

THE INTERNATIONAL DEVELOPMENT ASSOCIATION  
AND INTERNATIONAL MONETARY FUND

**AZERBAIJAN REPUBLIC**

**Joint Staff Assessment of the Poverty Reduction Strategy Paper**

Prepared by Staffs of the International Development Association  
and the International Monetary Fund

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**1. OVERVIEW**

1. **The State Programme on Poverty Reduction and Economic Development 2003-2005 (SPPRED) is the first full poverty reduction strategy paper (PRSP) of Azerbaijan.** It builds on the interim report (I-PRSP) presented to the Boards of the International Monetary Fund (IMF) and the International Development Association (IDA) in June 2001. The SPPRED represents an important milestone in Azerbaijan's ongoing efforts to elaborate a comprehensive, home grown strategy for poverty alleviation and economic growth. It marks the start of a comprehensive dialogue on the overall development strategy between the government and all key stakeholders. Recognizing that "poverty alleviation measures cannot be formulated just by national governments and donor organizations", the program deepens the involvement of the representatives of civil society in the formulation process.

2. **The SPPRED represents a joint effort between the government and civil society in the country.** It relies on the input of 15 Sector Working Groups (SWG) established at the respective ministries and including civil society representatives along with the government officials. The efforts of these working groups were coordinated in the PRSP Secretariat at the Ministry of Economic Development. Six key strategic aims were identified: (i) the facilitation of an enabling environment for growth of income-generating opportunities; (ii) the maintenance of macroeconomic stability; (iii) the improvement in the quality of and equity in access to basic health and education services; (iv) the improvement of infrastructure (including roads, delivery of utility services, communications, irrigation); (v) the reform of the current system of social protection to give more effective protection to the vulnerable; and (vi) the improvement of the living conditions and opportunities for the one million refugees and Internally Displaced People (IDP) of the Nagorno-Karabakh conflict.

3. **There remain areas where progress needs to be made during the implementation and subsequent updates of the SPPRED.** The poverty analysis has improved compared to the I-PRSP. The effort to improve data collection for the monitoring of living standards that began in 1999 with the implementation of the Household Budget Survey (HBS) needs to continue. For the government to target support to those most in need, it is important to further strengthen the capacity to collect and analyze data. The government also needs to ensure that the collection of data on the labor market, education and health follow internationally accepted definitions to allow better comparability between the living standards of Azeri people and other countries, and facilitate monitoring of progress towards the Millennium Development Goals (MDGs). Furthermore, the links between the poverty diagnosis, poverty reduction strategy objectives, and priority actions need to be further strengthened. Further progress is also needed in the areas of costing and prioritization of policy actions presented in Appendix 1 for future updates to enable the authorities to effectively fight poverty within the available resource envelope. In this regard, financing requirements and sequencing for priority SPPRED actions need to be further defined and linked with annual budgets within the Medium Term Expenditure Framework (MTEF) and Public Investment Program (PIP). Successful implementation of the SPPRED also calls for continued institutional capacity building within the government for strategy formulation, implementation, monitoring and evaluation, and resource management. Achieving better allocative and operational efficiency will be particularly important in view of rising oil revenues in the coming years, as outlined in the recent Public Expenditure Review (PER). At the same time, efforts must be undertaken to ensure continued and broad civil society participation in further policy development.

## 2. THE PARTICIPATORY PROCESS

4. **The SPPRED is based on a participatory process involving all branches of government, parliament, civil society, the private sector and donors—reflecting the recommendations outlined in the Joint Staff Assessment of I-PRSP.** The SPPRED was launched at a major workshop bringing together these stakeholders. To assure cross fertilization between the SWGs a number of roundtable discussions were held. A large number of focus group discussions and individual interviews were conducted throughout the country to capture the opinions of those most affected by poverty. The SPPRED commits to an even more expanded and intensified participation process during the implementation phase.

5. The program identifies the government, parliament, the national and international NGOs, media and the municipalities as the main players of the policy formulation process. **The consultation process revealed that communities have reasonable capacity to mobilize resources to resolve the most immediate needs of poverty reduction.** However, people living in remote areas feel socially excluded and are more skeptical and apathetic about the prospects for improvement, and participation amongst women remained low. In view of this, staffs encourage further community development as an important part of the poverty reduction strategy implementation. Support and further development of municipalities will also contribute to the improvement of basic social service delivery.

