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**TRADE AND INVESTMENT REFORM
SUPPORT PROGRAM IN AZERBAIJAN**



QUARTERLY REPORT

AUGUST 21 – DECEMBER 31, 2007 (Q4, 2007 - Q1, 2008)

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31 December 2007

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PROGRAM IN AZERBAIJAN**

**Contract No. AFP-I-00-04-00002-00, Task Order #10
under the SEGIR Commercial, Legal and Institutional Reform Indefinite
Quantity Contract (CLIR IQC)**

**Chemonics International, Prime Contractor
The Services Group, Subcontractor
Economic Integration Forum, Subcontractor**

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

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Cover Photo: Buildings shoot up throughout Baku at breakneck speed, as Azerbaijan experiences rapid oil-driven growth. USAID has been supporting the Government of Azerbaijan's efforts to stabilize the trade and investment environment and help make non-oil economic growth sustainable. Photo credit: Dustin DeGrande, Azerbaijan TIRSP, 2007.

ACRONYMS

AZE	Working Party file code for questions on Azerbaijan accession to the WTO
Azerbaijan TIRSP	USAID Trade and Investment Reform Support Program in Azerbaijan
CLIR IQC	USAID Commercial, Legal and Institutional Reform Indefinite Quantity Contract
EIF	Economic Integration Forum
GOAJ	Government of Azerbaijan
IPR	Intellectual Property Rights
LOE	Level of Effort (in person-days)
MED	Ministry of Economic Development (Government of Azerbaijan)
SO	USAID Strategic Objective
SOW	Scope of Work
SPS	Sanitary and Phyto-Sanitary
TBT	Technical Barriers to Trade
TSG	The Services Group
USAID	U.S. Agency for International Development
USTDA	U.S. Trade Development Agency
WTO	World Trade Organization

EXECUTIVE SUMMARY

Chemonics launched the project rapidly, deploying Component One WTO consultants one day after project award and commencing significant portions of Component Two business environment activities including near immediate deployment of our utilities specialist to commence assessments of the gas, power and water sectors.

The WTO Component (Component One)

The WTO activities can be divided into activities related to the accession process, assistance with bilateral negotiations on market access, advisory services respecting legislative reforms, capacity building through training, and awareness programs.

The Accession Process. TIRSP has provided significant assistance to the GOAJ in preparing documentation in support of the next Working Party meeting on the country's accession to the WTO. Six documents have been submitted to the WTO Secretariat covering trading rights, price controls, fees related to trade in goods, industrial subsidies, natural monopolies and legislative reform. Additional documents are in the process of being finalized including a customs valuation checklist, TBT checklist and a summary of certain amendments related to foreign trade formalities and import licensing procedures.

Bilateral Negotiations on Market Access. The TIRSP team provided critical advice on issues ranging from Initial Negotiating Rights to computations of various rates, duties and tariffs so that GOAJ could provide a market access offer demonstrating clear intent to move in the direction of WTO compliance.

Legal Reform. TIRSP has been providing legal research, analysis, legislative drafting expertise and significant on-the-job training. 17 draft laws have been submitted to the WTO Secretariat. Six additional drafts are at the ministerial level and nearing submission status. 12 drafts are slated for work in the first quarter 2008 together with the compliance review of 6 other laws.

Training. The TIRSP team has delivered seminars covering 13 topics critical to WTO compliance and accession ranging from rules of origin, anti-dumping and countervailing measures to a series of TRIPS sessions on a host of intellectual property issues to agricultural subsidies, technical barriers to trade and sanitary and phytosanitary measures.

Awareness Measures. TIRSO has participated in WTO media training, contributed to publications (AMCHAM) and the distributed educational materials on the benefits of WTO and the process of accession to WTO.

The first quarter has demonstrated such progress that the GOAJ expectation is that a Working Party meeting may be scheduled in late February or early March, representing a substantial step forward in achieving the accession objective.

The Business Environment Component (Component Two)

While the WTO component is well-defined and essentially provides a checklist of activities that must be satisfied to achieve the accession objective, Component Two is broad-based, requiring strategic decisions as to which activities will demonstrate sufficient impact to justify the committing of project resources. A significant portion of resources in the first quarter were dedicated to assessments that would further define the level of project commitment.

Business Registration and Licensing. The IFC is supporting the MED in crafting a new legal framework for business registration and licensing. TIRSP has agreed to focus on construction licensing and permitting and to monitor the other IFC activities standing ready to commit additional resources should there be a demonstrated need.

Property Rights. TIRSP is working together with the USAID-funded SME Support through Financial Sector Development Project to develop a new moveable property registration regime. A work plan has been prepared for an inter-agency working group. The working group worked during December at finalizing the first draft of the registration legislation. It was released for comment by TIRSP on January 7, 2008.

Competition Policy. TIRSP reviewed and commented on the first draft of a new Competition Law and engaged in several meetings on the topic in September and November. A Second Reading draft was released on December 25th. TIRSP has established dialogue with the Chair of the Standing Committee on Economic Affairs and will provide input on the Second Reading draft and proposed amendments in the first quarter 2008. In addition, TIRSP has explored developing the institutional capacity of NGOs to monitor and initiate grievances where there is evidence of anti-competitive behavior.

Investor Protection. To date, our primary counterpart has been the Corporate Governance Division of MED. TIRSP has participated in the Corporate Governance Task Force Meetings and expects to contribute to the further review of the reform of the Companies Law regime, contribute to the development of a national Corporate Governance Code and has been asked to provide input on a new State Owned Enterprise Law. In addition, TIRSP has engaged in dialogue with the Azerbaijan Investment Company with the expectation that it will provide key consulting services on the development of an investment fund governance program that satisfies international standards. Potentially with the partnership of World Learning's FORECAST program, TIRSP expects to support the development of a Mediation Association. First quarter activities laid the groundwork for collaboration with the International Commercial Arbitration Court as a possible partner in creating the mediation platform. Finally, CGD relationships were solidified when TIRSP sponsored CGD attendance at a Corporate Governance Conference in Almaty, Kazakhstan.

Tax Policy and Administration. TIRSP Tax Policy and Administration Expert Rup Khadka assessed the current tax policy and tax administration regime to identify areas that weaken the competitive position of the non-oil sector. Areas explored included VAT, personal income tax, corporate profit tax, excise tax, property tax and tax on land use. This assessment was informed by a legislative review, as well as meetings with the Ministry of Tax (MoT), Ministry of Finance (MoF), the Economic and Social Legislation Parliamentary Committee and the Tax Committee of the American Chamber of Commerce

in Azerbaijan. Changes were made to the Tax Code effective for the 2008 year. Counterparts indicated that several of the proposals put forth by TIRSP would be considered during the next legislative review scheduled to occur in the first quarter 2008. Modest improvements were achieved in targeted areas in the December amendments.

Agricultural Policy. TIRSP conducted an initial assessment of the agricultural policy development efforts at the Ministry of Agriculture and developed a TIRSP action plan for agricultural policy development support. In 2008, TIRSP expects to support an inter-ministerial working group that will be charged with the development of an agricultural sector operational plan. This group will be guided by MOED and MOF. TIRSP also staged a food security seminar in response to the Government's growing concern with escalating international grain prices and export bans imposed by some of Azerbaijan's major suppliers. This prompted further discussions on food security and may prompt further policy development assistance. The TIRSP action plan seeks to "gap-fill" in several important areas, which currently are not being explicitly addressed by the Bank, GTZ or by other donors. In developing the plan, the TIRSP team conducted preliminary review of four agricultural sub-sectors with good development potential. The team also identified other areas where TIRSP might assist, including reform of the inputs delivery system, and improving financial markets for investment credits and working capital.

SPS Implementation. TIRSP has assessed Azerbaijan's agriculture and food system's ability to comply with SPS norms, to define gaps between the requirements and current state, to define a set of prioritized activities to close these gaps, and to recommend trainings to upgrade food safety capacity. The areas of evaluation in the SPS study included the legal and regulatory framework; institutional structure and capacity (e.g.; organizational structure); facilities and equipment (e.g.; properly equipped labs and facilities); human resources and development (training, ability to conduct risk assessments and create disease-free areas); documented procedures and systems (standard operating procedures, checklists and quality control); and international/regional cooperation (ability to report outbreaks to international groups, ensure the inspection of imports and exports).

Mr. Hoffman has prepared a separate report that evaluates the capability of the public sector to conduct food safety inspections; assesses HACCP management systems; reviews the regulatory environment related to food safety; evaluates the educational system in the areas of food safety, quality control, HACCP, SSOP, and GMP; assesses local consulting firms' training capacity; reviews donor activities; provides a training work plan; examines company capacity to satisfy food safety assessments relative to international norms and proposes terms of reference in support of further technical assistance on SPS food safety matters.

The Hoffman/Deeb team has outlined a number of activities that may, in whole, in part, or in collaboration with other U.S. Government, bilateral and/or multilateral donors be conducted over the remainder of the TIRSP program.

