and a strong interest in using modern appraisal techniques. In order to strengthen the country's project appraisal capacities, the current capacity building efforts must be strengthened to include development of thorough project appraisal analysis skills in central and sector agencies and architectural, as well as engineering institutes. The capacity building efforts need to be sector-based, and include not only Azerbaijani case studies, but also appraisal of the existing projects under preparation. Coupled with efficient public expenditure regulations, guidelines, handbooks, and call circulars this will provide a better utilization of limited budget resources and significantly improve non-oil sectors of the economy and social welfare.

To address this need, during December 3-14, 2007 the PIP-Project facilitated a training program on Investment Appraisal and Risk Analysis for public servants involved in project preparation from 10 state agencies. The organizations represented at the training included MOED, the State Committee for Irrigation and Water Resources, the Ministry of Agriculture, the Ministry of Industry and Energy, the Ministry of Transport, the State Oil Fund, the Investment Fund, the Baku Planning and Architecture Committee, the State Standardization Committee, and the Ministry of Health. The ceremony for the training program was opened by Professor Arnold Harberger, USAID Chief Economist, who emphasized the importance of applying cost-benefit analysis techniques to project appraisal and management of public investments.

The training team consisted of international experts and project technical staff, was led by Dr. Glenn Jenkins – a world-recognized practitioner in the field of project preparation, appraisal and management.

The training focused upon providing best-practice techniques for project preparation, appraisal and risk analysis and included hands-on calculation of financial and economic net present values and internal rates of return when reviewing the practical case study for the power project, performing practical assignments in adjusting cash (resource) flow to market distortions and running risk analysis The new skills will be applied to the preparation and appraisal of individual public projects and will improve public investment planning and the use of limited public investment resources.

The trainees were awarded with the certificates for successful completion as a result of daily practical assignments and final test.

According to the evaluations completed by the participants, the training was highly appreciated and the trainees considered it successful and very useful. The PIP-Project viewed the training as very productive as well. Participation of the representatives from various ministries in the same training for a period of 10 days provided an opportunity to become more familiar with each other in a non-formal environment and establish friendly relations. It is expected that these relations will facilitate coordination of work among ministries. The training developed better understanding of the importance of sound project analysis both in line and central ministries. Some lessons learned suggest that training content and duration could be reviewed with the view of volume of materials vs. time frame for their absorption.

Finally, as acknowledged by the PIP-Project staff, international experts and the participants, there is a need to develop a follow-up training program with the focus on the hands-on practicing in project preparation following the project cycle. The project is working with this training team to develop a second round of training to address these issues. This second round may involve the same participants, ensuring that Azerbaijan has a strongly trained cadre of technical specialists capable to prepare and appraise projects.

Task 4: Strengthen the institutional and technical capacity of economic planning organizations to improve the quality and consistency of macro-level forecasting and analysis (Annexes 4.1- 4.2).

The PI policy needs to be embedded in a medium-term/long-term macroeconomic framework. The degree, to which this policy can efficiently and effectively manage the allocation of public resources largely depends upon the quality of macroeconomic analysis and economic forecasts. As such, during the last two years the PIP-Project has undertaken several efforts to improve the quality and consistency of economic data and analysis. In particular: the PIP-Project: (1) provided training on spreadsheet computing and database operations; (2) helped build a comprehensive PI project database; (3) designed and helped build a macroeconomic data system; (4) assisted with macroeconomic modeling and forecasting (SAM, Flow of Funds, and other modeling techniques); (5) provided assistance for the publication of a quarterly analytical bulletin designed to help policymakers and businesses to make timely and informed decisions in line with macroeconomic developments; and (6) sensitized GOAZ officials on the importance of sound and quality macroeconomic data and analysis for effective economic management

The GOAZ has requested PIP-Project's assistance in improving the capacity of its staff in the area of policy analysis and forecasting by means of the Financial Programming methods. The project is assisting in capacity improvements of MOED in the areas of macroeconomic policy analysis, Financial Programming modeling and forecasting.

During the period of November 8-17 the project mobilized a financial programming specialist (Dr. Mario Gutierrez) who cooperated with MOED and delivered **(Annex 4.1)**:

(1) a presentation of the concept and preparation of structure of model of financial programming (short and medium term), data, data sources, and data problems (November 13);

(2) a document for MOED on key characteristics of financial programming and the requirements for the outputs from the sectoral databases and allows the simulation of alternative scenarios. It is a comprehensive model with global consistency and several specific consistency checks in English (translated to Azerbaijani);

(3) a PowerPoint Presentation about financial programming; a Table showing the structure of the model he proposed to develop; and another table showing the differences between short and medium term financial programming, with a presentation of the key interrelationships among the real, external, fiscal, and monetary sectors required for consistency in the model; a table showing the data sources required; and a preliminary assessment of data problems and inconsistencies.

Mr. Gutierrez structured the model for the four sectors: real, external, fiscal, and monetary sectors, indicating the variables that would enter as exogenous into the model and the variables that would become endogenous. The model took the outputs from the sector databases and allowed the simulation of alternative scenarios. The model should be further refined in line with improvements in the data and in their capabilities for economic analysis and econometric techniques. Using the data from the four sectors provided by the Macroeconomic Analysis and Forecasting Division of MOED, Mr. Gutierrez entered the data for the years 2002-2007 for the real and external sectors (balance of payments).

The project aims to continue advancement of the Financial programming activities in Quarter 1, 2008 with additional emphasis upon refinement of the Azerbaijani Financial Programming model and training for its operational use.

Educational study tour to Kazakhstan (Annex 4.2)

During October 8-12, 2007 the Public Investment Policy (PIP) Project facilitated the educational study tour of six high-level officials from the Ministry of Economic Development (MOED) to Astana, Kazakhstan. The MOED delegation, headed by the Deputy Minister Ms Sevinj Hasanova included the department and division chiefs in charge for macroeconomic forecasting and public investment issues. The purpose of the tour was to learn about the progress Kazakhstan has achieved through efficient planning, fiscal and investment policies. Kazakhstan's experience is particularly valuable due to regional and traditional economic, political and social similarities as well as for its notable experience in placing rigid discipline in public investment project preparation and evaluation. Its experience as a resource-rich country and its management of the subsequent government revenues is particularly relevant for Azerbaijan.

During the study tour the delegation held a series of meetings with high level officials and technical staff at the Ministry for Social Protection and Labor, the Ministry for Economy and Budget Planning, the Ministry for Industry and Trade, the Ministry of Education/the President's Stipend Program for Education Abroad, "Kazina" the Fund for Sustainable Development, "Samruk" the Holding for the Management of the State Assets, and the Center for Economic Research.

MOED officials acknowledged they learned a great deal from the informational exchange, noting that the experience of Kazakhstan and lessons learned were very useful as they reform the public investment planning and programming in Azerbaijan.

III. RECRUITMENT AND ADMINISTRATIVE MATTERS

The PIP-Project continued mobilization of international and local experts in the areas of economy, finance, in support of the core Azerbaijan PIP-Project staff. In this context, during Q4/2007 several recruitments were made:

Mr. Mario Gutierrez was contracted as financial programming expert to provide assistance in capacity improvements of MOED in the area of macroeconomic policy analysis, Financial Programming, modeling and forecasting. Originally the assignment was scheduled for 36 work days in Azerbaijan. However, based on the discussions with counterparts and agreed upon with USAID, the further assignment of Mr. Gutierrez was discontinued. His mission to Baku was limited to the period of November 6 – 18. To fit the related task his replacement is being actively sought to mobilize the new candidate during the project extension period.

Mr. Harold Kurzman was contracted as transport economist to address specific technical activities and assistance to the Ministry of Transport (MOT). He was tasked to provide support aimed at improving the capability of MOT in medium-term sector development planning; investment project formulation and validation using project feasibility study format and modern methods of cost-benefit analysis. His mission to Baku was during November 8 – December 7.

To continue technical assistance to the Ministry of Agriculture, **Mr. Richard Anson** was contracted to provide further technical support in the area of improving the Agriculture Sector development Plan 2007-15 (ASDP) per the recommendations provided to the Ministry of Agriculture (MOA) in September 2007. The assignment included facilitation and leading the process for the preparation of the medium-term sector operational (4 year) plan including the sector performance indicators, as well as developing draft regulations for managing the preparation and implementation of public investments within MOA. His mission to Baku took place during November 25 – December 6.

As part of the Azerbaijan PIP-Project, **Prof. Glenn Jenkins** and the team of highly qualified experts (from the Eastern Mediterranean University) were contracted through the Cambridge Resources International to conduct, jointly with the PIP-Project, the two-week Training Program on Project Appraisal and Risk Analysis (Training of Trainers' Program). The objective of the Training Program was at improving the institutional capacity of host government agencies in project integrated analysis using modern cost-benefit analysis techniques combining theory with hand-on practice assignments. The training took place during December 3-14.

A change in Chief of Party was made in the fourth Quarter, whereby Janusz Szyrmer left the PIP-Project and was replaced by Acting Chief of Party, Andrei Parinov (former Deputy Chief of Party). No replacement Deputy Chief of Party was made.

The project received a no-cost extension, with a new ending date of February 29, 2008.

LIST OF ANNEXES

Task 1: Facilitate the establishment of a sound Public Investment Policy legal and regulatory framework, and improve state budget expenditures.

1.1 Presentation: Regulations for Formulation, Approval, Realization and Monitoring of Public Investment Policy and Public Investment Program: Concept and Institutions, October 23, 2007

1.2 Decree of the President of Azerbaijan on Measures to Improve Efficiency from the State Public Investments.

1.3 Overview of the draft Azerbaijan Republic Public Investment Program for 2008-2011.

Task 2: Improve selected sector strategic and operational planning to better address sector capital investment needs.

2.1 Strategy for the Development of the Agro-Industrial Sector of Republic of Azerbaijan (2007-2015): Summary of Main Comments and Suggested Framework for Substantially Improved Agricultural Strategy Document by Richard Anson, December 2007.

2.2 Improving Transport Sector Capacity in Medium- Term Development Planning by Harold Kurzman, December 2007.

Task 3: Implementation of the CBA Training and the Training of Trainers' (TOT) Program.

3. Improving Institutional Capacity of Host Government Agencies in Integrated Project Analysis Using Modern Cost- Benefit Analysis Techniques: Final Report by Glenn Jenkins, January 2008.

Task 4: Strengthen the institutional and technical capacity of economic planning organizations to improve the quality and consistency of macro-level forecasting and analysis.

4.1 Financial Programming: Concepts and Principles by Mario Gutierrez, November 2007.

4.2 Study Tour of GOAZ Group to Astana, Kazakhstan, October 8-12, 2007.

5. Action Plan for the PIP-Project Activities for September-December 2007.

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Public Investment Policy Project

Regulations for Formulation, Approval, Realization and Monitoring of Public Investment Policy and Public Investment Program:

Concept and Institutions

October 23, 2007

USAID FROM THE AMERICAN PEOPLE | Public Investment Policy Project

Purpose of the Presentation

- Discuss proposed concepts, key principles and institutions for management of Public Investment Policy and Program;
- Evaluate new draft Regulations from viewpoint of content, structure, scope, language, feasibility, MOED functions etc.;
- Discuss and specify general content and structure of Regulations, MOED functions, formulation of Public Investment Policy and Program, as well as other principles which Regulations should base on;
- Identify next steps, actions and timeframe for formulation of PIP regulations

2

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Table of Contents

3

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Key Principles

- Management of public investments are an integral and critical part of overall economic management system of the country;
- All capital investment from all sources are consolidated under PIP;
- Unified criteria, regulations and methodologies are applied for preparation, selection, implementation and monitoring of all PI projects;
- PIP preparation and implementation is coordinated and regulated by MOED;
- PIP is brought in consistency with country's economic development strategy;
- PIP is brought in consistency with country's resource/finance constraints and other economic and budget planning instruments (MTMF, MTBF);

4

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Key Principles (cont)

- Stakeholders (communities,NGOs,private sector etc.) are involved in development and selection of PI projects;
- Cost-benefit analysis, economic internal rate of return, net present value and other criteria are used for selection and appraisal of public investments;
- Transparency and accountability of PIP preparation and implementation process is ensured.
- Socio-economic impact of public investments is evaluated;
- PIP formulation and implementation regulations are simple and feasible;
- It is imperative to improve management of public investments within the legislation framework.

5

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Current Status

- Linkages between public investments and national, sectoral and regional economic development strategies are weak;
- Linkages between MTMF, MTBF and PI policy are weak;
- PI analysis and appraisal work is not sufficient (adequate);
- Criteria for selection of public investments for financing are unclear;
- PIP covers only some portion of public investments;
- Intra-government linkages for PI planning and management are not sufficient;
- Information is weak/undisclosed about public investments funded from internal funds by state owned enterprises;
- Public participation in PI planning is weak/lacking;
- Institutional and legal basis for PIP preparation and implementatio is inadequate.

6

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Current Status

Dövlət İnvestisiyalarının həcmi, mln. manat							
İllər	2001	2002	2003	2004	2005	2006	**Mənbə**
Məcmu dövlət investisiyaları	305.3	392.9	560	456	936	1797	DSK
Dövlət İnvestisiya Proqramı	0	0	0	96	164	882	Dövlət büdcəsi haqqında qanunlar
Neft Fondu	0	73.6	143	35.8	61.4	437	SOFAZ büdcəsi haqqında qanunlar
Dövlət müəssisələri və qeyri-DİP investisiya	305.3	319.3	418	251	452	60.3	fərq
Xarici kreditlər hesabına investisiyalar				73.5	259	418	MN-nin veb səhifəsi bə hesabatları

7

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Objectives of Regulations

- To ensure development of PI projects in accordance with modern standards and techniques;
- To strengthen linkages between economic planning and budget formulation instruments (means);
- To ensure application of international best practices for PIP formulation, implementation and monitoring.

8

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Duties of Regulations

- Identify principles for organization of PIP relationships/linkages between state agencies;
- Establish (1) Sectoral and regional Planning (Expenditure) Committees, (2) PI departments within state agencies, and (3) PI Training Center.
- Reconcile sectoral and regional development plans with MTEF, develop a comprehensive Call Circular and apply cost-benefit analysis;
- Select PI projects and set criteria for their inclusion in PIP;
- Identify requirements and guidelines for formulation, implementation and monitoring of public investments.

9

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MOED Functions

- Participate in formulation of sectoral and regional development plans;
- Jointly with COM, MOF and NBA develop MTMF;
- Reconcile PIP objectives with other macro and budget policy documents;
- Prepare regulations and standards for preparation, implementation, monitoring and socio-economic impact analysis of public investments;
- Oversee compliance with those standards;
- Establish TRAINING CENTER providing trainings related to all aspects of public investments;
- Jointly with MOF establish Planning (Expenditure) Committees by sectors and regions.

10

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New Institutions

- **Sectoral and Regional Planning (Expenditure) Committees:** are specialized units consisting of experts from MOED, relevant sector ministries and local governments from regions.
- Main duties:
  1. Identify development priorities for next and following 3 years in relevant sector or region;
  2. Set maximum public expenditure ceilings by sectors and regions;
  3. Analyze and evaluate efficiency and effectiveness of sectoral and regional public investment projects;
  4. Approve projects for inclusion in PIP;
  5. Identify sector-specific standards for PI project formulation and monitor their implementations.

11

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New Institutions

- PI Departments established within relevant state agencies and local governments;
- Key functions:
  1. Submit necessary PI project related information to MOED and Planning Committee;
  2. Prepare project concept papers (project proposals);
  3. Prepare Feasibility Studies;
  4. Perform internal monitoring of project implementation;
  5. Evaluate socio-economic impact of projects;
  6. Prepare comprehensive responses to Call Circular;
  7. Participate in formulation of sectoral and regional development plans.

12

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PIP Scope and Key Definitions

- PIP covers government's capital investment from all sources;
- Regulations provide 30 PI related definitions;
- Some definitions are based on international practices, while others are based on local legislation.

13

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Important Definitions

- Public Investment Policy – identifies objectives, directions, priorities and scope of public investments by sectors and regions.
- Discount rate – is the alternative value of foregone consumption.
- Economic Rate of Return – – is discount rate that makes aggregated discounted benefits equal to aggregated discounted costs.
- Net Present Value – represents net present value of the project by comparing the present value of the cost streams with the present value of the benefit streams,.
- Pre-Feasibility Study – a technical document analyzing the likely feasibility and effectiveness of a project on the basis of readily available information.
- Feasibility Study - an integrated analysis of project viability from technical, financial, economic, social, institutional, environmental, risk points of view by applying appropriate cost-benefit analysis.
- Project Appraisal Report – is the quality and accuracy assessment of the Feasibility Study conducted by the MOED.

14

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PIP Preparation Process and Period

- PIP preparation period starts in the beginning of current year and ends with the Presidential Decree on Parliament's resolution approving PIP.
- Process starts with MOED's Preliminary Economic Report.
- In March public investment policy is approved by COM.
- Sectoral expenditure ceilings are set by MOED and MOF.
- In April Call Circular is issued to all relevant agencies.
- In April MOED presents draft PIP to COM.
- In June responds to Call Circular along with feasibility study and other necessary documents are delivered to MOED.
- MOED together with MOF prepares project evaluation documentation.
- In September and October of current year draft PIP is presented first to COM and then to the President as part of Consolidated Budget.

15

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PIP Planning and Formulation

- MOED governs PIP and identifies requirements and standards to public investments.
- In PIP management MOED takes into account MTMF, MTBF, project's socio-economic benefit and fiscal impact. Sectoral and regional Planning Committees develop sector strategic development plans, approve public investments submitted for inclusion in PIP for sector and region, identify sector-specific PI requirements.
- MOF prepares MTEF and sets sectoral expenditure ceilings.
- MOF consolidates in specific section of Consolidated Budget and publishes planned public capital expenditure from all sources.

16

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Preparation of Feasibility Study (FS)

- FS is prepared for projects with estimated value above AZN 2 mln.
- Decision on FS is made by Sector and Regional Planning Committee.
- For projects with estimated value less than AZN 2 mln Project Concept Paper and Project Cost Estimates are submitted.

17

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Phases for Project Inclusion into PIP

- Sectoral or local governments prepare Project Concept Paper;
- Planning Committees priorities proposed projects based on SSDPs;
- Pre or Complete FS is developed for adequate projects;
- Projects submitted to MOED are included in PIP database;
- Based on project evaluation documents MOED includes investment projects in PIP candidate list.

18

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Criteria for Inclusion of Candidate Projects into PIP

- Internal rate of return, economic net present value;
- Consistency with national socio-economic development objectives;
- Fiscal impact of the project;
- Identification of private\public sector roles.

19

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PIP Implementation

- PI projects are implemented in accordance with the approved Project Implementation Plan.
- Requesting agencies bear responsibility for quality and timely implementation of the project.
- In the event when the project cost increases\decreases for reasons beyond requesting agency's control, relevant adjustments are made in project cost estimates.
- MOF performs financial control over PIP implementation.

20

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Monitoring of Project Implementation

- MOED develops requirements and guidelines for project monitoring.
- Monitoring of PI implementation provides for the following:
  1. Requesting agencies provide investment project implementation reports to MOED on quarterly basis.
  2. MOF submits project overall financial plan and actual expenditure information to MOED.
  3. MOED and sector state agencies evaluate efficiency of project implementation.
  4. MOED submits project implementation information to COM on quarterly basis.

o MOED presents to GOAz proposals on more efficient implementation of investment projects.

o MOED may establish Joint Committees for comprehensive inspection of investment projects.

21

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Evaluation of Project Efficiency

- Requesting agencies evaluate socio-economic impact of projects through specialized units.
- In April of current year sector\local governance authorities submit to MOED Annual Reports on socio-economic impact of PI projects.
- In June of current year MOED presents to COM Annual Reports on socio-economic impact of PIP.
- In October of current year COM presents to the Parliament Annual Report on evaluation of socio-economic impact of PIP.

22

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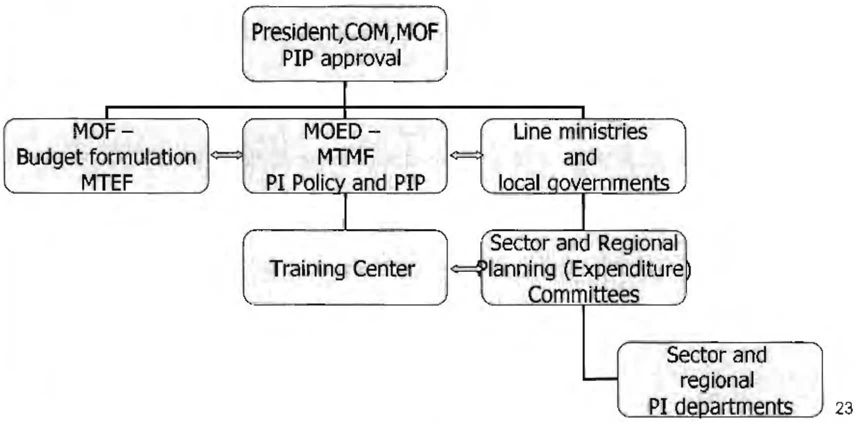
Summary – Proposed Structure for PIP and PI Policy Management



23

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Questions and Recommendation

- Should sectoral ceilings for investment expenditure be set by MTEF or Public Investment Paper?
- Should funds for FS be managed by MOED or Planning Committees?
- At which stage should project engineering papers be developed?
- Should shadow prices be used in project analysis?
- Are criteria set in regulations adequate (enough) for inclusion of projects in PIP? Which criteria should be applied for social projects?
- etc.

24

Decree of the President of Azerbaijan on Measures to Improve Efficiency from the State Public Investments

Given the increase in public investment expenditures experienced in recent years and the ambitious investment plans for the near to medium term, it is imperative to improve inter-agency coordination in economic planning and budgeting, and to implement modern medium-term expenditure planning and management procedures. In this regard, it is critical to promote the rational and transparent use of budgetary resources for public investment purposes, and to ensure the application of rigorous project preparation standards and practices which utilize best practices-consistent appraisal techniques. This in turn is a prerequisite for improving public expenditure management and accountability. These efforts should be aimed at improving sectoral development planning, increasing budgetary transparency and efficiency, and bringing public expenditure management in Azerbaijan closer to international practices of capital expenditure planning and management. Considering the above, **I ORDER**:

1. Approve the Regulations for Formulation and Realization of the Public Investment Program.

2. Establish the High Commission for consideration and approval of the annual and rolling three-year Public Investment Program consisting of the following members:

Abid Sharifov – Vice Prime Minister (Industry)
Ali Hasanov – Vice Prime Minister (Social)
Ramiz Mehdiyev – Head of Presidential Administration
Heydar Babayev – Minister, MOED
Samir Sharifov – Minister, MOF
Karam Hasanov – Chairman, State Committee for Management of the State Property
Abbas Aleskerov – Minister, State Architecture and Construction Agency
Valeh Alasgarov – Deputy Speaker, Milli Mejlis (per the agreement).

3. The decree enters force from the date of its signing. The Cabinet of Ministers bears responsibility for the implementation of terms of this Decree.

REGULATIONS
FOR FORMULATION AND IMPLEMENTATION
OF THE PUBLIC INVESTMENT PROGRAM

I. General Provisions

1.1. These Regulations are prepared in accordance with the Presidential Decree #9 of 27 December, 2003 "On application of the Law of Azerbaijan Republic "On Azerbaijan Republic 2004 year state budget".

1.2. These Regulations identify organizational-legislative bases of formulation and implementation of Public Investment Program (PIP) for the purposes of stimulation and sustainable development of the country's investment activity, of economic planning and coordination the activity of state budget formulation and of purposeful, efficient and transparent use of attracted domestic and foreign investments, and regulates the administration of the public investment (PI) activity in the following stages:

1.2.1. Formation of the public investment policy of Azerbaijan Republic and identification the main priority directions;

1.2.2. Preparation, appraisal and selection of public investment projects;

1.2.3. Approval of the PIP;

1.2.4. Implementation of public investment projects;

1.2.5. Monitoring and evaluation of outcomes from implementation of public investment projects.

1.3. The following terms are used for the purposes of these Regulations:

1.3.1. Public Investment Program – the state program comprising of public investment projects (and purposeful state programs) designed to address important issues of socioeconomic development of the Azerbaijan Republic;

1.3.2. Public investment expenditures – state budget expenditures, other than recurrent, aimed to achieve specified national, regional, sectoral, other development objectives and produce socioeconomic effects;

1.3.3. Public investment project – a set of activities aimed at achieving specified objectives (results) during the established time period using limited approved state budget expenditures;

1.3.4. Public investment objects – newly created, rehabilitated (bringing the objects subject for physical erosion or damages for various reasons, to the original outlook and conditions through application of special project solutions or application of construction-and assembly works), extended (increase in the productive power in the are of the existing object or in additional areas, extension of the work and service areas) or reconstructed (construction jobs conducted through application of special project solutions and partly through the construction of new building, equipment and communications) production, infrastructure, utility and socio-cultural constructions and objects, also other objects for which the investment is considered as necessary to be financed through the state budget and other resources during the next financial year and following three years;

1.3.5. Requestor agency – agency that prepares documentation for investment project and applies for its inclusion In Public Investment Program;

1.3.6. Project implementer agency – legal entity or physical person which is legally assigned to undertake the investment project during the specified time and within the approved budget;

1.3.7. Call Circular – letter sent by the Ministry of Economic Development to requestor agencies to gather information on financial and economic viability of the public investment projects;

1.3.8. High Commission on Public Investments – a specialized collegium, established by the President of Azerbaijan Republic, to make a decison on final composition of annual and rolling three year Public Investment Program.

1.3.9. Medium-term economic and social development program – analyzes and determines main directions of socio-economic development of the country for the next year and the following three years based on the medium-term social and economic development forecasts;

1.3.10. Sector strategic development plan – document that specifies long-term sector vision and goals to achieve;

1.3.11. Sector operational plan – summary of timeframe for implementation of sector strategic development plan, of financial resources and implementers, and identified administrative, legal, economic, social, environmental, financial and technical measures;

1.3.12. Sectoral work groups – permanent expert groups, established by the Ministry of Economic Development, tasked to coordinate preparation of sectoral operational plans and medium-term capital investment plans with relevant sectoral agencies, executive committees, appraise projects for economic efficiency, social significance and relation with other sectors of investment projects submitted by requestor agencies

1.3.13. Project proposal document – document that reflects the objectives, profits and beneficiaries of public investment project, impact on the development of sector and region, implementation period and expected expenditures. A project proposal document justifies the siginificance of the project and describes possible alternatives (main structure);

1.3.14. Pre-feasibility study – a technical document which includes preliminary analysis of the likely feasibility and effectiveness of a project on the basis of readily available information (including preliminary quantitative assessment, to the extent data allows). The results of the pre-feasibility analysis provide the basis for a project proposal document;

1.3.15. Feasibility study – a document that provides a more detailed analysis of an investment project's viability from technical, financial, economic, social, institutional, environmental and risk points of view;

1.3.16. Monitoring of implementation of investment project – a form of state control over public investment project implementation that aims at receiving, collecting and analyzing reliable information on project execution (quarterly), verifying actual implementation phases against the planned, expenditures incurred and quality observance;

1.3.17. Investment project (Public Investment Program) evaluation – a process, following project monitoring, to determine effectiveness of investment projects and the overall Public Investment Program based on collected data on outcomes and effectiveness of the post-realization of investment projects for up to 3 years after investment completion;

1.3.18. Cost-benefit analysis – is the application of quantified techniques, that assess the economic costs and benefits of proposed projects in order to help in selection of projects that could generate high economic returns. These techniques ensure the comparison of alternatives and of the projects with maximum return. Through a separate cost-effectiveness analysis, the most efficient method for achieving the desired objectives is selected for projects whose benefits cannot be readily quantitatively estimated and which aim to address the socioeconomic problems of poverty and regional accessibility;

1.3.19. Economic rate of return – is a discount rate that makes aggregated discounted benefits equal to aggregated discounted costs;

1.3.20. Net present value – is an indicator of the net benefits valued at present value and compares the present value of costs with the present value of benefits;

1.3.21. Investment project implementation plan – plan of activities prepared and approved to achieve the project objective over the established period using the limited financial resources;

1.3.22. Investment project cost estimate – is a calculation of expenditures in monetary form required for project implementation;

1.3.23. Project appraisal report – is an independent appraisal of the feasibility study and the relevant integrated project analysis by the Ministry of Economic Development of Azerbaijan Republic.

1.4. The process of the formulation and implementation of Public Investment Program is conducted in accordance with the law of Azerbaijan Republic (AR) "On the budget system", the law of Azerbaijan Republic on the state budget approved for every fiscal year, the decree #75 of May 4, 2004, of Cabinet of Ministers (COM) of Azerbaijan Republic on the approval of "Regulations for formulation and implementation of the state budget" and the other normative legislative acts, as well as with international conventions Azerbaijan Republic takes a part, and these Regulations.

II. Planning, preparation and approval of the Public Investment Program (PIP)

2.1. The formulation of Public Investment Program is conducted within the process of formulation of the state budget and in conformity with the investment project cycle.

2.2. Public Investment Program is implemented through individual projects (or state investment programs) validated for importance to the socio-economic development of the state and relevance to Sectoral Strategy Statements.

2.3. Capital investments are planned and implemented in accordance with the following principles:

a. Stability and interrelation of all program and development planning documents in the system of planning for socio-economic development of Azerbaijan Republic.

b. Continuity and conformity of the decisions of state bodies to the established state investment policy;

2.4. The order of planning and implementation of all public investment projects comprises three stages:

1) Formulation of sectoral development plans and preparation of project investment proposals;

2) Project documentation preparation and appraisal of candidate projects for inclusion in PIP; and

3) Screening and approval of priority investment projects for PIP.

2.5. **Formulation of sectoral development plans and preparation of investment proposals**

2.5.1. During January-February annually the Ministry of Economic Development of Azerbaijan Republic prepares macroeconomic forecasts of social and economic development of the country, of purposeful state programs and of specified medium-term economic and social development, and considering main directions and priorities of public investment policy on sectors and regions.

2.5.2. By February 15 MOED, in cooperation with central agencies, defines the concept and priorities of the PI policy for next year and rolling three years considering social-economic priorities, the medium-term socio-economic development programs, sectoral and regional development plans.

2.5.3. The Cabinet of Ministers determines the main directions of conception of public investment policy on sectors and regions to achieve the objectives of medium-term socio-economic development policy, and informs Ministry of Economic Development of Azerbaijan Republic and requestor agencies about this by March 1.

2.5.4. In compliance with the Article 11.4 of the Budget System Law and relevant budget regulations the initial medium-term budget forecast for the next year (revenues, expenditures, deficit and financing) and the budget for PIP are prepared. MOED and MOF, in consultation with the Cabinet of Ministers, establish PIP expenditure ceilings per sectors.

2.5.5. On March 1 MOED issues a PIP Call Circular for requestor agencies to submit project requests for consideration in the next year's PIP. The PIP Call Circular provides the scale of capital investments and sector expenditure ceilings for the medium-term period, requirements for project information and indicators to determine project economic viability, social importance, and fiscal sustainability.

