

**Azerbaijan Republic**

**Poverty Reduction Strategy Paper**

(Interim Report)

Baku, May 2001

## Poverty Reduction Strategy Paper (Interim Report)

### INTRODUCTION

The Poverty Reduction Strategy Paper (PRSP) Interim Report has been prepared on the basis of the Instruction No. 636 of the President of Azerbaijan Republic Heydar Aliyev, dated March 2, 2001, regarding the establishment of the Commission for the development of this Program. For the purpose of bringing in representatives and experts from the respective central executive government authorities, scientific institutions and nongovernmental and public organizations, a special Task Force was established in accordance with Protocol Decision No. 1 of the Cabinet of Ministers of Azerbaijan of March 9, 2001.

As agreed with the IMF, the World Bank, and the Asian Development Bank, the government of Azerbaijan intends to prepare the PRSP in two stages:

a) Development of the PRSP Interim Report, which will be conceptual in nature and will be submitted to the Commission. It will contain information on the economic situation, degree of poverty and its specific characteristics, the existing system of social protection, existing constraints on poverty reduction, as well as on the main principles of the state strategy, planned policy measures and reforms for the next 4–5 years, broad participation in the process of the development of this paper and mechanisms for implementation of the Poverty Reduction Strategy.

The following tables will be attached to the document:

- Main macroeconomic indicators;
- Medium-term budgetary plan;
- Standard of living of the population;
- Policy measures for the poverty reduction strategy;
- Tentative timetable for development of the Main PRSP, providing for broad participation.

b) Development of the Main PRSP, which will constitute a specific plan of action of the government, aimed at practical implementation of policy and economic measures for poverty reduction. As agreed with the IMF, the World Bank, and the Asian Development Bank, a one-year period has been allotted for the development of this paper. In this process, these organizations have expressed their readiness to provide all forms of assistance to the government (technical assistance, grants, consulting services, republican and regional seminars, training of personnel, etc.)

## I. INFORMATION ON THE STARTING LEVEL OF POVERTY AND ECONOMIC SITUATION

1. The poverty problem in Azerbaijan has its roots in its historical legacy. In the Soviet period, as one of the two Soviet republics that did not receive subsidies (Russia and Azerbaijan), Azerbaijan was tenth among the 15 Soviet republics in terms of the material well-being of its population. For example, in 1990 the average monthly wages in Azerbaijan were one-third less than the Union average, and half that of the same indicator for Baltic republics. Keeping in mind that wages constituted over 70 percent of the money income of population, the 1990 official statistics showing that the income of more than 35 percent of the population fell below the minimum subsistence level provide clear evidence of the high starting level of poverty in Azerbaijan on the eve of the collapse of USSR.

This situation was explained for the most part by the absence of objective conditions for more complete use of the GDP produced, and natural and human resources, as well as the political costs of the centralized system for the planning, distribution, and deployment of productive forces.

2. After regaining independence, in 1992–1994 Azerbaijan ran up against unprecedented political, military, economic, and social problems, the principal ones of which were:

– direct military aggression by Armenia against Azerbaijan, as a result of which 20 percent of the country’s territory still remains occupied by Armenia armed units, approximately 1 million Azerbaijanis were driven out of Armenia and from the territories of Azerbaijan that were seized, and the majority of them more than seven years later are still living in tents and dwellings that are not fit for human habitation. Approximately 60 percent of these refugees and displaced persons are classified as economically active members of the population, but practically all of them are without permanent jobs and are forced to subsist on occasional earnings and meager benefits from the state;

– the significant underutilization of the Republic’s economic potential, which was created during the years of the Soviet regime according to the “Union-wide division of labor” principle. This principle called for the export of 85–90 percent of the industrial products and 30–35 percent of the agricultural products from Azerbaijan to other republics in the form of raw materials, semifinished goods, and component parts. As a result, overall production began a downward slide, there were widespread layoffs of employees, and dozens of enterprises ceased operations;

– extremely destructive budget, monetary, and foreign trade policies and the lack of a clear idea of the devastating effect of inflation on the macroeconomic situation, led to an uncontrollable decline in the financial condition of the country as a whole, economic entities, and households;

– an extremely unstable internal political situation, which made it impossible to embark upon radical economic reforms and placed Azerbaijan among the countries that are unattractive to foreign investors.

Permanent measures that were taken during those years to ease social tension, such as the periodic doubling and tripling of wages, the establishment of a minimum wage, the introduction of numerous benefits, and so forth, spurred on the inflation process even more, since they were not backed up by the real possibilities of the country's economy.

At the same time, some elements of a market economy emerged and underwent a certain amount of development in 1992–1994, particularly in the trade, service, transportation, middleman and supply, and banking sectors. This process, however, was to a great extent spontaneous and superficial in nature, and was frequently carried out for some criminal purpose.

A lack of experience in foreign trade, as well as the absence of the requisite organizational and legal base, led to a situation in which enterprises, and especially newly established market structures, pursuing their own self-interest, as a rule, exported petroleum products, aluminum, cotton, and other products worth hundreds of millions of dollars at prices significantly below the market prices. As a result, Azerbaijan suffered not only an immense material loss, but also, and of no small importance, a significant share of the foreign exchange proceeds ended up in foreign banks.

These and other objective and subjective factors led to an unprecedented decline in the economy and in the population's standard of living:

1990 = 100 percent

	1991	1992	1993	1994
Change in real GDP	99.3	76.8	59.1	47.4
Industrial production	91.1	63.4	50.9	38.3
Agricultural production	100.3	76.5	64.7	56.7
Consumer price index (inflation) – expressed as a factor	2.06	21	257	4534
Nominal money income of the population – expressed as a factor	2.07	9.7	135.5	1216
Real average monthly wages	78.9	66.3	43.6	17.3
Household consumption	87	49	37	25
Accumulation (investments from all sources of financing)	79	47.4	29	54.8
Decline in the population's standard of living, expressed as a factor	0.99	2.2	1.9	3.7

The data shown above indicate that by the beginning of 1995 Azerbaijan had experienced a severe socio-economic crisis and they illustrate the obvious fact that there was a total loss of control over the economic situation. Naturally, under these circumstances, it

proved impossible for objective reasons to take serious steps toward addressing the problem of poverty.

3. By the end of 1994 there was some success in stabilizing the social and political situation in Azerbaijan, which made it possible to embark on the development and implementation of a sensible and purposeful economic policy that called for the implementation of widespread economic reforms.

To date, some 250 laws and more than 750 other regulatory and legal acts governing the reform process in all spheres of the economy and all aspects of life in the country have been adopted.

Since 1995 three government programs aimed at providing for macroeconomic stabilization, structural adjustments, and resumption of economic growth and improvement in the living standards have been developed and successfully implemented. As a result:

	1994 = 100 percent					
	1995	1996	1997	1998	1999	2000
Change in real GDP	88.2	89.3	94.5	104	111.8	124.5
Industrial production	78.6	73.3	73.6	75.2	78	83.3
Agricultural production	93	95.8	90	95.6	102.3	114.6
Consumer price index (inflation) – expressed as a factor	5.1	6.1	6.4	6.3	5.8	5.9
Nominal money income of the population – expressed as a factor	5.5	7.8	10.2	11.9	13.3	14.8
Average monthly wages– expressed as a factor	4.1	5.8	9.2	11	12	13.8
Household consumption	97.4	106.7	119.4	136	154	172
Accumulation (investments from all sources of financing)	82	172	287	416	403	413
Growth in the population’s standard of living, expressed as a factor	1.08	1.28	1.6	1.89	2.3	2.5

In addition to the above, the following gains were made:

- the budget deficit was cut from 10 percent of GDP in 1994 to 1–2 percent, and National Bank credits are no longer being used to cover the deficit;
- state expenditures on social needs have been brought up above 50 percent;
- the lending rates of the National Bank have been lowered from 250 percent in 1994 to 10 percent;

- a solid gold and foreign exchange reserve has been created for the country, equal to 4–5 times monthly imports, which allows for effective maneuvering on the exchange market;
- the exchange rate of the national currency, the manat, with respect to hard currencies has been stabilized;
- the process of denationalization has been started, and as of January 1, 2000 more than 29,000 small enterprises and over 1,000 medium-sized and large enterprises and facilities have been privatized through cash and check-based auctions;
- land reform was implemented through the free distribution of over 1.3 million hectares of agricultural land among rural residents, with the right to buy and sell their plots, resulting in the establishment of more than 40,000 individual owner-operated farms and about 5,000 other market units in rural areas (cooperatives, small enterprises, etc.);
- foreign trade activity has been liberalized substantially, which made it possible to bring the foreign trade turnover of goods and services up to \$4.2 billion (based on the balance of payments), or 2.5 times the 1994 level;
- a whole number of structural reforms have been carried out: more than 25 ministries, state concerns and associations have been eliminated, dozens of joint-stock companies have been created, the quota system has been abolished, and the export tax has been eliminated, among other things;
- a great deal of preliminary work has been completed to prepare for accession to the WTO.

As a result of privatization and land reform, as well as the creation of favorable conditions for development of the private sector of the economy, in 2000 the private sector's contribution to GDP reached 68 percent, compared to 29 percent in 1994; its share in industry rose to 44 percent (2.1 percent), in agriculture it was 98 percent (57 percent), in investments – 52 percent (39 percent), in passenger transport – 85.6 percent (14.3 percent), in trade – 98 percent (83 percent), in education – 20 percent, in medicine – 38 percent, and in municipal services – 79 percent.

At the same time, the positive results achieved in recent years at the macroeconomic level were far from enough to solve the poverty problem for certain categories of the population and regions of Azerbaijan.

## II. The Degree of Poverty and the Nature of Poverty

4. The basic criteria for evaluating the poverty level adopted by international financial, banking, and scientific institutions are: basic education, health care, nutrition, safe drinking water and sewer systems, as well as income, employment, and wage levels. Of these criteria, Azerbaijan has a fairly high level only in basic education (97 percent). In terms of the remaining criteria, Azerbaijan lags significantly behind both the scientifically-based norms and standards, and many other countries in the world.

From August 1995 through January 1996 World Bank experts conducted the Group Survey of 91 groups, the Nongovernmental Survey, and the Living Standards Survey of Azerbaijan. The results of these surveys appeared in World Bank Report No. 15601-AZ "Azerbaijan. Poverty Assessment." According to this document, the poverty level situation as of 1995 was as follows:

*(as a percentage)*

	Poor	of which: very poor	Not poor
Households throughout Azerbaijan as a whole	61.5	20.4	38.5
Households in Baku	59.6	19.6	40.4
Households of refugees and displaced persons	74.5	37.5	25.5
<i>by zones</i>			
Southwest	49.5	11.8	50.5
Near Northwest	64.4	20.5	35.6
Far Northwest	49.7	10.8	50.3
Central North	59	11.8	41
Central Zone	70.7	35.2	29.3
Far South	57	14.1	43
Apsheron	64.2	22.6	35.8
Nakhichevan	84.5	31	15.5

Although, as mentioned above, major positive changes have occurred throughout the republic as a whole in the past five years since the World Bank experts conducted their survey--macroeconomic stability has been achieved, the economy is experiencing dynamic development, the material well-being of the population has risen by a factor of 2.5, nevertheless, a differentiated examination of the social condition of individual categories of the population and regions reveals an extremely uneven distribution of GDP.

According to preliminary results for 2000:

- per capita GDP totaled \$664. In terms of this indicator, Azerbaijan is in 98<sup>th</sup> place among the 189 countries of the world, and in terms of the U.N. classification it is among the poor developing countries;

– nominal money income per capita was manat 2.26, or at the average annual exchange rate of the dollar (manat 4,474), \$505, which is equal to an average of manat 188,000 or \$42 per month (\$1.40 per day);

– average monthly wages of working people totaled manat 205,000, or \$45.80 (\$1.53 per day), with indicators for various sectors and spheres of the economy broken down as follows:

	<b>thousand manat</b>	<b>dollars</b>	<b>per day</b>
Extraction industry	667	149	5
Processing industry	299.5	66.9	2.2
Agriculture	66.7	14.9	0.5
Electric power – gas – water supply	267.8	59.8	2
Construction	452.8	101.2	3.4
Wholesale and retail trade	121.1	27	0.9
Hotels and restaurants	283	63.2	1.9
Financial intermediaries	593	132.5	4.4
Education	153.2	34.2	1.1
Healthcare	73.4	16.4	0.5
Government	187.5	42	1.4
Municipal and individual services	112.7	25.2	0.8

– the number of pensioners totaled 1.2 million, or 15 percent of the total population, and the average monthly pension was equal to manat 77,000, or \$17 (\$0.57 per day);

– manat deposits by the public in bank savings accounts fell from manat 69.7 billion in 1995 to manat 42 billion in 2000;

– food purchases and payment for services accounted for 73.8 percent of the population's expenditures;

– according to the manpower resources balance, as of the beginning of 2000 almost 1.4 million members of the active population were hired employees in various spheres of the economy (32 percent), while the remaining manpower resources included unpaid family members, mainly homemakers (10 percent); persons working but not under a hiring agreement (16 percent); and persons engaged in individual activity (8 percent); persons with occasional earnings, among others.

At the current stage of Azerbaijan's development, the most acute social problem continues to be the extremely low level of satisfaction of the minimum material and spiritual needs of an absolute majority of the population. Therefore, in our opinion, it is necessary

above all to determine and establish the minimum critical poverty line and by means of a large-scale survey identify those categories of the population, broken down by region (number), among whom the per capita money income, average monthly wages of working people, pension, and subsidies for educational, medical, and municipal services falls below this critical line.

5. Law No. 329 “On the Minimum Consumer Budget” was adopted in Azerbaijan on October 14, 1992; according to this Law, the State Statistics Committee calculates this budget, which in 2000 was equal to manat 337,900 a month per person, or \$76 (\$2.5 per day).

According to this Law, the Minimum Consumer Budget includes a large number of foodstuffs (assuming the consumption of 2,486 kilocalories per person per day, compared to the medical standard of 3,000) and nonfood goods, as well as municipal, transportation, consumer, and entertainment expenses, taxes, and other payments. The standards and structure of the “minimum” consumer budget show that in 1992 the compilers of the minimum consumer budget clearly did not account for the real possibilities of the economy. Even after eight years (during the last five of which the economy experienced dynamic growth), the ratio of the main indicators of the population’s material status throughout the Republic as a whole in 2000 to the minimum consumer budget appeared as follows: in terms of per capita money income – 55.6 percent; average monthly wages of working people – 60.5 percent; monthly pension – 23.3 percent; and finally, GDP per capita per month – 72.7 percent.