Utility Sector. Activities have focused on building relationships with key counterparts, providing education and training, and preparing diagnostic assessments and draft documents. The project has laid the groundwork for future reform proposals by presenting and/or providing information on strategic topics including Utility Sector Goals and

Strategy in Azerbaijan, Elements of Power Purchase Agreements for an IPP, Line Extension Policy for New Customer Connections, Linking Economic Growth and Institutional Strengthening in the Utilities Sector, and conducting a survey on behalf of the Tariff Council on Factors Affecting Regional Market Energy Transactions. Training materials have been developed on Elements of Utility Regulation (How a Regulatory Body Works); Electric Tariff Methodology, Calculation and Tariff design; Consumer Protection and Consumer Rights - DR and Complaint procedures; and Elements of a Power Purchase Agreement. The Utility Sector team spent much of the quarter preparing and submitting extensive data requests on system profiles, organization structure, functional costs, system losses, and consumption and tariffs to Azerigaz and Azerenergy. The data received has been analyzed and used to develop tariff recommendations. Further, several diagnostic assessments have been completed or are in the process of completion covering structure, legal authority, capacity assessments, unbundling strategies, tariff setting methodology, public private partnerships, sector status assessments and rehabilitation related to electric, gas and water sectors as applicable. The Utility Sector team resides in the Tariff Council and is expected to expand its staffing presence early in 2008.

E-Government/E-Commerce Support. TIRSP has had preliminary discussions with the Head of the Entrepreneur Development Policy division of MED respecting implementing e-signature in Azerbaijan. No assessment has been completed as TIRSP awaits USAID review of its workplan.

Industrial Zone Support. TIRSP provided a short-term Industrial Park Specialist, Geoff Wright, to review the current status of special economic zones and industrial parks in Azerbaijan and to map out a strategy for the creation of a unified industrial park and free zone regime in Azerbaijan. In December, Mr. Wright presented preliminary recommendations to Mr. Samir Nuriyev, Head of the Entrepreneurial Division at MED and provided a draft version of his report to the Ministry. The report analyzes Azerbaijan's potential as a regional transport and logistics hub, as well as potential competition from other regional players. It also analyzes the current legal, policy and institutional framework in place to regulate the operation of free zones and industrial parks, including the compliance of these frameworks with WTO accession requirements. The report recommends the establishment of a hybrid special economic zone (SEZ) regime that is flexible enough to regulate the development and operation of both free zones and industrial parks.

Staffing Changes

Darrell Brown replaced Julian Simidjyski as Chief of Party effective December 9, 2007. Mr. Brown will guide the overall project administration and provide targeted technical assistance in business environment areas. Project staff has expanded to 22 administrative and professional staff (though some are retained on a part time or periodic basis) plus drivers and maintenance workers. TIRSP anticipates adding additional staff in the utility sector early in 2008. Twenty-two short term consultants were deployed over the quarter with a total STTA LOE of 627 days.

PROJECT BACKGROUND

The USAID Trade and Investment Reform Support Program in Azerbaijan (Azerbaijan TIRSP) began its work at a time of great challenges and opportunities for the Azerbaijani economy. While the current economy is characterized by macroeconomic mismanagement and a poor enabling environment for business, the Government of Azerbaijan (GOAJ) has renewed interest in accelerating its accession to the World Trade Organization (WTO). The accession effort will require comprehensive legislative/regulatory and institutional reforms which can promote an enhanced enabling environment for private investment and sustainable job creation and remove barriers which inhibit competition, distort investment flows and limit economic integration.

The GOAJ began the WTO accession process in 1999 and has had four Working Party meetings and two bilateral meetings since that time. The U.S. Trade Development Agency (USTDA) provided accession assistance in 2003-2006; however, this work was ended due to concerns regarding the political will of the GOAJ to reform. Though political will may still be an issue, there are signs of renewed commitment to the accession effort. These include the public commitment of both President Ilham Aliyev and the U.S. Ambassador to Azerbaijan, as expressed through the execution of the U.S.-Azerbaijan Economic Partnership Commission. The joint communiqué of the Commission emphasizes, *inter alia*, the importance of accelerating Azerbaijan's WTO accession effort to precipitate changes in the trade and investment climate needed to develop the non-oil sectors of the economy. The communiqué also set the stage for bilateral technical assistance for accession—hence, Azerbaijan TIRSP.

Azerbaijan TIRSP, a two-year, \$7.2 million task order under the Commercial Legal and Institutional Reform (CLIR) IQC, was awarded to Chemonics International in August 2007. The contract number is AFP-I-00-04-00002-00, Task Order Number 10. Chemonics has begun implementing the project in collaboration with its CLIR consortium partner, The Services Group (TSG), as well as a non-consortium member, Economic Integration Forum (EIF).

Program Description

Azerbaijan TIRSP is divided into two components: WTO Accession (Component One) and Trade and Investment (Component Two). Under Component One, the project has been providing technical assistance and training to facilitate Azerbaijan's accession to the WTO and to build institutional capacity for WTO compliance. This includes assisting the GOAJ in responding to Working Party member questions (only at GOAJ request), providing analytical support on an as-needed basis for bilateral and plurilateral negotiations, providing analysis, model legislation and training to help Azerbaijan draft WTO-compliant laws, building capacity to conduct macro-econometric analysis of the impact of WTO accession recommending transitional strategies for vulnerable sectors, and institutional reform.

Component Two activities will improve the enabling environment in the non-oil sector by providing technical assistance and training in a wide range of areas. The scope of the Component Two mandate is broad and evolving now covering tax administration and

policy including fiscal impact analysis of proposed revisions; the competition law regime; moveable property registration; utilities sector restructuring and regulatory reform; several topical areas under investor protection including corporate, state-owned enterprise and investment fund governance, company and securities law review, and enhanced dispute resolution procedures; dedicated reforms to licensing and permit systems and procedures; an examination of the viability of free economic zone/industrial park strategies; assessments and targeted assistance in the agricultural policy and sanitary/phytosanitary regimes and possibly telecommunications sector assessments and assistance with e-signature implementation.

TIRSP consultants have assessed the need and donor coverage in a number of areas including business registration, licensing, property registration, dispute resolution mechanisms, tax policy and administration procedures, regulation and enforcement of anti-competitive practices, industrial and free economic zone policies and potential frameworks, the sanitary and phyto-sanitary regime, agricultural policy development and agricultural sector analysis and modalities of investor protection. The development of the first year work plan has been an iterative process shaped in part by these initial assessments, but also driven by Government counterpart requests for assistance and the desire to complement existing donor and Government programs in targeted areas. At the time of this Report's submission, a third draft of the work plan is being reviewed by USAID.

There are clear synergies between Component One and Component Two [e.g., competition policy, agricultural policy, sanitary/phyto-sanitary inspection (SPS)]. Activities in one component reinforce those in the other, and serve the overall project goal of increasing the competitiveness of the Azerbaijani non-oil economy. Both components also contribute to the fight against corruption in Azerbaijan by reducing discretionary bureaucratic behavior across a range of regulatory areas.

Project Start-Up

Within days of signing the contract, a team of administrative and technical specialists arrived in Baku to set up facilities, hire staff, and begin assessments and work planning. By the end of September, the project employed 13 long-term local and three long-term expatriate staff. By the end of December, that number rose to 17 long-term local and three long-term expatriate staff.

The start-up team moved into a centrally-located office with a flexible lease to provide for contingencies in housing staff, with the idea that some long-term experts would eventually imbed themselves into the relevant Government of Azerbaijan ministries. By the three-week deadline after contract signing, the project had submitted a draft Year One Work Plan to USAID for consideration, per the terms of the task order contract. The third draft of the Year One Work Plan, which incorporated the findings of short-term expert assessments in the respective areas of operations, was submitted for USAID comment in December.

COMPONENT 1 – WTO ACCESSION

Introduction

Significant progress has been made in moving the GOAJ toward the WTO accession objective. The prime objective over the first quarter of the project was to provide sufficient evidence of progress to the WTO Secretariat to justify the scheduling of a working party meeting. Over the course of the four months, TIRSP provided concentrated technical assistance related to the accession process, bilateral negotiations on market access, legal reform and training.

Hitting the Ground Running

TIRSP Senior WTO Accession Advisor Farhat Farhat has been working with the GOAJ intermittently since April 2007, with USAID funding provided through the START program. The TIRSP start-up was essentially a seamless bridge between the START support and continued WTO assistance under the project. TIRSP has assisted the GOAJ implement a series of activities that demonstrates the government's renewed commitment to WTO accession.

WTO Accession Specialist Farhat Farhat was fielded to Azerbaijan one day after contract signature and immediately began a series of meetings with key GOAJ counterparts, including meetings with representatives from the Ministry of Foreign Affairs (MFA), Ministry of Economic Development (MED), Ministry of Justice (MoJ), Tariff Council, Ministry of Agriculture (MoA) and others. The project hired a local WTO coordinator, translator and four attorneys with appropriate backgrounds in SPS/TBT, IPR, customs, etc. to work with international experts to help GOAJ develop draft WTO-compliant legislation. Local experts were also hired to help the GOAJ address Working Party questions on state regulation of prices, industrial subsidies, state-owned enterprises and natural monopolies in Azerbaijan. We expect that last deliverables prior to consideration of a working party meeting will be delivered to the WTO Secretariat in mid-January. We remain hopeful that a working party meeting may be scheduled in February, 2008. This would represent a significant transformation from GOAJ intractability on WTO issues for several years to a concerted effort to move forward the accession process.

The Accession Process

The USAID Trade and Investment Reform Support Program has assisted the GOAJ in preparing documentation in support of the next Working Party meeting on the country's accession to the WTO. These documents provide additional information and clarification on questions raised by the last Working Party on AZE/18 and previous AZEs. All six documents prepared with TIRSP assistance were submitted by the GOAJ to the WTO Secretariat for circulation to Working Party members:

- Trading rights, including import and export licensing, activity licensing for importing, and contract registration;
- Price controls, covering goods, commercially-traded services, and state services;
- Fees related to trade in goods;

- Industrial subsidies;
- Natural monopolies, enterprises with dominant positions, and state trading enterprises; and
- Legislative reform (summarizing improvements made in draft legislation, to be shared with the WTO Secretariat).

