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Report No: 22113

IMPLEMENTATION COMPLETION REPORT
(PPFB-P1920; IDA-27080)

ON A

CREDIT

IN THE AMOUNT OF SDR 14.3 MILLION (US\$20.8 MILLION EQUIVALENT)

TO THE

AZERBAIJAN REPUBLIC

FOR A

PETROLEUM TECHNICAL ASSISTANCE PROJECT

May 31, 2001

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CURRENCY EQUIVALENTS

(Exchange Rate Effective May 7, 2001)

Currency Unit = Azerbaijannian Manat (AZM)

1 Manat = US\$ 0.0002

US\$ 1 = 4624 Manats

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
EU (TACIS)	European Union (Technical Assistance for the Commonwealth of Independent States)
FID	Foreign Investment Department of SOCAR
FSU	Former Soviet Union
IDA	International Development Association
IT	Information Technology
MIS	Management Information System
MOP	Memorandum of the President
PC	Personal Computer
PIU	Project Implementation Unit
PPF	Project Preparation Facility
PTAP	Petroleum Technical Assistance Project
PSA	Production Sharing Agreement
SOCAR	State Oil Company of Azerbaijan Republic
TA	Technical Assistance
UEIP	Urgent Environmental Investment Project

Vice President:	Johannes Linn
Country Manager/Director:	Judy O'Connor
Sector Manager/Director:	Peter Thomson
Task Team Leader/Task Manager:	Michael Levitsky

**AZERBAIJAN REPUBLIC
PETROLEUM TECHNICAL ASSISTANCE PROJECT**

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<i>Project ID:</i> P008282	<i>Project Name:</i> PETROLEUM TA
<i>Team Leader:</i> Michael Levitsky	<i>TL Unit:</i> COCD1
<i>ICR Type:</i> Core ICR	<i>Report Date:</i> May 31, 2001

1. Project Data

Name: PETROLEUM TA *L/C/TF Number:* PPFB-P1920;
IDA-27080
Country/Department: AZERBAIJAN *Region:* Europe and Central
Asia Region
Sector/subsector: GG - Oil & Gas Adjustment

KEY DATES

<i>PCD:</i> 09/03/1992	<i>Effective:</i> 08/23/1995	<i>Original</i>	<i>Revised/Actual</i>
<i>Appraisal:</i> 03/22/1994	<i>MTR:</i> 05/31/1997		11/22/1995
<i>Approval:</i> 04/20/1995	<i>Closing:</i> 11/30/1999		10/27/1997
			11/30/2000

Borrower/Implementing Agency: GOV'T OF AZERBAIJAN/STATE OIL CO. OF AZER. REP. (SOCAR)

Other Partners:

STAFF	Current	At Appraisal
<i>Vice President:</i>	Johannes Linn	Wilfried Thalwitz
<i>Country Manager:</i>	Judy O'Connor	Yukon Huang
<i>Sector Manager:</i>	Peter Thomson	Jonathan C. Brown
<i>Team Leader at ICR:</i>	Michael Levitsky	Michael Levitsky
<i>ICR Primary Author:</i>	Michael Levitsky; Jann Masterson	

2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S
Sustainability: L
Institutional Development Impact: M
Bank Performance: S
Borrower Performance: S

Quality at Entry: QAG (if available) ICR
S
Project at Risk at Any Time: Yes

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

The original objectives of the project as stated in the Memorandum of the President dated March 28, 1995 were: “(a) to accelerate foreign private investment and financial participation in petroleum exploration and production through providing TA to SOCAR, particularly for restructuring of the Guneshli field; (b) to strengthen petroleum sub-sector institutions through development of petroleum legislation, training, and improvements in information systems; and (c) to prepare investment projects in the petroleum sub-sector, through joint studies between SOCAR and foreign advisors.”

The objectives were well aligned with the first Azerbaijan CAS (presented to the Board with the project). Azerbaijan’s oil sector was identified as a priority area for attracting foreign investment to stimulate economic recovery. As a major oil producer and exporter for over a century, Azerbaijan had substantial remaining producing reserves and a large legacy of infrastructure and institutions from the Soviet period. This legacy required substantial restructuring and strengthening. In addition, large new oil reserves had been identified offshore Azerbaijan, in the Caspian Sea, and there was significant interest from major international oil companies in development of these reserves. Thus the country faced a dual challenge of attracting foreign investors to the new offshore fields, and of restructuring its Soviet legacy of decaying infrastructure and inappropriate institutions.

The issues facing the oil sector, and proposals for future action, were assessed in detail in the Azerbaijan Energy Sector Review (Dec. 1993). The project was designed to meet the issues identified in the Review, which were recognized by both IDA and the Government following considerable dialogue. The subsequent evolution of Azerbaijan’s economy, in which foreign-financed oil investment has been almost the only support for economic revival, shows that IDA's early focus on the oil sector was justified.

3.2 Revised Objective:

Not applicable

3.3 Original Components:

The original description of the project in the MOP was as follows: “The project will provide TA in the following areas of the petroleum sub-sector: (a) provision of resources to SOCAR to recruit financial, legal and technical advisors for: (i) formulation and management of a project for the rehabilitation of the Guneshli field, (ii) exploration and development of other fields and construction of related infrastructure, (iii) legal studies on Caspian Sea boundary determination, (iv) development of an oil export pipeline, and (v) petroleum licensing and exploration promotion (base cost: US\$14.36 million); (b) development of a legislative and fiscal framework for petroleum exploration and production (US\$0.45 million); (c) institutional strengthening of SOCAR through training, and introduction of information and communication systems (US\$1.5 million); (d) detailed investment and restructuring studies of the older oil fields, gas processing facilities and oil export infrastructure improvements (US\$3.35 million); (e) TA for a Project Implementation Unit (PIU) covering financial, procurement and project management services (US\$0.75 million); and (f) an unallocated amount of US\$1.0 million (foreign currency cost) to cover additional project preparation activities and advisory services in the energy sector.”

These components were well integrated with the objectives of the Project. However, since this was IDA's first project in Azerbaijan, the number of components was perhaps ambitious. Yet the large size of the oil sector in Azerbaijan, and its importance to the economy, may have rendered a smaller TA project, with fewer components, insignificant. Moreover, the components selected already represented a focusing of efforts on specific areas in which the Energy Sector Review had demonstrated that IDA intervention might

produce results. Thus the project excluded consideration of the downstream oil sector (oil refining and marketing), despite its many problems, because of the absence of suitably motivated counterparts.

At the time that the project was designed, Azerbaijan and its oil sector were undergoing very rapid evolution. While each component was supported by detailed Terms of Reference and costing, agreed with SOCAR and the Government, it was recognized that changes would probably be required to the specific project components during the course of implementation.

3.4 Revised Components:
Not applicable.

3.5 Quality at Entry:

There was no formal Quality at Entry review of this project at its initiation. Nonetheless, there are good indications that care was taken to ensure that the project could be implemented effectively, and would deliver sustainable results. In particular, the Development Credit Agreement set out conditions for effectiveness which ensured that the project would be supported by a strong PIU (appointment of a Director, adequate staff and accommodation, etc.). In addition, credit covenants were designed to ensure commitment by SOCAR and the Government to effective project implementation, including: submission of regular progress reports, preparation and submission of a mid-term review, and submission of a draft Petroleum Law to Parliament (based upon TA funded under the project) by February 1996 (approximately 1 year after project initiation). Overall, therefore, considerable care was taken to ensure that the project would have the best chance of succeeding, taking account of the lack of Bank lending experience and the unstable situation in the country. The relatively strong performance of the PIU during most of the period of project implementation demonstrates that project management was well designed, even if the record of implementation of components (mostly outside the direct control of the PIU) was somewhat variable.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

Overall, the project can be judged to have achieved its Objectives, and is therefore rated as Satisfactory. However, the achievement of objectives was stronger in some cases than others. Achievement was negatively affected by the general difficulties in IDA operations in Azerbaijan, which were reflected in the downgrading of Azerbaijan's IDA rating during the course of the project. Also, during the course of the project, Azerbaijan became a major focus of interest and investment by foreign oil companies. The scale of activity and investment involved may have overshadowed the relatively modest Petroleum TA Project. Thus, it is not always easy to assess the contribution from the project in isolation from the broader impact of foreign investment.

