

Azerbaijan: World Bank Country-Level Engagement on Governance and Anticorruption

IEG Working Paper 2011/9

Clay Wescott, Raj Desai and Antti Talvitie



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Clay Wescott
Raj Desai
Antti Talvitie

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Independent Evaluation Group, The World Bank Group
1818 H St., NW
Washington, DC 20433

1 2 3 4 22 21 11

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ISBN 13: 978-1-60244-206-1
ISBN 10: 1-60244-206-1

Contact: IEG Communication, Learning and Strategies (IEGCS)
E-mail: ieg@worldbank.org
Telephone: 202-458-4497
Facsimile: 202-522-3125
<http://www.worldbank.org/ieg>

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Abbreviations

| | |
|--------|--|
| AAA | Analytic and advisory activities |
| ACGP | Azerbaijan Corporate Governance Project |
| ADB | Asian Development Bank |
| APL | Adaptable program loan |
| ARS | Azerbaijan Road Service |
| AZN | Azerbaijan Manat |
| BEEPS | Business environment and enterprise performance survey |
| CAPSAP | Corporate and Private Sector Accountability Project |
| CAS | Country Assistance Strategies |
| CASCR | CAS Completion Report |
| CCT | Conditional Cash Transfer Program |
| CDD | Community Driven Development |
| CFAA | Country Financial Accountability Assessment |
| CGAC | Country Governance and Anticorruption |
| CIDA | Canadian International Development Agency |
| CIS | Commonwealth of Independent States |
| CO | Country Office |
| CPAR | Country Procurement Assessment Report |
| CPIA | Country Policy and Institutional Assessment |
| CPS | Country Partnership Strategy |
| CSO | Civil society organization |
| DAC | Development Assistance Committee |
| DANIDA | Danish International Development Agency |
| DFID | Department for International Development (UK) |
| DPL | Development Policy Loan |
| EBRD | European Bank for Reconstruction and Development |
| EITI | Extractive Industries Transparency Initiative |
| EMIS | Education Management Information System |
| ESAF | Enhanced Structural Adjustment Facility |
| ESW | Economic and sector work |
| EU | European Union |
| FY | Fiscal year |
| GAC | Governance and anticorruption |
| GAVI | Global Alliance for Vaccines and Immunization |
| GDP | Gross domestic product |
| GEF | Global Environment Facility |
| GPF | Governance Partnership Facility |
| GTZ | Deutsche Gesellschaft für Internationale Zusammenarbeit (German International Cooperation) |
| IBRD | International Bank for Reconstruction and Development |
| ICA | Investment Climate Assessment |
| ICR | Implementation Completion and Results |
| IDA | International Development Association |
| IEG | Independent Evaluation Group (World Bank Group) |
| IFAD | International Fund for Agricultural Development |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| INT | Department of Institutional Integrity (World Bank) |
| JMP | Judicial Modernization Project |
| LIL | Learning and Innovation Loan |
| MTEF | Medium Term Expenditure Framework |
| NASCO | Accounting standards for commercial organizations |
| NGO | Nongovernment organization |
| ODA | Official development assistance |

| | |
|---------|--|
| OECD | Organization for Economic Cooperation and Development |
| OSI | Open Society Institute |
| PEFA | Public Expenditure and Financial Accountability assessment |
| PER | Public Expenditure Review |
| PETS | Public Expenditure Tracking Survey |
| PFM | Public financial management |
| PIP | Public Investment Program |
| PISA | Program for international student assessment |
| PIU | Project implementation unit |
| PRGF | Poverty Reduction and Growth Facility |
| PRSP | Poverty Reduction Strategy Paper |
| SAF | Structural Adjustment Facility |
| SECO | State Secretariat for Economic Affairs (Switzerland) |
| SIDA | Swedish International Development Cooperation Agency |
| SOE | State-owned enterprise |
| SWaP | Sectorwide Approach (World Bank) |
| TACIS | Technical assistance to the Commonwealth of independent states |
| TIMS | Treasury information management system |
| TRACECA | Transport Corridor Europe – Caucasus – Asia |
| TTL | Task team leader (World Bank) |
| UNAIDS | United Nations Program on HIV/AIDS |
| UNDP | United Nations Development Program |
| UNFPA | United Nations Population Fund |
| UNHCR | United Nations High Commissioner for Refugees |
| UNICEF | United Nations Children’s Fund |
| UNODC | United Nations Office on Drugs and Crime |
| USAID | United States Agency for International Development |
| USD | United States Dollar |
| VAT | Value added tax |
| WDR | World Development Report |
| WFP | World Food Program |
| WTO | World Trade Organization |

Preface

This case study summarizes the findings of desk reviews and a country field visit carried out in January 2011 as part of the Independent Evaluation Group's (IEG's) evaluation of the 2007 Governance and Anticorruption Strategy. The case study sought to evaluate the relevance and effectiveness of Bank support for governance and anticorruption efforts over the FY2004-10 period, to assess the contributions of 2007 GAC strategy implementation, and to identify early outcomes and lessons.

The case study was prepared by Clay Wescott (lead), Raj Desai, and Antti Talvitie as a background paper for IEG's GAC evaluation. The report was prepared under the supervision of Navin Girishankar and the overall guidance of Cheryl Gray and Ali Khadr.

The authors are grateful to officials from the Government of Azerbaijan and the World Bank's Country Team for constructive discussions. The paper benefitted from comments from the Bank's Baku Country Office. The authors are also grateful for comments from the IEG's GAC Evaluation team members. Barbara Balaj provided editorial support and Aimée Niane provided administrative support.

The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors and do not represent the views of the World Bank, its Executive Directors, or the countries they represent.

Summary

Azerbaijan is a secular, majority-Shiite, oil and gas-rich country whose per-capita income quadrupled in real terms during the period 2004–10. While rising incomes have reduced poverty, steps towards a more secure, diversified economy are held back by a public sector that rests on vested interests, patronage-based incentive structures, and ingrained patterns of behavior that include significant rent extraction, particularly from the non-oil economy, with minimal checks and balances from Parliament, the private sector, and civil society.

Bank engagement in Azerbaijan at the country level focused on areas which had government support. Some modest results have been achieved, even though in many cases modern laws and practices were adopted without adequate plans for implementation. At the project level, the Bank has supported the strengthening of project implementation units (PIUs) and tools for monitoring, and governance and institutional filters have signaled that Governance and Anticorruption (GAC) processes need to be embedded in the Bank projects. At the sector level, the Bank's work was highly relevant in supporting oil revenue transparency, primary education, roads, and the development of safeguards. It was substantially relevant in public financial management, and private sector development and procurement. Bank engagement was moderately relevant in decentralization, civil service reform, and accountability institutions.

Effectiveness at the country level is rated negligible, with some progress on GAC issues, but there has been too much emphasis on changing formal rules without affecting actual government behavior. The Bank was moderately effective at the project level in using GAC-related tools such as a Governance Action Plan. These actions were, however, insufficient in managing portfolio risks and delays. There was negligible effectiveness in the use of country systems, with ring fencing used instead. Ratings at the sector level ranged from highly effective Extractive Industries Transparency Initiative (EITI) oil revenue transparency measures on the one hand, to negligible effectiveness in decentralization, civil service, investment climate, and accountability institutions on the other. The overall impact of GAC strategy implementation was moderate. Despite the engagement of management and staff on GAC issues, there were serious shortcomings in several operational responses, including an overambitious design, and an unrealistic estimate of the Bank's and government's ability to adequately address GAC issues in a sharply scaled-up program.

Table S.1 Azerbaijan—Summary IEG Assessment

| GAC Elements | IEG Ratings | |
|---|-------------|---------------|
| | Relevance | Effectiveness |
| 1. GAC at Country Level | ■ ■ | ■ |
| 2. GAC in Sector Level | | |
| <i>Core Public Sector</i> | | |
| Public Financial Management (PFM) | ■ ■ ■ | ■ ■ |
| <i>Oil revenue transparency</i> | ■ ■ ■ ■ | ■ ■ ■ ■ |
| Decentralization | ■ ■ | ■ |
| Procurement | ■ ■ ■ | ■ ■ |
| Civil Service Reform | ■ ■ | ■ |
| <i>Basic Service Delivery</i> | | |
| Roads | ■ ■ ■ ■ | ■ ■ ■ |
| Land acquisition policy framework | ■ ■ ■ ■ | ■ ■ ■ |
| Primary Education | ■ ■ ■ ■ | ■ ■ |
| <i>Investment Climate</i> | ■ ■ ■ | ■ |
| <i>Accountability Institutions</i> | ■ ■ | ■ ■ |
| 3. GAC at Project Level | ■ ■ | ■ ■ |
| Implementation of GAC-related tools | ■ ■ | ■ ■ |
| Use of Country Systems | ■ | ■ |
| 4. 2007 GAC Strategy Implementation | | |
| Staff attitudes towards GAC issues | ■ ■ | ■ ■ |
| Enhancing quality of operational response | ■ ■ | ■ ■ |

Ratings: ■ Negligible || ■ ■ Moderate || ■ ■ ■ Substantial || ■ ■ ■ ■ High

Source: IEG

1. Introduction

Background: 2007 GAC Strategy and Implementation Plan

1.1 The 2007 strategy—a corporate strategy—set forth several objectives relating to the development of capable and accountable states and committed the Bank to seven principles of engagement on GAC issues (Box 1). In response to shareholder concerns about the perceived arbitrariness of senior management decisions to cut off lending to certain countries, the strategy reiterated the Bank’s use of rules-based criteria for allocating resources, as well as its aim to stay engaged even in poorly governed countries to ensure that the “poor do not pay twice.” At the same time, the strategy placed considerable emphasis—more than earlier strategies—on safeguarding Bank funds from fiduciary risks. Early on, it was acknowledged that, to achieve its “vision of success,” the strategy required a more detailed implementation plan.

Box 1.1 The Multiple Objectives and Guiding Principles of the 2007 GAC Strategy

1. The GAC strategy had several objectives:
 - “to support poverty reduction....”
 - “...[by] developing capable and accountable states[undertaking] sound policies, improving service delivery, [establishing] rules for markets, combating corruption,” and
 - “...to ensure that its funds are used for their intended purposes.”
2. In addition, the “GAC guiding principles” were as follows:
 - Focus on “[a] capable and accountable state to create opportunities for poor people, provide better services, and improve development outcomes.”
 - Country ownership and leadership are key. Country government is the principal counterpart.
 - Remaining engaged so the poor do not pay twice.
 - Consistent approach across countries, even though one size does not fit all.
 - Engage broad set of stakeholders with focus on transparency, accountability, and participation.
 - Strengthen rather than bypass country systems.
 - Harmonization (the Bank will not act in isolation).

Source: World Bank documents.

1.2 The implementation plan (IP) sought to define concrete steps for “what the World Bank itself will do to support the GAC agenda, and how it will work with governments, domestic stakeholders, and development partners to support country-level governance improvements and regional and global initiatives.” The plan’s success was to be measured by (i) a significant and growing number of countries seriously addressing key governance impediments to development effectiveness and poverty reduction; (ii) Bank-supported projects and programs increasingly addressing GAC impediments; and (iii) countries and

global partners valuing and respecting the Bank's capacity in this area (World Bank 2007a). It was envisaged that these objectives would eventually be reflected empirically in improvements in country governance performance.

1.3 To this end, the IP proposed to deliver guidance materials, tools, training, incremental resources, and strategic staffing to help deepen Bank engagement in the following areas:

- *GAC-in-Countries.* These initiatives sought to enhance Bank-country engagement on governance and anticorruption issues. Initially, country-GAC (CGAC) processes – comprising joint workshops, peer-to-peer learning events, clinics, and upstream assessment activities – were launched in 27 countries to help Bank teams systematically diagnose governance challenges and identify ways of addressing them through CAS design, sector strategies, and project preparation. The CGAC processes were intended to deepen the Bank's understanding of what can be done to strengthen GAC in CASs and help identify governance entry points (for example, core public management and accountability institutions, private sector engagement, and demand-side capacities and frameworks). Following the CGACs, a more targeted effort involving 18 countries sought to enhance GAC responsiveness with the help of considerable support provided under the Window One facility of the Governance Partnership Facility (GPF).¹
- *GAC-in-Sectors and GAC-in-Projects.* These efforts aimed to strengthen incentive and accountability frameworks in sector dialogue and project design, as well as systematic risk assessment and management (for example, through the use of political economy analysis, actionable governance indicators, and demand-side measures). Guidance notes and toolkits were designed to advise Bank teams on how to address GAC issues in the sectors and to support cross-cutting concerns, such as social accountability (World Bank 2008b and 2009c). Also included were handbooks, tools, and training to support efforts to prevent fraud and corruption in projects.² A 2009 Quality Assurance Group (QAG) survey of projects approved in FY08 aimed to establish a baseline for incorporation of "generic" GAC elements in projects (World Bank 2009f).
- *Global GAC Efforts.* The Bank proposed to increase its involvement in peer learning networks and collaborative governance initiatives. These included the Extractive Industries Transparency Initiative (EITI) and global and regional legal conventions such as the Stolen Asset Recovery (StAR) Initiative,³ Medicines Transparency Alliance (MeTA), and Construction Sector Transparency (CoST) Initiative. In addition, the Bank sought to harmonize GAC policies (for example, on cross-

¹ World Bank (2008a); IEG, Back-to-Office Report, October 2010.

