Azerbaijan Republic
Poverty Assessment
(In Two Volumes) Volume I: Summary and Conclusions

June 4, 2003

Human Development Sector Unit
South Caucasus Country Unit
Europe and Central Asia Region

Document of the World Bank
Azerbaijan Republic: Poverty Assessment

Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AIDPS</td>
<td>Azerbaijan Internally Displaced People Survey</td>
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<td>ARRA</td>
<td>Azerbaijan Reconstruction and Rehabilitation Agency</td>
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<td>ASLC</td>
<td>Azerbaijan Survey of Living Conditions</td>
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<td>ASSC</td>
<td>Azerbaijan State Statistical Committee</td>
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<td>AZM</td>
<td>Azerbaijan Manats</td>
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<td>BEEP</td>
<td>Business Environment and Enterprise Performance</td>
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<td>CDF</td>
<td>Cumulative Density Function</td>
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<td>COM</td>
<td>Cabinet of Ministers</td>
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<td>CPI</td>
<td>Consumer Price Index</td>
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<td>DFID</td>
<td>Department for International Development</td>
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<td>DOTS</td>
<td>Directly Observed Treatment Strategy</td>
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<td>DPT</td>
<td>Diphtheria, Pertussis, Tetanus</td>
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<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>ECA</td>
<td>Europe and Central Asia</td>
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<td>EPI</td>
<td>Expanded Program of Immunization</td>
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<td>EU</td>
<td>European Union</td>
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<td>EXCOM</td>
<td>Executive Committee</td>
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<td>FSU</td>
<td>Former Soviet Union</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GNI</td>
<td>Gross National Income</td>
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<td>GOA</td>
<td>Government of Azerbaijan</td>
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<td>HBS</td>
<td>Household Budget Survey</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IDP</td>
<td>Internally Displaced People</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IFRC</td>
<td>International Federation of Red Cross and Red Crescent Societies</td>
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<td>ILO</td>
<td>International Labor Organization</td>
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<td>IMC</td>
<td>International Medical Corps</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IMR</td>
<td>Infant Mortality Rate</td>
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<td>LFPR</td>
<td>Labor Force Participation Rate</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<td>MED</td>
<td>Ministry of Economic Development</td>
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<td>MICS</td>
<td>Multiple Indicators Cluster Survey</td>
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<td>MLSPP</td>
<td>Ministry of Labor and Social Protection of Population</td>
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<td>MMR</td>
<td>Maternal Mortality Rate</td>
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<td>MOE</td>
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<td>Ministry of Finance</td>
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<td>MOH</td>
<td>Ministry of Health</td>
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<td>MTP</td>
<td>Management Training Program</td>
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<td>NBFI</td>
<td>Non-Bank Financial Institution</td>
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<td>NGO</td>
<td>Non-Governmental Organization</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
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<td>PPP</td>
<td>Purchasing Power Parity</td>
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<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
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<td>RDF</td>
<td>Revolving Drug Fund</td>
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<td>SCR</td>
<td>State Committee for Refugees</td>
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<td>SFDI</td>
<td>Social Fund for Development of IDPs</td>
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<td>SME</td>
<td>Small- and Medium-Sized Enterprises</td>
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<td>SPF</td>
<td>Social Protection Fund</td>
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<td>SPPRED</td>
<td>State Program on Poverty Reduction and Economic Development</td>
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<td>SSC</td>
<td>State Statistical Committee</td>
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<td>State Social Protection Fund</td>
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<td>UNDP</td>
<td>United Nations Development Program</td>
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<td>UNESCO</td>
<td>United Nations Educational, Scientific and Cultural Organization</td>
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<td>UNFPA</td>
<td>United Nations Fund for Population Activities</td>
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<td>UNHCR</td>
<td>United Nations High Commissioner for Refugees</td>
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<td>UNICEF</td>
<td>United Nations Children's Fund</td>
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<td>UNIDO</td>
<td>United Nations Industrial Development Organization</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WFP</td>
<td>World Food Program</td>
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<td>WHO</td>
<td>World Health Organization</td>
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Vice President: Johannes F. Linn
Country Director: Donna Dowsett-Coirolo
Sector Director/Sector Manager: Annette Dixon/Maureen Lewis
Task Manager: Michael Mills
PREFACE

Azerbaijan has experienced impressive economic growth over the last seven years, but the limited data available suggest that the impact on poverty has been only modest and mixed in nature. It is very likely that there has been some overall reduction in income poverty, especially in the rural areas, due to the successful farm and land reform program and the resulting expansion in agricultural production. At the same time, most non-income indicators of poverty, including the quality of health care and schooling, and also access to basic services, appear to have deteriorated. In urban areas, there may not have been any significant reduction in income poverty, while the non-income indicators of poverty have clearly worsened, albeit to a lesser extent than in the rural areas. The rapid expansion of the oil sector has not generated much employment. Growth in the non-oil sectors has been comparatively slow. As a result, many find themselves working in relatively low productivity and low income occupations. Also, unemployment has remained high, especially among the youth.

However, the growth prospects for the country are strong, particularly with the expansion of the energy sector. But a substantial reduction in poverty in the future will require (i) the further development of the non-oil economy, (ii) measures to increase employment and raise the productivity of the poorer members of the community, (iii) the reform and strengthening of basic services, including education and health, and (iv) social assistance for those who are in need and who for various reasons are not able to take advantage of the opportunities offered by general economic growth.

The Government has recently published the State Program on Poverty Reduction and Economic Development (SPPRED). This is a very welcome development and shows the commitment of the Government to try to ensure that the country's projected economic growth is accompanied by significant poverty reduction. The SPPRED and the World Bank's Poverty Assessment were compiled in parallel and in a participatory fashion, with considerable sharing of data and analysis. There is, therefore, considerable consistency between them. However, they are each distinct documents with varying scope and focus. The Poverty Assessment Report is also accompanied by a separate Public Expenditure Review by the World Bank. It is my hope that these reports will complement the ongoing discussion in the country about the nature of poverty in Azerbaijan and the appropriate strategies for addressing it effectively. While it is our intention that these reports will prove helpful for the Government of Azerbaijan, they are also intended to inform the broader civil society in the country as well as orient members of the external donor community.

Donna Dowsett-Coirolo
Country Director
for Republic of Azerbaijan
South Caucasus Country Unit
Europe and Central Asia Region
The World Bank
Azerbaijan Republic
POVERTY ASSESSMENT

Table of Contents

Volume I – Summary and Conclusions

PREFACE ................................................................................................................................. ii

ACKNOWLEDGEMENT........................................................................................................... vi

Summary and Conclusions ........................................................................................................ 1
I. Taking Stock of Poverty in Azerbaijan.................................................................................. 1
   A. Recent Trends..................................................................................................................... 2
   B. The Challenge for the Future............................................................................................ 3
II. A Strategy for Poverty Reduction ........................................................................................... 4
   A. Building Opportunities ........................................................................................................ 4
      1. Macroeconomic Policies to Support Poverty Reduction
      2. Private Sector Development
      3. The Rural Sector............................................................................................................ 7
   B. Strengthening Human Assets ......................................................................................... 9
      1. Education...................................................................................................................... 9
      2. Health.......................................................................................................................... 12
   C. Protecting the Vulnerable ................................................................................................. 14
      1. Social Protection.......................................................................................................... 14
      2. Internally Displaced People .......................................................................................... 16
   D. Monitoring of Living Standards ....................................................................................... 18

Volume II – The Main Report

PART A. TAKING STOCK......................................................................................................... 1