a) Accelerate foreign private investment and financial participation in petroleum exploration and production through providing TA to SOCAR, particularly for restructuring of the Guneshli field: During the implementation of the project, Azerbaijan was extremely successful in attracting foreign petroleum investors to the most promising areas offshore and onshore. A total of 21 Production Sharing Agreements (PSAs) have been signed with international companies, and investments of several billion US Dollars have already been made. Components of the project which helped SOCAR to deal with this influx of investment more effectively included: training, study of Caspian boundaries issues, reservoir engineering development, and information technology upgrading. With respect to the Guneshli field (specifically the Shallow Water section operated by SOCAR which was the target of the project), no agreement with foreign investors has yet been signed. However, a major review of the field by Western engineers was completed, which caused SOCAR management to accept the scale of the rehabilitation challenge to international standards. This

work also led to greatly improved understanding of the reservoir behavior and the costs of re-development, and entailed significant knowledge transfer to the local offshore design institute. Using material from the report, SOCAR has been making sizable investments in existing field infrastructure. SOCAR negotiated for over two years with a major Western oil company which wished to undertake field rehabilitation, and these negotiations were based in part on the technical and economic analysis carried out under the project. These negotiations broke down in 1999 due to failure to agree on commercial terms, and serious negotiations are underway with a different major oil company.

b) Strengthen petroleum sub-sector institutions through development of petroleum legislation, training, and improvements in information systems: The Government decided early in the project's implementation not to develop petroleum legislation under this project, in part because the legal framework for petroleum was evolving in a somewhat different direction. With regards to training, significant contributions were made to upgrading the skills of SOCAR staff through the financial and commercial training program, and the reservoir engineering assistance. In addition, the design of project components (e.g. investment feasibility studies, IT design, Caspian legal regime) incorporated a substantial training and knowledge transfer element through close involvement of SOCAR staff. The objective of strengthening IT systems was partially achieved, since the project financed the upgrading of IT equipment for reservoir engineering and also funded the feasibility study and bidding process which has allowed SOCAR to procure a crucial Management Information System meeting its requirements.

c) Prepare investment projects in the petroleum sub-sector, through joint studies between SOCAR and foreign advisors: This objective was fully achieved through the preparation of substantial investment studies on the old onshore fields, the old offshore fields and the gas processing plant reconstruction (in addition to the study of the Guneshli field). These studies elicited substantial interest from potential investors (although specific investments have not yet been made), and have considerably enhanced the understanding of SOCAR and of foreign investors of the challenges of restructuring the massive infrastructure which SOCAR has inherited from the Soviet system. Through presentation of these reports SOCAR gained experience in international promotion of petroleum projects.

4.2 Outputs by components:

There were some adjustments to the specific components during the course of project implementation. The components which were implemented generally produced satisfactory outputs. Details of the output by components are described below.

Part A. Support for Foreign Investment in Petroleum Exploration and Production

Study of the Rehabilitation of the Shallow-Water Guneshli Field: Phase 1 of this work, which involved a study of basic field characteristics, installations, investment options and costing was completed satisfactorily. The study was formally accepted by SOCAR's Board in September 1996. SOCAR staff worked with a reservoir engineering company in Norway. The study provided the basis for SOCAR's negotiations with a major foreign oil company which made detailed proposals for a rehabilitation contract to SOCAR (negotiations eventually broke down over commercial terms in 1999). An important result of the study was recognition that the reservoir modeling capability of SOCAR and its affiliated institutes was outdated, and this had led to likely misinterpretation of Guneshli field characteristics. Since this field is SOCAR's major producing asset, this was a critical issue. It was decided to address this matter directly within the project through development of a Reservoir Engineering Center, based upon the work done on the Guneshli field (see Part B below). The original project plan had foreseen a Phase 2 of advisory work on the Guneshli field, involving work with potential foreign investors. However, these funds were reallocated to the Reservoir Engineering Center and SOCAR used the Phase 1 work and its own resources

in discussions with foreign companies concerning Guneshli.

Legal Study of Caspian Sea Riparian Issues: This study was undertaken by a highly qualified international lawyer. The study involved consultation with SOCAR and the Azerbaijan Government. A final report was delivered in October 1997, and was judged very useful by SOCAR and the Government. At the request of SOCAR the study has remained confidential.

Financial and Commercial Advisors for Export Pipeline Negotiations: Due to the speed of events in 1995 to 1997, SOCAR did not procure advisors under the project for the first major set of pipeline negotiations in 1995 and 1996. In 1999 SOCAR requested IDA funding for advisors under the project, to deal with anticipated negotiations on the Main Export Pipeline for oil. The need to procure such advisors was the key factor behind the extension of the Closing Date for the project, from November 30, 1999 to November 30, 2000. Difficulties in drawing up an acceptable short list hampered implementation of this component. Nearly all the qualified advisors were already committed to other work in the Caspian region which might have conflicted with advising SOCAR. Eventually SOCAR and IDA agreed not to procure advisors due to the delays in initiating procurement.

Part B: Institutional Strengthening of the Petroleum Sub-Sector

Development of a Petroleum Law: The government decided at a late stage not to use IDA funds under the project for this work. At the time (1995/96) Azerbaijan had already passed two PSAs as specific Laws by Parliament, and was on the verge of passing a third such Law. There was concern that development of a new Petroleum Law might cause uncertainty regarding this process. Foreign oil investors appeared to find the Parliamentary endorsement of each PSA acceptable. The success of the PSA Laws in dealing with foreign petroleum investment reduced the need for the comprehensive Petroleum Law envisaged under the project. The government eventually obtained support from EU TACIS for work on a Petroleum Law, on a grant basis. A draft law has been prepared and is being considered by Parliament. This component of the project was therefore canceled and the funds made available for reallocation. The Covenant in the Loan Agreement requiring submission of a Petroleum Law to Parliament by February 1996 was waived.

Financial and Commercial Training: A specialized petroleum industry training firm was selected for this work and courses were run in Baku and in Boston during October 1997. About 250 SOCAR staff attended the courses, and the training program was deemed highly satisfactory.

Management Information Systems: SOCAR and IDA agreed that a priority in this area was development of a geological and geophysical data management system. This would allow SOCAR to acquire and process data which the foreign oil companies were obliged to supply, and would also allow SOCAR to convert and interpret its own data in a modern digital format. A specialized consulting firm was hired by SOCAR to develop specifications and bidding documents, and the firm's recommendations and the draft bidding documents were approved by IDA. Bids were received in July 1999. However, following receipt and opening of the technical and financial proposals, SOCAR raised with IDA new criteria which it wished to take into consideration in selecting the MIS provider. According to SOCAR, after the initial evaluation of the proposals had been completed, it became aware that the foreign oil companies had mostly standardized their data in a specific format, and the critical criterion for an MIS system was therefore complete compatibility with this particular format. This had not been adequately described in the bidding documents. The lowest priced bid which was fully responsive to the bidding documents was deemed unacceptable by SOCAR on the basis of the new compatibility criterion. SOCAR requested IDA's permission to select a higher-priced bid which it now believed more closely met its requirements. IDA informed SOCAR that this was not acceptable under IDA's Procurement Guidelines. Since SOCAR

declined to complete the procurement process by selecting the lowest-priced responsive bid, IDA declared misprocurement, and SDR 1,495,800 of the Credit was canceled. However, SOCAR did make considerable use of the tender by proceeding to purchase the preferred system (as bid under the project) using its own funds.

SOCAR also obtained the advice of a consulting firm in the design of a financial information system. The initial report of the consultants was judged by IDA reviewers to be inadequate to proceed with a request for bids, and due to time constraints imposed by the Closing Date, procurement for this component was not implemented.