Thus, at this stage in Azerbaijan’s socio-economic development the minimum consumer budget is clearly too high and cannot be taken as the basis for determining the poverty line.

The government believes that the best practice is to draw on the experience of many transition economies in which determination of the poverty line is based on the method of establishing a minimum subsistence basket for age and gender groups, which includes minimum standards for the most essential foodstuffs required for a person living a normal life (based on 2,000–2,200 kilocalories per day), plus expenditures on municipal and consumer services, transportation, and minimum expenditures on nonfood goods.

Experts from the IMF, the World Bank, and the Asian Development Bank, as well as local researchers, specialists and nongovernmental and community organizations, are in agreement with this approach. In-depth research is currently being performed by the relevant government authorities and medical and scientific institutions using this method.

In the preparation of the Main PRSP, the Minimum Subsistence Basket as the poverty line will be determined by the respective highly differentiated calculated and will be established officially for Azerbaijan for the next 4–5 years. This will be the minimum subsistence level that the country’s economy will be able to provide to each of the country’s citizens by the end of the planned period.

When describing poverty in Azerbaijan, one must focus attention on certain specific features:

- the presence of approximately 1 million refugees and displaced persons, more than 60% of whom belong to the active age group. The absolute majority of these people do not have permanent jobs and live on occasional earnings and meager government benefits;
- each year actual aggregate consumption exceeds GDP produced (by 3–5 percent according to official data from the State Statistics Committee, and by 17–20 percent according to projected estimates). This is graphic evidence of the existence of an unregistered economy in the Republic, the real size of which will be identified in the preparation of the Main PRSP, as currently unused reserves, so that it can be included when determining the real income of the population and as an additional source for replenishing the budget.

### **III. The Existing Social Protection System**

**6.** The Constitution of the Azerbaijan Republic (Article 38) provides for the right to social security upon reaching an age established by law, in the event of illness, disability, loss of a breadwinner, inability to work, employment, and in other cases established by the legislation. To date, 5 laws and over 40 Decrees and Directives of the President of the Azerbaijan Republic have been adopted that are related to social protection for various categories of the population (refugees, disabled persons, employment, pensions, war veterans, etc.). Four relevant programs have been developed and are being successfully implemented.

**6.1.** The social protection system covers the entire human life cycle, from birth to the loss of the ability to work due to old age, that is it protects the rights and interests of children, young people, working citizens, disabled persons, the elderly, and other citizens who are unable to work, and their dependents.

Differentiation provides for differences in the selection of the purpose, subject, forms, methods, and sources of financing social protection mechanisms depending on the degree of a person's economic independences, as well as the possibilities of the country's economy.

A minimum wage of manat 27,500, or approximately \$6, has been established in Azerbaijan, and minimum benefits (per child) have been set at manat 9,000, or approximately \$2.

**6.2.** The Law “On Pension Security” guarantees the constitutional right of citizens to material security in old age, in the event of a complete or partial loss of the ability to work, as well as the loss of a breadwinner, and it establishes a single government pension system. This same law regulates issues of pension security for citizens of Azerbaijan, as well as citizens of

other states and stateless persons who are permanent residents of Azerbaijan. It also provides for uniform standards and conditions of pension security for white- and blue-collar workers, the self-employed, persons engaged in individual entrepreneurial activity, and other categories of working people, as well as the rights of disabled persons to receive a social pension.

Furthermore, specific regulatory acts have established various benefits for unemployed military personnel, refugees, and displaced persons which provide reduced payments for municipal and transportation services.

**6.3.** This, from a legal standpoint the social protection system is consistent with contemporary standards of government security for those in need of material assistance.

At the same time, the amount and standards for this assistance are still extremely low. Specifically:

- the lump-sum childbirth benefit per child – manat 70,000 (\$15.60);
- benefits for children of low-income families up to the age of 16 years, if the income per family member is not more than manat 16,500 per month (\$3.70) – manat 9,000 per month;
- benefits for children of disabled war veterans – manat 20,000 per month (\$4.50);
- benefits for persons disabled in the defense of the Homeland – from manat 50,000 to manat 70,000 per month (\$11.20–\$15.60);
- benefits for pensioners who are not working – manat 11,000 per month (\$2.40).

Other large low-income categories of the population are in a similar situation.

7. Although over the past 7–8 years the nominal size of pensions has been increased repeatedly in accordance with certain decisions of the President of Azerbaijan, including old-age pensions, disability pensions, pensions awarded in connection with a loss of the head of the household, and social pensions, at the same time the level of these pensions remains extremely low given the fairly high rates for insurance premiums, especially if one compares them to the average monthly wages throughout the country as a whole. The main factor that is hindering adequate growth in the amount of pensions is the extremely low collection rate for insurance premiums payable to the Social Protection Fund, which according to official data is no more than 60 percent of hired employees. This situation applies not only to state-owned enterprises, but also to the private sector, which accounts for 54 percent of the total number of people employed in the economy.

Thus, there is an urgent need to improve the pension security system, with a view to bringing it into conformity with the norms of the International Labor Organization (ILO) and the real possibilities of the economy in the coming years (the next 4–5 years).

#### IV. Problems To Be Addressed on the Path to Poverty Reduction

8. The contribution of the non-oil sector to the formation of GDP is currently more than 75 percent, which is going to decline over the next few years in connection with the coming rapid development of the oil sector. At the same time, there is a vast industrial and agricultural potential in the non-oil sector of the economy that can be drawn into the economic turnover, and thereby contribute significantly to poverty reduction.

But in terms of its technical, technological, and organizational parameters a strategically important part of this potential is not capable of producing competitive products that are consistent with world standards. A large share of industrial production capacities are extremely energy-intensive, which has an impact on production costs. The inefficiency of industrial production led to layoffs of hundreds of thousands of blue-collar workers, highly-skilled specialists, and white-collar workers.

This same situation can be found to an equal extent in agriculture. Due to the limited nature of financial resources, in recent years it proven impossible to maintain the vast land reclamation and irrigation system in proper working order, as a result of which more than 60 percent of irrigated land has been subject to salinization, which led to a sharp decline in agricultural yields. Almost 1.7 million able-bodied people live in the Republic's rural areas today, and more than 1.1 million of them, or 65 percent, are engaged in agriculture (this figure was 897,000 in 1990). There is an average of 1 hectare of land per able-bodied rural resident, which produces an average income of almost manat 700 million per year, or \$156 (\$13 per month, or \$0.43 per day). When family members are taken into account, this income per rural resident is one-fourth the figure cited.

Moreover, due to the absence of a system of services supporting agricultural producers and a land market, farmers are deprived of the opportunity to apply high-tech production methods and to use land as security for obtaining credits.

In addition to the above, the production and social structure, including the service sphere, is at an extremely low level, especially outside the city of Baku.

9. There educational system has an extensive network functioning in Azerbaijan. This system encompasses 1,814 pre-school institutions serving 112,000 children, 4,561 general education schools (with 1.6 million students), 110 vocational schools and academic preparatory schools (with 24,000 students), 25 public and 18 private universities (with 113,000 students), and 70 colleges (with 35,000 students). Thus, there are more than 2.2 million people studying at all of these institutions (27.5 percent of the total population), and they are being taught by over 400,000 instructors, teachers, on-the-job training supervisors, and other workers. According to a comprehensive survey, the educational level of the population is greater than 97 percent.

9.1. At the same time, the existing educational system is in need of fundamental improvements, and it needs to be brought closer in line with progressive world standards.

This applies not only to improving the quality of the educational and instructional process and the qualifications of teaching personnel, but also to improving the administrative structure in the educational sphere. Moreover, the current status of the material and technical base of educational and training institutions, and especially general education schools, lags significantly behind what is needed. Over the past ten years almost no schools have been built in Azerbaijan, and due to the limited budget resources that have been allocated it is not possible to purchase up-to-date equipment, supplies, electronic and other technical equipment. As a result, it is not possible to incorporate new technologies into the learning process at many educational institutions, especially in rural areas, and the absence of adequate computer equipment prevents students and teachers from obtaining the necessary information and organizing the educational process on a contemporary level.

Measures that are being taken to improve the educational system and ones that are planned for the future will be discussed in the section “Conceptual Framework of Policy Measures and Programs for 2001–2005.”

**10.** The health care sphere in Azerbaijan, as well as other public service spheres, did not escape the general socio-economic crisis. Funds allocated from the budget for medicine were cut to a fraction of their previous level. Immunization efforts practically came to a halt, there was a sharp increase in the activity of the remaining breeding grounds of infectious diseases, there were outbreaks of epidemics, and the system of universal and free medical care gradually collapsed. Demographic indicators fell off sharply. The birth rate per 1,000 people dropped from 26.4 in 1989 to 17.4 in 1997, while the mortality rate stabilized in the 6.4–6.2 range. In this connection, while the natural population growth in the 1970s and early 1980s remained steady at 1.8–2.2 percent per year, over the past 10 years it fell to 0.8–1 percent.

The steep decline in attention given to preventive care and the impossibility of carrying out therapeutic and public health and epidemic prevention measures at the proper level, results in epidemics of polio, diphtheria, and malaria, there was an increase in the incidence of rabies, brucellosis, anthrax, tuberculosis, and other infectious diseases. This situation can be explained to a great extent by the significant underfunding of the health care system, as well as a conservative approach to the need to reform this system, especially with regard to management of the system.

Without a doubt, the government could not ignore the overall decline in the population’s health.

Urgent measures that are being taken to improve the situation in the health care sphere and ones that are planned for the future will be presented in the section “Conceptual Framework of Policy Measures and Programs for 2001–2005.”

**11.** The current state of municipal services is falling extremely short of meeting even the minimum needs of the population. In the majority of cities and urban-type settlements water supply and sewer systems were built in different years according to plans that for all

practical purposes did not take into account the possibility that these population centers would grow. Meanwhile, in rural population centers practically no projects of this kind were carried out at all.

At the present time a significant proportion of water supply and sewer systems and structures are in a state of disrepair, while in the majority of regional population centers there are no such systems at all. It is not realistic to speak of the development and expansions of municipal services given the current state of the country's economic possibilities, since this will require billions of dollars.

According to expert estimates, just 40–45 percent of the cost of providing municipal services and public utilities as a whole, just for the Republic's cities, is covered. This is tied primarily to the extremely low collection rate for payments for the municipal services and public utilities being provided, and in particular for the supply of electricity, gas, and water. The collection rate for these services alone is: 15–20 percent for electricity, 20–25 percent for gas, and 50–60 percent for water. Therefore, the subsidizing of municipal and public services can be explained to a great extent by the need to meet at least the absolute minimum needs of not even the entire population, but something on the order of 50–55 percent of the population.

Nevertheless, considering the extreme state of neglect of municipal services and the fact that this sector is ill-suited to function under the conditions of a market economy, there is an urgent need to reform this sector, taking into account the creation of an entirely new system for providing municipal services and public utilities to the population, and placing this sector entirely under the control of municipal entities.

There will be a more detailed discussion of the key elements of policy in this area in the section "Policy Measures and Reform Programs for the Next 4

**12.** Over the past 7–8 years certain measures were implemented in Azerbaijan aimed at institutional reforms, as well as measures in the area of management of the economy.

On the basis of regulatory legal acts that have been adopted, the system of state orders, quotas, and licensing of foreign trade has been abolished; foreign economic activity has been liberalized completely; significant restrictions have been imposed on interference by the state in the financial, economic, and foreign trade activities of enterprises; some 30 ministries, committees, concerns, and associations have been eliminated; changes have been made in the functional duties of central and local government authorities; commercial activity on the part of central government authorities has been prohibited; the first phase of privatization has been completed; and the reform program in the agro-industrial complex is being carried out at an accelerated pace, among other things. In addition, six new government bodies necessary for the market regulation of reforms have been created.

All of this has played a positive role in providing for macroeconomic stability and in the resumption of dynamic growth in the economy and in the material well-being of the population.

At the same time, the fact that the situation has changed, and the coming deepening of institutional reforms, requires that improvements be made in the existing economic management system with a view to enhancing its effectiveness, converting it more fully to functional management, reducing the administrative structure, and raising the level of professionalism and responsibility of government employees. The Law “On the Civil Service” that has been adopted contains the relevant provisions for regulation of this process.

There will be a more detailed discussion of the government’s intentions with regard to institutional reforms and improving the management system in the section “Conceptual Framework of Policy Measures and Programs for 2001–2005.”

## **V. Main Principles of the Government’s Poverty Reduction Strategy**

**13.** The positive results that have been achieved in providing for macroeconomic stability, structural reforms, dynamic growth of the economy and material well-being of the population, have created a solid base for further more rapid, consistent, systematic and targeted resolution of the poverty reduction problem in Azerbaijan.

The main principles of the government strategy are as follows:

- completion of the transition from an administrative-command economy to a market economy;
- continued implementation of specific actions aimed at strengthening the macroeconomic stability that has already been achieved, through pursuit of a responsible budgetary and monetary policy based on lowering the budget deficit, strict control over the inflation process, and ensuring the stability and convertibility of the national currency, the manat;
- the adoption of effective measures to eliminate the negative impact of the fuel and energy sector on this policy;
- under the medium-term fiscal program providing for a stable increase in budget revenues, restructuring the system of public expenditure management with a view to improving the effectiveness of expenditures;
- limitation of foreign borrowing at a stable level, giving preference to concessional credits subject to a substantiated non-financial need;

- creation of the necessary environment for growth in production and stimulation of commercial investments for the development of the country’s regions (the key to reducing the poverty rate);
- substantial improvement in the delivery of government services to the lowest-income segments of the population (electricity, gas, and water supply, education, health care, land reclamation, ecology, etc.);
- improvement of the social protection system, including the possibility of providing a person with a decent income after retirement.

**13.1.** The main principles of government action listed above will lead to balanced economic growth against a backdrop of price stability, which will promote poverty reduction and the creation of new jobs.

Balanced economic growth will require an increase in investments in the non-oil sector as the principal segment of the economy. But the most important strategic principle is the adjustment of investment policy, with a view to creating favorable conditions for a significant increase in investments in the non-oil sector, especially beyond the Apsheron Peninsula. More than half of the active population is concentrated in country’s regions, and they are essentially unemployed, living off of occasional earnings or emigrating to other countries in search of work. In light of this, great importance is assigned to the attraction of domestic and foreign private capital, which, as a rule, is used more effectively and with an eye to market conditions. Implementation of Phase II of the Privatization Program will play an extremely important role in this process; it provides for a more flexible and targeted denationalization policy, and the creation of an attractive investment climate for development of the non-oil sector through a gradual lowering of tax rates and the use of other incentives.