In addition to the above, the following documents have been prepared with TIRSP assistance and are ready for submission to the WTO Secretariat:

- Customs valuation checklist;
- TBT checklist; and
- Summary of improvements made in draft amendments to Decrees 609 and 782, in relation to foreign trade formalities and import licensing procedures.

Bilateral Negotiations on Market Access

TIRSP performed the following in support of revising and improving the market access offer on goods:

- Assisted in structuring the offer as requested by USTR
- Assisted in converting from HS 2002 to HS 2007
- Assisted in computing average duties
- Assisted in converting specific rates to *ad valorem* rates of duties
- Assisted in identifying and reflecting the tariff line items related to sectoral initiatives including the Information Technology Agreement
- Advised on the importance and benefit of incorporating sectoral initiatives in the revised offer
- Provided advice/memo on understanding Other Duties and Charges drawing on the experience of recently acceding countries
- Provided advice/memo on understanding Initial Negotiations Rights drawing on the experience of recently acceding countries.
- Prepared a comparative paper on international experience and trends related to service market access negotiations in areas such as audio-visuals, banking, insurance, telecommunications, and real estate.

Legal Reform

In the first months of the project, the TIRSP WTO accession team assisted the GOAJ in significantly advancing the legal reform process and bringing draft legislation into greater conformity with WTO standards. In supporting legal reform, TIRSP has been providing legal research, analysis, and legislative drafting expertise, as well as significant on-the-job training to appropriate ministries and state bodies. Specifically, TIRSP:

- Helped the GOAJ finalize 17 draft laws which have been submitted to the WTO Secretariat for consideration;
- Helped the GOAJ finalize 6 additional drafts of legislation at the ministerial level for imminent submission to the WTO Secretariat and Cabinet of Ministers;

- Completed the analysis, and initiated the process, of assisting the GOAJ in drafting 12 laws for submission to the WTO Secretariat and Cabinet of Ministers, in the first months of 2008;
- Is now finalizing an analysis of WTO conformity of six laws.

A complete list of draft legislation sent to the WTO Secretariat, and an update of its status within the legislative process can be found in Annex B.

Training

TIRSP has delivered training seminars on the following topics targeting the public sector:

- Customs valuation
- Rules of Origin
- Safeguards
- Government procurement
- Anti-dumping Measures
- TRIPS: patents, industrial designs, variety protection, topography of integrated circuits
- TRIPS: copyrights and related rights
- TRIPS: trademarks, geographical indications
- Trade Secrets/unfair competition
- Countervailing Measures
- Agricultural Subsidies and Notification
- Technical Barriers to trade
- Sanitary and Phytosanitary Measures

Awareness

- TIRSP participated in a WTO awareness seminar targeting Azerbaijani media.
- TIRSP published in the first issue of AMCHAM IMPACT AZERBAIJAN publication an article titled “Azerbaijan and the WTO: Challenges and Opportunities”
- TIRSP disseminated educational materials on benefits of WTO and the process of accession to the WTO.



Image 1 – Procurement Specialist Simeon Sahaydachny explains procurement best practices.

COMPONENT 2 – TRADE AND INVESTMENT REFORM

Introduction

The Component Two agenda presents a broad-based portfolio of business environment activities as its starting point. Through the first quarter of the project, project technical staff as well as targeted expatriate consultants conducted assessments to determine the current status in targeted areas, gauge other donor commitments and formulate complementary technical assistance activity plans. In all of the activities that were specified in the RFTOP, the contract and subsequently embodied in iterations of the draft work plan there is existing technical assistance being provided from bilateral and/or multilateral donors, sometimes from other agencies within the U.S. Government (e.g. Treasury, Trade and Defense). Our objective was to identify areas where there was a clear need for immediate assistance that could result in tangible results being demonstrated in the near term. We have had meetings to coordinate both the U.S. Government provision of targeted assistance and multi-agency donor participation. Although the Ministry of Economic Development is our prime counterpart, because of the sweeping nature of the potential Component Two coverage, we have endeavored in this early implementation phase to cultivate as many appropriate GOAJ relationships as possible including with representatives of the Tariff Council, the State Committee for Management of State Property, the Corporate Governance Division of the MED, the Azerbaijan Investment Company, the Entrepreneurship Division of MED, and representatives from the Ministry of Finance and Ministry of Taxes, to name a few.

Because there were not specific commitments and an agreed upon set of activities determined between USAID and GOAJ prior to project inception, the work plan and first quarter activities represent an evolution of proposed activities that have been actively discussed by TIRSP and USAID primarily but not exclusively with the MED, since it sits as the donor coordinating body.

Activity One: Business Registration and Licensing

During this quarter, TIRSP experts met several times with representatives from the Ministry of Economic Development to discuss how the project could help in one-stop shop (OSS) implementation. In May 2007, the President issued a decree stating that a OSS business licensing system should be implemented in Azerbaijan with an effective start-up date of January 1, 2008. Even into the early Fall there was ambiguity as to which agency or ministry would take the lead role in establishing automated business registration processes. We raised this as a concern in our first meeting with MED Deputy Minister Jabbarov in October. The initial Ministry response was to indicate that coordinating committees had been established, design and implementation activities were on target and that we should look to other areas where resources could be better deployed. Both at the Deputy Minister and Entrepreneurship Division levels, MED indicated that there was little need for TIRSP intervention in the business registration and licensing arena since the IFC had committed to support this activity.

TIRSP held a series of meetings with the IFC to ascertain their level of commitment and whether there were gaps in coverage where TIRSP could play a meaningful and needed

role. Because these IFC registration and licensing efforts are coordinated out of their Moscow office, the IFC Country Director could only speak in general terms as to the potential gaps in coverage that might warrant TIRSP intervention. We were aware that a preliminary assessment of the licensing regime had been conducted by the IFC and requested provision of this study both from the GOAJ and from the IFC. There were delays both in the provision of information on IFC assessments to date and the indication of their level of commitment. It was not until mid-December that the IFC was able to provide specific information on their level of effort and disclosed its earlier assessment work.

During the course of meetings in mid-November with the Entrepreneurship Division of MED, it was confirmed that the Ministry of Taxation (MoT) would host the OSS system. Samir Nuriyev, Head of the Entrepreneurship Division voiced confidence that the Ministry had both the equipment and software to go live for OSS testing by mid-December and would meet the Presidential deadline for implementation by January 1, 2008. While Mr. Nuriyev voiced confidence in meeting the Presidential mandate, further inquiry as to the details of implementation implied that the OSS structure may only operate as the front end of an essentially incomplete system – at least initially. It appeared that there had been little work with the downstream agencies and ministries who would receive transmissions of data collected during business registration at the MoT to ensure that duplicate information processing was eliminated and multiple registration functions would be integrated and automated. Mr. Nuriyev acknowledged that there could be considerable back-office systems work required to ensure that the OSS would function as a streamlined, automated system and that there may be room for TIRSP support to these line ministries and agencies.

Concurrent with the above ministerial inquiries, an ongoing dialogue was established between USAID, the World Bank Doing Business team and TIRSP. Simeon Djankov (World Bank) voiced skepticism that the IFC would be able to provide timely and sufficient technical assistance for the OSS implementation and for ongoing work on licensing and permit systems. This sparked further attempts by TIRSP to coordinate with IFC and MED to facilitate work on business registration, licensing and permitting reforms.

The mid-December meeting with Aliya Azimova (IFC Country Director) and Dina Nicholas (IFC-Moscow) clarified the level of commitment that the IFC would dedicate to the registration and licensing initiative. A Norwegian consultant was on the ground completing an assessment of the system scheduled to go live in mid-December. By the end of January, the IFC would place a ten person team dedicated to the registration and licensing initiative. The team would provide two years of technical assistance in support of business registration and licensing as part of a five million dollar five year business environment venture.

A visible gap in the IFC coverage is in the construction sector. The MED has agreed that the IFC will not be supporting reform of the Construction Code, construction licensing and permitting. MED supports TIRSP providing technical assistance in the construction sector including supporting reform of the licensing and permit process and development of a new construction code. However, this is not within the purview of the Ministry of Economic Development other than as a donor coordinator. Initial meetings are to be arranged in the

New Year with relevant GOAJ counterparts to discuss TIRSP dedicated support in this area and obtain their buy-in.

Activities Planned for Next Quarter:

- Conduct diagnostic phase of the construction sector, including the fielding of a short-term technical expert to review the Construction Code.
- Meet with IFC business registration/OSS team deployed in January 2008 to explore how TIRSP can support downstream applications.
- Monitor OSS reform progress

As outlined in the proposed work plan, the diagnostics, design, implementation and evaluation of a new construction licensing and permitting system is estimated to run from January through August. We have yet to specify the level of STTA as it will depend in part on the nature of our agreed assistance. However, a holistic approach would require legal, systems engineering and IT input. Conservatively, we would anticipate 8 weeks of expatriate LOE with ongoing support from full time project specialists through August 2008.

Activity Two: Property Rights

Given the donor resources already mobilized in the area of immovable property, TIRSP has focused its efforts thus far on improving the legal regime for *movable* property, most specifically on the establishment of a system that supports the use of movable property as collateral. This quarter, TIRSP fielded Daniel Fitzpatrick, a commercial lawyer with broad background in business climate reform to collaborate with the USAID-funded SME Support through Financial Sector Development Project.