2.5.6. MOED prepares instructions on completion of Call Circulars for the draft PIP for the next year and following three years and send it to requestor agencies.

2.5.7. Project requestor agencies develop sector startegic (long-term) and operational (medium-term) development plans, indicating objectives to be achieved with quantifiable indicators, and formulate capital investment plans and individual projects.

2.5.8. Sectoral work groups (SWGs), consisting of representatives of Ministry of Finance of Azerbaijan Republic, sectoral and local executive bodies, other stakeholder agencies with relevance to the public request and other requestor agencies and independent experts shall be created at Ministry of Economic Development of Azerbaijan Republic to coordinate preparation of sectoral operational plans and medium-term capital investment plans, appraise projects for economic efficiency, social significance and relation with other sectors of investment projects submitted by requestor agencies.

SWGs perform the following functions to:

a) Coordinate preparation of sectoral operational plans and medium-term capital investment plans;

b) Appraise the submitted investment projects and provide a justified opinion on projects' viability and priority for inclusion in PIP;

c) Systematize and prioritize investment projects;

d) Prepare appropriate documents on sectoral and regional investment projects to be included in the Public Investment Program based on the preliminary selection;

e) Recommend investment projects for the inclusion in the Public Investment Program final draft.

2.5.9. By May 1 requestor agencies submit completed project responses to the PIP Call Circular to MOED along with project pre-feasibility or complete feasibility studies, and other documentation required by MOED.

2.5.10. For projects with the estimated costs below AZN 2M a pre-feasibility stidy is prepared in accordance with the requirements established by MOED considering project objectives, costs, and review of least-cost alternatives.

2.5.11. For project with the estimated costs above AZN 2M a complete project feasibility study is prepared, and submitted in the next year(s), follwing approval of the project pre-feasibility study. It provides documentation on technical, financial, economic, social, environmental, risk and other analysis.

2.5.12. The requirements for preparation of project pre-feasibility and project feasibility studies are established by MOED.

2.6. Project documentation preparation and appraisal of candidate projects for inclusion in PIP

2.6.1. Preparation of projects includes development of project documentation with technical-economic justification, cost estimates, and initial project appraisal for economic viability and social importance.

2.6.2. Project requestor sectoral agencies establish relevant structures and units for project preparation, monitoring and evaluation activities.

2.6.3. Requestor agencies bear responsibility for quality and comprehensive preparation of cost estimates and feasibility studies, as well as accurate forecast of costs and risks (environmental, institutional, financial, other) that could affect implementation of a public investment project.

2.6.4. Project documentation consist of *Project Proposal, Project Pre-Feasibility Study, Project Feasibility Study,* and *Project Appraisal Document.* MOED establishes requirements for project documentation preparation and appraisal for projects, and actively participates in project preparation following the established sequence and requirements for project preparation and appraisal using cost-benefit analysis.

2.6.5. Financing of project documentation preparation and appraisal work is rendered from requestor own funds or per the special budget allocation or otherwise, as determined by the Ministry of Finance jointly with MOED.

2.6.6. Project requestor agencies prepare *Project Proposal Documents* in conformity with the established national, sectoral and regional development priorities and plans, and submit to MOED at any time of the year via the MOED standard Project Proposal Forms (PPF). The Project Proposal Document is a concise document that describes objective(s), expected net benefits and beneficiaries, expected contribution to the development of a sector, region, as well as the approximate size, duration and preliminary cost of the planned investment project, appropriate roles of private and public sectors, and review of alternative options. Normally, the least-cost expenditure option is proposed.

2.6.7. Requestor agencies are also responsible to discuss sectoral development priorities and possible capital improvements with civil society and conduct public hearings. Requestor agencies should document and make necessary adjustments in project profiles based on the comments and the suggestions expressed during the discussions with the affected communities.

2.6.8. MOED conducts review of the *Project Proposal Documents* on the quarterly basis and may return back to the requestor agency for clarification or additional rationale.

2.6.9. MOED prepares a *Quarterly Appraisal Report* that justifies the MOED decision on the submitted project proposals that may result in:

- Approval and proceed with the project preparation (project pre-feasibility study, feasibility study, to be submitted further with the Call Circular);
- Rejection;
- Return to the agency for revision and consideration of specific requirements (such as timing, scale, location) to better address national and sectoral development priorities.

2.6.10. MOED establishes requirements for documentation required for submission by the requestor agencies in response to the PIP Call Circular.

Requestor agencies prepare project pre- and feasibility studies pursuant to the requirements established by MOED.

2.6.11. *Project pre-feasibility study* is prepared for all PI projects by the requestor agencies in cooperation with SWGs. This is a technical document which includes preliminary analysis of the likely feasibility and effectiveness of a project, review of alternative solutions, projected recurrent expenditures, and preliminary costs. The Pre-feasibility study contains quantifiable data on benefits to be achieved from a project.

2.6.12. By August 1 MOED reviews and appraises *project pre- and feasibility studies.* Additional documents and information for verification may be requested from requestor agencies. Project Appraisal Report summarizes the analysis conducted individually for all project submissions and may result in the following:

- Approval of project pre- and feasibility studies;
- Rejection due to insufficient data, analysis, and insufficient socio-economic returns;
- Approval of project pre-feasibility study and return to the agency; for feasibility study preparation and submission in the next years;
- Conditional approval and return to the requestor agency for project re-engineering and reconsideration for re-submission in the next year.

2.6.13. In accordance with the legislation if requestor agency attracts a contractor for works in construction and objects included in PIP and during implementation of the contract construction cost decreases, the requestor agency identifies public investments for the whole construction period distributed by years, financing amounts and sources and submits relevant information (by November 1 of current year based on scope of work completed in 9 months) to MOED and MOF in order to direct the unused funds to other state order objects. Proposals on changes in PIP are submitted to COM.

2.6.14. The Ministry of Economic Development, in consultation with the Ministry of Finance and of the authorized organizations, prepares a *Project Appraisal Report.* The Appraisal Report provides verification of the project-related information and may provide approval, rejection, a request for a full Project Feasibility Study, or a request for specific engineering and cost revisions or further consideration of project design and costs. After all technical, budget etcetera data is verified the Ministry of Economic Development issues a *Final Appraisal Report.* The following merits are considered for project validation: 1) net present value yields from project realization over time, and the economic rate of return on public investments; 2) social-economic development necessity; and 3) project fiscal sustainability.

2.6.15. Based on the positive results of the technical studies and other expert analyses, the Ministry of Economic Development, in coordination with the project requestor agency and the Ministry of Finance, qualifies the proposed projects for the Public Investment Program in the merit order of their social-economic importance, results of project cost-benefit analsysis and fical sustainability. Eligible projects are uploaded in the Registry of Candidate Projects in the Ministry of Economic Development.

2.6.16. Investment projects are grouped based on the following characteristics after the research:

- Projects important for the national economy and to be financed through the state budget;
- Projects to be financed through foreign credits;
- Projects with no state participation, but accepted as priority by the state.

2.6.17. The Ministry of Economic Development of Azerbaijan Republic determines the inclusion of investment project into Public Investment Program based on recommendations of SWG. The Public Investment Program includes the following objects in the first place:

- Objects to be completed by the current year, but not completed yet;
- Constructions and other objects with additional financial sources attracted by requestor agencies;
- Constructions and objects of the national importance left due to the insufficient allocation of resources.

2.6.18. The inclusion of newly created constructions and objects with the purpose of production into the list is conducted after meeting the financial needs of the similar transitional objects.

2.7. Screening and Approval of Priority Investment Projects for PIP.

2.7.1. By August 30 MOED and MOF jointly review the draft PIP and consider implication of public investment projects on the recurrent expenditures in next years.

2.7.2. By September 1 MOED and MOF finalize project selection and budget alignment and submit the draft PIP to the attention of the High Commission on Public Investments.

2.7.3. A High Commission on Public Investments is established at Cabinet of Ministers with participation of representatives from selected sectoral ministries as resolved by the High Commission. CoM determines the composition of the High Commission on Public Investments by the end of January annually.

2.7.4. The High Commission on Public Investments considers the list of projects recommended by MOED for the Public Investment Program. The following considerations are taken into account:

- Project national and sectoral significance;
- Project net present value from project realization over time, economic rate of return on public investments, social-economic development necessity, and project fiscal sustainability;
- Unfinished construction due to delayed financing from previous years;
- Attraction of additional funding sources (cost sharing, public-private initiatives, grants), sectoral expenditure limits, other.

2.7.5. The High Commission on Public Investments reviews the list of priority projects for inclusion to PIP, and makes a decision on final composition of PIP. In case of budget realighnment the High Commission may resolve to review additional economically viable projects for PIP during the fiscal year.

2.7.6. By September 25 COM, pursuant the legislation, submits the draft PIP to the President for approval.

2.7.7. By October 15 the President submits draft PIP as part of draft consolidated budget to the Parliament for budget hearings and approval.

2.7.8. By November 30 the Parliament holds discussions of PIP along with consolidated budget, and approves PIP by December 20.

2.7.9. By January 15 COM, pursuant the legislation, issues a decree on distribution of the current year's PI budget by projects and agencies in accordance with the approved PIP.

III. Public Investment Program implementation

3.1. Investment projects are implemented in accordance with the investment project implementation plan and project documentation. Requestor and implementer agencies bear responsibility based on the legislation for timely and quality implementation of investment project, compliance with the approved expenditure plan, and for the purposeful expenditure of resources.

3.2. No work is granted above the amount of the state capital investment determined for every investment project for the current year.

3.3. The amount allocated for the state capital investment for the current year and not spent by the end of the corresponding budget year is returned to the state budget. In case of unexpected cost increases for goods and works (project cost overruns), the project implementer agency prepares a revised budget with rationale and justification and submits for MOED and MOF consideration and approval in conformity with the existing budget legislation.

3.4. A requestor agency provides quarterly and annual reports to the Ministry of Economic Development of Azerbaijan Republic on the implementation of investment projects. Quarterly reports are submitted by the 15 of the first month of the next quarter, and the annual report is provided by January 31 of the following year.

3.5. In accordance with the legislation, if requestor agency attracts a contractor for works in construction and objects included in Public Investment Program and during implementation of the contract construction cost decreases, the requestor agency identifies public investments for the whole construction period distributed by years, financing amounts and sources and submits relevant information (by November 1 of current year based on scope of work completed in 9 months) to Ministry of Economic Development of Azerbaijan Republic and Ministry of Finance of Azerbaijan Republic in order to direct the unused funds to other state order objects.

Proposals on changes in Public Investment Program are submitted to Cabinet of Ministers of Azerbaijan Republic.

3.6. Requestor agencies informs the Ministry of Economic Development of Azerbaijan Republic immediately in cases of increases/decreases of the value of investment projects due to uncontrallable processes.

3.7. Financial oversee of Public Investment Program implementation is conducted by the Chamber of Accounts of Azerbaijan Republic and Ministry of Ficance of Azerbaijan Republic in accordance with the legislation. To conduct a financial oversight of Public Investment Program implementation, the Ministry of Finance of Azerbaijan Republic, in collaboration with Ministry of Economic Development of Azerbaijan Republic and relevant bodies, conducts reviews of the financial statements submitted by the implementor agencies and organizes controls. The purpose of controls is to determine the compliance with the rules for purchasing the goods and services, the use of the resources in accordance with assignments and the compliance with appropriate legislation in the implementation of the projects.

IV. Monitoring of Public Investment project implementation

4.1. Monitoring of Public Investment project implementation is performed by the Ministry of Economic Development of Azerbaijan Republic in accordance with investment project monitoring guidelines. For this purpose the Ministry of Economic Development of Azerbaijan Republic:

4.1.1. Issues questionaires for requestor agencies and collects necessary information;

4.1.2. Checks regularly the realization of investment projects;

4.1.3. Gets appropriate information from requestor agencies and the Ministry of Finance of Azerbaijan Republic to determine whether the financial resources allocated for investment projects are spent for their assignment, and conducts measures for this purpose;

4.1.4. Attracts experts and speacialists to conduct monitoring.

4.2. Requestor agencies should respond to these questionnaires in no later than the final dates provided in the questionnaires.

4.3. In the event of serious deviation or violation of approved plans Ministry of Economic Development of Azerbaijan Republic has a right to demand the investigation of situation of implementation of investment project(s), as well as to conduct other measures in accordance with the legislation.

4.4. The requestor agencies should provide conditions for conducting the monitoring.

V. Evaluation of Public Investment projects' efficiency

5.1. Evaluation of efficiency of Public Investment projects is performed by the requestor agency (within their authorities), the Ministry of Economic Development of Azerbaijan Republic and Ministry of Finance of Azerbaijan Republic, as well as other relevant agencies.

5.2. Agencies evaluating Public Investment project efficiency submit their annual reports to Ministry of Economic Development of Azerbaijan Republic by April 1 of the year following the end relevant fiscal year.

5.3. The Ministry of Economic Development of Azerbaijan Republic submits the annual report on Public Investment Program evaluation to the Cabinet of Ministers by April 25, the following year. Summary of the annual report on Public Investment Program evaluation is submitted to the President of Azerbaijan Republic by May 5 the following year.

5.4. Annual reports on evaluation of Public Investment Program include analysis of socio-economic impact of Public Investment Program implementation, achieved results and recommendations for next Public Investment Program formulation.

5.5. The timeframe and forms of submission of information on monitoring and evaluation of Public Investment projects is determined by the Ministry of Economic Development.

VI. Municipality participation in Public Investment Program formulation

6.1. Municipalities participate in Public Investment Program formulation through preparation of investment project, attraction of temporarily suspended or conserved construction and objects on municipality property to investment process.

6.2. During distribution of subsidies from state budget to local budgets Ministry of Economic Development of Azerbaijan Republic is provided with information on investment projects and those projects are included in PIP.

VII. Public Investment Program Funding Sources

7.1. By July 1 the Ministry of Economic Development of Azerbaijan Republic and the Ministry of Finance of Azerbaijan Republic identify the volume of public capital expenditure in state budget for the following year.

7.2. Financial resources for Public Investment Program implementation are formed through following sources:

7.2.1. Funds considered for public investment expenditure of state budget and extra-budgetary expenditure of state budget funded organizations;

7.2.2. Capital expenditure of extra-budgetary funds, including allocations from State Oil Fund of Azerbaijan Republic;

7.2.3. Financial aid of international organizations and financial institutions and state guaranteed loans;

7.2.4. All kinds of targeted grants and loans attracted for economic purposes;

7.2.5. Projected operational funds of state owned enterprises – requestor agencies;

7.2.6. Other sources.

7.3. Decisions on state budget financing of investment projects to be co-implemented with foreign countries and international institutions are made by Azerbaijan Republic after relevant treaties are signed.

Overview of the draft Azerbaijan Republic Public Investment Program for 2008-2011

The Public Investment (PI) Program constitutes a significant portion in Azerbaijan public expenditures and plays a major role in Azerbaijan. The economic justification for the allocation of public funds is usually that certain strategic purposes are not adequately provisioned for by the private sector (for example, the maintenance of remote regions), or public goods need to be provided, so that it becomes economically rational to use public funding. The challenge for the government is not so much over the quantity of public investment but over its quality in terms of the allocative efficiency of investment expenditures across sectors, projects, and regions. Total public investment in Azerbaijan for 2008 is estimated at about 11 percent of forecasted GDP and about one-third of government expenditures. The level of public investment is thus comparable with most OECD countries, where it ranges from 3 to 5 percent. This highlights the need for the investment budget to be based on objective criteria in the context of a national economic or investment policy which reflects the inter-sectoral and inter-regional priorities for investment. The Azerbaijan Government has embarked on upon this path to improve the efficiency of public investments.

There has been considerable improvement the past few years in the preparation of Public Investment Program by MOED. This brief note makes an overview of the PI Program preparation process, impact of improved requirements of Call Circular and provides the analysis of Public Investment Program for 2008-2011 by size, sectoral scope, financial sources and beneficiaries.

Background

The major objective of the GoAZ in launching its Public Investment Program initiative was to establish an appropriate review and selection process that: (1) provided clear statements of project and program priorities; (2) linked those priorities to both available domestic and external finances and macro-economic strategies and socio-economic policy; and (3) concentrated budgetary resources on selected critical investments. Other important objectives were to develop a PI Program formulation process that: (1) facilitated the capacity of line ministries and agencies to prepare strategies, build consensus around them, and use them to guide project and program selection; and (2) resulted in a document that assists in guiding GoAZ decision making.

The USAID-funded PIP-Project provided technical and institutional assistance in designing new PIP Call Circular (CC) forms for the MOED. The information collated through these forms was to be the foundation for an improved process of Public Investment Program preparation and management by the MOED. The PIP Call Circular forms for 2008-2011 were improved significantly based on the observations from previous year experience and numbers of changes were introduced:

- PIP CC were redesigned and simplified to provide sufficient information on sector, plans and a project.

- An instructions booklet that explains each Form in the CC and how to fill each line to accompany the CC forms were prepared and attached to PIP CC.

- Electronic version of PIP CC forms were placed at the official web-site of MOED and floppy disks were attached to the hardcopy of PIP CC sent in total to 132 line ministries/agencies.

- Technical training on completing the PIP CC 2008-2011 forms was conducted jointly by PIP-Project, PI Department and Economic Reforms Scientific Research Institute (ERSRI) for selected line ministries and state agencies during Q2-2007.

As a result of joint PIP-Project and MOED staff work, the PIP Call Circular 2008-11, were issued on March 19, 2007 and sent in 132 copies to line ministries, state agencies and regional executive governments. Considering the second year of introduced PIP CC practice and formal technical training provided, the staff of the line ministries realized the need to strengthen strategic and medium-term sector planning and justify requests for public investment projects. There was notable progress in quality of responses from those agencies/line ministries who participated at the technical training on completing the PIP Call Circular 2008-11 forms, namely, Ministry of Youth and Sport, Minsitry of Transport, Ministry of Culture and Tourism, Ministry of Education, "Azersu" Open JSC Azerbaijan Melioration and Irrigation Open JSC, "Azerigas Open JSC, "Azerenerji" Open JSC.

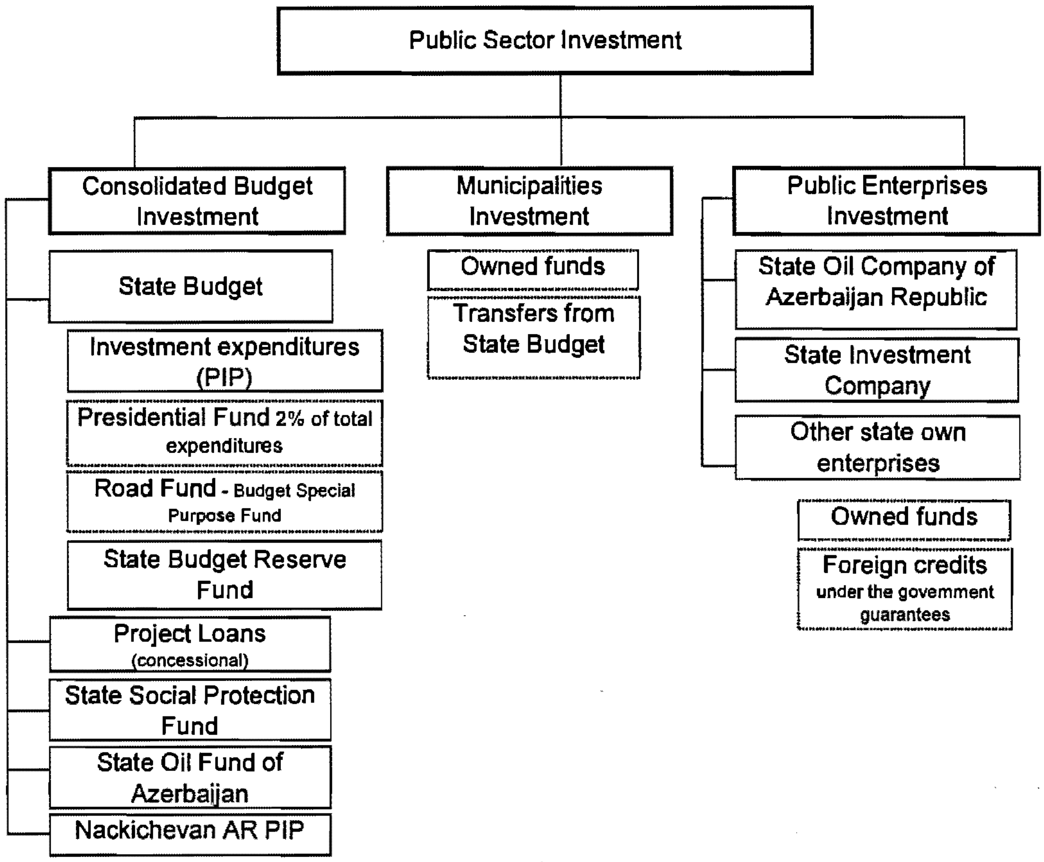
Despite the availability of electronic version of PIP CC forms at the official web-site of MOED and floppy disks attached to the hardcopy of PIP CC sent to 132 line ministries/state agencies, the most of the responses were in hard copy format. Though, the electronic version responses were more completely and qualitatively better prepared than the hard copy responses.

PIP-Project staff actively participated in providing assistance in preparation of PI Program, namely, by helping to answer to queries on requirements on PIP CC from line ministries and committees, by entering the project data to the newly created PI projects database and providing recommendations on the content of PI Program itself.

Coverage of PI Program: current situation and recommendations

Despite recent gains in medium-term planning of investments (notably, presenting breakdowns of investment projects by sector in the annual budget law), there are a few challenges remaining. A complete list of investment projects, integrating domestically and externally financed projects, needs to be compiled and aggregated within major programs and sectors. Such a comprehensive list can then be reviewed for consistency with the broader government strategy. To have a more complete view of public sector investment PI Program should cover all investments by the central government, municipalities and investments by public entities that are financed fully or partly by the central government. A consolidated general government budget on investment will facilitate improvements in policy and planning. (See Diagram 1)

Diagram 1: Proposed coverage of public sector investment by government level



Trends in Public Investment Expenditure 2005-2008: Level and Composition

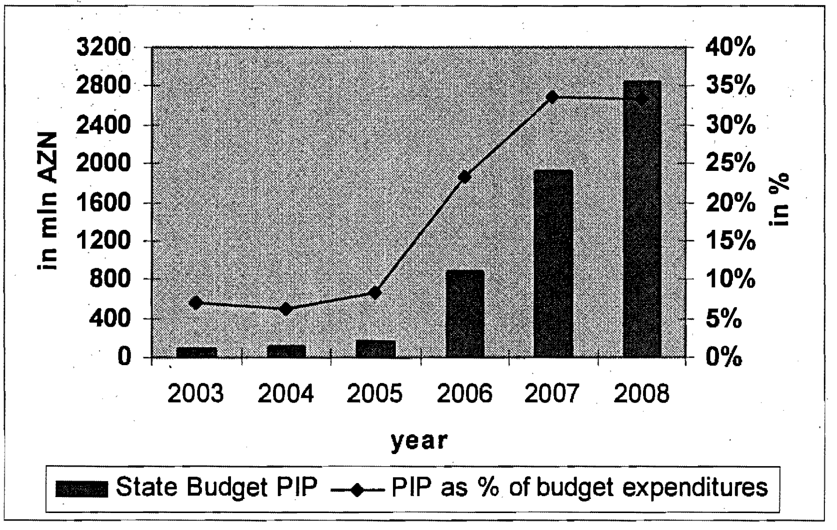
The growth of the GDP and the budget, both largely driven by the windfall of oil revenues, in recent years provided impetus for GoAZ to significantly expand public expenditures to address acute issues of poverty, disparities in regional development, infrastructure needs. This situation creates a number of bottom-up initiatives, projects and unsolicited proposals for considerations and approval/deferral.

Over the last few years, the Government has significantly improved the budget preparation process and the strategic allocation of resources. With the adoption of Budget System Law (BSL) and the Poverty Reduction Strategy Program (PRSP) document in 2003, GoAZ has taken some measures to address the need for developing capital budgeting as a macroeconomic policy instrument. To this end it has introduced new economic and budget planning instruments such as MTEF, MTMF, and the PI Program. With the PRSP document GoAZ has determined the nature and strategic direction of public investments for the immediate medium term. The Government has also taken steps to integrate the investment budget into the MTEF and the annual state budget. At the same time, these remain different interpretation on the nature of capital investments and, consequently, capital outlays are represented in the recurrent budget, the Public Investment Program and in foreign-financed borrowings.

Analyzing the PI expenditures one can indicate the significance increase in allocation of public funds for investment expenditures as of percentage of total budget expenditures during past 3 years from 8% in 2005 to 33% in 2008 (See Figure 1)[1].

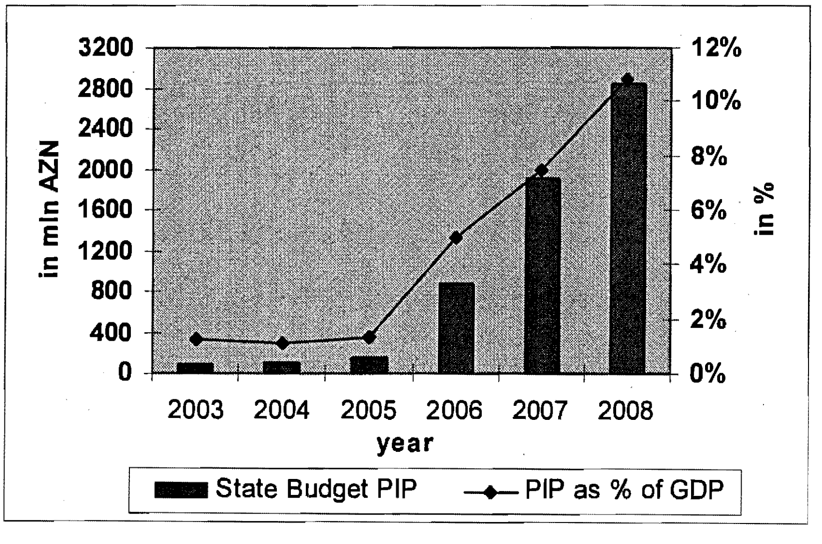
[1] Sources : State Statistic Committee and Ministry of Economic Development

Figure 1: Public Investment in Azerbaijan : 2003 -2008 (percent of budget expenditures)



The coverage of the PI Program has substantially expanded to capture more and more share of aggregate public capital expenditures. Over the period of 2003-2008 share of public investments in the overall fixed capital formation has increased. The real GDP and growing share of the oil sector in the economy appear to have favorable effects on the upward trend of public investments. Measuring public investment as broadly as possible, including expenditures that are typically understood in international practice as current spending (e.g., spending on the maintenance of existing assets), suggests that public investment has averaged about 7 percent of GDP in recent years (See Figure 2)[2].

Figure 2: Public Investment in Azerbaijan : 2003 -2008 (percent of budget expenditures)



2008-2011 PI Program: composition and main indicators

During last three years MOED based on the responses for PIP Call Circular consolidates, by September 15, 2007 its investment budget with the budget (recurrent and investment) prepared by the Ministry of Finance (MOF), and submits it to the COM as a part of the draft consolidated budget. The PI Program provides the analysis of the recent economic development, macroeconomic policies and overview of structural reforms and policies as well

[2] Sources : State Statistic Committee and Ministry of Economic Development

provides the size of public investment expenditures, distribution by sectors, financial sources and project status (ongoing or new) and beneficiaries.

Overall, the draft Public Investment Program included the most urgently needed projects in social sectors (schools and hospitals), and basic infrastructure (power stations, highways, railroads, irrigation), which needed to be implemented after many years of under-investment and neglect. Analyzing the 2008-2011 PI Program one could mention the following trends and developments in composition of the program:

1. *Size.* The real GDP and growing share of the oil sector in the economy appear to have favorable effects on the upward trend of public investments. The amount of state budget investment expenditures increased from 160 mln AZN in 2005 to 2841 mln AZN in 2008 the corresponding increase in the number of projects almost six times since 2005 (from 225 to 1513). In 2007 there are 773 projects listed, while during the period of 2008-2011 is projected to finance twice more (total 1513, of which 460 projects are on-going and 1053 are newly started (see Annex 1).

2. *Sector-specific allocation.* Infrastructure sectors dominated in the share of capital investments. Transport, industry and energy and utilities' infrastructure account for the significant share of the total PI expenditure (in 2008 they together they will account for 48% percent of the total public investments). The most important category in these sectors is the transport infrastructure. It alone will account for almost 21 percent of total expenditures in 2008. The public utilities and energy sectors follow the transportation according to the size of fixed asset formation. Expenditures for education, health and housing add up to 12 percent of total capital investments (See Annex 2).

3. *Source of financing.* Due to growth of budget expenditures, driven largely by the windfall of oil revenues the share of domestic financing[3] in public sector investment increased sharply from 40% to 83% of total PI expendituresAt the same time, the share of foreign capital participation in public investment projects financing decreased from 33% in 2005 to 17% in 2008 (see Figure 3).

4. *Beneficiaries.* The number of beneficiaries of PI Program extended as well involving the line ministries, state committees, state enterprises and regional executive governments. Line ministries and state committees account for 69% of total public investment expenditures. (See Figure 4).

5. *Project portfolio.* Portfolio of public investment mainly consists of projects involving construction of different object or spending on the maintenance of existing assets, the expenditures that are typically understood in international practice as current spending.

6. *Funds for documentation preparation.* There are allocations for preparation of project estimates amounting 5 mln AZN each year in the draft 2008-2011 PI Program. At the same time there is an explicit item allocating funds for project estimate preparation in 49 projects implementing by Ministry of Culture and Tourism, Ministry of Justice and State Melioration and Irrigation Committee.