6. **The SPPRED views giving a genuine voice to the poor as an important challenge for the implementation and monitoring stages of the PRSP process.** It emphasizes the importance of a properly organized monitoring system that would help evaluate the effectiveness of the policy measures, and specifies the role the civil society, international organizations and donor community can play in the regular monitoring process of SPPRED. The staffs recommend to fully utilize the capacity of the civil society in data/information collection through the involvement of NGOs and other independent institutions in qualitative research activities.

7. **The authorities have actively involved international financial institutions (IFIs) and donors throughout the preparation of the SPPRED.** Donors have provided significant technical and financial support from the outset.<sup>1</sup> This was crucial in supporting preparation of a number of analytical studies that helped in formulation of the SPPRED, including a poverty assessment prepared jointly by the World Bank and the government. A series of Town Hall Meetings encouraged by USAID continued the dialogue between Azeri citizens and the government. Overall, such broad and open discussions were a new experience for Azerbaijan. To ensure broad-based ownership of the reform agenda as part of the SPPRED it will be necessary to further strengthen the participatory process. Institutionalizing the participation, developing capacity of the key players in the process, and enhancing the role of Parliament in particular will help achieve that objective. A professionally designed and executed two-way communication strategy could be key in this respect.

8. The SPPRED process received coverage on both TV and radio. **The highlight was the PRSP workshop in October 2002, which was chaired by President Aliyev and aired on TV.** Currently, the PRSP Secretariat is setting up a comprehensive reference library. Regular coverage both in the broadcast and print media are being considered to ensure dissemination of information during the implementation stage. In addition, the staffs support the ongoing development of the government's dedicated PRSP website.<sup>2</sup>

### 3. POVERTY DIAGNOSIS

9. **The SPPRED poverty diagnosis is based on representative household data and was produced in collaboration with the Bank's Poverty Assessment 2002.** While the State Statistical Committee (SSC) has been carrying out regular Household Surveys for decades, its original form was not adequate for poverty monitoring or for measuring the impact of social policies. Therefore, a new household budget survey was introduced in January 2001. The sample (8000 households achieved through full quarterly rotation: 2000 new households

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<sup>1</sup> In addition to the Fund and the World Bank, the ADB, the EBRD, EU, UNICEF, UNDP, USAID, and other donors have been closely involved in developing the SPPRED.

<sup>2</sup> [www.economy.gov.az/PRSP/Index\\_PRSP.htm](http://www.economy.gov.az/PRSP/Index_PRSP.htm)

participate in the survey each quarter) uses three-stage probability sampling with preliminary stratification by urban and rural areas and by region. The poverty analysis of the SPPRED is based on the representative 2001 HBS. A few more years of consistent HBSs would be needed in order to develop a satisfactory analysis of the impact of growth on poverty, especially given the dichotomy between the oil and the non-sectors. Such an exercise would be important to pursue.

10. Poverty remains a major challenge in Azerbaijan. Azerbaijan is a country with about 8 million population and per capita gross domestic product (GDP) of \$650. **Almost 4 million people or about 50 percent of population of Azerbaijan lived in poverty in 2001, consuming less than AZM 120,000 (US\$25) per capita per month.** Among these, a group of 1.3 million persons, or 17 percent of the total population, lived in extreme poverty, with monthly consumption below AZM 72,000 (US\$15) per capita per month.

11. **It is clear that the IDPs are a core group of particularly vulnerable people, as they lack assets and their livelihood depends heavily on state transfers, or donor assistance.** It also appears that the IDP population in Baku is of particular concern, as they tend to be significantly worse-off than the rest of the population in the capital city. However, there is some uncertainty about the extent of income poverty among the IDPs compared to the general population. According to the national household survey results, individuals living in a rural IDP/refugee household are more likely to be poor than the average. A possible reason for this may be because IDPs and refugees did not receive land and other agricultural assets in the farm privatization process. However, the results of a more detailed survey focused on IDPs suggest that they do not seem to have significantly lower incomes than the other groups in the same areas with whom they were compared, although the survey did find some substantial differences among the income levels of IDPs.