In addition, the government will increase the volume of its own capital expenditures in proportion to growth in its revenues, while at the same time making the management of government investments more effective.

**13.2.** With a view to increasing competitiveness in business, the government will support certain initiatives in strategic sectors of the economy, and in particular in major hydrocarbon extraction projects, it will revise the system of subsidies in the energy sector, it will step up efforts to make fuller use of Baku’s transit possibilities as a communications and transportation center on the Caspian Sea.

**13.3.** Over the medium term, economic growth will be mainly dependent on two vast oil and gas fields – “Azeri-Chirag-Guneshli” and “Shakhdeniz” and, accordingly, on the construction of the Baku-Tbilisi-Ceyhan Main Export Oil Pipeline and the Baku-Tbilisi-Turkey Gas Pipeline. The feasibility of these projects is beyond doubt, and extensive preparatory work has already been carried out for their implementation.

At the same time, the government believes that successful development of the oil sector alone is not enough to ensure the harmonious development of the country's economy, and growth in the population's income and employment. This is based on the fact that the oil sector, which soaks up huge investments, does not create an adequate number of jobs. Therefore, while recognizing the danger of dividing the economy into the flourishing oil sector and the stagnant non-oil sector (which also poses the threat of dividing society), the government is setting itself the task over the medium term of creating a competitive non-oil sector (especially in the regions) with the aim of resolving the problems of unemployment, raising the income level, and establishing a sound social protection system, as well as delivering adequate public services aimed at poverty reduction.

## **VI. Conceptual Framework of Policy Measures and Programs for 2001–2005**

**14.** Macroeconomic policy will entail the strengthening of financial stability and the implementation of balanced monetary and exchange rate policies with strict control over the inflation process.

**14.1.** The key elements of the government's fiscal policy consist of providing for a tax and budget plan that will make it possible to maintain the trend toward a guaranteed increase in budget revenue and expenditures in volumes adequate for poverty reduction. To this end, the Government intends to provide for a stable budget policy and a more complete, efficient and transparent use of available resources.

**14.2.** The government intends to embark in the near future on improvements in management of the budget process. The practice of adoption of the budget prior to the beginning of a new financial year will be continued. In addition, there are plans to: include in the budget all expenditures of government agencies, including social funds; establish an overall budget package and expenditure guidelines for government agencies; set up an integrated process for the submission of budget plans and reports; update the budget classification; introduce international accounting standards; improve the system for making changes in tax rates, social contributions, customs duties, and other compulsory payments; introduce a more efficient system for reporting on budget execution; publish on a regular basis extensive information on budget execution to ensure transparency of budget revenues and expenditures.

**14.3.** The revenue policy calls for a substantial increase in the tax collection rate by: expanding the tax base; establish real targeted tax charges, especially for large taxpayers; introducing effective mechanisms to eliminate the release of fuel, electricity, and gas without payment; creating the most competitive common taxation system in the regions; strengthening fiscal and tax discipline and tax administration.

At the same time, the government intends to continue the policy of gradually shifting the center of gravity of taxation from the producer to the consumer.

**14.3.1.** The forthcoming WTO accession highlights the necessity of revising customs duties with the aim of rate optimization. At present import duties (export taxes have been abolished) account for 8.7 percent of total budget revenues, with a single duty rate of 15 percent. Ministry of Finance forecasts call for bringing the share of the import tax down to 4.6 percent in 2005, which will mean maintaining a relatively stable volume of customs fees (in the range of manat 310-350 billion).

The government will track the course of negotiations with the WTO in order to prevent damage to the interests of local producers, on the one hand, and on the other hand, to bring Azerbaijan into line with internal foreign trade standards. The experience of CIS countries that have already joined the WTO shows that extremes should be avoided, even in the context of liberalization of foreign trade.

**14.3.2.** Taking into account the planned growth of the economy, the government is planning the following measures:

- an increase in the ratio of budget revenues to GDP from 15.1 percent in 2000 to 16.4 percent in 2005;
- identification and more complete utilization of the potential capacity of taxpayers to replenish the budget;
- ensuring the required proportion between the shares contributed by taxpayers in accordance with the real growth rate in their production and services;
- expansion and more complete coverage of the tax base with regard to taxes paid by individuals, reduction in the number of tax rates, application of the maximum tax rate for higher personal income levels;
- continued implementation of the policy of a gradual reduction in direct and indirect tax rates aimed at stimulating production and investment growth, development of small and medium-sized enterprises, simplification of the tax system;
- streamlining the system of targeted tax concessions, taking into consideration their economic and social relevance.

**14.4.** The government expenditure policy will be aimed at ensuring a high degree of effectiveness of expenditures within the framework of the goals that have been set, including poverty reduction, as well as the macroeconomic strategy of strengthening stability. the government has set targets for current and capital expenditures, which are attached to this document. Specifically, nominal expenditures as a whole will increase by a factor of 1.8 in the period 2001–2005, and will represent almost 17.1 percent of GDP in 2005, compared to 16.0 percent in 2000. At the same time, expenditures on social needs as a proportion of the total will rise from 48.7 percent under the projection for 2001 to 55.9 percent in 2005, including the following increases by sector: from 22 percent to 23.6 percent for education,

from 5.8 percent to 8.0 percent for health care, from 16 percent to 18.6 percent for social protection and social security, and from 2.1 percent to 2.4 percent for housing and municipal services, respectively. There are also plans to increase the proportion of capital investments in total budget expenditures from 3.8 percent in 2001 to 4.5 percent in 2005.

**14.4.1.** With the creation of the modern Treasury system, all budgetary operations are performed exclusively through a single Treasury account, which made it possible to take strict control over government expenditures effected by government authorities. Therefore, the government intends to continue upgrading and strengthening the technical base (full computerization) of the Treasury, and expanding its scope until it covers all operations, including those of special funds.

**14.4.2.** The principle of distribution of social expenditures will consist of targeting them at those who need them the most, based on a clear assessment of household income. A universal survey of real income of individual categories of population broken down by regions of the country will be conducted for this purpose.

**14.4.3.** The government will make every effort to increase the volume of funding allocated for pension security, particularly for those pensioners whose pensions are lower than average for the republic. The forthcoming pension system reform, the Conceptual Framework of which has already been prepared, will be aimed at building a financial base for future pensioners. In the long term, the pension reform conceptual framework provides for the establishment of individual accounts for each payer of social contributions, which will serve as an additional resource for augmenting the basic state pension.

According to the projected indicators of living standards (see the attached table) average monthly pension in the republic as a whole will grow faster than the average monthly wage, which will bring them much closer together (from 35.6 percent in 2000 to 50 percent in 2005).

**14.4.4.** The government is committed to a substantial increase in salaries paid to employees of government authorities, to be achieved by reducing government staff (both at central and local levels), in order to eliminate the practice of searching for alternative sources of income. These measures will be implemented within the government reform strategy approved by the World Bank, which calls for the staffing of government agencies with qualified personnel and optimization of the general administrative structure by eliminating the duplication of ministerial functions, among other things.

**14.4.5.** The planning of expenditures will take into account the proposed measures for reform and restructuring in the fields of education, health care, culture, sports, science, housing and municipal services, and law enforcement authorities.

There are also plans to introduce a procedure for the funding of various expenditures on the basis of short-term and medium-term programs and tender arrangements (for goods and services).

**14.4.6.** The government plans to revise through legislative procedures the system of issuing guarantees for government borrowing, with introduction of effective mechanisms for assessing the economic advisability of specific operations. In this context the management of government debt will be strengthened, particularly in terms of debt service (this will entail the establishment of strict monitoring to ensure that debt servicing during specific consecutive years does not exceed 3–4 percent of GDP).

**14.5.** In order to improve fiscal management, the government intends to implement measures based on new principles and provisions of the Tax Code. This means the strengthening of the tax administration. In particular, relations between the tax administration and taxpayers will be depend on their discipline. In other words, those who evade taxes regardless of the reasons will be subject to regular audits, while those who comply will tax requirements will be audited once every two years. The assets of delinquent taxpayers will be frozen and will be sold in accordance with the procedure established by legislation in order to cover tax arrears.

The system that has been created for consultations with representatives of taxpayers' organizations will be incorporated into the budgetary process.

**14.5.1.** Particular attention will be given to personnel policy in tax administration. In addition to systematizing the process of training and professional development for employees of tax services, there are plans to raise the salaries of tax administration staff, complete the computerization of the entire tax system, and strengthen its material and technical base.

**15.** Monetary policy will be aimed at maintaining macroeconomic stability, determining the real exchange rate of the manat, deepening the normalization of currency circulation, supporting domestic producers, stimulating exporters, increasing the country's gold and foreign exchange reserves, and improving the operation of the banking system.

**15.1.** There are plans to implement a more flexible policy in the money and credit market, with a view to increasing the money supply in an amount appropriate to the projected average annual inflation rate of 2.5 percent in 2001–2005. Such mechanisms as refinancing incentives, introduction of reserve requirements, open market operations, enhanced requirements for banks, and other instruments for regulating the money and credit market will be used to implement this policy. In addition, effective steps will be taken to prevent intensification of the inflation process.

**16.** Exchange rate policy will be characterized by smooth changes in the exchange rate of the manat, with a view to bringing it closer to its real value in order to provide for self-regulation of the foreign exchange market.

**16.1.** Successful implementation of the Oil Strategy has already led to the inflow of petrodollars into the country, which will grow rapidly in the coming years. In this connection there are plans to develop and introduce flexible regulatory mechanisms, which, on the one

hand, will eliminate the negative impact of the inflow of large amounts of foreign exchange on the non-oil sector (the “Dutch disease”), and on the other hand, will provide for the optimal money supply given the projected increase in foreign exchange reserves. In order to achieve these goals the government intends to provide for the accelerated fundamental modernization of strategically important enterprises in the non-oil sector, with the aim of achieving a significant increase in the output of products for export and import substitutes, as well as insulating the liquid assets of the banking system from the inflation process.

**16.2. Institutional policy in the banking system calls for:**

- increasing the role of banks in supporting small and medium-sized enterprises;
- creation of conditions for development of a micro-lending system;
- adoption of targeted measures aimed at strengthening public confidence in banks, with the use of deposit insurance mechanisms;
- speeding up the process of privatization of state-owned banks;
- development of conditions for competition in the banking services market;
- speeding up the introduction of international standards in the banking system and establishment of the necessary conditions for attraction of foreign bank capital into the country;
- continuation of reforms in the private banking system, with optimization of the number of private banks and acceleration of the process of increasing their authorized capital, qualitative evaluation based on various criteria, completion of the process of merging of small banks, etc.;
- speeding up the universal introduction of electronic banking operations, development of the appropriate banking infrastructure, improvement of the legal base, and implementation of the necessary institutional reforms in the banking system.

**17.** The policy in the social sector calls for the adoption of urgent measures, aimed, first and foremost, at decreasing the number of people living in extreme poverty, as well as at ensuring the participation of all population groups in the opportunities for higher income and in gaining access to the sufficient level of public services in the social sphere.

**17.1.** The health care system reform program has been prepared and its implementation has been started with the simultaneous support of World Bank. The objective of this program is to improve the quality of medical care and to provide access to medical services, especially for poor segments of the population.

The government intends to revise current fees for medical services with the aim of identifying a set of urgent health care services that will be delivered free of charge to all population groups or at subsidized rates.

**17.2.** At the same time, strict control will be established over the medical services and medications to be delivered on paid basis. Information on the cost of medical services at specific medical facilities will be published regularly, and a transparent and competitive environment will be established for the participation of the private sector in the delivery of medical care.

**17.3.** Taking into consideration the fact that no matter what form is used for the organization of medical care (medical insurance, public, mixed, etc.), in the next 5–7 years up to 70–75 percent of the country’s residents will be in need of public medical services, the government intends to increase the share of budgetary expenditures for health care in total state expenditures and optimize their distribution between the republican and local budgets, taking into account a reasonable reduction in the number of medical facilities that are not viable, duplicate each others’ functions, or are inefficient, as well as a reduction of the number of beds, personnel, etc.

The government will continue its commitment to the policy of expanding paid medical services and creating modern private medical facilities.

**17.4.** Efforts will continue in the development of the health care infrastructure and the training of medical personnel to meet the needs of Azerbaijan, with further rationalization of numbers of beds and hospitals and adjustments in the number of spaces available for those entering medical schools. With a view to making more efficient use of resources and achieving high performance in the delivery of medical services, including “emergency \_will strengthen the financial management and control system, drawing on the experience gained in projects being carried out in a number of regions of Azerbaijan with the support of the World Bank.

**17.5.** The Government intends to pay particular attention to improving the health of mothers and children. This means carrying out comprehensive vaccination against the main infectious diseases without regard for any financial limitations. Under a special program effective measures will be implemented that are directed at lowering maternal and infant mortality, and improving family planning and reproductive services, with the aim of improving the health of mothers and children.

**18.** The traditional values of Azerbaijani society and surveys that have been conducted provide evidence of the population’s clear desire to have access to education, which is considered a means of improving well-being. Therefore, the government intends to continue the policy of providing all-round support for this sphere, particularly funding provided at government expense. With the aim of bringing education up to world standards, the government will make a persistent effort to attract international donors to address this

issue, and especially to help improve the material and technical base of secondary schools in rural areas and to introduce new standards for primary and secondary education.

**18.1.** In accordance with the Constitution of Azerbaijan Republic, the government will provide universal free general education.

According to the age structure of population, based on forecasts of the Ministry of Education, the number of students in primary schools (grades 1–4) will decrease from 686,000 in 1999-2000 to 599,000 in 2004–2005. This will make it possible to optimize the workload of teachers to a significant extent during these years, and also to create the conditions for improving the quality of primary education.

**18.2.** The education reform program has been prepared, and its implementation has already started, with World Bank support. In addition to other measures, the Programs calls for:

- increasing the availability of free textbooks for students;
- strengthening the material and technical base in a significant number of schools, including provision of computer equipment and improvement of library services;
- reforming the education system taking into consideration the requirements of a market economy;
- introduction of modern curricula and improvement in the quality of in-service training for teachers and the effectiveness of instruction;
- revision and rationalization of the number of educational institutions, personnel and enrollment in the education system;
- reforming the system of higher education, with a view to optimizing the ratio of free and tuition-based higher education institutions, access to free higher education for the poorest segments of the population, as well as better targeting in the granting of scholarships.