² Recent efforts included the introduction of new procurement and financial management risk management systems (P-RAMS and PRIMA).

³ Closely related were efforts to help strengthen the integrity of financial sectors in developing countries through a sound Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime. More recently, the Bank helped launch of the International Corruption Hunters' Network to facilitate closer cooperation among enforcement agencies around the world.

debarment) with other multilateral development banks, and to establish common response principles for high-risk countries under the auspices of Gov-Net.

1.4 *Internal Reforms.* Other important internal reforms were carried out as complements to the GAC agenda, including implementation of Volcker Panel recommendations on strengthening the Integrity Vice Presidency,⁴ launch of a new WBI strategy emphasizing multistakeholder engagements (World Bank 2009a), update of the Bank's disclosure policy,⁵ launch of a new Operational Risk Assessment Framework (ORAF) for investment lending, the recruitment of a Chief Risk Officer, an annual integrated risk monitoring report, and other efforts to modernize investment lending (World Bank 2011a).

1.5 *Resourcing the Strategy.* Significant incremental budgetary and donor resources were deployed over the FY08–12 period to support GAC implementation. This comprised \$54 million in incremental Bank budget as well as \$61 million in donor funds allocated through the GPF. The GPF was supported by the United Kingdom, the Netherlands, and Norway.

1.6 *Change Management.* GAC implementation was viewed as a significant change management agenda. Institutional arrangements to support this Bank-wide initiative prominently featured a GAC Council, consisting of the Vice Presidents and chaired by the Managing Directors. The Council was supported by a GAC Secretariat, various other partnership secretariat units, and GAC focal points in Regional and network units. The Bank also periodically sought the advice of a Group of External Advisers, an Independent Advisory Board (that advises the President and Audit Committee on Integrity Vice Presidency performance), and an International Technical Advisory Group (that advises on the Use of Country Systems pilot).

IEG GAC Evaluation and Country Case Studies

1.7 The evaluation aims to help enhance the Bank's approach to governance and anticorruption and to improve its effectiveness in helping countries develop capable and accountable states that create opportunities for the poor. Pursuant to this objective, the evaluation assessed the relevance of the 2007 GAC strategy and implementation plan, as well as the efficiency and effectiveness of implementation efforts in making Bank engagement with countries and other development partners more responsive to GAC concerns. It also sought to identify early lessons about what works and what does not in helping to promote good governance and reduce corruption.

1.8 A key component of the evaluation involved case studies of six country programs over the FY04-10 period: these case studies assessed the quality of Bank country engagement on

⁴ Recommendations included the establishment of an Independent Advisory Board; appointment of an external member of the Sanctions Board as the chairperson; development of a confidentiality protocol; transfer of the responsibility for staff misconduct from the Integrity Vice Presidency to Bank's office of Ethics and Business Conduct; enhancement of selected staff rights to improve fairness of internal investigations; expansion of the Preventive Services Unit; strengthening of communication between the Integrity Vice Presidency and the Regions; and refinement of Integrity Vice Presidency results metrics. See Volcker and others (2007).

⁵ Four out of 11 ORAF risks relate to GAC: country risk, sector/multisector institutional, implementing agency governance risks, and implementing agency fraud, and corruption risks.

GAC issues, and identified what has worked and what has not in implementing GAC efforts. Case studies were selected from a quasi-random sample of twelve candidate countries, which sought to ensure representation across geographic regions and countries that received special GAC support over the FY07-10 period. Based on IEG's desk review of GAC responsiveness, country programs with *documentary evidence of some degree of GAC-responsiveness* over the pre- and post-GAC periods were selected for case studies. Accordingly, case studies were conducted in Azerbaijan, Bangladesh, Cambodia, Guatemala, Liberia, and Moldova. Field missions to these countries were undertaken between December 2010 and February 2011. Case studies were reviews from World Bank country teams and comments were duly incorporated.

1.9 The Azerbaijan case study is based on an extensive desk review as well as a field visit to Baku from January 10-14, 2011. It evaluates the relevance and effectiveness of Bank support for governance and anticorruption efforts since the launch of the Bank's Governance and Anticorruption (GAC) Strategy in 2007. It elaborates on a desk review of the GAC responsiveness of the Bank's Azerbaijan program and reviews the following GAC entry points: core public sector reform (public financial management, revenue transparency, procurement, and civil service); GAC in sectors (roads, education, and social protection); investment climate; and accountability institutions. The case study also focused on the extent to which the Bank's GAC Strategy has made a difference in staff attitudes toward addressing GAC issues in their operational work. The mission interviewed key donors, nongovernmental organizations (NGOs), government officials, and staff in the project implementation units (PIUs) and the Bank Country Office.

1.10 This evaluation reviewed the work by the Bank and other donors in core public sector areas and possible links with improvements in service delivery. The mission looked at the opportunities for using country systems, third-party monitoring mechanisms, enhanced donor coordination, and other processes that are part of the GAC agenda. Also examined were geographic effects and other strategic elements that might affect the willingness of the government to reform, and the leverage that the Bank and other donors might have in promoting reform. Finally, the mission assessed whether opportunistic responses to governance challenges might contribute to a future portfolio-wide approach to improving governance.

2. Azerbaijan Country Context

2.1 Azerbaijan's per-capita income quadrupled in real terms during the period 2004–10. The increase was primarily driven by large pipeline investments that became operational in 2006, and was supported by rising oil prices. Growth in gross domestic product (GDP) from 2005 until the global financial crisis of 2008 averaged 20 percent per year. Between 2001 and 2008 the poverty headcount in Azerbaijan fell from 49 percent to 16 percent, and the country is expected to graduate from the International Development Association (IDA) in FY11.⁶

2.2 Azerbaijan has achieved impressive development results despite serious governance weaknesses. The main GAC constraints are those typically associated with formerly centrally-planned economies and with petro-states. Corruption is considered a significant challenge, not simply as a result of bribe taxes and administrative barriers, which are pervasive, but also through direct ownership and control of large holding companies by political leaders and their families. The deeply dysfunctional organizations of the public sector rest on vested interests, patronage-based incentive structures, and ingrained patterns of behavior that include significant rent extraction, particularly from the non-oil economy, with minimal checks and balances from Parliament, the private sector, and civil society. Corruption in Azerbaijan is an integral part of the governance regime, a multi-player prisoner's dilemma where no single player can make a unilateral move because they owe their position to the President's inner circle, and breaking the trust of this group would be severely punished.

2.3 The Bank is constrained in addressing GAC issues for two reasons. First, official credits and grants constitute less than 1 percent of GDP, of which the Bank provides 39 percent.⁷ The Bank has minimal leverage to press the sensitive GAC agenda given the government's buoyant oil and gas revenues. Second, the strategic importance of the Azerbaijan Republic to the West, including key shareholders of the Bank,⁸ was mentioned in several interviews. This "neighborhood effect" is exacerbated by the politics of the unresolved conflict over Nagorno-Karabakh and affects the government's private sector choices from energy to banking to trade on the Caspian Sea.

2.4 Azerbaijan is a secular, majority-Shiite, oil and gas-rich country providing a vital non-Russian, non-Iranian source of fuel to the West. The European Union and United States have strongly supported construction of the Nabucco pipeline, which would allow Azeri and Central Asian gas to transit through Georgia and Turkey to Europe. Counterbalancing the aspirations of the West is Russia's overt support of Armenia, investments in Armenia's energy sector, control of the Volga-Don canal (which can restrict Azerbaijan's shipping operations), and its desire to increase its presence in the private sector in Azerbaijan. Russia's neighbor Georgia is a physical barrier to Azerbaijan's often expressed aim to strengthen

⁶World Bank, *Azerbaijan Country Partnership Strategy FY11 to FY14*, p. 1.

⁷ Data for 2008-9. World Bank, 2010b: 98-99.

⁸ Murad Ismayilov, "Continuity and Change in Azerbaijan's Energy Diplomacy," *Caucasus Analytical Digest* 16, 10 (2010): 2-5.

Western ties and become a modern democracy by 2020. The effects of these factors are unquantifiable and unpredictable.

2.5 The drive to expand the World Bank's lending portfolio in Azerbaijan came at a time when lending to the region was declining. It is an important backdrop for understanding the Bank's relationship with the government as well as the Bank's approach to GAC engagement.

Public Sector Governance

2.6 The quality of *public financial management* (PFM) in Azerbaijan is similar to that of its regional comparators as measured by the Bank's Country Policy and Institutional Assessment (CPIA). Azerbaijan lags behind Kazakhstan and Russia in second-generation reforms as measured by the European Bank for Reconstruction and Development (EBRD) Transition Index. There has been a major improvement in (oil) revenue management, but less improvement on expenditures. A National Oil Fund was established in 1999, and as of July 1, 2011, it had assets of \$30.4 billion. Azerbaijan became one of only five countries worldwide to be judged compliant to the Extractive Industries Transparency Initiative (EITI).

2.7 Important components of an effective *expenditure management* system are lacking despite an increase in public spending by four and a half times between 2005 and 2008. The 2008 Public Expenditure and Financial Accountability (PEFA) assessment found that budget implementation was working well, but prioritization and medium-term investment budgeting were lacking. Although the level of unreported extra-budgetary expenditure is insignificant, transparency is lacking with the investment budget (26 percent), which is reported as a lump sum and not broken down by functional or administrative classifications. The defense budget (25 percent, of which 10 percent is disclosed) and the discretionary budget (15 percent) also lack transparency. The entire budget is approved by the Parliament after two days of very limited and uninformative discussion. The Treasury Information Management System has been under preparation for seven years, and the Investment Appraisal System is still being designed. The Chamber of Accounts will publish this year, for the first time, a "black book" listing investment projects for which there is no result. The 2008 Country Procurement Assessment Report (CPAR) found that public procurement left too much discretion and had insufficient controls to prevent fraud and corruption (World Bank 2008a, 2009a, 2009b). The evaluation concurs with this assessment.

2.8 The quality of the *civil service* is similar to regional comparators, except Georgia, which has a higher CPIA rating. There are rising disparities between public and private sector pay, ranging from two to four times in most sectors. This makes it difficult for the government to recruit and retain qualified staff. The disparities are addressed in most areas by envelopes of cash given to staff at the end of each month in addition to their normal pay; however, these payments are reportedly given to reward loyalty and patronage ties and are not linked to performance. A civil service commission, reporting to the President, was created. The commission holds exams, and recruitment is based on exam scores. However, organizations generally have not defined the results they are trying to achieve or the indicators that would define what is being accomplished. It is unclear if results are monitored in activities not supported by the Bank.

Investment Climate

2.9 One of the more difficult areas for the World Bank to engage with the government on GAC-related concerns has been the investment climate, particularly in the non-oil sector. Corruption—often involving transfer of wealth by and to individuals and corporations with government connections (and often involving familial relations)⁹ through public investments, “inspections,” and tax collections—is widely recognized as a major impediment to improving the business environment. A central argument of the 2009 Country Economic Memorandum, and even from the beginning of the Bank lending program in Azerbaijan, is that the economy must diversify away from natural resource extraction, which currently accounts for more than 50 percent of GDP and over 90 percent of exports. GAC reforms are at the heart of several of the proposed reforms: improving trade facilitation, improving and making transparent public-private sector dialogue, expanding access to financial services, and deregulating. Doing Business ranked Azerbaijan the leading reformer of business regulations in the world in 2008, with improvements in 7 out of 10 areas (World Bank 2008c).

2.10 Despite reforms, however, new market entrants, particularly those that lack political connections, are treated punitively. This observation was confirmed by a number of development partners and NGOs, who also pointed out that monopolistic behavior and anticompetitive practices continue. The difficulties of relying on investment climate reforms as an entry point for GAC engagement are illustrated by the EBRD’s limited activities in Azerbaijan, which no longer include private sector projects outside the oil sector due to the strong presence and corruptive practices of “politically-exposed persons” in those areas.

2.11 Firms surveyed more than twice since 2005 (**Error! Reference source not found.2**) indicate increased problems with accessing land, labor force skills, crime, the legal system, infrastructure, and corruption. The Bank has been and continues to be involved with these concerns. A land acquisition law, hailed as a model for the region, was developed in conjunction with the (first) Highway Project, but it may have also become a vehicle for extracting rents.¹⁰ Skills development and training, not restricted to civil servants, is provided by the Public Investment Capacity Building project. Most of those interviewed emphasized the importance of skills development—and the training component of the project was satisfactory. The problem is the functioning of the organizations, which either do not reward or cannot use the skills developed by the training. This suggests that governance of both private and public sector is an issue, with a negative effect on the investment climate.