CHAPTER I: THE MAGNITUDE AND CAUSES OF POVERTY.................................................. 1
   A. Monetary Indicators of Poverty ....................................................................................... 1
      1. Measurement of Monetary Poverty.............................................................................. 1
      2. Extent of Poverty.......................................................................................................... 3
      3. Characteristics of the Poor........................................................................................... 5
   B. Correlates of Poverty......................................................................................................... 12
   C. Non-Monetary Indicators of Poverty............................................................................... 17
      1. Health.......................................................................................................................... 18
      2. Malnutrition ............................................................................................................... 19
      3. Education ................................................................................................................... 19
      4. Access to Basic Services ............................................................................................ 21
      5. Perceptions of Poverty................................................................................................. 22
   D. Internally Displaced People............................................................................................. 23
      1. The context and Background to the IDP Situation...................................................... 23
      2. The Poverty Profile of IDPs........................................................................................ 25
   E. Conclusions...................................................................................................................... 32

iii
CHAPTER II: MACROECONOMIC DEVELOPMENTS
AND LIVING STANDARDS IN THE 1990s
A. Macroeconomic Developments
1. The 1990-1995 Period
2. Developments in 1995-2001
B. Employment
1. Labor Force Participation
2. Unemployment
3. Labor Hoarding
4. Structural Changes in the Labor Market
5. Wages and Incomes from Employment
C. Trends in Poverty
1. National Trends
2. Rural Trends

CHAPTER III: THE CHALLENGE
A. Increasing the Incomes of the Poor: Macroeconomic Framework
B. Meeting the Millennium Development Goals

PART B: RESPONDING TO THE CHALLENGE

CHAPTER IV: BUILDING OPPORTUNITIES
A. Macroeconomic Policies and Private Sector Development
1. Macroeconomic Policies to Support Poverty Reduction
2. Development of Small-, Medium-Sized and Micro Enterprises
3. Legal, Regulatory and Administrative Framework
4. Access to Finance, Business Development and Training
5. Improving Access to Basic Services: Electricity
6. Advocacy Groups and Associations
7. Labor Redeployment Programs
B. The Rural Sector
1. Improving Public Services
2. Ensuring Sustainable Income Growth from Farming
3. Advisory Services and Agricultural Research
4. Agricultural Marketing and Land Markets
5. Micro Credit Facilities for Farmers
6. Irrigation
7. Non-agricultural Employment in the Rural Areas
8. Agriculture and the Exchange Rate
9. Public Spending on Agriculture

CHAPTER V: STRENGTHENING HUMAN ASSETS
A. Education Sector
1. Overview
2. Spending on Education
3. Education and Poverty
4. Determinants and Patterns of Enrollments
5. Major Issues
B. Health .......................................................................................................................................... 92
   1. Health Status ......................................................................................................................... 92
   2. Access to Health Services ..................................................................................................... 99
   3. Primary Health Care ............................................................................................................ 101
   4. Health Service Management and Financing ........................................................................ 103

CHAPTER VI: PROTECTING THE VULNERABLE ........................................................................ 106

A. Social Protection .................................................................................................................. 106
   1. Social Protection and Poverty ............................................................................................ 106
   2. Social Assistance ................................................................................................................. 110
   3. Social Insurance ................................................................................................................ 113
   4. Government Strategy ........................................................................................................ 115

B. Internally Displaced People ................................................................................................ 120
   1. Public Expenditure for IDP Assistance ............................................................................... 120
   2. Land and Relocation ........................................................................................................ 121
   3. Employment Programs .................................................................................................... 122
ACKNOWLEDGEMENT

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The mission would like to extend its sincere thanks to the Government, and especially to the PRSP Secretariat and the PRSP Working Groups, all of which interacted very intensively with the World Bank team. It would also like to commend the State Statistical Committee particularly for its strong collaboration, and especially for the carrying out of the Household Budget Survey, upon which many of the findings of the poverty assessment are based. The team would like to thank all of the other Government officials and national experts, who contributed so generously of their time and ideas to assisting the team to try to understand the poverty situation in the country.

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Azerbaijan Republic Poverty Assessment

Summary and Conclusions

I. Taking Stock of Poverty in Azerbaijan

*Poverty remains a major challenge in Azerbaijan.* Azerbaijan is a country with about 8 million population and per capita gross domestic product (GDP) in 2001 of $709 (current dollars). Almost 4 million people or about 50 percent of population of Azerbaijan lived in poverty in 2001, consuming less than AZM 120,000 per capita per month. Among these, a group of 1.3 million persons, or 17 percent of the total population, lived in extreme poverty, with monthly consumption below AZM 72,000 per capita per month.

*Income poverty is spread throughout all parts of the country, although the provincial towns appear to be of increasing concern.* The results of the Household Budget Survey in Year 2001 suggest that the incidence of income poverty among urban households may perhaps be even greater than among rural households, with the majority of the poor now living in urban areas where poverty is associated with limited employment opportunities in the formal economy. The current low level of public services in rural areas of Azerbaijan has led to substantial rural-urban migration, but the migrants are not usually immediately employable and find employment only in low-paying jobs. Within the urban areas, there are significant differences between the poverty rates in the capital city and the rest, with a poverty risk being higher in the provincial towns than in Baku City (although Baku has the largest group of poor due to its size). In the rural areas, income poverty rates may be somewhat lower, due largely to the benefits of the land reform program. The risk of being poor is fairly similar across the nine regions of the country.

*The available household data suggest some particular demographic characteristics of the poor, although the pattern of poverty is mostly quite diffuse.* The risk of poverty increases with household size, for both total poverty and extreme poverty. Specifically, the poverty headcount is higher for a household with six or more members. In contrast, the number of children per household is a weak discriminator of the risk of being poor, as households with children tend to live in extended households, where the elderly take care of children. The age of the household head is also a poor predictor of the risk of poverty, with two notable exceptions: the households headed by younger and older heads. There are no significant differences in the poverty rate by gender of the household head; while there is a negative, but so far rather weak, relationship between poverty and the educational achievement of the household head. The risk of income poverty is higher for households headed by unemployed workers though the largest number of poor live in households headed by employees and by pensioners.

*It is clear is that the Internally Displaced People (IDPs) are a core group of particularly vulnerable people, as they lack assets and their livelihood depends heavily on state transfers and donor assistance.* It also appears that the IDP population in Baku is of particular concern, as they tend to be significantly worse-off than the rest of the population in the capital city. However, there is some uncertainty about the extent of income poverty among the IDPs compared to the general population. According to the national household survey results, individuals living in a rural IDP/refugee household are more likely to be poor than the average. A possible reason for this may be because IDPs and refugees did not receive land and other agricultural assets in the farm privatization process. However, the results of a more detailed survey focused on IDPs suggest that they do not seem to have significantly lower incomes than the other groups in the same areas with whom they were compared, although the survey did find some substantial differences among the income levels of IDPs.
There are also serious concerns about the non-income indicators of poverty, including the quality of health care and education, and access to basic services. Azerbaijan's official health indicators are still mostly better than in many countries of a similar per capita income, but there are major doubts about the quality of the official statistics especially with the increasing reluctance of many people to use government health facilities. Survey data suggest that the actual rates of infant and maternal mortality may be considerably higher than officially reported. A recent survey also found that in Year 2000, nearly 20 percent of the children were suffering from stunting, with rates as high as 27 percent for the children from the poorest quintile, down to 13 percent for those belonging to the richest quintile. Although Azerbaijan is still very close to achieving universal primary education, school enrollment rates decreased a little during the period 1995-2000 and almost 50 percent of children now drop out of school by the age of 16-17. In particular, the quality of schooling needs to be improved. Rural households in particular have poor access to public services, especially electricity and gas supplies for heat.

A. Recent Trends

The economy of Azerbaijan has been growing quickly in recent years due to the Government's reform program and the signing of the production sharing agreements with foreign oil companies. Overall labor force participation rates are now relatively high, and there have been some significant structural changes in the labor market, with a rapid movement of workers from the state to the private sector.