**19.** Social protection and pension security for the population is one of the government's priorities in the poverty reduction process. The existing system of government social expenditures does not provide sufficient targeting of support to those who are in need of it. With this in mind, the government intends to start pension reform soon, and it also intends to strengthen social policy in general.

**19.1.** The projected indicators of Azerbaijan's social and economic development in 2001–2005 assume continuation of the social orientation of the budget and faster growth of average monthly pensions compared to the average monthly wage throughout the country as a whole, which will bring them substantially closer together. With a view to implementing

this policy, the government intends, along with expanding economic opportunities, to take serious measures to make more efficient use of available resources, including a reduction in unjustified benefits to a minimum and more targeted social protection.

**19.2.** The key elements of pension reform are:

- observance of citizens' rights to state social support, guaranteed by the Constitution of Azerbaijan;
- adapting the pension security system to the conditions of the market economy;
- a more equitable differentiation of pensions and increased targeting;
- improvement of the organizational and legal framework of pension administration.

Within the framework of these key elements of pension reform, the government is developing a specific plan of action, which will be set forth in the Main PRSP.

**19.3.** At present the bulk of social expenditures are earmarked for pensions (64 percent), and only 13 percent is earmarked for social benefits paid to those who are in need of material support based on subjective assessments. The government intends to earmark the expected increase in social expenditures mainly for those who are objectively living in extreme poverty based on a detailed assessment of household income, while simultaneously limiting benefit payments to individual citizens according to their status. In this connection, the information on household income and expenditures which is currently used will be revised.

**19.4.** Particular attention will be given to increasing state protection for orphaned children, who presently number about 30,000 throughout the country. At the initial stage the government will search for ways to improve conditions at the facilities where these orphans live, and will provide support to help them enter the labor market upon reaching the age of 16. Later on, measures will be undertaken for the placement of orphans at the facilities in question, by supporting adoption and the development of social services that help disabled and difficult children to live a normal life with families. The appropriate regulatory and legislative framework will regulate these processes.

The government also plans to study the question of granting a large number of special benefits to various groups of disabled adults, with a view to improving support for those who need it the most.

**19.5.** Suspension of the indexation of household deposits in savings banks since the beginning of 1992 is a matter of particular concern among the population. Objectively speaking, it has been impossible to even begin this process over the last several years. Nonetheless, each time it reviews the draft annual budgets, the government will study ways to resolve this issue, proceeding from the real capacity of economy.

**20.** Providing normal living conditions for refugees and internally displaced persons still remains an extremely difficult problem. The prolonged uncertainty in resolving the conflict between Armenia and Azerbaijan has created a paradoxical situation: on the one hand, if all efforts are concentrated on solving problems related to the survival of this category of the population in the areas where they are currently located, this will create significant constraints for their return to the places which they were forced to leave, upon liberation of these regions from occupation; on the other hand, it is extremely unfair to leave some 1 million refugees and displaced persons in such socially disadvantaged circumstances. Although the government and international humanitarian organizations are providing what material assistance they can, and they are exempted from all types of taxes and enjoy numerous concessions, all of this is nonetheless wholly inadequate for providing them with even the minimal conditions for survival.

Therefore, the government intends to continue all efforts, within international law, to achieve the liberation of Azerbaijani territories that have been occupied by Armenian aggressors and the return of refugees and displaced persons to their own population centers that have been plundered and destroyed, according to the available information. Time and immense capital investments will be required for the comprehensive rehabilitation of liberated areas. In this connection, on the basis of a special national program supported by the country's own economic possibilities and help from foreign donors, the government intends to provide for the rapid establishment in liberated population centers of housing, jobs, the essential infrastructure (water, electric power, gas, roads), social facilities (schools, vocational schools, higher education institutions, cultural and sports facilities, medical institutions, etc.).

**20.1.** At the same time, the government will strengthen its policy of providing comprehensive support for refugees and displaced persons by increasing the allowances for bread and food, and it will continue providing free municipal and medical services, free fuel, as well as exemption from taxes.

Simultaneously the government will create the necessary conditions that will enable this category of population to achieve economic self-reliance, in particular by providing micro-credits and other forms of assistance to refugees and displaced persons.

**21.** Agriculture occupies a special position in the country's economy. More than 30 percent of labor resources are employed in this sector and it currently accounts for approximately 20 percent of GDP. The favorable natural and climatic conditions make it possible to keep the population supplied with food, to a significant extent, and to supply the processing and food industry with raw materials.

This sector of economy, however, has experienced a serious crisis over the last 10–12 years. Only after the land reform (since 1997) has production growth been observed in agriculture, especially in animal husbandry. All the collective farms and state farms were

liquidated in recent years: over 1.3 million of hectares of land has been distributed among 819,000 rural families, representing some 3.2 million people.

**21.1.** At the same time, the potential capacity of agriculture, not only in terms of production, but also in terms of providing ten of thousands of people with jobs, is currently significantly underutilized.

With a view to drawing this potential capacity into the economic turnover, ensuring food security, and reducing poverty, the government is planning the development and implementation of targeted programs aimed at the comprehensive resolution of problems in the agrarian sector of the economy. These programs will include measures aimed at:

- capital improvement of land resources (rehabilitation of the land reclamation and irrigation system, erosion prevention work, etc.);
- creation and development of the agricultural infrastructure (the service system, improvement of the material and technical base of veterinary and breeding services, creation of a modern system of services for procurement, storage, packaging, and shipment of produce, development of small, medium-sized and large processing shops and enterprises, commodity exchanges, etc.);
- establishment of the necessary conditions for lending for agricultural production (land market, leasing services, improvement of the agricultural insurance system, etc.);
- support for the establishment of market forms of management (specialized cooperatives, associations, small enterprises, etc.);
- establishment of agrarian informational and zonal scientific services for the introduction of new technologies and modern types of labor organization, the study of international experience;
- solving problems related to providing the infrastructure for agricultural production (uninterrupted supply of energy and water, construction of roads, improvement of the telecommunication system, etc.);
- establishment and development of crafts, use of forest plant resources, development of rural tourism;
- economic incentives for any type of investment in rural areas;

**21.2.** Partial resolution of these and other problems has already been started with assistance from:

- the World Bank (pilot farms, the uniform registration of real property, information and consulting services, creation of a financial and credit system);
- the European Union under the TACIS program (establishment of financial and credit services, agribusiness consulting, etc.);
- the Islamic Development Bank (reconstruction of the irrigation system);
- the government of the Netherlands (establishment of a base for the production and storage of potato seeds, organization of breeding services);
- the government of Japan (supply of agricultural equipment)
- the Government of Japan and IFAD (development of mountainous areas).

In addition, the Agricultural Credit Fund has already been established with the government as one of its founders. It will provide financing for various projects in the agricultural sector. With the aim of increasing the effectiveness of agricultural production, the government adopted a decision to exempt agricultural producers from all types of taxes (except the land tax).

**22.** Recognizing the important role of the development of entrepreneurship in poverty reduction, the government will strengthen its support of this process within the framework of the Program for the development of small and medium-sized businesses. This program provides for the establishment of favorable economic, procedural and organizational conditions for the development of entrepreneurship, the establishment of small enterprises and small artisan-based businesses, use of available natural, raw material and labor resources of the regions of the Republic for the creation of modern new production capacities and job opportunities, and a significant expansion of the delivery of various services. A substantial lowering of tax rates for small and medium-sized enterprises is provided for in the Tax Code recently adopted by the Parliament.

**23.** Given all the other conditions, economic growth will be the main mechanism capable of providing present and future generations with socially useful work with the aim of achieving a more appropriate standard of living.

Against the backdrop of financial stability, the government's top priority is the fundamental modernization of the entire real sector of the economy and the non-oil sector and infrastructure, in particular. Achievement of poverty reduction in Azerbaijan is unlikely unless this fundamental task is addressed.

**23.1.** According to the Oil Strategy of the Azerbaijan Republic the development of the oil and gas extraction industry for the coming decades is predetermined by the contracts that have been signed with the largest foreign oil companies in the world. As these contracts are implemented, the volume of oil and gas extraction will increase, as will their export and

the inflow of foreign exchange revenues, which will make it possible to resolve many economic and social problems, raise the living standards of the population, and provide for economic security.

According to SOCAR projections, the volume of oil extraction will increase from 13.8 million metric tons in 1999 (including 4.8 million metric tons extracted by foreign companies) to 17.5 million metric tons in 2005 (including 9.0 million metric tons extracted by foreign companies), and gas production will rise from 6.0 billion m<sup>3</sup> (0.4 billion m<sup>3</sup>) to 11–12 billion m<sup>3</sup> (6–7 billion m<sup>3</sup>), respectively.

Revenues from the output of contracted oil and gas deposits will be utilized according to the provisions of the Regulation “On the State Oil Fund,” which calls for the earning of dividends, through the placement of revenues in highly rated banks; these dividends are to be used to address current social and economic priorities; while fixed capital, in the case of extreme necessity, will be used to address the most important national problems and for the construction of new and reconstruction of existing and strategically important infrastructure facilities.

**23.2.** After achieving the objective of further development of the dominant sector of the economy – the oil and gas extraction industry, the government of Azerbaijan intends in the next few years to implement a special program for development of the non-oil sector of the economy and infrastructure, in order to bring them up to modern standards. This will make it possible to create a significant export and import substitute potential as an alternative to oil and gas, and to involve hundreds of thousands of citizens of the republic in this process, thereby significantly improving their well-being.

Achieving this strategic objective, however, will require major capital investments and time. Calculations show that over the next 3–4 years Azerbaijan will not have sufficient financial resources at its disposal to achieve this objective. Therefore, the development of the non-oil sector will be carried out for the most part through the attraction of foreign investments, for which economically favorable conditions and incentives will be created, including participation by investors in the privatization of facilities in which investments are being made. This policy is already in place and is producing good results in terms of the creation of new relatively high-paying jobs, and the upgrading of technologies at enterprises to modern levels to enable them to produce competitive products for export and import substitutes. Therefore, the government intends to step up this process, particularly in the regions of the country. A new Law on Privatization has been adopted, Phase II of the Privatization Program has been approved, enterprises have been selected based on specific criteria (real possibilities for a significant increase in export and import substitution potential, creation of new labor-intensive production operations, utilization of raw material and labor resources of the regions, etc.), and a draft addendum to the Tax Code has been prepared which deals with economic incentives for investors for the rehabilitation and development of the most important types of production operations and increasing the employment rate.

**23.3.** The government also intends to establish a domestic market for oil as a raw material to be used for the organization of new and expansion of existing production operations for finished export products. This promising direction is viewed as a priority, since it is an important additional resource, in particular for addressing poverty and employment problems.

**24.** The infrastructure, which is tied to resolving the poverty reduction problem, currently falls significantly short both in terms of the level of its development and proper delivery of services. It essentially fails to meet its obligations to the budget functions and delivers low-quality and unreliable services.

**24.1.** The government will pursue the following strategy in electric energy and gas supply:

– gradual substitution of gas for fuel oil in the generation of electric power and heat. At the first stage this will be based on imported gas, the price of which on the world market is much lower than that of fuel oil, and expenditures on the import of gas will be covered through exports of petroleum and fuel oil. Later on, as the vast gas reserves at the “Shakh-Deniz” oil field are developed and additional gas is obtained

–Chirag-Guneshli” oil fields, it will be possible to do away with gas imports entirely and convert all of the country’s electric and heating stations to gas. This will lead to a significant reduction of the cost of electric power and will make it possible to revise tariffs downward and to eliminate all subsidies for various types of municipal services;

– implementation of structural measures aimed at increasing the collection rate of fees for electric power, water, and gas supply through optimization of tariffs, and promotion of private sector participation in delivery of these services;

– strengthening the tariff and price policy in the energy sector, based on a realistic evaluation of the cost of production and distribution, and ensuring an acceptable profit level for producers, with a simultaneous revision of the principles followed in granting special concessions to certain sectors and categories of the population.

**24.2.** In addition, the Government intends to track the consequences of the measures being implemented for domestic consumers, broken down by each individual tariff group, with the aim of providing poor segments of the population with an adequate level of municipal services at acceptable prices. This does not rule out the possibility of replacing existing special concessions with subsidies for the poorest groups.

At the same time, the government will require the operators of distribution networks (electric power, gas, heat) to publish monthly data on the level of services delivered, following a standard format.

**25.** According to calculations by specialists at the respective administrative authorities, over \$6 billion (!) is required to provide a safe water supply and sewer systems for all population centers in the republic (excluding Baku). This is clear evidence of the poor development of these public services in the regions of the country. It is obviously unrealistic to set a task of resolving this issue within the next 10–15 years. Therefore, the government is planning to develop a long-term program to address this problem in stages (based on the real possibilities of the economy).

In the course of preparing the Main Poverty Reduction Strategy Paper, the potential amount of investments will be determined, including foreign investments, which can be earmarked up to 2005 for the construction of water supply facilities and sewer systems in population centers outside Baku, as well as for reconstruction of the system in Baku itself.

**26.** Azerbaijan, particularly the Apsheron Peninsula, is one of the most polluted areas on Earth. This depressing situation can be explained by the disregard for environmental safety issues during the Soviet era, which was characterized by high levels of pollutants discharged into the atmosphere and water, as well as the irresponsible pollution of vast land areas.

In recent years the government has undertaken measures aimed at rehabilitation of the environment. In particular, high standards of environmental responsibility were introduced which apply to foreign oil companies, and the National Environmental Action Plan was developed and is now being implemented; ensuring environmental safety is one of the top priorities when new projects are being considered.

Taking into consideration the fact that pollution of the environment has a greater impact on the poor, who do not have any means to protect themselves, particularly with regard to safe drinking water and appropriate land use, the government will bring its environmental policy into conformity with the poverty reduction policy. It will strengthen measures against air emissions and pollution of water and soil by imposing tougher sanctions on those legal entities and private individuals who do not comply with requirements. In this connection, the activities of agencies conducting environmental monitoring will be strengthened.

**27.** The government's economic policy in the area of trade and investment will reflect the state's strategic ideology, which is focused on the establishment and development of a true market economy. It will be aimed at ensuring competitiveness in all sectors and spheres of the economy through an effective antimonopoly policy, attraction of investment, particularly foreign investment, as well as strengthening of cooperation with the private sector.

