CURRENCY
Currency Unit = Azerbaijani Manat (AZM)
US$ 1.00 = AZM 4,848.0000 (May 8, 2002)

FISCAL YEAR
January 1 - December 31

ACRONYMS & ABBREVIATIONS

ARRA
AMO
ANB
AZ
BER
BSL
CAS
CFAA
CPAR
CPPR
CTF
EBRD
ECA
EDI
EU
FDI
FIAS
FY
GPA
GTZ
ICB
IFI
IMF
I-PRSP
IS
PPL
MED
MOF
NCB
NGO
NS
PEIR
PIU
PPL
PMAU
PSA
RFP
RPA
SBD
SOE
SPA
TA
TC
UNCITRAL
UNDP
WGPP
WCO
WTO

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Azerbaijan Agency for Rehabilitation and Reconstruction
Anti-monopoly Office
Azerbaijan National Bank
Azerbaijan
Bid Evaluation Report
Budget Systems Law
Country Assistance Strategy
Country Financial Accountability Assessment
Country Procurement Assessment Report
Country Portfolio Performance Review
Consultative Task Force
European Bank for Reconstruction and Development
Europe and Central Asia Region
Electronic Data Interchange
European Union
Foreign Direct Investment
Foreign Investment Advisory Service
Financial Year
Government Procurement Agreement of the World Trade Organization
Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ) GmbH
International Competitive Bidding
International Financial Institution
International Monetary Fund
Interim Poverty Reduction Strategy Paper
International Shopping
Public Procurement Law
Ministry of Economic Development
Ministry of Finance
National Competitive Bidding
Non-Governmental Organization
National Shopping
Public Expenditure and Institutional Review
Project Implementing Unit
Public Procurement Law
Project Monitoring and Auditing Unit
Production Sharing Agreement
Request for Proposal
Regional Procurement Adviser
Standard Bidding Documents
State-owned Enterprises
State Procurement Agency
Technical Assistance
Tender Committee
United Nations Commission for International Trade Law
United Nations Development Program
Working Group on Public Procurement
World Customs Organization
World Trade Organization
AZERBAIJAN
Country Procurement Assessment Report

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EXECUTIVE SUMMARY

INTRODUCTION

Improvement of Azerbaijan’s public procurement system falls squarely within the Government’s Poverty Reduction Strategy, which is concerned with restructuring the system of public expenditure management with a view to improving the effectiveness of the expenditures. The Government’s Interim Poverty Reduction Strategy Paper (I-PRSP) of May 2001 demonstrated its intention to improve the country’s 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 CAS of November 29, 1999 identified the area in need of the most urgent attention to be comprehensive public sector reform and improved governance. The main thrust of the CAS was therefore assistance to the Government in implementing its public sector reform agenda to improve public sector management. Clearly, efficient spending of public funds is a critical element of good governance. In the procurement context, it was expected that, under SAC-II, substantial progress will be made in: (i) governance; (ii) the business environment; (iii) transparent budget execution and accounting; (iv) implementation of public procurement legislation (v) the institutional capacity responsible for oversight in the field of public procurement and (vi) monitoring of improvements in public procurement expenditure. These expectations were fulfilled and, by the date of the finalization of this CPAR, the conditionalities for the second tranche of SAC-II linked to procurement reform were satisfied in all material aspects.

Procurement reform has been a priority in Azerbaijan in the last two or three years and significant progress has been made. This first comprehensive assessment of the public procurement system in Azerbaijan seeks to investigate and assess all relevant aspects of procurement operations including the legislative framework, the effectiveness of its regulatory institutions, the strength of its enforcement regime, the capacity of its institutional and human resources and the threat of corruption. It was carried out in consultation with counterparts from the relevant ministries and with the valued cooperation of the State Procurement Agency.

The primary objectives of the CPAR are to:

- review the country’s public sector procurement structure, including the new legal framework, organizational responsibilities and capabilities, and present procedures and practices, including how these may differ from the formal rules and procedures;
- make possible a general assessment of the institutional, organizational and other risks associated with the procurement process;
- establish the basis for dialogue between the country and donors on how to streamline and improve the economy, efficiency and transparency of public sector procurement;
- develop a detailed action plan for reform to achieve institutional improvements, including interim modifications to existing practices in the country so that contracts being financed under current projects will meet the Bank’s procurement standards pending completion of the broader reform program; and
- encourage better commercial practices in the private sector.
OVERALL ASSESSMENT

The CPAR's key findings, including risk assessment, the strengths and weaknesses of the public procurement system currently in place and the main features of a proposed action plan, are summarized below.

Key Findings

Legal Framework (C.1)

Azerbaijan has very recently adopted a new Public Procurement Law (PPL) which clarified and consolidated two existing and contradictory pieces of legislation. The PPL is based extensively on the UNCITRAL Model. It was also discussed at length with the Bank during the drafting stage and was found to be largely satisfactory. The version of the PPL as adopted has, to a large extent, incorporated the previous comments of the Bank. There are a few remaining issues with the PPL which would benefit from future amendment but they are not urgent nor do they detract from the immense progress made in the legal framework in the last five years. In terms of substance and degree of development, the PPL is one of the better such laws in the region.

With a view to assisting further development of the PPL, this report makes a number of recommendations for improvement. As a result of the positive opinion of the PPL, these further recommendations together with a commentary on the PPL are contained in a separate Annex II which discusses the PPL and recommendations in detail. These recommendations do not seek to detract from the considerable progress made to date and are offered as positive suggestions. Many of these suggestions may readily be incorporated into guidance and explanatory statements by the State Procurement Agency which will then be in a position to propose appropriate amendments to the PPL at a later date when experience has shown such amendment to be appropriate.

The World Bank makes the following recommendations for dealing with a number of issues which would be best dealt with by way of amendments to the current legislation when the time is right, rather than simply relying on explanatory statements and guidance.

1. **Applicability**: There is confusion among the parties interviewed during the mission (notably State-owned enterprises and municipalities) as to the precise coverage of the PPL. The definitions contained in the PPL do not clarify the situation in a way which enables those applying the Law to understand whether or not they are covered. The result is that many entities do not believe they are subject to the PPL when in fact they are. The definition of procuring entity should be amended to define the position clearly. This may be done by reference to the identity of the procuring entity rather than by relying exclusively on the source of funds. The current plan is that, once the new Law on municipalities is adopted, the position will be reconsidered.

2. **Donor-funded contracts**: In the previous laws, such contracts were subject to the rules applied by the appropriate donor. The PPL is silent but the definition of State funds (the spending of which are subject to the PPL) includes grants and credits contracted by the government. In theory, Article 151 of the Constitution provides that where there is a conflict with an international agreement, that agreement will prevail. However, it would be preferable to make clear, in the specific context of procurement, that donor funded contracts may be subject to local procurement rules provided that, in cases of conflict, the donor agency may impose a requirement that its rules shall prevail.

(3) **Services contracts**: The PPL concerns both intellectual (consulting) services and more general services which may be contracted on the basis of performance of a measurable physical output. Whilst the PPL does permit the use of the primary procurement procedures (open, restricted procedures) for the award of services contracts (but only under vague conditions referred to in Article 16(3)), the PPL appears to foresee the award of all services contracts under a separate Chapter V which is more appropriate to intellectual services. The different treatment of the two types of service should be clarified, preferably by making Chapter V applicable only to the award of intellectual services contracts, leaving other services subject to the primary procurement procedures. More detail on the use of chapter V is provided in some of the supporting documents relating to services contracts and the SPA has said that it will clarify the position in the implementing regulations. Ultimately, however, this would best be done by way of amendment to the PPL.

(4) **Prior authorization**: Currently, Article 17.3 of the PPL requires procuring entities to seek the prior authorization of the SPA before using a procurement procedure other than the open procedure. Given that the conditions for the use of these alternative procedures are clearly set out in the PPL, this is unnecessary, duplicative and merely likely to cause delays. It is recommended that this requirement be deleted and, as a corollary, that the procuring entity’s choice of procedure be subject to review under the review procedures of Chapter VIII. As a transitional measure, such prior authorization may be acceptable as a means of familiarizing procuring entities with the conditions for using procedures other than the open procedure but this should only be seen as a temporary measure.

(5) **Preferences**: Though preferences for domestic suppliers and restrictions on the nationality of tenderers are foreseen in the PPL, the circumstances and conditions under which these may be used is not mentioned. Both requirements should be used only in limited circumstances and these should be made clear in the legislation. The new Charter of the SPA which was approved on February 20, 2003 appears to give the SPA the task of making proposals on the level of preferences to the Cabinet of Ministers but no further details are provided in the legislative provisions. It appears that proposals have been prepared by the SPA as part of the implementing mechanisms and have been submitted to the Cabinet of Ministers. It is imperative that these be adopted.

(6) **Technical specifications**: Article 15.2 currently guarantees objectivity in the setting of technical specifications. However, there will be circumstances where there is no meaningful way of describing products without reference to specific makes or processes and it is important, in this respect, to allow such references to be made subject to a requirement to accept any other “equivalent” product. The SPA’s current position is that it will always be possible to define technical specification without such references.

(7) **Estimated prices**: The PPL allows tenders to be cancelled where the prices are significantly above or below the procuring entity’s estimated prices. Whilst such estimates are appropriate for the purposes of calculating the budget, they have no place in comparison and/or evaluation of bids. This provision should be removed. The SPA’s position is that procuring entities will always be able to make accurate estimates.
Review: The review mechanisms contained in Chapter VI11 of the PPL, whilst they are extensively based on the comparable provisions of UNCITRAL, appear to have been interpreted in a novel way. In particular, the administrative review procedure before the SPA does not result in a binding decision of the authorities which can be relied upon by disappointed bidders in the event of infringements of the PPL. The powers of the SPA are limited to making recommendations, not decisions. Only the courts have the power to make binding decisions. This removes an effective tool for the enforcement of the PPL and should be corrected in order to preserve the integrity of the system set up by the PPL and the confidence of tenderers in that system.

Fraud and Corruption (C.2)

There is a widely held perception in the private sector that fraud and corruption exist and have a counterproductive effect on public procurement. As a result, the PPL sets out a number of provisions which address fraud and corruption, notably fraudulent practices, misrepresentation, conflicts of interest and bid-rigging. Nonetheless, these provisions are often vague, ill-defined and leave excessive scope to the procuring entities themselves to decide when they might apply.

The CPAR therefore recommends (1) that these provisions be more clearly defined, preferably relying on provisions contained in UNCITRAL, (2) that the procedures for applying these provisions be established in a transparent manner and (3) that the appropriate authorities having jurisdiction to make findings of guilt be identified (although the new Charter of the SPA implies that the relevant authorities will be the courts or unspecified administrative bodies).

State Procurement Agency (C.3, C.4)

This regulatory agency has been in operation since 1998. It is staffed, at the highest level, by able and competent individuals whose commitment and personal contributions to the development of the PPL cannot be overstated. In addition to drafting the PPL, the SPA has prepared a number of implementing mechanisms and a range of standard form tender and contracts documents to be used by procuring entities and a series of guidelines. It has been involved in the dissemination of information through its annual reports (bulletins), the publication of articles and through procurement training programs.

It has responsibility for general supervision and monitoring and, despite the absence of a sufficiently systematic and appropriate reporting system, has been able to identify and correct a number of breaches by procuring entities of the procurement rules (those applicable before the adoption of the PPL). It has, encouragingly, adopted a practice of “naming and shaming” those procuring entities who are found to be in contravention of the law and publishes the results of its findings in an annual bulletin. This policy appears to be the result of the SPA’s findings as a result both of its supervisory functions and of complaints brought to it for review.

The weakness of this system is the lack of reporting requirements. Whilst procuring entities are required to keep extensive records of their procurements, there is no systematic reporting requirement, which makes the SPA’s task of monitoring more difficult. The CPAR recommends the design and introduction of a systematic reporting system based on measurable benchmarks with a view to making monitoring more effective. The SPA has prepared a reporting format for use by procuring entities which is now being considered by the Cabinet of Ministers. This must be adopted and implemented before matters will improve. In addition, the appropriations procedures and statistics are opaque in respect of procurement contracts. It is also recommended
that the appropriations procedures be designed to more clearly identify spending on goods, works and services contracts with a view to enabling the SPA to carry out its own monitoring and reporting activities.

In addition to this general supervisory role, the SPA also constitutes the second and potentially most effective tier for review (the effectiveness of the third tier of judicial review is open to question). To carry out these tasks, it does not yet have in place either an appropriate review department/division separate from its functional departments or a transparent and formalized review procedure. Whilst the personal approach to review adopted by the current head of the SPA (a man of considerable authority in Azerbaijan) may well successfully address infringements of the procurement laws in the current political environment of Azerbaijan, characterized by the dominance of key personalities and political patronage, it is not satisfactory as a permanent solution. The CPAR, therefore, recommends that formalized review procedures be put in place under the aegis of the SPA.

An even greater weakness of this system is the fact that the SPA appears to have no power to make binding decisions, merely recommendations. Given the state of the judicial system, this would effectively deprive bidders of any meaningful recourse in the event of an infringement of the PPL. The CPAR strongly recommends, therefore, that the SPA be given the power to make binding decisions as foreseen in the UNCITRAL model.

Institutional Capacity (C.3, C.4)

With the PPL in place and a competent regulatory agency to oversee its implementation, the main weakness in the procurement system appears to be one of capacity and resources. Procurement based on market economy principles is a relatively new concept and there are few trained procurement officers. There are, it is true, a number of purchasing and supply departments in some ministries but, for the most part, procurement is undertaken by staff with little or no procurement training. Despite the best efforts of the SPA, there is currently no comprehensive country-wide program of procurement training. The SPA simply has insufficient funds to achieve this. It has, nevertheless been active in conducting seminars and training sessions in Baku and surrounding areas. Consideration is also being given by the SPA to set up a training institute (perhaps in partnership with an educational establishment, to be identified) with a view to certifying procurement officers. Resources need to be found to implement a comprehensive training program and the Bank is actively discussing possibilities for funding of such initiatives. As a result, EU Tacis has committed funds in its 2002-2003 program.

The SPA’S limited resources also affect its ability to disseminate information as widely as is desirable. It publishes a great deal of information in its annual bulletins (including the laws, standard documents and annual reports) and these are distributed free of charge to procuring entities. It is unable, however, because of cost, to maintain adequate stocks of this and other information (such as copies of seminar/training materials) and as a result, wider distribution is simply not carried out. Copies will readily be copied to diskettes brought in to the SPA by individuals but this is a wholly unsatisfactory state of affairs since it presupposes sufficient knowledge of the individual (i.e. that he knows what he is looking for and where to find it) and the ability to visit the SPA office in Baku which is not always possible for provincial officers and tenderers.

The CPAR recommends greater emphasis on information dissemination and is also assisting in the search for funding in this respect. The CPAR notably recommends the use of an information website to be created by the SPA with a view to publishing relevant information to both procuring entities and tenderers. The PPL already provides for the possibility of limited communication by electronic means in the procurement procedure. The proposed action plan
seeks to build on this initiative and the proposed website will form an integral part of the SPA’s information dissemination strategy and may ultimately be used as a springboard for the introduction of more sophisticated electronic procurement.

**Procurement Procedures in Practice (C.5, C.6)**

Experience of procurement is limited, with the previous legislative provisions on procurement dating from 1996-97. The volume of public procurement is not substantial. Based on extrapolation from public expenditure data (excluding extra-budgetary funds), actual expenditure on goods, works and services has been relatively constant over the 1995-2000 period at around 1.3 billion Manat but declining as a percentage of the government budget from about 55 percent to 35 percent. The percentage of budget-financed contracts awarded by tender increased from less than 8 percent to 23 percent from 1999 to 2001 to a level of about 500 million in 2001. Including procurement contracts funded with extra-budgetary funds, total procurement is on the order of 1 billion Manat a year.

At least in respect of central government authorities in Baku and the surrounding local authorities, there appears to be a reasonably good understanding of what competitive tendering means and, with the assistance of the SPA, a large number of procuring entities have been able to develop a consistent practice and approach to the organization of their procurement functions which was compatible with the previous legislation. Sufficient time has not yet passed to determine whether the new PPL is fully understood but a number of procedures are already being conducted under it and the SPA has launched a training initiative.

Experience outside the capital and surrounding areas is much less developed. Very few local authorities have experience of tendering procedures under the previous provisions and, although they have been informed of the new PPL, only a handful of procedures under the PPL are foreseen. Even then, the contracts to be opened for tender mostly fall well below the threshold for the application of the PPL. There is a serious lack of investment in the provinces (though it does not appear to be significantly greater in the capital) which implies very few contracts open to tender.

Despite the decentralization of the procurement function, the Ministry of Finance continues to exercise a certain control over the procurement process, namely *ex post* approval, which creates significant uncertainty for tenderers. Given the existence of a strong SPA with, if the recommendation made in relation to strengthening its review procedures is adopted, appropriate powers of control over the procurement process, there is less need for the Ministry of Finance to exercise any additional controls and the CPAR **recommends** abandonment of specific control over the procurement function by the Ministry of Finance. In addition, this Ministry of Finance approval also relies in part on a comparison of competitively bid prices with some hypothetical estimated price which simply ignores the underlying rationale of a competitive bidding process. **The CPAR recommends** that such a comparison be abandoned.

**Performance of Bank-assisted Projects (C.7)**

The overall performance of the Bank’s portfolio has returned to satisfactory after a worrisome performance in 2000-01 (see Annex I for summary of Bank’s operations in Azerbaijan). The CPAR mission identified problems affecting procurement of Bank-financed contracts in the areas of taxation and customs clearance procedures, bank issuance of bid securities, and technical procurement knowledge on the part of PIU staff. **Government and the Bank have agreed** to (1) set up a working group that would meet regularly with the deputy prime minister on project
implementation issues, including procurement, (2) establish good reporting procedures to keep the MOF informed on donor-funded activities, and (3) improve consistency and expediency in Bank responses to procurement inquiries and contract approvals. The Bank is now hiring a procurement specialist who will be located in the Georgia office to handle the Caucasus portfolio. The CPAR also recommends that:

- project officers in the Bank’s Baku office receive basic procurement training,
- civil servants from the line ministries work with existing PIUs on simple procurement tasks to build capacity within the ministries, and international procurement consultants hired to support the PIUs are requested, as part of their TOR, to train line ministry staff during the course of project implementation,
- a number of other steps be taken to help reduce risk to Bank funds, including legal provisions to make National Competitive Bidding procedures acceptable to the Bank (see side letter in Annex V), mandatory independent supervision of civil works contracts, and independent procurement audits every three years.

Private Sector (C.10-13)

The Azeri private sector is at the very early stages of development. Notably in the construction sector, many of the “private” sector firms are former in-house government construction departments and those that are no longer in-house tend to retain a limited State shareholding or be owned by former and sometimes current government employees. There is a feeling in the private sector, confirmed by others, that such companies are favored by procuring entities. Outside the oil sector, the limited level of investment ensures that private companies lag behind in terms of experience and ability to grow and develop. The CPAR, therefore, recommends a speeding up of the privatization program and a clarification, by way of legal instrument if necessary, of the status of these entities and of their entitlement to tender for public contracts.

The general business environment does not encourage the establishment and growth of the private sector, with excessive bureaucracy and spurious spot checks being the norm, along with associated “facilitation” payments. Though difficult to prove, there is a widely held perception in the private sector that corruption is widespread and has a significant effect on the procurement process. The PPL addresses many issues of corruption but cannot deal with all levels. Similarly, company registration, licensing and customs procedures are outside the scope of the PPL. Problems in these areas do, however, have a significant effect on public procurement and need to be addressed at the highest level. The main areas of concern relate to the procedures and delays in the registration of companies, licensing of certain activities and in customs clearance procedures.

Risk Assessment (C.8)

Based on the analysis of its legislative framework, the effectiveness of its regulatory institutions, the strength of its enforcement regime, the capacity of its institutional and human resources, performance on Bank-assisted projects and the threat of corruption, the assessment found that the environment for conducting public procurement in Azerbaijan is medium-to-high-risk.

Action Plan Summary (D.1-4)

Given the stage of development reached in the public procurement reform of Azerbaijan, the pressing need is to ensure effective implementation of the PPL through the institution of the SPA. Immediate requirements center around capacity building, training, information dissemination and monitoring. To that end and in discussions primarily with the SPA, a major part of the action plan
has been translated into a technical assistance project (see Annex III for TOR for TA and Annex IV for detailed Action Plan).

In addition to the recommendations made above, the main focus of this assisted action plan is:

**Legal Development**

1. Assistance to the SPA to prepare suitable explanatory statements and guidance with a view to the eventual amendment of the PPL;

**Monitoring and Control**

2. The development and implementation of a reporting and monitoring system to enable the SPA better to prepare its bulletins and annual reports, including the preparation of a benchmarking system for assessing the progress of implementation and conduct of pilot audits;

3. Assistance to prepare, design and implement a formal and effective review procedure, including decision-making powers, within the framework of the SPA;

**Capacity Building**

4. The training of SPA staff as well as the training of trainers;

5. The establishment of a substantively and geographically comprehensive in-country training program for procuring officers;

**Information Dissemination and Transparency**

6. A public awareness campaign which would provide, in addition to information, basic training to potential tenderers;

7. Improved information dissemination through increased printing and publication of basic procurement documents and training materials;

8. The creation and maintenance of an information website to provide an electronic means of dissemination and access to relevant procurement information with a view, ultimately, of facilitating electronic procurement.
A. PREFACE

A.1 Date and Bases for the Report

This report was completed on May 10, 2002.

The report is based on the results of interviews with more than 90 public institutions and companies during a series of three World Bank missions that visited Azerbaijan between November 14 and 21, 2001, January 27 and February 2, 2002 and February 26 and March 6, 2002. The mission held discussions with public sector institutions at State, local and municipal levels as well as with many State-owned enterprises. With regard to the private sector, interviews were conducted with private domestic and foreign companies operating in the field of works, supplies and services as well as with a number of consultancies, trade associations and educational establishments. Meetings were also held with a number of donor agencies and NGOs.

Whilst interviews were conducted outside the capital, notably in Sungayet municipality and with some private companies in various neighboring municipalities, it was not possible to conduct as comprehensive an assessment in the provinces. Nevertheless, the services of a locally established consultancy were retained in order to investigate procurement practices in four regions outside Baku. The regions chosen (both as large regional centers and for reasons of geographical spread) were the Baku province municipalities, the Autonomous Republic of Nakchevan, Ganja in the North-West and Lenkaran in the South.

A.2 Acknowledgements

The mission members wish to acknowledge the extensive cooperation and assistance received from officials and staff of the public organizations, State-owned enterprises and private companies interviewed.

Ms. Judy O’Connor, Country Director, and Mr. Nicolas Mathieu, Senior Country Officer, offered invaluable guidance on the scope and overall direction of the assessment in advance of the mission. Mr. Roberto Tarallo, Senior Financial Management Specialist, and Mr. Ranjan Ganguli, Financial Management Consultant, who conducted the related Country Financial Accountability Assessment (CFAA) jointly with this assessment, provided essential inputs to the assessment and the report on accountability and auditing issues. Ms. Pamela Bigart and Robert Hunja, Senior Procurement Specialists OPCPR, Mr. Naseer Rana, Senior Procurement Specialist, EACIF, Mr. Gary Reid, Lead Public Sector Management Specialist ECSPE, Ms. Alison Micheli, Senior Counsel, Legal Department acted as peer reviewers for the report. Mr. Gurcharan Singh, Senior Procurement Specialist ECSPE, provided input for the risk assessment of the Bank financed portfolio. Mr. Akbar Noman, the Bank's Country Manager in Azerbaijan offered advice and guidance throughout the mission stages. The staff of the Bank's Baku office offered the mission invaluable assistance, especially Ms. Saida Bagirova, Operations Officer, Mr. Farid Mamedov, Operations Officer, Ms. Ulviya Ibrahimova and Ms. Nigar Aliyeva, all of whom helped in arranging the mission’s program. Ms. Ana Cristina Hirata and Mr. Mohammad Ilyas Butt assisted with the formatting of the report. Ms. Suzanne Snell assisted with report editing and formatting.
A.3 Participating Government Organizations

This assessment was conducted in consultation with a counterpart team comprising representatives from the Milli Majlis (Parliament), Ministry of Finance, Ministry of Economic Development, the Chamber of Accounts and the State Procurement Agency. The mission members would like to express their particular thanks for the cooperation and assistance received from Mr. Imran Mehdiyev (Head) and Mr. Vagif Nasirof (Deputy Head) of the State Procurement Agency.

A.4 World Bank Team

The World Bank team that worked on this report comprised Ms. Els Hinderdael (Senior Procurement Specialist, ECSCS), Task Team Leader; Mr. Peter Trepte (Procurement Consultant), Mr. Urfan Nadirov and Dr. Raulf Muradov of Currie & Brown (Consultants).
B. BACKGROUND

B.1 Country Background

The Republic of Azerbaijan is located in the southeastern Caucasus region of western Asia. Azerbaijan was part of the Russian Empire from the early nineteenth century to 1918, briefly an independent republic from 1918 to 1920, and a part of the Soviet Union from 1922 to 1991. On August 30, 1991, it declared its independence from the Soviet Union. Azerbaijan covers an area of 33,440 square miles (86,600 sq. km), has a population of 7.8 million and includes two administrative divisions with special status, the autonomous Republic of Nakhchevan, which is separated from Azerbaijan proper by southern Armenia, and the autonomous district of Nagorno-Karabakh (Qarabag). The capital and largest city of Azerbaijan is Baku.

As an independent nation for only ten years, Azerbaijan is still in political and economic transition. The Constitution of the Republic of Azerbaijan (the Constitution), ratified by popular referendum six years ago in November 1995, contains a Western system of checks and balances aimed at securing separation of powers among the legislative, executive and judiciary branches of the government. The Constitution provides for a unicameral parliament (the National Assembly or Milli Majlis), a president, and a prime minister.

Following the break-up of the Soviet Union and until the mid-1990s, Azerbaijan's economy suffered a dramatic output collapse, with a cumulative real GDP drop of about 60 percent, accompanied by hyperinflation, sharp currency depreciation and rapidly depleting foreign exchange reserves. These difficult initial conditions largely reflected the collapse of the Soviet Union and related trade and transport links, sharp negative terms-of-trade shock as suppliers moved to market pricing, the military conflict over the Nagorno-Karabakh region, and large fiscal deficits financed by money creation.

Azerbaijan has only recently begun making progress on economic reform, and old economic ties and structures are slowly being replaced. Following President Aliyev's succession to power in 1993 and the cease-fire in Nagorno-Karabakh in July 1994, the Government launched a comprehensive stabilization and structural reform program in 1995, supported by the IMF and IDA. Prospects for growth were further improved by the negotiation of 19 production-sharing arrangements (PSAs) with foreign firms that have thus far committed $60 billion to oil field development and should generate the funds needed to spur future industrial development. During the past five years, Azerbaijan has made significant progress in securing macroeconomic stability, price and trade liberalization, as well as in land and small-scale enterprise privatization. Real GDP growth averaged 7.1 percent during 1996-2000.

Azerbaijan shares all the formidable problems of the other countries of the former Soviet Union in making the transition from a command to a market economy, but its considerable energy resources brighten its long-term prospects. Important challenges need to be overcome if future growth prospects are to be realized and provide for rapid expansion of employment and income opportunities as well as a decline in poverty: the non-oil sector remains constrained by slow progress with financial discipline and efficient management in public utilities that together generate a significant quasi-fiscal deficit; weaknesses in public sector governance, the judicial and financial systems, and slow progress in privatization of large enterprises also deter non-oil investment; and delivery and quality of infrastructure and social services have deteriorated, especially in the rural areas. The majority of the population lives below the poverty line.
B.2 Bank Portfolio in Azerbaijan

The Azerbaijan Republic joined the World Bank in September 1992 and the Multilateral Investment Guarantee Agency (MIGA) in that same year. Azerbaijan has also been a member of the International Development Association (IDA) and International Finance Corporation (IFC) since 1995.

The Bank’s portfolio in Azerbaijan currently comprises 16 loans totaling US$359.8 (see Table 1). Three loans, including one structural adjustment loan, have been completed. The current pipeline contains five new projects totaling US$59.92 million. A detailed breakdown of World Bank Group Operations in Azerbaijan is presented in Annex I.

Table 1. Azerbaijan: Current Composition of World Bank Loan Portfolio

<table>
<thead>
<tr>
<th>Loan No.</th>
<th>Project Name</th>
<th>Year Signed</th>
<th>Year Closing</th>
<th>Loan Amount (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR-27690-AZ</td>
<td>Institution Building Technical Assistance Project</td>
<td>1995</td>
<td>2002</td>
<td>18.0</td>
</tr>
<tr>
<td>CR-33900-AZ</td>
<td>Rehabilitation and Completion of Irrigation and</td>
<td>2000</td>
<td>2006</td>
<td>42.0</td>
</tr>
<tr>
<td>CR-29230-AZ</td>
<td>Drainage Infrastructure Project</td>
<td>1996</td>
<td>2003</td>
<td>20.2</td>
</tr>
<tr>
<td>CR-27510-AZ</td>
<td>Gas System Rehabilitation Project</td>
<td>1995</td>
<td>2002</td>
<td>61.0</td>
</tr>
<tr>
<td>CR-32360-AZ</td>
<td>Pilot Reconstruction Project (Supplemental Credit)</td>
<td>1999</td>
<td>2004</td>
<td>30.0</td>
</tr>
<tr>
<td>CR-35170-AZ</td>
<td>Farm Privatization Project</td>
<td>2001</td>
<td>2005</td>
<td>40.0</td>
</tr>
<tr>
<td>CR-36150-AZ</td>
<td>Strategic Adjustment Credit Project (02)</td>
<td>2002</td>
<td>2003</td>
<td>60.0</td>
</tr>
<tr>
<td>CR-31070-AZ</td>
<td>Structural Adjustment Credit Project (02)</td>
<td>1998</td>
<td>2003</td>
<td>20.0</td>
</tr>
<tr>
<td>CR-32200-AZ</td>
<td>urgent Environmental Investment Project</td>
<td>1999</td>
<td>2002</td>
<td>5.0</td>
</tr>
<tr>
<td>CR-32070-AZ</td>
<td>Education Reform Project</td>
<td>1999</td>
<td>2004</td>
<td>7.5</td>
</tr>
<tr>
<td>CR-35230-AZ</td>
<td>Pilot Reconstruction Project</td>
<td>2001</td>
<td>2004</td>
<td>5.0</td>
</tr>
<tr>
<td>CR-35180-AZ</td>
<td>Health Reform Project</td>
<td>2001</td>
<td>2006</td>
<td>5.4</td>
</tr>
<tr>
<td>Q1960-AZ</td>
<td>Financial Sector Technical Assistance Project</td>
<td>1999</td>
<td>2002</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>359.8</strong></td>
</tr>
</tbody>
</table>
C. FINDINGS

PUBLIC SECTOR

This section briefly reviews the main legal enactments which currently govern public procurement in Azerbaijan, highlighting provisions for dealing with fraud and corruption, and indicates the extent to which legislative texts and procurement information are accessible to the public. The section also examines the role and powers of the State Procurement Agency (SPA) in the monitoring and implementation of the applicable procurement rules as well as considering other methods used to enforce procurement legislation. Finally, this section assesses public sector management performance and performance on Bank-assisted projects and assesses general risk.

