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POVERTY REDUCTION STRATEGY PAPER

AND

JOINT IDA-IMF STAFF ASSESSMENT OF THE PRSP:

STATE PROGRAMME ON POVERTY REDUCTION AND ECONOMIC DEVELOPMENT (2003-2005)

April 15, 2003

Poverty Reduction and Economic Management Unit
South Caucasus Country Unit
Europe and Central Asia Region

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
ARWC	Aspheron Regional Water Company
BEEPS	Business Environment and Enterprise Performance Survey
BTC	Baku-Tbilisi-Ceyhan
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investments Advisory Services
GDP	Gross Domestic Product
HBS	Household Budget Surveys
HIV	Human Immunodeficiency Virus
IAS	International Accounting Standards
IDA	International Development Association
IDPs	Internally Displaced Populations
IFIs	International Financial Institutions
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction and Strategy Paper
MDGs	Millennium Development Goals
MTEF	Medium Term Expenditure Framework
NGOs	Non-Governmental Organizations
OSCE	Organization for Security and Cooperation in Europe
PER	Public Expenditure Review
PIP	Public Investment Program
PRSP	Poverty Reduction and Strategy Paper
PRGF	Poverty Reduction Growth Facility
SAC	Structural Adjustment Credit
SME	Small and Medium Enterprise
SOCAR	State Oil Company of Azerbaijan Republic
SPPRED	State Programme on Poverty Reduction and Economic Development
SSC	State Statistical Committee
SWG	Sector Working Groups
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund
USAID	United States Agency for International Development

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INTERNATIONAL DEVELOPMENT ASSOCIATION
AND
INTERNATIONAL MONETARY FUND

AZERBAIJAN

Joint Staff Assessment of the Poverty Reduction Strategy Paper

Prepared by Staffs of the International Development Association
and the International Monetary Fund

Approved by Johannes Linn and Gobind Nankani (IDA)
And Julian Berengaut and Martin Fetherston (IMF)

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THE INTERNATIONAL DEVELOPMENT ASSOCIATION
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1. OVERVIEW

1. **The State Programme on Poverty Reduction and Economic Development 2003-2005 (SPPRED) is the first full poverty reduction strategy paper (PRSP) of Azerbaijan.** It builds on the interim report (I-PRSP) presented to the Boards of the International Monetary Fund (IMF) and the International Development Association (IDA) in June 2001. The SPPRED represents an important milestone in Azerbaijan's ongoing efforts to elaborate a comprehensive, home grown strategy for poverty alleviation and economic growth. It marks the start of a comprehensive dialogue on the overall development strategy between the government and all key stakeholders. Recognizing that "poverty alleviation measures cannot be formulated just by national governments and donor organizations", the program deepens the involvement of the representatives of civil society in the formulation process.

2. **The SPPRED represents a joint effort between the government and civil society in the country.** It relies on the input of 15 Sector Working Groups (SWG) established at the respective ministries and including civil society representatives along with the government officials. The efforts of these working groups were coordinated in the PRSP Secretariat at the Ministry of Economic Development. Six key strategic aims were identified: (i) the facilitation of an enabling environment for growth of income-generating opportunities; (ii) the maintenance of macroeconomic stability; (iii) the improvement in the quality of and equity in access to basic health and education services; (iv) the improvement of infrastructure (including roads, delivery of utility services, communications, irrigation); (v) the reform of the current system of social protection to give more effective protection to the vulnerable; and (vi) the improvement of the living conditions and opportunities for the one million refugees and Internally Displaced People (IDP) of the Nagorno-Karabakh conflict.

3. **There remain areas where progress needs to be made during the implementation and subsequent updates of the SPPRED**. The poverty analysis has improved compared to the I-PRSP. 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. For the government to target support to those most in need, it is important to further strengthen the capacity to collect and analyze data. The government also 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 (MDGs). Furthermore, the links between the poverty diagnosis, poverty reduction strategy objectives, and priority actions need to be further strengthened. Further progress is also needed in the areas of costing and prioritization of policy actions presented in Appendix 1 for future updates to enable the authorities to effectively fight poverty within the available resource envelope. In this regard, financing requirements and sequencing for priority SPPRED actions need to be further defined and linked with annual budgets within the Medium Term Expenditure Framework (MTEF) and Public Investment Program (PIP). Successful implementation of the SPPRED also calls for continued institutional capacity building within the government for strategy formulation, implementation, monitoring and evaluation, and resource management. Achieving better allocative and operational efficiency will be particularly important in view of rising oil revenues in the coming years, as outlined in the recent Public Expenditure Review (PER). At the same time, efforts must be undertaken to ensure continued and broad civil society participation in further policy development.

2. THE PARTICIPATORY PROCESS

4. **The SPPRED is based on a participatory process involving all branches of government, parliament, civil society, the private sector and donors—reflecting the recommendations outlined in the Joint Staff Assessment of I-PRSP**. The SPPRED was launched at a major workshop bringing together these stakeholders. To assure cross fertilization between the SWGs a number of roundtable discussions were held. A large number of focus group discussions and individual interviews were conducted throughout the country to capture the opinions of those most affected by poverty. The SPPRED commits to an even more expanded and intensified participation process during the implementation phase.

5. The program identifies the government, parliament, the national and international NGOs, media and the municipalities as the main players of the policy formulation process. **The consultation process revealed that communities have reasonable capacity to mobilize resources to resolve the most immediate needs of poverty reduction**. However, people living in remote areas feel socially excluded and are more skeptical and apathetic about the prospects for improvement, and participation amongst women remained low. In view of this, staffs encourage further community development as an important part of the poverty reduction strategy implementation. Support and further development of municipalities will also contribute to the improvement of basic social service delivery.

6. **The SPPRED views giving a genuine voice to the poor as an important challenge for the implementation and monitoring stages of the PRSP process.** It emphasizes the importance

of a properly organized monitoring system that would help evaluate the effectiveness of the policy measures, and specifies the role the civil society, international organizations and donor community can play in the regular monitoring process of SPPRED. The staffs recommend to fully utilize the capacity of the civil society in data/information collection through the involvement of NGOs and other independent institutions in qualitative research activities.

7. **The authorities have actively involved international financial institutions (IFIs) and donors throughout the preparation of the SPPRED.** Donors have provided significant technical and financial support from the outset.[1] This was crucial in supporting preparation of a number of analytical studies that helped in formulation of the SPPRED, including a poverty assessment prepared jointly by the World Bank and the government. A series of Town Hall Meetings encouraged by USAID continued the dialogue between Azeri citizens and the government. Overall, such broad and open discussions were a new experience for Azerbaijan. To ensure broad-based ownership of the reform agenda as part of the SPPRED it will be necessary to further strengthen the participatory process. Institutionalizing the participation, developing capacity of the key players in the process, and enhancing the role of Parliament in particular will help achieve that objective. A professionally designed and executed two-way communication strategy could be key in this respect.

8. The SPPRED process received coverage on both TV and radio. **The highlight was the PRSP workshop in October 2002, which was chaired by President Aliyev and aired on TV.** Currently, the PRSP Secretariat is setting up a comprehensive reference library. Regular coverage both in the broadcast and print media are being considered to ensure dissemination of information during the implementation stage. In addition, the staffs support the ongoing development of the government's dedicated PRSP website.[2]

3. POVERTY DIAGNOSIS

9. **The SPPRED poverty diagnosis is based on representative household data and was produced in collaboration with the Bank's Poverty Assessment 2002.** While the State Statistical Committee (SSC) has been carrying out regular Household Surveys for decades, its original form was not adequate for poverty monitoring or for measuring the impact of social policies. Therefore, a new household budget survey was introduced in January 2001. The sample (8000 households achieved through full quarterly rotation: 2000 new households participate in the survey each quarter) uses three-stage probability sampling with preliminary stratification by urban and rural areas and by region. The poverty analysis of the SPPRED is based on the representative 2001 HBS. A few more years of consistent HBSs would be needed in order to develop an

[1] In addition to the Fund and the World Bank, the ADB, the EBRD, EU, UNICEF, UNDP, USAID, and other donors have been closely involved in developing the SPPRED.

[2] www.economy.gov.az/PRSP/Index_PRSP.htm

satisfactory analysis of the impact of growth on poverty, especially given the dichotomy between the oil and the non-sectors. Such an exercise would be important to pursue.

10. Poverty remains a major challenge in Azerbaijan. Azerbaijan is a country with about 8 million population and per capita gross domestic product (GDP) of $650. **Almost 4 million people or about 50 percent of population of Azerbaijan lived in poverty in 2001, consuming less than AZM 120,000 (US$25) 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 (US$15) per capita per month.

11. **It is clear that the IDPs are a core group of particularly vulnerable people, as they lack assets and their livelihood depends heavily on state transfers, or 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.

12. **The HBS survey needs to be strengthened further**. In particular, the measurement of welfare should move from the current definition of expenditures toward the economic concept of consumption. 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. Furthermore, the discrepancy between official statistics and survey data points to a weak system of reporting in the public health system, and to the fact that many households are reluctant to use public facilities from which the official statistics are generated. Therefore, to monitor the progress on specific MDGs, such as infant mortality, maternal mortality, HIV, additional monitoring efforts beyond the HBS are needed. Efforts should also be made to review the living conditions of IDPs. This work could build upon the IDP survey carried out by the World Bank and UNDP. Finally, it will be important to monitor and mitigate the distributional and poverty impact of the ongoing and envisioned reform program.

4. PRIORITY PUBLIC ACTIONS

13. **The broad policy priorities of the SPPRED are appropriate**, and the six pillars discussed above are consistent with the multi-dimensional nature of poverty alleviation. The policy matrix set forth in the SPPRED is generally consistent with these pillars.

14. **With the SPPRED the authorities made a good attempt at costing, prioritizing and sequencing policies**. However, there is a need to improve cost estimates. The staffs see this as a serious shortcoming of the SPPRED and further capacity building effort will be needed in this area. An appropriate tool for better costing, prioritization and sequencing of the plan is the recently

introduced MTEF. As articulated in the new PER, full implementation of the new Budget Systems Law and integration of the SPPRED with the stipulated budget planning process and procedures is important. The PER will also be helpful in communicating a coherent and feasible reform agenda to civil society.

MACROECONOMIC FRAMEWORK, FISCAL CHOICES, AND FINANCING PLAN

15. **The medium-term macroeconomic framework aims to achieve balanced economic growth and a stable macroeconomic environment as the basis for a sustainable poverty reduction effort.** The macroeconomic framework targets a low inflation rate of around 2-3 percent per annum and projects real GDP growth of about 11 percent per annum, over the period 2003-05. [3] These targets are realistic given the real growth performance of around 11 percent and inflation of 2.3 percent on average over the last three years, and expected future growth in the oil sector with spillovers to the non-oil sector. Real growth in the non-oil sector is projected to average 9.7 percent in 2003-05, and will be critical for successful poverty reduction. The SPPRED rightly recognizes that careful macroeconomic management will be critical to achieving balanced growth between the oil and the non-oil sector given the expected large net FDI influx and even larger oil export revenues in the future. The SPPRED, therefore, could have benefited from a detailed analysis of the sources of future non-oil sector growth. The oil-sector is forecast to receive a major boost in 2005 with a growth rate of 41 percent that year. While such a rapid expansion of the oil sector—which now comprises 1/3 of the economy—runs the risk of impeding growth in the non-oil sector, the foreseeable rapid profit repatriation and the planned build up of the State Oil Fund will limit the Dutch disease risks. The staffs encourage the authorities to discuss the implications to all aspects of the SPPRED of any revisions to the macroeconomic framework, which are made over time to reflect changes in the economic outlook, in the context of the participatory process going forward.

16. **The medium-term fiscal policy supports the objectives of the SPPRED, while it aims at the same time to ensure macroeconomic stability.** The consolidated government deficit is projected to remain roughly stable at 2 percent of GDP between 2003 and 2005. Prudent assumptions about available resources and sustainable levels of borrowing provide a realistic resource envelope for overall expenditure plans. Staffs agree with the cautious use of Oil Fund assets and limited reliance on external borrowing. Staffs recommend that the authorities develop a long-term strategy for the use of oil revenue while taking into account Dutch disease effects.

17. **Given the expected growing importance of the oil sector, the SPPRED would have benefited from including alternative medium-term macroeconomic scenarios** which explored the effects of large oil price changes on the economy and the poverty reduction strategy and

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[3] Differences between the macroeconomic framework in the SPPRED and the most recent Letter of Intent for the PRGF arrangement reflect the fact that the PRSP macroeconomic framework was finalized some months before the PRGF framework. The government has acknowledged, in writing, that the macroeconomic framework for the PRGF is consistent with the SPPRED framework, updated to reflect new information and developments in such things as oil prices.

discussed contingencies and policy options. Overall, Azerbaijan has attained a relatively solid track record of macroeconomic stability, but the country is clearly vulnerable to volatility in world oil prices.

18. **The fiscal choices in the SPPRED are consistent with the policy objectives, but mechanisms to allocate expenditures are at an early stage of development**. The MTEF targets a significant increase in the share of capital spending in overall expenditures in an effort to meet urgent infrastructure needs. While Staffs agree with this objective the authorities need to strengthen the PIP to ensure a prioritized project selection. Expenditure goals for other items such as public wages, social transfers and spending on health and education are reasonable. However, expenditure choices should be more closely tied to underlying reform plans and more work is needed to flesh out the expenditure implications of these structural reforms.

19. **Development of further fiscal policy indicators and an analysis of the implications of alternative economic scenarios would greatly enhance the MTEF as a policy instrument.** Staffs encourage the government to use alternative policy measures such as the non-oil deficit, which reflect the reliance on the oil sector and provide indicators of the underlying fiscal impulse. Furthermore, in discussing alternative scenarios the government would need to determine fiscal priorities and develop contingency plans.

20. **The SPPRED's assessment of the availability of domestic and external financing is broadly reasonable, while incorporating debt sustainability concerns.** External financing to cover budgetary financing gaps have already been committed or are in the process of being negotiated, and donor financing for infrastructure projects are consistent with scheduled disbursement commitments and indications that generous donor support will continue. The contribution from the World Bank, according to the CAS, may be somewhat less than anticipated in Appendix 2 of the SPPRED. The Staffs welcome the authorities' intention to contract new external borrowing on concessional terms and to limit state debt to no more than 30 percent of GDP (publicly and publicly guaranteed external debt was 23 percent of GDP as of 2002), in the context of ensuring debt sustainability.

STRUCTURAL AND SECTORAL POLICIES

21. **The SPPRED recognizes the central importance of good governance and public resource management for poverty reduction. Perhaps the most significant development in public finance in recent years in Azerbaijan has been the establishment of the State Oil Fund**. It has among other things significantly improved the transparency and accountability of oil sector revenue, and together with the restructuring of SOCAR that is now under way, has provided the foundation for a meaningful consultation with the civil society on the use of these resources. The government is committed to exercise considerable caution over the use of the expected oil and gas windfall and to ensure that the benefits resulting from the exploitation of this natural asset would accrue to all citizens and to future generations. This cautious approach of the government is deemed even more essential given the fiscal institutional reforms presently underway and the need to implement the SPPRED within a sustainable MTEF and a consistent PIP. Rapid implementation of the new Budget Systems Law is key, including the agreed amendments to ensure full integration of the State Oil Fund in the consolidated budget expenditure envelope approved in the annual

Budget Law. While the SPPRED notes the progress made with respect to the State Procurement Agency and the Chamber of Accounts, the action plans of the recently completed Country Procurement Assessment Report (CPAR) and the Country Financial Accountability Assessment (CFAA) should be incorporated in the government agenda. Likewise corporate governance and accountability of SOCAR, Azerenergy, Azerigaz, and the ARWC need to be improved, and implicit untargeted subsidies made explicit and targeted at the poor.

22. **The SPPRED recognizes the importance of attention to the institutional agenda including the structure, administration, and remuneration of the civil service**. What has not been fully articulated is a concept of the type of central government structure that would be suitable for a market economy in the context of Azerbaijan. This involves setting up criteria and principles for existing ministries, state committees and the Cabinet of Ministers, to guide a civil service reform strategy that encompasses all aspects of a professional and modern civil service. While it is recognized that the structure of public administration in the country as a whole and its institutional capacities cannot be transformed in a short time frame, there ought to be a guiding blueprint for change with time bound targets. This should include: (i) rationalization of public sector employment; (ii) a unified and decompressed public sector pay scale; (iii) avoidance of across the board cuts in the wage bill; and (iv) monetization of in-kind supplements through integration with the pay scale. There is also a need to recognize, and address, the burden placed on the poor by petty corruption by civil servants, including the need to pay bribes to educators, health professionals and police officers.

23. **The SPPRED should recognize the need to empower line ministries to effectively participate in the budget preparation process**. Stronger links should be made between budget allocation decisions and operational outcomes. As the new Budget Systems Law is implemented, the government could move from allocating resources based on norms to a more "program/performance" based budget model.

24. **The SPPRED identifies the need to further define the government's decentralization strategy and in particular the role of municipalities.** The staffs recommend this task be given high priority to ensure that the objectives and goals set out in the SPPRED are not undermined by confusion about responsibilities at different levels of government. This would be particularly dangerous with regard to future public investment activities, which may involve capital expenditure from a line ministry but maintenance and operational expenditure commitment from local government. Successful implementation of the public expenditure envelope is possible only with an appropriately decentralized fiscal system that is transparent and accountable. A government body in charge of municipal issues should define the policy of the government on decentralization and to coordinate and address local matters. The intergovernmental fiscal framework between the central government and the municipalities would include the creation of a transparent fiscal transfer mechanism and the finalization of the transfer of state properties to municipalities. Financial, technical, and managerial capacity of the newly created municipalities need strengthening.

25. **A comprehensive plan to strengthen the financial sector is a key component of the SPPRED.** The program identifies measures to be undertaken to strengthen bank supervision, and improve the regulatory framework. It also identifies near-term actions to privatize remaining state-

owned banks, and to strengthen the payments system, establish a centralized collateral registration system, and other essential components of financial sector infrastructure. The staffs believe that, with proper implementation, these concrete actions should help significantly in allowing the banking system to play its proper role in facilitating financial intermediation. One aspect that could be supported more aggressively is the building of banking infrastructure that would allow banks to push into retail more quickly. The role of the Postal service could be expanded to include terminals for smart-card payment systems. In addition, tendering for the provision of banking services to the government could improve competition in the banking sector. The staffs note that proper sequencing and design of financial sector reforms are essential for success. The planned deposit insurance scheme should be implemented only when the preconditions for deposit insurance viability are fulfilled. In addition, reforms in regulations such as capital requirements should be designed to effectively strengthen viable banks, rather than forcing banks to raise capital independently of the risk profile of their activities. By contrast, the SPPRED lacks an agenda to develop the capital market, contractual savings institutions, and leasing. While pension reform is featured as an important component of the social safety net, the financial sector side necessary for a viable pension system is not elaborated. Also, there is undue emphasis in the SPPRED on access to credit rather than financial services, and it lacks an agenda to develop non-bank financial institutions, including the development of infrastructure for the insurance sector.

26. **The SPPRED recognizes balanced growth as key to sustainable economic development and poverty reduction.** To develop the non-oil sector, the SPPRED identifies three types of government policies: public finance policy, regulation and privatization. It acknowledges the need for continued transformation of economic activity from the public to the private sector; a sound legal and regulatory framework (particularly reducing administrative barriers to private investment and SME development); good corporate governance principles (particularly introduction of international standards for accounting and auditing and effective commercial dispute resolution mechanisms); and export development (particularly through increasing the role of processing industries, further improving the customs and tax policies). While the staffs support the development of infrastructure to encourage export development, it will be important for the government to avoid the temptation to engage in industrial policies that involve "picking winners." Additional efforts are needed in ensuring enforcement of legislative reforms; in specifying concrete policy actions and timetable for elimination of administrative barriers; and in enhancing partnership with business clusters for articulating specific actions and programs geared to increase quality and consistency of production for export markets. While a uniform cut in profit taxes may be considered for the non-oil sector, the staffs would advise against using tax policy for regional or sectoral incentives. Rather, the staffs recommend construction of physical infrastructure, including the rapid reconstruction of reliable power and gas supply, as well as financial infrastructure in the regions outside Baku.

27. **Sustaining agricultural growth and developing agro-processing clusters are critical for the country's poverty reduction efforts in the medium term.** The lower poverty prevalence in rural relative to urban areas can to a large extent be attributed to the successful land reform and privatization. The SPPRED rightly puts the development of agriculture in the context of an integrated rural development policy including linkages to non-farming activities such as agro-processing, industry, handicrafts, retail, distribution, transport, construction and other aspects of rural infrastructure, and taking into account environmental concerns. Irrigation systems are in

urgent need of rehabilitation and repair. That will require both investment and a system for financing ongoing maintenance. The government has stated its intent to do this, but complementary reforms are needed to ensure that over time the ownership and management structures for these systems provide for better cost recovery and meet maintenance requirements. The development of rural finance cooperatives should be encouraged, as should the government's programs to develop alternative models of agricultural extension services that are more relevant and financially sustainable. The staffs welcome the strong linkages made in the SPPRED between rural development and environmental sustainability.

28. **The SPPRED discusses comprehensively the needs in the education and health sectors.** The overview of both the health and the education sectors provides a sound assessment of progress with reforms to date, the need for additional budgetary allocations, especially in the health sector, and the major challenges ahead. However, the action plans outlined for both sectors would benefit from greater attention to prioritization and sequencing. The staffs believe that the first priority should be to provide education of acceptable quality in the compulsory cycle of education. Staffs agree with the SPPRED's conservative expenditure envelope for the education sector. Budget funds should be reallocated across expenditure lines to realize cost-savings. On the other hand, proposals to exempt educational institutions and their suppliers from tax and customs payments would be counterproductive, as they would create opportunities for tax evasion and would counter efforts at simplifying and enforcing tax procedures throughout the economy. Furthermore, the government would promote private sector involvement in the education sector by removing the existing barriers to entry, such as Article 28 of the 1992 Educational Law, which prohibits for-profit private schools.

29. **The health sector requires immediate attention.** Undoubtedly, there is a need to progressively increase the budgetary proportions devoted to health care. But what is critical is a fundamental realignment of the approach toward the delivery of health services as outlined in the SPPRED. A move toward an outpatient-oriented approach with emphasis on primary health care would improve efficiency. For this purpose, a reallocation of staff within the sector is needed, with a substantial retraining program and a reduction in the number of hospital personnel. This would facilitate a move away from the current allocation of funds based on the number of hospital beds toward output-based allocations according to actual services rendered. Staffs support the SPPRED plan to provide a basic package of medical services free to all citizens and to charge for other services. However, this program would need to be combined with a more systematic monitoring of user charges and wages in the public health care system, including a review of the existing regulations in order to reform those that encourage informal payments. Accountability of health providers to Azeri citizens and communities should be strengthened. This could be advanced by (i) enhancing the self-regulation of providers through establishing professional associations and technical standards, rules of ethics, and systems of accreditation and quality assurance; (ii) strengthening the involvement of clients in monitoring performance through patients' associations, community-based services, and participatory approaches; and (iii) providing collective action of monitoring through public expenditure tracking surveys, and information and media campaigns. Unless such steps are taken, the poor in particular will continue to suffer from a lack of essential services of an acceptable standard.

30. **The SPPRED recognizes the challenges of devising an effective, equitable and affordable social protection strategy.** At present, the programs are not well targeted, with the result that benefit levels are very low and those most in need are not being adequately cared for. No real account is taken of family needs. Furthermore, there is a co-mingling of social insurance and social assistance, again with little regard to real need. Reforms should focus on the rationalization of the many programs, perhaps into a single-family benefit system, with explicit targeting to the poorest. It may also be beneficial to eliminate one-time benefit payments, which are regressive insofar as no allowance is taken of income levels in determining eligibility for these benefits. The social safety net could become better targeted assistance by: (i) replacing the income-tested child allowance, the nonworking pensioner allowance, and the allowance for the single elderly by a unified cash benefit for families with children and pensioners; (ii) replacing social pensions by budget-financed social assistance and reviewing the minimum pension; and (iii) restructuring the sick leave to include an increase in the cost sharing of employees and employers. Staffs support the strategy outlined in the SPPRED for strengthening the pension system, and a proposed Bank project would support these reforms and building of institutional capacity.

31. **Men and women are affected in different ways by other aspects of poverty, and more research is required in order to document these in Azerbaijan.** For example, employment data suggest that females have a higher risk of unemployment. Employment of working age men exceeds the rate for women by 13 percentage points (67.3 percent and 53.9 percent), despite the fact that the retirement age for females is 5 years lower.

32. The available data on gender in Azerbaijan show that women tend to concentrate in the social services sector, such as health and social care, education and other public services. Wages in the health sector are circa 30 percent of the national average, and in education 70 percent. However, the gender employment statistics cover only the formal sector of the economy, and due to the lack of a regular labor force survey not much is known about the sectoral distribution of labor in the economy as a whole. **Wage statistics by gender are scarce but the available data confirms that even in female dominated sectors of economic activities, such as health care, social work and education, wage levels for females are much behind the levels for males.** Women and children are considered the most vulnerable subgroup of this population group.

33. **Labor participation rates are high, but in all age groups men participate more than women, and the gap is especially significant in the most active years of work**. This has implications for female poverty and vulnerability. There are gender differences in some health indicators. For example, the number of cases of tuberculosis has been growing, and this has especially affected men. Also, there is no systematic collection and analysis of school attendance rates, which would give a better indication of changes in the access to and quality of education being received by different sections of the population, and the extent to which there are gender differences in attendance and access.

34. **Integration of IDP's and refugees in the economy is a key concern of the SPPRED.** This segment of the population constitutes one of the most poor and vulnerable sections of society. Increasingly government's own resources are being used for social welfare programs, housing, irrigation, power, education, and health related infrastructure. Studies, data and information on IDP's and refugees are scattered in a number of institutions—designed to meet specific program

needs with different input, output and impact indicators—and are often not comparable. Programs aimed at enhancing skills and income generation activities, and improving the living conditions of this most vulnerable population, need to receive priority, accompanied by the establishment of a systematic monitoring and evaluation system to help design and implement cost effective resettlement programs for IDP's and refugees.

35. **The SPPRED correctly identifies the energy sector as critical for the country's development prospects.** Lack of reliable energy is considered a major problem by the rural populations, and was identified as the number one constraint in a recent FIAS business environment survey. The policy agenda in the SPPRED is based on the government's detailed program for strengthening financial discipline in the energy sector supported by the Bank's SAC-II and the IMF's PRGF. Good progress has been made so far in increasing collections of billings for electricity and gas services, and on making previously implicit subsidies explicit on the budget. Power distribution is now managed through private management contract, and similar private sector participation arrangements are sought for gas and water supply. The regulatory framework for private sector operation needs to be defined. While a Tariff Council was established in 2002, a time schedule should be fixed for the introduction of an independent regulator. Likewise, a time bound plan for gradually bringing tariffs up to economic prices should be published. The corresponding mitigation mechanism to compensate the poorest should be decided now, and the actual design of the means testing apparatus started as soon as possible. Yet energy supply is unreliable, especially outside the Baku area, and substantial investments are needed. The SPPRED is prioritizing public investment in power generation. Staffs would recommend a sequence with early emphasis on the rehabilitation of the transmission system in order to strengthen reliability and reduce technical losses. Furthermore, corporate governance and accountability of SOCAR, Azerenergy, Azerigaz, and the ARWC need to be improved. A strict time schedule for upgrading of accounting systems to IAS compliance is overdue.

36. **While more information at all levels of society is at the center of the SPPRED strategy, a comprehensive telecommunications sector reform program is totally lacking.** The telecom sector is dominated by one player, Azertelecom, which is closely linked to the Ministry of Communications, and even the two "independent" cellular operators (Azercell and Bakcell), as well as other existing joint ventures, per current regulations, are forced to have about 50 percent shareholding by the Ministry. While the sector in Azerbaijan has the potential of making a major impact on the economy, particularly inflow of FDI, its performance is much worse than for instance in neighboring Georgia, where the telecom sector accounts for almost 7 percent of GDP--in Azerbaijan it accounts for less than 2 percent. Separation of commercial and regulatory activities is crucial for the sector to develop, and enable other sectors to develop. **Currently there is a disconnect between the SPPRED and the cheap access to the information and communication services needed to implement it.**

5. TARGETS, INDICATORS AND MONITORING

37. **The SPPRED does not yet provide medium-term targets for poverty reduction but sets out a framework for improved indicators to define these targets over time.** The PRSP Secretariat will monitor changes in poverty levels in the coming year, and where possible analyze

the effect of policy on poverty results. In order to focus the practical implementation of the poverty reduction strategy and to provide a better framework for monitoring progress, the setting of a poverty reduction baseline path with intermediary targets before 2010 should be considered. The selected core indicators—e.g. income poverty, maternal and child mortality, access to primary education and health care services—constitute a good attempt to utilize the Millennium Development Goals (MDG) framework, and the current range of selected core indicators would capture progress on a broad range of issues. There is a need, however, for future PRSPs to make an explicit link of the core poverty indicators with the MDGs. The staffs welcome the government's intention to gradually expand the core set of indicators, especially for measuring the targeting of social benefits and the growth of income opportunities in the private sector. The document lacks a clear distinction between inputs, outputs and outcomes, and their corresponding monitoring frequency. It is prudent for the government now to refine the list of indicators that will be monitored and reported in the SPPRED annual progress reports. In terms of the monitoring system, the SPPRED seems to pay less attention to the role of line ministries/agencies and role of administrative data, and intra-governmental communications and linkages should be strengthened.

38. **There are some weaknesses in the proposed range of indicators.** The core indicators focus mainly on the social sphere, although a few productive sector indicators are included such as private sector share in GDP. Looking ahead, these could be supplemented with indicators such as the business climate and the cost of doing business. Regular follow-up to the FIAS and BEEPS is important. In some cases, indicators could be better chosen to reflect the objectives and key constrains. Governance indicators could also be broadened to monitor problems of corruption. More generally, the indicators would greatly benefit from greater disaggregation to capture rural/urban inequities, regional differences, income disparities and gender imbalance.

39. **The staffs believe that given the vulnerability of the country's economic performance to external shocks, it will be necessary to undertake sensitivity analysis of the impact of lower than expected economic growth on poverty reduction** On that basis, a contingency priority action plan could be developed. In particular, contingency plans should be developed to prepare for the possibility that a sharp and sustained reduction in oil prices could lead to significant delays in planned oil and gas sector investments. These efforts should also focus on clearly spelling out linkages among key policy actions and the SPPRED targets for important sectoral policies (education, health, social protection, rural development and infrastructure). The staffs encourage the authorities to include multiple scenarios in the context of future SPPRED progress reports.

40. **The implementation of plans for monitoring and evaluation remains a challenging task.** The staffs welcome the emphasis the SPPRED puts on a monitoring system that is based on sample surveys, as well as statistical reporting systems. Public expenditure management reform will also contribute to improve the timeliness and quality of expenditure data. The existing public expenditure reporting systems provide an incomplete basis for monitoring poverty-related expenditure, in part because the classification of expenditure does not cover all categories of pro-poor spending. Again, rapid implementation of the new budget systems is very important as well as the strengthening of the capacity of line ministries to fully engage in medium term budget planning.

6. RISKS TO THE STRATEGY

41. **The most important risk the Azeri economy is exposed to today is the risk in the external environment.** These risks include the sharpening of regional instability resulting from conflicts in neighboring countries and the possible fall-out of the conflict in Iraq. Probably the most important source of regional instability for Azerbaijan is the unresolved conflict over Nagorno Karabakh. Resumption of open hostilities would have major economic and human costs for Azerbaijan, while a peaceful resolution of the conflict would improve the growth and poverty reduction prospects significantly. The international community is actively involved in trying to resolve the dispute through the OSCE's Minsk Group.

42. **Internal political risks include the possibility that a political transition in Azerbaijan leads to instability and/or significant shifts in policy.** To mitigate against this risk it is important to continue and expand the participatory efforts of the SPPRED to ensure broad-based civic and political ownership of the country's development strategy.

43. **The main economic risk is that the BTC pipeline and/or the Shah Deniz gas development do not go forward as planned.** This could, for example, happen because of a drop in energy prices, or difficulties in securing financing. This would have a serious impact on the country's revenues in the short and medium term. **The volatility of energy prices itself represents a related risk, as is the risk of Dutch disease**. These risks are partially mitigated by the government's adoption of a prudent fiscal stance, the establishing of the State Oil Fund, and its strategy of facilitating the development of the non-oil sector.

44. **The implementation and governance capacity is another set of risks to the achievement of the SPPRED objectives.** The attention paid in the ongoing reform agenda to the transparency and management of public expenditures (including from the Oil Fund) and the business environment along with the significant improvement in governance indicators as captured in the BEEPS contribute to the mitigation of this set of risks. The technical support and assistance being provided by the Fund and Bank and by other external partners will also help to overcome implementation risks.

7. CONCLUSIONS

45. **Notwithstanding the above risks, the SPPRED represents a significant achievement.** Although weaknesses remain, notably in definition of the public sector's role in the country's development strategy, and in costing, prioritizing, and sequencing measures as well as in their monitoring and evaluation, the staffs acknowledge that the preparation of the SPPRED document represents a credible and inclusive effort on the part of the Azeri authorities. The staffs commend the authorities for recognizing in the SPPRED some of its shortcomings, and believe that with experience and continued development and refinement of strategies these can be overcome.

46. **The staffs of the IDA and the IMF consider that the SPPRED presents a credible poverty reduction strategy that provides a sound basis for Bank and Fund concessional assistance.** The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.

Republic of Azerbaijan

State Programme on
Poverty Reduction and Economic Development
2003-2005

Baku – 2003

ACRONYMS:

ADB	- Asian Development Bank
AIDS	- Acquired Immune Deficiency Syndrome
ARRA	- Agency for Rehabilitation of Reconstruction of Liberated Areas
ARWC	- Absheron Regional Water Company
AZM	- Azerbaijan National Currency (Manat)
BA	- Bankers' Association
BEP	- Baku Executive Power
BSSD	- Baku Sewerage System Department
BSTDB	- Black Sea Trade and Development Bank
CH	- Chamber of Accounts
CIDA	- Canadian International Development Agency
CMAR	- Cabinet of Ministers of Azerbaijan Republic
CMNAR	- Cabinet of Ministers of Nakhchevan Autonomous Republic
EBRD	- European Bank for Reconstruction and Development
ECCD	- Early Child Care and Development
EF	- Eurasia Foundation
EU	- European Union
EU TACIS	- European Union Technical Assistance to Commonwealth of Independent States
FIAS	- Foreign Investments Advisory Services
FSIS	- Food Security Information System
GAVI	- Global Alliance for Vaccination and Immunisation
GEF	- Global Environmental Fund
GER	- Gross Enrolment Rate
GTZ	- German Agency for Technical Co-operation
HBS	- Household Budget Survey
HIV	- Human Immune Deficiency Virus
HPS	- Hydro Power Station
IAS	- International Accounting Standards
ICS	- Indicator Cluster Survey
IDA	- International Development Association
IDB	- Islamic Development Bank
IDP	- Internally Displaced Person
IFRC	- International Federation of Red Cross and Red Crescent Societies
ILO	- International Labour Organisation
IOM	- International Organisation for Migration
I-PRSP	- Interim Report on Poverty Reduction Strategy Paper
JBIC	- Japanese Bank of International Cooperation
KF	- Kuwait Fond
LEB	- Local Executive Bodies
LFPR	- Labour Force Participation Rate
MA	- Ministry of Agriculture
MASHAV	- International Co-operation Agency of the Ministry of Foreign Affairs of Israel
MC	- Ministry of Culture
ME	- Ministry of Education
MED	- Ministry of Economic Development
MENR	- Ministry of Ecology and Natural Resources
MF	- Ministry of Finance
MFE	- Ministry of Fuel and Energy
MH	- Ministry of Health
MIA	- Ministry of Internal Affairs
MICS	- Multi-Indicators Cluster Survey
MJ	- Ministry of Justice
MLSPP	- Ministry of Labour and Social Protection of Population

MM	- Milli Mejlis (Parliament)
MT	- Ministry of Taxes
MTEF	- Medium Term Expenditure Framework
MTr	- Ministry of Transport
MYST	- Ministry of Youth, Sport and Tourism
NB	- National Bank of Azerbaijan
NOC	- National Olympic Committee
OXFAM	- Oxford Committee for Famine and Relief
PC	- Para Olympic Committee
PIP	- Public Investment Programme
PMU	- Poverty Monitoring Unit
PO	- Presidential Office
PPP	- Purchasing Power Parity
SASMP	- State Agency for Standardisation, Meteorology and Patent
SPPRED	- State Programme on Poverty Reduction and Economic Development
SCC	- State Customs Committee
SCCA	- State Committee for Construction and Architecture
SCAI	- State Committee for Amelioration and Irrigation
SCRIDP	- State Committee for Refugees and Internally Displaced Persons
SCS	- State Committee for Securities
SCSM	- State Committee for Soil and Mapping
SCWA	- State Committee on Woman Affairs
SDFIDP	- Social Development Fund for IDPs
SF	- Saudi Fund
SG	- Swiss Government
SME	- Small and Medium Enterprises
SOCAR	- State Oil Company of Azerbaijan Republic
SOFAR	- State Oil Fund Azerbaijan Republic
SPF	- Social Protection Fund
SSC	- State Statistics Committee
STVBC	- State TV and Broadcasting Company
SWG	- Sector Working Group
UEIP	- Urgent Environmental Investment Projects
UNDP	- UN Development Programme
UNEP	- UN Environmental Programme
UNFPA	- UN Population Fund
UNHCR	- UN High Commissioner for Refugees
UNICEF	- UN Children Fund
UNIFEM	- UN Development Fund for Women
UNWFP	- UN World Food Programme
USTDA	- United States Trade Development Agency
USAID	- United States Agency for International Development
USD	- US Dollars
WB	- World Bank
WHO	- World Health Organisation

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Introduction

Poverty reduction is a global challenge for the international community. While until now, poverty has been largely measured by a population's income level and food security, now this phenomenon has gained a broader sense. Today, poverty reduction means improving access of the population to basic resources, including land and water, as well as to employment, education and health care services, ensuring equal rights for men and women at all levels, meeting needs for infrastructure and utility services, improvement of sanitary and hygienic conditions and providing adequate living standards for the population.

Many countries throughout the world recognise the need to address poverty problems. The World Development Report (2000/2001) prepared by the World Bank suggests that at the beginning of the 21st century almost half of the world's population (2.8 bln. people) live on less than 2 USD per day, and 1.2 bln. people on less than 1 USD per day. For every 100 newborn infants, 6 die before they reach one year, and 8 before they reach 5 years. 23 out of every 100 school-aged children have no access to education. In order to tackle these problems poverty reduction strategies are currently being developed in over 70 countries throughout the world. International experience shows that macroeconomic stability and reforms aimed at the formation of a market-based economy are crucial for reducing poverty.

The World Development Report defines 3 main directions for poverty reduction:

1. Promoting economic opportunities;
2. Expanding rights and access;
3. Increasing financial security.

Promoting economic opportunities under the current conditions of economic growth implies ensuring that economic reforms lead to improved income-generation opportunities for the population. Measures for expanding rights and access are largely related to the need to link social and political processes. The main objective here is to increase the efficiency of state administration and legal institutions and remove existing obstacles for relations with the civil society. Increasing financial security implies measures for protecting the population against economic and natural disasters, disability and human violence, and reducing such risks.

