



Country Operations Business Plan

September 2017

Azerbaijan 2018–2020

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 10 August 2017)

Currency unit	–	Azerbaijan manat/s (AZN)
AZN1.00	=	\$0.5880
\$1.00	=	AZN1.7007

ABBREVIATIONS

ADB	–	Asian Development Bank
COBP	–	country operations business plan
KSTA	–	knowledge and support technical assistance
MFF	–	multitranche financing facility
OCR	–	ordinary capital resources
PBL	–	policy-based lending
PPP	–	public–private partnership
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government of Azerbaijan ends on 31 December.
- (ii) In this report, “\$” refers to United States dollars.

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I. CONSISTENCY OF BUSINESS PLAN WITH COUNTRY PARTNERSHIP STRATEGY

1. The country operations business plan (COBP), 2018–2020 is consistent with the country partnership strategy, 2014–2018 of the Asian Development Bank (ADB) for Azerbaijan that focuses on promoting inclusive growth by increasing economic opportunities and improving access to basic services.¹ The COBP is also aligned with the Government of Azerbaijan's Strategic Roadmap on the National Economy Perspective adopted in December 2016—a strategy to respond to macroeconomic and financial challenges, and re-double efforts to diversify the national economy and promote sustainable, non-oil economic growth.² The COBP also considers the strategies and priorities of other development partners in Azerbaijan.

2. The COBP comprises (i) programmatic policy-based lending (PBL) in public sector management, and (ii) sector development program (SDP) in the railway sector. The PBL and SDP modalities used for the first time in Azerbaijan will optimally meet the government's reform and investment financing needs in the concerned sectors. ADB will stand ready to continue supporting the investment program in the power sector, contingent on the government's request.

3. In response to a less favorable economic environment, public sector operations will focus on strengthening the country's public expenditure framework, the governance of state-owned enterprises, and financial sector deepening. Public sector operations will also support the improvement of railway infrastructure to enable the country to capitalize on its crossroads location. Private sector operations will look for opportunities in infrastructure finance and continue to catalyze support for the development of the financial sector through engagement with commercial banks in onlending to small and medium-sized enterprises.

II. INDICATIVE RESOURCE PARAMETERS

4. Azerbaijan, a Group C developing member country, is eligible for regular ordinary capital resources (OCR) lending. The indicative resources available for commitment for sovereign operations during 2018–2020 amount to \$780 million. Cofinancing and funding from other sources, including the regular OCR regional cooperation and integration set-aside, will be explored.

5. An indicative sovereign lending program of \$900 million, 15% higher than the indicative resources, is proposed in Appendix 2.³ The final amount of assistance is subject to the resource availability and project readiness. During 2018–2020, ADB also expects to commit technical assistance (TA) amounting to \$2.5 million to be financed from internal sources and supplemented, whenever feasible, by ADB-administered trust funds and other external sources.⁴

6. The ADB indicative program for 2017 consists of two loans totaling \$450 million on a standby basis, and TAs totaling \$1.225 million from internal and external sources (Appendix 3).

7. ADB will closely monitor the government's public–private partnership (PPP) program for financing consideration. Through the Asia Pacific Project Preparation Facility, ADB will consider providing TA to support the preparation of pilot projects and strengthen the capacity of

¹ ADB. 2014. *Country Partnership Strategy: Azerbaijan, 2014–2018*. Manila.

² President's Decree no. 1138 dated 6 December 2016.

³ The indicative pipeline is on the basis of commitment. For the pipeline beyond the quantum of 3-year ADB commitment resources, other options will be explored (para. 4).

⁴ ADB's Central and West Asia Department will work closely with the Office of Cofinancing Operations to identify potential cofinanciers.

government agencies in PPPs. Knowledge work will focus on analytical and advisory assistance to support preparation of lending operations, capacity development, and government's priority reform initiatives. Knowledge products and services planned for 2018 are listed in Appendix 4.