Reservoir Engineering Center: Following the successful study of the Guneshli field, in which SOCAR specialists became acquainted with state-of-the-art reservoir modeling, it was decided to allocate part of the funds for the Guneshli field component to design and procurement of a Reservoir Engineering Center (with the Guneshli reservoir model as a core element of the Center's work). Design and procurement were duly carried out, by the same consulting firms which undertook the Guneshli work. The Center was formally opened in 2000, and represents an important extension of SOCAR's technical capabilities.

Financial Audit of SOCAR: An audit of SOCAR was required under the Loan Agreement (in addition to the annual audit of the project accounts). This was to be the first audit of SOCAR to Western accounting standards. SOCAR's importance to the economy of Azerbaijan, and to the Government, made this an important and sensitive aspect of the Project. A full audit of SOCAR also became an important policy issue for IDA and IMF macro-lending. SOCAR selected a major international accounting firm to undertake the audit for 1997/98. The auditors disclaimed any opinion in their 1997/98 audit, which was delivered in March 2000. The auditors had two major reservations: firstly, the auditors had been refused access to SOCAR's Aznefteyag refinery (representing some 20% of SOCAR's business), and secondly, SOCAR's information systems and records were not suitable for an audit to international standards. IDA insisted at the highest level of government that completion of the audit to include the Aznefteyag refinery was a key policy issue. The auditors were given access to the Aznefteyag refinery in September 2000, and the first full international audit of SOCAR (for 1997/98) was duly completed. Audits for 1999 and 2000, although required in principle under the Loan Agreements, could no longer be funded from the project because of the November, 2000 Closing Date. Moreover, the auditors have recommended that SOCAR carry out substantial improvements in its internal systems in order to provide information of a standard suitable for international auditing, and SOCAR has been implementing these recommendations. Using the 1997/98 audits as a base, SOCAR has since commissioned (at its own expense) full audits by the same international accounting firm for 1999 and 2000, representing major progress in transparency and understanding of oil industry finances.

C. Energy Sector Investment Studies

Restructuring of the Old Onshore Oil Fields: A consulting firm was selected and produced a satisfactory report in mid-1997. The consultants worked jointly with Azerbaijani counterparts. The reports presented the data on the old oil fields in a manner accessible to potential Western investors. "Road shows" were held in London and Houston in August 1997, and a large number of companies attended and expressed interest in the information. These events were reported in the international oil industry press. SOCAR was able to sell 11 copies of the reports at US\$25,000 each to potential investors, thereby recouping a portion of the cost of this component (all funds from the sales were sent directly to SOCAR's Finance Department for crediting towards SOCAR's repayment of its sub-loan from the Ministry of Finance). Although a few investment proposals were received by SOCAR, they were not judged to be adequate. The report thus indicated strongly that it would be difficult to attract credible Western investors to the most marginal

onshore fields. The environmental component of these studies was regarded as particularly useful by SOCAR, and has assisted at least one foreign investor to establish a remediation project on one of the most polluted fields.

Restructuring of the Old Offshore Oil Fields: A consulting consortium was selected for this component in January 1997. Substantial work was undertaken jointly with SOCAR counterparts, and satisfactory reports were produced in July 1998. As with the Onshore Fields, promotional activities were undertaken in London and Houston and there was coverage in the industry press. SOCAR also created a web site to advertise the fields. Considerable interest was expressed by oil companies. However, commitment by oil companies to investments was tempered by the very low oil prices in 1998.

Reconstruction of the Gas Processing Plant: Following selection of a qualified consulting firm in February 1996, the report was satisfactorily completed in January 1998. The consulting firm worked closely with SOCAR experts from the existing Gas Processing Plant. The report was presented to potential investors in July 1998. The report continues to be used extensively in discussions of further investment in gas processing.

Urgent Environmental Investment Project (UEIP): In December 1997 an IDA environmental team proposed to use certain PTAP funds for the preparation of the oil field clean-up component of the UEIP Project (US\$210,000). An Environmental Assessment and several bidding documents were prepared using this funding.

E. Project Implementation Support

Advisory Services for Project Management and Procurement: SOCAR's PIU concluded a contract with a foreign consulting firm with experience in project management in August 1995. This firm greatly assisted PIU staff to manage the project. The contract was extended until November 1999.

Office Equipment for the PIU: The PIU procured PCs, printers, a fax and other office equipment and supplies for use at its office. Since the PIU was located within SOCAR's Foreign Investments Department, this equipment is also available for use by other SOCAR staff.

4.3 Net Present Value/Economic rate of return:
Not applicable.

4.4 Financial rate of return:
Not applicable.

4.5 Institutional development impact:
The project's impact has been mainly within SOCAR. The training provided both through the specialized courses, and during implementation of studies, has upgraded the skills of the SOCAR workforce, particularly for interaction with foreign investors. The Reservoir Engineering Center has had an important impact in bringing a key part of SOCAR's analytical capability to international standards.

Since the Petroleum Law component of the project was canceled, developments in this area have been proceeding separately from the project. A draft law has been prepared, which has been extensively discussed and revised. This law is under consideration by Parliament. IDA's early dialogue with the Government on the need for a comprehensive legal framework for petroleum investment probably assisted in focusing attention on this area.

The first audit of SOCAR to international standards, undertaken within the project, has been important in improving understanding of the company in Azerbaijan and among foreign lenders. The audit is also important in allowing SOCAR to start to move towards commercial operations and, eventually, towards participation in international capital markets. By requiring completion of the audit, despite resistance from the Aznefteyag refinery, the project has brought increased transparency to SOCAR.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:

The ability of the project to contribute to SOCAR's negotiations with foreign companies for PSAs and export pipelines was to some extent affected by the speed with which events unfolded in the Caspian region during 1995 to 1999. Given the geo-political issues involved and the need of Azerbaijan for early revenue and investment, the Government had to react rapidly to interest from international investors. During this period SOCAR signed some 17 PSAs, the US\$2.0 billion Early Oil project went from initial planning to full production, and SOCAR was involved in intensive preparation for a major oil export pipeline. The rapid pace of events and intensity of activity made it difficult for SOCAR's Foreign Investments Department to procure and involve new advisors, since it was leading the negotiation and implementation of multiple agreements with foreign oil companies and governments. This problem was most notable in the early years of the project. In general, the pressures of complex geo-political and commercial negotiations may have detracted from attention to the project at the highest levels of SOCAR.

An additional factor was the volatility in oil prices during project implementation. Prices fell from an average of between US\$19 and US\$20/barrel in 1996 and 1997, to a low of US\$13/barrel in 1998, before recovering in mid-1999 to average US\$18/barrel in that year. The collapse in oil prices in 1998 had a chilling effect on investor interest in the investment proposals prepared by SOCAR and its consultants under the project.

5.2 Factors generally subject to government control:

Several factors affected project performance, which were clearly within the government's control:

- a) Petroleum Law: The government's early decision not to utilize funds under the project to prepare a Petroleum Law limited the impact of the project outside SOCAR. The government did eventually pursue drafting of a Petroleum Law, but this has not yet been enacted.
- b) Implementation of IDA Projects: The ability of the SOCAR PIU to implement the project was frequently compromised by interference from the Government. This in turn was related to the poor overall performance of Azerbaijan in implementing IDA projects during the period in question. Changes in senior government personnel during the project led to uneven commitment to the project.
- c) Institutional Arrangements in the Petroleum Sector: Azerbaijan has had no Ministry specifically responsible for the Energy Sector. (In April 2001, the Government announced the formation of a Ministry of Energy.) SOCAR reports directly to the President of the Republic. However, the Cabinet of Ministers, and specific ministries, do have substantial control over implementation of IDA-financed projects, and there is therefore a misalignment between the parts of the government interested in project objectives (SOCAR and the Presidency), and the parts interested solely in project processing. Despite repeated promises of reform, and plans to improve regulation and policy formulation in the petroleum sector, no action was taken. Weak governance and limited regulation impeded IDA's ability to find suitable counterparts in the government for the work on the petroleum sector and caused unnecessary friction between SOCAR and the

Cabinet of Ministers.