12. **The HBS survey needs to be strengthened further.** In particular, the measurement of welfare should move from the current definition of expenditures toward the economic concept of consumption. The training of the interviewers should also be improved, and the survey should have a flexible design that can quickly respond to the demand for policy analysis in any period. Furthermore, the discrepancy between official statistics and survey data points to a weak system of reporting in the public health system, and to the fact that many households are reluctant to use public facilities from which the official statistics are generated. Therefore, to monitor the progress on specific MDGs, such as infant mortality, maternal mortality, HIV, additional monitoring efforts beyond the HBS are needed. Efforts should also be made to review the living conditions of IDPs. This work could build upon the IDP survey carried out by the World Bank and UNDP. Finally, it will be important to monitor and mitigate the distributional and poverty impact of the ongoing and envisioned reform program.

#### 4. PRIORITY PUBLIC ACTIONS

13. **The broad policy priorities of the SPPRED are appropriate**, and the six pillars discussed above are consistent with the multi-dimensional nature of poverty alleviation. The policy matrix set forth in the SPPRED is generally consistent with these pillars.

14. **With the SPPRED the authorities made a good attempt at costing, prioritizing and sequencing policies.** However, there is a need to improve cost estimates. The staffs see this as a serious shortcoming of the SPPRED and further capacity building effort will be needed in this area. An appropriate tool for better costing, prioritization and sequencing of the plan is the recently introduced MTEF. As articulated in the new PER, full implementation of the new Budget Systems Law and integration of the SPPRED with the stipulated budget planning process and procedures is important. The PER will also be helpful in communicating a coherent and feasible reform agenda to civil society.

#### MACROECONOMIC FRAMEWORK, FISCAL CHOICES, AND FINANCING PLAN

15. **The medium-term macroeconomic framework aims to achieve balanced economic growth and a stable macroeconomic environment as the basis for a sustainable poverty reduction effort.** The macroeconomic framework targets a low inflation rate of around 2-3 percent per annum and projects real GDP growth of about 11 percent per annum, over the period 2003-05.<sup>3</sup> These targets are realistic given the real growth performance of around 11 percent and inflation of 2.3 percent on average over the last three years, and expected future growth in the oil sector with spillovers to the non-oil sector. Real growth in the non-oil sector is projected to average 9.7 percent in 2003-05, and will be critical for successful poverty reduction. The SPPRED rightly recognizes that careful macroeconomic management will be critical to achieving balanced growth between the oil and the non-oil sector given the expected large net FDI influx and even larger oil export revenues in the future. The SPPRED, therefore, could have benefited from a detailed analysis of the sources of future non-oil sector growth. The oil-sector is forecast to receive a major boost in 2005 with a growth rate of 41 percent that year. While such a rapid expansion of the oil sector—which now comprises 1/3 of the economy—runs the risk of impeding growth in the non-oil sector, the foreseeable rapid profit repatriation and the planned build up of the State Oil Fund will limit the Dutch disease risks. The staffs encourage the authorities to discuss the implications to all aspects of the SPPRED of any revisions to the macroeconomic framework, which are made over time to reflect changes in the economic outlook, in the context of the participatory process going forward.

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<sup>3</sup> Differences between the macroeconomic framework in the SPPRED and the most recent Letter of Intent for the PRGF arrangement reflect the fact that the PRSP macroeconomic framework was finalized some months before the PRGF framework. The government has acknowledged, in writing, that the macroeconomic framework for the PRGF is consistent with the SPPRED framework, updated to reflect new information and developments in such things as oil prices.

16. **The medium-term fiscal policy supports the objectives of the SPPRED, while it aims at the same time to ensure macroeconomic stability.** The consolidated government deficit is projected to remain roughly stable at 2 percent of GDP between 2003 and 2005. Prudent assumptions about available resources and sustainable levels of borrowing provide a realistic resource envelope for overall expenditure plans. Staffs agree with the cautious use of Oil Fund assets and limited reliance on external borrowing. Staffs recommend that the authorities develop a long-term strategy for the use of oil revenue while taking into account Dutch disease effects.

17. **Given the expected growing importance of the oil sector, the SPPRED would have benefited from including alternative medium-term macroeconomic scenarios** which explored the effects of large oil price changes on the economy and the poverty reduction strategy and discussed contingencies and policy options. Overall, Azerbaijan has attained a relatively solid track record of macroeconomic stability, but the country is clearly vulnerable to volatility in world oil prices.