[3] PI Program is financed domestically by allocations from state budget and State Oil Fund

Figure 3: 2005-2011 PI Program by financial sources

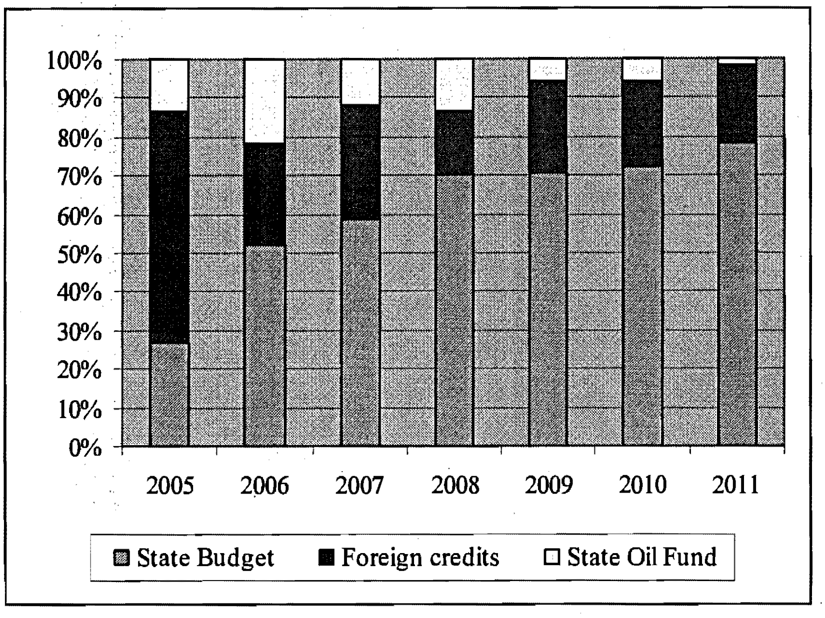
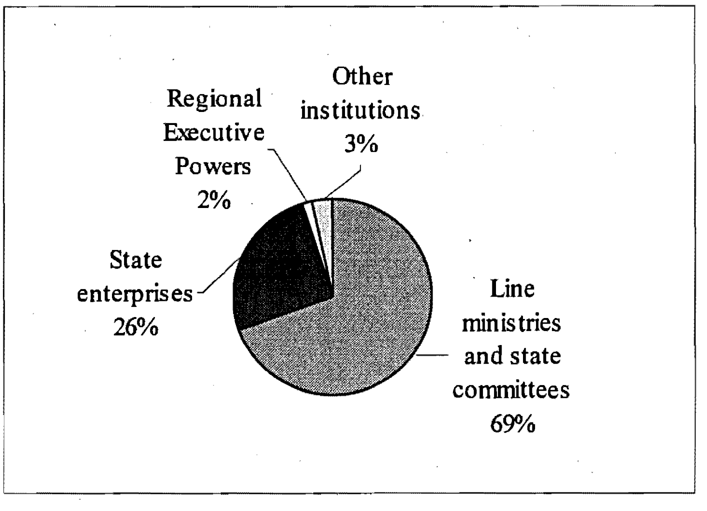


Figure 4: 2008 PI Program by beneficiaries



Further improvements

Preparation of sound PI Program requires the adoption of new techniques, methodologies, and procedures. It also demands increased economic and planning capacity, as well as to develop or reinforce institutional capacities. Institutional capacity building will embrace diverse activities, ranging from briefing senior administrators on the purpose of the PI Program exercise or advising upon procedures and responsibilities, to expansion of professional staff and intensive training of those immediately involved in the PI Program. MOED as PI Program architects can help by: (1) producing guidelines and criteria for investment projects portfolio review; (2) screening ongoing projects and programs; (3) ensuring national and sectoral policy provides a clear lead to defining project and program priorities; and (4) working with the line ministries and agencies to introduce a disciplined, standardized project cycle process providing a set of procedures that govern the identification, design, documentation, and implementation of projects and programs.

Continued efforts are needed to upgrade PI Program data, especially financial information, so that it is more accurate and better able to sustain pertinent analysis and provide a basic input to the financial planning. Project and program categorization and status needs to be more explicit. Further, to allow detailed analysis, all projects and programs should be coded by economic expenditure classification. Currently, the classification is provided at the agency level and thus only aggregate, making it difficult to carry out analysis on resource allocation patterns per each project.

In terms of coverage, the PI Program should be expanded to more fully include public enterprises off-budget capital investments that are supported by a government guarantee or are financed by their own account. Their investment programs should be subject to a similar degree of scrutiny as is given, or proposed to be given, to ministerial and agency projects and programs.

Finally, one of the main objectives of the PI Program is to engender more accurate forecasting of future recurrent expenditure demands resulting from capital investment. There are currently no systematic efforts to estimate the implied future recurrent expenditure requirements of new investment projects, the so-called "r coefficients" or the ratio of incremental recurrent costs to total investment, for both domestically financed investments as well as externally financed investments. These coefficients reflect the amount of maintenance spending, repairs, and personnel expenditures required for the efficient functioning of a completed investment project. In some countries, the computation of these coefficients has served to demonstrate that some investment projects were unsustainable in the long run. Forecasting operation, maintenance, is not easy and will involve developing budgeting "norms" for a wide variety of capital investments and other development activities. However, it is critical that determined action is taken to limit capital investments to a level that can be sustained through future recurrent finances.

Annex 1 : Azerbaijan Republic, Public Investment Program for 2008-2011 : distribution by agencies and status of projects

1. The table shows state budget investment allocations for projects for 2008-2011 period distributed by agency and status of the project.
2. Total state budget investment allocations for the period of 2008-2011 are at average 2.8 mln AZN per year.
3. The list of allocations covers 86 agencies and contained 1513 projects for the period, of which 460 is on-going and 1053 is new projects.
4. The main beneficiaries of 2008-2011 PI Program by number of projects are Ministry of Education (436), State Melioration and Irrigation Committee (115), Azersu JSC (100), Ministry of Culture and Tourism (99) and Ministry of Health (90).
5. The main beneficiaries by allocated amount of state budget investment are Ministry of Transport (2.21 mln AZN), Ministry of Education (1.26 mln AZN), State Melioration and Irrigation Committee (0.987 mln AZN), Azersu JSC (0.851 mln AZN) and Azerenergy JSC (610 mln AZN).

Annex 2 : Sector breakdown of Public Investment Programs for 2005-2011

1. The table shows state budget investment allocations for period of 2005-2011 distributed by sectors.
2. Total state budget investment allocations increased 17 times and reached 2.8 mln AZN in 2008.
3. The infrastructure sector is dominating in absorption of state budget investment. Its share remains steadily at average 55% of total state budget investment allocations. Within the infrastructure sector the transportation and industry and energy has the major portions.
4. Social sector share is increasing and starting from 2008 will have at average 25% of the total allocations.

Annex 1 : Azerbaijan Republic, Public Investment Program for 2008-2011 : distribution by agencies and status of projects

	thousand AZN									
	Name of Agency	**2008**	**2009**	**2010**	**2011**	**2008-2011**	**Gov Share**	**On-going projects**	**New projects**	**Total**
1	Ministry of Transport	513,081	564,754	547,885	584,898	2,210,618	18	25	13	**54**
2	The Ministry of Environment and Natural Resources	4,177	11,281	5,397	5,632	26,487	1	6	9	**16**
3	The Ministry of Agriculture of the Azerbaijan Republic	7,736	8,395	12,616	10,000	38,747		10	32	**42**
4	State Veterinary Service near the Ministry of Agriculture	3,244	4,868	3,500	4,000	15,612		9	16	**25**
5	State Phyto Sanitation Control Service near the Ministry of Agriculture of the Azerbaijan Republic	2,542	1,947	285	274	5,048		5	10	**15**
6	The Ministry of Culture and Tourism	123,575	157,817	153,744	144,599	579,735		30	69	**99**
7	The Ministry of Health of the Azerbaijan Republic	69,344	70,616	75,500	59,046	274,506	1	18	71	**90**
8	The Ministry of Youth and Sport of the Azerbaijan Republic	108,320	79,510	80,000	70,000	337,830		27	7	**34**
9	The Ministry of Economic Development	158,894	166,000	85,000	5,000	414,894		5	1	**6**
10	The Ministry of Finance of the Azerbaijan Republic	13,290	-	-	-	13,280	0	1	0	**1**
11	The Ministry of Tax of the Azerbaijan Republic	4,334	10,599	7,181	3,500	25,614		2	6	**8**
12	The Ministry of Foreign Affairs of the Azerbaijan Republic	28,400	33,000	35,000	35,000	131,400		4		**4**
13	The Ministry of Population and Labor Protection of the Azerbaijan Republic	28,071	38,242	41,930	34,716	142,959	1	19	61	**81**
14	National Academy of Sciences	11,179	42,720	28,150	9,560	91,609		8	5	**13**
15	The Ministry of Communication and Information Technology	3,000	8,700	11,250	16,315	39,265		2	4	**6**
16	Ministry of Education	214,504	300,000	350,000	400,000	1,264,504	1	50	385	**436**
17	The Ministry of Justice of the Azerbaijan Republic	22,189	20,531	15,799	9,204	67,723	2	14	30	**46**
18	The Ministry of National Security of the Azerbaijan Republic	20,000	20,000	20,000	20,000	80,000		1		**1**
19	The Ministry of Defense Industry of the Azerbaijan Republic	30,000	50,000	80,000	100,000	260,000		1		**1**
20	State Frontier Service of the Azerbaijan Republic	18,000	20,000	25,000	30,000	93,000		1		**1**
21	Special State Protection Service of the Azerbaijan Republic	23,259	12,000	15,000	18,000	68,259		2		**2**
22	The Ministry of Internal Affairs of the Azerbaijan Republic	25,920	11,670	9,900	3,300	50,790		8	35	**43**
23	The Ministry of Defense of the Azerbaijan Republic	18,000	20,000	20,000	20,000	78,000		1		**1**
24	The Ministry of Emergency Cases of the Azerbaijan Republic	53,700	60,000	70,000	70,000	253,700		8	6	**14**
25	Ministry of Industry and Energy	1,452	1,733	-	-	3,185			11	**11**
26	Main Prosecutor Office of the Azerbaijan Republic	1,570	1,200	-	5,000	7,770		4	8	**12**
27	Military Prosecutor Office of the Azerbaijan Republic	3,769	2,309	42	-	6,119		6		**6**
28	Supreme Court of the Azerbaijan Republic	5,000	5,000	-	-	10,000		1		**1**
29	Court of Appeal of the Azerbaijan Republic	220	146	-	-	366		1		**1**
30	State Committee of the Azerbaijan Republic on Deals with Refugees and Internally Displaced Persons	1,944	9,340	7,845	-	19,129	3	1	1	**5**
31	State Statistic Committee of the Azerbaijan Republic	1,874	370	300	350	2,894		2	9	**11**
32	State Committee on Management of the State Property	75,500	63,430	-	-	138,930		2		**2**
33	State Land and Cartography Committee	1,000	988	-	-	1,988		1		**1**
34	State Committee of the Azerbaijan Republic on Religious Affairs	372	500	-	-	872		1		**1**
35	State Committee on Family, Women and Child problems	500	1,188	-	-	1,688			1	**1**
36	State Securities Committee	500	3,000	11,250	13,750	28,500			3	**3**
37	State Customs Committee	6,490	13,865	16,060	13,425	49,840			13	**13**
38	Administrative Office of the President of the AR	134,660	18,500	10,900	4,000	168,060		4	16	**20**
39	Administrative Office of the Cabinet of Ministers of the Azerbaijan Republic	4,800	-	-	-	4,800		1		**1**
40	Administrative Office of Milli Meclis of the Azerbaijan Republic	10,417	9,337	-	-	19,754		2		**2**
41	State Committee on Students Admission	-	600	750	-	1,350			1	**1**
42	"Azerbaijan Airlines" State Concern	28,200	32,600	28,000	5,000	93,800		3	4	**7**
43	Agency on Rehabilitation and Reconstruction of territories of the Azerbaijan Republic liberated from occupation	17,800	26,802	12,780	16,586	73,968		5	5	**10**
44	State Agency on Farmer Credits near the Ministry of Agriculture	6,727	5,665	2,655	-	15,048		4		**4**
45	Baku Metro	55,596	65,501	60,348	61,562	243,007		4	2	**6**
46	State Marine Administration neaPthe Cabinet of Ministers of the Azerbaijan Republic	400	20,000	40,000	70,000	130,400			3	**3**
47	Caspian Shipping Company	-	38,180	38,180	-	76,360			2	**2**
48	Voluntary Military Patriotic Technical Sport Society	870	1,025	1,460	870	4,225		1	4	**5**
49	Azerbaijan Health Ministry Cancer Center	29,500	5,500	-	-	35,000		2	2	**4**
50	Service of the State Register of real estate	3,500	4,492	3,382	1,000	12,374		1	3	**4**
51	State Agency on Standardization, Metrology and Patent	2,760	3,345	1,000	1,300	8,405			6	**6**
52	Azerbaijan State Art Academy	-	1,000	3,500	-	4,500			1	**1**
53	Azerbaijan Architecture and Construction University	1,330	5,300	5,000	3,000	14,630		1	6	**7**
54	Baku State University	3,500	4,860	-	-	8,360		1		**1**
55	Azerbaijan Technical University	4,500	2,000	1,500	2,470	10,470		1	1	**2**
56	Azerbaijan State Medical University	8,000	5,000	-	-	13,000		1		**1**
57	Azerbaijan Nizami Gencevi Literature Museum	460	-	-	-	460		1		**1**
58	"Azersu" SC (water company)	188,751	215,671	257,129	189,946	851,497	5	26	69	**100**
59	State Melioration and Irrigation Committee	158,821	229,970	269,392	329,661	987,843	3	68	44	**115**
60	"Azerenergy" OJSC	339,200	102,000	103,100	66,000	610,300		3	6	**9**
61	"Bakielektrikshebeke" JSC	58,000	58,000	38,000	28,000	182,000	1			**1**
62	"Azerigas" JSC	18,583	86,193	117,207	98,785	320,768		5	39	**44**
63	"Azeristiliktechizat" SC (heating company)	32,000	47,000	43,037	43,800	165,837		1	1	**2**
64	"Azerbaijan TV Broadcasting" JSC	1,500	5,500	3,000	-	10,000		2	2	**4**
65	Azerbaijan Public Broadcasting Company	4,175	1,740	-	-	5,915			2	**2**
66	National Archive Department	1,200	6,360	7,100	12,500	27,160		1	7	**8**
67	"İçərişəhər" State Historical -Architecture Department	1,400	3,400	4,500	6,250	15,550			5	**5**
68	Chamber of Accounts	1,000	-	-	-	1,000			1	**1**
69	Ganja State University	500	-	-	-	500		1	1	**2**
70	Seismological Service Centre under the NAS	373	326	816	-	1,515		1		**1**
71	Baku City Executive Offices	36,424	16,027	17,329	19,132	88,911		5		**5**
72	Yasamal Rayon Executive Office	3,033	-	-	-	3,033		1		**1**
73	Surakhani Rayon Executive Office	2,000	-	-	-	2,000		1		**1**
74	Ganja City Executive Office	1,600	1,340	1,000	1,200	5,140		2	2	**4**
75	Sumqayit Executive Office	206	-	-	-	206		1		**1**
76-86	Other Rayon and City Exec Offices	2,516	2,898	1,487	-	6,901	0		12	**12**
87	The development of design estimate documents	5,000	5,000	5,000	5,000	20,000				**0**
88	Reserves	66,750	153,150	8,814	8,370	237,084				**0**
	Total	**2,841,000**	**3,000,000**	**2,815,000**	**2,660,000**	**11,316,000**	**34**	**426**	**1053**	**1513**

Annex 2 : Sector breakdown of Public Investment Programs for 2005-2011

	Sector	2005	2006	2007	2008	2009	2010	2011	2008-2011
	Total in mln AZN	**160**	**880**	**1915**	**2841**	**3000**	**2815**	**2660**	**11316**
I	**Infrastructure projects**	**55.1%**	**63.3%**	**48.8%**	**55.9%**	**55.4%**	**59.2%**	**57.3%**	**56.9%**
	of which								
	Transport	18.9%	24.4%	20.1%	21.0%	24.0%	25.4%	27.1%	24.3%
	Utilities infrastructure	21.7%	8.5%	13.9%	11.2%	14.2%	16.9%	14.5%	14.2%
	Water reserves and irrigation	8.7%	2.9%	3.7%	5.6%	7.7%	9.6%	12.4%	8.7%
	Industry and Energy	5.1%	27.3%	6.1%	16.2%	8.5%	6.5%	2.5%	8.5%
	Ecology	0.5%	0.1%	0.2%	0.1%	0.4%	0.2%	0.2%	0.2%
	Agriculture	0.2%	0.1%	0.1%	0.7%	0.7%	0.7%	0.5%	0.7%
	Development of Entrepreneurship	0.0%	0.0%	4.7%	1.1%	0.0%	0.0%	0.0%	0.3%
II	**Social projects**	**13.3%**	**11.5%**	**16.7%**	**24.0%**	**25.6%**	**26.1%**	**27.4%**	**25.8%**
	of which								
	Construction of new schools	5.2%	4.7%	5.5%	7.6%	10.0%	12.4%	15.0%	11.2%
	Construction of medical objects	3.2%	3.3%	3.9%	3.5%	2.5%	2.7%	2.2%	2.7%
	Construction of dwelings for invalids	0.6%	0.1%	0.7%	1.0%	1.3%	1.5%	1.3%	1.3%
	Construction of cultural objects	1.4%	1.4%	1.8%	7.4%	7.8%	6.0%	6.1%	6.8%
	Construction of sports objects	2.5%	1.6%	3.5%	3.8%	2.7%	2.8%	2.6%	3.0%
	Construction of objects for IDPs and refugees	0.3%	0.1%	0.3%	0.1%	0.3%	0.3%	0.0%	0.2%
	Other social projects	0.2%	0.2%	1.0%	0.8%	1.0%	0.4%	0.1%	0.6%
III	**Institutional projects**	**0.5%**	**0.5%**	**3.4%**	**0.1%**	**0.1%**	**0.0%**	**0.0%**	**0.0%**
IV	**Defence and protection**	**2.6%**	**6.0%**	**9.1%**	**5.9%**	**5.5%**	**6.7%**	**7.8%**	**6.4%**
V	**Rehabilitation and reconstruction of territories**	**13.2%**	**6.8%**	**2.9%**	**2.5%**	**2.9%**	**2.9%**	**3.3%**	**2.9%**
VI	**Other projects**	**15.1%**	**12.0%**	**18.7%**	**9.2%**	**5.5%**	**4.7%**	**4.0%**	**5.9%**
VII	**Reserve amount**	**0.0%**	**0.0%**	**0.4%**	**2.3%**	**5.1%**	**0.3%**	**0.3%**	**2.1%**
	TOTAL	**100%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Updated December 10, 2007

GOVERNMENT OF AZERBAIJAN
STRATEGY FOR THE DEVELOPMENT OF THE AGRO-INDUSTRIAL SECTOR OF REPUBLIC OF AZERBAIJAN (2007-2015):

SUMMARY OF MAIN COMMENTS AND SUGGESTED FRAMEWORK FOR SUBSTANTIALLY IMPROVED AGRICULTURAL STATEGY DOCUMENT [1]

BACKGROUND

1. On the request of Government of Azerbaijan, through MOED and MOA, USAID-financed technical specialists reviewed in August/September the above mentioned draft document (or called "SDAIS") and developed a follow-on report. The summary conclusion of the report (dated September 7, 2007) stated:

"In summary, the main comments and suggestions on the current draft SDAIS confirm the importance of MOA Management completing its draft document, and in a manner which will reflect significant improvements in order to achieve its own goals/targets, reflect clearly good international standards, and enhance Azerbaijan's prospects for gaining accession to the WTO."

2. The same note provided detailed comments and suggestions on the entire draft agricultural sector strategy report. It was agreed with the Deputy Minister of Agriculture (September 13, 2007) that MOA would endeavor to incorporate the relevant suggested points. At that time, MOED also conveyed to MOA the need to make substantial improvements; subsequently, in about early October, 2007, MOED sent to MOA written comments and suggestions, reinforcing many of the same points highlighted in the report, and stating that their "sign-off" on the document was contingent on addressing adequately MOED's comments/suggestions. Apparently, MOA believes that MOED has now signed off on their agricultural strategy document.

3. In late November, 2007, USAID provided follow-up technical assistance to the Government (mainly through MOA) to support finalization of a much improved agricultural strategy, and to assist in developing a framework for the operational plan. During the visit, the Deputy Minister of MOA provided the USAID lead consultant (Mr. Anson) a copy of the latest version of the draft strategy document, and informed him that MOA was awaiting final approval by MOF. **Subsequently, in early December, it is understood that MOF has submitted its comments and possible clearance.**

4. The USAID-financed technical team has reviewed MOA's latest draft strategy document (dated around mid to late October, 2007), and concluded that, while there have been some improvements in the first 2 pages of the draft document, the overall document continues to be deficient, and whereby the majority of the substantive comments and suggestions conveyed by MOED and USAID sector specialists have not been addressed and incorporated. The USAID-financed team has also reviewed the Government's approved Food Security Policy Paper (2001). Generally, it provides a sound framework and key elements for the SDAIS, including a sound assessment of the main problems constraining agricultural development, and a short and long term strategy. MOA's current draft SDAIS document actually is reversing some of the important strategy measures outlined in the approved Food Security Paper. At the same time, there are a number of important developments since 2001

[1] Prepared by Richard Anson (PH.D.), international agricultural sector development policy and strategy specialist, in consultation with various officials from MOA, MOED, Cabinet of Ministers, as part of the USAID-funded Trade and Investment Project and Public Investment Policy. Paul Davis from USAID is providing overall guidance to these external support efforts. The views in this note do not necessarily reflect the official views of USAID.

which warrant a further updating of the strategies outlined in the Food Security Paper, which could be done by a much improved SDAIS document.

5. Given the vital importance of supporting the next phase of formulating and implement prioritized reforms, there is a proposal for Government of Azerbaijan, coordinated by MOED, to establish an interministerial working group on "Agro-Industrial and Food Security **Strategy**" (as a proposed name, to be consistent with current name of **Government's Agricultural Strategy document** and importance of food security), to re-draft and facilitate the implementation of a much improved agricultural sector strategy, and to help guide the preparation of a supporting operational plan. **It is also highly desirable that this working group continue to work during the implementation phase, especially given the urgency of promoting the development of the non-oil sector which can generate substantial employment opportunities.** It is recommended that MOED coordinate the steps to establish this working group on an urgent basis. The core of this proposed working group could include senior technical level officials from MOED (as chair), MOA (co-chair), MOF, Cabinet of Ministers, and Irrigation Committee. Other key Ministries could be consulted, as relevant. In addition, it is recommended that a higher level Interministerial Coordination Commission on Agro-Industrial and Food Security **Strategy** be established, at the Ministerial level, given that many of the critical decisions and actions required to meet the objectives of an improved sector strategy will require this collective and **central government** support **(including for key aspects during the implementation phase).** Recognizing the busy schedule of these persons, and the strategic importance of the agro-processing sector, this Commission could meet **2** times per year. The agenda and follow-up to the coordination meetings would be facilitated by the above mentioned working group, which could meet on a more regular basis, including during the budget/PIP process and calendar.

SUGGESTED FRAMEWORK FOR IMPROVED AGRICULTURAL SECTOR STRATEGY

6. Given the importance of GoAZ finalizing and approving a sound and significantly improved SDAI document, in a reasonable period of time (by end February, 2007), and taking into account relevant inputs from the already approved Food Security Policy and the draft SDAIS, and international good practice, the section below outlines a suggested vision, guiding principles and 8 key elements (or "pillars").

Vision and Measurable Objectives:

7. Provide a clear statement of sector "vision" and objectives for Azerbaijan's agricultural sector over the next 10 years, with measurable outcomes (for example: it would be useful to refer to achieving broad-based accelerated agricultural growth, continued rural poverty reduction, and a more diversified and competitive agricultural sector which will realize its vast agricultural potential, and contribute to much needed increases in household incomes and employment generation). It is common practice to indicate measurable and strategic sector outcomes (e.g., such as a sustainable growth rate in agricultural value-added of at least ______% per annum, export growth rate of at least ____% p.a., ______jobs generated per year). It is understood that these projections will be based on various assumptions and best judgments.

8. Guiding Principles:

- Adoption of a new role of the public sector, which focuses primarily on providing sound policies, regulatory in the internal and external trade environment, enhanced business/investment environment, key legislation, structural changes, and provision of "public goods" in its priority public investments
- Define clearly the scope of the agricultural sector, for purposes of the strategy document and proposed interventions (for example, focus on the agro-based production aspects, including agro processing activities, thereby excluding provision of rural social services such as health, education). This strongly affirms the sector approach being currently taken by MOA, such that other key related ministries (i.e. irrigation, rural infrastructure, energy) needs to be a part of the scope.

- Focus on the design of a strategy which takes effectively into account the sector competitiveness challenges facing different rural household types (e.g. small, medium and large farms) and regional agro-ecological zones.
- Expanding and strengthening the roles of private sector, and appropriate public-private sector partnership arrangements and sustainable incentives
- Promoting an agricultural sector which will increasingly realize its "natural" comparative advantages (according to its regions) and become competitive in export markets
- Providing fiscally sustainable incentive structure and public expenditures, where subsidies need to be clearly justified (with an "exit" strategy), while endeavoring to focus on "public goods", and to be consistent with meeting WTO requirements)

9. **Suggested** Priority Elements and Pillars:

i) Sound and Sustainable Incentive Structure: includes sound approach to fiscal and trade incentives, enabling rural investment environment, targeted subsidies justified in all cases by the application of sound cost/benefit analysis principles, without distorting input and output markets (in order to promote sustainable sector development objectives and to meet WTO accession requirements and principles).

ii) Enhanced and Sustainable Food Security: consists of sound approaches to grain reserves and their management and associated emergency interventions, and most importantly, establishing a medium and long-term strategy for promoting sustained increased agricultural productivity, and more efficient access to international commodity markets.

iii) Reformed and Stakeholder-driven Agricultural Technology System and Services: These should be demand-driven by key stakeholders, and seek to complete and implement needed reforms in agricultural technology systems and services, working with and through farmer organizations.

iv) More Efficient and competitive market structure, system and supporting services: for domestic and international markets, enhanced services, in support of promoting enhanced vertical coordination of the agro food production systems/chains and enterprises. There will be a close link with the incentive structure theme.

v) Ensured WTO Accession Requirements and Implementation Plan: Ensure smooth WTO accession, including reduction of distorting subsidies on the agro-food (production and processing) sector, maintaining a liberalized trade regime, including steps to reduce high transaction costs, completion of the WTO compatible legislation, and preparation and implementation of sound and transparent implementation plan.

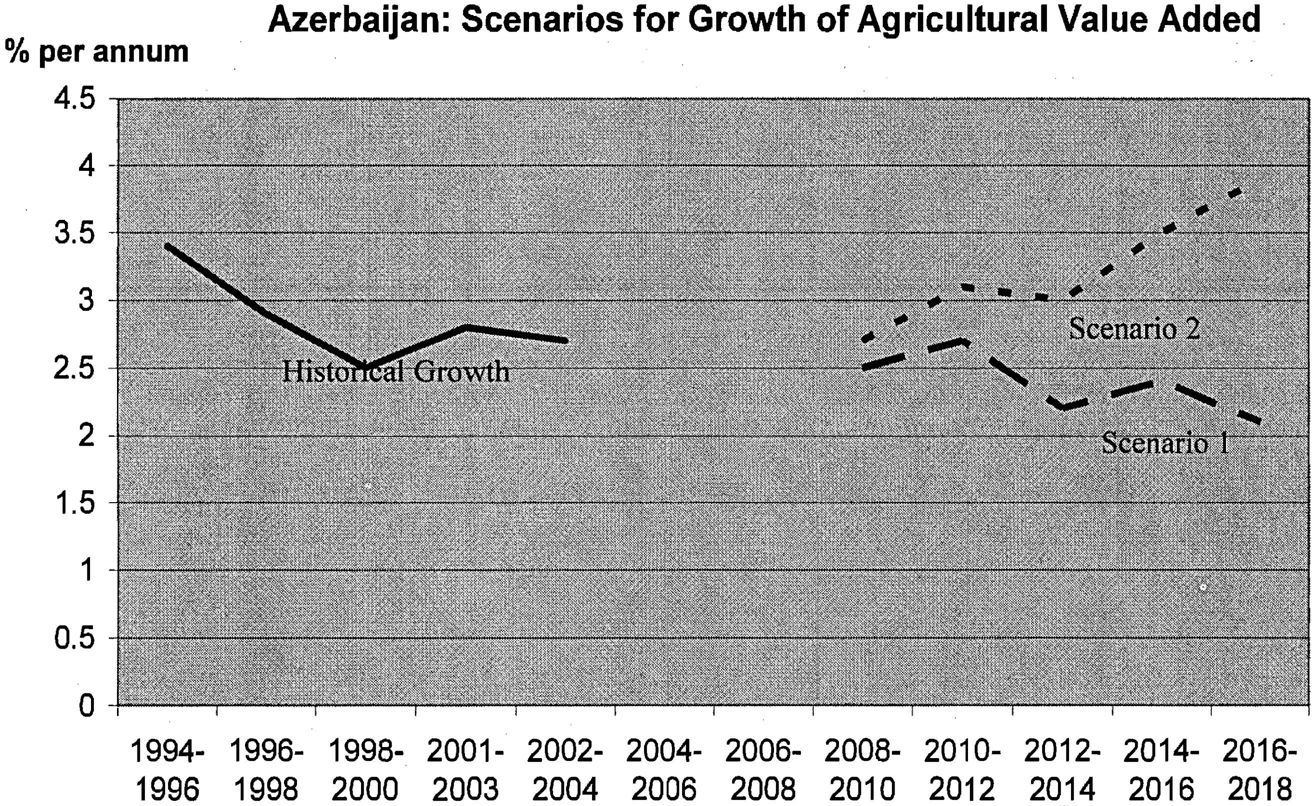
vi) Enhanced access to sustainable rural finance: promote market-based approaches to enhance rural access to formal and semi-formal sources of finance on a sustainable basis; enhanced harmony of directed credit lines offered by Government programs with the sustainable provision of commercial finance, in support of the sustainable development of agro-processing chains; with elimination of interest rate subsidies and subsequent phasing out of public sector credit provision programs and of direct and indirect subsidies for "private" goods.

vii) Increased and More Efficient Public Investments for Agriculture **Sector**: focus on "public goods", strategic rural infrastructure (especially irrigation, roads, energy), enhanced prioritization criteria and more transparent and rigorously formulated public investment policy and programme processes (in line with the proposed forthcoming PIP regulations currently under review), and an enhanced monitoring and evaluation system.

viii) Transformed and Strengthened Sectoral Institutional Arrangements, Roles and Capacities: Includes the sharpening of public and private sector roles and arrangements, including effective strengthening of institutional capacities of the relevant sector institutions (e.g., Strategy, Investment Planning, & Performance Monitoring

Dept. of MOA), enhancing public-private sector partnerships, and introducing and ensuring effective and appropriate intersectoral coordination arrangements (e.g., Agro-Industrial and Food Security high level commission and one at the working level). These institutional arrangements would need to take an active role in addressing relevant "transitional" issues in the effective implementation of the strategy.

10. Action Plan: The improved draft SDAIS would provide the basis for the proposed working group to prepare an operational plan, including a rolling plan of a sectoral medium term expenditure framework. Chart 1 illustrates the possible implications (in terms of future agricultural growth value-added) of adopting two fundamentally different scenarios: the current draft SDAIS; or a much improved SDAIS, as outlined above).