C.1 Legal And Regulatory Framework

Just one year following the ratification of the Constitution, Azerbaijan adopted two legislative texts on public procurement. These were the Law on Tenders of February 11, 1997 and Decree 524 of December 19, 1996 which set out the "Regulations" on the procurement of goods, construction and services of budget organizations. In essence, these texts were based partly on a tenuous understanding of a tendering system and partly on provisions very loosely modeled on the UNCITRAL Model Law. Apart from the incomplete nature of these texts, one of the main difficulties was the inconsistency and contradictions between them. Under the auspices of the SPA, work commenced fairly soon after their adoption to prepare a single revised text which would reflect more accurately the desired objectives of a more transparent and competitive bidding system.

1.1 Adoption Of 2001 Public Procurement Law

Following the preparation of various drafts and after extensive debate over a two-year period within the Government and Parliament, the draft Public Procurement Law (PPL) prepared by the SPA was adopted by Parliament and signed by the President on December 27, 2001. The PPL is inspired to a great extent by the UNCITRAL model law. Implementing mechanisms were promulgated by way of Presidential Decree and signed on January 29, 2002 as Decree No. 668. The PPL explicitly abrogates the previous Law on Tenders of February 11, 1997. Decree 668 explicitly abrogates Decree 524 of December 19, 1996. The new PPL in effect consolidates and amends both of these previous texts so that there is now only one legislative text applicable to public procurement in Azerbaijan.

Under article 33 of the Law on Normative-Legal Acts, existing legal acts concerning the same subject matter are implicitly abrogated on the adoption of a new Law, and existing acts which are explicitly abrogated in the new Law cease to have effect. The Public Procurement Law of December 27, 2001 thus now constitutes the primary legal text governing public procurement in Azerbaijan. It was published in the Respublika newspaper immediately following signature by the President and came into force that day. It will also be reproduced by the State Procurement Agency in its next bulletin.
1.2 Improved Legal Framework

During the conception and drafting of the PPL, the Azeri authorities, notably the SPA, were in communication with World Bank representatives concerning the scope and content of the draft law. The World Bank’s comments were largely favorable and it was generally accepted that the draft PPL was not only a considerable improvement on the previous applicable legislation but also a suitable law which was consistent with best international practice. Bank representatives made extensive comments and provided valuable assistance to the Azeri authorities in the preparation of the Law. Many of the suggestions made have been incorporated into the final PPL; some have not, and this report points out the few remaining issues that may hinder or distort the successful application of the PPL, which do not alter the CPAR team’s overall positive view of the PPL.

1.3 Conditions for Assessment

Recent changes in the legal and regulatory framework concerning public procurement place certain constraints on the assessment of this work. As in the case of all transition countries, the promulgation of procurement laws introducing market economy based concepts of purchases from a competitive private sector are novel acts for Azerbaijan and, not unusually, it takes time for the necessary changes in the procurement environment and attitudes to take hold. The introduction of public procurement legislation is relatively recent with the first acts having been adopted at the end of 1996 and the beginning of 1997. These initial acts were broadly based on the UNCITRAL Model but were deficient in a number of respects which became the subject of extensive discussions between the World Bank and the State procurement Agency. The result was the much improved PPL just passed. But any current assessment of procurement performance will necessarily be based on compliance with the earlier legislation and not on compliance with the PPL. This has only very recently come into force and success in its implementation cannot yet be measured. Analyses of procurement performance in this report must therefore be read in this light. Whilst the likely influence of the new PPL may be readily assessed in terms of its appropriateness and compatibility with international best practice, the assessment of the procuring entities’ awareness of the new provisions and of their willingness and ability to implement them successfully is less easy to gauge.

1.4 Outstanding Issues

There is little doubt that the new PPL is an immense improvement on the previous legislation and is a commendable piece of legislation. There are a number of minor issues which could benefit from detailed guidance and/or explanatory statements issued by the SPA. The Bank has a number of suggestions and recommendations and these are included in the detailed commentary in Annex II. Some of these issues are somewhat more significant in the sense that they may not be amenable to correction by way of guidance and would be better dealt with by way of amendment to the PPL or other appropriate legislation. These are also discussed in Annex II and are also identified here and in the Executive Summary.

(1) Applicability: There is confusion among the parties interviewed during the mission (notably State-owned enterprises and municipalities) as to the precise coverage of the PPL. The definitions contained in the PPL do not clarify the situation in a way which enables those applying the Law to understand whether or not they are covered. The result is that many entities do not believe they are subject to the PPL when in fact they are. The definition of procuring entity should be amended to define the position clearly. This may be done by reference to the identity of the procuring entity rather
than by relying exclusively on the source of funds. The current position is that, once the new Law on municipalities is adopted, the position will be reconsidered.

(2) Donor-funded contracts: In the previous laws, such contracts were subject to the rules applied by the appropriate donor. The PPL is silent but the definition of State funds (the spending of which are subject to the PPL) includes grants and credits contracted by the government. In theory, Article 151 of the Constitution provides that where there is a conflict with an international agreement, that agreement will prevail. However, it would be preferable for it to be made clear, in the specific context of procurement, that donor funded contracts may be subject to local procurement rules provided that, in cases of conflict, the donor agency may impose a requirement that its rules shall prevail.

(3) Services contracts: The PPL concerns both intellectual (consulting) services and more general services which may be contracted on the basis of performance of a measurable physical output. Whilst the PPL does permit the use of the primary procurement procedures (open, restricted procedures) for the award of services contracts (but only under vague conditions referred to in Article 16(3)), the PPL appears to foresee the award of all services contracts under a separate Chapter V which is more appropriate to intellectual services. The different treatment of the two types of service should be clarified, preferably by making Chapter V applicable only to the award of intellectual services contracts, leaving other services subject to the primary procurement procedures. More detail on the use of the alternative procedures is provided in some of the supporting documents relating to services contracts and the SPA has said that it will clarify the position in the implementing regulations. Ultimately, however, this would best be done by way of amendment to the PPL.

(4) Prior authorization: Currently, Article 17.3 of the PPL requires procuring entities to seek the prior authorization of the SPA before using a procurement procedure other than the open procedure. This is, however, consistent with the current wording of UNCITRAL (although it is understood that, following widespread criticism, this particular provision may be abandoned in the forthcoming review of UNCITRAL). Given that the conditions for the use of these alternative procedures are clearly set out in the PPL, this is unnecessary, duplicative and merely likely to cause delays. It is recommended that this requirement be deleted and, as a corollary, that the procuring entity’s choice of procedure be subject to review under the review procedures of Chapter VIII. As a transitional measure, such prior authorization may be acceptable as a means of familiarizing procuring entities with the conditions for using procedures other than the open procedure but this should only be seen as a temporary measure.

(5) Preferences: Though preferences for domestic suppliers and restrictions on the nationality of tenderers are foreseen in the PPL, the circumstances and conditions under which these may be used is not mentioned. Both requirements should be used only in limited circumstances and these should be made clear in the legislation. The new Charter of the SPA appears to give the SPA the task of making proposals on the level of preferences to the Cabinet of Ministers but no further details are provided in the legislative provisions. It appears that proposals have been prepared by the SPA as part of the implementing mechanisms and have been submitted to the Cabinet of Ministers. It is imperative that these be adopted.
(6) **Technical specifications**: Article 15.2 currently guarantees objectivity in the setting of technical specifications. However, there will be circumstances where there is no meaningful way of describing products without reference to specific makes or processes and it is important, in this respect, to allow such references to be made subject to a requirement to accept any other "equivalent" product. The SPA's current position is that it will always be possible to define technical specifications without such references.

(7) **Estimated prices**: The PPL allows tenders to be cancelled where the prices are significantly above or below the procuring entity's estimated prices. Whilst such estimates are appropriate for the purposes of calculating the budget, they have no place in comparison and/or evaluation of bids. This provision should be removed. The SPA's position is that procuring entities will always be able to make accurate estimates.

(8) **Review**: The review mechanisms contained in Chapter VIII of the PPL, whilst they are extensively based on the comparable provisions of UNCITRAL, appear to have been interpreted in a novel way. In particular, the administrative review procedure before the SPA does not result in a binding decision of the authorities which can be relied upon by disappointed bidders in the event of infringements of the PPL. The powers of the SPA are limited to making recommendations, not decisions. Only the courts have the power to make binding decisions. This removes an effective tool for the enforcement of the PPL and should be corrected in order to preserve the integrity of the system set up by the PPL and the confidence of tenderers in that system.

### C.2 Fraud and Corruption

#### 2.1 Provisions in the PPL

The PPL provides for a number of mechanisms designed to protect the procuring entity against instances of fraud and corruption. These are summarized here and discussed in detail in Annex II, which also details recommended actions. Reference is also made to the private sector perception of the incidence of corruption.

#### 2.1.1 Fraud

Article 12 permits the procuring entity to reject a particular proposal/tender where the entity determines that the tenderer has been engaged in fraudulent practices in order to influence adoption of a procurement decision. In this case, the procuring entity's determination must be confirmed by the SPA. The difficulties here are (1) that "fraudulent practices" are not defined and (2) that it is the procuring entity which makes the decision, subject to confirmation by the SPA. The definition should be expanded clearly, preferably along the lines of UNCITRAL Article 15 which includes both the offer and acceptance of a financial inducement. It is also imperative that the SPA (but preferably also the PPL) define the meaning of the term and have procedures in place to be able to carry out such a confirmation objectively and expeditiously.

Article 12 also permits the procuring entity to prohibit a tenderer determined to be fraudulent from participating in future procurement procedures, for a period of time fixed by the SPA or for an indefinite period of time. This latter penalty would appear to be excessive and should be used...
Findings—Public Sector: Fraud and Corruption

sparingly, if at all. In addition to its supervision of the procuring entities, the SPA also has the
duty to compile and disseminate a list (database) of suppliers, contractors and service providers
who have been in breach of the procurement legislation and who are therefore ineligible to
participate in tender proceedings. This type of blacklisting should be used very cautiously and its
use should be carefully controlled. Certainly the conditions for the use of blacklisting should be
set out in detail.

**Recommendation:** The SPA should set out clearly the bases for exclusion from future
procurements and the level of penalties in terms of exclusion, preferably sequential.

### 2.1.2 Misrepresentation

Under Article 6.2.6, tenderers may be disqualified where they “have been found guilty” of
“misrepresentation” or making false statements. It is not clear (1) how these terms are defined,
(2) how they relate to the fraudulent practices of Article 12 (above) or (3) which authority is able
to make a finding of guilty. As in the case of blacklisting due to fraud, the definitions and
procedures for a finding of guilt need to be clarified and explained. In the hands of the procuring
entity, this may be a dangerous power open to abuse.

### 2.1.3 Conflict of Interest

Article 13.1 renders ineligible, tenderers with a legal, financial or organizational dependency on
the procuring entity. Whilst this is an appropriate provision, the situation in Azerbaijan is such
that the majority of “private” works contractors are or were the former in-house repair and
maintenance departments of Ministries, local authorities and State-owned enterprises (see Private
Sector, below). A number of these have been privatized, although many still have a significant
State participation. During the privatization programs, there is also a concern that such companies
will be “looked after”. Under this provision, where persons in the procuring entity have a
financial interest in such a legal entities, that entity may not, quite properly, participate in
procurement procedures. On the other hand, since all of these entities are rather specialized in the
business of their former parent Ministries, this effectively cuts them off from their primary source
of work. It is difficult to see how such a practical difficulty will be resolved in a manner
consistent with the PPL.

### 2.1.4 Bid Rigging

The PPL provides in Article 11.2 a reason for terminating the procedure which, although used in
practice in many jurisdictions, is rarely made explicit: the tender may be cancelled if it is
discovered that at the time of tender proceedings tenderers have negotiated among themselves
with a view to raising prices. This is, in effect, an anti-cartel provision which gives to the
procuring entity the opportunity to terminate a tender where cartel behavior is discovered. Whilst
this may be useful in light of the lack of powers possessed by those authorities responsible for
antitrust enforcement (see 4.4.1 below), the danger is that the procuring entities themselves have
no additional powers to discover, verify or prove anti-competitive behavior on the part of bidders.
Cartel behavior is notoriously difficult to prove and, without proper investigation and the
appropriate powers to conduct such an investigation, procuring entities are in no position to make
the assessment foreseen in Article 11.2, whatever suspicions they may have. Further, the ability to
cancel tenders on such grounds provides a flexible tool capable of abuse in the wrong hands.
2.2 Additional Provisions

In addition to the provisions of Article 12 PPL that allow for a tenderer to be rejected where it has been determined that he has been engaged in fraudulent activities, there is a provision in the criminal code which makes it an offence for a government official to accept bribes. There is a similar provision in the Law on State Officials. Under the civil code, any citizen is entitled to appeal an administrative act and could, under this provision, challenge a corrupt official in the civil courts.

There is currently a draft Law on Anti-corruption before the Parliament which was approved during its first reading on December 29, 2001. This is a relatively extensive text making it unlawful for government officials to abuse their positions by accepting financial inducements (comprehensively defined in the draft) and imposing, in addition to reimbursement of the diverted funds to the Government, a series of administrative measures from reprimands and demotions to dismissal. A working group has been established in the President’s Office to combat corruption, although the draft Law envisages enforcement of the Law by the Azerbaijan Republic Public Service Administration Council.

2.3 Corruption

Corruption is by its nature clandestine and instances of corruption and those that practice it are often difficult to identify with precision. Whilst officials interviewed in connection with this assessment report did not readily acknowledge the existence of corruption in Azerbaijan, there is a clear perception on the part of the private sector actors who were interviewed that corruption is pervasive and that the procurement sector does not, uniquely, escape its effects. Even if, as the Government (SPA) appears to believe, corruption is not actually as widespread in the procurement sector as private companies would claim, the perception that it is a factor at all in the tendering procedure is enough to severely weaken confidence in the procurement system. Further, it is not only the private sector that recognizes the existence of corruption. The IMF and World Bank Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper of May 2001 expressed the view that corruption, particularly administrative corruption, had been a major constraint to Azerbaijan Republic’s economic growth and poverty alleviation.

The clandestine nature of corruption is such that it is impossible, in the short term, to make a proper and accurate assessment of the extent of corruption and of its effects on public sector expenditure. Strengthened procurement laws such as the PPL will certainly assist in the prevention of opportunistic corruption in the sense that the opportunities for making and receiving bribes or other incentives are curtailed. A strong and competent regulatory authority such as the SPA is likely to encourage greater probity on the part of procurement officers and procuring entities alike. Proper and extensive training and re-education not only in the procedures themselves but also in the underlying rationale of the competitive bidding system can only serve to improve understanding of the perniciousness of corrupt practices in the context of procurement.

In order to monitor the incidence of corruption on a longer term basis, the assessment has included within the scope of the Foreign Investment Advisory Service questionnaire/survey relating to the business environment in Azerbaijan, a couple of questions aimed at discovering the private sector’s perception of the incidence of corruption in public sector tendering. The FIAS survey is likely to be repeated at regular intervals and may, therefore, provide an indication of any progress or lack thereof in this area.
C.3 The State Procurement Agency

Azerbaijan has already established an executive body answerable to the Cabinet of Ministers with responsibility for carrying out State policy in the field of public procurement. This was done at around the same time as the introduction of the first procurement legislation. The Statutes of the State Procurement Agency (SPA) were adopted in 1997 (Presidential Decree 583 of May 16, 1997 and Cabinet of Ministers’ Order 66 of June 24, 1997) and the SPA became operational in 1998. This was an enlightened move and an unusual one in a country formerly part of the Soviet Union. The early establishment of the SPA in Azerbaijan serves to reflect the importance and commitment attached to the reform of the public procurement system in the country. The SPA is staffed, at the highest level, by competent and motivated staff and has, in its few years of existence, been very active in a number of areas, most notably in the preparation of the PPL. In addition, the SPA has prepared a number of critical documents for use by procuring entities, has undergone training and provided training to procuring entities in Azerbaijan and has prepared at least two annual reports of its activities.

A new Charter for the SPA has been approved by the Cabinet of Ministers. This Charter reflects the provisions of the new PPL and does not affect the functions and role of the SPA to any significant extent.

3.1 General Functions and Structure

The functions of the SPA are described here thematically by type of activity and not in the order they appear in the Statutes themselves. The general functions of the SPA are grouped into the following activities: implementation measures; information dissemination; training; supervision and control. In addition to the requirement in the SPA’s Statutes that it should report regularly to the Cabinet of Ministers on the status of the public procurement system, it is also required, under the Budget Law and in cooperation with the Ministry of Finance (MOF), to report twice a year to the President.

The SPA has a Director, appointed by the President, and Deputy Director, appointed by the Prime Minister, and is currently organized into six departments dealing with (1) organization and supervision of goods contracts; (2) organization and supervision of works and services contracts; (3) organization of seminars and (training) methodology; (4) preparation of legal documents; (5) finance and (6) administration.

Perhaps the most limiting aspect of the SPA’s Statutes is that it may have no more than 18 members of staff, including both professional and support staff (Cabinet of Ministers’ Order 66). Whilst the extent of its current activities are to be commended, there is little doubt that further expansion and improvement of its activities could be hindered by its inability to recruit more staff.

Recommendation: SPA staff levels need to be increased. Cabinet of Ministers and MOF should be approached to amend the current limitations.

The SPA also has one branch office in the autonomous Republic of Nakchevan with a head, a chief specialist and two senior specialists. The CPAR mission was told that this branch office will, in the near future, become an independent agency, funded by the Nakchevan Ministry of Finance. The intention is to increase the number of full-time staff to seven.
3.2 Implementation Measures

The first function given to the SPA is the establishment of the normative-legal grounds for the operation of the State procurement system and the development of rules, regulations and procedures of procurement, awarding contracts and the fulfillment of liabilities under them. The SPA’s initial focus on this very important function led to the draft of the PPL, now adopted. The task of consolidating and amending the previous inconsistent legal provisions regarding public procurement fell to the SPA and it was the SPA which liaised, for example, with the World Bank and others on the content of these drafts. Both during the drafting of the PPL and now with its adoption, the SPA continues to prepare further normative-legal acts. The SPA has also produced guidance on a number of contractual issues such as compulsory insurance, risk sharing between procuring entities and suppliers, payment schedules and contract administration.

As recorded in the bulletins issued by the SPA in 2000 and 2001, the rules adopted by the SPA govern mechanisms for the procurement of goods, works and services and include standard form tender documents, comparison tables, standard form contract documents (approved by Cabinet of Ministers’ Decree 87 of May 12, 2000), normative acts and other documents to guide the procurement process. There are also guidelines to assist in the selection of tenderers and mechanisms for implementing “scoring” systems. It is not clear whether these scoring systems rely on “weighting”. The Bank does not recommend such weighting but, where it is used, recommends that the evaluation criteria adopted be expressed in monetary terms.

Currently, the documents available provide instructions on:
- procurement of goods under the open tender, RFP, RFQ and single source procedures
- the preparation of the evaluation report for the procurement of goods
- the evaluation of bids for procurement of goods and works
- procurement of construction works (small works)
- the preparation of the evaluation report for the procurement of civil works
- procurement of consulting services
- the evaluation and comparison of bids for consulting service

| Recommendation: | Technical assistance should be provided to ensure the completeness and appropriateness of these normative-legal acts. |

3.3 Information Dissemination

The task of disseminating information on procurement does not appear as a single function in the Statutes of the SPA, although the SPA has clearly taken the need for this critical function on board. This task is really an amalgamation of a series of functions and duties which are assigned to the SPA., covering, for example,

1. the collection of information concerning procurement both in Azerbaijan and outside (including coordination with foreign procurement agencies) and the dissemination of resulting information in the country;
2. the provision of transparency and publicity in the procurement process; general advice and counsel to procuring entities;
3. provision of explanations of the normative acts regulating State procurement to participants in tender procedures;
4. compilation of bulletins for the purposes of disseminating procurement information.
It also concerns training which is dealt with separately below.

The annual bulletins are the main vehicle through which the SPA can disseminate information to a wide audience. Thus far, there have been two bulletins and these have contained copies of the applicable Laws and amendments thereto (the next bulletin will include a copy of the new PPL), instructions and the standard form documents prepared by the SPA, the SPA Statutes, annual reports and an estimation of savings as a result of adherence to the (pre-PPL) laws on procurement. These bulletins are provided free of charge to all procuring entities. They are also available free of charge to all other interested parties, namely the potential tenderers, although limited funds makes this process less than efficient. The SPA will gladly copy versions of the printed documents on a diskette brought in by a tenderer but is unable, for reasons of cost, to provide printed or photocopied versions. A prohibition on commercial activities effectively precludes the sale of the bulletin (which would, at least, have provided funds for the production of further copies).

The other vehicle for the general dissemination is the authorship and publication of newspaper notices and articles informing the general public of the adoption of laws and other normative-legal acts in the field of procurement. SPA staff regularly publish such articles in the Respublika newspaper. More targeted information dissemination takes place as part of the SPA’s functions of advising and counseling procuring entities and it is apparent that this is an ongoing process. There is clearly no problem with the motivation of the SPA staff who are consistently seeking ways of disseminating more information on procurement. There are, however, significant problems with capacity (in terms of the number of staff) and funding.

| **Recommendation:** Technical assistance should be provided to assist in a number of areas related to information dissemination. The immediate need, in terms of funding, would appear to be (1) assistance in producing and disseminating more bulletins and (2) the creation and operation of a procurement information website. |

### 3.4 Website

Article 9.2 of the PPL is unusual for a transition economy in that it already provides for certain communications to be made by electronic means. Certain communications may be made by a means that does not provide a record of the content of the communication provided (e.g. e-mail) that, immediately thereafter, confirmation of the communication is given to the recipient of the information in a form which provides a record of the communication (i.e. a hard copy version). At present, the range of documents that may be submitted by electronic means is limited, including, for example,

1. requests for clarification and the results of pre-qualification procedures;
2. notice of rejection of proposals;
3. requests for clarification of tender securities;
4. clarifications of proposals and arithmetical errors;
5. notification of successful bids.

In addition, electronic means of communication may also be used for direct solicitation in services contracts under chapter V and for the direct solicitation of proposals in restricted procedures. These possibilities are mostly, of course, for the benefit of the procuring entities. On the tenderers’ side, electronic means of communication may also be used for the submission of the pre-tender submission.
At a more global level, a national IT strategy is currently being developed and coordinated by a division of the President’s Office. Originally set up to manage the President’s information database, it now seeks to coordinate the computerization process in the country. It is, for example, responsible for the Global Development Gateway in Azerbaijan. It is also seeking to establish an interministerial council to debate the desirability of interfacing all the separate databases maintained in the country. At a very practical level, it has drafted a law on e-signatures. It has tried to advertise the idea of the electronic government and has at least considered the possibility of e-procurement. This is also something which finds support at the SPA.

In terms of public access to and availability of the Internet, there are a number of private sector ISPs operating in Azerbaijan. Access is currently estimated to be around 35¢ per hour (down from $5 per hour, two years ago). There is increasing use of digital lines offering free dial-up. Baku is 40 percent digital and Nakchevan, 100 percent.

3.5 Electronic Procurement

Azerbaijan would, therefore, appear to be well placed to explore the possibilities of e-procurement. As a term of art, “e-procurement” tends to be used (and mis-used) to cover a number of different activities. Perhaps the most basic level consists in the posting to the Internet of procurement notices (generally and preferably, simultaneously with the hard copy publication of the same notices in a newspaper or Gazette). This is a procedure used extensively, for instance in the U.S. (Business Commerce Daily), in the EU (the TED database and, now, SIMAP), in most GPA signatory countries and by most of the donor organizations.

The next level (and the one already adopted in Azerbaijan without having employed the on-line advertising) is perhaps the use of electronic communications to post subsequent notices and to communicate in other ways. This is, in truth, little more than making use of e-mail facilities, although this could also be accomplished by posting such information on a dedicated website. The subsequent level could well consist in the submission of tenders via e-mail or the Internet. There remain some difficulties with this application, however, not least the questions of confidentiality (i.e. when the tenders are opened) and authenticity (the issue of e-signatures, already addressed in Azerbaijan).

Whilst these initiatives may demonstrate the increased use of electronic means of communication and of the Internet, they are not, strictly speaking, “e-procurement”. What existing systems do not do (e.g. SIMAP), at least not yet, is to enable direct electronic communications to be established between the buyers and sellers so as to allow them to proceed further with and, ultimately, conclude a procurement transaction. In fact, e-procurement, as understood above, is possibly too underdeveloped/underused globally to seek to introduce to Azerbaijan in the short term.

That is not to say that such transactions cannot already be concluded electronically. Apart from the obvious but time-consuming manual possibilities offered by e-mail, automated systems also exist. Electronic Data Interchange (EDI) is a system which has enabled the creation and transmission of electronic forms and documents needed to conclude commercial transactions, such as purchase orders, tenders and invoices between buyers and sellers. But it is expensive and requires compatible equipment and software at either end. Then there are business-to-business (B2B) electronic marketplaces which overcome compatibility constraints but they are still expensive and require high transaction volumes and sophisticated users. B2B marketplaces are Internet software systems that take traditional stages of the purchasing process online, such as product search and identification, tendering negotiation, ordering, receipt, and invoicing. The
A significant difference with EDI is that the data interchange is no longer dependent on bilateral equipment compatibility but is open to all.

Apart from the dollar cost (which is easily remedied) the real difficulty in adopting these approaches to e-procurement is likely to be liquidity (ie. the level and number of transactions) of an electronic procurement market and the sophistication of users. Nevertheless, there is no reason why Azerbaijan should not seek to develop further its promising start with electronic communication. The SPA is keen to proceed and the conditions of the country would appear to be favorable. Following discussions with the SPA, the ideal solution would appear to be the creation of an information website which will contain all the relevant documentation (otherwise only available in the bulletins) and which may serve, in future, as a means of publicizing progress of implementation of the PPL. Indeed, it could serve as an on-line bulletin and contain all the same information as the hard copy, including the “name and shame” section described below (see 3.7). Tender-specific information and notices could be posted on the Internet and tenders submitted online (provided this is compatible with the procedures and time limits of the PPL). It may also provide a useful means of publicizing blacklisted suppliers, also referred to in IBTA and SAC-II. The website may also, ultimately, act as a platform for more sophisticated e-procurement mechanisms. The immediate purpose of the website would be to provide a readily accessible means of disseminating information.

**Recommendation:** Technical assistance should be provided to create an information website at the SPA. This should include not only the software and website development costs but also the necessary equipment. In addition, the TA should consider ways of moving forward to the next level of e-procurement and consider the necessary building blocks for a phased electronic government procurement program.

### 3.6 Training

The statutes of the SPA require it to provide training free of charge to the personnel of ministries, committees and other State bodies which deal with procurement in order to improve their qualifications and skills in accordance with the legislative procedures and to provide them with education materials; coordinate the exchange of specialists; arrange visits to seminars, conference and training programs abroad.

#### 3.6.1 SPA Staff Training

Training has many aspects and calls for a number of comments. In the first place, a distinction must be made between at least two levels of training. The first consists in the training of the SPA staff themselves as a means of simply providing for competent and able SPA staff. The second consists in training SPA staff as a means of also providing trainers for in-country training programs. Both of these tasks are critical to developing sustainable domestic procurement knowledge and capacity. Ideally, such training should take place at a recognized training center with a view to repatriating the knowledge and experience gained to provide a solid domestic base from which to develop in-country training. The director of the SPA has participated in training outside Azerbaijan on a number of occasions, most notably at the ILO training center in Turin. Indeed, it is believed that he also teaches at the ILO. It is believed that other members of staff have also participated in such training but the extent and depth of this training is unknown. However, given the lack of financial resources, it is unlikely that such training has been sufficient to establish a comprehensive and reliable resource from which to produce a sufficient number of trainers to carry out in-country training.
Recommendation: Technical assistance should be provided to ensure training of SPA staff at two levels: training for familiarization purposes and the training of trainers. This should ideally take place at appropriate training institutions such as the ILO in Turin.

3.6.2 Training for Procuring Entities

The SPA has been working hard on creating training programs and seminars for the relevant procuring entities in Azerbaijan. The SPA has conducted a number of seminars at different levels (central and local authority level) as well as for State-owned enterprises and the Ministry of Defense. This, of course, is the primary target audience for ensuring a properly implemented Law. In the case of Azerbaijan, as with many other, if not all, transition economies, this task is imperative given the absence of a class of professional procurement officers. With an economic history and experience founded in a command economy, there has in the past been no call for and no development of a separate profession concerned solely with purchase and supply functions in the public sector. There may be individuals who have experience of international procurement activities and there is clearly a growing number of individuals who have experience of procurement under donor funded contracts. These are, however, rather a recent development.

