



USAID
FROM THE AMERICAN PEOPLE

PUBLIC INVESTMENT POLICY PROJECT

Quarterly Performance Report

Period: July 1 – September 30, 2006

OCTOBER, 2006

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

Quarterly Performance Report

Period: July 1 – September 30, 2006

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

TABLE OF CONTENTS

ABBREVIATIONS	4
1. STATUS OF PROGRESS IN WP TASKS IMPLEMENTATION SCHEDULED FOR Q3/06 BY COMPONENTS	5
COMPONENT A.....	5
COMPONENT B.....	7
COMPONENT C.....	10
COMPONENT D.....	11
2. COOPERATION WITH THE GOAZ COUNTERPART ORGANIZATIONS.....	13
3. COORDINATION WITH DONORS, IFIS AND USAID PARTNERS	14
4. ADMINISTRATIVE TASKS.....	15
5. CONCLUSIONS AND IMPLEMENTATION ISSUES	15

ATTACHMENTS:

1. Scope of Work for the Functional and Institutional Review of the Ministry of Economic Development
2. Participatory processes in local budgeting:
 - a. Presentation to LMs;
 - b. Presentation in Guba;
 - c. BTO for Guba;
 - d. Conference Assessment and Recommendations.
3. Proceedings from the Study Tour of senior GOAZ officials to Ankara, Turkey:
 - a. Agenda;
 - b. List of Participants;
 - c. BTO Prepared by Dr. Mete Durdag, COP;
 - d. BTOs Prepared by MOF and NBA Participants.
4. Presentation to the USAID on 22/09/06 of the PIP Project activities since Project inception.
5. Monthly Calendar of Meetings (July-August-September).

ABBREVIATIONS

ABTC	Azerbaijan Bank Training Center
BTO	Back-to-Office Report
CER	Center of Economic Reforms
CSO	Civil Society Organization
CTO	Cognizant Technical Officer
DAI	Development Alternatives Inc.
EBRD	European Bank for Reconstruction and Development
F&IR	Functional and Institutional Review
FPM	Financial Programming Model
GOAZ	Government of Republic of Azerbaijan
HPPC	High-Policy and Planning Council
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
LTTA	Long- Term Technical Assistance
MOED	Ministry of Economic Development
MOED/DEPF	Ministry of Economic Development/Dept. of Economic Policy and Forecast
MOF	Ministry of Finance
MTEF	Medium-Term Expenditure Framework
MTMF	Medium-Term Macroeconomic Framework
NBA	National Bank of Azerbaijan
PIP	Public Investment Program
PIPP	Public Investment Policy and Program
PIP Project	Public Investment Policy Project
Q3/06	Quarter 3, 2006
QPR	Quarterly Performance Report
SPPRED	State Program for Poverty Reduction and Economic Development
SPPRS	State Program for Poverty Reduction and Sustainable Development
SSC	State Statistics Committee
SSDP	Sector Strategic Development Plan
STTA	Short-Term Technical Assistance
TAMIS	Technical and Administrative Management Information System
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WB	World Bank
WLI	World Learning Inc.
WP	Work Plan

Q3/06 PROGRESS REPORT

During Q3/06, the Public Investment Policy Project continued work in implementation of the Work Plan tasks scheduled for the period. Work proceeded in assisting the line ministries to prepare PIP funding requests according to the new call circular format, which was developed by the PIP Project; assisting MOED in preparation of various information materials; drafting of the PIPP Manual and its reference documents; extending work into four new ministries/agencies; preparing for the Round 3-4 of the Training Program; taking the educational study tour to Ankara; and other activities.

The PIP Project staff briefed USAID on the development and the implementation of the PIP Project. The Project cooperated with the World Bank in its activities related to the planned WB Public Expenditure Review in 2007. The Project staff cooperated with other USAID implementing partners (CHF and Counterpart International) in delivery of local budget-related presentations in selected regions in Azerbaijan in the framework of the Community Development Activity. The Project staff coordinated with WLI arrangements for the top-level official's travel to Ankara, Turkey.

This Quarterly Performance Report for Q3/06 presents an overview of developments in the PIP Project/WP tasks scheduled for that period.

1. STATUS OF PROGRESS IN WP TASKS IMPLEMENTATION SCHEDULED FOR Q3/06 BY COMPONENTS

Component A:

Long-term national and sector development and investment policy planning

The Functional and Institutional Review of the Ministry of Economic Development (MOED)

The MOED has requested the PIP Project to conduct functional and institutional review and provide an objective and non-partisan analysis of its main strengths and weaknesses vis-à-vis its objectives and functions. The aim is to identify the underlying causes of institutional weaknesses and options for dealing with them. To undertake successfully the activity the PIP Project involved a seasoned economist and public finance professional, Dr. Mark Gallagher, with expertise in over 25 countries. The PIP Project COP was very closely involved in F&IR consultation.

Historically, the MOED (and its predecessor institutions) has a very important place in the organizational framework of GOAZ, with crucial responsibilities for policy-making, technical work, and inter-agency coordination for successful management of economic development. The current Charter of the MOED bestows upon it wide range of mandates to discharge its crucial responsibilities. On the other hand, the MOED Charter appears to have collated a large number of essential functions but *without adequately systemizing them* as well as many others whose presence may be questioned if they are needed in a market-based economy. More importantly, however, the current organizational structure of the Ministry needed to be

reviewed carefully vis-à-vis its functions envisaged in the Charter, particularly in light of the many functions assumed from other GOAZ agencies.

The draft F&IR report was submitted to MOED Deputy Ministers at the beginning of October. The formal report submission will be made soon after the editorial work. At this time, the report is suppressed for general public view at the request of the MOED. The detailed Terms of Reference for the activity is enclosed to this QPR as the Attachment 1.

As a background, the Public Investment Policy and Program of GOAZ needs, *first*, to be saved from its current fragmentation by making it comprehensive of all government capital spending, whether funded from the budget or by donors, and whether undertaken by the budget organizations or by the extra-budgetary funds. *Second*, the public investment policy and program should be developed as an integral part of a medium-term national and sectoral development framework adopted by the GOAZ. *Third*, there should be only one, and the same set of national and sectoral development objectives, strategies, targets and policies, common to the Poverty Reduction and the Regional Development Programs, the Medium-Term Expenditure/Budget Framework (MTEF), the Public Investment Program (PIP), and the annual State Budget. *Finally*, the success of the above will depend on the establishment of effective guidance, overview, and evaluation of all planning and budgetary work of both the central and line ministries by the top leadership (the President and, on his behalf, the Cabinet of Ministers).

Development of the Financial Programming Model (FPM)

In accordance with Task 3 of the Sub-Component A.1 the PIP Project staff pursued work in preparation of the Financial Programming Model (IMF) for Azerbaijan. During July-August, 2006 the PIP Project staff assisted the MOED/DEPF staff in compilation of spreadsheets with economic data for FY 2002-2005 and expected outcome for 2006 received from MOED, MOF and NBA. The PIP Project worked with MOED towards creating the economic, fiscal, and monetary databases for FPM. The Project also independently compiled spreadsheet tables from IMF review and statistical documents to demonstrate the consistencies in economic sector linkages. The PIP Project staff held a meeting with Mr. Sh. Sadigov, DEPF Director, and his staff, to discuss the FPM status and scope for the educational seminar.

The MOED/EPFD staff collated information for the last 4 years in fiscal, monetary, external and real sectors of the economy. The MOED contacted MOF, NBA, and SOFAZ to request data. It was expected that after completing the spreadsheets, there would be issues regarding the consistency between the data from different sources. This had been a problem in other instances over the years. The issue of having access to the data overwhelmed the possible data consistency issue. The interagency contacts for information sharing resulted in varying degrees of results. Most pointedly, it showed the need to formalize the content and format of economic information sharing among GOAZ economic agencies. The exercise remained a valuable experience and the compiled economic data were in turn used by the MOED in its work with *PIP 2007-2010* document.

The use of FP Model or a similar type of model, principally by the MOED, the MOF and the NBA, is of paramount importance. It is the simplest method to make economic agencies to discuss economic policies in a consistent way and in turn to advise the GOAZ. The FPM is, essentially, an accounting framework that integrates four broad sectors of the economy: real sector, government sector, external sector (current and capital accounts of the balance of payments) and monetary sector. The FPM data culminate in a "flow of funds" balancing table

for each year to highlight relationships among the four sectors of the economy in a systematic and coherent way. It helps to bring out inconsistencies in the available data, assumptions or policies, and thereby helps to understand the economic relations among the sectors and to facilitate macroeconomic analysis. The model reveals any unbalanced or unresolved dependency among the sectors and forces economic policies towards consistency. Finally, it provides an indicative basis for broad recommendations on economic policies.

Enhance the appropriate channels and venues between the government and non-government stakeholders (Civil Society, Non-Government Organizations, the political parties, the private sector and workers' organized representatives, etc.) for consultation and feedback on national, regional and sectoral development objectives, strategies and investment policies.

In Q3/06, the PIP Project distributed the Azerbaijani language version of the Participatory Process Report to the GOAZ counterpart agencies and invited them to discuss actions suggested to the Government to improve transparency, openness and participatory decision-making in public investment policy and programming. The PIP Project hired an STTA consultant to draft a presentation based on the Report to be used during the discussions with the LMs reviewing and commenting on the Report. The presentation is enclosed as Attachment 2a.

The PIP Project continued with the initiative it had started at the end of Q2/06, on public participation aspects of public investment and budgetary decisions at the local government levels in the regions. In this effort to disseminate information, the Project collaborated with the CHF International and the Counterpart International, the USAID partners in Democracy and Governance Project area. As a part of the Community Development Activity of the USAID, the CHF organized three regional conferences to take place in Sheki, Lenkoran and Guba. The PIP Project staff participated in these conferences, the last two taking place in Q3/06. The Project made presentations touching upon the topics of local budget cycle, local budget relations with the central government budget (timing and fiscal dependency), link to the national and regional strategies (i.e. SPSEDR and SPPRSD), timing of budget hearings at the local level, and the benefits of local participatory practices in the use of public funds. The BTO for the Guba Conference and the presentations given at the Conferences are enclosed in Attachment 2b and 2c.

Following the conferences and further interaction with the local finance officers the PIP Project staff prepared a note on assessment and recommendations of public participatory processes and budgeting at local budget (rayon and municipality levels). The brief technical note "Participatory Processes in Local Budgeting: Assessment and Recommendations" to that effect was prepared. A short 'Assessments and Recommendations' was included with the informational package of Participatory Process Report submitted to GOAZ central and line ministries. This short notice is enclosed as Attachment 2d.

Component B:

Evolution of the Public Sector Capital Budget Formulation as a bridge within an MTEF between development planning (SPPRSD and RDP) and the Consolidated State Budget

Discussions on SPPRSD 2006-2010 Program

In Q2/06, at the request of the SPPRED Secretariat, the PIP Project staff reviewed and provided comments as well as recommendation for the improvement of the new *SPPRSD Program 2006-2015* particularly in the areas of investment programming and budgeting. As a follow-up in the ongoing discussions with the SPPRED Secretariat, a meeting was held with the SPPRED Chairman, on the specifics of recommendations in line with the PIP Project's concept on linkages and interdependence of SPPRSD, SPSEDR, PIP, MTEF and Budget Call Circular. The SPPRED Chairman was appreciative for the valuable comments and recommendations produced by the PIP Project. The Chairman said that the SPPRED Secretariat is annualizing its activities as PIP Project had recommended. This year, the SPPRED staff was working with the MOF staff to link draft 2007 budget (and MTEF) to SPPRSD Action Plan's annual tasks. He noted that many necessary formulation of a much better SPPRED 2006-2015 document could not be accomplished in the current technical/institutional environment. The Chairman asked that the PIP Project copy any official communication with SPPRED Secretariat to DM MOED, Mr. Niyazi Saffarov according to MOED minister's recent decision.

Develop a Manual for Public Investment Policy and Project Development (PIPP Manual)

During Q3/06, the PIP Project staff, led by the Project COP, finalized the draft PIPP Manual. The Manual was conceived as a modular product where the ongoing outputs of the PIP Project would be incorporated over the duration of the Project. The Technical Notes and outputs of presentations and workshops were to create the sequential stages of public investment policy and project cycle management. The timing of the producing Manual was pushed somewhat forward by the MOED's desire to put in place certain institutional structures and procedures by end-2006. So the PIP Project has produced a draft PIPP Manual, which covers the processes up to and including the approval of Public Investment Program by GOAZ.

The areas and procedures dealing with project implementation and M&E in a manual format will be produced separately. Towards that goal, many documents about the technical aspects of project implementation and M&E from international sources are included as support materials and references in e-format to the draft Manual document.

Links to SSDPs and MTEF, and integration with the recurrent budget are emphasized across the document. Importantly, the draft Manual sets the technical aspects of project management inside a public investment policy led by a coherent and rational macroeconomic policy. The overall vision for the draft Manual must account for potential administrative and structural adjustments in the operations of the GOAZ to maximize the benefits from the use of the Manual. These potential adjustments are considered with great caution and within realistic assessment of the existing institutional ground rules. Nevertheless, the MOED and other agencies of the GOAZ will have to commit to important administrative and legislative measures to put the Manual into operation. To that extent, the Manual makes references to clearly defined implementation requirements for macroeconomic management, comprehensive budgeting system, and sectoral development plans that will help the efficiency of public investment programming.

The draft Manual is being reviewed by the MOED. Following comments and amendments by the MOED and other agencies of GOAZ, the draft should be in good shape for adoption by GOAZ. There is already much important support to the institutional and procedural adjustments to address the current inadequacies of the PIPP management. The central economic agencies and selected LMs have been informed thoroughly during the course of the

PIP Project's first year about the general aspects of the draft Manual arrangements. For these reasons, the institutional conditions for PIPP Manual implementation may be promising. The big uncertainty is the degree of agreement to its components by the COM.

The draft PIPP Manual was submitted in English to MOED. It is being proofread in the Azerbaijani language for formal submission to GOAZ agencies to comment. The next step would be adoption of the PIP Manual by GOAZ. Following this, a set of instructions will be prepared for GOAZ central and line ministries to follow in PIP-related work. The draft PIPP Manual was provided to USAID as a separate document.

Help enhance the capacity of the sector divisions of MOED/DMAF in preparation of PIP Call Circular, review and evaluate the Line Agencies' capital spending programs and investment projects.

The PIP Project staff continued discussions and consultations with the key counterparts at MOED (S. Hasanova, S. Sadigov, N. Pashayev) on configuration of the PIP policy and procedures. The officials recognized the need in revision and overhaul of the entire system of economic planning and ground it on appropriate economic consistency models. The budget for development needs to serve the economic growth patterns, and investments streamlined to achieve sectoral programmatic objectives with strong cross-sectoral impact. The PIP call Circular 2007-10, prepared jointly by MOED and PIP Project, is an interim document that calls for the solid preparatory work on strategy and development programming. Reportedly, the Ministry of Finance has become interested in the document and the PIP Project will explore ways to involve MOF experts in issues related to capital budget planning, establishment of sector ceilings and estimation of fiscal impact of every investment project on the budget, as well as possible losses (social tariffs and subsidies) and recurrent expenditures.

The PIP Project worked with MOED EPFD and PIP Division in designing a format for more robust description and analysis of public investments for the 2007-2010. A template for the textual content of the *PIP 2007-2010* document was done, which included descriptions of the past and future medium-term macroeconomic environment and description of GOAZ socio-economic plans to guide the medium-term PIP projects. Tables for medium-term macroeconomic parameters, the breakdown of investment expenditures into sectors, years and sources and comparisons of trends in expenditures with previous years were made.

Help the Line Agencies develop or improve their institutional and technical capacity to identify, formulate and prioritize the necessary investment policies and programs to realize the sector strategies and objectives while at the same time complying with the guidance and requirements of the Central Government.

During Q3/06, the PIP Project staff assisted the line ministries in the formulation of the PIP goals and objectives for FY 2007 and the medium-term horizon. The staff of line ministries now realizes the need to strengthen strategic and medium-term sector planning and justify requests for public investment projects. A series of joint MOED-PIP Project meetings were held with the staff of the line ministries involved in the draft *PIP 2007-10* preparation processes. The PIP Project sector specialists assisted the cooperating line ministries in filling in forms and questionnaires.

Component C:

Help MOED and MOF to jointly develop a set of “project appraisal, preparation and negotiations procedures”, which will emphasize integration of social, economic, financial and engineering analysis based on market economy and modern engineering norms rather than old Soviet practices.

The Project staff continues to conduct technical exchanges in the environment of the Former Soviet Union (FSU) technical requirements for formulation of capital investment projects. The cost system in the FSU was based on the established system of “norms” and “normatives” that made sense for the vertically integrated state economic planning. Countries with economies in transition need to begin using new cost accounting according to market economy principles for efficiency, effectiveness, and accountability. The PIP Project staff continues to teach and familiarize the GOAZ authorities and staff with methodology of cost-benefit analysis with concepts of integration of social, financial, engineering, social impact, distributional and other analyses. This is an ambitious but absolutely a basic building block for proper investment project choices but also for fundamental understanding of public investment policy. This knowledge and practice, in the long-term, will become one of the basic elements in preparing and justifying better PIP projects that yield higher economic and social returns. In Q3-06, the training materials of the PIP Project are reviewed to make adjustments to integrate and ingrain the new concepts in more contextualized format. The PIP Project searched and collected project case studies and project appraisal documents from ministries and IFIs to use in Rounds 3-4 at end-2006. This search experience has been less than satisfactory where in all project documents, time profiles of costs and benefits were missing or were denied by the LMs and IFIs when asked. In the meantime, training materials from the Rounds 1-2 Training (February-April 2006) is serving as the bases for training course for integrated project analysis.

Help improve the selected line ministries’ capacity, without additional resources, for effective monitoring and evaluation of the public investment programs and projects in terms of their socio-economic impact.

The PIP Project continuously emphasizes the role of permanently functioning PIP divisions in the line ministries. These divisions must closely collaborate with other expenditure planning departments of the ministries in realizing the SSDPs. Undoubtedly, to-be-established or modernized PIP departments and divisions in LMs will be set up in a variety of forms and will be responsible for investment project preparation, implementation, monitoring and evaluation as they put into operation their forward-looking and demand-responsive strategic sector plans. To make these goals operational many organizational and methodological modification are required over time and the PIP Project promotes all necessary interventions. The PIP Project has already made initial arrangements with LMs for the next cycle of training and working together on SDP formulation and project preparation.

During Q3/06 the PIP Project staff held meetings with the executives from the Ministry of Industry and Energy (R. Rzayev, F. Muradov) and discussed issues related to institutional capacity-building and investment planning. Issues related to preparation of documents in conformity with the new requirements of the PIP Call Circular 2007-10 were extensively discussed and PIP Project staff offered regular consultations and counseling. Mr. Rzayev, Head of the Department Policy and Reconstruction of Industrial Enterprises, MOIE, became interested in involving the PIP Project staff in development of the industrial policy formulation

in Azerbaijan. Meetings were also held with AzerEnerji representatives (H. Hasanov, A. Shikmetov) to discuss strategic planning and investment policy at AzerEnerji – one of the largest investment funds' requestor agencies.