5.3 Factors generally subject to implementing agency control:

Several factors were within the control of SOCAR:

- a) SOCAR Organization: The Foreign Investments Department gave the PIU good support and SOCAR's top management usually delivered decisions promptly. However, despite the PIU's good record in initiating and processing the project, the performance of other parts of the SOCAR organization occasionally left much to be desired. It was often difficult for the PIU to obtain cooperation from other parts of SOCAR, even with the support of SOCAR's President. In addition, in certain cases (for example training and MIS) it was difficult for the PIU to identify any part of SOCAR which was willing or able to take responsibility for implementation. While these problems were beyond the control of the PIU and the Foreign Investments Department, they could have been dealt with through greater focus of SOCAR's Board on implementation of the project.
- b) Negotiations Advisors: SOCAR could have benefited from making the effort, however substantial, to utilize project funds to hire advisors for its many international negotiations. As previously stated, SOCAR has been under great pressure to respond to international companies wishing to invest in Azerbaijan. This has been compounded by the need to agree export routes for oil and gas and to manage the complicated geopolitical situation in the Caspian region. In the process, SOCAR's small and dedicated group of specialists capable of handling this work may at times have been overwhelmed. While the hiring of petroleum negotiations advisors to assist with the work-load would have required significant diversion of resources in the short term, it would have benefited SOCAR in the medium and long term. However, the length of time needed to hire consultants under IDA procurement procedures also prevented SOCAR from reacting to rapidly changing circumstances by using IDA-funded specialist advisors.
- c) MIS Procurement and Training: The misprocurement declared by IDA in respect of the MIS resulted from several factors. One of these was SOCAR's belated recognition of the importance of complete compatibility of its software with that of the international operators in Azerbaijan. In general, the project suffered from SOCAR's weak capacity in IT, which IDA should probably have done more to remedy through intensive supervision. SOCAR also has demonstrated a lack of focus in organizing training, which caused SOCAR to underutilize the opportunities for training under the project, after the successful initiation of the financial and commercial training in 1996-1997.

5.4 Costs and financing:

The IDA funds were lent to the Ministry of Finance, which signed a Subsidiary Loan Agreement, at a more "commercial" interest rate and maturity, with SOCAR. This agreement has operated effectively and the Subsidiary Loan has been repaid by SOCAR.

Disbursements under the project have been only 49% of the total original credit amount. The pace of disbursements has also considerably lagged the projections in the MOP: by the time of the mid-Term Report prepared by the SOCAR PIU in July 1997, only about 1% of the credit had been disbursed, compared with 8% projected at appraisal. At the original closing date of November, 1999, only 37% of the credit had been disbursed. These delays indicate that the projections in the MOP were probably over-ambitious for the first project in Azerbaijan, but they also reflect project-specific factors which have been noted above (e.g., the cancellation of 11% of the credit amount due to the MIS misprocurement). On April 13, 2001, the undisbursed amount of SDR 5,776,272.10 was canceled.

6. Sustainability

6.1 Rationale for sustainability rating:

The project's achievements are in general rated as "likely to be sustainable". Several of the components, including those related to investment projects (such as the Guneshli project), were in part specific to the time at which they were implemented. However, the general conclusions and methodology of these reports will remain valid for investors for some time to come, since no other reports of this caliber are available for most of these assets. SOCAR continues to discuss possible investments with foreign companies for the older fields, Guneshli and the gas processing plant, and the studies provide a useful input into this process.

The training components generated additional skills and knowledge which SOCAR staff will continue to use. Staff turnover in SOCAR is relatively low so the trained personnel generally remain in the company.

The study on Caspian Sea Riparian Issues remains a substantial and relevant legal reference for the government and SOCAR in the continuing deliberations on a final status of the Caspian Sea.

The Reservoir Engineering Center funded by the project is now fully operational, and is expected to make a substantial contribution to improving SOCAR's technical capabilities in future. Considerable staff training in reservoir engineering and modeling has been undertaken under the project, which will strengthen SOCAR's human resource base.

Although the project did not finance the Geological and Geophysical MIS due to the procurement issues mentioned above, SOCAR did use its own funds to purchase its preferred system, at the same bid price and specifications as under the IDA-supervised tender. Although the preferred system was not least cost (under the tender definitions), the price of the system was substantially below market list prices, because of the competition in the tender. The organization of the system specifications and of the bidding under the project helped SOCAR to establish an essential and enduring capability to interface with the data generated by foreign oil companies working in Azerbaijan. SOCAR has also used the preliminary work of the consultant on the financial MIS to improve its information systems.

The SOCAR audit funded under the project marked an important milestone in the evolution of SOCAR as a company. It forced greater transparency and identified essential actions to bring internal controls and reporting up to international standards. Government policy is to increase SOCAR's commercial focus, and consideration is being given to have SOCAR gain access to international capital markets. Having initiated the process of international auditing under the project, SOCAR will find it difficult to turn back to the previous non-transparent "state-agency" mode, given pressures from parts of the Government, civil society, multilateral agencies, partner companies and potential commercial financiers. This is shown by SOCAR's decision to continue the audits (using its own funds) for 1999 and 2000.

During project implementation, IDA's Country Assistance Strategy shifted its focus away from the energy sector. However, from late 1999 onwards IDA and IMF attention has again focused on energy (and oil and gas) as key elements of the reform program. This is reflected in the I-PRSP. Many of the insights gained during the project are thus being used as building blocks for future reform.

6.2 Transition arrangement to regular operations:

Given the technical assistance nature of the project, there are few project financed assets to be maintained once the project is completed. Continued use of the studies completed under the project was described above in para 6.1. The Reservoir Engineering Center, financed under the project, will continue to operate. Regular operation of the Reservoir Engineering Center is now a component of SOCAR's Offshore Design

Institute, and the Center is fully managed and maintained by this large institute.

7. Bank and Borrower Performance

Bank

7.1 Lending:

The project was the first IDA Credit to Azerbaijan. The effort in preparation, and the identification of counterparts, legal issues and implementation mechanisms was thus substantially greater than might usually have been expected. The project was designed on the basis of the Energy Sector Review which had been prepared in 1993, and the priorities reflected issues identified in the Review. Project preparation was delayed by political instability in Azerbaijan in mid-1993.

The project had been preceded by a Project Preparation Facility, which was refinanced under the Credit. This PPF was only partly focused on SOCAR, with part being devoted to preparation of assistance to the petroleum equipment industry (also identified as important in Bank sector work), which was not pursued. In this sense the project's eventual design reflected a focusing on a few key areas, and on SOCAR, from among a wide range of competing priorities. Under the circumstances in Azerbaijan at the time, the project team was justified in keeping the structure of the project relatively simple. The project team made suitable arrangements to obtain evidence of high level commitment to the project, but this was difficult to convert into actual deeds due to rapid changes in the government in the period 1993 to 1995.

The project was originally designed as an IBRD-financed operation. Just before the scheduled Board presentation date, however, Azerbaijan was converted to an IDA-only country, and the financing and Board Documents had to be revised. The delay of several months in Board presentation contributed to some loss of momentum for the project in its initial phase, as well as to some confusion on the part of the Borrower about how the World Bank functioned.

7.2 Supervision:

Like many Technical Assistance projects with multiple components, the project was relatively demanding of supervision resources. The resource requirements were increased by the inexperience of Azerbaijan with IDA borrowing. However, the high quality of the PIU staff and their early engagement of advisors helped to limit implementation problems in comparison with some projects in transition economies.

The project was supervised by three task managers in five years, due to staff rotation. This may have affected the quality of supervision, given the time required for staff to develop understanding and trust in Azerbaijan. Supervision did weaken somewhat during 1997 to 1999, and IDA management eventually rearranged task management responsibilities to address this problem. IDA's supervision at times suffered because some task managers had limited specialist expertise in oil and gas, and also did not obtain sufficient support from IT specialist staff.

During the period in question, the focus of country strategy shifted away from assisting the energy sector as a key component of economic recovery, towards a strong focus on civil service reform, and on the social and rural sectors. The lack of likely follow-on work in energy diminished the perceived importance of building on the Petroleum TA project as the first in a potential series of energy sector operations.