III. SUMMARY OF CHANGES TO LENDING AND NONLENDING PROGRAMS

8. The processing timeline of lending projects is consistent with the government's decision to moderate public investment spending due to reduced fiscal space arising from the fall in oil prices. Key changes from the COBP 2016–2018 include the following:⁵

- (i) **Transport.** The railway sector development program is proposed as a firm project in 2018 to support the rehabilitation of the North–South rail corridor (an integral part of the Central Asian Regional Economic Cooperation network) and reforms in the Azerbaijan Railways Company.⁶ The proposed multitranche financing facility (MFF) and Project 1 for the Third Road Network Development Investment Program (RNDP) planned for 2019 has been dropped given the still on-going implementation of the first and the second RNDPs and the road programs financed by other multilateral development banks.
- (ii) **Energy.** Project 2 of the MFF for the Power Distribution Enhancement Investment Program in the amount of \$250 million has been moved from 2017 to 2020 (standby). Project 3 of this program has been rescheduled beyond 2020 due to the government's policy to limit external debt. To ensure continuous support for the energy sector reforms, knowledge and support TA (KSTA) totaling \$0.5 million for sustainable and inclusive energy support is proposed for 2020 (standby).
- (iii) **Water and other urban infrastructure and services.** The MFF for the water and sanitation rehabilitation program planned for 2018 (standby) was dropped due to the still on-going implementation of the MFF for the Water Supply and Sanitation Improvement Program and the lapsing of the approval validity of Tranche 4 of this MFF. Transaction TA totaling \$1.0 million is proposed for 2020 to prepare the integrated urban development project, which will improve basic urban services and address priority needs in intermediary cities.⁷
- (iv) **Public sector management.** To maintain the momentum of the government's structural reform agenda, PBL for the Improving Governance and Public Sector Efficiency Program (with 2 subprograms) totaling \$500.0 million is planned for 2018 and 2019. This program will support reforms relating to (a) improving macro-fiscal policies and public debt management, (b) strengthening state-owned enterprises' governance framework, and (c) enhancing access to finance and business environment. KSTA totaling \$1.0 million is proposed in 2020 to sustain the public sector efficiency reforms and serve as a policy dialogue platform after program completion. KSTA totaling \$0.5 million is proposed for 2018 to improve the delivery of infrastructure by the public and private sectors.⁸

9. The country assistance results areas in Appendix 1 have been revised to reflect the firm projects and changes in the planned sectors during 2018–2020. These changes include dropping water and other urban infrastructure and services, and adding public sector management.

⁵ ADB. 2015. *Country Operations Business Plan: Azerbaijan, 2016–2018*. Manila. The government did not endorse the COBP 2017–2019 in 2016 due to the ongoing development of the public debt management strategy.

⁶ Transaction TA totaling \$1.0 million was approved in September 2016.

⁷ National Urban Assessment of Azerbaijan was prepared in 2016 within the framework of ADB's Urban Operational Plan 2012–2020.

⁸ This TA will synergize with the \$1.0 million KSTA on mainstreaming PPPs in education planned for the second half of 2017.

COUNTRY ASSISTANCE RESULTS AREAS

Key Country Development Outcomes that ADB Contributes to	ADB		
	Key Areas of Assistance	Indicative Resource Allocation in 2018–2020 ^a	Changes from Last COBP
1. Transport			
More efficient, reliable, and safe movement of people and goods to domestic and international markets	Railway infrastructure Railway safety; maintenance and asset management Transport policy formulation	Amount: \$400.0 million (OCR) and \$100.0 million (cofinancing) Share of the COBP envelope: 44%	Key areas related to roads have been dropped.
2. Public Sector Management			
Improved allocative efficiency of state budget resources, enhanced performance of state-owned enterprises, and reduced cost of financial intermediation in the public and private sectors	Public expenditure and fiscal management Reform of state-owned enterprises Public debt management	Amount: \$500.0 million (OCR) and \$233.2 million (cofinancing) Share of the COBP envelope: 56%	Public sector management added to respond to the policy reform agenda of the Government of Azerbaijan.

ADB = Asian Development Bank, COBP = country operations business plan, OCR = ordinary capital resources.

^a Shares calculated using a denominator of \$900 million, including overprogramming. If shares are calculated using a denominator of \$780 million (the indicative allocation for 2018–2020 mentioned in para. 4), then transport accounts for 51% of the COBP envelope and public sector management accounts for 56%.

Source: ADB.