It is broadly recognised by the international community that poverty alleviation measures need joint efforts. In the World Summit for Sustainable Development, which was held in Johannesburg, in August-September 2002 it was stated that all efforts towards reducing poverty should be joint and coordinated. Poverty alleviation measures cannot be formulated just by national governments and donor organisations; there is also a need to involve all the representatives of civil society in the formulation process.

Although poverty is also a problem in the Republic of Azerbaijan, it has some specific features. During the late 1980s and early 1990s political repression in USSR, the disruption of economic relations, mass strikes in all regions throughout the country that were generated by the separatism movement which started in Nagorni Karabakh led to the closure of many enterprises. During that time GDP decreased by an average of 10-15% per annum with the process of hyperinflation gaining speed.

Following national independence in 1991 the Republic of Azerbaijan underwent sweeping changes in its social and economic foundation and transition from one socio-economic development pattern to another led to new, unprecedented political, institutional, juridical, economic, social and psychological challenges. These problems on one hand, and Armenian occupation, up to a million refugees and IDPs, an economic and information blockade and unstable political situation in the country on the other hand, prompted a sharp decline in the living standards of the population.

Following the achievement of a ceasefire agreement and signing of the first oil contract in 1994 the government embarked on comprehensive economic reforms conducted in close collaboration with IMF and WB. These led to an increase in investment, financial stabilisation, economic growth and a drop in inflation.

On the other hand, work towards government-building based on global values and democratic principles has started in the country and considerable achievements have been made in this regard. Thus, the achieving of political and macro-economic stability created the conditions under which the government of Azerbaijan could make poverty reduction a priority for social and economic policy.

A State Commission led by the Prime Minister of the Republic of Azerbaijan was established and instructed to develop a State Programme on Poverty Reduction and Economic Development, in accordance with the Decree No. 636, dated March 2 2001 by HE. Heydar Aliyev, the President of the Republic of Azerbaijan with a view to achieving this high goal and undertaking necessary measures in a systematic way.

An interim report was prepared, which was approved by the WB and IMF in July 2001. 15 Sector Working Groups (SWG), with members from government institutions, non-government organisations, and civil society were established to prepare the final document. A Secretariat, supported by foreign experts, was established at the Ministry of Economic Development with the task of coordinating the work of the SWGs, as well as facilitating the participation and contribution of international donors in the process. As the Programme is of national significance, attempts have been made to incorporate the comments and recommendations from all strata of civil society.

All policy measures envisaged in the Programme have been checked for consistency with the available sources of finance, all the proposed items of government expenditure are included in Medium Term Economic Framework (MTEF), and indicators for monitoring implementation of the measures have been defined. Care has also been taken to ensure that the objectives of the State Programme on Poverty Reduction and Economic Development (SPPRED) are consistent with the Millennium Development Goals as developed in the United Nations Millennium Declaration.

The SPPRED that covers a period of 3 years (2003-2005) and it will be revised annually in line with monitoring of the implementation and effectiveness of the envisaged policy measures.

The Programme provides estimates of existing poverty and an examination of the causes of poverty; defines main directions of institutional reforms aimed at reducing poverty in economic and social spheres; and emphasises the need to tackle the problems faced by the most vulnerable groups of the population, including refugees and IDPs.

Implementation of the measures outlined in the State Programme on Poverty Reduction and Economic Development will lead to increased income-generation opportunities, improvements in

the system of social protection, the introduction of targeted social assistance benefits to the most needy strata of the population, increased quality of education and health care services, and improved living standards for refugees and IDPs.

Executive Summary

Poverty in Azerbaijan: An Analysis of the Existing Situation

There are many different ways to define and measure poverty. The main objective of the SPPRED is to define and measure poverty in Azerbaijan using a variety of indicators, identify the causes of poverty, and develop a strategy to address these causes.

Poverty – dimensions, characteristics and causes

In 2001 the State Statistical Committee of Azerbaijan (SSC) introduced a new Household Budget Survey, and the first results have been used to provide estimates of poverty in the country. Using an absolute poverty line of 120,000 AZM (25.8 USD) per capita per month, it is estimated that 49% of the population is living in poverty. Using a relative poverty line set at 72,000 AZM (15.5 USD) it is estimated that 17% of the population is living in extreme poverty.

The main conclusions with regard to the characteristics of the poor and the causes of poverty are:

Poverty is greater in urban areas than rural areas (55% vs 42%). Poverty in Baku is neither below nor above the national average (49%), but it is lower than in other urban areas. However, the largest group of poor, one quarter of the total poor population is situated in Baku.

The higher incidence of poverty in urban areas is linked to the loss of non-agricultural employment and the importance of access to land and home produce in protecting rural inhabitants from poverty. The rural population is relatively better protected due to the value of produce consumed from its own household production. However, other participatory studies have shown that rural areas and small towns suffer from unreliable supplies of energy and gas, declining infrastructure, and less access to basic health and education services. Access to land is important in protecting the rural population from poverty, but in many cases cannot be used for more than subsistence farming.

The data so far do not allow strong conclusions to be made about differences in living standards across different regions of the country. These require further monitoring.

Large households have a greater risk of being poor: households with one or two members have a very low poverty risk (8-18%) compared to households with over 6 members (61%). Households with more than three children have a higher risk.

Children have a higher poverty risk than the elderly. The increasing vulnerability of part of the child population is also manifested in the increase in the number of children being put into institutional care by parents (so-called "social orphans"), and in the increase in the numbers of street children.

According to the HBS results, the poverty risk for men and women is equal. However, there is evidence that women are more vulnerable on the labour market, in that they face a higher risk of

unemployment, and females tend to dominate those sectors where wages are below the national average.

Households where the head of household has higher education have a slightly lower poverty risk.

Households where the head has refugee or IDP status are more likely to be poor (poverty incidence of 63% for IDP households). Poor temporary housing and living conditions contribute to the vulnerability of this group. A large part of this population has no permanent employment (around 70% of the IDP population), and is dependent on state transfers and humanitarian aid. School facilities are also often temporary, and health indicators are in many cases below the national average.

Employment is one of the most important ways of protecting households from poverty. Official registered unemployment is currently 1.2%, but estimates based on the 1999 census data suggest that non-registered unemployment is about 15.8%. Growth in agricultural employment from 31% of total employment to 41% over the last decade is the result of land reform, but much employment in this sector is self-employment in subsistence farming.

Labour force participation remains high, but many are engaged in temporary jobs, and many in the public sector earn low wages. High employment rates do not therefore imply higher income security. Females, young people, and graduates of vocational education dominate the registered unemployed. Labour force participation rates are higher for men than for women, suggesting that women are retreating from the labour market with implications for female poverty and vulnerability.

In the period immediately following independence, most health indicators deteriorated. There have been signs of improvements in some indicators since the mid 1990s. With the help of international organisations there have been successful efforts made to combat the spread of infectious diseases in the country. According to official data there has been a decline in infant mortality, under 5 years morality and maternal mortality rates since 1995, but there is a need to improve data collection and health statistics in order to get the full picture. Fertility rates have been declining apart from the 15-19 age group, with worrying implications for the education and health of teenage girls.

Azerbaijan has a high literacy rate (98.8%), a net enrolment rate of 86% for the 6-16 year age group. School enrolment rates for obligatory education are relatively good, but there have been problems with deterioration in the quality of school education, due to lack of textbooks, poor physical infrastructure, outdated curricula, low pay and shortage of teachers. There are signs of falling rates of enrolment for the higher grades of school (8-11th classes), and also for vocational and higher education.

Azerbaijan inherited several environmental problems from the Soviet period. Environmental problems are particularly acute in large economic centres such as Baku, Sumgait, Ganja and Ali-Bayramli. The water resources, land, air, and flora and fauna have been negatively affected by the Soviet environmental practices and also the economic difficulties of the 1990s. Environmental problems are increasing the vulnerability of some sections of the population, in that it affects the land which can be used for agriculture. On the other hand, poverty is also aggravating some environmental problems due to, for example, over-fishing in the Caspian Sea, over-grazing due to the poor management of common grazing areas. The country's forests are threatened by

uncontrolled logging, due to the pressure on poor households to find fuel or heating and cooking given the lack of guaranteed gas and electricity supplies.

Poverty Strategy

On the basis of what is known about poverty and living standards in the country, the government has designed a Poverty Reduction Strategy based on six key strategic aims:

(i) the facilitation of an enabling environment for growth of income-generating opportunities; (ii) maintenance of macroeconomic stability; (iii) improvement in the quality of, and equity in access to, basic health and education services; (iv) improvement of infrastructure (including roads, delivery of utility services, communications, irrigation); (v) reform of the existing system of social protection to give more effective protection to the vulnerable; and (vi) improvement of the living conditions and opportunities of the refugees and IDP population.

Current Economic Status

From the point of view of economic trends, the post-independence period can be divided into two distinct sub-periods, namely the 1991-95 period, and the post 1995 one.

At the beginning of 1990s the economy of Azerbaijan was characterised by high inflation, which was largely fuelled by production decline, rapid growth of the money supply, and unreformed financial institutions. In the 1991-95 periods, some policy measures were taken to try to ease social tensions, but these just spurred on the inflation process, and did not tackle the root problems. There was a cumulative real GDP drop of about 60%, hyperinflation, sharp currency depreciation and nearly depleted foreign exchange reserves. It is estimated that GDP in 1995 was only 44% of the 1990 level, and that household consumption expenditures also declined by circa 50% in the same period.

Immediately after Heydar Aliyev came to power by the request of the people in June 1993, a degree of social and political stability was restored in the country starting from the end of 1994, which made it possible to embark on a series of economic reforms. Since 1995, 3 government programmes aimed at achieving macroeconomic stabilisation, structural adjustment, and resumption of economic growth have been launched. A comprehensive stabilisation programme was launched, supported by the IMF and WB. As a result of these programmes, the budget deficit has been cut from 10% of GDP in 1994 to 1-2%; and credit from the National Bank is no longer used to cover the deficit; the lending rate of the National Bank has been lowered from 250% in 1994 to 7%; and foreign exchange reserves equal to 4 – 5 times non-oil imports has been created. The inflation rate has been kept below 2%, falling to 1.5% in 2001 and the currency made fully convertible domestically. The process of privatisation was started, and the private sector now accounts for more than 70% of GDP. Land reform was carried out, and 1.3 million hectares of agricultural land distributed to rural residents. Banking reform has been undertaken, and efforts made to bring the accounting system, payment system, banking supervision and banking legislation up to international standards. In the 1995-2001 periods, the pattern of economic recovery was dominated by the oil sector; but at the same time the economy registered economic growth across different sectors, including agriculture. Overall in the 1995-2001 period, GDP increased by 2.5 times, industrial production by 3.5 times and foreign trade by 2.2 times.

Economic Challenges

The six key poverty reduction strategy aims were outlined above. The challenge is to design economic and fiscal policies which support these aims. In particular, fiscal policy has to reflect the aim of maintaining macroeconomic stability; economic policy has to support the aim of promoting income-generating opportunities, which is dependent on development of the non-oil sector and regional development. Both fiscal and economic policies have to reflect the need to obtain public and private sector investment in infrastructure.

Social Policies Aimed at Protecting the Poor and Human Capital Development

Although economic growth has been impressive over the last years and has been generally resulted in increase on the living standards of the population, the relevant actions will still be continued in this regard. Social policies will be implemented to support the key strategic aims of introducing targeted social assistance to support the most vulnerable, improving the delivery of core health and education services, and providing support to the IDP/ refugee population.

Improving Social Protection for the Vulnerable: Social Insurance and Social Assistance Reform

There are two urgent reforms required, namely pension reform and reform of targeted social assistance benefits. Social insurance and social assistance benefits have become indistinguishable, due to the fact that there are not enough funds collected from pension contributors to finance pensions. There is no longer any link between the size of the pension and the length of contributions. The state budget is used to pay supplements to pensioners. There is a large number of social assistance benefits allocated on the basis of categories of the population rather than on need. As a result existing resources are spread over a large section of the population, rather than providing meaningful support to the poorest sections.

A Concept Paper on pension reform has been prepared, and the main objectives of social insurance reform are: reliable and regular payment of pensions, increasing the size of pensions, introducing forecasting models, equalising of retirement age between men and women and eliminating occupational privileges, changes in the social insurance contributions ensuring full collection of social security contributions, improving the administration of pension provision, and developing an automated social insurance and pension system based on individual accounts, thus creating a link between contributions and size of pensions.

The main task for the government with respect to social assistance policies is to define an effective safety-net that will enhance the targeting efficiency, support the poorest and most vulnerable groups and will mitigate the social impact of new public utility policies in the short-run. The main objectives for reform of the social assistance system are to ensure that social benefits are targeted to the poor and that the policies are efficient and effective, and secondly to improve the management and administration of the social assistance system. It is hoped to begin with better targeting of the child benefit, which constitutes one of the largest items in the social assistance budget. In order to develop an improved system of targeted social assistance, the following six sets of policy actions have been identified. All actions are of similar priority and are to be executed more or less simultaneously: (i) establishment of an effective administrative structure; (ii) development of the necessary legal framework for targeted social assistance policies; (iii) development of a Social Assistance Strategy paper; (iv) development of a targeting mechanism for the identification of the

poorest and most vulnerable groups of the population; (v) creation of a system of adequate compensation for the poorest against the impact of new public utility policies; (vi) Creation of a monitoring and evaluation system for the development and implementation of social assistance policies.

Children in Institutions

Institutional care can have detrimental effects on children's education and development. The increase in the numbers in institutions is partly due to the increasing inability of poor families to feed and cloth their children. The main thrust of the child protection strategy is to prevent children being put in institutions and to develop alternative policies aimed at providing support to families in need. In order to achieve this it is necessary to: (i) develop new family support services to try to help families who are having difficulty in caring for their children (ii) develop services for families with children that need special care (iii) develop legislation on foster care, as an alternative to institutional care (iv) rationalise the resources currently spent on institutions for children, and direct the savings towards supporting families and re-integrating children.

The Disabled

Apart from social benefits to the disabled the main policy direction is to integrate as far as possible the disabled into society. The government will continue to install the necessary facilities for the disabled in transport and public places. It is envisaged to increase the number of centres such as Para-Olympic health-sport centres for the disabled. Rehabilitation services and centres will be developed, with special emphasis on providing services in the regions.

Promoting Employment Creation and Protecting the Unemployed: Labour Market, Employment and Wage Policy

The government will stimulate demand for labour through economic and investment policies. With regard to wage policy, the government intends to increase wages and decompress wages in the public sector in order to improve delivery of health and education services, and to improve the motivation of civil servants. Regional coefficients will be introduced in order to attract qualified professionals to the regions.

The government will develop labour market policies aimed at ensuring that the unemployed are protected in the restructuring caused by privatisation and public sector reform. New advisory services and labour exchange offices will be set up in the regions, and training and re-training courses designed. Job creation schemes for the long-term unemployed will also be used.

There is a need for reliable data on the labour force and employment in designing the development of passive and active labour market policies. The government intends to design and implement a regular labour force survey to help fill this information gap.

Investing in Human Capital: Improving Delivery of and Access to Education and Health Services

Education: In order to improve delivery of basic education services, the government will gradually take over the financing of provision of textbooks for all school children. Enrolment rates in primary and basic education remain relatively high, but there are concerns about the quality of education

being offered. Wage increases for teachers will help to motivate the teaching staff, while review of the curricula and teaching methods will help improve educational attainments. Physical conditions at many schools are poor due to lack of repair, while in some areas there is overcrowding. The government will take some steps to tackle this problem by allocating funds for the repair of 200 schools, and construction of 28 secondary schools.

The content of vocational education no longer matches the skills required in the current labour market, and reform of vocational education is planned.

The introduction of new education technologies will help ensure that children from all backgrounds are introduced to modern computer technology.

The number of children attending pre-school education has decreased in recent years, and the government will promote the establishment of alternative institutional, family and community based facilities in order to increase access to early childhood development programmes.

Health: Health sector reform was launched in 1998 with the establishment of a State Commission charged with organising and implementing reform in the health sector; and in 1999 a concept paper for health care reform was adopted. The main thrust of health sector reform is currently reform of primary health care services. The principle health problems faced by the poor are communicable diseases, acute respiratory diseases, diarrhoea, and other illnesses, which are best and most efficiently approached on an ambulatory basis rather than hospital care. The health reform efforts are therefore now focused on improving the capacity to provide accessible and good quality primary care services. A number of reform measures have been implemented in five districts over the past three years, and it is intended to expand the programme in the 2003-2005 period.

The second main thrust of reform is that of developing cost-effective health care services; i.e. elaborating specific interventions that have proved to be effective in the improvement of the population's health status and which can be provided at relatively low cost. Such measures include health education campaigns, improved immunisation programmes, and improved treatment practices, such as Integrated Management of Child Illnesses (IMCI), safe motherhood and new-born care, the salt iodisation programme.

Apart from co-operating with donors on comprehensive primary health care reform, the government plans to increase expenditure on the health sector; establish in co-ordination with donor organisations the cost of a basic per capita package of primary health care, and work towards gradually increasing government expenditure to ensure this; increase the salaries of health sector employees; design a system of targeted exemption from paid medical services; take over full state financing of immunisation programmes (excluding hepatitis B); design public awareness campaigns to help improve maternal and new-born welfare, as well as campaigns to reduce the incidence of TB, malaria, iodine-deficiency and HIV/AIDS; design public awareness campaigns for health life styles and nutrition, especially targeted to poor; improve the protection of the population's reproductive health; improve the information collection system for producing the main health indicators and adoption of international standard definitions for key health indicators; improve training of health sector staff, including raising awareness of the need to shift to more user-friendly services and the need to concentrate on prevention rather than just treatment of the illnesses most prevalent among

the most vulnerable sections of the population; and finally monitor access to clean drinking water as well as other environmental factors affecting health.

Social Policy and the Refugee/IDP Population

Efforts are being made to improve the living conditions of refugees and IDPs who have poor living and housing conditions. New settlements are being constructed using funds allocated from the State Oil Fund. Schools, pre-school facilities, hospitals and medical centres are also being built. Repair is being carried out of buildings in densely inhabited IDP settlements, and the infrastructure and sanitation are being improved in others. The government is carrying out this work together with private sector organisations and also international organisations.

A high proportion of the working age IDP population is unemployed and efforts are being made to address the employment problems by promoting the provision of micro credits for SME developments and for agricultural activities, and also by provisionally allocating land to 20,000 IDP households.

Food assistance is being provided by the state and by donor communities. IDPs and refugees are also entitled to a monthly food subsidy of 25,000 AZM. Efforts will continue to be made to ensure that this section of the population does not suffer from lack of access to school education or health services.

Since there are differences in living standards within the IDP/ refugee population, better monitoring of this group is required through regular surveys in order to design and target assistance to the most vulnerable.

Economic Policy and Poverty Reduction

The Poverty Reduction Strategy includes two main challenges for economic policy. Firstly fiscal and monetary policies must be flexibly and carefully used in order to maintain macroeconomic stability. Secondly, the government must now foster balanced growth of the economy. The need for balanced growth is linked to the need to stimulate the non-oil sector and to create jobs especially outside of the Absheron peninsula.

Macroeconomic stability: In order to maintain macroeconomic stability, the NB will continue to use monetary policy to maintain low inflation rates (2-3%); the government will limit its expenditure to a level that is sustainable over the medium term and is non-inflationary; and the government will increase the effectiveness of its fiscal planning and control, by making institutional improvements to key economic and financial agencies. Institutional improvements will involve improvement of the budget process, including the preparation of a medium-term expenditure framework (MTEF) ensuring balanced expenditures and revenues and defining the government's expenditure priorities. A Public Investment Programme will also be prepared with details of major investment. Revenue management will be improved through improvements in the Tax Code and Customs Code, as well improvements in their organisational structure and processes, and capacity building for staff. State debt management will be improved, issuance of new state guarantees limited, and the financial discipline for guarantees strengthened.

Balanced economic growth: The government will use three sets of tools to promote balanced growth, namely public finance policy, regulation and privatisation. These tools will be used to bring about improvements in some of the key economic sectors: to improve the investment climate, increase access to credit among businesses and entrepreneurs, to develop infrastructure, to develop small and medium enterprises, to develop the regions and agriculture, to improve the environment, to reform energy generation and distribution and to promote tourism.

Investment in Human Capital

As part of the Poverty Reduction Strategy, the effectiveness of the government's spending on human capital development, particularly in social security, health and education will be improved. Health care expenditure will more than double and will account for 6% of total government expenditures; use of the funding will also be rationalised in line with the reform in primary health care provision. Education spending will increase, but its share in total expenditure will fall from 17% to 16.4%. Resources will be re-allocated within the education budget to ensure improvements in the equality of education, and equal access to school materials and facilities.

Agriculture and Regional Development

Development of the agricultural sector, within the framework of a comprehensive rural development policy, is also crucial for development of the non-oil sector and regions. A rural development policy will encompass development of agriculture on the basis of sustainable use of the country's natural resources, and will encompass development of infrastructure, irrigation and drainage, and promotion of non-agricultural employment. For sustainable use of natural resources, better management of the land and soil quality will be obtained. The creation of new forms of organisations such as Farmers' Unions will be supported in order to enable small farmers to reduce the costs of production and processing as well as to build up economies of scale. Better information services will be provided to farmers through local advisory services providing information on micro-credits, best use of land practices, etc.

Privatisation of some veterinary services will be promoted, while the state will retain responsibility for the protection of public health by improving food safety through better control at state laboratories, improved coverage of veterinary vaccines, and upgrading quarantine control at the borders.

Most of the country's agriculture is dependent on irrigation and drainage systems. Public investment is required to rehabilitate these systems. Improvement in management is also required, and the further development of Water Users' Associations will be supported with this purpose in mind.

Polices aimed at improving national-level environmental problems include cleaning up mercury sludge and improving waste management; reconstruction of purification units and sewerage systems in selected areas; protection of the bio-diversity of the Caspian Sea; protection of soil from pollution and re-cultivation of polluted soil; improved management of the country's forests and prudent re-forestation projects; improvement of the monitoring of environmental indicators.

Energy Sector Reform

Lack of reliable energy supplies is considered a major problem by the rural population. Equally important, the provision of energy at subsidised rates represents a large drain on the state budget. The government has adopted the government programme "On Strengthening of Financial Discipline in the Energy Sector" for sequential implementation of the reform agenda in this sector. The policy measures planned include several steps. First, it is intended to make the implicit subsidies explicit by making sure that they are recorded clearly in the state budget documents. It is planned to increase the payments to SOCAR from the utility companies gradually between the years 2002 and 2006. In the this period, in order to make the subsidies explicit, the Ministry of Finance will issue securities to Azerenergy and Azerigas for the amount of money which it cannot pay to SOCAR for fuel.

Budget organisations and state enterprises will be transferred enough funds to pay for energy and gas consumption, and limits will be put on their consumption. If they surpass these limits, they will face sanctions, including disconnection. There will be compulsory installation of meters. This should stop the accumulation of debts, and also encourage less wasteful consumption.

Improvement of the collection rates from households will need careful planning. Installation of meters will take some time and enforcement of collection rates will have to be accompanied by a new compensation benefit for low-income households. It is also planned to carry out public awareness campaigns (for organisations and households) on energy saving methods.

It is planned to improve the management of utility supply by transferring the management of regional electricity, gas and water supply networks to the private sector. Transfer the management of the regional electricity distribution networks in Baku, Sumgait, Ganja and Ali-Bayramli have already been completed. Restructuring of SOCAR, Azerenergy and Azerigas will continue. The regulatory functions performed by the state will be carried out by the Ministry of Fuel and Energy, while SOCAR and the utility companies will be responsible for commercial operations. A tariff board has been established to advise on tariff levels, and to regulate them. The aim is to achieve a gradual reduction in the distinction between domestic and world prices for oil, oil products and natural gas.

Tourism

Azerbaijan is a large and varied country with some good potential for both domestic and international tourism. This potential can only be utilised with a well co-ordinated set of policies, bringing together the public resources and the private sector for a sustainable development of tourism. The tourist industry is strongly linked with several other main areas of the government's strategy for poverty reduction through income generation. Tourism can generate income at regional and local levels by creating demand for specific services, ranging from high-skill to low-skill jobs. It can attract SMEs in a variety of activities, and at local levels. It will also enhance local participation in environmental preservation and development. The government will help encourage tourism through public investment in infrastructure.

The Institutional Framework for Poverty Reduction

The main strategic objectives of institutional reform can be summarised as follows: (i) to re-define the role of the state in the changing economic environment, including the clear and precise separation of regulatory and commercial activities; (ii) to rationalise and improve the professionalism and transparency of the public administration system; (iii) to promote decentralisation and local self-governance; (iv) to reform the juridical system; and (v) to fight corruption at all levels.

Institutional reform in Azerbaijan is closely tied to the process of redefining the role of the state in the transition to a market economy. The regulatory role of the state is very important for improving the business and investment environment in the country. Over the last five years the state has taken important steps to withdraw from commercial activities. The process redefining the role of the state will be continued.

Another important part of institutional reform is the rationalisation and improvement of public administration structures. In this regard, some measures have been taken to rationalise through the merging of government agencies. So far nearly 30 central government structures have been either liquidated or merged and new ones established. A civil service reform is underway, with the aim of improving the professional and managerial capacity of civil servants and decompressing the wages within the civil service will be undertaken so that pay levels correspond to levels of responsibility and qualifications. Institutional reform is also being undertaken in those bodies responsible for the country's fiscal and monetary policies. These were outlined above, and are aimed at improving revenue collection, better management of state debt, and improvement of the budget process.

The government has been trying to decentralise management within the public sector. The creation of municipalities can be considered an important step in this process. As part of the process of decentralisation, the municipalities can contribute to the strengthening of local governance and decision making by improving allocation of resources at the local level, promoting regional development and allowing local communities to participate more actively in decision making.

Juridical reforms are also being undertaken with the aim of improving the legal qualifications of judges, prosecutors, defence attorneys; improving the court procedures for handling legal cases; improving legal access to the public and allowing public participation in trials; making sure that the legal profession has the background to ensure that new laws and legislation are consistent with the requirements of a market economy; and improving the performance of law enforcement agencies.

As part of institutional reform, the government is undertaking a number of active measures to reduce corruption and increase transparency in the public administration system. Since 1995 a series of Decrees were issued by the President of the Republic in this regard, and in June 2000 a Law on Combating Corruption was drafted. The draft law has already passed its first reading in the Milli Mejlis.

The Participatory Process

The Role, Significance and Objectives

The role of a participatory dimension in the SPPRED is to ensure a comprehensive and genuine process of consultation with the civil society. This is crucial for several reasons: to complement the formal data on poverty and its causes through methods of direct observation and consultation; to identify solutions which are more congruent with the needs, aspirations and potentials of those affected by poverty; to better inform the policy makers of the scope, method and impact of their poverty reduction policies; to develop capacity at local levels for the implementation and monitoring phases of the SPPRED.

The Scope

The Participatory component of the SPPRED in Azerbaijan marked the initial step in bringing together the government officials and a broad spectrum from the civil society into direct, working contact, both in Baku and in five regions of the country (Guba, Nakhichavan, Massally, Ganja and Sheki). It was carried out at sectoral, regional and national levels, applying appropriate methodology for each. A number of international donor organisations supported this process. The preliminary constructed interviews and the regional consultation and workshops process covered 63 villages and cities, with around 120 Focus Groups sessions conducted (i.e. about 2,000 participants), plus about 1000 individual interviews and questionnaires.

Empirical Evidence

The main purpose of this elaborate process has been to draw attention to the multi-facet feature of poverty. In particular, it brought into focus the phenomenon of "New Poverty". That is, people who would not have been ordinarily poor, but are so due to the transition and the resulting dramatic changes in the economic structure. This includes a large part of professionals (teachers and health workers in particular), the IDPs and refugees, children and pensioners. The process also stressed the large and growing gap between Baku and the rest of the country in terms of opportunities and access.

The participatory process highlighted the following issues for policy considerations:

- Land ownership, in itself did not make the households feel any less poor, unless they could utilise it productively and profitably.
- High unemployment is mainly due to lack of opportunities not skills, especially amongst the IDPs. The high rate of unemployment amongst the highly skilled, in addition to those with low or no skills, requires specific labour market policies.
- Poverty and Social Exclusion are strongly related. Proximity to city centres has an impact on the general outlook about prospects for change. More remote areas generally appeared skeptical or apathetic about the prospects for a visible improvement in their living standards. Accordingly, the difference in motivation for participation between the unemployed and those earning some income through work was quite pronounced. The difference was most visible amongst the IDPs.
- There is a need for a long and sustainable strategy for poverty reduction, which should include intensive training in public education on participation.

The participatory exercise also revealed some crucial components for this process to be successful, as listed below.

The Significance of Public Education on Environment

The protection and preservation of the environment is both a source and an outcome of sustained economic growth. However, for the poor communities, the priorities are not always necessarily in the direction of preserving the environment, but rather meeting their urgent needs for subsistence.

A useful way of extending and implementing the participatory process would be to provide public education on environmental issues, and to recommend monitoring measures at local and community levels too.

Gender Dimension

Participation amongst women remained generally low. During the first round of regional missions around 37% of the whole respondents, and during Focus Group Meetings at around a mere 10%. This reinforces the need to address the issue of a higher social presence for women in the next phases. One particular priority expressed by women participants was the need for special business training facilities for women entrepreneurs.

Protection of the domestic market

There is a common notion amongst the farmers that the agriculture sector is suffering due to the competition from some neighbouring countries. It had to be stressed that the government strategy will focus on increasing the productivity and competitiveness, rather than resorting to market-protecting measures as such.

Role and capacity of Municipalities

Municipalities have emerged as one of the most crucial institutions, reflecting the democratisation process in the country, as well as facilitating the registration of economic and social needs at local and community levels. They can become very useful institutions for the process of decentralisation, and the mutual flow of information between regions and Baku. They have 2,700 branches throughout the country, can work closely with local NGOs, and are related to the development of socio-economic programmes at regional and community levels. They also have a direct interest in the development of SMEs and economic activities in their regions.

However, in order to use their potential in participatory implementation and monitoring of poverty reduction programmes, the municipalities themselves should be the subject of improvements in their organisation, training, and capacity building.

The Time Horizon

While poverty reduction is a long-term process, the need to do something about at least some of its aspects requires short-term, even urgent, measures. There is reasonable capacity of relevant skills

and local knowledge within the communities to mobilise their resources to tackle the most immediate needs of poverty reduction, provided that they can be supported with some management back up and tangible incentives.

Possible Ways to Deepen and Broaden the Process

There is need for training, information dissemination, clearer definitions, and broader regional coverage, monitoring indicators and mechanisms, impact assessment of participation and reporting mechanisms. In short, the civil society should know what they are expected to do by participation, why they should do it, how they can do it, and should be able to see the result of it.

Implementation, Monitoring and Evaluation

The policy matrix attached to this document gives a summary of the list of policy actions envisaged, and the indicators which will be used to monitor implementation. For poverty levels and poverty profile, the data were derived from the Household Budget Survey (HBS) results for 2001. The same survey, welfare indicator and poverty lines will be used to monitor changes in the poverty levels over the coming 3 years, and also changes in the poverty profile.

With regard to other indicators, it should be noted that it is considered necessary to improve relevant information sources before full monitoring can be carried out as there is still a considerable information gap.

In order to monitor the successful implementation of measures aimed at promoting the creation of income-generating opportunities, there is a need for a labour force survey. Proxy indicators include growth in the non-oil sector and the number of annually registered SMEs, and bankruptcy data in the private sector.

For targeting of social benefits, the HBS survey will be used to look at receipt of benefits by expenditure of income deciles, and to look at inclusion and exclusion errors. Administrative data will be used to monitor the decrease in the number of children in institutional care.

In order to monitor improvements in infrastructure, administrative data on public investment figures will be used. Participatory research will also be used to monitor this aspect of the Poverty Reduction Strategy, and the government will cooperate with donors in carrying out rural and urban infrastructure surveys.

Improvements in the delivery of health services will be monitored by reductions in infant, under 5 years and maternal mortality rates, as well as reduction in the incidence of certain diseases, including malaria, TB, acute respiratory diseases among children, and the number of children covered by immunisation programmes. It is also planned to monitor the reduction in the number of teenage births. Collection of data and definitions have to be improved in order to monitor implementation. Intermediate indicators will include increases in salaries to health sector workers, reduction in the number of hospital beds by raion accompanied by a corresponding increase in the numbers being treated in outpatient facilities.

The final indicators for education will be maintenance and improvement in the net enrolment rates, and increases in attendance rates by gender. For this recording and publication of attendance rates

needs to be improved. The intermediate indicators will include increases in salaries to education workers, increases in the budget allocated for materials, and number of pupils receiving free text books.

With regard to the IDP/ refugee situation, the main administrative indicator will be the number of IDPs in tent camps and temporary accommodation; the numbers being voluntarily re-settled in new settlements; and the numbers receiving soft micro-credits for agricultural or other commercial activities.

For economic growth and macroeconomic stability, the main indicators will be: inflation rates kept at 2-3%, international reserves kept at least at the level of 16 weeks of non-oil imports, increase in credits to enterprises and individuals, fiscal deficit kept at a sustainable level of not more than 3% of GDP, and state debt kept at a level of not more than 30% of GDP.

Data Sources and Instruments

The main source of information will be the HBS. The quality of the field work and other aspects of the survey will be improved in order to guarantee regular and reliable survey data to monitor national and regional living standards. Information from the FSIS Unit at the SSC will also be used. The government will cooperate with donors in introducing and carrying out regular labour force surveys, rural infrastructure studies, surveys of the IDP/ refugee population, MICS, and environmental monitoring. Participatory methods and research will also be used to supplement the quantitative survey methods, and gender-disaggregated results will be published whenever possible.

Institutional Capacity

In the period 2003-2005, the SPPRED Secretariat will have overall responsibility for coordinating the implementation process, and also for monitoring this process. It is planned that the SPPRED Secretariat will be responsible for publishing an annual review of the implementation process. This will report on how the monitoring indicators have been used to monitor progress in implementation, and will also include a review of the policy measures, making suggestions on how to improve and adapt these in accordance with evidence on their poverty impact.

In the preparation phase, it has been found that institutional capacity for analysis of living standards data is still quite weak. There is still very little capacity within the relevant government structures for poverty analysis. It is planned to set up a Poverty Monitoring Unit attached to the SPPRED Secretariat to use survey and other data for living standards analysis. The core team at the unit will have the main responsibility for carrying out living standards analysis, and should then train staff in other government bodies to use the data for policy-making and evaluation. The main poverty indicators will be monitored by analysing the HBS data on an annual basis. As new survey data becomes available from other sources (e.g. labour force survey), the type of analyses which can be carried out by this group will be broadened, and the links between various aspects of poverty made clearer.

Chapter 1. Poverty in Azerbaijan – An Analysis of the Current Situation

Poverty is usually understood to be a multi-dimensional phenomenon, with the living standards and welfare of individuals and households being influenced by different factors. This chapter uses the available data to determine how many people and which population groups in Azerbaijan are most affected by different dimensions of poverty.

The most commonly used dimension of poverty is that defined by levels of per capita consumption or income. This has not been done on a regular basis in Azerbaijan.

In 2001 the State Statistical Committee of Azerbaijan (SSC) introduced a new Household Budget Survey (HBS), and this will now be carried out on a regular basis to provide grounds for poverty estimates based on income and expenditure welfare indicators. The first results are now available, and have been used as the basis for estimates of poverty in the country, using a new revised absolute poverty line and also a relative poverty line.

Poverty as characterised by low income or consumption as a whole usually reflects limit of opportunity. This is closely linked to labour market and employment issues, since employment provides jobs and regular income generation opportunities for the population. But opportunities are not only connected to employment, but also to ownership of assets; for example, access to land, and the opportunities to exploit land as an source of income.

However, poverty cannot be defined purely in terms of low income or consumption levels. Health and education indicators can be used to measure the difference in capabilities between different population groups. The two dimensions of poverty are linked, in that poor education, illness, malnutrition tend to lead to low income and income poverty. In this regard, the same survey data would ideally be used to look at the correlations between income / consumption levels and health and education. However, the available HBS data do not yet permit us to make such connections. Therefore, sometimes other information sources as well as official data on health and education indicators are used in order to show the links between low income and poor health and education.

While the HBS results on income poverty reported below give no clear indication of a gender dimension to poverty, it is important to note that other aspects of poverty affect men and women in different ways. Poverty is also connected with vulnerability and insecurity. Vulnerability and insecurity are linked to other dimensions of poverty, such as unemployment, risk of illness.

Azerbaijan has a refugee and IDP population of circa 1,000,000. Most of them are those who have been deported from Armenia and become refugees or IDPs due to the occupation of 20% of the country's territory by Armenia. While poverty in Azerbaijan cannot be explained solely by the refugee / IDP problem, it is true that the IDP and refugee population represent a particular social policy problem for the country in that there are concentrations of extreme poverty among sections of the IDP/refugee population.

Several studies have been carried out in Azerbaijan with the participation of the poor to help define ways of reducing poverty. As part of the preparation of the SPPRED, meetings were held with poor people and representatives of civil society in several regions of the country. The results of these meetings are also used to help build up the full picture of the various dimensions of poverty.

This chapter begins with a brief summary of the demographic situation in the country, and then provides an estimate of the extent of poverty in the country using a monetary welfare indicator (consumption expenditure). The available results are used to build up a picture of the poverty profile for Azerbaijan, and the categories or regions of the population, which are most at risk of being poor.

1.1. Demographic Background

During the last decade of independence the country's resident population grew from 7,131,900 to 8,016,200; the urban population grew from 3,847,300 to 4,086,400 with an increase of 6.2% while the rural population grew from 3,284,600 to 3,929,800 with an increase of 19.6%. Currently, 51.7% of the population live in urban areas, and 48.3% in rural areas. The share of male and female population is 48.9% and 51.1% respectively.

As was mentioned above circa 12% of the population are refugees or IDPs, many of whom are still living in unsatisfactory and unsanitary temporary living quarters.

According to the data for the year 2000, 4,617,331 or 57.6% of the population were of working age, while 2,469,000 were under working age, and 930,000 of retirement age. There has been an aging of the population during the last decade, with the share of population under working age decreasing, and the share of working age and above-working age increasing.

The birth rate and natural growth rate of the population has been decreasing; while infant and maternity mortality rates increased in the 1990-99 period. The annual population growth rate declined from 1.7% in 1985 to 0.4% in 1997[1]. Marriage rates have also decreased, while the number of illegitimate children has increased. There has also been a negative migration balance in the 1990-99 periods; this is mainly due to the out-migration of working-age men. Overall, the demographic situation in the country is characterised by low population growth.

1.2. Poverty Incidence

The SSC introduced a new HBS in 2001. Analysis of the poverty levels in the country given here is based on data from the first year of this survey. The choice of welfare indicator is per capita consumption expenditure. Here two poverty lines are used: the first is an absolute poverty line of 120,000 AZM (25.8 USD[2]) per person per month. This line is based on the cost of a minimum food consumption basket, which guarantees a daily calorie intake of 2,200 kilocalories. The food share in the total minimum consumption basket is calculated at 70%, which corresponds to the actual food share in the household expenditure structure as reported in the HBS results. Using this poverty line, we get a poverty rate for the country as a whole of 49% for the year 2001 (Table 1.1.)[3].

[1] UNICEF, MICS, 2000

[2] the nominal exchange rate is used here and in the dollar equivalents quoted throughout the text.

[3] Note that here we use the data from the HBS to get the share of individuals living below the poverty line, not households. In the SSC bulletin with tables from the HBS ("Main Results of Household Budget Survey in 2001", Baku 2002) the distribution of households by per capita expenditure levels is given in Table 37. In this table, it can be seen that 42% of households have a per capita expenditure level below 120,000 AZM. However, the share of individuals is higher (49%) due to the fact that the households in the lower expenditure deciles tend to have larger household sizes.