Moreover, the scaling back of the IDA program in Azerbaijan due to poor implementation and policy performance may have led to less funds being used for supervision than might otherwise have been the case. In order to achieve all the objectives of the project, and to implement a larger proportion of the planned components, substantial IDA resources would have been needed to cooperate with the PIU in dealing directly with counterparts in SOCAR and the government. The only area in which IDA brought

substantial country management resources to bear was in performance of the SOCAR audit, and in this case demonstrable results were achieved.

Concerning the problem of bidding and misprocurement of the MIS system, IDA staff were placed in a difficult position by SOCAR's desire to alter the selection criteria after bids had been received and technical evaluation had taken place. Substantial time was spent in reviewing the procurement of this component, and as a result IDA responses were at times rather slow. However, the course of events gave IDA little choice in the end but to declare misprocurement. It is not clear to what extent the inadequate technical requirements in the bidding documents were due to incomplete advice from the specialized consultants, but this may have played an important role given SOCAR's lack of in-house experience in this area. IDA's supervision can be faulted here, since not enough specialized staff resources appear to have been committed to reviewing the consultants' report and the bidding documents. Regarding IDA procurement advice, it may have been better to require a two-stage bidding process (technical and price bids opened separately), rather than the one-stage process approved. The one-stage process assumed that the technical requirements of the system were relatively standardized and straightforward, which turned out not to be the case in the all-important area of the proprietary software, where different systems turned out to have very different compatibility characteristics. This issue could have been identified at an early stage if an appropriate specialist in petroleum IT had reviewed the procurement arrangements on behalf of IDA.

It should also be noted that there was little encouragement given by IDA to staff in SOCAR who were trying to use the investment studies to attract investors (for example, IDA staff did not accompany SOCAR on presentations to international investors as had often been done in such projects). Moreover, IDA did not follow up key policies suggested by the investment studies by mobilizing further assistance or by incorporating the policies in the country dialogue. A case in point relates to the old oil fields, where the financial losses, employment issues and environmental problems identified could have been the focus of IDA policy dialogue similar to that undertaken for old coal mines in other parts of the FSU.

7.3 Overall Bank performance:

Overall IDA performance is rated Satisfactory. While the quality of supervision weakened during 1997-1999, this was fully addressed by the rearrangement of task management, and supervision improved markedly in the final year of the project. It should also be noted that more could have been done to help SOCAR with implementation in certain cases, although this may not have been possible within the limits of the available supervision budgets.

Borrower

7.4 Preparation:

The Borrower assisted considerably in the preparation of the project, with various parts of SOCAR providing guidance on project design and priorities. However, as stated earlier, SOCAR's capacity was stronger in certain areas (such as oil field investments) than in others (such as training and IT). The government, having committed to the project, also assisted with preparation in key Ministries (e.g. Ministry of Finance), which required particular effort as this was the first IDA operation in the country.

7.5 Government implementation performance:

The government designated certain counterparts for the work on the Petroleum Law (i.e. the relevant administrative unit of Parliament), but subsequently changed the counterparts (to the Office of the President and the Cabinet of Ministers) in a manner which prevented implementation of the component. The government also did not maintain continuous commitment to the project, partly due to frequent changes in staffing, particularly during 1995 to 1997 (a critical period for project implementation). During these years there were general problems with implementation of IDA projects in Azerbaijan. There was some

improvement in government performance from 1999, although by this time the project was perhaps too far behind schedule to fully meet the implementation plan.

7.6 Implementing Agency:

SOCAR identified the Foreign Investment Department as being responsible for overall management of the project from the outset, and this greatly assisted project preparation. The Director of the PIU was also the Deputy Manager of the Foreign Investments Department, and the Deputy Director of the PIU was located within this Department. This gave the PIU ready access to SOCAR's top management, including the President, resulting in quick turnaround for key decisions.

The PIU staff were exceptionally capable, in part because the Foreign Investments Department has retained some of the most outstanding specialists and managers in SOCAR given its importance in negotiating terms for large foreign investments. The PIU created joint implementation groups with other parts of SOCAR in an attempt to facilitate implementation. However, the PIU could not directly influence SOCAR's many departments, in which implementation capacity, and sometimes the commitment to the project's objectives, was less strong. Thus while PIU administration of the project was very good, the performance of the parts of SOCAR implementing project components (e.g. oil field departments, IT department, training department etc.) was variable.

7.7 Overall Borrower performance:

The overall performance of the Borrower can be considered Satisfactory, but only if due allowance is made for the difficult business environment within which the project was implemented. A key reason for the Satisfactory rating is the strong performance of the SOCAR PIU in managing the project and in preventing difficulties in implementation from becoming a cause for cancellation of the project and concomitant failure.

8. Lessons Learned

As the first operation in a country which has not had a strong record of IDA project implementation, the project can be regarded as moderately successful. Several lessons can be learned from this project:

The positive lessons from the Project are:

- 1) **Management:** The project was able to retain a capable PIU within SOCAR, which provided consistency in project administration. One of the reasons for this was the location of the PIU within the Foreign Investments Department, which is the part of SOCAR best equipped to deal with implementation of agreements with foreign entities. This suggests that similar IDA projects would also benefit from trying to access staff dealing with foreign investments in implementing agencies where capacity is limited.
- 2) **Flexibility:** Because of the difficulties encountered by both SOCAR and IDA in defining fully all priority components during project preparation, the ability to alter the content of components was important (e.g. from project development to the Reservoir Engineering Center). This demonstrates the importance of flexible implementation and design in multi-component TA projects.
- 3) **Follow up to Sector Work:** Some of the key project components which were implemented (esp. the investment studies of the old fields and gas processing) were chosen as a result of detailed Energy sector work. This allowed the project to focus on areas where the knowledge base for policy decisions was lacking, and where responsive counterparts were likely to be found (hence the project's exclusion of the SOCAR refining Department which was shown to be rather uncooperative in the course of the independent

audit). The execution of the studies by the consultants was thus relatively successful.

There are areas where lessons can be learned from the problems encountered by the project:

4) Project Design: Despite attempts to keep project design relatively simple, the desire to incorporate the Petroleum Law component into the project greatly complicated the design (requiring implementing entities in government as well as in SOCAR). On balance, given the challenges of working with a new IDA member country, it would have been better to keep the design even simpler, and to attempt to obtain grant funds or other assistance for components outside SOCAR, such as the Petroleum Law.

5) IDA Support: Project implementation probably required more IDA support than estimated at the outset. The project team overestimated SOCAR's ability to organize itself, given administrative support from a strong PIU. SOCAR is quite de-centralized and is not well structured, which hindered implementation of key components (e.g. training, MIS). If the IDA budget for stronger supervision support was not available, the project could have been focused on fewer key components.

6) Specialized Supervision: The misprocurement of the MIS system was in part the result of insufficient specialized review in IDA. In cases where very specific technical expertise is required it is essential that suitable specialists are available, and that IDA provide the budget for this.

7) IDA Follow-up: IDA did not provide follow-up advice or support for the investment studies as they were being presented to potential investors. The studies addressed vital issues for Azerbaijan's petroleum sector, and indeed for its economy, and were the first serious work of their kind. They were intended to provide a foundation for further work, both by private investors and potentially by IDA or other donors. In practice, no attempt was made by IDA staff to follow up on issues identified in the reports in a timely manner, in 1997 and 1998, although this could have been done using Trust Funds, by mobilizing other lenders or by attracting private investors. More impact from the project could also have been achieved by incorporating key policy actions implied by the studies into the country dialogue and lending program. This demonstrates the need to follow-up key issues identified through TA with further support through IDA staff engagement, additional funding and policy dialogue.

8) Coordination with Country Strategy: The project was designed at a time when support for Azerbaijan's energy sector was a priority under the CAS (the Petroleum TA Credit was followed by the Gas System Rehabilitation Project in 1996). After 1996, however, Bank strategy changed significantly, with little attention being devoted to the energy sector (in spite of its overwhelming importance to the economy), and a strong focus on such areas as civil service reform, and social and rural sector operations. This led to limited management attention to supervision of energy projects, and to a lack of longer term perspective on the relationship between IDA and SOCAR. While IDA needs to adjust its priorities in each CAS, it is important that strategy not be refocused so sharply that projects in certain sectors are effectively left as "orphans" under a new set of tightly constrained priorities.