18. **The fiscal choices in the SPPRED are consistent with the policy objectives, but mechanisms to allocate expenditures are at an early stage of development.** The MTEF targets a significant increase in the share of capital spending in overall expenditures in an effort to meet urgent infrastructure needs. While Staffs agree with this objective the authorities need to strengthen the PIP to ensure a prioritized project selection. Expenditure goals for other items such as public wages, social transfers and spending on health and education are reasonable. However, expenditure choices should be more closely tied to underlying reform plans and more work is needed to flesh out the expenditure implications of these structural reforms.

19. **Development of further fiscal policy indicators and an analysis of the implications of alternative economic scenarios would greatly enhance the MTEF as a policy instrument.** Staffs encourage the government to use alternative policy measures such as the non-oil deficit, which reflect the reliance on the oil sector and provide indicators of the underlying fiscal impulse. Furthermore, in discussing alternative scenarios the government would need to determine fiscal priorities and develop contingency plans.

20. **The SPPRED's assessment of the availability of domestic and external financing is broadly reasonable, while incorporating debt sustainability concerns.** External financing to cover budgetary financing gaps have already been committed or are in the process of being negotiated, and donor financing for infrastructure projects are consistent with scheduled disbursement commitments and indications that generous donor support will continue. The contribution from the World Bank, according to the CAS, may be somewhat less than anticipated in Appendix 2 of the SPPRED. The Staffs welcome the authorities' intention to contract new external borrowing on concessional terms and to limit state debt to no more than 30 percent of GDP (publicly and publicly guaranteed external debt was 23 percent of GDP as of 2002), in the context of ensuring debt sustainability.

## STRUCTURAL AND SECTORAL POLICIES

21. **The SPPRED recognizes the central importance of good governance and public resource management for poverty reduction. Perhaps the most significant development in public finance in recent years in Azerbaijan has been the establishment of the State Oil Fund.** It has among other things significantly improved the transparency and accountability of oil sector revenue, and together with the restructuring of SOCAR that is now under way, has provided the foundation for a meaningful consultation with the civil society on the use of these resources. The government is committed to exercise considerable caution over the use of the expected oil and gas windfall and to ensure that the benefits resulting from the exploitation of this natural asset would accrue to all citizens and to future generations. This cautious approach of the government is deemed even more essential given the fiscal institutional reforms presently underway and the need to implement the SPPRED within a sustainable MTEF and a consistent PIP. Rapid implementation of the new Budget Systems Law is key, including the agreed amendments to ensure full integration of the State Oil Fund in the consolidated budget expenditure envelope approved in the annual Budget Law. While the SPPRED notes the progress made with respect to the State Procurement Agency and the Chamber of Accounts, the action plans of the recently completed Country Procurement Assessment Report (CPAR) and the Country Financial Accountability Assessment (CFAA) should be incorporated in the government agenda. Likewise corporate governance and accountability of SOCAR, Azerenergy, Azerigaz, and the ARWC need to be improved, and implicit untargeted subsidies made explicit and targeted at the poor.

22. **The SPPRED recognizes the importance of attention to the institutional agenda including the structure, administration, and remuneration of the civil service.** What has not been fully articulated is a concept of the type of central government structure that would be suitable for a market economy in the context of Azerbaijan. This involves setting up criteria and principles for existing ministries, state committees and the Cabinet of Ministers, to guide a civil service reform strategy that encompasses all aspects of a professional and modern civil service. While it is recognized that the structure of public administration in the country as a whole and its institutional capacities cannot be transformed in a short time frame, there ought to be a guiding blueprint for change with time bound targets. This should include: (i) rationalization of public sector employment; (ii) a unified and decompressed public sector pay scale; (iii) avoidance of across the board cuts in the wage bill; and (iv) monetization of in-kind supplements through integration with the pay scale. There is also a need to recognize, and address, the burden placed on the poor by petty corruption by civil servants, including the need to pay bribes to educators, health professionals and police officers.

23. **The SPPRED should recognize the need to empower line ministries to effectively participate in the budget preparation process.** Stronger links should be made between budget allocation decisions and operational outcomes. As the new Budget Systems Law is implemented, the government could move from allocating resources based on norms to a more “program/performance” based budget model.