The training programs organized by the SPA have been wide-ranging and have also included free training materials, though limited funds have again meant that there is no constant supply of materials generally available. The practice of the SPA has been to assign staff to research and prepare training materials on specialist subjects and then to deliver their papers at the seminars. In this way, the SPA has covered a range of topics such as bank securities; how to buy goods, works, services and consultancy services (as separate papers); pre-qualification; technical specifications for bid preparation; description of tender procedures; rules for open tender; rules for the use of alternative procurement methods; planning and forecasting.

Nevertheless, this training is not systematic and is irregular. This is due, as above, not to the lack of need or willingness but to a lack of capacity and funds. There are, so far as can be ascertained, no universities or technical schools which teach procurement, for either private or public sector users, as a readily identifiable module or even as part of a wider course, although the SPA is considering, jointly with the Ministry of Education and a number of State universities, to introduce a discipline on the theory and practice of government procurement. Approaches have been made to the Economic University of Baku. Other than this, there are no procurement modules taught as part of any courses dealing with engineering subjects or those dealing with law, economics and commerce. The Public Administration Academy appears to have just commenced a course dealing with project management but no more is known about this. There is a fledgling NGO called the Azeri Project Management Association which is a member of the International Project Management Association (IPMA) and which hopes to begin training courses in project management once accepted by IPMA, but this is very much in its early stages. As with many NGOs, the commitment and desire to improve the lot of their countrymen is there, but resources and the slow pace of development hold back rapid progress.

For the moment, therefore, it is fair to say that there is no discernible body of procurement professionals in Azerbaijan and that those who do have experience of procurement are those who have learned it whilst carrying out their duties. Whilst there is an argument for saying that such on-the-job learning is as useful as any more academic teaching methods, the situation in Azerbaijan suggests that on-the-job training is inadequate. In addition to the command economy background of any established officials are the novelty of any public procurement legislation, the conflicting experience of using different procurement rules (of the different donors) and the
relative inappropriateness of the pre-PPL procurement legislation. Extensive new training and re-training are, therefore, necessary.

**Recommendation:** Technical assistance should be provided to ensure adequate in-country training to procuring entities at all levels of government and in all parts of the country. A mechanism should also be created to establish a procurement profession perhaps beginning with a certification procedure through the SPA and/or associated schools or associations.

### 3.6.3 Training for Senior Officials

In addition to ensuring training at the operational level, the adoption of the new PPL provides an excellent opportunity to create awareness of the legislation at the highest level, especially with those senior officials who are likely to become members of the TCs or those who have the authority to commence tender proceedings. For this reason, specific training should be provided, preferably by experienced procurement trainers.

**Recommendation:** A training assessment should include or program awareness training of senior government officials by, for example, the ILO.

### 3.6.4 Training of Tenderers and the Public

The training component of the SPA’s Charter is confined to the training of procuring entities although its information dissemination function also includes tenderers. There is little point in changing the legislation on public procurement and training the public purchasers when those on the supply side of the equation have not got the same information. Tenderers must also be informed of the rules with which they need to comply and of the opportunities presented by a more competitive bidding environment. Public awareness and tenderer awareness of the new procurement legislation should be a key component of any initial implementation drive and a series of specific training seminars and conferences should be envisaged at the outset. With the intended creation of a procurement information website, consideration should also be given to providing appropriate distance learning modules on-line.

**Recommendation:** technical assistance should be provided to fund public awareness and tenderer awareness campaigns now that the PPL has been adopted.

### 3.7 Supervision

Supervision means the general monitoring of the public procurement system to ensure, so far as is possible, compliance with the applicable legislation. Supervision is to be contrasted with “control” (see C.4, Control and Review Mechanisms), a term which is used here to refer to direct control by the SPA of a particular tender procedure through the provision of a complaints and review procedure. The SPA’s statutes require it to supervise the compliance of State bodies with national procurement legislation; to raise issues of violation cases before the relevant State authorities; and to regulate and oversee implementation of procurement procedures and contract payments, all in compliance with legislation.

This is a task the SPA appears to take very seriously. Staff of the SPA are in constant contact with ministries, departments, committees and State-owned enterprises that enquire about procurement practices and request assistance. The methodology and frequency of these contacts is unclear but the results are very clear. The new Charter of the SPA does, however, give the SPA the right to
participate as an observer in all State procurement processes. It is assumed that this means it may monitor the decisions of tender commissions or TCs (possibly where a particular procuring entity has a history of non-compliance) by attending, though not participating in, the deliberations of a TC.

The SPA has adopted a "name and shame" policy in its annual bulletins through which it refers to procuring entities by name and sets out their failures to follow the procurement legislation or to errors of compliance. These are not vague references but specific and detailed challenges to the defaulting procuring entities. In the 2001 bulletin, for example, the SPA cites the Baku City authorities' failure to follow tender procedures in awarding contracts whose value exceeded the AZM 250 million threshold and proceeds to identify each and every such contract together with its value. It does the same for the Ministry of Defense, Ministry of Health, several State Committees and for a number of State-owned enterprises such as the Caspian Shipping Company, SOCAR and Azerigaz. It then proceeds to examine those tenders which were sought to be awarded competitively and to set out deficiencies in the procurement process or the results, seeking to give explanations. Whilst it may be too early to assess the success of such a policy, it is a positive course of action which has the potential to be a very useful and successful tool in the supervision of procuring entities.

3.8 Records and Reporting

In order to accomplish its supervisory role, the SPA needs information from procuring entities as well as from the Treasury. Without such information, monitoring and supervision become superfluous. The basic information required are, from the Treasury, statistics of procurement expenditure (discussed under Public Sector Management Performance, below) and, from procuring entities, records of procurement procedures conducted.

The PPL sets out extensive reporting requirements. There are two types of records which must be kept by the procuring entity. The first type of records, under Article 10, are records of procurement proceedings containing all the relevant information, including

- a brief description of the works, goods or services;
- the identity and prices offered by the bidders and the successful bidder;
- the internal "estimated market price";
- an explanation of any cancellation of the tender;
- an explanation of the failure of any procedure other than open tender;
- statements regarding any tenderers rejected on the basis of fraud or conflict of interest;
- reasons for employing methods other than open tender in the case of goods or works or methods other than Chapter V in the case of services;
- the reasons for restricting eligibility on the grounds of nationality;
- a description of any clarifications sought of tender documents or pre-qualification documents.

This article allows tenderers to request portions of the records following award or following termination of the procedure without an award, subject to the proviso that information containing commercial secrets shall not be disclosed. In addition, there will be no detailed disclosure of the evaluation and comparison of tenders.

The second type of records, under Article 54, consists in a set of documents for each procurement containing
• the official decision to commence the procurement;
• copies of the tender notices;
• the tender documents;
• bank documents confirming payment of the participation fee and tender proposals of all the bidders;
• minutes of the TC regarding the results of the procedure;
• the final procurement contract;
• in the case of long-term contracts, reports on progress of implementation;
• any documents relating to the settlement of disputes;
• documents relating to payment of tender expenses; and
• contract completion document.

The report containing this second set of documents must be completed within 20 banking days after completion and be kept by the procuring entity for five years. Thereafter, it will be archived.

Despite these extensive recording requirements, the use made of the records in terms of reporting is much less extensive. It is clear that the SPA does have information concerning a number of tenders, as is evident from the information contained in its annual bulletins. This information is not, however, provided either on the basis of a comprehensive and standard format or systematically. The new Charter of the SPA appears to give the SPA power to define the format of reports on procurement and it is unclear how this sits with the provisions of the PPL. However this apparent conflict is to be resolved, there is an urgent need for the reporting function to be properly established. The current status appears to be that the SPA has submitted a draft format for reports from the procuring entities for approval to the Cabinet of Ministers.

The only requirement of the PPL is that the SPA should be sent a copy of the minutes of the TC making the award decision within three days of that decision. For the moment, it is unclear what these minutes will contain. Article 37.6 of the PPL, states that the sample form of the TC’s final minutes are to be developed and approved by the Council of Ministers. Given the absence of any other reporting requirements, the design of these minutes will be crucial and provides an excellent opportunity for ensuring that the SPA is given, without the need for making specific requests, adequate information upon which to base its own reports. Again, the SPA has already submitted a draft form for the TC final minutes to the Cabinet of Ministers for approval.

The difficulty in reporting and monitoring is compounded by the opacity of the appropriations system discussed under Public Sector Management Performance which makes it very difficult to identify data relating to procurement contracts.

Recommendation: The design of the sample form of the TC’s final minutes should be meticulously completed and adopted by the Council of Ministers as soon as possible.

3.8 Annual Reports

The SPA has a duty to make regular reports both to the Council of Ministers and to the President. No information is available on the content of these reports but it is fair to assume that their content is reflected in the consolidated annual reports contained in the published bulletins. The SPA has been heavily involved in the preparation and drafting of the PPL and has been actively involved in persuading and lobbying the relevant executive powers and the Parliament. Whilst the SPA clearly has the authority to seek information where necessary, there is little in the way of systematic voluntary reporting by the procuring entities to the SPA and the only obligation on
procuring entities is to supply a copy of the TC's final minutes to the SPA, for which a sample form has yet to be prepared by the Council of Ministers.

Also it is evident from the available statistics used to extrapolate current procurement volume (see C.6, Public Sector Management Performance), there is no readily accessible source of information from which procurement statistics can easily be extracted. The SPA cannot, therefore, easily describe the existing state of public procurement and would have difficulty in making reliable projections. The SPA has indeed done an admirable job of making the most of the available information, but the extent and availability of pertinent information is insufficient to allow it to make a comprehensive and accurate assessment of the situation.

**Recommendation:** Technical assistance should be provided to enable the development of a comprehensive reporting system which would (1) oblige procuring entities to provide relevant information on a timely basis (through the use of obligatory procedures) and (2) enable the SPA to gain access to country-wide procurement statistics from a range of other relevant authorities.

### C.4 Control and Review Mechanisms

#### 4.1 The Basic Structure

Chapter VIII of the PPL provides for the complaints and review mechanism set out in the UNCITRAL Model, which requires an initial complaint to the procuring entity before review by the relevant executive authority, in this case the SPA. It also provides for jurisdiction of the national courts over breaches of the PPL and for judicial review of the decisions of the procuring entity and the SPA.

The provisions are not, however, identical. In particular, in respect of damages or compensation, the PPL fails to elect either of the options offered by UNCITRAL (wasted costs or loss of profits) and simply states that compensation is an available remedy. This is unfortunate since the determination of the level of compensation is an issue which has caused much controversy and is subject to much debate in a number of jurisdictions. Lack of clarity at this level may well be problematic. Whilst the Civil Code provides for the possibility of both measures of damages before the courts, there is no guarantee that an administrative body such as the SPA would have such authority (see below). Even if it does, tenderers need to know. The SPA should issue a "practice direction" setting out the bases for obtaining and the level of damages to be awarded for breaches of the PPL.

Despite the current wording of UNCITRAL, the CPAR recommends that the selection of the procurement method and any limitation on the nationality of bidders be subject to review.

#### 4.2 SPA Administrative Review

As well as providing for review by the procuring entity itself and for the general availability of judicial review, the PPL also provides for a complaints and review procedure before the SPA either in lieu of a complaint to the procuring entity (when the contract has entered into force) or on appeal from such a decision. Given the uncertainties over the effectiveness of judicial review
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(see 4.3), the SPA thus constitutes the second and potentially most efficient tier of the complaints review mechanism foreseen in the legislation. It is no secret that tenderers in most countries are court-averse and experience has shown that an administrative review procedure before an independent review board (independent of the procuring entity) offers an acceptable and often preferable review mechanism. It is important, therefore, that this possibility be and be seen to be accessible, fair, objective and effective. However, this potential appears to be seriously hindered by the SPA’s lack of teeth, in the sense that it is unable to make binding decisions such as those foreseen in the UNCITRAL Model.

To assist the SPA, its statutes provide it with limited powers of investigation in the conduct of its review procedure. It is, for example, entitled to obtain any information on procurement from procuring entities and may examine procurement documentation and “draw conclusions”. In conducting the review, it may make “recommendations” setting out the governing principles (of the PPL) and may, where it has found evidence of violation of the legislation, make further “recommendations” to annul decisions of the procuring entities, for the revision of unlawful decisions, to terminate the award procedure, for the suspension of the tender procedure and, where necessary, for the extension of that suspension. It may even make a recommendation for the award of damages. Despite the superficial similarity with UNCITRAL, however, these are only recommendations and are pursued largely through personal contacts between the Chairman of the SPA (and sometimes Ministers) and the procuring entities. This lack of power and/or authority is a serious weakness of the review mechanism foreseen.

Currently the review procedure is conducted on the authority of the Director. Complaints are received by the Director, who then transfers the dossier to a relevant department of the Agency. These may be the departments responsible for procurement of goods, works or services (depending on the subject matter of the complaint) and could also be the Legal Department, whose primary tasks largely consist of drafting documents rather than conducting reviews. There is no separate or independent department responsible for review. The procedure is handled by the existing departments under the supervision of the Director and it is the Director who takes the appropriate action.

Given the current political climate of Azerbaijan, where personality is key and where the degree of authority and therefore compliance is heavily reliant on the personality and competence of individual office holders rather than on the office itself, this approach has the distinct advantages of practicality and realism. In other words, in the context of Azerbaijan, it is a system which appears to work and to achieve results. The current Director is a man of considerable authority in Azerbaijan who was previously Prime Minister of the autonomous Republic of Nakchevan and was appointed by and enjoys the support of the President. These advantages cannot be exaggerated. His ability to challenge non-compliant procuring entities is evident in the “name and shame” approach of the SPA bulletins and his personal intervention (both on the basis of complaints and of his own motion) have resulted in significant and positive changes to the procurement practices of the procuring entities found to be at fault. The CPAR team was told that there have been a total of 17 complaints in 2001, of which 12 were decided in favor of the complainant but was given no further information about the substance of any of these cases.

Perhaps the greatest advantage offered by the strength and authority of the current Director will be his ability gradually to set in place and establish a structured review mechanism within the SPA. His influence will facilitate the creation of the system and his authority will guarantee respect of a system that does not depend on such a personal approach, which is not sustainable in the longer term. Officers change or are replaced even where the office remains, political allegiances and patronage shifts and further development and familiarity with the PPL will
require more systematic and sophisticated responses to violations of the PPL. Whilst it is undeniable that this is an effective system in the current context, it should only be seen as a temporary solution to direct control over the tender procedures of procuring entities covered by the PPL.

An internal structure capable of conducting reviews independently of the other departments of the SPA should be based on clear procedures relating to access and the conditions which apply to review procedures, adequate and transparent time limits, the filing of appropriate documents, suitable hearings which enable the presentation of evidence, educated and objective decision-making and clear and effective remedies. In addition to further procedural drafting, the system’s effectiveness will also require the retention of suitably qualified technical and/or legal staff who are trained in and have experience of procurement matters and dispute resolution. This requirement further underlines the need to increase the number of staff recruited and the funds necessary to build adequate capacity in dispute resolution.

**Recommendation:** Technical assistance should be provided to assist the SPA in the development of a medium- to long-term internal review structure and to ensure the build up of sufficient capacity in terms of staff trained in dispute resolution. In addition, measures should be taken to endow the SPA with effective decision-making powers.

### 4.3 Judicial Review

Under the Constitution, the separation of the executive, legislative and judicial powers is guaranteed. Judicial power is exercised through a three-tier court system consisting of first instance courts, appeal courts and cassation. The latter is heard by the Supreme Court. Apart from the specific criminal and military courts, the first instance court in civil cases (which will include procurement cases) is either a Regional District Court (RDC) or a Local Economic Court (LEC). There is no separate administrative court system, although there has been some discussion of setting up such a system. GTZ is conducting a preliminary investigation into the feasibility of such an administrative system, although there had been no concrete developments in this regard at the time of the CPAR missions.

#### 4.3.1 Jurisdiction

The RDCs, of which there are 85 countrywide, will hear all civil cases, except those concerned with economic matters, including cases of administrative violation. These cases essentially concern disputes between natural persons and between a natural person and a legal person, including public bodies and civil cases concerning corrupt officials. Appeals from the RDCs are heard by the Court of Appeal which has a committee to hear appeals in civil cases.

The LECs, of which there are four (in Baku, Ganja, Ali-Bayramli and Nakchevan) hear cases concerning administrative or economic disputes between two or more legal persons, including disputes over contract terms, contract amendments and termination. These courts hear “economic” cases, defined as those which concern disputes between legal persons, one of whom may be a public authority. A special economic court, the Economic Court dealing with Arguments of International Agreements located in Baku, will have jurisdiction over commercial matters involving a foreign entity or (and here there is a difference with the general jurisdiction of the LECs) foreign natural person. Appeals from the LECs are heard by the Economic Court.

In brief, jurisdiction depends on the nature of the parties. Cases brought by natural persons, either against another natural person or a legal person (including the Government) will be brought in an
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RDC. Cases brought by a legal person against another legal person (including the Government) will be brought in an LEC. Whenever one of those parties is either a foreign natural or legal person, the special economic court has jurisdiction. In procurement cases, therefore, any dispute brought against a public authority by a tenderer who is a legal person would be brought in an LEC. Cases brought by natural persons (such as individual consultants) would be brought in the RDCs. Wherever a case is brought by a foreign tenderer (a legal or natural person), it would be brought in the special economic court. To the knowledge of the Ministry of Justice, no procurement cases have been brought in any of the courts to date.

4.3.2 Procedures

According to the Ministry of Justice, procedures before the courts take about three months from commencement to decision. It is possible that, when a foreign entity is involved, the court will require further information or documentation from abroad and that there will be a delay in the procedure. The courts also have the power to appoint experts in any given case which may also cause a delay. In all cases, the courts have power to suspend the procedure pending further information.

The decisions of the courts must be implemented within one month of the decision (or 20 days in the case of criminal actions). Failure to comply with a court’s decision is a criminal offence. There is a department of control within the Ministry of Justice together with a Marshall Service. Once a failure to comply has been notified, the Marshall Service will inform the public prosecutor who initiates a procedure. The investigation department of the Ministry of Justice then pursues the matter.

4.3.3 Liability for Damages

The powers of the courts are set out both in the Constitution, the Civil Code and in the Law on Rules and Rights of Court. Under Article 21 of the Civil Code, wherever a person’s civil rights have been violated, there is a concomitant right to full recovery of damages. These may consist of recovery of losses incurred or to be incurred (actual loss) as well as profits the person would have earned had the right not been breached (lost profits). The rights violated encompass both contractual rights and tortious liabilities. Articles 22 and 1100 provide that state authorities, bodies of local authorities, municipalities or officials of such bodies are also responsible for all losses caused as a result of their unlawful actions, their failure to act or (under Article 1100) of their approval of unlawful acts. This imposes liability, therefore, on those, on the demand side, who have decision-making authority in the procurement procedure or those who have the right to approve decisions of other government officials. In addition, Article 19 provides that acts of public bodies and local administrations which are incompatible with legislation in force and which violates the rights and interests of natural or legal persons may be declared invalid.

In principle, therefore, in procurement cases the courts have the ability both to declare invalid acts of public procuring entities which are incompatible with the procurement laws and to award damages to tenderers who have suffered or will suffer harm as a result of the infringement. Damages may compensate actual losses or lost profits. In the absence of any cases, however, the Ministry of Justice was unable to comment further. Similarly, there has not, to the Ministry’s knowledge, ever been a claim for injunctive relief, although the possibility of such relief should not be discounted. Whenever an action is commenced in the first instance courts, a preliminary meeting is held within 7 days (3 days in a criminal case) and the court has the power to take appropriate measures. Article 1098 of the Civil Code provides the courts with a general protective remedy which allows them to prohibit activities which risk causing (tortious) damage in future.
The balancing provision provides that a claim for such an injunction may be rejected where the injunction would be against the State's interest. Such a remedy is available in addition to damages.

4.3.4 Arbitration

Azerbaijan is a signatory of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards which became effective on May 29, 2000. There is currently no system of private arbitration in the country, although it is not prohibited. Indeed, Article 17(2) of the Civil Code provides that "a contract may provide for dispute resolution between parties prior to resorting to a court." The former arbitration courts which existed under the Soviet system have metamorphosed into the LECs. There is a Law on International Arbitration which appears to regulate international disputes, although it is not based on the UNCITRAL model. Under this Law, parties may select independent arbitrators of any nationality and the proceedings may be conducted in any language chosen by the parties. The applicable law (other than in the case of matters which must be resolved exclusively under Azeri law) and the procedural law may be chosen by the parties. In general terms, the parties are free to stipulate the terms of the arbitration.

4.3.5 Legal Retraining and Public Respect for Law

The courts and judges have recently been the subject of an educational drive steered by GTZ and USAID/ABA. A number of seminars have been organized and conducted dealing with a number of legal topics worthy of judicial interest. All judges have recently undergone re-training followed by an examination. However, failure in the examination did not result in dismissal: instead, the judges were subjected to a secret interview and re-admitted. Doubts concerning their competence, therefore, remain. The novelty of many recent economic laws and the apparent acceptance by many commentators of the poor academic levels and competence of judges in Azerbaijan suggests that many judges, especially those sitting in the economic courts, lack sufficient understanding of the market principles which underpin the new laws, including the PPL. Sadly, there is also a widely held belief that corruption is as prevalent in the court system as elsewhere. Whether that is true or not is, to some extent, irrelevant. What matters, particularly in the context of procurement disputes, is the perception that there is corruption and that, as a result, infringement cases brought before the courts will not be decided fairly.

Respect for the rule of law is not something which can be legislated; it is something which develops over time where the law and the application of the law is seen as something worthy of respect. Notwithstanding the recent improvements in the educational and training opportunities made available to the courts, there appears to be some way to go before the general public (and tenderers are members of that general public) will have sufficient confidence in the court system to make it a suitable forum for the resolution of procurement disputes. In the meantime, therefore, the powers of the SPA, staffed as it is and will be, by competent people well versed in the PPL, will be critical in ensuring the proper implementation of the PPL. However, without sufficient decision-making authority, even this review mechanism will be insufficient to guarantee the integrity of the procurement system set up by the PPL or to foster the necessary bidder confidence in that system.
4.4 Additional Control Mechanisms

4.4.1 Supply-side Control

Whilst any public procurement legislation can readily monitor and control the activities of demand-side procuring entities, it is notoriously difficult and, one might say, inadvisable for the same legislation to seek to deal with supply-side activities (bid-rigging, for example) which might impede the proper course of a competitive bidding process. Such control is normally within the purview of the anti-trust authorities. Article 11.2 of the PPL does introduce a mechanism whereby procuring entities can cancel tender proceedings where it is discovered that tenderers have negotiated among themselves with a view to raising prices (see 2.1.4). Apart from the evidential difficulties involved, such a power can (1) impose unnecessary burdens on the procuring entities who already have a difficult task to perform and (2) lead to and certainly facilitate abuse by the procuring entity.

In any event, an anti-monopoly office (AMO) has recently been created as a department of the Ministry of Economic Development. Whilst part of the AMO's functions would appear to be to enforce the provisions of the Civil Code relating to unfair competition (Article 560 which prohibits both anti-competitive agreements between legal entities and the abuse of a dominant position), a further important function would seem to be the regulation of the activities of natural and State-owned monopolies. Indeed, this would seem to be the primary function of the AMO. Part of its functions concern the setting of tariffs and monitoring of investments for the purpose of protecting the rights of the consumer. To this extent, the AMO considers that it could, as part of its regulatory functions, ensure that prices paid for goods and services are compatible with "market prices." In conducting investigations up to now, the AMO has noticed a tendency to split contracts into smaller lots in order to avoid the application of the procurement laws. The AMO has the option to notify the law enforcement authorities (in this case the SPA) and to impose their own economic sanctions, although it is unclear whether either course of action has been followed in a concrete case.

Whilst the provisions of Article 560 of the Civil Code appear to be co-extensive with the comparable provisions of the Sherman Act in the U.S. and the Treaty of Rome, as amended, in the EU, with respect to the prevention of anti-competitive behavior by undertakings or groups of undertakings, the AMO lacks the investigatory powers and the staff of comparable authorities. They may not carry out unannounced "dawn raids" of business premises, for example, and have no power, other than the ability to request, to compel production of written documents. The AMO has no power to initiate investigations and may only act on the basis of a complaint. Even in the case of the construction sector, which is especially prone to cauterization, the AMO has not been in a position to take any action, because there have been no complaints, although AMO suspects that anti-competitive behavior has taken place.

There is clearly room for improvement but, rather than seek to impose anti-trust responsibilities on procuring entities in addition to their existing duties under the PPL, it would be preferable to enhance and strengthen the powers and field of action of the AMO. GTZ currently has a program which is linked to the AMO but it is not clear whether they are intending to review its powers in this way.

**Recommendation:** Technical assistance should be found to assist the strengthening of the AMO.
4.4.2 Smuggling and Money Laundering

The Ministry of Justice states that there are a number of laws which deal with terrorism, although they did not identify any of those laws. Money laundering is dealt with in the same laws. There is also a draft law working group (under the Council of Ministers) set up to revise the existing provisions. It is envisaged that this will culminate in an action plan for the Government, although it is not intended to set up any specialized Agency to implement a specific program. Rather, it is intended to establish internal security units in each government department. These will be given the task of prevention rather than any powers to correct ex post.

It should be added that the State Customs Committee is very aware of the dangers of drug smuggling as a means of funding terrorist activities. This is a particularly live issue in Azerbaijan as it is, geographically, a transit country for illegal substances between, for example, Afghanistan and Georgia. In 2000, the Committee had some 120 officers dedicated to the anti-smuggling and fraud investigation but the results have been modest. Azerbaijan is a member and active participant of the World Customs Organization (“WCO”) which is currently considering the setting up of a second regional training center in Azerbaijan. Funds have been secured for the building of facilities, although the customs authorities are still looking for funds for equipment, library documentation and training. An important part of the proposed training will include border security and anti-terrorist measures.

C.5 Procurement Procedures in Practice

5.1 Administrative Decentralization

Following the collapse of the Soviet system, there has been a move towards the decentralization of administrative power. The Constitution provides for the creation of elected local authorities and municipalities which remain, at least during the transition period, subject to a local Executive Power whose head is nominated by the President of Azerbaijan (Article 109 of the Constitution gives the President power to create a local executive body, funded by the budget, to exercise the executive power which, under Article 99, belongs to the President). The Executive Power has a representative in each of the local authorities.

This system is presently in transition and the municipalities are currently subsidized by the central budget (which covers the operational costs in any event) but will have their own budgets as well as their own assets and property. The Executive Powers are currently in the process of allocating these assets and property, including land and buildings. The Law on the Financial Status of Municipalities identifies some 17 taxable activities which will provide revenue to the municipalities; for example, taxes on land (of individuals and legal persons); land use (mines, quarries); State duties (such as parking fees); distribution of advertisements, hotels, health resorts and the like. These taxes are collected locally but are regulated by the tax code and may be spent by the municipalities upon the authorization of the MOF. For its part, the Executive Power is funded through another set of local taxes which include VAT and income tax, utility fees and maintenance charges (for sewerage, for example). These are collected by the local office of the Ministry of Taxes. Based on an annual revenue plan, the percentage of these taxes to be retained by the Executive Power is identified and the remaining funds are sent to the central tax administration.

In terms of procurement, the local municipalities generally have responsibilities for the repair and maintenance of facilities which are located in their area. Whilst buildings such as schools and
hospitals are built and owned by the relevant Ministries, it is the municipality in which the building is located that is responsible for its upkeep. Similarly, the municipalities will be responsible for streets, for example, but not for the highways which are the responsibility of the Road Agency. In Sungayet municipality (one of the largest outside Baku), for example, there has been no capital investment above AZM 250m. The value of most of the repair and maintenance contracts has also been below AZM 250m and, even where the value of a single contract is above that, the novelty of the administrative system and the procurement laws are such that there is little practical experience of competitive procurement. Nevertheless, efforts are being made by the municipalities to educate themselves and to prepare for the PPL. A number, such as Sungayet and Baku municipalities have conducted seminars with the assistance of the SPA and have initiated pilot procurements under the PPL.

Once the municipalities become financially independent of the State budget, it is arguable that these municipalities will no longer be subject to the PPL since this, by its definitions, covers only budgetary institutions. The position of post-independent municipalities is very unclear. The definition of State funds in the PPL, as adopted, includes “non-budgetary funds of budget organizations and other funds recognized by legislation as state funds,” but this would not appear to resolve the uncertainty. This is another specific case of confusion about the coverage of the PPL, and the CPAR has recommended that the definition of procuring entity be amended to define the position clearly (see also 1.4 above and Entity Coverage in Annex II).

### 5.2 State-owned Enterprises and Utilities

There are a number of State-owned enterprises (SOEs) operating in Azerbaijan, mainly in the utilities sector. Many are 100 percent State-owned but a number have a more limited State participation. Where the State participation is less than 100 percent, these companies are commonly referred to simply as joint stock companies (as is correct, for that is what they are). The Law on Enterprises properly defines a joint stock company as one which provides that the liability of shareholders is limited to their share participation (regardless of whether the stock is State-owned or not). Only entities in which the State owns 100 percent, are referred to as SOEs. However, in terms of terminology actually in use in Azerbaijan, reference to joint stock companies would, confusingly, seem almost always and only to refer to companies in which the State holds a less than 100 percent shareholding, although this is clearly not the case in reality.

#### 5.2.1 Legal Status of SOEs

Unlike other forms of corporate entity in Azerbaijan, such as the joint stock company, there is no Law or other legal provision which either defines or regulates 100 percent State-owned enterprises, although their existence is recognized in the Law on Enterprises. This is at least partly due to the fluidity of the transition period from the Soviet regime to the Azeri market economy, but the result is to keep in place a legal entity which is largely unregulated, save that it is subject to its own Charter. Historically, these companies have tended also to be the regulators in their own spheres of activity. Thus, for example, the Caspian Shipping Company is both the major operator of water transport services in Azerbaijan and also the authority with the duty to license other water transport companies. The same was true for the State oil company (SOCAR), although this situation may change as a result of the creation of a new Ministry for Fuel and Energy, which also now takes on the political/regulatory functions of Azerigaz and Azerenergy, the State-owned monopoly providers of gas and electricity.