However, labor force participation rates are significantly lower in the urban areas than in the rural areas, and unemployment has remained high. The rapid expansion of the oil sector has not generated much employment and there has been comparatively slow growth in the non-oil sectors of the economy. Unemployment is particularly high among the youth and those with secondary special and vocational education, and non-participation in the labor force has become more widespread. Labor hoarding has also been substantial in many firms, where productivity and income levels remain very low.

While data limitations preclude direct comparisons and rigorous analysis, rough estimates and anecdotal evidence suggest that the economic growth has probably had some modest impact on income poverty. In the first place, it is clear that real per capita consumption has been increasing in the last few years. Second, some very limited comparisons can be made between the results of the 1995 Survey of Living Conditions and the data from the ongoing Household Budget Survey (HBS) now being carried out by the State Statistical Committee, even though these surveys are not comparable in several major ways. Specifically, the results of the HBS survey in Year 2001 suggest that there may have been only a small increase in overall inequality since the mid-1990s. If correct, then one can estimate the extent of poverty in 1995 using the data from the 2001 survey and the economic growth performance in the period 1995-2001. Compared to a poverty rate of 50 percent in 2001, the simulation for the comparable rate six years earlier would have been considerably higher, at about 76 percent. Third, the results of another simulation exercise for the agricultural sector suggest that from 1995 to 1998 real rural expenditures per capita increased by nearly 10 percent, lowering the poverty headcount by 3.9 percentage points; and that from 1998 to 2001 expenditures per capita increased 5.7 percent and the poverty headcount decreased by 2.2 percentage points. These simulations are only indirect evidence on likely income poverty trends, and so the results of the HBS in Year 2001 need to be used as a benchmark for measuring future poverty changes.

Whether or not income poverty has indeed decreased in recent years, it is clear from consultations with the poor that many people are still very dissatisfied with their income levels and living conditions. Poverty is associated in the minds of many people as being due to a variety of factors, including the Karabakh war and the subsequent displacement of families and communities, the introduction of a market economy in Azerbaijan and the slow adjustment to new commercial practices,
and the closure or reduction of the Government’s centralized control over production and services. While the loss of employment opportunities is the primary concern of the poor, there is also clear evidence of a continued deterioration in many public services (notably gas, water supplies and heating) in the second half of the 1990s, just as they had from 1990 to 1995. This is especially the case in the rural areas.

B. The Challenge for the Future

The macro-economic outlook for Azerbaijan is positive, and it should be possible to have a significant impact on poverty over the next decade if appropriate policies are followed. The oil and gas windfall should be of major benefit to the country and its citizens and could contribute to lasting poverty reduction and raising incomes. As a base or “middle” case, the World Bank is projecting that the average annual growth rates during 2001-2010 for total GDP could be 13 percent, with oil GDP growing at 21.5 percent and non-oil GDP growing at 6.3 percent. In this base case, the proportion of the population falling below the poverty line would drop from 50 percent to 36 percent, assuming no change in income distribution. However, in contrast to the projected non-oil GDP growth rate of 6.3 percent, it needs to be remembered that value added in the non-oil sectors grew at an annual rate of only 3.8 percent in the period 1995-2000. Thus both policy improvements and institutional strengthening will be needed if this 6.3 percent growth rate for the non-oil sectors is to be accomplished. It should also be noted that even with this rate of non-oil sector growth, there would still be over one third of the population below the poverty line in Year 2010.

If the rate of growth in the non-oil sector were to continue to grow at only about 4.0 percent in the period up to 2010, then the growth rate of total private consumption would only be 1.9 percent, and the per capita private consumption growth rate would drop to 1.0 percent, and total poverty would still be as high as 44 percent in 2010. In contrast, for the proportion of the population below the poverty line to be reduced to 22 percent by the end of the decade, the growth rate of the non-oil economy would need to average 9 percent throughout the 2002-2010 period. This would permit total private consumption to grow at an average annual rate of 5.7 percent and per capita consumption by households to grow at 4.8 percent. If this 9 percent growth rate for non-oil GDP could be sustained, the proportion of the population classified as in "extreme poverty" would fall to 4 percent. For poverty to fall even to one third of the population by the Year 2010, it will be necessary for the Government to take active steps to ensure that the growth rate of the non-oil economy does accelerate, and that particular measures are taken to ensure that policies are adopted in specific favor of the poor.

In addition to the targets for reduction in income poverty, Azerbaijan has a challenge to meet all of the Millennium Development Goals. For some targets, such as infant mortality, maternal mortality, the prevalence of HIV, progress will be difficult to measure, unless a major effort is made to improve the accuracy of the statistical data-base. For example, administrative and survey data tend to disagree about the extent to which infant and maternal mortality have been reduced since the 1990s. Similarly, there is uncertainty about the true extent of HIV/AIDS. One particular area where progress is clearly insufficient is in access to safe water in rural areas. In large towns, about 96 percent of households have access to safe water, and in small towns, the figure is about 81 percent. In contrast, in the rural areas, only 11 percent of the households have access to treated, piped water and virtually no progress has been achieved in the last ten years.

Between 1990 and 2015, the Millennium Development Goals (MDGs) include: halving income poverty and hunger; achieving universal primary education; gender equality in primary education; reducing under five mortality by two thirds; reducing maternal mortality by three quarters; reversing the spread of HIV/AIDS; ensuring environmental sustainability (including halving the proportion of people without access to safe water); and developing a global partnership for development.
II. A Strategy for Poverty Reduction

Reducing poverty in Azerbaijan is a substantial challenge, but it can be achieved through increased employment and productivity in the non-oil economy, measures to strengthen and improve the provision of basic services and infrastructure, and the provision of well-targeted social assistance for the less fortunate members of the society who are less able to take advantage of the opportunities offered by the growth of the economy. The sustaining of economic growth will be critical, but it has to be accompanied by targeted programs, focused on education and health programs and social assistance for those most in need.

A. Building Opportunities.

1. Macroeconomic Policies to Support Poverty Reduction. Poverty reduction in Azerbaijan requires continuing the progress being made in increasing total GDP, and also changing the pattern of growth so that it makes a greater contribution to improving living standards. Key to this will be the generation of sufficient employment opportunities in the more highly productive economic activities, especially in non-oil industry. Growth in average productivity per worker will depend on "within-sector" productivity increases and also on the movement of workers from lower productivity to higher productivity activities. Unfortunately, in recent years, the movement of labor has been in the opposite direction. Between 1995 and 2001 employment in agriculture and service activities (where output per worker is well below the level in non-oil industry) increased by 28 percent, while employment in non-oil industry declined by 7 percent. Employment in non-oil industry was, in 2001, less than half of the level in 1990. This "deindustrialization" trend characterizes the 1995-2001 period, when the economy was recovering, as well as the 1990-1995 period of economic decline.

To reduce poverty will therefore require macro-economic policies that have two objectives: to promote internal and external fi-nancial stability and also to encourage further structural change in the economy. The first objective is needed as inflation adds to social inequities and also reduces the efficiency of entrepreneurs and markets in mobilizing and allocating resources. The income from oil exports also creates serious issues in the management of foreign exchange inflows, due to the potential effect on the manat (AZM) exchange rate and the danger of "Dutch disease". This means finding the right balance between increases in the money supply, increases in international reserves, net credit to the budget, and increases in credit to the enterprise sector. However, macro-economic policies will also need to encourage further structural change in the economy, as the growth of the non-oil sector will require productivity gains through resource shifts to more productive firms and activities. Such structural change will be needed even to accelerate the real growth rate in non-oil output from the recent figure of 3.8 percent annually to the base case target of 6.3 percent annually, which would be required for poverty to come down to 36 percent of the population by the Year 2010. Policy change would need to be extremely strong and determined for the structural changes to be sufficient to increase the growth rate in the non-oil economy to 9 percent throughout the 2002-2010 period, which would reduce the proportion of the population in poverty to 22 percent by the end of the decade.