Historical growth is based on the data from Government of Azerbaijan Official Statistics and World Bank Reports

Scenario 1 – Illustrative trend line resulting from the current deficient Agricultural Sector Strategy document, **taking into account the historical trend line, the nature of the sector constraints, and relevant international experience and lessons.**

Scenario 2 – Illustrative trend line resulting from a significantly improved Agricultural Sector Strategy document and effective implementation, taking into account **relevant** international experience and lessons, **adapted to the Azerbaijan context.**

UPDATED DRAFT FOR DISCUSSION
December 10, 2007

SUGGESTED FRAMEWORK FOR MOA'S IMPROVED PIP PROCEDURES AND GUIDELINES [1]

SUMMARY

Up to now, the public investment policy and program is determined in a traditional "top-down" manner. There is a recognized need to improve the process and content of the PIP in order to help ensure more efficient and sustainable public expenditures. The USAID-funded Public Investment Policy (PIP) Project has been assisting Government of Azerbaijan, working in close collaboration with MOED, to improve the PIP process and content. Currently there are discussions with MOED on a draft "Regulations for the Formulation and Implementation of the Public Investment Program", to be legitimized and empowered by a proposed Presidential Decree ("Decree of the President of Azerbaijan on Measures to Improve Efficiency from the State Public Investments"). It is anticipated that the Government's approval and subsequent effective implementation of the final version of these regulations can generate substantial benefits to the economy, supported by enhanced capacities in the central and line ministries.

This note outlines briefly:

- The main thrusts of the proposed improvements to the PIP procedures and guidelines at national level
- A brief assessment of the current procedures and guidelines being used in the Ministry of Agriculture, which reflects the shortcomings at the national level and an ad-hoc process to determining the PIP submissions in MOA (and the regions)
- Outlines a framework for improved procedures and guidelines which could be initiated in a phased manner in MOA, simultaneous to the introduction of the PIP regulations at the national level. It is suggested that MOA apply these procedures to at least 25% of its PIP total cost for the 2009 PIP, and increase it to 100% by the 2011 PIP cycle. It is proposed that, under the leadership of the Minister, MOA strengthen/restructure its Project Planning Department to coordinate and support the implementation of these improved and guidelines procedures within MOA, reporting directly to one of the Deputy Ministers (and can rename it: "Agricultural Strategy, Investment Planning and Performance Monitoring Department). The proposed procedures focuses on requiring key actions according to the project cycle, as follows:

  (1) Project Identification and Screening Phase: a key requirement would be a project concept paper, underpinned by a pre-feasibility study, for all proposed projects which would exceed an estimated cost of about 1.0 AZM (the threshold amount is subject to discussion)

[1] Prepared by Richard Anson (PH.D), consultant for the USAID-funded Public Investment Policy Project, during his visit to Baku in August/September, 2007. This version has been updated to reflect further clarifications and consistency with the latest draft version of the proposed PIP Regulations, This work has been based on available previous assessment carried out by the PIP Project, and further discussions with key officials from MOA. The recommendations are framed to be consistent with the emerging recommendations for the Government's new PIP Regulations, currently under discussion with MOED and other key actors (especially Cabinet of Ministers and Ministry of Finance). This discussion note is intended to encourage and support MOA's efforts to improve its PIP procedures and guidelines, consistent with the Government's/MOED's emerging PIP guidelines and procedures. It is understood that this note would be further updated in the light of the results and decisions of the national level PIP regulations. In the meantime, it is recommended that MOA Management take the initiative to begin the implementation of the suggested guidelines.

(2) Project Preparation and Design Phase: a key requirement would be a project feasibility report for all proposed projects which would exceed an estimated cost of about 1 AZM (amt. to be confirmed)
(3) Project Appraisal Phase: It would involve an independent assessment of the feasibility study, to be coordinated by MOED, for all projects which exceed the threshold amount.
(4) Project Negotiations/Approval Phase: (these aspects also apply to state funded projects, whereby the processes are adjusted to internal steps within Government).
(5) Project Implementation Phase: It is vital to ensure a much improved M&E system
(6) Post-Implementation Phase: Taking appropriate actions to ensure the benefits are sustained

NATIONAL CONTEXT

Rationale: The Public Investment Policy and Program are being determined following the traditional "vertical down path" inherited from the FSU GosPlan (State Economic Planning). The Cabinet of Ministers (COM), *de-facto*, retains an exclusive mandate to accept/veto projects for the Public Investment Program. In accordance to the existing patterns, COM pre-defines the composition of the Public Investment Program (PI Program) and ranges then per the following administrative priorities: (1) projects ordered by the President of Azerbaijan (e.g., education sector computerization); (2) projects necessitated by the special decrees from COM (e.g., roads, building, bridges' construction); (3) projects in implementation; and (4) new projects. Until recently, no rigid cost-benefit analysis for project viability was required. There is no clear procedures or guidelines for following an integrated project analysis, in accordance with international good practices. The Ministry of Economic Development (MOED), being *de jure* responsible for the composition of the PI Program, *de facto* serves as a clearinghouse and registry body with limited authority to appraise project submissions by the line ministries.

Objective: To draft an efficient regulation that empowers MOED, establishes clear and sound requirements and procedures for project preparation, appraisal and validation for inclusion in the PI Program; consolidate all capital expenditures from state budget and extra-budgetary organizations (e.g., State Oil Fund); establish sectoral and regional PI Committees; harmonize national, regional and sectoral development agendas with the sector expenditure ceilings (MTEF); improve financial control and accountability; foster transparency, promote stakeholder participation in all stages of the project cycle, and public advocacy.

The draft PIP Regulation currently under discussion establishes new concepts and provisions to the PIP Program formulation and management. The following proposed points and key decisions by Central Government are under discussion.

1. MOED authority over the PI policy and program to be significantly strengthened

2. National Development Framework to be further improved, through harmonizing national, regional and sectoral development strategy programs, based on a sound macroeconomic framework, and linked to an emerging Medium-Term Expenditure Framework (MTEF)

3. The Ministry of Finance is tasked to consolidate and reflect all capital outlays (as different from recurrent expenditures), and include projects listed in the PI Program in the State Consolidated Budget

4. The Ministry of Finance, in coordination with central agencies, establishes and transparently announces sector expenditure ceilings and estimates impact from capital outlays on the recurrent budget and macroeconomic (particularly, inflation) situation and define mitigation efforts .

5. Sector Working Groups are proposed to be established to determine and guide sectoral strategies and operational plans, for the upcoming year and medium-term perspective (4 years), and to estimate the

required capital expenditures. While these inter-ministerial working groups will be coordinated by MOED, it is expected that MOA would need to be strengthened to undertake most of the actual work.

6. MOED to establish the procedures and requirements for PI project identification, preparation, appraisal and submission for approval. Projects submitted to MOED will require compliance with the PIP Call Circular issued by MOED as part of the budgetary/PIP cycle (including compliance with conducting sound integrated investment analysis, including appropriate application of cost-benefit analysis). This will include preparing a project concept paper for each proposed investment project to provide the basis for establishing initial investment priorities for each sectoral ministry, followed by a sound feasibility report (See Annex 1 for a suggested framework for these two outputs).

7. Active stakeholder participation in the investment cycle will be promoted, from the outset of project identification.

8. Performance Indicators for monitoring and evaluation for results framework are established

II) SUGGESTED FRAMEWORK FOR SUGGESTED APPLICATION OF IMPROVED PIP GUIDELINES PROCEDURES TO THE MOA

Summary of Current Situation in MOA[2]

Background: The Ministry of Agriculture (MOA), following its Charter, oversees project preparation for its Departments and its two subordinated agencies – the State Veterinary Service, and the State Phyto-sanitary Service. There is a specialized PI Program Department for project management (Investments, Program and Project Preparation Department (IPPPD), and all projects reportedly undergo initial screening in one or more MOA departments (Agro-leasing, Husbandry, Plant Growing, Agro-service, Law, Licenses, Use of Public Lands, Reforms). There is also the State Agency for Agriculture Credits (with lending from International Financial Institutions/IFIs) that manages capital expenditures. The level of funding from the State PI Program in FY2007 is AZN 2.92m, which is an extremely low fraction (0.15%) of the AZN 1.9b expenditure envelope. The structure of projects in the FY2007 budget does not highlight the strategic and programmatic themes the investments aim to achieve.

Generating project ideas: Relevant departments and the MOA regional offices forward project ideas they find worthy of further consideration to the Investments, Program and Project Preparation Department (IPPPD) of MOA. It analyzes the submissions and examines their relevance to the state development programs, in absence of an approved SDP (Sector Development Plan) for MOA. The State Program for Socio-economic Development of Regions (SPSEDR) 2004-2008 serves as a main reference for many agricultural investment projects. MOA recently prepared a draft Sector Development Strategy Program for the Agricultural Sector (2007-15), which is intended to serve as a framework and guide for PI projects during the period 2007-2015. It is currently under discussion, and it is expected to be further improved, hopefully to ensure enhanced compliance with WTO accession requirements, past analysis and international good practices.

Prioritizing projects: The project ideas found to be consistent with the SPSEDR are put forward (by the IPPPD, and the relevant Deputy Ministers) to the Minister of Agriculture for his concurrence and approval for further development of the investment projects. These endorsed projects, in turn, are submitted to the Project Planning and Design Bureau of MOA, which prepares cost estimates for

[2] This assessment was carried out by Ramil Maharramov from the USAID-funded PIP Project, and is summarized below, based on further discussions in MOA.

the projects. The final decisions on the list of PI projects which will be included into the next year of the PI Program are made within COM. It is not clear that the Minister of MOA has the opportunity to engage in a discussion with the COM on these endorsed projects. No known or written document or criteria exists for prioritization of public investments in the agricultural sector within both MOA and COM.

Engineering projects: A company selected as project implementer is held responsible for the development of engineering documents and design components of the project. IPPPD reviews cost estimates for projects, and validates parameters and specification for the construction work to be undertaken. Projects with the cost estimates are then submitted to MOED, in accordance with the PI Program Call Circular issued by MOED, and to the COM. COM has a significant weight in decision-making on the prioritization of PIs in the agricultural sector. It exercises its decisions on all planning and budgeting matters related to agriculture in the country through the Agriculture and Industry Department, the Regional Development Department and the specialized COM work group on agriculture. In most instances, the basis for the CM decisions are not communicated to MOA, which contributes to a vicious cycle of deficient PIP submission by MOA. This cycle contributes to a very low PIP to MOA.

Appraising Projects: Projects are monitored by MOA's IPPPD on, reportedly, a regular basis. The department staff monitors projects to determine progress against the scheduled tasks (as determined by construction companies), and public funds' expenditures (MOF requirement). The reports on results of the monitoring process are subsequently submitted to the Minister of Agriculture. There are no established patterns for monitoring or evaluation in MOA. The pre-feasibility study phase (which does not result in preparation of the project document) does not predicate use of benchmarks for project monitoring. There appears to be a limited basis for MOED and the COM to objectively appraise the proposed projects submitted by MOA, as part of the PIP budget cycle. Of the 90 projects which MOA submitted to MOED in the 2007 budget cycle, only about 18 were approved for inclusion in the final approved PIP.

Implementing Projects: Depending on the source of financing, agriculture projects are implemented either by local and/or international firm, selected through tender. International contractor companies establish Project Implementation Units (PIUs). When a project is commissioned, MOA, together with other relevant agencies, signs the Act of Acceptance and includes the new asset on its balance.

Monitoring and evaluating projects: MOA has not undertaken evaluation of its investment projects to determine their social and economic impact over time. Notably, MOF and the Accounting Chamber have the authority to examine and monitor the project implementation process to ensure efficient and planned use of public resources throughout the construction process. The revised Charter of MOED equally provides it with the authority to monitor and evaluate PI projects.

FRAMEWORK FOR IMPROVED PROCEDURES AND GUIDELINES FOR MOA

It is recommended that MOA management consider a phased approach to adopting the following improved PIP guidelines and procedures, beginning for the 2009 PIP/budget cycle. It is further suggested that these procedures apply for all projects (donor funded and state budget) which exceed about AZM 1.0 (the amount should be specified by MOA, such that it would cover at least 50% of its PIP submissions, in terms of total financial requirements). Once there is agreement in principle, further details, and supporting table formats (in the form of MOA's equivalent PIP call circular), could be prepared by MOA. It is recommended that MOA's Investments, Program and Project Preparation Department (IPPPD), which is recommended to be restructured, have the main responsibility for the implementation of these improved procedures and guidelines, including the needed training for MOA and regional officials, which could be done through a 1-2 day training workshop. It is proposed that MOA strengthen/"retool" its IPPPD to carry out this important role, and its Director could report directly to one of the Deputy Ministers (and rename it: "Agricultural Strategy, Investment Planning, and Performance Monitoring Department). It is recommended that MOED PIP Division work with and support this initiative, as part of its efforts to strengthen the PIP planning capacities of the line Ministries.

(1) Project Identification and Screening Phase: Key Features

- To identify and formulate the project concept, and ensure consistency and coherence with macro and sectoral strategies and priorities. There is a need for MOA to involve its regional offices in this process of generating strategic proposals, consistent with the national and sectoral strategies, and MOA's emerging operational plan for the sector strategy (which would be updated on an annual rolling basis).

- To outline the proposed objectives, key target groups, alternative designs and approaches, likely benefits and risks, preliminary implementation arrangements, and next steps

- To prepare an initial Project Logical (or "Results") Framework, as a conceptual skeleton of the envisioned project (a suggested format is shown as Annex 2)

- To carryout a "pre-feasibility" study (to apply key concepts and tools), and should involve consultations with key "stakeholder" groups.

- To prepare (by the "sponsoring" Department of MOA, together with the relevant region(s) MOA "sponsor") an initial Program/Project Concept Paper (up to 4 pages), underpinned by a prefeasibility study, for a "decision" meeting by MOA Management (coordinated by the restructured IPPPD). It is suggested that MOED and COM technical representative also participate in this initial project concept meeting, and will be synchronized with MOED's PIP process.

(2) Project Preparation and Design Phase: Once there is an "approved" project concept paper, MOA, in collaboration with the relevant sponsoring department (and donor agency, if applicable), and often contracting a consultant and/or research institute), would:

- take the lead in preparing (usually supervising) the project proposal, and supporting integrated project analysis (including technical, institutional, financial, economic, social, environmental, risk and sustainability analysis). The main output is a full "feasibility report" (see suggested outline in annex 1)

- ascertain the best alternative method/design for achieving the stated objectives, and to solidify a "Project Results Framework" as a skeleton to guide the basic design and economic analysis of the project

- Ensure the relevant costs and benefits are identified and quantified, and are valued at financial and economic prices.

- Ensure the economic validity of the chosen alternative is established.

(3) Project Appraisal Phase: – Government (coordinated by MoED), together with the relevant donor(s), if donor funded, in close collaboration with the Government central ministries (MOF and Cabinet of Ministers) and with MOA, would focus efforts on:

- validating and improving the feasibility report, with a focus on the project design and assessments
- making the needed revisions/improvements to project design and implementation arrangements (essentially, the "project"). The results of the appraisal by MOED/COM should be reflected in a revised/updated project report (supported by an implementation plan).
- If donor funded, most often, the donor agency would drive this appraisal process, but should endeavor to involving the central and line (or sponsoring) Ministries in a "meaningful" manner.

(4) Project Negotiations/Approval Phase: (these aspects also apply to state funded projects, whereby the processes are adjusted to internal steps in Government).

- Based on the outcome of the appraisal process, it is assumed that there will be an agreed project document on the project's key design features (between proponent Ministry and with central Government Ministries, and with the relevant donor(s) agency(ies), if it involves external funding. This provides the basis for negotiations and eventual agreement.
- Negotiations Within GoAZ (between proponent line ministry and Central Ministries (especially Cabinet of Ministers, MoED and MOF), on key project design features, especially project scope, financing arrangements and budgetary provisions, and key strategy and policy actions (it is highly desirable to have explicit procedures and guidelines, adapted to MOA context, and consistent with the national level PIP regulations)
- Negotiations Between GoAZ and relevant donor(s) (or within GoAZ.), If the project is proposed to be financed by a donor, on key project design features
- The negotiated documents provide the basis for the donor agency(ies) seeking its formal approval from its Board of Directors (or equivalent decision-making body), and for GoAZ securing formal approval, in line with existing or improved approval.

(5) Project Implementation Phase:

- MOA carries out the agreed/approved project, in line with the relevant implementation plan (an implementation plan should be required for all projects which exceed AZ 1.0 M). (amount to be completed)
- An improved monitoring and evaluation system in MOA's restructured Strategy, Investment Planning, and Performance Monitoring Department, would play an important role to help ensure timely and effective implementation. An M&E system should also be a requirement, but needs to be phased according to capacities of MOA. The restructured IPPPD should coordinate this system for all projects, working with the relevant MOA department and region.

– Technical assistance can be provided to MOA to support effective and timely implementation and compliance of these improved PIP guidelines, and especially to enhance implementation performance.

Post-Implementation: Sustaining the Benefits..........

- Following the project's implementation/disbursement period, the MOA, facilitated through the Strategy, Investment Planning and Performance Monitoring Department, should take the lead to ensure key project activities are "integrated" with on-going MOA programs in order to promote their sustainability.

- It is desirable for MOA, with the support of the IPPMD, to prepare and agree on a post-implementation plan (at least 1 year prior to "closing")

- Often, a donor agency (where applicable), arranges a "completion" report (for example, World Bank requires an "Implementation Completion Report"), to assess the project's progress toward achieving the project objectives, outcomes, outcomes, implementation achievements and constraints, and lessons learned. MOA should require this independent completion report for all projects which exceed AZM 1.0 M (or whatever threshold amount is specified by MOED/MOA).

- It is important that MOA, facilitated by the restructured Strategy, Investment Planning, and Performance Monitoring Dept., be directly involved in leading the post-implementation activities. Over time, it is understood that the operational departments (and regions) would increasingly take a more active role, as their capacities are enhanced, through "learning-by-doing").

PROJECT CONCEPT PAPER: SUGGESTED OUTLINE

A) Country and Sector Context

- Key Development/sector problems to be addressed by the project
- Performance of related programs/projects

B) Proposed Project Objectives (including key stakeholders as priority targets, and outcome indicators)

C) Preliminary Components/Key Features

D) Approximate costs and financing framework

E) Expected benefits and beneficiaries

F) Institutional Arrangements and Roles (with clear roles of private/private sectors)

G) Potential Risks and Mitigation Measures

H) Key Design Issues and Options

I) Proposed schedule and arrangements for preparation of the feasibility report

SUGGESTED OUTLINE OF THE FEASIBILITY REPORT

A) Country and Sector Context

- Key Development/sector problems to be addressed by the project
- Performance of related programs/projects

B) Proposed Project Objectives (including key stakeholders as priority targets, and outcome indicators)

C) Proposed Components/Key Features

D) Approximate costs and financing framework

E) Expected benefits and beneficiaries

F) Institutional Assessment, Arrangements, & Roles

G) Assessments: Financial/Fiscal, Economic, Social, Environmental

H) Potential Risks and Mitigation Measures

I) Framework Operational/Implementation Plan

J) Proposed schedule and arrangements for preparation

K) Annexes: Detailed supporting information/analysis

UPDATED DRAFT FOR DISCUSSION
December 10, 2007

GOVERNMENT OF AZERBAIJAN
STRATEGY FOR THE DEVELOPMENT OF THE AGRO-INDUSTRIAL SECTOR OF REPUBLIC OF AZERBAIJAN (2007-2015):

PROPOSED FRAMEWORK FOR OPERATIONAL PLAN 2008-2011

I) CONTEXT

- MOA has prepared its draft agricultural sector development strategy ("Strategy for the Development of the Agro-Industrial Sector of the Republic of Azerbaijan/SDAIS (for the next 10 years). It is under review by Government, and there are numerous suggestions to improve it, to be more consistent with progressive market-based strategies which build on good international practices and lessons
- There is a need for an operational plan as a "road map" to guide the implementation of an improved strategy document. For now, it would be useful to develop an initial framework for the operational plan, which could be used to enlist the participation and inputs from key stakeholders (various Departments in MOA, as well as other relevant Ministries, and also the regions)
- There is limited experience in Azerbaijan in developing and implementing these planning and implementation instruments. They can be used to promote reforms and capacity building in MOA (and collaborating agencies), as well as facilitate various agencies working together (along with the regions).

II) OBJECTIVES AND APPROACH

A) Objectives: the operational plan (2008-2011) will translate the agricultural strategy plan into priority programs and activities for each strategy component, indicating for each component the following key information:

First, at national level:

1) priority policies and legislation
2) priority programs and activities
    - the results and performance targets and measures for each program and activities (using a "results framework approach", with measurable outcomes and intermediate outcome measures)
    - clear responsibilities and roles of public and private sectors, and public-private sector partnership
    - the estimated public expenditures (according to budget and PIP ceilings of MOF and MOED, showing recurrent and capital expenditures), consistent with GoAz' draft Medium Term Expenditure Framework (MTEF)

Second, at the regional level: similar information, but organized and integrated in a coherent manner according to each region (with their participation, taking a phased approach), consistent with national and sectoral policies and strategies:

1) priority policies and legislation
2) priority programs and activities
   - the results and performance targets and measures for each program and activities (using a "results framework approach", with measurable outcomes and intermediate outcome measures)
   - clear responsibilities and roles of public and private sectors, and public-private sector partnership
   - the estimated public expenditures (according to budget and PIP ceilings of MOF and MOED, and other sources, showing recurrent and capital expenditures).

B) Approach: In order to achieve the SDAIS's objectives and agricultural sector outcomes, it is vital to take a participatory approach to the formulation and implementation of the operational plan, involving key actors from public and private sectors, especially at the local/regional level. It is important to launch the work of the operational plan after the agricultural strategy has been improved and approved by Government. While MOA awaits the formal approval of the sector strategy, especially in relation to using the operational plan as an input for the 2009 budget/PIP cycle, it is suggested that the MOA team, under the overall leadership of the MOA Minister (and his Deputy Ministers) can carry out some preparatory work, including the involvement of one or two "progressive" regions in the exercise. Accordingly, there is a need for MOA, with the strong collaboration of MOED, to devise and gain high level approval of appropriate inter-ministerial coordination arrangements and mechanisms to help guide the formulation and implementation of the operational plan, in line with an improved and approved agricultural strategy. Appropriate inter-ministerial arrangements for a working group and higher level commission are in the process of being proposed and worked out.

C) Suggested Framework: Once the agricultural strategy document is improved/approved, it is suggested that the operational plan be developed in accordance with the framework/matrix shown below, at the national and regional levels (see Tables 1 and 2). It would need to be developed in a sequential manner, such that the summary version could be similar to the one shown below. Details according to each strategy element would need to be shown separately, while ensuring that there are clear linkages between the strategy elements, to ensure a coherent operational plan. The strategy elements shown below are consistent with the strategy elements which have been suggested in a separate note (updated December 10, 2007). Once the final version of the strategy is approved, it is understood that its elements will be used as the appropriate reference for the operational plan, while recognizing that there could also be some further improvements to the strategy elements, which could result from the inter-ministerial working group.

It is recommended that the working group, once formed, develop an action plan for the development of this operational plan. It is estimated that it would require 4-6 months of intensive work, to prepare an initial plan, and which can be improved each year. Hopefully, the initial draft can provide inputs for the 2009 budget/PIP cycle.

Table 1
OPERATIONAL PLAN: SUGGESTED FORMAT FOR MATRIX
- NATIONAL LEVEL - *

STRATEGIC COMPONENT & PROGRAM AND ACTIVITY	EXPECTED OUTPUTS AND OUTCOMES (KEY INDICATORS)	PRIMARY RESPONSBILITIES (PUBLIC & PRIVATE SECTOR)	TIMEFRAME	PUBLIC EXPENDITURE REQUIREMENTS (2008-2011) *
1. Sustainable Incentive Structure a) Key policies and legislation b) Priority Programs Priority Activities	- fiscal and trade indicators - subsidy indicators - rural private sector investments - WTO accession requirements/indicators			
2. Enhanced Food Security a) Key policies and legislation b) Priority Programs Priority Activities	- grain reserve indicators - targeted interventions (by target group) - productivity indicators - wheat price stabilization indicators - transactions in int'al wheat market			
3) Reformed Agricultural Technology System and Services	- Results of institutional reforms - Productivity measures (such as improved tech'al packages, farmer adoption rates)			
4) Efficient and competitive	- Various indicators of			

market structure and systems	market efficiency in domestic and int'al markets and agro-processing market chain			
5. Enhanced WTO Accession Requirements and Implementation Plan	- Measures of distorting input and output subsidies - relevant WTO legislation - Key elements of Implementation Plan			
6. Access to Sustainable Rural Finance	- Access indicators to formal and informal rural finance (by different farmer groups) - Extent of harmonization of directed credit programs - level of interest rate subsidies			
7) Efficient Public Investments for Agriculture Sector	- Level and Composition of Public Expenditures - Prioritization Criteria - Key indicators for strategic public goods, especially: irrigation, roads, energy, technology, phytosanitary services, institutional strengthening			

8) Strengthened Sectoral Institutional Arrangements, Roles and Capacities	- Key indicators on clarity of institutional arrangements, roles and capacities			

* Further details will need to be worked out separately, for each of the strategy elements. The proposed programs/projects would be subjected to the project lifecycle and PIP Regulations (including the call circular issued by MOED). The initial work at the national level will help guide the work/operational plan at the regional level, such that the two levels will be complementary. Efforts should be made to ensure coherence and linkages between the strategic components, facilitated by an improved M&E system.

Table 2:
OPERATIONAL PLAN: SUGGESTED FORMAT FOR MATRIX
-- REGIONAL LEVEL -- *

STRATEGIC COMPONENT & PROGRAM AND ACTIVITY	EXPECTED OUTPUTS AND OUTCOMES (KEY INDICATORS)	PRIMARY RESPONSBILITIES (PUBLIC & PRIVATE SECTOR)	TIMEFRAME	PUBLIC EXPENDITURE REQUIREMENTS (2008-2011) *
1. <u>Sustainable Incentive Structure</u> a) Key policies and legislation b) Priority Programs Priority Activities	- fiscal and trade indicators - subsidy indicators - rural private sector investments - WTO accession requirements/indicators			
2. <u>Enhanced Food Security</u> a) Key policies and legislation b) Priority Programs Priority Activities	- grain reserve indicators - targeted interventions (by target group) - productivity indicators - wheat price stabilization indicators			

	- transactions in int'al wheat market			
3) Reformed Agricultural Technology System and Services	- Results of institutional reforms - Productivity measures (such as improved tech'al packages, farmer adoption rates)			
4) Efficient and competitive market structure and systems	- Various indicators of market efficiency in domestic and int'al markets and agro-processing market chain			
5. Enhanced WTO Accession Requirements and Implementation Plan	- Measures of distorting input and output subsidies - relevant WTO legislation - Key elements of Implementation Plan			
6. Access to Sustainable Rural Finance	- Access indicators to formal and informal rural finance (by different farmer groups) - Extent of harmonization of directed credit programs - level of interest rate subsidies			
7) Efficient Public Investments for	- Level and Composition of Public			

Agriculture Sector	Expenditures - Prioritization Criteria - Key indicators for strategic public goods, especially: irrigation, roads, energy, technology, phytosanitary services, institutional strengthening			
8) Strengthened Sectoral Institutional Arrangements, Roles and Capacities	- Key indicators on clarity of institutional arrangements, roles and capacities			

* It is understood that the regional matrix will be developed in a phased manner, starting: (a) after the national level matrix is prepared (with an initial draft), as this will provide a reference point for the regional level application of this matrix, with the relevant adjustments; and (b) with 2 regions (for 2009 budget cycle) which are more "progressive" in their agricultural strategies, such that they can provide a positive model to other regions. The other regions could be included for the 2010 budget cycle, building on the experiences of 2009.

PUBLIC INVESTMENT POLICY PROJECT
IMPROVING TRANSPORT SECTOR CAPACITY IN MEDIUM-TERM DEVELOPMENT PLANNING

by Harold Kurzman

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Public Investment Policy Project

Improving Transport Sector Capacity in Medium- Term Development Planning by Harold Kurzman

TABLE OF CONTENTS

LIST OF ANNEXES

I. RECOMMENDATIONS FOR FUTURE ACTIVITY BY USAID IN THE TRANSPORT SECTOR

The process of commencing TA in the transport sector should be demand driven. Tasks need to be as specific as possible and prioritized. They can always subsequently be amended by mutual agreement. With tasks agreed, then details for contracting for T A can be determined. This would include expert skills required, number of person months, schedule of interventions and the Department which each expert will be primarily assisting.

Typical tasks might include:

- Training, including use of case studies, workshops and preparation of manuals o Evaluation of regulatory reforms needed, as identified by MOT. This is particularly useful to help in areas where MOT has little prior experience, such as public/private investment partnerships, logistics services, tariff deregulation, introduction of new transport user fees, and regulations governing the enforcement of heavy vehicle axle load limits.

- Drafting new regulations and implementation guidelines

- Estimating staffing requirements for review of pre-feasibility and feasibility studies, including what services should be contracted from private enterprises, universities and research institutes o Building capacity for urban transportation planning

- Establishing benchmarks for measuring success in achieving desired outcomes of the tasks included in the T A and a reporting schedule.

Tasks where TA might be helpful may include:

1. The transport strategy calls for Azerbaijan to become a major player in as a corridor for transit traffic and regional integration between Turkey and Central Asia. Infrastructure upgrades are essential but not sufficient. In trade logistics, comprising inter-modal facilitation and information support services, there are substantial deficiencies which raise costs and reduce reliability of transport services. Inter-modal connectivity is required to achieve global competitiveness. Substantial knowledge transfer from U.S. and EU experience would be helpful. The Trade Logistics Branch of UNCTAD is also an important resource.

2. A sub-set is the need to establish a modern containerized cargo service. This would require some investments in terminals, customized rail wagons, and handling equipment. Just as important would be the introduction of modern management techniques, such as door-to-door bills of lading, unit trains, real time cargo tracking, and tariffs which are not based on commodity categories of cargo but on actual costs of service and market conditions.

3. Efficient, competitive marine services links with other Caspian Sea countries would provide a major potential competitive advantage for Azerbaijan to capture transit traffic. Presently service quality and frequency is poor, the service is operated by a State monopoly at high tariffs. There are several vessels carrying rail wagons, which are antiquated and inefficient, and there are plans to purchase more such vessels. One should be building capacity to load and carry containers. There is an opportunity, as part of the reform program which aims to increase competition, to make a significant impact aimed at improving this service. Planning is also beginning for the new port, which should provide good inter-modal terminal services supporting the maritime modernization. Port capacity in Azerbaijan needs to be coordinated with capacity planning in the neighboring national ports to which vessel services are now or will be provided.

4. The MOT has to become the focal point for inter-disciplinary focused project preparation. The modal agencies are not staffed for or driven by this need. Therefore, actions that USAID could support to increase capacity and sensitivity in this respect are recommended. A project evaluation unit with these capabilities needs to be established in MOT. Training is required both in methods and criteria that meets internationally accepted standards. Institutional linkages with other Ministries' professional staff should be identified and encouraged. This need is discussed in more detail later in this document.