⁹ These issues are extensively explored in recent Wikileaks cables; see Edwards 2010.

¹⁰ The land acquisition law, motivated by the Tovuz bypass, had a long gestation period, and as a law it is a good model. However, without challenging the written law, persons in several interviewed entities said that the law was misused --as was often the case with laws and technical specifications in the former Soviet Union. Instead, it has become a vehicle for extracting rents. In Azerbaijan, in practice, those whose land would be sold and at what price were decided beforehand.

Table 2.1 Azerbaijan—Investment Climate Constraints

| | 2005 | 2008 | Change |
|-----------------------|------|------|--------|
| Access to land | 72 | 29 | -43 |
| Skills | 82 | 46 | -36 |
| Crime | 68 | 41 | -27 |
| Courts | 79 | 57 | -22 |
| Transport | 78 | 62 | -16 |
| Corruption | 27 | 15 | -12 |
| Telecommunications | 78 | 67 | -11 |
| Electricity | 59 | 55 | -4 |
| Labor | 68 | 72 | 4 |
| Access to finance | 25 | 30 | 5 |
| Tax Rates | 12 | 18 | 6 |
| Licensing and permits | 36 | 44 | 8 |
| Tax administration | 14 | 35 | 21 |
| Customs and trade | 32 | 58 | 26 |

Source: Business Environment and Enterprise Performance database.

Notes: Figures represent percentages of firms indicating that the issues are “no obstacle” (negative change signifies deterioration in the investment climate constraint). Unweighted averages.

2.12 Although cumbersome procedures, lack of skills, and arbitrary practices compel companies to operate in the gray economy and to stay small to avoid unwanted attention, improvements have been made in directions for which change is possible. The government adopted a State Program for Reform of Customs in 2008. The alignment of customs legislation with World Trade Organization (WTO) accession requirements and the introduction of one-stop business shops were expected to improve customs procedures and reduce informal barriers and transaction costs. The government is also considering improvements to tax administration. Electronic tax filing is being implemented. In July 2009, the President signed into law 46 amendments to the tax code that are expected to help development of micro and small to medium enterprises. The changes, which became effective in January 2010, reduced the maximum income tax rate and aimed to strengthen taxpayers’ rights. In addition, the government recently stepped up its efforts to improve the regulatory environment for business, including relaxing the rules for starting small and medium businesses and creating a “one-stop window” for registrations.

2.13 Despite these procedural reforms, the prevalence of informal and anticompetitive practices makes the administrative costs in the non-oil private sector unpredictable and hinders the sector’s development. Such practices include onerous licensing and permit fees, as well as “inspections,” which include taxes, health, fire, security, labor, and standardization.

Basic Service Delivery

2.14 *Primary education* is funded mostly through central budgetary resources, but the government is seeking to decentralize spending and decision making to the municipal and community levels. Enrollment is over 90 percent, but many aspects of school quality need

improvement. After the end of the Soviet period, public spending on education decreased from 7.6 percent of GDP in 1993 to 2.7 percent in 2006. The shift from Cyrillic to Latin script in the early 1990s led to shortages in reading materials. There is also growing inequality of access, inefficient use of resources, weak incentives, over-centralization of authority with weak liaisons to *rayon* (district) Education Departments, and weak monitoring and planning.

2.15 The results for the 2006 Program for International Student Assessment (PISA) placed Azerbaijan among the lowest of comparator countries in reading and science, whereas mathematics scores were higher than comparators. The Organization for Economic Cooperation and Development (OECD) will release PISA scores for 2009 soon. National assessments are to be carried out every two years in grades 4 and 9, and a new pilot curriculum is being rolled out over the next few years (World Bank 2010a: 16). Other reforms are underway to close schools with too few students, raise teacher remuneration based on performance, and assess the link between spending and educational quality.

2.16 Azerbaijan's *roads* are sufficient in length and coverage, but especially the local roads are in poor condition. Many are not passable throughout the year. Forty-five percent of roads are unpaved—most of them local roads with very low traffic volumes. In 2009, 56 percent of main corridors were in fair or better condition and no main roads were in very poor condition. Ongoing road works are expected to put the main roads in satisfactory condition by 2015. The main roads are no longer a constraint on the country's expansion as a transit country. Local roads, of which 70 percent are estimated to be in poor condition, are a constraint to Azerbaijan's regional development and its non-oil exports. These roads limit access to markets and social services in rural areas and increase accident risks (EBRD 2010 and 2011).

2.17 The government's Poverty Reduction Strategy envisaged a comprehensive reform of the social protection system. Consequently, the government undertook several actions aimed at increasing the efficiency, effectiveness, and sustainability of social protection, including modernization of the public pensions administration, modernization and strengthening of the financial management of the State Social Protection Fund, and transfer of administrative responsibilities over social insurance benefits from state enterprises to that fund. These changes, the expenditures on the road network, and improvements in the educational system are steps in the right direction. However, as discussed below, the government apparatus in these sectors need to pursue improvements at a faster pace than has been the case in the past 10 years. Government revenues are not the constraint to these efforts.

3. Relevance of World Bank Engagement on GAC Issues

3.1 World Bank engagement on GAC issues in Azerbaijan was not defined by one overarching priority or entry point between 2004 and 2010. Rather, the Bank supported the government's own efforts in different ways and in different sectors as opportunities arose. Prior to 2007, GAC was a peripheral issue at the country level. By 2007, the Bank had satisfactorily completed or was close to completing five projects for total lending of \$113.3 million. Two infrastructure projects comprised close to 85 percent of the credits; the other three were small credits for financial sector technical assistance, cultural preservation, and a Learning and Innovation Loan for the health sector. These projects responded to Azerbaijan's immediate development needs in the early 2000s.

Country–Level Relevance

3.2 The 2007-2010 Country Partnership Strategy (CPS) for Azerbaijan outlined a Governance Action Plan supporting key dimensions of the governance framework with analytic and advisory activities and projects.¹¹ The core dimension was effective public sector management (PFM, civil service and social sector reform, reduction of subsidies), supported by dimensions of political accountability (EITI), checks and balances (judiciary, audit, banking, and investment climate regulations), civil society and private sector (EITI monitoring, corporate governance reform), and local participation and community development.

3.3 Given the constraints the Bank faced in pursuing GAC, the evaluation rates relevance at the country level as moderate. GAC results are mixed. Based on desk reviews, it appears that selectivity has improved in the post-GAC Country Partnership Strategy for assessing the political economy constraints and for results measurement over the pre-GAC Country Assistance Strategy (CAS). The country's accountability institutions also seem to have improved. Signaling of GAC and responsiveness to GAC concerns and risks remain at high levels both pre- and post-GAC. However, "smart design," a key feature in GAC strategy is not well reflected in the Bank's portfolio.

3.4 The Bank recognized governance constraints and limitations in Azerbaijan, and chose to focus on areas for which there was governmental support and in which tangible results could be achieved. In this regard, the Bank was influenced by governmental support for oil revenue transparency, capacity-building assistance to institutions of PFM, and the development of safeguards.

3.5 The Bank participates in policy dialogue (for example, the 2009 High Policy Forum, and preparation of Country Economic Memorandum), and leads coordinated donor assistance in the financial sector, agriculture, and investment climate issues. However, other development partners complain that the World Bank actually has underutilized leverage with the government, and that the Bank has been too cautious in its relationship. The Bank (IDA

¹¹ Lending to Azerbaijan increased in the 2007-10 CPS. A total of 19 projects (\$2.71 billion) were planned for the period. Twelve projects (\$1.82 billion) were actually delivered, and seven were dropped for no apparent reason.

and the International Bank for Reconstruction and Development -IBRD) is very careful in its relationship with the government, notably in that the Bank does not engage in direct policy dialogue. The Bank focuses on sustainability within projects, with minimal efforts to use country systems in projects. It has emphasized the enactment of modern laws and practices without following up on implementation. In fact, the Bank often acts alone. Many difficult GAC issues might be more effectively addressed in coordination with other development partners. The European Union has recently taken the initiative of bringing development partners together to share information. The government has also requested partners to provide information on their activities so it can exercise a coordination function, which has been recommended by a recent International Monetary Fund (IMF) mission.

3.6 The selection of projects responded to country needs and signaled the government's desire to restore utility services throughout the country, improve agricultural production, rehabilitate the arterial road network, increase road capacity in high-demand locations, and modernize transport services. All of the investment loans had demanding technical assistance and institution-building services. In addition, some projects used community-driven development, water user associations, and information technology systems to promote transparency and efficiency. The project completion reports suggest that institutional development and capacity building have not progressed at the pace project teams had envisaged. However, modern management methods and procedures are being developed and slowly adopted. The transformation and restructuring of entities for administering, managing, and delivering services has proved difficult and slow, although the physical results of investment projects were successful and sustainable. Some projects also achieved their intended results. In short, governance structures and associated technical support were transferred from the Western countries without full understanding of what these concepts embodied.

Sector-Level Relevance

3.7 ***Public Financial Management.*** Important efforts were undertaken to strengthen PFM and procurement between 2004 and 2010. PFM was a key priority in the CPSs and in Azerbaijan's country objectives, with public investment increasing from AZN 0.5 billion (\$625 million) in 2005 to AZN 4.6 billion (\$5.75 billion) in 2009 (World Bank 2010b: 2). There were Institutional Development Funds and economic and sector work (ESW) to support PFM, plus parallel support from other development partners.

3.8 The 2006 CPS sought to establish medium-term functional ceilings, a Medium-Term Expenditure Framework, an annual Budget Law, improved presentation of the budget, annual disclosure to EITI, a strengthening of internal and external audit, initiation of e-procurement, and increased civil society participation and voice. Bank support was given through annual programmatic expenditure reviews, the 2008 PEFA (World Bank 2008a), and a Country Procurement Assessment Report (World Bank 2009a), as well as an ongoing policy dialogue.

3.9 The Bank, along with the IMF, also supported the design of a National Oil Fund starting in 1999. The Bank has continued to support implementation of the fund with bi-annual visits by the Bank's Treasury Department. The Bank has supported the related initiative of Azerbaijan's adoption of EITI through the EITI Global Secretariat. The Corporate and Private Sector Accountability Project, approved in 2008 and financed by the

Swiss State Secretariat for Economic Affairs, further intends to strengthen accounting and financial management capacity of line ministries (World Bank 2008b). The Public Investment Capacity Building Project is supporting certification training courses to support improvements in the quality and efficiency of preparation and implementation of investment projects in priority sectors, with a focus on infrastructure. An initial course has trained participants from Azerroadservis, Azersun,¹² Azerenergy, and other infrastructure entities (World Bank 2008b).

3.10 Technical issues of GAC design have not changed and are appropriate for the context. Training is targeted to organizations that have carried out reforms requiring staff to have new skills, and to organizations that are planning such reforms (World Bank 2008d). The mission was told by the government that it highly valued Bank ESW, policy dialogue, and technical assistance in this area, and that responsible agencies are working to implement recommendations made by technical assistance.

3.11 *Relevance.* The evaluation concludes that the relevance of the Bank's engagement on (oil) revenue transparency is high. Bank PFM and procurement efforts are substantial. Bank efforts on decentralization and civil service reform are moderate. Azerbaijan is a leader among countries of the Commonwealth of Independent States in developing institutional capacity to manage large oil and gas inflows, and the Bank is well placed to provide support. Strengthening PFM and procurement are substantially relevant, given sharp increases in expenditures in recent years. Yet there are concerns about government commitment as an increasing amount of the budget is allocated to discretionary funds with no explanation as to purpose. Policy dialogue could have better reinforced the messages from ESW and technical assistance. Strengthening procurement is also substantially relevant, but there is widespread concern that the new procurement law may not be properly implemented. In civil service reform, the Bank's approach focusing on specialized training is considered moderately relevant to addressing capacity issues.

3.12 *Accountability Institutions.* The Judicial Modernization Project, approved in 2006, formed a major component of the Bank's effort to improve the functioning of accountability institutions. The project aimed to: (i) build capacity of the Ministry of Justice; (ii) improve the functioning of the civil, criminal, and economic courts by strengthening the management capacity of judicial institutions, upgrading the court facilities (by building and rehabilitating courthouses, and providing technology and equipment); (iii) strengthening the professionalism of judges and justice sector staff by providing training and upgrading training facilities; and (iv) improving citizen access to information. The project also sought to have a measurable impact on a national scale, with special attention to the Baku area (approximately 60 percent of the cases). Following establishment of the Chamber of Accounts, the Bank provided some initial capacity building. Under the 2006 CPS, an arrangement was developed to help the Chamber of Accounts conduct audits of public institutions and connect online to the new computerized Treasury Information Management System.