Policy Recommendations on Macroeconomic Policies

- Poverty reduction in Azerbaijan requires both continuing the progress being made in increasing total GDP and, at the same time, changing the pattern of growth so GDP growth will make a

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2 The impact of oil revenues on the budget is examined in the Public Expenditure Review Report.
greater contribution to improving living standards. The growth strategy should emphasize creating productive employment opportunities in the non-oil sectors of the economy.

- Macro policies will have to continue to promote internal financial stability, as inflation both adds to social inequities and reduces the efficiency of entrepreneurs and markets in mobilizing and allocating resources.

- More attention needs to be given to both the costs and the volume of credit to the enterprise sector, as restoring the volume and reducing the cost of banking system credit to the enterprise sector could make a major contribution to the expansion of non-oil GDP. Improving credit to small and medium commercial and industrial activities could be important in restoring output, employment and productivity in these relatively labor intensive activities.

- Due to the potential danger of "Dutch disease" on the non-oil economy, resulting from the foreign exchange earnings from oil exports, it will be important to manage the Oil Fund in a manner that ensures that the country's producers are competitive with imports and in export markets for a wide range of import substitutes and exported goods. The growth of both agriculture and non-oil industry will depend substantially upon improving their competitiveness, which in turn will depend upon both structural reforms and an appropriate exchange rate.

2. Private Sector Development. Sustainable poverty reduction in Azerbaijan will depend on positive economic growth based on a vibrant private sector, resulting from a more liberal business environment, better financial intermediation and the availability of credit to the enterprise sector, a clear legal framework, the implementation of the privatization program, the elimination of critical infrastructure bottlenecks, and investment in human as well as physical capital.

Poverty in Azerbaijan is associated with insufficient employment opportunities and earnings in the formal economy, and reflects the unfinished restructuring agenda of the industrial complex inherited from the Soviet era. The private sector can provide the necessary employment creation and higher incomes, and also the tax base for the sustainable funding of key public services which impact positively on the poor. So far, however, the emerging private sector is too small to compensate for the collapsed industrial base. Private sector development will only occur in a favorable business and investment environment. Improving the business environment for local entrepreneurs and for non-oil sector foreign direct investment is essential for broad-based growth. The overall business environment in Azerbaijan is important to all entrepreneurs. However, certain aspects of the business environment impact disproportionately on small- and medium-sized enterprises and micro enterprises, which in turn impact disproportionately on poor people, due to presently restricted employment opportunities (including self-employment opportunities) in these sectors.

To develop Azerbaijan's micro, small- and medium-sized enterprises, including in agro-processing, tourism and manufacturing, measures need to be taken to improve the business climate, increase access to credit and address some of the infrastructure constraints. Specifically, steps also need to be taken to reduce the administrative barriers, especially in simplifying and speeding up the processes for the registration and licensing of new legal entities, NGOs and non-bank financial institutions. To reduce corruption, there also needs to be a strict limit on the number of inspections by officials, as well as enforcement of the administrative policies with criminal provisions against officials who abuse their authority during inspection. The tax and customs rules need to be applied in a guaranteed, consistent and uniform way, and the forms and the processes used for the submission of taxes should be simplified. Finally, it will be important for the Government to liaise further with representative entrepreneur groups business advocacy groups.
Policy Recommendations on Private Sector Development

- The Government should, in close consultation with all interested role players, develop a comprehensive strategy for the promotion of the SME and micro enterprise sectors, with due consideration of the specific constraints which exist for these sectors. However, the Government should, as far as possible, limit its role to creating a favorable environment and not become dominant in the commercial sphere.

- There is need for the Government to streamline the business registration procedures, including simplifying and speeding up the processes for the registration and licensing of new legal entities. The number of inspections of all levels of officials should have strict limitations in terms of frequency, supported by an effective monitoring system and enforcement. There is also need to enforce the administrative policies and criminal provisions in respect to officials who abuse their authority during inspection, particularly in respect to rent seeking.

- The essence of the tax legislation needs to be made available in an easy and understandable fashion, in writing and in well publicized locations. Guidelines and interpretative administrative provisions need to be issued for assisting tax administrators in the application of the tax code. These provisions should be made available to the public. Even the simplification of the forms and the process for the submission of taxes would be of substantial help to small entrepreneurs.

- The customs legislation should be made available in an easy and understandable fashion, and again there should be a guaranteed, consistent and uniform application of this legislation. Professional chartered agents should be licensed to facilitate the process of importing goods, supported by a strictly enforced Code of Conduct.

- The Government should refine and enforce the procedures to speed up the registration of collateral in respect to privatized enterprises. Preferably, there should be no distinction between various classes of property, and all property should be registered in a central registry. The efficiency and transparency in relation to the registration and execution of collateral also needs to be improved; and legislative changes should be made to allow crops to be collateralized.

- The authorities should work with all parties, including the service providers, to ensure that electricity is supplied to consumers in the business community in a consistent and predictable manner, even if a permanent supply cannot be guaranteed.

- The Government is encouraged to liaise with representative entrepreneur groups, business advocacy groups, such as the Business Development Alliance and the National Confederation for Employers (specially in relation to matters affecting SMEs), but particularly those representing the micro enterprises and micro entrepreneurs.

- The Micro Finance Forum presently being formed, should be encouraged and have regular and official access to appropriate Government officials.

- The regulatory framework governing the access of SMEs to the services provided by natural monopolies and utilities needs to be strengthened; and the tariffs of monopolies (such as railways and the energy sector) need to be transparent, fair, well published and accessible, and without any prejudice to the particular interests of small entrepreneurs. The Government should also proceed
with the corporatization and privatization of any state-owned enterprises which presently act as a barrier to the entry of new business.

- The Government is encouraged to develop a favorable environment for managerial training capacity in Azerbaijan to meet the demand of the SME sector in upgrading managerial skills. Such training programs should be targeted to practicing managers and to solving the current managerial problems of SMEs, provided by trainers who have managerial and consulting experience, be fee-based to reflect demand, provide opportunities for foreign internships, and be longer-term (couple of months) executive education as well as short-term (one-two weeks and less) awareness courses.

- In many cases, local governments also need to take action to deal with policy issues and barriers to private sector development, particularly in the areas of local regulations and governance and in promoting training and education locally.

- An evaluation of labor market programs should be carried out to examine whether the resources currently being spent by the Government are being efficiently utilized, and whether the programs are having the intended impact on the reduction of poverty and unemployment. In general, the employment programs should be reoriented towards counseling and job search assistance.

- There is need for a nationwide labor force survey, so that the labor market can be thoroughly analyzed as part of a move from supply-driven to demand-driven employment policies.

3. The Rural Sector. The rural poverty reduction strategy should aim at improving the incomes from agriculture of the poor rural population. However, it should also emphasize the development of non-agricultural activities, such as food processing and services in rural areas.

Out of the poor population of 4 million individuals in Azerbaijan, 1.7 million live in the rural areas and the rural population is heavily dependent on agriculture. In the rural areas, much of the population avoids income poverty through the production and home consumption of food. However, many people are still below the poverty line, and there is a general lack of adequate access to basic services and infrastructure. As agriculture is the major source of income for rural households, and as the contribution of agricultural income to total income is higher for non-poor rural households, reliance on agriculture as major source of income is associated with a lower risk of poverty. However, as market forces continue to shape Azerbaijan's agricultural sector, there may also be further consolidation of land and farming to increase agricultural productivity, with possible implications for both unemployment and income inequality in the rural areas. Accordingly, a rural poverty reduction strategy also needs to emphasize the development of non-agricultural activities, such as food processing and services in rural areas.