9. Partner Comments

(a) Borrower/implementing agency:

Azerbaijan Petroleum Technical Assistance Project - Post Review Report by SOCAR's Project Implementation Unit

Partner comments (by Implementing Agency)

1. Evaluation of Project Tasks and Objectives:

Over the course of its implementation, the Petroleum TA Project has been restructured several times reflecting the rapid changes the petroleum industry in Azerbaijan has been undergoing in recent years. Thus, the Government and SOCAR requested a reallocation of project funds from advisory services towards information technology and training.

While the original objectives of the project remained essentially the same, the focus had shifted from assistance in negotiations with international oil companies and support in attracting international investors to a strengthening of SOCAR's capacity to better manage its operations, in particular its finances.

In parallel, the project, also supported strengthening of SOCAR's capacity to deal more effectively with foreign investors. This includes financial and commercial training, English language training, advisory services by expatriate consultants to the PIU, a legal study on the sectoral delineation of the Caspian Sea and support for establishing a Reservoir Engineering Center.

A great emphasis was put on consequent strengthening of SOCAR's management. This has to be accomplished through the design of a management information system.

2. Summary of Project Implementation by Components

Although not in the full scale, the project has achieved its original twin objectives, being:

- accelerating foreign private investment in Azerbaijan's petroleum sector, in particular through the restructuring of the Guneshli oil field and preparation of investment projects; and
- strengthening SOCAR through the development of petroleum legislation, training and improvements in information systems.

Part A: Support for Foreign Investments in Petroleum Exploration and Production and Part C: Petroleum Production and Investment Studies

- a. **Caspian Boundaries Legal Study:** The contract for this study was awarded to and undertaken by an internationally recognized expert in marine law. He successfully completed his work by July 1997. SOCAR found the study very helpful, and asked IDA for further assistance in the negotiations with the other countries that border the Caspian about its sectoral demarcation. IDA felt that it could not provide unilateral assistance to only one of the countries. Thus, SOCAR used their own funds to finance further assistance in this area.
- b. **Guneshli Rehabilitation Preparation (Phase 1):** This component was planned to be implemented in two phases. Phase I of this component has been completed by an alliance of two foreign companies. The scope of services included both carrying out of an investment rehabilitation study, and preparation of the Guneshli oilfield model. Also, SOCAR benefited from extensive technical training program, provided by the above alliance. The program covered various aspects of reservoir modeling and was undertaken in both SOCAR and the consultants' premises.
- c. **Old Onshore Fields Rehabilitation Study:** An experienced consulting firm has been appointed to undertake this assignment. At the request of SOCAR (and in addition to the contract financed under

this project), the consultants have opened two 'data rooms' where potential investors interested in the rehabilitation of the oil fields covered by this study could purchase the information packages. Many potential investors have purchased packages, and a number of them have submitted proposals. Despite great interest in the project among international oil companies, extraordinary fluctuations of the oil price have affected the redevelopment agreement negotiations.

d. Mature Offshore Fields Study: A consulting consortium have completed their work on the mature offshore fields rehabilitation study. As in the case of the mature onshore fields, SOCAR had used this study to invite investment proposals for the rehabilitation of the offshore fields in Azerbaijan Sector of the Caspian Sea. As a result of intensive marketing program, jointly undertaken by SOCAR and the consultants, several promising proposals have been received.

e. Gas Processing Plant Reconstruction Study: The feasibility study for the rehabilitation of this plant has been completed by qualified consulting firm.

General Conclusion: With the completion of certain studies and project reports about important investment opportunities, such as the rehabilitation of the gas processing plant, the rehabilitation of older onshore and offshore fields; SOCAR is now in position to seek investors for areas that are critical for the country (e.g. increasing gas supplies) and that have important social and environmental dimensions (rehabilitation of older onshore and offshore oil fields). These projects are at best marginal financially and perceived as being outside the scope of the oil majors with their substantial overheads. Completion of these studies makes it easier for SOCAR to capture attention of smaller companies who do not have the budgets to undertake their own studies but, by virtue of the smaller overheads, can tackle marginal fields.

Part B: Institutional Strengthening

I. Development of Petroleum Legislation: In the Credit Agreement signed with IDA, the Government undertook to prepare Petroleum Legislation under the Project for submission to Parliament by February 1996. Later, at the request of the Government, this component aimed for the preparation of a draft petroleum legislation was transferred to EU TACIS. Thus, IDA funds had been substituted by equivalent EU-TACIS funds for this component.

II. Strengthening through acquisition of computing and communication equipment and technologies, and specialized training programs.

a. MIS Design and Database System for SOCAR: The aim of this component was to provide SOCAR with state-of-the-art computerized management information system with a database designed to meet SOCAR's information and data processing needs in the medium term and telecommunications equipment that would connect electronically SOCAR's far-flung operations to a central information unit and thus provide managers of all units access to critical information.

A large database system to international standards would provide for data capture, transmission, electronic storage and manipulation of data relating to SOCAR's principle activities in exploration and production. This will include physical and financial data for fields operated by SOCAR and by foreign companies.

The contract for the design phase was awarded to a specialized consulting firm. Within the frameworks of their scope, company prepared an umbrella MIS plan and the bidding documents for

actual procurement and installation of the respective computer and telecommunication equipment and programs.

Upon careful consideration of trends of the rapidly changing information technologies, as well as Y2K problem, SOCAR has come to a conclusion not to proceed immediately with the second (procurement/installation) stage under IDA financing. Thus, SOCAR management decided to leave it outside the framework of the PTAP. With unexpectedly high oil prices, SOCAR has purchased the Geological/Geophysical Database and Financial/Accounting Information System using their own funds.

b. Commercial and Financial Training: SOCAR was extremely satisfied with a specialized petroleum industry training firm's performance and that the results and experience with this training program will be utilized in the design of other programs that can be undertaken in the future. One of the main positive outcomes of this component was the English language and oil economics training provided under the contract with the training firm. As a part of their contractual obligations, the training firm had sent five SOCAR staff to its Boston-based management program on international oil and gas management.

However, SOCAR has been receiving numerous offers for training from international oil companies that obviates the need for next phases of this component. This is why the decision had been made to cease use of the credit funds for training needs.

c. Advisory services to support the SOCAR PIU: Two contracts were executed to appoint respectively short- and long-term technical consultants to support the Project implementation.

A short term consulting contract was awarded to an individual consultant in 1995. The task has been successfully completed.

SOCAR is also highly satisfied with the work performed by the foreign consulting firm appointed for assistance in project management in 1995-1999. The company performed valuable on the job training for the PIU staff. It also established a number of the project management systems and procedures, such as accounting, reporting, risk management, etc. In order to meet the numerous changes in the structure of the Petroleum TA, the expiry date of the contract with the consultant was extended, as were the contract work scope and budget.

d. Pilot Clean-up Projects, Preparation Phase: In December 1997, an IDA environmental team, having considered the tight schedule for preparation of IDA's Urgent Environmental Investments Project (UEIP), proposed to use certain PTAP funds for preparation of this new project. An alliance of two companies, appointed for this assignment, prepared an Environmental Assessment (in cooperation with experts of the Azerbaijan State Committee on Ecology) and a number of the Bidding Documents. Preparation of these documents was stipulated as a condition of the review and approval of the UEIP by IDA's Board.

e. Audit of SOCAR's Corporate and Project Accounts: Under its agreement with the IDA, SOCAR was required to have the Project Accounts audited annually by an independent auditor to international standards. This task was undertaken by a world-renowned company.

In addition to annual audits of the project accounts, SOCAR has undertaken the overall audit of its corporate accounts. This was not only a requirement that stems from the Project Agreement, SOCAR

has signed with the Bank, but also essential for any efforts on the part of SOCAR to obtain commercial credit abroad, as well.

Indeed, the importance of the above auditing project for SOCAR cannot be overestimated. SOCAR, a state owned company with huge turnover, with tens of major units and amalgamations and with more than 70 thousand employees, has never been audited before. This was a significant obstacle in its moving towards international market (financial market, first of all). Also, successful integration of SOCAR into world economy requires a shift to international accounting standards.