5. Qualitative and quantified benchmarks for measuring progress in policy and project implementation is needed. This should reach beyond current measurements of physical project progress and financial accountability. Policy and project socio-economic baseline data collection has to be collected, changes monitored and then impact evaluated for up to 3 years after policy activation or project completion. There may be a need to establish a project monitoring and evaluation unit in MOT to ensure that adequate resources are assigned to this task and that staff are trained in required techniques.

6. The MOT has no experience in the preparation, appraisal, and negotiation of private public partnership projects. There should be a unit specialized to identify opportunities, examine financial viability, and to interact with potential private investors. Unit staff will require training in the requisite skills, possibly including some external on-the job experience. This would include several alternatives such as Build-Operate-Transfer and Concession for Operation and Maintenance. To ensure a sustainable revenue flow, facility tolling is normally required, which has not been used yet in Azerbaijan, with rates normally regulated and negotiated to achieve financial viability and rate of return targets. There are likely to be several major projects which might be good candidates for partnerships in the near future, such as the Baku by-pass highway, the bay bridge, the new port, inter-modal terminals, and new enterprises offering rail freight services.

7. Baku is facing major challenges in supply and management of urban transport services. MOT needs to have better capacity for study and recommendations in this area. This requires a multi-disciplinary approach and close coordination with local government and State land use planning agencies. Urban transport planning expertise should be useful and well received.

8. The PIP can be strengthened substantially in terms of results and cost efficiency, if subproject appraisal methods are improved. Financial and economic criteria used in project appraisal should be specific, transparent, and uniform. Among other major shortcomings presently are: 1) weak demand analysis leading to poor judgments on capacity increases required; 2) inadequate consideration of multi-modal solutions to meeting demand; 3) sustainability of the investment in terms of capacity to operate and maintain facilities and of the funding required to do so; 4) insufficient consultations with civic society and stakeholders in the early stages of project appraisal and 5) prioritization in terms of national economic impacts, and particularly those contributing to poverty alleviation and reduction in regional inequality.

9. Project appraisal skills training will benefit from use of several key instructional tools . A number of case studies should be prepared applying examples from Azerbaijan cases studies, which may include projects currently being appraised, a critical review of the process used for projects for which appraisals were prepared earlier, and projects which are still at a conceptual phase. The HDM-4 model is the currently accepted standard tool for project evaluation by IFIs, so staff training should include a through appreciation of this methodology. The model also has applications useful to evaluating programmatic issues, such as budget constraints, network planning, and multi-year investment optimization. Training should also emphasize the need for

each investment appraisal to identify targeted measurable outcomes, with benchmarks for measuring outcomes. Guidelines and manuals for project appraisal are available from the ADB and World Bank. These should be used for instructional purposes and may be incorporated in part into MOT guidelines for project appraisal. The principal features of HDM-4 modeling are described in an Annex. An outline of the Analysis Process for Appraisal of Transport Projects is included in an Annex.

10. MOT should begin to create a larger data base of transport statistics. This could begin with a better compilation of data already collected by agencies supervised by MOT. One goal would be to expand this in ways which would assist managers to see trends in productivity, quality of services and in efficient utilization of capital investments. To achieve this objective requires additional resources to acquire process and update statistics. There should be realistic targets over say a 5 year period. The data users need to be consulted. Access to users via the internet is desirable.

11. In order to implement many of the sector strategic goals and policies many new regulations will have to be adopted. This is especially true in order to carry out the major institutional reforms related to the restructuring of the railways, which has begun and is scheduled for completion by mid-2010. The separation of port ownership and regulation from the navigation services operating company is another major institutional change requiring a new set of regulations. The expansion of inter-modal services, and especially cargo containers, requires new policies and regulations. In the road sub-sector, new safety regulations have been drafted and consulting services for overhaul of the Road Act have been arranged Additionally, regulations are required to govern the operations of the planned expansion of axle load limits' enforcement, to improve licensing and operating standards criteria of commercial bus and truck operators, and to regulate the access of foreign owned vehicles to national markets.

Regulations have to be supported by credible enforcement measures. Therefore, each regulatory measure should be accompanied by a clear statement of institutional responsibility for implementation and enforcement, the sanctions to be applied to parties which disregard the regulations, an estimate of the annual cost to the implementing agencies and how that cost will be met, and a procedure for monitoring and evaluation of actions taken to implement the regulation.

12. The strategy calls for greater application of user fees to ensure investment assets' maintenance is funded without resort to the uncertainties of annual budgeting. Implementation will require research to estimate how much in total fee revenue is desirable and how to equitably distribute the costs among users. The new Road Fund is a good start but its income is well below what is required for road routine and periodic maintenance. Azerbaijan is exceptional in that no user fees are collected through fuel purchases. This policy should be reviewed.

II. COMMENTS ON THE TRANSPORT SECTOR DEVELOPMENT STRATEGY

1. Increase potential transit traffic and revenues generated

This is a core part of the strategy for road and rail development and a priority in the capital investment plan through 2015.

There needs to be included several possible scenarios considering a range of capital expenditures and quantitative targets for volume of traffic, especially non-fuel, and for revenues, which would imply some assumptions respecting tariffs, long-term contracts with major shippers, gross and net revenues. International agreements place some limits on freedom to set tariffs and conditions of transport. Also needed is an estimate of the shares of traffic which each country using then transit corridor would generate.

There should be a brief outline of policy issues which need to be addressed to make the strategy work. What consultations have been undertaken with corridor traffic source countries' governments and shippers respecting service requirements and tariffs? What is required to ensure equal competitive conditions in this market for Azeri transport organizations? As with any plan to substantially increase cross border trade, uncertainties which may largely be beyond the control of the national government, need to be recognized. What constraint does the different rail track gauges in former Soviet countries and those in Europe place on competitiveness of this corridor?

2. Develop national and secondary and local roads network to facilitate broader based economic growth in support of State programs for poverty alleviation and regional socio-economic growth.

The 2006-2015 Roads Program includes about 9,500 kms for reconstruction and rehabilitation. This includes most of the "Republic significant network" but less than half the length of local roads considered in poor condition. Should MOT prepare, in support of local authorities, guidelines of how priorities are and will be determined. What are the minimum and desirable accessibility and mobility service criteria and goals? What are the highest priority regions? Planning process must include coordination with and support of investments planned in other sectors which will promote more productive outcomes, such as irrigation, electric power supply, mining and tourism. Inter-sectoral scheduling and priorities needed to be synchronized. Stakeholder consultation should be part of the prioritization and project preparation process.

3. Preservation of infrastructure assets by devoting more resources to and systematic programming of maintenance activities.

There should be a clear statement as to how the resources for sustainable maintenance should be raised through user charges [tariffs, taxes, tolls, etc.]. The strategy seeks to have user charges cover operating and maintenance costs and contribute to capital costs, as far as possible. The strategy also aims to have taxation policy shift from taxing of production and commerce to taxation of resource consumption, but the rationale and impacts are not described.

The strategy should call for a clear set of standards against which budgets would be prepared, works scheduled, responsibility for execution assigned, and a system of monitoring and evaluation of performance. Should the use of private enterprise contractors for maintenance be encouraged? The enforcement of axle load restrictions is a significant component of this strategy.

4. Multimodal approach

The opportunities for multimodal planning and investment need to be made more explicit. This could include:

Maritime linkages to road and rail, especially access to the new port and type and number of vessels required to meet future demand for transit traffic.

Containerized cargoes can be carried on and transferred from all three modes. This is a service that is likely to be very cost effective and marketable for transit traffic The service requires specialized logistic management skills and a world-wide network of service providers. Therefore, it should be provided or managed by a new logistics enterprise in the private sector.

Passenger services: inter-urban and international. Most train travelers begin or terminate travel using road vehicles. There needs to be linkages between bus and train services. What modal split is desirable for inter-urban trips? Is termination of rail inter-urban service, with service replaced by buses, an option, once the highway investment program has improved service levels on the principal highway network? Buses services have the operational flexibility to provide more service coverage to low income persons than rail. The buses could be publicly owned but privately operated as concessions with MOT setting necessary service requirements to address societal needs. Vehicles could be leased. This would allow ADDY to concentrate on core, profitable freight business and avoid up to AZM 62 million of investment in passenger coaches.

Once highways are improved, will rail and truck be competitive for certain non-oil cargo movements? How should taxation and user fees policies be adjusted to achieve modal equality? Should rail be preferred over highways to some extent because it is more energy efficient, causes less air pollution, reduces road congestion, and is safer?

A more detailed discussion of multimodal policy issues is attached.

5. Safety improvements

Planned improvements in rail track, signaling and communications systems should make train movements safer. There should be accident prevention and safety goals, for workshop and track maintenance staff. Policies for better protection of rail/highway crossings and of track in areas with high population concentrations should be addressed.

For highway vehicle travel, a campaign is needed to educate the motoring public on required safe driving practice and laws. Licensing and vehicle inspection procedures need to be effective and especially rigorous for public transport. Speed restrictions, to be credible, need to be enforced, especially since road improvements will enable drivers to travel faster. A policy on use of seat belts and child restraints in cars and helmets for motorcycle operators is suggested. The strategy should place emphasis on institutional reforms and the policing responsibilities and resources required to improve safety and with specific goals for accident reductions.

In central Baku, to improve traffic flow and pedestrian safety, parking on narrow streets and sidewalks should be more restricted. Parking garages are needed. Opportunities for better demand management should be considered, such as encouraging more flexible work hours, beginning with those of persons working for Government. This could relieve congestion on both public transit facilities and on streets clogged with car owners driving to work.

6. Transport related institutional and regulatory reforms

The linkages and inter-dependency between the reforms and the effectiveness of the capital investments needs to be clearer. Reforms and institutional change often require more time than investments. These often require political and legislative actions for which consensus may not be presumed, despite agreement in principal represented by approval of the Sector Strategy statement. They also require human attitude and behavior modification with respect to staffing requirements, training, performance-based recognition and rewards, the competitive market environment and customer service. By comparison, the investment decisions, implementation measures and scheduling may be more predictable and manageable.

The implementation of the strategy to incorporate more commercial business practices in railway management, the sale of State assets to private sector and contracting for private companies to do more of the operations historically undertaken by government agencies represent a huge shift in policy. This may require that the MOT establish a unit with specialized skills devoted to implementation activities and contract for some financial services. For example, managing the sale of all non-core ADDY business units, in an efficient and transparent manner, requires a high level of effort by persons with commercial skills.

III. DEMAND-BASED TRANSPORTATION PLANNING, POLICY AND PERFORMANCE

Public sector planning and policy formulation need to be closely linked with market-defined transport capabilities and private sector performance measures. Without such links, public policy and private enterprise may pursue contradictory objectives. Planning and policy can be responsive to stakeholder constituencies and be market driven by concentrating on and facilitating improvements of those transport capabilities and performance dimensions deemed most important by transport users.

Transport infrastructure and inter-modal hubs should be designed to provide a catalyst to commercial activities which have a great impact on economic growth, productivity, and global competitiveness of a nation. To achieve this outcome, related implementation actions, budgets, and performance indicators are necessary. This process is needed to transform State strategic plans and Agency mission statements into results. Performance indicators and measurable targets determine whether government goals and objectives are being met.

Network connectivity becomes increasingly important as a means for increasing productivity and global competitiveness. Inter-modal integration has the potential to combine the best capabilities of two or modes of transportation. What has succeeded elsewhere is seamless service that is transparent to users and their customers, facilitating their success. It is the overall package of transportation capabilities, rather than specific transport modes, which is important to users. The MOT has an institutional responsibility to break down long standing single mode prejudices and operations' blind spots by becoming the vision, advocate and spokesperson for comprehensive transport investment and service delivery.

Transportation capabilities can be the building blocks for supply chain strategies and a source of competitive advantage.. Supply chain management, commonly referred to as logistics, optimally links transportation with procurement, production, marketing, and distribution. Supply chain performance is the "bottom line" for transport planning, public policy, and enterprise effectiveness. It is critical that planning and public policy continuously dialogue with customers to determine those performance measures deemed most important by them.

Five important private sector performance categories that are strongly influenced by public policy are cost, productivity, asset management, customer service, and logistical quality.

- Cost includes not only freight costs but also cost of damage, late delivery merchandise returns, and service failures;
- Asset management affects productivity measures such as inventory turnover and stock

levels, which are impacted by transport speed, lead times, dependability, direct routing, enterprise location decisions, and safety.

- Variability in quality of customer service, especially delivery time consistency, is strongly influenced by transport facility disruptions [such as accidents, maintenance related delays and strikes], congestion, arising from modal capacity constraints, inter-modal connectivity, and customs facilitation at international border crossings.
- Logistics quality is impacted especially by inter-modal connectivity, delivery time dependability, and information systems support, such as real time cargo tracking and customer access to reliable shipment status data through transport providers' websites.
- North American, European, and Pacific Basin firms are in remarkable agreement as to which transport capabilities are most important for supply chain success. Customer service is ranked first, while delivery dependability is ranked a close second. Also influenced by transport policy, low logistics costs and delivery flexibility are considered significant ingredients for commercial excellence. Delivery speed is a relatively low priority, and where very important, is often obtained by use of air freight.

IV. MULTI-MODAL TRANSPORT POLICY

1. **Most important is to define roles of road and rail services and where investment and operational planning should be integrated.** For rail freight, there is a line volume threshold below which new investment is unwarranted and where alternative investment in road infrastructure capacity is more economical. One should consider even the eventual possibility of closure of rail services in sections where roads can perform more efficiently.

2. **Most rail trips require a road trip link at origin and destination.** For passengers, this normally requires direct rail to road mode transfers [train/bus/taxi]. Freight is normally held/stored at a station before or after train loading/unloading for pickup/delivery by trucks. Facilities for adequate and secure storage must be provided by either private enterprises or the ADDY. These facilities need to use modern cargo tracking logistic systems linked to those of the ADDY to the maximum extent possible. The shipper should have confidence in the efficiency and security at cargo transfer points and that IT technology is in place to support seamless transfers between modes and to provide operator and shipper with reliable freight tracking information.

3. **Multi-modal transport in international trade normally includes a major component of containerized cargos** for all except petroleum and other products moved in bulk. Presently there is a small volume of containerized cargo on road and rail. This market has not been prioritized as a transport business opportunity. The market potential needs to be researched. If attractive, added capacity for carriage by road and rail needs to be included in strategic and operation plans and capital investment budgeting. Container transport operations should attract private investment and management participation by companies with logistics skills.

4. **In passenger services, road and rail may complement or compete. Government's policy should favor neither.** Presently ordinary class rail tariffs are so low that private bus services can not compete for the mass market, low income customer. What is the justification for subsidizing rail services while privately owned public transport has to operate at market prices? The State Program policy objective is to have more competition in a market economy environment, whereby both modes would compete on equal terms. One would expect that bus services, benefiting from similar subsidized tariffs, could more efficiently carry a larger market share, especially on roads which are programmed for improvement in the capital investment

program. When competitively priced, rail is normally most efficient only for long haul trips and occasionally in providing high volume short-haul urban commuter service. Bus services have the advantage of more frequent schedules, provide service closer to passenger O/Ds and have routing flexibility which can be targeted to provide accessibility to under-served populations. Before investing in expanding the capacity of rail passenger services [investment budgeted at AZM 63 million], the relative efficiency of road public transport needs to be evaluated. Pricing strategy may include subsidies to private bus operators to meet social equity goals.

5. **Inter-modal linkages between maritime and rail** needs further strategic and policy evaluation. The Caspian Sea maritime services are already an important mode for transit traffic, especially petroleum products. National transport strategy includes taking advantage of AZ's geographical location to increase volumes. Most of this traffic is transferred from tanker vessels to ADDY for delivery to ports in Turkey. This is much more efficient than to move rail tank cars on ships, as petroleum products can be easily transferred from one mode to the other. Yet the draft ADDY investment plan there is an allocation of AZM 105 million for purchase of 3 vessels to carry wagons. There is an unrealized potential for vessels based in Baku to carry manufactured products to/ from the Caspian sea littoral countries, principally in containers, linked to road and rail services, or for carriage of truck trailers in the Ro-Ro mode. Investment in container and Ro-Ro vessels would be required. Complementary investments in port facilities would be needed.

6. **Policy on taxation and user charges.** To promote Government policies on tariff reform and competition in a market economy, these charges should be equal for both road and rail commercial passenger and freight traffic. Therefore the charges for use of government assets, highways and rail track and its power systems, should not be preferential to one mode, unless there is compelling reasons for doing otherwise. ADDY pays a 24% tax rate on its profits. What do commercial truck and bus operators pay? Rail operators, under the reform plan, will pay government a track usage charge. Has this been estimated? How will this compare to taxes and fees collected from road users [criteria being based on either pa/km and ton/km or vehicle/ km]. Does rail pay customs duties on its imports used for rail operations? Road vehicle operators do. Will road use tolling be a tool for recovery of capital and/or operating costs?

V. OPERATIONAL PLANS IN THE TRANSPORT SECTOR

1. Rationale

No matter how well a project has been identified, prepared, and appraised, its development benefits can be realized only when it has been properly executed. All projects face implementation problems, some of which can not be foreseen. These problems may stem from difficulties inherent in the development process or from more specific causes, such as changes in the economic and political situation, in project management, or even in the weather. Consequently, the implementation path often varies from that which was envisaged.

Adequate supervision is a high priority for the organization responsible for executing the project but also by an independent party, to ensure objectivity, transparency and to flag issues and bottlenecks while they can be corrected relatively early and quickly. The aim is not to blame but to engage in collective problem solving.

Another central objective of supervision is gathering the accumulated experience to "feed back" into the design and preparation of future projects and into the improvement of policies and procedures. Monitoring and evaluation units should be created to gather information for this purpose. This information would extend beyond technical and scheduling parameters, associated with physical infrastructure facility completion, to include economic, environmental and social impact outcomes and institutional support. Socio-economic baseline data needs to be collected before construction begins, by persons experienced in conducting these types of surveys.

2. Sequencing

A first priority is to ensure that there is no significant policy or legal issues unresolved which could stop implementation. This would include the requirements and procedures for acquisition of private properties. The procurement rules applicable also need to be specified and approved as being in accordance with laws and regulations, by whatever agency has jurisdiction in such matters. This often determines the period that must be scheduled between tendering, contract awards, contractor mobilization and delivery of equipments. Where IFI funding is involved, these rules are very specific, often not very flexible, and usually differ from the rules for projects funded from national resources.

Finance for a project may include several sources: internally generated funds, loans, national budget, and the PIP. It is imperative that the funds be available for disbursement on a schedule which is coherent with physical project implementation schedules.

For major projects, a PIU is required, staffed with all of the relevant skills or provided with the resources to hire consulting services, when the appropriate skilled manpower is not available or sufficient "in house".

If other organizations need to participate in project execution, the scheduling of their interventions has to be consistent with overall project scheduling. For example, a rail transport project may be very dependent on power supply, where rail and roads intersect new infrastructure may be required for grade separation, and for road construction there is usually utilities' infrastructure that has to be relocated or installed. Agencies, departments and persons responsible for coordination must be determined. Any activities which may cause an interruption in services during construction need to be identified and mitigation measures planned. These might include temporary closure or periods of congestion impacting roads, rail or other public utility. Mitigation might include construction of detour facilities, night and weekend work scheduling, probably involving additional costs.

3. Performance Criteria and Indicators

At the beginning of project implementation, criteria, indicators and bench marks should be clearly stated for performance measurement, both for maintaining schedules and budgets. A critical path analysis is usually helpful, especially if it defines the primary persons and agencies to be help responsible for scheduled implementation actions. The process should extend beyond the completion of physical works and equipment delivery to measure the extent to which service delivery and productivity targets have been met. The productivity goals may be defined by the agency which operates the transport service. The service delivery criteria should be driven by customer perceived improvements and be generated in consultation with key stakeholders. They should be measurable quantitatively to the extent possible. However, some qualitative indicators of improvements may also be useful and ranked from best to worst on a scale of say 1-10.

4. Sustainability

Where new investments will require additional operating manpower, a reduction in employees or hiring and training of persons with new skills, scheduling and costing should be incorporated in the implementation plan. The estimated requirements for routine and periodic maintenance of facilities and equipment should be estimated and the source of funding for this specified and confirmed by the appropriate financial entities.

5. Public Information

Communities that will be impacted temporarily and inconvenienced by construction works need to be provided with waming of the nature, scale, and timing of these adverse events. Their concerns should be incorporated, to a reasonable extent, in measures for example to reduce air and noise pollution and to avoid work at night. The benefits that will flow from the works completion should be clearly explained and hopefully appreciated.

VI. CONSULTANT COMMENTS ON THE STATE PROGRAM FOR DEVELOPMENT OF AZERBAIJAN STATE RAILWAYS IN 2006-2011

The Program presents a concise summary of the strategic role of the railway, for meeting potential demand for transit services on the corridor between Europe, the Caspian Basin region and Central Asia. These services already produce significant revenues to the railway and important foreign exchange contributions to the country's balance of payments. Growth of traffic transiting through Azerbaijan is forecast to increase 32% by 2015, or 3-4%/year. Crude oil and other oil products exports, however, are the revenue base, presently accounting for about half of the railways' revenues. There is no presentation of the expected growth in transport of these products or of their expected contribution to revenues. There is provision in the Investment Plan for purchase of 1,500 new tank cars. This product traffic will be larger in volume than any other transit traffic well beyond 2011.

The other main goal of the State Program is to ensure high socio-economic growth in the country by satisfying the growing demand of the population and the economy for transportation services, upgrade level of services and reduce costs. There is no explanation clearly linking railway services to economic development, poverty alleviation and regional accessibility policies.

The need for major restructuring of the railway to shed its operating role and to divest of all non-core assets is clearly explained, and a time phased implementation plan is presented. The reforms would be completed by June, 2010. This would be a remarkably rapid transformation, by which date a holding company would be established consisting of 4 independent companies engaging in passenger, freight, infrastructure, and non-core activities. International standard accounting methods [IFRS] would be installed so that the operating costs for charging track access charges could be systematically estimated in a transparent manner understandable by customers. Additionally, policy and regulatory functions would be transferred to the MOT.

1. The assumption that railway should continue to operate all passenger services presently offered needs to be evaluated. It may be that some markets, especially in regions where poor accessibility and poverty prevail, can be more effectively served, at lower capital and operating costs, by new bus services. This is especially relevant because rail passenger services are delivered only to stations which are often distant from trip origins or destinations, are operated at a loss and with a large capital investment in new coaches is proposed. The Investment Plan

includes AZM 62 million for passenger transport, of which 35 million for purchase of 50 new coaches.

2. The requirements for purchase of new freight wagons should take into consideration that the railway expects to phase out of its operating role. It is the intent that private firms will purchase or lease wagons for their own use. This should be encouraged especially for tanker wagons, specialized wagons for bulk commodities and container flat wagons. The potential is illustrated by the fact that 30% of Kazak wagons are now privately owned. The Investment plan provides AZM 48 million for 8,000 new wagon boggies and AZM 60 million for purchase of 1,500 new tank cars for oil products. Purchases should be staged over a longer period and only made where contracts for product movement or leases are obtained from shippers committing to their use over several years

3. The inter-modal interface between rail and maritime cargo services is not discussed. If vessels are to be an important element in successfully capturing transit traffic, this should be clearly stated in the Program. The estimates of volume and commodity categories should shape the investment decisions for new vessel purchases. The policy to encourage expansion of nationally and privately owned and operated vessels, and consequently the shares these may carry, must be part of the decision making process. Information on planned vessel capacities operated by other Caspian littoral countries must be considered Facilities at the new port must be designed to efficiently handle transfer of specific types of cargoes between rail and ships and temporary cargo store of age cargoes between rail and ships. The Investment Program allocates AZM 105 million for purchase of 3 new vessels to carry rail wagons. The investment planning for the port was not available for the Consultant's review

4. Tariff policies will directly affect profitability of rail services. Some recognition in the Program is needed on the suitability of established tariff mechanisms and obligations of railways, which are members of OSJD. The Uniform Transit Tariff and International Railway Transit Tariff place limits on tariff charges. These do allow for discounts which is necessary for competitive reasons. What modifications will Azerbaijan seek in these tariff arrangements in order to adapt to the reform placing rail infrastructure and freight functions into separate companies and to achieve transit cargo revenue goals?

5. The introduction of track charges will require a new system of freight tariffs. The customer would pay rates per wagon not based on the type of cargo carried. Probably there would be a fixed cost plus a variable one based on a per km cost multiplied by trip kms. If rail performed loading/unloading services there would be an additional charge. The contract with the wagon owner/lessee would have to specify a maximum trip charge, liability for goods damaged and penalties for late delivery. New regulations and perhaps laws governing contractual relationships will be needed. A new rail Department specialized in commercial matters and marketing, staffed with persons trained in new skills, will be required.

6. Policy concerning which services, among those which will remain the railway's responsibility, could possibly benefit from private sector investment and/or management is not addressed. For example, should the railroad seek to contract with private firms to undertake some maintenance of facilities, such as signals and communications? Freight terminals in Kazakhstan have been privatized. Some have become logistic centers with warehousing and inter-modal operations. Who should be responsible for identifying and encouraging privatization opportunities and for presenting these to the State Committee on State Property?

ANNEX 1: ANALYSIS PROCESS FOR PROJECT APPRAISAL [FEASIBILITY] STUDIES

General Topics: These cover project description, history, justification in terms of Sector or Regional strategic and policy objectives, and linkages to other projects or institutional reforms. This information would have been presented in earlier justification documents, such as PIP Call Circular, Project Concept Paper and Pre-feasibility Study, but need to be included and expanded, if requested by MoED, or if new significant information is available.

A. Project Objectives
   1) Development objectives
   2) Key performance indicators

B. Strategic Context
   3) Sector related goals supported by project
   4) Main sector issues and line Ministry/Agency strategy
   5) Sector issues addressed and strategic choices

C. Summary Project Description
   6) Project Components
   7) Key policy and institutional reforms supported
   8) Benefits and target population
   9) Institutional and implementation arrangements

D. Project Rationale
   10) Alternatives considered
   11) Major related projects in sector completed, on-going and planned
   12) Lessons learned and reflected in proposed project design
   13) Indications of line Ministry/Agency commitment to strategic context

ANNEX 2: POLICY IMPLEMENTATION ACTION PLANNING
Example: Enforcement of Axle Weight Limits on Commercial Vehicles

Investment: 12 weighbridges to be installed at many locations

Implementation Actions Needed:

What new laws required? Is the legal basis for enforcement in place? If not, what is required, who will draft, and how long required to become effective?

What will be enforcement options: vehicle impoundment, unloading to meet legal limits, suspension of business license, fines. How will these be collected? Do revenue collections go into Road Fund? What judicial appeal process? Issues related to foreign registered vehicles?

Procurement: Have specifications been written and procedures and schedule for bidding agreed? What locations and prioritization? Design, static or weigh-in-motion, and cost estimate of facilities. Possible purchase, and operation of some mobile equipment? How will maintenance and scale calibration be assured, by supplier or highway agency?

Staffing: Who will operate facilities, private contractor or government? What are the training requirements? How many staff with what skills? What are the estimated operating costs and where will these become budgeted? Will operations be 24/7? What is the traffic police staffing and vehicle requirements for enforcement?

Risks of corruption: Penalties for those operators running overloaded must be sufficiently high to provide a credible deterrence. The penalties have to cost more than the cost savings or revenue maximization obtained by overloading. Therefore, some operators may seek to circumvent the law. Their target would be to bribe operators of the weighbridges either to avoid weighing or to devise means to understate true weights. The weighbridge staff may threaten the operators with recording false overweight values unless illegally compensated. Measures must be undertaken to minimize this risk. Otherwise the credibility and effectiveness of the policy will be lost.

Among the most effective is to have the weighbridges operated by a private firm. It seems that the threat of quick disciplinary action of employees accepting bribes is more certain than for a public employee. Moreover, the firm can be held legally accountable by the Government for the illegal actions of its employees, and therefore supervision and financial controls are tighter. Forcing trucks to unload overweight can be very effective but requires equipment and storage facilities on site, for which use the operator would have to pay before release of goods. The traffic police should stop any vehicle that appears overloaded to verify that they have been weighed.

Impact on freight rates: Transporters price their services on either price t/km or vehicle/km. If enforcement results in a reduction of say 20% in tonnage load, the transporter may argue that rates must rise by 20% to achieve the same revenue per trip. This will only impact movement of commodities which are now normally overloaded. However, the capital investment in road improvement and more resources directed to maintenance will low vehicle operating costs substantially, often by more than 20%. Improved roads will also encourage the use of larger capacity vehicles, which have lower operating costs per t/km than smaller ones. So freight rates need not increase as a consequence of the axle load enforcement policy.

Public information process: How will operators be educated/ informed? Planning for publicity, workshops, campaign to get voluntary compliance. Target construction materials, mining, and bulk agricultural product industries.

Monitoring and Evaluation: Have reduction in overloading targets been achieved? What improvements suggested. Are financial controls adequate? Who will perform these tasks and how often?

ANNEX 3: CASE STUDY – INVESTMENT TO PROVIDE IMPROVED INTERURBAN PASSENGER SERVICES

Project Objectives

National development objectives- linkages to poverty alleviation and improving regional access

- Efficiency: delivery of transport services at lowest economic cost
- Key performance indicators: frequency of service, trip time, trip cost, return on capital investment

Strategic Context

- Sector related goals supported: stimulate competition, encourage more private sector participation in service delivery, increase accessibility in remote areas, fleet modernization, decrease service delivery costs, increase safety standards, reduce environmental pollution, and provide tariff subsidies only to satisfy social equity policy
- Sector issues and strategic choices: Can some of the passenger services presently provided by rail be better provided by bus services? Can a better quality and capacity of services be delivered to more communities by buses at lower capital investment and operating cost?

Summary Project Description

Project components: Investment in massive rehabilitation and modernization of rail coach fleet and facilities or investment in new inter-urban bus fleet.

Presently ADDY handles about 2.5 million passengers a year in inter-urban services, equivalent to about an average 7,000 daily. The Investment Plan [item 6] allocated about AZM 62 million for repair of 14 coaches and new purchase of 50 coaches, as well as for a new maintenance workshop, spares, wheel pairs and gear wheels. Is this a sound investment?

- Key policies supported: Need to provide improved levels of regional passenger service as efficiently as possible
- Benefits: Increased frequency of service, reduction of travel time, reduction of subsidies per trip through reduction in operating costs, and most efficient use of capital investment to achieve these benefits
- Target beneficiaries: All users of public transport but especially those living in remote regions and those who have the lowest incomes
- Institutional and implementation arrangements for buses: Purchase of environmentally suitable bus fleet, arrangements for sale or lease of buses to private operators, selection of routes and minimum service levels, setting tariffs, subsidy criteria for operators, new regulations, monitoring and inspections as necessary; for rail; purchase of new coaches, support equipment and facilities for repairs, reduction of staff if some services discontinued, separation of passenger and freight service management.