The SME Support through Financial Sector Development Project has been working with an informal inter-agency working group of government officials coordinated by the director of the legal department at the State Service for Registration of Real Estate (SSRRE). The process of formalizing the working group under the leadership of the SSRRE is now complete. The mandate for the working group will be to develop a modern legislative and regulatory framework for secured transactions. It appears that the members of the nascent working group are well-informed and motivated. Several of them have been discussing this issue for well over a year, having traveled to Bosnia to study the system for secured transactions in that country in 2006. Further, for most of the reforms necessary to establish a registry, there appear to be few, if any, major political obstacles to reform.

With input from TIRSP, ACDI-VOCA has prepared a work plan for the activities of the working group, laying out the steps and timeline for its work. The work plan will be discussed with members of the working group and could be approved by them before the presidential decree is signed. Examples of activities and results that may be included in the work plan have been presented in our draft Year One work plan.

A draft law is scheduled to be submitted for review on January 7, 2008. An English version of the law is expected to be available approximately one week after the Azeri versions submission.

Activities Planned for Next Quarter:

- Provide technical support for the working group as it drafts the necessary legislation and implementing regulations, with particular emphasis on enforcement issues.
- Help ACDI-VOCA organize an expected study tour for working group members to a country in Eastern Europe that has a working regime for registering and enforcing collateral rights
- As the legislation takes final shape and is submitted to the Majilis, advise as to technical aspects entailed in establishing a workable, modern, electronic registry

We anticipate approximately 6 weeks of expatriate LOE to be deployed intermittently over the final three quarters of first year activities by the secured transactions specialist. However, we expect his time to be split between examination of competition law reforms and examination of the legal and procedural changes for moveable property. Consequently, 3 weeks of STTA LOE will be attributed to support for the property rights regime.

Activity Three: Competition Policy/Anti-Monopoly Regulation

The Draft Competition Code is a key piece of legislation among “Set II” systemic laws being analyzed for WTO conformity under Component One. It is crucial that this legislation, once passed, serve as more than a formalistic stepping stone to WTO accession; that it be used, in tandem with other efforts, to open up competition in sectors dominated by entities through the tacit or explicit support of various departments of national and local government. Further, it is important that this legislation not be misused by parties to compete unfairly with, or otherwise hamper the operation of, private entities that have captured a substantial share of a given market through superior performance.

During this quarter, draft anti-monopoly legislation was submitted to the Majilis through the auspices of the Standing Committee on Economic Affairs (“SCEA”) and has now passed a first reading. TIRSP was able to obtain a copy of the submitted legislation and mobilized a short term expert in September and November 2007 to review and provide comments. In general, the legislation is sophisticated and competently drafted. In particular, the draft identified numerous instances in which government entities could allow particular commercial or state owned entities to compete unfairly. Unfortunately, the draft gave little power to the antimonopoly agency to halt these arrangements, other than moral and political suasion. The draft also, to its detriment, identified several areas where the line between pro-competitive and anti-competitive activity is very difficult to distinguish (such as charging prices for products at levels below their costs of production).

The TIRSP short-term expert developed a “first impression” set of proposed changes based on a translation of the draft that focused on the concerns discussed above. These were submitted to the chairman of the SCEA at a lunch time briefing held in mid-September. In the November trip, the TIRSP short-term expert provided an overview of his commentary to key representatives of the profile Parliamentary Committee (Economic and Social Legislation Committee) charged with reviewing the legislation.

On December 25, the Second Reading draft of the Competition Law was released. The TIRSP team engaged in dialogue with the Committee's legal staff primarily through its Head, Rauf Hajiyeu, both to obtain a copy of the current draft and to discuss the nature of the amendments being proposed to the Second Reading version. Although there were rumours that the law would be passed and enacted in the current session, we were assured that, due to the large number of proposed amendments, there could not be passage and enactment until at least March. We were also invited to provide direct input on the Second Reading draft and the proposed amendments. Mr. Hajiyeu welcomes our input as he would like to provide a review that represents international best practice on these issues.

The World Bank has been planning to utilize a foreign expert to review the legislation before passage. Between World Bank and TIRSP input, we expect that the Committee will have an opportunity to review a critical assessment of the proposals and justification for moving forward best practice amendments.

TIRSP has also developed an alternative strategy for the promotion of competition – to support NGO monitoring of anti-competitive practices and initiation of complaints when violations are identified. Because TIRSP has relatively limited resources in this regard, we have applied to World Learning's FORECAST program to finance and support institutional strengthening of targeted NGOs. At the time of this writing, World Learning was still in the process of reviewing applications from the respective AID initiatives.

This quarter the project also met briefly with the head of the Anti-Monopoly Service to discuss the law and the direction of antimonopoly enforcement in the country.

Activities Planned for Next Quarter:

- Follow the draft Competition Code as it develops, taking opportunities to hold policy dialogues with relevant decision makers and donor organizations to ensure that the best version possible gets enacted.
- Identify NGOs and/or business associations who may be motivated to provide referrals to the antimonopoly agency regarding sectors of the economy that are dominated by artificial monopolies.
- Work with USAID to secure the antimonopoly agency's buy-in for a plan to improve its capacity to investigate cases of abuse of dominant position by companies and market power by natural monopolies.

We anticipate using three weeks of STTA LOE in support of competition legislative analysis. However, there will also be the need to provide economic analysis and capacity building at the new or revamped existing Anti-monopoly service. The extent of STTA commitment will be determined based on the nature of the reforms adopted, the likelihood of buy-in by key counterparts and the potential for cost sharing by FORECAST and other similar initiatives.

Activity Four: Investor Protection

This quarter, TIRSP undertook a comprehensive review of the investor protection regime in Azerbaijan. The assessment was conducted by the COP, DCOP and local legal experts. Investor protection is a broad term that can encompass multiple, diverse initiatives. TIRSP has proposed to focus on activities that can generally be characterized under one of the following categories: collective mobilization, legislative development, conflict resolution, institutional reform, training, and education. Admittedly, these categories are not mutually exclusive. Activities under one category will have application in others. The assessment allowed the TIRSP team to make inroads with key counterparts, in particular the MED Corporate Governance Division, the Azerbaijan Investment Company, and others.

Over the course of several meetings, TIRSP was able to obtain permission and support from the Director of the Corporate Governance Division, Sanan Tapdigov, for TIRSP representatives to attend as observers in an inter-agency corporate governance task force established by the Corporate Governance Division in MED with IFC support and inspiration. Given the presence of the IFC, there were questions as to whether there was a perceived need for other donor input. Anecdotal evidence from others at the World Bank implied that the level of support from IFC was diminishing and that there were significant gaps where TIRSP could play a meaningful role. On December 12, the TIRSP COP and DCOP met with the departing Head of the IFC Corporate Governance Project, Chuck Canfield, Deputy Project Manager Murad Alizada and Legal Adviser Anar Aliyev. Mr. Canfield indicated that new funding had been approved for an additional three years of corporate governance support. Despite this, he emphasized the value of TIRSP providing support for the task force and the hope that this task force could transition to a more permanent body promoting corporate governance initiatives.

The Task Force provides a strategic avenue for policy input. In addition to the MED Corporate Governance Division, the task force includes members from the Ministry of Justice, the National Bank, the State Committee on Securities, the International Financial Corporation, and the Azerbaijan Investment Company and is therefore a key platform for the promotion of broad-based investment protection reforms. The task force considers current problems in corporate governance, and endeavors to identify and propose remedies to constraints as they are identified. It is developing a paper entitled Concept of Corporate Governance in Azerbaijan, which will serve as the guiding document and form the basis for the Task Force to lay out specific proposals for further actions. It is also working on a draft Corporate Governance Code for Azerbaijan.

The MED/Corporate Governance Division has asked for TIRSP assistance in supporting the task force in a number of areas. Its resources are diminishing with Chuck Canfield's departure. The Division needs additional support, which provides TIRSP with the opportunity to influence the process, both on an ongoing basis and at key junctures.

The relationship between the CGD and the project was solidified when TIRSP sponsored the participation of Sanan Tapdigov at a corporate governance conference in Almaty, Kazakhstan in mid-November. Mr. Tapdigov was accompanied by DCOP Joseph Deaunay. Over the course of the trip, Mr. Tapdigov noted several activities where he felt TIRSP could provide meaningful assistance. He requested that TIRSP:

- a) provide the full-time services of a dedicated Azerbaijani lawyer to be located within TIRSP to draft/support enactment of provisions to move SOE assets onto their balances (and related provisions), and possible support in implementation;
- b) lead in development of a strategy to provide access to corporate governance scoring;
- c) support a conference in-country but outside of Baku with international experts to build support especially around (a) above, and possibly (b) contemporaneously;
- d) provide one notebook computer to support meetings with governmental and private/NGO bodies in relation to the above issues and for use at task force meetings; and
- e) promote institutional strengthening of the MOED corporate governance division by providing them with on-line subscriptions to such publications as the Financial Times, etc.

The above requests were forwarded to USAID for consideration and comment. No formal response has been provided to date.

The SOE issue has been repeatedly raised both by CGD and the IFC as a gaping hole in technical support coverage. CGD would like to take a lead role in championing change. Currently, property of SOEs is held and managed by the State Property Committee. There are rumours circulating that a draft SOE law will soon be submitted. Tapdigov fears that a new law may contain provisions contrary to SOE governance best practices and run against general governance objectives that the Task Force is seeking to promote. He requested our assistance to draft provisions that would shift ownership of SOE assets directly to the balance sheets of the SOEs themselves and terminate any ownership or management role for the State Property Committee. Tapdigov's view is that the state's proper role should be to own the companies and not the companies' property, to require sound management and curb internal wrongdoing through (i) modern and transparent corporate governance practices, and (ii) corporate and criminal litigation where appropriate and applicable. The state's role should evolve to that of any other commercial beneficial owner. The objective is to make SOEs the subject of standard corporate ownership provisions. Subjecting SOEs to corporate governance standards and share ownership requirements may provide the GOAJ with additional options for financing, investment and privatization.