24. **The SPPRED identifies the need to further define the government's decentralization strategy and in particular the role of municipalities.** The staffs recommend this task be given high priority to ensure that the objectives and goals set out in the SPPRED are not undermined by confusion about responsibilities at different levels of government. This would be particularly dangerous with regard to future public investment activities, which may involve capital expenditure from a line ministry but maintenance and operational expenditure commitment from local government. Successful implementation of the public expenditure envelope is possible only with an appropriately decentralized fiscal system that is transparent and accountable. A government body in charge of municipal issues should define the policy of the government on decentralization and to coordinate and address local matters. The intergovernmental fiscal framework between the central government and the municipalities would include the creation of a transparent fiscal transfer mechanism and the finalization of the transfer of state properties to municipalities. Financial, technical, and managerial capacity of the newly created municipalities need strengthening.

25. **A comprehensive plan to strengthen the financial sector is a key component of the SPPRED.** The program identifies measures to be undertaken to strengthen bank supervision, and improve the regulatory framework. It also identifies near-term actions to privatize remaining state-owned banks, and to strengthen the payments system, establish a centralized collateral registration system, and other essential components of financial sector infrastructure. The staffs believe that, with proper implementation, these concrete actions should help significantly in allowing the banking system to play its proper role in facilitating financial intermediation. One aspect that could be supported more aggressively is the building of banking infrastructure that would allow banks to push into retail more quickly. The role of the Postal service could be expanded to include terminals for smart-card payment systems. In addition, tendering for the provision of banking services to the government could improve competition in the banking sector. The staffs note that proper sequencing and design of financial sector reforms are essential for success. The planned deposit insurance scheme should be implemented only when the preconditions for deposit insurance viability are fulfilled. In addition, reforms in regulations such as capital requirements should be designed to effectively strengthen viable banks, rather than forcing banks to raise capital independently of the risk profile of their activities. By contrast, the SPPRED lacks an agenda to develop the capital market, contractual savings institutions, and leasing. While pension reform is featured as an important component of the social safety net, the financial sector side necessary for a viable pension system is not elaborated. Also, there is undue emphasis in the SPPRED on access to credit rather than financial services, and it lacks an agenda to develop non-bank financial institutions, including the development of infrastructure for the insurance sector.

26. **The SPPRED recognizes balanced growth as key to sustainable economic development and poverty reduction.** To develop the non-oil sector, the SPPRED identifies three types of government policies: public finance policy, regulation and privatization. It acknowledges the need for continued transformation of economic activity from the public to the private sector; a sound legal and regulatory framework (particularly reducing administrative barriers to private investment and SME development); good corporate

governance principles (particularly introduction of international standards for accounting and auditing and effective commercial dispute resolution mechanisms); and export development (particularly through increasing the role of processing industries, further improving the customs and tax policies). While the staffs support the development of infrastructure to encourage export development, it will be important for the government to avoid the temptation to engage in industrial policies that involve “picking winners.” Additional efforts are needed in ensuring enforcement of legislative reforms; in specifying concrete policy actions and timetable for elimination of administrative barriers; and in enhancing partnership with business clusters for articulating specific actions and programs geared to increase quality and consistency of production for export markets. While a uniform cut in profit taxes may be considered for the non-oil sector, the staffs would advise against using tax policy for regional or sectoral incentives. Rather, the staffs recommend construction of physical infrastructure, including the rapid reconstruction of reliable power and gas supply, as well as financial infrastructure in the regions outside Baku.

**27. Sustaining agricultural growth and developing agro-processing clusters are critical for the country’s poverty reduction efforts in the medium term.** The lower poverty prevalence in rural relative to urban areas can to a large extent be attributed to the successful land reform and privatization. The SPPRED rightly puts the development of agriculture in the context of an integrated rural development policy including linkages to non-farming activities such as agro-processing, industry, handicrafts, retail, distribution, transport, construction and other aspects of rural infrastructure, and taking into account environmental concerns. Irrigation systems are in urgent need of rehabilitation and repair. That will require both investment and a system for financing ongoing maintenance. The government has stated its intent to do this, but complementary reforms are needed to ensure that over time the ownership and management structures for these systems provide for better cost recovery and meet maintenance requirements. The development of rural finance cooperatives should be encouraged, as should the government’s programs to develop alternative models of agricultural extension services that are more relevant and financially sustainable. The staffs welcome the strong linkages made in the SPPRED between rural development and environmental sustainability.