During Q3/06, the PIP Project staff held initial introductory meetings in the Ministry of Communications and Information Technologies, the Ministry of Agriculture and the Corporation for Irrigation and Water Economy. The initial meetings were successful and paved way to development of customer-tailored annual plans of activities as well as participation of the counterparts in the formal training in integrated project analysis. Management of the these ministries were extremely receptive to the PIP Project concept of PIP development and encouraged their earliest involvement. At the same time, the PIP Project staff experienced difficulties in establishing a dialogue with the Ministry of Health (MOH). The PIP Project staff plans to further explore the issues there and also contact other USAID implementing partners (AIHA, ACQUIRE, AMC/Abt Associates) and have MOH extensively involved in project activities.

Component D:

Study Tour of the Senior GOAZ Officials to Ankara, Turkey

The PIP Project's Training Program, among other objectives, places great emphasis on educational study tours to countries that benefits from effective and efficient economic planning, investment programming, and budgeting. The PIP Project had offered World Learning, Inc. (WLI) to arrange a study tour to a country where the public investment programming was being successfully implemented. Poland, Slovakia, Malaysia, and Turkey were chosen as possible countries that demonstrated sustained economic growth with effective and efficient use of budget capital resources for infrastructure and social sector development. In the end, Turkey was selected for the study tour visit. During Q2/06, the preparations were completed and the study tour took place on June 26-30, 2006 through organizational support provided by the WLI. The support for the study tour's logistics and program design came from the Turkish International Cooperation and Development Administration Agency (TIKA). The TIKA management was extremely helpful during the study tour program and did their utmost to ensure its success. The assessment and impact of the lessons learned from the tour occurred during Q3/06. The details of the proceedings of the study tour are enclosed in Attachment 3.

The PIP Project had requested its prime counterparts to nominate two persons at the level not lower than a Deputy Minister and/or a Head of Department. In the end, nine GOAZ senior officials from ministries were selected. Mr. O. Haqverdiev, Head of Economic Policy of COM also joined the official group. In addition, the US Treasury's Budget Adviser at the MOF, Ms. Linda Decker was authorized by the USAID to join the tour along with her assistant/interpreter. The tour team was headed by Dr. Mete Durdag. Dr. Durdag's participation in the study tour proved to be extremely helpful in facilitating discussions in topics of economic planning, budgeting and investment planning, and the logical linkages between them.

The PIP Project had identified seven main areas of interest both to GOAZ and the project and requested WLI, TIKA and the State Planning Organization (SPO) of Turkey to help arrange topic presentations and discussions. The TIKA Head Office in Ankara, jointly with the cooperating agencies, arranged the five-day program consisting of intensive sessions with the key central economic agencies of Turkey, including the State Planning Organization (SPO), the Technical Secretariat for Treasury, and the Technical Secretariat for Foreign Trade, as

well as MOF. Upon the request of participants, the Plan-Budget Commission of the Parliament and the Central Bank were also added to the program of visits. The participants took the opportunity to learn and ask questions of their interest and discuss them both at daily sessions and informal meetings.

The study tour was a success, and the participants returned to Azerbaijan with new energy and ideas on improvements in planning, budgeting, and investment programming. The Turkish counterparts extended invitations to Azerbaijani authorities to participate in further agency-to-agency technical exchanges. The PIP Project recommends new and more technically oriented training courses in Turkey (or another country) for the mid-level staff working in the areas of economic planning, budgeting and investment programming. The study tour to Turkey helped senior officials to learn from the Turkish Government's experience in design and implementation of effective and efficient macroeconomic, fiscal, and sectoral development frameworks, which they are promoting and implementing. In the similar vein, the PIP Project expects that the mid-level GOAZ staff, upon return from traineeship programs, will practice and implement their newly acquired skills in planning, public investment programming, and budgeting in Azerbaijan. In the meantime, the PIP Project submitted a study tour request to travel to Norway. Norway is an oil-rich country, which has managed its oil revenues well by planning and investing well. Observing the workings of such an example would motivate the senior official of GOAZ in a positive direction. The BTOs of MOF and NBA are enclosed in Attachment 3.

Multi-Week Training Program in Integrated Project Analysis

During February-April, 2006 the PIP Project successfully completed two rounds of formal training in Integrated Project Analysis. The Program involved senior GOAZ decision-makers as well as technical staff from central economic and sector line ministries. The Training Program was appraised by GOAZ as "outstanding" one and aiding to the institutional and professional capacities to effectively and efficiently manage capital investment program and projects. The PIP Project, following contractual obligations and the Work Plan, will conduct two new rounds of training during November-December, 2006. The training will be conducted mainly for the both for the new counterpart organizations: the Ministry of Health, the Ministry of Agriculture, the Corporation for Irrigation and Water Economy, and the Ministry of Communication and Information Technologies. PIP Project's existing counterparts from the COM, the MOF, the MOED, the Ministry of Transport, the Ministry of Education, the Ministry of Culture, Sports and Youth, the Ministry of Industry and Energy and the Ministry of Ecology and Natural Resources will also join the training.

During the next rounds of training of the PIP Project, Dr. Mete Durdag will serve as the STTA International Training Expert in the design and delivery of the formal multi-week program in investment program preparation, appraisal and management. The training materials (Training Curriculum, slides, narratives and case studies) from the previous rounds are being revised to bring them in conformity with the revised Training Curriculum, draft PIPP Manual and the PIP Call Circular 2007-10. During the next round of training the instructors/economists from the Center of Economic Reforms (CER), the PIP Project local training partner organization, are being engaged in the training course preparation and delivery.

English Language Training

According to a request from the MOED and subsequent endorsement from the USAID, the PIP Project staff, together with WLI staff, prepared an English Language Training Program.

Twenty-five people participate in five groups in the training program. The PIP Project made available to the students the office conference room before and after work hours and on Saturday to make the language training successful. The PIP Project monitors the attendance and progress of the groups in the program.

Updating of e-library and of MOED/PIP Project website

The Project updated and catalogued the materials for the e-library that it is building for the MOED. The materials currently consist of economics, finance, investments, public expenditures management, project management, and sectors. There are IFI reports on countries and specific issues such as PRSP, participation or anti-corruption. The PIP Project has transferred these to the MOED in CD format. The MOED is deciding where and how to make it available to its staff. The PIP Project is building the hardcopy library of the MOED in the Project office. The Project identified a potential place to locate the materials at the MOED. The MOED prefers for now not to assume the management of the hardcopy library.

The PIP Project transferred to MOED the Project documents to be made available at the website of MOED. The PIP Project has a link from the official MOED website. The MOED has granted the Project the authority to upload any document it sees necessary for the purposes of improving PIPP management.

2. COOPERATION WITH THE GOAZ COUNTERPART ORGANIZATIONS

During Q3/06, the PIP Project staff cooperated with the key counterpart agencies: MOED, MOF, the Ministry of Industry and Energy, the Ministry of Transport, The Ministry of Youth and Tourism, the Ministry of Environment and Nature Protection in preparation and execution of the PIP Call Circular 2007-10. Along these lines the PIP Project staff extensively cooperated with the staff of MOED/DEPF in identification of the national development priorities and medium-term public investment programming. Undoubtedly, certain line ministries had experienced problems with the submission of their budget requests for investment projects this time, as the format for submission requires a solid ground work and justification. The PIP Project staff provided, to the extent requested, the necessary clarification and guidance on the completion of the PIP Call Circular tables. In addition, the Project management held a meeting with Mr. Mehman Abbas, the SPPRED Secretariat Head, to discuss comments related to the draft SPPRSD Program 2006-10.

The PIP Project worked with MOED towards creating the databases for FPM. The MOED/EPFD staff collated much information for the last 4 years in fiscal, monetary, external and real sectors of the economy. In the absence of data, MOED contacted MOF and NBA to collaborate on information sharing. These contacts resulted in varying degrees of results. The exercise remained a valuable experience and the economic data were in turn used by the MOED in its work with *PIP 2007-10* document.

The PIP Project provided comments on draft law "On Construction Projects" for the MOED. The Project also drafted a country brief for MOED management authorities to present during their official visits abroad. The Project worked on these at the request of the MOED.

The PIP Project also worked with MOED in designing a format for more robust description and analysis of public investments for the 2007-2010 period. A template for the textual content of the *PIP 2007-2010* document was done, which included descriptions of the past and future medium-term macroeconomic environment and description of GOAZ socio-economic plans to guide the medium-term PIP projects. Tables for medium-term macroeconomic parameters, the breakdown of investment expenditures into sectors, years and sources and comparisons of trends in expenditures with previous years were made. The MOED was to finalize the document in order to include it in the draft 2007 Budget for submission to COM. As of end Q3/06, the *PIP 2007-2010* document was still being completed to account for COM and MOF recommendations.

The PIP Project staff prepared a slide presentation on local budgeting issues and delivered three presentations at the Community Development Activity Conferences in Guba, Lenkoran and Sheki two of which took place in Q3-06. The Project staff had the opportunity to meet with the local executives and learn more of their long-and medium-term local development and budgeting issues.

The most prominent interaction activity in Q3/06 was the study tour of the senior GOAZ officials to their counterparts in the Government of Turkey. The Project COP Dr. Mete Durdag facilitated exchange of technical opinion and the GOAZ counterparts (especially that of MOED and MOF) recognized the importance of strategic and medium-term development planning with budgeting and integrated project analysis. Following the study tour, the GOAZ participants wrote a summary of findings and made recommendations to their superiors (Ministers) to address changes in areas of economic planning and public expenditures.

Finally, the PIP Project staff started work planning activities with the new ministries and agencies: the Ministry of Agriculture, the Corporation for Irrigation and Water Economy, the Ministry of Communication and Informational Technologies, and the Ministry of Health. The PIP Project plans to identify, jointly with the counterparts, 5-6 building blocks of topics to collaborate on during FY 2006-07 with an objective to have the staff of ministries become proficient in sector planning, budgeting (investment planning expenditures and revenue planning) and integrated project analysis.

3. COORDINATION WITH DONORS, IFIs AND USAID PARTNERS

In Q3/2006 the PIP Project staff enjoyed cooperation with international donor organizations, particularly with IMF and WB on issues related to the public investment planning and program/project management. Extensive meetings continued with Mr. Christos Kostopoulos, WB Senior Country Economist and Mr. Rasim Jafarov, WB Budget Economist in the Azerbaijan WB Mission, who were keenly interested in broader public expenditure reform in Azerbaijan and phased transition from line item to program-based budgeting.

The PIP Project management requested from the IMF Country Resident Representative Dr. Basil Zavoico to enroll two GOAZ officials into the IMF Institute's Public Investment and Fiscal Policy Course scheduled for mid-November 2006.

Following coordination with the USAID partners in local community development issues, the CHF International and Counterpart International, the PIP Project staff actively participated in the three regional conferences (Sheki, Lenkoran and Guba) and to deliver presentations

related to local budget and public investment issues. The PIP Project staff met with Mr. Jerome Gallagher, resident Advisor, Urban Institute/Counterpart, Civil Society Project, to discuss future coordination of activities of the two projects with respect to local government budgeting and budget preparation, in particular. A calendar of monthly meetings is included as Attachment 5.

Finally, responding to the request from MOED and MOF in international PIP-related study tour, the Project COP and Training Coordinator cooperated with TIKA (Turkish Economic Development Agency) in determination of the program of the study tour to Turkey.

4. ADMINISTRATIVE TASKS

Departure of Project COP

In August 2006, Dr. Mete Durdag, the PIP Project COP, notified DAI/HO and USAID of his resignation from his capacity as COP. Dr. Mete Durdag will continue to contribute to the Project work through assistance in design and delivery of the PIP Project Training Program and the PIPP technical ad hoc assignments, as required.

Modified PIP Project Budget

On September 26, 2006, USAID approved modification to the PIP Project Contract and the budget, authorizing incremental compensation to the local staff for the loss of purchasing power due to inflation effective August 2005.

Staff Recruitment

The PIP Project advertised an opening to fill in for the Position of Public Finance Economist. Mr. Fuad Ganjaliyev was hired with 3-months probationary period.

The PIP Project advertised an opening for the Position of Assistant-Secretary to replace for Ms. Leyla Mammadova who left the PIP Project in early September to continue studies in the Central European University (Hungary). Ms. Gunel Askerova was hired as the Project Assistant-Secretary with 3 months probationary period.

5. CONCLUSIONS AND IMPLEMENTATION ISSUES

- The PIP Project management was extensively involved in briefing of its activities to the new U.S. Ambassador Honorable Anne Derse, the USAID Country Director Scott Taylor and the new Head of the Office of Economic Growth Stephen Morin. The PIP Project staff coordinated its activities in extensive consultations with the World Bank and the U.S. Treasury Advisor. During August-September 2006 the status of implementation of the PIP Project activities was reviewed by the Office of the USAID Inspector General. In relation to a number of briefings the PIP Project staff prepared a Power Point Presentation on mid-term accomplishments. It is included as Attachment 4.
- The PIP Project emphasized notable progress achieved at a technical level and preparation of the Call Circular for *PIP 2007-10* in a new format and completed all chapters of the draft PIPP Manual. Yet methodology and extensive training will not be sufficient to achieve success programmatically unless new policies and procedures

become approved at the highest executive level (the Cabinet of Ministers and the President's Office). The PIP Project staff has reviewed the PIPP-related legislation and methodology in Kazakhstan. It concluded that, (1) the PIP Project work was correct attending and advancing the methodology and technical module preparation for PIPP management as prerequisites as legislation is adopted; and (2) acknowledged that the Government of Kazakhstan has succeeded to adopt the legislation that addresses broad PEM issues. The effectiveness of the procedures and implementation of the Kazakh legislation needs further review.

- The PIPP reform success is dependent on the GOAZ determination to establish a clear direction in economic policy decision-making that would rest on the state programs for poverty reduction and sustainable development, and the regional development program, on the one hand and sector strategic and medium-term development plans linked to MTEF and budget sector allocations, on the other.
- Since the Project inception in April 2005 the DAI/PIPP management has been emphasizing on a need for USAID and other donors/IFIs (particularly, WB, ADB and UNDP) to bring the conditions and process of the PIPP reform to the highest authorities in GOAZ. The DAI PIPE Proposal (2004) clearly stated on a need for USAID and GOAZ to establish a sustainable Steering Committee to coordinate PIPP-related activities and ensure correction and adoption of the necessary methodology and recommendations. Equally, WB could have established a broader Task Force to focus in areas of Public Finance Management. The partners (central economic and sectoral ministries), with which the PIP Project extensively cooperates, state openly that in absence of the clear policy signals (in a form of the President's Decree with consequent Cabinet of Ministers' Resolution) they are obliged to follow the current though obsolete PIP preparation procedures with only cosmetic changes involved.
- Now, with the existence of the PIP Project produced draft PIPP Manual, there appears a critical period with its approval and implementation by GOAZ. The PIP Project will continue advocacy in the approval of the draft PIPP Manual. But, as a contractor agency, our efforts may not be sufficient to persuade GOAZ approve it and endorse preparation of the necessary GOAZ instructions on PIP policy and procedures. Hence, the PIP Project management will seek for the support from the leadership of the U.S. Mission and USAID/Azerbaijan to promulgate the necessary policy support for the PIPP Reform with the highest authorities in GOAZ.

NOKI

PUBLIC INVESTMENT POLICY PROJECT

**The Functional and Institutional Review of
Ministry of Economic Development (MOED)**

Scope of Work for International Consultant

1. The National Context

1.1. Since its independence Azerbaijan has undertaken intensive oil and gas exploration highlighted by the realization of the transnational Baku-Tbilisi-Ceyhan (BTC) pipeline project to export its oil to international markets. Oil production is expected to peak around 2011, plateau for a few years and then decline by 2024 to about one-quarter of the peak level. While enjoying windfall resources from oil sales, the country continues to experience inflationary pressures, slow reengineering of its non-oil industries, pervasive poverty, and deteriorating social indicators. The challenge of handling the projected rapidly rising oil revenues through 2012 and its later decline will thus become more demanding. Experience of other oil-rich countries (Mexico, Nigeria, other) indicates inability of their governments to use oil revenues to industrialize, develop businesses, invest in infrastructure, alleviate poverty, and compete in international markets. On the other hand, Indonesia, Malaysia, Norway, UAE, UK, and Norway have all made good use of their oil revenues and have been continuing to perform well. The oil and gas windfall could be of great benefit to Azerbaijan if it is combined with careful macroeconomic and fiscal management and highly disciplined implementation of regional development and poverty reduction strategy.

1.2. Management of rapid but controlled expansion of public capital spending requires strengthening the Government of Azerbaijan's (GOAZ) institutional and technical capacity in the areas of development planning, budget formulation, and project development and management. This involves, in the first place, developing adequate capacity to prepare a medium-term Public Investment Program in line with both macroeconomic stability goals and medium-term development objectives. In this respect, USAID has been supporting the GOAZ's efforts with the Public Investment Policy Project (March 2005 – end-2007).

2. Rationale for PIPP's Interest

2.1. The primary objective of the PIP Project is to help GOAZ to strengthen its institutional and technical capacity to formulate sound public investment policy and program in order to make most efficient use of the country's rapidly growing oil revenues. To this effect, the PIP Project focuses on capacity building in the areas of (a) medium- and long-term national and sector development planning; (b) capital budgeting and investment programming; and (c) project preparation, appraisal, and monitoring and evaluation. PIPP also has an extensive training program to help build capacity in all these areas. For detailed information on the PIP Project's work, please refer to the www.economy.gov.az website.

2.2. The public investment policy and program of the GOAZ needs, **first**, to be saved from its current fragmentation by making it comprehensive of all government capital spending, whether

funded from the budget or by donors, and whether undertaken by the budget organizations or by the extra-budgetary funds. **Second**, the public investment policy and program should be developed as an integral part of a medium-term national and sectoral development framework adopted by the GOAZ. **Third**, there should be only one and the same set of national and sectoral development objectives, strategies, targets and policies, common to the Poverty Reduction and the Regional Development Programs, the Medium-Term Expenditure/Budget Framework (MTEF), the Public Investment Program (PIP), and the annual State Budget. **Finally**, the success of the above will depend on the establishment of effective guidance, overview, and evaluation of all planning and budgetary work of both the central and line ministries by the top leadership (the President and, on his behalf, the Cabinet of Ministers).

2.3. As described below, MOED's functions as stated in its Charter and particularly its organizational set-up have developed over the decade and half in an ad hoc manner without paying much attention in a systematic way to the above functions. The PIP project has therefore welcomed MOED's request for support in undertaking a thorough review and appraisal of the Ministry's current functions and organization.

3. Background to the Functional and Organizational Review

3.1. The MOED is the central executive body which, by its mandate, is *in charge of the formulation and implementation of state policy* in the areas of socio-economic development and international cooperation, macroeconomic development, trade, investment and entrepreneurship development, prevention of monopolization, and promotion of competition (Attachment 1).