A number of these State-owned enterprises are self-financing and their funds are, therefore, extra-budgetary. They tend to be strong and powerful companies. Despite their ostensibly private
nature, the chairman/director is generally nominated by the President and the company’s Charter is approved by the Council of Ministers. The deputy directors are nominated by the chairman/director with the approval of the Council of Ministers. There is some confusion as to their exact status but the members of the board of the Caspian Shipping Company, for example, consider themselves to be government officials.

There is also some confusion with respect to the status of internal organizations. Most of the State-owned enterprises are divided into a number of departments or units and have a number of subsidiaries. In practical terms, these units may perhaps best be described as separate cost or budget centers which are regulated by the central administration. In some cases, these “subsidiaries” have been corporative; in others, they have not. In all cases, however, the status of these internal organizations is wholly unclear, especially since they are, almost without exception, considered to be separate legal entities. Since they do not fit within any definition of legal entity contained in the Constitution or Law on Enterprises, they are not legal entities in the same way as companies defined in that Law. On the other hand, they are clearly treated as such by the organizations themselves and, indeed, in some cases are also self-financing. Notwithstanding the claim that they are separate legal entities, the relationship between these entities and the “parent” State-owned enterprise is not governed by contract. They are treated in exactly the same way as departments of a ministry, for example. This structure is undoubtedly the result of the transition from the Soviet “apparat” to market economy and there are no signs that this fluidity will be remedied quickly.

5.2.2 Procurement by SOEs

Confusion over the status of the State-owned enterprises leads to similar confusion over their procurement practices. The Caspian Shipping Company, for example, considers that, because it is entirely self-financing, it is not subject to the previous Law on Tenders, notwithstanding the State’s 100 percent ownership of it. It considers itself not to be a budget organization and that, as such, it “may” apply the Law on Tenders. This optional use of the Law appears to result from the original Law on Tenders which was curiously drafted so that the use of open tender was not an obligation but a right (notwithstanding the provisions of the Presidential Decree making it obligatory). This optional use of tender procedures is no longer the case under the PPL and an entity is either covered by the PPL or it is not. If it is covered, then it must comply with the prescribed procedures. But the position of SOEs is uncertain and certain SOEs clearly do not consider themselves subject to the PPL (see Annex II, Entity Coverage).

In respect of the Caspian Shipping Company, its requirements for materials and spare parts are largely satisfied by its subsidiary factories. Its contracts department carries out all procurement (for electrical devices, uniforms, fuel, lubricants and so forth) on the basis of its own market searches and by using personal contacts. It does not procure by tender. The value of such contracts was not disclosed to the CPAR team as it is considered a commercial secret. On the other hand, the company did suggest that its purchases were of low value falling below the relevant threshold and that there has been no attempt to aggregate smaller contracts. It considered that the purchase of vessels would have been subject to the Law on Tenders and, presumably, is now subject to the PPL.

In contrast, SOCAR, responsible for oil extraction, would appear to consider itself generally subject to the Law on Tenders. Within SOCAR, its procurement functions are divided into those for imported and those for local goods. All purchases which need to be imported (mostly commodities) will be dealt with by the department of foreign economic relations. The supply departments will determine, on the basis of local market research and Internet searches, whether
to advertise locally or internationally. In all other cases, each of SOCAR’s seven subsidiary production units (on-shore and off-shore extraction, design and construction, refinery production and three other production units, employing in total some 70,000 people) has a department for purchase and supply. These purchase local goods needed for the oil operating activities such as rigs and associated equipment. For both types of procurement function, where contracts are below AZM 250 million, they will follow their own procedures. Above AZM 250m, they procure by tender. In the case of subsidiary companies and in the event of a need to import products, a representative of the department of foreign economic relations will be a member of the TC. In the case of procurement of domestic goods, the units and subsidiaries will seek the approval of the central administration before making the purchases (based on an annual estimate of needs submitted to the supply department) and a representative of the relevant department (each unit is responsible to a specific central department) will be invited to sit on the TC. The beneficiary unit will set the technical specifications. The relevant department will authorize the ultimate contract.

Likewise, Azerigaz, another wholly State-owned enterprise, also considers itself subject to the Law on Tenders. This company provided a service to the public in the field of the extraction, transport and distribution of natural gas. It is also divided into a number of units, most particularly the transport subsidiaries which are responsible for maintaining the pipeline network and the self-financing regional maintenance departments which receive the gas and undertake distribution. There are also a number of repair and maintenance companies which are currently in the process of being corporative and may act as subcontractors to other organizations such as SOCAR. When carrying out work for Azerigaz, these companies are clearly paid something but there is no contract and the amount paid is less than the going market rate. In this capacity, they are treated as internal works departments.

Unlike the case of SOCAR, Azerigaz procurement is controlled from the center. In the case of low-value supplies where no tender is required, procurement may be made by these units against a procurement plan approved by the president of Azerigaz. Where the AZM250m threshold is exceeded (generally in the case of large-scale projects funded by the government budget), the President of Azerigaz will authorize the procurement and establishes the TC for all of the units. Members of the TC will be the heads of department of the central apparat (e.g. gas maintenance department, planning department). The TC makes the final award decision which does not need approval of the President. The contract will be signed by the beneficiary unit.

5.3 Budget Allocation

The Budget Department of the MOF is responsible for budget appropriations and for preparing the annual budget based on an MOF order each February. The department is organized in a number of divisions which are responsible for sectoral activities and which collect data pertaining to the relevant sector activities. These divisions collect budget requests from each of the relevant line Ministries and central government departments. There are also different divisions which are responsible for the various hierarchical budgetary institutions such as the local government departments (for example, the local office of the Treasury or the financial departments of the Executive Powers). These are not further sub-divided by sectoral activity and collect aggregated budget estimates from each region or municipality (at least, while they still receive budget funds). These report to the sectoral divisions who collate the information for the purposes of the budget. It is not clear, however, how the sectoral divisions are able to allocate the local budgets by sector for the purposes of the annual budget which is drafted on a sectoral, rather than institutional, basis. Based on the data collected by June, draft budgets are prepared and submitted to the Cabinet of Ministers in order to bring the overall budget into line with the perceived needs of the country. The final draft is submitted to the President in September.
As is indicated in the discussions above on reporting and below on public sector management performance, the relative opacity of the budgetary system in relation to public procurement spending makes it difficult to paint an accurate picture of the precise levels of spending and of the identity of the purchasers.

5.4 Treasury and MOF Involvement

The Treasury is the implementing arm of the MOF. Whilst the Budget department is responsible for setting policy and establishing the budget for the budgetary institutions, the Treasury is responsible for expenditure and for transferring funds.

There is a two-stage control by the Treasury following budget allocation, (1) a contract-by-contract control under which the prices bid are compared to some “average market price” and rejected to the extent that the successful bid price exceeds the hypothetical market price, and (2) a further total budget control to ensure that the value of all contracts let in any one budgetary year does not exceed the budget allocation for that year. The first of these controls should be abandoned.

These appear to be the only controls by the MOF, other controls present during the Soviet era having been abolished as part of Government’s strategy to reduce obstacles for private sector development. A Presidential Decree was issued in late 2000 abolishing all internal inspection/control departments in the ministries, except for the financial control and internal audit department (KRU) in the MOF. It was felt that these departments unduly harassed the budget organizations and companies under their jurisdiction, leading to both widespread inefficiencies and corruption. The role formerly played by these departments in terms of monitoring compliance with fiscal requirements was taken over by the tax inspectorate, and in terms of compliance with accounting rules and regulations was assumed by KRU in the MOF. The KRU does not appear to involve itself in auditing the procurement function.

5.4.1 Use of “Average Market Price”

Once the TC has decided on the award of the contract and has proceeded with the signature of the contract, a package of documents needs to be sent to the Treasury department of the MOF. This package will include the bid documents, the minutes of the TC meeting making the award of the contract and a copy of the signed contract. The MOF will then consider the “appropriateness” of the contract, with particular reference to the payment terms. However, in looking at “appropriateness”, the MOF will also consider the price to be paid. In the food sector, the Council of Ministers has established a special commission which identifies the quality and price of different food products on a quarterly basis. To the extent that the price included in the contract for a food product exceeds the price indicated in the Council of Ministers’ list, the Treasury will not agree to pay. According to the Treasury, there are no other such price lists (although other institutions, such as the State Construction Committee, may maintain their own list to create, for example, schedules of rates). There is also a State Statistics Committee which maintains a consumer/retail price index and a production price index. It is not at all clear to what extent the Treasury has recourse to such indexes.

Even outside the food sector, the Treasury remains concerned with overpayment. In cases of procurement for products other than food, the Treasury will seek to identify the “average market price”. It will do this by way of informal market survey as well by looking at prices paid in previous contracts, especially in the case of consumer products such as vehicles. It will even contact known dealers by telephone, for example. If it discovers that the lowest price offered (and
accepted by the TC in its *signed* contract) substantially exceeds this supposed "average market price", then it will simply refuse to pay, i.e. transfer the relevant budget to the procuring entity which, in turn, will be unable to honor its contractual obligations. Where the Treasury does approve the contract, it will issue a document approving the expenditure which is attached to the contract and returned to the procuring entity.

It should be added that, in the autonomous Republic of Nakchevan, the price of goods, works and services are set in accordance with a price list set by a special commission of the Nakchevan Ministry of Finance. The prices are reviewed every quarter. The price list is used as a guide on prices when the TCs submit their recommendation for a "no objection" clearance from the Nakchevan Ministry of Finance.

This practice of estimating an abstract (however well researched) average market price, following and despite the results of a competitive bidding procedure,—common in many transition countries not only in Azerbaijan—is of considerable concern and demonstrates a lack of understanding of a competitive procurement system. The prices offered as a result of an open tender, for example, are the market prices available to the procuring entity. It may be that similar products are available in the retail market for different prices but the bid prices will be the market prices available in the case of and under the terms and conditions offered by a public purchaser. To arbitrarily decide otherwise, as the Treasury seeks to do, is to undermine the competitive bidding system. Once tenderers realize (if they have not already) that their best and final offers will not be accepted, they will have no reason to provide such offers.

Of course, if all the bid prices offered exceed the budget allocated, then all the offers may be rejected. But that is a simple calculation to make and should be made, in any event, before a contract is signed. However, there does not appear to be a systematic mechanism for estimating the price of proposed contracts. Nevertheless, procuring entities as well as the MOF seem to believe that they are able to estimate market prices accurately and tend, as a result, to compare bid prices with their abstracted average market prices which are sometimes wildly divergent. More often than not and in the absence of any compelling evidence to the contrary, this is the result not of inflated bid prices but of an inability to estimate prices correctly. Where the estimated contract prices are used to set in stone the allocated budget, problems will invariably arise. The problem is not with excessive bid prices but with unrealistic estimates and this issue needs to be tackled.

**Recommendation:** The MOF should be encouraged (1) to reject tender prices only when they exceed the allocated budget and *not* when they differ from their own arbitrary average market prices and (2) to develop and put in place a budget allocation system which is based on realistically estimated prices with a degree of flexibility. See also the recommendation in Annex II, Estimated Prices.

Though frequent in practice, it appears that this process of refusing to honor signed contracts is largely accepted (though not happily) by the bidders. Nevertheless, the Treasury has stated that some bidders have taken procuring entities to court for failing to proceed with the signed contract and that, moreover, some court decisions have been in favor of the bidders. No records have been kept of such actions and no figures are available. This is consistent with the Civil Code which, by Article 17 requires state bodies to respect civil rights, including rights arising under contract. Under Article 399 of the Civil Code, an agreement becomes effective and binding on the parties from the moment of its conclusion and, under Articles 405 et seq., an agreement is concluded once an offer has been accepted.
The CPAR finds that this use of “average market price” is wholly unsatisfactory because it means the Treasury is unnecessarily placing procuring entities in an unlawful position. Article 40.8 PPL does provide that, if the solicitation documents stipulate that the contract is subject to approval by a higher authority, the procurement contract shall not enter into force before approval is obtained. This provision requires additional foresight by the procuring entity and, in any event, does not resolve the underlying problem (i.e. the attempt to replace actual market prices with a fictitious estimated market price); it merely seeks to protect the procuring entity from the legal consequences of an economically unjustified interference by the higher authority.

**Recommendation:** The MOF should take note of its responsibilities and the legal consequences of its actions under the Civil Code and discontinue the use of “average market prices” in refusing to honor signed contracts.

The Treasury is currently in the process of automating its management systems and is implementing a Treasury Information Management System (TIMS). As part of this modernization, it appears that the Treasury will recommend a condition in the contract that it will be subject to Treasury approval. There was even a suggestion that it would act as co-signatory. If this were merely a formality making the MOF liable in law to make payments for services rendered, it would not be objectionable. However, if it implies any further involvement of the MOF in the decision-making process, it would constitute a backward step from the process of decentralization of the procurement function and, as such, would not receive the support of the Bank. **The CPAR, therefore, recommends** that the MOF does not become a co-signatory.

### 5.4.2 Control of Total Spend

A further budgetary control exercised by the Treasury is over the total spend of any given procuring entity. Based on their estimated spend on each proposed contract, each procuring entity will be given a total annual budget allocation. The procuring entity may not exceed that total budget, even if, in the case of any particular contract, the budget is exceeded. As a result, where the contracts let in the first part of the year exceed their estimated budgets (but are nevertheless approved by the Treasury under its contract-by-contract approval system), the approval will cease at the point at which the value of a later contract exceeds not its own estimated value, but the total budget available. No contracts will be authorized for the remainder of the budget year. There appears to be no facility for increasing the budget including, it is believed, to cover increases in costs following change orders.

### 5.5 The Conduct of Procurement

Given that the existing procurement rules have only been in place for three to four years and that the government’s budget (as opposed to contracts funded externally and, therefore, more often than not, subject to different procurement rules) rarely allow for contracts above the thresholds, it is not surprising that there is little practical experience of competitive procurement. Further, despite the existence of the previous legislation, it is clear that it is the importance being attached to the new PPL by procuring entities that is encouraging a desire for compliance. Many procuring entities are only now beginning a process of compliance with the PPL and initiating procedures compatible with it, including the setting up of appropriate TCs.

Having said that, a number of procuring entities clearly do have some experience of competitive procurement. There is quite different experience between the capital and surrounding municipalities and the provincial authorities.
5.5.1 Baku and Environs

From those procuring entities interviewed by the CPAR team, it appears that the system adopted in practice is widely recognized and consistent. Once the budget has been approved, the head of the procuring entity will issue an internal order/directive setting up the TC and naming its members. In many cases, the TC will include the deputy head of the procuring entity or other senior management (who will chair the TC), along with technical and, sometimes, legal experts from the entity itself. External advisers are also occasionally used. Membership of the TC is generally around seven or eight persons, although this can increase to up to 20 in the case of large or particularly important contracts. It is then the TC that prepares all the relevant documents, including the advertising, and processes the bids.

Members of the TC are generally taken from the staff of the procuring entity. It is possible that the same individuals act on different TCs but there appears to be no systematic procedure for either using experienced people, training them specifically in procurement or developing and maintaining procurement expertise within a procuring entity. On the other hand, a number of entities do have purchase and supply departments where such experience can be fostered and some have already launched a series of training seminars with the assistance of the SPA. However, it is too early to say that there is a distinct class of procurement professionals (see also C.3.6, Training).

In open procedures which appear to form the majority of procedures above the thresholds, there will invariably be a formal bid opening. In terms of advertising, it appears that there is no central publication in which potential contracts can be advertised. Procuring entities have a choice of suitable newspapers, although the most popular would appear to be Respublika, published in Baku which carries much government-related information. It would also seem to be a common practice to send tender documentation, after the advertisement, to known bidders.

Where a restricted procedure is used (and this is, apparently, quite rare), invitations to bid are generally sent to known suppliers and contractors. These are known generally as a result of having performed contracts previously and appearing on a roster or list of suppliers/contractors. These are not formal lists and are not compiled on any formal basis requiring the attainment of any qualification criteria. Below the thresholds, the common practice would still appear to be to conduct some form of market search, though this is far from formalized.

Standard form tender and contract documents have only recently been prepared (not surprising, considering the 1996/97 date of the first legislative provisions on procurement) and the procuring entities have largely been depending on their own versions, some of which had presumably been adapted from documents supplied by international lending institutions.

It is the TC that carries out all the steps in the procurement procedure from preparing the tender documents to making the award decision. The practice for signing the contract does seem to vary, however. In some cases, it is the head of the procuring entity that signs the contract, in others, the chairman of the TC acting as the delegated authority of the head of the procuring entity. In all cases, the signed contract together with the minutes of the TC meeting making the award decision will be sent to the MOF for approval (see also C.3.8, Reporting).

One procurement practice which appears to be widespread is the practice of aggregating various procurements into one announcement. For example, the Ministry of Education conducted one tender and made one announcement in 2001 for the purchase of textbooks to the value of AZM 1.6 billion. These were effectively divided into lots of AZM 200m, 189m, 547m, 633m. The
contracts were split between “four of the nine successful tenderers” although it is not clear whether this was based on the lowest price for each lot or whether the contracts were divided in some other way. This may well be the result of the PPL’s Article 24.1.6 which provides for the division of contracts, not based on the award of contract lots. This is not a recommended procedure. Nevertheless, the value of competitive bidding was clearly recognized because the estimated cost of these lots prior to bidding was in the region of AZM 2.5 billion.

Whilst the aggregation of contracts for the supply of textbooks would appear logical, this may not always be so. The municipality of Sungayet, for example, has simply aggregated a number of disparate procurement requirements in order to conduct their first tender under the new PPL. By doing so, the municipality is able to bring the value of a contract (albeit a number of lots) above the AZM 250 million threshold for the first time thus allowing it to rely on the provisions of the PPL. Of course, the threshold is meant to be only an indicator of when they must apply the Law whereas they may use its provisions at any time. Nevertheless, procuring entities are just beginning to use and understand the Law, and the attempt to aggregate contracts with a view to exceeding the threshold is a positive indicator of commitment and, obviously, far better than the reverse.

5.5.2 Provincial Authorities

As is perhaps to be expected where funds are limited, the experience of the provincial authorities with the public procurement legislation is more mixed and, certainly, more limited. That is not to say that there is no procurement conducted under the legislation, but the number of contracts exceeding the threshold is limited, mainly due to a lack of investment available at local level. Though the heads of the finance departments of provincial authorities would appear to have taken steps to inform all authorities of their obligations under the new legislation (PPL), information is generally scarce and formal procurement is a new skill. Although the need is recognized, very little local experience exists and, for the moment, all procurement will be carried out with the help of the experts in Baku (SPA and others).

There is no evidence of historical formalized tendering procedures but there are strong indications that the PPL is known and of a willingness to comply. In two of the provinces investigated (Ganja in the Northwest and Lenkaran in the South), there are examples of procurement by the local health departments under the PPL. However, the value of the packages to be procured would appear to be below the AZM 250m threshold which, as above, indicates a strong willingness to comply and to gain experience of the new procedures.

The autonomous Republic of Nakchevan is in a slightly different position since it also plays host to a branch office of the SPA (which will, in future, become an independent agency). There is evidence of at least 11 procurement exercises having been conducted under the previous legislation (even though the value of the procurements was below the AZM 250m threshold), at a time when the SPA could itself be represented on the TC, and it would appear that SPA was indeed actively involved in the procurement exercises. The participation of the SPA branch office took place before the promulgation of the new PPL which does not provide for the participation of, at least the principal office of the SPA in any TC. The position of the Nakchevan branch of the SPA, as future independent office, is unknown.

Whilst this is positive in one respect, namely that the local authorities were given the benefit of the SPA staff’s greater expertise and familiarity with procurement law and procedure, it also has a potentially negative effect: Active participation of any body in the decision-making process makes that body responsible for the outcome and the role of procuring entity and overseer must
be kept separate. To the extent that there is a complaint (whether founded or not) that body would, apart from a purely internal administrative review, be excluded from participating in any external review. Given that the SPA is, in fact, the second level review body in cases of infringement of the procurement legislation, this would effectively prevent any review by the SPA. Whatever the actual probity and objectivity of the SPA, the appearance of a body being a judge in its own cause is sufficient reason to abandon SPA’s participation in the review procedure. It is unlikely that tenderers would have confidence in such a system. The SPA is also very well aware of the invidious position in which such a dual responsibility would put it and is in favor of keeping these roles separate. To the extent that the SPA’s branch office in Nakchevan continues to be involved in the decision-making process, this practice should be terminated as soon as is practicable.

With the assistance of the SPA branch office, procurement in Nakchevan has followed a consistent course through the following steps.

1. The procuring entity obtains a letter of authorization from the SPA branch office to proceed with procurement;
2. Invariably because the procurement is small in value and is for goods which are of a repeat nature in the form of standard food, medical supplies and such like, the solicitation document is based on a standard request for quotations;
3. The procuring entity convenes a meeting to appoint and confirm the procurement/tender committee, which consists of three or four personnel selected for their knowledge of the subject of the particular tender. One member of the committee is from the Nakchevan Ministry of Finance;
4. The Invitation to Tender (RFQ), clearly indicating the substance of the tender, is prepared and confirmed by the procuring entity;
5. The deadline for submission and bid opening dates are agreed upon;
6. Tender documents in the form of standard quotation documents and Form of Agreement are dispatched to all tenderers;
7. When bids are received they are held under lock and key;
8. The bids are formally opened;
9. Minutes of the Tender opening are prepared;
10. The committee then evaluates the tenders, technically and commercially;
11. Recommendation for award is based on lowest economic compliant bid;
12. The committee submits their recommendation to the Nakchevan Ministry of Finance special committee for no objection;
13. The award is made by the procuring entity;
14. The successful tenderer is informed of the award;
15. The procuring entity signs the contract;
16. The Final minutes of meetings are prepared and sent to the MOF and the SPA.

There is little doubt that the provinces require significantly increased information and training in order to prepare them for the full application of the PPL. As a result of the limited funds available to the SPA and despite its best efforts, training by the SPA has tended to be concentrated around Baku. Since this is where most of the larger value contracts will be let, this makes the most of the available funds but there is a danger that many procuring entities will be left without sufficient training and knowledge of the PPL and of the procurement procedures it imposes. Further financial assistance needs to be provided.
C.6 Public Sector Management Performance

6.1 Procurement Expenditure for 1995-2000

General data for the budgetary years 1995-2000 is available but is not broken down sufficiently to provide accurate information indicating procurement information. The data represented below has, therefore, been extrapolated from the available figures. The Government has prepared a new Budget Systems Law (BSL) which has been reviewed in detail by the IMF. The Law is intended to set the stage for major improvements to the budgetary process, clearly delineating the core responsibilities of the Treasury, establishing a clearer delineation of state revenues as well as separating general government from the non-government sector, including state-owned enterprises (SOEs). The budget preparation process is intended to have better strategic priority setting and involvement of line ministries, executed according to a detailed budget calendar and a comprehensive list of documents to be submitted with the draft State Budget to the Parliament. Enactment of the BSL was a core policy action required prior to Board presentation of SAC-II. It is, however, too early to tell whether the new BSL will have a significant beneficial effect on the identification of procurement expenditure.
6.1.1 Goods and Services

In the case of item (1), there is clearly a need to break down the figures further in order to extract expenditure figures for goods and services which would be subject to the PPL. These figures also contain a small element of works, namely current repairs on buildings. A further difficulty with these categories is that, in addition to including purchases of electricity, gas and water (which, under the definitions of the PPL would, were there competition in these sectors, be covered by the PPL) they contain a number of disparate services which are difficult to identify. Nevertheless, it is possible to make a breakdown for these broad categories of goods and services on the basis of the available figures.

6.1.2 Capital Expenditure

Item (4), capital expenditure, also poses a similar difficulty in that this heading contains expenditure both for capital goods and capital works. The available data for the years 1995-2000 do not contain a sufficiently detailed breakdown to enable an accurate distinction to be drawn between the goods and services (as well as other items not subject to the PPL) contained in this heading. Nevertheless, the data for the planned 2001 budget does contain such information. In order to provide some yardstick by which to estimate historical expenditure, therefore, the percentage of the capital expenditure applied to goods and works contracts, respectively, as total of capital expenditure for the planned 2001 budget, has been applied to the previous years. Thus, in the planned budget for 2001, of the total funds to be spent on capital expenditure, 64 percent was to be spent on the procurement of works and 4.6 percent on the procurement goods. The results of this extrapolation cannot, of course, be considered as accurate since it assumes a constant level expenditure throughout all the previous years despite the fact that the percentage of the budget spent on procurement contracts has been decreasing. However, it does provide an appropriate yardstick for comparison purposes.

6.1.3 Estimate of Overall Public Sector Procurement

In order to present a realistic, if not entirely accurate, picture of procurement expenditure, the CPAR team conducted an estimation involving a breakdown of data for all eight categories by type of contract (goods, works and services), seeking to exclude obviously non-procurement items, in order to provide more pertinent data. This also involves breaking down into goods and works, the items under capital expenditure (by applying the percentages derived above). This exercise yields Figures 3 and 4, the first in value terms, the second as a percentage of the total annual budget.
6.2 **Procurement Expenditure for 2001**

![Diagram](image)

Budgeted expenditure on goods, works and services foreseen for 2001 is displayed in Figure 5. These figures are again broken down in a way which seeks to reflect the expenditure on goods, works and services under item (1) in the budget and on works and services under item (4).

### 6.3 Competitiveness of Procurement

The biggest difficulty with providing complete data on procurement expenditure arises from the fact that the state budget provides information only on procurement contracts funded by the consolidated budget (central and local). It does not provide information on expenditure financed through extra-budgetary resources used to fund many government departments, local administrations and State-owned enterprises. Whilst disposal of such funds also requires adherence to the PPL, there are no figures available for the total value of these funds, although, as will be seen below, there are figures for the value of contracts funded through extra-budgetary resources which have been let pursuant to the PPL.

The SPA has, in its 1999 and 2000 annual reports, provided some basic information on tendering through budgetary funds. Whilst there are also figures for the value of contracts awarded by tender from extra-budgetary funds, the absence of the total extra-budgetary funds available means that it is impossible to calculate what percentage of these extra-budgetary funds are spent in accordance with the existing procurement laws.

In terms of value, Figure 6 represents the procurement contracts let by tender.
In percentage terms and for budgetary funds only, Figures 7 and 8 show the percentage of budget financed contracts which were let by tender.

One final difficulty with these later figures is that they refer to contracts let by tender. What is not clear is whether that refers to open tendering procedures or also to any other forms of tendering such as restricted procedures, RFPs or single-source procurement. A further breakdown of the various tendering procedures within these figures would be required or, where the reference in the reports is only to open tendering, additional figures for the other forms of tendering foreseen in the existing legislation. The SPA must hold this information. Both the PPL and the existing legislation require procuring entities to seek the approval of the SPA before using any form of tendering other than open tendering—to do so without their approval is an infringement of the existing laws. If SPA does not have the date, then it is clear that either (1) the procuring entities are not in compliance with the existing laws or (2) there are inadequate reporting or data collection and retrieval systems in place.

C.7 Performance on Bank-assisted Projects

This section reviews the quality of the government’s conduct of Bank-financed procurement in terms of its adherence to Bank fiduciary requirements. It identifies the major problems and lessons learned from past implementation and recommends measures to be instituted to strengthen procurement portfolio management arrangements. In addition, it provides a basis for decisions on the level of intensity of supervision over Bank operations, including whether and to what extent the Bank’s fiduciary responsibility for procurement can be delegated to field offices. Last, this section serves the purpose of identifying those areas where national procurement procedures are suitable for procurement under Bank financing.

7.1 Development of the World Bank Portfolio

The Bank’s main focus in Azerbaijan has been in providing policy advice, financing for both investments and the government budget and coordination of aid. Specifically, the Bank’s development strategy has been to promote a radical reform of public sector institutions and improved governance, to strengthen the regulatory and business environment for sustainable private sector development (with particular emphasis on non-oil sectors), and to invest in social development. The vast majority of the credits (twelve in all) are investment projects in the energy, environment, social, agriculture, culture and infrastructure sectors. The remaining four are adjustment projects (see also Annex I).
7.2 Common Problems and Lessons Learned

Based on Country Portfolio Performance Review: The overall performance of the portfolio has returned to satisfactory after a worrisome performance in 2000-2001, when the Bank declared misprocurement in three instances (in Education Reform, Gas Rehabilitation and IBTA-I). The December CPPR indicates that nine out of 10 active projects in the portfolio were rated satisfactory in terms of procurement performance.

Based on Post-Reviews: During the period 2000-2002, the Bank carried out a very limited number of Post Reviews of projects in Azerbaijan (two contracts under the Financial Sector TA project, 4 under IBTA and 5 under the Pilot Reconstruction Project) and found no non-compliance with the Bank’s procurement guidelines. However, based on feedback from the task teams, it is apparent that contracts subject to post review are frequently submitted to the Bank for prior review. This appears to indicate that procurement capacity in the PIUs is weak and that many of the PIU staff do not feel comfortable dealing with Bank procurement procedures and are not empowered to make decisions.

Based on Independent Procurement Audit: The auditor completed his fieldwork in Baku on May 10, 2002. The audit report, dated June 2002 identifies the following common operational issues related to procurement:

1. Lack of procurement planning: except for the initial Procurement Plan as presented in the Appraisal Document, four of the five projects reviewed (Gas Rehabilitation, Pilot Reconstruction, Education Reform, IBTA-I) did not have updated annual procurement plans. This lack of procurement planning has in all cases resulted in ad hoc procurements, non-competitive procurement methods and higher prices.

2. Serious lack of procurement expertise and capacity in project PIUs specifically with respect to conducting NCB and ICB. The overuse of IS and NS has not helped in building capacity in applying more complex methods. This has led to lengthy evaluations, inappropriate decisions and undue delays in contract awards.

3. Insufficient attention is given to contract administration, specifically of works contracts. In almost all works contracts reviewed, there was little or no supervision of the construction activities resulting in poor workmanship as well as use of low quality materials in the construction.

4. Poor record management. The review pointed out that all projects had difficulty procuring some of the files requested for review.