¹² Azersun is a food production, processing, and retail company.

3.13 The Bank has engaged little with civil society organizations (CSOs) in Azerbaijan, and has not supported institution-building among municipalities— both reasons for which NGOs have criticized the Bank. The Bank may have missed an opportunity to help build and support an active community of independent CSOs and promote fiscal decentralization and tax sharing as part of fiscal reforms. The central government retains tight control over municipal budgets and has demonstrated an unwillingness to devolve authority beyond the *rayon* (district) level. The Bank has chosen not to support the inclusion of CSOs in monitoring and related functions because the Country Team believes such work would hinder the Bank’s relationship with the government, jeopardizing both willingness to borrow and openness to policy dialogue. The Bank is working to improve accountability systems at the local level through community associations and other forms of community involvement. One of the components in the \$21.1 million Rural Development Project, initially approved in 2004, for example, seeks participatory development planning by communities.

3.14 *Relevance.* The team concludes that the relevance of the Bank’s engagement on accountability institutions is moderate. The judiciary and Chamber of Accounts have important roles in investment climate and PFM reform, though political willingness for reform is modest. Given the governance conditions and the imperative for lending, the Bank’s programmatic responses have been appropriate.

3.15 *Basic Service Delivery.* The Bank’s support to *primary education* has occurred in two phases. Under the first phase, the objectives were to improve quality, relevance, efficiency, access, and management of general education (World Bank 2003). Bank-supported reforms focused on the development of a new national curriculum framework and syllabi in primary and tertiary education, the training of teachers, establishment of a new national system of student assessment, and the development of new per capita financing arrangements for education. The project built on lessons learned from the Bank’s Education Reform Project, a Learning and Innovation Loan that began in September 1999. Lessons included the need for ministry ownership, greater project focus, and enhanced participation with key stakeholders.

3.16 The Open Society Institute was a cofinancing partner and the first example of such cooperation between government, an international finance agency, and an NGO. The Institute supported textbook policy development through the provision of a textbook consultancy and a number of training activities, seminars, and roundtables for policymakers, textbook publishers, evaluators, and authors. Project design was also coordinated with the United Nations Children’s Fund (UNICEF), taking into consideration their work in a pilot teacher education program and preschool education program (World Bank 2010a: 7, 27, 65).

3.17 The second phase of the Adaptable Program Loan, the Second Education Sector Development Project, added objectives for improving teacher training and learning results in schools that received new school libraries (World Bank 2008f). The GAC design structure has been consistent and appropriate. There were implementation hurdles (for example, a need to close under-used schools and to adopt per capita financing) in moving from the first to the second phase, but these are being addressed.

3.18 Prior to the Bank’s first roads credit, TRACECA (the Transport Corridor Europe – Caucasus – Asia, an interstate program supported by the European Union) had funded technical assistance to restructure the road administration, Azeravtoyol, an entity from the

Soviet era. It also supported another activity to establish the Ministry of Transport. There was an unsigned loan agreement with EBRD to rehabilitate a 90-kilometer section of the M1, the east-west highway from Baku to Georgia.

3.19 Since engaging in the road sector in Azerbaijan, the Bank has become perhaps the most important donor in this sector. Over the review period, Bank projects have included:

- ❖ Highway Project (\$65.51 million, approved 2001, closed 2009)
- ❖ Second Highway Project (\$200 million, approved December 2005, ongoing)
- ❖ Additional Financing to the Second Highway Project (\$113 million, approved April 2010)
- ❖ Third Highway Project (\$70 million, approved April 2010).

3.20 *Relevance.* The evaluation concludes that the relevance of the Bank's engagement on GAC in education and roads is high. The Bank's work is helping the government to take tough decisions that contribute to progress in the sector despite the political, logistical, and technical challenge of moving from the institutional structures of education in the Soviet era to those required in a modern society. However, the pace of reform will need to increase if the ambitious hopes of providing the skills needed for an internationally competitive, non-oil economy are to be realized.

3.21 Regarding the road sector, the Bank's GAC engagement through technical assistance and road works programs is highly relevant. With the Bank's effective support, the Ministry of Transport has been established and Azeravtoyol has evolved into Azeroadservice (ARS), a government-owned joint-stock company reporting to the Ministry of Transport. The centrality of the Bank's presence in the road sector is due not only to the large road credits, but especially to the extensive technical assistance and road management modernization components in the project credits. These are relevant because they help leverage the work of other significant donors including the Asian Development Bank, the Kuwait Fund, the Islamic Development Bank, and EBRD, which do not engage in the management of the road sector as comprehensively as the World Bank. The Bank's work also helps improve the quality of substantial road investments from the government, as well as providing credit counterpart funding. The earmarked budget fund for maintenance is relevant because, if efficiently used, it would be able to fund maintenance of the modernized main roads and bring the local road network under ARS jurisdiction to good condition in about 10 years¹³.

¹³ The Bank has a long history of opposing any earmarked funds. This is an unfortunate history whose analytic basis is in public economics textbooks and not in empirical facts. Since the mid-1990s, there are no papers with analytic and empirical underpinning that show that road funds have reduced efficiency and effectiveness of public resources. On the contrary, since mid-1990s the evidence, in and outside of the Bank, is favorable to (second generation) road funds. Elimination of road funds has in fact reduced allocative efficiency and the effective use of public resources. It has resulted in a deteriorated road network, and poor road maintenance and investment projects. For positive evaluations of the "second generation" road funds for both low and high volume roads, see Heggie (1994), Potter (1997), Malmberg (1998), Gwilliam and Kumar (2002), Schwartz, Corbacho and Koranchelian (2006), and Reja (2010). Azerbaijan's road fund is not yet a second generation fund, but

Decentralization of ARS management is tied to progress in general administrative decentralization in Azerbaijan.

3.22 Private Sector Development. Given the often severe governance constraints, the World Bank has chosen to tread lightly in private sector development, and to focus efforts on projects that were reasonably assured of achieving results. In the period reviewed, consequently, only three private- and financial-sector projects were implemented: two financial services projects (aimed at expanding public access to financial services through the use of the postal system) and the \$24 million Corporate and Public Sector Accountability Project (CAPSAP).¹⁴ Additionally, efforts to promote governance improvements in the investment climate were undertaken through support for the implementation of the International Financial Reporting Standards (IFRS) in state-owned enterprises. Supported by IDA, Technical Aid to the Commonwealth of Independent States (TACIS), and other donors, the government enacted a new accounting law before 2006.¹⁵

3.23 The CAPSAP was an important component of the 2007-10 CPS. The first pillar in particular aimed at improving the quality and transparency of public sector governance, strengthening financial management and procurement systems, and establishing proper public sector and corporate governance, accounting, and auditing frameworks while creating an investment climate conducive to growth. The CAPSAP focused on improving the capacity, transparency, and accountability of state institutions that controlled or regulated the private sector, such as support implementation of IFRS for “public interest entities”—commercial entities deemed by the Government of Azerbaijan to have a public interest in their operations (that is, major corporations), as well as the National Accounting Standards for Commercial Organizations for other commercial entities.

3.24 Other Bank efforts aimed at improving regulatory regimes for business. The World Bank’s assistance in this area was limited to analytical inputs: periodic surveys of the business enabling environment and advisory services, particularly from the International Finance Corporation (IFC).

3.25 Relevance. Given the stated commitment of the government to diversify and expand its non-oil economy, the Bank’s response was both substantially relevant and GAC-responsive, considering the limited entry points available. The CAPSAP appears to have been built around the few entry points available to the World Bank: supporting the reform and strengthening of governance arrangements affecting public-interest entities and improving the rules that shaped the overall transparency and accountability of the public sector bodies that regulated or managed the private sector.

there is institutional development work to bring it to this point. Recently, also the EU is moving toward approving what the Report reviewer calls “earmarking”.

¹⁴ In addition, indirect support to the Chamber of Accounts will be provided through the strengthening of the statutory audit function via the CAPSAP.

¹⁵ See World Bank, *Azerbaijan Completion Report, Country Partnership Strategy FY07-FY11*.

Project-Level Relevance

3.26 The 2007-10 CPS sets out a Governance Action Plan based on a shared framework with multilateral and bilateral donors, government, and civil society. It calls for a Governance Advisory Group to coordinate, derive lessons, and identify binding constraints to the plan. It calls for increasing the frequency of procurement audits and other supervision, more emphasis on synergies between Bank-financed projects, support to NGOs in external monitoring, greater disclosure of contract awards and financial information, and strengthening PIUs by providing for transparent record keeping that safeguards fiduciary standards. The monitoring framework provides for tools such as the EITI, the PEFA, Public Expenditure Tracking Survey, Financial Sector Advisory Program update, and the Report on the Observance of Standards and Codes (ROSC), as well as the Doing Business reports, the Business Environment and Enterprise Performance Survey (BEEPS), the CPIA, and the World Bank Institute Governance Indicators. It also sets out measures to minimize corruption risks.

3.27 The new 2011-14 CPS calls for the use of a cross-cutting governance and institutional filter focusing on four areas: (i) project implementation capacity, including strengthening country systems for procurement, better attention to monitoring and evaluation systems, closer supervision, increased analytic work and feedback channels from stakeholders, and enhanced procurement and financial management training for the PIUs and the government; (ii) institutional capacity building, including strengthening the Waste Management Company, Azerbaijan Rail Company, the Roads Department, and other entities through building the legal and regulatory framework, budgeting, accounting and information systems, adequate staffing, and training; (iii) policy reforms to reduce corruption, with processes identified for each activity supported by the Bank, such as the use of automatic teller machine (ATM) cards for withdrawals of social assistance, use of community-based decision making and supervision of small investment projects, and solutions for merit-based hiring of judges and competitive remuneration for public employees; and (iv) promoting transparency and public debate, including promoting public awareness, consulting with stakeholders, encouraging government publications, and periodic surveys (World Bank 2010b).

3.28 The GAC tools and processes from both CPSs are moderately relevant to the country context. The strengthening of PIUs supports the ring-fencing of the Bank-supported projects, which insulates them from the country's weak governance. The monitoring tools help the country see how it is doing relative to comparators. The recent governance and institutional filter signals that GAC processes need to be embedded in Bank work.

4. Effectiveness of World Bank Efforts

Country–Level Effectiveness

4.1 Overall, the Bank efforts have less impact than desired on overall governance in Azerbaijan. The Bank put considerable faith in formal rules, organizational structures, and technology to change government behavior, and this led to overconfidence in the Bank's ability to design and predict the direction and pace of institutional change. However, there has been progress in certain areas, such as oil revenue transparency, streamlined distribution of social assistance, and GAC in primary education and roads.

Sector-Level Effectiveness

4.2 **Public Sector Management.** Government efforts to improve PFM with Bank support have delivered mixed GAC results. Setting up the National Oil Fund is the greatest accomplishment, initially supported by joint advice from the IMF and the World Bank in 1999, and with continuing support from twice-yearly visits by staff from the Bank's Treasury Department. Oil production and revenues are reported and audited to international standards.¹⁶ The EITI Board designated Azerbaijan as EITI-compliant on February 16, 2009. The Azerbaijan government has since formalized a multi-stakeholder group and established a work plan.

4.3 The Bank supported the EITI process from the global secretariat and directly in Azerbaijan during 2004-05. It also helped finance the Transparency International Europe and Central Asia Regional Meeting in 2007 in Baku. Transparency International is a key international partner in supporting EITI. However, there are concerns that EITI reports are unreadable by non-experts and do not affect distribution of contracts or management of revenues to benefit key constituencies (Benner and others 2010). EITI reports also do not provide data on payments by individual oil companies, although this may change as a result of U.S. legislation adopted in 2010.

4.4 Other aspects of the PFM agenda have progressed little. Strategic budgeting based on the Medium-Term Expenditure Framework and Public Investment Plan has not been adopted. Although an internal audit law was passed in 2007, it has not been implemented. An Accounting Law was adopted in 2004, but there has been limited presentation of financial statements, and balance sheets are not published or made available to Parliament. Regarding procurement, large contracts in excess of AZN 50,000 are done by open tender, but political influence still affects decision making. Although the 2008 CPAR found much room for improvement, the choice of projects is more important than the procurement details (World Bank 2008a).