The contract for auditing of SOCAR's corporate accounts was awarded to a very authoritative company. An important output of this audit was the package of recommendations made by auditor, aimed to improve the existing Financial/Accounting Management Information System. The Auditor provided a structured training program specially tailored for different levels of SOCAR's financial and accounting specialists and management.

f. Establishment in SOCAR of Reservoir Modeling Center, RMC (Guneshli Field Rehabilitation, Phase II): Under this component, SOCAR intended to obtain a complete reservoir engineering capability in Baku, including specialized computer work stations, software and training. SOCAR continued its cooperation with the alliance awarded the contract for preparation of the Guneshli Rehabilitation project.

The workscope provided for training of about 50 staff, the provision of computers and software. Since the training would aim at developing a model for the Guneshli field, it intended to facilitate the negotiations with interested investors.

In the light of the fact that this component strengthened SOCAR's capacity in an area that is critical for its efforts to attract foreign investment, establishment of an RMC is among the matters of great importance.

3. Operational Experience and Other Benefits Derived from the Project

SOCAR counterpart teams (both PIU and each component working group) have proved themselves by performing a highly professional job. Because of the diverse structure of SOCAR each case required the involvement of many people from different divisions, all the requisite support and assistance was provided to the entire satisfaction of SOCAR.

Personnel of the Foreign Investments Department acting as the PIU have been very successful in learning the Bank's procurement policy, procedures, disbursement arrangements, accounting procedures, reporting and auditing procedures. Having gained both valuable knowledge and experience SOCAR's PIU continue working as the Component Implementation Unit, providing the implementation of the Oil Clean-up of the separate Urgent Environmental Investment Project.

4. The Borrower and Bank Performance

The Borrower's Performance: In the initial stages of the Project, some delays were encountered due to the need to clarify issues with the government, especially the Ministry of Foreign Economic Relations and the Tax Inspectorate. The Ministry of Finance showed good understanding for the problems of the implementation of the project. As far as the Cabinet of Ministers is concerned, there was always full understanding and support, in particular from Mr. Sharifov, deputy prime minister of

the Azerbaijan Republic.

SOCAR, as was agreed as the local contribution of the borrower, provided the PIU with personnel, salaries, office accommodation and the appropriate equipment and computer hardware. Telephone lines (including an international one) were provided. The PIU was set up within the FID structure as department for interrelation with international financial institutions and banks.

As a unit within the structure of one of the departments of SOCAR, the PIU did not possess sufficient autonomy or independence, did not have the right to sign financial documents or to spend funds (even on consumables such as paper, cartridges, etc.), and did not have the right to sign any official documents on behalf of the borrower. All payments were made through the SOCAR Central Accounting Department, later reorganized as the Financial and Economic Department, and as a rule, from the Credit Account. The not very active use of the Special Account is explained both by the specifics of the contracts concluded (basically, fixed price contracts) and a complex internal procedure. The bureaucratic delay caused each time by International Bank of Azerbaijan Republic (IBAR) when funds were transferred from Washington should separately be noted. The PIU were forced to make explanations to the IBAR regarding the financial credit mechanisms of the Bank in general and the Petroleum TA project in particular.

IDA's Performance: As has already been noted above, the reason for the restructuring on several occasions of the Project has been the rapid evolution of the oil industry. The Bank and its management must be given their due: as a rule they have demonstrated understanding for the requests of the borrower concerning various changes in the structure of the Project.

However, in the course of the implementation of the project both Procurement Guidelines were subjected to review by the Bank, as well as the Standard Tender Documents, which (given all other problems) did not facilitate the acceleration of the implementation of the Project.

It should be noted before reorganization of the system/structure of the Bank itself its response to the requests and wishes of Borrower were more constructive and effective and less bureaucratic.

During the implementation of the Project three managers of IDA's team were replaced in turn. One cannot say that the management continuity significantly suffered, but it indubitably left its mark.

(b) Cofinanciers:

Not applicable.

(c) Other partners (NGOs/private sector):

Not applicable.

10. Additional Information

Not applicable.

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR	Actual/Latest Estimate
<p>Negotiation and implementation of project for rehabilitation of the Guneshli field, with foreign investment.</p> <p>Development and implementation of projects for financing by foreign investors and international financial institutions for other mature offshore fields, old onshore fields, construction of new gas processing plant and other significant projects.</p> <p>SOCAR capacity strengthened in terms of foreign language skills, and international commercial business practices through: intensive training of at least 200 staff in English language and petroleum commercial practice; development and installation of MIS.</p> <p>Negotiation of financing for Baku-Ceyhan oil pipeline; negotiation of basic agreements for gas export.</p>	<p>Feasibility study for rehabilitation of the gas processing plant was completed. Study on rehabilitation of old onshore fields completed and 2 data rooms for investors interested in the rehabilitation of these fields were opened. Study completed on the old offshore fields.</p> <p>250 SOCAR staff trained by 12/31/98. MIS specifications & bidding documents were developed under the Project. Although the funds for this component were cancelled, SOCAR purchased the MIS system with its own resources.</p>	<p>A major review of the Guneshli field was completed, and negotiations were held with a major Western oil company, although these negotiations broke down in 1999, and negotiations began with another major oil company.</p> <p>SOCAR did not seek financing of negotiations advice.</p>

Indicators taken from the Project Status Reports (PSRs).

Please note that at the time of project appraisal, the Logical Framework Approach was not being used.

Output Indicators:

Indicator/Matrix	Projected in last PSR	Actual/Latest Estimate
<p>Project Proposal for Rehabilitation of Guneshli Oil Field Phase I.</p> <p>Reservoir Engineering Center (rehabilitation of the Guneshli Oil Field Phase II).</p> <p>MIS System for SOCAR.</p> <p>Financial and Accounting Information System.</p> <p>Concrete project proposals to address problems of old onshore fields, and presentation to potential investors.</p>		<p>A major review of the Guneshli field was completed, and negotiations were held with a major Western oil company, although these negotiations broke down in 1999, and negotiations began with another major oil company.</p> <p>Design and procurement of a Reservoir Engineering Center were completed and the Center opened in 2000.</p> <p>Consulting firm developed specifications and bidding documents, but during the bid evaluation SOCAR realized that there was a compatibility problem between the system proposed by the lowest bidder and the systems used by international oil companies. Since SOCAR could not accept the lowest bidder, it purchased the MIS system from its own resources.</p> <p>Bidding documents were prepared but required considerable revision and procurement could not be completed by the closing date, so was abandoned.</p> <p>Feasibility study on restructuring the old onshore oil fields was completed and road shows were held in London and Houston where a number of companies expressed interest.</p>

End of project

Annex 2. Project Costs and Financing

Project Cost by Component (in US\$ million equivalent)

Project Cost By Component	Appraisal Estimate US\$ million	Actual/Latest Estimate US\$ million	Percentage of Appraisal
A. Support for Foreign Investment in Petroleum Exploration and Production:			
1. Financing/Contract Advice	4.70	0.00	0
2. Legal Advice	1.26	0.32	0.25
3. Technical Costing Advice	8.40	3.41	0.41
B. Institutional Strengthening of the Petroleum Sub-Sector:			
1. Petroleum Legislation	0.45	0.00	0
2. Training	0.45	0.35	0.78
3. Equipment-Computers/Communication TA	0.70	0.32	0.46
4. SOCAR Audit	0.00	1.31	0
C. Energy Sector Investment Studies:			
1. Project Preparation	3.35	3.10	0.93
D. Components to be Identified:	1.00	0.21	0.21
E. Project Implementation	0.75	1.22	1.63
F. Refinancing Project Preparation Facility	0.70	0.13	0.19
Total Baseline Cost	21.76	10.37	
Price Contingencies	1.10		
Total Project Costs	22.86	10.37	
Total Financing Required	22.86	10.37	

Project Costs by Procurement Arrangements (Appraisal Estimate) (US\$ million equivalent)

Expenditure Category	Procurement Method ¹			N.B.F.	Total Cost
	ICB	NCB	Other ²		
1. Works	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
2. Goods	0.00 (0.00)	0.00 (0.00)	0.60 (0.60)	0.10 (0.00)	0.70 (0.60)
3. Services	0.00 (0.00)	0.00 (0.00)	20.20 (20.20)	2.00 (0.00)	22.20 (20.20)
4. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
5. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
6. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
Total	0.00 (0.00)	0.00 (0.00)	20.80 (20.80)	2.10 (0.00)	22.90 (20.80)

1/ Figures in parenthesis are the respective amounts funded by IDA, and have been rounded.