5. Changes in staff of Bank task teams combined with limited basis procurement knowledge of the task team leaders has led to inconsistencies in Bank replies/no-objection letters.

Based on meetings of the CPAR mission with PIU staff, the following main problems or weaknesses were identified as affecting efficient procurement of Bank financed contracts:

1. Taxation/customs clearance procedures: There is a clear policy on taxation (Tax Code) and customs duties (Customs Code) for Bank-financed projects (see C.12.4 below). The process is not always known to tax and customs officers and there are no clear and transparent procedural arrangements in place on how to apply the policy. The result is an
Findings—Public Sector: Performance on Bank Projects

2. Interference of the SPA in tender committees: this will no longer be the case since SPA membership of TCs is no longer provided for under the new PPL.

3. Problems with the technicalities of bid securities: Several local banks are not familiar with issuing bid securities and they often adjust the Bank’s standard forms, thereby making the security unacceptable. In addition, some banks are still using an old version of the standard bid security form from the goods document. This has frequently resulted in rejection of otherwise acceptable bids. There is a need to standardize local forms and train banks.

4. Insufficient knowledge by PIU staff of contracting concepts such as joint and several liability. There is a need for training of PIU staff.

To ensure closer monitoring by Government of the Bank financed projects and closer cooperation between the Government and Bank teams, the following initiatives were agreed upon at the CPPR meeting:

1. A working group, consisting of PIUs and representatives from the respective line ministries will hold regular meetings with the deputy prime minister and the World Bank to address issues (including procurement) arising during project implementation;

2. In order to address MOF’s interest in more involvement in project implementation, Government agreed to establish clear reporting procedures for the PIUs to inform the MOF of the implementation status of grants, credits, PPFs and other donor-funded projects. The Bank will ensure that MOF receives adequate information and feedback on the findings of the supervision missions;

3. The Bank will improve its country focus in addressing procurement issues and ensure consistency and expedience of replies/no objections.

There is one additional issue which the Bank will need to bear in mind when financing construction related contracts. To be able to participate in Bank-financed procurement, firms, contractors and suppliers must be legally and financially independent from the State and operate under commercial law. However, the majority of “private” construction companies were former works departments of the various ministries (see C.9 below). In many cases, these retain a limited State participation and are sometimes owned by current as well as former government employees. In determining eligibility of contractors, therefore, the status and ownership of the tenderer would have to be looked at on a case-by-case basis bearing in mind the Bank’s requirements.

7.3 Local Procurement Capacity

Currently no procurement capacity exists in the Bank’s Baku office and procurement for all projects is handled from headquarters. The Bank is in the process of hiring an international procurement staff member, to be stationed in Tbilisi, Georgia, who would be responsible for providing a wide range of procurement services for projects in the three Caucasus countries. To improve local procurement capacity, the CPAR recommends training several of the project
officers in the Baku office in order for them to obtain a basic understanding of the Bank’s procurement requirements.

Procurement under Bank-financed projects is carried out by project implementation units (PIUs), most of which are established as independent legal entities. Although it is suggested, and confirmed by the Government at the CPPR meeting, that beneficiary line ministries are the appropriate implementing bodies, very few PIUs currently consist of staff of the relevant beneficiary line ministries. To allow phase-out of independent PIUs, the CPAR recommends having civil servants from the line ministries cooperate with some of the existing PIUs on simple procurement tasks in order to promote a gradual transition from independent PIUs to implementing entities within the line ministries, thus building capacity to conduct procurement within the beneficiary ministries. Line ministry employees could start by attending some of the SPA training to familiarize themselves with procurement concepts. In addition, international procurement experts hired to assist the PIUs could be tasked with training line ministry staff or alternatively, could advise the line ministry PIUs instead of the independent PIUs. Such transition will, of course, require a change in the roles, organizational structure, and accountability frameworks of the public entities involved. Independent of the status of the PIUs, serious training of PIU staff in Bank procurement is a must for every new project.

7.4  Recommended Supervision Approach

7.4.1  Thresholds

The following financial thresholds for procurement methods are recommended for Bank-financed procurements:

Table 2. Thresholds by Procurement Method.

<table>
<thead>
<tr>
<th>Procurement Method</th>
<th>Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICB: Works</td>
<td>&gt;US$ 600,000</td>
</tr>
<tr>
<td>NCB: Works</td>
<td>&lt;US$ 600,000</td>
</tr>
<tr>
<td>Minor Works</td>
<td>&lt;US$ 100,000</td>
</tr>
<tr>
<td>ICB: Goods</td>
<td>&gt;US$ 100,000</td>
</tr>
<tr>
<td>International Shopping: Goods</td>
<td>&lt;US$ 100,000</td>
</tr>
<tr>
<td>National Shopping: Goods</td>
<td>&lt;US$ 50,000</td>
</tr>
</tbody>
</table>

For the future, in regard to goods for which a sufficiently competitive supply market exists in Azerbaijan and for which foreign firms would not be interested in bidding, the Bank may consider, on a project-by-project basis, the procurement of goods by NCB below a threshold of US$100,000; above this threshold, ICB would apply for such goods.
Based on the relatively low level of development of the Azeri consulting industry, it is recommended to establish $100,000 as the national threshold below which shortlists for consulting firms may consist entirely of national firms.

7.4.2 Prior and Post Review

The Bank should conduct prior review on:
- all contracts for goods and works procured by ICB;
- the first two to five contracts for goods and works procured by NCB (may be modified depending on the nature, number and size of contracts);
- contracts with consulting firms >US$100,000; and
- contracts with individual consultants >US$50,000.

The Bank should also conduct post review on at least one in five of contracts that are subject to post review. An appropriate frequency to include a procurement accredited member of staff in Bank supervision mission would be once a year.

7.4.3 Strategy for Fiduciary Safeguards

The fiduciary risk for Bank portfolio in Azerbaijan continues to be high. The overall weak procurement environment raises concerns about the value of money and accountability for public funds, especially because the PPL is still new and procurement practices are in the early stages of transition to efficient procurement. The increasing shift in the World Bank’s new lending to adjustment lending and social sector projects, which involve thousands of small-value contracts at the sub-national government level that are generally not subject to prior review by Bank staff, and where capacity for implementation and monitoring is generally weak, would further increase fiduciary risks in Bank-financed projects.

Despite the Bank’s best efforts, it is simply not possible to fully insulate Bank-financed projects from the systemic problems of the environment in which they are implemented. Given the rating of Azerbaijan as a medium to high-risk country from a procurement point of view, the Bank’s strategy to help reduce further risk to Bank funds should be suitably cautious and include the following steps:
1. Building adequate safeguards for fiduciary risks, including actions to strengthen capacity of PIUs to conduct procurement and finalize procurement arrangements at an early stage, in the design of new projects.
2. Ensuring adequate procurement planning and establishing of procurement reporting systems at an early stage and requiring updated and satisfactory annual procurement plans to guide implementation and supervision.
3. Adding legal provisions to make the National Competitive Bidding (NCB) procedures acceptable to the World Bank. The current side letter on the acceptability of NCB procedures is being substantially strengthened based on findings of this report, for use in all future projects (see side letter in Annex V).
4. Following up on procurement complaints and procurement audit findings.
5. Relying on Corruption and Fraud Investigation Unit (CFIU) to investigate cases of alleged fraud and corruption, and apply sanctions where called for.
6. Exercising particular vigilance to prevent discrimination by Azeri implementing agencies against foreign bidders under all procurement methods, but especially NCB.
7. Exercise particular diligence in reviewing requests received from Azeri implementing agencies to award contracts on a Single Source basis.
8. Ensuring that procurement post reviews are conducted as per the provisions of the credit agreement and that the Back-To-Office report of the post-review supervision missions contains a specific annex dealing with procurement post review, which should be sent promptly to the Regional Procurement Adviser.
9. Supporting organization of business seminars to encourage Azeri industry to participate as bidders in Bank-financed projects;
10. Ensuring that staff other than civil servants from the beneficiary ministry who are appointed to PIUs are appointed following a competitive process and that they are properly qualified.
11. Keeping to a minimum, procurement by less competitive procurement methods, including International Shopping and National Shopping, for all new projects (both per contract and aggregate thresholds).
12. Requiring quality independent supervision of civil works contracts.
13. Placing an obligation on all implementing agencies, through Credit Agreements and/or Sub-Credit Agreements, to establish and maintain an asset register for all goods and works financed by Bank funds.
14. Conducting independent procurement audits every three years.

C.8 General Risk Assessment

Any assessment of risk in a country’s national public procurement system should be based on the stage of development of its legislative framework, the effectiveness of its regulatory institutions, the strength of its enforcement regime, the capacity of its institutional and human resources and the threat of corruption.

Legal Framework: With the introduction of the new PPL, Azerbaijan’s legal framework is in good shape. It is based extensively on the UNCITRAL model. The early drafts were discussed extensively with the Bank and many of the Bank’s comments were incorporated into the final text. There remain some minor issues which should be resolved but these do not affect the overall positive assessment of the PPL (C.1.4).

Regulatory Functions: These are vested in an appropriate institution (the SPA) which is staffed with competent and well-trained people. It has appropriate duties and powers and has shown a willingness to ensure compliance with the PPL. The only obvious weaknesses are the lack of adequate budget and the restriction on the number of staff that it may employ (C.3.).

Enforcement Regime: The PPL has set up a three-tier review system based on the UNCITRAL model. This consists of an internal administrative review, review by the SPA and judicial review. Perception of the courts’ ability to deal with procurement disputes is poor and under current conditions, judicial review is unlikely to prove to be an effective means of redress. The SPA’s current review procedure may be effective in the current circumstances but will fail, in the medium- to long-term, to provide a sufficient degree of confidence and transparency in the review process and is unlikely to be sustainable (C.3.7, C.4).

Institutional Capacity: Despite the SPA’s valiant attempts on its low budget to provide procurement training, there remains a concern that the training of procurement officers is inadequate and geographically uneven. Whilst some procuring entities do have purchase and
supply departments, staff who undertake the procurement task often do so without sufficient or any formal training. The country lacks a planned training system for procurement (C.4.5).

Corruption: Whilst the Government and its agencies do not recognize corruption as a problem at all, the private sector (domestic and foreign) has a strong and consistent perception that corruption is rife. To be fair, there have been few allegations of corruption specifically in the field of public procurement (though sufficient complaints of bias and favoritism towards former government departments now partially in the private sector); it concerns more the general perception of a culture of corruption which affects the business environment generally (C2).

Whilst the private sector perception of pervasive corruption and the performance on Bank-assisted projects are both serious concerns, the advanced state of the procurement law and the existence of an appropriate and competent regulatory framework mitigates in favor of assessing the environment for conducting public procurement in Azerbaijan as medium to high risk.

PRIVATE SECTOR

This section has a number of objectives. In the first place, it will consider the competitiveness and participation of the private sector in public sector contracts. Secondly it will examine performance in public sector contracting. Thirdly it will examine commercial practices as they relate to the public procurement system. This section will also deal, fourthly, with aspects of the business environment which may impact on the public procurement system. Many of the comments made in this section are based on extensive interviews with the private sector as well as with the public sector. The CPAR team recognizes that, from current experience in Azerbaijan, it is unlikely that the views of the private sector will be accepted by government representatives. However, whether they are accepted or not, it is only proper that they should be aired. If the views of the private sector should prove to be incorrect or unwarranted, then there may well be a problem of perception which will need to be addressed by the appropriate government authorities. The SPA can play a pivotal role in changing these perceptions through information dissemination and training (see C.3.3 and C.3.6 above).

C.9 Competitiveness and Participation

As is apparent from the country background and commentary above, Azerbaijan continues to face a number of difficulties. It is a country still very much in transition and, although there has been much progress, the pace of privatization and administrative decentralization is slow. These issues have a significant effect on private sector participation in public contracts.

9.1 The Construction Industry

9.1.1 Privatized Government Companies

There are a number of private construction and "maintenance" companies in Azerbaijan, many of which were formerly government departments or units which were corporative, turned into joint stock companies and then privatized. In some cases and depending on the level of transition achieved, these corporatized/privatized companies remain not only State-owned but also structurally dependent on certain ministries. This is particularly the case with low-cost construction and maintenance companies. For example, the State Committee for Water Use and Irrigation, unlike the gas and oil utilities which might be called public undertakings and clearly part of the State apparatus, remains a public body and continues to rely on some 100 regional
maintenance departments which, although in some cases privatized, are part of the structure of the Committee. They are, however, separate legal entities and, as in the case of other government agencies (e.g. the Road Agency) and the State-owned enterprises which have a similar structure, these maintenance companies may also enter into agreements with third parties (with farmers, for example, to provide irrigation).

Where these former maintenance companies have been properly privatized and are no longer part of the State apparatus, most of them retain a State participation of some 25 percent but this figure will vary. The subway construction company, for example, remains 100 percent publicly owned (by the City of Baku). The remaining stock is held by private individuals or current government and former government employees.

One example is Promstroi, the former State construction company which had previously been the Ministry of Industrial Construction (MOIC). In the 1970s, the MOIC, founded in 1957, created a series of departments each of which was assigned to a different Ministry (e.g. Agrastroi to the Ministry of Agriculture construction department; Glabakstroi to the Baku City construction department). Each of these companies tended, as a result, to be specialized in certain fields of construction (e.g. Promstroi in the construction of factories), although they have now considerably broadened their respective portfolios. In 1997, the MOIC was dissolved and many of these departments were corporative and eventually privatized. These companies together with the former and existing in-house construction companies of the Ministries and State-owned enterprises appear to constitute the bulk of contractors bidding for all construction works (usually low value) outside the oil sector. The highest value contracts tend to be in the AZM 1.5 to 2 billion range ($400,000 equivalent).

Other examples are Azerkendikinti, formerly part of the Ministry of Rural Construction (now with a 25 percent State participation) which, as its name suggests, concentrated initially on construction in rural areas, including processing factories, schools and hospitals but which has now expanded its portfolio; and Azerenergy construction, responsible in Soviet times for the construction of electricity plants in Azerbaijan and elsewhere in the USSR which is now a joint stock company in the sense understood by many, i.e. with a 51 percent State participation.

The problem expressed by many is that these former government construction companies are often seen to be preferred by public procuring entities, regardless of the merits of their bids, and tend to win a disproportionate number of contracts. No figures are available on the identity of the successful bidders in budget-funded construction contracts and this (rather strong and consistent) perception cannot, therefore, be verified.

9.1.2 Private Contractors

Whilst there is, according to a many procuring entities, a significant number of private construction companies (though not many have been discovered during this assessment), these tend to be much smaller and to compete for the lowest value contracts. This may be the result of the relative novelty of the market economy although many concerns have been raised that the bureaucracy involved in establishing and operating a private company (in terms of registration, licensing, spurious spot-checks and tax inspections) is such as to discourage the growth of the private sector in general, including the construction industry (see C.12 below). At the same time, the established construction companies complain about the high incidence of "briefcase" contractors, whose office is their briefcase. This would seem to represent two sides of the same coin.
Interviews with private construction companies indicate a distinct lack of interest in bidding for public contracts. This is not only evident in the construction industry but applies equally in the case of the private providers of goods and services interviewed. Apart from the general feeling that the result of public tenders is a foregone conclusion, those interviewed also expressed their concern that there is often little or no information available on upcoming tenders; that the tender advertisements are mostly unclear on the scope of works and assignments; and that technical specifications are often ambiguous. In addition, the Government has a reputation for paying late among the few private contractors that do exist, a further disincentive.

9.1.3 Construction Demand

In terms of demand, the Azeri construction industry is, as with many things in Azerbaijan, split into two distinct categories: construction related to the oil and gas sector, and all other construction. Procurement in the oil and gas sector is, thanks to significant private foreign involvement and the existence of extensive production sharing arrangements, largely private procurement and not subject either to the existing procurement laws or the new PPL. A large proportion of these contracts is let to foreign companies, leaving the local construction companies lagging behind in terms of experience. Of the remaining construction in the country, a consistent picture emerges of modest demand by the Government (which is nevertheless the biggest purchaser of goods, works and services by far), probably due to a shortage of funds rather than an absence of need. It should be pointed out, however, that many low-value construction and maintenance contracts which might otherwise provide work for private contractors are given (as internal work orders) to the remaining in-house departments/units of ministries, agencies and committees which are considered to be separate legal entities.

Given the limited funds available outside the oil and gas sector, it is perhaps not surprising that there is little experience of using the existing Law on Tenders, since there appear to be very few construction projects funded by the national budget which exceed the relevant threshold of AZM 250m. The exception would appear to be contracts funded through the Oil Fund (and spent by procuring entities subject to the Law on Tenders and, now, the PPL). The Oil Fund finances the work of ARRA and would appear to be one of the main sources of publicly funded contracts available to the private sector. Those contracts which do exceed the AZM 250m threshold, and there are a number which exceed it significantly, are generally funded by international donors or international lending institutions. These contracts are, for the most part, governed by the procurement procedures of and supervised by those organizations. As a result, many of the former Government construction companies which inherited not only the plant and equipment from their previous incarnations but also the large labor force, often spread geographically in a number of regional “subsidiaries,” are burdened with many idle units, despite their perceived advantage in relation to other private contractors.

9.2 Road Construction

Road construction in Azerbaijan is carried out by the Road Agency (Azeravtoyol). Formerly, this was the Ministry of Construction and Maintenance of Roads (in Soviet times, the Department of Highways). It became a production unit for road maintenance in 1984 and, in 1993 became the Road Agency which is a structural unit of the Council of Ministers. As with other Ministries, the Road Agency is divided into several departments and controls a series (73 in number) of local and regional “maintenance subsidiaries.” In common with the structure of local government and of State-owned enterprises during this transition period, these maintenance companies are considered to be separate legal entities (with their own charters) whilst, at the same time being controlled by the Agency as structural units. In the case of the Agency, it would appear that some
of these units are self-financed, although others (47) are financed directly by the central budget. In addition, these units are also free to attract funding by providing, on a contractual basis, repair and maintenance works to local government where the latter are responsible (e.g. streets and rural feeder roads) or contract with the private sector, e.g. to maintain factory access roads. Such agreements must be sanctioned by the Agency.

Other than in the case of these private contractual arrangements, works are carried out on the basis of works orders emanating from the central administration of the Agency. The program of works and the corresponding budget plan for each subsidiary is approved by the MOF. Their performance is monitored on a monthly basis and, if satisfactory and in accordance with the agreed program, the salary of the payroll staff and seasonal workers will be paid. Their annual budgets range from AZM 500 million – AZM 5 billion. The Agency’s total budget was AZM 75 billion of which AZM 5 billion was for Nakchevan, AZM 14 billion for the financing of an ongoing road project (Baku-Alet), leaving AZM 42 billion for road maintenance and repairs in the rest of the country and divided between the remaining 47 maintenance units. This AZM 42 billion represents about 5 percent of the needs of the Agency.

Of these 73 units, 20 were selected to be privatized in the second privatization program (2000). Most of these have been corporative but not yet privatized. There is apparently a legal obligation in the privatization program which requires the Agency to help sustain these newly corporative entities for a period of some 4-5 years. As a result, when contracts are below AZM 250m, the work is allocated to these 20 companies. This is done on the basis of contract since these companies are separate legal entities as defined by the legislation. In the only contract to be tendered and awarded above AZM 250m by the Agency last year (at a value of AZM 59bn.), the successful bidder was also one of these 20 companies.

9.3 Goods and Services

Due to the very diversity of goods and services which may be provided to the Government by way of tender, it was not possible to achieve an adequate cross-section of opinion. Nevertheless, interviews were also conducted with a number of suppliers of industrial products and construction related services as well as with construction related consultancy companies (mostly, it has to be said, in the oil sector). Whilst this does not provide sufficient evidence to make a complete assessment, the results of these interviews serve to confirm the opinions expressed in interviews with the private construction industry. Comments were, in fact, almost identical, indicating a lack of publicity or inadequate publicity, the feeling that the successful bidders had already been chosen, unclear specifications and scope of works/services. The payment record of the Government was also a disincentive for suppliers of goods and services. As with all private sector parties interviewed, considerable unhappiness was expressed in relation to the bureaucracy involved in doing business in Azerbaijan, discussed more fully below. Those fortunate enough to be employed by the oil sector expressed no desire to work for the Government.

C.10 Performance on Public Procurement Contracts

Since there have to date been few procurement procedures conducted under the previous law and, understandably, almost none under the PPL and given that there are relatively few private sector contractors (as discussed above, it is more difficult to identify suppliers of goods) with the majority of works contracts going to former (and existing or partly State-owned) entities, it is perhaps not surprising that there is little information regarding the performance of private sector companies on public procurement contracts. All procuring entities interviewed expressed their
general satisfaction with the performance of the few private sector companies they had come across. The same story emerges from the few CPAR questionnaires returned, including, significantly, the questionnaire returned by the SPA.

In discussions with some of the procuring entities, there was mild reference to the existence of “briefcase” private contractors but no details were provided. With the limited number of public contracts on offer (as a result of a lack of investment funds), it is not surprising that those private companies that do emerge have themselves invested little in their own plant and equipment. “Briefcase” contractors may simply be a euphemism for struggling private contractors. On the other hand, in discussions with the private sector, as mentioned below, it emerged that the fear of onerous bureaucracy, unjustified inspections and a desire to avoid “facilitation” payments, also leads to a tendency for private businesses to keep as low a profile as possible and to avoid any obvious signs of success. This is confirmed by comments from the banks interviewed regarding the availability of bank securities, including reference to the absence of audited accounts, prompted, in their view, by this very same desire for discretion (the term used by one of the banks was the “shadow economy”).

C.11 Commercial Procurement Practices

The position on private sector tendering is extremely difficult to determine. As discussed above in the context of the Azeri construction industry, most of the “private” companies retain a significant State shareholding (and receive State funds to pay salaries and operating costs) and, to the extent that their own procurement exceeds the relevant threshold which is, in any event, a rare occurrence, they would be bound by the PPL. Finding any truly private companies whose spending power is sufficient to warrant any formal tendering has proved almost impossible. None at all were identified in the provinces. Several private companies were identified in Baku and interviewed. Of those, most did not procure by formal tender but based their purchases either on informal requests for quotations or on negotiations with known suppliers.

The largest private purchasers in Azerbaijan are to be found in the oil sector. Most entities are formed on the basis of production-sharing agreements (PSAs) and, although they obviously include Azeri (State-owned) companies, it is the foreign participants (the large oil companies) which are largely responsible for procurement. The procurement practices adopted by these entities reflect their international experience and bear no relationship at all to commercial procurement practices in Azerbaijan. It is of little benefit, therefore, to look at these practices in any detail with a view to identifying commercial procurement practices in Azerbaijan. There are, of course, a number of specialized local private companies clustered around these PSAs but they are generally retained for very specific projects (generally consultancy-type services or minor repair and maintenance work) of a relatively low value. There is no evidence to suggest that their obligations to the PSAs require them to conduct their own procurement in order to fulfill those obligations. To the extent that these companies are in a position to grow and expand into more domestic markets, it is likely that they will “import” the purchasing procedures they have learnt with the PSAs.

C.12 The Business Environment

A common complaint by all private sector companies, both domestic and foreign, operating in all sectors (works, supplies and services) concerned the difficulties of doing business in the country. These problems affect all private sector companies and are not specific to companies seeking to bid for public contracts. Nevertheless, they may significantly hinder the latter’s access to public
contracts. The main issues concern access to bank guarantees, company registration, licensing, inspections, and customs procedures.

12.1 Bank Guarantees

There are some 53 registered banks in Azerbaijan, some of which are more creditworthy than others. There are 15 very strong banks all of which are audited by the big 5 accounting firms and all of which have credit lines with larger international banks. There are currently some restrictions on currency transfers and the National Bank (ANB), as regulator, will prepare appropriate Regulations.

All of these banks carry out guarantee operations which is one of the elements of the banking license. The practice of requiring and acquiring bank guarantees in the shape of tender securities and performance guarantees is reasonably well developed. The main difficulty with the terms of the guarantees themselves stems from the absence of an accepted Azeri format. Most procuring entities will have their own standard form for tender securities but this will often have been translated from a different language. They will, of course, all be similar but the translation will sometimes create uncertainties, particularly where parts of the original text have not been translated. These problems are, however, generally remedied through discussions and, in most cases, the proffered forms are accepted.

It may be an indication of the level of activity in the market that not many bank guarantees are issued. Though precise figures are unavailable, in the case of one large foreign commercial bank with an active local presence, for example, no more than 12 are issued each year. In the case of a local bank whose clients request bid securities for goods procurement the figure is higher at something less than 10 per month (though, given the uncertainty of the interlocutor, this figure could be anything from 1 to 9).

Access to bank guarantees is very much dependent on the client in question. This may well be similar to practices elsewhere, although the issues do seem to be rather acute. In the case of long-standing clients with funds in the bank and with a demonstrated large turnover (usually demonstrated by the production of balance sheets since few companies can produce audited accounts), banks will generally provide the requested bank guarantees without collateral. In the case of a newly established company or a new client with the bank, the banks will require collateral such as cash, goods and immovable property.

There appears to be some confusion over the possibility of using land as collateral. In some cases, the banks say that it is not possible to mortgage land (since *sic.*, in law, all the land is the property of the State, although this position is not consistent with the Civil Code which recognizes both the right to private property in land and the mortgage obligation), in others the banks seem prepared to accept a mortgage on land.

Where the client requesting a bank guarantee is not a regular client, the practice appears to be to require collateral exceeding the value of the guarantee. For a guarantee of $50,000, one private bank, for example, would ask for collateral to the value of $100,000. Another requires only 100 percent collateral. In both cases, there is a concern that, in the current market conditions, it is not possible to guarantee the value of the collateral.
The difficulties for the banks of assessing the financial situation of their clients are exacerbated by the lack of financial information. There are few, if any, audited balance sheets and many companies do not have adequate records of their turnover because they work extensively in the shadow economy. They have little experience of working with Banks and have been used to working with their own capital. Further, legislation in this area is weak in the sense that it is not known what documents and formalities must be concluded in order to present a building, for example, as collateral. Reflecting the comments made by the private sector, a number of bank interviewed expressed their belief that the tender securities were a mere formality since it was always known beforehand who the successful tenderer would be and that the securities were easily issued to such a tenderer. It is nor surprising, therefore, that only one bank interviewed was able to indicate an occasion when a security needed to be cashed in.

The cost of providing guarantees varies from bank to bank. In one, it is 3-5 percent of the value of the guarantee. In another, the rate is set at 6-8 percent per annum, with the cost of an average tender security for goods procurement valid over 3 months amounting to some 1.5 percent. This latter bank tends only to receive requests for tender securities for the procurement of goods and has little experience of issuing performance guarantees. The rates for such guarantees would be negotiated separately.

There is one additional formality. Where the beneficiary of the guarantee is a client of a different bank to the person supplying the guarantee, the guarantee must be registered at the National Bank.

The CPAR team has found that there are no real alternative means of providing guarantees other than through issuance of bank guarantees, because there are no bonding companies to issue bid bonds and insurance companies are not well established in the Caucasus countries in general.

### 12.2 Company Registration

Until 1996, there was no comprehensive State strategy on company registration and, from about 1985, registration was carried out in an *ad hoc* fashion by some 10 different ministries in their relevant sectors, e.g. the National Bank for financial institutions. A new law was introduced in 1996, the Law on the State Registration of Entities, which brought in some order and transferred the duty for company registration to the Ministry of Justice. The Ministry’s registration functions are divided into 12 departments, two in Baku, and 10 in the regions, including Nakchevan.

All companies, whatever their legal form, must be registered. Foreign companies must also be registered where they carry out an activity in Azerbaijan or where they open a representative office, affiliate or branch in the country or participate in a joint venture. No company may participate in a public tender unless it is registered. Where registration is required of foreign companies, they must also be registered before bidding.

There are currently some 80,000 registered companies and 4,500 foreign registered companies, many of which are NGOs. Whilst the official line is that company registration will be completed in a matter of weeks, none of those interviewed achieved such a feat. Most felt relieved to have completed the formalities and received registration in one or two years, although there appear to be many cases of even longer periods.

The Law sets out the documents to be presented, the reasons for rejection of termination of registration and the appeal mechanism. Following the Law, registration should now be completed within 10 days of the application. A new proposal to amend the Law is currently being prepared.
which will reduce this time to seven days. The cost of registration has been fixed by Parliament. For agricultural companies and NGOs the cost is AZM 11,000 ($2.50 equivalent). For branches of foreign companies, the cost is $200. For all other companies, it is AZM 55,000 ($12 equivalent).

12.3 Licensing

In addition to company registration, some 70 activities require a license. As with company registration, the grant of licenses would also appear to be somewhat arbitrary and can entail significant delays. In some cases, the authorities responsible for granting licenses themselves compete with the licensees, either directly or through subsidiaries.

Licensing is not carried out centrally, but by the relevant Ministry, depending on the area of activity. The activities to be licensed are determined, however, by the Council of Ministers. The most current list is contained in the President's Decree 637 on the Types of Activity to be Licensed of October 4, 1997. Whilst many of the activities to be licensed concern such things as the handling and transport of dangerous substances, there are a number of activities which are relevant for procurement legislation. For example, the following activities require a license: geological surveys (State Committee of Geology and Mineral Reserves); mining industry, pipelines for the transport of gas, oil and oil products, high pressure facilities and boilers, design, construction, operation and maintenance of transport pipelines (State Committee for Industrial Safety and Mining Supervision); installation and repair of energy related equipment and facilities (State Committee for Industrial Safety and Mining Supervision); communications services (Ministry of Communication); civil and erection works including design, construction, engineering, survey, commissioning and start up (State Committee for Construction and Architecture); production and maintenance of medical equipment (Ministry of Health); attraction and use of foreign work force (Ministry of Labor and Social Protection); establishment of customs warehouses and customs operations activities (State Customs Committee).