4.5 Other results have been reported subsequent to the PEFA. The Ministry of Finance adopted all 24 national accounting standards in line with International Public Sector Accounting Standards in December 2008 (World Bank 2010a: 55). In addition, Azerbaijan's score on the Open Budget Index increased from 37 in the 2008 survey to 43 in the 2010

¹⁶ World Bank, 2008a. EITI reports since 2003 are at <http://www.oilfund.az/eiti/en/account/>.

survey (International Budget Partnership, 2008, 2010). This improvement reflected the publication of In-Year Reports and Audit Reports for the first time, the addition of more program-level data to the budget, and publication of budget data on the Ministry of Finance Web site. The increased budget transparency resulted from demands from opposition party members, reforms introduced by the European Union's Action Plan for Azerbaijan, a proactive head of the external audit agency, and advocacy from civil society groups (International Budget Project 2010: 65). IEG was given an explanation of the 2010 budget published by the Open Budget Group, and was also informed that the Ministry of Finance will be soon publishing its own brief explanation of the budget.

4.6 In addition, IEG was told that the government has accepted about 90 percent of the recommendations of the 2008 CPAR and is incorporating them in a new procurement law, with support from the U.S. Agency for International Development. The new law is expected to be adopted by spring 2011. The Ministry of Finance has set up a working group to address PFM processes rated C or below in the 2008 PEFA, and is preparing a plan that will be discussed with the World Bank in 2011. IEG was informed that the 2008 report is now out of date, so it would not be useful to publish it.

4.7 The Bank's efforts to support the building and strengthening of accountability institutions have been moderately effective. Due to implementation hurdles encountered by both the Bank and the Ministry of Finance, the CAPSAP project has not yet produced results (the first contract was signed in December 2010). Looking ahead, the 2009 Public Investment Capacity Building Project is supporting the PFM agenda (see <http://www.dikpgl.az/>) in providing project management training to government ministries and agencies to improve quality and efficiency of preparation and implementation of investment projects in priority sectors in Azerbaijan. Training is ongoing, and plans for 2011 cover monitoring and evaluation, cost-benefit analysis, and human resources management. Country Office staff involved with the CAPSAP stated that the Chamber of Accounts continues to conduct Soviet-style "investigations" rather than to perform audits in accordance with international best practice. Donor representatives also noted that the Chamber of Accounts remains hampered by the lack of adequate enforcement mechanisms with regard to state-owned enterprises, such that audits rarely result in effective sanctions. The Rural Development Project, by contrast, shows positive results (for example, in increasing citizen empowerment and in improving community perceptions of infrastructure and service quality).

4.8 **Education.** The first phase of the Bank's support achieved results which included participating, for the first time, in the international student assessment (PISA) in 2006, generating education statistics, including learning outcomes, using the Ministry of Education's Education Management Information System, and posting exam results and student assessments on the ministry's Web site.

4.9 A Public Expenditure Tracking Survey was completed in 2006, and the report submitted to the government in 2007. It highlighted the skewed allocation of financial resources toward salaries, and the inefficient distribution mechanism for non-salary expenditures. Although the report has not been published, there has been modest progress in addressing the resource distribution issue using per-student financing in 59 schools in the three pilot districts in 2007. The report indicates there were some GAC problems, including budgeting restrictions and lack of support for the reform from the Ministry of Finance.

Support for and understanding of education reforms among parents, teachers, and school officials has increased. There is some evidence that teacher training is leading to improved learning outcomes, and disparities in distribution of core textbooks are being reduced (World Bank 2010a).

4.10 The evaluation team was informed that the following results have been achieved under the Second Education Development Project: a new curriculum has been adopted for grades 1 to 3 that focuses on practical knowledge. Recruitment of teachers has been rationalized, with the entire process from information on job openings to testing to announcement of results and new teacher postings, all done online (this and other information and communications technology reforms have reportedly been delayed by the Bank's procurement processes). Teacher training is increasingly outsourced, and the increased competitiveness has improved training quality. The student-teacher ratio has increased to 12, and teachers now teach a minimum of 12 hours per week, up from 4 when reforms were initiated. Teachers that are not performing are being removed. Finally, the number of schools with 30 children or less has been reduced from 700 to 315.

4.11 **Roads.** The civil works in the road projects are being implemented satisfactorily and the quantity and quality of the main road assets are improving with consequent improvement in the quality and reductions in road user costs. The ARS PIU has matured into a competent manager of the projects. However, there have been implementation delays. One significant delay was caused by the rewriting of the land acquisition law and practices. This delay has paid subsequent dividends. Other delays are due to procurement and safeguard processes for which all parties—the government, the contractors, the supervision consultants, and the Bank—share responsibility.

4.12 Once it is approved, the new procurement law will introduce more stringent contractor mobilization requirements with the Bank's follow-up, timelier reporting, and control by the supervision consultants. The absence of interference from high government officials will enable ARS, the PIU, and the donors to manage on-time delivery of the projects. On the whole, however, the ARS PIU functions and the civil works of the Bank-supported projects are now delivered in a satisfactory manner. There are indications that the budget-supported road works, both investments and maintenance, are not efficiently executed. The investment costs are high and maintenance quality is spotty, especially on low-volume local roads.

4.13 From a GAC perspective several governance changes are desirable. These are likely to have effects on anticorruption as well. The core of the problem is that ARS does not operate like a government-owned joint-stock company. The responsibilities of the involved entities (the Ministry of Finance, the Ministry of Transport, and ARS) are not sufficiently clear. In particular, it is unclear who expresses the shareholder interests in ARS, who expresses the client interests, and how ARS should organize road administration and management, preferably in a competitive environment.

4.14 A concrete and timely example, restructuring and decentralizing of the ARS maintenance function, clarifies the issue. When this issue was raised in the Ministry of Finance, the response was that "ARS is a joint stock company and they can organize themselves as they want." However, it is the ARS Board, representing the owner, who makes

the decisions. It is unclear under the current law whether the Ministry of Transport expresses the client and the road user views. The shareholder owner—the Ministry of Finance or the Cabinet of Ministers (this also is unclear in the law)—lays out the means and ends of the road sector and should give the ARS management clear guidance about what is expected from it. Currently, ARS has no regional *road management* offices—as would be desirable—but it has 63-68 maintenance *service suppliers*, force account units, called Maintenance Units.

4.15 The World Bank had proposed, under the (first) Highway Project, a Corporate Plan including a service-level agreement (Performance Agreement) between the Ministry of Transport and ARS, against which the ARS performance could be measured and evaluated annually. The Corporate Plan also envisaged establishment of a Road Advisory Board and the development of a new Road Law. The implementation of the Corporate Plan was subsequently supported by an EBRD technical assistance grant to the Ministry of Transport.

4.16 The Performance Agreement in the Corporate Plan proposed separation of the road administration and management from the supply of maintenance services, which are proposed to be contracted from the private sector. This proposal, consistent with modern road management practices, would mean that the government would establish regional offices and separate the Maintenance Units from ARS. It would consolidate and organize them as corporate entities with maintenance work contracts with ARS regional offices. Ultimately, the Maintenance Units would obtain the maintenance contracts in a competitive market in which other private companies could also bid for road maintenance services.

4.17 This restructuring of the road sector requires a government decision. It is the experience in numerous countries, including some developing countries, that the proposed reorganization of the maintenance function has made maintenance much more cost-efficient (the experience shows cost savings of 15-40 percent). No country that has reorganized road maintenance in the above manner has reverted back to the force account supply of maintenance services as practiced now in Azerbaijan.

4.18 The Advisory Board of ARS, proposed in the Corporate Plan, included private (non-oil) sector representatives and had as its purpose promoting increased transparency in planning, a voice for the private sector and affected interests in the choice of projects, and better efficiency of service delivery—as experienced in the developed countries. The new Road Law, also proposed under the (first) Highway Project, has not yet been approved. Several iterations of the law, prepared by a lawyer with many years' experience in developing countries, have been carried out. If the Corporate Plan and the new Road Law are implemented transparently they should serve the government's anticorruption and decentralization objectives as well. The current Third Highway Project again includes a proposal to gradually reorganize the road maintenance function as described above. That proposal is consistent with the government's goal to modernize the road sector.

4.19 The road sector projects have contained significant sector governance components; some of them—land acquisition law, the Road Law, and procurement initiatives—have extended beyond sectoral concerns. Progress has often been very slow, and has been overseen and influenced by many factors and persons not under sector management control. However, the adopted gradual approach has been correct and consistent with developing

human resource capacity in the sector—notwithstanding the IEG evaluation and comments on the (first) Highway Project. Given the inauspicious starting position, the overall road sector effectiveness is substantial.

4.20 Private Sector Development. Despite the highly selective agenda, the Bank’s private sector development program has shown mixed results. The linkages between the financial services program and GAC were not evaluated in Azerbaijan. Progress in improving governance, accounting, and auditing practices in the corporate sector are considered positive mainly due to the IFC’s advisory program, and particularly the Azerbaijan Corporate Governance Project, which is beyond the scope of this evaluation.¹⁷ However, the Bank’s main private sector project, the CAPSAP, approved in 2008, remains completely undisbursed due to problems in spreading IFRS to the private sector. The Implementation Status and Results Report rates the project as moderately unsatisfactory. Country Office project staff noted, additionally, that the PIU has failed to find a suitable director or advisers with sufficient technical expertise. Negligible results in developing the non-oil sector of the real economy indicate the need for a renewed effort and approach.

4.21 The Bank appears to have underestimated the extent to which progress in structural reforms would stall, as well as the vulnerability of the overall program to implementation delays. For example, the government did not take steps to remove administrative barriers to business start-ups or to streamline registrations until 2009. Additionally, the government continues to engage in selective protectionism and has delayed WTO accession, the completion of which would have sent a credible reform signal. Country Office staff indicate that there is little appetite in the government to pursue the customs, standards, and tax reforms required by WTO accession.

4.22 During the review period, the World Bank Group has undertaken only limited support for private sector involvement in predominately state-owned industries (such as telecommunications, petrochemicals, and metallurgy) through privatization, public-private partnerships, or technical assistance to facilitate the restructuring of state-owned assets. The Country Economic Memorandum (World Bank 2009b) recognizes that an increase in the efficiency of state-owned enterprises is critical to reduce budgetary pressures, as well as to the diversification agenda. However, the World Bank appears not to have pushed for even minimal steps, such as corporatization of enterprises. Finally, although the analytical services to support improved and streamlined business regulation were relevant, the Bank missed an opportunity to push for a reduction in discretionary powers of the bureaucracy, in the number of decision-making layers and regulations, and the powers given to police, law enforcement agencies, and tax and customs authorities as part of its efforts to improve public sector management to support the growth of the non-oil private sector. Moreover, it is unclear to what extent reforms to the formal business regulatory, trade, and licensing environment would have affected private sector development given the extent to which informal,

¹⁷According to the CPS review, the project has helped local companies and banks to enhance operations and attract financing and investment. It has provided advise for over 400 joint-stock companies and banks on improving corporate governance practices, and implemented better corporate governance practices in three pilot companies. In addition, it has provided advisory services on four pieces of legislation, including amendments to the Civil Code on related-party transactions and fiduciary duties of directors. World Bank, *Azerbaijan Country Partnership Strategy FY07-FY11*, p. 22.

anticompetitive practices exist in the Azerbaijani economy. More likely, these conditions argue for a much more aggressive stance on enforcement of existing regulations coupled with legal and judicial reforms. In the event that governmental authorities are unwilling to pursue such institutional reforms, a more forthright and public assessment of the political economy of investment climate reform constraints in Azerbaijan would also be in order.

Project-Level Effectiveness

4.23 Although the Bank set out an ambitious Governance Action Plan, the measures were insufficient to manage portfolio risks, particularly following the unanticipated expansion of lending in 2008. Delays were pervasive across the portfolio, particularly in projects approved after 2008. These projects were not sufficiently attuned to political economic realities, and were not ready for implementation. Expanded lending in 2008 was hampered by non-transparent decision making in government and poor procurement readiness.

4.24 The Bank took steps to address these challenges, including strengthening capacity of its Baku Country Office, establishing a working group representing all key ministries and the Central Bank to resolve implementation issues, and increasing supervision budgets. Problem projects have since been mostly cancelled or restructured following changes in the Bank country unit management and an internal Bank report on disbursement in Azerbaijan. Currently, portfolio delays are average for the region and the physical project components are being delivered with moderate effectiveness.

4.25 The only anticorruption efforts in projects have been the standard anticorruption declarations in the credit agreements and procurement documents. Project procurement evaluation panels have included representatives from three ministries, and the procurement processes have been ring-fenced with no effort made to use country systems. Even then there has been pressure for choosing preferred contractors or subcontractors. Mis-procurement was declared in one case, after an investigation in the water sector by the Bank's Institutional Integrity Department.

5. Impact of the 2007 GAC Strategy Implementation

5.1 This evaluation sought to assess the impact of the 2007 GAC Strategy implementation efforts on the country program. In particular, Bank staff were interviewed about their attitudes toward and awareness of GAC issues. The evaluation also sought to determine whether support provided under the GAC Strategy has made a difference in the Bank's responsiveness to GAC issues.