The second poverty line used is a relative one[4], set at 60% of the median per capita consumption expenditure level, which was 72,000 AZM (15.5 USD) for the year 2001. Using this second poverty line poverty incidence is estimated at 17%. The results using this second poverty line can be taken as an estimate of extreme poverty in the country.

1.3. Poverty Profile

The new HBS data have been used to build up a picture of poverty in the country. Here the results which are "robust" for both of the chosen poverty lines have been reported. Although the number of the poor changes with the poverty line, the characteristics of the poor remain the same. The main results are summarised in Tables 1.1. and 1.2. below. The survey data suggest the following[5]:

- Individuals living in urban households have a higher risk of being poor than rural households (poverty rates of 55% in urban areas compared to 42% in rural areas; 60% of the poor live in urban areas). Poverty in towns is slightly worse than in larger cities (58% and 54% respectively). Poverty in Baku is neither below nor above the national average (49%), but it is less than in other urban areas. However, the largest group of the poor is also concentrated in Baku city: one quarter of the total number of the poor.

- The larger the household, the greater the poverty risk. Households with one or two members have a very low poverty risk (poverty rates of 8 – 18%), compared to households with over 6 members (poverty rate of 61%). The presence of up to two children does not have a particularly strong influence on the probability of being poor, but the risk increases particularly when households have more than three children. Conversely, households without children have a lower then average poverty rate (38%).

- Children aged 1-15 years have a higher risk of poverty than the elderly aged over 60 years (52% compared to 44%)

- From the point of view of per capita expenditure, gender does not influence the poverty risk – both male and female members of the population have an almost equal probability of being poor (48% for males and 50% for females). The sex of the head of household also does not influence the likelihood of a household being poor; i.e. female-headed households are not more likely to be poor than male-headed ones (both 49%).

- Households where the head of household has IDP or refugee status have a higher poverty risk Poverty rates of 55% when the head of household has refugee status and 63% if the head has IDP status.

- Households where the head of household has higher education are less likely to be poor Poverty rates of 42% compared to 54% for households where the head of household has less than secondary education.

[4] The relative approach is used by several countries, and is the one currently recommended by Eurostat. The government of Azerbaijan will monitor poverty levels using both an absolute approach (the 120,000 AZM line), and a relative one (60% of the median per capita consumption level).
[5] All results reported below are calculated using the absolute poverty line of 120,000 AZM.

Table 1.1. Poverty Incidence by Categories of the Population (individuals).

Category of Population (Individuals)	Poverty Incidence Absolute Poverty Line (120,000 AZM or 25.8 USD)	Poverty Incidence Relative Poverty Line (72,000 AZM or 15.5 USD)
Total population	49%	17%
Urban	55%	20%
Of which		
Large city	54%	18%
Town	58%	24%
Rural	42%	13%
Nakhchivan AR	45%	8%
Absheron-Guba	58%	25%
Mugan-Salyan	51%	20%
Ganja-Gazakh	50%	16%
Sheki-Zagatal	49%	27%
Lankaran-Astara	45%	8%
Shirvan	38%	14%
Karabakh-Mil	54%	21%
Baku	49%	13%
Male	48%	16%
Female	50%	17%
0-15 years	52%	18%
16-29 years	50%	17%
30-39 years	50%	18%
40-49 years	48%	15%
50-59 years	45%	14%
60 + years	44%	15%

Source: SSC, HBS, 2001

Table 1.2. Poverty Incidence by Characteristics of Household and Head of Household.

Household	Poverty Incidence Absolute Poverty Line (120,000 AZM or 25.8 USD)	Poverty Incidence Relative Poverty Line (72,000 AZM or 15.5 USD)
Higher education	42%	12%
Secondary	51%	18%
Lower than secondary	54%	20%
Household with no children	38%	12%
Household with 1 child	49%	15%
Household with 2 children	51%	18%
Household with 3 children	55%	19%
Household with 4+ children	63%	25%
Age of head of household		
18-29 years	38%	11%
30-39 years	46%	15%
40-49 years	49%	15%
50-59 years	48%	15%
60 + years	53%	20%
Household with 1 member	8%	1%
Household with 2 members	18%	4%
Household with 3 members	30%	5%
Household with 4 members	42%	12%
Household with 5 members	50%	16%
Household with 6+ members	61%	23%
Head of household Refugee	55%	20%
Head of household IDP	63%	26%
Head of household male	49%	17%
Head of household female	49%	17%

Source: SSC, HBS, 2001

1.4. Urban and Rural Poverty

According to the HBS data, the urban population has consistently higher poverty rates than the rural population. For example, 55% and 42% poverty levels for urban and rural areas respectively could be found using the 120,000 AZM (25.8 USD) absolute line.

The higher risk of poverty in towns can be attributed to the importance of land and home produce as a safety net. The rural population is relatively better off because of the value of produce consumed from the household's own agricultural plot or livestock. The structure of cash expenditures only shows that urban households spend more overall, and in particular on food, than rural households. Table 1.3. below shows that total average per capita monthly expenditure in cash is 143,912 AZM (30.9 USD) for urban households, and 95,344 AZM (20.5 USD) for rural households; expenditure on food is 86,368 (18.5 USD) and 53,981 AZM (11.6 USD) respectively.

Table 1.3. Consumption Expenditures by Urban – Rural (Per capita per month in AZM)

	Urban	Rural	Urban	Rural
	in AZM		In USD	
Total consumption expenditure	143,912	95,344	30.9	20.5
Food	86,368	53,981	18.5	11.6
Alcohol and tobacco	4,142	4,066	0.89	0.87
Clothes and footwear	5,298	4,715	1.1	1
Housing, water, electricity, gas and other fuels	7,009	7,805	1.5	1.7
Furnishings, household equipment and routine maintenance of the house	9,469	2,253	2	0.5
Health	3,568	2,210	0.8	0.5
Transport	7,479	5,441	1.6	1.2
Communications	2,270	1,298	0.5	0.3
Recreation and culture	3,631	3,536	0.8	0.8
Education expenditures	2,201	1,462	0.5	0.3
Restaurants, cafes and etc.	7,632	4,942	1.6	1.1
Miscellaneous goods and services	4,846	3,637	1	0.8

Source: SSC, HBS 2001

As stated before, poverty is not only measured using monetary indicators, but also in terms of access to essential goods and services. The regional discussions and Town Hall Meetings in Azerbaijan revealed that many among the rural population do not have access to basic sanitation and health services, even if they wanted to spend money on them. The lack of availability was only partly explained by their price. More notably, they were explained by a noticeable absence of such goods and services, due to the collapse of the infrastructure or to badly needed repairs.

1.5. Regional Differences in Living Standards

Regional differences in living standards have been influenced above all by the concentration of economic growth in the oil and gas industries, and the development of the related service industries being concentrated in and around Baku. However, this has not meant that all of the Baku population are richer than the rest of the country: Baku has a full range of rich and poor categories.

The SSC uses 9 economic regions: Nakhchivan, Absheron, Mugan-Salyan, Ganja-Gazakh, Sheki-Zagatala, Lankaran-Astara, Shirvan, Karabakh-Mil, and Baku city. The available HBS survey data is still not complete enough to give a full picture of regional differences in living standards. However, the picture emerging suggests that poverty is relatively higher in Absheron, Karabakh-Mil and Sheki-Zagatala. Baku has neither the highest nor lowest poverty risk (49%). Nakhchivan, Lankaran-Astara and Shirvan are relatively better off.

Nakhchivan faces a difficult situation, since it is physically separate from the rest of the country, and due to the conflict with Armenia, is effectively under a blockade. However, it benefits from proximity to Iran and Turkey, and cross-border trading with the latter.

Small scale surveys have shown that energy supply is much less reliable in the regions outside Baku and the Absheron peninsula. Electricity supply is often guaranteed for only several hours per day. This affects household welfare directly, and also indirectly, in that lack of guaranteed electricity is a major disincentive for the development of business in the regions.

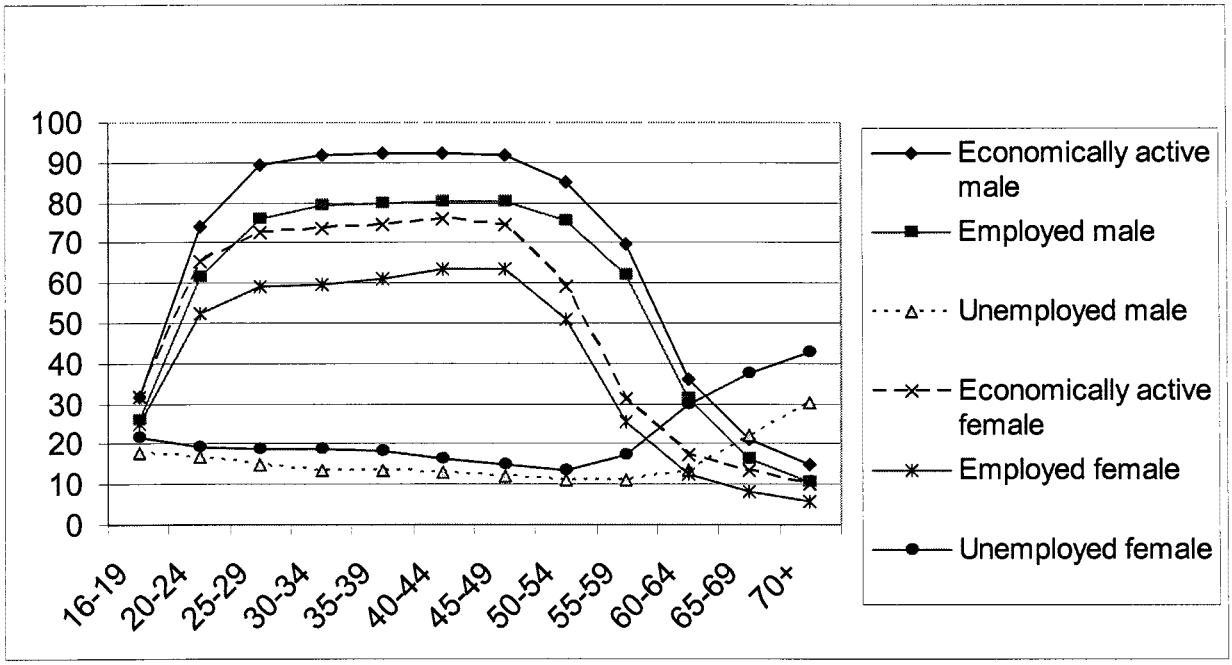
The HBS data do not yet give any clear indication of regional differences in living standards. Poverty appears to be spread quite broadly over the country. Baku and the Absheron peninsula appear to be more privileged than other regions in terms of infrastructure and services, but a large section of the poor population are also situated there.

1.6. Gender and Poverty

The HBS results give no clear correlation between the sex of the head of household, and the likelihood of the household being poor, i.e. the poverty incidence is 49% whether the household head is male or female (Table 1.2.). If we look at the results for individuals we find that females and males have more or less the same likelihood of being poor, in that women have a 50% poverty rate, and men 48%. Thus, the HBS results for the year 2001 do not give any clear indication of a gender dimension to poverty.

However, as stated above, poverty cannot be measured purely on the basis of income and expenditure indicators. Men and women are affected in different ways by other aspects of poverty, and more research is required in order to document these in Azerbaijan. For example, employment data suggest that females have a higher risk of unemployment. Employment of working age men exceeds the rate for women by 13 percentage points (67.3 percent and 53.9 percent), despite the fact that the retirement age for females is 5 years lower.

Figure 1.1. Economically active, employed and underemployed by gender and age groups in 1999, % (ILO definitions).



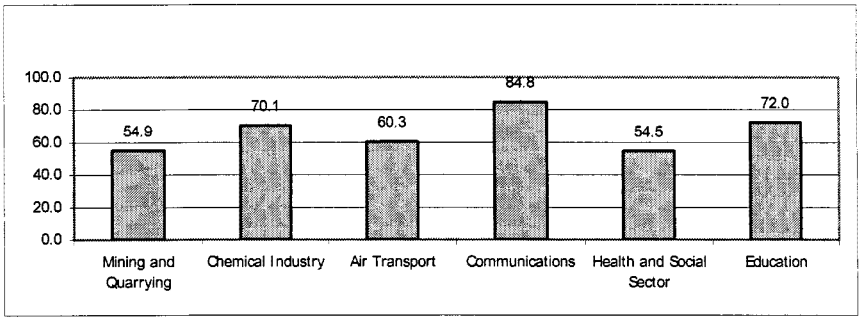
Source: SSC and WB, 2002

It is a worldwide phenomenon that women and men dominate different sectors of economy and different occupations, with female dominated occupations often having lower status and pay than those dominated by men. The available data on gender in Azerbaijan show that women tend to

concentrate in the social services sector, such as health and social care, education and other public services. Wages in the health sector are circa 30% of the national average, and education 70%. However, the gender employment statistics cover only the formal sector of economy, and due to the lack of a regular labour force survey not much is known about the sectoral distribution of labour in the economy as a whole.

In Azerbaijan, wage statistics by gender are scarce but the available data confirms that even in female dominated sectors of economic activities, such as health care, social work and education, wage levels for females are much behind the levels for males.

Figure 1.2. Females' wages as % of males' wages.



Source: SSC and WB, 2002.

Thus, while there is currently no clear evidence that women have a higher income poverty risk than men in Azerbaijan, there is evidence that they are more disadvantaged in the labour market.

1.7. Income Distribution and Inequality

The following chapter shows that country has made notable progress in achieving macroeconomic stability and positive growth figures. At the same time, there exists inequality in the incomes of the population.

The Gini-coefficient is usually used as the indicator of income inequality in a country. In 1999, the World Bank estimated a Gini-coefficient of 0.44 for Azerbaijan[6]. But initial results from the 2001 Household Budget Survey put the Gini-coefficient at 0.35, indicating a more equal distribution that the former. The Gini-coefficient will be monitored from now on using the HBS results, thus ensuring comparability across years.

[6] World Bank Development Indicators, 2000

1.8. IDPs and Refugees

As a result of the ethnic purging policy pursued by Armenia in a planned way during 1988-1992, 250,000 Azerbaijanis were deported and expulsed from their native land to Azerbaijan. The refugee population also includes about 50,000 Meshetian Turks from Central Asia who sought refuge in Azerbaijan from 1990.

As a result of Armenia's armed aggression against Azerbaijan in 1988, 20% of the country, including the territory of Nagorni Karabakh and 7 regions attached to it have been occupied. Thus, 60,000 Azerbaijanis from Nagorni Karabakh and over 600,000 Azerbaijanis from neighbouring regions have become IDPs. They are currently living in circa 1,600 temporary accommodations in 62 cities and districts of the Republic. Additionally, about 100,000 Azerbaijanis whose lives were at risk have been obliged to leave their permanent residences situated along the borderline with Armenia through Nakhchivan Autonomous Republic, Aghstafa, Tovuz, Aghjabedi, Gadabay, Tartar.

The armed aggression resulted in the occupation of the most productive land of 17,000 km^2, which previously provided 35-40% of agricultural production, has brought ruins to 900 towns and villages, 7,000 industrial and agricultural units, 700 educational establishments and 665 health facilities, motor roads covering an area of 800 km, 160 bridges as well as 15,000 km of water lines and 23,000 km of electric lines. The socio-psychological damage aside, the war has caused damage amounting to 22 billion USD to the economy of Azerbaijan. As a result of the armed aggression 20,000 Azerbaijanis have died, 100,000 have been wounded and 50,000 became disabled. There are now 8,000 martyrs' families, 5,000 war invalids, 5,400 children who have been deprived of parental care in the country.

Currently there are circa 1 mln. refugees and IDPs in the country, which makes up approximately 12% of the country's overall population. Although 14 years have passed since the beginning of Armenia-Azerbaijan conflict over 1,722 refugee households have not still been permanently settled. 10,000 refugee households became IDPs after the occupation of the districts where they had settled.

Within the IDP population, there is still a sizeable group living in unsatisfactory and sometimes unsanitary living quarters. After 10 years, over 55,000 of them still live in tent camps, 32,000 in prefab houses, 57,000 in farms and dig-outs, 8,000 in railway cars and the rest of them live in hostels, public buildings, in incomplete buildings, and other unsatisfactory and unsanitary living quarters with no utilities. Many new families have already appeared within the IDPs whose separate housing has become an urgent problem.

Table 1.4. Temporary IDP Accommodation (as of 2002)

Type of Accommodation	No. of Households	No. of Individuals
Total	178,259	760,020
including		
Tent Camps	11,392	55,154
Prefab Houses	6,458	32,793
Railway and Freight Vehicles	1,905	8,353
Farms and dug-outs	14,463	57,502
Schools and kindergartens	15,664	58,139
Hostels	21,179	103,150
Public Buildings	29,462	113,932
Sanatoriums	4,163	16,130
Pensions and Guest Houses	2,876	10,987
Tourist Centres	1,448	5,477
Along the roads	3,786	15,350
Illegally occupied flats	13,665	54,141
Incomplete Buildings	21,791	74,005
With relatives	21,287	121,344
Houses constructed with the funds of SCRIDP	2,106	9,125
Houses constructed with the funds of international humanitarian organisations	6,614	24,436

Source: SCRIDP, July 1, 2002

Since 2001 the government has taken serious measures to re-allocate IDPs from the worst conditions in tent camps temporarily to new settlements and to provide them with land for agricultural purposes. ARRA and Azerbaijan National Agency for Mine Action is operating with support from EU, IDB, IFRC, USAID, UNDP, UNHCR, UNICEF, WB and some donor countries to alleviate the results of military conflict and to provide housing to the population in the liberated areas.

The Household Budget Survey results confirm that households with refugee or IDP status have a relatively higher risk of being poor, especially IDPs. Poverty incidence among IDPs is 63% using the absolute poverty line. However, the sample size is too small to allow us to look further at differentiation within the IDP/ refugee group. Anecdotal and other smaller surveys suggest, however, that there is considerable differentiation in living standards within the IDP/ refugee population. Apart from the housing conditions/ unsanitary conditions, the vulnerability of some of this group is often increased through loss of main breadwinners due to death or invalidity caused by the war.

There is much concern among the IDP women in terms of issues related to gender, family planning, protection of child health and etc. Currently, 40,000 IDP women suffer from various diseases (infectious, gastrointestinal infections, virus infections, skin diseases, malaria, diphtheria, typhoid, nervous disorders, tuberculosis, anaemia, diabetes) and disease incidence among children is increasing due to poor living conditions and lack of access to clean drinking water. Infant mortality is 3-4 times higher than the republican average.

The table below illustrates the extent to which health indicators for IDPs are below the national average levels. It is estimated that 26% of IDP households suffer from malnutrition, compared to 10% nationwide; and 30% of children (aged 6-59 years) suffer from chronic malnutrition, compared to 21% nationwide. The indicators for anaemia are also worse for IDPs (children, women and men).

Table 1.5. Comparison of Health Indicators for the IDP population with the National Average.

Diseases	% of IDP's	% Nationwide
Households with malnutrition	26.3	10.4
Children of 5 years with diarrhoea	23.4	15.2
Children of 6-59 months with acute malnutrition (body mass deficiency)	1.3	3.0
Children of 6-59 months with chronic malnutrition (physical retardation)	30.5	21.5
Elders with malnutrition	10.1	13.7
Children 12-59 months with anaemia	46.1	43.3
Non-pregnant women with anaemia	40.7	35.5
Men with anaemia	34.4	25.0
Adults with 1 grade goitre	23.0	9.8

Source: MH, SCRIDP, 2000.

The literacy level among IDP population can be considered as high as in other sections of the population. Thus, 60% of this population have general, secondary and higher education.

Women and children are considered the most vulnerable subgroup of this population group. 200,000 of the IDP population are children; more than 86,000 are under school age, and about 98,000 are schoolchildren. In order to involve children in education over 703 schools have been established, some in prefab buildings, some in sub-standard buildings. Schools work shifts due to the lack of classrooms. This as well as the lack of modern educational technical equipment affect negatively the quality of education.

Provision of employment to IDPs remains a problem. It is estimated that, 300,000 out of 400,000 able-bodied IDPs are without work; over 70% of the working-age IDP population. A certain share of IDPs is employed in non-permanent and part-time jobs. Unemployment problems are particularly acute among IDP women, in that 175,000 out of 380,000 are able-bodied. 38,000 of them have been provided with employment.

Most displaced households currently depend on assistance from the government and humanitarian organisations for their survival. But humanitarian assistance has been decreasing sharply in scale especially during the last 2-3 years. Thus, the number of IDPs receiving food aid from those organisations has decreased to 214,000 during the last 2 years and also the volume of food provision per capita has been reduced from 20 kg. to 4-5 kg. These difficulties have adversely affected the natural increase of the IDP population and this indicator has decreased 2-3 times compared to 1990.

Conclusions:

The IDP population in general is considered to be the most vulnerable group of the population with poor living standards, low income and employment levels and increased health risks.

Despite the measures undertaken by both government and international humanitarian organisations there is a need to provide some part of IDPs with food on monthly basis, improve the social-living conditions of those with the worst living standards, upgrade health and education services, and create micro-financing capacity for expanding employment and income generation opportunities.

In this regard, recent policy measures aimed at providing more permanent housing solutions to certain part of those IDP households living in tent camps will contribute to improving the living conditions of some of the most vulnerable, and contribute greatly to their integration into society.

1.9. Social Protection System

Social Protection in Azerbaijan comprises a number of social insurance and social assistance benefits. In principle social insurance benefits are paid from social security contributions made by the working population, and social assistance benefits are paid from the state budget to the most vulnerable.

Social Insurance

The main social insurance payments currently available are as follows: old age pensions; disability pension; survivor's benefit; pension for the years of service; unemployment benefit etc. Social insurance payments amounted to 3.1 % of GDP in 2001.

Pension Provisions

In 2001 there were 1,245,079 receiving pensions in Azerbaijan (15.5% of the total population). Of these, 734,758 received old age pensions, 179,514 disability pensions, 136,189 loss of breadwinner pensions, 194,618 for the years of service and social pensions.

As a result of recent measures the average size of the monthly old age pension is 92,900 AZM (19.2 USD). Working old age pensioners have the right to receive 50% of granted pension regardless of their salaries.

The state Budget makes various kinds of supplements to pensions. Pensions are supplemented by a total of 23 benefits. Thus, according to the Order by the President of the Republic of Azerbaijan dated May 22 1996, a supplementary benefit of 11,000 AZM (2.3 USD) is paid to non-working pensioners, and according to the Decree issued 17 June 1997, a supplementary benefit of 20,000 AZM (4.1 USD) is paid to single pensioners over 70 years. Benefits are paid to the disabled of the Great Patriotic War, martyrs' families and those who have become disabled for the territorial integrity and sovereignty and constitution building of the Republic of Azerbaijan, and those affected by the 20th of January 1990 and Chernobyl NPP accident.

According to the Order "On Increasing the State Assistance for the Disabled and a Group of Underprivileged Citizens from Other Categories" issued by the President of the Republic of Azerbaijan in December 29, 2000, a benefit of 70,000 AZM (14.4 USD) per month is paid to the disabled of the first category; 60,000 AZM (12.4 USD) to those of the second category and; 50,000 AZM (10.3 USD) to those of the third category by increasing the monthly supplements to the pensions of those who have become disabled while protecting the Republic of Azerbaijan from Armenian aggression and during the events on the 20th of January 1990. As a result the size of the pensions of the people in this category has been increased up to 30%.

According to the legislation in force, pensions for the number of the years of service as well as social pensions are funded by SPF. The SPF also finances childbirth allowances, childcare allowances for mothers with children under 3 years and funeral benefits. All are entitled to these

benefits, not just those who have paid social insurance contributions. The childbirth allowance is currently 70,000 AZM(14.4 USD) and the funeral benefit 150,000 AZM (30.5 USD).

Pension expenditures account for 60% of the overall social insurance and social assistance payments. Old age pensions make up 63.2% of the whole Pension Fund. Thus the elderly benefit from a major part of social insurance and social assistance payments. In this regard, the social protection of elderly people is much better organised than those in other categories, including children.

The size of the disability pensions is defined according to the cause and extent of disability. These pensions are financed by social insurance contributions and supplemented by allowances. These allowances too are determined according to the cause and extent of disability. The supplementary allowances for disabled are not targeted according to the income level of the recipients.

Households without a breadwinner are paid benefits from the Social Protection Fund from obligatory social insurance contributions. While pensions are supplemented by allowances each member of the household who is entitled to this pension is taken into account. The minimum amount of these pensions is set at 70,000 AZM (14.4 USD) per household member.

Able-bodied people who have been registered as job seekers in the state employment service offices and who have no jobs and earning opportunities, but are prepared to start working, are entitled to the status of unemployed.

The State Employment Service Office provides the applicants who have been registered as job seekers with the status of unemployed if they do not receive any eligible job offer by the employment service for 11 days after submitting the necessary documents. If the people with status of unemployed have had a paid job for 26 weeks in the previous 12 months before unemployment, their benefits are determined at 70% of the last average monthly wage. In other cases, a minimum benefit is paid. After the new Law on Employment was adopted (August 2001) the minimum level of the benefit was increased from 5,500 AZM (1.2 USD) to 30,000 AZM (6.2 USD). After the increase, the average size of the unemployment benefit was 67,000 AZM (13.8 USD) in the first half of 2002 compared to 37,000 AZM (8 USD) in 2001.

According to the legislation the benefit is paid only to those registered at the State Employment Service Offices. The maximum level of the benefit is set at the level of the national average monthly salary.

Social assistance

Social assistance benefits include child benefits for low-income families, child birth allowances and child care allowances.

One main component of the social assistance is benefits and compensations. Benefits paid to low income families with children take a special place amongst these payments. Currently, 1,320,000 children and 303,000 working people receive such benefits from the Ministry of Labour and Social Protection. Every year over 15 billion AZM (3.09 mln USD) are spent for this purpose. It is paid if the per capita monthly income of the household is less than 16,500 AZM (3.4 USD). The size of this

benefit is 9,000 AZM (1.9 USD) per month per child under 16 years (or under 18 years if the child studies and receives no grant).

The income assessment carried out for this benefit is very rough, and is based on formal wages. The benefit is low and non-targeted as it covers most of the children. There is a need to review income assessment procedures for increased, targeted benefits.

Other types of social assistance include the food allowance benefit paid to IDPs, social services provided through the offices of the Ministry of Labour and Social Protection, and allowances paid to pensioners, allowances for the children from certain families (families of martyrs and the war disabled) irrespective of their income. Again, the food allowance benefit (25,000 AZM or 5.2 USD) paid to IDPs is not targeted as it covers all IDPs.

Until 2001, there were non-tax privileges related to utilities, communications, education, health and transport services, as well as supply of medicine. Overall, 1.5 million individuals in 25 different categories of the population were granted with these privileges. These privileges were abolished in January 2002, and now compensations are paid to 10 most needy groups of the population instead of the privileges.

Overall, the system of social assistance is not targeted. Therefore, there it is necessary to improve the targeting and transparency of the system.

Table 1.6. Size of Social Benefits Compared to Monthly Average Wage, 2001.

	Monthly Average Wage	Minimum Wage	Minimum Subsistence Level, per capita	Average Old Age Pension	Minimum Pension	Child Benefit (0-16 years)	Unemployment Benefit
In AZM	260,000	27,500	120,000	92,900	70,000	9,000	37,000
In USD	55.8	5.9	25.8	19.2	14.4	1.9	8

Source: MLSPP

The biggest item of social protection in terms of expenditure is utility subsidies, which are in fact a very inefficient way of protecting the poor. This issue is discussed further in Chapter 4. The government has taken some important steps towards the removal of these subsidies with adoption of the State Programme "On Strengthening of Financial Discipline in the Energy and Water Sectors". There is a need to design and implement a targeted social assistance scheme in order to help needy households cope with the increases in costs for utilities.

The key problems in the current social protection system can be summarised as follows:

- There is no mechanism for benefits to be specifically targeted at the poor
- Due to shortage of funds for social insurance payments, the state budget is used to make supplements to pensions and other benefits, meaning that there is no clear definition of social insurance and social assistance payments.
- Despite the huge socio-economic changes which have occurred since 1991 the system of the social protection does not reflect the new reality and remains practically unchanged.
- There is an urgent need to develop a new targeted social assistance benefit.

- There are problems in pension provision as a main sector of social protection system: difficulties in collecting obligatory social security dues and its relation to pension amounts. A new system of individual records has to be introduced in order to bring the pension provision up to international standards. The main objective of the system is to provide a direct link between the obligatory social security payments and individual pension payments.

1.10. Employment

Paid employment is one of the most important ways of protecting the population from poverty. If citizens do not have the possibility to generate income for their families, the risk of poverty and vulnerability increases.

In 2000, the labour force in the Republic was 4,685,800 which exceeded the figure for 1990 by 17%. The economically active population grew by 0.3% in 2000 and became 3,748,200 in 2000, of these 3,704,500 were employed in all kinds of economic activities.

There has been a decline in the industrial and construction sectors, and a growth in the agricultural sector in the period 1991-2000.

Table 1.7. Distribution of Employed Population by Economic Sector in 1991 and 2000.

	1991	2000
Total employment (1000)	3,732	3,705
Industry (% of total employment)	12	7
Agriculture	32	41
Construction	7	4
Services	49	48

Source: CIS Statistical Handbook. 10 years of the CIS, Moscow 2001.

As can be seen from the table, in 2000 industry accounted for only 7% of the economically active population, and construction for 4.2%. The service sector accounted for 48% of the overall employed population. In 1991 the agricultural sector accounted for 31.8% of the overall economically active population, while it increased to 41% in 2000. It is important to note that growth in agricultural employment is directly related to a land reform, which has resulted in the allocation of small land plots to most of the rural population. However, as mentioned above, agriculture on the whole still remains poor in investment and capital. Thus, it is important to accelerate the implementation of the necessary measures to develop this sector.

The number of employed in the public sector was 2,618,900 in 1990, while it declined to 1,278,200 in 2000. However employment in the private sector is growing. There were 2,426,300 employed in the non-government sector in 2000, which was 2.2 times more than the figure for 1990. Currently, the process of creating organisations of collective or private ownership is underway. This partly provides employment for the work force that is unable to find a job in the public sector. Analysis of the employment in the private and public sectors suggest that, public sector employment rate is much higher than the republican rate (34.5%) in Nakhchivan (45.1), Khojavand (45.5), and in Sheki (44.5).

According to the 1999 census data, 64.6% of population over 16 years was employed (73% of males and 57.2% of females). By international standards this is also a relatively high labour force participation rate (LFPR: those who are employed, and the unemployed who are seeking employment). Among the working age population the LFPR is 71.9% (78.2% among males and 65.7% among females; working age – 16-62 years for males and 16-57 for females).

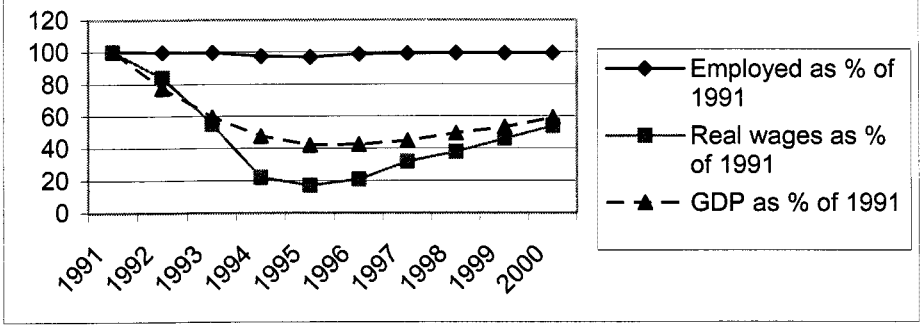
Table 1.8. Distribution of Population of 16 Years and Over by Economic Activity, (1999 census data, %)

Age group	Labour force	Economically active			Economically inactive	Economic status not defined
		Total	of which:			
			employed	unemployed		
Males						
Working age	100	78.2	67.3	10.9	21.4	0.4
Pension age	100	20.0	15.4	4.6	79.8	0.2
Females						
Working age	100	65.7	53.9	11.8	33.9	0.4
Pension age	100	15.2	10.2	5.0	84.6	0.2
Urban population at age 16 and over	100	59.3	45.6	13.7	40.3	0.4
Rural population at age 16 and over	100	70.5	63.5	7.0	29.1	0.4

Source: SSC 2001 and WB 2002.

Although overall participation rates are quite high, many are engaged in temporary jobs in the informal sector, which leads to insecurity; and many of those in the formal sector, especially the public sector, earn low wages. Overall employment levels have not dropped nearly as much as GDP levels: despite falls in output, unemployment did not rise proportionally. This can be explained by the fact that workers are willing to accept reduced pay or hours of work; and it is a clear sign that real wages, through lower labour productivity, have decreased dramatically (Figure 1). Thus the relatively high employment and participation levels cannot necessarily be interpreted as implying higher income security. Although there is relatively low open unemployment, there is much hidden unemployment, with workers being retained on low wage, low productivity jobs.

Figure 1.3. The dynamics of employment, real wages and GDP in 1991-2000, %



Source: SSC and WB, 2002

With regard to unemployment, in 2001 there were 48,446 unemployed registered with the State Employment Services (giving an unemployment rate of 1.2%), but the 1999 census data suggest that among the able-bodied and economically active population there were 519,000 unemployed. This shows that non-registered unemployment is higher (15.8%). This gives an unemployment rate of 14.2% for men and 18.6% for women.

The main characteristics of the registered unemployed are presented in Table 1.9. Females dominate among the registered unemployed, as well as the youth aged less than 30 years. The share of highly educated unemployed among the pool of registered unemployment is extremely high in Azerbaijan: in late 1990s and in 2000, more than 60 percent of the unemployed had higher or secondary special education. 56.9% of the registered unemployed are graduates of higher and vocational educational establishments; 24.5 percent of registered unemployed left their previous job voluntarily and only 13.8 percent – due to staff reduction. This suggests that many of the professional education establishments produce workers with skills that are not in demand in the labour market.

Table 1.9. Registered Unemployment (end-December)

	1991	1995	1996	1997	1998	1999	2000	2002
Total	3,969	28,314	31,935	38,306	42,329	45,211	43,739	48,446
Of which: Males	1,452	11,411	13,086	16,227	18,234	19,622	19,283	21,808
Females	2,517	16,903	18,849	22,079	24,095	25,589	24,456	21,633
% of females out of total	63.4	59.7	59.0	57.6	56.9	56.6	55.9	55.0
At age less than 30 years, %	38.0	49.9	43.4	43.5	49.4	49.1	42.6	43.0
Share of unemployed having higher or secondary special education	51.5*	38.1	45.9	47.2	62.7	62.5	61.1	60.1
Received unemployed benefit till the end of report year.	-	2,981	3,266	3,113	2,685	2,387	2,768	9,339
Of which: Males	-	1,162	1,445	1,423	1,142	1,173	1,313	4,808
Females	-	1,819	1,821	1,690	1,543	1,214	1,455	4,531
Registered vacancies	18,584	9,083	9,459	10,078	8,034	6,556	5,197	4,748
Unemployed over one year, % of total	8.8**	39.7	21.2	28.4	39.9	55.5	59.6	59.6
Unemployed between 6 and 12 months, % of total	17.5**	12.7	11.4	33.3	32.5	13.9	11.4	11.2

* - 1992; ** - 1993.

Source: SSC

Table 1.10. Employment by Type of Economic Activity

	1000'		In %		Share of female workers, %
	1999	2000	1999	2000	2000
Total	3,702.8	3,704.5	100.0	100.0	45.7
Agriculture, hunting and forestry	1,566.3	1,566.5	42.3	42.3	21.8
Fishing	0.5	0.5	0.0	0.0	7.6
Mining and quarrying	39.6	39.6	1.1	1.1	22.6
Manufacturing	180.6	180.7	4.9	4.9	35.0
Electricity, gas and water supply	38.8	38.8	1.0	1.0	21.9
Construction	154.7	155.0	4.2	4.2	10.6
Wholesale and retail trade; repair of cars, motorcycles and personal and household goods	576.4	577.0	15.6	15.6	25.9
Hotels and restaurants	9.8	9.8	0.3	0.3	34.6
Transport, storage and communications	168.4	168.6	4.5	4.5	23.9
Financial intermediaries	15.2	15.2	0.4	0.4	41.3
Real estate, renting and business activities	98.7	98.7	2.7	2.7	48.7
Public administration and defence; compulsory social security	260.2	260.2	7.0	7.0	35.7
Education	299.6	299.6	8.1	8.1	68.8
Health and social services	168.2	168.4	4.5	4.5	75.3
Other community, social and personal service activities	125.5	125.6	3.4	3.4	59.8
Extra-territorial organisations and bodies	0.3	0.3	0.0	0.0	-

Source: SSC and WB, 2002

The overall conclusions from the available labour market data are as follows:

Participation rates are quite high, but in all age groups men participate more than women, and the gap is especially significant in the most active years of work. This implies that women are retreating from the labour market, and has implications for female poverty and vulnerability.

Rural employment is slightly better than urban, due to the opportunities for agricultural self-employment promoted by land reform. However, the opportunities to develop agricultural assets are limited, and this self-employment is more of a survival/coping strategy rather than income generation.

Youth unemployment is high, especially among young people with secondary special and vocational education. Vocational education does not appear to be giving young people the skills they require to be competitive on the labour market.

1.11. Health

Poor health outcomes and low education achievement not only decrease well-being, but also limit people's income-earning potential. They are dimensions of poverty, which interact and reinforce income poverty. There is a general recognition of the fact that the country experienced a worsening of the health status of the population in the period immediately following independence. However, there is less consensus on the trends in health status since the mid-1990s, when many of the national health status statistics have indicated an improvement.

Table 1.11. Selected Official Statistics on Health Status and Health System Performance

	1989	1990	1995	1999	2000	2001
Infant Mortality Rate, per 1,000 live births	26.2	23.0	23.3	16.5	12.8	12.5
Under 5 Mortality Rate, per 1,000 live births	45.6	40.5	43.2	31.7	25.9	24.8
Maternal Mortality Rate, per 100,000 births	28.6	9.3	37.0	43.4	37.6	25.4
Total Fertility Rate	2.8	2.8	2.3	2.0	1.9	1.8
Average Life Expectancy: Male	66.6	67.0	65.2	68.1	68.6	68.6
Female	74.2	74.8	72.9	75.1	75.1	75.2
Average yearly male population (thousands)	3,446.6	3,502.9	3,778.7	3,899.6	3,936.4	3,971.6
Average yearly female population (thousands)	3,617.8	3,672.3	3,906.2	4,083.2	4,122.2	4,139.6
Female per 100 Male	104.9	104.8	103.4	103.7	104.5	104.2
Number of marriages	71,874	73,119	43,130	37,382	39,611	41,861
Number of divorces	11,436	14,040	5,669	5,013	5,478	5,382
Number of abortions	39,022	24,611	28,700	20,911	17,529	18,361
Abortion Rate (Number per 1,000 women 15-44)	22.1	14.2	14.2	9.4	7.7	7.9
% of pregnant women receiving pregnancy consultations	96.3	95.6	97.8	97.5	97.2	94.8
% of women at term with anaemia	5.0	6.7	14.5	15.6	20.0	19.0
Number of midwifes	15,373	12,439	11,969	10,952	10,321	10,222

Source: MH

Table 1.12. Infant Mortality Rate (per 1,000 live births)

IMR,	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Azerbaijan	26.2	23.0	25.3	25.5	28.2	25.2	23.3	19.9	19.6	16.6	16.5	12.8	12.5
Kyrgyzstan	20.4	18.6	17.9	18.5	17.1	15.1	14.2	15.5	15.4	14.7	15.4	-	-
Armenia	43.2	40.7	40.6	45.9	47.0	40.6	30.9	31.2	27.9	23.4	19.4	-	-
Tajikistan	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**

Source: MH and WB

There are gender differences in some health indicators. For example, the number of cases of tuberculosis has been growing, and this has especially affected men (3,780 cases registered, compared to 1,320 for women).