No attempt has been made to investigate all licensed activities but in the case of buildings construction, for example, the State Committee for Construction and Architecture issues 5 separate licenses for topographical/topological works; design works; construction works (which includes a number of sub-licenses such as licensing for mechanical works, electrical works, concrete works, steel works, including building materials and supervision works); plant manufacture and the reconstruction and rehabilitation of monuments. It has issued some 150 licenses for design works. This is relevant because it is itself an entity which offers design and project management services to other government entities through a number of special departments of the Committee and subsidiary design institutes. Government entities choose the design institute or organization by way of tender. This is a common feature in all sectors of activity where the ministries involved in granting licenses for the operation and provision of certain activities are themselves active in the provision of those services.

Private companies operating in the construction sector require a series of licenses in order to operate. For example, a private cement factory visited explained the need for, in addition to a production license, a series of other licenses such as licenses to operate electrical transformers, to ensure power and water supply, for equipment and crane operation and for the operation of transport by truck. Each of these licenses must be obtained from the relevant ministry.

License fees will vary from ministry to ministry and according to the type of license. Some known figures suggest that a construction design works license costs $500 and a consultancy activity in the context of privatization costs $1,000. One example was given of a license granted...
by the State Mapping Committee for the use of (old) topographical maps prepared by it on
database. The cost of this was $2,000 for a period of five years. It would appear that a retroactive
additional fee was also levied amounting to 2 percent of the profits earned on each project using
these original database maps.

12.4 Foreign Currency Payments

The three cases of misprocurement in bank funded contracts identified in section 7.2 above, have
also shed light on a further difficulty in the business environment which affects procurement. The
auditor's review of these misprocurements sought to identify the underlying reasons for these
cases. It was noted that in almost all cases where it was identified, the misprocurement was due to
the award and payment to a company other than the supplier who had won the bid. As a result of
this discovery, meetings were held with both the Tax Ministry and the National Bank of
Azerbaijan to identify the related country laws and rules with respect to import of goods and
foreign currency payments. The review showed that the current laws on foreign currency
payments provide a ceiling of USD10,000 for advance payments (to be increased to $25,000
under a new proposed law) for imported goods and that a local supplier cannot open a foreign
currency bank account outside the country unless (1) it has a foreign branch that is approved by
the Azerbaijan National Bank or (2) there is a one-off project which also requires specific
approval from the National Bank. Exceptions to these rules can only be authorized by the
Azerbaijan National Bank which requires submission of extensive documentation and, as with
many things in Azerbaijan, the process can also take a great deal of time.

These provisions which are designed to protect the country against large outflows of currency are
not necessarily successful in protecting the outflow of currency and the local suppliers have
generally found ways of circumventing these rules by either partnering with a foreign company
outside of Azerbaijan or by opening an account in another country under a different company
name (and hence the root of the problem underlying the misprocurements). These companies are
then used for invoicing and receiving payments on all foreign currency accounts. As such, not
only are the revenues not brought into the country, taxes can also not be imposed on these
activities. Discussions with the business community also revealed that even if the local supplier
does not have a bank account outside the country but still needs to send foreign currency abroad
for the purchase of goods, the local bank is generally amenable to arranging for the transfer of
any sums of money outside Azerbaijan for a commission fee of 3% of the total transaction.

Given that the Azerbaijan business community and the Government is seeing an increase in
import/export transactions requiring payments in foreign currencies, these restrictions are clearly
a hindrance to efficiency. The deleterious effects of these restrictions are clearly seen in the
context of bank funded contracts. These problems are likely to be amplified when the PPL is
implemented and are likely to act as a disincentive to bidders seeking to source from outside the
country as well as to foreign bidders. The auditors rightly recommended that a review of these
laws and the imposed restrictions needs to be made and a decision reached on the usefulness of
these laws under the current environment.

12.5 Inspections

Various permits and licenses appear to proliferate and companies routinely complained that they
are subject to frequent and spurious spot checks by various branches of the bureaucracy. Spot
checks can be halted fairly quickly, by all accounts, where facilitation payments are made. This
problem has clearly been recognized by the Government which is seeking to deal with the problem. A Presidential Decree to minimize the incidence of unauthorized checks has been adopted, although the resources and powers available to the Ministry of Economic Development to enforce this Decree would seem, at first sight, to be inadequate.

Checks are carried out by various branches of Government. The most frequently mentioned were the Ministry of Labor and the Ministry of Taxes. In the construction sector, the State Standards Committee also has a department/division for technical inspections which will make general inspections of, for example, equipment and machinery, cranes and trucks, in the case of a construction materials factory. Technical inspections are not the sole reserve of the State Standards Committee, however, and may be carried out by different authorities in the relevant sectors. For example, in the construction industry, the State Committee for Construction and Architecture has departments of “expertise” (Gostraya) and for the inspection of the quality of construction works which carry out similar functions in the construction sector. The department of expertise will check designs submitted by procuring entities (and prepared either by an SCCA design institute or private firm) to make sure that they comply with national standards. Such a “feasibility study” is a requirement for any construction project. The cost of this expertise is between 0.1 percent and 20 percent of the cost of the design works and is borne by the procuring entity. This department also calculates quantities for the Bill of Quantities and sets unit costs and average prices for the construction industry for the purpose of verifying the estimated costs of the procuring entities. The State Committee is able to assist in this verification because it also provides a representative in the TCs of the procuring entities.

The department for the inspection of the quality of construction works will carry out compulsory inspections of works against quality standards following completion and, where necessary, will make recommendations for improvements. A successful inspection will result in a certificate of satisfactory completion. Failure by the contractor and his design firm to comply with any recommendations made by the Committee could lead to the loss of a design firm's license (also granted by the Committee). There is no charge associated with this inspection. Many ministries also have their own technical supervision departments who supervise whether works are in compliance with the contract documents including the technical specifications and the drawings. There are also a number of private companies who conduct construction supervision on the basis of a license granted by the Committee.

12.6 Customs

The customs authorities are largely financially independent of the MOF in the sense that they generate their own income and do not depend on budget funds for their operations. They rely entirely on extra-budgetary funds save for a portion of the salaries paid. Customs officials earn about $70 pcm [STANDS FOR?], of which 30 percent is financed from the budget. The remaining 70 percent is financed from funds obtained by the customs authorities themselves from (1) penalties imposed for customs infractions, (2) the sale of confiscated goods and (3) a customs “service fee” charged to importers which is currently set at 0.15 percent of the value of imported goods. In addition to the basic salary, customs officials receive significant bonus payments when they prevent customs infractions and seize illegal imports (smuggling). Though no figures are available, it is understood from the customs authorities themselves that these bonus payments are large enough to make the basic salary incidental. There are 1,870 employees throughout the country, including the decentralized customs points.

The average rate of duties is 7.8 percent and, in 2001, the customs authorities collected about AZM 822 billion in customs duties, representing some 20 percent of the Government's total
budget. Of this, AZM 23 billion was collected in cash at the customs points of entry, AZM 20 billion (90 percent) of which related to payments of duties by individuals on the import of vehicles. In 2001, there were 18,889 recorded cases of infringement, although this figure is generally and gradually decreasing.

12.6.1 Customs Procedures

At border crossings, the physical facilities include warehousing and offices for customs officials and customs clearance service providers who are licensed by the Committee. It is understood that these latter rent space from the customs authorities and, for a fee paid to the authorities, carry out many of the customs clearance procedures on behalf of the authorities. These are not formally customs brokers but have been described by the IMF, which is participating in a project to modernize the customs service, as “declaration officers.” They are generally, it would seem, experienced former customs officers who are employed by independent organizations to provide assistance to importers in completing customs documents. Once the relevant documentation has been completed and the customs procedures finalized, the final forms are approved by the customs officials. Inspections are carried out by the customs officials.

For the payment of duties other than by way of cash payments at the border, the customs procedures are as follows: before the goods arrive, the importer needs to fill out a customs declaration on the basis of which the appropriate duties are calculated (with the assistance of a declaration officer), and this declaration is approved by a cargo officer. The duties are calculated, based on the declaration, by the tariff and finance office of the Committee. The importer then pays the appropriate duties at the bank and receives a receipt. The receipt is attached to the declaration and submitted at the border, for further verification, at the time of examination (by a customs officer) and collection of the goods.

There are special procedures used for clearance of goods imported under exempt schemes, i.e. those that are funded by international organizations such as the World Bank. These procedures are not written down in any formal normative act but, in practice, the procedure is as follows: the beneficiary line Ministry will send a letter containing a description of the goods and the quantities to be imported free of VAT and customs duties to the Council of Ministers which verifies the contents of the letter; the verification is then given to the customs authorities in Baku which will provide a signed certificate of exemption; this certificate is handed to the customs officer with the customs declaration who will then release the goods free of VAT and customs duties.

Goods arrive sealed at the border, are opened and checked against the declaration. There is systematic inspection at the border and 90 percent of all imports are inspected. According to the customs authorities, the declarations appear to be false in about 90 percent of those inspections. The two main areas of default appear to be connected with under-invoicing (declaring lower prices) and declaring lower volumes. This latter is a particular problem with goods imported by road (as opposed to rail and air cargo) where volumes appear to be systematically under-declared.

12.6.2 UNDP Modernization Program

There is little doubt that the current customs declaration and other procedures are cumbersome and bureaucratic and that the systematic inspection of goods causes delay. A common complaint among those interviewed has been that goods are often delayed at customs for significant periods of time. There is a distinct lack of transparency in the procedures and practices of the customs authorities with importers unable to ascertain, in all cases, the reasons for the delay. Under a project financed by UNDP to modernize the customs procedures, a recommendation has been
made to change to a system of random inspections. The UNDP modernization project is intended to improve the situation by automating the procedure so that customs officials will have advance information concerning the imported goods. The system will also enable imported goods to be tracked from the point of import to final delivery. Given the apparently large number of detected irregularities, this is not an option favored by the customs authorities who are not ready to implement a “Green Line” (“nothing to declare”) system. This reluctance may be related to the frequent comment that under current procedures, customs clearance is speedy where “additional payments” are made.
D. RECOMMENDED ACTION PLAN

D.1 Recommended Actions

This section sets out a series of recommendations designed to address the various weaknesses in the public procurement environment in Azerbaijan, as identified in the preceding sections and attached Commentary on the PPL. The recommendations contained in this report are designed to be as comprehensive as possible given the current stage of development of the Azeri procurement system. The recommendations in the CPAR action plan (Annex IV A) were discussed both with the SPA and with the Working Group established as the Counterpart Team and the resulting Action plan for the Improvement of Public Procurement in the Azerbaijan Republic (Annex IV B) represents a consensus between the parties setting out the priority and medium term goals for further reform. Before finalizing the Action Plan, the SPA also sought input from the Ministry of Justice.

Discussions on the Action Plan were conducted within two joint CPAR/CFAA workshops held in Baku on 27 January 2003. As well as including members and representatives of the Working Group (Cabinet of Ministers, Ministry of Economic Development, Ministry of Finance, Chamber of Accounts, and the State Procurement Agency), other interested parties (National Bank, Parliamentary Commission for Economic Reforms) and representatives of the international donor community (USAID, EU TACIS, IMF) were also invited. In this way, the CPAR and Counterpart Teams were able to gather the broadest possible spectrum of opinion and advice and to engage the international donor community in the process of reform funding. As already mentioned, EU TACIS has agreed to fund a number of the larger scale actions set out in the Action Plan.

The recommended actions may conveniently be divided into two main parts. First, the detailed analysis of the PPL has revealed a number of procedural issues, some of which may be resolved by guidance issued by the SPA as part of its powers under its Charter, and others which are more fundamental and should be considered as part of the eventual amendment of the PPL. A detailed commentary of these issues is contained in Annex II. A detailed list of recommended actions, based on this commentary, is contained in Annex IV. The main areas of concern which require legislative changes are identified in C.2 and the Executive Summary of the CPAR report.

Secondly, flowing from the generally positive view of the PPL, there is an urgent need to ensure sufficient financial and human resources and institutional capacity. In particular, the following actions are envisaged to support successful implementation of the PPL.

1. To support SPA monitoring and supervision of procurement and to prepare better bulletins and annual reports, SPA needs to develop and implement a reporting and monitoring system. This system would cover not only the information to be provided by procuring entities but also the data and information made available to the SPA through the budget appropriations procedure. The Bank is proposing to fund TA for this purpose.

2. There is a pressing need to provide a transparent and reliable review mechanism under the aegis of the SPA which is the second tier review body. SPA requires assistance to prepare, design and implement a formal review procedure. EU TACIS has agreed to fund these reforms by way of technical assistance.
(3) It is critical that knowledge and training capacity be built up within the SPA. In particular, there is a need to train SPA staff and to provide additional training of trainers. EU Tacis has also agreed to fund such training.

(4) With new laws and procedures, it becomes imperative to ensure adequate training for procuring entities throughout the country. The establishment of a substantively and geographically comprehensive in-country training program for procuring officers is also foreseen under the EU Tacis TA.

(5) The new laws and procedures must be disseminated as widely and comprehensively as possible at the outset, which is to say, now. The Bank is ready to provide assistance for a public awareness campaign which would provide, in addition to information, basic training to potential tenderers.

(6) Information may also be disseminated in printed form and the EU Tacis TA will also finance increased information dissemination through increased printing and publication of basic procurement documents and training materials.

(7) This CPAR recommends encouraging the use of electronic means for improving both information dissemination and for the procurement process itself. An IDF grant and EU Tacis funding have been agreed to assist with the creation and maintenance of an information website to provide an electronic means of dissemination and access to relevant procurement information with a view, ultimately, of facilitating electronic procurement.

D.2 Detailed Action Plan

In view of the general compatibility of the new PPL with international procurement practice, the main thrust of any action plan must be to ensure that the aims and objectives of this very solid law can be translated into effective procurement in practice. The detailed action plan in Annex IV places the detailed recommendations summarized here and made throughout the CPAR into a framework for action. Effective implementation requires the participation and commitment of three main groups of stakeholders acting in concert: (i) the Government as legislator and regulator, acting essentially through the SPA, (ii) the procuring entities and (iii) the private sector tenderers themselves. The action plan addresses the duties and needs of these three groups under separate headings. The benefits arising from the successful implementation of the action plan will be felt by all three groups and are not mutually exclusive. Greater dissemination of information, for example, will benefit all three groups of stakeholders equally directly. The separate treatment in the detailed action plan serves to highlight where action is needed and how it may best be achieved.

This detailed agreed Action plan for Improvement of the Public Procurement in the Republic of Azerbaijan, representing the combined efforts of the CPAR and Counterpart Teams, was approved by the Cabinet of Ministers before the finalization of this CPAR and thus satisfies one of the conditionalities for the second tranche of SAC-II.

D.3 Measures Taken by the Government

It is clear that primary responsibility for ensuring that the PPL is comprehensive and effective lies with the Government of Azerbaijan, in particular with the SPA. To the extent that clarifications of the PPL can be achieved by use of guidelines and interpretative documents, it is the SPA that is best placed to carry out the necessary actions in order to achieve the stated results. Likewise, it is
the SPA that should ensure the development of an appropriate long-term review procedure which will guarantee speedy and effective recourse to tenderers who suffer damage as a result of infringements of the PPL.

D.4 Technical Assistance

Clearly, at this stage in the development of Azerbaijan's public procurement reform, the emphasis of the action plan should be on ensuring the capacity of the SPA to carry out its assigned task of implementing the PPL. Of particular importance at this juncture is technical assistance to assist with information dissemination and capacity building through in-country training programs. The best means of addressing these critical issues were all considered during the CPAR missions and a number of immediate possible initiatives were identified. In discussions with the SPA, a TA program was devised (see Annex III for TOR for TA) which, in brief, seeks to address the capacity building of the SPA itself (notably with regard to monitoring) and to strengthen the dissemination of information not only within the Government and the contracting entities but also to the private sector. This capacity-building exercise foresees, further, a series of public awareness seminars and campaigns as well as intensive external and in-country training for both SPA staff (training of trainers) and procurement officers throughout the country. The TA envisages, in particular, the creation of an information website which will contain all the relevant documentation and which may serve, in future, as a means of publicizing progress of implementation. It may also, ultimately, act as a platform for more sophisticated e-procurement mechanisms. However, with a view to achieving the possible in a short time frame, the initial purpose of the website is merely to provide a readily accessible means of disseminating information, including information concerning the forms for initiating complaints as well as the progress and outcome of complaints.

The Bank has already financed technical assistance as a follow-up to the CPAR and as outlined above, through an agreed Institutional Development Grant (IDF #052027), for the purpose of ensuring the effective implementation of the PPL. Two areas, in particular, have been progressed swiftly:

- **Pilot Study**: With a view to increasing the monitoring capacity of the SPA, it was agreed that a study needed to be made of the implementation of the existing law in order to identify weaknesses in the system. With this in mind, a conditionality was included in the second tranche of SAC-II which required the commencement of a process of random reviews by an independent procurement auditor of completed procurements and conducting of pilot audits in 2002. The pilot results were to be published together with plans for any appropriate remedial action. Under the IDF grant, an international consultant was appointed to conduct the pilot audit. Three entities were visited based on the high level of procurement (the Ministries of Agriculture and Education and the Azerenergy joint stock company). Though there was a high degree of compliance, the resulting report identified a series of shortcomings and provided recommendations to deal with them. This report was published as a press release by the Head of the SPA who also indicated in the press release the development of a country-wide action plan to eliminate the identified shortcomings. The immediate result of this activity is that Azerbaijan was able to meet a further SAC-II conditionality.

- **Web-based Information System**: The local capacity for information dissemination and monitoring has been identified as one of the weakest areas of the current reforms. In order to start the process of dissemination, it is necessary for the SPA to have the
technical equipment required to collect, collate and present procurement related information. Specifications have been prepared and procurement is underway for the provision of a local area network, software, computerized database, website, computer hardware, as well as copying and other hardware to produce and disseminate bulletins and training materials and assess data on completed procurements.

The Bank has also been coordinating with other donor agencies such as the EU in order to determine whether the technical assistance would benefit from a division of funding to deal with the different tasks. The good news is that EU Tacis has agreed to fund a significant portion of the proposed action plan and TA and has approved a TA package of 1 million Euro. It is understood, however, that the EU Tacis funds are not immediately available. Discussions therefore took place with the Counterpart Team and the SPA with a view to identifying the most urgent requirements so that the Bank may provide immediate and productive assistance in those areas. The priority areas are currently being funded through the IDF grant, above.

D.5 Monitoring Results

This CPAR action plan is being implemented by the SPA per the PM approved Action Plan for the Improvement of Public procurement in the Azerbaijan Republic. Monitoring and Follow-up of the implementation of the priority actions will be done though supervision of the IDF grant and follow-up missions by the Bank.
## ANNEXES

### ANNEX I

**Summary of Bank Operations in Azerbaijan**

**A. Statement of Bank Loans**
(as of May 9, 2002)

<table>
<thead>
<tr>
<th>Loan No.</th>
<th>Fiscal Year</th>
<th>Project</th>
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<td><strong>US$ Million</strong> (Less Cancellations)</td>
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ANNEX II
COMMENTARY ON THE PPL

The Commentary below takes a thematic approach and discusses the PPL according to the salient issues. Whilst this does generally follow the numbering of the Articles, this is not always the case.

1 APPLICABILITY OF THE PPL

The PPL makes a significant change to the previous legislation regarding the coverage and applicability of the law. Curiously, under the terms of the previous Law on Tenders, the use of open tender was not an obligation imposed on defined procuring entities but a right, i.e. it was optional. In this way, no entity covered by that Law was obliged to apply the Law; it was merely given the right to use it. On the other hand, the Presidential Decree setting out the Regulations on public procurement (and it is accepted that these texts were often contradictory), appears to have been obligatory. The PPL clarifies this position by (correctly) requiring all defined procuring entities to apply the procedures of the PPL. Nevertheless, this ambiguous history may have added some unnecessary confusion which may take time to overcome. Certainly, there are some entities that one would expect to be covered by the PPL (see main report, C.5.2, State Owned Enterprises and Utilities) which clearly do not consider themselves to be covered.

The PPL applies to government organizations and State-owned enterprises as well as to any other organization or enterprise in which the Government share of its authorized capital is equal to or exceeds 30 percent. This is an arbitrary figure which was originally set at 50 percent in the draft. This was a figure similar to the 50 percent public subsidy which triggers the EU’s procurement directives. In the absence of a full and detailed list of State entities or public utilities, the 30 percent shareholding figure will guarantee that any entity with a significant State participation will be covered by the PPL.

There is a second condition: it applies only where these organizations and enterprises use State funds. This is an important definition since the previous legislative texts, notably the Regulations, applied essentially to organizations and enterprises using budget funds. State funds are defined as including the extra-budgetary funds of budget financed organizations as well as other funds that are recognized by legislation as State funds. This definition gives rise to a number of separate considerations.

First, the program of decentralization will result in a number of local authorities and municipalities which will be self-financing in the sense that they will receive no funds from the national budget (see main report, C5.1, Administrative Decentralization). They would be financed from local taxes specified in the Tax Code and elaborated in the Law on the Financial Status of Municipalities of December 1999, which will be collected locally. When they become self-financing, they would not, therefore, be benefiting from budget funds and would escape the provisions of a procurement law applying only to bodies using budget funds. This would appear to be the current understanding of a number of municipalities who consider that, once they have become self-financing, they will no longer be covered by the PPL. The position under the PPL is unclear. The PPL, as adopted, states that “state funds” includes non-budgetary funds of budget financed organizations as well as other funds that are recognized by legislation as State funds. But non-budgetary funds will only be covered where they are spent by budget organizations. State funds are also defined as “other funds that are recognized by legislation as State funds” but there is no explanation in the PPL as to what this might mean or where such a definition might be found. Most importantly, it is unknown whether this expression would encompass local taxes collected by the municipalities.
As a result of the lack of clarity of the definition of “State funds”, therefore, there remains some ambiguity in the minds of those bound to apply it.

There is currently a new Law on Municipalities under discussion. Once that has been adopted, there will be an opportunity to reconsider the definitions of the PPL and its applicability. The Bank would propose (i) a definition of “procuring entity” which includes department, agency, organ or other unit, or any subdivision thereof, or public company engaging in procurement, or any non-public company engaging in procurement using public funds to carry out an activity in the public interest, with the exception of certain clearly identified entities; and (ii) a section addressing the scope of the PPL which states that the PPL applies to all procurement by procuring entities except for certain expressly identified types of procurement that are exempted.

**Recommendation:** All public funds emanating from taxpayers should ideally be subject to the provisions of the PPL. Guidance notes, training materials and seminars distributed and conducted by the SPA should make clear the entity coverage of the PPL with particular reference to what precisely is meant by “State funds”. Further, the meaning of “other funds that are recognized by legislation as State funds” should be clarified, preferably by way of an official statement or direction from the SPA or other relevant authority. Ultimately, this implies an amendment to the PPL.

Second, is the position of certain State-owned enterprises which are revenue producing. Although many State-owned enterprises benefit from State funds at least for their salaries and operating costs, a number of them are financially independent and rely entirely on extra-budgetary funds. Despite inclusion in the definition of State funds of extra-budgetary funds, contracts funded by such funds are covered only where the entity using those funds is a budget financed organization as explained above. To the extent that State-owned enterprises receive no budget funds at all, they may believe that they would escape the provisions of the PPL. This may be the case, for example, of enterprises such as the Caspian Shipping Company which consider themselves outside the PPL. Thus, even where an enterprise is entirely State-owned and where it is controlled by the State through appointments to the board (which would be sufficient to bring it within the EU directives, for example), it may not be covered by the PPL where it relies entirely on extra-budgetary funds.

The result of this wording of the PPL is to open up the possibility that a range of State-owned enterprises, especially utilities, could fall outside the terms of the PPL notwithstanding their “State” character and their monopoly (natural or legal) positions in respect of their activities.

**Recommendation:** The position of State-owned enterprises and utilities should be made clear in the SPA’s guidance notes and, where appropriate should be the subject of explicit normative-legal acts to ensure the correct coverage.

Third, “public funds” will also include “grants and credits contracted by the Government.” This may be problematic. In an earlier draft, as in the previous legislation, there was an exception for procurement funded by grants and credits of different donors which would be governed by the procurement procedures determined by those donors. The adopted PPL is completely silent on the fate of procurement funded by donors but, with public funds defined as including grants and credits, it is to be supposed that such procurement is also subject to the PPL and not to other procurement rules and/or procedures, even where there is a conflict. During the Parliamentary hearings on the PPL, it was apparently stated that Article 151 of the Constitution regulates conflicts between national law and obligations undertaken in the context of international
agreements. It was, therefore, assumed that this would be sufficient to resolve this issue in the context of procurement legislation. Even if every grant of donor funds were an "international agreement" (which is far from clear and subject to debate under public international law), this general provision may not be sufficiently well-known and apparent to ensure that it is applied in the context of donor funded contracts.

**Recommendation:** This situation must be clarified and, notwithstanding the generally applicable legal provision in the Constitution which resolves conflict between national law and international agreements, a procurement specific provision should be expressly made, either by amendment to the PPL or by way of Decree. In addition, it should be clarified that, in case of conflict between the national and the donor-funded procurement rules, the latter will prevail.

2 **SCOPE**

The PPL applies to the procurement of goods and works and services. Services are defined as anything other than goods or works and go well beyond the limited consultancy services ordinarily covered by the provisions of the World Bank and other donors. This definition is more akin to the definitions used in the EU directives, the WTO and UNCITRAL. No attempt has been made to define or limit the services covered (as is the case with the systems referred to) with the result that the procurement of any service is covered by the PPL.

**Recommendation:** Given the breadth of services covered, the SPA should take especial care in preparing appropriate standard RFP and contract documents which are apt to apply to the range of services likely to be procured under the PPL.

3 **DEFENSE PROCUREMENT**

The Ministry of Defense and other Forces were not originally subject to the previous Law on Tenders (1997) for any of their purchases. However, following a proposed amendment to the Law on Tenders presented by the SPA and supported by the President, the President adopted a Decree in 1999 (No. 147 of July 1, 1999) which applied the provisions of the Law on Tenders to purchases of items such as food, general services, clothes, transport facilities for auxiliary services and capital repairs and construction by the Ministry of Defense, Department of National Security and the Security Department of the Ministry of the Interior. A further Decree added purchases of medical equipment to the list. Thus defense procurement is not excluded from the scope of the PPL.

In the case of clothes, service facilities, medicines, medical equipment, transport facilities for auxiliary services, civil construction and repairs, procurement will, as before, be conducted on the basis of open tenders. For the procurement by these entities of all other goods, works and services, procurement will be by way of "closed tender." These entities have been cooperating with the SPA, which has already assisted in the preparation of a series of tenders by these entities.

4 **THRESHOLD**

Decree 668 sets out a universal threshold of AZM 250 million above which all procurement of works, goods and services will be subject to the bidding process of the PPL. This is the equivalent
of some US$55,000. Whilst there may be advantages in terms of simplicity to maintaining a single threshold level for the application of the PPL, the figure chosen (or any figure for that matter) would appear to be rather too high for the procurement of goods and services and rather too low for the procurement of works.

**Recommendation:** Consideration should be given to providing for two thresholds, one for works and the other (lower) for goods and services.

The terms and order of Article 17 are not particularly clear and, although an improvement on previous drafts, has not taken up a previous World Bank recommendation to avoid reference to the alternative procurement methods in the provision relating to thresholds since the conditions for the use of those methods are not threshold related. The essence of this Article, however, is that (i) above the threshold, the open tender is to be used, save that (ii) with the authorization of the SPA (see comment under Methods of Procurement, below), an alternative method may be used and that (iii) below the threshold, any procedure may be used.

There is a specific anti-avoidance provision in Article 17.2, prohibiting the splitting of contracts in order to avoid the applicable value threshold of the PPL.

### 5 Eligibility

Unusually, the PPL provides explicitly that, except in cases specified in the procurement legislation, tenderers of any nationality may participate in procurement proceedings in Azerbaijan and that none may be disqualified on the basis of nationality. Article 8.2 does, however, provide that, where a procuring entity limits participation of bidders on the basis of nationality, it shall describe the reasons for such a limitation in its report on the procurement procedure. This appears to contradict the main principle of non-discrimination on grounds of nationality but there is no explanation at all of when or why such a limitation might occur or which authority may authorize it. The SPA has prepared implementing regulations which deal with this issue as well as with the issue of national preferences (see below) and these have been submitted to the Cabinet of Ministers for approval. Further, a limitation on participation based on nationality is not an action which is subject to review (Article 52.2.2).

**Recommendation:** The conditions for the use of a limiting eligibility on the grounds of nationality must be explained and adoption by the Cabinet of Ministers is a priority.

The PPL also sets out conflict of interest prohibitions such that a number of tenderers are ineligible to participate in procurement procedures. These are welcome provisions, although there is one which may be difficult to implement in practice. It is the provision in Article 13.1 which renders ineligible tenderers with a legal, financial or organizational dependency on the procuring entity. Whilst this is an appropriate provision, the situation in Azerbaijan (as described in section C.9 of the Report) is such that the majority of “private” works contractors are or were the former in-house repair and maintenance departments of Ministries, local authorities and State-owned enterprises. A number of these have been privatized, although many still have a significant State participation. During the privatization programs, there is also a concern that such companies will be “looked after”. Under this provision, where persons in the procuring entity has a financial interest in such a legal entities, that entity may not, quite properly, participate in procurement procedures. However, since all of these entities are rather specialized in the business of their former “parent” Ministries, this effectively cuts them off from their primary source of work. It is
difficult to see how such a practical difficulty will be resolved in a manner consistent with the PPL.

**Recommendation:** Given the uncertainty over the status of many former public works departments, the SPA should consider providing guidelines which set out the permitted activities in the case of procurement procedures. For example, that any remaining works departments may be given works orders without any procurement procedures but that once they are corporatized and exist as separate legal entities, they must be treated as private companies. Where the State or a government official retains a participation, those companies may not bid on works contracts let by their former “employers”, though they may bid for contracts let by other Ministries, authorities or State-owned enterprises.

6 FORMATION OF TENDER COMMISSION

Before commencing a procurement procedure, the procuring entity must form a tender commission (TC), prepare tender documentation and announce the tender. The members of the TC will include specialists from the procuring entity and will be chaired by a member of the procuring entity’s managerial staff. The other members of the TC will be approved by the head of the procuring entity. At the previous suggestion of the World Bank, there is no longer a requirement for the composition of the TC to be approved by any higher executive authority. On the other hand, the new draft Charter of the SPA gives the SPA the authority to supervise the process of establishment of a TC. If this is used as a method of approval, then the Bank’s previous recommendation will be ignored, notwithstanding the terms of the PPL.