For poverty reduction, actions in several areas are now needed. First, investments are needed to address the deficiencies in the supply of public services in the rural areas. These are an obstacle to poverty reduction because the inconvenience of life without heat, electricity and sewage systems in rural areas discourages both people and businesses from locating there and from carrying out new economic activities. Improvements are also needed in the technology of agricultural production and marketing in private and household farms. Most farms use few inputs, have low and quite variable yields, and usually market only locally. This constrains net revenue generation. It is also very risky, as a dry season can cause a crop failure, which can plunge even a successful farmer into poverty. However, Azerbaijan produces fresh fruit and vegetables, which could be sold for higher prices in Russia or other northern countries by selling either through marketing cooperatives or through direct contracts with exporters or
processors. The main irrigation canals of Azerbaijan have deteriorated since Soviet times and the smaller canals and distribution systems are often unusable. Moreover, farm privatization has meant that farmers themselves are responsible for the upkeep and control of the water distribution system through water user associations. Since 75 percent of cropped land in Azerbaijan is supposed to be irrigated, the deterioration of the irrigation system is of vital importance for farming in Azerbaijan. Such deterioration needs to be reversed.

The prospects for non-agricultural employment in rural areas also needs to be enhanced. This will require similar measures to be taken in improving the business climate, increasing access to credit and addressing the infrastructure constraints as discussed above for small and medium-sized enterprises generally. Non-agricultural employment ranges from retail stores, to food processing industry, to trade and other industry. An important part of non-agricultural employment could come from food processing, which used to be an export industry in Soviet times. However, production fell further than that of agriculture, and the industry has been slow to recover. Now many rural households in Azerbaijan are dependent on the recovery of food processing, both as demand for agricultural production and export, and for employment. Thus, problems in the food industry impact on rural households directly. There is also concern about the loss of the competitive position of domestically produced tradable goods as a result of currency appreciation connected with the oil boom. Since agriculture is a potential export sector and since foreign food products compete with domestic food products on Azeri markets, an excessive exchange rate appreciation would have a depressing effect on incomes in rural areas, due to losses of domestic and foreign food markets.

Public spending in the agricultural sector also needs to be reviewed to assess in more detail its efficiency and impact on the poorest groups. Some of the key priorities for poverty reduction relate to establishing information and advisory services for private farming, reforming the existing agricultural research system, rehabilitating the irrigation system where economically justified, supporting the development of the rural credit system, consolidating the system of land registration to support land market development, and establishing and strengthening veterinary disease control.

Policy Recommendations for The Rural Sector

- There is need to test a variety of models for providing advisory services to farmers and for establishing such centers in each economic region. These could include private sector involvement, and should allow for a high rate cost recovery of service though with special provisions to protect the poorest so that they could also benefit from them. Market information systems need to be set up for farmers and the information disseminated through the press and other outlets such as the advisory service system.

- Apart from technical training, business training and marketing should be included in the spectrum of advisory services. Consideration could be given to sponsoring trade promotion fairs and seminars within and outside Azerbaijan to introduce Azeri products to new markets.

- The system of agricultural research needs to be restructured in accordance with the needs of private farmers. Sufficient public funding should be allocated for agriculture research perhaps through a competitive research grant system. The dissemination of agriculture research results should be ensured through the extension system.

- There is need to develop a feasible plan to restructure and rehabilitate the irrigation system and pursue irrigation rehabilitation on the basis of economic viability. User charges for irrigation systems need to be applied and extended without excluding the poor from using them. In parallel, an institutional reform should be carried out of irrigation management systems at the community,
district, regional and central level. Private specialized technical support is needed for the formation of water user associations.

- The performance of micro-finance schemes in Azerbaijan and in the region should be reviewed, and a strategy designed for the provision of micro-finance services that are financially and operationally feasible and targeted to the poor. If the analysis justifies it, State funds could be allocated to the establishment of a revolving fund for privately implemented and financially feasible micro-credit schemes.

- Steps need to be taken to ensure that land titles actually reach land owners, rather than local officials.

- The veterinary services to be delivered publicly should be defined, and the state services restructured accordingly.

- To generate more off-farm employment, there is need to improve the business environment, such as through simplifying the business licensing process for agro-business, reducing the processing time, and making the system more transparent. In addition, steps need to be taken to break the prevailing culture of individual rent seeking at local and central levels, and the malfunctioning judiciary system.

- The present situation and needs of agro-processor’s need to be presented to officials from the Government, banks and other services suppliers, as well as raw material suppliers and clients.

- Business training programs are needed to increase non-farm employment in areas such as handicrafts, wood products, rural tourism, etc. Such training programs could involve grants for market studies for such products and services.

- Investments are required in improving rural infrastructure (electricity, heating, roads, drinking water, social infrastructure, communication) with clear priority setting and coordination with lower level entities to ensure an impact on rural areas. In addition to large-scale infrastructure investments, small-scale investments could also improve living conditions. Even poor communities can afford some of these investments and would benefit directly. Technical assistance needs to be provided to municipalities to improve the delivery of municipal services and infrastructure in compliance with economic principles and community priorities.

B. Strengthening Human Assets.

If a relatively high growth rate can be maintained long enough to largely eliminate "disguised employment" and if the incomes of the less skilled and relatively poorly paid workers therefore increase, the economic growth will contribute significantly to the reduction in poverty. But even so, some individuals—because of factors such as age, geographical location, health, skills and culture—will not be able to take advantage of the opportunities offered by general economic growth. Another element of the national poverty reduction strategy therefore needs to be programs which focus particularly on the education and health of the children in poor families, so when these children grow up they will be better able to take advantage of the opportunities available.

1. Education. Increasing the level and quality of education is a key strategy for the poor to move out of poverty. Azerbaijan still maintains a high level of enrollment rates in compulsory education
(grades 1-9) across the country, regardless of gender, socioeconomic status, or ethnicity, but the quality of education has deteriorated considerably in recent years. Student and teacher absence rates have become a serious problem in compulsory basic education, affecting the quality of basic education, but this problem has not been captured by official enrollment statistics. The quality of basic and secondary education has also deteriorated sharply due to the lack of textbooks and basic teaching and learning materials, poor teacher training, and poor physical infrastructure. The enrollment rates at the non-compulsory levels (including preschools, upper secondary education, and VET) have declined sharply, especially in poor regions and rural areas, and the poor are likely to be affected most from these sharp declines. Poor students are also likely to be excluded from attending higher education institutions because of the increased direct costs of higher education.

The main bottleneck for the poor is at the upper secondary and higher education levels. The poverty reduction strategies through education therefore need to focus on improving the access of the poor to upper secondary (including selected post-secondary VET programs) and higher education through targeted policy intervention. At the basic education level, the main problem appears to be the rapid deterioration of the quality of teaching and learning environment in which poor children are disadvantaged due to the lack of basic teaching and learning materials and poor teaching staff, especially in rural areas and poor regions. The low quality of basic education is not only affecting the probability of the access of the poor to upper secondary and higher education, but it is also affecting labor market outcomes, since the poor are less likely to be equipped with the right skills and knowledge demanded in a market economy. As a consequence, poverty reduction strategies through education also need to focus on the preservation of traditionally high access rates in basic education, while improving the quality of teaching and the learning environment.

**Policy Recommendations on Education**

- Although primary and secondary education institutions are still available across the country, particular attention needs to be given to maintaining the coverage and quality of upper secondary education because of sharp declines in the number of students during the transition.