**28. The SPPRED discusses comprehensively the needs in the education and health sectors.** The overview of both the health and the education sectors provides a sound assessment of progress with reforms to date, the need for additional budgetary allocations, especially in the health sector, and the major challenges ahead. However, the action plans outlined for both sectors would benefit from greater attention to prioritization and sequencing. The staffs believe that the first priority should be to provide education of acceptable quality in the compulsory cycle of education. Staffs agree with the SPPRED’s conservative expenditure envelope for the education sector. Budget funds should be reallocated across expenditure lines to realize cost-savings. On the other hand, proposals to exempt educational institutions and their suppliers from tax and customs payments would be counterproductive, as they would create opportunities for tax evasion and would counter efforts at simplifying and enforcing tax procedures throughout the economy. Furthermore, the government would promote private

sector involvement in the education sector by removing the existing barriers to entry, such as Article 28 of the 1992 Educational Law, which prohibits for-profit private schools.

29. **The health sector requires immediate attention.** Undoubtedly, there is a need to progressively increase the budgetary proportions devoted to health care. But what is critical is a fundamental realignment of the approach toward the delivery of health services as outlined in the SPPRED. A move toward an outpatient-oriented approach with emphasis on primary health care would improve efficiency. For this purpose, a reallocation of staff within the sector is needed, with a substantial retraining program and a reduction in the number of hospital personnel. This would facilitate a move away from the current allocation of funds based on the number of hospital beds toward output-based allocations according to actual services rendered. Staffs support the SPPRED plan to provide a basic package of medical services free to all citizens and to charge for other services. However, this program would need to be combined with a more systematic monitoring of user charges and wages in the public health care system, including a review of the existing regulations in order to reform those that encourage informal payments. Accountability of health providers to Azeri citizens and communities should be strengthened. This could be advanced by (i) enhancing the self-regulation of providers through establishing professional associations and technical standards, rules of ethics, and systems of accreditation and quality assurance; (ii) strengthening the involvement of clients in monitoring performance through patients' associations, community-based services, and participatory approaches; and (iii) providing collective action of monitoring through public expenditure tracking surveys, and information and media campaigns. Unless such steps are taken, the poor in particular will continue to suffer from a lack of essential services of an acceptable standard.

30. **The SPPRED recognizes the challenges of devising an effective, equitable and affordable social protection strategy.** At present, the programs are not well targeted, with the result that benefit levels are very low and those most in need are not being adequately cared for. No real account is taken of family needs. Furthermore, there is a co-mingling of social insurance and social assistance, again with little regard to real need. Reforms should focus on the rationalization of the many programs, perhaps into a single-family benefit system, with explicit targeting to the poorest. It may also be beneficial to eliminate one-time benefit payments, which are regressive insofar as no allowance is taken of income levels in determining eligibility for these benefits. The social safety net could become better targeted assistance by: (i) replacing the income-tested child allowance, the nonworking pensioner allowance, and the allowance for the single elderly by a unified cash benefit for families with children and pensioners; (ii) replacing social pensions by budget-financed social assistance and reviewing the minimum pension; and (iii) restructuring the sick leave to include an increase in the cost sharing of employees and employers. Staffs support the strategy outlined in the SPPRED for strengthening the pension system, and a proposed Bank project would support these reforms and building of institutional capacity.

31. **Men and women are affected in different ways by other aspects of poverty, and more research is required in order to document these in Azerbaijan.** For example, employment data suggest that females have a higher risk of unemployment. Employment of

working age men exceeds the rate for women by 13 percentage points (67.3 percent and 53.9 percent), despite the fact that the retirement age for females is 5 years lower.

32. The available data on gender in Azerbaijan show that women tend to concentrate in the social services sector, such as health and social care, education and other public services. Wages in the health sector are circa 30 percent of the national average, and in education 70 percent. However, the gender employment statistics cover only the formal sector of the economy, and due to the lack of a regular labor force survey not much is known about the sectoral distribution of labor in the economy as a whole. **Wage statistics by gender are scarce but the available data confirms that even in female dominated sectors of economic activities, such as health care, social work and education, wage levels for females are much behind the levels for males.** Women and children are considered the most vulnerable subgroup of this population group.

33. **Labor participation rates are high, but in all age groups men participate more than women, and the gap is especially significant in the most active years of work.** This has implications for female poverty and vulnerability. There are gender differences in some health indicators. For example, the number of cases of tuberculosis has been growing, and this has especially affected men. Also, there is no systematic collection and analysis of school attendance rates, which would give a better indication of changes in the access to and quality of education being received by different sections of the population, and the extent to which there are gender differences in attendance and access.