With regard to reproductive health, there has been a reduction in abortions compared to 1989, thanks to efforts by international organisations and the government to extend family planning services to the population. And with regard to maternal mortality, the risk of this is growing among poor sections of the population, due to the lack of financial means to pay for maternal care in maternity homes or hospitals.

In the 1985 – 1997 periods, the total fertility rate declined from 2.9 births per woman to 1.9, while the crude birth rate declined from 27 per thousand to 17 per thousand. While fertility has decreased dramatically, the decrease occurred in all age groups apart from that of 15-19 years. For this age group, fertility increased by 2 times. This is worrying due to the early age of childbirth, the

implication being that these girls will miss some of their obligatory education with negative consequences for their future employment opportunities.

UNICEF carried out a survey in the year 2000, with the aim of establishing the health, education, and overall welfare status of children and women in Azerbaijan (the Multiple Indicator Cluster Survey, MICS). This is a nationally representative sample survey, which, like the HBS, aims to show the links between the different aspects of women and child welfare. One finding, for example, is that children whose mothers have at least college or vocational school education are the least likely to be underweight and stunted compared to children of mothers with less education. Using the survey results and international definitions, UNICEF calculates a maternal mortality rate of 79 per 100,000 for 1988. This is considerably higher than the rate reported in Table 1.11. above.

Since the mid 1990s attempts have been made by the government of Azerbaijan with the help of international organisations to combat the spread of infectious diseases in the country. Thus, by 1996 Azerbaijan had succeeded in eliminating polio and received Certificate on Polio-Free Country in Europe in 2002. Additionally, diphtheria has almost been eradicated; there as been a reduction in the number of cases of malaria, infectious hepatitis, measles, whooping cough and tetanus.

1.12. Education

The HBS results show a link between the education level of the head of household and poverty risk, i.e. the higher the education level, the lower the likelihood of the household being poor (Table 1.2.). Access to good quality education is therefore one factor, which can help protect the population from vulnerability. This is partly due to the fact that the better educated are also more competitive on the labour market: the 1990 census data confirms that employment levels of those sections of the population with higher and incomplete higher education are significantly higher in all age groups.

Azerbaijan inherited relatively good education indicators from the Soviet period. However, the results of the HBS give some worrying indicators of how the education system is struggling to preserve the country's strong educational heritage. In the 30-40 year age groups, 13-14% have higher education; 16-18.5% in the 40 – 60 year age group; compared to 11% in the 20-25 year age group (Table 1.14). According to the administrative statistics, only 16% of the 3-6 year old age category attends kindergarten, meaning that the system of pre-school education has almost collapsed in the post-Soviet period.

Overall literacy rates and school enrolment rates remain good, but there are problems with deterioration in the quality of the education being offered. It has also been noted above that unemployment among young people is high, and this is partly a direct result of inappropriate methods and subjects being taught in the general and vocational education system. Also, there is no systematic collection and analysis of school attendance rates, which would give a better indication of changes in the access to and quality of education being received by different sections of the population, and the extent to which there are gender differences in attendance and access.

Education enrolment and literacy rates

Azerbaijan has a high literacy rate (98.8%), high school enrolment rates (165,870 students have been enrolled in secondary schools in 2001/2002, that is 84.1% of total population of the age group 6 to 16 (1,971,200)), and good teacher/ pupil ratios (1:10).

Formal school education lasts 11 years, and is free and compulsory. Primary education consists of the first 4 years of this period. Studies conducted for and by the Ministry of Education show that there is a trend towards decreasing attendance of children in schools, especially in grades 8-11.

The number of vocational educational institutes, as well as the number of students studying in them, has declined over the last decade. While in 1990 there were 176 vocational schools with 82,188 students; at the end of 2001 there were 109 vocational education schools with 21,619 students. However, higher educational establishments experienced a relatively mild drop in the number of students – from 107,945 in 1991/92 to 89,155 in 1994/1995 but by 2000/01, the number of students already exceeded the pre-transition level – 119,683 students were enrolled in higher schools.

Table 1.13. Number of Public Education Establishments and Students in 2001

	Number	Number of Students Enrolled
Pre-school institutions	1,794	111,352
Secondary Schools	4,538	1,658,570
Vocational Schools and Lyceums	109	21,619
Special secondary education (state)	66	47,726
Special secondary education (non-state)	3	1,477
High schools (state)	25	98,959
High schools (non-state)	15	21,494

Source: SSC

Table 1.14. Level of Education of Population by Age Groups in 1999, %

Age groups	Level of education				
	Higher and incomplete higher	Secondary special	Secondary general	Incomplete secondary	Vocational
25-29	12.3	13.4	63.4	5.8	4.3
30-34	12.8	15.2	60.1	5.8	5.1
35-39	14.8	16.9	55.8	6.0	5.4
40-44	17.8	18.5	50.6	6.8	4.9
45-49	20.6	19.3	45.2	8.4	4.1
50-54	21.1	17.5	41.4	11.3	3.4
55-59	14.6	14.4	40.1	16.2	3.3
60-64	10.3	11.6	35.2	19.4	2.9

Source: SSC

Data on the gender distribution of students in the education system show that there are some gender differences in the enrolment at different types and levels of education.

Table 1.15. Gender Distribution in Enrolment in Different Types and Levels of Educational Facilities. (1997-2000)

	Secondary school		Vocational (state)		Technical Colleges (state)		Technical Colleges (private)		University (state)		University (private)		Post-graduate	
	M	F	M	F	M	F	M	F	M	F	M	F	M	F
1997	50.9	49.1	68.5	31.5	35.1	64.9	-	100	56.9	43.1	67.2	32.8	75.4	24.6
1998	51.0	49.0	69	31	34.9	65.1	11.4	88.6	58.6	41.4	68.7	31.3	68.3	31.7
1999	50.9	49.1	65.5	34.5	32.6	67.4	3.5	96.5	58.6	41.4	63.8	36.2	68.7	31.3
2000	51.5	48.5	67.6	32.4	31.0	69.0	4.7	95.3	57.7	42.3	60.4	39.6	64.9	35.1

Source: SSC

While secondary school enrolment is slightly lower for females, the difference is not very striking. However, the table shows that females are over-represented in both state and private technical colleges; while males are over-represented in state and especially private universities. Post–graduate studies are also dominated by male students. This suggests that there is an increasing tendency towards the feminisation of certain vocational studies, and that this will probably be reflected then in the feminisation of certain types of employment. There is a tendency for the share of females in university and postgraduate education to grow, but the higher education levels, and therefore access to more prestigious jobs, are more accessible to men.

Quality of Education

Although the basic indicators in education remain good, there are several urgent problems relating to the quality of education being provided, which will have long term effects on the country's education outcomes unless they are tackled. The problems in the education sector can be summarised as follows:

1. The quality of the learning environment has deteriorated at all levels of education, but especially in primary and secondary education. This is manifested in the poor condition of physical infrastructure, lack of textbooks, basic education materials and supplies, poor teacher training or shortage of teachers in remote regions. In addition, outdated curricula and teaching methods, poor teaching skills, and low wages have also had negative effects on the quality of education. The quality of teaching personnel has deteriorated considerably due to sharp drops in real teacher salaries, deteriorating conditions of the school environment, and poor teacher training. Such factors have prompted many of the best teachers to leave the system, de-motivated the existing teaching staff and reduced the demand for teacher training. Low salaries are one of the main reasons for the deterioration of the quality of education. The average monthly wage for the teachers working in general education establishments in 2001 was 193,200 AZM (41.5 USD).

2. Almost all education institutions lack basic textbooks and teaching materials and supplies to perform an acceptable high standard. Teaching and educational facilities for various subjects are not available. By law, the state is supposed to provide free textbooks for elementary grades 1-4, but it is reported that only 35 or 40 percent pupils receive free textbooks due to shortages. There have also been reductions in the budget funds available for maintenance and repairs, resulting in deterioration in the overall physical conditions of many school buildings, especially in rural areas.

3. Outdated school curricula and teaching methods, which were inherited from the Soviet system, bear little relevance to the needs of an emerging market economy and an independent country. Teaching methods usually do not reflect modern teaching practices.

4. An inappropriate linkage between education and the labour market, which requires substantial changes in the content of the education programmes being offered (in general secondary, vocational, higher education) to respond to the new skill demands in a market economy. In addition, there is still a major need for development of new curriculum, particularly for grades 7-11. Vocational education is reported to be more accessible to the poorer sections of the population, yet it offers training in skills which are not in demand on the labour market.

There is a need to develop policies to address the problems. These are discussed in Chapter 3.

1.13. Children and Poverty

The results from the HBS reported above show that children have a relatively high poverty risk, especially if they are members of large families. Children under the age of 15 years have a higher poverty rate than the over 40 year-old age groups (52% compared to 44-48%). The poverty rate for members of households with four or more children is 63%, compared to the national average of 49%.

Since independence, there have been two other visible pieces of evidence pointing to the increasing vulnerability of part of the child population. Firstly there has been an increase in the numbers of children in institutionalised care. Anecdotal evidence suggests that this is often due to the fact that families cannot afford to feed their children. Secondly, the problem of street children has become more visible. This is in many ways related to the problems of institutionalised care, since many of the street children have either run away or graduated from institutionalised care. There is also some evidence that the children of some sections of the IDP population have had to take to the streets to try to earn some money not just for themselves but for their families.

The table below shows that over 17,000 children are currently living in various forms of institutions and boarding schools. These include orphaned children, but also an increasing number of "social orphans"; i.e. children who have been placed in institutions by their parents, because they cannot afford to feed and cloth the children themselves. Once children are in institutions they are segregated from society, and many have problems re-integrating when they leave.

Table 1.16. Children in Institutions in Azerbaijan (end of each year)

	1990	1995	1996	1997	1998	1999	2000	2001	Responsible Ministry
Number of institutions for infants	4	4	4	4	4	4	4	4	
Number of children	241	166	159	181	181	184	197	191	MH
Number of orphanages	5	4	4	4	5	5	6	6	
Number of children	397	395	435	461	548	608	684	705	ME
Number of Internat schools for orphanages and for children deprived from parental care	2	2	2	2	2	2	2	2	
Number of children	505	548	633	616	575	569	554	540	ME
Number of special schools for children with disabilities	16	13	11	13	14	14	13	13	
Number of children	2,811	1,607	1,938	2,132	2,359	2, 498	2, 679	2, 731	ME
Number of special schools for children with mental disabilities	2	2	2	2	2	2	2	2	2
Number of children	515	271	228	262	302	300	300	348	MLSPP
Number of general type Internat schools	50	38	38	38	37	38	38	39	
Number of Children (in thousands)	19,4	15,2	16,3	16,5	16,1	17,1	17,6	17,8	ME

Source: ME

It is the right of every child to grow up in a family environment. The policies needed to help ensure that this right is realised in Azerbaijan are discussed in Chapter 3.

1.14. Environment

The well-being of the population is also affected by the environmental conditions in which it lives. Poverty and vulnerability are closely linked to environmental problems, in that land which has been ruined by environmentally detrimental practices cannot be used for agriculture; polluted air and drinking water leads to increased health risks for the population.

Azerbaijan inherited several environmental problems from the Soviet period. Environmental problems are particularly acute in large economic centres such as Baku, Sumgait, Ganja and Ali-Bayramli. The water resources, land, air, and flora and fauna have been negatively affected by the Soviet inheritance and also the economic difficulties of the 1990s.

Water:
Water sources are decreasing, while water consumption and supply is wasteful. Only 50% of the population has piped water. Rivers are lakes are polluted to various degrees. Clean water is becoming a privilege of the rich, since they can afford filters, mineral water etc. This leads to increased risk of infection through polluted water for the poorer sections of the population.

Land:
Degradation of land surface leading to soil erosion, salinisation, is affecting the ability of the rural population to use the land to generate income. Use of harmful chemical fertilisers means that they are absorbed into the soil and ultimately penetrated into the food system, with a negative impact on the population's health.

Forests:

Forest and woodlands are currently at risk. In particular, insufficient energy provision to the regions has given rise to harmful use of woodland resources. International experience shows that creating opportunities for participation of communities and user groups in managing these resources can help reverse this process. Participatory forest management and monitoring can have a positive impact on agro-pastoral practices in the areas concerned. Appropriately-designed tree plantation schemes both on state-owned and private land can improve watershed protection system, and preserve the biological diversity.

Air:
Emission of toxic pollutants into the air is mainly caused by power plants, industry and transport. Health outcomes for the population living in Absheron peninsula are negatively affected, since 70% of such units are located here.

The other main environmental problem linked to the living standards of the people of Azerbaijan is the pollution of the Caspian Sea. The livelihood of large sections of the population is connected with the Caspian Sea, whether due to the oil industry, or the fishing industry. The Baku bay area can be considered virtually dead from a biological point of view. Attempts are needed to protect the Caspian Sea from further pollution through limitations on fishing and prevention of biomass reduction, which in turn will adversely affect the livelihood of many coastal inhabitants.

Conclusions

Poverty is a multidimensional phenomenon. The new Household Budget Survey in Azerbaijan allows us to begin to define more clearly the characteristics of the poor in the country. The HBS data, as well as the results of smaller one-off surveys and administrative sources suggest the following:

There is a strong correlation between poverty and household size, and children have a higher poverty risk than the older age groups, including the pension-age group. This has implications for the design of social assistance and social protection policies: children are a very vulnerable group in this country.

The older the head of household, the more likely the household is to be poor. The poverty rate for individuals in households where the head is more than sixty years old is 53%. On the other hand, individuals where the head is 18-29 years old have a poverty rate of just 38%. Thus pensioners as a group are not particularly vulnerable, but if the head of the household is of pension-age, the vulnerability increases significantly.

Access to land is important in protecting the rural population from poverty, but is not enough to let them use it for income generation rather than subsistence farming.

The IDP/ Refugee population have a higher than average poverty risk. Not all of this section of the population are poor, but there are pockets of severe poverty and vulnerability which require specific solutions.

Rural regions appear to be better protected from income poverty and unemployment, but suffer more from declining infrastructure, and irregular energy supplies.

Regional differences in living standards are largely connected to the one-sided character of economic growth in the last years.

Chapter 2. Current Economic Status

2.1. The Macroeconomic Background

Although Azerbaijan has started the independent government building and economic transformation process, it has inherited a lot of problems from the Soviet period. It was one of only two Soviet Republics which did not receive subsidies from the centre (the other being Russia), and it ranked tenth in terms of living standards among the 15 Soviet Republics. In 1990, average monthly wages were approximately 30% below the average for the Soviet Union, and were 50% lower than those of the Baltic republics. Official statistics from 1990 show that 35% of the population had per capita incomes below the national minimum subsistence level.

After gaining independence, Azerbaijan was faced with serious political, military, economic and social problems. It was exposed to military aggression by Armenia, as a result of which 20% of the country's territory remains occupied by Armenian military units; and about one million Azerbaijanis were forced to leave Armenia and the occupied territories. This gave rise to a large refugee and IDP population, many of whom are still living in temporary accommodation, with no regular employment, and dependent on aid coming from different channels.

The system of economic relations established under the Soviet Union did not allow for full development of the country's economic potential. During that period 80-95% of industrial products and 30-35% of agricultural products were exported to other parts of the Soviet Union in the form of semi-finished products and raw materials. The processing industry was underdeveloped. The collapse of the unified economic complex resulted in the breakdown of the system of existing division of labour, a drastic drop in production and increase in unemployment.

At the beginning of 1990s the economy of Azerbaijan was characterised by high inflation. Actually inflation was impossible to manage at that time. Market mechanisms did not work normally. There was a deficit of food products in the country. The unstable internal political situation also made it difficult to launch substantial economic reform, and made Azerbaijan unattractive to foreign investors.

Analysis of the reasons for high inflation and the fast devaluation of the national currency showed that, along with the decline in production, other factors were an unnecessarily large monetary emission, and financial institutions inherited from the administrative-command system which were incompatible with the market economy. The increase of cash volume which had with no links to the economic situation had paralysed the country's financial system and served to increase the uncertainty in the performance of economic units.

In the 1991-95 periods, some policy measures were taken to try to ease social tensions, such as the periodic doubling and tripling of official wage rates, the establishment of a minimum wage and the introduction of numerous state benefits and privileges. But these just spurred on inflation and did not tackle root problems. There was a cumulative real GDP drop of about 60%, hyperinflation, sharp currency depreciation and a nearly depleted foreign exchange reserve:

Table 2.1 Economic Indicators, 1990-1994

	1990	1991	1992	1993	1994
GDP in real terms (1990=100)	100.0	99.3	76.8	59.1	47.4
GDP per capita at current prices, USD	346	98	180	180	218
Investments from all sources of financing (1990=100)	100	79	47.4	29	54.8
Inflation (CPI), annual % change	-	106.6	912.3	1129.1	1663.5
State budget deficit, % of GDP	0	3.0	1.5	14.4	9.4
Gross International Reserves (NB), mln USD					16.4
Foreign trade balance, mln USD					-125
Exchange rate average, AZM/USD	-	-	-	100	1209

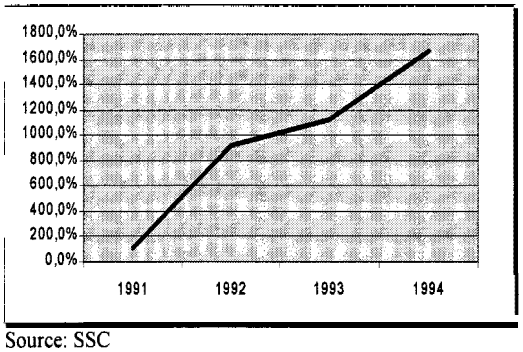
Source: SSC

During this period, elements of the market economy emerged and developed to a certain extent, particularly in trade, service sector, transport, middleman and retail trade, and banking. This development was, however, often informal and frequently tinged by criminal elements.

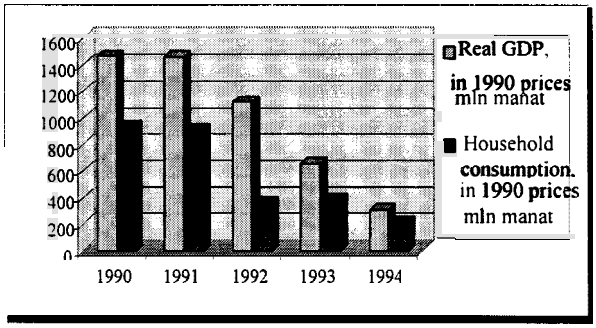
All of the above contributed to a continuing slide in the economy and the population's standard of living. It is estimated that GDP in 1995 was only 44% of the 1990 level, and that household consumption expenditures also declined by about 50% in the same period:

Figure 2.1. Inflation, Real GDP and Household Consumption in 1990-1994

Inflation (annual % change)



Real GDP and Household Consumption



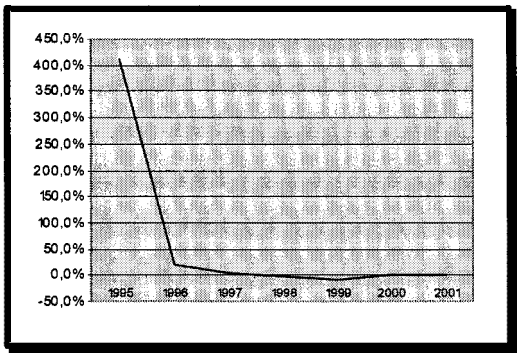
Source: SSC

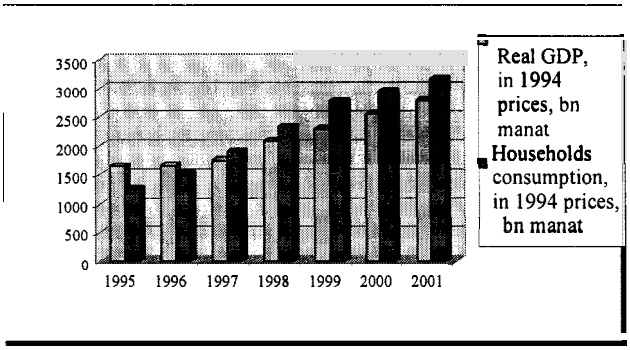
2.2. Achievements

Immediately after Heydar Aliyev came to power in June 1993, a degree of social and political stability was restored in the country, which made it possible to embark on a series of economic reforms. Since 1995, three government programmes aimed at achieving macroeconomic stabilisation, structural adjustment, and resumption of economic growth have been launched. A comprehensive stabilisation programme was launched, supported by the IMF and WB. The State Oil Company (SOCAR) signed a number of production sharing agreements with foreign investors.

Figure 2.2. Inflation, Real GDP and Household Consumption in 1994-2001

Inflation (annual % change) **Real GDP and Household Consumption**





Source: SSC

As a result of these programmes there have been several achievements. The budget deficit has been cut from 10% of GDP in 1994 to 1-2%; and credit from the National Bank of Azerbaijan is no longer used to cover the deficit. The lending rate of the NB has been lowered from 250% in 1994 to 7%; and an adequate gold and foreign exchange reserve has been created, which is equal to four to five times the value of monthly imports. Currently the strategic foreign exchange reserve of the country including SOFAR's assets has reached 1.3 billion USD. This all allows the effective manoeuvring on the exchange market and contributes to maintenance of financial stability, low inflation, stable exchange rates, and a rise in gold and foreign exchange reserves. Overall, the inflation rate has been kept below 2%, falling to 1.5% in 2001 (Figure 3.2); and the currency made fully convertible domestically within a short period of time.

Table 2.2. Economic Indicators, 1995-2001

	1995	1996	1997	1998	1999	2000	2001
Change in real GDP (1994=100), %	88.2	88.9	94.3	111.6	122.2	136.0	149.4
GDP per capita (at current prices), USD	319	416	513	571	572	652	709
Investments from all sources of financing (1994=100)	82	172	287	416	403	413	442
Inflation (CPI), annual % change	411.8	19.9	3.7	-0.8	-8.5	1.8	1.5
State budget deficit, % of GDP	-5.2	-2.9	-2.4	-1.8	-2.4	-1.0	-0.4
Gross International Reserves (NB), mln USD	250	268	550.2	521.3	726.9	691.4	698.4
Foreign trade balance, mln USD	-30	-329	-232	-641	-105	573	883
Exchange rate average, AZM/USD	4414	4303	3986	3868	4119	4474	4656

Source: SSC

The process of privatisation has been started and more than 29,000 small enterprises together with over 1,000 medium-sized and large enterprises have been privatised through cash and voucher auctions. The private sector now accounts for more than 70% of GDP. Land reform was carried out through the free distribution of over 1.3 million hectares of agricultural land among rural residents. They have the right to buy and sell plots. The result has been the establishment of more than 40,000 individual farms and 5,000 other farming units.

Foreign trade has been liberalised, making it possible to increase foreign trade turnover. Thus, balance of payment and foreign trade are in surplus now. Preliminary work has been completed to prepare for accession to the WTO and bilateral and multilateral negotiations are on-going.

Table 2.3 Structure of Direct Foreign Investments by Sector, in mln. USD

	1994	1995	1996	1997	1998	1999	2000	2001
By sectors								
Industry	44	162	467	916	1148	773	604	851.5
Of which oil sector	22	140	417	780	944	553	574	820.5
Construction	25	20	32	104	154	29	31	25
Trade and services	45	21	23	74	100	55	17	26.1
Transport and communications	4	4	6	21	37	38	17	36
Other	32	11	12	40	41	42	286	153.4

Source: MED

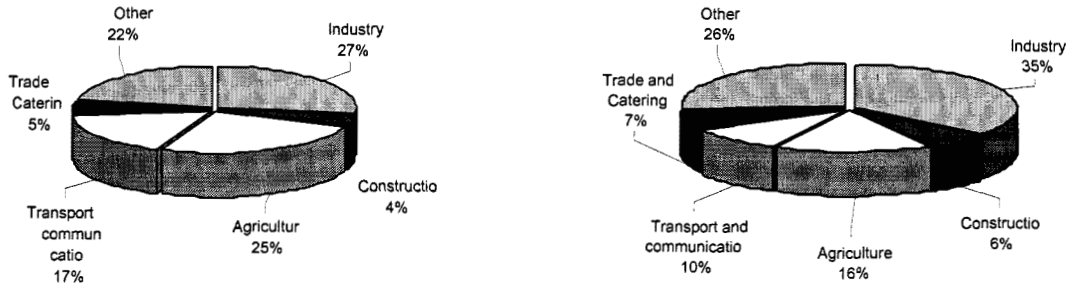
Stabilisation of the monetary situation allowed more determined steps to be taken to deepening the banking sector reforms, along with increasing business activity. The restructuring of state banks has been accomplished, and important steps have been made to consolidate and capitalise privately-owned banks. Currently 47 banks are operating in Azerbaijan: two of them with state capital and 14 with the participation of foreign capital. Certain steps have been made in terms of improving banking services in the regions and as of 1 July 2001 the number of bank branches was 192. Efforts have been made towards bringing the accounting system, payment system, banking supervision and banking legislation up to international standards, to develop financial markets and to build capacity for banking personnel. As a result of recent measures, the real growth in credit investment to the economy had increased six times over the last seven years, including long-term credit investment – 3.6 times, deposits of population – 13 times, cash volume in AZM – over 4 times, while consolidated bank assets had increased to 17% of GDP.

Structural reforms have been carried out at the institutional level, in about 30 ministries and other state organisations and new joint-stock companies created, the quota system abolished, export tax eliminated, etc.

In the 1995-2001 periods, the pattern of economic recovery was dominated by the oil sector; at the same time the economy registered economic growth across different sectors, including agriculture. In 2001 compared to 1995, GDP has increased by 2.5 times, industrial production by 3.5 times and foreign trade by 2.2 times.

Figure 2.3 Structure of GDP, 1995 and 2001

1995 **2001**



2.3. The Challenges

The key poverty reduction strategy aims were outlined in the previous chapter. The challenge for the government is to implement economic and fiscal policies which support these aims. In particular, fiscal policy has to reflect the aim of maintaining macroeconomic stability; economic policies have to support the aim of promoting income-generating opportunities, and to promote development of the non-oil sector and regional development. Both fiscal and economic policies have to reflect the need to obtain public and private sector investment in infrastructure. The policies to achieve these aims are presented in Chapter 4.

Chapter 3. Social Policies Aimed at Poverty Reduction

It has been noted that economic growth has been increasing during recent years. But, the living standards of the population have not yet reached an acceptable level. Increased inequality in income distribution, growing differences between Baku and the rest of the country are the important issues to be tackled.

Thus, while the main overall directions of economic policies now have to be to make sure that broad sections of the population have access to income-generating activities; the main aim of social policy is to ensure income re-distribution. While the former has the aim of achieving structural adjustments in the economy and further stimulating the private sector by ensuring growth in the non-oil sector and regional economic development, the second one requires the development of a comprehensive and cost-effective system of social protection.

3.1. Social Insurance and Social Assistance Reform

Social Insurance Reform

The current social protection system in Azerbaijan comprises mainly of provision of social insurance and social assistance. Azerbaijan inherited the foundations of this social protection system from the Soviet period. Since 1997, there have been some changes introduced to the system, however there has been no fundamental reform of either social insurance or social assistance. Thus while socio-economic conditions have changed dramatically, the system of social protection has not been adjusted accordingly.

In principle social protection benefits can be divided into those of a "social insurance" type, and those of a "social assistance" type. Social insurance benefits are designed to protect individuals from falling into poverty when special events occur (e.g. old age, disability, and unemployment). Pensions are financed from social insurance contributions that are made by the working population (and employers). The size of the pensions should be linked to the length of contributions. Unemployment benefits are funded from employer and employee contributions. Social assistance benefits on the other hand, are financed from the state budget. There is a need for redistributing resources to insure that the poor have a minimum consumption level. One of the main problems in Azerbaijan is that there is no longer any clear separation between these two social protection schemes particularly with regard to old age pensions. This is because the size of the pension received by a former contributor does not correspond to the amount and length of previous contributions and state supplements are paid to pensioners and funded from the state budget.

With regard to social assistance, there is still a heavy reliance on redistribution based on categories of the population rather than on need. As a result, existing resources have been spread very thinly over a large section of the population, rather than providing meaningful support to a more restricted number of the poorest sections. Until now there has been no survey data, no poverty line, nor the necessary information base for studying poverty and need; nor has any effective means-testing capacity for targeting the most vulnerable been developed. Another problem is that there is a multitude of different small benefits, making application and receipt of social assistance benefits unnecessarily complex.

The government is committed to carrying out reforms in the energy sector, and to removing explicit and implicit subsidies in order to guarantee sound market conditions. However, this will involve a notable increase in the energy bills for most households, and not all households will be able to afford these increases. It is therefore essential that a new social assistance programme be developed and introduced in parallel to the energy sector reform. This new programme should target assistance specifically to low-income families.

Another problem has been the inefficient way of administering both social insurance and social assistance, with various different organisations being involved in the collection of dues, delivery of benefits and services.

The main objectives with respect to social insurance reform are as follows:

- Achieving reliable provision of pensions to the population;
- Increasing the role of pension provision in improvement of welfare of the population and adjusting this system to the principles of market economy
- Ensuring full collection and meaningful use of contributions;
- Increasing the efficiency of pension provision system by improving its administration
- Creating a link between social insurance contributions and size of pensions.

The President of the Republic of Azerbaijan approved a concept paper on the "Pension Reform in Azerbaijan" in 2001 July 17. The concept paper outlines the provision of a mandatory social insurance pension, where the pension rate will be based on each participant's amount and length of contribution. It separates out the roles of mandatory pension insurance and social assistance benefits. For those who have not acquired the rights to receive social insurance pensions during their working life, the social assistance system will be responsible for providing adequate protection. In a later phase, the concept envisages the establishment and development of a private pension system based on voluntary participation.

The concept paper outlines the steps the government will have to take in order to reform the pension system.

1. Design of a new social insurance system;
2. Establishment of an effective administrative structure for an efficient management and delivery of pensions;
3. Development of an automated social insurance and pension system based on individual accounts.

The introduction and use of forecasting models will play an important role in the development of the new pension system. It will permit the modelling of various scenarios regarding the demographic composition of the population, economic development, the size of the formal labour market and the social insurance contribution rates, and improving the legislative framework accordingly. An improved legislation for the compulsory pension system will specify the retirement age (gradual elimination of occupational privileges, equalising retirement age for men and women in phases), the compulsory social insurance contribution period (increasing the minimum period) and shares of the social insurance contribution to be paid by employers and employees (gradual equalisation of this share), the calculation of the pension size (number of years and reference wage taken into account), and possible indexation. Social pensions, and pensions which are not based on social insurance contributions will be paid from the state budget.

Administration of the pension system will be concentrated in a new established executive body. This executive body will be responsible for collection of pension contributions, keeping and fulfilling individual records, control on provision of pensions, collection of statistic data about modifications in the levels of pension expenses and income.

The most expensive part of the envisaged reform of the social insurance system is the development and implementation of an automated system for the management of pensions and social insurance policies based on individual accounts. Major investment are needed in this area. The government already prepared legislation that will enable the introduction of individual accounts in Azerbaijan and some preparatory work has been done with the assistance of the EU TACIS. The introduction of individual accounts has to be planned carefully, and the same applies to the needs with respect to information technology. An IT plan would specify the necessary hard and software, the data management methods and the financing sources. Based on a model office, the government plans to assess the needs for a new fully automated administration system. However, the government will need additional assistance in order to finance and implement the desired system. Once there is an administrative system, which allows the storing and management of individual records, individual pension numbers can be issued, the benefit formula will be revised, making it possible to have more differentiation in pension levels thereby increasing incentives to contribute to the social insurance system, and finally making it financially sustainable.

Social Assistance Reform

The main task for the government with respect to social assistance policies is to define an effective safety-net strategy that will enhance the targeting efficiency, support the poorest and most vulnerable groups and will mitigate the social impact of new public utility policies in the short-run. The following are the main objectives for reform of the social assistance system:

1. Ensuring that social benefits are targeted to the poor and that the policies are efficient and effective;
2. Adjusting the system of social assistance to the developing market conditions, and increasing the efficiency of social assistance provision through improving the management and administration of social assistance system.

The government has already done some work in the area of social assistance. With the assistance from EU TACIS, a pilot project has been developed in order to test some of the envisaged policy principles. In order to develop an improved system of targeted social assistance, the following six sets of policy actions have been identified. All actions are of similar priority and are to be executed more or less simultaneously.

1. Establishment of an effective administrative structure;
2. Development of the necessary legal framework for targeted social assistance policies;
3. Development of a Social Assistance Strategy paper;
4. Development of a targeting mechanism for the identification of the poorest and most vulnerable groups of the population;
5. Creation of a system of adequate compensation for the poorest against the impact of new public utility policies;

6. Creation of a monitoring and evaluation system for the development and implementation of social assistance policies.

The main task for social assistance reform is to remove subsidies and the current array of small allowances, and to replace these with one social assistance benefit that is targeted to poor households. These social assistance benefits will be financed from the state budget in order to keep them strictly separated from insurance-type benefits. The preparation of a strategy paper is the first step in the development of a revised social assistance system and includes the formulation of the overall objective of social assistance policies. It has above all to identify monitoring indicators for the evaluation of social assistance system. The result is a streamlined menu of benefits. Ex-ante evaluation and social budgeting methods will help to estimate the amount and costs of the new benefits and set eligibility rules. Considering the limitations of the state budget in the coming years, the new social assistance benefits (amount and eligibility) are going to be based on the budget limits of the government.

One of the main policy priorities that have been identified for the reform of the social protection sector is to improve the targeting of the social assistance benefits. The limited resources available have to be well targeted, reaching the poorest and most vulnerable groups of the population in order to ensure an effective safety net policy. In order to set per capita income limits, more precise information on poverty is needed. If the purpose is to bring household per capita income up to a certain minimum level, then that level has to be set taking into account fiscal constraints. Work on this is being carried out now, and will be further developed. Another principle of the social assistance should be administrative simplicity: the system for applying and assessing eligibility has to be made as simple and transparent as possible. In order to assess eligibility, a new system of means testing will have to be developed and introduced, i.e. targeting can no longer be done on the basis of "categories". Since widespread employment in the informal sector makes estimation, checking of earning levels and formal income very difficult, it will be important to develop alternative approaches to means-testing, using, for example, proxy means-testing.

While the last sections have identified measures to be taken in the short to medium run, it is planned to develop a short-term strategy that will cushion the effects of envisaged changes in the public utility sector. The energy sector is planning to gradually improve the payment compliance rate of its clients and to increase energy prices in the future to reflect a more realistic price level. An increase in payment enforcement will hurt the poorest proportionally more. An energy price increase will have an even more serious impact on their living standard and the available income to consume other basic necessities. The government is therefore initiating a study outlining the preconditions under which it is meaningful to install a benefit compensating for the removal of utility subsidies. The results will be presented in a policy paper together with a proposal for the type of support to be offered as well as the target group that is going to benefit. The compensation is only a temporary support and will be reconsidered together with all other social benefits as outlined above.

Monitoring and evaluation of policies is a crucial element in any reform process and is necessary for the development of sound policies that are effective and efficient. The need to establish a monitoring and evaluation system is immediate. Monitoring of the policy starts immediately with its implementation. Therefore, a monitoring plan has to be outlined simultaneously with the policy proposal. It includes the definition of monitoring indicators. Data for these indicators need to be collected during the policy implementation and evaluated. The government and the public need to be regularly informed about the failure or success of a certain policy and of social policies in general.

Therefore, a monitoring system should be installed and a Poverty Monitoring Unit given the responsibility for regular monitoring and evaluation of the implemented policies. It is fully understood that only systematic evaluations will help to improve the existing policies. Some necessary work will be carried out at the Poverty Monitoring Unit towards training and capacity building for analysis and evaluation of policy outcomes. Poverty has to be monitored constantly in conjunction with monitoring of the effectiveness of social assistance policies in protecting the poor.

3.2. Social Protection of Most Vulnerable Groups

Children in Institutions

It was noted in Chapter 1 that there has been an increase in the numbers of children in institutionalised care in recent years. This has detrimental effects on children's education and development. The increase in the numbers in institutions is partly due to the increasing inability of poor families to feed and cloth their children.

The government is concerned to develop alternative strategies in order to prevent children being put in state care. These strategies are being developed with the support of NGOs and international organisations. One good example is provided by Youth Azeri Parcel Service (YAPS) started in 1997 with the support of UNICEF.

In recent years, a number of programmes and laws have been adopted which address children's issues, including the Family Code. More responsibility for child welfare is being delegated to the local executive powers, however these bodies need assistance in building up capacity to take on these responsibilities. The main thrust of the child protection strategy is to prevent children being put in institutions and to develop alternative policies aimed at providing support to families in need. In order to achieve this it is necessary to:

- Develop new family support services to try to help families who are having difficulty in caring for their children
- Develop services for families with children that need special care
- Develop legislation on foster care, as an alternative to institutional care
- Rationalise the resources currently spent on institutions for children, and direct the savings towards supporting families and re-integrating children

Crucial to all of these four strategies is the development of social workers as a profession in Azerbaijan. There is therefore also a need to develop a curriculum for social worker training, and to organise training courses in the Ministry of Education in collaboration with higher education institutes. Training and re-training will be required, as social workers will need to increase their skills in family social work and care.

Family Support Social Workers will be trained and they will work with families who are in crisis or have social problems. It is considered advisable to start by training existing staff within children's institutions. They can take on some of the initial tasks of working with families in need of support, and help with the re-orientation of the old policy. They will also work with children who are already in institutional care to help their parents or relatives to regain the child from state care. Once social workers are trained and active, they can also get further training in the methods of recruiting,

assessing, selecting and supporting foster families. Foster care families will also have to be trained initially to assess for themselves whether they have sufficient motivation and capability to take care of other children.

Social care centres will be created (at the local offices of the MLSPP or at existing children's institutions), which can serve as information and service centres for foster families with children that need special care.

It should be stressed that this approach requires training, and some re-organisation, but that it does not require large budget implications. Initial assistance will be required to train and pilot the system, but recurrent costs should be covered by savings from the cost of keeping children in institutionalised care.

This strategy will require an inter-sectoral approach involving the MLSPP, the ME, the MYTS. It is also proposed to establish a State Coordination Council on child problems at the Cabinet of Ministers. At the local level the (city and district) the commission on minors should be involved, as should the commission on guardianship and adoption.

The Disabled

Apart from social benefits to the disabled, mentioned above, the main policy direction is to integrate as far as possible the disabled into society. The government will continue to install the necessary facilities for the disabled in transport and public places. It is planned to increase the number of centres such as Para-Olympic health-sport centres for the disabled. Rehabilitation services and centres will be developed, with special emphasis on providing services in the regions.

3.3. Labour Market, Wage and Employment Policy

It was noted in Chapter 2 that economic growth has been achieved since 1995. But that growth has not been sufficiently accompanied by increases in productive employment. Economic and social policies have to complement each other, with the end aim of ensuring more equitable growth. In a market economy, the state plays a limited role in the direct creation of jobs. Its role is rather to stimulate entrepreneurship and create a favourable business environment. Policies aimed at these objectives are comprehensively discussed in Chapter 4.