3.2. Following independence, Azerbaijan named the former Gosplan as the Ministry of Economy, whose functions and organizational structure have gradually changed partly by decision and partly by inability to continue with the old functions in an economy increasingly becoming market-oriented. In year 2000, the Ministry of Economy became MOED and its portfolio has been expanded engulfing several other agencies (e.g. Ministry of Industry, Anti-Monopoly Committee, Entrepreneurship Development Fund, Privatization and State Property Committee, etc) with their existing structures and functions, while its macroeconomic and planning functions and cadres have been trimmed down to its current minuscule size. The resulting eclectic structure and functions of MOED have since become further disjointed with the establishment of two Secretariats for the State Program for Poverty Reduction and Development and for the Regional Development State Program Secretariat. Finally, MOED has very recently been sheared off, first, its "Industry" portfolio and, then, "Privatization and State Property", again without affecting the functions, organization, and cadres of the rest of the Ministry. Following these changes, the Charter of the Ministry has also been revised, but the amendments in the functions and structures of the remaining units were very limited, with the most significant change being the creation of two new deputy minister positions in addition to the existing one.

3.3. The MOED's current Statute (Charter) was adopted in 2001 and has since been subjected to several additions and deletions as agencies were brought in and taken out. The remaining functions and structures have very distinctly an eclectic and disjointed appearance. The Ministry's Statute seems to expect it to function like "the brain" of the economy, but its organizational structure hardly seems to be designed for this purpose. In addition, MOED has extensive "market intervention" responsibilities and quite independent structures to carry out such interventions. The "brain function" and the "market intervention functions" seem to hardly

have any connection in the Ministry's Statute, both in terms of decision-making and organizational set-up.

3.4. The MOED thus has a very important place in the organogram of GOAZ, with crucial responsibilities for policy making, technical work, and inter-agency coordination for successful management of economic development. MOED's current Charter seems to bestow it with a wide range of mandates to discharge its crucial responsibilities. On the other hand, the Charter appears to have collated a large number of essentially appropriate functions but without adequately systemizing them as well as many others whose presence may be questioned if they are needed in a market-based economy. More importantly, however, the current organizational structure of the Ministry needs to be reviewed carefully vis-à-vis the functions envisaged in the Charter, particularly considering that, as noted above, it has grown up in an ad hoc and eclectic way as a result of shifting many agencies in and out of the Ministry.

4. The Main Task

4.1. The starting point for the present functional and organizational review is the assumption that the Minister of Economic Development is happy with the wide range of responsibilities and associated functions bestowed to his Ministry by its Charter ("Charter" here refers to latest draft MoED Charter) and that he wants to retain them to achieve the current objectives of his Ministry. The relevant questions to ask then are: (i) if and how these functions could be grouped together and/or streamlined to better support one another; (ii) could alternative ways be developed to replace the existing functions to attain more effectively the same goals of the Ministry; and (iii) which functions seem to be candidates for shedding off or phasing out eventually, given the envisaged direction of political, social and economic developments in the country over the medium- to long-term.

4.2. Such a functional review should be accompanied by an institutional appraisal of MOED in order to provide an objective analysis of its main structural strengths and weaknesses vis-à-vis its objectives and functions. The aim should be to identify the underlying causes of institutional weaknesses and options for dealing with them, consistently with the MOED's broader functional reform objectives as would be emerging from the three questions in the previous paragraph.

5. Specific Areas for the Review to Focus

The following areas/issues require special attention by the Functional and Organizational Review team. The way they are worded here, however, is not sacrosanct, and they can be subject to revision, addition, and deletion to better meet the objectives stated in Section 4 above.

- (1) The Review Team will work in close cooperation with the Task Force, comprising all the three Deputy Ministers of MOED, who will function as both a Steering Committee and a resource body.
- (2) Analyze and assess MOED's functions and organizational units, using a classification such as the following:
 - a. Regulatory;
 - b. Economic (i.e., taking part in economic activities);
 - c. Policy making, Development Planning, and Public Investment Programming;
 - d. Co-ordination, supervision, performance monitoring, and evaluation; and

e. Other functions and units within the MOED Statute and organogram.

(3) Which functions and structures should be maintained? There is a need to review the functions and structures with a view to shedding some of them that can be duplicating others and to adding new functions and structures per the Ministry mission, vision, and objectives as decreed by the President. To this end, develop an approach, in consultation with the Task Force, for identifying which functions could be abolished, rationalized, or transferred to other public or private sector organizations.

(4) MOED's Organizational Setup:

- a. Is the existing structure of departments and divisions appropriate to successfully manage MOED's present and recommended functions/tasks? How can it be improved?
- b. Are scopes of work and job description for structures and personnel available and satisfactory?
- c. What is the personnel selection process?
- d. What motivations do personnel have for taking initiative, striving for progress at work, and developing professionally?
- e. Are some significant tasks requiring specialized expertise contracted out?
- f. Is the computer inventory and work space sufficient for MOED staff to successfully perform their functions?

(5) Recommendations

a) for streamlining MOED's functions listed in its current (newly developed by MoED) Statute/Charter and for necessary restructuring of the organizational set-up of the Ministry to more effectively fulfill its functions and attain its objectives; b) for improvements in functional and subsequent organizational arrangement in MoED.

(6) Deliverables:

- a) An annotated outline of the final report as specified below, and a detailed time-based work plan for the task;
- b) A detailed report of the "Functional and Institutional Review of the Ministry of Economic Development of the Republic of Azerbaijan" (including a summary PowerPoint presentation of it) that will:
 - Evaluate the MOED's current Charter (Statute) in terms of its objectives and envisaged functions;
 - Evaluate the effectiveness and efficiency of the current organizational structure (set-up) of MOED in relation to its current functions, and recommend necessary institutional/procedural improvements (including proposal of new structure of MoED and scope of work for each structure) for as much enhancement in the effectiveness of the Ministry as possible over the next year and consistent with a realistic recruitment and training program;
 - Prepare a "Strategic Results Framework" and, in line with that, propose a set of plausible recommendations for restructuring both functional and organizational structure of MOED on a well thought out

“phased program” consistent with a realistic recruitment and training program.

c) Other deliverables/assistance in regard to 2-5 above.

- (7) Team Members:** The Review Team will be composed of (i) an International Consultant with extensive experience in functional and institutional review and assessment of government agencies in charge of planning and budgeting in transition economies; and (ii) the Chief of Party of the PIP Project. The Team will use the office space made available to PIPP at MOED, and will have full access to PIPP’s office facilities.
- (8) Confidentiality:** The PIP Project and the international consultant agree that all ideas, information and written material disclosed to them by MOED are the sole property and proprietary information of MOED and that they will not use or disclose them to any other person except in carrying out MOED’s work with its prior approval.
- (9) Timing and Period of Assignment:** The International Consultant is expected to work for 7 weeks (7x6= 42 work days) from September 4, 2006, jointly with the COP of PIPP, to carry out the following tasks in three phases as follows:
- **First Phase:** Over the first week the necessary diagnostic meetings will be held; all initial information collected; and the deliverables in (#6.a) submitted to and approved by the Task Force;
 - **Second Phase:** During the next three weeks, the deliverables in (#6.b) will be completed and submitted to the Task Force;
 - **Third Phase:** The Review Team will deliver its final report to MOED by mid-October 2006. After reviewing and digesting the report and recommendations of the Review Team, MOED may invite the Team back sometime in November for a final week of fine tuning work on the report and consultations about the implementation of recommendations.
 - The progress of work will be reviewed and agreed by the Task Force on its weekly meetings with the Review Team;





USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Attachment 2 (a).

PUBLIC INVESTMENT POLICY PROJECT (PIPP)

**Azerbaijan:
Participatory Processes
in Public Investments**

Assessment and Recommendations



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

New Situation

Early 1990s

- Political instability
- Economic disorganization
- Active war
- Separatism, no clear development path

2000s

- State institutions are stronger
- Growth is one of the highest in the world
- Lasting ceasefire
- Membership in the COE, prospects for accession to WTO, oil revenue inflow



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Why participation is good?

- Feedback from stakeholders
- Support of voters to the government
- Improved quality of investment programs
- Better implementation

Note: participatory practices do not necessarily lead to adopting best decisions, but they allow to avoid serious mistakes.

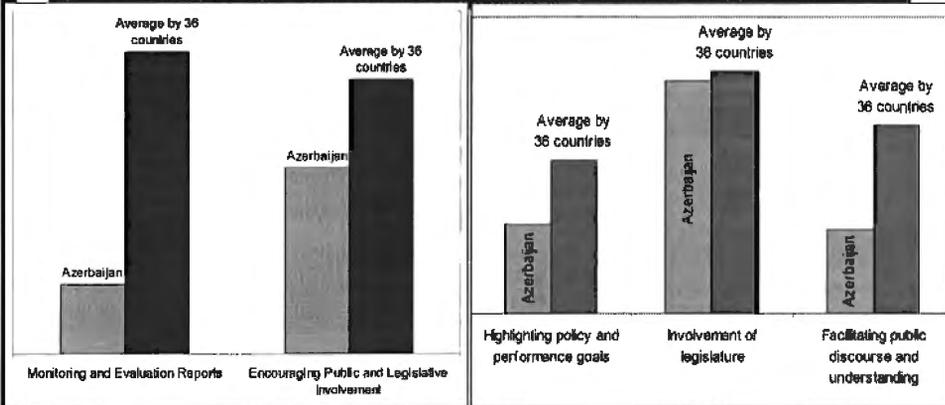


USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices Legislation and rules

Budgetary process recently improved
(adoption of the new Law "On Budget System" in 2002)
although still below of international standards in terms of participation





USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices Legislation and rules

- The public relations offices
- Entrepreneurship Council
- Trade Unions
- Milli Meclis
- Elected local governments

5



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices

- **rules of access to the government information are not clear or not respected;**
- **consultations with stakeholders are not systematic;**
- **mechanisms of consultations are not well-organized and/or not working**

6



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices Capacity of civil society elements

- NGOs and business associations
- Labor unions
- Political parties
- Elected local governments

7



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices in selected sector ministries

Ministry of Ecology and Natural Resources

- degree of participation is often limited to academia and local executive powers only, and excludes the rest of the civil society
- project consultations with stakeholders are irregular and on ad-hoc basis

8



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices in selected sector ministries

Ministry of Culture and Tourism

- project awareness actions are limited to the project preparation and approval stages
- Stakeholders are not provided with adequate mid-term and final implementation progress reports or information, which would provide feedback for possible adjustments

9



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices in selected sector ministries

Ministry of Industry and Energy

- No opportunities and occasions for individuals or civil society organizations to participate in the decision-making of investment processes.
- a benefit-cost analysis for investment financing projects is never outsourced to independent specialized institutions. This function is routinely performed by the branch institutes.

10



Ministry of Industry and Energy

PROPOSED KEY FUNCTIONS OF THE PUBLIC INFORMATION/COMMUNITY SERVICE DEPARTMENT OF MOIE



Current Participatory Practices in selected sector ministries

Ministry of Transport

- no participation of any non-governmental stakeholders in the identification, appraisal, review or evaluation of its public investment programs



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Current Participatory Practices in selected sector ministries

Ministry of Education

- The final beneficiaries - teachers, parents, and students, are not involved in any stage during preparation of investment plans
- even the well-organized civil society entities have no access to public investment planning, implementation and monitoring processes in the sector, although Parents' Committees and Pedagogical Boards do play some role in other school-related issues.

13



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Barriers to participation

- Reasonable confidentiality is a legitimate barrier
- Political rivalry
- Corruption and monopolies
- Lack of a standard approach

14



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Recommendations

Guiding principles

- Outcome-based participation
- Inclusion
- Transparency
- Sustainability
- Cost of participation
- Intra-governmental participation
- National level civic engagement
- Publicity
- Implementation of existing laws

15



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Recommendations

Participation toolkit

- Central Government Budget Hearings
- Local budget hearings
- Public Information Strategy
- Open door program (accessibility)
- Strengthening role of multi-partisan legislature
- Measuring participation
- Early ministerial consultations
- Opinion surveys
- Capacity building
- Stakeholder analysis
- Develop agenda for participation
- End of term reports by ministers and elected bodies

16



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Attachment 2 (b).

PARTICIPATORY PROCESS IN LOCAL BUDGET PREPARATION

Guba
July 26, 2006



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

“Local” Budgets

- **67 cities and rayons and 2,754 municipalities in Azerbaijan**
- **Local revenues = local taxes and fees + subsidies from Central Government Budget**
- **City and rayon budgets heavily depend on Central Government subsidies except Baku City (12 rayons)**
- **Municipalities' own revenues are outside of Consolidated Budget**



“Local” Budgets

- **34.7% of all municipal revenues are from Baku Municipalities (51)**
- **71.2% of all rayon revenues are from Baku City (12 rayons)**
- **Excluding Baku City, all rayons’ own revenues are 2.2% of total 2006 State Budget revenues (20-25% in Central and Eastern European Countries)***

* Municipal and rayon are actual 2005 budget.



2005 BUDGET ACTUAL * FIGURES

(mln AZN)

	Source	Revenues	Expenditures	Subsidies	Share of subsidies in exp
	State budget	2 055. 2	2 140.7	-	-
Rayons (approved figures)	Rayons (exc. Baku)	46.4	311.2	264.9	85%
	Baku	114.6	114.6	0	0
Municipalities	Municipalities (exc. Baku)	15.8	15.5	1.7	11%
	Baku	8.4	9.2	0.2	2%

* Except rayons



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Objectives in *State Program on Social Economic Development of Regions 2004-2008*

- **Increase effectiveness of the local resources**
- **Build and enhance local infrastructure**
- **Restore and extend local productive capacity**
- **Accelerate the second phase of agricultural reform**
- **Establish attractive environment for investing in businesses and creating jobs**
- **Improve communal services provided to local population**

5



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Major Goals of Local Budgets

- **Implement social-economic programs for social and economic development in the regions in line with the national and regional strategies and priorities**
- **Promote business and competition through investing public funds in infrastructure**
- **Be responsive to population demand**
- **Be accountable for results and control over the public funds' use**

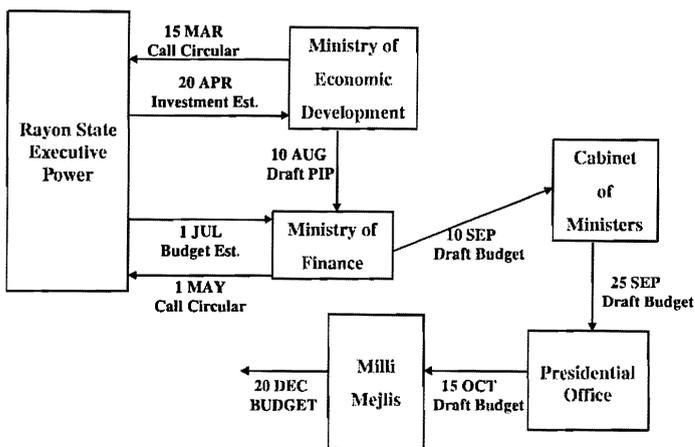
6



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Rayon Budget Preparation and Approval



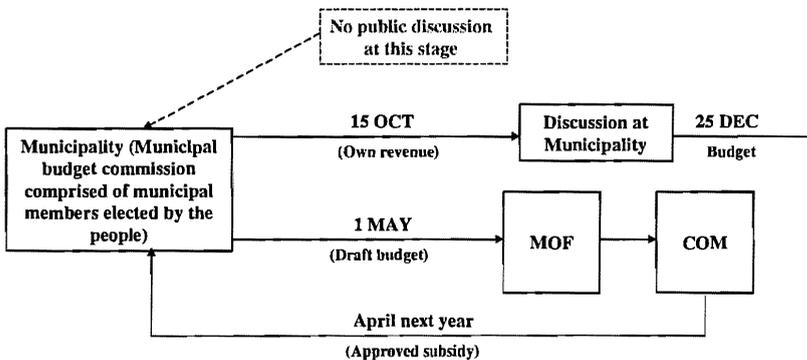
7



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Municipal Budget Drafting Process



* Supporting documents to be provided by Municipality to MOF within it's draft budget proposal include:

- 1) Forecast of the revenue and expenditure for the current year and last years' outcomes;
- 2) Forecast of the revenue and expenditure for the next year and justification of the requested subsidies;
- 3) Auditor statement on the execution of the last year's budget;
- 4) Other supplementary info requested by MOF.

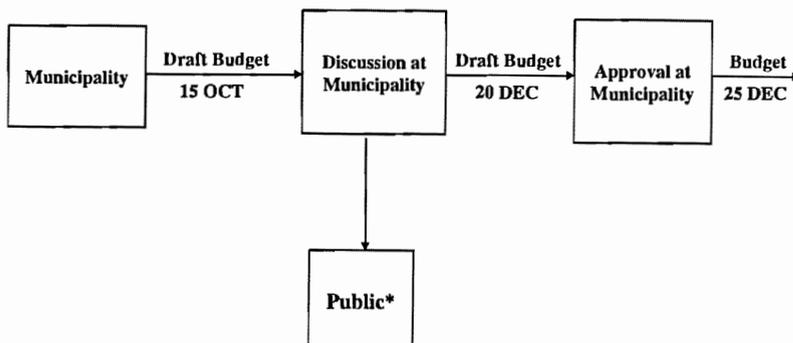
8



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Municipal Budgeting Process



* According to the Presidential Law on Basis of Municipal Finances (1999) the municipalities should inform the population within 10 days after the draft budget has entered the discussion phase.

9



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Local Budget Preparation Process (Strengths According to the Current Legislation*)

- The public, private business, and NGO are allowed to participate in the budget process and have access to budget-related information
- Public is eligible to participate in budget formulation and propose changes
- Government legitimized public awareness of government finances
- Local executive bodies initiate development projects
- Independent audits of budget execution

* Law on Basis of Municipal Finances (1999); Law on Local Taxes and Payments (2001); Budget System Law (2002)

10



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Local Budget Preparation Process (Opportunities for Improvement)

- **Increasing expenditure effectiveness (planning, implementing programs)**
- **Better documentation of requests for subsidies from the Central Government budget**
- **Better local medium-term development plans**
- **Increasing the involvement of population in local budget cycle**
- **Publishing approved and executed local budget revenues and expenditures**



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Participatory Process

Participation is any process through which citizens influence public decisions that affect their lives and the lives of other citizens.

- **Active participation:** public interact with their elected officials or local government staff to influence a public policy decision
- **Passive participation:** public attend public meetings to receive information

The most effective participation: people meet to learn, to discuss and to provide input; build consensus to guide their own affairs and government actions



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

What are “Public Budget Hearings”?

PUBLIC BUDGET HEARINGS are assemblies that are open to all members of the community for the purpose of discussing issues of key importance to the community and discussing the revenues and expenditures at all stages of budget cycle.