INDICATIVE ASSISTANCE PIPELINE

Table A2.1: Lending Products, 2018–2020

Project/Program Name ^a	Sector	Poverty Targeting	Strategic Agendas and Drivers of Change	Division	Year of TRTA /PDA	Cost (\$ million)							
						Total	ADB			Gov't	Co-finance		
							Regular OCR	COL	ADF Grants			Total	
2018 Firm													
Improving Governance and Public Sector Efficiency Program, Subprogram 1 (PBL)	PSM	GI	IEG, GCD, PAR	CWPF	2016	366.6	250.0	0.0	0.0	250.0	0.0	116.6 ^d	
Railway Sector Development Program 1 (SDP)	TRA	GI	IEG, RCI, GCD	CWTC	2016	350.0	200.0	0.0	0.0	200.0	100.0	50.0 ^c	
Total						716.6	450.0	0.0	0.0	450.0	100.0	166.6	
2018 Standby													
Improving Governance and Public Sector Efficiency Program, Subprogram 2 (PBL)	PSM	GI	IEG, GCD, PAR	CWPF	2016	366.6	250.0	0.0	0.0	250.0	0.0	116.6 ^d	
Total						366.6	250.0	0.0	0.0	250.0	0.0	116.6	
2019 Firm													
Improving Governance and Public Sector Efficiency Program, Subprogram 2 (PBL)	PSM	GI	IEG, GCD, PAR	CWPF	2016	366.6	250.0	0.0	0.0	250.0	0.0	116.6 ^d	
Total						366.6	250.0	0.0	0.0	250.0	0.0	116.6	
2019 Standby													
Railway Sector Development Program 2 (SDP) ^e	TRA	GI	IEG, RCI, GCD	CWTC	2016	350.0	200.0	0.0	0.0	200.0	100.0	50.0 ^c	
Total						350.0	200.0	0.0	0.0	200.0	100.0	50.0	

Project/Program Name ^a	Sector	Poverty Targeting	Strategic Agendas and Drivers of Change	Division	Year of TRTA /PDA	Cost (\$ million)						
						ADB					Gov't	Co-finance
						Total	Regular OCR	COL	ADF Grants	Total		
2020 Firm												
Railway Sector Development Program 2 (SDP) ^e	TRA	GI	IEG, RCI, GCD	CWTC	2016	350.0	200.0	0.0	0.0	200.0	100.0	50.0 ^c
Total						350.0	200.0	0.0	0.0	200.0	100.0	50.0
2020 Standby												
Power Distribution Enhancement Investment Program, Tranche 2 (MFF)	ENE	GI	IEG, ESG, GCD	CWEN	2015	335.0	250.0	0.0	0.0	250.0	85.0	0.0
Total						335.0	250.0	0.0	0.0	250.0	85.0	0.0

ADB = Asian Development Bank; ADF = Asian Development Fund; COL = concessional ordinary capital resources lending; CWEN = Energy Division; CWPF = Public Management, Financial Sector, and Trade Division; CWTC = Transport and Communications Division; ENE = energy; ESG = environmentally sustainable growth; GCD = governance and capacity development; GI = general intervention; Gov't = government; IEG = inclusive economic growth; MFF = multitranches financing facility; OCR = ordinary capital resources; PAR = partnerships; PBL = policy-based lending; PDA = project design advance; PSM = public sector management; RCI = regional integration; SDP = sector development program; TRA = transport; TRTA = transaction technical assistance.

^a Given the provisional nature of the indicative lending program, the composition of the lending instruments in the actual loan delivery may change.

^b Potential cofinancing from the German development cooperation through Kreditanstalt für Wiederaufbau (KfW) amounting to the United States dollar equivalent of €100 million. The amount of cofinancing is indicative and subject to the Government of Azerbaijan's request as well as approval by ADB and the German development cooperation through KfW.

^c Potential cofinancing from the Agence Française de Développement (AFD). The amount of cofinancing is indicative and subject to the government's request as well as approval by ADB and the AFD.

^d Potential cofinancing of subprogram 2 is expected to be at the same level as the cofinancing of subprogram 1. The amount of cofinancing is indicative and subject to the government's request as well as approval by ADB and the cofinancing development partner.

^e Subject to the agreement between ADB and the government during the preparation of the Railway Sector Development Program 1 (firm in 2018), the Railway Sector Development Programs 1 and 2 may be merged in a single sector development program for commitment in 2018. Due to the public debt optimization policy, the government expects the overall loan proceeds to be utilized as follows: (i) \$200 million of the ADB loan and \$50 million of the AFD loan in 2018, (ii) \$75 million of the ADB loan and \$25 million of the AFD loan in 2019, and (iii) \$125 million of the ADB loan and \$25 million of the AFD loan in 2020.

Source: ADB estimates.