Wage Policy

The average monthly wage in 2001 was 260,000 AZM (55.8 USD), although there are significant regional differences in wage levels (there is no gender disaggregated data on average monthly wage).

Wages from employment are one of the main contributions to the household budget, and are therefore crucial in ensuring household welfare. The state can do little directly to influence the size of wages, since in a market economy wages are defined by supply and demand in the labour market. The role of the government consists in creating conditions, which allow the market to function more effectively.

The government sets a minimum wage in order to protect the low-skilled and low-income workers. This is currently set at 27,500 AZM (5.7 USD). The minimum wage will be adjusted upwards, following increases in economic growth and productivity.

In the public sector, the government is developing policies to deal with increasing the low level of wages, and rationalising staffing structures. Low wages in the health and education sectors mean that the better-qualified staff is leaving the sector. The MTEF envisages an increase in expenditure to raise wages in these sectors. In education wage increases will also be accompanied by a gradual reduction in the numbers employed in the sector. It is also planned to introduce regional wage coefficients in the public sector.

The government is also committed to decompressing wages for civil servants. A wage structure, which takes into account the different responsibilities and functions will provide a better incentive for individual civil servants and should make them more motivated and productive. A more professional civil service should help improve the efficient allocation of available financial resources and increase the quality and delivery of public services.

Wages in other sectors will be largely determined by the market. As part of the redefining of the state's role in the economy new regulations are being worked out to govern the tripartite relations between the state, employers and employees.

Employment Policy

At present one of the main directions of State's employment policies is the development of the government's employment policy aimed at social efficiency of employment of the population and rational use of labour force.

One of the main concerns of the government is significant redundancies associated with enterprise privatisation and restructuring. A list including 450 enterprises in machine building, oil, chemical, and trade sectors has been prepared to be privatised during 2001-2003, which will eventually lead to significant layoffs. As noted above, increases in wages in the educational and other public sectors will be accompanied by rationalisation measures, which will also result in redundancies. The task of the state is to get ready for these redundancies, and make sure that labour market policies are in place to help those affected by them.

The social protection measures described above will minimise the risks for individuals affected by restructuring. Unemployment benefits should help in the first six months, and then targeted social assistance should be available to those who have not found alternative employment. However, the restructuring has to be accompanied by policy measures, which encourage investment and development of the private sector, so that this wave of redundant individuals can find new and productive work activities.

In order to facilitate this process, the government intends to develop micro-credit schemes, and also establish entrepreneurship support centres to promote the development of private enterprise in the regions.

In all cities and villages of the Republic, as well as in Baku, the Employment Department of the MLSPP will continue carrying out measures, such as vacancy fairs and labour exchanges.

The government also intends to reform the system of vocational education in order to ensure that the training being offered in the vocational education institutes matches the skills required in the current labour market. The system of vocational education in Azerbaijan covers 109 educational institutions with 22,000 students and 5,000 pedagogical and other staff. It was pointed out in Chapter 1 that graduates of vocational education are one of the groups highly represented among the registered unemployed.

Vocational education is currently provided by the system of professional schools under the Ministry of Education. The Ministry of Education plans to draw up a policy paper setting out how it sees the objectives of a reformed vocational education system. The training offered has to be re-orientated to the needs of a growing private sector.

It is necessary to regulate and give flexibility to the institutions of vocational education in designing their educational plans. It is necessary to arrange a connection between small and medium enterprises and the system of vocational education. In the framework of social partnership (with participation of state organisations, private enterprises, non-governmental organisations, etc.) it is necessary to develop services of employment for the graduates of technical colleges and universities.

Apart from this, training courses will be organised to help women engaged in crafts and agriculture to develop their skills and find outlets for their products.

Information and Monitoring

There is a need for reliable data on the labour force and employment in designing the development of passive and active labour market policies. Special and regular labour force monitoring is needed to analyse the data on economic migration, employment, underemployment and unemployment, including seasonal, occasional and informal employment; earnings and incomes generated; working hours, by occupational groups, regions, in the formal and in informal sector, household production, etc. The absence of special, regular and reliable information on the labour market does not allow flexible adjustments in labour market interventions by the government. For this reason, there is a need for a regular labour force survey to be carried out and for training to be provided to local experts in the use of labour force survey data for policy analysis.

3.4. Education Reform

Azerbaijan started the transition period with relatively good education indicators. However it was shown that at present Azerbaijan is struggling to sustain achieved education outcomes and that it is also struggling to re-orient its education system to the needs of a market economy and an independent country.

With regard to poverty and equity, there is little or no evidence of differences in access to basic primary/ secondary education (classes 1 – 11), although there are concerns about differences in the quality of the teaching, facilities, and access to textbooks at this level.

For the long term, poverty reduction is dependent on investment in the country's human capital. Growth in labour productivity will also require a highly qualified workforce. Continuing investment in education will be required to develop a skilled and well-educated labour force. As mentioned

above, there is an urgent challenge to redefine the goals of vocational education in order to provide the future workforce with skills which are relevant to the new market environment.

The overall strategic objectives of policy measures in the education sector are: (i) to provide equity in access to good quality education, including removal of differences in quality between urban and rural areas; (ii) to ensure that the content of education is revised and teaching methods modernised; (iii) to improve the motivation of teachers through increased wages and bonus system based on performance evaluation; and (iv) to ensure that vocational education provides skills appropriate to market economy.

In 1998 a State Reform Commission was established to help the government carry out the reform process in the education sector more effectively. The Reform Programme was approved in June 1999, and was launched at the beginning of the 1999/2000 school year.

The following policy directions will be pursued to tackle the problems outlined in Chapter 1 with regard to falling standards in education, and to achieve the above strategic objectives:

- Ensuring equity in the quality of primary and secondary education by guaranteeing text book provision to all pupils;
- Improving the quality of teaching by rationalisation of staffing, increasing teachers' salaries; and introduction of a bonus system based on performance evaluation
- Improving the quality of the content of education through curriculum development, and changes in teacher training and re-training
- Improvement of the material-technical base of educational institutions, in order to guarantee a basic standard of school environment for all pupils
- Establishing Special Assistance Funds at the local (raion) level to help poor families provide clothing and materials for their children to attend school
- Introduction of new educational technologies; improving training of pupils and teachers in use of information technology.
- Improving the life skills of adolescents by incorporating reproductive health, healthy life style and gender issues into the school curriculum
- Improving equality of opportunity of all young people to embark on higher education by developing a new grant system based on some type of means testing
- Improving early childhood care and development though establishment of alternative institutional, family and community based facilities to ensure equal access to pre-school education
- Increasing equality of access to learning materials by improving school library services
- Introduction of a more decentralised flexible budgeting system and improving transparency in this context.
- Improving the system for regular monitoring of quality and access to education

1. Improving equity in the quality of primary and secondary education by guaranteeing free textbook provision for all pupils

In schools today, one of the most urgent problems concerns textbooks: on the one hand, there is a lack of appropriate and necessary textbooks and other educational materials; and on the other hand,

poor and needy families are unable to purchase existing textbooks due to financial difficulties. It is therefore necessary to take measures to ensure (i) that new textbooks are developed, and (ii) that both old and new textbooks are available for all schoolchildren, including the children from poor and needy families.

2. Improving the Quality of Teaching

All teachers are paid from the state budget and the average wage for the education sector is low. The best teachers are leaving the profession, and those remaining have little incentive to improve the quality of their work. The number of male teachers has more than halved in recent years.

Increasing teachers' wages would contribute to reducing the pressure to make informal payments to teachers, which also penalises lower income families.

Presently, there are 1,658,000 students and 163,200 teachers (i.e. 10 students per teacher) in the primary / secondary schools (the obligatory 11 year school) of Azerbaijan. For comparison it is to be noted that the average international indicator is 17-18 students per teacher. Therefore, one of solutions of this problem would be a reduction in the total number of teachers and consequently increasing the basic wages. Bonuses for teachers should also be paid on the principle of «experience and knowledge», instead of age characteristics, and the criteria for hiring and promotion should be merit-based.

All these factors influence the quality of teaching and efforts that the teacher puts into the work. It will be possible to develop a system of classification ranks for teachers, professors, senior lecturers and other faculty staff. In accordance with this system it is possible to introduce a system of bonuses for those teachers, who participate actively in the improvement, development and introduction of new ideas, methods and technologies in the educational system of Azerbaijan. Such an approach will considerably increase the efficiency of education process, as well as the motivation of Azerbaijani teachers.

3. *Improving the Quality of Curriculum and Teacher Training and Re-training*

It is essential to update the content of education ensuring the continuity of the programmes for various levels of education (each preceding step should completely meet the requirements of the following). During the period of realisation of the Reform Programme it is necessary to shift from rigid standardisation of education into a personality-oriented education; also considering the particular interests of poor and needy sections of the population.

There is not only a shortage of textbooks; most textbooks are based on outdated curricula. There is a need to redesign the content of primary and secondary school education.

There is also a need to invest in and improve the system of training and retraining of teachers and managers at all levels of the educational system. As part of the reform, the content of the curricula will change (what is taught); and also the methods used to teach (how it is taught).

There is also a need to explore possibilities of introducing new information technology into school curricula and into teacher training institutions. All of these issues are being addressed under the current Education Reform Programme.

4. Improvement of material and technical base of educational institutions

This is the policy direction associated with most expense, i.e. the improvement and modernisation of the existing material-technical base of the education sector: construction, repair works, reconstruction and re-equipment of classrooms, laboratories and other facilities.

At present, the condition of the material and technical base of educational institutions and especially secondary schools does not correspond to accepted international standards and requirements. Because of the shortage of budgetary funds, almost no school construction and sufficient purchase of inventory, technical equipment, etc. has been possible in Azerbaijan in the past ten years. As a consequence, in many schools, especially in the schools based in rural areas, there is no opportunity for introduction of new approaches and technologies in the educational process.

School buildings and the material base of education are in decay. Rates of capital investment have sharply decreased. The majority of schools work on a 2-3 shift basis; many of the school buildings need to be repaired. It is unrealistic in the short-mid term to try to solve this problem purely through use of budget funds. A more optimal and effective settlement of the problems could be an increase in state financing coupled with attempts to attract additional off-budget aid to support the schools (partial self-financing). A certain part of the population (parents, businessmen and others) could be asked to undertake some portion of school expenditures. At the same time it is important to introduce some financial incentives for this (including exemption of these contributions from tax).

Today there are also problems in the distribution of various educational institutions (including specialised education) throughout the country, including Baku. For example, in Baku most of special educational institutions are located in the centre of the city, which again leads to lack of equality in the access to them: it is difficult for talented children and the children from poor and needy families, living in the suburbs and outside of the urban areas to attend these schools. In some rural areas, schools with only 9-year education cause problems for pupils in the 10^{th} and 11^{th} grades. This means that providing a certain quality of educational services in each city district and each region of the country, and the establishment of 10^{th} and 11^{th} grades in rural schools must become a priority policy.

5. Establishing of Special Assistance Funds at the Raion Level

The children from poor households can be prevented from attending school due to lack of shoes and clothing. Such households also cannot afford the relatively small expenditure required for other school materials, such as pencils, pens etc. It is therefore proposed to set up Special Assistance Funds, to be administered at the local level with the participation of the municipalities. Local knowledge of living standards and of the families' situation will be used to identify those households which are in need of such help.

6. Introduction of new educational technologies

One of the main priorities of the Ministry of Education is to establish a computer-integrated educational system in Azerbaijan and to create an environment for children from poor families to have access to information technology. In this area the Ministry of Education plans to cover the whole range of inputs: all necessary training materials (computers), software and other educational systems, constant training of teachers and technical support.

Introduction and organisation of financing of distant education should be carried out in accordance with a specially developed «National Programme of Distant Education» that will considerably improve the efficiency and quality of educational services, especially in regions. The programme should provide a needs-analysis for the system of distant education in the country, new educational plans with integration of new technologies, implementation plans, etc.

Creation of such a system can also facilitate the establishment of an education monitoring system based on modern technologies. Distant education is an important way to improve access to education and training. The respective departments of higher educational institutions can enable the students in the remote regions who do not have opportunities to attend the classes regularly (mainly students from poor and needy families) to receive fresh knowledge and skills.

It is planned to create regional educational technology centres with elements of distant education (completely equipped with computers etc.). Thus, the Ministry of Education can solve through computer technology some of the problems of guaranteeing access to education of children from poor and needy families, and also to families of refugees living in regions, enabling them to have access to the modern educational programmes.

7. Improving the Life Skills of Adolescents

Adolescence is a crucial period for ensuring that young people make use of their capabilities and the opportunities available to them to limit the risk of being poor in the future, or to help them move out of poverty. It is also a period in life when young people tend to take risks, or be open to peer pressure to experiment with drugs and other forms of substance abuse.

It is therefore planned to introduce lessons on reproductive health, healthy lifestyle and gender issues in the school curricula. Support will also be given for the establishment of extra-curricular activities and resource centres for young people, through which the development of life skills can also be encouraged.

8. Equality of Opportunity to Enter Higher Education

At present, non-paying students[7] of state higher and secondary qualification educational institutions receive a monthly grant of as noted below.

[7] All students have to sit an entrance exam to be admitted to higher education. A certain proportion (those with the highest marks) are entitled to free education, while some (those with lower marks) are offered places for which fees have to be paid.

Table 3.1. Monthly Grant Received by State Higher and Secondary Education Students

Level of Education	Amount of Grant	
	in AZM	in USD
High Education	16.500 – 18.500	3.5 – 3.8
Technical College	15.500 – 16.500	3.2 – 3.4

Source: ME

Every year the government spends 17-18 billions AZM (3.5-3.7 mln USD) for these purposes. However, the grant is not sufficient to cover basic needs. Therefore, it is necessary to increase the size of the grants. There is a need for a means-testing system, which would allow grants to be given only to those who cannot afford to study. Thus the available resources would be targeted on those who really need it.

9. Early Child Care and Development (ECCD)

Early Child Care and Development (ECCD) is an integral part of the Education strategy. It has traditionally been provided through pre-schools and kindergartens. However, in recent years, the number and quality of these facilities has decreased with the declining ability of the national and district level social systems to support this public service. Total enrolments and gross enrolment rates (GER) have both declined significantly since 1990. Provision and participation in early childhood education in rural areas is particularly low (GER of less than 10%) compared to urban areas (GER of almost 25%). A further issue relates to gender parity. In all areas of the country, fewer girls than boys attend early childhood education programmes and this disparity is particularly significant in urban areas. Moreover, very few IDP and refugee camps have some kind of organised care for young children.

The formative role that public kindergartens played in ECCD has been shifted to the home where the stresses of the current transitional period make parental education and improving opportunities for ECCD more urgent than ever.

To arrest the alarming problem of declining welfare of the general population of children and especially the most vulnerable poor and IDP/refugee's children, the government intends to facilitate the development of child-centred community and family-based kindergartens.

It is also proposed to raise parents' knowledge, skills, and awareness of childhood care and development, by promoting good parenting skills, and stressing the importance of supporting children's education through media, advocacy, and educational programmes.

10. Improving Equality of Access to Learning Materials through Better Library Services

School libraries currently suffer from a deficit of books, particularly ones in the Latin alphabet. Stocks are old, and mainly in Cyrillic. The government proposes to support the publication of new textbooks, literature and scientific books in the Latin alphabet. These new books will be supplied to school libraries, so that children from all regions and sections of the population have the possibility to use them. It is also intended to introduce information technology in the libraries, and use them as centres where children can have access to the Internet.

11. Efficient and Flexible Management of Budget

One of the main directions of reform is to move away from the very centralised model of educational management inherited from the Soviet period. Decentralisation of management will improve management efficiency and contribute to the process of moving away from the model of teaching where the student is the passive receiver of information.

With regard to the budget, the Ministry of Finance is responsible for allocating funding to schools, early childhood institution and all other education institutions. For general schools the allocation is done through the District Finance Offices. There is a need for schools to have greater control and independence in the allocation of their budgets.

Since 1997, schools have been permitted to have special bank accounts, which can be used for funding provided by sponsors, parents, and local companies. (Funds from the state budget are not kept in these accounts). Such funding is used to improve the material basis of schools. Although the district education office is responsible for paying non-salary items, the budget is usually in deficit. Therefore there is a continual shortage of funding for repair and maintenance of school facilities and for supplies.

It is necessary to increase the autonomy and financial independence of schools. Broad autonomy in running the school budget will increase the efficiency of schools. With a flexible and transparent budget system, the saved financial recourses can be transferred from one budget item to another. This would increase the motivation among management at the schools. The financial contributions of individuals, local and foreign companies to educational establishments should be given a legal basis and be tax-exempt.

Decentralisation of the education system can be an auxiliary tool in organising the necessary support for development of educational system. However the state should keep the necessary control in places, so that the standards of education are observed in all areas of the country. This process should include careful control and regulation of the activities of local authorities. It is necessary to determine the possible forms of decentralisation and, for example, with this purpose to organise one pilot project in one pilot region.

12. Monitoring the Quality of and Access to School Education

To have regular and reliable information on the quality of education in different regions of the country for policy formulation, there is a need to develop a new national system of student assessment for the 1-11 classes. Equality of access will be better monitored through regular collection and monitoring of school attendance rates, disaggregated by gender.

3.5. Promotion of Culture and Protection of Cultural Heritage

The cultural heritage is a valid indicator of any nation's creative capacity. Its protection and development is an integral part of human societies' progress and their aspirations for higher achievements beyond mere economic spheres.

Azerbaijan has a rich and varied cultural heritage, as reflected in its many museums, public libraries, music and arts schools, monuments, parks, archeological sites, a number of them with international reputation. The sheer number of its artists, musicians and craftspeople, from all ages and regions, denotes the fact that cultural education has been a long-standing feature of the life style in this land.

As a country in transition, Azerbaijan is experiencing a sharp decline in the overall conditions of its cultural set up. Most of its public cultural outlets (museums, libraries, parks, theatres and concert halls) are in dire need of repair and upgrading. This is due to the weakening of the system whereby public funding would be available both for the infrastructure and for the students and staff engaged in the arts. Whatever the cause of it, the decline in arts and the loss of cultural heritage are not compatible with the overall goals of economic development. The government has outlined the main strategic steps for turning the declining trend, and for promoting the cultural dimension within its overall poverty reduction goals.

Cultural Development and Poverty Reduction

As pointed out throughout the document, poverty is a multifaceted phenomenon, and encompasses income and non-income factors. The government plans for fostering the cultural heritage and development and its further development will have an impact on its overall poverty reduction efforts in two main ways. These are reflected in details in the Policy Matrix.

The current level of salaries and wages in the arts are particularly low at the moment. Through increasing the wages and salaries for the arts teachers (as part of the overall improvement of pay system in the education sector) and the other service staff in public cultural entities, there will be an improvement in the living standards of the people concerned. This will be followed by other incomes policy measures, such as decompression and rationalisation. This economic incentive is also aimed at improving the quality of services and the development potential, making the cultural activities more attractive to the public.

The second main economic tool for reducing poverty through development of cultural entities comes in the form of public spending on rehabilitating and upgrading a selection of public libraries, museums, theatres and arts venues, particularly in the regions. This will generate some new jobs, as well as demand for complementary activities such as construction, transport, printing and other sectors.

On the non-income aspects of poverty reduction, the government intends to encourage and improve access to the arts schools, arts professions and cultural entities, particularly to the poorer sections of the population and the IDPs. Social exclusion, as pointed out in Chapter 1, is one of the hidden faces of poverty. Expanding and improving equity in the access, information, and choice of social activities and participation is therefore a crucial component of poverty reduction strategy.

The following illustrate the links of culture with other goals of the poverty reduction strategy, like private sector development, regional development and human capital development.

Private Sector Development

Like most other countries in the world, the fundamental development and maintenance of cultural heritage remains within the public funding domain as an integral part of government policy.

However, through linkages, the private sector can be induced to participate in complementary activities. This includes various training programmes, organising artistic events, cultural site tours, transport, information technology and publishing, as well as other retail activities. Moreover, some of the cultural sites can be managed by the private sector. All these will have a direct impact on income generation, and are fully in line with the government development policy.

Regional Development and Tourism

By expanding the cultural attraction in the regions, mainly through the initial public funding in rehabilitation of viable entities, tourism may be further developed. However, the government will use every caution to be selective in its funding, where there are obvious and relevant prospects for job and income generation and / or where access is very important to the public, such as public libraries and arts schools. Development of tourism can also have a function of encouraging local-level participation in implementation and monitoring of related activities.

Development of Human Capital

Promotion of cultural activities and more equitable access will have a direct and immediate impact on enhancing the current wealth of cultural capabilities in the country. It will also complement the government's efforts in bringing about a more equitable distribution of resources and prospects for fulfilling individual potentials in the years ahead. Lastly, a successful rehabilitation of cultural entities will do justice to Azerbaijan's international image in this sphere, and thereby facilitating influx of external resources and arts grants when appropriate.

3.6. Health Sector Reform

In the first half of the 1990's the situation in the health sector dramatically deteriorated: there was a decrease in real wages in the sector, lack of funds meant that immunisation programmes could not be fully implemented and there was an increase in infectious diseases, and health indicators worsened (Chapter 1). From 1995 onwards, a series of measures were undertaken to improve the situation. As part of this, changes were made in some medical services, and there was some privatisation of the health care services, particularly the pharmaceutical part. In 1998, a State Commission was established with the aim of organising and implementing reforms in the health care system, and in 1999 a concept paper for health care reform was adopted.

The main thrust of health sector reform is currently reform of primary health care services. In the Soviet period, the emphasis was on provision of inpatient treatment to the population – construction of hospitals, increasing hospital beds. However, the principle health problems faced by the poor are communicable diseases, acute respiratory diseases, diarrhoea, and other illnesses, which are best and most efficiently approached on an ambulatory basis. The health reform efforts are therefore now focused on improving the capacity to provide accessible and good quality primary care services. A number of reform measures have been implemented in five districts over the past three years. From this experience, it would appear that the reforms which were 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. The government will implement a Primary Health Care Project with UNICEF and World Bank support in an additional five districts over the next three years.

The second main thrust of reform is that of developing cost-effective health care services; i.e. elaborating specific interventions that have proved to be effective in the improvement of the population's health status and which can be provided at relatively low cost. Such measures include health education campaigns, improved immunisation programmes, and improved treatment practices, such as Integrated Management of Child Illnesses (IMCI), safe motherhood and new-born care, the salt iodisation programme.

These two main directions of health care reform outlined above (rationalisation of primary health care and introduction of cost-effective health care interventions) are complex and expensive. They require careful planning and piloting. Such interventions are therefore being implemented step by step in coordination with international donors.

In line with the Millennium Development Goals, the strategic objectives include reduction of infant, children under 5 year years, and maternal mortality rates in the country, and also monitoring of access to safe drinking water. Goals for achieving these will be set as part of the overall health reform effort, which also has the goal of improving access to and the quality of basic health services. The reform also envisages a move away from the focus on "treatment" to "prevention and treatment" of the most common diseases.

Apart from cooperating with donors on comprehensive primary health care reform, the government envisages the following to achieve these objectives.

- Increase expenditure on health sector (MTEF);
- Introduce a system of flexible budgeting to ensure that rationalisation efforts are not penalised by subsequent reductions in budget allocations;
- Establish in coordination with donor organisations the cost of a basic per capita package of primary health care, and work towards gradually increasing government expenditure to ensure this. Parallel to this, design a system of targeted exemption from paid medical services, and develop health insurance;
- Increase the salaries of health sector employees;
- Full state financing of immunisation programmes (excluding hepatitis B);
- Design public awareness campaigns to help improve maternal and new-born welfare, as well as campaigns to reduce the incidence of TB, malaria, iodine-deficiency and HIV/AIDS;
- Design public awareness campaigns for healthy life styles and nutrition, especially targeted to the poor;
- Take measures to protect the population's reproductive health
- Adopt international standard definitions for key health indicators and improve methods of data collection;
- Improve training of health sector staff, including raising awareness of the need to shift to more user-friendly services and the need to concentrate on prevention rather than just treatment of the illnesses most prevalent among the most vulnerable sections of the population;
- Monitor access to clean drinking water as well as other environmental factors affecting health.

Below we give a brief sketch of some of the elements of the primary health care reform, and then look at some of the particular areas of concern for improving the delivery of health care services and ensuring access to the poor.

1. Reform of the Primary Health Care

The main element of the reform is to ensure the rationalisation of health services in order to reduce the number of hospital beds and reallocate staff and resources to outpatient services. The reform also includes re-focusing services from being based on treatment of illnesses, to the introduction of preventative interventions, which are often cheaper and more effective.

Another important element is improving the provision of essential drugs and promoting rational drug use. This envisages training medical staff in rational use of drugs and drug management to avoid waste and excess use of drugs. As part of this, so-called revolving drug funds are being introduced on an experimental basis in some districts.

Another important element is the introduction of an "Integrated Management of Childhood Illnesses" (IMCI). This covers nutrition, immunisation, treatment of acute respiratory infections and diarrhoea diseases, and malaria.

Reform of primary health care also involves improvement of health management techniques and promotion of community participation through the establishment of community health councils, educational campaigns etc.

One of the principal problems of the health system, particularly for the poor, is access to good quality pharmaceuticals at reasonable prices. At present, in the absence of other alternatives, patients are usually obligated to seek pharmaceuticals in the private sector, often at prices considerably higher than those which could be offered by a well-integrated system with the ability to purchase drugs on a large scale at discount prices. The reform programme is trying to tackle this problem through training in rational drug use, and experimenting with various schemes to improve access of the most vulnerable.

2. Ensuring a Complete Child Immunisation Package

Infant and child mortality rates among the poor are considerably higher than the rest of the population. The average figures in 1998 were 17 per thousand live births of infants under one year of age. UNICEF has estimated that in poor populations the rates may be as high as 102 and 133. The proper way of preventing serious child illness and death is to provide immunisation against serious communicable diseases. Azerbaijan has in place a relatively comprehensive system of immunisation. UNICEF has supported the introduction of a national policy on the Expanded Programme on Immunisation (EPI) and vaccine procurement, as BCG, DTP, DT, Measles and Polio. With support from GAVI, vaccinations for Hepatitis B are also being introduced.

Excluding Hepatitis B, the entire vaccination programme costs about 10 USD per child. It not only saves lives and costs for all families, and especially the poor, but also avoids the more expensive costs of hospitalisation. Excluding Hepatitis B, which is provided free through the GAVI programme, the vaccines themselves cost about 2 USD per child. In the past, vaccines have been

provided entirely by UNICEF, but an agreement has been reached that from 2003 the government will cover 100% of the costs incurred excluding Hepatitis B.

The government will also work with international organisations to improve monitoring of the coverage and effectiveness of the immunisation programmes.

3. Improving Maternal Health and Care of New-born Infants

The government is concerned to improve access to maternal health care services and to care for new-born children. This is part of primary health care reform, and reflects the government's commitment to reducing infant and maternal mortality.

Maternal mortality rates will be improved through improvement in the quality of maternal health services and improving access to these services. The Ministry of Health, with donor assistance, is working on a Safe Motherhood and New-born Care project. This will involve capacity building of health staff especially at the primary health care level, raising awareness of pregnant women and adolescent girls on healthy life styles, improving access to essential maternal health services, promoting a mother-baby-friendly environment at maternity units, and ensuring the availability of maternal services with special focus on the vulnerable population including the IDPs and refugee population.

One appropriate way of improving maternal and new-born welfare is to encourage breastfeeding. According to surveys, most women who have given birth are aware of the benefits of breastfeeding and intend to do so for 6 months. But according to the UNICEF MICS survey, carried out in 2000, less than 10% of newborns were exclusively breastfed during their first 3 months. The widespread practice of providing formula milk implies costs of 15-20 USD per month which the poor can ill afford. Efforts therefore have to continue to educate women to exclusively breastfeed for the first 6 months and these efforts need to be particularly focused and targeted on the poor. Another effective intervention is the introduction of "baby friendly hospitals". This initiative has already been tested in Baku and in some regions, and has had positive results.

Another key component of health sector reform is "Integrated Management of Childhood Illness" (IMCI). This aims to improve the management of childhood illness with regard to nutrition, immunisation, acute respiratory infections, control of diarrhoea diseases, and malaria. This component involves improving provision of essential drugs, health education materials, training of health personnel, and further public awareness on better childcare.

Efforts are also continuing to improve the system of monitoring maternal, infant, and young child mortality rates. These include improving the system of collecting information, and moving towards consistent use of internationally accepted definitions.

4. Tuberculosis

In the year 2000 there were 5,123 tuberculosis patients, which imply 63.7 per 100,000 population. While this is below the levels of other CIS countries, it is still significantly higher than the EU level of about 12, or the Eastern European average of about 50. While there exists no specific evidence, it is likely that most of these people are poor, since tuberculosis is a disease aggravated through poor sanitary conditions.

The Ministry of Health jointly with the WHO has promoted the "Directly Observed Treatment - DOT" strategy, which was implemented in 1995 in 3 pilot districts. This programme focuses primarily on training physicians and nurses to treat patients with free medications taken under direct observation. It also includes educational programmes for both tuberculosis and healthy lifestyles.

In general, tuberculosis is best tackled through timely intervention, as well as education campaigns aimed at prevention. The disease is easier and cheaper to cure at the early stages. The government will also cooperate with international donors on improving coverage of the population with the BCG vaccination against tuberculosis.

5. Iodine Deficiency Disorders (IDD) and Universal Salt Iodisation

After the collapse of the Soviet Union, iodised salt was no longer imported, and an epidemic of iodine deficiency was observed particularly in small children in rural areas, particularly in the north, south and western areas of the country. This not only causes goitres, but first attacks the central nervous system causing multiple problems of growth and capacity. The government adopted a law in 2001 prohibiting the production, import and sale of non-iodised salt for the mass treatment of IDD.

6. Malaria

There was a rapid increase in the reported cases of malaria from the beginning of the 1990s onwards. However, since 1996 the trend has been reversed. In 1999, the reported incidence of malaria was less than half of 1998, and continued to fall in 2000 to about 19 per 100,000 or about 1600 cases and in 2001 about 1,058 cases.
Here the government is committed to raising community awareness of the dangers of this disease and how to prevent its spread. One innovative programme is the planting of large numbers eucalyptus trees in endemic areas. These trees grow quickly and absorb large quantities of water, reducing the breeding places of mosquitoes.

7. Promotion of Healthy Life Styles

Many of the problems of public health are directly affected by the lifestyles of the population. Unhealthy food, hygiene practices, alcoholism, smoking, unsafe sexual practices are serious concerns.

The Ministry of Health, with the help of numerous international organisations and NGOs, attempts to influence healthy lifestyles through counselling and health education. Campaigns targeted specifically at the young population have been developed. These efforts have to be continued. Other sectors and institutions must also participate in this effort; for example, health education will be introduced into the curricula of the schools in cooperation with the Ministry of Education. Campaigns against alcohol, drug and other substance abuse have also been undertaken, and will be continued.

Clearly special attention needs to be placed on combating the sexually transmitted diseases, both through educational efforts and the provision of drugs. UNFPA has developed guidelines on STI prevention. The guidelines include the sections for facilitators and for participants as well and is

intended for service providers working in rural areas of Azerbaijan. The government will also strengthen its work on public awareness campaigns on HIV/AIDS, especially for young people.

8. Protection of Population's Reproductive Health

One of the major causes of spiralling poverty is big families. Larger families among the poor lead to increasing costs, including health care, and contribute significantly to malnutrition since there is often simply not enough food to go around. The HBS results reported in Chapter 1 show that households with more than 6 members have a particularly high risk of being poor.

According to a UNICEF survey, about 55% of couples use some method of family planning, but modern methods are used less than one third, and use various considerably between economic groups. Traditional methods are much less effective, and probably their widespread use contributes to the high rate of abortions (one abortion for every four live births). For the poor, the cost of modern methods of family planning is an obstacle to their use. As a consequence, they use ineffective methods, and often resort to the much more costly abortion.

Clearly to protect the poor from the economically negative results of large families and the costs and suffering of abortions, modern methods of contraception should be made available to them. This requires active promotion, education and access to modern methods.

The Programme on Reproductive Health and Family Planning has been functioning in Azerbaijan since 1994 with the support of UNFPA. The first part of the Programme – Family Planning was implemented in the country in the period 1994-1999. 7 centres have been established in the framework of the Programme: Gusar, Sheki, Masalli, Ganja, Nakhchivan and 2 centres in Baku. The centres were supplied with equipment and contraceptives. 12 trainers were trained to arrange a training programme on family planning for obstetrician-gynecologists and midwives working in the medical facilities in Azerbaijan. Thus, 1,000 obstetrician-gynecologists and midwives on family planning passed the training aimed at improving the access of the population to quality services and data. Booklets, brochures and posters were published with a view to raising awareness of patients.

The second part of the Programme – "Protection of Population's Reproductive Health" - was launched in 2000. Currently implementation of the Programme is followed up by the National Office on Reproductive Health and Family Planning which was established within the Ministry of Health of the Republic of Azerbaijan for this purpose. A National Strategy on Reproductive Health of the Population of Azerbaijan has been developed. This will provide access for the families living far from cities and hospitals, including refugees and IDPs, poor and low-income people to services. In the framework of this stage of the Programme 8 more centres have been established in Aghdash, Shamakhi, Ismaill, Gabala, Jalilabad, Lankaran, Salyan and Khachmaz regions. At this point of time, the Ministry of Health and the National Office are making joint efforts to integrate the RH / FP centres established by international organisations in the areas populated by the large number of refugees and IDPs in Barda, Tartar, Aghdam, Mingachevir and Yevlakh. In the framework of the project about 350 obstetrician-gynecologists have been trained in Baku and other regions of the Republic, and brochures on protection from STD and RH / FP published for adolocents. It is proposed to bring the number of centres for reproductive health up to 21 in the future.

9. Availability of clean water

One of the primary causes of morbidity and mortality in children is diarrhoeal disease, usually resulting from contaminated water. This not only results in additional health care costs and loss of income, but also aggravates malnutrition by reducing the capacity to absorb the few nutrients available. It is of the utmost importance that all communities be provided with adequate sources of clean water.

According to UNICEF's MICS survey (2000) about 76% of the population has access to clean drinking water. This may be an over-estimate, since it assumes that all piped water is safe. The rural areas are particularly lacking in clean water supplies, as are specific areas of the country, particularly the south.

The only function of the health sector with respect to water is to monitor its quality. Availability is the responsibility of local and central authorities. It is intended to establish a system of regular and reliable monitoring.

10. Monitoring Indicators

One of the requirements for improving management is the availability of timely and accurate information related to all aspects of health care delivery. Without good information, effective decision-making is greatly weakened. As accurate and timely information has rarely been available, decisions have rarely been made on the basis of information, and thus the value of information is not fully appreciated.

A strong foundation on the national level has been developed, but there are many other aspects which require development. The first is an accurate system of vital statistics upon which to base the critical indicators of the health sector. This system focuses on births and deaths, and includes information related to each birth and information related to the deceased and the cause of each death. Without such a system, it is difficult to target specific populations, principally the poor, to better direct activities. The system has been designed and implementation has been authorised by a Ministerial decree from the beginning of 2002. Some computer hardware is in the process of being purchased, and software is presently being developed. Implementation of an accurate system of vital statistics will be carried out by a team which will train and supervise implementation at the regional level. Initial funding to train this team, prepare a manual, and implement the system in several regions will be provided by UNFPA. Further funding will be necessary to expand the system to other regions.

As noted in the text above, the system of data collection for monitoring infant, under 5 years, and maternal mortality has to be improved, and the definitions made consistent with standard international ones. Also, a system for monitoring access to clean water has to be developed and implemented.

UNICEF has cooperated with the SSC in the fielding of a "Multiple Indicator Cluster Survey" in order to increase the government's ability to monitor health indicators in the country. Elements of this survey, particularly the collection of anthropometric measurements, could be incorporated into

the HBS on a regular basis. For example, a special module could be developed, and fielded as part of the HBS once very 3-4 years.

11. Budgeting and Administration

Four main issues should be noted with regard to budgeting in the health sector. First an overall increase is required in state expenditure. The amount allocated to health expenditure has dropped from 1.4% of GDP in 1995 to 0.9% in 2001. Attempts to reverse this trend are incorporated into the MTEF for 2002 – 2005 (Appendix 2).

However, an increase in overall funding will not solve all the problems, especially since planned increases have to be realistic and be linked to increases in budget revenue. The Ministry of Health has already tried to increase resources available by introducing charges for some medical services representing circa 10% of budget allocations. However in the current economic situation, many groups of the population are granted exemption from payment (currently about 75% of the population). Therefore, at present it is not realistic to consider further increases from this source. The funds from paid services can be used by health institutions to improve the social welfare of employees and strengthen their material-technical base. It is therefore important that increases in the budget achieved through charging for medical services should not be used as justification for reducing rather than increasing state funding. However, attempts can be made to improve the targeting of exemption. This can be done in line with moves towards targeting of other social protection measures, as outlined in the section on social assistance reform above.

The second issue is linked to the rationalisation of resources. Since the health sector can not expect to solve all its problems through increased budget allocations and increased revenue from paid services, it has to undertake measures to rationalise the use of available resources. Much of this can be achieved through the shift from hospital services to ambulatory primary health services, and through other measures being piloted with UNICEF and WB support.

The third issue is to ensure new budget norms and budget flexibility. The budget for the country and for each raion is allocated on the basis of norms, namely the number of hospital beds, medical specialists and pharmacist and other indicators. These are rigid, and standardised, and do not take into account particular needs (e.g. increased incidence of disease) of different regions. The norms for allocation have to be changed and calculated either on a per capita basis (number of residents in the region), or on the basis of regional characteristics or disease incidence. As part of this, there is a need to calculate the cost of a minimum package of basic primary care services and to budget on the basis of the per capita cost of such a package.

The fourth issue is to ensure the increase of wage levels in the health sector. Although half of the budget goes on wages, these are very low. Health sector wages represent circa 30% of the national average in 2000 (50,216 AZM (10.4 USD)). This decreases staff motivation, and also encourages informal payments in the health sector.

The MTEF envisages increases faster growth in health sector wages in the coming 3 years.

Table 3.2. Total Health Expenditure as a Share of GDP; share of wages and other budget items within the total sector budget, in %

	1998	1999	2000	2001
Health sector expenditure as share of GDP	0.9	1.0	0.9	0.9
Total health expenditure	100	100	100	100
Wages	45	52	51	54
Drugs	9.6	9.7	11.3	11.8
Equipment and supplies	12.2	13.4	10.3	10.7
Repairs of furniture and equipment	4.6	2.8	2.5	2.5
Repair of buildings	0.3	0.3	0.2	0.4
Bed linen	1.7	1.3	1.3	1.3

Source: MH

Also critical for managing the resources in the health sector is a system of monitoring all financial flows in that sector. The system is still in a preliminary stage, but represents an important step towards improving financial management and transparency within the Ministry of Health. It is intended to expand and improve this system.

3.7. Promotion of Sports and Physical Education

Promotion of sports relates to the poverty reduction objectives in several ways. By encouraging physical exercise, a healthier life style will be induced, particularly amongst the youth. Positive outcomes may include generally higher levels of health awareness, and reduction in tendencies towards harmful habits such as smoking and drugs and substance abuse. The importance of promoting healthy life style has been stressed in the government's policy measures for health reform, and part of this includes improving access to sport facilities, especially for young people.

Ensuring a more equitable access to sports facilities will also be part of the social inclusion of the poorer sectors of the country. While the government will undertake to construct Olympia Centres in regions, repair the National Child Recreation and Health Centre and rehabilitate sport-health centre within Olympia and Sport Lyceum, it is planned to encourage municipalities and communities to play a role in providing basic sports facilities and public parks for outdoors sports.