- Community members learn what socio-economic programs are planned
- A new annual budget is proposed and compared with last year’s budget
- Community members discuss openly issues that the community supports or is concerned about
- Local development programs are brought into agreement with the national and sectoral development plans and priorities
- Programs and budgets are considered for the medium-term period

13



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Goals of Public Hearings

- To get community input on various issues related to community services (water supply, street lighting, education, health, privatization, waste management, roads)
- To inform the community of the local government’s activities
- To inform the community of new expenditure programs regarding specific issues and implementation of these programs
- To obtain the community’s support of lobbying activities at the higher levels of government regarding issues that are in the community’s interest (economic development, environment, etc.)
- To increase public confidence in the government by ensuring open information on management of public funds

14



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Benefits of Public Participation in the Local Budgeting Process

- Local insight and more inputs for local solutions
- Local prioritization of issues and public expenditures
- Public reconciliation of competing local demands
- Increase decision-making skills, create alliances, self-governance skills
- Make the local officials responsive to local demands
- More transparency, more effective implementation, more accountability
- Increase stake in the local issues for more sustainable local economic growth

**Back to Office Report for USAID Community Development Activity
Regional Conference in Guba, July 26, 2006.**



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Memo

To: Mete Durdag, COP
From: Hadji Husseyinov, Expert on Agriculture, Environment and Tourism
Date: August 13, 2006
Re: USAID Community Development Activity Regional Conference (Guba)

Participants of the Conference:

CHF Community Outreach Project
Counterpart International
FINCA Azerbaijan
Azerbaijan Business Assistance & Development (ABAD)
MOED: Regional representative
Local governance: rayon executives, municipal council members, local NGOs
PIP Project: Mr. Hadji Husseyinov, Expert on agriculture, environment and tourism

Introduction:

CHF International has organized three regional conferences during June and July. These conferences were to take stock of CHF activities with the municipalities in the three key regions of Azerbaijan as well as to highlight for the municipalities the local budgetary processes and the place of public participation in the local budget processes. Among the CHF activities in the regions there are the following key efforts:

- 1) Support the local economy and business development through the funding of the small projects implemented by the local communities;
- 2) Expand the local economic productive capacity through establishment of community and cluster based projects which restore and improve the economic infrastructure;
- 3) Strengthen and reward the local community institutions, which are involved in the provision of social services, and extend environmental skills through an integration of the well-tested environmental experiences into all local activities.

The Counterpart International supported the responsibilities of organizing the regional conferences with the CHF. Currently Counterpart International is implementing the USAID's Civil Society Project (CSP). The Project aims to assist the citizens and

Government of Azerbaijan to further develop dialogues in working towards the creation of a more representative and better functioning democracy.

The third regional conference took place on July 26 at Cennet Baghi Hotel in Guba. At the conference, the PIP Project was represented by one staff member. He traveled to Guba on July 25th; attended the conference on July 26th, and returned on the same day to Baku.

Conference/Workshops:

The Guba Conference was attended by about sixty representatives from municipal councils from 16 villages of 4 rayons (Guba, Gusar, Khachmaz, and Davachi) as well as the village/city representatives of rayon chief executives. The Conference started with a welcome speech by Mr. Neil McCullagh, CHF Country Director and continued with an account from the MOED's regional representative. The MOED representative gave recent economic information from the region (activities implemented in the region within the context of SPSEDR and SPPRSD, changes in output, creation of new jobs, rehabilitated infrastructure, and credits provided through the Fund of Support to Entrepreneurship).

Mr. H. Husseynov of the PIP Project made a presentation titled "Participatory Process in Local Budget Preparation." The presentation touched upon the topics of local budget cycle, local budget relations with the central government budget (timing and fiscal dependency), link to the national and regional strategies (i.e. SPSEDR and SPPRSD), timing of budget hearings at the local level, and the benefits of local participatory practices in the use of public funds. Following the presentation, there was a brief Q&A session with the representatives of the municipalities and local NGOs. The main questions addressed to the PIP Project expert were: 1) what kind of activities should be undertaken by the municipalities and rayons to improve the participatory approach and budget transparency; and 2) what are the GoA's plans in order to improve: a) the subsidy allocation mechanism and its timeframe, and b) the local taxation base.

The representative of the municipalities at the conference were told of MOF's intention (as far as the PIP Project was aware unofficially) to reduce the number of municipalities by merging the smaller municipalities into the bigger ones and allocating the subsidies based on the municipal medium-term program priorities instead of the current approach of basing them on per capita.

The PIP Project's presentation was followed with presentations by ABAD and FINCA. The USAID-funded ABAD Program is implemented by the International Rescue Committee (IRC) with partners Chemonics and FLAG International. The Program assists primarily through rural Marketing Centers staffed by business advisors who live and work in the regions. The ABAD Program aims to stimulate rural economic growth by helping farmers and small private enterprises increase their sales and create new employment opportunities. ABAD works directly with rural enterprises and local communities to create and strengthen market-linkages, improve technical and business skills, and improve regulatory environment.

FINCA is a non-bank credit organization, which provides micro-credits to local businessmen who are involved in the processing, trading and other service businesses in the regions.

ABAD's and FINCA's presentations reported on the projects implemented in the Guba region and described the main requirements needed by local entrepreneurship in order to apply for technical assistance from ABAD or funding from FINCA.

The last presentation of the conference was made by the representative of the Counterpart International. In particular, the CI staff informed the participants about the role of local NGOs in the civil society and economic development of the regions. The CI staff told the participants of CI's training activities implemented in the regions, and underlined the main shortcomings and the required improvements in the daily activities of local NGOs.

At the conclusion of the presentations, several Working Group sessions for the municipal council members were conducted. The sessions were designed to articulate common issues confronted by councils during community mobilizations for undertaking community programs and to consolidate the methods and the determinations necessary to push their programs forward. The council members spoke about their projects in their municipalities under the CHF assistance and the main problems encountered during the project implementations. Among the impediments to implementation were: unsatisfactory public awareness campaigns, lack of incentives and lack of motivation in the community, and resistance from local officials. At the end of each case discussion, the CHF staff members provided the council members with recommendations on how to resolve the obstacles to implementing the projects.

Conclusions/Observations:

The conference participants were eager and interested in providing feedback on the PIP Project presentation. Municipality and rayon officials welcomed the initiative by USAID for encouraging more transparency and more public participation in the local budget cycle. At the end of the conference, there were a number of queries on budget and investment procedures, budget timeframe, and public hearings.

The municipality and rayon officials said that they found the PIP Project well-informed about the budget procedures and the general recommendations valid. In turn, the municipal officials seemed to have good opinions on the needs and the means to improve the local budget cycle activities (i.e. planning, public discussion, approval and execution). The officials are, in general, the political protégés of the rayon senior management and, on the surface, may be expected not to be closely beholden to the electorate. Instead, they seemed to be well informed of their responsibilities and genuinely concerned with the urgent needs of their communities to improve their welfare.

In rayon and municipal budgets, the local revenues fall well short of required expenditures. To make up for the short-fall, the local governments request budget support with direct transfers from the central government. It appears that there are two issues that the municipalities grapple with related to realizing their development programs. One issue is structural in terms of basic inadequacy of municipality fiscal bases and in terms of calculation of subsidies that does not make enough differentiation among priorities. The other one is more practical issue based on presenting and communicating the justification of the budget transfer requests for the development programs.

Most of the interviewed municipality representatives stated that the local tax base needed reconsideration (i.e. more funds from local taxes should remain under the municipal authority). Currently, the MOF and the Ministry of Taxes are reviewing a proposal to provide the municipalities with the right to collect the juridical property tax. Moreover, MOF has considered several alternatives to the current subsidy mechanism and is finally supporting an idea of a program-based subsidy allocation. These measures, if

implemented, may improve the level of effective implementation of municipal development programs caused by financial constraints.

The transfer amount from the state budget calculated by the MOF for a rayon budget comes from the expected annual deficit between rayon budget own revenues and total expenditures. The MOF calculates the amount of subsidy to the rayon based on its own assumptions and usually drastically revises the rayon's forecasts of annual budget submission to the MOF.¹ A similar but a much more abbreviated budgetary estimation and inter-governmental funds transfer process ensue between the MOF and a municipality. In practice, the rayon budgets receive large portions of their budgets from the central budget. On average, 70-80% of rayon revenues are direct transfers from the central budget. The municipal budgets, on the other hand, receive much smaller ratio of their budgets as transfers, on average 5-10%.

There are significant differences in the amounts of transfers between the rural and the city municipalities due to the per capita subsidy allocation used by the MOF. The higher populations in the cities favor the cities in receiving total transfers where own resources of cities are already more robust.² The representatives from smaller municipalities questioned the MOF's current approach of per capita subsidy allocations which does not account for differences in local fiscal conditions and the cost of providing the same public service in different locales.

In formal budget support requests, the statements of priorities of municipal development programs may not appear in alignment with the national and regional strategies. This is one of the reasons that their fund requests fail. These priorities are very local but they also certainly represent the core of the SPSEDR and SPPRSD because the national strategies are the amalgamation of peoples' priorities. Hence, it is more of a practical problem that most of the municipality subsidy requests do not express formally the regional targets and activities outlined in the specific (region based) parts of the national strategies (particularly SPSEDR). Instead, the requests justify projects based on the municipality immediate needs in a format and language which may fail to communicate the broader development policy links. As a result, the narrow and direct descriptions and justifications of the municipal projects fail to gain acceptance readily by the rayon and MOF officials when pursuing funds and implementation.

The main shortcomings of all three conferences were the absences of the key government players most involved in the local planning and budgeting activities (i.e. rayon planning and budgeting staff and MOF rayon representative). These officials are the key personnel to ensure the proper public participation in the rayon planning and budgeting activities. However, the presence of MOED's regional representatives was very helpful in increasing the audience's awareness of national and regional perspectives and outcomes within the adopted and implemented national development policies in the regions.

CHF and Counterpart International were pleased with the PIP Project presentation. In particular, CHF management and local staff members agreed to emphasize the necessity of better budget transparency and public awareness at the local level. According to CHF staff, there are opportunities and willingness at CHF to deliver such training courses in the regions but CHF needs to become more familiar with sound public awareness campaigns (i.e. public hearings, round tables and other tools of public discussion). In another aspect

¹ This revision is to be expected because the incentives for the rayons are to underestimate revenues and overestimate expenditures.

² The per capita based calculations may already have problems due to the unreliable statistical information used by the MOF (i.e. it doesn't reflect the huge migration of labor force to Russia).

of cooperation in light of the CHF's support of small scale projects directed to improve municipal services, the PIP Project may involve municipal and rayon accountants in its project management training courses supposed to take place within the second year of PIP Project's activities. However, the training materials and case studies used for the project management cycle training held in the Q1-2006 may have to be massively revised or reconfigured to focus more on the strengthening of the planning and project cycle management capacities of the local governments. The resources required to alter the training courses may impede the extent of this potential collaboration.

Follow-up and Recommendations for PIP Project and CHF:

- In view of the PIP Project including activities in its second year Work Plan to improve the capacity of local governments in planning and budgeting, the Project staff needs to have more information on current practices in local planning, programming and budgeting.
- The PIP Project should establish working relationships with the local divisions of MOED's SPSEDR Secretariat and MOF's rayon offices in order to identify the weaknesses in local development planning and capital budgeting at rayon levels and in rayon office relations with the central ministry offices.
- The PIP Project should identify concrete case studies of small scale projects, which are in agreement with the national and sector strategies that have had adequate feasibility studies. Those case studies may be used in the PIP Project's future training programs on project management cycle to strengthen the planning and budgeting capacity of the local governments.
- The PIP Project's Note 'Participatory Processes in Public Investments,' which is to be disseminated and discussed with the line and central ministries can be further extended to include analyses and recommendations for better involvement of local population in the rayon capital expenditure budgeting.
- The regional conferences with local budgetary topics should include the MOF local office representatives and rayon accountants. This would help to heighten the awareness of the leading fiscal authority of GoA of participatory approaches in budgeting and of the current population needs and donor efforts.

Follow-up and Recommendations for GoA:

- The annual MOF Budget Call Circular (BCC) to the rayons has a two-page annex for the municipalities. This annex should provide more explanation and guidance on what exact information is required and how it should be presented. In particular, MOF can attach to its BCC sample formats of information and descriptions of rayon/municipal social-economic program (i.e. unified project concept paper) or examples of sound budget subsidy justification. The local MOF offices should facilitate this process of education and information dissemination.
- The rayon and municipal officials who deal with the planning and budgeting issues should implement, incrementally, participatory approaches at all stages of the local budget cycle. Currently, they provide public information solely to report on

semiannual and annual budget performances. Providing command, guidance and training/education to the local offices with respect to transparency and participation in local budgeting would have to come, initially, from the MOF and the MOED central offices.

- The GoA should assist with implementing effective observance of the budgetary stipulations of municipal legislation. The current situation would substantially improve if the local officials followed the reporting, auditing and public awareness requirements set by the legislation.
- The GoA should request donor technical assistance to learn from international experiences in municipality financial management and improve the local budgeting processes. As of now, there are no IFI or NGO proposals of assistance to the GOA or to the local governments on these issues.

**AZERBAIJAN REPUBLIC
PUBLIC INVESTMENT POLICY PROJECT**

**PARTICIPATORY PROCESSES IN LOCAL BUDGETING
ASSESSMENT AND RECOMMENDATIONS**

Introduction

The PIP project within its workplan's agenda had reviewed the status of public participation in public investment decision-making in Azerbaijan. The assessment has covered: a) current legislation and procedures for participation; b) stakeholder participatory practices in public investments; and c) participatory practices in five selected line ministries. Thus the paper has mainly focused on the status of the participatory process taking place in the planning and budgeting of the capital spending from the central budget. However, the overall picture of public participatory processes in public spending would not be complete unless the participatory process in the local budgeting (i.e. rayon and municipal budgets) is considered.

This brief note was initiated by PIP Project to tackle this missing component while focusing more on the aspects of municipal budgeting (i.e. the functional effectiveness of municipalities, revenue base and mechanism of subsidy allocation that is currently applied by MOF).

Rayon Budgets

There are 66 administrative cities and rayons subsidized in the annual state budget from the centralized expenditures (excepting the capital Baku, which plays the fund contributing rather than of the fund receiving role).

The preparation and execution of the rayon budgets are regulated by the "Budget System Law" and "Guidelines for the preparation and execution of the state budget". **This legislation does not prescribe any public participation in the preparation of rayon budgets.** Thus having the same preparation timeframe with the central budget, the rayon capital spending plans for the next fiscal year are drafted and submitted as response to the MOF's Budget Call Circular (by the 1 of July) and the MOED's PIP Call Circular (by the 20th of April). **In practice, there is not any public participation in the formulation of rayon budgets. All public awareness is limited to the discussion of rayons' revenue, expenditure and subsidy needs at the Milli Meclis in the discussions and approval of the annual budget envelope.**

The subsidy amount from the state budget calculated by the MOF for a rayon budget comes from the expected annual deficit between rayon budget own revenues and total expenditures. The MOF calculates the amount of subsidy to the rayon based on its own assumptions and usually drastically revises the rayon's forecasts of annual budget submission to the MOF.¹ In practice, the rayon budgets receive large portions of their budgets from the central budget. On average, 70-80% of rayon revenues are direct transfers from the central budget. **Majority of the interviewed local population stated that they have never been involved in any public awareness activities held by rayon executive committees with regard to their capital spending.**

Municipal budgets

¹ This revision is to be expected because the incentives for the rayons are to underestimate revenues and overestimate expenditures.

The issue of public participation in the preparation of municipal budgets seems to be better articulated in the current legislation in comparison to the absence of any legislative commitments set for the public participation in the rayon budgets. Thus, according to the “Budget System Law” and the “Law on basis of municipal finances”, the municipalities should ensure the public awareness of their budget at the stage of budget discussion, approval and execution. (See. Figure 1).



Figure 1. Process set by legislation for the preparation of municipal budgets

Municipal development and the issues of fiscal decentralization are important for the successful development and implementation of the national strategies and goals. Fiscal decentralization has many benefits, especially when it brings beneficiaries much closer to service providers, thereby improving accountability. However, this must occur within a framework in which responsibilities are clearly and unambiguously defined and this is linked to a clear revenue source. **There is an urgent need to clarify and specify more rigorously the public expenditure role of municipalities and rayons and to ensure that the objectives and goals set out in the MTEF, PIP, SPPRS and SPSEDR are not undermined by confusion over the responsibilities for the achievement of these objectives.**

In formal budget support requests, the statements of priorities of municipal development programs may not appear in alignment with the national and regional strategies. This is one of the reasons that their fund requests fail. These priorities are very local but they also certainly represent the core of the SPSEDR and SPPRS because the national strategies are the amalgamation of peoples' priorities. Hence, it is more of a practical problem that most of the municipality subsidy requests do not express formally the regional targets and activities outlined in the specific (region based) parts of the national strategies (particularly SPSEDR). Instead, the requests justify projects based on the municipality immediate needs in a format and language which may fail to communicate the broader development policy links. As a result, the narrow and direct descriptions and justifications of the municipal projects fail to gain acceptance readily by the rayon and MOF officials when pursuing funds for implementation. **The municipalities are generally unaware of the planned capital spending at the level of rayon budgets, SPPRS and SPSEDR that leads to an ineffective targeting of the limited municipal resources.**

In rayon and municipal budgets, the local revenues fall well short of required expenditures. To make up for the short-fall, the local governments request budget support with direct transfers from the central government. There are significant differences in the amounts of transfers between the rural and the city municipalities due to the per capita subsidy allocation used by the MOF. The higher

populations in the cities favor the cities in receiving total transfers where own resources of cities are already more robust.² The representatives from smaller municipalities questioned the MOF's current approach of per capita subsidy allocations which does not account for differences in local fiscal conditions and the cost of providing the same public service in different locales. Compared with the rayon budgets, the municipal budgets receive much smaller ratio of their budgets as transfers, on average 5-10%.

It appears that there are two issues that the municipalities grapple with related to realizing their development programs. One issue is structural in terms of basic inadequacy of municipality fiscal bases and in terms of calculation of subsidies that does not make enough differentiation among priorities. The other one is more practical issue based on presenting and communicating the justification of the budget transfer requests for the development programs.

Most of the interviewed municipality representatives stated that the local tax base needed reconsideration (i.e. more funds from local taxes should remain under the municipal authority). Currently, the MOF and the Ministry of Taxes are reviewing a proposal to provide the municipalities with the right to collect the juridical property tax. Moreover, MOF has considered several alternatives to the current subsidy mechanism and is finally supporting an idea of a program-based subsidy allocation. These measures, if implemented, may improve the level of effective implementation of municipal development programs caused by financial constraints.

The accountability of the municipal elected bodies and executive branches is not properly ensured from a financial standpoint. Indeed, the law does not provide clear rules and procedures in this regard. Although local budgets should be compliant with the general standards of budget preparation in use, there are no minimum financial safeguards determined transparently at the national level and no standard local budget formats and reporting procedures.