Preliminary feedback from USAID resulted in USAID requests that TIRSP delay assistance on SOE issues. To date, the project has provided generic input through the provision of sample laws from other jurisdictions but has not undertaken active consulting on SOE issues. There may be spillover benefits to providing such assistance. For example, the Azerbaijan Investment Company is interested in TIRSP providing consulting services on the fund's governance structure. Restructuring of the fund could relate directly to SOE reforms, given the government ownership and board oversight of the investment fund.

Our prime activities this quarter were to build relationships and obtain a commitment that TIRSP representatives would participate on an ongoing basis in task force activities. Mr. Tapdigov has confirmed our ongoing task force participation. We have also reviewed IFC proposals to reform the Civil Code and Companies Law framework. In mid-December, we received a draft Law on Investments that nullifies the previous Law on Protection of Foreign Investments, dated January 14, 1992, and the Law on Investment Activity, dated January 13, 1995. TIRSP is in the midst of conducting a preliminary analysis of this law, which may influence planned activities over the short term. The Corporate Governance Task Force may also be interested in aspects of the new draft law. A preliminary review of the framework for mediation, domestic arbitration, enforcement procedures, and bankruptcy/business closeout was also undertaken by the project team.

Activities Planned for Next Quarter

- Complete review of Law on Investment and provide recommendations;
- Pending approval of mediation development under the Forecast Program, provide complementary mediation development support;
- Actively participate in the Corporate Governance Task Force including providing technical input on development of the Corporate Governance Code, Company Law revisions and, with USAID buy-in, SOE governance reform.

We intend to provide technical assistance in the investor protection arena primarily from local and resident TIRSP staff. While we have retained STTA to conduct a preliminary review of the new Law on Investments and USAID has requested a two week resident deployment of that consultant during the next quarter, our expectations are to service the technical areas (corporate governance, mediation, contract enforcement, and investment regulation) primarily in-house on a go forward basis.

Activity Five: Tax Policy and Administration

This quarter, TIRSP Tax Policy and Administration Expert Rup Khadka assessed the current tax policy and tax administration regime to identify areas that weaken the competitive position of the non-oil sector. Areas explored included VAT, personal income tax, corporate profit tax, excise tax, property tax and tax on land use. This assessment was informed by a legislative review, as well as meetings with the Ministry of Tax (MoT), Ministry of Finance (MoF), the Economic and Social Legislation Parliamentary Committee and the Tax Committee of the American Chamber of Commerce in Azerbaijan.

The TIRSP expert review indicated that the current Azeri tax policy generates distortions in the following key areas that impede the competitiveness of the oil sector or are in conflict with WTO accession requirements:

1. Elevated personal income tax (PIT) rates are detrimental to growth as they discourage taxpayers to work more, save more, and invest more. As the PIT rate in Azerbaijan is the highest in the CIS countries (nearly double the average rate of CIS 12 members), it is believed that it has generated more costs to the economy than the low level PITs of other countries.

2. A 10 percent dividend tax at the shareholder level causes economic double taxation on dividends. The three year loss carry forward provision is rather limited. (This limit was moved to five years in amendments adopted in December.)
3. Restrictions on the input tax credit lead to double taxation as well as cascading/pyramiding and high costs. The application of cash basis on the input side but accrual basis on the output side of VAT puts businesses at a disadvantage.
4. Exemptions granted under different tax schemes to achieve various social, economic, and political objectives allow for the diversion of resources from the taxed to the untaxed, or from the highly taxed to the lightly taxed category, even when other economic considerations do not justify such reallocation of resources. They also complicate tax administration.
5. Differential rates of excise duties on some domestic products and imports violate WTO principles. This is also true in case of stamp duties that are levied at higher rates for foreigners than for Azerbaijani citizens.

Certain legal provisions have made the tax administration system unnecessarily complex and the following are just two examples that illustrate this observation:

1. Prior to the amendments adopted in December, 2007, every single AZN was subject to PIT when monthly income exceeded AZN 200. This increased both compliance and administrative costs without creating corresponding revenue gains. While the 2007 changes modified the basis of the exemption, it still imposes a monthly income level that is too low to justify the administrative costs of processing and collection.
2. A similar problem exists within the VAT return submission system. All groups of taxpayers are required to submit a monthly return as well as a number of documents, which is not in line with the international best practice. Such complicated procedures not only increase administrative and compliance costs, but also discourage voluntary compliance of taxpayers, leading some to join the shadow economy rather than the formal sector. They also make Azerbaijan a less attractive place for doing business.

The Azeri Government did move to simplify filing requirements for some VAT participants in the December Tax Code amendments, removing certain onerous filing requirements for certain voluntary tax filers.

Over the course of Dr. Khadka's two visits to Baku this quarter, working relationships have been developed in both the Ministry of Finance and Ministry of Taxation. While the respective ministries were receptive to proposals addressing areas of concern with the Tax Code amendments eventually enacted in December 2007, the legislation was too far along in the parliamentary process to exact change. The relationship building could prove fruitful in the next quarter. One of the amendments adopted in December establishes a new timeline for the review of the Tax Code. For 2008, any changes that effect tax policy, tax administration and tax rates must be submitted to the National Assembly of the Republic of Azerbaijan by May 15. Representatives from the respective ministries, in acknowledgement of this tight timeline, welcome TIRSP assistance in the review of the impact of the most recent amendments as well as providing legislative proposals in other areas that will improve the overall tax regime.

This quarter, Dr. Khadka also provided detailed comments on the tax section of the forthcoming American Chamber of Commerce 2008 White Paper.

U.S. Treasury has been involved in the provision of technical assistance in the tax policy and administration areas over the past eight years. One area where TIRSP intends to coordinate efforts with Treasury is in the analysis of the fiscal impact of proposed Tax Code changes. In mid-November, COP Darrell Brown met with Jean Tesche, the Treasury consultant working on the fiscal impact assessment. TIRSP, USAID and Treasury agreed to coordinate efforts so that TIRSP could complement the interim on site consulting provided by Tesche. Further work is expected to be generated in this regard in the next quarter.

Activities for Next Quarter:

- Develop draft legislative amendments to VAT, PIT, Profit Tax, and Excise Duties related sections of the tax code
- Field a short-term economic modeling expert to work with US Treasury and the Ministry of Taxes in estimating the revenue impact of the proposed tax reform measures.
- Conduct a comprehensive assessment of the existing administrative review and appeal system, including recommendations on reforming institutional set up, financial aspects, procedures, and time frames in order to make the administrative review/appeal mechanism efficient, fast and impartial.

We expect a minimum of four weeks STTA over the next quarter, two devoted to fiscal impact and two focused on further legislative analysis and reform. TIRSP staff will provide additional, ongoing support.

Activity Six: Agriculture Policy

This quarter, the project fielded Richard Burcroff, a PhD agricultural economist with extensive experience in agricultural policy development in Eastern Europe and the former Soviet Union, to conduct an initial assessment of the agricultural policy development efforts at the Ministry of Agriculture and to develop a TIRSP action plan for agricultural policy development support. The plan was developed in close coordination with TIRSP Agricultural Economist Fariz Ahmadov. TIRSP was also involved in collaborating with other USAID projects and the Ministry of Agriculture in developing an Agricultural Sector Strategy.

Agriculture Sector Strategy Development. In August-September, TIRSP began collaboration with the USAID-funded Public Investment Planning (PIP) Project to provide comments on a draft agriculture sector strategy produced by the Ministry of Agriculture. Though the MOA had received earlier World Bank assistance in developing the sector strategy, the Ministry's draft ultimately rejected the majority of the World Bank's suggestions. The result is a draft strategy that is neither market-oriented nor WTO compliant. TIRSP and PIP experts continued to discuss the draft strategy with various MOA and MOED staff and prepared, proposed, and discussed with concerned officials a

set of comments and recommendations to improve the strategy. TIRSP's recommendations emphasized the importance of avoiding policies that contradict WTO accession requirements.

In early December, MOA informed TIRSP that the draft strategy had been authorized for submission to the Cabinet of Ministers, where approval is expected by early 2008. It is our understanding that the submitted version contains only cosmetic changes from the draft commented on earlier by USAID's experts. Subsequent attempts to obtain a copy of the submitted draft and to discuss particulars were rebuffed, however, in both MOA (despite the Minister's assurance on December 3, 2007 in a joint meeting with USAID officials and consultants, that MOA's Senior staff would be available for consultation) and in the MOED. However, some within MOED at the department head level and above recognize the flaws, and informed that these would be addressed when the government develops its operational plan once the strategy has been approved.

We are awaiting the outcome of the approval process. MOED has indicated its need to staff up with agri-food industry and rural development experts. This could soon prove an especially acute need, as it appears the operational plan will be developed by an inter-ministerial working group whose work will be guided by MOED and MOF, in recognition that many of the elements of the draft strategy reside beyond the purview and responsibility of the MOA. In a slightly different context, we understand that the Ambassador has offered to provide expert support for the working group. Here, the TIRSP project could serve as an informal secretariat for the working group should Government so desire. If the Ambassador's offer is accepted by Government, TIRSP stands ready to support development of the operational plan with short term and local agriculture experts. Meanwhile, guidelines submitted earlier by a DAI consultant (Richard Anson) provide a framework and sequence of steps that the working group might usefully consider as it moves forward with the operational plan.