2/ Value of individual packages for computers/communication/office equipment items will not exceed US\$300,000 and will be procured on the basis of international shopping.

Short List and selection of firms for consultant services to be procured in accordance with IDA Guidelines.

Selection of consultants for legal consulting services will have the concurrence of the Legal Department.

Project Costs by Procurement Arrangements (Actual/Latest Estimate) (US\$ million equivalent)

Expenditure Category	Procurement Method ¹			N.B.F.	Total Cost
	ICB	NCB	Other ²		
1. Works	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
2. Goods	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.02 (0.00)	0.02 (0.00)
3. Services	0.00 (0.00)	0.00 (0.00)	9.49 (9.49)	0.73 (0.00)	10.22 (9.49)
4. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.13 (0.13)	0.00 (0.00)	0.13 (0.13)
5. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
6. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
Total	0.00 (0.00)	0.00 (0.00)	9.62 (9.62)	0.75 (0.00)	10.37 (9.62)

^{1/} Figures in parenthesis are the amounts to be financed by the IDA Credit. All costs include contingencies.

^{2/} Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and incremental operating costs related to (i) managing the project, and (ii) re-lending project funds to local government units.

3/ Miscellaneous is refinancing of PPF.

4/A negligible amount (\$5,104.82) was disbursed against goods (computers and office equipment), but is too small to appear due to rounding.

Project Financing by Component (in US\$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	Bank	Govt.	CoF.	Bank	Govt.	CoF.	Bank	Govt.	CoF.
Support for Foreign Investment:									
1. Financing/Contract	4.30	0.40					0.0	0.0	
2. Legal Advice	1.16	0.10		0.30	0.02		25.9	20.0	
3. Technical/Costing Advice	7.70	0.70		3.05	0.36		39.6	51.4	
Institutional Strengthening:									
1. Petroleum Legislation	0.40	0.05					0.0	0.0	
2. Training	0.40	0.05		0.25	0.10		62.5	200.0	

3. Equipment, Computers,Comm.	0.64	0.06		0.30	0.02		46.9	33.3
4. SOCAR Audit				1.27	0.04			
Energy Sector Invesment Studies:								
1. Project Preparation	3.05	0.30		2.95	0.15		96.7	50.0
Components to be Identified	2.00	0.10		0.20	0.01		10.0	10.0
Project Implementation	0.65	0.10		1.17	0.05		180.0	50.0
Refinancing Project Preparation Facility	0.50	0.20		0.13			26.0	0.0
TOTAL	20.80	2.06		9.62	0.75		46.2	36.4

In the appraisal estimate, components to be identified also includes US\$1.0 million of contingencies under IDA financing, and US\$0.1 million under Govt. financing.

Annex 3: Economic Costs and Benefits

NOT APPLICABLE.

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating		
	Month/Year	Count	Specialty	Implementation Progress	Development Objective
Identification/Preparation					
02/1993			1 Mission Leader, 1 Division Chief, 1 Principal Petroleum Specialist, 1 Senior Power Engineer, 1 Senior Refining Specialist, 1 Energy Economist, 1 Petroleum Engineer, 1 Finance Systems Consultant		
09/1993			1 Mission Leader		
01/1994			1 Mission Leader, 1 Senior Gas Engineer, 1 Operations Assistant		
04/1994			1 Mission Leader		
Appraisal/Negotiation					
05/1994			1 Mission Leader, 1 Principal Energy Specialist, 1 Principal Petroleum Specialist, 1 Senior Power Specialist, 1 Gas Specialist, 1 Legal Counsel, 1 Operations Assistant, 1 Consultant Petroleum Engineer - Offshore, 1 Implementation Consultant, 1 Consultant Procurement Specialist		
Supervision					
05/1995	1	1	1 Task Manager	S	S
02/1996	2	2	1 Task Manager, 1 Gas Specialist, 1 Petroleum Specialist, 1 Lawyer, 1 Training/Computerization Specialist, 1 Implementation Specialist	S	S
06/1996	3	3	Annual Update; No mission 1 Task Manager, 1 Energy Specialist	U S	S S
10/1996	4	4	1 Task Manager	S	S
02/1997	5	5	1 Task Manager, 1 Economist, 1 Petroleum Engineer, 1 Reservoir Engineer, 1 Financial Analyst,	S	S
10/1997	6	6	1 Task Manager, 1 Petroleum Engineer, 1 Energy Economist,	S	S

	06/1998	7	1 Task Team Leader, 1 Petroleum Engineer, 1 Consultant	S	S
	09/1998	8	1 Team Leader,	S	S
	02/1999	9	1 Team Leader, 1 Consultant	S	S
	06/1999	10	1 Team Leader, 1 Consultant, 1 Operations Officer (No PSR prepared following mission)		
	10/1999	11	1 Mission Leader, 1 Operations Officer, 1 Training Consultant	S	S
	04/2000	12	1 Mission Leader, 1 Financial Management Specialist, 1 Operations Officer	S	S
ICR	10/2000	1	Task Team Leader		
	2/2001	1	Task Team Leader		

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US\$ ('000)
Identification/Preparation	82.40	260
Appraisal/Negotiation	36.80	101
Supervision	171.59	540
ICR		
Total	290.79	901

It is estimated that about 6 weeks of the supervision time were spent on the ICR. (SAP time recording has no separate code for ICR).

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	Rating
<input checked="" type="checkbox"/> <i>Macro policies</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Sector Policies</i>	<input type="radio"/> H <input type="radio"/> SU <input checked="" type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Physical</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Financial</i>	<input type="radio"/> H <input type="radio"/> SU <input checked="" type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Institutional Development</i>	<input type="radio"/> H <input type="radio"/> SU <input checked="" type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Environmental</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<i>Social</i>	
<input checked="" type="checkbox"/> <i>Poverty Reduction</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Gender</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA
<input checked="" type="checkbox"/> <i>Private sector development</i>	<input type="radio"/> H <input type="radio"/> SU <input checked="" type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Public sector management</i>	<input type="radio"/> H <input type="radio"/> SU <input checked="" type="radio"/> M <input type="radio"/> N <input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H <input type="radio"/> SU <input type="radio"/> M <input type="radio"/> N <input checked="" type="radio"/> NA

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance

Rating

Lending

HS S U HU

Supervision

HS S U HU

Overall

HS S U HU

6.2 Borrower performance

Rating

Preparation

HS S U HU

Government implementation performance

HS S U HU

Implementation agency performance

HS S U HU

Overall

HS S U HU

Annex 7. List of Supporting Documents

Project Documents:

Azerbaijan: Petroleum Technical Assistance Project, President's Memorandum and Recommendation; Report Number P-6377-AZ, March 28, 1995.

Azerbaijan: Petroleum Technical Assistance Project, Technical Annex, Report Number T-6377-AZ, March 28, 1995.

Azerbaijan: Petroleum Technical Assistance Project, Development Credit Agreement (Cr. 2708-AZ), dated May 23, 1995.

Azerbaijan: Petroleum Technical Assistance Project, Project Agreement, dated May 23, 1995.

Azerbaijan: Energy Sector Review, Report No. 12061-AZ, December 27, 1993.

Supervision Documents:

Back-to-Office reports for supervision missions; Back-to-Office report dated December 12, 2000 for ICR mission.

Audit Reports of Project Accounts for financial years/periods ending: December 1997, December 1998, and December 1999.

Audit Report of SOCAR Accounts for 1997 and 1998.

Mid Term Report, July 1997, prepared by SOCAR Project Implementation Unit.