5.2 The Bank's dialogue on GAC in Azerbaijan dates back to at least 1999, when initial advice was provided on setting up the National Oil Fund. It continued apace during the pre-GAC period of this review, starting in 2004 with support on GAC issues to PFM, roads, education, the Court of Accounts, the judiciary, and rural participatory processes.

5.3 The relevance and effectiveness of the strategy to staff attitudes was moderate. Based on staff consultations in Washington, Baku, and Tbilisi, awareness of institutional development issues, and how GAC issues might be better addressed in Azerbaijan, have been heightened. The results were mostly due to a continuation of processes started before 2007. They were achieved despite serious constraints on the Bank's advocacy of the GAC agenda in Azerbaijan, including geopolitical factors, and lack of fiscal pressure on the government due to high oil prices and increases in newly discovered reserves.

5.4 The quality of operational response was moderately relevant and moderately effective. Despite the engagement of management and staff on GAC issues, several operational responses had serious shortcomings. The CPS Completion Report points out that the design of the program was overambitious in its estimate of the pace of government reforms and in the Bank's and government's ability to deliver a sharply scaled up program starting in 2008. These shortcomings were addressed in the second half of the CPS period with a high-level policy forum, joint portfolio review, and a slowdown of new lending.

6. Lessons Learned

6.1 Based on its review of the Azerbaijan program, the following lessons have been identified:

- ❖ **More tailoring of GAC to specific region, country, and project context is needed. GAC-in-projects tools may be less effective in oil-rich, non-democratic states.** The Bank lost its ability to leverage GAC issues in Azerbaijan. Recent oil and gas discoveries have further reduced the Bank's ability to address GAC concerns.
- ❖ **Bank staff and task team leaders need to work with government implementing entities and relevant sector staff to fully understand the country context. GAC efforts should involve active participation and ownership by Government.** Working with the government and affected interests is the key to ensuring that GAC concepts are understood by those who are expected to implement them. For instance, the Bank's experience with helping in the development of the Corporate Plan for Azerbaijan's road agency shows that, without prior experience, new governance concepts are difficult to understand and assimilate. Proactively engaging and helping country stakeholders develop an informed perspective on governance and institutional reforms may require an increase in Bank implementation support budgets.
- ❖ **A key entry point for GAC dialogue is to engage state and non-state actors through high-level governance and business forums.** The Bank need to work more closely with government implementing entities and relevant sector staff to understand how they think. The focus must be on Azerbaijan in its own unique context—not on theory, standard solutions, or examples from other countries. The atmosphere should be exploratory and non-accusatory. In the beginning, actions and action plans would be discouraged and the Bank would only comment on the government proposals when they have matured—in the opinion of Bank staff and experts—and can be implemented, at which time consultant help might be desirable.

High-level forums should be followed by a separate forum for lower-level government officials, and the CSOs. It is possible that some CSOs would be government “informants” or captured by the government; this matter, and the list of invitees, needs to be discussed with the CSOs. A variant/alternative is to begin by organizing a series of forums and let the participants decide when a more comprehensive governance forum and business forum could be productively organized.

- ❖ **The Bank should calibrate its messages regarding the objectives of INT investigations, and ensure that they are not viewed as purely punitive.** Although it is essential that the Bank maintain a zero tolerance stance on criminal activity, it should consider how different approaches to undertaking INT work can impact Bank-client relations over the medium term. The utility of work on “red flags” needs to be evaluated since it can be time-consuming and expensive, and may result in uncertain outcomes, if not properly managed.
- ❖ **Causes of project delays need to be better understood and addressed.** Most areas of the Bank's work have experienced implementation delays, although the overall value of

commitments at risk has broadly been within regional averages over the review period. The government informed the mission that one cause of these delays is that there are cases where Bank staff work with line ministries on project concepts before getting approval from the Ministry of Finance and other higher authorities. Although some prior discussions with line ministries are inevitable, the Bank needs to be careful that discussions do not get too advanced without approval from the leadership.

- ❖ **One of the driving forces for reform is reportedly concern among the leadership about Azerbaijan's international reputation.** There would seem to be many reasons for this, including a commercial motivation to maintain good relations with commercial partners from developed countries and aspirations to join the European Union and the WTO. These concerns provide leverage for the Bank's GAC policy dialog and could help to support a move to adopt EITI++, and a better linking with the expenditure side. They also provide a basis for working toward the overarching GAC-related theme of building up the non-oil sector.
- ❖ **For the Bank, the most important conclusion is to evolve a new, more effective way to work with the client.** In the political arena, including among politically exposed persons, there prevails a prisoner's dilemma. No important government functionary or politically exposed person can alone renounce or expose the dysfunctional governance structure. Approaching this problem requires delicate discussions first within the Bank and then with committed government officials, who, starting with the President, have publicly spoken against corruption and shortsighted governance. This process, with adequate preparation, could start with the forthcoming High-Level Forum to implement the new CPS.
- ❖ **The Bank should carry out evaluations of important GAC issues jointly with government and the CSOs.** These should be deliberative rather than statistical, and confidentiality of information may be necessary in the beginning. Later, such deliberations can be discussed in the print media and on local television. This issue should be part of the present policy dialogue because its acceptance is likely to take time.
- ❖ **Efforts to support donor coordination can pay off in terms of leveraging support for governance reforms, even in middle income countries.** The Bank can learn from recent work by other development partners in Azerbaijan to compile and share information on complementary activities.

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Appendix A Persons Interviewed

| Name | Title/Organization |
|-----------------------------|--|
| GOVERNMENT OFFICIALS | |
| Adil Gojayev | PIU Director, Highways |
| Alekper Guliyev | Head of Administration, State Procurement Agency |
| Ayyub Huseynov | Engineer, PIU, Highways |
| Isgender Isgenderov | Deputy Minister, Ministry of Education |
| Fatizade, Ilgar | Deputy Minister, Ministry of Finance |
| Agayev, Rovshan | Vice Chairman, Support for Economic Initiatives Public Union |
| Elvin Rustamov | Director PIU, Ministry of Education |

DONOR OFFICIALS

| | |
|-------------------|---|
| Faraj Huseynbeyov | Project Implementation Officer, Asian Development Bank |
| Kotaro Matsuzawa | Head of the Economic Affairs and Economic Co-operation Development Department, Embassy of Japan |
| Olli Noroyono | Resident Representative, Asian Development Bank |
| Nailya Safarova | National Program Officer, Swiss Development Cooperation/SECO |

CIVIL SOCIETY REPRESENTATIVES

| | |
|-------------------|---|
| Fidan Bagirova | Director, Open Society Institute |
| Ibadoglu Gubad | Chairman, Economic Research Center |
| Rena Safaraliyeva | Executive Director, Transparency International Azerbaijan |
| Gopakumar Thampi | Chief Operating Officer, Affiliated Network for Social Accountability |

FORMER AND CURRENT WORLD BANK STAFF

| | |
|----------------------|------------------------------------|
| Asad Alam | Country Director, ECCU3 |
| Saida Bagirli | Senior Operations Officer, ECCAZ |
| Deborah Bateman | Country Program Coordinator, EACSQ |
| Jaques Bure | Senior Highway Engineer, ECSS5 |
| Christos Kostopoulos | Former Country Economist |
| Lili Mescarin | Social Development Specialist |
| Jiangbo Ning | Former Senior Highway Engineer |
| Joe Owen | Country Manager, ECCAZ |
| Lili Sisombat | Former Program Manager, IFC |

Appendix B. Azerbaijan—Country Data Sheet, IEG Ratings of GAC Responsiveness, 2004-2010

| CAS Desk Review Results | | |
|---|-----------------------|-----------------------|
| Selectivity | | |
| | Pre-GAC (04-07) | Post-GAC (08-10) |
| Explicit assessments of GPE constraints | Somewhat Incorporates | Highly Incorporates |
| Explicit choice of governance entry points | Somewhat Incorporates | Somewhat Incorporates |
| Mix of financial and knowledge instruments | Somewhat Incorporates | Somewhat Incorporates |
| Results measures | Somewhat Incorporates | Highly Incorporates |
| Overall rating of country strengthening | | |
| | Pre-GAC (04-07) | Post-GAC (08-10) |
| Core public sector institutions | Somewhat | To a great extent |
| Sectoral state institutions | Somewhat | To a great extent |
| Domestic accty | To a great extent | To a great extent |
| Civil society | Somewhat | Somewhat |
| Investment climate | Somewhat | Somewhat |
| Overall rating of signaling of GAC concerns and risks through Bank portfolio processes | | |
| | Pre-GAC (04-07) | Post-GAC (08-10) |
| Portfolio risks are regularly monitored by the Bank | To a great extent | To a great extent |
| Portfolio processes track the progress of governance reforms at sector and project levels | To a great extent | To a great extent |
| Portfolio reviews and results monitoring are regularly disclosed | To a great extent | To a great extent |
| Overall rating on results | | |
| | Pre-GAC (04-07) | Post-GAC (08-10) |
| Quality of indicators | Moderate | Moderate |
| Overall rating of GAC responsiveness in the CAS | | |
| | Pre-GAC (04-07) | Post-GAC (08-10) |
| Minimized fiduciary risk | To a great extent | Somewhat |
| Selectivity of Bank country strategies and programs | To a great extent | To a great extent |
| Signaling of GAC concerns and risks through Bank portfolio processes | To a great extent | To a great extent |
| Smart design of programs and projects by countries | Not at all | Not at all |
| System strengthening | Somewhat | To a great extent |

| Projects: Smart Design Overall Rating | | | | | | |
|--|---|---|---|---|---|---|
| Project Smart Design Ratings Pre-GAC | | | | | | |
| Results orientation | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of institutional strengthening | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Use of country systems | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Demand-side of governance | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of fiduciary aspects | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of governance and political economy analysis | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| | 0 | 1 | 2 | 3 | 4 | 5 |
| | ■ To a Great Extent ■ Somewhat ■ Not at all | | | | | |

| Project Smart Design Ratings Post-GAC | | | | | | |
|--|---|--|--|--|--|---|
| Results orientation | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of institutional strengthening | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Use of country systems | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Demand-side of governance | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of fiduciary aspects | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| Quality of governance and political... | <div><div></div><div></div><div></div><div></div><div></div><div></div></div> | | | | | |
| | 0 | | | | | 1 |
| | ■ To a Great Extent ■ Somewhat ■ Not at all | | | | | |

| 2009 Country Policy and Institutional Assessment Ratings for Azerbaijan and Comparative | | | | | | |
|---|---------|------------|---------|-----------------|---------|-----------------|
| Country | Albania | Azerbaijan | Georgia | Kazakh- stan | Moldova | Uzbeki- stan |
| Property rights and rule-based government | 3.0 | 3.0 | 3.5 | 3.5 | 3.5 | 2.5 |
| Quality of budget and financial management | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 3.5 |
| Efficiency of revenue mobilization | 3.5 | 3.5 | 4.5 | 3.5 | 3.5 | 3.5 |
| Quality of public administration | 3.0 | 3.0 | 4.0 | 3.5 | 3.0 | 3.0 |
| Transparency, accountability, and corruption in public sector | 3.0 | 2.5 | 3.0 | 2.5 | 3.0 | 1.5 |
| Cluster average | 3.3 | 3.2 | 3.8 | 3.4 | 3.4 | 2.8 |
| Overall rating | 3.7 | 3.8 | 4.4 | 3.7 | 3.7 | 3.3 |

APPENDIX B

Appendix C. Statistical Tables

ICR & IEG Project Ratings for Azerbaijan FY2004-10

| Country | CAE period of evaluation | Date of review (FY) | CAE rating | | | | | | | | | | |
|------------|--------------------------|---|----------------------------|--------------------|-------------|---------------------------------|--------------------|------------------------------|----------------------------------|-------------|--------------------|------------------------------|----------------------------------|
| Azerbaijan | 1996-1999 | 2000 | No overall rating provided | | | | | | | | | | |
| Country | CAS period | CASCR review period | IEG CASCR-R rating | | | | | | | | | | |
| Azerbaijan | FY07-FY10 | FY07-FY10 | Moderately unsatisfactory | | | | | | | | | | |
| EXIT FY | Project ID | Project name | Total evaluated (US\$M) | Lending instrument | ICR outcome | ICR risk to development outcome | ICR sustainability | ICR overall Bank performance | ICR overall borrower performance | IEG outcome | IEG sustainability | IEG overall Bank performance | IEG overall borrower performance |
| FY07 | P008284 | Rehabilitation and Completion of Irrigation and Drainage Infrastructure Project | 48.0 | SIL | S | M | # | S | S | S | # | S | S |
| FY06 | P008288 | Greater Baku Water Supply Rehabilitation Project | 66.0 | SIL | S | M | L | S | # | MS | # | # | # |
| FY06 | P035770 | Pilot Reconstruction Project | 28.5 | SIL | S | # | L | S | # | S | # | S | S |
| FY06 | P035813 | Agricultural Development and Credit Project | 31.1 | APL | S | # | L | S | # | S | # | S | S |
| FY04 | P040544 | Farm Privatization Project | 13.4 | SIL | HS | # | HL | S | HS | S | # | S | HS |
| FY09 | P040716 | Highway Project | 46.6 | SIL | S | N | # | S | S | MS | # | # | # |
| FY05 | P055155 | Urgent Environment Investment Project | 17.8 | SIL | S | # | L | S | # | MU | # | S | S |
| FY04 | P057959 | Education Reform Project | 4.8 | LIL | S | # | L | S | # | MU | L | S | S |
| FY07 | P058969 | Cultural Heritage Preservation Project | 7.6 | SIL | S | M | # | MS | S | MS | # | # | S |
| FY07 | P069293 | Health Reform Project | 4.9 | LIL | S | M | # | # | # | MS | # | # | # |
| FY07 | P070973 | Financial Sector Technical Assistance Project | 6.2 | TAL | S | N | # | S | S | S | # | S | S |
| FY06 | P074938 | Poverty Reduction Support Credit | 18.8 | PRC | MS | S | # | MS | MS | MS | # | S | # |

Source: World Bank data as of 11.23.10.