- The public system of basic education should be maintained fully and should be protected from cuts in education spending. Where necessary, improvements in primary and secondary education could be achieved through reallocation of public resources from vocational education, boarding schools, specialized secondary, and higher education institutions to primary and secondary education.

- To address the educational financial needs of the poor, consideration could be given to: (i) free basic teaching materials (for example, textbooks and school uniforms) for the poor; and (ii) the introduction of a reformed assistance program to provide financial support to needy students to increase their enrollment in post-secondary education.

- The budgetary allocation mechanism should be reformed to address regional variations in the adequacy of fiscal capacity for education funding. If funding is provided to schools on a per pupil basis, consideration should be given, for example, to weighting the capitation formula according to the poverty level of the local community.

- Efforts should continue to be made to reform the school curricula and teaching methods to meet the new skills needs of a market economy. Curricula for vocational, specialized secondary and higher education institutions should also be reviewed and revised. The new curricula and
teaching methods also need to be accompanied by appropriate textbooks and instructional materials.

- The Government should carry through with its proposals to reform teacher training, recognizing that the new teaching methodologies require significant changes.

- School rehabilitation and minor repair should become a priority, because of the considerable future cost of deferred maintenance and the danger of unsafe buildings. Because of the substantial cost of school improvement programs, a nationwide school rationalization plan should be prepared, and parental and community resource mobilization should be continued through establishment of parent-teacher associations in all rayons.

- The country's educational monitoring and evaluation process should be reoriented from inputs to a system which monitors inputs, teaching and learning and also outcomes.

- There is a need to strengthen the linkages between education and the labor market. The output mix of the educational system of Azerbaijan is inappropriate for the current labor market. The reform of curricula and teaching methods is especially important for vocational technical education and higher education, which remain closely linked to the former planned economy.

- The efficiency with which available funds are used could be improved in a variety of ways, including reduction of excess staff, reducing duplication of services, coordinating institutions, and removing vertical and/or horizontal barriers (different ministries providing similar services).

- The budgeting and utilization of financial resources available to education could be improved considerably through improved budgeting and resource allocation processes, strengthened financial management, focusing increased allocations on providing basic education materials and supplies for primary school students, removing direct social welfare provisions and responsibilities from the education budget, and replacing these subsidies with benefits targeted to the poor.

- The excessive reliance on state funding should be reduced through making increased use of student fees in higher and upper secondary education, targeted financial support being available for poor families, reviewing the effectiveness of stipends in ensuring access to professional and higher education, creating a program of student loans, and encouraging more parental and community contributions to schools.

- Consideration could be given to increasing the educational and financial autonomy for specialized secondary ("teknikum") and higher education institutions, by reducing Ministerial control over inputs while increasing monitoring student outcomes.

- A larger role for the private sector could be induced through the removal of tax disincentives and incentives for taxes and removing Article 28 of the 1992 Educational Law (which prohibits for-profit private schools).

- Radical reform and considerable strengthening of education management is required for the creation of a more decentralized system of flexible management which responds to labor market and other changes and local conditions.
A new system of student assessment and monitoring should be introduced, based on the monitoring of inputs, teaching and learning processes, and also outcomes.

2. Health. As in the case of the education sector, there is also a key role for the health sector to play in the national poverty reduction strategy. For this to happen, however, major reforms will be needed in the further development of the primary health care system, the management and financing of the health services, and interactions with other important agencies and ministries that regulate or provide services which impact on health services, like education, the environment, water and housing.

Azerbaijan is at the beginning of the demographic and epidemiological transition, with a young and growing population. The country experienced a worsening of the health status of its people in the period immediately following independence from the FSU; but since the mid-1990s, the official statistics have indicated an improvement in most of the health indicators, bringing the situation to the same level or even better levels than at independence. However, the evidence from social assessments and household surveys suggests that much of the apparent improvement is due to non-reporting, as many households do not use public health facilities from which the official statistics are generated, as they have to pay for nearly all the health services, either formally or informally. The main health problems faced by the poor are communicable diseases such as tuberculosis, diarrhea, and other maladies which are best and most cost-effectively approached on an ambulatory basis.

Major reforms are now needed in the health sector as part of a poverty reduction strategy, in particular in improving accessibility to high quality primary care services. The present health care system emphasizes hospital and specialized services, is fragmented particularly between in-patient and ambulatory services, has primary care services provided by multiple physician specialists with low productivity, and is expensive and difficult to sustain. From the experience so far, it would appear that most of the primary health care reforms already implemented have had a positive impact on the health care of the population in terms of access to better quality care, particularly for the poor. Chief among those reforms have been revolving drug funds, training in up-to-date clinical procedures for primary care, the provision of basic equipment, and health education.

Major reforms are also needed in the management of health services, including financing, resource allocation, the information system, and interactions with other important agencies and ministries that regulate or provide services which impact on health services. The public health budget needs to be enhanced and allocated in a manner that better reflects population needs and distribution. Consideration also needs to be given to defining a basic health care package free of charge to all residents. Currently, the delivery of basic health services is jeopardized because there is only a limited provision in the budget for basic health service, and most of the population is exempt from the official fees charged. It would be more advisable to define a limited core set of basic services, make adequate provision in the budget for it, and provide it free of charge to the whole population. In parallel with the development of primary health care, the hospital sector should also be rationalized. Many of the existing hospitals have low occupancy rates and pose a cost burden on the health sector. As equipment is generally old and technologically out-dated, the consolidated establishments would offer the opportunity not only to reduce costs but also to provide higher quality services. There is already a strong foundation for the health information system at the national level, but there is urgent need for an accurate system of vital statistics upon which to base the critical indicators of the impact and efficiency of the health sector. Without such a system, it is difficult to target specific populations, principally the poor, to better direct activities. Interactions also need to be strengthened with other important agencies and ministries that regulate or provide services which impact on health services, like education, the environment, water and housing.
Policy Recommendations on Health

- The health reform efforts of the Ministry of Health need to continue to focus on improving the capacity to provide accessible and good quality primary care services. The key reforms include revolving drug funds, training in up-to-date clinical procedures for primary care, the provision of basic equipment, and health education.

- In parallel with the development of primary health care, the hospital sector should also be rationalized. To make better use of limited resources, some hospitals could be closed or limited in function, consolidating services in centralized units. Usually, some refurbishment would be required as well as the purchase of professional equipment. Staff would also need to be reallocated and rationalized in order to better meet the needs of the population.

- Given the importance of immunization as an effective health measure, it would be advisable for the state to show a separate budget for vaccines in a protected sub-category of the budget which would be financed annually through the state budget.

- The WHO-promoted Directly Observed Treatment Strategy (DOTS) for tuberculosis should be continued, to halt the hidden epidemic and decrease mortality in the next few years. In order to expand this program nationally, considerable resources would be required to train health care personnel, provide drugs, and expand the educational component. However, these costs could be somewhat offset by consolidating some of the existing tuberculosis hospitals which are currently functioning at low capacity.

- Good prescription practices need to be promoted including through the formulation of standard drug lists, the revision of standards of treatment, the education of physicians and patients, and the monitoring of drug use through rapid survey techniques.

- Revolving drug funds should be continued and then evaluated for nationwide application.

- To protect the poor from the costs and suffering of abortions, modern methods of contraception should be made available to them. This entails active promotion, education and accessibility to modern methods to a degree not presently available.

- A key strategy for improving all health services, including those for the poor is to make better use of existing resources. This means improving management on all levels, particularly at the regional level. This involves not only financial management, but also expert planning and decision-making based on adequate information, the anticipation of problems and creative problem solving, and the management, supervision and motivation of human resources.