34. **Integration of IDP's and refugees in the economy is a key concern of the SPPRED.** This segment of the population constitutes one of the most poor and vulnerable sections of society. Increasingly government's own resources are being used for social welfare programs, housing, irrigation, power, education, and health related infrastructure. Studies, data and information on IDP's and refugees are scattered in a number of institutions—designed to meet specific program needs with different input, output and impact indicators—and are often not comparable. Programs aimed at enhancing skills and income generation activities, and improving the living conditions of this most vulnerable population, need to receive priority, accompanied by the establishment of a systematic monitoring and evaluation system to help design and implement cost effective resettlement programs for IDP's and refugees.

35. **The SPPRED correctly identifies the energy sector as critical for the country's development prospects.** Lack of reliable energy is considered a major problem by the rural populations, and was identified as the number one constraint in a recent FIAS business environment survey. The policy agenda in the SPPRED is based on the government's detailed program for strengthening financial discipline in the energy sector supported by the Bank's SAC-II and the IMF's PRGF. Good progress has been made so far in increasing collections of billings for electricity and gas services, and on making previously implicit subsidies explicit on the budget. Power distribution is now managed through private management contract, and similar private sector participation arrangements are sought for gas and water supply. The regulatory framework for private sector operation needs to be defined. While a Tariff Council

was established in 2002, a time schedule should be fixed for the introduction of an independent regulator. Likewise, a time bound plan for gradually bringing tariffs up to economic prices should be published. The corresponding mitigation mechanism to compensate the poorest should be decided now, and the actual design of the means testing apparatus started as soon as possible. Yet energy supply is unreliable, especially outside the Baku area, and substantial investments are needed. The SPPRED is prioritizing public investment in power generation. Staffs would recommend a sequence with early emphasis on the rehabilitation of the transmission system in order to strengthen reliability and reduce technical losses. Furthermore, corporate governance and accountability of SOCAR, Azerenergy, Azerigaz, and the ARWC need to be improved. A strict time schedule for upgrading of accounting systems to IAS compliance is overdue.

36. **While more information at all levels of society is at the center of the SPPRED strategy, a comprehensive telecommunications sector reform program is totally lacking.** The telecom sector is dominated by one player, Azertelecom, which is closely linked to the Ministry of Communications, and even the two "independent" cellular operators (Azercell and Bakcell), as well as other existing joint ventures, per current regulations, are forced to have about 50 percent shareholding by the Ministry. While the sector in Azerbaijan has the potential of making a major impact on the economy, particularly inflow of FDI, its performance is much worse than for instance in neighboring Georgia, where the telecom sector accounts for almost 7 percent of GDP--in Azerbaijan it accounts for less than 2 percent. Separation of commercial and regulatory activities is crucial for the sector to develop, and enable other sectors to develop. **Currently there is a disconnect between the SPPRED and the cheap access to the information and communication services needed to implement it.**

## 5. TARGETS, INDICATORS AND MONITORING

37. **The SPPRED does not yet provide medium-term targets for poverty reduction but sets out a framework for improved indicators to define these targets over time.** The PRSP Secretariat will monitor changes in poverty levels in the coming year, and where possible analyze the effect of policy on poverty results. In order to focus the practical implementation of the poverty reduction strategy and to provide a better framework for monitoring progress, the setting of a poverty reduction baseline path with intermediary targets before 2010 should be considered. The selected core indicators—e.g. income poverty, maternal and child mortality, access to primary education and health care services—constitute a good attempt to utilize the Millennium Development Goals (MDG) framework, and the current range of selected core indicators would capture progress on a broad range of issues. There is a need, however, for future PRSPs to make an explicit link of the core poverty indicators with the MDGs. The staffs welcome the government's intention to gradually expand the core set of indicators, especially for measuring the targeting of social benefits and the growth of income opportunities in the private sector. The document lacks a clear distinction between inputs, outputs and outcomes, and their corresponding monitoring frequency. It is prudent for the government now to refine the list of indicators that will be monitored and reported in the SPPRED annual progress reports. In terms of the monitoring system, the

SPPRED seems to pay less attention to the role of line ministries/agencies and role of administrative data, and intra-governmental communications and linkages should be strengthened.

