I. Introduction and Context

Country Context

Azerbaijan is the largest and most populous (9.5 million) country in the South Caucasus. Thanks to the oil and gas boom, Azerbaijan’s economy grew significantly in recent years with an average annual GDP growth rate of 24 percent in 2005-2008, with 12 percent growth in the non-oil sectors. As a result of the global economic recession, GDP growth after 2008 decreased to 9 percent – 3 percent in the non-oil sectors. Agriculture maintained a positive growth of 3.5 percent in 2009 in part due to government support during the global food price crisis.

The economic growth has significantly reduced poverty in the country but also resulted in greater income disparity. In 2008, some 16 percent of the Azerbaijani population was poor, compared to 50 percent in 2001. Rural poverty declined from 44 percent in 2001 to 18 percent in 2008. About 51 percent of Azerbaijan’s poor live in rural areas, although rural areas accounts for only 45 percent of the total population. With limited oil and gas reserves, the Government’s main challenge and priority is to diversify the economy and reduce the economic dependence on the oil sector.

Sectoral and Institutional Context

The agricultural sector is a key component of Azerbaijan’s non-oil economy with great potential for competing on the internal and external markets. While the agriculture accounts for only 7 percent of GDP, it is a key employer of the economy, providing income and employment for about 40 percent of the workforce. The sector is seen as a priority in the context of food security and a priority for improving rural incomes. After experiencing a major decline during transition period (1991-1995), the sector began to recover in 1998 and has been growing at an average annual rate of 6 percent since. Given its existing knowledge and export base, and its climatic and geographic advantages, the sector has significant business, job creation and trade opportunities. However, a number of bottlenecks need to be resolved in order for these opportunities to materialize.

Azerbaijan’s agriculture faces weaknesses in the legal and regulatory system, weaknesses in infrastructure provision, and low availability of credit. At the same time, policymaking has sometimes been counter-productive or has not been pro-active enough. Increasing domestic demand for agricultural products provides significant opportunities for the private sector, including shifting production from subsistence crops to high-value products with a competitive advantage. The growth in agricultural exports and value-added processing, and import substitution through investments in agriculture would contribute to stimulating the rural economy. Investments in the oil and gas sector are expected to require the procurement of up to $150 million annually in agri-food products much of which is currently being imported. This creates a unique opportunity to stimulate domestic production of high quality and safe foodstuff. Access to these market opportunities, however, requires significant modernization in the sector.

The sector needs to produce higher value added and safe products in order to meet the more demanding, upper-middle-income markets. The lack of improved seed varieties and animal genetics, combined with outdated processing technologies, limits product quality and, in turn, restricts the ability of processors to access lucrative markets in Baku and abroad. Inconsistent or inadequate regulation and enforcement compromises compliance and limits incentives for the long term and even seasonal contracting between producers and processors. Cooperation between producers and processors mainly takes place in spot markets, thus inhibiting the ability of either party to profitably plan and expand production.

Though credit financing for agriculture has been increasing steady, the volumes remain comparatively small, and the sector
continues to be under-financed. Demand for the financing remains very high, especially for the long-term funding. In addition, the menu of financial products is limited to simple working capital and investment loans. Structured products, including transaction finance and use of non-physical asset-based collateral, are almost non-existent, which limits the opportunities for the sector to access the needed loan products. Agricultural insurance which would improve access to finance for the sector is almost non-existent too.

The development of competitive value chains also requires a rationalization between supply and demand with adequate processing capacity to ensure smooth process flow and ready market access. Considerable constraints are being encountered along the supply chain related to on-farm production, handling, distribution, warehousing, distribution centers, and processing for fruits, vegetables, nuts and animal source foods. It is recognized that there are considerable gaps in the supply chain links from #farm to fork.#

A supply chain approach to development of the agrifood sector in Azerbaijan would be driven by about 300 existing SMEs, but many of these enterprises lack the understanding, knowledge and motivation and operate under ad hoc procedures with minimal strategic planning or commitment to food safety standards. Some agrifood processors do obtain domestic food safety certification for HACCP and ISO but these lack credibility. Improvement in food safety and quality is a fundamental priority for the government and is expected to drive agricultural competitiveness through the high value agrifood chains.

The policymakers in Azerbaijan have made a strong commitment to diversify from oil and promote the non-oil sectors such as agriculture. Modernization of the agricultural sector is a priority as a key component of the economic development strategy. The stated policy goals continually refer to the need for a modern and productive agricultural and food sector. There is a widespread agreement that improving the performance of markets is a key factor before Azerbaijan can realize this potential.

Relationship to CAS

The Country Partnership Strategy (CPS) for Azerbaijan for 2011-2014 is focused on achieving results in two key pillars: (i) building a competitive non-oil sector and (ii) strengthening human and social services. The CPS acknowledges a considerable growth potential for the sector on both domestic and external markets. The proposed project contributes to the first objective by supporting development of a competitive agricultural sector through the agri-food value chain development. It also addresses the second pillar through the cross sectoral institution-building amongst ministries and food safety agencies and upgrading of key organizations such as the national veterinary services and state phytosanitary control services. The project is included in the new CPS for the period 2011-2014.

II. Proposed Development Objective(s)

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The Project Development Objective (PDO) would be to support the development of commercial agriculture activities by enhancing key value chains and improving access to financial resources, extension and veterinary services and product quality.

Key Results

The proposed project will aim to achieve the following results: (i) increased sale of agricultural products by (x%) as a result of more effective functioning of targeted value chains; (ii) increase in the income of participating farmers by (x%). A full results framework including indicators will be developed during project preparation and baseline data on indicators will be collected to facilitate the measurement of project impact. For demand driven type or other type of activities that will be defined during course of the project, the collection of baseline data will be incorporated into investment implementation cycles.