The government plans to repair and upgrade the youth sports schools in the regions, and also to construct new sport centres. Part of the reason for the decline in availability of public sports facilities is the fact that some of them were used to provide temporary accommodation for IDP families. As IDP families are voluntary re-settled, these sports centres will be gradually re-constructed and re-opened to the public. In particular, the government plans to re-open the Mingachevir Rowing Centre by the year 2003.

Hence, apart from the direct impact on health promotion and social inclusion, there will also follow a more equitable regional balance as a result of promoting sports and its infrastructure.

3.8. Gender Policy

Integration of gender policy into the country's overall development strategy will ensure increased efficiency in the implementation of this programme and equal access to the benefits envisaged in the programmes directed at economic growth and social welfare of the poor.

The nature, causes and impact of poverty can be various; men and women can experience poverty in different ways. It is of great importance that this is taken into account by policy makers in general and in the sector policy-making process. It is necessary to deepen the diagnosis of poverty with more gender analysis as a basis for developing more appropriate strategies.

Gender issues are discussed in various sections of this document. This section gives a brief summary of the main directions of gender policy.

The current gender policy in Azerbaijan has its root in the "women issues" of the Soviet period. In that period, women enjoyed formal equality: there were legal guarantees of equal pay for equal work; a quota system which ensured women were represented at all levels of government; and other types of legislation that guaranteed women most rights. The "women's soviets" regulated women affairs. These soviets represented women's interests at all levels and they had the tasks of protecting women's rights. At the end of the 1980s the women's issue was de-ideologised and was no longer an explicit part of the government's policy. At this point, NGOs representing the concerns and rights of women began to be formed.

Discussion of women issues in line with international practise emerged during the independence period of Azerbaijan. As part of the preparation for the IV International Conference on Women (Beijing 1995), all government and non-government women's organisations were mobilised to address women's problems. In this regard, in 1994, a National Preparatory Committee was set up according to a Decree issued by the President of the country. This Committee included representatives of women from government agencies, and leaders of women's NGOs. In 1995 Azerbaijan ratified the "Convention on the Elimination of All Forms of Discrimination against Women." The women's delegation from Azerbaijan took an active part in the work of the Beijing conference.

In 1998 the State Committee for Women Affairs was established in the Republic and a Presidential Decree on the Measures to Promote Women's Role in Azerbaijan" was issued. The responsibility of the Committee is to address issues related to the status of women in various fields. In 1997-2000 a joint government and UNDP project "Gender in Development in Azerbaijan" was launched. This project included the activities of organising gender institutionalisation, dissemination of gender related information, logistical support and backup to the newly formed State Committee on Women Affairs and Women's NGOs.

In March 2000 the President of the Republic of Azerbaijan issued a Decree "On the Implementation of State Policy on Women's Issues in Azerbaijan" With the Resolution of the Cabinet of Ministers related to the implementation of this Decree, responsible persons for women issues were appointed to supervise gender policy in the state owned enterprises and a programme for provision of employment to refugee and IDP women was approved. According to the Decree the SSC was commissioned to develop statistics on the position of women. At the same time the National Action Plan on Women's Issues was adopted. This plan envisages taking measures on 12 "strategic objectives" of the Beijing Action Platform as a collaborative effort by ministries, state committees and NGOs.

Taking all these into consideration it was decided to focus on the following fields within the framework of Poverty Reduction Strategic Paper.

Employment: this objective covers the need to promote credit availability for women wishing to set up private businesses; organisation of special courses to train female entrepreneurs in legal and business matters; special employment initiatives for female single parents; promotion of self-employment opportunities in rural areas; provision of legal services to low income women, in order to help them get better information on their legal rights and rights to economic resources; involve female entrepreneurs in economy strategy development; help with technical and vocational training for women;

Education: this objective covers the need to promote equal participation of women in education; development of programmes for women to develop their legal and economic knowledge, gender awareness.

Health: promote education on family planning; promote government support to women NGOs to help in health services to women; prepare recommendations on women's reproductive health and ecological problems; prepare recommendations on the problems of unmarried mothers.

Violence: Adopt and implement international conventions related to the human trade as well as women and child trafficking; provide medical, psychological and other kinds of consultation to women subject to domestic violence and during the military aggression and to offer legal advice to them.

Refugees and IDPs: assist in promoting availability of credit to IDPs and refugees; expand medical, social and education services to IDPs and refugees; promote social protection and employment of women refugees;

Girl Teenagers: To provide special training for developing work skills of girls;

Decision-making process: To take relevant measures ensuring gender balance of women in electoral, political and social life, to ensure more active involvement of women in social life.

The aim of the Poverty Reduction Strategy is to identify and implement policies, which will benefit both men and women, and thus maximise the benefits targeted to poor households.

New HBS (2001) is designed primarily to provide information on income poverty. In order to supplement the HBS it will also be necessary to take carry out special surveys to study the gender dimensions of different aspects of poverty more closely. The ground has already been prepared for this. The UNDP has already supported the project "Gender in Development in Azerbaijan" and CIDA has supported the development of gender-disaggregated statistics in Azerbaijan. This has contributed notably to the ability of policy makers to study gender related problems in the country, and to be aware of the gender aspects of current or proposed policies. For example, gender indicators were included in latest (1999) census, and statistics in many spheres are presented on the basis of gender-disaggregated statistics. Since 1998 an annual statistical report entitled "Women and Men in Azerbaijan" has been published. Along with this there is great need to extend the coverage, dissemination of available gender disaggregated statistics, and to publish these gender-disaggregated statistics regularly.

There is already official recognition in Azerbaijan that poverty can affect women and men in different ways and that policies have to take into account these differences. At present international organisations extend support and assistance to measures related to gender and women issues. The following should be emphasised among them: UN Agencies (UNDP, UNICEF, UNIFEM, UNFPA, UNWFP and IOM), OSCE, OXFAM and OSI.

Great efforts have been made to ensure that gender issues are reflected in the priorities formulated in this SPPRED. One of the main conditions for successful implementation of the SPPRED will be further attempts to increase gender awareness in programme monitoring in the implementation phase.

3.9. Social Policy and the Refugee - IDP Population

It was stated in Chapter 1 that refugees and particularly IDPs have a higher than average poverty risk.

Within recent years a legal framework for the social protection of these people has been established based on international practice. The President of the Republic of Azerbaijan has issued about 24 Decrees and Orders, the Parliament has adopted 13 laws (including the law on the Status of Refugees and Internally Displaced Persons (IDPs), the law of the Republic of Azerbaijan "On protection of IDPs and those who have equivalent status"), The Cabinet of Ministers has adopted about 140 orders and resolutions. The State Programme on the Solution of Problems of Refugees and IDPs has been approved by the Order of the President of the Republic and a Social Development Fund for IDPs has been set up.

Over 60 international organisations, about 54 Ministries, Committees, companies of the Republic are actively involved in refugees' and IDPs' settlement, improvement of water supply, sanitation conditions, addressing problems related to their education and health care.

Currently about 357,000 IDPs are provided with food assistance. About 143,000 of them are provided with assistance by UNWFP (the programme was prolonged to the end of 2005), and 214,000 by the state (until the end of this year). UNHCR is financing local and international organisations and coordinating their activities to improve housing, water supply and sanitation, income generation, health status of IDPs etc. Despite budget limits, each IDP and permanently settled refugee is paid 25,000 AZM (5.2 USD) a month as a food subsidy.

As a result of substitution of privileges for subsidies for permanently settled refugees and IDPs since early 2002, 15,000 AZM (3.1 USD) monthly subsidy per person is directly transferred to the utility companies from the state budget.

In order to improve the social and living conditions of 5,019 IDP families provisionally settled in refugee camps, and to provide permanent settlement to 1,722 refugee families, 359 billion AZM (74 mln USD) has been allocated from the State Oil Fund, in accordance with the respective Decree of the President of the Republic of Azerbaijan. Alongside with the infrastructure, it is intended to build 15 secondary schools, 14 kindergartens, and 15 hospitals and medical centres in the new settlement.

About 60,000 ha of land have been allocated to 20,000 provisionally settled IDP families, and 611 farmer households in order to contribute to the solution of employment problems of IDPs. However,

only 400 out of them have been given privileged credits at the expense of a billion AZM (215 thousand USD) allotted from the state budget in 2001. In this area there is a need for support from the international organisations.

529 refugee and 92,000 IDP families provisionally settled in camps, prefab houses, and other temporary housing and in the villages are provided with paraffin in the autumn and winter seasons. Refugee and IDP children like the local population get free education at secondary schools and members of the 1^{st}-4^{th} grades are provided with free textbooks. Refugees and IDPs are also granted exemption from income tax, and from tuition fees in the paying sections of the state high and secondary education establishments and are transported at the expense of the state budget when they move houses.

The living conditions of Refugees and IDPs should be periodically analysed in order to increase the targeting and efficiency of social protection measures, to focus them on the most vulnerable people. Surveys and monitoring of the living conditions of these people through international financial and humanitarian organisations is expedient. This will also enable the government to monitor the extent of poverty among the refugee and IDP groups of the population.

The complete solution of refugees' and IDP's social problems will only be possible when the Nagorni Karabakh conflict comes to an end, and the return to their homeland is secured. But the implementation of special measures should be continued for improving the living standards of these people in order to avoid loss of human capital by the time this conflict is solved. In this important work the support of international financial and humanitarian organisations is necessary to complement the efforts of the state authorities.

Chapter 4. Economic Policy and Poverty Reduction

The Poverty Reduction Strategy includes two main challenges for economic policy. Firstly, fiscal and monetary policies must be flexibly and carefully used in order to maintain macroeconomic stability. It was already noted in Chapter 2 that since 1995 Azerbaijan has enjoyed considerable success in this regard; the task now is to continue and consolidate these successes. Secondly, the government must now foster balanced growth of the economy. Transfers to households have until now been considered the major tool to alleviate poverty, although it was shown in Chapter 3 that in fact they are in general too low to have any major impact on living standards. There is still an important role for targeted transfers in the poverty strategy, but it is increasingly obvious that transfers alone will not resolve all the issues of poverty. Therefore, the government will focus on promoting business activity and entrepreneurship in order to generate employment and income.

As was shown in Chapter 2, Azerbaijan has achieved significant growth in the oil sector, which is the leading sector for the national economy. However, foreign investment in Azerbaijan's petroleum wealth creates relatively limited job opportunities. In 2002, about 5,000 people are employed in foreign oil companies in Azerbaijan (mostly living in Baku), and about 61,000 for SOCAR (of which 74% are men and 26% women) out of total labour force of about four million. Oil and gas sector development plays an important role in increasing state revenues but only creates a limited number of employment opportunities.

The government will attempt to achieve balanced economic growth through development of the non-oil sector for job creation and promoting regional development. It should be noted, however, that the government will stimulate job creation, not create jobs itself. Job creation will be stimulated through various aspects of economic policy, for example investment policy, regional development programmes, privatisation, developing the financial and banking sector, and encouraging the growth of small and medium enterprises (SMEs).

The remainder of this chapter is divided into three parts. First, the need for continued stability, and the achievements which have been made, are highlighted. Second, an overview of the government's medium-term expenditure strategy, which will support the reduction of poverty, is provided. Finally, sectoral initiatives which will promote balanced growth are explained. These include plans to provide a supportive environment for businesses, and to reform the energy and agricultural sectors.

4.1. Maintaining Economic Stability

As a result of the prudent economic policies pursued by the President of the Republic of Azerbaijan, with support from international financial institutions, economic stability was restored in the country in 1995. The government stopped the practice of borrowing from the National Bank in order to finance the state budget deficit, and the inflation rate was reduced to a minimum. The National Bank refinancing rate fell from 250% to 7% while the exchange rate stabilised. The state budget deficit was cut from 9% of GDP in 1994 to the current level of 1 – 2% (This excludes Social Funds and inflows into the State Oil Fund. The Consolidated budget, which includes SOFAR receipts, is now in surplus by about 1% of GDP.)

The government of Azerbaijan set up the State Oil Fund (SOFAR) to mitigate the potentially negative impacts of rapid inflows of oil revenues to the state budget, and to preserve an appropriate portion of the oil wealth for future generations. Careful management of oil wealth is of the utmost

important for the maintenance of macroeconomic stability. In the absence of such measures Azerbaijan would be very much at risk of suffering from "Dutch disease". International experience has shown that countries which enjoy rapid increases in their exports of oil or gas often suffer from shrinking manufacturing and agriculture sectors caused by an appreciation of the real exchange rate.

In Azerbaijan, as in other countries, rapid changes in the prices of goods and services have hurt the poor much more than the rich. Therefore, one of the key planks in the government's Poverty Reduction Strategy is to maintain macroeconomic stability. This will be realised in three forms: first, the NB will continue to use monetary policy to maintain low inflation rates taking the new environment into account; second, the government will limit its expenditure to a level that is sustainable over the medium term and is non-inflationary; and third, the government will increase the effectiveness of its fiscal planning and control, by making institutional improvements to key economic and financial agencies.

Monetary Policy and Maintaining Price Stability

The achievements in economic development have led to new challenges in economic policy, including monetary policy. The National Bank will continue to use monetary policy to support macroeconomic stability and poverty reduction. The main aims of exchange rate policy will continue to be maintaining a low rate of inflation and maintaining exchange rate stability. It is proposed to limit inflation to 2-3%.

The maintenance of foreign exchange reserves at a sufficient level will be ensured, and efforts to liberalise the foreign exchange regime will be sustained. Thus, it is planned to gradually bring about the external convertibility of national currency, the domestic convertibility of which has already been achieved.

It is planned to improve monetary policy tools and broaden their scope according to the current macroeconomic conditions in order to increase the effectiveness of the monetary management mechanism. Flexibility of monetary policy will be ensured to facilitate expansion of the economy as well as the banking-fiscal sector.

To achieve the goals, efficient links between monetary policy and other aspects of macroeconomic policy will be ensured.

Efforts will continue to be made to ensure that the efficiency and credibility of monetary policy are guaranteed through bringing transparency in the policy up to international standards.

Increase Efficiency of Expenditure

Azerbaijan has established a strong record of limiting fiscal deficits to low levels. Since 1996, the government budget deficit (excluding flows into SOFAR) has not exceeded 4.5% of GDP; it was 2.2% of GDP in 2000, and 2.1% in 2001.[8] This prudence has left the country with low levels of debt, both domestic or external. Furthermore, Azerbaijan is in the fortunate position of anticipating rapid increases in the resources available for poverty reduction. For the years 2003 – 2005 the total

[8] The deficit of the state budget (which does not include extra budgetary funds, and extra budgetary funds of budgetary organisations) was 0.4% of GDP in 2000.

receipts available to the government will increase by an average annual 9% in nominal terms, while the state budget is expected to grow by an average annual 15% in nominal terms (inflation is expected to be about 2.5% per annum, so that real growth of the resource envelope will be about 6% annually). This strong revenue growth is driven by very high levels of investment in the oil sector, and is supported by appropriate levels of external borrowing, all of which will be available on concessional terms.

Improvement of the Budget Process

The Milli Majlis has adopted a new Law "On the Budget System" with a view to improving the budget process and ensuring transparency in expenditures. The law endorses a move from a one-year to a medium term fiscal forecast.

Budget planning in Azerbaijan has until now been undertaken on an annual basis. This has helped to maintain financial stability, but has not especially supported the reduction of poverty. A number of key economic and social expenditure programmes cannot be implemented within one fiscal year. Furthermore, the country's revenues will soon undergo a dramatic change, as oil revenues begin to be paid to the state budget from the offshore oil and gas projects. Therefore a need has emerged to produce forecasts for several future years in order to increase opportunities for more efficient management of public expenditures and revenues.

The new Law "On the Budget System" requires preparation of budgets for the upcoming year as well as for the three following years. For this purpose, firstly, mid-term economic forecasts should be prepared and on the basis of these budget revenues determined and thus a medium term expenditure framework (MTEF) worked out, ensuring balanced expenditures and revenues and defining the government's expenditure priorities. Within the framework of the MTEF a Public Investment Programme (PIP) will be prepared. Both documents will be annually updated in keeping with the changing economic environment, and the PIP will be presented to the Milli Majlis as part of the annual budget package.

Consolidation, balancing and coordination of budgets at all levels will be improved. The mid-term expenditure framework will be fully consolidated (which is to say, it will include the State Budget, Social Protection Fund, SOCAR budgets, and expenditure on projects funded with foreign credits). This will provide a more effective and longer planning horizon for public expenditure aimed at reducing poverty.

New rules for the preparation, introduction, revision and implementation of the budget will be developed and a new budget classification will be adopted in line with international standards. Norms and standards used in forecasting budget expenditure will be improved.

At the same time, changes in procedures will result in better management of extrabudgetary funds. Some extrabudgetary funds will be eliminated, while remaining extrabudgetary funds of budgetary organisations[9] will be consolidated with the state budget. Additionally, all budgetary and extrabudgetary funds will follow the same procedures for expenditures: any expenditure (except for the State Oil Fund meeting its own administrative expenses) must be recorded and enacted by the Treasury. The Ministry of Finance and the two extrabudgetary funds (SOFAR and SPF) will

[9] Extrabudgetary funds result from charges made for the use of public services, for example hospital user fees.

continue to work closely together. A consolidated budget will be presented to the Milli Majlis, showing the revenues and expenditures of each of these three budgets.

The Ministry of Finance will continue upgrading the Treasury system, including a computerisation and capacity building program, which has already commenced. This will result in strengthened capacity to control the expenditures of the budgetary organisations, and to produce timely and accurate financial reports in compliance with the Budget System Law.

At the same time, audit functions implemented by the newly formed Chamber of Accounts will be strengthened, in order to ensure that budgetary funds are used for the purposes for which they are intended. The Chamber of Accounts will prepare proposals on preventing deviations which have been noted as well as on the improvement of the budgetary process as a whole, and will submit them to the Milli Majlis. These are aimed at ensuring that the funds of the state budget and extrabudgetary funds are allocated according to the time schedule and purposes indicated in the expenditure items of the approved state budget.

The simplified norms and standards used as the basis for expenditure budgeting by appropriate executive bodies will be updated. While there is an intention to move to output-based budgeting in the future, there is a need to revise existing norms and standards in order to manage expenditure in a more rational way.

Finally, the government will undertake relevant measures to build up capacity for self-sufficiency of municipalities. Active participation of the municipalities in the country's social and economic life as part of the participatory process is very important. Therefore, it is planned to develop an action plan on increasing the local budget revenues in order to reduce the dependence of municipalities on the state budget and to improve their financial opportunities.

Revenue Management

In order to provide greater opportunities for business development and employment creation, the government is committed to continuing reform of its revenue raising policies and institutions.

Significant improvements of the tax system were made with the enactment of the Tax Code in 2001, which now provides a sound and transparent basis for taxation.

It is planned to amend the Tax Code to remove current problems in the tax legislation related to calculation, collection and payment of taxes. The Code will also be amended to allow for the payment of interest, where necessary, to taxpayers who have over paid to the budget, and dispute settlement processes which will take into account any legitimate concern of taxpayers.

The Ministry of Taxes will begin by improving regulations relating to the Tax Code, by consolidating the regulations into one book and renumbering them so that they correspond to the relevant section of the Tax Code. The Code itself is in need of some further amendment, so that the administrative law on taxation is itself contained in the Code, and not in other legislation. For example, the penalties for late payment of taxes are currently contained in the Administrative Code, when they should properly be found in the Tax Code. These moves will complete the development of a coherent and taxpayer friendly code of law for taxation. The Customs Code will also be improved, to simplify procedures for importers and exporters.

The Ministry of Taxes will continue to reform its organisational structure and processes with a view towards enhancing taxpayer compliance, increasing revenues and minimising expenditure. This will include enhancing the Large Taxpayers Unit with more staff and better training opportunities. There will be fewer audits for compliant taxpayers, and an increased focus on non-registered and non-compliant taxpayers. It is recognised that an effective and impartial appeals procedure is an essential part of creating a culture of compliance among taxpayers – to this end the appeals procedure will be reviewed and improved. Modernised and systematised practices and procedures for return filing, returns and payments processing, and collection of overdue returns and debt will be implemented.

The qualifications and motivation of tax and customs officials will be enhanced. A new Tax Training Centre has opened for officials of the Ministry. There are plans to develop a special higher pay scale for highly-qualified tax officials. This would mean increased pay for Large Taxpayer Unit staff, audit staff in local offices, and key staff in the Ministry.

In order to enhance compliance, a programme of taxpayer education will be developed and implemented by both the Ministry of Taxes and State Customs Committee. Taxpayer information brochures, which clearly set out taxpayers' rights and obligations will be published and made widely available. Information services will be set up at each local office of the Ministry of Taxes. Key returns will be simplified and modernised.

Both organisations will expand the scope of international cooperation with a view to aligning their processes with international best practices.

State Debt Management

The government remains committed to maintaining appropriate levels of debt and debt service, and intends to take action to improve mechanisms for debt management. As part of the MTEF, a statement about the borrowing over the medium term will be made to the Milli Majlis, and detailed information will be provided on state debt and state guarantees. The government will continue to limit new borrowing to a level sustainable in the medium term, and to make that commitment public in the annual Budget.

Two new legal documents will help the government to better manage its debt. The law "On State Debts and Guarantees", which is now before the Milli Majlis, will enable the Ministry of Finance to better track external official obligations. The regulations for the law "on Foreign Loans Registry," will formalise the recording of official debts and guarantees in a public registry.

The government intends to limit the issuance of new state guarantees through a close examination of applications for such undertakings. Financial discipline for guarantees will be strengthened, as the Ministry of Finance continues to take action to recover loan payments made on the government's behalf for defaulting enterprises.

4.2. Tools for Balanced Growth

While stability is a prerequisite to the alleviation of poverty, it is not enough on its own. Opportunities to find work or to start businesses are essential. The challenge for the government is to create growth and opportunities in all regions of the country, and in all sectors.

As Azerbaijan continues to move towards a market economy, the government can no longer provide jobs directly to the population. Instead, it will rely upon three sets of tools which can support balanced growth: public finance policy, regulation, and privatisation.

Public Finance Policy

Use of public finance, through both expenditure and tax policies, will have an important role in reducing poverty and encouraging balanced growth. Tax policy will be used to enhance equality by redistributing income, and can provide implicit subsidies to particular sectors or regions by offering reduced rates of taxes.

The government's spending plan affects human capital formation (including spending on health and education), poverty alleviation through state transfers to households, and public investment in infrastructure.

Despite the importance of these policies, in the past, the government has not been always taken a strategic view of its expenditures. Instead, it has indiscriminately applied across-the-board increases to many functional and economic[10] categories of expenditure. The lack of restructuring has meant that public expenditure has not reduced poverty. The government recognises the very real need to restructure spending within each spending category and full details of the expenditure strategy are found in Appendix 2: Medium Term Expenditure Strategy. In this chapter the relationship between the MTEF and the government's focus on promoting balanced growth is explained.

One important method by which the government will improve its spending is through the implementation of a Public Investment Programme (PIP). All major capital projects financed from different sources will in the future be undertaken only as part of the PIP to ensure transparency of decision making and co-ordination of their implementation. The PIP itself will be fully consistent with the government's Poverty Reduction Strategy. In order to ensure that this occurs, it is intended to strengthen the newly established PIP Division in the Ministry of Economic Development, with support from international donors. The Division will evaluate public investment projects on technical, financial and economic bases, and will select and prioritise capital works. The PIP will be presented as part of the MTEF to the Milli Majlis with the annual budget, and will show expenditure on (and, where relevant, revenues from) approved investment projects.

Regulation

The government will promote pro-poor economic activity directly to improve the lives of the poor. At the same time, it will eliminate regulations that disadvantage the poor or limit their income generating opportunities.

Providing a framework in which farmers' associations can properly function is an example of regulation working directly to alleviate poverty. By cooperating to share equipment and knowledge,

[10] Expenditures are often classified into two different sets of categories: functional and economic. Functional classifications describe the purpose or objective of government spending (for example, spending on health or education). Economic classifications describe the nature or economic effect of the spending (for example, wages or capital expenditure).

such associations can help farmers to improve their livelihoods. Similarly, setting up an Export Promotion Fund can help entrepreneurs to sell their products to other countries, allowing them to expand their businesses and employ more people.

Some regulations, many of which have their origins in Soviet times, are stopping the poor from improving their lives. For example, onerous licensing conditions have been a real barrier to starting up new businesses. With the recent announcement of a reduction in the number of fields for which licences are required, this barrier will be greatly lessened. Similarly, entrepreneurship has in come cases been stifled by the overlapping role of the state as both owner of commercial businesses and regulator of the sector. Structural adjustments to relevant ministries and state entities, including clear separation of commercial and policy functions, will be part of the government's policy. The prevalence of corruption also inhibits business growth, and will be reduced by introducing new legislation.

Privatisation

Privatisation is an essential step in order to attract new investment. The government believes that in a properly regulated competitive market, the private sector is more efficient at providing goods and services than the state. When properly managed, privatisation increases the efficiency of privatised firms. Privatisation also brings capital for upgrading of networks and technology, introduces best practice management techniques and lays the basis for competition among providers. It should be noted that privatisation is a tool that the government can use to promote better corporate governance, increased efficiency, and to stop the drain on state resources. Privatisation is not an end in itself.

The adoption of the "Second State Programme on Privatisation of State Property of the Republic of Azerbaijan" in August 2000, has brought additional impetus to the process of decentralisation of state property.

As per adopted legislative acts, certain measures are applied with regards to the enterprises to be privatised, such as pre-privatisation rehabilitation, restructuring (including debt management), application of certain tax exemptions, provision of financial support as needed, including other methods of revitalisation, such as post-privatisation technical, legal and financial support.

To encourage foreign investment in the privatisation process, the option mechanism, which was a kind of ceiling for participation of foreign investors in privatisation, was fully liberalised. Now the only case where options are required for foreign investors is in the case of cheque privatisation; in all the other cases this requirement has been eliminated. At the same time, it was determined that foreign investors can participate in privatisation without options when investments are made with revenues earned from business operations in Azerbaijan.

Certain problems go along with achievements in the course of privatisation. Thus, some of the privatised enterprises either completely or partially ceased their operations. This is result of the government's emphasis on privatising large numbers of enterprises, the collapse of commercial relations, the loss of market and equipment becoming outdated.

The government will, where possible, revitalise large enterprises before they are privatised. Additionally, foreign and domestic strategic investors which have successful records of managing privatised enterprises will be encouraged to participate in the privatisation process.

The Presidential decrees of 22 and 29 March 2001 made possible the privatisation of enterprises in certain attractive fields which had until then not been scheduled for sale. The list of these fields includes machinery, chemistry, communications, and air transport.

To increase the efficiency of privatisation process, the government will use such privatisation mechanisms as investment competitions and individual project approaches to revitalise large enterprises which are considered of great importance to the economy

Given the importance of transparency and attracting strategic foreign investors, the services of well known international privatisation consultants will continue to be used.

The government will also pursue regulatory reforms which allow the objectives of privatisation to be met where the sale of an enterprise to a strategic shareholder is not practical. For example, as outlined in the section on infrastructure development below, the government may sign long-term management contracts with private enterprises to manage public utilities.

4.3 Sectoral Strategies for Balanced Growth

As outlined in the previous section, public finance policy, regulation and privatisation are three sets of tools which will be employed to encourage balanced growth of the economy. These tools will be used to bring about improvements in some of the key economic sectors: to improve the investment climate; to increase access to credit among businesses and entrepreneurs; to develop infrastructure; to develop small and medium entrepreneurship; to develop the regions and agriculture industry; to improve the environment; to reform energy generation and distribution and to promote tourism.

Poverty is a multidimensional problem, and cannot be solved with a single approach. The strategies below work together to help solve the problems which have so far inhibited balanced growth. For example, the growth of small businesses outside of Baku will be assisted by strategies to improve the investment climate, to increase access to credit, and to improve infrastructure. Farmers will benefit from increased access to credit, improved infrastructure and regional and agriculture development.

Improvement of the investment climate

Azerbaijan's impressive record of attracting foreign investment in the oil industry has not, unfortunately, been matched in the non-oil sector. The government will take steps in order to encourage investment, by both international and domestic investors. Rebuilding infrastructure and ensuring better access to credit are important strategies. At the same time, the government will examine tax rates, and reform its regulation of businesses, in order to encourage investment. Special attention will be paid to the needs of entrepreneurs, and to small and medium enterprises. SMEs are often very labour intensive, and can create new jobs in regions where large-scale investment rarely take place.

Regulation

It is planned to improve the existing legal and regulatory base in order to attract investment to the non-oil sector and to develop regions of the country outside of Baku. A draft law "on Investment

Activities" will be submitted to the Milli Majlis. This law will provide for equal treatment of domestic and foreign investors, and will replace all existing investment laws. A draft law "on Establishment of Special Economic Zones" will also be submitted.

Regulations for businesses have already been considerably simplified. Up to the present time, according to legislation 75 types of business fields have been subject to licensing. These fields have been broken into certain activities (communications, mining, alcohol and tobacco production) resulting in 270 types of activities being subject to licensing. Licensing and supervision have been implemented through 27 central and local executive power authorities, their departments and other entities.

As a result of the meeting of the President of Azerbaijan Republic with the local and foreign business community, steps are now being taken to improve legislation and procedures. Based on the Presidential decree of 2 September 2002, the number of activities for which licenses will be required will be sharply reduced, to only 27.

It is planned to conduct regular studies on the investment environment in the country, and to discuss the results jointly with the representatives of public and private sectors and undertake relevant measures in this regard. An Entrepreneurs Council has recently been established (by the Presidential decree of August 27, 2002), which will represent both local and foreign entrepreneurs.

A comprehensive programme of support for entrepreneurs was announced on August 17, 2002, when the President of the Republic of Azerbaijan issued a decree approving the "State Programme on Small and Medium Enterprise Development." The programme includes over sixty specific measures, which are grouped into six broad areas: improving regulation of entrepreneurship; financial and investment support for SMEs, assisting structural and technological progress; human resource development; promotion of regional development, and strengthening the legal rights of entrepreneurs.

A Tariff Council was established in early 2002 with the participation of government officials and private sector representatives in order to ensure the improvement of the tariff system of the country and flexible regulation of the level of tariffs based on the requirements of the economy. Regular adjustment of tariffs from the point of view of entrepreneurs' interests through capacity building for this organisation would be of great importance.

The government also plans to undertake several measures in order to promote exports. Several initiatives are currently being considered, including the creation of a database to increase marketing opportunities for local products, arrangement of trade fairs, establishment of exhibition centres and bonded warehouses as well as opening trade representations in potential partner countries and establishing an Export Promotion Fund.

The government plans to continue with efforts to move to International Accounting Standards (IAS). As part of the process, joint stock companies with turnover exceeding a prescribed level will be required to develop their reports in line with IAS.

The government will strengthen the fight against corruption that is considered to be a worldwide social menace. Thus, in 2003 the government plans to adopt and enforce the law "On Fight Against Corruption" which has passed its first reading in the Milli Majlis. The law will aim to prevent,

uncover and investigate corruption related infringements and to eliminate their consequences, to protect human rights and civil liberties by means of punishment of the individuals guilty of such infringements, to protect public interests and state security, to ensure efficiency and lawfulness of the activities of the public and local municipal organs and of public officials. This law also will intend to strengthen the confidence of the populace towards the state and its individual structures thereof, and to encourage professionals to enter public or local municipal service, and to create conditions excluding involvement of the staff of such organs from corrupt practices.

It is planned to continue the process of applying for admission to the World Trade Organisation. Bilateral and multilateral trade negotiations will be held for this purpose. The WTO offers Azerbaijan the opportunity to participate in a rules-based multilateral trading system (as opposed to a bilateral trading system, where differences in economic power often decide the outcome of trade disputes).

Public Finance Policy

With regard to tax rates, changes are planned in the 2003 budget for the rate of social contributions. It seems clear that social insurance contribution rates are unhelpfully high, and are discouraging both compliance with the tax regime, and the growth of employment in the country. Steps have already been taken to reduce this tax burden by consolidating Disability and Employment Funds with the Social Protection Fund, and reducing taxes accordingly. It is intended to further reduce social insurance contributions by lowering the rate levied upon employers on employee's pay from 29% to 27%. At the same time, the rate to be paid by employees will be raised from 1.5% to 2.0% of their wage. These changes will make it less expensive for businesses to comply with their legal obligations, and less expensive to hire additional employees.

The National Fund for Entrepreneurship has been operating since 1993, providing both concessional credits and advice and training to small businesses. Over the period of 1993-2001 the National Fund for Entrepreneurship has implemented over 100 businesses development investment projects on a concessional basis. The amount of soft loans given to entrepreneurs from the state budget during 1999-2001 was 5.4 billion AZM (1.1 million USD). According to the Presidential Decree, it is planned to allocate 250 billion AZM (51.5 million USD) to increase financial support for the development of entrepreneurship.

The government has already taken an important step for the purpose of education, counselling and information provision, by organising training and seminars and sending entrepreneurs to foreign countries to gain experience. The government intends to continue its efforts in this field.

Increased Provision of Credit

A major problem which entrepreneurs and small and medium sized businesses face is the lack of credit, to start up or expand their businesses. This is because the Azeri financial sector, which is dominated by banks, is small and still needs to be developed. Increased availability of credit will come about primarily as a result of improvements to the banking sector, although there will be some targeted provision of credit by the state. These improvements will increase the public's trust of the banking system, and so encourage them to deposit their savings in banks. At the same time, better run banks will be better able to provide credit to entrepreneurs and investors.

Trust in the banking system is low, and consumers largely keep their savings outside the banking system, so bank deposits, mainly in dollars, amount to just over 7% of GDP. At the same time, borrowers do not finance much investment through banks – with loans, many of them bad loans, amounting to just 9% of GDP – since the cost of borrowing is very high. To improve competitiveness and so attract more deposits and lower the cost of loans the NB will develop and implement a strategy of banking system reform. This will include several measures, designed to lead to the expansion of banks' role in the economy, improvement of opportunities for credit and especially to the decrease of interest rates, which in turn will improve credit provision to entrepreneurs and increase employment opportunities.

Privatisation

The government will sell much of its stake in the International Bank of Azerbaijan and will also improve the operational and management system of the Universal United Joint Stock Bank (BUS Bank) to prepare it for privatisation.

Regulation

The minimum capital requirements for banks will be increased. It is also planned to undertake measures to improve the competitive environment in the banking services market.

The expansion of the number of regional bank branches, establishment of the regional banks and financial institutions, as well as the promotion of credit unions are planned within the framework of the institutional development of the banking sector. It is planned to develop microcredit banks, which will provide credits to SMEs and to further liberalise foreign capital participation regime.

As in many countries, in Azerbaijan not all entrepreneurs feel confident in depositing the receipts from their businesses in the banking system. Some fear that they have not fully complied with the tax regime, while others prefer the convenience of keeping funds in cash. Keeping these funds in cash form prevents banks from making loans to other businesses. Many countries have attempted to tackle the problem of encouraging legitimate businesses to deposit their funds with banks, while discouraging the laundering of money earned from illegal businesses. Thus, it is also intended to study international practices in order to encourage holders of cash to use their funds to finance entrepreneurs, and to create new jobs.

Completion of the small payments system, development of the intrabank payment system, completion of the transition to international accounting standards, improvement of the bank control system, and the establishment of credit bureaus are amongst the measures to be undertaken.

It is also planned to introduce deposit insurance for individuals, taking into account reconstruction and enhancement of the banking system. Deposit insurance will increase the confidence of the population, and will prevent small depositors or depositors with poor knowledge about banking activity from losing their deposits due to a bank's inability to repay. This measure will play an important role in transforming free resources into investment and thus will lead to the acceleration of economic growth and improvement of social welfare by strengthening banks' role as financial intermediaries.

At the same time, there will be a continued focus on the improvement of human resource management systems, and the development of internal information systems of the banks.

In order to provide a better environment for banks, the government will establish a centralised and simplified collateral registration system, and will set up an effective land market, as noted in several sections in this document. Special emphasis will be placed upon the stimulating non-cash transactions and limiting dollarisation of the economy in order to ensure healthy money turnover and its effective regulation.

Improvement of banking legislation is of particular importance for the development of banking infrastructure. In this regard, it is planned to amend the Law of the Republic of Azerbaijan "On the National Bank" and to adopt a new Law "On Banks in the Republic of Azerbaijan". These changes are necessary in order to implement better supervision of banks by the National Bank, and provide for the deposit protection scheme.

Development of Infrastructure

The unreliability of infrastructure such as gas, electricity and water supplies, and the poor quality of transport infrastructure is a serious impediment to economic development and the standard of living of the Azeri population. Lack of reliable power supplies outside of the Absheron Peninsula limits the opportunity for private sector investment, and stifles the creation of new jobs. Given the importance of underinvestment in infrastructure, the government intends to undertake comprehensive actions in this regard during 2002-2005, as reflected in relevant sections of this document and the Policy Matrix.

Public Finance Policy

As noted above, all new infrastructure including major maintenance and repairs will be undertaken only as part of the Public Investment Program. Planned expenditure on capital works will increase from 17% to 21% of total government expenditure; it will total 2,015 billion AZM in 2005, a 111% increase in nominal terms from expenditure in 2001.

This increase takes into account many pro-poor capital projects which have already begun. These include rebuilding essential transport infrastructure such as roads, railways and ports. Improvements to the Trans Caucasus Highways have as a specific focus improving the quality of transport services for the low income rural population living in the vicinity of the highway and the tertiary road network connected to it. Rehabilitation of the port will emphasise minimising the negative environmental impact of the operations on the Caspian Sea. Improvement of transportation will help to promote trade and economic growth, and will help to spread the extent of growth to include regions outside of Baku.

Improvements to the Baku water supply system have also been designed with the poor in mind. The reconstruction of the Greater Baku water supply system is focused on emergency short-term improvements of water supply, especially supplies for the poorer elements of the population.

As is shown in the policy matrix, the programme of capital works includes the following:

- building 28 new schools, and rebuilding 200 schools;
- building new houses for refugees and IDPs, and upgrading facilities in IDP camps;
- anti-pollution measures, including the treatment of mercury and radioactive waste;
- rebuilding irrigation and drainage facilities;
- conversion of oil-fired power stations to natural gas-fired, and building of new power plants;
- reconstructing underground gas storage facilities;
- building Olympic centres in regions;
- rebuilding cultural and art centres, and preserving cultural heritage.

Regulation

These improvements to public infrastructure are funded by the government. It does not seem likely that there will be significant interest from the private sector in investing in infrastructure in the medium-term. However, the government is already pursing new methods of improving governance for existing infrastructure. For example, the management of the Baku and Sumgait electricity network has been let to a private company, Barmek Holdings, and Ganja and Ali Bayramli electricity networks to "Baku High Voltage Power Equipment" JSC for a 25 year period. This sort of public-private partnership will be used in the future, and may extend to include management of other utilities.

Investment in Human Capital

In the long term, poverty reduction is dependent upon investment in the country's human capital. Building up human capital embraces a broad spectrum from meeting basic needs to empowering and enriching capabilities. As such, it rests on making a more efficient use of the existing capacity, as well as creating additional human capital through developing capacity, skills and know-how. As part of its Poverty Reduction Strategy, the effectiveness of the government's spending on human capital development, particularly in social security, health and education, will be improved. As has been noted above, the government has developed a strategic medium term expenditure plan which provides for a more rational use of public funds in order to fight again poverty.