Follow-up and Recommendations for GoA:

- The lack of clarity regarding the separation of the responsibilities of the central government and the municipalities creates confusion in oversight, decisions, and management in key areas such as taxes, municipal assets, local infrastructure, and facilities. Therefore, **the legal framework needs to be further developed**, and an adequate implementation plan should be defined and followed by the Government, as laws would be worthless if they were not implemented after being adopted by the Parliament.
- **The annual MOF Budget Call Circular (BCC) to the rayons has a two-page annex for the municipalities. This annex needs to be improved to provide more explanation and guidance** on what exact information is required and how it should be presented. In particular, MOF can attach to its BCC sample formats of information and descriptions of rayon/municipal social-economic program (i.e. unified project concept paper) or examples of sound budget subsidy justification. The local MOF offices should facilitate this process of education and information dissemination.
- **The rayon and municipal officials who deal with the planning and budgeting issues should implement, incrementally, public participation practices at all stages of the local budget cycle.** Currently, only municipalities provide public information solely to report on semiannual and annual budget performances. Providing command, guidance and training/education to the local offices with respect to transparency and participation in local budgeting would have to come, initially, from the MOF and the MOED central offices.

² The per capita based calculations may already have problems due to the unreliable statistical information used by the MOF (i.e. it doesn't reflect the huge migration of labor force to Russia).

- **Define and implement the government policy and administrative action plan for municipalities that would address:** (i) the issues of clarification of the functions and responsibilities between the local branches of the state administration and the municipalities; (ii) the issues of adequate and homogeneous budgeting systems for municipalities; and (iii) the establishment of transparent safeguards and controls for municipal budgeting systems.
- **Strengthen the financial, technical, and managerial capacity of the newly created municipalities,** allowing them to: (i) preserve and invest in local infrastructure and facilities, (ii) provide reliable access to basic infrastructure and services, and (iii) foster economic development by removing the barriers to private sector development.
- **The GOAZ should assist with implementing effective observance of the budgetary stipulations of municipal legislation.** The current situation would substantially improve if the local officials followed the reporting, auditing and public awareness requirements set by the legislation.
- **The GOAZ should request donor technical assistance to learn from international experiences in municipality financial management and improve the local budgeting processes.** As of now, there are no IFI or NGO proposals of assistance to the GOA or to the local governments on these issues.

**AZERBAIJAN REPUBLIC
PUBLIC INVESTMENT POLICY PROJECT**

**PARTICIPATORY PROCESSES IN LOCAL BUDGETING
ASSESSMENT AND RECOMMENDATIONS**

Introduction

The PIP project within its workplan's agenda had reviewed the status of public participation in public investment decision-making in Azerbaijan. The assessment has covered: a) current legislation and procedures for participation; b) stakeholder participatory practices in public investments; and c) participatory practices in five selected line ministries. Thus the paper has mainly focused on the status of the participatory process taking place in the planning and budgeting of the capital spending from the central budget. However, the overall picture of public participatory processes in public spending would not be complete unless the participatory process in the local budgeting (i.e. rayon and municipal budgets) is considered.

This brief note was initiated by PIP Project to tackle this missing component while focusing more on the aspects of municipal budgeting (i.e. the functional effectiveness of municipalities, revenue base and mechanism of subsidy allocation that is currently applied by MOF).

Rayon Budgets

There are 66 administrative cities and rayons subsidized in the annual state budget from the centralized expenditures (excepting the capital Baku, which plays the fund contributing rather than of the fund receiving role).

The preparation and execution of the rayon budgets are regulated by the "Budget System Law" and "Guidelines for the preparation and execution of the state budget". **This legislation does not prescribe any public participation in the preparation of rayon budgets.** Thus having the same preparation timeframe with the central budget, the rayon capital spending plans for the next fiscal year are drafted and submitted as response to the MOF's Budget Call Circular (by the 1 of July) and the MOED's PIP Call Circular (by the 20th of April). **In practice, there is not any public participation in the formulation of rayon budgets. All public awareness is limited to the discussion of rayons' revenue, expenditure and subsidy needs at the Milli Meclis in the discussions and approval of the annual budget envelope.**

The subsidy amount from the state budget calculated by the MOF for a rayon budget comes from the expected annual deficit between rayon budget own revenues and total expenditures. The MOF calculates the amount of subsidy to the rayon based on its own assumptions and usually drastically revises the rayon's forecasts of annual budget submission to the MOF.¹ In practice, the rayon budgets receive large portions of their budgets from the central budget. On average, 70-80% of rayon revenues are direct transfers from the central budget. **Majority of the interviewed local population stated that they have never been involved in any public awareness activities held by rayon executive committees with regard to their capital spending.**

Municipal budgets

¹ This revision is to be expected because the incentives for the rayons are to underestimate revenues and overestimate expenditures.

The issue of public participation in the preparation of municipal budgets seems to be better articulated in the current legislation in comparison to the absence of any legislative commitments set for the public participation in the rayon budgets. Thus, according to the “Budget System Law” and the “Law on basis of municipal finances”, the municipalities should ensure the public awareness of their budget at the stage of budget discussion, approval and execution. (See. Figure 1).

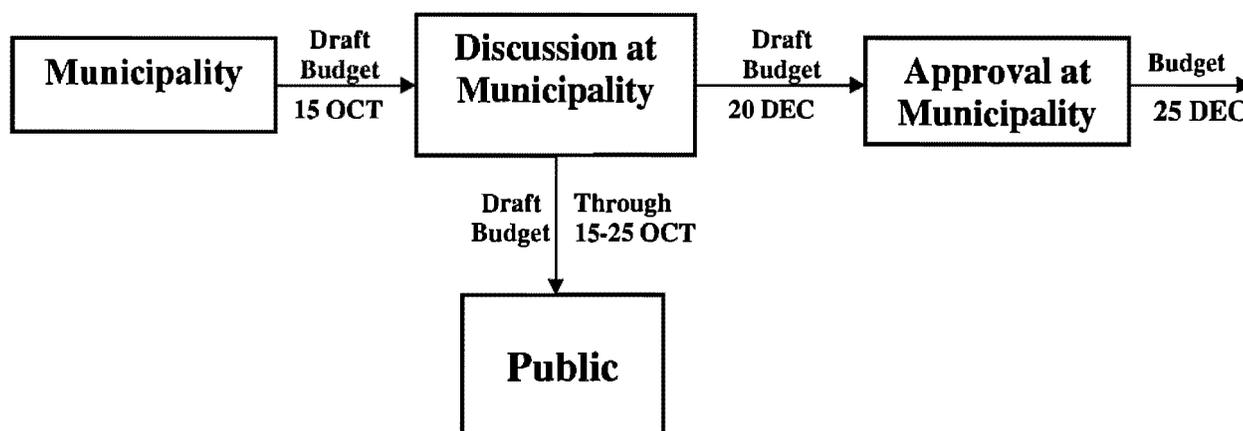


Figure 1. Process set by legislation for the preparation of municipal budgets

Municipal development and the issues of fiscal decentralization are important for the successful development and implementation of the national strategies and goals. Fiscal decentralization has many benefits, especially when it brings beneficiaries much closer to service providers, thereby improving accountability. However, this must occur within a framework in which responsibilities are clearly and unambiguously defined and this is linked to a clear revenue source. **There is an urgent need to clarify and specify more rigorously the public expenditure role of municipalities and rayons and to ensure that the objectives and goals set out in the MTEF, PIP, SPPRS and SPSEDR are not undermined by confusion over the responsibilities for the achievement of these objectives.**

In formal budget support requests, the statements of priorities of municipal development programs may not appear in alignment with the national and regional strategies. This is one of the reasons that their fund requests fail. These priorities are very local but they also certainly represent the core of the SPSEDR and SPPRS because the national strategies are the amalgamation of peoples' priorities. Hence, it is more of a practical problem that most of the municipality subsidy requests do not express formally the regional targets and activities outlined in the specific (region based) parts of the national strategies (particularly SPSEDR). Instead, the requests justify projects based on the municipality immediate needs in a format and language which may fail to communicate the broader development policy links. As a result, the narrow and direct descriptions and justifications of the municipal projects fail to gain acceptance readily by the rayon and MOF officials when pursuing funds for implementation. **The municipalities are generally unaware of the planned capital spending at the level of rayon budgets, SPPRS and SPSEDR that leads to an ineffective targeting of the limited municipal resources.**

In rayon and municipal budgets, the local revenues fall well short of required expenditures. To make up for the short-fall, the local governments request budget support with direct transfers from the central government. There are significant differences in the amounts of transfers between the rural and the city municipalities due to the per capita subsidy allocation used by the MOF. The higher

populations in the cities favor the cities in receiving total transfers where own resources of cities are already more robust.² The representatives from smaller municipalities questioned the MOF's current approach of per capita subsidy allocations which does not account for differences in local fiscal conditions and the cost of providing the same public service in different locales. Compared with the rayon budgets, the municipal budgets receive much smaller ratio of their budgets as transfers, on average 5-10%.

It appears that there are two issues that the municipalities grapple with related to realizing their development programs. One issue is structural in terms of basic inadequacy of municipality fiscal bases and in terms of calculation of subsidies that does not make enough differentiation among priorities. The other one is more practical issue based on presenting and communicating the justification of the budget transfer requests for the development programs.

Most of the interviewed municipality representatives stated that the local tax base needed reconsideration (i.e. more funds from local taxes should remain under the municipal authority). Currently, the MOF and the Ministry of Taxes are reviewing a proposal to provide the municipalities with the right to collect the juridical property tax. Moreover, MOF has considered several alternatives to the current subsidy mechanism and is finally supporting an idea of a program-based subsidy allocation. These measures, if implemented, may improve the level of effective implementation of municipal development programs caused by financial constraints.

The accountability of the municipal elected bodies and executive branches is not properly ensured from a financial standpoint. Indeed, the law does not provide clear rules and procedures in this regard. Although local budgets should be compliant with the general standards of budget preparation in use, there are no minimum financial safeguards determined transparently at the national level and no standard local budget formats and reporting procedures.

Follow-up and Recommendations for GoA:

- The lack of clarity regarding the separation of the responsibilities of the central government and the municipalities creates confusion in oversight, decisions, and management in key areas such as taxes, municipal assets, local infrastructure, and facilities. Therefore, **the legal framework needs to be further developed**, and an adequate implementation plan should be defined and followed by the Government, as laws would be worthless if they were not implemented after being adopted by the Parliament.
- **The annual MOF Budget Call Circular (BCC) to the rayons has a two-page annex for the municipalities. This annex needs to be improved to provide more explanation and guidance** on what exact information is required and how it should be presented. In particular, MOF can attach to its BCC sample formats of information and descriptions of rayon/municipal social-economic program (i.e. unified project concept paper) or examples of sound budget subsidy justification. The local MOF offices should facilitate this process of education and information dissemination.
- **The rayon and municipal officials who deal with the planning and budgeting issues should implement, incrementally, public participation practices at all stages of the local budget cycle.** Currently, only municipalities provide public information solely to report on semiannual and annual budget performances. Providing command, guidance and training/education to the local offices with respect to transparency and participation in local budgeting would have to come, initially, from the MOF and the MOED central offices.

² The per capita based calculations may already have problems due to the unreliable statistical information used by the MOF (i.e. it doesn't reflect the huge migration of labor force to Russia).

- **Define and implement the government policy and administrative action plan for municipalities that would address:** (i) the issues of clarification of the functions and responsibilities between the local branches of the state administration and the municipalities; (ii) the issues of adequate and homogeneous budgeting systems for municipalities; and (iii) the establishment of transparent safeguards and controls for municipal budgeting systems.
- **Strengthen the financial, technical, and managerial capacity of the newly created municipalities,** allowing them to: (i) preserve and invest in local infrastructure and facilities, (ii) provide reliable access to basic infrastructure and services, and (iii) foster economic development by removing the barriers to private sector development.
- **The GOAZ should assist with implementing effective observance of the budgetary stipulations of municipal legislation.** The current situation would substantially improve if the local officials followed the reporting, auditing and public awareness requirements set by the legislation.
- **The GOAZ should request donor technical assistance to learn from international experiences in municipality financial management and improve the local budgeting processes.** As of now, there are no IFI or NGO proposals of assistance to the GOA or to the local governments on these issues.



Attachment 3 (a).

**Study Tour for Governmental Officials to Turkey
in the framework of USAID PIP Project
June 26- 30, 2006
Ankara**

AGENDA

June 25 2006, Sunday

Arrival to Ankara and registration at Hilton SAS Hotel.

June 26, 2006, Monday

- 09.00 – 09.30 Visit to TİKA's Head Office in Ankara
*Atatürk Bulvarı, No: 15
Opera Meydanı, Ulus – Ankara
(meeting with Mr. Musa Kulaklıkaya, Acting President, TİKA)*
- 10.00 – 12.00 State Planning Organization
*Necatibey Caddesi, No: 108
Yüce-tepe – Ankara
(meeting with Dr. Əhməd Tıktık, Head of SPO and three deputies: Mr. Birol Aydemir, Mr. Halil İbrahim Akça, and Mr. Lütfi Elvan).*
- 12.15 – 13.45 Lunch (by SPO)
- 14.00 – 15.00 SPO (*meeting with Annual Programs and Market Evaluation Dept. Head.*)
- 15.30-16.30 SPO (*meeting with Economic Models and Strategic Research Dept. Head.*)
- 20.00 – 23.00 Banquet by Azerbaijani team
(Ankara Hilton Hotel, Marko Polo Hall)

June 27, 2006, Tuesday

- 10.00 – 11.00 State Planning Organization (*meeting with Economic Sectors and Coordination Dept. Head.*)
- 11.30 – 12.30 SPO (*meeting with Social Sectors and Coordination Dept. Head.*)
- 12.30 – 13.15 Lunch (by SPO)
- 13.30 – 14.15 State Planning Organization (*meeting with Regional Development and Structural Management Dept. Head.*)
- 14.15 – 15.00 SPO (*meeting with European Union Cooperation Dept. Head.*)
- 15:30 – 17:00 Visit to Anitkabire (Ataturk's Tomb)

June 28, 2006, Wednesday

- 11:00 – 12.00 Büyük Millət Məclisi (Parliament) of Turkey
Budget Planning Commission
Dr. Sait Acba, Head of Commission
- 12.15 – 13.15 Lunch
- 14.00 – 16.00 Treasury (Meeting Room, 15th floor)
*İnönü Bulvarı, No: 36,
Emek – Ankara*

June 29, 2006, Thursday

- 10.00 – 12.00 Ministry of Foreign Trade
*İnönü Bulvarı, No: 36,
Emek – Ankara
(Opening Remarks and Presentation)*
- 12.15 – 14.00 Lunch (by Ministry of Foreign Trade)
- 14.30 – 16.30 Ministry of Foreign Trade
- 20.00 – 23.00 Banquet by TİKA
*Kale Washington Restaurant
Doyran Sokak, No: 5–7, Kaleiçi – Ankara*

June 30, 2006, Friday

- 10.00 – 12.30 Ministry of Finance
*İlkaddım Caddesi, No:6
TBMM Karşısı, Dikmen – Ankara
(Presentation and meeting with Mr. Hasan Basri Aktan, Secretary
General, Ministry of Finance).*
- 13:00 – 14:30 Lunch (by MOF)
- 16:00 – 17:30 Central Bank of Turkey
*Mr. Durmus Yilmaz, Head
Dr. Erdem Basci, Deputy Head*

July 1, 2006, Saturday

- 20:00 Departure

**Study Tour for Azerbaijan Officials
in the frame of USAID and PIP Project
Ankara, Turkey June 26-30, 2006**

List of Participants

No	Names	Positions	Agencies	Contact numbers
1	Ruslan Abdulalimov	Head of Investment and Technical Programs Dept,	Ministry of Culture and Tourism	498 2009
2	Farzali Gadirov	Head of Strategic Analysis and Planning Dept	Ministry of Education	496 3515 (com.)
3	Firdovsi Aliyev	Deputy Minister	Ministry of Ecology and Natural Resources	492 4173, 441 4205 (com.)
4	Fizuli Ismayilov	Head of Finance and Accounting Division	Ministry of Ecology and Natural Resources	492 4173, 441 4205 (com.)
5	Ogtay Hagverdiyev	Head of Economic and Financial-Credit Policy Dept	Cabinet of Ministers	492 1779, 492 7415
6	Shahin Sadigov	Head of Economic Policy and Forecast Department	Ministry of Economic Development	4928425
7	Mikayil Jabbarov	Deputy Minister	Ministry of Economic Development	492 4110 (com.)
8	Farman Safarov	Deputy Head of Dept. of Transportation Policy and Economics	Ministry of Transport	433 99 60
9	Faig Alekberov	Head of Financial and Credit Dept	Ministry of Transport	431 4636
10	Mahammad Beydamirov	Deputy Head of Economic Dept	Ministry of Industry and Energy	431 80 73
11	Hafiz Humbatov	Head of Financial Department -Chief Accountant	Ministry of Industry and Energy	431 8012 (com.)
12	Ilgar Fatizade	Deputy Minister	Ministry of Finance	493 14 84
13	Rafiq Huseynov	Acting Head of Projects' Financial Appraisal Dept	Ministry of Finance	493 29 62 493 81 03 (3-13)
14	Khagani Abdullayev	Monetary Policy Dept. Director	National Bank of Azerbaijan	493 11 22 (commut)
15	Mete Durdag	COP	PIP Project	498 83 37

**Back-to-Office Report for Study Tour of GOAZ Group
Prepared by Mete Durdag,
Chief of Party, USAID Public Investment Policy Project
June 26-30, 2006 Ankara, Turkey**



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Memo

To: Geoff Minott, CTO, USAID
From: Mete Durdag, COP
CC: Dan Rathbun, DAI/HO, Bethesda, USA
Date: July 21, 2006
Re: Study Tour to Ankara, Turkiye

As you know, the PIP Project arranged, with funding provided by World Learning, Inc. (WLI) and logistics and programming help by Turkish Cooperation and Development Agency (TIKA), a study tour to Ankara during June 26–30, 2006 to learn about Turkiye's recent experience in integration of planning, investment programming, and budgeting. The participants' list and the tour program are attached to this memorandum. The tour was conducted and completed as planned, and the participants hopefully returned with significant new thoughts and ideas concerning possible improvements in planning, budgeting, and investment programming in Azerbaijan. I shall present here an account of the study tour and possible lessons that we may draw from it.

This "back-to-office report" is meant to answer information requirements of all agencies and individuals involved in the Study Tour, whom I shall each send a copy of it. For this reason, the memo will be rather long and perhaps too detailed in parts. I am, however, organizing it in sections so that audience can read it selectively.

Background

The PIP Project's Training Program envisages arranging study tours abroad for the selected officials of GOAZ to learn about other countries' technical information and experiences relating to planning, investment programming, and budgeting. Since its inception in March 2006, PIPP has done extensive work on how to further strengthen GOAZ's capacity for better planning and investment programming with a view to more effective integration of them with government budgeting. To this end, PIPP has produced and distributed several technical notes and slide presentations; discussed them with technical cadres of MOED, MOF, and the selected line ministries; arranged two rounds of formal multi-week training for mid-level

managers as well as experts from the said ministries; and held a one-day workshop for high-level participation from GOAZ, including the Parliament and the PM's Office, IFIs, and key donor countries. A study tour abroad has thus been conceived on this background as a means of more effective dissemination of PIPP's proposals so far by showing them working in another country.