**27.1** In an open economy trade (domestic and foreign) will play an important role in the poverty reduction process.

The domestic consumer market will be as free as it is today with regard to pricing, equal conditions for competition, and freedom of access. Regulation of the domestic market will be performed only in matters of safety and protection of consumer interests.

**27.2.** As far as foreign trade is concerned, the government plans to revise downwards the customs duties for producer goods and raw materials (investment goods) in order to support local producers and spur on development of the real sector of the economy, with a simultaneous increase in duties for consumer goods.

**27.3.** The current structure of exports reflects the actual situation in the economy, namely the dominant position of petroleum and petroleum products (80–85 percent). The government policy of creating a new export potential as an alternative to oil is described in items 21–24 above. The plan is to create favorable conditions for increasing the competitiveness of products and goods produced in the republic in the non-oil sector through the fundamental modernization of strategically important enterprises, the creation of new export-oriented production operations, and the promotion of export operations through implementation of an appropriate monetary and exchange rate policy.

**27.4.** The Government is performing intensive preparatory work for accession to the World Trade Organization (WTO). Working groups have been established for specific issues to elaborate the government's position at the forthcoming negotiations with the WTO.

**27.5.** The government's investment policy will be strengthened in connection with the need for fundamental modernization and development of the non-oil sector and involvement of unused raw material and labor resources in the regions of the country in the economic turnover. In order to make this government plan a reality, the most favorable organizational and legal, procedural, and economic conditions will be created for domestic and foreign investors. Pursuant to a Decree of the President of the Azerbaijan Republic, the Ministry of Economic Development has been created out of five executive government bodies. It will be the sole agency responsible for the development and implementation of the country's investment policy, which will significantly simplify the procedures of documentation and implementation of various investment projects.

Investments in the oil sector will have be cyclical in nature in accordance with the terms and timetables of oil contracts.

Generally speaking, the government intends to pursue a strategy aimed at the transformation of Azerbaijan into a regional investment center over the next 5–6 years. According to forecasts based mainly on the expected implementation of the specific projects over the next five years, the volume of investments from all financing sources will increase from 6.6 trillion manat in 2000 to 22.5 trillion manat in 2005, including direct investment, which will account for about 65-70 percent of the total.

**27.5.1.** The main appeal of Azerbaijan in terms of investment will be based on maintaining macroeconomic stability, creating a competitive environment of general taxation

with incentive rates for companies and the work force, as well as providing guarantees of fiscal stability of the most important elements of taxation for priority projects over a specific period of time, particularly for those that will contribute to poverty reduction.

**28.** At present Azerbaijan's financial sector is relatively small and underdeveloped. It is not yet capable of properly performing its main function of financial intermediation between savings and investments. The macroeconomic indicators of the banking sector, particularly the low level of household deposits and loans compared to GDP (12 percent and 11 percent, respectively), the wide differentiation of interest rates (from 10 percent to 20 percent), among other things, demonstrate the necessity of deepening the reforms in the banking sector.

**28.1.** Over the next few years the National Bank intends to:

- create a competitive and reliable private banking system through the closing or merger of small banks with inadequate capital, with the aim of establishing a more professional group of banks;
- carry out the restructuring of state-owned banks, including acceleration of their privatization;
- provide for the development of the banking infrastructure, including reform of the payment system. Already in the first quarter of 2001 the introduction of the real time gross settlement system (AZIPS) for large-value transactions was completed. This system will eventually be extended to small national electronic payments;
- implement institutional development of the banking sector through improvement of banking legislation, strengthening bank supervision, and establishment of a deposit insurance system for small depositors.

**28.2.** The recently created Stock Exchange enables the government to strengthen its policy of development of a securities market. The government intends to develop for further development of the insurance market. The government will also do everything possible to support the introduction of new financial instruments for depositors, which will encourage their participation in the investment process through access to the government short-term bond market, and private pension and investment funds.

**29.** With its vast hydrocarbon reserves, and having signed 20 oil contracts with major foreign companies for the extraction of these resources, over the next decade Azerbaijan will join the ranks of the leading oil- and gas-producing countries of the world. In connection with the expected significant increase in oil and gas production, the government is already successfully addressing the issue of transportation of these resources to world markets. The preliminary work for the construction of the Baku-Tbilisi-Ceyhan Main Export Pipeline, with a capacity of 50 million metric tons of oil per year, is about to be finalized. Negotiations are almost complete with Turkey for the construction of the Baku-Tbilisi-Turkey gas pipeline to

export gas to Turkey from the “Shakh-Deniz” deposit, where reserves of natural gas and gas condensate total some 1 trillion cubic meters.

**29.1.** Within the framework of Azerbaijan’s Oil Strategy, the government intends to continue the work on establishment of the required infrastructure for off-shore oil deposits and timely use of capacities for their exploration. Specifically, it will promote rapid progress in the construction of the fourth drilling platform and consider the possibility of development of export services.

With regard to the development of on-shore oil deposits, the government is likely to change the status of the existing fields to a “Production Sharing Agreement” (PSA), since practical experience has shown such arrangements to be more attractive to investors than establishing joint ventures or keeping on-shore oil deposits under government ownership. This approach to the exploitation of on-shore oil fields may promote an increase in national oil production until the major off-shore contract projects go online.

**29.2.** Currently around 20 percent of investment in Azerbaijan’s oil sector remains in the country, and the rest leaves the country as a foreign partner’s share under the contract and as payment for imports. Therefore, the government, with the aim of creating a domestic oil market, will do everything possible to support the development of new production operations that use petroleum as a raw material for manufacturing competitive finished goods, and it will undertake measures to prevent losses in competition with foreign companies under PSA contracts. The government will also step up discussions with foreign customers with the aim of making wider use of Azerbaijani contractors in the development of the oil sector.

With the aim of cutting production costs of oil and gas at contracted sites and enhancing the export potential in the non-oil sector, the government intends to provide for the fundamental reconstruction of enterprises that manufacture petroleum equipment, in order to establish production and supply to contracted oil fields of oil equipment and spare parts that are consistent with world petroleum industry standards (API).

**29.3.** The situation with regard to the financial status of SOCAR remains tense due to: first, the impossibility of obtaining payment for fuel oil delivered to Azerenergy, and gas supplied to Azerigaz, which amounts to a subsidy of \$200 million at regulated prices: second, extremely low crude oil prices for domestic consumers (\$7 per barrel). In order to transform SOCAR into an economically competitive organization, the government intends first to increase the supply of gas for electric power generation from year to year, accompanied by a simultaneous increase in petroleum (fuel oil) exports to cover expenditures on gas imports. At the same time strict measures will be undertaken in order to increase the fee collection rate for the use of gas, electric power, and heat. Over the long term the government will revise the domestic regulated crude oil prices with a view to bringing them into line with world prices, which will permit effective utilization of oil and eliminate subsidies in the domestic petroleum market. In the medium term the government will avoid sharp increases in the price of petroleum and petroleum products which could lead to negative economic and social consequences.

**30.** Baku is probably the only city on the Caspian Sea with a sufficiently strong position to develop into a regional center for providing the growing Caspian market with financial, transportation, oil, and communication services. Keeping in mind the intense competition in the Caspian region for the establishment of basic transport routes for the delivery of the Caspian Sea's hydrocarbon resources to the world markets, the government of Azerbaijan will work vigorously to hold on to its leading role in the field of transportation of these resources across the territory of Azerbaijan.

**30.1.** With the aim of practical implementation of these government plans, a stronger transportation policy will be developed by the Ministry of Transportation; the timetable for the beginning of the Ministry's functional operation will be accelerated (in 2001). Functions involving the reform and implementation of transportation policy will be transferred to the Ministry, as well as the implementation of measures aimed at increasing the efficiency of commercial activities of the Azerbaijan Railway, Caspian Shipping Company, Baku Sea Port, Azeravtonagliyyat [Azerautotransport], Azeravtoyol, and AZAL.

**30.2.** For reinforcement of Baku's competitive position on the Caspian Sea and more effective utilization of its geographic advantages, the government will develop a strategy for the transformation of Azerbaijan into a more attractive transportation corridor, including simplification of procedures at borders, establishment of the required modern transportation infrastructure, revision of transport tariffs, etc.

**31.** Improvement of the economic management system and a clear definition of the role of the state are among the government's most important tasks. Much has been done in this area over the last several years, including significant restrictions on government intervention in the economic and financial activities of enterprises, elimination of around 30 central government authorities and all collective and state farms, establishment of 6 central regulatory structures, lifting of the export tax, the placement of control functions with regard to financial flows exclusively with the Ministry of Finance (for economic entities) and the National Bank (for banks), the strengthening of audit activities, and so on.

**31.1.** Nevertheless, the existing system of management (particularly in terms of functional responsibilities) is not entirely consistent with the current requirements of the transition period. Therefore, the government will continue its policy of reforming the existing management structure, with a view to strengthening and developing Azerbaijan's state system, improving the efficiency of public services and social protection of population, and lifting administrative barriers to investment and economic growth.

To this end, the policy of coordination among agencies will be strengthened by eliminating the duplication of functions, restructuring the Cabinet of Ministers, eliminating or merging certain Ministries and departments, accelerating the timetable for the Accounting Chamber to begin its functional operation in monitoring the efficiency of public expenditures, further strengthening of the operation of the Treasury and budget process, deepening of the reforms in the banking system, and other economic administrative authorities.

**31.2.** The recently adopted Law “On the Civil Service” will make it possible to strengthen personnel policy on a legal basis and to rule out favoritism. Competitive mechanisms for the hiring of civil servants will be introduced in this connection. With a view to increasing responsibility, a periodic performance review will be introduced in order to assess the professional level of the staff, promising employees will be sent for training abroad and at the Academy of Public Administration, and a system will also be introduced that will allow senior civil service employees to gain practical work experience in the private sector.

**31.3.** The government intends to strengthen the policy of separating commercial and administrative functions that has already been initiated. Within the framework of the program to reform the administrative structure, all the ministries and central departments, without exception, will be denied the right to engage in any kind of direct or indirect commercial activities, which will eliminate the possibility of commercial interests affecting public interests. At the same time, companies such as SOCAR, Azerenergy, Azerigaz, Azeravtonaglyyat, Azeravtoyol, Azerbaijan Railway, Baku Sea Port, Caspian Shipping Company, and AZAL will be stripped of their policy development functions. These functions will be turned over to the Ministry of Fuel and Energy and the Ministry of Transportation.

**31.4.** In July 2002 the President of Azerbaijan issued a decree on combating corruption, and pursuant to this decree a draft law and a program to combat this illegal phenomenon have been prepared. An anticorruption campaign was launched even before the adoption of these documents. Specifically, wages in the public sector were significantly increased, especially for high-level officials; and reform of the judicial system and tax and privatization administration was initiated. Within the framework of the anticorruption program the government will revise the list and cost of licenses issued for various kinds of activities in order to reduce the number of licenses, it will make the licensing system more transparent, and it will also bring the level of fines into line with the seriousness of the offenses. Measures will be taken to bring about a substantial improvement in access by the population, especially the poor, to public services (medical care, higher education, etc.). Based on the principles of equity and efficiency, the government will complete the privatization of most services and will target the limited resources for those who need these services the most.

**32.** The government will continue the judicial reform that has already been initiated. Reform of the judicial system entails measures to improve the legal qualifications of judges, prosecutors, and defense attorneys; to improve the courts and procedures for handling cases; to increase the responsibility of judges for their rulings; and to allow the public to participate in trials. Particular attention will be paid to the adoption of laws that are consistent with the requirements of a market economy, ensuring the independence and competence of judicial personnel, and improving the performance of law enforcement agencies that are responsible for ensuring the execution of court rulings and observance of human rights.

**33.** The government intends to promote corporate governance in order to improve the performance of the private sector of the economy. In particular, the government will:

- work with entrepreneurs to introduce modern management techniques and to improve the training and professionalism of Azerbaijani managers;
- step up its efforts to implement the program to support small and medium-sized businesses;
- work vigorously to introduce International Accounting Standards in order to provide investors with high-quality financial information;
- require all joint-stock companies with turnover exceeding the established minimum level to compile their accounts in accordance with International Accounting Standards and will establish a timetable requiring the publication of annual reports, including records of commercial transactions (including invoices and checks).

**34.** Recognizing that privatization is not the goal, but a means to develop a real market economy and improve economic performance, the government has changed the principles underlying the privatization process. The new Law and Phase II of the Privatization Program contain provisions stating that from now on all facilities to be privatized will be subject to pre-privatization preparation (write-off or freezing of debts, removal of social facilities from their balance sheets, and design of investment business plans). Thirteen auctions for the privatization of small and medium-sized enterprises have already been held under Phase II of the Privatization Program. In the form of directives issued by the President of Azerbaijan, the decision was made to transfer the assets of the electric power distribution networks of the cities of Baku, Gyanja and Sumgait, as well the “Azeraluminum” joint-stock company, for long-term management. Privatization activities have been started at dozens of medium-sized and large enterprises in the machinery and chemical complex, the fishing industry, communications, and aviation.

**34.1.** The main principles of privatization are that replacing government ownership with private ownership should increase the efficiency and competitiveness of the production of goods and services, contribute to private sector development, intensify the investment process, and enhance the antimonopoly policy.

**34.2.** The government is confident that in the process of privatization there will be an increase in income and the amount of investments, since the private sector is free in its actions to promote the efficiency of its operations, including in assets and investment management. Therefore, the government intends to offer strategically important enterprises of the non-oil sector for privatization to those who have real capabilities for investing in the fundamental modernization of enterprises, and introducing modern methods and forms of management. This is the only way to achieve profitability of privatized enterprises and strengthen confidence in Azerbaijan’s privatization program.

When necessary, the government will bring in qualified legal and financial consultants for the effective privatization of strategic enterprises, especially in cases requiring a complex long-term approach.

The government will also protect the interests of holders of privatization vouchers so that they are able to exchange their vouchers for shares in companies, while simultaneously holding auctions for money with the aim of concentrating assets in order to increase income and investments.

## **VII. Issues Pertaining to the Organization of Broad Participation in the Development of the Main PRSP and the Timetable**

**35.** This Interim “Poverty Reduction Strategy in Azerbaijan” Paper (PRSP) was developed with the participation of representatives of 34 governmental and nongovernmental organizations, who were included as members of the official working group headed by the Deputy Minister of the Economy. Some of these representatives previously participated in Poverty Reduction Seminars in November in Moscow, in December in Baku, and in February in Manila (Philippines).