Note: APL= Adaptable Program Loan; CAS= Country Assistance Strategy; CASCR= Country Assistance Strategy Completion Report; ICR= Implementation Completion Report; IEG= Independent Evaluation Group; LIL= Learning and Innovation Loan; PRC= Poverty Reduction Support Credit; SIL= Specific Investment Loan; TAL=Technical Assistance Loan.

Ratings: H= High; HL= Highly Likely; HS= Highly Satisfactory; L= Likely; M=Modest; MS= Moderately Satisfactory; MU= Moderately Unsatisfactory; N= Negligible to Low; S= Significant; #= not available.

IEG Project Ratings for Azerbaijan and Comparators, FY2004-10

| Region | Total evaluated (US\$M) | Total evaluated (number) | Outcome % satisfactory (US\$) | Outcome % satisfactory (number) | RDO % moderate or lower (\$) * | RDO % moderate or lower (number) * |
|---------------|------------------------------------|-------------------------------------|--|--|---|---|
| Albania | 279.6 | 20.0 | 89.5 | 85.0 | 28.6 | 37.5 |
| Azerbaijan | 293.7 | 12.0 | 92.3 | 83.3 | 79.4 | 77.8 |
| Georgia | 312.6 | 20.0 | 86.1 | 80.0 | 85.3 | 73.7 |
| Kazakhstan | 423.4 | 6.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Moldova | 132.0 | 13.0 | 91.9 | 91.7 | 67.7 | 62.5 |
| Uzbekistan | 180.2 | 7.0 | 86.6 | 71.4 | - | - |
| Region | 16,452.2 | 329.0 | 89.7 | 85.4 | 80.6 | 68.7 |
| World Bank | 96,831.8 | 1,507.0 | 85.2 | 77.8 | 73.7 | 63.7 |

Source: World Bank data as of 11.23.10.

* With IEG new methodology for evaluating projects, institutional development impact and sustainability are no longer rated separately.

APPENDIX B

Portfolio Status for Azerbaijan and Comparators, FY2004-10

| Fiscal year | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------|----------|----------|----------|----------|----------|----------|----------|
| Azerbaijan | | | | | | | |
| # Proj | 14 | 18 | 18 | 16 | 24 | 24 | 19 |
| Net Comm Amt | 341.3 | 421.0 | 572.9 | 768.0 | 2,034.7 | 2,177.7 | 2,237.1 |
| # Prob Proj | 2 | 1 | 0 | 2 | 4 | 3 | 3 |
| # Proj At Risk | 2 | 1 | 0 | 2 | 4 | 4 | 3 |
| % At Risk | 14.3 | 5.6 | - | 12.5 | 16.7 | 16.7 | 15.8 |
| Comm At Risk | 103.9 | 15.0 | - | 26.0 | 89.9 | 160.0 | 501.0 |
| % Commit at Risk | 30.5 | 3.6 | - | 3.4 | 4.4 | 7.3 | 22.4 |
| Albania | | | | | | | |
| # Proj | 20 | 14 | 16 | 17 | 17 | 16 | 14 |
| Net Comm Amt | 290.5 | 224.4 | 250.8 | 261.7 | 300.6 | 290.6 | 260.6 |
| # Prob Proj | 3 | 0 | 2 | 1 | 3 | 3 | 6 |
| # Proj At Risk | 3 | 0 | 2 | 2 | 3 | 3 | 6 |
| % At Risk | 15.0 | - | 12.5 | 11.8 | 17.6 | 18.8 | 42.9 |
| Comm At Risk | 35.0 | - | 18.5 | 12.0 | 59.9 | 61.6 | 120.4 |
| % Commit at Risk | 12.0 | - | 7.4 | 4.6 | 19.9 | 21.2 | 46.2 |
| Georgia | | | | | | | |
| # Proj | 18 | 17 | 18 | 18 | 14 | 11 | 12 |
| Net Comm Amt | 344.8 | 328.8 | 290.4 | 308.5 | 253.3 | 295.3 | 469.3 |
| # Prob Proj | 3 | 0 | 2 | 1 | 1 | 1 | 1 |
| # Proj At Risk | 4 | 0 | 2 | 1 | 2 | 1 | 1 |
| % At Risk | 22.2 | - | 11.1 | 5.6 | 14.3 | 9.1 | 8.3 |
| Comm At Risk | 82.1 | - | 55.7 | 15.7 | 18.7 | 10.0 | 55.0 |
| % Commit at Risk | 23.8 | - | 19.2 | 5.1 | 7.4 | 3.4 | 11.7 |
| Moldova | | | | | | | |
| # Proj | 12 | 10 | 13 | 12 | 11 | 10 | 11 |
| Net Comm Amt | 160.5 | 143.8 | 170.0 | 164.1 | 169.3 | 173.3 | 242.3 |
| # Prob Proj | 1 | 0 | 0 | 0 | 0 | 1 | 1 |
| # Proj At Risk | 1 | 1 | 0 | 0 | 0 | 1 | 1 |
| % At Risk | 8.3 | 10.0 | - | - | - | 10.0 | 9.1 |
| Comm At Risk | 11.1 | 35.0 | - | - | - | 5.0 | 14.0 |
| % Commit at Risk | 6.9 | 24.3 | - | - | - | 2.9 | 5.8 |
| Kazakhstan | | | | | | | |
| # Proj | 7 | 7 | 9 | 9 | 11 | 11 | 14 |
| Net Comm Amt | 545.9 | 512.9 | 642.9 | 558.2 | 607.8 | 2,592.8 | 3,657.8 |
| # Prob Proj | 1 | 0 | 1 | 3 | 1 | 3 | 2 |
| # Proj At Risk | 1 | 0 | 2 | 3 | 2 | 3 | 2 |
| % At Risk | 14.3 | - | 22.2 | 33.3 | 18.2 | 27.3 | 14.3 |
| Comm At Risk | 12.0 | - | 124.0 | 89.0 | 59.0 | 78.4 | 48.4 |
| % Commit at Risk | 2.2 | - | 19.3 | 15.9 | 9.7 | 3.0 | 1.3 |
| Uzbekistan | | | | | | | |
| # Proj | 8.0 | 7.0 | 5.0 | 6.0 | 5.0 | 6.0 | 8.0 |
| Net Comm Amt | 302.8 | 285.0 | 237.5 | 252.3 | 222.8 | 250.8 | 356.5 |
| # Prob Proj | 4.0 | - | 2.0 | - | - | - | 1.0 |
| # Proj At Risk | 5.0 | 3.0 | 3.0 | - | 1.0 | 1.0 | 2.0 |
| % At Risk | 62.5 | 42.9 | 60.0 | - | 20.0 | 16.7 | 25.0 |
| Comm At Risk | 188.8 | 153.3 | 141.3 | - | 15.0 | 40.0 | 55.0 |
| % Commit at Risk | 62.4 | 53.8 | 59.5 | - | 6.7 | 15.9 | 15.4 |
| ECA | | | | | | | |
| # Proj | 285 | 276 | 294 | 286 | 283 | 273 | 264 |
| Net Comm Amt | 14,383.0 | 15,675.5 | 16,295.5 | 16,472.9 | 17,758.1 | 21,206.5 | 24,191.5 |
| # Prob Proj | 45 | 17 | 25 | 24 | 30 | 44 | 41 |
| # Proj At Risk | 50 | 24 | 28 | 26 | 34 | 48 | 46 |
| % At Risk | 17.5 | 8.7 | 9.5 | 9.1 | 12.0 | 17.6 | 17.4 |
| Comm At Risk | 2,507.9 | 1,413.0 | 1,177.8 | 1,647.9 | 2,216.8 | 3,422.8 | 4,311.7 |
| % Commit at Risk | 17.4 | 9.0 | 7.2 | 10.0 | 12.5 | 16.1 | 17.8 |

Source: World Bank data as of 11/24/2010.

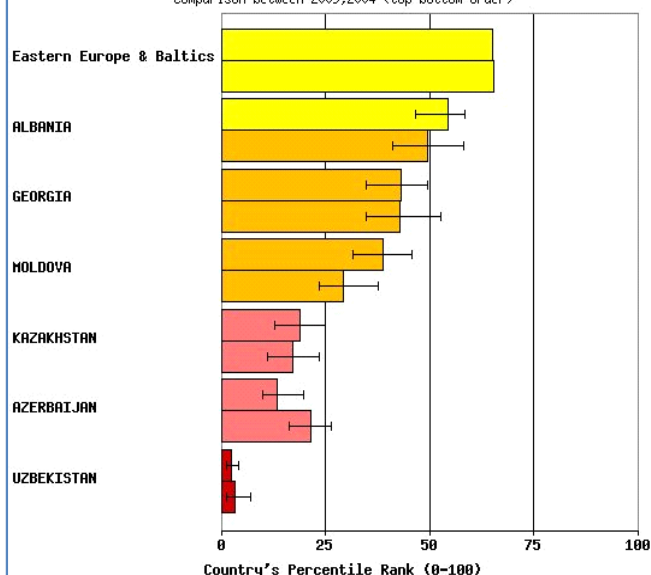
IBRD/IDA Net Disbursements and Charges Summary Report for Azerbaijan (in US\$ million)

| FY | Disb. Amt. | Repay Amt. | Net Amt. | Charges | Fees | Net Transfer |
|------------------------|--------------|-------------|--------------|-------------|-------------|--------------|
| 2004 | 42.25 | 0.00 | 42.25 | 2.82 | 0.36 | 39.08 |
| 2005 | 54.48 | 0.13 | 54.35 | 3.56 | 0.88 | 49.91 |
| 2006 | 57.08 | 3.56 | 53.52 | 3.72 | 0.74 | 49.06 |
| 2007 | 51.96 | 4.11 | 47.85 | 4.49 | 1.69 | 41.67 |
| 2008 | 90.07 | 7.08 | 83.00 | 3.39 | 3.68 | 75.92 |
| 2009 | 122.74 | 8.02 | 114.73 | 2.12 | 7.47 | 105.13 |
| 2010 | 192.79 | 9.39 | 183.40 | 2.03 | 8.54 | 172.83 |
| Total (2004-10) | 611.4 | 32.3 | 579.1 | 22.1 | 23.4 | 533.6 |

Source: WB Loan Kiosk, Net Disbursement and Charges Report as of 11/24/10.