III. Preliminary Description

Concept Description
The project components comprise: (i) food safety and animal health; (ii) agri-food value chain development and support services; (iii) access to credit; and (iv) project management.

Component 1: Food safety and animal health. This component would support the enhancement of food quality and safety systems. The existing legal and regulatory framework for the system is inadequate and the roles and responsibilities are distributed amongst eight agencies in a fragmented manner. The project would support: (i) review the current food safety legal and regulatory framework and advising on reforms for improvement of the system and (ii) upgrading plant protection services and veterinary services. The component would finance the following activities:

A. TA to complete the review of the current legal and regulatory framework to identify gaps and working out options for regulatory and institutional reforms. This would include the review of the current roles and responsibilities of various ministries and agencies involved in food safety and working out the proposals for improving the institutional set up to rationalize the administration of the existing network of registration, licensing, inspection and food safety certification. The project would work on developing appropriate food safety standards which would be adapted from existing international public and private standards for various levels of the agrifood value chain. An interministerial working group would be established to work closely with the TA team on reviewing the legislation. The group will be comprised of the key agencies responsible for various elements of the food safety and would provide a forum for joint consultations amongst the institutions and arrive at a consensus on the division of roles and responsibilities to avoid redundancy and ensure optimal efficiency.

B. Upgrading the plant protection and veterinary services based on the strategic plans to be developed in collaboration with the IPPC for plant health and the OIE for animal health. These agencies would undertake sectoral assessments and develop the strategic plans for upgrading the state phyto-sanitary services and the state veterinary services. These assessments would identify investments required for the system-wide modernization including information systems, lab diagnostics, surveillance activities, TA and training. The project would support implementation of priority activities set forth in the strategic plans and which relate specifically to the selected value chain products for specific plant health and animal disease control programs. This would, ultimately, demonstrate a multi-sectoral approach to systemic improvements and their impact on the specific value chains.

C. The successful private veterinary support program under ADCP-2 would be expanded country-wide. The development of an active network of private veterinarians, which would undertake some public good services, is critical to success of the livestock value chains. The project would support TA, training and basic start-up packages of equipment and medications. The project would also support establishment of an accreditation program for private veterinarians which could evolve into a veterinary chamber, if deemed appropriate.

Component 2: Agri-food value chain development and support services. This component would support improved on-farm production, post-harvest technologies, processing and marketing of selected crop and livestock products in response to specific market demands. This would be achieved through (i) facilitating the development of selected value chains, (ii) introduction of new seed varieties, improved animal genetics and related inputs, (iii) provision of support services to farmers and agri-businesses. Specific activities will include:

A. Identification of high value agri-food chains. First, a comprehensive analysis of the value chains, including an assessment of production and market potential, will be conducted. The next step would be identification of 2-3 initial high value chains for the first stage of the project. Project interventions on facilitating the first group of value chains will be analyzed and the results be reflected in the project design. This would allow for learning and experimentation and to demonstrate the approach and opportunities.

B. Introduction of new seed varieties, improved animal genetics and related services to improve yields, productivity and competitiveness. The process would be demand-driven and would require rapid identification of market needs and introduction of new seed and cultivars to address these demands. Most of the activities would be implemented through the private sector, but would also require public sector research and development programs. The component would facilitate the procurement of new seeds, testing and demonstration of new varieties, support multiplication and distribution of new seed varieties and cultivars to producers through management improvement and technical support for seed farms. Some targeted R&D activities linked to the selected commodity value chains would be required to promote optimal crop yields, to ensure sustainability and accelerate the introduction of improved seed varieties and animal genetics. This would be informed by the baseline value chain analysis and demand for specific commodities and produce directed by the private sector.

C. Support to farmers and agribusinesses. The existing Regional Advisory Centers (RACs) or other service providers would be contracted to act as facilitators in developing supply chains between farmers and processors/wholesalers and to provide a comprehensive package of advisory services to help farmers meet buyers’ needs. This would include assistance to prepare simple product specific development plans and support to implement those plans including: (i) sourcing of improved quality seed and inputs; (ii) demonstration of improved technologies; (iii) planning of investments to improve post-harvest storage and handling and (iv) support in establishing contractual arrangements with traders and the market. The package of support would be defined in cooperation with target agribusinesses purchasing from farmers. Support to agro-processors would include TA and training in technological development, investment planning (including investments which could be financed under the credit line) and upgrading food safety. Possible support for strengthening of rural advisory services will also be considered.

Component 3: Access to Credit. Investment lending through banks would be continued with a particular focus on investments in value chain, processing modernization and quality and safety. In addition, the project would possibly introduce innovative
structured finance products, such as transaction finance and supply chain financing, to help agribusinesses borrow to deliver under signed contracts, and develop relationships with farmers, agro-processors, wholesalers, retailers, etc. TA and training will be provided to the banks and the borrowers to help them assess the suitability and effectiveness of these products and mitigate the related risks. The possibility to promote development of the agricultural insurance will be explored. Currently, agricultural insurance is almost non-existent in Azerbaijan, and there is low awareness of its opportunities and constraints. The project would build the capacity of the local insurance sector in risk assessment and product development, and explore opportunities for introduction of selected suitable crop and/or livestock insurance products.

Component 4: Project Management. This component will finance the administrative and operational project implementation and management costs (FM, procurement, safeguards compliance, M&E), including overheads of Project Management Unit (PMU) professional staff as well as support staff.

### IV. Safeguard Policies that might apply

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### VI. Contact point

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### VII. For more information contact:
The InfoShop