Food Security Seminar. On December 5, MOED and TIRSP organized a seminar titled "Food Security, Food Crises and Price Stabilization - Lessons from International Experience" Chaired by Vice Minister Sevinj Hasanova (MOED), the seminar was organized in response to Government's growing concern with escalating international grain prices and export bans imposed by some of Azerbaijan's major suppliers. Topics covered ranged from "What does 'food security' really mean?", to an overview of policy instruments used internationally to improve food security, pointers for implementation, and a discussion of the WTO requisites for approval of state managed stockpiling operations. World wheat indicators and likely price developments were discussed, followed by an overview of country responses to the current and impending shortages among Azerbaijan's major suppliers and in China and Serbia. The seminar concluded with a summary of lessons for short-term "crisis" management and the design of longer-term market-driven strategies to better realize food security in future crisis situations. Attendees included representatives from the Cabinet of Ministers, from MOED, MOA and several other Government departments as well as from donor agencies and specialized UN agencies.

Following the seminar, and at the request of the Chair, TIRSP staff visited offices of several of the participants to further discuss Azerbaijan's intended responses to instability

in international wheat markets. The Government's preparations to address the immediate crisis, expected to continue into the 2008 import and 2008/09 marketing year, appear to be five-fold. These include a mix of temporary and permanent incentives designed to subsidize fertilizers and on-farm fuel consumption, subsidize wheat plantings, and cheapen the price of imports by removing the VAT of wheat flour and bulk wheat imports. Additional measures aim to rejuvenate the domestic supply of certified seeds (mainly wheat) and assist import financing from soon to be established grain and seed (import) funds. These measures are now before the President, with approval expected by mid-January.

Though management of the several aspects of these programs will require inter-agency coordination, we were advised that no attempt has yet been made to re-establish the Food Security Commission which was activated following the issuing of the Government's (well-conceived) Food Security Strategy of 2001. The head of the Agro-industrial Dept. of the Cabinet of Ministers informs that the Government will organize itself to better coordinate these food security measures once presidential approval has been received, and allowed that it will require expert assistance in setting up the import marketing strategy and longer term features of a staples price stabilization/import management scheme. The Project will continue to monitor developments in this realm, and will follow up with short-term advisory service should an (expected) opportunity to engage be requested following issuance of Presidential approval.

Action Plan Development. In December, ST Agricultural Expert Burcroff submitted his report and action plan for agricultural policy development under TIRSP. The action plan was developed in recognition of the extensive involvement of the World Bank in Azerbaijan's agri-food sector. World Bank and IFC prior and continuing involvement covers an extremely wide swath of the policy, investment and technical assistance needs for developing the sector, even by World Bank standards. Rather than attempt to duplicate or compete with the Bank Group's operational program, the TIRSP action plan seeks to "gap-fill" in several important areas, which currently are not being explicitly addressed by the Bank, GTZ or by other donors. In developing the plan, the TIRSP team conducted preliminary review of four agricultural sub-sectors with good development potential. The team also identified other areas where TIRSP might assist, including reform of the inputs delivery system, and improving financial markets for investment credits and working capital. The report has been submitted to USAID and is awaiting approval.

Activities for Next Quarter:

- Assist inter-agency working group with development of the operational plan to implement an improved program for agricultural development;
- Work with PIP (or upcoming PERSP) implementer to rationalize the Agricultural Public Investment Program;
- Advise MoA as needed on food security issues;
- Commence agricultural sub-sector targeted support.

The above activities could be STTA intensive. USAID has requested redeployment of our agricultural economist by the end of January to support the inter-agency working group. Proposed work plan activities, if approved, could also require food security,

marketing/value chain, seeds industry and legal specialists. Should all activities be endorsed by USAID we anticipate no less than 12 weeks of STTA deployment over the next quarter.

Activity Seven: SPS Implementation

The TIRSP SPS expert, Bill Hargraves completed a preliminary assessment of the SPS system in September-October 2007; however Mr. Hargraves departed from the project in early October 2007. Mr. Hargraves' initial work has been supplemented by two major assessments completed in the November/December time frame. Short term experts, Thomas J. Hoffman (Food Safety Specialist) and Dr. Thomas Deeb combined forces to complete a diagnostic of the SPS and food system in Azerbaijan. The draft reports detail Azerbaijan's agriculture and food system's ability to comply with SPS norms, to define gaps between the requirements and current state, to define a set of prioritized activities to close these gaps, and to recommend trainings to upgrade food safety capacity.

The areas of evaluation in the SPS study included the legal and regulatory framework; institutional structure and capacity (e.g.; organizational structure); facilities and equipment (e.g.; properly equipped labs and facilities); human resources and development (training, ability to conduct risk assessments and create disease-free areas); documented procedures and systems (standard operating procedures, checklists and quality control); and international/regional cooperation (ability to report outbreaks to international groups, ensure the inspection of imports and exports). As part of the evaluation, seventeen SPS summary categories were scored covering a broad range of capacities:

The draft SPS Assessment Report provides a full summary of the various organizations ability to meet the international norms as outlined by the IPPC, OIE, and CAC. In addition, Mr. Hoffman has prepared a separate report that evaluates the capability of the public sector to conduct food safety inspections; assesses HACCP management systems; reviews the regulatory environment related to food safety; evaluates the educational system in the areas of food safety, quality control, HACCP, SSOP, and GMP; assesses local consulting firms' training capacity; reviews donor activities; provides a training work plan; examines company capacity to satisfy food safety assessments relative to international norms and proposes terms of reference in support of further technical assistance on SPS food safety matters.

The Hoffman/Deeb team has outlined a number of activities that may, in whole, in part, or in collaboration with other U.S. Government, bilateral and/or multilateral donors be conducted. Areas to be covered by TIRSP will be identified following USAID's review of the assessment, the prioritization of key areas and an assessment of TIRSP's ability to assume responsibility of certain activities given its limited resources and scope.

Activities for Next Quarter:

Since we have yet to agree on a full slate of activities and priorities, we can only provide a sampling of contemplated second quarter activities. These include:

- Assistance with establishing standards priorities (approximately 25 days of LOE);

- Assessment of public and private laboratories assessments (30 days);
- Support for USDA sessions on inspection training;
- Training on Sanitation Standard Operating Procedures (SSOPs);
- Training on animal health.

Activity Eight: Utility Sector

The utility sector subcomponent has the overall goal to transform the current state-owned, vertically integrated utility sector into an efficiently managed, unbundled, modern, privately operated system delivering high quality services at reasonable prices.

This quarter TIRSP, through the work of Utility Sector Advisor Hasso Bhatia and local Utility Sector Specialist Mehman Rzayev, has made strides in building relationships with key counterparts, providing education and training, and preparing diagnostic assessments and draft documents.

Counterpart/donor relationships. Utility Sector Advisor Bhatia had a pre-existing relationship with Tariff Council Secretary Elshan Asadov, and this has been a boon to the project. Our relationship building with the Tariff Council has resulted in the Council's provision of office space to the project and, we hope, the expansion of that space in the near future to support additional TIRSP utility sub-component staff. The utility sector team has also built relationships with key figures at MED, Ministry of Industry and Energy, State Committee for Management of State Property, Azerenergy, Azerigaz, Baku Electric Distribution company and the Imshili Water Joint Venture. TIRSP has also developed strong working relationships with other donors working in the utility reform area, including the World Bank, EU, ADB, KfW, and ERRA and has proposed holding periodic roundtables with donors on utility sector developments.

Education and training. This quarter, the project:

- Prepared and delivered presentations on *Utility Sector Goals and Strategy in Azerbaijan* and *Elements of Power Purchase Agreements for an IPP*
- Prepared a White Paper on *Line Extension Policy for New Customer Connections* and a draft paper on *Linking Economic Growth and Institutional Strengthening in the Utilities Sector*, and
- Preparation of a survey questionnaire at the request of the Tariff Council on *Factors Affecting Regional Market Energy Transactions* in support of Mr. Asadov's attendance at an ERRA meeting in Bucharest, Romania.

The project has also developed training materials on several topics including:

- Elements of Utility Regulation (How a Regulatory Body Works);
- Electric Tariff Methodology, Calculation and Tariff design;
- Consumer Protection and Consumer Rights - DR and Complaint procedures; and
- Elements of a Power Purchase Agreement.

These materials will be used in seminars and workshops scheduled to commence next quarter. Though the bulk of these trainings were required in the RFTOP and therefore inserted in the draft work plan, presentations have been shaped by requests from

counterparts. For example, Deputy Minister Jabbarov (MED) requested and received a presentation on power purchase agreements. Likewise, the State Committee for Management of State Property has requested targeted analysis and training in the first quarter of 2008 covering restructuring of the gas supply system, opening of the gas distribution system to private management, and institutional and financial restructuring of water and heat supply systems. Consequently, while a number of initiatives were pre-defined, GOAJ has responded by making training requests that are consistent with our previously constituted plans.

The audience will vary depending on the topic and targeted sector. For example, those dealing with the details on tariff methodology will be attended primarily by Tariff Council staff. However, for the broader based policy issue seminars, we will seek to attract appropriate representatives from the Tariff Council, the State Committee on Management of State Property, MED, Ministry of Energy and Industry, Azerigaz, Azersu, Azerenergy, etc.

Diagnostic assessments and draft documents. The Utility Sector team spent much of the quarter preparing and submitting extensive data requests on system profiles, organization structure, functional costs, system losses, and consumption and tariffs to Azerigaz and Azerenergy. The data received has been analyzed and used to develop tariff recommendations.