**36.** For the purpose of preparation of the Main PRSP in the first quarter of 2002 the government, in order to ensure broad participation, will establish specialized working groups for each sector. Experts from central and local government authorities, Parliament, scientific institutions, nongovernmental organizations, and broad strata of civil society will be involved in these working groups. The government will also implement public relations measures in order to properly explain the poverty reduction strategy to Azerbaijani society.

**37.** The process of preparing the Main PRSP will include regional workshops and seminars in the summer and fall of 2001 to shed light on existing problems and government policy in education, health care, social protection, income, and investments. This process will be finalized by holding a national PRSP workshop in January 2002 in Baku prior completion and approval of the Main PRSP.

**38.** The purpose of the public relations campaign will be to inform the public of the real state of affairs regarding poverty and the government’s plans for poverty reduction, in order to establish a dialogue and gain public understanding and support for the Program. In this connection there are plans to:

- hold a series of public meetings in Baku and the regions to allow for discussion of the Strategy;
- produce a television program to be shown twice a month, dedicated to poverty and ways to reduce poverty, as well as a regular radio program on the same topic;
- publish special pamphlets and booklets discussing these problems, which will be distributed throughout the country;

– organize a series of meetings with the public in the poorest regions and zones of the country in order to provide information on the scope and nature of poverty in Azerbaijan and proposed measures for its reduction.

**39.** In the course of Main PRSP development, the government will set up a number of sectoral working groups, including fiscal and monetary policy, health care, education, social protection, agriculture and the environment, refugees, municipal services, financial and energy sectors, infrastructure, as well as the administrative structure. The work of each group will result in development of a sectoral policy paper, which will be discussed and refined through a series of seminars, as well as a detailed reform program implementation plan. The sectoral working groups, as well as the various ministries and departments concerned, will determine expenditures on the reforms and measures that will be outlined in the Main PRSP and will coordinate these expenditures with the Ministry of Economic Development and Ministry of Finance within framework of the medium-term socio-economic forecasts and budgetary structure.

**40.** The sectoral working groups will work in close cooperation with nongovernmental organizations, international and donor organizations in the development of their sectoral strategies. The government will set up a Secretariat to ensure the effective and coordinated operation of the sectoral working groups.

### **VIII. Institutional Mechanisms**

**41.** The State Statistics Committee, in cooperation with the World Bank, is already implementing a quarterly household income and expenditure survey, the results of which were described above in the section on the nature of poverty. These data, which will be published regularly, will provide a basis for timely monitoring of the success of the government poverty reduction program in Azerbaijan that will be established and approved in the next 3–4 months, and in particular, the number of people living below poverty line.

**42.** The government, in close cooperation with nongovernmental and international organizations, will undertake a number of additional measures to improve the material and technical base for monitoring of the program, including:

– improvement of the health care monitoring system, performance of multiple-indicator group surveys in cooperation with UNICEF for improvement of data on public health and increasing the effectiveness of various measures aimed at its improvement;

– establishment of a social sector policy group within the government to enhance understanding of the nature and causes of poverty and the effectiveness of various strategies aimed at its reduction;

- improvement and provision of detailed data on expenditures as a result of capacity building in the Ministry of Finance and sectoral ministries with regard to the planning of expenditures through the development of a medium-term expenditure plan;
- public opinion polls on satisfaction with government and municipal services and self-assessment of poverty.

**43.** The Government is counting on assistance from the World Bank and the Asian Development Bank to organize the monitoring of progress in the poverty reduction program through the establishment of a center that will publish regularly updated data on progress with respect to basic indicators, such as:

poverty – the number of people below the poverty line, percentage of household expenditures on food;

municipal services – access to clean water, adequate sanitation, electricity and gas;

health - life expectancy, maternal and infant mortality, immunization rate;

education – percentage of who have completed secondary school. These indicators may be corrected or modified if necessary in the Main PRSP.

## **IX. Government Statement**

**44.** The existence of widespread poverty and unemployment indicates that Azerbaijan will have to embark on a long-term and concentrated effort to resolve these problems. As explained in detail in this Interim Document, the government is committed to reducing poverty and improving the living standards and well-being of the population in cooperation with the Azerbaijan public and the international community.

**45.** The poverty reduction strategy proposed by the government is described in this document. It is based on a policy which will:

- maintain macroeconomic stability;
- maintain and facilitate rapid and balanced economic growth;
- improve and strengthen health care and education sectors;
- improve municipal services, in particular, electricity, gas and water supply;
- strengthen the social protection system.

**46.** The Poverty Reduction Strategy is a national program, and in connection with this fact, the government intends to work with society as a whole to achieve its successful implementation. The Program will be further improved and reworked in accordance with the requirements of specific stages and through broad participation of the public. The Main PRSP will feature a final definition of tasks in each sector, as well as the policy through which they will be achieved. During the implementation of the program, the government will

regularly publish progress indicators and continue consultations with the public with regard to strengthening and improving the poverty reduction program.

#### **X. Main tables and attachments**

1. Main Macroeconomic Indicators: 1998–2005
2. Medium-Term Budget Plan: 1999–2005
3. Living Standards of the Population: 1998–2005
4. Policy Measures for Poverty Reduction: 2001–2005
5. Tentative Timetable for Preparation of the Main PRSP

**POLICY MEASURES FOR POVERTY REDUCTION  
TO BE IMPLEMENTED BY THE GOVERNMENT AND THE RESPECTIVE  
CENTRAL GOVERNMENT AUTHORITIES**

<b>MEASURES</b>	<b>OBJECTIVES AND TASKS</b>	<b>TIME FRAME</b>	<b>EXPECTED RESULTS</b>
<b>I. MACROECONOMICS</b>			
1. Strengthening of the financial stability that has already been achieved, implementation of balanced monetary and exchange rate policies with strict control over the inflation process	<ul style="list-style-type: none"><li>- Maintain inflation at an acceptably low level</li> <li>- Lower the budget deficit by achieving a higher rate of growth in revenues over expenditures, while making efficient use of expenditure</li> <li>- Set a limit on official borrowing to restrict growth in foreign debt, giving preference to concessional credits</li> <li>- Create favorable legal and organizational conditions for private investments within the framework of the privatization program and reforms in the financial and fiscal sectors, accounting, and regulation of private sector development</li></ul>	2001–2005	<p>The average annual inflation rate will be stabilized in the 2.5% range, with an annual economic growth rate above 5%</p> <p>By 2005 the budget deficit will be no more than 1% of GDP</p> <p>Foreign debt will not exceed 35% of GDP</p> <p>The role of the private sector in GDP formation will be expanded</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
<p>1.1. Reinforcement of fiscal policy by strengthening the trend toward a guaranteed increase in budget revenues and expenditures in quantities that will promote poverty reduction</p>	<p>- Increase the collection rate of taxes and mandatory social insurance contributions by expanding the tax base and bringing in the unregistered economy, and increasing the share of tax revenues from the non-oil sector</p>	<p>2001–2005</p>	<p>In 2001–2005 the ratio of budget revenues to GDP will be increased from 15% in 2000 to 16% and the figure for expenditures will increase from 16% to 17%, respectively, including an increase in expenditures for social needs from 8.5% to 9.5%</p>
	<p>- Provide for funding in annual budgets to finance a reduction in taxes for producers of work and services, within the context of the policy aimed at gradually shifting the center of gravity of taxation from the producer to the consumer. Gradually reduce the rates for mandatory social insurance contributions</p>	<p>In annual budgets</p>	<p>There will be dynamic growth in the real sector of the economy and an increase in personal income and investments</p>
	<p>- Gradually reduce the rates for mandatory social insurance contributions</p>	<p>2001–2005</p>	<p>In view of the reform of the social insurance system, enterprises will have greater opportunities to increase income and investments</p>
	<p>- Revise the criteria for the granting of tax and other concessions, with greater emphasis on the grounds for granting them</p>	<p>2001–2005</p>	<p>There will be a more targeted approach to the granting of concessions</p>
	<p>- Continue to make improvements in tax and customs legislation with a view to creating a clearer and more effective system for the collection of taxes and duties and increasing their collection rate</p>	<p>2001–2005</p>	<p>There will be an increase in tax and customs collections, with transparency of taxation and collection of taxes and duties</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Create a favorable tax regime in order to intensify the investment process in the non-oil sector, including simplification of the depreciation deduction system</li> <li>- Based on the real possibilities of the economy, gradually reduce the income tax rate in accordance with poverty reduction principles</li> <li>- Introduce the practice of performing regular reviews of targeted and non-targeted concessions and subsidies that are being provided</li> <li>- Harmonize the tax system with the legislation of other countries, particularly neighboring ones, taking into consideration protection of Azerbaijan's interests</li> </ul>	<p>2001–2003</p> <p>2001–2005</p> <p>Ongoing</p> <p>2001–2005</p>	<p>Significant investments will be attracted for development of the non-oil sector and regions</p> <p>There will be an increase in the standard of living of working people that is consistent with economic growth</p> <p>Improvement in the system for granting concessions and subsidies</p> <p>Elimination of factors hindering the establishment of effective foreign trade mechanisms</p>
<p>1.2. Improvement of tax administration</p>	<ul style="list-style-type: none"> <li>- Continue the process of improving tax and customs administration, taking into consideration higher collection rates</li> <li>- Strengthen auditing activities, as well as activities of subdivisions working with large taxpayers</li> <li>- Increase efficiency and transparency in the Customs Committee system</li> <li>- Create effective mechanisms to help raise the collection rate for the Social Protection Fund</li> </ul>	<p>2001–2005</p> <p>2001–2005</p> <p>2001–2003</p> <p>2001–2003</p>	<p>An increase in the collection rate of taxes and duties</p> <p>An effective system for informing tax services of the real possibilities of taxpayers will be created</p> <p>The activities of customs services will be brought up to world standards</p> <p>There will be an increase in the financial resources of the Social Protection Fund</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Introduce the practice of issuing quarterly Treasury reports on accrued budget revenues</li> <li>- Step up efforts to collect excise taxes on outgoing petroleum products directly from oil refineries</li> </ul>	<p>2001</p> <p>2001–2005</p>	<p>There will be transparency with regard to real budget revenues</p> <p>Factors contributing to the undercollection of excise taxes in oil refining will be eliminated.</p>
<p>1.3. Increased efficiency and targeting of state expenditures, taking into account the poverty reduction strategy</p>	<ul style="list-style-type: none"> <li>- Develop and announce a medium-range expenditure plan, which should be part of the macroeconomic and fiscal plan</li> <li>- Provide for steady growth in current expenditures, including social expenditures for 2002–2005</li> <li>- Within the framework of the real budget plan, increase the share of capital expenditures earmarked for poverty reduction (as a whole and for individual ministries)</li> <li>- Develop and approve simplified norms and standard indicators for use as a baseline in calculating expenditures based on market prices</li> <li>- Implement consistent reform of the labor compensation (wage) system in the public sector</li> <li>- Pursue restructuring of the government administration with a view to converting it to functional management</li> </ul>	<p>End of 2001</p> <p>In annual budgets</p> <p>In annual budgets</p> <p>2001–2002</p> <p>Ongoing</p> <p>Ongoing</p>	<p>Inclusion in the 2002 budget package and announcement to the public</p> <p>Strengthening of social protection policy. Bringing the share of social expenditures up from 48.7% of total expenditures in 2001 to 55% in 2005.</p> <p>Bringing the proportion of capital investments up from 3.8% of total expenditures in 2001 to 4.6% in 2005</p> <p>An increase in the efficiency of expenditures. Publication of norms and standard indicators</p> <p>Eliminate factors of alternative income of government employees</p> <p>Development and implementation of a policy</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Revise the principles for granting subsidies to regions (bring greater objectivity to determining the amount of subsidies)</li> </ul>	2001–2002	Development of sound criteria for subsidies, notifying regions of these criteria
1.4. Improved management of the investment process	<ul style="list-style-type: none"> <li>- Prepare an Investment Program based on the Poverty Reduction Strategy for 2002–2005</li> <li>- Intensify efforts to determine the economic soundness of investment projects and to track their implementation</li> <li>- Revise the system for issuing government guarantees for external and internal borrowing and strengthen management of government debt</li> <li>- Create the most favorable investment climate, bearing in mind the granting of differentiated economic concessions to investors who intend to make investments to create new jobs in regions, and fundamental modernization of the non-oil sector of the economy and infrastructure</li> </ul>	<p>2001</p> <p>2001</p> <p>2001–2005</p> <p>Ongoing</p>	<p>Increase in the volume of investments in the non-oil sector and infrastructure development</p> <p>Concentration of functions related to the development and implementation of investment policy within the framework of the national socio-economic policy</p> <p>Introduction of effective mechanisms for determining the economic advisability of issuing guarantees</p> <p>On the basis of the adoption of the relevant legislative and other regulatory legal acts, there will be stimulation of the investment process for the country’s harmonious development, the possibility of the “Dutch disease” will be ruled out, and support for the poorest segments of the population will be improved</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
<p>1.5. Application of tighter controls on government finance</p>	<p>- Improve the budget process by revising budget legislation</p>	<p>2001–2002</p>	<p>All government revenues will be included in the budget, including social funds; an overall budget package and guidelines will be established; an integrated process for the submission of budget plans and reports will be provided; the budget classification will be modernized; international accounting standards will be introduced; and comprehensive information on budget execution will be published regularly, among other things.</p>
	<p>- Establish the rule that all changes in revenue policy must be effected exclusively as part of the budget process</p>	<p>Starting with the 2002 budget</p>	<p>Expansion of the tax base, establishment of real targeted tax charges, especially for large taxpayers; elimination of the release of fuel, electric power, and gas without payment; establishment of the most competitive general taxation system in the regions; strengthening of fiscal and tax discipline</p>
	<p>- Revise customs duty policy with a view to optimizing rates</p>	<p>2001–2002</p>	<p>The volume of import customs duties will be kept at a relatively stable level (in the range of 310–350 billion manat)</p>
	<p>- Complete the computerization of the Treasury</p>	<p>2002–2003</p>	<p>The coverage of Treasury controls will be expanded, including social funds and project credits</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Improve the preparation of the financial plan</li>   <li>- Strengthen the legislative and directive base for the management of external debt</li> <li>- Improve the Ministry of Finance system for management of the government's internal debt</li> <li>- Publish detailed tax and budget data on a quarterly basis</li> </ul>	<p>Ongoing</p> <p>2001–2002</p> <p>2001–2002</p> <p>Ongoing</p>	<p>Management of the flow of government cash will be strengthened and there will be more effective use of short-term Treasury bill financing</p> <p>This issue will be addressed through the legislation</p> <p>Mechanisms for management of internal debt will be strengthened</p> <p>There will be transparency in the operation of the Treasury and tax services</p>
<p>1.6. Strengthening of the policy aimed at stability and improved monetary and exchange rate management</p>	<ul style="list-style-type: none"> <li>- Maintain a low inflation rate</li>   <li>- Ensure a stable level of international reserves for the financing of non-oil imports within the framework of monetary policy</li>   <li>- Maintain a stable exchange rate for the manat and a balanced exchange market</li>   <li>- Expand access to treasury bond auctions, including permitting the National Bank to buy treasury bonds as part of the monetary program, and creation of a secondary market for treasury bonds</li> </ul>	<p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p>	<p>The average annual inflation rate will not exceed 2.5%</p> <p>The level of gold and foreign exchange reserves at the National Bank will correspond to 15–16 weeks of non-oil imports</p> <p>There will be regulation of the exchange market, taking into account adherence to the principles of supply and demand</p> <p>Open market operations with treasury bonds will be established</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	- Publish annual reports on the inflation rate and the activities of the National Bank in this area	Starting in 2001	There will be transparency in the activities of the National Bank
<b>II. POLICY IN THE SOCIAL SECTOR</b>			
2. Reduction in the number of people living in extreme poverty, participation by everyone in rising income and access to a sufficient level of public services in the social sphere	<ul style="list-style-type: none"> <li>- Prepare a National Poverty Reduction Program for Azerbaijan (NPRP)</li> <li>- Make adjustments in the Health Care System Reform Program, taking into account implementation of the Poverty Reduction Strategy</li> </ul>	<p>Late 2001 and early 2002</p> <p>2001</p>	<p>Government and nongovernmental organizations will be brought in to participate in this work</p> <p>There will be an improvement in the quality of medical services and access to services, especially for low-income segments of the population (a reduction in the maternal and infant mortality rate)</p>
2.1. Bring the health care system into conformity with the requirements of the Poverty Reduction Strategy	<ul style="list-style-type: none"> <li>- Optimize the share of free and fee-based medical services on a regional basis, with a view to providing free universal medical care in the poorest parts of the country</li> <li>- Achieve the maximum level of vaccination against the major infectious diseases</li> <li>- Make a gradual transition from the financing of specialized and hospital treatment to the financing of out-patient treatment</li> <li>- Maintain a transparent and competitive environment for participation of the private sector in medical services</li> </ul>	<p>2001–2002</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p>	<p>Poor segments of the population will have improved access to medical care</p> <p>There will be a reduction in the mortality rate</p> <p>Rational use of financial resources</p> <p>Expanded coverage of medical services</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Identify a basic package of health care services that will be available free of charge to the entire population</li> <li>- Revamp the system for the training of medical personnel</li> <li>- Periodic publication of information on the status of the public's health</li> </ul>	<p>2002</p> <p>2002</p> <p>2002</p>	<p>Improved access to certain types of medical services for the entire population</p> <p>The system will be brought into line with the demand for these personnel</p> <p>The public will be kept informed of the health status of the population by age and gender groups and by region</p>
<p>2.2. Improved effectiveness and quality of education, especially for low-income segments of the population</p>	<ul style="list-style-type: none"> <li>- Within the framework of the general Poverty Reduction Strategy, prepare an Education Sector Reform Program</li> <li>- With the assistance of foreign donors, create a special subdivision to implement policy in the education sphere</li> <li>- Establish an optimal number of educational institutions, as well as personnel and enrollment in the education system</li> <li>- Strengthen the material and technical base at the majority of schools, including access to computer equipment</li> <li>- Raise the professionalism and effectiveness of teaching</li> <li>- Reform the higher education system with a view to optimizing the ratio of free and tuition-based higher education institutions</li> <li>- Improve library collections</li> </ul>	<p>September 2001</p> <p>By the end of 2001</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>2001–2002</p> <p>Ongoing, as budget funds are available</p>	<p>It will be included in the Main Poverty Reduction Strategy Paper</p> <p>Strengthening of planning and control policies</p> <p>The system will be brought into line with the need to improve the quality of instruction</p> <p>Improvement of the educational process</p> <p>Improvement in the quality of the educational process</p> <p>Free access to higher education institutions for the poorest segments of the population and better targeting of scholarships</p> <p>Access to educational and scientific literature</p>