- One of the main areas for improvement of Government efforts in the public health sector is assuring access of the poor to health care services. While under the current system, there exist at least twelve groups of citizens that are supposedly exempt from paying fees in public facilities, this policy does not seem to work in practice since the health care system is plagued with informal payments. There is a need to address the issue of unofficial payments in the sector since they disproportionately affect the poor.
The public health budget needs to be enhanced and allocated in a manner that reflects population needs and distribution. This increase should only proceed in parallel with reforms in the sector to improve the efficiency of resource use.

Consideration needs to be given to defining a basic health care package free of charge to all residents. The basic services should include: (i) education concerning prevailing health problems; (ii) maternal and child health care, including family planning; (iii) immunization against the major infectious diseases; (iv) prevention and control of locally endemic diseases; and (v) provision of essential drugs.

At present, there are some significant differences in the amount of money the regions receive per capita. The resources of the poorest regions should be increased to bring them at least up to a scale with the others. As the available funding for health services is so limited, however, these small increases may not be expected to have much impact nor to benefit the poor necessarily. Over the long term, it will be important for the budgetary system to allocate resources taking into account the disease burden and patterns. More flexibility in reallocating funds between line items should also be considered.

The existing strong foundation for the health information system at the national level needs to be extended by improvements in the system of vital statistics.

The MOH and other sectors and institutions all need to participate in an effort to address public health problems due to the unhealthy lifestyles of the population. Housing is of critical importance as a measure for reducing disease, particularly tuberculosis. Health education also needs to be introduced into the curricula of the schools.

C. Protecting the Vulnerable.

1. Social Protection. An effective anti-poverty program will need to include social assistance for those in special need and who are not able to benefit significantly from the other programs designed to create more employment and a high rate of general economic growth, and programs to strengthen basic services and priority infrastructure for the poorer members of the community. Unfortunately, the existing social protection system does not make a major important contribution to poverty reduction due to lack of targeting and the low level of benefits.

The current social protection system is built on two components: a social insurance system that provides mandatory insurance for old age, illness, disability and unemployment; and a social assistance that provides non-contributory, tax-financed cash benefits targeted to certain categories assumed vulnerable or poor. In principle, the first component provides the means to mitigate social risks, while the second provides enhanced coping capacity for the poor and the vulnerable. While pensions do reduce substantially the poverty gap, the social assistance programs have only a modest impact. Most of the social assistance benefits are too small to reduce the consumption deficit of the poor. Also, in most cases they do not target the poor and there is significant leakage of resources to the non-poor. While public spending on social protection is still substantial, it has declined considerably in recent years and it is not realistic to increase transfer payments to the extent that would be necessary to raise all households up to even a very modest poverty line. Nevertheless, improving the social safety net needs to be a central part of the poverty reduction strategy, and Government spending needs to be maintained at a sufficient level to allow a reformed and targeted program to be developed for those genuinely in need of support. These programs are, therefore, in urgent need of reform.
The Government has made a good start to the process of pension reform with the transfer of the financing of social pensions to the state budget. The challenge now is for the Government to follow through on the reform plans and for the draft legislation to be approved and implemented. The draft Law on Pension Provision is commendable, in that it aims to enhance financial sustainability, improve contribution incentives, enhance the pension system’s transparency by eliminating discretionary rules, eliminate existing inequities within the system by rationalizing early retirement provisions and equalizing the male and female retirement age, and would establish a greater distinction between contributory and non-contributory pensions.

The Government acknowledges that there are targeting problems with the existing social safety net, and is committed to revise social assistance benefits and to improve targeting, along with improvements in poverty monitoring and evaluation capabilities. The development of targeted social assistance instruments to alleviate the impact on the poor of the new public utility policies will be of the utmost importance, as the new energy policies will definitely impact households, some of whom are poor. There are several options which could be considered by the Government: life-line tariffs, the burden limitation approach, and/or compensation to poor households for part of their utility bills above a given share of household income. Given the particular circumstances of the Azerbaijan economy, efficient targeting would not be simple to achieve. This is because poverty is pervasive and diffuse, and informal income tends to be a large part of total income. However, there are several possible main targeting mechanisms, such as means testing, proxy means tests, geographic and demographic targeting, which could be considered. Of these, proxy means testing is probably the best approach in the short term, and the Government may wish to explore its possibilities further with technical assistance.

While public spending on social protection is still substantial, it has declined considerably in recent years, and it is not realistic to increase transfer payments to the extent that would be necessary to raise all households up to even a very modest poverty line. Nevertheless, improving the social safety net needs to be a central part of the poverty reduction strategy, and Government spending needs to be maintained at a sufficient level to allow a reformed and targeted program to be developed for those genuinely in need of support. It is, therefore, encouraging that social protection expenditures are projected to increase as a proportion of budgetary expenditures over the coming three years from 16 percent in 2000 to 18.6 percent in 2005.

Policy Recommendations on Social Protection

- Due to lack of targeting and low level of benefits, the existing social protection system does not make a major important contribution to poverty reduction. While pensions do reduce substantially the poverty gap, the social assistance programs have only a modest impact. Most of the social assistance benefits are too small to reduce the consumption deficit of the poor. Also, in most cases, they do not target the poor and there is significant leakage of resources to the non-poor. These programs are, therefore, in urgent need of reform.

- The level of the pensions needs to be adjusted to reflect contribution history. All non-pension benefits also need to be separated from the social insurance system. The minimum pension guaranteed in the labor system needs to be differentiated from the social pension. The non-targeted flat allowance for pensioners, financed from the state budget, should be reassessed; and for current pensioners, the labor pension and the flat allowance could be consolidated into a single benefit and the minimum pension guarantee could incorporate the value of the allowance.

- The Government has made a good start to the process of pension reform with the transfer of the financing of social pensions to the state budget. However, further revisions to the pension system are
needed, and they should pay particular attention to the principles of financial viability, transparency (to enhance the system's credibility and minimize distortions), and fairness (so that individuals with similar contribution levels receive similar benefits, each contribution year receives an equal value, and those retiring at higher than the minimum statutory age are properly compensated). Early retirement provisions should be minimized or even eliminated.

- Regarding the social safety net, it is also very encouraging that the Government acknowledges that there are targeting problems and is committed to revise social assistance benefits and to improve targeting. It is hoped that the planned comprehensive social assistance reform strategy would be developed urgently, along with the planned improvements in poverty monitoring and evaluation capabilities.

- The development of targeted social assistance instruments to alleviate the impact on the poor of the new public utility policies will be of the utmost importance, as the new energy policies will definitely impact households, some of whom are poor. There are several options which could be considered by the Government: life-line tariffs, the burden limitation approach, and/or compensation to poor households for part of their utility bills above a given share of household income.

- Given the particular circumstances of the Azerbaijan economy, efficient targeting would not be simple to achieve. This is because poverty is pervasive and diffuse, and informal income tends to be a large part of total income. There are several possible main targeting mechanisms, such as means testing, proxy means tests, geographic and demographic targeting. Of these, proxy means testing is probably the best approach in the short term, and the Government may wish to explore its possibilities further with technical assistance.

2. Internally Displaced People. The assistance provided by the Government in support of IDPs represents the single largest social protection program in the country. In recent years, there have been some important new pilot initiatives to support the return of IDPs to their original homes, through rehabilitation and income generation activities. Government support for IDPs does reduce the extent of poverty among them, but it does not rely on any evaluation of individual vulnerability or need and there is need to increase the efficiency of targeting of the support to IDPs. The approach to poverty reduction among IDPs needs to involve a range of Government ministries and agencies, state-owned enterprises, international donors and NGOs.