Project Rationale

- Major related sector project investments and reforms completed, on-going and planned: business plan for institutional reform includes establishment a new publicly- owned company to operate rail passenger services by 2010. If some rail services are terminated, there should be reduced requirements for locomotives and an increase line capacity.
- Lessons learned from experience in provision of existing inter-urban public transportation services: rail services and bus services

- LM commitment to strategic context: Other activities on-going or planned to achieve similar sector related goals

Demand Forecast and Economic Analysis

- Begin with an evaluation of the market. What are the traffic volumes by O/D pairs? Not limited to the railroad statistics of ticket sales; conduct a sample survey of passenger trip O/Ds. Identify the mode of transport used to access stations, its cost and the distance and/or time used for the total trip, for example to/from residence to work place. The survey would also include customer satisfaction level with existing services and what improvements would be most appreciated.
- Select a method for estimating growth of normal traffic, which might be a global growth rate based on growth in population and per capita income. Make separate forecasts for international and domestic trips. There should be a forecast range, best estimate and best and worst cases scenarios.
- Would train or buses most efficiently provide the quality and frequency of services at the lowest cost?
- Prepare schematic bus service network. Assign existing train trips to road networks. Test assignment rules. Calculate bus VOCs for network trips. Calculate average trip costs. Assume 30-50 passengers loading to obtain cost per passenger and pa/km.
- Calculate/estimate the variable [marginal] operating costs of rail passenger services, assume a range of value for average passenger loading/train. Trains are restricted to providing service at stations on rail alignments. Therefore add average trip cost of access to/from to obtain total trip cost for persons using rail. Prepare a 10 year expenditure schedule for rail and road. Discount values. Compare NPVs of rail costs with bus costs.
- Calculate the investment cost needed to supply a coach or bus fleet to meet the demand. Prepare a pro forma investment schedule for 10 years and compare NPVs for rail and bus.

Note: Busses can be operated efficiently within a range of 30-50 passengers per vehicle, whereas trains, say with 600 passenger capacity, require in the order of 50-70% average loads. Assuming buses would average daily vehicle productivity of 250 passenger trips daily, about 30 buses would be required to provide 7,000 passenger trips daily. By estimating the operating cost per bus for an assumed daily km running, one could estimate the running cost of the service. If a clean technology [natural gas fueled] bus of 50-60 passenger capacity can be purchased for AZM 150,000 , the fleet capital cost would be AZM $ 4.5 million. Spare parts, garage and maintenance facilities might add AZM 0.5 million

- Estimate benefits from added capacity and efficiency in rail freight services. Passenger trains travel faster than freight and according to schedules. Therefore passenger trains are given priority. Freight has to go off-line and stop to allow passenger trains to pass. Freight is core rail business and generates profitable revenues.
- Calculate economic evaluation parameters. Criteria would be least cost alternative as expressed by highest NPV.

Financial

- Adjust economic costs to financial costs: add taxes and possible shadow costing adjustment for foreign exchange
- Tariffs for bus and train trips
- Revenue projections
- Debt amortization schedules

- Income from subsidies
- Estimated track access charges for infrastructure usage. These are not included as economic costs, because bus operators do no pay access charges for highway use.
- Calculate financial evaluation parameters. Criteria would be least cost solution.

Externalities

- Air pollution: Rail electric or diesel. Estimated pollution from power source used per train/km. For bus, diesel or clean technology vehicle. If the latter, no adverse pollution impact and clearly preferred.
- Energy use: Compare rail and bus values per pa/km.
- Safety: Bus operating accident statistics. Assume some decrease for new services, operating safer vehicles, more qualified drivers under stricter supervision

Technical

- Estimate cost of new buses and calculate normal economic values for VOCs
- Select operating criteria for rail passenger service such as number of trains/day, capacity utilization, average km/day
- Estimate cost of new coaches and marginal train running costs including maintenance
- Summarize operating cost/pa/km and service frequency for each station served

Institutional

- Operated by one or more privately owned companies under contract to MOT.
- The service providers would have to meet specific performance criteria.
- Government would own the vehicles or lease them to the operator on incentive terms. Government might pay for periodic maintenance and insurance
- Government would regulate the tariff structure and agree to subsidies as required.
- Bidding process for contracting services to remote regions and on main highway routes

Social

Bus service offers several advantages over rail:

- Buses can provide more frequent, therefore convenient services
- Buses can service many more trip origins/destinations, especially to remote and low passenger trip volume areas
- Buses can shorten total trip time and distance
- Buses require a smaller capital investment relative to productivity, lower costs
- Bus fleet capacity can be increased in smaller increments than coach fleets
- Buses offer flexibility for change in routing, scheduling and capacity utilization

Summary Evaluation

For most trips up to 400-500 kms, buses are the least cost alternative for providing quality inter-urban passenger services. Because they cost less per passenger km than rail, the cost of subsidies required to support the same fare structure will be less. Only on longer or high volume routes may rail be competitive. The risk of making investment decision errors is low for buses, because the capital cost increments can be sized in small increments in rapid response to actual demand. Buses operations can be precisely managed to provide service to target populations with greater scheduling frequency and accommodation of peak demands. Running times for both may be similar once planned infrastructure improvements are completed. Travelers using trains, however, frequently need to travel by road [in Baku perhaps Metro] to/from stations, which adds to trip time and costs, which will determine the travel mode chosen.

This case study demonstrates that one should look at the options for meeting an important national obligation and sectoral strategic goals, that of providing basic public services equitably, before making assumptions as to how this can be most efficiently accomplished.

ANNEX 4: HDM-4 MODEL, DESCRIPTION OF APPLICATION TO PROJECT EVALUATION

[insert Power Point presentation]

ANNEX 5: CONTACT LIST AND PERSONS MET

Government

Qurban H. Nazirov, Chief Engineer, Azerbaijan State Railway

Elmar Farajov, Head of TRASECA and International Projects unit, International Relations Department, MOT

Mirgasim M. Abasov, Head of Investment Policy Sector, Finance and Credit Department, MOT

Rovshan Badalov, Senior advisor, Investment Policy Sector, Finance and Credit Department, MOT

Saoreddin Mammadou, Head of Transport Policy and Economics Department, MOT

Hajiyev V. Addikhan, Chief Deputy of " Azeryolservis" OJSC, MOT

Fuad Evasovr, Infrastructure Policy Sector Head, Ministry of Economic Development

International Finance Institutions

Nijat Valiyev, Infrastructure Specialist [roads], the World Bank country office, Baku

Hadji Huseynov, Infrastructure Specialist [rail], the World Bank country office, Baku

Faraj Huseynbeyov. TransporSt Officer, Asian Development Bank country office, Baku

Private Sector

Fina Garber, Managing Director, Blue Water Shipping Caspian Ltd.

Rufat Gasimov, Managing Director, Baku Cargo LCC.

Dr. Ramiz M. Akhundov, Deputy Secretary, Azerbaijan International Road Carriers' Association

Sunlight Clearing and Forwarding

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HDM-4

Harold Kurzman

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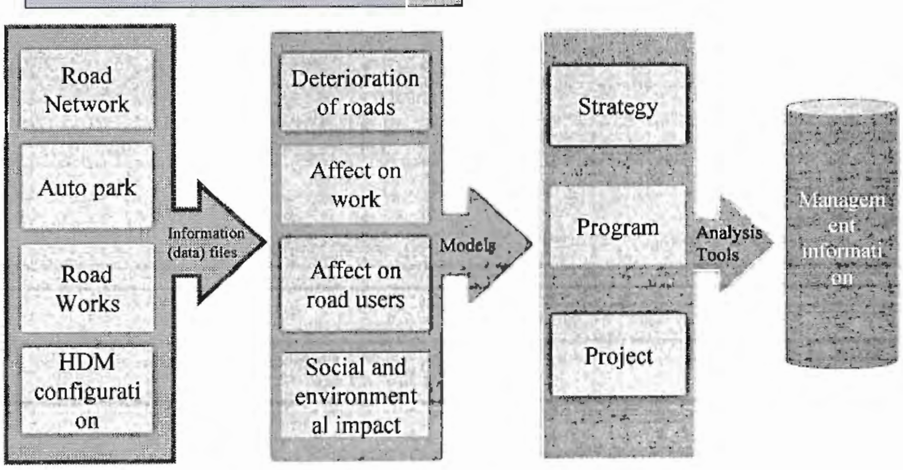
HDM 4 Structure



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ROAD SECTIONS

- Fundamental unit for HDM-4 analysis
- Each section is based on following criteria:
  - ✓ Road level
  - ✓ Traffic speed/flow type
  - ✓ Climate zone
  - ✓ Types of transport stream
  - ✓ Width of transportation (freightage) road
  - ✓ Construction on roadside
  - ✓ Volume of road density

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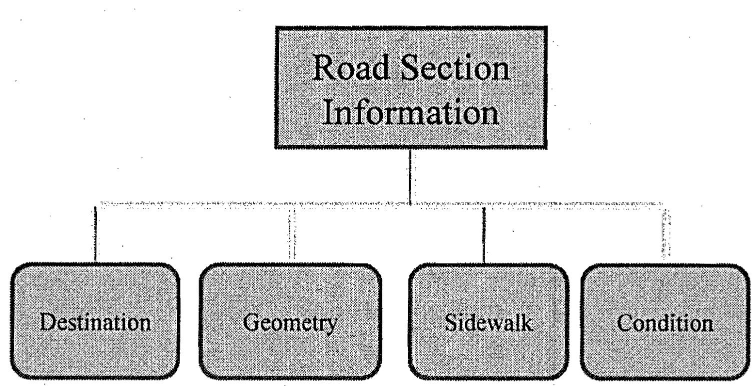
SET OF ROAD NETWORK INFORMATION



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GEOMETRY OF ROAD SECTION

- Average raise + slope (m/km)
- Raise and slope per each km
- Average horizontal curve (° per km)
- Speed limit (km/hour)
- Hight (altitude)

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SIDEWALKS (1)

- Bituminous concrete (asphalt)
  - Type of coating (Asphalt-concrete or cold-mixed)
  - Latest coating thickness (mm)
  - Previous – old coating thickness (mm)
  - Previous works, construction year
  - Sidewalk durability

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SIDEWALKS (2)

- Earth (unpaved) roads
  - Pavement (coating) materials
    - Maximum fraction size (mm)
    - Percentage exceeding 2 mm, 0.425 mm, and 0.075 mm
    - Plasticity index (%)
  - Types of materials
    - (as indicated above)

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CONDITION OF THE ROAD

- Unevenness (m/km IRI)
- Skid resistance at 50 km/hour
- For bitumen (asphalt)
    - Total area cracks (%)
    - Worn out (abrasion) zone (%)
    - Tyre tracks per km.
    - Breakings/damages (m^2 / km)
    - Depth of major tyre tracks (mm)
    - Gravel depth (mm)

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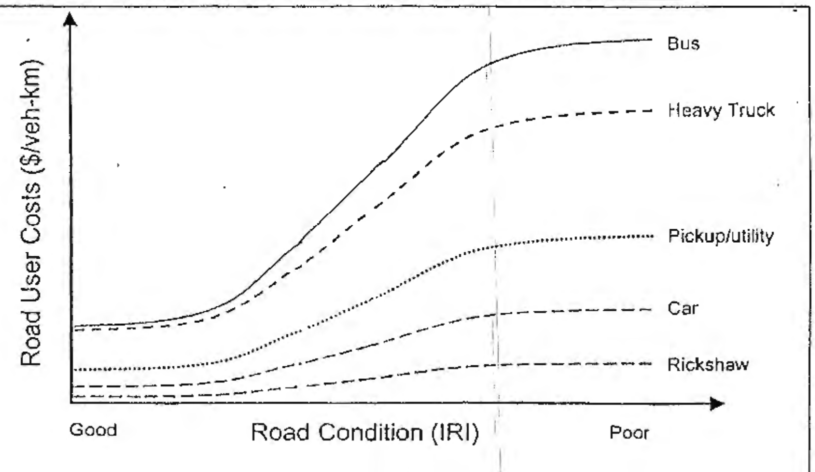
Impact of condition of roads on automobile flow costs



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SET OF CAR INFORMATION

Information on automobile types

- Destination
- Key information
- Economic costs per unit
- Financial costs per unit

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MOTORISED VEHICLES

Engine

- Motorcycle
- Passanger cars
  - Small cars
  - Medium cars
  - Large cars
- Communal service cars
  - Light delivery
  - Light cargo
  - 4-weel vehicles
- Trucks
  - Light trucks
  - Heavy trucks
  - Medium size trucks
  - Trucks with detachable parts
- Buses
  - Minibus
  - Light buses
  - Medium size buses
  - Heavy buses
  - Training buses

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KEY CAR INFORMATION

- Use
  - Average annual mileage (km)
  - Work hours (hour/year in two-way travel)
  - Average service life
  - Average number of passengers per automobile
  - Vehicles used in private trips %
  - Passenger transportations used for business trips%
- Load
  - Number of equivalent single axel loads per vehicle (ESAL)
  - Average work load of vehicle

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ECONOMIC UNIT COSTS OF VEHICLES (1)

- Automobile resourses:
  - New automobile costs
  - Wheel change costs
  - Cost of fuel used by automobile (per liter)
  - Cost of machine oil used in automobile (per liter)
  - Cost of labor/workforce (per hour)
  - Total team salary (per hour)
  - Average annual other (insurance, license etc.) costs

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ECONOMIC UNIT COSTS OF VEHICLES (2)

Time value

- Time value of people on business trips (per hour)
- Time value of passengers on non-business trips (per hour)
- Time value of cargo transported through vehicles (per hour)

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HDM Transport activity costs (2)

	Car	Pickup	Minibus	Big bus	Light truck	Medium size truck	Heavy truck	Truck with detached parts
Characteristic features								
General traffic weight	1600	2700	3200	12600	4000	12300	40000	50000
Number of switches	2	2	2	2	2	2	4	5
Number of wheels	4	4	4	6	4	6	12	18
Number of passangers	2.7	4.5	11.8	52.8	3	6.4	4.4	2.2
Life cycle (year)	9	8	8	10	10	8	8	8
Annual km	20000	25000	75000	75000	45000	80000	100000	100000
Annual hour (spent on road)	375	450	2000	1200	1200	1500	1800	1800
Annual interest costs	12	12	12	12	12	12	12	12
Economic costs ($)								
New vehicle costs	11631	10589	26080	73906	26080	54118	90532	115575
Wheel cost	116	169	434	489	434	502	539	530
Hours of labor force maintenance	2 ,94	2 ,94	2 ,94	2 ,94	2 ,94	2 ,94	2 ,94	2 ,94
Team hours	0							0,93
Passanger hours	0.055	0.008	0.002	0.002	0.006	0.006	0.006	0,006
Cargo delay time					0,02	0,02	0,02	0,02
Annual other costs (insurance etc.)	289	261	340	1713	340	669	1291	2837
Petrol/litre	0,41							
Diesel/litre	0,38							
Oil/litre	2							

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Indicators for road works

Indicators for road works

Maintenance standards

Development standards

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WORK HOURS

- Scope of work
- Specific intervention criteria
- Attention to specific tasks

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MAINTENANCE STANDARDS (1)

- Bituminous (asphalt)
  - Regular works on the roadside
    - Coating of cracks
    - Patching
    - Repair works on the roadside
  - Preventive actions
  - Re-coating works
  - Rehabilitation works
  - Reconstruction works

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MAINTENANCE STANDARDS (2)

- Un-paved roads
  - Leveling
  - Small scale re-gravelling works
  - Re-gravelling or re-paving

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MAINTENANCE ISSUES – FORMAT OF GENERAL INPUT INFORMATION

- Overall
- Design
- Intervention
- Cost (expenditure)
- Impact

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REGULAR WORKS ON THE ROADSIDE (1)

- General
  - Naming (defining) tasks (sections)
  - Short codes for tasks
  - Pre-defined activity type (e.g., coating of cracks, patching, repair of the roadside etc.)
  - Type of intervention (immediate interventions, both scheduled and ad hoc)

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REGULAR WORKS ON THE ROADSIDE (2)

Intervention

- Time period/frequency (throughout the year for scheduled interventions)

OR identified based on:

- Condition of road sides (verges)
- Structure and durability
- Conditions of water provision
- Density of transport.

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REGULAR WORKS ON THE ROADSIDE (3)

- Limitations to interventions
  - Last year of intervention
  - Maximum road roughness for intervention (IRI)
  - Minimum intervention scale based on traffic intensity (AADT)
  - Minimum intervention scale based on traffic intensity(AADT)

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REGULAR WORKS ON THE ROADSIDE (4)

Costs

- Unified tariffs for tasks (for economic and financial items\paragraphs)
  - Costs per m^2
  - Costs per m^3
  - Costs per km
  - Annual costs per km
  - Annual total costs
- Impacts
  - repaired damages % (of damaged sections)

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RE-COATING AND REHABILITATION WORKS (1)

General

- Similar to "Regular works on the roadside"

Design

- Type of coating (for new layer of coating)
- Height\thickness of new coating
- AASHTO durability ratio
- Depth of crushed material (if necessary)
- Sections to be paved in transportation roads (if necessary)

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RE-COATING AND REHABILITATION WORKS (2)

Intervention

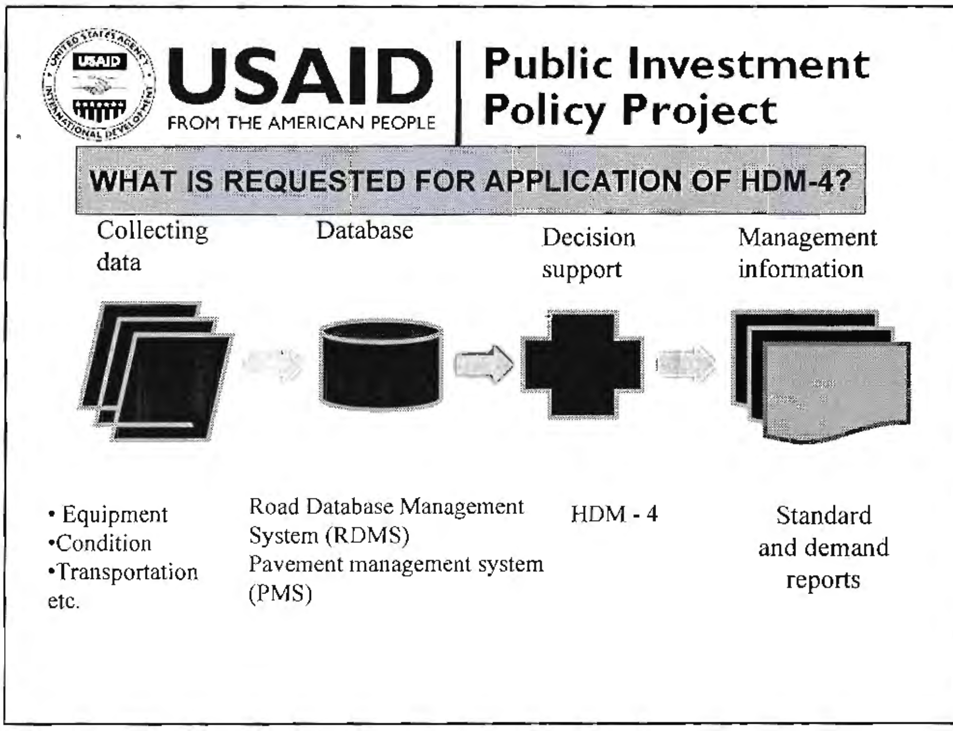
- Similar to "Regular works on the roadside"

Costs

- Similar to "Regular works on the roadside"

Impacts

- Roughness (IRI)
- Depth of average tyre track (mm)
- Depth of surface track (mm)
- Skid resistance (SCRID at 50 km/hour)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WHAT IS REQUESTED FOR APPLICATION OF HDM-4?
Collecting data
Database
Decision support
Management information
• Equipment
•Condition
•Transportation
etc.
Road Database Management System (RDMS)
Pavement management system (PMS)
HDM - 4
Standard and demand reports

CRI

CAMBRIDGE RESOURCES INTERNATIONAL

FINAL REPORT

Improving Institutional Capacity of Host Government Agencies in Integrated Project Analysis Using Modern Cost-Benefit Analysis Techniques

Purchase Order No. 5844
from
Prime Contractor DAI
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December 2007

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Improving Institutional Capacity of Host Government Agencies in Integrated Project Analysis Using Modern Cost-Benefit Analysis Techniques

Overview

Preparations for the design and deliver of this course began in October 2007 and the delivery of the course took place from December 3 to 14, 2007 in Baku Azerbaijan.

The course focused on the techniques for analyzing public sector investment projects, with particular emphasis on the construction of the models for the evaluation of the financial, economic and stakeholder aspects of an integrated project appraisal. A total of 23 participants attended the course with 18 participants completing all aspects of the program, including the final examination. The participants were from a total of 11 government Ministries and Departments, with a core of 10 participants from the Ministry of Economic Development.

The arrangements, translation, and participant recruitment by the staff of the PIPE project prior to the beginning of the program was outstanding. The lecturers who delivered the course were, Glenn Jenkins, Mustafa Besim, Andrey Klevchuk, Kaan Kultay, Aygul Ozbafli, and Necati Ozkan. In additional, essential assistance was provided by the staff of the PIPE project, including Sabira SHIHALIYEVA, Nigar ISMAYLOVA, Elchin RASHIDOV, Sabina IBRAHIMOVA, Gulsabah AMIROVA, and Bagish AHMADOV. Highly skilled translation was provided by Matin AXUNDLU and Turan ALIYEV. The continuous support and guidance of Andrey PARINOV both before and during the program was greatly appreciated.

The lectures in the course were delivered in English with sequential translation in to the Azerbaijani language (Azeri). All the lecture notes and case studies were translated into the Azeri. All the lecturers, except Glenn Jenkins, could speak Turkish addition to English, and Andrey Klevchuk's mother tongue is Russian. In the laboratory when completing the case studies, the assistance was given to the participants using Turkish, although the Microsoft Excel software being used was either in Russian or in English. In terms of the language needed for communication, it was a complicated situation, but through the assistance of the local PIPE project staff, and the fact that the lecturers could communicate in Turkish, everything proceeded smoothly.

The course was conducted in the facilities of the Irshad hotel. From our point of view the facilities were, with minor exceptions, fully adequate. Given the close proximity of the training room to the restaurant, very little time was wasted due to the logistics.
The course schedule is included in this report as Appendix A, with the professional profiles of the participants and the lecturers are included as Appendix B.

Assessment of the Course

The participants of the course were evaluated on the basis of three case studies (including a major case that involved the preparation of a prefeasibility study) which they completed during the two weeks, plus a final examination. All completed case studies were graded and returned to the participants. In addition 10 percent of the final grade was determined jointly by the faculty based on the quality of the independent work done in by the participant on the case study applications. The final grades and ranking of the participants is given in Appendix C.

Overall the level of knowledge of investment appraisal, finance or economics of the participants coming into the course was not as high as is usually the situation with government officials from central government agencies in either developing or developed countries. In the main the participants were eager to learn and by the end of the program the level of knowledge of most of the participants had increased significantly. The top 50% of the class showed a strong desire to achieve a high level of professionalism in this field, and were able to achieve a significant level of competence.

The need is great in Azerbaijan for such hands-on courses where the emphasis is on transferring practical skills in cost-benefit analysis to government officials. From the detailed evaluation of the program provided by participants, Appendix D, it is clear that this type of professional education is wanted and appreciated. There was a high level of approval of all aspects of the program.

If the objective is to raise the professional level of analysis for the type of government officials we had in this program, then general lecture-only academic type courses in cost-benefit analysis are likely to be a waste of resources. Many of the participants had an engineering training as background, with some "economic development" training at an academic level. They are in the most part practical people with a significant amount of practical experience. They are able to learn fairly quickly when showed in a hands-on fashion how to evaluate public sector investment projects using cases of actual projects that they can relate to easily.

The December 2007 course was not sector specific in its focus. The main case dealt with electricity investments and the participants were briefed on cases taken from the water and health sectors. Before a high level of skills can be achieved the responsible officials will be a need to receive this type of training on a sector basis, and at a more advance level. Our recommendation would be to provide all the people who need such training with a basic two week course, similar to the one conducted in December 2007. Then fairly soon afterward, a second two week (or longer) course should be given (to those who demonstrate promise) that is focused on either a single sector or perhaps two sectors. After that the participants should be expected to start actually doing this type of analysis, or supervising consultants who are doing this work, as part of their professional duties. To be effective, the graduates of these programs will initially need to have access to experienced professionals to give them periodic guidance on how to set up the analysis, and to identify the key issues so that informed decisions can be made.

Conclusions

The training of the government officials needs to be integrated with the functions that they are going to be expected to carry out. In order to carry out these investment appraisal functions in a professional manner, guidelines and sector specific handbooks will need to be developed that can serve as the basis of the training materials for such courses. In order carry out an economic appraisal of investment projects, the basic national parameters will need to be estimated and approved for use in Azerbaijan.

Until such basic intellectual infrastructure is put in place, then the training will have to be based on the cases and guidelines developed for other countries. While the professional body of knowledge for Cost-Benefit analysis is certainly transferable from one country to another, it is not the way that the average government official in the government of Azerbaijan thinks about such decision making techniques. They are used to applying the norms and rules that have been sent to them from a central planning authority for use in Azerbaijan. Hence, it will be important for the successful implementation of cost-benefit analysis as a tool for the rational selection of public sector investments that such an institutional infrastructure of guidelines, procedures and sector specific analysis handbooks be developed for Azerbaijan.

In summary, the design and delivery of this integrated investment appraisal program has been a challenging but very enjoyable endeavor for all those from Cambridge Resources International who have been involved in it. We appreciate the opportunity to work with DAI in its planning and implementation.

Glenn P. Jenkins

Date: December 31, 2007

Glenn P. Jenkins
President

Appendix B

Public Investment Policy Project

Cambridge Resources International

Public Investment Policy Project
and
Cambridge Resources International

Program on Investment Appraisal and Risk Analysis

Participant Profiles

December 3-14 2007

The USAID Public Investment Policy (PIP) Project is a technical assistance development project that will contribute to the government of Azerbaijan's (GOAz) objective of making the most efficient use of the country's financial resources. To effectively manage the GOAZ's public investment program, the PIP-Project strengthens GOAZ's institutional and technical capacity in the areas of long-term planning, capital budget formulation, and project development and management.

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Cambridge Resources International Inc. (CRI) provides advisory services, training, and support in each of the areas of investment appraisal, tax policy, and fiscal administration for both developed and developing countries. The group has also conducted training programs for professionals in each of these areas. This group has been working internationally over the past 25 years and more than 30 countries in North America, Asia, Africa, Latin America, Europe, the Caribbean and the former Soviet Union in projects sponsored by international organizations, development banks, governments, and private corporations.

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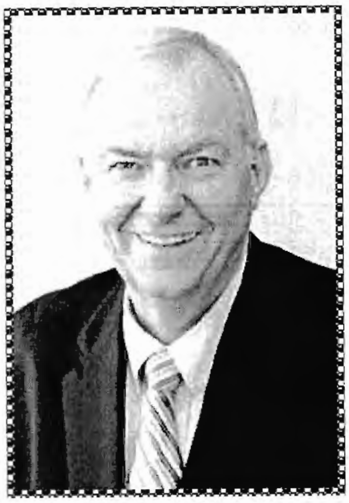

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Appendix C

Program on Investment Appraisal and Risk Analysis

Baku, Azerbaijan

December 3-14, 2007

Participants Grade

Name	Letter Grade	Rank
Nəsimi İsmayılov	A	1
Calal Bağışov	A	2
Rauf Rzayev	A	3
Maqsud Tağıyev	A	4
Bayram Rzayev	A	5
Vügar Əzizov	A	6
Ayaz Qədirov	A	7
Əşəd Məmmədov	A-	8
Bəhəddin Əliyev	A-	9
Fayaz Şükürov	A-	10
Orxan Cavadov	A-	11
Məhəmməd Bəydəmirov	B+	12
Firuddin Cabrayılov	B+	13
Arif Nəzərov	B+	14
Azad Musayev	B	15
Hamlet İsmayılov	B-	16
Şükür Hüseynov	B-	17
Vüsal Məmmədov	B-	18
Mahir Himlostov	Incomplete	
İlqar Məhərrəmov	Incomplete	
Farhad Mikayilov	Incomplete	
Əli Vəliyev	Incomplete	
Mahmud Hüseynov	incomplete	

Participants

Questions*	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	Average
Financial Analysis																					
Glenn Jenkins	10	10	8	9	10	8	10	10	8	10	10	10	9	9	10	5	10	10	10	10	**9.3**
Mustafa Besim	9	7	10	10	8	10	10	10	8	10	10	10	10	9	10	5	10	10	10	10	**9.3**
Aygul Ozbafli	10	5	9	9	8	8	10	10	8	10	10	10	10	8	9	5	10	10	10	10	**9.0**
Andrey Klevchuk	10	8	10	9	8	8	10	8	9	10	10	10	9	10	9	5	10	10	10	10	**9.2**
Economic Analysis																					
Andrey Klevchuk	10	8	9	9	8	8	10	9	9	10	10	10	9	10	9	5	10	10	10	10	**9.2**
Aygul Ozbafli	10	3	9	9	8	8	10	9	9	10	10	10	9	8	10	5	10	10	10	10	**8.9**
Stakeholder Analysis				9																	
Andrey Kevchuk	10	7	9	9	9	8	10	9	9	10	10	10	9	10	10	5	10	10	10	10	**9.2**
Risk Analysis																					
Andrey Klevchuk	10	3	9	10	5	8	10	9	9	10	10	9	10	10	10	5	10	10	10	10	**8.9**
Aygul Ozbafli	10	3	9	8	5	8	10	10	9	10	10	10	9	8	10	5	10	10	10	10	**8.7**
Practical Sessions																					
Andrey Klevchuk	10	5	10	8.5	7.75	8	10	8.5	8.75	10	10	10	9.5	10	10	5	9.75	10	10	10	**9.0**
Aygul Ozbafli	10	4.25	10	9.25	7.75	8.5	10	9.5	8.75	10	10	10	9	8	10	5	10	10	10	10	**9.0**
Necati Ozkan	10	4	10	8	5.75	8.5	10	9	8.75	10	10	10	10	8	9	5	10	10	10	10	**8.8**
Kaan Kutlay	10	5	9	8.5	6	8.5	10	7	8.75	10	9	10	9	8	9	5	9	10	10	10	**8.6**
Nigar Ismaylova	10	6.25	7.75	8	7	7.5	10	10	9	10	10	5	9.75	9	7.75	5	9	10	10	10	**8.6**
Elchin Rashidov	10	5	8	8.75	7	10	10	5	9	10	10	10	9	10	8	5	9	10	10	10	**8.7**
Case Studies																					
Alternative Investment Criteria Case	10	5	8	10	5	8	10	10	9	10	10	10	9	9	8	5	10	10	10	10	**8.8**
Inflation and Exchange Rates	10	5	9	10	8	8	9	10	9	10	10	10	10	9	8	5	10	10	10	10	**9.0**
Arkati Power Project	8	8	10	9	8	8	10	10	9	10	10	10	8	9	8	5	10	10	10	10	**9.0**
Administrative Issues																					
Sabira Shihaliyeva	10	10	10	8.5	10	10	10	10	9	10	10	10	9	10	10	5	9.5	10	10	10	**9.6**

Summary

Training period: 1- Too Little; 5- Just Right; 10- Too Much	3.8	4.8	10	8.6	5	5.75	10	10	4.4	10	10	5	10.25	6	5	5	10	10	1.8	5	**7.0**
Course components: 1- Too Easy; 5- Just Right; 10- Too Difficult	3.5	4.8	7.7	8	7.9	5.9	10	8	4.6	5	5	10.5	8.5	5	5	5	5	10	4.6	4.6	**6.4**
General Issues**																					
Would you recommend that a colleague or staff member in your organization attend the program in the future?	1	1	1	1	1	1	1	1	1	1	1	1		1	1	2	1	1	1	1	**1.1**
Was the Training room comfortable?	2	1	2	2	1	1	1	1	1	1	1	1		4	1	2	1	1	1	1	**1.4**
Were the handouts clear and understandable?	1	1	1	2	2	1	1	1	1	1	1	1		1	2	2	1	1	1	1	**1.2**
Was the quality of the food good?	1	2	1	3	2	1	1	2	2	1	1	1		1	2	2	2	1	2	1	**1.5**

***Questions**

1 - poor (inappropriate, irrelevant, unclear, disorganized)

5 - adequate (met expectations, appropriate)

10 - excellent (surpassed expectations, thought provoking, highly relevant)

****General Issues**

1- Definitely Yes

2- Probably Yes

3- Probably No

4- Definitely No

Comments on trainers:

Glenn Jenkins

Positive :

1) Lecturing style
2) High professionalism
3) Detailed approach and explanation.
4) Very good comparisons
5) Ability to explain in an efficient and productive way
6)The subject and practical cases are explained clearly

Negative:

7) Brief explanations
8) Time for case studies was limited

Mustafa Besim

Positive:

1) Ability of being a good lecturer and attracting the audience
2) Ability to grasp questions
3) Detailed explanations

Negative:

4) Short period of participation as a trainer
5)Time for explanation should be extended to facilitate understanding of the material

Aygul Ozbafli

Positive:

1)Concrete explanation of topics
3) Lecture was concise
5) Being exact

Negative;

2) Fast manner of lecturing
3) Lecture was compact
4) There was no software presented

Andrey Klevchuk

Positive;

1)Takes advantage of breaks to explane unclear issues in informal situations
2) Good presentation of lectures

Negative;

3) The number of case studies should be less and time for explanation should be extendec
4) Limited time for comprehensive explanation of the subject
5) Repetition of Glenn Jenkins' lecture on Economic Analysis

General comments on the training:

Positive:

1) Training was very successful from the point of project analysis
2) Material was clearly delivered
3) Desirable to start training at 10 a.m
4) Desirable to prolong the training period
5) Desirable to arrange such trainings outside of Azerbaijan
6) The training was comprehensive

Negative:

7) Limited time for explanation of case studies
8) Limited number of case studies
9) Short period of the training
10) Training materials and translation needs to be improved

FROM THE AMERICAN PEOPLE

PUBLIC INVESTMENT POLICY PROJECT

FINAL REPORT by MARIO GUTIERREZ

NOVEMBER 2007

This publication was produced for review by the United States Agency for International Development. It was prepared by Development Alternatives, Inc.