Diagnostic assessments have been completed or are now in draft form on:

- Tariff Council legal authority, procedures, organization, analytical capacity, and staffing needs;
- Structure, organization, sector unbundling, and recent privatization/management contracting history, current status of the electric and gas sector
- Gas and electric tariff issues and options in tariff reform (preliminary assessment)
- Current structure, rehabilitation, tariff levels and structure, private-public partnership pilot, and options analysis for the water sector.

In addition, supporting research has been completed to allow for the drafting of a new Energy Law or the Regulatory Law at short notice once counterpart buy-in is achieved; an unbundling plan has been outlined for Azerenergy; and drafts have been prepared of consumer complaint and dispute resolution procedures, initial reviews on service quality standards, and identification of options and practical constraints;

The project has also completed an initial review of barriers to reforms, private investments, and GoAJ responsiveness has been completed.

Activities for Next Quarter:

- Prepare detailed presentations on the rationale, recommendations and action plan and legal basis for establishment of Energy Law which includes creation of the regulatory body;
- Develop and recommend an organization structure to strengthen the utility sector functions of the Tariff Council

- Develop and commence the training program for TC staff
- If sufficient buy-in can be obtained from relevant GOAJ decision makers, draft detailed documents for creation of an Energy Law, including formation of a regulatory body, market restructuring, wholesale market and access.
- Analyze cost data, development of electric tariff levels for each functional component: generation, transmission and distribution
- Recommend electricity tariff levels approaching full-cost levels
- Analyze component gas cost data
- Recommend the realignment of transport/storage, wholesale distribution tariffs; and retail use tariffs
- Detailed assessment of water sector structure, regulation and tariffs
- Begin developing recommendations for decentralized systems with local management control
- Begin developing recommendations for regional regulatory scheme with central guidelines
- Conduct trainings on Elements of Utility Regulation (How a Regulatory Body Works), Electric Tariff Methodology, Calculation and Tariff design; and Consumer Protection and Consumer Rights - DR and Complaint procedures

We anticipate providing STTA to focus on tariff setting methodology. The estimated LOE would be in the range of 4 to 6 weeks. We have added an additional local consultant who is slated to work part time in addition to Mehman Rzayev and Hasso Bhatia. We are also considering retaining a local tariff specialist short term to assist with revisions to the tariff setting methodology.

This quarter commences more intensive training activities. We have met with NARUC to discuss coordinating training programs to ensure that we collectively provide complementary assistance and make the most efficient use of scarce technical assistance funding.

Activity Nine: E-Government/E-Commerce Support

In the draft TIRSP work plan submitted in December, the project suggests working in the area of e-government and e-commerce support. This stems from a specific request from the Head of the Entrepreneurial Development Policy.

In 2003, the GOAJ developed a nine year (2003 – 2012) action plan on development of a national information and communication technology infrastructure. GOAJ has received intermittent technical assistance. TIRSP has not had an opportunity to ground truth at what stage the government is at in fulfilling its stated ICT objectives under its ICT strategy. However, we can define in general terms areas that would be consistent with and support reform activities specified in other areas of this work plan.

Activities for Next Quarter:

Should the e-signature work be approved as part of the overall work plan, proposed activities for next quarter include:

- Assess status of secure signature penetration
- Prepare an Action plan to support broad based issuance of digital signatures
- Conduct Legal review of filing requirements across legislation to identify needed omnibus legislative amendments authorizing e-filing
- Draft omnibus legislation permitting e-filing
- Harmonize legal framework to prevent cyber crime, including implementation of the Council of Europe Cyber Crime Convention

The initial inquiries should be conducted by in-house TIRSP personnel. If USAID mandates support, we anticipate at least one STTA assignment of two to three weeks duration.

Activity Ten: Support for the Establishment of Industrial Zones

In October, MED indicated it was on a fast track to promoting the development of an industrial park at Sumqait, north of Baku. MED told the project that 267.34 hectares had been allocated for an industrial zone, 10 million USD had been allocated to support the establishment of a modern infrastructure for the park (electric power, potable water, natural gas, sewage system, roads, communications, etc.), and construction was slated to commence in October to November 2007 pending selection of a contractor through an open tender process. TIRSP offered to review any plans undertaken thus far and provide best practices/lessons learned in industrial park development.

In November, however, the GOAJ reversed its position. The land previously designated for park use would now be dedicated to other uses. While MED still wished to pursue the industrial park option, it was essentially re-starting the entire process. TIRSP provided a short-term Industrial Park Specialist, Geoff Wright, to review the current status of special economic zones and industrial parks in Azerbaijan and to map out a strategy for the creation of a unified industrial park and free zone regime in Azerbaijan. In December, Mr. Wright presented preliminary recommendations to Mr. Samir Nuriyev, Head of the Entrepreneurial Division at MED and provided a draft version of his report to the Ministry.

The report analyzes Azerbaijan's potential as a regional transport and logistics hub, as well as potential competition from other regional players (e.g., Georgia, Kazakhstan, Turkmenistan). The report also analyzes the current legal, policy and institutional framework in place to regulate the operation of free zones and industrial parks, including the compliance of these frameworks with WTO accession requirements. In the end, the report recommends the establishment of a hybrid special economic zone (SEZ) regime that is flexible enough to regulate the development and operation of both free zones and industrial parks. This will prevent the creation of two competing zone regimes in Azerbaijan, and help ensure serviced land is available to industrial as well as transshipment activities.

Activities for Next Quarter:

Should the industrial zone work be approved as part of the overall work plan, TIRSP will :

- Complete studies on market demand, location and infrastructure completed (March 2008)
- Complete Investor Interest Studies (March 2008)
- Draft implementing regulations for the entire regime

The industrial park work is STTA driven and, depending on the extent of the commitment, intensive and resource significant. The above work essentially entails the conducting of pre-feasibility and feasibility studies together with assistance in creating the appropriate legal framework. Mr. Wright's estimate to complete all aspects of Phase 1 would entail 220 days of expat LOE and 160 days of local STTA. He wrote a draft SOW on the assumption that there would be GOAJ co-funding and possibly investor contributions to certain aspects of the industrial park design. However, even with co-funding, MED expectations of TIRSP assistance likely far exceed the available resources and funding that can be committed to this activity. TIRSP will attempt to carve out a meaningful intervention based on the level of commitment that is approved in the draft work plan.

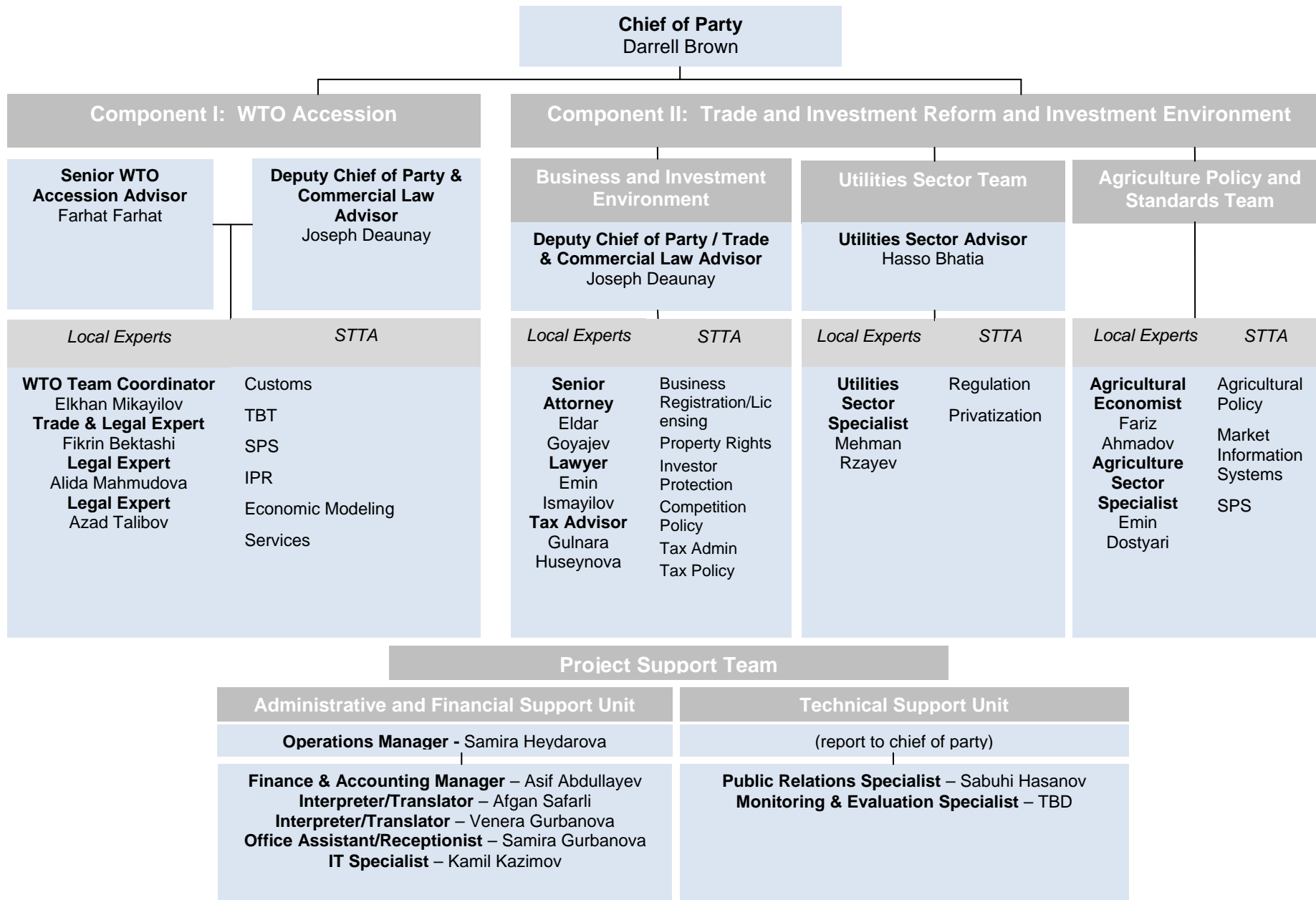
STAFFING

Annex A shows the staffing chart as of the end of this quarter. The staff number has grown to 22 with three long term expatriate advisors. Darrell Brown replaced Julian Simidjiyski as the Chief of Party effective December 9th. Mr. Brown had been deployed in September and October on short term business environment engagements and played a key role in revising the draft work plan. While he has overall responsibility for the project's functioning, his technical focus will be on business environment initiatives. Other long term expatriate personnel include Mr. Joseph Deaunay who provides crossover support in both the WTO and business environment arenas and Hasso Bhatia, who is dedicated to utility sector technical assistance. Although scheduled to be deployed roughly 50 percent of the time, Farhat Farhat plays a critical role in monitoring and implementing the Component One WTO activities. The expats are buttressed by an impressive pool of local consultants who, particularly on the WTO issues, bridge the gaps in expat coverage.