Selection of Turkiye

Initially, PIPP has given to WLI the names of four countries (Malaysia, Poland, Slovakia, and Turkiye) for arranging a study tour to the one that would be receptive to such a request. We have however realized soon that it would take too long to finalize this project through the usual WLI procedure of holding a tender for private consulting firms in the said countries to make the necessary arrangements. PIPP has therefore approached the TIKa Office in Baku and inquired if they could work with WLI to make the necessary logistic arrangements and liaising with Turkish authorities. Mr. Raif Kutluk, TIKa's Program Coordinator in Baku, very much welcomed the idea and arranged for me to convey my request personally to Mr. Lutfi Elvan, Deputy Undersecretary of the State Planning Organization of Turkiye, who happened to be on an official visit to Baku. From then on, both Mr. Kutluk and Mr. Elvan have done their best to have this study tour realized.

Turkiye's selection out of the four candidate countries was thus a pragmatic choice. But there were good reasons for Turkiye's inclusion in the initial group of four candidate countries:

1. Turkiye has rich experience in development planning, having just completed the implementation of its 8th Five-Year Development Plan, 40 Annual Programs, and the same number of annual Public Investment Programs.
2. In addition, the Government of Turkiye (GOT) adopted from this year a Medium-Term (3-year) Program as well as a Medium-Term Financial Plan, in line with the WB and EU recommendations to improve linkages between planning and budgeting.
3. Turkish Economic Ministries/Agencies' web-sites are far better than most other countries'; this provides good potential for follow-up work on the Study Tour findings.
4. Language advantage, as in both countries people speak Turkish.

Selection of Participants

The study tour was mainly intended to bring together several key decision makers on plan-budget-PIP related matters from both the central Economic Agencies and the selected line ministries and give them opportunity to contemplate for a whole week what Azerbaijan needs to do for more efficient use of public resources. In this respect, Azerbaijani participants would benefit from listening to the presentations by their Turkish counterparts and exchanging views with them through questions and answers as well as from interaction and discussion with each other on the topics of each after completing the day's program. Upon PIPP's request, the cooperating GOAZ agencies each nominated one or two high-level (deputy minister or director level) representatives to participate in the study tour.

The GOAZ team that was formed for this study tour has indeed proved to be most appropriately composed for the task, as the all team members have shown high professional and intellectual qualities in interactions with their Turkish counterparts and strong interest to learn most from this opportunity provided to them. Due to heavy work pressure back in Baku, however, Mr. Jabbarov, Deputy Minister of MOED, could join the program only for the first two days, and Mr. Firdovsi Aliyev, Deputy Minister of Ecology and Natural resources, for the first three days.

The US Treasury's Budget Adviser at the MOF, Ms. Linda Decker, also wanted to join the tour together with her assistant/interpreter, and PIPP welcomed her request after checking with CTO. Finally, PIPP planned to send on this tour Dr. Durdag, COP, and Ms. Sevinj Hasanova, Public Finance expert, on the project's account. Ms Hasanova, however, had to

cancel her trip at the last moment on account of a family matter. Dr. Durdag's participation in the trip proved to be helpful during the meetings as this was acknowledged by the several members of the team.

The Study Tour Program

For this study tour, **the PIP Project has identified seven main areas of interest** both to GOAZ and the project and requested WLI, TIKA and the State Planning Organization (SPO) of Turkiye to help arrange the presentations and discussions focused on them.

These seven areas were as follows:

- The legislative and institutional set-up for development planning and public investment policy and program (PIPP) formulation;
- Linkages between medium-term macroeconomic and sectoral development framework;
- PIPP formulation, prioritization, substantiation, and approval for financing, and its integration with development planning, and budgeting;
- Project preparation, appraisal and financing;
- Techniques of project analysis: financial, economic, social, technical, and environmental;
- Public participation process in PIPP preparation, approval, implementation; and,
- Lessons learned from the PIPP implementation in Turkiye.

The program prepared by TIKA Head Office in Ankara jointly with the cooperating agencies was arranged by agency and department as seen from Attachment. The presentations were not therefore focused on the issues identified by PIPP, but we somehow managed to steer them towards our concerns with our questions and comments.

The five-day program was arranged so as to have intensive sessions with the key central economic agencies of Turkiye, including the State Planning Organization (SPO), Undersecretariat for Treasury, Undersecretariat for Foreign Trade, and MOF. Upon our request at the first meeting with TIKA, the Plan-Budget Commission of Parliament and the Central Bank were also added to the program. Finally, in response to a strong demand from all Azeri members of our team, TIKA also made room in our program for a visit to Ataturk's Mausoleum

SPO hosted our team for the first two days of our program. We were met by the Director of International Economic Relations, Mr. Ferruh Tigli, who accompanied us throughout our program at SPO, and introduced us to Dr. Ahmet Tiktik, Undersecretary of SPO, who, accompanied by his three deputies, gave us a warm welcome and an introductory statement on recent developments in the Turkish economy and in planning and budgeting procedures. During the two-day program at SPO, the General Directors of the Departments of Annual programs and Conjuncture Evaluations; Economic Models and Strategic Research; Economic Sectors and Coordination; Relations with the EU; and Foreign Economic Relations, accompanied by their deputies and/or division chiefs, gave us presentations on their responsibilities and functions and answered our questions both during presentation and afterwards.

Established almost half-a-century ago, SPO has gone through a remarkable evolution in its functions in parallel to changes in dominant systemic features of the Turkish economy from a typically mixed economy with heavily protectionist policies in the 60s and 70s, to a rapidly liberalizing economy with full opening up to world economy in the 80s and 90s, and to almost complete market- and private-sector-based economy accompanied with gradual decentralization of public administration since early 2000s. It was interesting to hear about SPO's recently evolving functions in the form of adoption of a Medium-Term Program as well as a Medium-Term Financial Plan as layer introduced between their Seven-Year

Development Plan and Annual programs in order to improve integration of planning with budgeting. They also emphasized that SPO has been moving towards more general central planning while establishing the regional development agencies at regions for the planning of local development. They also seemed to pride themselves that SPO was serving as the brain of the economy in its capacity of Secretariat to the High Planning Council, which is a Cabinet cluster of main Economic ministers and some key line ministers.

Our program at SPO was completed with a quick tour of the Library. It was an eye-opening experience for all of us to know that the SPO Library had over 70,000 documents; exchange programs with all major libraries in Türkiye and abroad; a large subscription program for Turkish and foreign periodicals; a documentation section for unpublished materials and SPO archives; and a rapidly expanding e-library program.

Next in the program was a half-day session at the **Undersecretariat for Treasury (UT)**. We were welcomed by Mr. M. A. Akcay, the Director of External Economic Relations, who made a brief statement on broad functions of Treasury in Türkiye. Mr. Akcay seemed to be the right person to answer the several questions that Mr. Ilgar Fetizade, First Deputy Minister of Finance, had prepared, but he unfortunately excused himself after a brief statement to meet a Spanish Delegation while leaving us there with three young experts. This was a rather disappointing experience we had during our program in Ankara, and certainly calls for some efforts by UT to mend the resulting loss of goodwill of the Azeri delegation, particularly Deputy MOF who also oversees Treasury. The slide presentations by the three experts explained in detail (i) the important role of UT in external borrowing for investment projects of the public sector agencies whether included in the General Budget or not; (ii) types and terms of Treasury guarantees; and (iii) UT's role in overseeing the World Bank's loan portfolio for Türkiye, which currently includes 20 loans for a total amount of \$6 billion.

Visit to the **Plan and Budget Commission of the Parliament** (Grand National Assembly of Türkiye) was brief, and turned out to be not much interesting to our Azeri colleagues, perhaps because Azerbaijan Milli Mejlis has still long way to go before it can exert any influence on the plan-budget-investment program processes. The statement by Dr. Sait Acba, Chairman of the Plan and Budget Commission, particularly emphasized (i) the Commission's full access to any information it may require from any government agency; (ii) the statutory obligation of the Government to submit to Parliament the annual Final Accounts within 3 months of the completion of a fiscal year; and (iii) the importance of the external audit of all public agencies by Sayistay (the Independent Chamber of Accounts) on behalf of the Parliament.

The fourth day of our program was fully taken up by meetings at the **Undersecretariat for Foreign Trade (UFT)**, where we were extended a warm welcome and utmost care together with presentation of an overwhelming amount of information on Türkiye's foreign economic relations. Information on Türkiye's relations with a number of regional multilateral organizations was of interest to the members of our team because Azerbaijan was also a member in most of them, including the Organization of the Islamic Conference (OIC) and its Permanent Committee of Economic and Trade Cooperation (COMCEC), Economic Cooperation Organization (ECO), and Black Sea Economic Cooperation (BSEC). Presentation on Türkiye's bilateral economic relations engendered interest of our group particularly with respect to the volume of trade with Azerbaijan, Türkiye's border trade with its neighbors, and Türkiye's FDI and Construction Companies abroad. The general feeling, however, was that our program at UFT could have been confined to the areas most relevant to PIPP-related topics in order to make time available to extend the program at MOF or Treasury to a full day.

We spent our fifth and final working day in Ankara at the **Ministry of Finance (MOF)** and the Central Bank. At MOF, we were met by Mr. Halit Ocal, Director of EU and Foreign Affairs Department, and a number of division chiefs and experts. Mr. Hasan Basri Aktan, Undersecretary of MOF invited up to four members of our group to his office. Messrs. Fetizade, Haqverdiyev, Sadigov and I met with Mr. Aktan in his office and received most

welcoming and appreciative words for our visit to MOF. He also expressed thanks for USAID and the PIP Project making this visit possible and assured us that his Ministry was ready to extend any kind of technical assistance and cooperation that may be required by Azerbaijan. He then accompanied us down to the Conference Room and remained with us during two-and-a-half hour presentation. Mr. Aktan was interrupting the presentation at times to give clarifying explanations, and was personally responding to Mr. Fetizade's questions and making sure that his information requests were met immediately.

The MOF presentation gave an effective overview of public sector financial reform efforts in Turkiye initiated in 1995 by the signing of the Public Sector Financial Management Project with the World Bank. The project has produced a large number of reports through year 2000, when GOT started adopting serious institutional and procedural reform measures in line with the WB recommendations. Over the past five years, Turkish public financial management system has been completely overhauled, with the introduction of a new public sector accounting and budget classification system; dissolving all extra-budgetary accounts; establishing strong discipline over public debt management; building up a web-based automated public sector accounting system in 2001 and e-budget system in 2003; and finally enacting in 2003 a new Public Sector Financial Management Law (PSFML). Over the past three years, GOT has prepared all secondary legislation, implementation procedures, and reporting formats that would be needed for the effective implementation of PSFML, which was introducing the multi-year budgeting practice as well as a Medium-Term Program and a Medium-Term Financial Plan to better bridge the annual budget and the public investment program with the Seven-Year Development Plan. An equally significant reform action was the establishment in all budgetary agencies of Strategic Planning Units that would be in charge of the preparation of all budgeting, investment programming, and planning documents in close cooperation with the Strategic Planning Department of SPO and with MOF. Turkiye thus began in 2006 her multi-year budgeting experience, together with a MT-Program and a MT-Financial Plan, following meticulous preparations, and both MOF and SPO rightly seem to be sure that everything will work without significant hitches.

The final Agency on the Study Tour program was the **Central Bank of Turkiye (CBT)**. We were met by Mr. Suha Mirahur, Director of External Relations, and introduced to Mr. Dumus Yilmaz, one of the three Deputy Governors and other staff. Governor Yilmaz, who was appointed very recently upon the former Governor's completion of his term, extended to us a warm welcome and full cooperation of his institution for any technical support that Azerbaijan may require. Mr. Durmus also gave an overview of the CBT's current policies to control the then on-going mini-crises in financial markets of Turkiye, which was largely prompted by developments in the international financial markets. Mr. Durmus then left the meeting asking his Deputy, Dr. Erdem Basci, to continue acting as our host.

Our questions mainly focused on how reconciling the independence of CBT with the GOT's need to use the monetary policy as an active policy tool in macroeconomic management was working in practice. Dr. Basci agreed that the independence of CBT should not be interpreted as if it could stand aloof to the government's overall macroeconomic policies. At the end, the GOT could take the Bank in tow along its policies, but this would be going against to the government's own commitment to keep inflation under control. Hence, he emphasized that the Central Bank's independence was very much dependent on the government pursuing responsible fiscal policies. Last part of our meeting was taken by questions from Mr. Khagani Abdullayev of NBA and answers by Dr. Basci on issues relating to banking practices in both Azerbaijan and Turkey.

Organization and Logistics

The planning, coordination, and implementation of the Study Tour were smoothly carried out by a harmonious cooperation among PIPP-WLI-TIKA/Baku-TIKA/HQ-SPO.

The economy class air travel by Turkish airlines was comfortable, though the senior members of the Azeri delegation expressed their disappointment that they did not fly business class.

The group was booked in the Ankara Hilton Hotel, which offered good-size and well-equipped rooms at a corporate rate for TIKA of \$130 including breakfast (cf. \$210 at Radisson in Baku).

TIKA/HQ met us at Ankara Airport; arranged for two buses to be at our service throughout our stay in Ankara; arranged, with SPO's help, our program and made the last minute changes in it to meet our requests; assigned one native Azeri officer to accompany us to all meetings and to also help us with sightseeing and shopping arrangements; and finally hosted the group for a delightful dinner at an exquisite restaurant.

Mr. Musa Kulaklikaya, Acting President of TIKA, stated on several occasions that his organization was very happy about this cooperation with USAID and he hoped to have more of the same in the future.

Lessons to Learn

PIPP believes that this Study Tour offered great opportunity to the participating Azeri officials to make valuable observations relevant to their work and to establish contacts with their Turkish counterparts for cooperation to support Azerbaijan's efforts to reform her budgeting and investment programming systems. Most GOAZ officials, including many who participated in the PIPP Study Tour, however, have two misconceived beliefs that will hinder the potential benefits of the Tour from being materialized. These beliefs are as follows:

- a) Azerbaijan should look rather to the US and the west European countries for learning from others' experience because only those countries' systems and experiences have proven to be successful; and,
- b) Turkiye could not offer much to learn from her experience in multi-year budgeting and effective integration of planning-budgeting-investment programming, because she just adopted this practice from this year while Azerbaijan has already been implementing it over the past three years.

Instead of countering these beliefs, I rather prefer to highlight here my assessments, as listed below, of what we saw in the Turkish agencies, which were relevant to the PIP project and were educating at least for me. These observations, to the extent shared by the Azeri participants of the Tour, may be useful also to the GOAZ's planning, budgeting, and investment programming work.

Planning and Investment Programming

- 1) The work of all GOT agencies on the medium- to long-term development of economy is guided and supervised by the High Planning Council (HPC), which is a sub-Cabinet chaired by the Prime Minister and composed of 8 key economic and line ministers. The HPC, which dates back to 1960, is provided with secretariat services by the State Planning Organization (SPO), which is an undersecretariat reporting to one of the Prime Ministers.
- 2) SPO is a large, well staffed, widely experienced, and highly respected organization with important technical, advisory, and coordination responsibilities.
- 3) SPO owes its strength and prestige to its ability to adapt to the changing economic development strategies of successive governments. Since 2000, it has been de-emphasizing macro planning while developing its regional development centers for greater and closer emphasis on local development efforts.
- 4) As a result, SPO has been moving away from the comprehensive and large economic models, despite its great experience in such modeling, towards the use of simple consistency models, and also away from detailed five-year development plans to brief seven-year plan documents supplemented with separate implementation programs.

- 5) SPO has a Strategic Planning Department with close direct rapport with line agencies' Strategic Planning Units, which are responsible for the preparation of line agencies' Strategic Development Plans as well as their submissions to MOF and SPO for the medium-term budget and for the long-term, medium-term, and annual plans and programs.
- 6) All capital spending decisions must be evaluated and given visa before they can be included in the PIP, and no capital spending can be included in the budget unless first cleared by SPO for the PIP.
- 7) Over the 1990s, Turkiye's PIP has become overburdened with ever growing number of on-going projects while the average completion period of projects was becoming unacceptably longer. This was due to initiating more and more new projects while the overall size of PIP could not be expanded because of resource constraint.
- 8) SPO has dealt with this problem with a strict program of the rationalization of the PIP implemented since 2001 cutting down the number of projects in the PIP from over 5000 in that year to less than 2000 today. This is a remarkable testimony to the determination of the GOT to bring financial discipline and efficiency to its public expenditure management.
- 9) The large size and high professional capacity of SPO's Library and Documentation Center provides an indication of the high and wide range of technical capacity of SPO staff. SPO earns its influential position in the economic management of Turkiye not so much by its statute as by the quality of its work.

Government Budgeting

- 10) Turkiye started implementing multi-year (three-year) budgeting together with a Medium-Term Program (MTMF/MTEF) and a Medium-Term Financial Plan (MTFF) from 2006 after systematic and determined preparations since 2000. Obviously, Turkiye decided to change its budgeting and planning systems, which were in force since 1927 and 1960, respectively, along with those principles which had been gaining acceptance in all advanced countries, mainly because of its own assessment that the new systems would lead to more effective and efficient practices.
- 11) This has naturally been reflected in meticulously prepared procedures, extensive training of staff, and setting up the necessary IT technology network to ensure successful implementation of the new public financial management system once it was launched (see above). The IMF and WB should derive most significant lessons from this practice of Turkiye in re-evaluating their past coercion policies of hurrying the transition economies to adopt MTEF and MTFF without necessary statutory and technical preparations. Similarly, the transition countries, which are simply pretending to have multi-year budgeting and MTEF/MTFF, should look into Turkiye's practice if and when they realize that they need those instruments for their own good and not for pleasing the IFIs and donors.
- 12) Turkiye's government budget meets all the key budgeting principles like:
 - All government expenditures are included in the budget irrespective whether they are capital or current expenditures and whether funded from domestic or external sources;
 - SPO is responsible for the preparation of PIP, but all capital expenditures are budgeted and approved by the Parliament under administrative, functional and economic classification.
 - Full transparency and accountability are ensured by almost every means of legal and administrative framework. In this context, Parliament is given ample time (75 days) to thoroughly discuss the budget both at the committee level and on the floor, and each Ministry's budget is voted separately.

- The preparation of the multi-year budget, plan documents, and public investment program is all done with full inter-linkages with each other within a medium-term program and financial plan.

Treasury Function

- 13) Treasury is a separate undersecretariat reporting directly to the Prime Minister (currently through a Deputy PM).
- 14) Thus, the actual dispensing of public funds and checking all statutory requirements for each dispensing is vested in an agency other than the one(s) making and approving the spending decision.
- 15) Treasury does more than just a cashier's function, however; it forms a judgment and advises the GOT about the progress and prospects of the financial implementation of the current year's budget.
- 16) Treasury is particularly successful in public debt management. No state agency, other than Treasury, is allowed to negotiate and sign any external funding, including grants and GOT guarantees.