Where the estimated value of the contract exceeds AZM 5 billion, or AZM 1.5 billion in the case of budget organizations, the TC will also include representatives of the Ministries of Finance and Economic Development. Under the previous law, the SPA could also be invited to sit on a TC in high value contracts. This participation has now been removed in the PPL.

7 ESTIMATED PRICES

Prior to a procurement procedure, the procuring entity must prepare a cost estimate. This is, in any event, necessary in order to obtain budget, at least in the case of budget organizations. The resulting estimate is to be kept confidential and used only for evaluation purposes. This is, of course, right and welcome. The inclusion in the tender documents of such a price estimate, a flaw pointed out by the World Bank, has now been deleted.

However, Article 27.4 maintains that the procuring entity may reject tender proposals which are significantly different to the estimated cost. This may be useful where (1) the prices submitted exceed the budget available (based on the estimated cost) or (2) the prices submitted are abnormally low (such a procedure is permitted under the EU and GPA rules although the Bank does not, under its own guidelines, accept the rejection of abnormally low prices). However, it is more appropriate to include specific provisions to deal with such situations. The provision as it stands is dangerous because it leads to a comparison of competitively priced bids with an often arbitrarily calculated estimated cost. The tender procedure will result in the actual market prices (which may differ considerably in the case of differentiated products) at a given point in time whereas the estimated cost is not based on the actual prices available in the marketplace at the time of the tender and under the conditions of the tender.
Annexes

! Recommendation: The SPA should issue guidance on the way in which prices are determined in a market economy (and, therefore, in a competitive bidding situation) in order to educate procuring entities as to the value and significance of the prices they will receive following a competitive bidding procedure and the futility of expecting such prices accurately to reflect any estimated prices they may have calculated. This should also be an important part of the training conducted by the SPA.

There is excessive reliance on the use of estimated market prices and the Ministry of Finance also conducts an ex post review based on such estimated prices.

! Recommendation: The Ministry of Finance should be encouraged to abandon its policy of refusing payment where bid prices substantially exceed their supposed estimated market price.

8 OPEN TENDER AND OTHER METHODS OF PROCUREMENT

The PPL provides for a range of UNCITRAL-inspired procedures: open tender, two-stage tender, closed/restricted tender, request for proposals, request for quotations and single source procurement. Methods other than open tender may only be used if certain conditions set out in the PPL are met.

Notwithstanding an earlier recommendation by the World Bank, there continues to be a requirement in Article 17.3, as in previous drafts, that use of alternative procurement methods be approved by the relevant executive authority (in this case, the SPA). In practice this would mean that each procuring entity would need to seek the authorization of the SPA each time it wanted to tender other than by way of open tender. This is mere duplication since the conditions for the use of alternative methods are set out in the PPL and the added level of bureaucracy is likely to create delays. The inclusion of this authorization procedure may arise from reliance in the PPL on Article 52 of the UNCITRAL model which permits exclusion from the right to review of the selection of procurement methods (also excluded from the PPL). Recent experience in the EU, for example (but this is a common occurrence in other systems), shows that a significant source of abuse in the procurement process is precisely in the choice of the method of procurement with procuring entities using less competitive procurement methods on spurious grounds. The PPL seeks to redress this imbalance by requiring prior authorization by the SPA. As a transitional measure, this may be acceptable as a means of familiarizing procuring entities with the application of provisions which permit the use of procurement procedures other than open procedures. However, it is, in the longer term, a wasted effort and unnecessarily bureaucratic and the practice should be abandoned as soon as possible.

! Recommendation: Consideration should be given to extending the right of review to include the selection of procurement methods in order to both decrease excessive bureaucracy (by removing the prior authorization requirement) and guarantee adherence to the PPL’s conditions for the use of alternative methods of procurement.

8.1 Two-Stage Tendering And Requests For Proposals

Terms such as “tender”, “requests for proposals” and other similar terms are used with the meaning attributed to them in the PPL and UNCITRAL Model law. They do not necessarily have the same meaning as that attributed to them by the Bank.
The conditions for the use of these two procedures are identical to the provisions of the UNCITRAL model, with some minor exceptions. The PPL allows an RFP to be used in cases of urgency where adherence to the normal tendering procedures is impractical provided that the circumstances giving rise to the urgency were neither foreseeable nor the result of undue delay on the part of the procuring entity. In the UNCITRAL model, that is a condition which gives rise to competitive negotiation (which does not require advertising), not an RFP. This is of little consequence and, in any event, tends to reinforce the use of competitive bidding even in cases of urgency by giving the possibility of using RFPs. The only inconvenience is that an RFP requires advertising, albeit without the strict time limits of open or restricted tenders. This, therefore, creates a simplified and accelerated tendering procedure to be used when time is short. In the event that there is too little time, recourse may be had to single source procurement.

It should be pointed out that two-stage tendering is a form of open bidding to be used in the appropriate circumstances. It is not, as such, an alternative method of procurement as suggested in the PPL. The conditions for using two stage tendering are appropriate. However, it may be worth making this clear in any future amendments to the PPL and certainly in the training and guidance notes.

The procedures to be used for two-stage tendering and RFPs are identical to the provisions contained in the UNCITRAL model. They are so similar that there has been an apparent oversight: the advertisement for the RFP is to be published (Article 48.2) in a newspaper of wide international circulation. This is probably meant to read an official newspaper (as is the case with open and closed/restricted tenders) since it will generally apply to contracts of all values, most of which will not benefit from international advertising.

! Recommendation: If this reference to advertising internationally is an oversight, it should be remedied to make clear that advertising is required in an official newspaper.

8.2 Restricted and Closed Tender

A closed tender and a restricted tender are the same procedure save that, in closed tendering, there is no advertising requirement. It is simply that the special term “closed tender” is used to describe tenders conducted for defense procurement in contradistinction to the restricted tender used for non-defense goods, works and services. The conditions for the use of a restricted tender and the procedures to be used are identical to the conditions and procedures set out in the UNCITRAL Model. The notice shall be published in an official newspaper.

Article 19.2.2 provides that this procedure may be used where the cost of conducting the tender is disproportionate to the value of the contract.

! Recommendation: The Bank would recommend setting a threshold value for such a situation in order to avoid abuse.

8.3 Request for Quotations

The conditions for the use of a request for quotations and the procedures to be used are identical to the conditions and procedures set out in the UNCITRAL Model. The Ministry of Finance will establish the threshold below which this procedure may be used.
8.4 Single-source Procurement

The conditions for the use of single-source procurement and the procedure to be used are identical to the conditions and procedures set out in the UNCITRAL Model with the addition that, in order to assist with the evaluation of the price offered, the procuring entity will calculate the estimated market price.

Single-source procurement may only be used with the approval of the SPA but there is no longer to be any "public notice and adequate opportunity to comment", a provision in a previous draft which caused some concern to the World Bank. Despite a previous recommendation by the World Bank to remove the reference, the condition relating to exclusive rights continues to refer to works contracts. It should refer only to supplies contracts.

Recommendation: The condition relating to exclusive rights should not refer to works contracts.

9 Tender Documents

The contents of the tender documentation are enumerated exhaustively and are largely identical to the provisions of the UNCITRAL Model. Following an earlier recommendation by the World Bank, Article 24.1.7 is now in line with the UNCITRAL model and includes in the tender documentation the terms and conditions of the procurement contract and contract form to be signed by the parties. The tender documents will no longer contain any reference to preliminary cost estimates, a previous inclusion which caused concern to the World Bank. The provisions relating to clarifications and modifications of tender documents contained in Article 30 are consistent with the UNCITRAL Model.

10 Procedures for Soliciting Tenders

For open tenders, the invitation is to be published in an official national newspaper as well as in publications with a wide international circulation. It is to be published at least twice, 30 days and 20 days respectively, before the date for the opening of tenders. In the case of large scale works and complex equipment those time limits are 60 and 40 days, respectively. It is not clear whether invitations should always be published in publications with international circulation or whether that applies only in certain circumstances. It is to be questioned whether advertising twice is going to achieve anything other than increasing the costs of the procuring entity, particularly where advertisements are to be placed with publications of international circulation.

Recommendation: The SPA should consider issuing guidance on when it is appropriate to advertise in publications with international circulation.

In all other cases (other than open procedures) save in the case of a closed tender, the procuring entity will prepare a list of not less than three potential candidates to whom it will send out invitations. These invitations must contain the same type of information as the published invitations.
Despite the previous suggestion of the World Bank, there is no indication of the date on which the procuring entity must be ready to issue tender documents, other than the general requirement in Article 22 that tender documents should be prepared in advance of the tender proceedings.

The contents of the invitation to participate in an open tender and in a pre-qualification procedure are the same as those listed in the UNCITRAL Model. The only difference would appear to be that whereas in the UNCITRAL Model the price of the tender documents must be included, the PPL indicates that the amount of the “participation fee” is to be included. This is probably not an error of translation because Article 29 provides for the payment of a participation fee to cover the costs of the tender procedure. See below.

11 **Qualification Criteria**

The qualification criteria set out in the PPL are consistent with international best practice and include criteria relating to financial capacity, economic standing and technical ability and competence. All qualification criteria to be relied upon must be set forth in the tender documents and the procuring entity may rely only on such disclosed criteria. Other than in cases where a domestic preference is to be applied, procuring entities may not adopt a qualification criterion which discriminates against or among tenderers.

On the recommendation of the World Bank, procuring entities shall not disqualify a tenderer on the ground of the submission of incomplete information which is not critical to determine the qualification of the tenderer provided that such deficiencies are satisfactorily eliminated by the tenderer at the request of the procuring entity. This effectively introduces the concept of substantial responsiveness.

As with the case of the cancellation of tenders, below, tenderers may be disqualified where they “have been found guilty” of “misrepresentation”. It is not clear which authority is able to make a finding of guilty but, in the hands of the procuring entity, this may be a dangerous power open to abuse.

**Recommendation:** For the avoidance of doubt, the SPA should issue guidance setting out how misrepresentation may be proven and by whom, although this may be better in the PPL itself.

12 **Pre-qualification**

The PPL permits the use of a pre-qualification procedure in the case of not only works contracts but also goods and services contracts. Pre-qualification may only take place on the basis of the qualification criteria set out in the PPL. Article 7.8 also makes provision for post-qualification against the same criteria. The PPL has re-inserted text identified by the World Bank in Article 7.4 (formerly Article 9.2.2) to the effect that responses to inquiries regarding pre-qualification shall be communicated “without identifying the source of the inquiry”.

**Recommendation:** Given that pre-qualification *may* be used for all works, goods and services contracts, thought should be given by the SPA to explaining to procuring entities, those circumstances in which pre-qualification might be most appropriate, rather than allowing a situation to arise in which recourse is had to pre-qualification as a matter of course.
For the sake of clarity, the Bank recommends including, at the end of Article 7.1, a sentence to the effect that Article 6 applies to pre-qualification proceedings.

13 Technical Specifications

The PPL requires that any specifications, plans, drawings, designs or descriptions of goods, works and services be based on their relevant objective technical and quality characteristics. Though not as extensive as comparable provisions in the EU directives, the GPA or UNCITRAL, the provision of Article 15.2 is satisfactory in that it prohibits the use of specifications etc., including requirements concerning testing and test methods, packaging, marking or labeling or compliance certification, symbols or terminology that create obstacles to participation (including those based on nationality) of tenderers. However, it does not allow flexibility in the sense that where there is no meaningful way of defining technical specifications without reference to specific makes, products or processes, these may be used subject to the acceptance of equivalent products. The SPA’s position is that it will always be possible to define technical specifications without making such references. This is not the Bank’s experience nor the experience of the draftsmen of the EU rules, the GPA or the UNCITRAL Model. Even if it were possible effectively to rewrite the technical specifications of complex or technologically advanced equipment without favoritism, the time and cost involved in such an exercise would be counterproductive.

Recommendation: Notwithstanding the SPA’s position, therefore, the Bank recommends that the SPA might consider providing guidelines which state that where it is necessary and unavoidable to define such specifications in a non-objective way by reference to particular makes, products or processes, then it may exceptionally be permissible to do so provided that the words "or equivalent" are used.

From a practical standpoint, Gost standards, developed by former Soviet Gostandard are recognized as Azeri standards. The Law on Standardization has provisions to allow the introduction of other standards. The time limits applicable to Gost standards have been temporarily lifted pending revision by one of the technical departments of the newly established State Agency for Standardization, Metrology and Certification (formerly the Azeri Center for Standardization and Metrology) as a result of the imminent membership of the WTO. There is a move to harmonize the revised standards with those of the EU. Thus, all standards issued since 1992 have a corresponding reference to international standards such as ISO. The Law lists mandatory standards (re. safety, environmental health and oncology safety). In addition, it allows voluntary standards that are regulated by contractual obligations between parties.

In terms of certification, the State Standards, Metrology and Certification Committee, certifies that goods are in compliance with safety and technical requirements of applicable standards. Many local manufacturers submit sample for certification on a voluntary basis (not related to bidding process). Specialized certification departments cover all sectors of the industry. Rates for certification are approved by the MED and MoF. There is an approved list of types of imported goods that require certification. If such products are not certified, they cannot be imported.

Goods must be certified as complying with the relevant standards before they may be entered as part of a tender. The tender documents will require the production of documents certifying the safety and quality of the goods and, if they are not certified, the goods cannot be tendered. There is a practice of recognizing foreign certificates where there is a bilateral agreement recognizing foreign certificates. There are such bilateral agreements currently with all CIS countries and Turkey, a draft agreement with Iran and negotiations underway with Bulgaria (the major
importers). If there is no bilateral agreement and therefore no recognition of foreign certificates, the bidder may specify the protocol of foreign certification for approval by the Committee. In these instances, a delegation of the Committee may be sent to confirm that the certificate from the foreign certification institute is acceptable.

14 Tender Documents to be Submitted by Bidders

Tenderers must submit the application to tender, a bank certificate confirming payment of the tender fee (this is the participation fee, not tender security) and other documents relating to the tenderer (identity, qualifications, financial information) a full seven banking days before bid opening. This is to enable completion of any missing documents before bid opening. Inclusion of the “soliciting letter” was abandoned at the suggestion of the World Bank.

The tender must be submitted one banking day before bid opening. They must be sealed in two envelopes. Any proposals received after this deadline will be returned unopened. It is not clear why these documents need to be submitted separately and a strong suspicion that this opens the procedure to abuse. It would be preferable to have all documents submitted at one and the same time.

The Bank recommends that express provision should be made concerning the delivery by hand or mail of original tenders.

15 Participation Fee

Despite the previous recommendations of the World Bank to limit such a fee to the cost of reproducing the solicitation documents, the PPL contains an Article (29) which requires the payment of a non-reimbursable participation fee by tenderers. The purpose of this fee is to cover the costs and expenses of the tender proceedings including advertisement, announcement, rent of facilities for bid opening, financing of the tender commission, preparation of tender documentation and delivery to bidders as well as any other expenses. The level of the participation fee shall not exceed 0.5 percent of the estimated price of the contract and may not exceed 1.5 times the expenses. This latter provision presumably means the total of the fees collected, although there is no mechanism for such a calculation.

Such a payment is not, as indicated previously by the World Bank, desirable. It serves to deter participation and, therefore competition and also fails to recognize the benefit of competitive bidding. The point of conducting bidding procedures is that the savings made in terms of lower prices will be considerable. This offsets any added expenditure in conducting the procedure. Further, it should not be supposed that such additional costs are neutral vis-à-vis the tenderers. It is inevitable that these additional transaction costs will be factored in to the tender prices which will be increased as a result. The practical consequence of imposing such costs is simply that the procuring entity will pay higher prices – they will ultimately be paying these fees themselves. This defeats the object of the competitive bidding exercise. Moreover, participation in tender commissions is part of the function of procuring officers – that is one of the reasons they receive a salary. There is no need either to rent Government property in order to conduct bid openings.

! Recommendation: Participation fees should be abandoned as soon as possible. Any fees should be restricted to the cost of producing tender documents.
16  **Period of Tender Validity**

The provisions relating to the period of validity of tenders are largely identical to those in the UNCITRAL Model.

17  **Tender Securities**

These are to be fixed at a between 1 percent and 5 percent of the value of the bid. The provisions relating to tender securities are largely identical to those in the UNCITRAL Model. They appear to be permitted in the case of works, supplies and services contracts. Unlike the case of the participation fee whose payment and time of delivery is clearly identified, there is no mention in the PPL of the form of security nor of the time it must be submitted or verified.

| Recommendation: The SPA should issue guidance on the standard form of tender securities and on the procedures for their submission. |

The previous suggestions of the World Bank in respect of the reimbursement of tender securities have been taken into account.

In practice, tender securities are always requested and their value is generally between 1 and 2 percent of the bid value. There is a certain demonstrated lack of confidence in the degree of confidentiality attached to bank securities. This is not necessarily a generalized concern but it is one that was voiced on a number of occasions. In its own procurement, for example, the National Bank has, as a precautionary measure, a practice of setting the bid security as a fixed figure equal to between 1 and 2 percent of the estimated bid value. In this way, no unauthorized disclosure of the level of bid security would result in disclosure of the bid price. This is, of course, always a danger where the tender security is based on a percentage of the bid price.

18  **Bid Opening**

The provisions relating to bid opening are largely identical to those in the UNCITRAL Model.

19  **Examination, Evaluation and Comparison of Tenders**

The provisions relating to examination, evaluation and comparison of tenders are largely identical to those in the UNCITRAL Model. The drafters of the PPL have made a choice, offered by UNCITRAL, in the award criteria: the successful tender shall, subject to any margin of preference applied, be the one with the lowest *evaluated* tender price, the addition of the word “evaluated” bringing it more into line with World Bank procedures. The weighting provisions are those of UNCITRAL.

It would be preferable to make clear that clarification sought by the procuring entity should be in writing.

20  **Domestic Preference**

Article 36.9 provides that a domestic preference may be applied where that has been stipulated in the tender documents. Despite a previous recommendation by the World Bank, there is no further
It is important that margins for domestic preference and their rules of application be set out as soon as possible in a clear and precise manner and, where possible in order to achieve the objectives sought by the application of such preferences, taking into account the market relevant conditions on a product-by-product basis.

Under the previous legislation, according to the SPA in its completed CPAR questionnaire, domestic preferences were in practice 15 percent for goods and 7.5 percent for works.

21 Post-tender Negotiations

No negotiations are permitted between the procuring entity and tenderers in relation to the submitted tenders.

22 Decision of the Tender Commission

The TC makes the final award decision with a minimum ¾ quorum. TC members who disagree with the majority view shall record their opinion in the minutes. A copy of the minutes will be sent to the SPA within 3 days.

Article 37.3.3 permits the TC to take a decision on splitting the tender among two or more bidders to ensure efficiency if no proposal covers the full implementation of the proposed contract. This is not a question of awarding lots but of splitting an otherwise single contract. The previous World Bank recommendation was to delete this provision from the draft. This was not done.

Recommendation: The provision allowing the splitting of a contract should be deleted.

The TC and its members are made explicitly responsible for any infringements of the PPL.

23 Signature of the Contract

Following notification of the award to the successful tenderer, the successful tenderer must submit a performance security and sign the contract within the time limits set out in the tender documents. Under Article 40.4 a procurement contract enters into force upon being signed and is governed by the terms of the Civil Code. Article 40.8 provides that, if the solicitation documents stipulate that the contract is subject to approval by a higher authority (this may be the Ministry of Finance, for example), the procurement contract shall not enter into force before approval is obtained.
24 Post-award Notice

By Article 5.3 of the PPL, information regarding procurement contracts signed as the result of a tender is to be published, within 5 banking days, in the publication in which the tender was announced. Article 40.9 ensures that a notice is sent to the unsuccessful bidders which will include the name and address of the successful bidder and the contract price. The Bank would recommend, however, that this notification take place before contract effectiveness in order to give unsuccessful bidders the opportunity of seeking a meaningful review in appropriate circumstances.

Despite the requirement on the procuring entity to notify unsuccessful candidates for pre-qualification promptly (Article 7.6) and the possibility of making notifications regarding a failure to qualify by electronic means (Article 9.2), there appears to be no general requirement to notify unsuccessful bidders of their failure to qualify in a timely fashion. Such a provision should be included in the PPL, possibly, under Article 5.

25 Price Adjustments

Article 51 of the PPL provides that the rules for price adjustments that will apply to the implementation of the contract shall be provided in the solicitation documents. However, the operative provision should be a contractual provision and, contrary to the suggestion in this Article, price adjustments would be made on the basis of the contractual price adjustment clause.

The method of calculation of the price adjustments is to be determined by the Council of Ministers. There is currently an SPA proposal before the Cabinet of Ministers.

\[ \textbf{Recommendation:} \text{ It is imperative that the price adjustment formulae be completed and adopted as soon as possible and included in the procurement contracts.} \]

It should be added that the State Statistics Committee prepares a series of price indexes. They prepare a monthly consumer price and production price index and an annual index of consumer and manufacturer prices. The monthly price index must be requested from the Committee and is not published in a readily available newspaper or periodical. The annual index is published in a yearbook (Prices in Azerbaijan). There are also further annual indexes of wages (The Labor Market) and construction prices (Construction in Azerbaijan). This latter is fairly detailed and covers all usual construction materials. For consumer products, staff from the Committee will collect price data by visiting shops to collect the prices. For industrial products, manufacturers are required to submit their prices on a monthly basis.

26 Services Procurement

The PPL provides a separate Chapter V on the method to be used for the procurement of services. This is based on the UNCITRAL model’s procurement methods for services. This tends to lay emphasis on consultancy services or services which require a high level of technical ability and expertise which may justify the use of the method proposed. In this, it is closer to the provisions governing the procurement of consultancy services by donor organizations. As a result, the PPL adopts the technical minimum qualifying mark approach which requires attainment of a certain quality/technical to be met before being considered for price comparison. There are, however, no further details.
Recommendation: The SPA must issue guidelines on where the technical minimum mark approach is adopted and on operating such a system indicating the desired weighting and threshold levels.

However, in addition to technical consultancy services, the PPL applies to the procurement of all services and the definition is even broader than the definition in the EU directives (which allows an exception for certain services). Thus, the PPL could apply to the procurement of such things as window cleaning services, waste disposal services and landscaping, for example. To that extent, there is no compelling reason why the procedures chosen for the procurement of services should be any different to those applicable to other procurements. Article 16 of the PPL correctly, therefore, states that notwithstanding Chapter V, procuring entities may rely on the use of open tendering procedures where that is appropriate taking into account the nature of the services to be procured and where it is feasible to formulate detailed specifications. They may also rely on the alternative methods of procurement provided the relevant conditions set out in the PPL are met. These provisions, however, are not clear or sufficiently detailed to allow procuring entities to make the correct assessment. Whilst the SPA is currently working on guidance documents to clarify the conditions on using the different procedures, these conditions should best be provided in the PPL itself.

Recommendation: To ensure a sensible approach, the SPA needs to finalize guidance on when the nature of the services are such that they may be procured on the basis of open tendering or other procedures rather than on the basis of Chapter V, which should address intellectual services only. Ultimately, the PPL should be amended to reflect the criteria for making the decision.

27 Cancellation of Tenders

The PPL contains provisions concerning the cancellation of tenders and the consequent liabilities which are largely consistent with international best practice. There are, however, two comments.

First, under Article 11.1, where the number of bidders is less than three, the procuring entity “shall” terminate the tender proceedings. Whilst this serves to protect the primacy of competition in the bidding process, it does appear to be rather inflexible given that there may be many valid reasons for having less than 3 bidders. It may simply be that there are less than three bidders able or prepared to bid for a particular contract. In such cases, it is futile to cancel the tender and to start again. It is, of course, different if the lack of competition is attributable to poorly drafted specifications, for example, which might require correction followed by re-tendering. Nonetheless, the apparent inflexibility is a concern. It also begs the question of what is the appropriate response in those circumstances.

Recommendation: SPA should provide guidelines to clarify the situations in which such an automatic cancellation of tenders is the correct response and identify the course of action to be followed in such an event, for example, re-tendering with new specifications or use of the restricted procedure.

Second, there is one reason for terminating the procedure which, although used in practice in many jurisdictions, is rarely made explicit: the tender may be cancelled if it is discovered that at the time of tender proceedings tenderers have negotiated among themselves with a view to raising
prices. This is, in effect, an anti-cartel provision which gives to the procuring entity the opportunity to terminate a tender where cartel behavior is discovered. Whilst this may be useful in light of the lack of powers possessed by those authorities responsible for antitrust enforcement (see 4.4.1 of the Report), the danger is that the procuring entities themselves have no additional powers to discover, verify or prove anti-competitive behavior on the part of bidders. Cartel behavior is notoriously difficult to prove and, without proper investigation and the appropriate powers to conduct such an investigation, procuring entities are in no position to make the assessment foreseen in Article 11.2, whatever suspicions they may have. Further, the ability to cancel tenders on such grounds provides a flexible tool capable of abuse in the wrong hands.

**Recommendation:** A the very least, the SPA should provide guidance on when this provision regarding price fixing should be used, preferably only when cartel behavior has been identified and proven by the relevant authorities. As a corollary, efforts should be made to strengthen the investigatory powers of the Anti-Monopoly Committee in the MOED to deal with such situations.

An analogous situation arises under Article 12 PPL under which the procuring entity may reject a particular proposal/tender where it determines that the tenderer has been engaged in fraudulent practices in order to influence adoption of a procurement decision. In this case, the procuring entity’s determination must be confirmed by the SPA. This is preferable to the situation above but it is imperative that the SPA has procedures in place to be able to carry out such a confirmation objectively and expeditiously.

**Recommendation:** SPA should put in place a specific procedure aimed at verifying the existence of fraudulent practices under Article 12.

Article 12 also permits the procuring entity to prohibit a tenderer determined to be fraudulent from participating in future procurement procedures for a fixed period of time fixed by the SPA or for an indefinite period of time. This latter penalty would appear to be excessive and should be used sparingly, if at all.

**Recommendation:** SPA should set out clearly the bases for exclusion from future procurements and the level of penalties in terms of exclusion, preferably sequential. Provided the system is objective and transparent, leaving no room for abuse, blacklisted firms could be posted on the Web site.
ANNEX III

TOR FOR PROPOSED TA TO THE STATE PROCUREMENT AGENCY

Consultants’ Terms of Reference

Background

From 1997, procuring entities in Azerbaijan have been conducting procurement on the basis of two legislative documents: the Procurement Regulations of 1997 and the Law on Tendering of 1998. Since 1997, implementation of these legislative acts has been carried out by the State Procurement Agency whose Charter dates from 1997. These texts are currently the subject of consolidation and extensive amendment contained in the new Public Procurement Law which is currently before the Parliament. It is anticipated that this Law will be adopted by the end of 2001 and will enter into force immediately thereafter.

Objective

Implement the Public Procurement Law by assisting and providing to the Government the means to carry out the tasks required by the Law to inform, educate, advise, monitor, supervise and enforce the Law through appropriate and effective institutional arrangements and thereby to guarantee the effective implementation of the Law.

The TA will consist of two consultants: (i) a Lead Procurement Consultant; (ii) a local IT consultant

The Lead Procurement Consultant will be responsible for the overall implementation of the TA and will have specific responsibility for the devising and implementing the work plan for the proper and effective implementation of the Public Procurement Law. The local IT consultant will be responsible for designing and implementing a management information system for use by the Agency and for designing and bringing on line an information website for the Agency. The local IT consultant will work closely with the lead procurement consultant and Agency staff to ensure that the system conforms to the needs of the Government and to develop and subsequently maintain the computer the management information system and website.

Scope of Work

A LEAD PROCUREMENT CONSULTANT

The consultant will:

1. In cooperation with the State procurement Agency ("SPA") and the Counterpart team identified by the Ministry of Economic Development, discuss and review the new Public Procurement Law ("PPL") with a view to developing a work plan for its proper and effective implementation by all procuring entities within its scope, including central and local government and State-owned enterprises as defined in the PPL.

2. Assist the SPA and Counterpart team in progressing the work plan. The work plan will, in the first place, include a review of "implementing mechanisms”. These implementing mechanisms are expected to be adopted by Presidential Decree simultaneously with the
adoption of the PPL (to be signed by the President following adoption by Parliament). To the extent that refinements are still necessary or possible, the consultant will discuss with the SPA the possibility of making any desirable amendments. The implementing mechanisms currently envisage, among other things, identification of the relevant executive authorities involved in public procurement and the determination of the threshold values to be applied for the application of the various methods of procurement foreseen in the PPL.

3. Consider with the SPA its current Charter and organizational structure with a view to improving and strengthening its ability to perform its designated functions in an efficient and suitably objective manner. In particular, this exercise should consider:

- the division of functions and responsibilities between the various departments of the SPA;
- working procedures of the SPA;
- the extent to which the SPA does and should participate in the TC established by the procuring entities pursuant to the PPL with a view to ensuring that the SPA does not itself become part of the procuring entities' decision-making process;
- the need to ensure that the SPA, as the second tier of the complaints review procedure established by the PPL, has (i) an appropriate department capable of carrying out this function sufficiently independent from, for example, any SPA department giving technical advice to the procuring entities or participating in any TCs and (ii) suitably qualified members capable of conducting technical and objective reviews of complaints;
- the extent to which the SPA requires for the fulfillment of its tasks increased manpower and improved facilities;
- the possibilities for the printing, publication and dissemination of hard copies of all relevant documentation to both the public and private sectors;
- the possibilities open to expand the existing bulletin to include also all procurement notices to be published pursuant to the PPL;
- the desirability and likely effectiveness of improving working practices as well as dissemination of information through the establishment of (i) a local area network ("LAN") within the SPA and (ii) the creation of a procurement website which would provide access to all relevant documents (at least the PPL, implementing mechanisms; guideline documents and standard form bidding and contract documents);
- given that one of its functions is to establish and maintain, pursuant to the PPL, a blacklist of tenderers who have been found guilty of fraudulent or corrupt practices, the development and establishment of appropriate procedures for blacklisting capable of taking into account the number and gravity of offences so as to provide sequential and increasing penalties rather than a simple and indefinite suspension of eligibility.