Table A2.2: Nonlending Products and Services, 2018–2020

Assistance Name	Sector	Division	Assistance Type	Sources of Funding				
				ADB		Others		Total (\$'000)
				Source	Amount (\$'000)	Source	Amount (\$'000)	
2018 Firm								
Improving Public and Private Sector Modalities of Infrastructure Delivery	PSM	AZRM	KSTA	TASF	500		0	500
Total					500		0	500
2018 Standby								
Preparing Integrated Urban Development Project	WUS	CWUW	TRTA	TASF	1,000		0	1,000
Total					1,000		0	1,000
2019 Firm								
Preparing Integrated Urban Development Project	WUS	CWUW	TRTA	TASF	1,000		0	1,000
Total					1,000		0	1,000
2019 Standby								
Enhancing Public Sector Efficiency	PSM	CWPF	KSTA	TASF	1,000		0	1,000
Total					1,000		0	1,000
2020 Firm								
Enhancing Public Sector Efficiency	PSM	CWPF	KSTA	TASF	1,000		0	1,000
Total					1,000		0	1,000
2020 Standby								
Sustainable and Inclusive Energy Support	ENE	CWEN	KSTA	TASF	500		0	500
Total					500		0	500

ADB = Asian Development Bank; AZRM = Azerbaijan Resident Mission; CWEN = Energy Division; CWPF = Public Management, Financial Sector, and Trade Division; CWUW = Urban Development and Water Division; ENE = energy; KSTA = knowledge and support technical assistance; PSM = public sector management; TASF = Technical Assistance Special Fund; TRTA = transaction technical assistance; WUS = water supply and other urban infrastructure and services.

Source: ADB estimates.

ASSISTANCE PROGRAM FOR CURRENT YEAR

Table A3.1: Lending Products, 2017

Project/Program Name ^a	Sector	Poverty Targeting	Strategic Agendas and Drivers of Change	Division	Year of TRTA/PDA	Cost (\$ million)						
						Total	ADB			Gov't	Co-finance	
							Regular OCR	COL	ADF Grants			Total
Standby												
Improving Governance and Public Sector Efficiency Program, Subprogram 1 (PBL)	PSM	GI	IEG, GCD, PAR	CWPF	2016	366.6	250.0	0.0	0.0	250.0	0.0	116.6 ^b
Railway Sector Development Program 1 (SDP) ^d	TRA	GI	IEG, RCI, GCD	CWTC	2016	350.0	200.0	0.0	0.0	200.0	100.0	50.0 ^c
Total						716.6	450.0	0.0	0.0	450.0	100.0	166.6

ADB = Asian Development Bank; ADF = Asian Development Fund; COL = concessional ordinary capital resources lending; CWPF = Public Management, Financial Sector, and Trade Division; CWTC = Transport and Communications Division; GCD = governance and capacity development; GI = general intervention; Gov't = government; IEG = inclusive economic growth; OCR = ordinary capital resources; PAR = partnerships; PBL = policy-based lending; PDA = project design advance; PSM = public sector management; RCI = regional integration; SDP = sector development program; TRA = transport; TRTA = transaction technical assistance.

^a Given the provisional nature of the indicative lending program, the composition of the lending instruments delivered may change. Investment lending accounted for 55% of sovereign lending commitments during 2014–2016, while conventional PBL accounted for 45% and results-based lending accounted for 0%.

^b Potential cofinancing from the German development cooperation through Kreditanstalt für Wiederaufbau (KfW) amounting to the United States dollar equivalent of €100 million. The amount of cofinancing is indicative and subject to the government's request as well as approval by ADB and the German development cooperation through KfW.

^c Potential cofinancing from the Agence Française de Développement (AFD). The amount of cofinancing is indicative and subject to the government's request as well as approval by ADB and the AFD.

^d Subject to agreement between ADB and the government, the Railway Sector Development Program 1 may be merged with the Railway Sector Development Program 2 planned for 2019 (standby) in a single sector development program for commitment in 2018. Due to the public debt optimization policy, the government expects the overall loan proceeds to be utilized as follows: (i) \$200 million of the ADB loan and \$50 million of the AFD loan in 2018, (ii) \$75 million of the ADB loan and \$25 million of the AFD loan in 2019, and (iii) \$125 million of the ADB loan and \$25 million of the AFD loan in 2020.

Source: ADB estimates.