The IDPs are presently entitled to a range of benefits, but the two most important are the provision of bread money and the across-the-board exemption of IDPs from utility payments (most importantly, for electricity). In addition, for several years, IDPs have been provided with temporary land as part of the Government's strategy to reduce poverty among them. This is clearly very important, due to the correlation between access to land and poverty reduction, and it has had some impact on poverty among the IDPs. However, not all IDPs, even in rural areas, have access to land. In recent years, there have been some important pilot initiatives to support the return of IDPs to their original homes, although this program is, by its nature, limited to those who came from areas which are under Azerbaijan's control. Beginning in 2001, the Government initiated a new strategy of providing more permanent provision of land (with tenure of ownership), together with relocation and construction of houses and other infrastructure. This represents a major step for the IDPs who remain displaced and with no immediate opportunities to return home. It is too early to tell how successful these programs will be, but the initiative has very strong merits. However, the resettlement of large groups of people is a very complex multi-sectoral process and requires close attention and monitoring. While the recent expansion of the land distribution programs for IDPs is likely to help to address this problem for some of the IDPs in the rural areas, it will not be insufficient to reduce poverty among other IDPs settled in urban areas. This is a critical issue, as the rate of extreme poverty is higher among IDPs in the urban areas, particularly in Baku,
than in the rural areas. Another strategy adopted by the Government to address the unemployment problem has been through the Social Fund Development Initiative (SFDI), which was originally designed to rehabilitate small-scale infrastructure for IDPs. While also being an important initiative, infrastructure rehabilitation does not necessarily address the key unemployment problem. Efforts are now being undertaken to shift the emphasis to the establishment of micro-credit facilities and support existing efforts of international NGOs, as well as through the financing of business and other training for IDPs.

Nevertheless, current Government policy, for the most part, does not distinguish between differing degrees of poverty of individual IDP households, but instead makes a group determination in terms of eligibility for benefits. In order to improve the efficiency of targeting and to channel existing resources to further enhance the quality of life of the most vulnerable among the IDP population, an alternative methodology is required to identify those who are most in need. For the future, it is unlikely that the objective of employment generation for IDPs can be dealt with solely by programs which explicitly target the IDPs. It is perhaps more important for the IDPs in the long run for there to be investment in the general socio-economic development of the regions below the national level, in line with the priority placed by the Government in expanding non-oil sector employment. Indeed, the IDPs need to be integrated into the mainstream society, before their skills and entrepreneurial behavior are undermined further and lost. It will also be important that efforts are focused particularly on those IDPs who fall below the poverty line. Finally, the approach to poverty reduction among IDPs will need to involve a range of Government ministries and agencies, state-owned enterprises, international donors and NGOs. Whether the nature of IDP strategies in the coming years involves the planning of reconstruction and return initiatives following an eventual peace accord, or whether it continues along its present course of working in various ways to invest in the self-reliance of IDPs during displacement, many actors will continue to be involved within line ministries and in a range of other institutions inside and outside of Government. The coordination of all of these diverse actors is essential if opportunities for helping IDPs are to be maximized.

Policy Recommendations Related to IDPs

- There should be regular monitoring of the living standards and poverty rates among IDPs, both to test the conclusions of the current poverty assessment (including the relatively higher level of poverty among urban IDPs) and to contribute to the future planning of IDP strategies. Eventually such monitoring should be integrated with existing quarterly household surveys through special sampling of IDPs to ensure comparability of data. A first step would be to repeat the July 2002 IDP survey during the winter months to ensure that the current survey results were not affected by distortions due to seasonal employment strategies of IDPs. Poverty monitoring should also include IDPs who have returned home in Fizuli and other rayons, as well as IDPs and refugees who have been relocated under provisions of recent presidential decrees to ensure that programs are achieving their objective of building self-sufficiency.

- The Government should review its current entitlement programs for IDPs and implement measures to base public transfers to IDPs on vulnerability criteria to maximize the impact on the living conditions of the most vulnerable IDPs. In parallel with a restructuring of transfers, and priority should be given to ensuring that IDPs have full access to basic health and education services, and that suitable publicity is given to the support measures.

- Existing safety net and employment strategies for IDPs should re-evaluate their regional targeting and look more closely at the situation of IDPs (and refugees) in Baku and other urban centers due to the high levels of poverty among IDPs in urban areas.
• Programs such as SFDI and other initiatives supported by the Government and donors should emphasize the generation of sustainable employment opportunities for IDPs in their activities. This might include the reprogramming of existing resources. The specific obstacles causing higher levels of IDP unemployment need to be explored through both quantitative and qualitative methodological tools.

• Programs to relocate IDPs and provide secure title to agricultural land should be expanded where possible to provide new opportunities for rural based IDPs and for those urban-based IDPs who wish to voluntarily take advantage of such opportunities. However, it is also critical that early programs be viewed as pilots and include intensive monitoring and consultation with IDP participants to maximize the chance of success and to learn lessons useful for expanded programs.

• Approaches to IDPs should maximize the support of existing social organizations among the IDP communities and seek to empower IDPs. While many IDP communities have been fragmented by displacement, many communities from specific rayons of origin have been able to settle together and keep in close contact.

• There should be a review of the role of the SFDI, including ways to improve its operational efficiency, to expand partnerships with international NGOs already involved in micro-level programs, and to learn from the experiences and find channels to directly invest in an expansion of promising activities.

• IDP employment strategies cannot be confined to IDP-specific programming but also need to feed into national strategies for investment in the regions with high IDP concentrations.

• There is need for the Government to develop capacity to coordinate and monitor the progress of IDP initiatives; integrate the lessons from existing initiatives into future IDP programming; plan for future programming and design IDP strategies, taking into account the appropriate roles of the line ministries, the SFDI, ARRA and the State Committee for Refugees. It is further recommended that a small unit with specialized professionals be placed at a senior level in the Government, ideally within the office of the Deputy Prime Minister or at a similar level.

• It may be advisable for the Government to acquire international technical assistance to develop systems to implement and monitor relocation programs. The international experience with resettlement programs demonstrates the high risk of complications arising in such programs and international technical assistance may help to avoid problems which have occurred in other countries. The Government is also encouraged to promote contacts with counterparts in other countries to share experiences and contribute to the development of innovative approaches to the self-reliance of IDPs in Azerbaijan, as well as to permit other countries to benefit from the experience of Azerbaijan in its efforts to improve the situation of IDPs.

D. Monitoring of Living Standards

Poverty monitoring. Both to monitor the effectiveness of the Government's programs, and to be able to target support to those most in need, it will be necessary for further steps to be taken to strengthen the capacity to collect and analyze the necessary data. The effort to improve data collection for the monitoring of living standards that began in 1999 with the implementation of the Household Budget Survey (HBS) needs to continue.
- The Government needs to ensure that the collection of data on the labor market, education and health follow internationally accepted definitions to allow better comparability between the living standards of Azeri people and other countries, and facilitate monitoring of progress towards the Millennium Development Goals (MDG).

- Some strengthening of the HBS is needed. Consideration could be given to the collection of the data only during a particular period of the year, or organizing the survey as a two-period panel. The measurement of welfare should move from the current definition of expenditures toward the economic concept of consumption. The labor market, education and health information should be collected using internationally accepted definitions. The training of the interviewers should also be improved, and the survey should have a flexible design that can quickly respond to the demand for policy analysis in any period.

- In some dimensions of well-being, such as consumption poverty, access to safe water, infant and maternal mortality, Azerbaijan face serious development challenges and needs steady and significant progress to achieve the related MDGs.

- For some targets, such as infant mortality, maternal mortality, prevalence of HIV, progress towards the MDGs is difficult to measure, and efforts are needed to improve the collection of accurate information.

- One particular area where progress towards the MDGs is clearly insufficient is in access to safe water in rural areas. To advance toward the achievement of this particular target, the Government should give high priority to rural water investments in its public investment program.