4. Following this exercise, assist the SPA and Counterpart team in the search for and recruitment of additional appropriate technical, management and legal human resource skills needed to staff the existing and enhanced procurement functions of the SPA.

5. Identify and assist in the procurement of the required additional facilities in terms of computers, servers, LAN, printers, copiers etc.

6. Assist, where appropriate, in the identification and recruitment of suitable international and local consultants for the creation and maintenance of an information website.
7. Devise and develop a training strategy to (i) educate and train procurement staff within all relevant procuring entities in the implementation of the PPL and (ii) to inform contractors, suppliers and service providers of the system and to increase awareness of procurement opportunities presented by the PPL and demonstrate how such opportunities are to be achieved.

8. Conduct, in close cooperation with the SPA and the Counterpart team, an initial series of workshops for at least the three levels of procuring entity envisaged by the PPL (central and local government and the State-owned enterprises) and public awareness seminars/workshops for government departments in general (i.e. Not necessarily procurement officers), tenderers and the general public.

9. Establish, by way of benchmarking mechanisms, a comprehensive system for the assessment and monitoring of compliance with the PPL by procuring entities with a view to assisting the SPA in the preparation of its annual report, such system to be based on the existing and, to the extent necessary, improved reporting requirements set out in the PPL.

10. Carry out, on the basis of the benchmark mechanisms above, a series of random procurement audits on at least 2-3 contract procedures at each level of public authority covered by the PPL.

11. Make recommendations on possible improvements of either the legislative or institutional framework based on the results of the random audits above.

12. Generally, liaise, together with the SPA, with other donor agencies active in Azerbaijan with a view to avoiding a multiplicity of conflicting advice.

B   LOCAL IT CONSULTANT

The consultant will:

1. Assist in the development of the applications and website, assuring its long-term sustainability.

2. Assist the procurement consultant to define the necessary system inputs and outputs.

3. Design, develop and supervise the development of the management information system and website.

4. Procure and manage the installation of the computer hardware and software required to develop the applications and website.

5. Provide training to the users of the system and website in its operation and maintenance.

6. Assist in procurement of the necessary computer hardware and software.
# ANNEX IV A

## DETAIL CPAR ACTION PLAN

<table>
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<th>Risk</th>
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<th>Timeframe &amp; Status</th>
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<tr>
<td>*1A. Applicability of the PPL</td>
<td>Inadequate coverage of the PPL will lead to failure to reap the benefits of competitive tendering where it is most useful</td>
<td>All public funds emanating from taxpayers should ideally be subject to the provisions of the PPL. Guidance notes, training materials and seminars distributed and conducted by the SPA should make clear the entity coverage of the PPL with particular reference to what is meant by State funds. The meaning of &quot;other funds that are recognized by legislation as state funds&quot; should be clarified, preferably by an official statement or direction from the SPA or other relevant authority. The position of State owned enterprises and utilities should be made clear in the SPA's guidance notes and, where appropriate should be the subject of explicit normative-legal acts to ensure the correct coverage. Given the uncertainty over the status of many former public works departments, the SPA should consider providing guidelines which set out the permitted activities in the case of procurement procedures. For example, that any remaining works departments may be given works orders without any procurement procedures but that once they are corporatized and exist as separate legal entities, they must be treated as private companies. Where the State retains a participation, they may not bid on works contracts let by their former &quot;employers&quot;, though they may bid for contracts let by other Ministries, authorities or State owned enterprises.</td>
<td>Guidance is a priority but awaiting new Law on Municipalities. Ultimately requires an amendment to the PPL.</td>
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<tr>
<td>*1B. Donor-funded contracts</td>
<td>There is a likely conflict where the PPL does not make explicit the fact that donor funded contracts may be subject to donor procurement rules</td>
<td>This situation must be clarified and, notwithstanding the generally applicable legal provision in the Constitution which resolves conflict between national law and international agreements, a procurement specific provision should be expressly made, either by amendment to the PPL or by way of Decree. In addition, it should be clarified that, in case of conflict between the national and the donor-funded procurement rules, the latter will prevail.</td>
<td>Explanatory statement from SPA setting out the implications of Article 151 of the Constitution is a priority.</td>
</tr>
<tr>
<td>1C. Common threshold</td>
<td>The same threshold for works, supplies and services may lead to excessive regulation for small scale works or to an absence of sufficient regulation for large supplies and services contracts</td>
<td>Consideration should be given to providing for two thresholds, one for works and the other (lower) for goods and services.</td>
<td>Based on experience, can wait until amendment of the PPL.</td>
</tr>
<tr>
<td>1D. Bidder nationality</td>
<td>The absence of conditions for restrictions on bidders on account of nationality leaves procuring entities with excessive discretion</td>
<td>The conditions for the use of a limiting eligibility on the grounds of nationality must be explained.</td>
<td>Draft currently before the Cabinet of Ministers. Adopion a priority.</td>
</tr>
<tr>
<td>*1E. Prior authorization for procedures other than open tendering</td>
<td>Decrease in efficiency to require authorization where the conditions are clear in the PPL.</td>
<td>Consideration should be given to extending the right of review to include the selection of procurement methods in order to both decrease excessive bureaucracy and guarantee adherence to the PPL's conditions for the use of alternative methods of procurement.</td>
<td>Acceptable as transitional measure but should be removed within 1 to 2 years together with amendment of PPL.</td>
</tr>
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<td>Issue</td>
<td>Risk</td>
<td>Recommendations</td>
<td>Timeframe &amp; Status</td>
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<tr>
<td>*1F. Technical specifications</td>
<td>Rigidity in the conditions for the use of specifications may result in procuring entities buying something they do not want</td>
<td>The SPA might consider providing guidelines which state that where it is necessary and unavoidable to define such specifications etc. In a non-objective way, i.e. by reference to particular makes, products or processes, then it may exceptionally be permissible to do so provided that the words &quot;or equivalent&quot; are used.</td>
<td>SPA needs to be persuaded of value of amendment.</td>
</tr>
<tr>
<td>1G. Participation fees</td>
<td>Disincentive to bidders and procuring entities will see the prices offered increase commensurately</td>
<td>Participation fees should be abandoned as soon as possible. Any fees should be restricted to the cost of producing tender documents.</td>
<td>Priority.</td>
</tr>
<tr>
<td>*1H. Domestic preferences</td>
<td>Possibility of arbitrary exclusions where these are ill-defined</td>
<td>It is important that such margins and their rules of application be set out as soon as possible in a clear and precise manner and, where possible in order to achieve the objectives sought by the application of such preferences, taking into account the market relevant conditions on a product by product basis.</td>
<td>Draft currently before the Cabinet of Ministers. Adoption a priority.</td>
</tr>
<tr>
<td>2A. Staffing levels</td>
<td>Lack of capacity to carry out duties of implementing PPL</td>
<td>Cabinet of Ministers and Ministry of Finance should be approached to amend the current limitations.</td>
<td>Ongoing but should be seen as a priority for the Government.</td>
</tr>
<tr>
<td>2B. Information dissemination</td>
<td>Lack of capacity and resources will lead to sub-optimal implementation</td>
<td>Need to create an information website at the SPA. This should include not only the software and website development and maintenance costs but also the necessary equipment. There is also an immediate need to produce and disseminate more bulletins.</td>
<td>Priority. Possible IDF grant to assist with start-up. EU Tacis funds to develop system.</td>
</tr>
<tr>
<td>2C. Training</td>
<td>Insufficient training capacity will leave abuses and inappropriate procedures uncorrected</td>
<td>Training of SPA staff is required at two levels: training for familiarization purposes and the training of trainers. This should ideally take place at an appropriate training institution such as the ILO in Turin. A training strategy should be developed to ensure adequate in-country training to procuring entities at all levels of government and in all parts of the country. Steps should also be taken to establish a procurement profession perhaps beginning with a certification procedure through the SPA and/or associated schools or associations. Thought should be given to providing awareness training of senior government officials.</td>
<td>Priority. Possible IDF grant to fund training of trainers, notably in the area of review. EU Tacis funds to develop and implement full training strategy.</td>
</tr>
<tr>
<td>2D. Reporting</td>
<td>Inadequate information will hinder the proper monitoring and implementation of the PPL.</td>
<td>The design of the sample form of the TC's final minutes should be meticulously prepared a soon as possible. It is required to develop a comprehensive reporting system which would (1) oblige procuring entities to provide relevant information on a timely basis and (2) which would enable the SPA to gain access to country wide procurement statistics from a range of other relevant authorities.</td>
<td>Forms for both TC minutes and reporting have been prepared by SPA and currently before the Cabinet of Ministers. Adoption a priority.</td>
</tr>
<tr>
<td>2E. Blacklisting</td>
<td>Arbitrary blacklisting does not assist procuring entities nor does it improve domestic industry.</td>
<td>The SPA should set out clearly the bases for exclusion from future procurements and the level of penalties in terms of exclusion, preferably sequential. Provided the system is objective and transparent, leaving no room for abuse, blacklisted firms could be posted on the website.</td>
<td>Since work has begun on database, urgent need to ensure objectivity and fairness.</td>
</tr>
<tr>
<td><strong>Issue</strong></td>
<td><strong>Risk</strong></td>
<td><strong>Recommendations</strong></td>
<td><strong>Timeframe &amp; Status</strong></td>
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<td>2F. Ministry of Finance Intervention</td>
<td>A further ex post control by another authority is unnecessary (particularly where it is based on dubious logic) and causes further delay.</td>
<td>The Ministry of Finance should be encouraged (1) to reject tender prices only when they exceed the allocated budget and not when they differ from their own arbitrary average market prices and (2) develop and put in place a budget allocation system which is based on realistically estimated prices with a degree of flexibility.</td>
<td>Ongoing but should be seen as a priority.</td>
</tr>
<tr>
<td>2G. Bid Rigging</td>
<td>Cartel behavior seriously distorts competition and deprives the Government of best value.</td>
<td>The PPL includes a provision for excluding bidders found to have fixed prices but the conditions are wholly unclear. At the very least, the SPA should provide guidance on when the provision regarding price fixing should be used, preferably only when cartel behavior has been identified and proven by the relevant authorities. As a corollary, efforts should be made to strengthen the investigatory powers of the Anti-Monopoly Committee in the MOED to deal with such situations. In any event, strengthening of the AMO is required.</td>
<td>Guidance should be a priority but reform of AMO is a longer term task and dependent on EU Tacis program funding underway.</td>
</tr>
<tr>
<td>*3A. Estimating prices</td>
<td>Comparison between bid prices and estimated prices does not indicate unfair pricing but inaccurate estimates. Inappropriate reliance on estimated prices vitiates the competitive bidding procedure.</td>
<td>The SPA should issue guidance on the way in which prices are determined in a market economy (and, therefore, in a competitive bidding situation) in order to educate procuring entities as to the value and significance of the prices they will receive following a competitive bidding procedure and the futility of expecting such prices accurately to reflect any estimated prices they may have calculated. This should also be an important part of the training conducted by the SPA.</td>
<td>Ongoing but should commence as soon as SPA can be convinced of the danger of heavy reliance on estimated prices.</td>
</tr>
<tr>
<td><em>3B. Services Contracts</em></td>
<td>Lack of clarity on appropriate procedures to be used may result in inadequate evaluation.</td>
<td>Given the breadth of services covered, the SPA should take especial care in preparing appropriate standard tender and contract documents which are apt to apply to the range of services likely to be procured under the PPL. It may be useful for the SPA to provide guidance on when the nature of the services are such that they may be procured on the basis of open tendering or other procedures rather than on the basis of Chapter V, which should address intellectual services only.</td>
<td>Guidance contained in implementing regulations concerning services contracts. To be incorporated into amendment of PPL.</td>
</tr>
<tr>
<td>3C. Advertising</td>
<td>Lack of guidance may lead to an inadequate bidder response</td>
<td>The SPA should consider issuing guidance on when it is appropriate to advertise in publications with international circulation.</td>
<td>Within 1 year.</td>
</tr>
<tr>
<td>3D. Verification of uncompetitive or fraudulent behavior and/or misrepresentation</td>
<td>Inappropriate to burden procurement officers with task of making such decisions. In the wrong hands, this power may easily lead to abuse.</td>
<td>For the avoidance of doubt, the SPA should issue guidance setting out how misrepresentation may be proven and by whom, although this may be better in the PPL itself. SPA should put in place a specific procedure aimed at verifying the existence of fraudulent practices under Article 12.</td>
<td>Priority.</td>
</tr>
<tr>
<td>3E. Pre-qualification</td>
<td>Burdensome and unnecessary to use pre-qualification in all procedures</td>
<td>Given that pre-qualification may be used for all works, goods and services contracts, thought should be given by the SPA to explaining to procuring entities those circumstances in which pre-qualification might be most appropriate rather than allowing a situation to arise in which recourse is had to pre-qualification as a matter of course.</td>
<td>Within 1 year.</td>
</tr>
<tr>
<td>3F. Price adjustment</td>
<td>The absence of agreement appropriate formulae may jeopardize completion.</td>
<td>It is imperative that the price adjustment formulae be completed as soon as possible. These should be included in the procurement contracts.</td>
<td>Currently before the Cabinet of Ministers. Adoption a priority.</td>
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<tr>
<td>3G. Tender cancellation</td>
<td>Rigid policies will result in a failure to purchase needed supplies or services (works)</td>
<td>SPA should provide guidelines to clarify the situations in which such an automatic cancellation of tenders is the correct response and set out the appropriate course of action.</td>
<td>Within 1 year.</td>
</tr>
<tr>
<td>4A. Awareness</td>
<td>Private sector tenderers must be fully informed of the implications of the PPL</td>
<td>Public awareness and tenderer awareness campaigns are needed now that the PPL has been adopted.</td>
<td>Priority. Possible IDF grant</td>
</tr>
<tr>
<td>4B. Tender securities</td>
<td>Uncertainty may lead to undesirable exclusion</td>
<td>The SPA should issue guidance on the standard form of tender securities and on the procedures for their submission.</td>
<td>Within 1 year.</td>
</tr>
<tr>
<td>4C. Review</td>
<td>The absence of an appropriate and effective review mechanism will lead to a lack of confidence in the system by tenderers. Procuring entities will be the losers</td>
<td>The SPA should issue a “practice direction” setting out the bases for obtaining and the level of damages to be awarded for breaches of the PPL. The SPA should develop a medium to long term internal review structure and ensure the build up of sufficient capacity in terms of staff trained in dispute resolution. Efforts to be made by relevant authorities to ensure that SPA has the power to make binding decisions.</td>
<td>Within 1 year. Possible IDF grant to assist with training for review purposes. Part of wider TA program to be funded by EU Tacis.</td>
</tr>
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# ANNEX IV B
The CPAR action plan is being implemented by the SPA Per the PM approved
**ACTION PLAN FOR THE IMPROVEMENT OF PUBLIC PROCUREMENT IN THE AZERBAIJAN REPUBLIC**

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<th>Issues and determined objectives</th>
<th>Actions to be taken</th>
<th>Timeframe</th>
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<tr>
<td>1</td>
<td>Coverage of public procurement&lt;br&gt;a) Applicability of the PPL and the concept of &quot;public funds&quot; should be clearly defined;&lt;br&gt;b) Procuring entities that carry out procurement of goods (works and services) using public funds should be fully covered by the law.</td>
<td>The meaning of government receipts from taxes, duties and other fees, credit and grant funds contracted upon government guarantees under international contracts, funds of enterprises and joint-stock companies with state-owned share in the capital equal 30% and more, as well as &quot;other funds that are recognized by legislation as public funds&quot; should be clarified, and the concept of those should be specified in relevant guidelines. Procuring entities that carry out procurement of goods (works and services) using those public funds should be the subjects of the PPL, and this has to be approved by relevant normative-legal documents. Issues on including municipalities and public organizations in the coverage of the PPL should be reviewed, and relevant additions shall be made to the legislation in this regard. Database should be established with regard to procuring entities and tenders these entities conduct for procurement of goods (works and services) using public funds.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>2</td>
<td>Conflict of interests in public procurement</td>
<td>Based on the status of former public enterprises, departments and organizations under the framework of privatization program, participation of those in procurement procedure should be determined by State Procurement Agency. Should these enterprises be dependent on procuring entities or become private companies after incorporation, the terms of their participation in tenders should be clarified. Should the legislation prohibit enterprises that are dependent on procuring entity from participating in tenders conducted by that procuring entity, the possibility for such enterprises to participate in tenders conducted by other procuring entities should be determined. In order for public enterprises, departments and organizations not to create the conflict of interest during procurement that is conducted in relation to their incorporation in accordance with privatization program, the legal status of those enterprises, departments and organizations should be constantly supervised, and procuring entities should be instructed in this regard. The issues mentioned should be included in the ongoing seminar program on public procurement, and attendants of the seminar should informed in detail on this matter.</td>
<td>During 2003-2004</td>
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<td>3</td>
<td>Donor-funded public procurement&lt;br&gt;a) Rules on tenders conducted under donor-funded public procurement and resolution of possible conflicts between these rules and the PPI.</td>
<td>Rules on tenders that are conducted under donor-funded public procurement should be clarified. Instructions related to tender documents, terms of procurement contracts, procedural rules and other formal requirements should be clarified. In order to eliminate possible conflicts with the legislation that governs public procurement in the Azerbaijan Republic, relevant normative-legal documents should be adopted, or relevant additions should be made to existing legislation.</td>
<td>During 2003</td>
</tr>
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<td>4</td>
<td>Minimum price threshold for open tender in procurement of goods (works and services)</td>
<td>By analyzing the international practice, a minimum threshold used in other countries for procurement of goods, services and individual works through open tender should be studied. Under current condition of the country, the minimum price threshold that is determined by the PPL for conducting an open tender for procurement of goods and services should be differentiated from the minimum price threshold for procurement of works. In order to improve effectiveness of bidding competition, the minimum price threshold for open procurement tenders for goods and services should be set lower than that for procurement of works.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>5</td>
<td>Restriction of supplier (contractor) on the grounds of nationality&lt;br&gt;a) Conditions for restriction of supplier (contractor) from participation in procurement procedures on the grounds of nationality, and legal justifications for this.</td>
<td>The conditions for restricting participation of supplier (contractor) in competitive bidding on public procurement in the Azerbaijan Republic on the grounds of nationality should be explained. Restriction of participation of supplier (contractor) in competitive bidding on public procurement on the grounds of nationality should be determined based on existing legislation and decrees adopted under international agreements. Azerbaijan Republic is a party to, and normative-legal documents in this regard should be drafted and adopted.</td>
<td>During 2003</td>
</tr>
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<td>Actions to be taken</td>
<td>Timeframe</td>
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| 6  | Application of open tender and other procurement methods  
   a) Clarification of terms and procedures for use of procurement methods envisaged in the PPL | In accordance with provision of the PPL, specific features and procedures of application of open tenders and other procurement methods should be clarified, broad explanations should be given in respect to their terms, and recommendation regarding application should be provided in relevant documents. Instructions and methodical manuals with regard to arranging and carrying out procurement of goods, works and services through various methods should be developed and adopted in a determined manner. Broad information should be provided at seminars on procurement methods. | During 2003 - 2004      |
| 7  | Requirements regarding technical specifications of the set of main terms of tender                | In order for a tender to be held under fair conditions, requirements with regard to technical specifications of goods, works, and services should ensure fair competition and create equal approach to bidders. Requirements on technical specifications should be explained in detail at seminars, and training in this regard should be envisaged as well. Broad explanations should be provided in respect to provisions of the PPL article on description of goods (works and services), as well as methodical manuals on this should be developed and adopted. In order to improve requirements with regard to description of goods (works and services), proposals should be prepared based on gained experience, about making changes and additions to the legislation. | By end-2003             |
| 8  | Tender participation fee  
   a) High tender participation fees envisaged by procuring entities artificially limits the number of tender participants | Certain measures should be taken in order to lower the tender participation fee to an extent possible. Any payment by bidders during a tender should not exceed the costs of producing of tender documents and delivery of those to bidders. Relevant proposals should be prepared and adopted with regard to simplification of tender participation fee in legislative documents. | In the first half of 2004 |
| 9  | Application of preferential discounts in favor of tender proposals on local goods (works and services) | In order to justify application of preferential discounts in favor of tender proposals on local goods (works and services) in the process of public procurement and to eliminate possible difficulties, relevant guidelines should be prepared and approved with regard to application of discounts when types of goods and services are identified, taking into account the domestic market and local producers. | October 2003            |
| 10 | Staff capacity of the State Procurement Agency  
   a) In order to ensure the implementation of the PPL, the State Procurement Agency needs to increase the number of staff | In order to meet current demand, the Cabinet of Ministers and the Ministry of Finance should take relevant measures. In order for the staffing table of the State Procurement Agency to be revised, relevant proposals should be presented to the Cabinet of Ministers. | August 2003             |
| 11 | Dissemination of information on public procurement  
   a) Lack of technical and financial capacities creates difficulties in broad dissemination of information on public procurement | In order to ensure dissemination of information about public procurement, technical assistance should be provided to the State Procurement Agency. Also, under the grant funding to be provided, the Agency should be provided with local administrator computer network, software, computerized database, website, computer hardware, as well as copying and other hardware to produce and disseminate bulletins and training materials. | April 2003              |
| 12 | Seminars and training on public procurement, establishment of a training center  
   There is a big need in broad involvement of specialists in seminars and training courses on public procurement, and thus there is a need to improve financial and technical capacities of the State Procurement Agency | Two types of training program seminars should be organized for staff of the State Procurement Agency. Technical assistance should be envisaged for this. These funds should be mainly used to improve professional skills of employees of the Agency, whereas the remaining amount should be spent on training of trainers. For this purpose, capacities of the ILO in Turin should be used.  
   Technical assistance should be provided to organize in-country training and seminars for government officials involved in public procurement. Attendants of seminars and training courses should be provided with relevant certificates. In order to improve seminars and training courses, proposals should be prepared and submitted to the Cabinet of Ministers regarding establishment of a training center under the State Procurement Agency. Involvement of government officials in short-term training courses should be envisaged in order to provide awareness training to them. | During 2003-2004        |
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<td>13</td>
<td>Reporting on public procurement&lt;br&gt;Reporting on public procurement should meet requirements of the PPL and create conditions for monitoring.</td>
<td>In order to create reporting system in the field of public procurement, technical assistance should be provided to the State Procurement Agency. The system to be developed should envisage timely presentation of relevant information by procuring entities and enable to collect public procurement statistics within the country. A relevant database should be organized in this regard. Monitoring data should be constantly analyzed, and relevant guidelines should be prepared with regard to elimination of shortcomings and difficulties detected in application of the legislation.</td>
<td>June 2003</td>
</tr>
<tr>
<td>14</td>
<td>Blacklisting of supplier (contractor)</td>
<td>The State Procurement Agency should keep the list of suppliers (contractors) that fail to meet obligations undertaken under competitive biddings on public procurement, as well as under procurement contracts, on time and in accordance with envisaged quality requirements. Depending on shortcomings, which suppliers (contractors) have had in the process of competitive biddings or during execution of procurement contract, the rates of fines to be applied against those suppliers should be determined. Information about such suppliers (contractors) should be constantly posted on the website of the State Procurement Agencies, as well as published in bulletins and press. Participation of a blacklisted supplier (contractor) in future competitive biddings should be restricted for a certain period of time.</td>
<td>September 2003</td>
</tr>
<tr>
<td>15</td>
<td>Cases of collusion aimed at increasing prices in tenders</td>
<td>In order to detect and prevent cases of collusion aimed at increasing prices in public procurement tenders, procuring entities should carry out marketing operations at the stage of tender procedures planning, and calculate an estimated price of goods (works and services) under procurement. Methodical assistance and relevant guidelines should be provided in carrying out the above-mentioned operations. This issue should be broadly discussed at seminars and training courses.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>16</td>
<td>Review, evaluation, and comparison of tender proposals</td>
<td>The methodical guidelines paper on comparison and evaluation of tender proposals should be prepared and approved, depending on specific features, complexity and volume of goods (works and services) to be procured. This document should provide for detailed explanations and recommendations regarding criteria that define the subject of tender, and determination of their reference prices.</td>
<td>October 2003</td>
</tr>
<tr>
<td>17</td>
<td>Key method for procurement of complex services</td>
<td>When it is practically impossible to prepare a detailed design of specific features of complex services, or when it is impossible to apply open tendering or other procurement methods due to technical nature, special guidelines should be developed with regard to arranging and carrying out the procurement of such services, as well as preparing of the set of main terms of a tender, and these guidelines should differ depending on the type of services to be procured (advisory services, services of various experts under complex projects, service in the field of scientific research).</td>
<td>By end-2003</td>
</tr>
<tr>
<td>18</td>
<td>Tender announcement&lt;br&gt;Selection of locally and internationally circulated press for publishing of a tender advertisement</td>
<td>In order to ensure broad participation of bidders in competitive biddings held with regard to public procurement, a local official newspaper, as well as international press where tender advertisement is to be published should be selected, and procuring entities should be informed about the form and the way of posting of such tender advertisement with those press bodies. This issue should be a separate topic for discussion at seminars.</td>
<td>In the fist half of 2003</td>
</tr>
<tr>
<td>19</td>
<td>Cases of uncompetitive and fraudulent behavior&lt;br&gt;Clarification of cases of fraud in public procurement and specification of relevant provisions of the PPL in this regard</td>
<td>Relevant normative-legal acts should be prepared and approved on detection of cases of uncompetitive and fraudulent behavior in public procurement and on taking of appropriate measures in this regard.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>20</td>
<td>Qualification procedures&lt;br&gt;Specification of cases that require carrying out qualification procedures</td>
<td>Cases that require pre-qualification of bidders prior to carrying out tender procedures on public procurement should be clarified in relevant methodical documents. Instruction papers that are prepared by the State Procurement Agency should include the procedure that identifies qualification of a tender participant, and detailed explanations and recommendations should be provided on this matter at the seminars.</td>
<td>During 2003</td>
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<td>#</td>
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<td>21</td>
<td>Contract price adjustment during the period of implementation of procurement contract</td>
<td>Adjustment of a contract price in the course of implementation of procurement contract due to reasons beyond the activities of both the procuring entities and the winning bidder should be done in accordance with procedures approved by the Cabinet of Ministers Decree # 165 dated October 28, 2002, and the method of calculation of impact from adjustment of prices of goods (works and services) on procurement contract should be specified in the set of main conditions of tenders, as well as relevant methodical guidelines on application of this method should be prepared.</td>
<td>April 2003</td>
</tr>
<tr>
<td>22</td>
<td>Tender cancellation</td>
<td>Reasons for cancellation of a tender should be analyzed by the State Procurement Agency, as well as recommendations and advise should be provided to procuring entities at seminars and training courses with regard to organizing and conducting a tender, including broad involvement of bidders, in order to minimize such cases in future.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>23</td>
<td>Dissemination of normative-legal acts on public procurement</td>
<td>Legislative documents governing public procurement should be continuously published in bulletin of the State Procurement Agency, as well as in the form of separate set of normative-legal documents. At the same time, adopted normative-legal acts should be posted at the website of the State Procurement Agency. Participants of seminars should be provided with printouts of normative-legal acts. Detailed explanations should be provided with regard to methodical guidelines on provisions of legislative acts that govern public procurement.</td>
<td>During 2003-2004</td>
</tr>
<tr>
<td>24</td>
<td>Tender proposal security and procurement contract performance bonds</td>
<td>The form and conditions should be designed and approved in respect to guarantees that are required from bidders in the course of public procurement competitive biddings or in respect to execution of procurement contract to be signed with tender winner, depending on procurement of goods, works or services. Requirements in respect to tender proposal security and procurement contract performance bond, including advance security, should be reflected in the set of main conditions of tenders.</td>
<td>September 2003</td>
</tr>
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<td>25</td>
<td>Procedures for filing and review of complaints</td>
<td>Relevant normative-legal acts should be prepared and approved, in order to create an effective mechanism for review of complaints in the field of public procurement. These documents should specify rights of supplier (contractor) participating in a tender, cases and procedures for filing of complaints, as well as include provisions about review of complaints by procuring entities prior to enactment of procurement contract, and administrative and court review after enactment of procurement contract.</td>
<td>December 2003</td>
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ANNEX V

SUPPLEMENTAL LETTER ON NATIONAL COMPETITIVE BIDDING (NCB) PROCEDURES

In connection with the Development Credit Agreement of this date between the Republic of Azerbaijan and the International Development Association (the Association) for the above-captioned Project, I [insert name], the undersigned, am authorized to act on behalf of the Republic and to represent that the procedures to be followed for national competitive bidding under the Loan/Credit Agreement shall be those set forth in the Public Procurement Law of December 27, 2001 subject to the clarifications enumerated in the following paragraphs and required for compliance with the provisions of the “Guidelines for Procurement under IBRD Loans and IDA Credits” (the Guidelines).

1. There will be no eligibility restrictions based on nationality of bidder and/or origin of goods.

2. Pre-qualification shall not be used for simple goods and works procurement and shall be conducted only for large works projects.

3. Entities in which the State or a State official owns a shareholding of whatever size shall not be invited to participate in tenders for the Government unless they are and can be shown to be legally and financially autonomous and they operate under commercial law.

4. No national preferences may be applied on the basis of the origin of products or labor.

5. Joint venture partners shall be jointly and severally liable for their obligations.

6. No “participation fee” shall be required of bidders for the purchase of bidding documents. The only charge shall be equivalent to the cost of producing (copying) the bidding documents.

7. In the evaluation of bids, bids may not be rejected where they differ substantially from the estimated prices calculated by the procuring entity, except where the bid prices exceed the available budget.

8. Rebidding shall not be carried out without the Bank’s prior approval.

9. Works contracts of more than 18 months’ duration shall include appropriate price adjustment provisions.

10. Advance Bank approval is required for any modifications in the contract scope/conditions during implementation.