<b>MEASURES</b>	<b>OBJECTIVES AND TASKS</b>	<b>TIME FRAME</b>	<b>EXPECTED RESULTS</b>
<p>2.3. Strengthen the social protection policy and improve targeting in the social protection system</p>	<ul style="list-style-type: none"> <li>- Prepare a reform strategy for the social protection sector that is aimed at poverty reduction</li> <li>- With the assistance of foreign donors, create a special subdivision for the implementation of social protection policy</li> <li>- Study the question of merging three social funds</li> <li>- Increase benefits for low-income families based on an in-depth study of their real income to ensure proper targeting</li> <li>- Develop a special reform program for the system that provides support for disabled persons and orphans, which calls for comprehensive targeting and effective use of financial resources</li> <li>- Public discussion and adoption of a Conceptual Framework for Reform of the Pension System, and preparation on this basis of a new draft Law on Pension Security for submission to Parliament</li> <li>- Begin development of mechanisms for the practical introduction of individual retirement accounts</li> </ul>	<p>September 2001</p> <p>By the end of 2001</p> <p>In the formation of the 2002 and 2003 budgets In annual budgets</p> <p>2001</p> <p>2001–2002</p> <p>2001–2002</p>	<p>It will be included in the Main Poverty Reduction Strategy Paper</p> <p>Improved planning and monitoring of reform of the social protection sector</p> <p>Determination of the advisability of creating a single fund financed out of a single social assessment on wages Improvement in the material well-being of the poorest families</p> <p>Its implementation will begin in 2002 within the framework of budget planning</p> <p>Gradual introduction of international standards in the pension security system</p> <p>Formation of additional sources for pension security to increase the amount of pensions</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
<p>2.4. Step up the process of liberating areas and population centers occupied by Armenian armed units to allow refugees and internally displaced persons to return to their permanent homes, and support for their economic independence</p>	<ul style="list-style-type: none"> <li>- Accelerate the negotiation process for a peaceful and fair settlement of the conflict between Armenia and Azerbaijan</li>   <li>- Request international financial and banking institutions to provide humanitarian financial and technical assistance to create normal living conditions in areas and population centers liberated from occupation</li> <li>- Support the activities of refugees and internally displaced persons to obtain independent sources of income</li> <li>- Periodically increase the benefit to refugees and internally displaced persons, based on the real possibilities of the budget, and maintain all concessions currently provided to them</li> </ul>	<p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>Until they are able to resume normal activities</p>	<p>Liberation of occupied lands and return to these lands of refugees who were driven out and internally displaced persons</p> <p>Removal of mines, construction of housing and infrastructure, social facilities, creation of new jobs, etc.</p> <p>Reduction in the number of people living in extreme poverty</p> <p>State support for members of the population who ended up as refugees and internally displaced persons due to Armenian aggression</p>
<b>III. AGRICULTURE</b>			
<p>3. Draw into economic circulation the underutilized potential of agriculture in order to bring about a significant increase in production, provide for food security, raise the level of employment, and make effective use of land and water resources</p>	<ul style="list-style-type: none"> <li>- Prepare a reform strategy for agriculture that is aimed at poverty reduction and food security</li> </ul>	<p>September 2001</p>	<p>Inclusion in the Main Poverty Reduction Strategy Paper</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- With the assistance of international donors and using internal funds, carry out work aimed at capital improvement of land resources (restoration of the land reclamation and irrigation system, implementation of anti-erosion measures, etc.)</li> <li>- Support the creation and development of the agricultural infrastructure, introduce effective mechanisms for lending and providing insurance for agricultural production</li> <li>- Create an effective and differentiated fee-based system for the use of water for irrigation, including lower fees for water provided to the poorest segments of the rural population</li> <li>- Provide all kinds of assistance for the creation of a system of private services involving the procurement, storage, packaging, and transport of products, and the development of small and medium-sized processing shops and enterprises and commodity exchanges</li> <li>- Complete the land register and create a widespread network of Regional Registration Services</li> <li>- Revise the system for granting concessions to agricultural producers for the purchase of fuel and introduce effective mechanisms that will help increase the collection rate for electricity and gas payments</li> <li>- Intensify efforts to provide veterinary services and services to protect plants from pests and diseases</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing</li> <li>2001–2002</li> <li>2001–2002</li> <li>Ongoing</li> <li>2001</li> <li>2001–2002</li> <li>Ongoing</li> </ul>	<ul style="list-style-type: none"> <li>An increase in the output of agricultural products, especially cotton, grapes, tobacco, tea, grains, and feed crops</li> <li>Stimulation of agricultural producers</li> <li>Application of market principles in agriculture</li> <li>Reduction and elimination of losses of agricultural products</li> <li>Formation of a land market</li> <li>Encouragement of energy conservation and formation of market relations in agriculture</li> <li>Higher productivity in animal husbandry and higher crop yields</li> </ul>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Expand information support for agriculture and promotional activities for owner-operated farms, and create conditions for the creation and development of marketing services</li> </ul>	Ongoing	Elevation of agriculture to a contemporary level
<b>IV. INFRASTRUCTURE</b>			
<p>4.1. Fundamental improvement in the reliability of the country's energy supply</p>	<ul style="list-style-type: none"> <li>- Prepare a Conceptual Framework for Reform of the Energy Sector, with a view to strengthening government control over this sector by shifting the functions of policy development and price and tariff regulation away from companies and to executive government bodies, and denationalization of distribution networks and the sale of electricity and gas</li> <li>- Gradual replacement of fuel oil with gas in the generation of electricity</li> <li>- On the basis of structural reforms, raise the collection rate for electricity and gas payments</li> <li>- Improve antimonopoly and price (tariff) policies</li> <li>- Review the question of lowering and eliminating unfounded subsidies for municipal services payments</li> <li>- Track the consequences of measures implemented for each individual tariff group, with a view to providing the poor segments of the population with a sufficient level of municipal services at an acceptable price</li> </ul>	<p>2001–2002</p> <p>2001–2005</p> <p>Ongoing</p> <p>2001–2002</p> <p>2002</p> <p>Ongoing</p>	<p>Inclusion of the basic measures of the Conceptual Framework for Reform of the Energy Sector in the Main Poverty Reduction Strategy Paper</p> <p>Reduction in production costs of electricity, improved environmental conditions</p> <p>Prevent an increase in arrears, improve the financial condition of the energy sector</p> <p>Prices and tariffs will be economically justified</p> <p>The proportion of the cost of municipal and consumer services covered by consumers will be raised to 60%–70% by 2005</p> <p>Reduction in the poverty level</p>



MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Develop a strategy and concrete plan of action for development of the export potential in the non-oil sector, using the Cooperation and Partnership Agreement to expand access of Azerbaijan's goods to European markets</li> <li>- Review the issue of creating free trade zones</li> </ul>	<p>2001–2002</p> <p>2001</p>	<p>Inclusion in the Main Poverty Reduction Strategy Paper and the Development Program for the Non-Oil Sector</p> <p>Preparation of a draft law “On Free Economic Zones” if necessary</p>
<p>5.2. Creation of an attractive investment climate in Azerbaijan</p>	<ul style="list-style-type: none"> <li>- Announcement of an official investment policy of the Azerbaijan government that calls for the creation of the most favorable organizational, legal, and tax and budget conditions for domestic and foreign investors</li> <li>- Development of separate investment programs for the public and private sectors and for each project</li> <li>- With the assistance of international donors, step up the work of the Investment Department of the Ministry of Economic Development, granting it special status</li> </ul>	<p>2001</p> <p>By the end of 2001</p> <p>2000</p>	<p>Encouragement of investors to participate in a fundamental modernization of strategically important enterprises in the non-oil sector and in the development of regions</p> <p>Inclusion in the Main Poverty Reduction Strategy Paper; potential donors and investors will also be informed through the Internet</p> <p>Improvement in review and decision-making procedures for investment projects</p>
<p>5.3. Development of competition and free access to the market for new participants</p>	<ul style="list-style-type: none"> <li>- Perform an analysis of the status of the competitive environment in various sectors and spheres of the economy with a view to eliminating obstacles to the development of a competitive market</li> </ul>	<p>Ongoing</p>	<p>Formation of a true market economy</p>
<b>VI. SECTORAL POLICY</b>			
<p>6.1. Improvement in the functioning of financial markets and creation of the necessary conditions for growth in savings and investment of savings</p>	<ul style="list-style-type: none"> <li>- Against the backdrop of macroeconomic stability, deepen reforms in the budget process, the banking system, and the securities market, and step up liberalization of investment policy</li> </ul>	<p>Ongoing</p>	<p>Implementation of the Poverty Reduction Strategy</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Create a competitive and reliable private banking system, accompanied by the introduction of effective mechanisms aimed at increasing public confidence in banks</li> <li>- Accelerate the privatization of state-owned banks</li> <li>- Develop the banking infrastructure, including completion of the introduction and improvement of the Real Time Gross Settlement System for the wholesale market</li> <li>- Improve banking legislation, intensify banking supervision, and create a deposit insurance system</li> <li>- Develop the financial market, including the insurance market, the stock market, and various financial instruments</li> <li>- Review the question of using securities as a way to solve the problem of mutual arrears</li> </ul>	<p>Ongoing</p> <p>2001–2002</p> <p>2001–2002</p> <p>Ongoing</p> <p>2001–2005</p> <p>2001–2002</p>	<p>Optimization of the number of private banks with a reliable and adequate amount of authorized capital</p> <p>Enhanced effectiveness of the banking system</p> <p>Improvement in the quality and more rapid handling of banking operations, transparency of these operations</p> <p>Introduction of the necessary amendments to the existing legislation to meet time requirements, greater public confidence in the banking system</p> <p>A wide range of participants will gain access, with a view to stepping up entrepreneurial and commercial activity</p> <p>Financial recovery of enterprises</p>
6.2. Development of Azerbaijan's hydrocarbon potential	- Taking into consideration the creation of the Ministry of Fuel and Energy, begin the process of restructuring SOCAR [the State Oil Company of the Azerbaijan Republic], including the splitting off and privatization of ancillary structures of SOCAR and a clear separation between the company's commercial interests and state interests in oil revenues	2001–2002	Within the framework of the Oil Strategy, creation of a market-based company with all the ensuing consequences