FINAL REPORT by MARIO GUTIERREZ

November 2007

TABLE OF CONTENTS

Financial Programming

Concepts and Principles

Mario Gutiérrez
Consultant
Ministry of Economic Development, Baku November 2007

Concept of Financial Programming.

- A Financial Program is a consistent set of policy measures designed to achieve a sustainable balance of payments and price stability (low and predictable inflation).
- A financial programming relies on the interactions between the monetary accounts and the balance of payment accounts. The fiscal accounts are in many cases crucial for the evolution of the monetary and balance of payment accounts.
- Financial Programming is different to a Plan as the Plan set objectives and targets as a micro level, interfering with the operation of markets. In a Financial Programming a consistent macro framework but do not interfere with the operations of markets in the allocation of resources across different economic activities.

2

Functional Relationships used in Financial Programming

- In a Financial Programming it is necessary to choose a simple but comprehensive and flexible scheme of economic relationships that ensures consistency of the program.
- Partial equilibrium or general equilibrium models would not prove useful as main objectives and targets are linked to economic policies that induce structural changes in the type of interrelations among the monetary, fiscal, external (balance of payments) and the real sector.
- The incorporation of functional relationships will depend on the situation specific to a particular country: availability and reliability of statistics, dynamic of policies and structural changes (which may change the functional links among variables), institutional capabilities concerning training and resources available, and type of communications and data sharing among government agencies.

3

Objectives, Targets, and Instruments.

- In a Financial Program it is required to distinguish between Objectives (or final goals) for ex. reduce inflation, and Intermediate Targets that help to assess the degree of achievement of the objectives for ex. setting a target for the expansion of domestic credit.
- In the achievement of goals and targets the policy makers need to use Instruments linked to the targets. For ex. cutting the expansion of domestic credit may require raising interest rates to curb the demand of credit by the private sector or limit the fiscal deficit.
- The exchange rate may also become an instrument for ex. for helping to contain inflation (an objective).
- In some cases an Instrument could also become a Target for ex. reducing domestic inflation could require cutting domestic credit (Instrument) but a ceiling on the expansion of domestic credit could also be set as a Target as it relates to the achievement of a final objective (reducing inflation).

4

The Short and the Medium Term

- The main objectives of macroeconomic policy are price stability, economic growth, and employment.
- Other social objectives can be added depending on a particular country situation such as reduction of poverty, achieving a more equitable income distribution, and improvements in infrastructure, health, and education.
- The achievement of the selected objectives is subject to budget and capacity constraints which force the assignment of priorities to the various objectives in a time perspective.
- Budget constraints applying at the country level (current account balance, inflationary pressures, or access to foreign borrowing) and at the government level (budget balance, implementation capacity, or access to credit by the government).
- Capacity constraints relate to the limits for expanding the provision of output and services required for achieving some selected objectives (for ex. expansion of education or public investment constraints).

5

- Price stability and balance of payment objectives (change of international reserves) sustainability are at the center of short run Financial Programs (IMF Stabilization programs). Policies aimed for the Short Term are often called Demand Management or Stabilization Policies.
- In Medium term Programs (as the type used by the World Bank) economic growth, investment and savings (national and foreign) are at the center of these programs. The policies are in most cases different to those associated with short run stabilization programs.
- Medium Term Instruments include investment in infrastructure and human capital (health and education), improving the efficiency of the financial system, improving the operation of domestic markets (deregulation and competition policies), and opening the economy to international trade and promotion of exports. Polices aimed for the Medium Term are often called supply-side or structural policies.
- Raising economic growth on a sustainable basis requires more time than reducing inflation through demand management because the structural policies that are required take time to be designed and implemented.
- For this reason the design of a Financial Programming that takes account of the medium term requires policy and political compromises that involve assigning priorities to the objectives from a time perspective.
- Functional relationships become more important for medium term projections because of the dynamic relationships between investment, savings, and economic growth.

6

Macroeconomic Accounting Framework: Flow of Funds

- The design of Financial Programming is developed having in mind a Flow of Funds view of the economy. The economy is divided into four aggregate analytical sectors (used in Financial Programming): Private sector, Non-Financial Public sector, Banking sector, and External sector.. For each sector we distinguish between the sources and uses of funds:

  Sources (right side): sources to finance the acquisition of financial assets.
  Uses (left side): net acquisition of financial assets (including money).

  The net source of funds for the non banking sector is equal to the excess of the current account balances (saving) over the acquisition of physical assets (investment).
  The banking sector issue domestic and external liabilities (sources) that are used to acquire domestic and external financial assets (uses)

7

Private Sector

Uses	Sources
dMd	Sp
- dDp	- Ip
-Fp	

Non-Financial Public Sector

Uses	Sources
- dFg	Sg
- dDg	- Ig

Banking Sector

Uses	Sources
dR	dM
+ dD	+ dFb

External Sector

Uses	Sources
dF	Sx
- dR	

8

- **Private Sector:**
  Sources: Sp - Ip: Private Saving (national disposable income – private consumption)- Private Investment.
  Uses: dMd - dFp: Change in the demand for money – Change in the private sector's domestic demand for credit – Change in the private sector's net foreign borrowing.

- **Non-Financial Public Sector:**
  Sources: Sg - Ig: Non-Financial Public Sector Savings (current revenue – current expenditure) – Public Sector Investment.
  Uses: -dFg - dDg: Change in the non-financial public sector's net foreign borrowing - Change in the non-financial public sector's domestic demand for credit.

- **Banking Sector:**
  Sources: dM + dFb: Change in the supply of money + Change in the financial sector's foreign borrowing.
  Uses: dR + dD: Change in net international Reserves + Change in total domestic credit (=dDp + dDg).

- **External Sector:**
  Sources: Sx: External saving = - balance in the current account of the balance of payments.
  Uses: dF – dR: Change in the aggregate foreign borrowing of the country – change in net international.

9

- Adding the sources and uses of funds for the four sectors and considering an ex-post identity between the changes in the demand and supply for money we get:
  (Sp + Sg + Sx) = (Ip + Ig) (total saving = total investment).
- Consolidating only the three domestic sectors gives us the balance of payments:
  (Sg + Sp) – (Ip + Ig) = - Sx = dR – dFp – dFg – dFb
  Sn (national saving) – I (domestic investment) = - Sx = dR – dF

- An excess of national saving over domestic investment is reflected in a surplus in the current account of the balance of payments (negative foreign saving), which is also reflected in an accumulation of international reserves and/or decline of foreign borrowing (capital account of the balance of payments).
- The flow of funds scheme helps to visualize the links that exist between the changes in savings and investment and changes in the financial variables (M, D, and F) and changes in the capital account of the balance of payments (including changes in foreign reserves).

10

Financial Programming Basic Relationships

- From the Banking Sector sources and uses of funds (also called Monetary Survey) we have:
  dM = dR – dFb + dD
  dR = dM –dD + dFb

- The work of financial programming centers on the relations between money (dM), domestic credit (dD), and foreign borrowing by the banking sector (dFb) on one side the balance of payments (dR) on the other side.

- Increments in International Reserves reflect expansion in the supply of money (in the monetary base leads to expansion of ultimate monetary aggregates: M1, M2, M3), contractions of domestic credit, and increases in foreign borrowing by the banking sector (central bank + commercial banks). Changes in domestic prices are related to the changes in the supply of money: Inflation is considered a monetary phenomenon.

11

The role of the Exchange Rate

- In country with fixed exchange rates an increase of international reserves could be induced by a contraction of domestic credit. This is because the quantity of money (M) is what is demanded by people, which in turn is determined by GDP growth and inflation.

- But in practice, a contraction of credit induces reductions in inflation and economic growth. A financial program that relies on "expenditure reductions" as cut in domestic credit implies cuts in spending by the government and the private sector.

- To alleviate the magnitude of the contraction impact on growth and at the same time facilitate improvements in the balance of payments the exchange rate is used to induce "expenditure switching". An increase in the exchange rate switches aggregate demand away from imports and into domestically produced goods and services.

- The exchange rate is in some cases used also as a main instrument to reduce inflation. In some cases the rate is fixed or a crawling peg system is adopted to bring down inflationary expectations. In these cases, it is crucial a monetary policy and wages policy consistent with the use of the exchange rate to reduce inflation. An excessive monetary expansion or wages indexed to past inflation would maintain or rise inflationary pressures, producing undesirable movements in the real exchange rate.

12

Two simple examples of Financial Programming

- **Case 1:** Country has fixed exchange rate or crawling peg system. Growing current account deficit caused by a rising demand for imports. International reserves are falling. Inflation is rising. Public balance is deteriorating. Access to foreign financing is narrowing.

  Diagnostic: It is found that the main source of the balance of payments problem is an excessive monetization of the public deficit. The public deficit has been growing and reflected in growth of domestic credit to the public sector. This expansion of credit (given a fixed exchange rate system) is producing a loss of international reserves and rising inflation.

  Financial program:

  Objective: Contain the loss of international reserves (set floor for international reserves).

  Targets: Ceiling on domestic credit to the public sector

  Instruments: Reduction of the fiscal deficit and/or a devaluation of the exchange rate to induce an improvement in the current account balance (mainly through a contraction of imports) and/or an increase of interest rates (to help reduce demand for credit).

13

- **Case 2:** Country has fixed exchange or crawling peg system. Growing current account surplus caused by a rising price of a main primary exported commodity. Public sector revenues from the exports commodity used to finance public spending. International reserves are rising. Inflation is rising. Public spending growing fast.

  Diagnostic: It is found that the monetization of international reserves is producing pressures for nominal exchange rate appreciation and inflationary pressures. Rapid growth of public spending but limited expansion of supply constraints adding to exchange rate appreciation and inflationary pressures.

  Financial program:

  Objective: Contain inflationary pressures and appreciation of the real exchange rate that deteriorate competitiveness of export sectors. Establish a feasible path for growth of public spending in line with pace of structural policies aimed at expanding supply.

  Targets: Ceiling on domestic credit and public spending, and on accumulation of monetizing international reserves.

  Instruments: Limits to fiscal balance and/or some limited nominal exchange rate appreciation and/or an increase of interest rates (to help reduce demand for credit). Leave some foreign assets outside the country (stabilization fund). Acceleration of structural policies to alleviate capacity constraints.

14

Financial Programming
And Economic Policy
Concepts and Main Principles

Consultancy US AID/DAI
Azerbaijan: Ministry of Economic Development
Consultant: Mario A. Gutierrez
November/December 2007

- Concept of Financial Programming.

A Financial Program is a consistent set of policy measures designed to achieve a sustainable balance of payments and price stability (low and predictable inflation). It is a tool to help achieve internal equilibrium (price stability) and external equilibrium (sustainable current account deficit or surplus). Policies in the monetary, balance of payments, and fiscal areas are crucial to achieve the balance of payments and inflation goals. This is because a financial programming relies on the interactions between the monetary accounts and the balance of payment accounts. The fiscal accounts play in many cases a central role in the evolution of the monetary and balance of payment accounts: the government deficit may add pressures on domestic credit and inflation, which impact the balance of payments (demand for imports and international reserves) and put pressures on the exchange rate.

Financial Programming is different to a Plan as the Plan set objectives and targets as a micro level, interfering with the operation of markets. In a Financial Programming a consistent macro framework is set but not interference with the operations of markets in the allocation of resources across different economic activities.

- Functional Relationships used in Financial Programming.

In a Financial Programming it is necessary to choose a simple but comprehensive and flexible scheme of economic relationships that ensures consistency of the program. Using partial equilibrium or general equilibrium models would not prove useful as main objectives and targets are linked to economic policies that induce structural changes in the type of interrelations among the monetary, fiscal, external (balance of payments) and the real sector. Flexibility allows the incorporation of functional relationships linking some key variables that are projected (for ex. imports made function of real GDP growth and the real exchange rate). The incorporation of functional relationships will depend on the situation specific to a particular country related to: availability and reliability of statistics, dynamic of policies and structural changes (which may change the functional links among variables), institutional capabilities concerning training and resources available, and type of communications and data sharing among the government agencies responsible for the compilation of the monetary, external, fiscal, and national accounts statistics.

- Objectives, Targets, and Instruments.

In a Financial Program it is required to distinguish between Objectives (or final goals) for ex. reduce inflation, and Intermediate Targets that help to assess the degree of achievement of the objectives for ex. setting a target for the expansion of domestic credit. The targets are intermediate measures for monitoring the extent to which the final objectives are being achieved.

In the achievement of goals and targets the policy makers need to use Instruments linked to the targets. For ex. cutting the expansion of domestic credit may require raising interest rates to curb the demand of credit by the private sector or limit the fiscal deficit. The exchange rate may also become an instrument for ex. for helping to contain inflation (Objective). In some cases and Instrument could also become a Target for ex. reducing domestic inflation could require cutting domestic credit (Instrument) but a ceiling on the expansion of domestic credit could also be set as a Target as it relates to the achievement of the final objective (reducing inflation).

- The Short and the Medium Term.

The main objectives of macroeconomic policy are price stability, economic growth, and employment. Other social objectives can be added depending on a particular country situation such as reduction of poverty, achieving a more equitable income distribution, and improvements in infrastructure, health, and education. The achievement of the selected objectives is subject to budget and capacity constraints which force the assignment of priorities to the various objectives in a time perspective. Budget constraints applying at the country level (current account balance, inflationary pressures, or access to foreign borrowing) and at the government level (budget balance, implementation capacity, or access to credit by the government). Capacity constraints relate to the limits for expanding the provision of output and services required for achieving some selected objectives (for ex. expansion of education or public investment constraints).

Price stability and balance of payment objectives (change of international reserves) sustainability are at the center of short run Financial Programs (IMF Stabilization programs style). For achieving these objectives typical instruments are the level of domestic credit, interest rates, exchange rates, tax rates, and the level of government spending. Policies aimed for the Short Term are often called Demand Management or Stabilization Policies. In Medium Term programs (World Bank style) economic growth and raising domestic savings are at the center of the program.

In Medium term Programs (as the type used by the World Bank) economic growth, investment and savings (national and foreign) are at the center of these programs. The policies are in most cases different to those associated with short run stabilization programs (that center on inflation and the balance of payments).

These policies include establishing incentives for domestic savings and investment. Medium Term Instruments include investment in infrastructure and human capital (health and education), improving the efficiency of the financial system, improving the operation of domestic markets (deregulation and competition policies), and opening the economy to international trade and promotion of exports. Polices aimed for the Medium Term are often called supply-side or structural policies. Raising economic growth on a sustainable basis requires more time than reducing inflation through demand management because the structural policies that are required take time to be designed and implemented.

At the same time, the Medium Term objectives are generally influenced by the Short Term objectives. Changes in exchange rates, interest rates, and controls on the expansion of domestic credit and government budget may interfere with the timing for achieving some Medium Term objectives of raising investment and economic growth. On the other side, achieving price stability (Short Run objective) becomes also a basic element to stimulate private investment, which is crucial in a Medium Term program.

Designing a Financial Programming with a Medium Term perspective is complicated for the reasons explained above: conflicts usually arise between the short and medium term objectives, targets, and instruments. For this reason the design of a Financial Programming that takes account of the medium term requires policy and political compromises that involve assigning priorities to the objectives from a time perspective. Functional relationships become more important for medium term projections because of the dynamic relationships between investment, savings, and economic growth.

- Macroeconomic Accounting Framework: Flow of Funds

The economy is divided into four aggregate analytical sectors (used in Financial Programming): Private sector, Non-Financial Public sector, Bnaking sector, and External sector. For each sector we distinguish between the sources and uses of funds:

Sources (right side): sources to finance the acquisition of financial assets.
Uses (left side): net acquisition of financial assets (including money).

The net source of funds for the non banking sector is equal to the excess of the current account balances (saving) over the acquisition of physical assets (investment).

The banking sector issue domestic and external liabilities (sources) that are used to acquire domestic and external financial assets (uses)

1. Private Sector:

Private Sector

Uses	Sources
dMd	Sp
- dFp	
- dDp	- Ip

Sources: Sp - Ip: Private Saving (national disposable income – private consumption)- Private Investment.
Uses: dMd - dFp: Change in the demand for money – Change in the private sector's domestic demand for credit – Change in the private sector's net foreign borrowing.

2. Non-Financial Public Sector:

Non-Financial Public Sector

Uses	Sources
- dFg	Sg
- dDg	- Ig

Sources: Sg - Ig: Non-Financial Public Sector Savings (current revenue – current expenditure) – Public Sector Investment.
Uses: -dFg - dDg: Change in the non-financial public sector's net foreign borrowing - Change in the non-financial public sector's domestic demand for credit.

3. Banking Sector:

Banking Sector	
Uses	Sources
dR	dM
+ dD	+ dFb

Sources: dM - dFb: Change in the supply of money + Change in the financial sector's foreign borrowing.
Uses: dR + dD: Change in net international Reserves + Change in total domestic credit (=dDp + dDg).

4. External Sector:

External Sector	
Uses	Sources
dF	Sx
- dR	

Sources: Sx: External saving = - balance in the current account of the balance of payments.
Uses: dF – dR: Change in the aggregate foreign borrowing of the country – change in net international reserves.

Adding the sources and uses of funds for the four sectors and considering an ex-post identity between the changes in the demand and supply for money we get:

(1) (Sp + Sg + Sx) = (Ip + Ig) (total saving = total investment)

Consolidating only the three domestic sectors gives us the balance of payments:

(Sg + Sp) – (Ip + Ig) = - Sx = dR – dFp – dFg - dFb

(2) Sn (national saving) – I (domestic investment) = - Sx = dR – dF

An excess of national saving over domestic investment is reflected in a surplus in the current account of the balance of payments (negative foreign saving), which is also reflected in an accumulation of international reserves and decline of foreign borrowing (capital account of the balance of payments).

Remark: Sx is called foreign savings because it is the excess of saving over investment that rest of the world is transferring to finance the deficit of the current account (via a surplus in the capital account). If the level of foreign savings is negative (current account surplus) it is our economy that is transferring the excess of savings over investment to the rest of the world (via a deficit in the capital account.

The flow of funds scheme helps to visualize the links that exist between the changes in savings and investment and changes in the financial variables (M, D, and F) and changes in the capital account of the balance of payments (including changes in foreign reserves).

Savings and investment variables derived through the National Accounts System:

$$Y = Cp + Ip + G + X - Z$$

The current account balance is the difference between national income and domestic spending:

$$Yn - (Cp + Ip + G) = X - Z + NIx + NTRx$$

$$Yn = Cp + Ip + (Cg + Ig) + X - Z + NIx + NTRx$$

$$Ynd + T = Cp + Ip + (Cg + Ig) + X - Z + NIx + NTRx$$

Total Saving = Total Investment

$$(Yd - Cp) + (T - Cg) + (Z - X - NIx - NTRx) = Ip + Ig$$

$$Sp + Sg + Sx = I$$

Where,

Y = GDP
C, Cp, Cg = total consumption, private consumption, government consumption
I, Ip, Ig = total investment, private investment, government investment
G = total government spending
X = exports of goods and services
Z = imports of goods and services
T = taxes
NIx = net income from abroad
NTRx = net transfers from abroad
S, Sp, Sg, Sx = total saving, private saving, government saving, external saving.

- Financial Programming Basic Relationships

From the Banking Sector sources and uses of funds (also called Monetary Survey) we have:

$$dM = dR - dFb + dD$$

$$dR = dM - dD + dFb$$

The work of financial programming centers on the relations between money (dM), domestic credit (dD), and foreign borrowing by the banking sector (dFb) on one side the balance of payments (dR) on the other side.

Increments in International Reserves reflect expansion in the supply of money (in the monetary base leads to expansion of ultimate monetary aggregates: M1, M2, M3), contractions of domestic credit, and increases in foreign borrowing by the banking sector (central bank + commercial banks). Changes in domestic prices are related to the changes in the supply of money trough a type of quantitative equation of the form:

Inflation is basically a monetary phenomenon. In the short run it is generally assumed that GDP real growth (dY*/Y*) is determined by more fundamental variables such as investment) and the demand for money (inverse of the income velocity of money) is unchanged.

$$dM/M = dP/P \times dY^*/Y^* - dV/V$$

- The Role of the Exchange Rate

In country with fixed exchange rates an increase of international reserves could be induced by a contraction of domestic credit. This is because the quantity of money (M) is what is demanded by people, which in turn is determined by GDP growth and inflation. In practice, a contraction of credit induces some reductions in inflation and undesirable contractions of economic growth. This type of program relies on "expenditure reductions" as cut in domestic credit implies cuts in spending by the government and the private sector.

In order to alleviate the magnitude of the contraction impact on growth and at the same time facilitate improvements in the balance of payments the exchange rate is used to induce "expenditure switching". An increase in the exchange rate switches aggregate demand away from imports and into domestically produced goods and services.

The exchange rate is in some cases used also as a main instrument to reduce inflation. In some cases the rate is fixed or a crawling peg system is adopted to bring down inflationary expectations. In these cases, it is crucial a monetary policy and wages policy consistent with the use of the exchange rate to reduce inflation. An excessive monetary expansion or wages indexed to past inflation would maintain or rise inflationary pressures, producing undesirable movements in the real exchange rate.

- Examples with Short Term Financial Programming

Two classic examples of the use of financial programming are described. Each case is followed by a diagnostic elaborated after analyzing the economic performance and the different sectoral accounts:

Case 1: Country has fixed exchange rate or crawling peg system. Growing current account deficit caused by a rising demand for imports. International reserves are falling. Inflation is rising. Public balance is deteriorating. Access to foreign financing is narrowing.

Diagnostic: It is found that the main source of the balance of payments problem is an excessive monetization of the public deficit. The public deficit has been growing and reflected in growth of domestic credit to the public sector. This expansion of credit (given a fixed exchange rate system) is producing a loss of international reserves and rising inflation.

Financial program:
Objective: Contain the loss of international reserves (set floor for international reserves).
Targets: Ceiling for domestic credit to the public sector
Instruments: Reduction of the fiscal deficit and/or a devaluation of the exchange rate to induce an improvement in the current account balance (mainly through a contraction of imports) and/or an increase of interest rates (to help reduce demand for credit).

Case 2: Country has fixed exchange or crawling peg system. Growing current account surplus caused by a rising price of a main primary exported commodity. Public sector revenues from the exports commodity are used to finance public spending. International reserves are rising. Inflation is rising. International reserves are rising. Inflation is rising. Public spending has been growing fast.

Diagnostic: It is found that the monetization of international reserves is producing pressures for appreciation of the nominal exchange rate and inflationary pressures. Rapid growth of public spending in a context of limited expansion of supply are adding to the exchange rate and inflationary pressures.

Financial program:
Objective: Contain inflationary pressures and the implied appreciation of the real exchange rate to prevent loss of competitiveness faced by other export sectors. Establish a feasible path for growth of public spending in line with the pace of structural policies aimed at expanding supply.
Targets: Ceiling on domestic credit and public spending, and ceiling of accumulation of international reserves.
Instruments: Limits to fiscal balance and/or some limited nominal exchange rate appreciation and/or an increase of interest rates (to help reduce demand for credit). Leave some foreign assets outside the country to prevent monetization (stabilization fund). Acceleration of structural policies to alleviate capacity constraints.

IV. Structure of a Financial Programming Model Data Base, Exogenous and Endogenous variables, Data sources, and Potential Data Issues.