Monetary Policy

- 17) Monetary and credit policy is formulated by CBT, which has an independent status. Its Governor is appointed by the Cabinet of Ministers, subject to President's approval, for seven years and cannot be replaced.
- 18) Although independent of GOT, the CBT could implement a successful monetary policy only if the fiscal policy is conducted by MOF with an appropriate sense of responsibility for maintaining economic stability.
- 19) Similarly, the monetary and credit policy has to be consistent with funding requirements of both the public and private sector investment programs as planned and envisaged, respectively, by SPO. This is ensured by the necessary oversight of the "Money-Credit and Coordination Council", which meets as needed under a Deputy PM's Chairmanship, with CBT participating as one of the nine members and SPO bots as a member and Secretariat.
- 20) Our hosts in all three agencies (SPO, MOF, and CBT) were baffled by our questions about how they were succeeding in effective cooperation among themselves. For them, this was a natural process realized through routine communication among their staff at all levels as well as through the statutory review and decision meetings, culminating in the meetings of the High Planning Council.

General Observations

- 21) Perhaps the most striking observation of this Study Tour was about the high quality of all Turkish officials, both at technical and managerial level, whom we met in all agencies we visited. Obviously, they were all well trained and experienced in their fields, speaking English, and computer-literate.
- 22) I must add here my own explanation of the above observation: Most good graduates of the best Turkish universities aspire to join one of these key government agencies. For this they have to be successful in a nation-wide competitive examination, followed by a selection interview. New recruits join as assistant expert for three years, which is a probation period with special training programs both in-house and abroad to be concluded with a successful "expertship thesis". Once become an expert, his survival and promotion will depend not only on satisfactory performance but also on continually producing good quality operationally oriented papers. A visit to the web-sites of these agencies for just checking the long list and good quality of research papers by their experts will better explain this (www.dpt.gov.tr; www.tcmb.gov.tr; www.maliye.gov.tr; www.hazine.gov.tr).

- 23) All agencies we visited had good facilities and, most importantly, seemed to have online access to all government data as they were bringing to us any information we request in a few minutes. In any case, this is also apparent from a visit to the above web-sites and stands as a stark contrast to what is experienced in Azerbaijan and some other FSU countries, where a ministry should send a written request to another ministry for obtaining a standard data.
- 24) Turkiye has been progressing rapidly in the development of internet use to improve efficiency and accessibility of government services. The implementation of this policy has been progressing since early 2000s through the "E-Transition Turkiye" project managed by SPO (see www.bilgitoplumu.gov.tr; www.turkiye.gov.tr ; and <http://ekutup.dpt.gov.tr/plan/aep/e-dtr/2005.pdf>). In addition, the e-State project has been transforming government operations from being based on physical flow of information to web-based communications and data transfers (see <http://ekutup.dpt.gov.tr/bilisim/e-devlet/tr2005.pdf>). Finally, the accounting system of GOT, with more than 1600 accountancies spread across the country, now operates on an automated on-line accounting system, called "say2000i", capturing receipts and payments as they are made and producing up-to-date statements as needed.
- 25) Both Dr. Tiktik and Mr. Aktan, Undersecretaries of MOF and SPO, offered help to establish these systems in Azerbaijan if GOAZ was interested in them.

**Back-to-office Report for Study Tour of GOAZ Group
Prepared by Rafiq Huseynov,
Acting Head of Projects' Financial Appraisal Dept., MOF
June 26-30, 2006 Ankara, Turkey**

Within the framework of Public Investment Policy Project, USAID has financed participation of MOF key management in a study tour to Ankara, Turkey on June 25-July 02, 2006. Under the resolution of Minister of Finance (No.116, dated June 22. 2006) the ministry was represented by Mr. Ilgar Fatizade, first deputy minister and Mr. R. Huseynov, Deputy Head of Division for Financing National Economy.

The goal of the study tour was to introduce to GOAZ representatives Turkey's experience and best practices in the field of public investment programming.

The Azerbaijani group consisted of 10 managers from 7 government agencies: Cabinet of Ministers, MOF, MOED, Ministry of Industry and Energy, Ministry of Environment and Natural Resources and National Bank of Azerbaijan.

Pursuant to the agenda of the tour, meetings and discussions were held at Organization of Cooperation and Development, State Planning Organization, Ministry of Finance, Treasury, Foreign Trade Agency; participants studied practices and management models of the host organizations and exchanged views.

Furthermore, the Governor of the Central Bank, who is also the Chairman of Budget Committee under Parliament of Republic of Turkey met with Azerbaijani delegation.

During the study tour, participants became familiar with and discussed practices of Republic of Turkey in following areas: public investments programming, state budget's capital expenditure (public investment) projections, funding of public investment, 3 year development plan, 3 year financial plan, external economic relations, foreign trade turnover of the country, monetary-credit policy implemented by the central bank, discussion of draft state budget in the parliament and other issues.

During the program, GOAZ representatives also got to know achievements of Turkey in implementing public investment policy and program.

Participants of the study tour also reviewed Statute of Ministry of Finance, structure of its central apparatus, scrutinized legislative acts related to financial management and supervision, as well as budgeting. These activities were followed with intensive discussions and exchanges of views.

Representatives of Government of Turkey informed their Azerbaijani counterparts of how the issues prescribed in the study tour are regulated by relevant legislation; Azerbaijani counterparts obtained sample material on target subjects, including fiscal policy, budget legislation with purpose of using these materials in practical work.

Based on the proposals arising from review of materials obtained during the aforementioned study tour, collegiums of MOF resolute:

1. Following should be taken into account:

- MOED in coordination with MOF and COM should prepare medium term (current year and following 3 years) draft public investment program and present it to the President of Azerbaijan Republic for approval;
 - State budget's capital expenditure (public investment expenditure) projections should be based on approved public investment programs;
 - Capital repair expenditure should not be projected in public capital expenditure of state budget; and should be reflected within the budgetary lines (i.e. capital repair expenditure line) of the budgetary institutions given in functional classification.
2. Ilgar Fatizade, first deputy minister; M. Agazade and R. Huseynov, Head and Deputy Head of Division for Financing National Economy should ensure following:
- With purpose of regulating public investment programming issues mentioned in Paragraph 1 above, I. Fatizade, M. Agazade and R. Huseynov should closely participate in preparation of draft guidelines for preparation, monitoring and implementation of public investment program; coordinate their work with relevant units of MOED; regularly inform ministry's management on the progress;
 - Until issues mentioned in paragraph 1 are regulated, projects lacking cost-estimates and expert appraisal should not be included into annually approved public investment program;
 - The aforementioned managers should submit to MOF's management, proposals regarding approval of capital expenditure breakdown by agency in annually approved state budget (including the name of investment project and total investment) and changes/amendments to relevant legislation within 1 month after enforcement of this resolution. These proposals would be later delivered to the Cabinet of Ministers for approval;
 - Proposals regarding changes/amendments to legislation, requiring that expenditure related to budget funded construction of residential, non-residential and other buildings be considered solely in public investment program and forecasted in capital investment expenditure, should be submitted within 1 month after approval of this resolution.
 - With purpose of more effectively regulating MOF's authorities and duties related to public investment policy, proposals on amendments/changes to the Statute and structure of the central apparatus of the ministry should be presented within 1 month after approval of this resolution.
3. Authority for implementation of this resolution shall remain after me.

**Back-to-office Report for Study Tour of GOAZ Group
Prepared by Khagani Abdullayev,
Head of Monetary Policy Dept., NBA
June 26-30, 2006 Ankara, Turkey**

Organization of Macroeconomic Management in Republic of Turkey

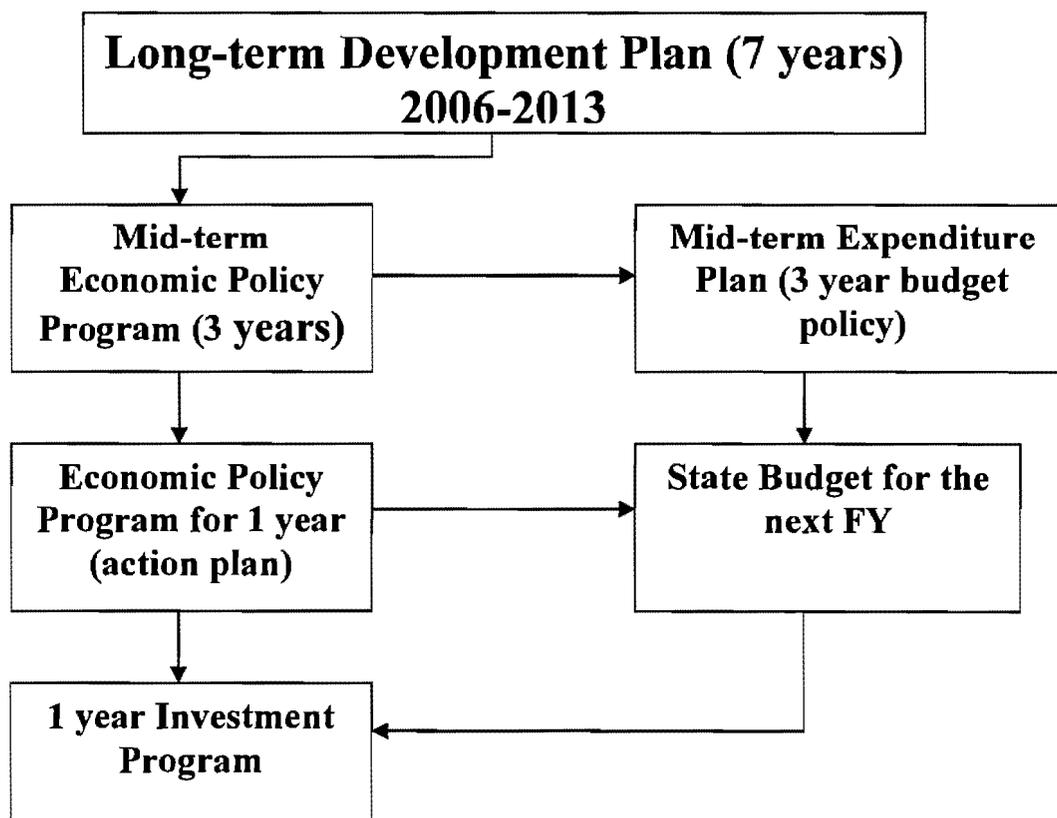
Institutional framework. State Planning Organization (SPO) of Republic of Turkey is the state body responsible for developing and implementing short, medium and long term macroeconomic policy. SPO is directly accountable before the Prime Minister and is the state's strategic apparatus for economic policy.

SPO has a representative in each ministry and these representatives monitor achievement of targets set in national programs (in other words they guard/ensure planned economic "stability")

Ministry of Finance and Treasury also have certain responsibilities related to macroeconomic management.

Macroeconomic and budget policy strategy in Turkey is established by High Policy Planning Council (HPPC) comprising 8 key ministers + the Prime Minister.

Macroeconomic Management Mechanism in Turkey



Long and medium term programs. As can be seen, the country's long-term economic policy framework is prescribed in 7 year Plan (Development Plan). This plan identifies major national development targets, as well as macroeconomic and structural objectives.

The 5 key objectives of the Plan are:

- To strengthen the country's international competition capacity;

- To increase employment rate;
- To develop human capital and ensure social solidarity;
- To expedite regional development;
- To improve the quality of state services (expenditure).

Broad public discussions are held and about 60 committees function with purpose of developing this plan. General Development Plan is formulated based on the reports of these committees.

After preliminary approval from HPPC, the Plan is submitted to the Parliament for approval. The Parliament's approval has following objectives:

- Adhere to democratic principles in approval of the plan;
- Ensure compliance of laws to be approved with National Plan.

For phased implementation of this plan 3 year Medium Term Economic Policy Program (MTEPP) was adopted. This program details global targets prescribed in the National Plan. The program reflects 3 year development strategy for each sector identifies sub-targets of 5 key goals of the National Plan and delineates activity programs to achieve these targets.

MTEPP identifies macroeconomic targets, including 3 year inflation targets. As monetary policy of the Central Bank of Turkey functions in inflation targeted regime, **the Government in all cases takes into account the Central Bank's opinion when identifying MTEPP's budget deficit/GDP and budget expenditure.**

Following preparation of MTEPP, Medium Term Financial (Fiscal) Plan (MTFP) is developed as its financial support (financing economic policy program). MTFP is developed jointly by SPO, MoF and the Treasury and reviewed and approved by HPPC by the end of may.

Importance of MTFP. MTFP is a financial document (financial program) which reflects government's medium term economic priorities and prescribes for top-down planning of budget expenditure.

Annual budget expenditure volume is formulated on the basis of macroeconomic framework (*deficit/GDP, inflation, debt/GDP etc.*) initially identified by the government, not budget requests of certain ministries and organizations.

MTEF identifies 2-step limit system: *i) global limit and ii) sectoral limit.*

Global limit identifies overall limit for increase in budget expenditure for the period of 3 years, specifying every year. Limits for each sector (health, education, defense etc. functional classification) are identified within the overall limit. These sectoral limits are calculated on the basis of each sector's strategic goals.

Sectoral limits are based on each sector's development strategy in MTFP and are invariable. However, these limits could be revised on 2nd and 3rd years of MTFP.

Upon receipt of these limits, every relevant ministry starts allocation expenditure among the organizations. In this process every ministry responsible for a certain company is free to set the limit.

After these limits are distributed among state enterprises, relevant organizations prepare strategic plans and justify outcomes/results to be achieved from the allocated resource envelop – (these results have to conform with 7 year National Plan).

Medium term capital expenditure and medium term current expenditure for MTFP are planned respectively by SPO and MoF.

SPO sets investment limits for each ministry and subordinating organizations. Medium term investment program is separately discussed at HPPC, These discussions are attended by all sector ministries and the chairman of the central bank.

The Prime Minister issued "Guideline on Public Investment Policy" to ensure preparation of investment program on technical level (by the enterprises).

Annual Budget Cycle. Upon approval of MTFP in May, the document is acknowledged to the public. Following this, preparation of detailed state budget for the 1st year of MTFP is started.

Similar to MTFP, SPO and MoF start planning (June-August) respectively annual public investment program and current budget expenditure, taking into account National Plan targets and sectoral constraints. MoF summarizes the budget when current and capital expenditure are ready. Draft budget is reviewed and approved by HPPC.

State Budget is submitted to the Parliament no later than October 17. MoF officially presents state budget to the Parliament. The Parliament should approve the budget no later than 75 days before the end of year.

At the same time HPPC should approve by the end of October next year's economic policy program (Action plan) which was the basis for the annual budget. This plan is developed jointly by SPO, MoF, Treasury and Central Bank.

The Parliament approves annual budget's capital and current expenditure limits for each sector (ministry).

Every ministry should adhere to the budget limit set for it. *However, every ministry can independently (i.e. without addressing SPO or MoF) make item relocations between current and capital expenditure by 20% of the limit set for the ministry.*

Public Investment Program. Annual program of detailed investment projects by enterprises is approved by SPO no later than January 10.

External funding source of every project in annual investment program should be agreed with the Treasury. Because, the Treasury can perform detailed economic analysis of the project and is responsible for concluding external credit agreements on behalf of the government. No public projects can receive external funding without Treasury's approval. If state enterprise has an old external arrear or low solvency, Treasury may refuse to sign external credit agreement.

Every ministry has a Council analyzing feasibility studies (Technical Economic Justification) of investment projects.

SPO performs monitoring of investment programs of organizations and reports to HPPC on quarterly basis. Broad reporting is done on annual basis (all details of project's economic classification – fixed asset, wages/salaries, rapidly aging assets etc.)





USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

Attachment 4.

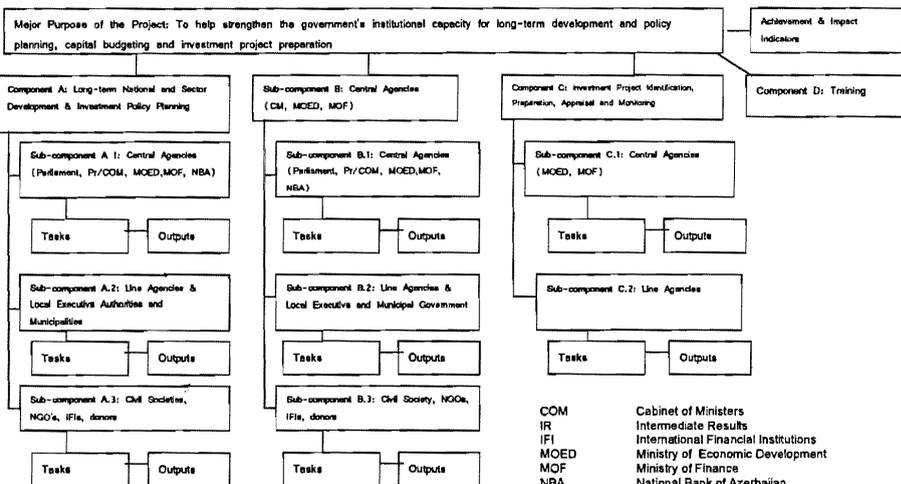
**AZERBAIJAN:
PUBLIC INVESTMENT POLICY PROJECT**



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

PIP Project Roadmap Structure





USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component A: Development Objectives, Strategies and Investment Policies Key Issue 1. Lack of Guidance for PIPP Preparation

Problems:

- No GOAZ leadership to set a National Development Framework (NDF).
- Lack of technical capacity at Central Ministries (CMs) for NDF.
- Disconnect between macro-policy, planning, and budgeting instruments.

PIP Project Inputs:

- Help establish the High Policy Planning Council (HPPC).
- Help MOED to:
 - Develop Medium-Term Macroeconomic Framework.
 - Establish framework for a JCC for SPPRS/RDP/PIP/Budget.
 - Draft procedures for the above as input for PIPP Manual.

PIP Project Progress and Next Steps:

- A Technical Note (TN) on macroeconomic policy coordination disseminated.
- A TN on preparing 2007-2010 MTMF; training on RMSM-X in Moscow and Baku; and background work for FPM.
- A JCC for PIP 2007-10 was issued. Training was given to MOED and LMs.
- The draft PIPP Manual has procedures on MTMF and JCC.
- Success depends on enforcement decreed by President. USG support is crucial.

3



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component A: Development Objectives, Strategies and Investment Policies Key Issue 2. Poor Capacity to Formulate SDPs

Problems:

- SDPs are not based on NDF.
- SDPs are used to avoid scrutiny by MOF & MOED.
- SDP programs and sector budgets are not linked.

PIP Project Inputs:

- Help develop procedures to prepare SDPs.
- Work with selected LMs to prepare SDPs.

PIP Project Progress and Next Steps:

- A TN on SDP has been disseminated to MOED and selected LMs.
- Draft PIPP Manual includes SDP procedures.
- SDP dissemination to new LMs.
- Actual SDP procedures use only by decree from President/ COM.

4



**Component A: Development Objectives, Strategies and Investment Policies
Key Issue 3. Weak Participatory Processes**

Problem:

- Participatory processes are used only for new SPPRSDs.
- Even for SPPRSD, the process is superficial (no grassroots).