Public Finance Policy

As has been described, there is a pressing need to increase expenditure on health care. Health care expenditure will more than double over the life of the SPPRED program, and will account for 5.4% of total government expenditure (up from 3.8% in 2001). Spending reforms will support the reform of primary health care delivery, and the introduction of cost-effective health care interventions. At the same time, the wages of health sector employees will be significantly increased. As noted in Chapter 3, increased spending from the state budget cannot solve the problem of poor health care outcomes. In addition to increased funding, resource use will be rationalised, and the emphasis of care will shift from hospital services to ambulatory primary health services. Furthermore, it is planned to review budget norms, and possibly to budget on the basis of a per capita, rather than a per bed basis.

The increase in education funding will be relatively modest. Until there is significant restructuring of expenditures in the education sector, additional funding will probably have little impact upon

educational attainment by students. Thus, the share of total expenditure on education will fall, from 17.0% to 15.2% of total government spending. Within this total, it is planned to reduce the total number of teachers, and to increase pay for those who remain. A bonus system will be implemented, which will reward teachers who participate in the improvement and development of the education system. Resources are being allocated to help ensure that all children receive equally high quality education, including providing free textbooks to all children, and to build or significantly improve over 200 schools.

Agriculture and Regional Development

A key element of the Poverty Reduction Strategy is the development of the non-oil sector and reducing differences in living standards between Baku and the other regions of the country.

The government intends to implement a number of measures within the framework of the Poverty Reduction Strategy to stimulate business outside of the Baku area. In addition to that, preparation and implementation of specific proposals on preferential wage indexation, and preferential tariff rates on energy carriers, to local producers in mountainous and border regions and Nakhichivan, is planned. Additionally, in the areas mentioned special consideration will be given to promoting investment by providing tax breaks or soft loans. The government will also support the expansion of financial services in the regions, whether provided by banks, credit unions, or micro-finance institutions.

Development of the agricultural sector, within the framework of a comprehensive rural development policy, is also crucial for development of the non-oil sector. Over the last decade the numbers employed in agriculture have grown from 1,144,000 in 1990 to 1,515,000 in 2001. Over 40% of the economically active population is now employed in agriculture, of whom 21% are female. This growth in agricultural employment is largely a result of the land reform, but is also a result of the loss of employment in villages and small towns due to the closure of state factories.

Although the land reform has been completed successfully, it has not led yet to higher living standards for the rural population. Wages in the agricultural sector were reported to be only 30% of the national average in 2000, and although 40% of the workforce is employed in agriculture, the sector accounts for only 16% of GDP. Amongst the most important factors hindering better economic outcomes are the small size of the land plots; the need to develop a land market; pressure on common grazing lands; shortage of inputs such as seeds, water and equipment; lack of market outlets; poor transport, and poor efficiency of irrigation and other crucial elements of rural infrastructure; as well as lack of access to credit and lack of collateral to secure credit.

The agricultural sector is crucial to the rural economy, with strong linkages to non-farming activities such as the agro-processing industry, handicrafts, retail, distribution, transport, construction and other aspects of rural infrastructure. As such, any improvements in the performance of the agricultural sector in Azerbaijan will have far reaching effects in increasing demand and generating growth and development in the rural economy as a whole, and in the regions. For this reason the government considers it important to place development of the agricultural sector in the context of an integrated rural development policy. Such a policy will take into account environmental concerns, since rural development will only be successful if it is based on sustainable use of the country's natural resources. It will also encompass development of infrastructure, and promotion of non-agricultural employment. The government has already taken first steps in the direction of

developing a rural development strategy with the Presidential Decree on National Food Security Policy Framework and Programme of March 2001.

Regulation

The integrated rural development policy will take into consideration the achievements already obtained through the land reform. The government is committed to continuing the land reform and to developing the necessary institutional and legal framework to enforce and secure the property rights stemming from the Land Reform Law. However, the current level of fragmentation of land plots and the poorly developed land market are hindering the establishment of viable agricultural businesses. The government will therefore facilitate the formation of Farmers' Associations to help the process of consolidation of land plots. The government will also strengthen the Land Committee Regional Cadastre Centres which will play a key role in regulating land distribution, land demarcation, delivery of remaining land certificates, and will help to create a transparent and functioning land market.

The government will continue institutional reforms in the agricultural sector in order to improve the management of the country's natural resources and create conditions for sustainable agricultural production. Institutional reforms will result in a more transparent distribution of responsibilities between governmental organisations, and help prevent further degradation of land and other resources. The overuse of land, lack of maintenance of water infrastructure, reduction of pasture share and poor management practices have resulted in land erosion, the raising salinity of soils and pollution of water resources. There is currently a duplication of functions between the Ministry of Agriculture, State Amelioration and Water Resources Committee, State Committee for Soil and Mapping and Ministry of Ecology and Natural Resources, which hampers good management. Institutional reform will also serve to bring about a clearer separation of the state's regulatory role from its commercial functions in the agricultural sector. The government will form an inter-ministerial commission to prepare a comprehensive proposal for institutional reforms of the agrarian institutions.

The government will develop policies aimed at guaranteeing sustainable use of the country's natural resources.

Azerbaijan has a large variety of climatic zones and types of agricultural land. In the mountainous areas, livestock is more important than cultivation of crops, making pasture administration is particularly important. Hence it is important that the regulation of pastureland be improved, in order to ensure that there is not too much pressure on the pastureland located in the immediate vicinity of the villages. It is equally important to prevent any irresponsible exploitation of summer and winter pastures, and to ensure that the rights of access of poorer herders are protected. The involvement of municipalities in the regulatory process will be beneficial to the communities concerned.

In order to improve the land protection and soil quality, it is proposed to develop a State Programme for Soil Conservation, which will include specific measures aimed at protecting soil from wind and water erosion, as well as to carry out amelioration programmes to reduce the levels of soil salinity.

The creation of new forms of organisations in rural areas, such as farmers' unions, will serve to promote private initiatives and will help small farmers increase productivity through better access to appropriate technology and inputs, and also to access markets. It will also enable them to reduce

costs of production and processing as well as to build up economies of scale. The government will facilitate and promote the establishment of the Farmers Associations or Unions with these objectives in sight by preparing the necessary legislation for their development.

Easier access to micro-credits, and transparency in licensing procedures, are required to encourage the development of alternatives to current farming technology. These are also required to help private suppliers to set up, and fill the gap left by the dismantling of former state-owned machine-tractor parks and the collapse of the agro-processing industry. Small farmers cannot afford to buy equipment, but they can afford to lease it for short periods. Access to seeds and other inputs is also limited at present, and private supply of these has to be stimulated.

Another problem to be addressed is the need to promote the creation of marketing channels for farmers' products. As mentioned in Chapter 6, many rural inhabitants are demanding a return to state orders, whereby produce was bought at favourable prices; and increasing customs duties to protect domestic producers. Such solutions are incompatible with the need to develop a market economy, but alternative solutions need to be found. That is why the attraction of private sector to the agricultural products processing in rural areas in order to increase its capacity is part of the country's agricultural sector development strategy. At the same time the preparation for WTO accession will be continued.

Privatisation

As has been noted, land has largely been privatised. The government is planning to rebuild the Sumgait superphosphate plant through privatisation in order to increase the provision of fertiliser. It is envisaged that a comprehensive privatisation programme will also facilitate the supply of the other vital inputs into the agricultural sector by the private sector, including equipment and services. Promotion of participation of the private sector in veterinary services, medication provision and technical services is considered one of the priorities.

Public Finance Policy

Improved management of the country's natural resources also requires better supply of information to local farmers. There is a need to continue the development of an effective and accessible extension network providing advisory information services to farmers in order to promote adequate technical and managerial know how, while also showing the need to respect the ecological balance. This information will cover the different approaches and practices that are best suited to local soil and agro-ecological conditions. It is planned to expand local advisory services for farmers providing information on micro-credits, increase the number of technical and management associations etc. These centres will also be used to provide training for local farmers, and to distribute information leaflets on best farming practices for local conditions. The centres will build on the existing experience of both public and private service delivery and will strengthen linkages with national and regional research and academic institutions.

Favourable conditions for the establishment of rural micro-financing institutional capacity, such as credit unions and micro-credit banks, will be created. There will also be an increase in state transfers to agriculture for the purpose of improving financial provision to farmers.

The state will retain responsibility for the protection of public health by improving food safety. In order to improve the quality of livestock, and reduce the risk of human brucellosis and tuberculosis, it is planned to improve the coverage of veterinary vaccinations and introduce improved measures of epizootic control in the country. For this, the provision of veterinary vaccines will be improved, and laboratory conditions and equipment modernised. The Khanlar production complex will be rebuilt to improve production of veterinary preparations, and the facilities and equipment in the national diagnosis laboratory and in three regional laboratories will be modernised in order to improve epizootic control. It is also important to improve the control of food safety by the state laboratories, and to upgrade the quarantine control at the borders.

Development of agriculture and alternative employment in rural areas is closely linked to the infrastructure. Unreliable power, water and gas supply, as well as poorly developed communications and transport systems discourages the development of entrepreneurship. It is planned to eliminate the above-mentioned problems through investment and privatisation programmes, in particular through the PIP.

Most of the country's agriculture is dependent on irrigation and drainage systems. Public investment is required to rehabilitate much of these systems and make them more efficient. But efficiency and effectiveness also require improved management and control of the irrigation and drainage infrastructure. Therefore, "Water Users' Associations" involvement will be further expanding in this regard. It is important to introduce cost recovery systems to assure sustainability of public investment. Until full cost recovery is achieved, it is necessary to allocate public money for operation and maintenance of state owned infrastructure.

The future sustainable development of agriculture will also depend on human resources' development through applied research aimed at capacity building for experts in this field, as well as improvement and modernisation of capacity and the quality of the technical training provided by the Agrarian Academy and Agrarian Studies/Research Institutes, and to promote cooperation with foreign universities for student/researcher exchange programmes in agricultural science.

Environmental Improvement

Economic development which upsets the environmental balance cannot be sustainable. Environmental pollution has a negative effect on the population's ability to earn income; firstly through adverse affects on the health of individual citizens, and secondly, as has been shown above, by leading to a depletion of the natural resources available for income-generating activity in agriculture and other sectors. The government therefore needs to develop a poverty strategy, which takes into account environmental concerns. This involves tackling large-scale national and international projects, such as those concerning the Caspian Sea, and also measures such as those outlined in the Agriculture Section above, aimed at improving management of the country's natural resources. There is also a need to improve regular monitoring of environmental pollution, and to conduct campaigns to raise public awareness of the need to respect the ecological balances. Local communities will be involved in monitoring, regulating, and providing information on the environment.

Public Finance Policy

Among the most urgent problems to be tackled are the need to clean up mercury sludge and improve waste management. With regard to water purification and sewerage system management, it is planned to reconstruct the purification units and sewerage system in Sumgait, expand the purification facilities in Baku, and finish construction of new facilities in Ganja.

The government is cooperating with GEF, UNDP, WB, UNEP and EU on a project to protect the bio-diversity of the Caspian Sea. It is planned to protect the traditional spawning areas for sturgeon in the Kura and Araz rivers, and to treat the contaminated water discharged from the Zykh and other lakes into the Caspian Sea.

Soil pollution has to be monitored systematically. In the Absheron peninsula, efforts will be made to re-cultivate the oil-polluted soil. The radioactive waste in the coal storages at Ramany, New-Surakhany and Neftchala iodine-processing plants will be treated.

It is noted in Chapter 6 that the country's forests are threatened by uncontrolled logging, due to the pressure on poor households to find fuel or heating and cooking given the lack of guaranteed gas and electricity supplies. There is a need to control this practice, and also to undertake re-planting operations. Forests will be planted along the banks of the Kura and Araz river, covering an area of 5000 ha. There will be further planting of forests covering an area of 6000 ha, and native vegetation and plants will be planted to cover an area of 4500 ha. The process of re-forestation will in turn have a positive impact on reducing the level of salinity in the areas concerned. It will be preceded by a feasibility study, which will ensure that the re-forestation is compatible with the government's overall rural development strategy, and that it does not limit further the access of local communities to land for grazing and cultivation.

Regulation

In the long term, the government is planning to develop alternative energy sources, and with this in mind it will conduct a study to define profitable geo-thermal energy sources, will develop a national programme on solar and wind power generation, and work on the restoration of Guba and Gusar Power Stations.

Environmental protection should be enforced through the improvement of monitoring of environmental indicators. Administrative reforms are planned to improve management, as is the provision of regional laboratories with the necessary equipment for monitoring. The Geographic Information System will be improved, and the municipalities and communities involved in the assessment of the environmental impact of regional economic development projects.

Waste collection and disposal and rehabilitation of sewage systems at municipal level will be developed taking advantage of best available technology at affordable costs to introduce recycling practices and reduce water and soil contamination.

Energy Reform

Lack of reliable energy supplies is considered a major problem by the rural population. It limits employment opportunities and limits opportunities for investment. Equally as important, the

provision of energy at subsidised rates represents a large drain on the state budget. These subsidies are not targeted, and the benefit is disproportionately enjoyed by better-off segments of the community. Thus, energy reform, especially improvements to financial discipline, are the government's top priorities.

Public Finance Policy and Regulation

The energy sector is intrinsically linked to the Poverty Reduction Strategy due to the way in which utility subsidies have been used as a form of social protection. Currently consumers of energy and gas receive huge subsidies from the state budget, but these subsidies are hidden, in that they are never explicitly calculated or published. At present many budget organisations, businesses and private households do not pay their utility bills. This means that the two main utility suppliers, Azerenergy and Azerigas, are unable to pay SOCAR for the mazut and gas which they need as inputs. (In 2001, SOCAR received only 0.5% of the value of the fuel supplied to Azerenergy and 1.3% of the value of supplied gas to Azerigas). As a result, SOCAR has major shortfalls in its revenue, and cannot pay its full tax liabilities. Thus the state budget also loses significant amounts of revenue. The IMF has estimated that in 2001 the government paid roughly 50 percent more to subsidise the activities of Azerenergy and Azerigas than it spent on health and education.

The average level of collection for the entire country is 27% for electricity and 30% for gas. Such explicit and implicit subsidies for electricity, gas and water have a detrimental effect on the economy and negatively impact public expenditures, in that energy producers are unable to pay their taxes. The money collected for consumption of gas and electricity is enough to cover salaries and operational expenses, but nothing more.

With regard to households, utility subsidies are a cost-ineffective form of social protection. Since the amount of subsidy received by households depends on the quantity they consume, those who consume more benefit most. Both rich and poor households benefit from these subsidies. However many low-income families have no access to the subsidies because they have either limited or no services. As a result of non-collection of payments and arrears (the implicit subsidies) the utility companies have no money to invest in maintenance, and improved supply, especially to rural areas. The present widespread failure to pay for utilities is a de facto subsidy to households, in particular those living in urban areas, and the use of these implicit subsidies as a form of social protection is neither pro-poor, nor cost-effective.

The government has taken some important steps towards the removal of these subsidies. In particular it has adopted the government programme "On Strengthening of Financial Discipline in the Energy Sector". The policy measures planned include several steps. First, it is intended to make these implicit subsidies explicit by making sure that they are recorded clearly in the state budget documents. It is planned to increase the payments to SOCAR from the utility companies gradually between the years 2002 and 2006. In the this period, in order to make the subsidies explicit, the Ministry of Finance will issue securities to Azerenergy and Azerigas for the amount of money which it cannot pay to SOCAR for fuel.

Budget organisations and state enterprises will be transferred enough money to pay for energy and gas consumption, and limits will be put on their consumption. If they surpass these limits, they will face sanctions, including disconnection. A list of consumers will be kept, and there will be

compulsory installation of meters. This should stop the accumulation of debts, and also encourage less wasteful consumption.

Payment cards will be used for all utility services, and this will ensure a significant increase in collections. These cards will only be valid for payment of utility service fees.

Improvement of the collection rates from households will need careful planning. Installation of meters will take some time (in rural areas, 13% of households do not have metering of electricity consumption, and metering of gas consumption is available to only 10% of households), and enforcement of collection rates will be accompanied by a new compensation benefit for low-income households (Chapter 3). It is also planned to carry out public awareness campaigns (for organisations and households) on energy saving methods.

It is planned to improve the management of utility supplies by transferring the management of regional electricity and gas supply networks to the private sector. Transfer the management of the regional electricity distribution networks in Baku, Sumgait, Ganja and Ali-Bayramli have already been completed.

Restructuring of SOCAR, Azerenergy and Azerigas will continue. The regulatory functions performed by the state will be carried out by the Ministry of Fuel and Energy, while SOCAR and the utility companies will be responsible for commercial operations. There are two main problems with regard to increasing the financial viability of the utility suppliers. One involves improving collection rates, as has been discussed above. The second involves gradually increasing tariffs to bring them in line with world prices. Estimates show that even if consumers make full payments to Azerenergy and Azerigas, these companies would still not be in a position to pay all their bills to SOCAR. A tariff board has been established to advise on tariff levels, and to regulate them. The aim is to achieve a gradual reduction in the distinction between domestic and world prices for oil, oil products and natural gas.

With regard to the future development of the sector, it is planned to achieve an efficient exploitation of the remaining reserves in the oil fields, and to take measures to ensure stable increase in oil and gas output levels. It is planned through construction and rehabilitation of energy infrastructure to switch thermal power plants from heavy fuel oil to gas, which is more efficient and is less damaging to the environment. The export potential of the sector will be increased by the construction of new oil and gas pipelines, and the energy supply system will be improved through the integration of Azerbaijan into the regional energy supply systems (linking with Russia, Turkey, Georgia and Iran). The following targets have been set for 2005:

- to increase gas storage capacity to 3.5 bln. m3;
- to increase oil export capacity 50 mln. t/year;
- to increase gas export capacity to 7 bln. m3;
- to have additional 2,600 mWt power production.

Both the government and foreign companies involved in the development of the country's oil and gas sectors will respect environmental considerations, since the energy sector has in the past been responsible for much of the country's pollution problems.

Improved collection rates and increased tariffs will ultimately lead to more funds for investment in the supply and distribution systems, especially in rural areas. In the short-term, capital investment will be undertaken in new power plants in line with the PIP.

Promotion of Tourism

Azerbaijan is a large and varied country with some good potential for both internal and international tourism, especially if better integrated into a kind of network with other tourist-attracting countries in the region of Southern Caucasus and Caspian sea (e.g. Georgia, Uzbekistan, Turkey, Iran). This potential can only be utilised with a well co-ordinated set of policies, bringing together the public resources and the private sector for a sustainable development of tourism.

The tourist industry can play a role in the overall development and growth of the country. It is strongly linked with several other main areas of the government's strategy for poverty reduction through income generation.

Tourism, by definition, implies flow of resources to the regions. Given the climatic and natural variety of Azerbaijan, the development of tourism will enhance the government policy of regional growth. This takes the form of long-term, infrastructural investment, as a prerequisite for tourism to flourish, as well as flow of income through tourists' spending in the regions.

Tourism can generate income at local levels by creating demand for specific services, ranging from high-skill to low-skill jobs. Given the present situation of unemployment levels in the regions, a boost in demand for low-skill jobs, mainly in services, will lift some of the immediate economic constraints at local levels, and would foster the poverty reduction objectives in the country. In a longer term perspective, as the demand for higher skills in tourist industry may rise, so will the human capital by way of training for new skills in the regions.

Tourism can attract SMEs in a variety of activity lines, and at local levels. Essentially a service-based sector, tourism requires relatively little capital. This makes it a labour-intensive sector. With relative abundance of labour, compared to capital, the entry barriers for SMEs into tourism at the local level may be modest. This in turn would contribute to the overall government's strategy for attracting the private sector into new lines of income-generating activities, and in generating more gainful employment in the regions.

A boost in tourism can also have positive impact towards improving and maintaining the artistic and cultural heritage of the country. This again will enhance the regional development, as many sites, museums and cultural monuments are located outside the capital.

The development of tourism is dependent on better and healthier natural environment. As such, the linkages with environmental improvement are obvious, and strongly in line with the government's policy on the issue of environmental safety and preservation.

The development of tourism can facilitate a more equitable distribution of income and resources, in favour of the poorer income groups. Provided appropriate implementation and monitoring, it can also make the non-income aspects of poverty less pronounced for the poor, by facilitating familiarity and access to cultural and artistic wealth in the regions to the local population.

With concern for all these major aspects of development and balanced growth strategy, the government plans to encourage the development of the tourist industry. The role of the state in this process is important by way of creating a favourable environment for the private sector.

Public Finance Policy

The state, through its public investment policy (PIP), will try to ensure that the necessary infrastructure for the development of tourism is in place. While Azerbaijan can boast considerable natural beauty, the government will focus on improving roads, electricity supply, telecommunications, water supply and sewage systems to support tourism development and contribute to the country's regional economic development. In this regard, the role of municipalities and the local communities are very important.

The government will also encourage the development of so-called green and rural tourism, concentrating initially on domestic tourism. In this particular respect, the existing capacity and quality of museums, arts galleries and music venues need considerable upgrading in the urban centres and in the regions, as these can bring in regular visitors from nearby, as well as from farther away.

The government will set up tourist information centres in Baku and in seven regions of the country. These centres will coordinate work on the advertising and publicity for tourism, as well as providing brochures with information on local services and sights for tourist. It is planned to develop well-defined tourist routes within the country, to guide tourists to the most interesting sights. The government will also organise courses to train specialists in the tourism industry.

Regulation

The government will prepare and approve a new licensing rules for simplification of licensing in tourism industry.

The government will also make an effort to ensure that the tourist visa regime is as simple as possible, to ensure that entry and exit procedures are improved, and to help encourage foreign tourists.

In line with the measures envisaged to encourage SMEs development, the government will try to ensure that access to credit is improved, in order to allow the development of the private sector in tourism.

Chapter 5. Institutional Framework for the Poverty Reduction Strategy

Institutional reform in Azerbaijan is closely tied to the process of redefining the role of the state in the transition to a market economy. As mentioned in Chapter 4, the regulatory role of the state is very important for improving the business and investment environment in the country. Over the last five years the state has taken important steps to withdraw from commercial activities. The process of redefining the role of the state will be continued.

Another important part of institutional reform is the rationalisation and improvement of public administration structures. In this regard, some measures have been taken to rationalise through the merging of government agencies. So far nearly 30 central government structures have been either liquidated or merged and new ones established. A civil service reform is underway, with the aim of improving the professional and managerial capacity of civil servants; and decompression of wages within the civil service will be undertaken so that pay levels correspond to levels of responsibility and qualifications.

The government has been trying to decentralise management within the public sector. The creation of municipalities can be considered an important step in this process. As a part of the process of decentralisation, the municipalities can contribute to the strengthening of local governance and decision making by improving allocation of resources at the local level, promoting regional development and allowing local communities to participate more actively in decision making.

Juridical reforms are also being undertaken with the aim of improving the legal qualifications of judges, prosecutors, defence attorneys; improving the court procedures for handling legal cases; improving legal access to the public and allowing public participation in trials; making sure that the legal profession has the background to ensure that new laws and legislation are consistent with the requirements of a market economy; and improving the performance of law enforcement agencies.

As part of institutional reform, the government is undertaking a number of active measures to reduce corruption and increase transparency in the public administration system. Since 1995 a series of Decrees were issued by the President of the Republic in this regard, and in June 2000 a Law on Combating Corruption was drafted. The draft law has already passed its first reading in Milli Mejlis.

The main strategic objectives of institutional reform can be summarised as follows: (i) to re-define the role of the state in the changing economic environment, including the clear and precise separation of regulatory and commercial activities; (ii) to rationalise and improve the professionalism and transparency of the public administration system; (iii) to promote decentralisation and local self-governance; (iv) to reform the juridical system; and (iv) to fight corruption at all levels.

Institutional reforms will consequently contribute to economic efficiency, social safety, good governance and transparency.

5.1. Public Administration Reform

The government aims to provide key social and economic services for the citizens and help to remove impediments to growth and employment in the non-oil sectors through efficient

management of the country's natural resource wealth. In order to achieve this it is important to improve the existing governance, policies and institutions for public expenditure management.

The overall aims of public administration reform are:

- To improve governance, financial discipline and transparency
- To improve resource allocation and use
- To improve the efficiency of programmes and services

Although 30 central government structures have been reformed, it is still considered necessary to continue with these reforms in order to rationalise the existing government structures. Public administration reform envisages a close review of the mandates and expertise of separate government agencies since there is still significant duplication of functions in most of the government agencies dealing with economic issues. Therefore, it is intended to continue structural reforms with a view to ensuring the efficient functioning of different government agencies particularly in the agricultural sector.

The government continues with its efforts to improve transparency in the management of public financial resources. A Budget System Law has been adopted, almost all extra-budgetary funds abolished and consolidated into the state budget. All budget operations are currently implemented by the Treasury. Transformation of the implicit subsidies to explicit ones notably with regard to the structural reforms in the energy sector is one of the important steps towards improving transparency in budget reporting.

The preparation of SOFAR's and the government's budgets will be coordinated to ensure agreement on the key macroeconomic and fiscal aggregates, and to ensure that domestic investment and expenditure of the Oil Fund are coordinated with the budget and implemented through the Treasury.

The existing situation of SOCAR's financial resources will be discussed and published by its Supervisory Board on a quarterly basis for public dissemination.

Work is being carried out towards a clearer separation of commercial and administrative functions. On the one hand, companies such as SOCAR, Azerenergy, Azerigaz, Azerbaijan State Railway Department, and Azerbaijan Airlines have been stripped of all policy development or regulatory functions. On the other hand, the establishment of the Ministries of Fuel and Energy and Transportation is part of the process of re-enforcing the state's regulatory role.

The recent Law "On Civil Service" is designed to strengthen recruitment policy. A competitive mechanism is being developed as the basis for hiring civil servants, and a periodic performance review will be carried out to assess the professional level of the staff. Capacity building measures to improve management skills are also envisaged, including a system which will allow senior civil service employees to gain work experience in the private sector.

As discussed in the MTEF (Appendix 2), a pay reform for civil servants is also envisaged. Thus, there will be significant decompression of wage levels, and pay levels of senior civil servants will be increased to correspond to their responsibilities and achievement in order to attract and retain senior qualified staff.

In order to ensure the successful implementation of the SPPRED, a Poverty Monitoring Unit will be established with technical assistance from international institutions in the SPPRED Secretariat, within the Ministry of Economic Development. The main objective in establishing the Unit is to analyse the impact of poverty reduction policies in the country, using the HBS data from SSC and also the results of other surveys and to prepare recommendations on new policy priorities.

5.2. Juridical Reforms

The strategic aims of juridical reform are (i) to improve access of the population to information on the law and their legal rights and their access to legal institutions (including secured guarantees for the rights of the accused); (ii) capacity building of the legal profession to ensure development of the relevant legal framework.

In order to improve the access of the population, especially the underprivileged to information about their legal rights, local legal advisory services (citizen advice bureaus) will be set up in the regions. It is also proposed to improve and simplify the working of the courts and procedures for processing legal cases, and to increase the possibilities for the public to participate in trials.

The work carried out towards capacity building for legal personnel, ensuring the independence and competence of judges, improving the performance of the agencies that are responsible for the execution of court rulings and ensuring observance of human rights is underway in order to develop a legal framework in line with the requirements of the market economy and this will remain a priority area for the government.

It is important to note that, a significant step has already been taken towards protecting human rights in the country and a new independent structure "Ombudsman" was set up in July 2002.

5.3. Decentralisation: Role of Municipalities in Poverty Reduction

In December 1999, the first municipalities' elections were held and circa 2,700 municipalities were established in Azerbaijan. Of these 200 began as city (town) municipalities and 2,500 as rural (village) municipalities. Delegating some decision-making responsibilities to the municipalities plays an important role in strengthening the sense of responsibility and participation of the regions in their own development. Communities should be given the opportunity to participate to a greater extent in the decisions affecting their living conditions and environment.

The municipalities also can play an important role in targeting assistance to the poor. They can, for example, help to define the most vulnerable as they have better knowledge of local conditions. They are also in a position to prepare proposals on social and economic policy issues, which would have an effect on improving living standards in their locality.

Furthermore, municipalities can play a role in attracting investors, partly by providing necessary information to potential investors, and also by helping local inhabitants with the problem of providing collateral. It may be possible in the future to use municipality property as collateral for communal projects. The municipalities also have a role to play in improving the information flow from the regions to the centre, and thus in ensuring that national level policy decisions are better informed.

Municipalities can take on a role in controlling and preventing environmental degradation in their locality.

The creation of municipalities in 1999 proved a successful step towards improving local self-governance and deepening democratic development in the country. Parliament has adopted a Law "On the Financial Basis of Municipalities" and a Law "About Municipal Services". However, a lot more work has to be done to improve the work of these local self-governance bodies. For example, there is still no clear definition of the role and functions of municipalities, and no clarity between the authority of the municipalities and that of the local executive bodies and no clear definition of their relationship with the central government agencies. Municipalities still do not have full use of the property which is allocated to them, and the funding which they are entitled to from the central budget.

As noted in Chapter 1, living standards in rural areas have been particularly affected by the deterioration in rural infrastructure, including school buildings, public health centres, water supply and roads. Although the management responsibility for most of this infrastructure has been transferred from the central government to the municipalities, the municipalities do not yet have adequate capacity for taking over this responsibility.

Thus, the main direction of the government's decentralisation policy will include further defining of the role of municipalities, capacity building and support for municipalities in terms ensuring their rights to property and financing. Decentralisation policy will also involve promotion of the municipalities' role in encouraging the creation of income generation opportunities in the regions.

The role of national non-government organisations (NGOs) should be mentioned along with that of the municipalities in the implementation of decentralisation policy within the framework of SPPRED. NGOs with various profiles have managed to varying degrees to establish broad relations with either local populations or the international community and create their own infrastructure as independent structures. There are many specialists working in NGOs with international experience as well as experience of working in production and administration spheres, and who have implemented large-scale projects and programmes.

The participatory process has been strengthened through the involvement of NGOs, which are one of the main elements of the civil society. National NGOs have been closely involved in the development of the SPPRED and have helped to ensure national ownership of the document.

The positive experience with national and international NGOs during the preparation of the SPPRED has shown the necessity of using their potential and expertise in the implementation of the programme in future. It is envisaged to involve them firstly in the development of a NGO-government partnership for the implementation of policy measures outlined in SPPRED, capacity building for municipalities and joint monitoring of poverty in the country.

5.4. Combating Corruption

The government is taking active measures to reduce corruption and increase transparency in the public administration system. Since 1995 the President of the Republic issued a series of Decrees in this regard. In June 2000 a Decree of the President called for the drawing up of a Law on Combating Corruption. The draft law has passed its first reading in the Parliament.

Chapter 6. The Participatory Process

6.1. The Role, Significance and Objective of the Participatory Component

The role of the participatory process in the SPPRED is best defined by one of its key features: the combination of a top-down approach with a bottom-up approach, making an almost full circle of the government and the civil society's aspirations in combating poverty.

The participatory component of the SPPRED in the preparation phase essentially has encompassed two activities. The first one consists of direct work with the government officials appointed as SWG heads and their respective members. The second activity concerns communicating directly with the representatives of civil society, particularly in the regions most affected by the emergence and expansion of "New Poverty". The Household Budget Survey suggests that poverty is widespread across all regions, therefore this second activity is ambitious in scale, and could only be tackled on a limited scale in this first phase of developing the Poverty Reduction Strategy. This activity will be expanded and intensified in the implementation phase. A full account of the methodology for the entire process is given in Appendix 4.

The aim of the participation process was to provide a sound and realistic feed back from society at large for the formulation of a strategy that will be viable only if it can reflect both the reality and potential of the country. In order to achieve this as fully as possible, the participatory process was designed to be effective at three distinct, but related levels: *Inter-sectoral*, *Intra-sectoral* and *National*.

6.2. The Main Players

The Poverty Reduction Programme in Azerbaijan has attracted an extensive and high degree of interest, matching its complexity and scope. As such, listing all the organisations, institutions and individuals actively involved in it would be outside the scope of this document. Therefore, just a short list of the main actors is given.

All the line and sectoral ministries are involved, with the ultimate supervision authority resting with the State Commission. The Secretariat at the Ministry of Economic Development has played a leading role in efficient co-ordination and successful organisation of the participation process. Apart from these, the local authorities played an active role. On the civil society side, the Parliament, the national and international NGOs, the municipalities and the media are the most easily identifiable. An inclusive cross section of the civil society will be increasingly involved in the process. This will ensure a representative inclusion of the private sector, trade unions, women groups, and particularly vulnerable sub-groups of the population, such as the IDPs and refugees, the pensioners, the unemployed and the inhabitants of remoter areas of the country.

International donors and government representatives are the other main counterparts actively involved in the process. In October 2001, a Participation Action Plan was prepared with UNDP support, which formed the basis for the further participation by all international donors in the SPPRED process. Additionally, a number of conferences, seminars, workshops, as well as direct consultancy input by all international donor organisations in Azerbaijan, have been instrumental to achieving a participatory approach in the formulation of the Poverty Reduction Strategy. In April

and May of this year, conferences on "Poverty and employment problems" and "Impact of poverty on children and women" were held with the support of UNDP and UNICEF. Other organisational and project links between the Secretariat and the international donor organisations are enriching the scope of the participatory process. Recently, a series of detailed empirical surveys was carried out in several remote areas by the EU-Food Security Programme on the patterns of production and consumption of farming households that provides concrete examples of this enriching process.

In preparation for the next phases of SPPRED, i.e. implementation and monitoring, a number of international donor organisations are considering the continuation of their participatory contribution to the programme.

6.3. Empirical Evidence

Based on the observations from the regional missions, a summary picture was obtained for each region. It has to be noted that it will be possible in the future to obtain a fuller picture once the scope and depth of the regional coverage is extended. These initial findings are by no means complete "monographs" of the regions. Their main function was to provide a clear and simple working document to facilitate the open debates during the regional workshops between the government officials and the civil society participants.

The empirical findings of the focus group regional field trips provide an interesting account of the participatory process, and how it could be improved. These are briefly covered here. A more systematic set of findings relevant to the policy actions proposed in the policy matrices of the SWGs emerged from the Town Hall Meetings and are detailed in Appendix 4.

Inside Perceptions and Self-assessment

The range of concerns mentioned by the local community was broad and varied: from putting in a wooden floor at the local school to building a bridge, repairing a mechanical water pump, rehabilitating energy and irrigation infrastructure, reopening food processing and textile factories in the area and rehabilitating tea plantations. However, from a relative point of view, each one of them was top priority for the community concerned.

Closely connected to this "subjective" element in assessing needs and priorities, is the notion of poverty itself. When encountered with requests to rank the local population according to levels of living standards, most of the village participants challenged the terms "rich, middle class and poor". On many occasions, they preferred to rank the community members by their degree of "poverty" rather than their degree of "wealth". They would hence rather rank families, and themselves, as "more poor" or "less poor".

Land ownership is often used as a common proxy for measuring the level of poverty. However, land privatisation on its own has not necessarily created better living conditions for the rural population. During the brief focus group observations, this point was made very clearly, when even households with access to land would count themselves poor, as they would often not be able to utilise the land. Shortage in complementary inputs (seeds, equipment, irrigation, transport and market) would hinder use of the land for farming purposes. Rather, ownership of herds or poultry, or access to (and not necessarily ownership of) land and water and houses would determine the relative living standards of the rural population. On the other hand, despite poverty in many of the regions and villages

visited, there was little evidence of lack of food. Even the poorest members of these communities apparently do not go starving, mainly due to the sense of community and solidarity. However, malnourishment and food deficiency was quite visible in some areas amongst the children. On several occasions, the communities would cite a regular income, no matter how little, as a source of being considered "rich". As such, even pensioners and local state employees were considered amongst the richest in the communities concerned.

Poverty and Social Exclusion

Proximity to city centres has an impact on the general outlook. More remote areas generally appeared sceptical or apathetic about the prospects for a visible improvement in their living standards. However, those closer to larger towns or city centres seemed more optimistic on these issues. In other words, the sense of apathy and exclusion, while a general feature amongst most of the poor, came across more strongly in the areas farther away from other villages and main cities.

Those with more limited access to economic well being, including education, health and communication would be more cut-off from the process of participation. Employment is vital in creating a network of economic and social cohesion, without which many forms of social inclusion would be impossible.

During the focus group meetings, some subtle differences were observed in the motivation for participation between the unemployed and those earning some income through work. The difference was most visible amongst the IDPs.

Voice for the Poor

The process of comprehensive participation has already started in the country and it will be improved in the further stages. Giving a genuine voice to the poor, which could then be usefully and effectively utilised in formulating and carrying out a long strategy for poverty reduction is its main challenge. This would need intensive training in public education on participation, establishing a clear understanding on what it is that they are invited to participate in, working out a system of regular channelling of the feedback into the decision making bodies, assessing the impact of the participation (of the poor, in particular), and feeding back the information to civil society in a transparent way.

6.4. Main Findings

The results of the Regional Workshops shed light on some of the earlier findings of the regional missions, as well as enriching the government's and civil society's understanding of the scope of the tasks ahead. As in the regional missions and focus group discussions, the range of priorities, as expressed by the civil society participants, varied according to the overall economic condition of the region. For instance, in Ganja city, although unemployment was visibly high, the main problems as expressed by the Regional Workshops' participants evolved around the issue of the IDPs and their economic and social integration, while in Nakhchivan the first priority was seen as the region's full access to the mainland. Again, the degree to which these priorities related directly to poverty reduction, and the means of achieving this varied; they were partly subjective and partly location-specific. To the extent that these findings could be fed back into the other chapters of the present document, they have been.

The common issues of concern are summarised below:

In areas with previous industrial texture, the main concern was to restore the hydro and electric power stations and factories. There was still a strong sense of resorting to the older style of mass employment in large enterprises, as unemployment has hit hardest in those areas dominated in the past by large state enterprises. There is a clear tendency to search for the past solutions in these expectations: the idea being that the large state enterprises should retain their workforce, with no consideration for economic viability or efficiency. These are certainly not practical solutions in the process of reforms currently underway. However, the fact remains that people affected by these changes feel poorer than before, and therefore it is necessary to deepen the process of social dialogue and participation to move forwards to find new and viable solutions to new problems. The participatory approach should be used to identify these new solutions, especially at community level.

The unemployed in these regions are normally highly skilled, but unfortunately the lack of demand in the labour market, has gradually made them unemployable despite the considerable amount of social investment in their education and skills. Therefore, it is mentioned in Chapter 3 that, it is crucial to carry out thorough reforms in vocational education.

In agrarian communities, it would be mainly the question of water and access to land, equipment, and the marketing of their produce. In some regions, the rehabilitation of tea plantations and food processing factories were also a strongly expressed desire. As mentioned earlier, the lack of ability to use the land, rather than access to land itself is the most frequently cited factor for unemployment in the rural areas. In some regions, a process of re-consolidation of land has also started, as poorer households sell or rent their land, and work as farm labourers, if and when possible.

Common to both agricultural and previously industrial communities was the issue of lack of credit facilities, and lack of training and information on the use of it. Land, as the only collateral that most rural communities can afford, is not normally viewed a valid asset, compounded by the fact that there is effectively no land market. This issue is covered in more detail in Chapter 4.

In the social and cross-sectoral spheres, strong concerns were infrastructure in health, education, water, energy and roads, salaries, indexation of pensions, modification of the tax system in favour of poor families, specific social protection for women and children, lack of legislation on various issues or the lack of information on them, as well as a sense of exclusion from the process of decision making. Most importantly, creation of jobs and social welfare for the poor and the disadvantaged came across most frequently. In this respect, almost all the necessary steps were expected from the government. Such findings reinforce the need for more participatory work to explain the possibilities in the current situation and involve communities in finding these possibilities.