Over the first quarter, 22 STTA consultants have been deployed. For extended periods, the short term contingent numbered in double figures. Local staff has done an exceptional job in supporting the STTA consultants both on logistic and substantive matters so that key deliverables, diagnostics and assessments could be successfully completed.

As we move to the second quarter, the intensity of short term deployments is expected to lessen. This will allow TIRSP to launch another component of its proposal, the internship program. TIRSP is targeting to retain five interns in the first quarter to assist in various substantive and support roles including legal and translation services. More tasks will also be delegated to local technical staff in recognition that the budget will not support a continued STTA deployment at the rates incurred over the first quarter.

ANNEX A. USAID TRADE AND INVESTMENT REFORM SUPPORT PROGRAM IN AZERBAIJAN ORGANIZATIONAL PLAN



ANNEX B. DRAFT LEGISLATION SENT TO WTO SECRETARIAT

The following lists the drafts which have been sent to the WTO Secretariat and their status within the legislative process.

At Milli Mejlis (Parliament)

- Draft Amendments to the Law “On Normative Legal Acts” No. 761-IQ, dated November 26, 1999
- Draft Amendments to the Law “On Currency Settlement” N. 910 dated 21 October 1994

At President Office:

- Draft Amendments to the Law “On Copyright and Related Rights” No. 115-IQ, dated July 5, 1996
- Draft Amendments to Law of the Republic of Azerbaijan “On State Duty ” No. 223-IIQ, dated December 4, 2001
- Draft Amendments to President Decree 619 of December 26, 2001

At Cabinet of Ministers:

- Draft Customs Code – valuation
- Draft Amendments to the Law of the Republic of Azerbaijan “On Patent” No.312-IQ dated July 25, 1997
- Draft Law “On Securing Intellectual Property Rights and Combating Piracy
- Draft Law “On Protection of Rights of Broadcasting Organizations in Digital Network
- Draft Law “On Technical Regulation” (new)
- Draft Cabinet of Ministers Resolution “On Rules on Determination of the Minimum Amount, Distribution and Payment of the Author’s Royalty for Reproduction of Works and Audiovisual Works from Phonograms for Exclusively Personal Purposes”
- Draft Cabinet of Ministers Resolution “On Declaration of Works to be Fallen Into Public Domain
- Draft Cabinet of Ministers Resolution “On Minimum Tariffs for Use of Subject Matters of Related Rights”
- Draft Amendments to Cabinet of Ministers Resolution “On Rates of Customs Duties for Import and Export Transactions and Amount of Fees Charged on Customs Clearance in the Republic of Azerbaijan” No.80 dated April 12, 2001
- Draft Amendments to Cabinet of Ministers Resolution “On the Rules for Customs Valuation Methods for Goods Imported into and Exported out of the Republic of Azerbaijan” No. 7 dated January 12, 1998
- Draft Amendments to Cabinet of Ministers Resolution “On Approval of the Rules of Determination of Origin of Goods” No. 202 dated November 2, 2000
- Draft Amendments to Cabinet of Ministers “On Rates of Fees Paid for Currencies Taken of the Republic by Resident Physical Persons” No. 79 dated 17 May 2002

The following has been prepared with the assistance of TIRSP and submitted to the Cabinet. It will be sent to the WTO Secretariat as one package with other SPS Laws (food safety, veterinary, and phytosanitary).

- Draft Amendments to the Law of the Republic of Azerbaijan “On Sanitary and Epidemiologic Welfare” No.371 dated November 10, 1992

Drafts Being Finalized for Sending to the WTO Secretariat:

The following are currently being finalized with the assistance of TIRSP at the Ministerial level for sending to the WTO Secretariat and the Cabinet of Ministers before end of December 2007.

- Draft Amendments to the Law of the Republic of Azerbaijan “On Trademarks and Geographical Indications” No. 504-IQ, dated June 12, 1998
- Draft Amendments to Decree of the President “On Further Liberalization of Foreign Trade in the Republic of Azerbaijan” No.609 dated June 24, 1997
- Draft Amendments to the Rules “On Rules of Issuance of Special Permission (Licenses) for Some Types of Activities” approved by Decree of the President No.782 dated September 2, 2002
- Draft Amendments to the Law of the Republic of Azerbaijan “On Viticulture and Wine-Making” No. 208-IIQ dated October 19, 2001
- Draft Amendments to the Law of the Republic of Azerbaijan “On Tobacco and Tobacco Products” No. 138-IIQ dated June 8, 2001
- Customs Code – intellectual property section

Drafts at various stages of Preparation

The following are drafts at various stages of preparation to be finalized for submission to the WTO Secretariat during the first quarter of 2008:

- Draft Amendments to the Selection Achievement Law
- Draft Amendments to the Undisclosed Information Law
- Draft Amendments to the Law on Legal Protection of Topologies of Integrated Schemes Law
- Draft Amendments to the Law on Pharmaceuticals
- Draft Amendments to the Criminal Code - IP aspects
- Draft Amendments to the Code of Civil Procedures - IP aspects
- Draft Amendments to the Law on Food Safety
- Draft Amendments to the Law on Veterinary Service
- Draft Amendments to the Law on Phytosanitary
- Draft Law on Trade Remedies
- Draft Amendments to the Law on Public Procurements
- Resolution No. 165/2002 on Tender Prices

Legislation being Analyzed for WTO Conformity

- Law on Foreign Trade Policy (new)
- Resolution No 180/2002 on state fees for Licenses

- Law on Export Control
- President Decree No. 457/2001 on Temporary Suspension of Export of Scraps/wastes of Ferrous/Non-Ferrous Metals
- Law on Temporary Tax Exemptions for Agricultural Producers
- Law on Controlled Prices No. 462-IIQ, dated 30 May 2003
- Resolution No. 12/2002 on currency operations of residents/non-residents

Implementing Regulations

TIRSP has already provided and discussed the following model legislation with the Customs Service. The Customs Service agreed to fully implement TIRSP's proposed recommendations:

- Draft Resolution on implementation of the WTO Agreement Customs Valuation Interpretative Notes
- Draft Resolution on Non-Preferential Origin
- Draft Resolution on Valuation of Software
- Draft Amendments to Rules of Customs Committee of the Republic of Azerbaijan "On Carrying Out of Customs Controls over Transportation of Intellectual Property Goods across the Customs Borders of the Republic of Azerbaijan", dated 14 May 2003

ANNEX C. SHORT-TERM CONSULTANT LEVEL OF EFFORT

Please find below a summary table of all short-term expatriate (USN and TCN) consultant LOE approved and used from August through December 2007.

Table 1. Short-Term Consultant Level of Effort

Name:	Description:	Total Approved LOE:	LOE Used:	LOE Remaining:
Brown, Darrell	Commercial Lawyer	27	24	3
Burcroff, Richard	Senior Agricultural policy Specialist	30	28	2
Caner, Selcuk	Econometrician and Tax Expert	32	0	32
Deeb, Thomas	(SPS) Specialist	40	40	0
DeGrande, Dustin	Chemonics Home Office Manager – Start-Up Specialist	13	13	0
Farhat, Farhat Youwakim	Senior WTO Accession Advisor	192	57.57	134.43
Fitzpatrick, Dan	Collateral Law and Privatization Specialist	28	25.5	2.5
Hjort, Kim	SPS and TBT Specialist	72	50	22
Hoffman, Tom	SPS/Food Safety Specialist	19	19	0
Irvin, Benjamin	Trade Remedies Specialist	52	46	6
Khadka, Rup	Tax Policy and Administration Expert	38	26	12
Lewarne, Steven	Macroeconomist and Work Plan Advisor	9	9	0
Maier, Polly	IPR Specialist	38	20.75	17.25
Millan, Hector	WTO Advisor & Tariff Negotiations Specialist	30	30	0
Moisseyev, Andrey	Modeling and Trade Information Expert	79	79	0
O'Shea, Brian	Customs Specialist	40	26	14
Sahaydachny, Simeon	Procurement Specialist	40	36	4
Schanck, Jeremy	Chemonics Home Office Director - Workplanning	14	14	0
Schiffman, Steve	IPR Specialist	33	31	2
Snelbecker, David	Trade Policy Reform Expert	9	9	0
Wright, Geoff	Trade, Int'l Transaction, and Competition Policy Specialist	23	23	0
Zaldastanishvili, Diana	Project Management Specialist	20	20	0