Voice and Accountability (2009)

Comparison between 2009, 2004 (top-bottom order)

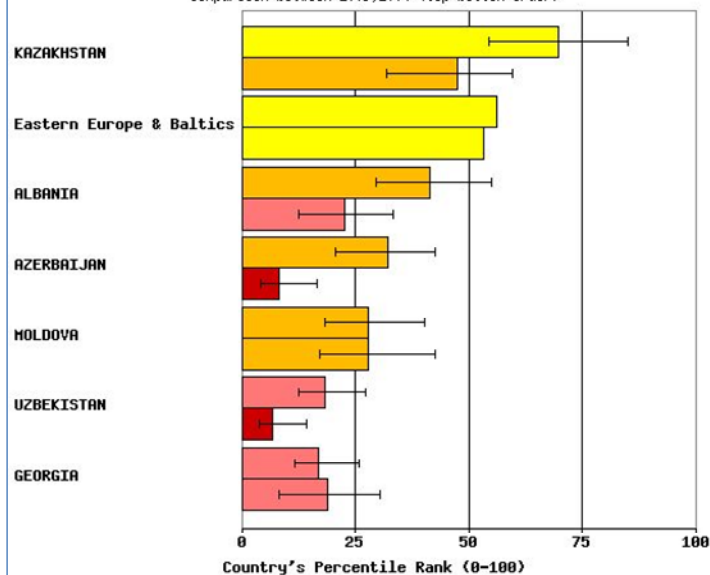


Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

Political Stability (2009)

Comparison between 2009, 2004 (top-bottom order)



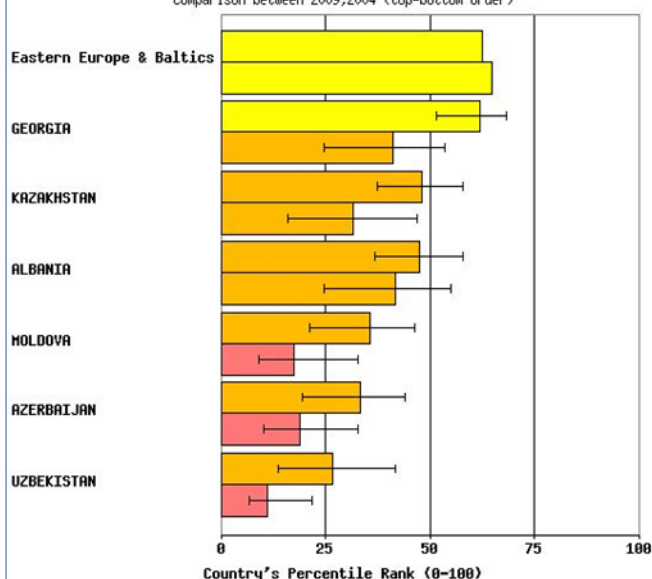
Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

APPENDIX B

Government Effectiveness (2009)

Comparison between 2009,2004 (top-bottom order)

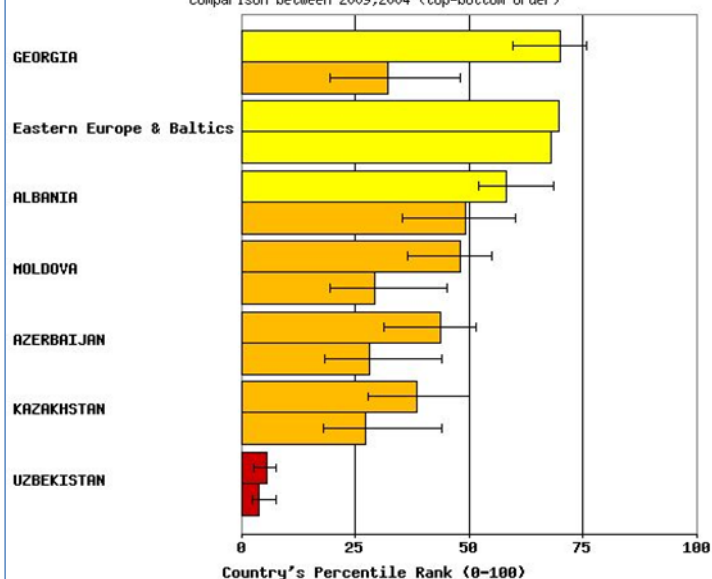


Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

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Regulatory Quality (2009)

Comparison between 2009,2004 (top-bottom order)

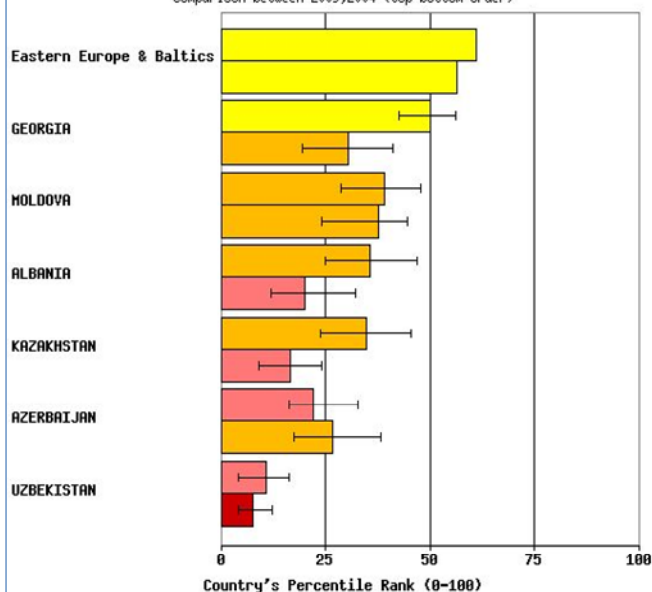


Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

Rule of Law (2009)

Comparison between 2009,2004 (top-bottom order)

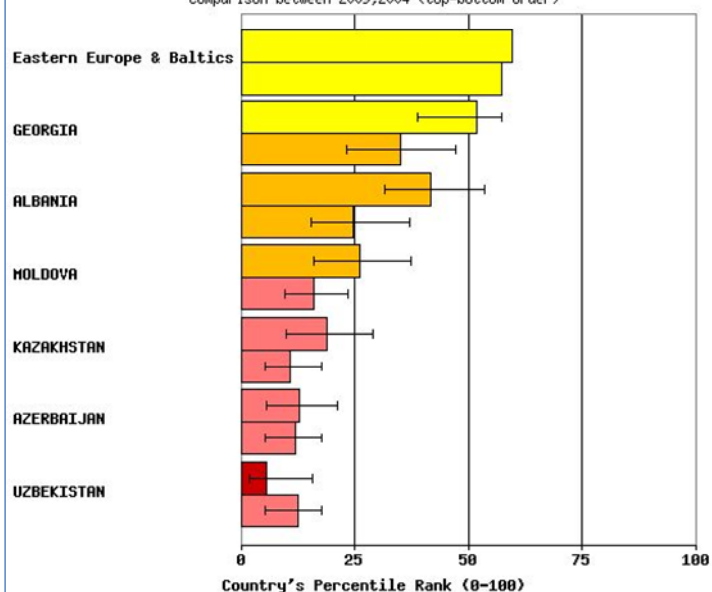


Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

Control of Corruption (2009)

Comparison between 2009,2004 (top-bottom order)



Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

APPENDIX B

| ODA Disbursements Amount type | | Current Prices (USD millions) | | | | | | |
|-------------------------------|--|-------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Donor Year | | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
| All Donors, Total | | 300.69 | 175.75 | 216.51 | 205.74 | 225.25 | 235.09 | 92.05 |
| DAC Countries, Total | | 158.54 | 92.35 | 95.56 | 95.54 | 110.53 | 120.04 | 44.92 |
| Multilateral Agencies, Total | | 131.82 | 57.28 | 91.88 | 73.57 | 72.75 | 72.76 | 47.13 |
| Non-DAC Countries, Total | | 10.33 | 26.12 | 29.07 | 36.63 | 41.97 | 42.29 | .. |
| G7, Total | | 145.51 | 77.76 | 75.01 | 83.41 | 96 | 95.94 | 42.65 |
| DAC EU Members, Total | | 20.44 | 25.48 | 31.09 | 25.29 | 36.4 | 62.46 | 43.25 |
| Austria | | 0.34 | 0.74 | 0.86 | 0.37 | 0.46 | 2.16 | 0.6 |
| Belgium | | .. | .. | 0.07 | 1.07 | 0.02 | 1.71 | .. |
| Canada | | 1.05 | 0.87 | 1.35 | 0.08 | 1.52 | 0.16 | .. |
| Finland | | 0.07 | 0.49 | 0.17 | 0.18 | 0.05 | 0.2 | .. |
| France | | 1.29 | 2.44 | 2.22 | 10.67 | 9.52 | 28.17 | .. |
| Germany | | 13.58 | 16.96 | 19.11 | 12.01 | 24.27 | 26.43 | 42.65 |
| Greece | | 0.25 | 0.31 | 0.64 | 0.2 | 0.31 | 0.3 | .. |
| Ireland | | 0.05 | 0.23 | 0.02 | .. | .. | 0.07 | .. |
| Italy | | 0.21 | 0.11 | 1.24 | 0.05 | .. | 0.16 | .. |
| Japan | | 79.82 | 9.64 | 8.25 | 4.06 | 11.36 | -2.8 | .. |
| Korea | | 0.03 | 0.07 | 0.13 | 0.3 | 0.78 | 3.87 | 1.67 |
| Luxembourg | | 0.14 | .. | 0.02 | .. | .. | .. | .. |
| Netherlands | | 3.86 | 3.5 | 5.47 | 0.05 | 0.06 | .. | .. |
| Norway | | 5.4 | 5.66 | 6.36 | 5.63 | 5.31 | 3.9 | .. |
| Spain | | 0.05 | 0.07 | 0.07 | 0.11 | 0.01 | 0.36 | .. |
| Sweden | | 0.31 | 0.47 | 1.16 | 0.58 | 1.35 | 1.03 | .. |
| Switzerland | | 2.53 | 3.05 | 5.58 | 3.64 | 6.18 | 10.5 | .. |
| United Kingdom | | 0.29 | 0.16 | 0.04 | .. | 0.35 | 1.87 | .. |
| United States | | 49.27 | 47.58 | 42.8 | 56.54 | 48.98 | 41.95 | .. |
| EU Institutions | | 24.56 | 10.61 | 26.02 | 18.67 | 9.04 | 13.01 | .. |
| Czech Republic | | 0.02 | 0.03 | 0.04 | 0.04 | 0.06 | 0.04 | .. |
| Hungary | | .. | .. | .. | 0.01 | .. | 0.03 | .. |
| Poland | | 0.02 | 0.02 | 0.03 | 0.13 | 0.47 | 0.33 | .. |
| Slovak Republic | | 0.01 | .. | .. | .. | .. | .. | .. |
| Turkey | | 3.65 | 22.9 | 28.62 | 36.87 | 36.22 | 33.9 | .. |
| Arab Countries | | 3.89 | 1.35 | -0.54 | -1.17 | 4.4 | 6.49 | .. |
| Other Donor Countries, Total | | 2.74 | 1.82 | 0.92 | 0.75 | 0.82 | 1.5 | .. |
| AfDF (African Dev. Fund) | | .. | .. | .. | .. | .. | .. | .. |
| Arab Agencies | | -1 | 6.4 | 2.93 | -0.79 | 7.93 | 5.05 | .. |
| AsDF (Asian Dev. Fund) | | .. | .. | 0.5 | 4.05 | 13.07 | 9.54 | .. |
| EBRD | | 2.3 | 3.05 | 2.44 | 0.16 | 0.14 | 0.07 | .. |
| GEF | | 0.2 | .. | 5.84 | .. | .. | .. | .. |
| GAVI | | .. | .. | .. | .. | 0.13 | 0.16 | 0 |
| Global Fund | | .. | .. | 0.97 | 6.16 | 3.96 | 6.4 | 5.85 |
| IDA | | 74.74 | 49.17 | 45.63 | 56.31 | 51.98 | 42.16 | 36.08 |
| IDB Spec. Fund | | .. | .. | .. | .. | .. | .. | .. |
| IFAD | | 1.79 | 1.91 | 3.29 | 2.75 | 3.24 | 3.92 | 3.55 |
| IMF (SAF,ESAF,PRGF) | | 20.47 | -21.66 | -5.18 | -24.1 | -25.61 | -15.44 | .. |
| UNAIDS | | .. | .. | 0.07 | 0.01 | 0.07 | 0.09 | .. |
| UNDP | | 2.45 | 2.43 | 2.91 | 2.96 | 2.13 | 2.77 | .. |
| UNFPA | | 0.57 | 0.53 | 0.64 | 0.76 | 0.69 | 0.76 | 0.68 |
| UNHCR | | 2.38 | 1.76 | 1.29 | 0.98 | 1.22 | 1.26 | .. |
| UNICEF | | 0.89 | 1.07 | 1.21 | 1.51 | 1.37 | 0.98 | 0.97 |
| UNTA | | 0.54 | 0.66 | 1.43 | 1.43 | 0.69 | 0.55 | .. |
| WFP | | 1.93 | 1.35 | 1.89 | 1.72 | 2.52 | 1.04 | .. |
| IDA as a share of ODA | | 25% | 28% | 21% | 27% | 23% | 18% | 39% |

Data extracted on 30 Nov 2010 22:28 UTC (GMT) from OECD.Stat

Note: DAC= Development Assistance Committee (OECD); EBRD= European Bank for Reconstruction and Development; ESAF= Enhanced Structural Adjustment Facility; EU= European Union; GAVI= Global Alliance for Vaccines and Immunization; GEF=Global Environmental Facility; IDA= International Development Association; IDB= Inter-American Development Bank; IFAD= International Fund for Agricultural Development; IMF= International Monetary Fund; PRGF=Poverty Reduction and Growth Facility; SAF= Structural Adjustment Facility; ODA= official development assistance; UNAIDS= United Nations Programme on HIV/AIDS; UNDP= United Nations Development Programme; UNFPA=United Nations Population Fund; UNHCR= United Nations High Commissioner on Refugees; UNICEF= United Nations Children's Fund; UNTA= United Nations Technical Assistance Programme; WFP= World Food Program.

