



<b>1. Project Data:</b>		<b>Date Posted :</b> 09/29/2004	
<b>PROJ ID:</b> P055131		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name:</b> Sac II (formerly Psrac)	<b>Project Costs (US\$M)</b>	60	60
<b>Country:</b> Azerbaijan	<b>Loan/Credit (US\$M)</b>	60	60
<b>Sector(s):</b> Board: PS - Central government administration (47%), Oil and gas (19%), Power (15%), Water supply (12%), General industry and trade sector (7%)	<b>Cofinancing (US\$M)</b>		
<b>L/C Number:</b> C3615			
	<b>Board Approval (FY)</b>		02
<b>Partners involved :</b>	<b>Closing Date</b>	12/31/2003	12/31/2003
<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
Michael R. Lav	Laurie Effron	Kyle Peters	OEDCR

**2. Project Objectives and Components**

**a. Objectives**  
Enhance the Government's ability to efficiently manage the resources generated by the petroleum boom, including poverty monitoring, social services and safety nets through better targeting and special initiatives for refugees and internally displaced populations; and to stimulate balanced (especially non-oil) economic growth, job creation, and poverty reduction through improvement in the business environment, and improved financial discipline and service delivery in the utility sectors.

**b. Components**  
Reforms to: (1) improve transparency and accountability in public financial management, including the establishment of a supreme audit institution; (2) strengthen the tracking of poverty-reducing public expenditures, and monitoring their impact on poverty; (3) improve strategic priority setting and transparency of medium-term public expenditure and investment programs; (4) introduce transparency and fiscal discipline in the energy sector, including fiscalization of quasi-fiscal activities; (5) reduce conflicts of interest and corruption in the business environment by enforcing regulations, separating regulatory and commercial functions, and improving tax and customs administration; and (6) improve transparency, financial discipline and competition in the banking sector .

**c. Comments on Project Cost, Financing and Dates**  
The project cost US\$60 million, financed by an IDA credit of US\$60 million in two equal tranches. The project was appraised in October, 2001, approved by the Board on March 12, 2002, made effective on March 13, 2002, and closed on December 31, 2003, on schedule. The first tranche was released at effectiveness, and the second tranche was released on schedule in June, 2003.

**3. Achievement of Relevant Objectives:**

(1) budgets from 2003 have been prepared in accordance with a medium term expenditure framework and include expenditures from the Oil Fund, and require Parliamentary approval . A single Treasury account has been established which improves cash management and enhances controls on budget execution . A new State Procurement Law which is in accord with international principles has been enacted . The Cabinet has approved the Charter of the State Procurement Agency (SPA) and a new Public Procurement Plan . A Chamber of Accounts was established as the supreme audit institution of Azerbaijan . Five qualified auditors have been appointed as a nucleus of staffing, a work program has been approved, equipment is being obtained . The Cabinet has approved the action plan recommended by the CFAA and Parliament has passed the new Accounting Law which introduces International Financial Reporting Standards (IFRS). (2) The State Program on Poverty Reduction and Economic Development is being implemented, with monitoring of progress in poverty reduction and towards achieving the MDGs for Azerbaijan . Resettlement of Internally Displaced Persons and improved conditions for them is being financed by expenditure from the Oil Fund. A detailed program of social assistance reform is being implemented . Various benefits are being consolidated into a cash benefit, with an increase in overall resources for social benefits and improved targeting . This is also supported by a separate IDA investment project . (3) Oil Fund accounts have been audited by a

reputable international audit firm and financial information published quarterly and made available on the Web . An improved governance framework for the State Oil Fund is being implemented and Azerbaijan recently joined the Extractive Industries Transparency Initiative . (4) Tariff increases have reduced Implicit subsidies in the energy and water sectors by 70 percent, and remaining electricity and gas subsidies have been made fully explicit . Governance for the energy, gas, and water agencies has been improved and they now provide audited statements . However, satisfactory draft regulations for electricity, gas, and water sectors to ensure fair and competitive behavior have been delayed despite efforts of government to move forward because of lags in getting necessary technical assistance in place. Draft regulations are expected during 2004 with implementation starting in 2005.(5) A Council for Entrepreneurs was established and meets regularly with the President . New laws have been drafted although some implementation delays have occurred, there is a substantial improvement based on a new "Law on Anti-Corruption" and other improvements. These improvements are reflected in Azerbaijan's improved "BEEPs" rating and its much higher CPIA scores and rankings for governance . Tax administration and Customs administration has improved . The average tariff rate has been lowered . (6) Concerning privatization, six state enterprises have been privatized through investment competition and four joint ventures were privatized .

#### 4. Significant Outcomes/Impacts:

The Business Environment and Enterprise Performance survey, FIAS survey and several other surveys (including International Country Risk Guide and Economic Freedom Survey ) all report improvements in the investment climate over the past three or four years, although from a low base . In addition, starting from low levels in 2000, a number of CPIA ratings for 2003 exceed the average for IDA countries . Finally, the quasi-fiscal deficit has been reduced from 20 percent of GDP to about 10 percent of GDP .

#### 5. Significant Shortcomings (including non-compliance with safeguard policies):

(1) Competition in the banking sector remains stifled . Entry of reputable foreign banks has been discouraged by a limit imposed on the foreign share of total banking sector capital . While the basic regulatory framework for bank supervision has been put in place, some of the new regulations such as those concerning loan loss provisions and asset classification may need to be revised . (2) Although privatization was not a core objective of the operation, it was listed in the matrix of conditions; here there has been considerable delays in the banking sector in particular because of political resistance to privatization .

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome :</b>	Satisfactory	Satisfactory	The SAC II fully achieved its objectives in central government administration and substantial progress was achieved in oil and gas, power, water supply sectors . Because of this record, an outcome rating of satisfactory is merited despite some shortfalls in banking and enterprise reform, on which the SAC put less emphasis.
<b>Institutional Dev .:</b>	Substantial	Substantial	
<b>Sustainability :</b>	Likely	Likely	Although a sustainability rating of likely is warranted, continuing attention will be required to ensure there is no slippage on the integration of oil revenues into the budget process. Sustainability will also be sensitive to further progress in subsequent operations on banking and enterprise sector reform.
<b>Bank Performance :</b>	Satisfactory	Satisfactory	
<b>Borrower Perf .:</b>	Satisfactory	Satisfactory	
<b>Quality of ICR :</b>		Satisfactory	

NOTE: ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

#### 7. Lessons of Broad Applicability:

1. A thorough assessment of ownership and capacity is needed, especially for complex reforms such as those supported by the SAC II. 2. Continuous policy dialogue underpinned by sector projects and ESW is needed to successfully implement many adjustment reforms . Country office staff can, and should, play a key role in this process. 3. Adjustment operations based on full ownership and adequate capacity can provide important signals to other sources of financing.

#### 8. Assessment Recommended? Yes No

**Why?** This operations should be assessed in conjunction with SAC I to derive more fully the lessons for

successful reform in a petroleum-endowed country, to see how the integration of oil revenues into the budget process is playing out, and to provide guidance for further reforms of the enterprise and financial sectors .

**9. Comments on Quality of ICR:**

The ICR clearly sets out the achievements and shortcomings of this operation . It provides a good deal of useful detail, especially regarding the BEEPS and CPIA indices, and usefully sets out the country context in a very clear manner. However, the ICR might have also included an overall number on the reduction of the quasi -fiscal deficit, which was available from the IMF PRGF documentation .