38. **There are some weaknesses in the proposed range of indicators.** The core indicators focus mainly on the social sphere, although a few productive sector indicators are included such as private sector share in GDP. Looking ahead, these could be supplemented with indicators such as the business climate and the cost of doing business. Regular follow-up to the FIAS and Business Environment and Enterprise Performance Surveys is important. In some cases, indicators could be better chosen to reflect the objectives and key constraints. Governance indicators could also be broadened to monitor problems of corruption. More generally, the indicators would greatly benefit from greater disaggregation to capture rural/urban inequities, regional differences, income disparities and gender imbalance.

39. **The staffs believe that given the vulnerability of the country's economic performance to external shocks, it will be necessary to undertake sensitivity analysis of the impact of lower than expected economic growth on poverty reduction.** On that basis, a contingency priority action plan could be developed. In particular, contingency plans should be developed to prepare for the possibility that a sharp and sustained reduction in oil prices could lead to significant delays in planned oil and gas sector investments. These efforts should also focus on clearly spelling out linkages among key policy actions and the SPPRED targets for important sectoral policies (education, health, social protection, rural development and infrastructure). The staffs encourage the authorities to include multiple scenarios in the context of future SPPRED progress reports.

40. **The implementation of plans for monitoring and evaluation remains a challenging task.** The staffs welcome the emphasis the SPPRED puts on a monitoring system that is based on sample surveys, as well as statistical reporting systems. Public expenditure management reform will also contribute to improve the timeliness and quality of expenditure data. The existing public expenditure reporting systems provide an incomplete basis for monitoring poverty-related expenditure, in part because the classification of expenditure does not cover all categories of pro-poor spending. Again, rapid implementation of the new budget systems is very important as well as the strengthening of the capacity of line ministries to fully engage in medium term budget planning.

## 6. RISKS TO THE STRATEGY

41. **The most important risk the Azeri economy is exposed to today is the risk in the external environment.** These risks include the sharpening of regional instability resulting from conflicts in neighboring countries and the possible fall-out of the conflict in Iraq. Probably the most important source of regional instability for Azerbaijan is the unresolved conflict over Nagorno Karabakh. Resumption of open hostilities would have major economic and human costs for Azerbaijan, while a peaceful resolution of the conflict would improve the

growth and poverty reduction prospects significantly. The international community is actively involved in trying to resolve the dispute through the OSCE's Minsk Group.

42. **Internal political risks include the possibility that a political transition in Azerbaijan leads to instability and/or significant shifts in policy.** To mitigate against this risk it is important to continue and expand the participatory efforts of the SPPRED to ensure broad-based civic and political ownership of the country's development strategy.

43. **The main economic risk is that the BTC pipeline and/or the Shah Deniz gas development do not go forward as planned.** This could, for example, happen because of a drop in energy prices, or difficulties in securing financing. This would have a serious impact on the country's revenues in the short and medium term. **The volatility of energy prices itself represents a related risk, as is the risk of Dutch disease.** These risks are partially mitigated by the government's adoption of a prudent fiscal stance, the establishing of the State Oil Fund, and its strategy of facilitating the development of the non-oil sector.

44. **The implementation and governance capacity is another set of risks to the achievement of the SPPRED objectives.** The attention paid in the ongoing reform agenda to the transparency and management of public expenditures (including from the Oil Fund) and the business environment along with the significant improvement in governance indicators as captured in the BEEPS contribute to the mitigation of this set of risks. The technical support and assistance being provided by the Fund and Bank and by other external partners will also help to overcome implementation risks.

## 7. CONCLUSIONS

45. **Notwithstanding the above risks, the SPPRED represents a significant achievement.** Although weaknesses remain, notably in definition of the public sector's role in the country's development strategy, and in costing, prioritizing, and sequencing measures as well as in their monitoring and evaluation, the staffs acknowledge that the preparation of the SPPRED document represents a credible and inclusive effort on the part of the Azeri authorities. The staffs commend the authorities for recognizing in the SPPRED some of its shortcomings, and believe that with experience and continued development and refinement of strategies these can be overcome.

46. **The staffs of the IDA and the IMF consider that the SPPRED presents a credible poverty reduction strategy that provides a sound basis for Bank and Fund concessional assistance.** The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.