PIP Project Inputs:

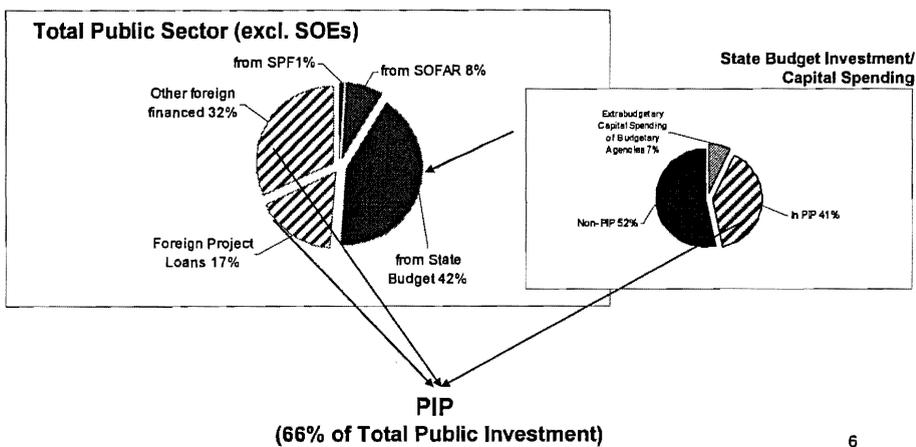
- Procedures for participatory processes through bottom-up planning and budgeting.
- Encourage grassroots participatory processes in SDPs and budgeting.

PIP Project Progress and Next Steps:

- Distributed a TN and a presentation to CMs and LMs.
- Collaborated with USAID Partners on local budgeting (will continue).
- PIPP Manual includes procedures for participatory processes.



**Component B: Evolution of the Public Sector Capital Budgeting
Public Sector Investment (Planned 2005)**





USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component B: Evolution of the Public Sector Capital Budgeting Key Issue 1. Lack of PIPP Procedures

Problems:

- PIP preparation without statutory procedures.
- Conflict of interest.
- Rent seeking.

PIP Project input:

- Help MOED develop a PIPP Manual by modular approach.

PIP Project Progress and Next Steps:

- Draft PIPP Manual is almost complete.
- MOED, MOF and LMs will review; submit to COM by end-2006.
- Help with implementation, after GOAZ endorsement. (USG support)

7



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component B: Evolution of the Public Sector Capital Budgeting Key Issue 2. Weak Capital Budgeting Process

Problems:

- Inconsistent and incomplete PIP coverage.
- Non-transparent and ineffective capital budgeting.
- No links to NDF and SDPs.

PIP Project input:

- Help GOAZ develop PIP/capital budgeting for development planning, macroeconomic management, and efficient resource use.

PIP Project Progress and Next Steps:

- Defined PIP as a policy and planning tool.
- Distinguished PIP and capital budgeting, as the latter being MOF responsibility.
- Proposals for effective linkage of plan, PIP, and budget processes and documents.
- Prioritization procedures for sector programs and projects.
- PIP 2007-2010 PIP CC according to the above.
- Draft PIPP Manual includes all of the above.
- Implement PIPP Manual with MOED, MOF and LMs when adopted by GOAZ.

8



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

**Component B: Evolution of the Public Sector Capital Budgeting
Key Issue 3. Poor Coordination among MOED/MOF/LMs in PIPP
Preparation**

Problems:

- Lack of coordination in PIPP and MTBF processes.
- MOED is not involved in almost half the budget capital expenditures.
- No recurrent expenditure implications of investments.
- No monitoring and evaluation system at any stage. No feedback.

PIP Project inputs:

- MOED and MOF draft a JCC for SPPRS/ RDP/ PIP/ Budget.
- MOED/MOF capacity to assess recurrent expenditure implications of investment programs increase.
- MOED develops procedures for cooperation with MOF and LMs in PIP and capital budget formulation and M&E.

PIP Project Progress and Next Steps:

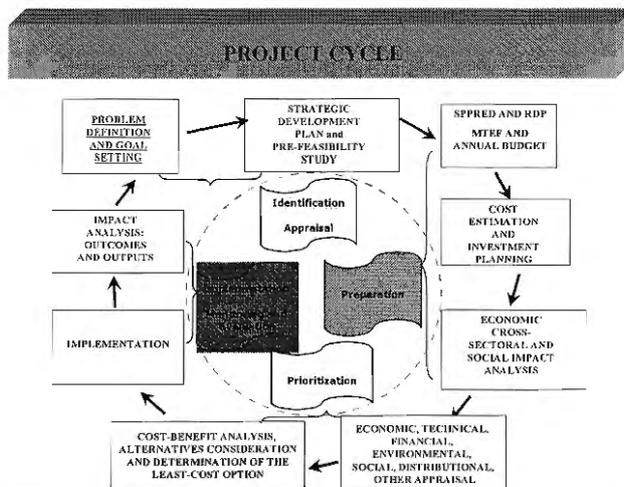
- Helped MOED to issue a new PIP CC for the 2007-2010 PIP.
- MOF (and WB) is interested in the new PIP CC format (for budget CC).
- PIP CC has a comprehensive coverage, including all budget capex.
- Draft PIPP Manual regulates MOED/ MOF budgeting of PIP/capex.
- MOF will participate in recurrent expenditure implications during MOED evaluation of PIP.



USAID
FROM THE AMERICAN PEOPLE

**Public Investment
Policy Project**

**Component C: Project Cycle Management Capacity
Key Issue: Lack of Relationship between Project Cycle and NDF/PIPP**





USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component C: Project Cycle Management Capacity

Key Issue: Lack of Relationship between Project Cycle and NDF/PIPP

Problems:

- Lack of relationship between project cycle and NDF/PIPP.

PIP Project Inputs:

- Promote recognition by GOAZ of importance of sound project development.
- Help MOED develop a set of "project development and monitoring procedures" as part of the PIPP Manual.
- Help MOED/MOF/LMs develop capacity for C-B analysis.
- Work with LMs to promote participatory processes in project development.

PIP Project Progress and Next Steps:

- Sound project development has been emphasized in all PIPP work.
- Training on Project Cycle, with emphasis on C-B analysis, to 85 GOAZ staff in Feb.-Mar. 2006. 3rd round in Nov.-Dec. 2006. Repeat 3 rounds in 2007.
- PIPP Manual emphasizes sound project development process.
- Disseminate participatory processes recommendations.
- Once PIPP Manual is approved, PIP Project work will focus on implementation.

11



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component D: Training Plan for PIPP

Key Issue 1. Extensive Needs for Training

Problems:

- Need to train staff at all levels (policy makers, managers and technical staff).
- Coverage of a large number of trainees at technical level.

PIP Project Inputs:

- Design and deliver training in line with best PIPP requirements.
- Training activities (workshop, seminar, formal classes, on-the-job-training) at different levels for different groups.
- About 500 staff trained in MOED, MOF, and 8 LMs by end-2007.

PIP Project Progress and Next Steps:

- Training program and materials were prepared for three-week training on Project Cycle.
- 85 staff from COM, MOED, MOF and 5 LMs trained in 2-rounds of 3-week courses.
- Third round in Nov.-Dec. 2006; repeat the 3 rounds in 2007.
- Seminars on MTMF/HPPC for MOED staff; on SDP for MOED and LMs staff.
- High-Level Workshop was held on HPPC in April 2006 (policy coordination).
- Study Tour to Turkey to support to the HL Workshop results. WLI and TIKa support.
- Continuous on-the-job training to MOED and LMs staff on SDPs and PIP CC.

12



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component D: Training Plan for PIPP Key Issue 2. Poor Training Environment

Problems:

- Poor technical background of trainees.
- Lack of motivation for receiving training.
- Time constraint of key potential trainees.

PIP Project Inputs:

- Contextualizing training to Azerbaijan and to selected LMs.
- Training content is specific rather than generic.
- Use practical case studies on Azerbaijan.
- Create interest in training by study tours, internships, and certificates.

PIP Project Progress and Next Steps:

- Multi-week training used Azerbaijan projects funded by the WB.
- Third round (Nov.-Dec. 2006) to use Azerbaijan case briefs.
- Project Cycle course graduates received Certificates.

13



USAID
FROM THE AMERICAN PEOPLE

Public Investment Policy Project

Component D: Training Plan for PIPP Key Issue 3. Lack of Local Training Capacity

Problems:

- Only few qualified local training organizations in any field.
- None with any experience on PIPP-related subjects.

PIP Project Inputs:

- Enlisting 3 local organizations: ABTC, CER and Khazar University.
- Arrangement with reputable international institutions to carry out TP and TOTs.

PIP Project Progress and Next Steps:

- Chose CER (over ABTC). CER is willing and competent.
- PIP Project made all preparatory work for multi-week TP, hired an STTA, and used own staff to carry out the scheduled program. (Arrangement with TRG and BIDE were unsatisfactory.)
- TOT course was given to CER trainers and PIP Project staff. CER TOT will take over future training of GOAZ staff.

14

Attachment 5.

PIPP Monthly Calendar: Period July- September 2006

July 2006

July 03, 2006

1. 13.00 USAID Data Quality Assessment Session, AP

July 05, 2006

2. 17.30 USIAD, MD

July 06, 2006

3. All day event Regional Conference on Community Development, Lenkoran, HH, SSh
4. 09.30 Jim Purcell, Farid Bakhshiyev, USAID, MD, AP, SC
5. 17.00 Firuza Hasanova, Program Officer, Telman Yolchiyev, Program Coordinator, WLI, MD

July 07, 2006

6. 14.00 Introduction of Ambassador Derse to USAID program and implementation partners, Ambassador Derse, Jason Hyland, DCM, Bob Wilson, USAID/ Caucasus Deputy Mission Director, Jim Goggin, USAID/ Azerbaijan Country Coordinator, AP, SC

July 10, 2006

7. 15.00 Sevinj Hasanova, Deputy Minister of Economic Development, Shahin Sadigov, Head of DEPF, MOED, MD, SC

July 11, 2006

8. 11. 00 Shahin Sadigov, Head of DEPF, MOED, SC
9. 14.00 Raif Kutluk, Country Coordinator, TIKA, MD, SSh

July 12, 2006

10. 11.45 Shahin Sadigov, Head of DEPF, MOED, MD, SC

July 13, 2006

11. 11.30 Christos Kostopoulos, WB, Geoff Minott, USAID, MD, SC, AP
12. 16.00 Meeting with Study Tour Participants (Ankara, June 26-30, 2006), WLI, MD, SSh
13. 16.00 MOED, SC, HH
- July 14, 2006**
14. 09.30 Sevinj Hasanova, Deputy Minister of Economic Development, Shahin Sadigov, Head of DEPF, MOED, SC, SSh
15. 12.00 Mehman Abbas, Head of SPPRED Secretariat, Geoff Minott, USAID, SC
16. 15.00 Sevinj Hasanova, Deputy Minister of Economic Development, Shahin Sadigov, Head of DEPF, MOED, MD, SC
- July 17, 2006**
17. 14.30 USAID Ethics Training, RA, SSh
18. 14.30 MOED, MD, SC
19. 17.00 Ilgar Mammadov, PIPP Short-term Specialist, Discussion on Participatory Processes, MD
- July 18, 2006**
20. 14.30 MOED, NI
21. 16.00 MOED, MD
- July 19, 2006**
22. 10.00 MOED, MD, HH, SSh
- July 21, 2006**
23. 10.30 Jerome Gallagher, Resident Advisor, Urban Institute/Civil Society Project, SC, HH
- July 24, 2006**
24. 14.30 Scott Taylor, USAID's new Country Coordinator, Linda Decker, US Treasury, MD
- July 25, 2006**
25. 17.00 MOED, MD, SC

July 26, 2006

26. All day event Regional Conference on Community Development, Guba, HH
27. 10.00 MOED, SC

July 27, 2006

28. 11.15 Ambassador Derse, Linda Decker, US Treasury, MD

July 28, 2006

29. 09.30 Shahin Sadigov, Head of DEPF, MOED, SSh

August 2006

August 21, 2006

1. Sabit Bagirov, NGO Coalition Group, HH, SC

August 21, 2006

2. 14.30 Jeyhun Mammadov, Dept. of Management of Educational Information Systems, MOE, SH, NI

August 30, 2006

3. 11.00 Hikmet Hasanov, Head of Economic Dept. Aydamir Shihmetov, Head of Capital Construction Dept., Azerenergy SC, AP

August 31, 2006

4. 15.00 USAID Outreach Meeting, Andrea Dickson, Senior Development Outreach and Communications Officer, USAID/Caucasus Mission, Aybeniz Ganjaliyeva, Development Outreach and Communications Specialist, USAID, GA, SI

September 2006

September 01, 2006

1. 11.00 Ramiz Rzayev, Head of Dept. of Investment Policy and Reconstruction of Industrial Enterprises, Feyzulla Muradov, Head of Regional Development Sector, Dept. of Investment Policy and Reconstruction of Industrial Enterprises, MOIE, AP, NI

2. 15.30 Natig Pashayev, Head of PIP Division, MOED, SC, HH

September 05, 2006

3. 14.00 USAID All-Partners Meeting, AP, SC

September 06, 2006

4. 14.00 Geoff Minott, CTO, USAID, Meral Karan, Dan Rathbun

September 07, 2006

5. 11.00 Rafiq Mejidov, Head of Financial Dept. MOA: PIP Introduction, HH

6. 14.00 Sevinj Hasanova, Deputy Minister, MOED, Farid Bakhshiyev, Geoff Minott, USAID, Meral Karan, Dan Rathbun

7. 15.30 Linda Decker, US Dept. of Treasury, Meral Karan, Dan Rathbun

September 08, 2006

8. 14.00 David McCormick, Economic Officer, Alan Eyie, Economic Officer, US Embassy, Meral Karan, Dan Rathbun

9. 16.30 Training on PIP Call Circular and Sector PIP Submission for MOIE: Feyzulla Muradov, Head of Regional Development Sector, Dept. of Investment Policy and Reconstruction of Industrial Enterprises, MOIE, AP, NI, HH

September 11, 2006

10. 11.00 NBA, Meral Karan, Dan Rathbun

11. 12.30 Sevinj Hasanova, Deputy Minister, Niyazi Safarov, Deputy Minister, MOED, Mark Gallagher, MD, GA

September 12, 2006

12. 10.00 Shahin Sadigov, Head of DEPF, MOED, Mark Gallagher, MD

13. 10.30 David McCormick, Economic Officer, US Embassy, Meral Karan, Dan Rathbun

September 13, 2006

14. 10.00 Sevinj Ismaylova, Head of HR Dept., MOED, Mark Gallagher, GA

- 15. 11.00 Eishan Mammed-zade, Head of Investment and International Economic Relations Dept., MOED, Mark Gallagher, GA
- 16. 12.00 Samir Veliyev, Administration Head, MOED, Mark Gallagher, GA
- 17. 14.30 Vagif Rustamov, CER Director, MOED, Mark Gallagher, GA
- 18. 16.00 Mehman Abbas, Head of SPPRED Secretariat, MOED, Mark Gallagher, GA
- 19. 17.30 Khalig Mammadov, Director of Commodity Certification Center, MOED, Mark Gallagher, GA

September 14, 2006

- 20. 10.00 Agajan Ahmadov, Head of RDP, MOED, Mark Gallagher, GA
- 21. 11.00 Nazilya Gasimova, General Dept., MOED, Mark Gallagher, GA
- 22. 12.00 Riyad Gasimov, Head of Law Dept., MOED, Mark Gallagher, GA
- 23. 16.00 Elchin Zeynalov, Head of Entrepreneurship Fund, MOED, Mark Gallagher, GA
- 24. 17.00 Samir Dadashov, Head of Antimonopoly Dept., MOED, Mark Gallagher, GA

September 18, 2006

- 25. 17.00 Rovshan Najaf, Senior Advisor, Investment and International Economic Relations Dept., MOED, Mark Gallagher

September 19, 2006

- 26. 10.00 Siyavush Yeganly, Director of Baku Business Center, Mark Gallagher, GA

September 20, 2006

- 27. 11.00 Rukhsale Vezirova, Agriculture Policy Division, DEPF, MOED, Mark Gallagher, GA
- 28. 11.30 Rustam Mahmudov, Ecology Policy Division, DEPF, MOED, Mark Gallagher, GA

- | | | |
|---------------------------|---------------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| 29. | 14.30 | Igor Kavass, WTO, Mark Gallagher |
| 30. | 17.00 | Emin Huseynov, Head of Research and Statistical Dept., NBA, Mark Gallagher, GA |
| September 21, 2006 | | |
| 31. | 13.00 | Geoff Minott, USAID, Mark Gallagher |
| 32. | 15.00 | Rasim Jafarov, Economist, WB, Mark Gallagher |
| 33. | 17.00 | Elshan Asadov, Head of Price and Tariff Secretariat, MOED, Mark Gallagher, GA |
| September 22, 2006 | | |
| 34. | 10.00 | PIPP Presentation to USAID, Steve Morin, Farid Bakhshiyev, USAID |
| 35. | 11.00 | Emil Mejidov, Director of Azerbaijan Export and Investment Promotion Foundation, Mark Gallagher, GA |
| 36. | 14.00 | Nizami Gasimov, Head of Fiscal and Monetary Policy Division, DEPF, MOED, Mark Gallagher, GA |
| 37. | 15.00 | Adalyat Muradov, Head of Macroeconomic Analysis and Forecast Division, DEPF, MOED, Mark Gallagher, GA |
| 38. | 16.00 | Jemaleddin Gulaliyev, Head of Social Policy Division, DEPF, MOED, Mark Gallagher, GA |
| September 25, 2006 | | |
| 39. | 10.00 | Kamran Aliyev, Head of PR and Analytical Information Dept., MOED, Mark Gallagher, GA |
| 40. | 11.00 | Fuad Eyvazov, Infrastructure Policy Division, DEPF, MOED, Mark Gallagher, GA |
| 41. | 14.00 | Sanan Tapdigov, Head of Division for WTO Affairs, Dept. of Investment and International Economic Relations, MOED, Mark Gallagher, GA |
| 42. | 15.00 | Rafael Abbasov, Economist, Philip Chang, Azerbaijan Country Economist and Officer in Charge for Azerbaijan Resident Mission, ADB, Mark Gallagher |
| September 26, 2006 | | |
| 43. | All day event | RDP, MOED, Shamakhi, Mark Gallagher, GA |

September 27, 2006

44. All day event RDP, MOED, Guba, Mark Gallagher, GA
45. 11.00 Rashad Nabiyev, Head of Financial and Economic Analysis Dept., MOCIT, AP, NI, SSh
46. 11.00 Nadir Ibadov, Head of Financial and Economic Dept., Elman Rahimov, Head of Health and Projects System Development Planning Sector, MOH, FG

September 28, 2006

47. 15.00 David Eizenberg, Deputy Resident Representative, UNDP, Mark Gallagher
48. 17.00 Sevinj Hasanova, Deputy Minister, MOED, MD, Mark Gallagher

September 29, 2006

49. 15.00 Samir Nuriyev, Deputy Head of Entrepreneurship Development Dept., MOED, Mark Gallagher

Abbreviations for PIP Project staff: MD (Mete Durdag), AP (Andrei Parinov), SC (Samim Cilem), HH (Hadji Husseynov), SSh (Sabira Shihaliyeva), NI (Nigar Ismaylova) FG (Fuad Ganjaliyev), GA (Gulsabah Amirova), SI (Sabina Ibrahimova).