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Accelerate the resolution of issues tied to the construction of the Baku - Ceyhan Main Export Pipeline and the Baku - Tbilisi - Turkey gas pipeline</li> <li>- Create the necessary infrastructure for underwater oil deposits, including the construction of a fourth drilling platform and the development of the corresponding production and export services</li> <li>- Through the attraction of foreign investments and technologies, provide for the fundamental reconstruction of enterprises producing petroleum equipment so that the equipment is manufactured in accordance with the API American standard</li> <li>- Increase imports of gas to replace fuel oil in generating electricity, with a corresponding increase in exports of domestically produced petroleum, and a subsequent decline in and termination of gas imports as more and more gas is produced at the Shakh-Deniz deposit</li> <li>- Study the question of the advisability of the development of inland oil deposits with the participation of foreign companies under production sharing agreements</li> <li>- Do everything possible to facilitate the creation of a domestic oil market</li> </ul>	<p>2001</p> <p>Ongoing</p> <p>2001–2005</p> <p>2001–2005</p> <p>2001–2002</p> <p>2001–2005</p>	<p>Greater opportunities for the export of Azerbaijan’s hydrocarbons</p> <p>Increase in the extraction of oil and gas and uninterrupted transport thereof</p> <p>Reduction in the proportion of imports of petroleum equipment by foreign companies and SOCAR; and also for export of the equipment to neighboring countries</p> <p>Greater efficiency in the generation of electricity, which will make it possible to lower rates, especially for low-income families</p> <p>An increase in national oil production</p> <p>Creation and development of new production facilities that use petroleum as a raw material to obtain final products for export and import substitutes</p>



MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Develop and begin implementation of an Anti-Corruption Program</li> <li>- Improve the system of licensing and sanctions</li>   <li>- Step up efforts to train highly skilled management personnel and make the shift to hiring government employees on a competitive basis</li> <li>- Step up efforts by statistical services in conducting household surveys and in identifying available manpower resources in the country's various regions, accompanied by regular publication of the survey data</li> <li>- Provide for the publication, starting in 2002, of reports by all large enterprises (including private ones) in accordance with international standards, accompanied by the development and publication of a relevant regulation for this purpose</li> </ul>	<p>2001</p> <p>2001–2002</p> <p>2001–2002</p> <p>2001–2002</p> <p>2001</p>	<p>Approval of a Law and the Anti-Corruption Program</p> <p>Optimization of the list of activities that must be licensed, establishment of fines that are appropriate to the seriousness of the offenses committed</p> <p>Higher professional standards for government employees, elimination of favoritism in hiring</p> <p>Determination of real household income and the employment rate, so that these data can be used in the implementation of the Poverty Reduction Program</p> <p>Establishment of legal obligations for economic entities</p>
<p>7.2. Ensuring transparent and professional performance of privatization</p>	<ul style="list-style-type: none"> <li>- Regular publication in the mass media of the privatization schedule under Privatization Program II and the schedule for the remaining facilities from Program I</li> <li>- Study the question of the deadline and conditions for the privatization of “Azeraluminum” and Baku State Electric Power Station</li> </ul>	<p>Ongoing</p> <p>2001</p>	<p>Public participation in the privatization process</p> <p>Stimulate the attraction of investments</p>

MEASURES	OBJECTIVES AND TASKS	TIME FRAME	EXPECTED RESULTS
	<ul style="list-style-type: none"> <li>- Attract legal and financial consultants with the appropriate qualifications to conduct clearly defined tender procedures in the privatization of strategic facilities</li> </ul>	Ongoing	More efficient privatization process, objectivity and transparency in this process
<b>VIII. MANAGEMENT OF OIL REVENUE</b>			
8. Effective management of the government's stake in contractual oil revenues	<ul style="list-style-type: none"> <li>- Provide for transparency of the functioning of the Oil Fund in accordance with the Regulation</li> <li>- Strengthen the management of assets and internal use of resources of the Oil Fund</li> <li>- Create a group for forecasting oil revenues and expenditures</li> <li>- Streamline the functioning of the Accounting Chamber and authorize it to audit all institutions in the public sector that are financed by the state budget</li> </ul>	<p>Ongoing</p> <p>Ongoing</p> <p>2001–2002</p> <p>2001</p>	<p>Performance of periodic audits</p> <p>Efficient management of revenues and use of foreign exchange proceeds from the sale of Azerbaijan's share of oil and gas from deposits under contract</p> <p>These forecast data will be taken into account in the development of long-range programs and projects</p> <p>Efficient management of state expenditures</p>

Tentative Timetable for Preparation of the Main PRSP

**2000**

Unofficial establishment of the Working Group on the basis of broad participation and appointment of the Deputy Minister of the Economy as the lead person for development of the first drafts of the Interim Poverty Reduction Strategy Paper. Discussions with donors. Workshops in Moscow, Baku, Manila (Philippines).

**March 2001**

Presidential Decree on establishment of the Commission for the Development of the Poverty Reduction Strategy, under the Chairmanship of the Prime Minister. The Commission issues a decision establishing the Working Group for Development of the Interim PRSP, to be headed by the Deputy Minister of the Economy.

**May 2001**

Completion of the Interim PRSP, its approval by the Commission and the President of the country.

**June-July 2001**

Establishment of Sectoral Working Groups in the areas of health care, education, social policy, fiscal and monetary policy, and other key sectors, as well as consideration of the issue of establishment of the Center for Poverty Monitoring with the assistance of international donors. Establishment of the procedure for calculating the costs of PRSP implementation.

Development of the detailed plan of action for Main PRSP development.

Initiation of consultations with general public.

Discussion of the Interim PRSP by the Executive Board of the IMF and World Bank.

Sectoral Working Groups, assuming broad participation, will start work on defining the poverty reduction strategies in their own fields, accompanied by intensive consultations with international organizations.

**December 2001**

Sectoral Working Groups finalize their strategies, including determination of the costs of Program implementation.

Table 1

**BASIC MACROECONOMIC INDICATORS OF THE SOCIO-ECONOMIC  
DEVELOPMENT OF THE AZERBAIJAN REPUBLIC**

	Unit of measure	1998	1999	2000	FORECAST				
					2001	2002	2003	2004	2005
Gross Domestic Product (GDP)	billion manat	17203	18771	23565	26457	28731	30626	33794	38680
	million dollars	4447	4596	5267	...	...	...	...	...
Real growth	%	10.0	7.4	11.1	8.5	8.5	8.5	8.0	11.2
Deflator Index	%	-1.0	1.6	13.0	3.5	0.1	-1.8	2.2	3.0
Share of non-state sector	%	55	62	67.8	69	71	73	75	76
Gross Domestic Product (without oil sector)	billion manat	15392	15720	17685	19902	22344	25086	28164	31329
	million dollars	3958	3702	3932	...	...	...	...	...
Real growth	%	4.6	2.1	12.8	9.1	9.0	9.0	9.0	8.0
Deflator index	%	3.5	0.0	-0.3	3.2	3.0	3.0	3.0	3.0
Share of added value of the oil sector in GDP	%	10.5	16.3	25.0	24.8	22.2	18.1	16.7	19.0
Volume of investment from all sources of financing	billion manat	6147	6317	6072	8499	12449	15761	16724	20207
Goods turnover	billion manat	9239	9448	10599	11800	12900	14100	15500	17000
Real growth	%	10.3	13.3	9.8	8.1	4.6	5.1	5.3	5.5
Price index	%	-1.3	-9.7	2.2	3	4.5	4	4.4	4
Share of non-state sector	%	97.1	97.9	98.3	98.6	98.6	98.6	98.6	98.6
Services purchased by the public	billion manat	2103	2267	2386	2560	2900	3265	3650	4110
Real growth	%	14	5.4	5.8	3.2	7.4	6.2	6.5	6.7
Price index	%	14.7	2.3	-0.5	4	5.5	6	5	5.5
Share of non-state sector	%	35.8	36	41.3	41.7	42	44	45	46
Exports of goods and services	million dollars	1010	1283	2155	2403	2339	2074	2122	2646
Imports of goods and services	million dollars	2417	1917	2023	2487	3185	3749	3925	4568

Table 2

## MEDIUM-TERM BUDGET PLAN 1999–2005 (State Budget) <sup>1</sup>

billion manat

	1999	2000	FORECAST				
			2001	2002	2003	2004	2005
<b>Revenue – total</b>	<b>2797</b>	<b>3572</b>	<b>4175</b>	<b>4620</b>	<b>5170</b>	<b>5720</b>	<b>6350</b>
as a proportion of GDP – %	14.8	15.1	15.8	16.1	16.9	16.9	16.4
<b>Expenditures – total</b>	<b>3245</b>	<b>3761</b>	<b>4595</b>	<b>5030</b>	<b>5510</b>	<b>6030</b>	<b>6630</b>
as a proportion of GDP – %	17.1	16.0	17.4	17.5	18.0	17.8	17.1
<i>of which:</i>							
– expenditures on general government services (administration, lending agencies, insurance, etc.)	253	262	390	415	446	492	546
proportion – %	7.8	7.0	8.5	8.3	8.1	8.2	8.2
as a proportion of GDP – %	1.3	1.1	1.5	1.4	1.5	1.5	1.4
– support for law enforcement and security authorities, judicial system, prosecutor's offices	344	372	470	512	571	630	699
proportion – %	10.6	9.9	10.2	10.2	10.4	10.4	10.5
as a proportion of GDP – %	1.8	1.6	1.8	1.8	1.9	1.9	1.8
– expenditures on social needs – total	1745	2007	2238	2595	3004	3312	3673
proportion – %	53.8	53.3	48.7	51.6	54.5	54.9	55.9
as a proportion of GDP – %	9.2	8.5	8.5	9.0	9.8	9.8	9.5
<i>of which:</i>							
a) expenditures on education	795	906	1011	1127	1279	1410	1564
proportion – %	24.5	24	22.0	22.4	23.2	23.4	23.6
as a proportion of GDP – %	4.2	3.8	3.8	3.9	4.2	4.2	4.0
b) expenditures on health care	186	204	267	341	435	480	532
proportion – %	5.7	5.4	5.8	6.8	7.9	8.0	8.0
as a proportion of GDP – %	1.0	0.9	1.0	1.2	1.4	1.4	1.4
c) expenditures on social protection and social security	604	697	736	878	1007	1110	1231
proportion – %	18.6	18.5	16.0	17.5	18.3	18.4	18.6
as a proportion of GDP – %	3.2	3	2.8	3.1	3.3	3.3	3.2
d) expenditures on culture, the arts, information, sports, and religion	89	106	126	137	152	168	186
proportion – %	2.7	2.8	2.7	2.7	2.8	2.8	2.8
as a proportion of GDP – %	0.5	0.5	0.5	0.5	0.5	0.5	0.5
e) expenditures on housing and municipal services	71	94	98	112	131	144	160
proportion – %	2.2	2.5	2.1	2.2	2.4	2.4	2.4
as a proportion of GDP – %	0.4	0.4	0.4	0.4	0.4	0.4	0.4
– expenditures on agriculture, forestry, and fishing	155	170	202	210	223	246	273
proportion – %	4.8	4.5	4.4	4.2	4.0	4.1	4.1
as a proportion of GDP – %	0.8	0.7	0.8	0.7	0.7	0.7	0.7
– capital investments	97	145	176	195	218	260	307
proportion – %	3.0	3.9	3.8	3.9	4.0	4.3	4.6
as a proportion of GDP – %	0.5	0.6	0.7	0.7	0.7	0.8	0.8
– other expenditures	651	805	1119	1103	1048	1090	1132
proportion – %	20.0	21.4	24.4	21.9	19.0	18.1	17.1
as a proportion of GDP – %	3.4	3.4	4.2	3.8	3.4	3.2	2.9
<b>Budget deficit</b>	<b>448</b>	<b>189</b>	<b>420</b>	<b>410</b>	<b>340</b>	<b>310</b>	<b>280</b>
as a percentage of GDP	2.4	0.8	1.6	1.4	1.1	0.9	0.7
Coverage of budget deficit:							
– internal sources (short-term government bonds, proceeds from privatization, earnings from domestic lottery bonds, etc.)	75	61	260	310	240	210	180
– foreign sources (credits and bonuses)	373	128	160	100	100	100	100
Gross domestic product	18771	23565	26457	28731	30626	33794	38680

<sup>1</sup> Excluding Social Funds, Oil Fund, Privatization Fund and revenues and expenditures of budgetary organizations.

*Table 3*

**POPULATION LIVING STANDARDS**

	unit of measure	1998	1999	2000	FORECAST				
					2001	2002	2003	2004	2005
<b>Gross domestic product (GDP)</b>	billion manat	17203	18771	23565	26457	28731	30626	33794	38680
	billion dollar	4.45	4.6	5.27	...	...	...	...	...
real growth	%	10.0	7.4	11.1	8.5	8.5	8.5	8.0	11.2
per capita: per year	thous. manat	2166	2342	2916	3248	3499	3701	4051	4600
	Dollar	569	568	652	...	...	...	...	...
per month	thous. manat	180	195	243	271	291	308	338	383
	Dollar	47.4	47.3	54.3	...	...	...	...	...
<b>Nominal personal money income</b>									
	billion manat	14424	16134	17923	19944	21840	23858	26176	30790
growth rate	%	116.6	111.9	111.1	111.3	109.5	109.2	109.7	117.6
per capita: per year	thous. manat	1851	2052	2261	2491	2701	2921	3173	3696
	dollar	478	498	505	...	...	...	...	...
per month	thous. manat	154.3	171	188.4	207.6	225	243.4	264.4	308
<b>Consumer price index (inflation)</b>									
	%	-7.6	-0.5	2.2	2.5	2.5	2.5	2.5	2.5
<b>Ratio to per capita GDP of:</b>									
– average personal money income	%	85.7	87.7	77.5	76.6	77.3	79	78.2	80.4
– average wage	%	93.6	94.6	84.4	99.6	108.2	115.6	121.3	130.5
<b>For reference:</b>									
Average annual population	thous. people	7944	8016	8080	8145	8210	8276	8342	8409

**January 2002**

Consultations with the World Bank, IMF, and other interested parties on the final draft of the PRSP.

Organization of a national workshop for discussion of the final PRSP, with the participation of all subcommittees, representatives of international organizations and donors, nongovernmental organizations, the private sector, the mass media, and the general public.

**February 2002**

Discussion and approval of the Main PRSP by the Governmental Commission.

Approval of the PRSP by the President of the country.

**April 2002**

Initiation of implementation of the Poverty Reduction Strategy in Azerbaijan, its further coordination and monitoring.