See Annex A

TABLE 1: FINANCIAL PROGRAMMING
STRUCTURE OF FINANCIAL PROGRAMMING DATA BASE

SECTORAL BREAKDOWN FOR FINANCIAL PROGRAMMING	MACROECONOMIC ACCOUNTS INTERRELATIONSHIPS
A5 NATIONAL ACCOUNTS	
A6 Total GDPmp (by econ setors)	=A7
A7	
A8 Total GDPmp (by expenditure)	=A8+A11+A16-A17
A9 Total Consumption	
A10 Private Consumption	
A11 Government Consumption	Fiscal Accounts: A28 + A29
A12 Total Investment	
A13 Fixed Capital Formation	
A14 Private Investment	
A15 Public Investment	Fiscal Accounts: A35 + A47
A16 Inventory Canges	
A17 Exports of gs and ss	Balance of Payments: A62 + adj cif/fob +adj exch rate
A18 Imports of gs and ss	Blance of Payments: A63 + adj cif/fob + adj exch rate
A19	
A20 FISCAL ACCOUNTS (consolidated NFPS)	
A21 General Goverment (central + local governments)	
A22 Total revenue	
A23 Tax Revenue (including social security contributions)	
A24 Non-Tax revenue	
A25 Capital revenue + grants	
A26 Total Expenditure	
A27 Current Expenditure	
A28 Wages and salaries	
A29 Purchase of gs and ss	
A30 Transfers and subsidies (including social secutiry payments)	
A31 Interst payments	
A32 on domestic debt	
A33 on external debt	Balance of Payments: from A66
A34 Capital Expenditure	
A35 Investment	National Accounts: A15
A36 Capital transfers and net lnding	
A37	
A38 Primary balance general government cash basis	
A39 Total balance general government cash basis	
A40 Financing general government (gener. Gov. borrowing requirements)	
A41 Domestic	Monetary Accounts: A91
A42 Foreign	Balance of Payments: A76
A43	
A44 Non-Financial State Enterprises (NFSEs)	
A45 Operating surplus	
A46 Capital expenditure	
A47 Investment	National Accounts: A15
A48 Other capita expenditure	
A49 Total balance NFSEs	
A50 Financing NFSEs (NFSEs borrowing requirements)	
A51 Domestic	Monetary Accounts: A92
A52 Foreign	Balance of Payments: A76
A53	
A54 Consolidated primary balance NFPS cash basis	
A55 Consolidated overall valance NFPS cash basis	
A56 Financing NFPS (NFPS borrowing requirements)	Monetary Accounts: A92
A57 Domestic	Balance of Payments: A76
A58 Foreign	
A59	
A60 BALANCE OF PAYMENTS (EXTERNAL ACCOUNTS)	
A61 Current account	
A62 Trade account	
A63 Exports of gs and ss fob	National Accounts: A17 + adj cif/fob +adj exch rate
A64 Imports of gs and ss fob	National Accounts: A17 + adj cif/fob +adj exch rate
A65 Income	
A66 Investment income	
A67 Compensation of employees (workers remmitances)	
A68 Current transferes	
A69 Capital and Financial Account	
A70 Capital account	
A71 Capital transfers	
A72 Net Purchase of non-produced nonfinancial assets	
A73 Financial account	
A74 Foreign Direct investment, net	
A75 Portfolio investment, net	
A76 Other investment (net borrowing from abroad)	Monetary accounts: A87
A77 Errors and Ommisions	
A78 Overall balance	
A79 Change in Net Foreign Assets	
A80 Change in net international reserves (at central bank)	Monetary Accounts: A86
A81 Change in other foreign assets, net	
A82	
A83 MONETARY ACCONTS (MONETARY SURVEY)	
A84 Net Foreign Assets	
A85 Net Foreign Assets central bank	
A86 Net International Reserves	Balance of Payments + adj exch rate: A80
A87 Medium & Long tem foreign liabilities	Balance of Payments + adj exch rate: A76
A88 Net Foreign assets commecial banks	Balance of Payments + adj exch rate: A76
A89 Net Domestic Assets	
A90 Net credit to the NFPS	
A91 net credit to the general government	Fiscal accounts: A41
A92 net credit to the NFSEs	Fiscal accounts: A51
A93 Net credit to private sector	
A94 Other items net	
A95 Broad Money	
A96 Narrow money (M1)	
A97 Currency in circulation	
A98 Demand deposits	
A99 Quasi-money	
A100 Time and saving deposits	
A101 Foreign currency deposits	
A102 Money market instruments	

TABLE 2: FINANCIAL PROGRAMMING
SHORT TERM AND MEDIUM TERM

		FINANCIAL PROGRAMMING Short term (1-2 years ahead)	FINANCIAL PROGRAMMING Medium Term (3-10 years ahead)
A5	**NATIONAL ACCOUNTS**		
A6	Total GDPmp (by econ setors)	Exogenous (trend + judgement)	Endogenous (from production funcion)
A7			
A8	Total GDPmp (by expenditure)		
A9	Total Consumption		
A10	Private Consumption	Exogenous (trend + judgement)	Endogeneous (consumption function)
A11	Government Consumption	Endogenous (from targeted budget)	Endogenous (structural policies)
A12	Total Investment		
A13	Fixed Capital Formation		
A14	Private Investment	Exogenous (trend + program instruments + judgement)	Endogenous (targeted growth requirements +structural policies)
A15	Public Investment	Endogenous (from targeted budget)	Endogenous (targeted growth requirements +structural polciies)
A16	Inventory Canges	Endogenous (residual + judgement)	Endogenous (residual + judgement)
A17	Exports of gs and ss	Exogenous (trend + main exports projections)	Endogenous (real exch rate + structural changes)
A18	Imports of gs and ss	Endogenous (trend + program instruments + judgement)	Endogenous (targeted growth requiremets +structural changes)
A19			
A20	**FISCAL ACCOUNTS (consolidated NFPS)**		
A21	General Govement (central + local governments)		
A22	Total revenue		
A23	Tax Revenue (including social security contributions)	Endogenous (elasticity to tax base)	Endogenous (elasticity to tax base + tax reforms)
A24	Non-Tax revenue	Exogenous	Exogenous
A25	Capital revenue + grants	Exogenous	Exogenous
A26	Total Expenditure		
A27	Current Expenditure		
A28	Wages and salaries	Endogenous (trend + program instruments)	Endogeneous (growth of employment and productivity)
A29	Purchase of gs and ss	Endogenous (trend + program instruments)	Endogenous (linked to growth of government +struct changes)
A30	Transfers and subsidies (including social secutiry payments)	Endogenous (trend + program instruments)	Exogenous (structural changes)
A31	Interst payments		
A32	on domestic debt	Endogenous (scheduled payments + program isntruments)	Endogeous (growth of domestic debt and interest rates)
A33	on external debt	Endogenous (scheduled payments + program isntruments)	Endogeous (growth of foreign gov debt and external interest rates)
A34	Capital Expenditure		
A35	Investment	Endogenous (trend + program instruments)	Endogenous (targeted growth requirements +structural polciies)
A36	Capital transfers and net Inding	Exogenous	Exogenous
A37			
A38	Primary balance general government cash basis		
A39	Total balance general government cash basis		
A40	Financing general government (gener. Gov. borrowing requirements)		
A41	Domestic	Endogenous (gov balance "above the line" + targeted domestic financing)	Endogenous (from projected growth of domestic debt)
A42	Foreign	Endogenous/Exogenous (depending on foreign borrowing constraints)	Endogenous (from projected growth of external debt)
A43			
A44	Non-Financial State Enterprises (NFSEs)		
A45	Operating surplus	Endogenous (trend + program instruments)	Endogenous (from projected operations + structural changes)
A46	Capital expenditure		
A47	Investment	Endogenous (trend + program instruments)	Endogenous (targeted growth requiremets +structural changes)
A48	Other capita expenditure	Exogenous	Exogenous
A49	Total balance NFSEs		
A50	Financing NFSEs (NFSEs borrowing requirements)		
A51	Domestic	Endogenous (balance "above the line" + targeted domestic financing)	Endogenous (from projected growth of domestic debt)
A52	Foreign	Endogenous/Exogenous (depending on foreign borrowing constraints)	Endogenous (from projected growth of external debt)
A53			
A54	Consolidated primary balance NFPS cash basis		
A55	Consolidated overall valance NFPS cash basis		
A56	Financing NFPS (NFPS borrowing requirements)		
A57	Domestic	Endogenous (balance "above the line" + targeted domestic financing)	Endogenous (from projected growth of domestic debt)
A58	Foreign	Endogenous/Exogenous (depending on foreign borrowing constraints)	Endogenous (from projected growth of external debt)
A59			
A60	**BALANCE OF PAYMENTS (EXTERNAL ACCOUNTS)**		
A61	Current account		
A62	Trade account		
A63	Exports of gs and ss fob	Exogenous (projecting main export items volumes and prices)	Endogenous (real exch rate + structural changes)
A64	Imports of gs and ss fob	Exogenous/Endogenous (depending if imports are or not a program instrument)	Endogenous (targeted growth requiremets +structural changes)
A65	Income		
A66	Investment income	Exogenous (mainly from projected interest paymn on foreign debt)	Endogenous (from projected growth foreign debt)
A67	Compensation of employees (workers remmitances)	Exogenous (trends + judgement)	Exogenous (trends + judgement)
A68	Current transferes	Exogenous	Exogenous
A69	Capital and Financial Account	Exogenous	Exogenous
A70	Capital account	Exogenous	Exogenous
A71	Capital transfers	Exogenous	Exogenous
A72	Net Purchase of non-produced nonfinancial assets	Exogenous	Exogenous
A73	Financial account		
A74	Direct investment net	Exogenous	Endogenous (foreign invest.requirements for projected growth)
A75	Portfolio investment net	Exogenous	Exogenous
A76	Other investment (net borrowing from abroad)	Exogenous/Endogenous (depending on foreign borrowing constraints)	Endogenous (from projected growth foreign debt)
A77	Errors and Ommisions	Assumed zero for projected program	Assumed zero for projected program

A80	Change in net international reserves (at central bank)	Endogenous	Endogenous
A81	Change in other foreign assets, net	Endogenous	Endogenous
A82			
A83	**MONETARY ACCONTS (MONETARY SURVEY)**		
A84	Net Foreign Assets	Endogenous (from the balance of payments projection)	Endogenous (from the balance of payments projection)
A85	Net Foreign Assets central bank	Endogenous (from the balance of payments projection)	Endogenous (from the balance of payments projection)
A86	Net International Reserves	Endogenous (from the balance of payments projection)	Endogenous (from the balance of payments projection)
A87	Medium & Long tem foreign liabilities	Endogenous (from the balance of payments projection)	Endogenous (from the balance of payments projection)
A88	Net Foreign assets commecial banks	Endogenous (from the balance of payments projection)	Endogenous (from the balance of payments projection)
A89	Net Domestic Assets	Exogenous/ Endogenous (depending if domestic assets are targeted or not)	
A90	Net credit to the NFPS	Endogenous (from fiscal accounts projections)	
A91	net credit to the general government	Endogenous (from fiscal accounts projections)	
A92	net credit to the NFSEs	Endogenous (from fiscal accounts projections)	
A93	Net credit to private sector	Endogenous (residual from A89 - A93)	
A94	Other items net	Exogenous (banking sector balance sheets)	
A95	Broad Money	Exogenous/Endogenous (depending if foreign assets or not)	Endogenous (from demand for money estimates)
A96	Narrow money (M1)	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A97	Currency in circulation	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A98	Demand deposits	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A99	Quasi-money	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A100	Time and saving deposits	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A101	Foreign currency deposits	Endogenous (money multiplier)	Endogenous (from demand for money estimates)
A102	Money market instruments	Endogenous (money multiplier)	Endogenous (from demand for money estimates)

TABLE 4; FINANCIAL PROGRAMMING
DATA ISSUES

		PRELIMINARY OBSERVATIONS FOR FINANCIAL PROGRAMMING IN AZERBAIJAN
A5	**NATIONAL ACCOUNTS**	
A6	Total GDPmp (by econ setors)	Potential underestimation (no estimates of informal ativities)
A7		Potential problems in estimating the contribution of the oil sector
A8	Total GDPmp (by expenditure)	
A9	Total Consumption	
A10	Private Consumption	
A11	Government Consumption	Potential Coordination problems with GFS
A12	Total Investment	
A13	Fixed Capital Formation	
A14	Private Investment	
A15	Public Investment	Potential undertimation of State Enterpises and coordination with GFS
A16	Inventory Canges	Potential problem if other expenditure items are understimeted
A17	Exports of gs and ss	
A18	Imports of gs and ss	Possible uderstimation K67
A19		
A20	**FISCAL ACCOUNTS (consolidated NFPS)**	
A21	General Goverment (central + local governments)	
A22	Total revenue	
A23	Tax Revenue (including social security contributions)	
A24	Non-Tax revenue	
A25	Capital revenue + grants	
A26	Total Expenditure	
A27	Current Expenditure	
A28	Wages and salaries	
A29	Purchase of gs and ss	
A30	Transfers and subsidies (including social secutiry payments)	
A31	Interst payments	
A32	on domestic debt	
A33	on external debt	
A34	Capital Expenditure	
A35	Investment	
A36	Capital transfers and net lnding	
A37		
A38	Primary balance general government cash basis	
A39	Total balance general government cash basis	
A40	Financing general government (gener. Gov. borrowing requirements)	
A41	Domestic	
A42	Foreign	
A43		
A44	Non-Financial State Enterprises (NFSEs)	Balances are not consiladated into the NFPS
A45	Operating surplus	
A46	Capital expenditure	
A47	Investment	
A48	Other capita expenditure	
A49	Total balance NFSEs	
A50	Financing NFSEs (NFSEs borrowing requirements)	
A51	Domestic	
A52	Foreign	
A53		
A54	Consolidated primary balance NFPS cash basis	
A55	Consolidated overall valance NFPS cash basis	
A56	Financing NFPS (NFPS borrowing requirements)	
A57	Domestic	
A58	Foreign	
A59		
A60	**BALANCE OF PAYMENTS (EXTERNAL ACCOUNTS)**	Potential Coordination problems with the central bank (ANB)
A61	Current account	
A62	Trade account	
A63	Exports of gs and ss fob	Potential problems depending on size of unmeasured informal sector
A64	Imports of gs and ss fob	Potential problems depending on size of unmeasured informal sector
A65	Income	
A66	Investment income	
A67	Compensation of employees (workers remmitances)	Potential understimation
A68	Current transferes	
A69	Capital and Financial Account	
A70	Capital account	
A71	Capital transfers	
A72	Net Purchase of non-produced nonfinancial assets	
A73	Financial account	
A74	Direct investment net	Potential understimation and l the breakdown between FDI and protfolio
A75	Portfolio investment net	
A76	Other investment (net borrowing from abroad)	
A77	Errors and Ommisions	
A78	Overall balance	
A79	Change in Net Foreign Assets	
A80	Change in net international reserves (at central bank)	
A81	Change in other foreign assets, net	
A82		
A83	**MONETARY ACCONTS (MONETARY SURVEY)**	Potential Coordination problems with the central bank (ANB)
A84	Net Foreign Assets	
A85	Net Foreign Assets central bank	
A86	Net International Reserves	
A87	Medium & Long tem foreign liabilities	
A88	Net Foreign assets commecial banks	
A89	Net Domestic Assets	
A90	Net credit to the NFPS	
A91	net credit to the general government	
A92	net credit to the NFSEs	
A93	Net credit to private sector	
A94	Other items net	
A95	Broad Money	
A96	Narrow money (M1)	
A97	Currency in circulation	
A98	Demand deposits	
A99	Quasi-money	
A100	Time and saving deposits	
A101	Foreign currency deposits	
A102	Money market instruments	

TABLE 3: FINANCIAL PROGRAMMING
DATA SOURCES

		DATA SOURCES
A5	**NATIONAL ACCOUNTS**	
A6	Total GDPmp (by econ setors)	National accounts statistics
A7		
A8	Total GDPmp (by expenditure)	
A9	Total Consumption	
A10	Private Consumption	National accounts statistics
A11	Government Consumption	Government finance statistics
A12	Total Investment	
A13	Fixed Capital Formation	
A14	Private Investment	National accounts statistics
A15	Public Investment	Government finance statistics
A16	Inventory Canges	
A17	Exports of gs and ss	Balance of payments statistics
A18	Imports of gs and ss	Balance of payments statistics
A19		
A20	**FISCAL ACCOUNTS (consolidated NFPS)**	
A21	General Govement (central + local governments)	
A22	Total revenue	
A23	Tax Revenue (including social security contributions)	Government Finance Statistics (tax revenue statisitcs)
A24	Non-Tax revenue	Government Finance Statistics (government budget)
A25	Capital revenue + grants	Government Finance Statistics (government budget)
A26	Total Expenditure	
A27	Current Expenditure	
A28	Wages and salaries	Government Finance Statistics (government budget)
A29	Purchase of gs and ss	Government Finance Statistics (government budget)
A30	Transfers and subsidies (including social secutiry payments)	Government Finance Statistics (government budget)
A31	Interst payments	
A32	on domestic debt	Government Finance Statistics (public debt statistics)
A33	on external debt	Government Finance Statistics (public debt +external debt statistics)
A34	Capital Expenditure	
A35	Investment	Government Finance Statistics (government budget)
A36	Capital transfers and net lnding	Government Finance Statistics (government budget)
A37		
A38	Primary balance general government cash basis	
A39	Total balance general government cash basis	
A40	Financing general government (gener. Gov. borrowing requirements)	
A41	Domestic	Government Finance Statistics (government budget + domestic debt statistics)
A42	Foreign	Government Finance Statistics (government budget + external debt statistics)
A43		
A44	Non-Financial State Enterprises (NFSEs)	
A45	Operating surplus	State enterprises statistics
A46	Capital expenditure	
A47	Investment	State enterprises statistics
A48	Other capita expenditure	State enterprises statistics
A49	Total balance NFSEs	
A50	Financing NFSEs (NFSEs borrowing requirements)	
A51	Domestic	State enterprises statistics
A52	Foreign	State enterprises statistics
A53		
A54	Consolidated primary balance NFPS cash basis	
A55	Consolidated overall valance NFPS cash basis	
A56	Financing NFPS (NFPS borrowing requirements)	
A57	Domestic	
A58	Foreign	
A59		
A60	**BALANCE OF PAYMENTS (EXTERNAL ACCOUNTS)**	
A61	Current account	
A62	Trade account	
A63	Exports of gs and ss fob	Balance of payments statistics
A64	Imports of gs and ss fob	Balance of payments statistics
A65	Income	
A66	Investment income	Balance of payments statistics
A67	Compensation of employees (workers remmitances)	Balance of payments statistics
A68	Current transferes	Balance of payments statistics
A69	Capital and Financial Account	
A70	Capital account	
A71	Capital transfers	Balance of payments statistics
A72	Net Purchase of non-produced nonfinancial assets	Balance of payments statistics
A73	Financial account	
A74	Direct investment net	Balance of payments statistics
A75	Portfolio investment net	Balance of payments statistics
A76	Other investment (net borrowing from abroad)	Balance of payments statistics
A77	Errors and Ommisions	
A78	Overall balance	
A79	Change in Net Foreign Assets	
A80	Change in net international reserves (at central bank)	International reserve statistics
A81	Change in other foreign assets, net	National responsible authority: ex. Oil Fund)
A82		
A83	**MONETARY ACCONTS (MONETARY SURVEY)**	
A84	Net Foreign Assets	
A85	Net Foreign Assets central bank	
A86	Net International Reserves	External debt statistics +exc rate adj
A87	Medium & Long tem foreign liabilities	External debt statistics +exc rate adj
A88	Net Foreign assets commecial banks	Banking sector statistics
A89	Net Domestic Assets	
A90	Net credit to the NFPS	
A91	net credit to the general government	Government Finance Statistics (government budget)
A92	net credit to the NFSEs	Monetary statistics + banking sector statistics
A93	Net credit to private sector	Monetary statistics + banking sector statistics
A94	Other items net	Monetary statistics + banking sector statistics
A95	Broad Money	
A96	Narrow money (M1)	
A97	Currency in circulation	Monetary statistics + banking sector statistics
A98	Demand deposits	Monetary statistics + banking sector statistics
A99	Quasi-money	
A100	Time and saving deposits	Monetary statistics + banking sector statistics
A101	Foreign currency deposits	Monetary statistics + banking sector statistics
A102	Money market instruments	Monetary statistics + banking sector statistics

AZERBAIJAN

Table 1

Real Sector

	2004	2005	2006	**2007e**	**2008p**	**2009p**	**2010p**
			(percent changes)				
Real GDP	10.1	26.4	34.5	30.5	19.7	13.5	7.5
Oil real GDP	3.0	66.3	63.1	51.0	25.0	17.1	3.9
Non-Oil real GDP	13.2	8.3	11.9	10.0	12.0	12.0	12.0
			(bln manat)				
Nominal GDP	8530	12522	18037	25501	28540	34207	38935
% change	19.4	46.8	44.0	41.4	11.9	19.9	13.8
Oil Nominal GDP	2672	5521	9808	15037	13299	15179	15378
% change	24.4	106.6	77.7	53.3	-11.6	14.1	1.3
Non Oil nominal GDP	5858	7001	8229	10464	13243	16316	20101
% change	17.2	19.5	17.5	27.2	26.6	23.2	23.2
Consumption	5856	6580	8154	10501	12327	14430	16621
Government	1100	1305	1838	3066	3170	3956	4414
Private	1100	1305	1838	3066	3170	3956	4414
Investment	4948	5201	5598	6969	8323	9652	11160
Fixed Investment	4924	5173	5568	6930	8283	9612	11120
Government	281	381	1176	2310	2223	2881	3156
Private	4644	4792	4392	4620	6060	6730	7964
Inventory changes	24	28	30	39	40	40	40
Exports of gs and ss	4036	7882	12467	17371	16055	18618	19279
Imports of gs and ss	6127	6625	7266	8030	8165	8493	8125
Consistency Check	-182	-516	-916	-1310	0	0	0
Memorandum items:							
GDP deflator % change	2.3	7.2	-7.8	0.8	-6.5	5.6	5.9
CPI average % change	6.7	9.6	8.3	16.0	13.0	10.0	10.0
Investment % of GDP	58.0	41.5	31.0	27.3	29.2	28.2	28.7
Government Investment % of GDP	3.3	3.0	6.5	9.1	7.8	8.4	8.1
Exports gs & ss % GDP	47.3	62.9	69.1	68.1	56.3	54.4	49.5
Oil and Gas Exports	37.2	51.7	59.8	60.5	47.8	46.4	41.2
Rest of Exports	10.1	11.3	9.3	7.7	8.5	8.1	8.3
Imports gs & ss % GDP	71.8	52.9	40.3	31.5	28.6	24.8	20.9
Brent crude oil price (USD/barrel)	37.7	53.4	64.3	68.9	50.0	50.0	50.0

Table 2

Balalance of Payments

	2004.0	2005.0	2006.0	**2007e**	**2008p**	**2009p**	**2010p**
			(bln USD)				
Current Account Balance	-2588	169	3372	4806			
% GDP	-29.8	1.3	16.7	16.0			
Total Exports goods and services	4236	8333	13955	20468			
Exports goods fob	3743	7649	13015	19317			
Oil and gas products	3232	6883	12075	18171			
Export services	493	685	940	1151			
Oil and Gas							
Total Imports of Goods and services	6312	7003	8468	9621			
Imports goods fob	3582	4350	5605	6465			
Oil sector	1624	1927	1752	1708			
Import services	2730	2653	2863	3157			
Oil and Gas (*)	1909	1658	1602	1562			
Total Income	-700	-1646	-2681	-6938			
Investment Income (*)	-628	-1698	-2747	-6960			
Workers remmitances, net (*)	-72	52	66	22			
Transfers, net (*)	188	484	566	898			
Capital and Financial Account Balance	3224	566	-1400	712			
Capital Account, net	-4	41	-4	-4			
Financial account	3228	525	-1396	716			
Foreign Direct investment, net	2330	458	-1306	504			
Oil sector, net (*)							
Portfolio investment, net (*)	-18	30	-12	349			
Other investment,net	917	36	-77	-137			
Errors and Ommisions	-192	-98	-633	-724			
Overall Balance	444	637	1339	4794			
Financing	-444	-637	-1339	-4794			
Change Net For. Ass. (ANB) (- = increase)	-317	-161	-1342	-2139			

Net credit from the IMF	-60	-29	-37	-37
Change Gross Off. Int. Res. (- = increase)	-257	-132	-1305	-2102
Change in Oil Fun Assets (- increase) (*)	-127	-476	3	-2656

Memorandum items:
Gross Offic Inter. Res. (ANB)
Net Inter. Res. (ANB)
Oil Fund Assets

Action Plan for the PIP-Project Activities September-December 2007

Task 1. Facilitate establishment of a sound Public Investment Policy legal and regulatory framework, and improve state budget expenditures

Objective: Strengthen the Public Investment Program (PIP) – related regulation to ensure a) sound sector development planning; b) mandatory use of cost-benefit project analysis; and c) make positive impact on the fiscal year budget and MTEF planning. The regulation will be supported through the procedural/operational instructions that provide requirements and sequence for project preparation, appraisal, execution and monitoring for results.

Expected results: PIP regulation and underlying instructions approved by December 2007; linkages between the content of PIP and MTEF strengthened and the FY2009 budget preparations proceed per the new requirements.

Potential policy/regulatory issues: MOED requires commitment on their new role and functions as the PIP regulator; COM, MOED, MOF, NBA require commitment in coordination of PIP preparation, especially in part related to macroeconomic forecasting, sector development priorities, and budget expenditure ceilings; MOED requires a stronger mandate to decline projects in case socioeconomic returns are not sufficient.

STTA requirements: a local lawyer involvement in preparation of the PIP Regulation; initial legal opinion **(20-25 man/days)**

Detailed Action Plan:

	Action	Period	Parties involved	Expected results	PIP-Project input
1.	Meeting with MOED DM S.Hasanova. Discuss the Task Force effort, and results to achieve:	2nd week/Sept	USAID, PIP-Project, IMF(?), IBRD(?)	DM Hasanova endorses establishment of the Task Force in support for the PIP legal and regulatory framework	Background paper on the institutional roles of MOED, MOF, COM, NBA and other agencies (e.g., Emergency Preparedness) in PIP composition and budgeting
2.	Meeting with MOED Minister H. Babayev	3nd week/Sept	USAID, PIP-Project, U.S. Embassy, IMF, IBRD	Minister commits to chair along with USAID the Task Force	A Position Paper on the MOED stronger mandate in governing PIP

3.	Task Force established in the framework of the USG-GOAZ MOU on PIP	4th week/Sept	GOAZ: COM, MOED, MOF, NBA Int'l: USAID, PIP-Project, U.S. Embassy, IMF, IBRD	Task Force established. Time table of activities approved	Draft PIP Regulation prepared and distributed
4.	Task Force meets and discusses the draft PIP Regulation and Operational Instructions OI)	1 week/Oct	GOAZ: COM, MOED, MOF, NBA, other Int'l: USAID, PIP-Project, U.S. Embassy, IMF, IBRD	The draft PIP Regulation and OI commented, suggestions for improvement received	The draft PIP Regulation and OI further improved per the proceeds from the Task Force meeting
5.	MOED initiates a legal opinion of the final PIP Regulation	3 week/Oct	GOAZ: MOED Legal Department, COM,MOF, NBA	The PIP Regulation posed for legal opinion	Coordination with the MOED Legal Department
6.	MOED submits the final document to the Cabinet of Ministers	1 week/Nov	GOAZ: MOED Legal Department, COM	The PIP Regulation submitted to COM	Coordination with the MOED Legal Department
7.	U.S. Ambassador and USAID, and donors (?) meet with the President and PM and express support for the soonest adoption of the PIP Regulation	2 week/Nov	Int'l: U.S. Embassy, USAID, IMF, IBRD	The PIP Regulation receives a political support from GOAZ	Coordination and technical briefings to the U.S. Ambassador
8.	The PIP Regulation is approved and its provisions enacted	3-4 week/Nov	GOAZ: President Administration; Cabinet of Ministers	The PIP Regulation approved	Coordination with COM is required
9.	MOED submits to the Cabinet of Ministers the procedural instructions for implementation of the PIP Regulation	2-3 week/Dec	GOAZ: MOED Legal Department, COM	The procedural instructions for implementation of the PIP Regulation approved by COM	Final procedural instructions for implementation of the PIP Regulation

Task 2. Implementation of the CBA Training and the Training of Trainers' (TOT) Program

Objective: Strengthen the GOAZ capacity in using cost-benefit analysis (CBA) techniques in preparation and appraisal of public investment projects. The programs targets to: a) train expert trainers in topics of CBA; b) develop training materials and formats of project preparation and appraisal; and d) facilitate demand in preparation of quality project pre-and feasibility studies.

Expected results: Establishment of a group of trainers from the selected GOAZ agencies (central ministries: MOED and MOF and designated line ministries: MOE, MOA, COIWS and MOT/MOIE) and train them on topics of CBA.

Potential TOT issues: 1) MOED requires commitment to practically assist the PIP-Project with the implementation of TOT; 2) MOED, MOF, MOE, MOA, COIWS and MOT/MOIE require commitment in participation of the assigned staff from their agencies in TOT; and c) the PIP Regulation requires soonest approval to provide impetus and demand for project CBA.

STTA requirements: 1) additional LOE for Richard Anson in November **(15 man/days)**; 2) involvement of an international short-term cost-benefit analysis (CBA) expert with training experience and hands-on expertise in preparation and review of productive, infrastructure and social sector projects in November-December **(30 man/days)**. Please refer to activities 7-8 for details.

Detailed Action Plan:

	Action	Period	Parties involved	Expected results	PIP-Project input
1.	Help prepare sector Operational Plan and conduct formal and on-the-job training in project CBA	4th week Aug – 2nd week Sept	Ministry of Agriculture; State Committee for Irrigation; MOED; other stakeholders	Agencies for agriculture and irrigation are capable to prepare the medium-term sectoral development framework; prepare and appraise projects	Dr. Richard Anson, agriculture expert with over 20 years experience of work in IBRD, is mobilize to work on the assignment during August 27-September 14. Possibly repeat the trip in November for 15 days
2.	Help review the cost structure of the computerization program in the Ministry of Education	4th week Aug – 2nd week September	Ministry of Education	Cost structure commented for cost-effectiveness	PIP-Project local professional staff and IT person involved
3.	Conduct training in project development and cost-effectiveness (CBA) analysis in	4th week Sept – 1st week Oct	Ministry of Education	MOE staff capable conduct cost-effectiveness analysis when reviewing various	PIP-Project and ERSRI staff involved in preparation of: 1) sector guidance in preparation

	education sector			project options; data management system becomes operational	and review of projects; 2) training materials and practical sessions/exercises; 3) Data management system.
4.	Prepare and discuss with MOED DM S.Hasanova the list of potential trainers	4nd week/Sept	USAID, PIP-Project, MOED	Set up of a group of potential trainers	1) Identification of potential trainers among GOAZ officials; 2) Preparation of the list of trainers
5.	Meeting with a group of trainers	1st week/Oct	Assigned GOAZ trainers, PIP-Project	Familiarization of the group with each other and tasks to be achieved	Prepare time-table of training activities
6.	Development of training program agenda and training materials	2nd-4th week/Oct	STTA and PIP-Project	Training agenda and training handouts	Preparation of training curriculum, materials, handouts, practical assignments (based on the PIP-Project Training Materials and new project case studies)
7.	One-two week formal training for the whole group of trainers	1st -2nd week/Nov	STTA and PIP-Project	Core principles and application of Integrated Cost Benefit Analysis	Preparatory activities for organizing training and delivery of training
8.	Once a week sector–specific on-the job-trainings in designated ministries	3rd week Nov – 2nd week Dec	STTA and PIP-Project,	Increased capacity to apply core principles of CBA to designated ministries	Conduct of the on-the job-training n preparation and review of project case studies

Task 3. Strengthen of the institutional and technical capacity of economic planning organizations to improve the quality and consistency of macro-level forecasting and analysis.

Objective: Develop a financial consistency model for producing internally-consistent medium-term macroeconomic framework (forecast) which will guide economic development planning, budgeting and public investment planning.

Expected results: Preparation of a reliable and consistent macroeconomic outlook for FY2008-2011; improved medium-term expenditures framework based on the macroeconomic framework; strengthened MOED's economic modeling capacity; medium-term macroeconomic framework for FY2009-2012 developed per the improved financial consistency model.

Potential issues: MOED's medium-level technical staff needs to commit to the tasks and become practically involved in implementation. MOED senior management and the technical staff are required to cooperate and share common approaches and objectives. MOED's technical staff to be actively involved in cooperation with the PIP-Project staff in implementation. MOED needs to take resolute steps to ensure full consistency of the expenditures framework (and the overall development planning) with the macroeconomic framework.

STTA requirements: 1) an international macro-economist with at least 10 years of experience in applied econometrics and expertise in design and application of the IMF consistency financial programming (**30-45 man/days**).

Detailed Action Plan:

#	Action	Period	Parties involved	Expected results	PIP-Project input
1.	Meeting with MOED DM Sevinj Hasanova and the relevant technical staff to discuss the concrete scope of work and required assistance	2nd week of September	USAID, MOED, PIP-Project, WB (?)	MOED specifies the concrete contours of the need for technical assistance; MOED DM and the MOED technical staff agree on the specified need.	Put the concrete need in writing; present to document with the needs assessment to USAID and MOED for review; prepare ToR for the international consultant.
2.	Approval of TOR.	2nd week of September	USAID, MOED, PIP-Project	Comments on the TOR provided by all parties; TOR is approved by USAID; MOED fully agrees with the scope of work described in TOR.	Revision to the TOR based on comments and suggestions received.

3.	Selection of the international STTA.	3rd & 4th week of September	USAID, MOED, PIP-Project, IMF, WB.	Potential candidates proposed by all parties; USAID and MOED review resumes of short-listed candidates; MOED and USAID interview the potential short-listed candidates and choose the STTA	STTA opportunity advertised; Potential candidates short-listed. Required logistical, financial and legal issues addressed
4.	The STTA begins work at MOED.	2nd week of October - 3rd week of November	USAID, MOED, PIP-Project	The current financial program, formulas, sectoral and inter-sectoral links reviewed and improved; On the job training on developing and using the financial program is provided;	A local STTA and a translator provided to support the work of STTA; Progress made on the task monitored on a daily basis.
5.	Preparation of the preliminary 2009-2012 macroeconomic outlook	3rd week of November	USAID, MOED, PIP-Project	MOED approves the preliminary 2009-2012 macroeconomic outlook.	Review and translation of the 2009-2012 macro outlook
6.	On the job training to MOED staff.	2nd week of October – 3rd week of November	MOED, PIP-Project	Capacity of MOED's technical staff on developing and using the financial program to produce forecasts improved.	Provide logistics for the training; Provide certificates on completion of the on-the-job training
6.	Preparation of a user friendly manual describing the formulas, links, and using the financial program to produce the macroeconomic framework.	3rd week of November – 1st week of December	USAID, MOED, PIP-Project	MOED approves the manual.	Review and translation of the manual
7	Evaluation of the task progress.	4th week of November	USAID, WB, IMF, PIP-Project	The impact of the task discussed and evaluated.	Preparation of the evaluation report.