Table A3.2: Nonlending Products and Services, 2017

Assistance Name	Sector	Division	Assistance Type	Sources of Funding				
				ADB		Others		Total (\$'000)
				Source	Amount (\$'000)	Source	Amount (\$'000)	
Mainstreaming Public–Private Partnerships in Education	EDU, PSM	OPPP	KSTA			AP3F ^a	1,000	1,000
Rapid Response for Innovative Economic Reform Initiatives	IND, PSM	AZRM	KSTA	TASF-others	225		0	225
Total					225		1,000	1,225

ADB = Asian Development Bank, AP3F = Asia Pacific Project Preparation Facility, AZRM = Azerbaijan Resident Mission, EDU = education, IND = industry, KSTA = knowledge and support technical assistance, OPPP = Office of Public–Private Partnership, PSM = public sector management, TASF = Technical Assistance Special Fund.

^a Subject to the Government of Azerbaijan's submission of the application to the Asia Pacific Project Preparation Facility, and the approval of this application by the facility's steering committee.

Source: ADB estimates.

INDICATIVE KNOWLEDGE PUBLICATIONS AND EVENTS

Table A4.1: Knowledge Publications and Events for 2018

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Critical Development Constraints	Economics	Publication and documentation	ERCD	Cluster TA 0011
Strengthening Governance and Public Sector Efficiency	Governance and public sector management	Publication and documentation	CWRD	TA 9259
Railway Sector Development	Transport	Publication and documentation	CWRD	TA 9154
Piloting Public–Private Partnerships in Education	Education	Publication and documentation	CWRD	TA ^a
Innovative Economic Reform Initiatives	Governance and public sector management	Event organization	CWRD	TA ^a
Country Gender Assessment	Gender	Publication and documentation	CWRD	TA 9088
Policy Brief and Country Background Paper on Inclusive Economic Development in Azerbaijan	Economics	Publication and documentation	CWRD	TA 8936
Policy Brief and Country Background Paper on Employment and Labor Market Policies in Azerbaijan	Economics	Publication and documentation	CWRD	TA 8936
Policy Brief and Country Background Paper on Enabling Inclusive Growth through IFI Operations in Azerbaijan	Economics	Publication and documentation	CWRD	TA 8936
Country Background Paper on Policy Responses to External Macroeconomic Shocks in Azerbaijan	Economics	Publication and documentation	CWRD	TA 8936
GJIG Study Corporate Report: Good Jobs for Inclusive Growth in Central Asia and the South Caucasus	Economics	Publication and documentation	CWRD	TA 8936
GJIG Study Volume 1: Inclusive Growth in Central Asia and the South Caucasus	Economics	Publication and documentation	CWRD	TA 8936
GJIG Study Volume 2: Employment and Labor Markets in Central Asia and the South Caucasus	Economics	Publication and documentation	CWRD	TA 8936
GJIG Study: Guidelines for Improving Project Design and Implementation to Enhance the Inclusive Growth and Good Jobs' Creation Impact of ADB Operations in the Central and West Asian Countries	Economics	Publication and documentation	CWRD	TA 8936
Total number of publications = 13 Total number of events = 1				

ADB = Asian Development Bank, CWRD = Central and West Asia Department, ERCD = Economic Research and Regional Cooperation Department, GJIG = Good Jobs for Inclusive Growth, IFI = international financial institution, REG = regional, TA = technical assistance.

^a Technical assistance to support this knowledge work is expected to be prepared in the second half of 2017 (Table A3.2).

Source: ADB.

Table A4.2: Additional Knowledge Publications and Events Delivered in 2017

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Economics of Climate Change Mitigation in Central and West Asia	Environment	Publication and documentation	CWRD	TA 8119
Training on Grievance Redress Management and Monitoring and Reporting	Capacity development	Training or capacity development	CWRD	TA 7433
Energy Investment Forum	Energy	Event organization	CWRD	TA 9156
Total number of publications = 1 Total number of events = 2				

CWRD = Central and West Asia Department, TA = technical assistance.

Source: Asian Development Bank.

Table A4.3: Innovation, Advanced Technology, and Pilot Initiatives to be Implemented in 2018

Item	Nature	Project Number	Sector or Theme	Division
Advanced Water and Wastewater Treatment for Nakhchivan	INO, TCH	Loan 2842	WUS	CWUW
Piloting Public–Private Partnerships in Education	PLT	TRTA	EDU	AZRM and OPPP
Total number of innovation, advanced technology, and pilot initiatives = 2				

AZRM = Azerbaijan Resident Mission, CWUW = Urban Development and Water Division, EDU = education, INO = innovation, OPPP = Office of Public–Private Partnership, PLT = pilot initiative, TCH = advanced technology, TRTA = transaction technical assistance, WUS = water and other urban infrastructure services.
Source: Asian Development Bank.