On more specific issues, the feedback from the Regional Workshops can be grouped into the following issues; social integration of the IDPs, special social protection measures for students from poor families and families in mountainous and border areas and reform of labour relations and property laws.

Apart from these, there are at least four issues, emerging from the regional missions and the Regional Workshops which merit specific and brief mention here:

The Significance of Public Education on Environment

The protection and preservation of the environment is both a source and an outcome of sustained economic growth. However, for the poor communities, the priorities are not always necessarily in the direction of preserving the environment. Rather, meeting the urgent needs of their subsistence living often leads to environmental degradation and destruction. Cutting trees for heating or over-fishing are obvious examples. These "vices" cannot be remedied until and unless poverty is reduced and alternative sources for heating and feeding are available at prices within their means. However, part of the environmental degradation is caused by complete lack of information on alternative methods of doing things, which are at the same time affordable by the community. Rotting rubbish disposal in the open and public areas, pollution of drinking water, burning toxic materials are examples of practices which could be avoided or reduced by public education and / or minimum necessary investment and organisation. Their impact on public health and the quality of life of the poor could, by contrast, be enormous.

A useful way of extending and implementing the participatory process would be to provide public education on environmental issues, and to monitor the measures at local and community levels too. As pointed out in Chapter 7, there is a need to establish appropriate monitoring indicators for rational use of land and environmental resources. This would be consistent with economising and mobilising community level resources, as well as the decentralising policy direction of the government.

Gender Dimension

Some points are made in Appendix 4 about the community's attitude (including those of the women themselves) towards women's participation in the regional focus groups. With regard to issues relating specifically to women, it is interesting to look at some figures. During the first round of regional missions with questionnaires, out of 200 respondents, 80 were women (40%). During the second round of questionnaires, 57 out of the total 163 respondents were women (35%). Hence, a total of 38% of all respondents during these first two rounds were women.

The focus groups (i.e. open, public discussion groups), covering more than 1,800 participants, included a mere 10% of women. This perhaps reinforces the point for the need to address the issue of a higher social presence for women in the next phases.

Apart from the social protection issues fully covered in Chapter 3, it has to be mentioned that the participatory meetings also revealed that there is a very acute need for pre-natal care and reproductive health services for poor women, living in more remote areas. The bad transport and roads system often leads to complications in the birth or indeed to the loss of life of either the mother or child, as well as general difficulties of access to everything else concerning improvement in their living conditions. Early teenage marriage amongst girls was one of the problems cited in more remote areas, where economic hardships lead to under-age marriages. Furthermore, as pointed out in Chapter 1, there is a need for complementary surveys and qualitative studies with a certain degree of gender-sensitivity to provide a fuller picture of some aspects of poverty, which may not necessarily be captured by the currently available data.

Many women in all the regional missions also indicated the need for special business training facilities for women entrepreneurs. Some steps have been taken in this direction at local level in

Sheki, where a special training and consultancy centre is established and run by a group of professional local women. They could be considered as models in some way for a broader and systematic coverage.

Protection of the domestic market

During the participatory missions, it was frequently mentioned that the agriculture sector is suffering due to the competition from some neighbouring countries that export their cheaper products to Azerbaijan. Most of the basic food items and fruits were in this category, according to the regional meetings. The solution by the local communities, therefore, was assumed to lie in some degree of domestic market protection, in order to enable the local growers to sell their products in the home market. Apart from the implications of this on the budget, as well as the clear conflict with strict conditionality by some major donors, there is another issue involved here. Promoting competitiveness on the basis of protection, rather than higher productivity and cost efficiency means higher prices for basic food items. This is in direct contrast to the aims and scope of a poverty reduction programme. As mentioned in Chapter 4, the development of social and economic infrastructure will be crucial to attract the development of the private sector, and hence sections of civil society, into the process of generating wealth and income. The problem of facilitating access to market for their products through investment in the infrastructure (including transport, storage and wholesale set-up) is one, which could very usefully be tackled by policy makers.

Role and capacity of Municipalities

Municipalities have emerged as one of the most crucial institutions, following the recent reforms in Azerbaijan. Apart from reflecting the democratisation process in the country, they have been instrumental in facilitating the registration of aspirations at local and community level regarding economic and social needs. Most importantly, they can become very useful institutions for the process of decentralisation, and the mutual flow of information between regions and Baku. This would be of crucial significance for sustaining a healthy and timely feed back, as well as keeping the participatory process alive. They can actively participate in monitoring the progress of the poverty reduction programme, in line with the appropriate indicators (Chapter 7). Additionally, municipalities have the following advantages in co-operating with NGOs; they have branches throughout the country (in total 2,700 of them), they are closely related to the development of socio-economic programmes at regional and community levels, they have a direct interest in the development of small and medium enterprises and economic activities in their regions as they have been authorised by the land reform Act to manage 33% of land and to lease the property under their disposal.

However, in order to carry out these demanding tasks, the municipalities themselves should be the subject of improvements in their organisation, training, and capacity building. This is necessary to help maintain their independence from the central government, so that they can provide honest and practical feed back for successful implementation of the strategy.

Close cooperation with local NGOs would contribute to building up the knowledge and skills of municipalities. An agreement signed between the National NGO Forum and the Permanent Commission on Regional Issues at Milli Majlis, as well as the NGO Forum and Municipalities provides a basis for this cooperation. Besides this, NGO Resource and Training Centres and

Forum's sector on municipalities could play a significant role in increasing the municipalities' potential.

The Time Horizon

While poverty reduction is a long-term process, the need to do something about at least some of its aspects requires short-term, even urgent, measures. Therefore, it is useful to take into account what steps can be taken in the immediate future and what in the longer term. Something which emerged through the participatory work, was that there in fact exists a reasonable capacity within the communities to mobilise their resources to tackle the most immediate needs of poverty reduction, provided that they can be supported with some management back up and tangible incentives. Labour, skills and experiences, which are relevant to the living conditions of the villages, are often found in sufficient supply within the community to bring about some immediate improvement. Other complementary inputs, however, will accompany such efforts.

This may in turn generate the incentive for longer term and more demanding objectives to receive initiatives and participation from the very sections of the society, which are the subject of the strategy.

6.5. Achievements and Drawbacks: A Critical Assessment

As mentioned earlier, the participatory process is part of a broader experience of learning and gaining experience on the way of fulfilling the objectives of the economic and social reforms. As such, the first phase has offered valuable insights and lessons, which no doubt will enrich the next stages.

The first lesson learnt was the realisation that there was a gap in the understanding of the main actors: the government (including local authorities) and civil society. This is true with regard to the scope, the purpose and the possibilities of the Poverty Reduction Strategy. While the enthusiasm for "participation" itself was generally high, knowledge of and incentive to learn about government measures was not. Apart from a general initial apathy on the part of civil society, as mentioned earlier, more often than not, the perception of participation was poor, and the expectation was that the missions themselves would be carrying out direct and immediate actions to alleviate poverty.

This could be explained as a need for information dissemination, on a direct and one-to-one basis. Time consuming it may have been, but it proved very effective in removing some barriers in understanding, and in attracting genuine interest and participation.

Given how young this experience is in Azerbaijan, however, the results so far have been very encouraging, and point the way to the next phases.

As a result of the participatory regional missions a wealth of good information has been gathered, and reflected in the following documents. Most of these are still working documents, and need to be developed and built upon for the future phases. These include the questionnaires I and II, village summary reports, regional summary reports and tabulations (The Focus Group findings), the Event Recorders findings (Regional Workshops), the Hand Book on Public Education and Outreach Programme (World Learning).

6.6. Possible Ways to Deepen and Broaden the Process

There is need for training, information dissemination, clearer definitions, broader regional coverage, monitoring indicators and mechanisms, impact assessment of participation and reporting mechanisms.

The civil society should know what they are expected to do by participation, why they should do it, how they can do it, and should be able to see the result of it.

In order to cover a sufficiently representative cross section of the civil society, specific programmes will be adopted, in addition to the universal ones, for example ones especially directed at youth or at IDPs.

It will be necessary to maintain the co-operation between the government and as many of the donors, which are willing to co-finance and co-operate on any of these crucial areas.

6.7. The Information Campaign: Public Education on Poverty

Participation, as a social process, is a process of public education, learning and change. As mentioned earlier, this has only recently started in Azerbaijan, and will be strengthened during the next phases of the Poverty Reduction Programme.

Preparing and disseminating clear and useful information on the programme is crucial to its success, and will ensure an effective feedback from all the interested parties.

Since February 2001, a number of steps have been taken towards informing the population at large about the SPPRED. Most of these have been Baku-based and through the media. Given the diversity of the country and the gap in access to information between Baku and other cities and regions, special activities will have to be formulated for guaranteeing a more comprehensive coverage.

The initial findings about the amount of information available to the public on the SPPRED suggest that almost all regions are poorly informed about the SPPRED, except for the contacts established during the participatory regional missions and meetings. A UNDP sponsored seminar at Khazar University in early June, 2002 revealed that even the university students and academia were not particularly enlightened on the programme. This reinforces the need for special information programmes to attract the interest and participation of various social groups.

Further, it is normally assumed that the flow of information is, or ought to be, from the capital to the region. However, it is considered that future phases of the SPPRED will ensure a mutual flow of information, i.e. also from the regions to the capital. Again, the role of municipalities and NGOs can be significant in this.

Chapter 7. Implementation, Monitoring and Evaluation

The main points of the Poverty Reduction Strategy have been set out in the chapters above, and summarised in the policy matrix attached to this document. The timetable for implementation is also set out in the policy matrix, as are the monitoring indicators for each policy action.

As was mentioned, the main directions of the policy actions included in the Poverty Reduction Strategy can be summarised as (i) the facilitation of an enabling environment for growth of income-generating opportunities; (ii) maintenance of macroeconomic stability; (iii) improvement in the quality of, and equity in access to, basic health and education services; (iv) improvement of infrastructure (including roads, delivery of utility services, communications, irrigation); (v) reform of the existing system of social protection to give more effective protection to the vulnerable; and (vi) improvement of the living conditions and opportunities of the refugees and IDP population.

As was stressed in the previous chapters, the success of the Poverty Reduction Strategy is intrinsically linked to economic and sectoral reform, as well as to institutional reforms. In particular, fiscal and monetary policies play an important role in the sound management of the country's resources to guarantee macroeconomic stability. The Public Investment Programme (PIP) can help improve infrastructure, and investment policy to create the enabling environment for the development of the non-oil sector. Energy sector reform is essential to guarantee stable supplies of gas and electricity to the population, especially the rural population. Agricultural reform will help the rural population use the land to generate additional income, rather than as a copying strategy and will help to provide productive rural employment.

It has been shown in the document that improvements in the welfare of the population will only be ensured if economic and sectoral reforms are accompanied by institutional reform. A successful Poverty Reduction Strategy depends on active measures being taken to combat corruption and increase transparency in the public administration system.

The Poverty Reduction Strategy also has to be based on sound use and management of the country's natural resources, and therefore requires a well-thought-out environmental policy framework; combined with the necessary institutions to monitor and enforce environmental protection issues.

7.1. Selection of Monitoring and Evaluation Indicators

The policy matrix attached to this document gives a summary of the list of policy actions envisaged, and the indicator which will be used to monitor implementation. The main indicators which will be used to monitor the impact of the policy actions on poverty levels and living standards are summarised in this chapter.

At the beginning of the document poverty levels in the country are reported using per capita consumption expenditure as a welfare indicator, and a poverty line of 120,000 AZM (25.8 USD) per capita per month. A measure of extreme poverty is also reported, using the same welfare indicator, but a poverty line of 60% of the median per capita consumption level. Data on per capita consumption levels were derived from the Household Budget Survey (HBS) results for 2001. The same survey, welfare indicator and poverty lines will be used to monitor changes in the poverty levels over the coming three years, and also changes in the poverty profile. For the moment it is not

possible to give an exact target for poverty reduction by the year 2005. The HBS is still young, and the first year's results may not be suitable to use as a base year. In this regard, the Secretariat will monitor changes in the coming year, where possible analyse the effect of policy on poverty results, and set a target for poverty reduction for the year 2010.

The document gives an overview of the main directions of the Poverty Reduction Strategy and shows the main indicators, which will be used to monitor progress in implementing them. The monitoring indicators used can be divided into two groups: direct indicators or output indicators (e.g. number of schools constructed, training courses held etc.) and indirect monitoring indicators or outcome/impact indicators (e.g. employment level and share of private sector in GDP).

It should be noted that it is considered necessary to improve relevant information sources before full monitoring can be carried out as there is still a considerable information gap.

1) Creation of income-generating opportunities

The ideal indicators here would be derived from a regular labour force survey, which would supply us with regular and reliable information on employment and unemployment levels, employment in the formal, informal, state, private, agriculture and other sectors. It is one of our policy actions to implement such a survey, but until then, proxy indicators for employment levels will be found. One proxy indicator will be absolute growth in the non-oil sector, which will give some indication of the growth in job opportunities. The number of registered SMEs will also be monitored.

2) Targeting of Social Benefits

The HBS allows us to look at the receipt of benefits by expenditure or income deciles, and to look at the prevalence of "inclusion" and "exclusion" errors; i.e. the extent to which the targeting mechanisms and eligibility criteria used to award benefits are failing to exclude the richer sections of the population (inclusion errors) and the extent to which the poor are not actually receiving benefits (exclusion errors). The HBS can also be used to look at the effectiveness of the benefits in protecting households from poverty; i.e. analysts can look at household per capita income or expenditure levels before receipt of benefit, and after, and judge whether the benefit actually helps lift households above the poverty line.

Alternative administrative data will be used to monitor the number of children in institutional care, and the effect of alternative policy measures designed to provide family support services and prevent children being put into institutions.

3) Improving of Infrastructure, especially in Rural Areas

This is difficult to monitor with existing data sources. The HBS gives some indication of access to drinking water, access to public transport, and housing conditions, but not enough, and it does not supply enough details on stable supply of gas, electricity, etc. Administrative data on public sector investment figures will be used to look at increases in investment in irrigation, electricity lines, water pipes, sewage. It is hoped to repeat the type of rural infrastructure survey carried out by the WB in 2000 in order to monitor improvements. Similar studies of urban infrastructure are also required.

It is necessary to develop and maintain the participatory element throughout the implementation and monitoring. This is not only in keeping with the conditionality of several donors, but also viewed as crucial by the government.

4) Improving Delivery of Basic Health and Education Services

The improvement of health and education services will be measured by intermediate and final indicators.

The final indicators in the case of health will be a reduction in infant and maternal mortality rates, a reduction in mortality rates for children under 5 years, as well as reduction in the incidence of certain diseases: malaria, TB, acute respiratory diseases among children; and the number of children covered by immunisation programmes. It is also planned to monitor the reduction in the number of teenage births.

The intermediate indicators will include increases in salaries to health care workers, and reduction in number of hospital beds by raion accompanied by a corresponding increase in the numbers being treated in outpatient facilities.

The final indicators for education will be maintenance of the current high enrolment rates, and increases in attendance rates by gender. For this recording and publication of attendance rates has to be improved. The intermediate indicators will include increases in salaries to education workers, increases in amount allocated for materials, and number of pupils receiving free text books.

5) Improving the Living Standards of IDPs and Refugees

It was mentioned above that a comprehensive survey of living standards among IDPs and Refugees is currently being carried out with assistance from the WB and UNDP. The results of this survey are not available in time to be included here. It is hoped in the future to repeat this survey on an annual basis in order to monitor the effect of policies on IDP living standards, and to compare IDP/ refugee living standards with those of the rest of the population. The main administrative indicator will be the number of IDPs in tent camps and temporary accommodation; the numbers being voluntarily re-settled in new settlements; and the numbers receiving soft micro-credits for agricultural or other commercial activities.

6) Macroeconomic Stability, Sound Fiscal Management, and Economic Growth

The Poverty Reduction Strategy has stressed the importance of maintaining macroeconomic stability, sound fiscal management and economic growth. The main indicators for fulfilment of these goals are: inflation rates kept at 2-3%, international reserves kept at least at the level of 16 weeks of non-oil imports, increase in credits to enterprises and individuals, fiscal deficit kept at a sustainable level of not more than 3% of GDP, and state debt kept at a level of not more than 30% of GDP.

7) Gender-Desegregated Indicators

This is possible for survey data on living standards (the HBS data), and will in the future be possible for labour force survey data, and for data emerging from the survey of IDPs/ Refugees. Administrative data should also be presented in a gender-disaggregated form. The SSC has already

received assistance from the UNDP in gender-disaggregated statistics, and has produced a bulletin on Women and Men in Azerbaijan. It is important that this type of bulletin be produced regularly, and that in the other publications produced by the SSC data are presented in a gender-disaggregated form wherever possible.

7.2. Data Sources and Instruments

The main source of information for monitoring poverty and living standards will be the Household Budget Survey. The SSC has received technical assistance from the WB, UNICEF and ADB in order to design and implement this new survey, and it is now carrying it out independently on a regular basis. The quality of the survey data will improve as interviewers, supervisors, data entry operators and survey managers gain experience. This data will provide the basis for monitoring changes in poverty using income and expenditure indicators. It will also be used to monitor changes in regional living standards.

UNICEF has carried out one Multiple Indicator Cluster Survey in order to look at the links between income poverty and health and education indicators. This survey produced interesting results. It provided a good comparison with the administrative statistics collected on maternal and infant mortality; and also used anthropometric measurements to measure the extent of "wasting" (low weight for age group) and "stunting" (low height for age group) among children. This latter is a very useful indicator of poverty and its effects on children. It is planned to repeat this survey with UNICEF support, and to work towards including some aspects of the survey in the regular household budget survey; for example, to carry out anthropometrical measurements at periodic intervals.

As was stated above, there is a lack of a regular and reliable labour force survey in the country. It is hoped that this can be introduced with technical assistance from donors, and then introduced into the regular activities of the SSC. At present employment data are collected through administrative sources. Enterprises and budget organisations supply the SSC with data on number of employees, and the State Employment Offices provide data on registered unemployment. However, private sector enterprises do not always comply with the SSC requests for data, and the number of registered unemployed is very low due to the low incentive to register (low level of unemployment benefit) and does not reflect the full picture with regard to unemployment.

There is a need for a regular monitoring of IDP living standards to allow us to monitor changes in their conditions, and also their living standards in comparison to other sections of the population. The SCRIDP collects full and regular administrative data on IDPs, including settlement type, employment, incidence of disease, school enrolment. However only survey data will allow us to look at differentiation in living standards within IDP/ refugee population, and to compare these with living standards for the rest of the population. This is necessary to evaluate the effectiveness of existing policies to help IDPs/ refugees, and to establish which sections of the IDP/refugee population are particularly vulnerable, and on which sections most resources should be targeted. It is considered to co-operate with the WB, UNDP and other donors in the future to carry out regular surveys of the IDP/ refugee population.

There is a lack of regular information gathered on environmental issues. There is a need to establish control indicators to monitor air pollution levels, soil erosion, and de-forestation. For soil erosion, useful indicators for monitoring include measuring areas where protective structures are built, areas

with high salinity, which have been ameliorated, as well as areas which have been positively affected by re-plantation and rehabilitation of native vegetation. The latter two factors, i.e. re-plantation and rehabilitation of native vegetation, are themselves very good indicators for monitoring the process of de-forestation.

Most of the indicators for soil erosion and de-forestation can be monitored regularly at the local level, provided the training and equipment exist. This would be highly effective in increasing the public awareness of environmental preservation issues and significance, and in motivating them to participate in safeguarding and improving their surrounding environment.

During the SPPRED preparation process, valuable information on living standards in the country, and on the population's perceptions of the main factors adversely affecting their living standards, was collected through participatory methods, including focus group discussions and in-depth interviews with representatives of civil society in 5 regions of the country. It is planned to continue this work in the implementation phase, and to gain useful insights into how the strategy can be improved and revised as implementation proceeds. As mentioned in some detail in Chapter 6, there are a number of proposals being prepared for participatory actions involving the poorer sections of the rural areas in particular, to provide clear feedback on the ways in which timely measures may be taken towards viable solutions to their numerous problems. This in particular involves their basic sanitation, health care and infrastructure.

7.3. Institutional Capacity

It is essential that the poverty reduction programme be monitored in the implementation period, in order to evaluate the effectiveness of the policy measures in achieving the expected results. However, implementation does not depend on a series of independent actions by different ministries and government agencies: on the contrary, many of the policy actions require coordinated action between different government bodies as well as with donor organisations and other stakeholders. In the period 2003-2005, the SPPRED Secretariat will have overall responsibility for coordinating the implementation process, and also for monitoring this process.

An Advisory Board from representatives of the Government, civil society, international organisations and donor community will be established to co-ordinate efficiently the above mentioned stakeholders' efforts in the regular monitoring process of SPPRED and to keep discussion process open on financing of the proposed actions and their evaluation. This would have added-value through increase the efficiency of donor organisations contribution to the country.

It is planned that the SPPRED Secretariat will be responsible for publishing an annual review of the implementation process. This will report on how the monitoring indicators have been used to monitor progress in implementation, and will also include a review of the policy measures, making suggestions on how to improve and adapt these in accordance with evidence on their poverty impact.

Monitoring, implementation and evaluation involve three main sets of activities: data collection, data analysis, and dissemination of results. The SSC has prime responsibility for *data collection*. But, as was indicated above, data collection for some indicators is not yet possible on a regular basis, and the government will cooperate with international organisations on improving the data collection (notably through a labour force survey, IDP survey, women and child welfare survey infrastructure surveys, and environmental monitoring surveys). It will be important to involve civil

society also in data/information collection through the involvement of NGOs in qualitative research activities.

In the preparation phase, it has been found that institutional capacity for analysis of living standards data is still quite weak. The main poverty indicators will be monitored by analysing the HBS data on an annual basis. As noted above, the SSC is responsible for carrying out high quality survey fieldwork and systematic quality control checks. However, there is still very little capacity within the relevant government structures for poverty analysis. It is therefore proposed to set up a poverty monitoring unit attached to the SPPRED Secretariat, staffed by four local experts, who will be trained in the use of survey data for living standards analysis (Chapter 5). This core team will have the main responsibility for carrying out living standards analysis, and should then train staff in other government bodies to use the data for policy-making and evaluation. As new survey data becomes available from other sources (e.g. labour force survey), the type of analyses which can be carried out by this group will be broadened, and the links between various aspects of poverty made clearer.

Every government ministry has different aspects of poverty to monitor and tackle, and they will use the survey data flexibly in order to evaluate the effectiveness of policy measures.

APPENDIX 1. POLICY MATRIX OF THE STATE PROGRAMME ON POVERTY REDUCTION AND ECONOMIC GROWTH FOR REPUBLIC OF AZERBAIJAN[1] 2003-2005

ECONOMIC DEVELOPMENT AND EMPLOYMENT GROWTH

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Fiscal Policy							
General							
1 Increasing the effectiveness of planning and expenditure by improving the budget process:							
▪ Develop and adopt budget legislation in keeping with international standards to improve budget process	ongoing-2005+	MF, CMAR	Budget System Law enacted by MM; Budget System Law Regulations approved;				
▪ Consolidating extra-budgetary funds of budgetary organisations into state budget	2003	MF, CMAR	Consolidation of extra-budgetary funds into State Budget.				
1 Preparing mid-term consolidated budget forecast in order to provide for longer planning horizon appropriate for effective poverty reducing expenditure:			Mid-term budget forecast presented to MM in budget envelope.				
▪ Preparing estimate of total resources available to Government, making an explicit statement about the desired fiscal deficit	2003-2005+	MF, MED, MT, SCC, SOFAR, SPF					
▪ Submitting the costed poverty reduction measures by the Sectoral agencies	2003-2005+	MED; MF; Relevant Ministries					

[1] Gender factor has been considered in all the actions and policies mentioned in the matrix.

				Financing (US$ thousand)			
▪ Prioritising expenditures, in accordance with the resource constraint and impact on poverty reduction	2003-2005+	MED, MF					
▪ Preparing mid-term budget forecast	ongoing-2005+	MF, MED					
3 Preparing action plan on increasing municipalities' revenues, in order to reduce their dependence on the State Budget	2003-2005	MED, MF	Increased financial independence of municipalities.				
Revenue							
3 Improving tax and customs legislation:							
▪ Improving regulations to Tax Code (including consolidation and renumbering)	2003-2004	MT, MF, CMAR,	Approval of Regulations of Tax Code by Cabinet of Ministers;				
▪ Improving the existing legislation to consolidate articles regulating tax administration with Tax Code	2003-2004	SCC, MF, CMAR, MM	Amendments to the Tax Code submitted to MM;				
▪ Simplifying procedures in Customs Code	2003-2004	SCC, MF, CMAR, MM	Amendments to Customs Code submitted to MM.				
2 Increasing tax collections and social insurance fees by legalizing non-registered economy:							
• Registering all non-recorded businesses	2003-2005	MT, SCC, SPF, MJ	Tax revenues as proportion of non-oil GDP increased.				
2 Examining opportunities and taking decisions about reducing income tax:							
▪ Revising income tax bands and rates	2003	MF, MT	Decisions incorporated in 2003 Budget.				
3 Examining opportunities and taking decisions about reducing taxes on business to promote private sector development:							
▪ Examining possibilities to reduce profit tax	ongoing-2003	MF, MT	Decisions incorporated in 2003 Budget;				
▪ Expanding scope of simplified tax system	ongoing-2003	MF, MT					
▪ Examining the possibilities to reduce tariff rates and exemptions	ongoing-2003	MF, SCC	Cabinet of Ministers approve amended tariff rates and exemptions.				

				Financing (US$ thousand)			
2 Increasing administrative capacity and transparency of tax and customs systems:							
▪ Increasing skills of tax and customs officials	ongoing-2005	MT, SCC, EU	Increased collection rates for customs and taxes;	1,460			1,460
▪ Expanding cooperation between customs and tax bodies and international organisations, and studying international practice	ongoing-2005	MF, MT, SCC, EU	Flow of taxes to other countries prevented, Tax and customs systems improved on the basis of international practice;	780			780
▪ Increasing transparency by giving information to the public on taxes and duties and collection procedures	ongoing-2005	MT, SCC	Public awareness campaign carried out.				
1 Reducing social insurance contributions to encourage employment:							
▪ Reducing the level of employers' contributions to Social Protection Fund	2003-2005	MF, SPF	Reduced cost of job creation.				
Expenditure							
1 Preparing a programme on rationalisation of public expenditure:			Increased efficiency of budgetary resource allocation.				
▪ Examining the number of public-sector employees and wage bill, employees' productivity and assessing the need for decompression	2003-2004	MF, MLSPP, SSC, Line Ministries					
▪ Reviewing the expenditure by budgetary organisations	2003-2004	MF, Line Ministries					
▪ Preparing a programme on rationalisation of public expenditure	2003-2004	CMAR, MF, Line Ministries					
1 Providing finance to support poverty reduction priorities:	Ongoing-2005+	MF, relevant ministries and organisations	Funds disbursed as outlined in the action plan;				
▪ Reform public pay system, and decompress and increase public sector wages (In keeping with budgetary constraints)			Increased workers' productivity.				
▪ Providing targeted social benefits and implementing necessary reforms in that system							
▪ Basing government expenditure on capital goods on poverty reduction priorities							

				Financing (US$ thousand)			
▪ Increasing expenditure on other goods and services, while making an appropriate allowance for increased payment for utilities by budgetary organisations ▪ Increasing expenditure on education moderately, to reflect the goal of better use of existing funding. ▪ Increasing budgetary allocation to the health sector, in order to increase the provision of primary health care ▪ Increasing expenditure substantially on economic services and state financial support for SMEs development.							
1 Improving control over use of budgetary resources:							
▪ Strengthening the capacity to monitor and control expenditure by budgetary organisations through improving the performance of the Treasury	ongoing-2005	MF	Expenditure budget allocated through treasury controlled; Accurate financial reports which are highly disaggregated are produced and are published regularly in compliance with the Budget System Law;				
▪ Completing the computerisation of the Treasury	ongoing-2005	MF, IMF, IDA, USAID		5,750	166		5,916
▪ Strengthening the auditing system on budget resources	ongoing-2005	CA, MF	Increasingly efficient use of budgetary resources.				
2 Updating and simplifying the norms and standards used as a basis for expenditure budgeting:							
▪ Norms and standards to be prepared by sectoral ministries	2003-2005	Line ministries	Norms to be approved by Cabinet of Ministers.				
Debt							
2 Maintain appropriate levels of debt and debt services, by improving mechanisms for debt management:							

				Financing (US$ thousand)			
▪ Enacting the law "On State Debts and Guarantees"	2003	MF, NB, CMAR, MM	Approval of legislation;				
▪ Enacting Regulations on Foreign Loans Registry	2003	MF, CMAR	Approval of regulations;				
▪ Improve assessment of applications for state guarantees	2003-2004	MED, MF	Reduced number of overdue payments by agencies receiving state guarantees.				

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Monetary policy and banking sector development							
1 Maintaining inflation at an appropriate level:							
▪ Continuing the policy of Government's not borrowing from NB for financing deficit	Ongoing-2005+	NB, MF	Inflation maintained at 2 – 3 % per annum;				
▪ Increasing effectiveness of monetary policy tools and regulation of bank system liquidity	Ongoing-2005+	NB	Increased effectiveness of monetary policy, development of financial market;			250	250
▪ Increasing the level of financing of economy without damaging financial stability	Ongoing-2005+	NB	Increased flow of investment credit into the economy.				
2 Improving exchange rate policy:							
▪ Continuing sterilisation of oil revenues through SOFAR and other methods of preventing excessive real exchange rate appreciation	Ongoing-2005+	NB, CMAR, SOFAR	Appreciation of Manat (national currency) avoided;				
▪ Maintaining a satisfactory level of international reserves	Ongoing-2005+	NB, CMAR	Sufficient international reserves to finance at least 15 – 16 weeks of non-oil imports;				
▪ Stimulating the development of domestic production and increasing the competitiveness of exporters, without losing control over inflation	Ongoing-2005+	NB	Increased competitiveness of domestic production;				
▪ Continuing the liberalisation of the currency control regulations	Ongoing-2005	CMAR, NB	Restrictions gradually removed.				
1 Institutional development of the banking system:							
▪ Creating conditions for development of micro-credit institutions to provide loans to individuals and small and medium enterprises	Ongoing-2003	EBRD, IFC, GTZ, BSTDB, NB	Micro-credit institutions established;				
▪ Promoting expansion of the banking network by establishing financial institutions in the regions	Ongoing-2005+	NB, BA	Development of regional banking infrastructure;				

				Financing (US$ thousand)			
regions ▪ Promoting the expansion of credit unions' networks	Ongoing-2005+	NB	Increased provision of credit to farmers and SMEs.			13,800	13,800
1 Restructuring and privatising state-owned banks: ▪ Reducing the Government's share in the capital of the International Bank of Azerbaijan	2003-2005	MED, MF, NB	Government's share in IBA privatised;			130	130
▪ Improving operations and management systems of BUS Bank, and preparing BUS Bank for privatisation	Ongoing-2004	MED, MF, NB, IDA	Plan for privatisation of BUS Bank announced.	1,500	210		1,710
1 Developing privately-owned banks: ▪ Increasing minimum charter capital of privately-owned banks	Ongoing-2005+	NB	Stock capital of privately-owned banks increased by 5 mln. USD by 2005;				
▪ Further liberalisation of limits of share of foreign banks' capital in domestic bank services market	2003	NB	Limits on maximum share of foreign bank capital fully eliminated.				
2 Increasing the regulatory capacity of the National Bank: ▪ Improving banking supervision system	Ongoing-2005+	NB	Improvement of management of bank risks;				
▪ Introducing amendments to the Law "On the National Bank of Azerbaijan	2003	NB, MM	Amendment to the Law.				
2 Develop banking infrastructure: ▪ Adopt a new law "On Banks"	2003	NB, MM	Adoption of the Law;				
▪ Implementing system of small payments and developing inter-bank payments system	Ongoing-2004	NB, IDA	Clearance centre established and plastic card payments automated;	2,030	320		2,350
▪ Completing transition to International Accounting Standards (IAS)	2003	NB	Recommendation for complete implementation of IAS prepared and implemented;			250	250
▪ Establishing a deposit insurance system	Ongoing-2003	NB, BA	Deposit Insurance Fund established;			350	350

				Financing (US$ thousand)			
▪ Establishing credit bureaus	Ongoing-2003	NB	Preparation and implementation of centralised credit bureau registration;			300	300
▪ Improving human resources management systems in banks	Ongoing-2003	NB, BA				300	300
▪ Stimulating non-cash transactions	Ongoing-2005+	MED, MF, NB	System of transactions introduced; Money circulation improved;				
▪ Establishing and modernising of corporate management and risks regulation systems in banks	Ongoing-2003	NB, BA	Preparation and implementation of standards on corporate management and risk regulation;			650	650
▪ Establishing a centralised and simplified credit and mortgage register	Ongoing-2003	CMAR, MJ, MED, SCS	Centre for registration of mortgages established.				

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Investment Policy							
1 Improving the legislative framework:							
▪ Analysing the legal-regulatory base of investment activity and privatisation and preparing proposals for their improvement;	2003-2004	MM, MED, MT, SCC, MF, SCS, IFC	New law "On Investment Activity" adopted; Law "On Special Economic Zones" adopted;				
▪ Formulating the legislative framework to combat corruption.	2003-2004	PO, MM, relevant ministries	Law "On Fight Against Corruption" adopted.				
2 Institutional improvement of the investment process:							
▪ Ensuring capacity building of the MED	Ongoing-2005+	MED, EU	Organisational capacity of the management of the investment strengthened	1,562			1,562
▪ Completing diagnostic study of investment climate, holding joint discussions on findings with participation of public and private sectors, carrying-out relevant actions to reduce barriers.	Ongoing-2005+	MED, MT, SCC, IDA	Volume of investments increased; System of licensing and permits improved; Council for Entrepreneurs established;	1,170	165		1,335
▪ Designing and implementing relevant structural reforms in transport sector;	Ongoing-2003	CMAR, MTr, MED, relevant ministries and organisations, EU	Separation of regulatory and commercial functions in energy, transport, communications and other public sectors;	976			976
▪ Designing and implementing relevant structural reforms in communications sector;	2003-2004	CMAR, MC, MED				1,000	1,000
▪ Design and implement relevant structural reforms in energy sector, as per Energy Policy Sector[2]	Ongoing-2004	CMAR, MFE, MED, EU		1,460			1,460
▪ Continuing transition to the international accounting system in private enterprises and	Ongoing-2005+	MF, MED, EU	The international accounting system	1,070			1,070

[2] This is also mentioned in the Energy Policy Section.

				Financing (US$ thousand)			
organisations.			introduced and implemented.				
1 Improving management of the investment process:							
▪ Preparing priority public investment projects for 2003-2005 based on SPPRED	2003	MED, MF, relevant ministries	Public Investment Programme prepared;				
▪ Ensuring capacity building for the Project Appraisal Division of the MED	2003-2004	MED, ADB, IDA	Volume of domestic and foreign investments increased;	800	44		844
▪ Designing regional investment maps to reflect social-economic capacity of each region	2003	MED, UNDP	Investment maps available; Investments in the regions increased;	50		50	100
▪ Establishing free bonded warehouses	2003	MED, MT, SCC	Bonded warehouses established.			500	500
1 Increasing effectiveness of the privatisation process:							
▪ Expanding the use of investment competition methods and privatisation on the basis of individual projects	Ongoing-2005+	MED	Increased share of private sector in GDP;				
▪ Continuing the policy of involving consulting companies in the privatisation process	Ongoing-2005+	MED	Improved financial-economic indicators in privatised enterprises;				
▪ Selling the state share in joint stock enterprises	Ongoing-2005+	MED, relevant ministries					
▪ Using appropriate international experience to privatise or management take-over of infrastructure sectors (gas, water, heating, sewerage, transport)[3]	Ongoing-2005+	MED, relevant ministries, IDA	Fair competition environment developed;	800	110		910
▪ Opening new sectors for privatisation including infrastructure, special machine building, etc.	Ongoing-2005+	MED, relevant ministries	Country's export capacity increased;				
▪ Liquidating unprofitable enterprises by declaring them bankrupt and selling them in parts, when applicable	2004-2005+	MED	Expansion of viable private sector;				

[3] This is also mentioned in Energy Policy section.

				Financing (US$ thousand)			
▪ Improving enterprises of special importance for country's economy before privatisation	2003-2005+	MED	Increase in the volume of investments;		10,000		10,000
▪ Providing support (technical, legal, financial etc.) for privatised enterprises	Ongoing-2005+	MED, MF	Growth in private sector productivity.				
1 Developing entrepreneurship in the regions:							
▪ Establishing an information data base for entrepreneurs	2003	MED, MC, SSC	Data base established;				
▪ Improving and simplifying tax regime for small enterprises	Ongoing-2003	MT, MF, MED	Efficient tax system for small enterprises developed;				
▪ Drafting legal-regulatory documents on the formation of professional association of entrepreneurs and craftsmen in regions	2003	MED	Relevant norms introduced and implemented;				
▪ Preparing and implementing concrete proposals on preferred wage coefficient, incentive tariff rate on energy carriers, provision of tax holidays for tax payers and soft loans to local production in mountainous and border regions, as well as in Nakhchivan.	2003-2004	MED, MF, MFE, MLSPP, MT, NB					
▪ Establishing local market infrastructure of entrepreneurship (consulting, training, information and etc.):	Ongoing-2005+	MED, relevant ministries, EU	Share of private sector in GDP increased.	1,172			1,172
2 Strengthening the competitiveness of domestic production and increasing the country's export capacity:							
▪ Continuing the process of admission to WTO through fair trade negotiations	Ongoing-2003	MED, relevant ministries, USTDA	Improved international trade status;	1,000			1,000
▪ Ensuring capacity building in the Tariff Council	2003-2005+	CMAR, MED, relevant ministries	Number of foreign trade partners and earning from exports increased.			400	400
▪ Reviewing customs import duties by the Tariff Council	Ongoing-2005+	CMAR, relevant ministries	Participation of local producers in domestic market increased;				
▪ Undertaking relevant measures with regard to introduction of anti-dumping mechanisms when necessary	Ongoing-2005+	CMAR, MED, relevant ministries					

				Financing (US$ thousand)			
▪ Promoting exports trough formation of the support infrastructure	2003-2005+	MED	Export Promotion Fund and export support centres established; Increase in export revenues;				
▪ Stimulating investment-oriented imports and production of import-substituting consumer goods	Ongoing-2005+	MED, MT, SCC					
▪ Increasing marketing capacity of domestic production (arranging fairs, establishing database, management training etc.)	Ongoing-2005+	MED, EU	Competitiveness of domestic production increased;	488.2			488.2
▪ Establishing Trade Fair Centres	2003-2005+	MED	Trade Fare Centres established; Number of fares held;				
▪ Opening Trade Representations in foreign countries	2004-2005+	MED, MFA	Access to international markets improved;				
▪ Strengthening the system of quality control	Ongoing-2005+	MED, SASMP, relevant ministries	Normative base for International Quality System prepared.				

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Energy Policy							
1 Improving energy supply to the population through strengthening financial discipline in the fuel-energy sector:							
▪ Making implicit subsidies explicit in the State Budget	2003-2005+	MF, MED, MFE	Transparency of implicit subsidies ensured;				
▪ Improving the payment system for consumption of energy carriers and imposing sanctions on the consumers violating financial discipline	Ongoing-2005+	MF, MED, MFE	Collection level increased; Financial indicators improved; Efficiency and flexibility in the payment of energy bills ensured; Timely and complete realisation of commitments to the budget;				
▪ Ensuring liquidation of bad debts	2003	MF, MED, MFE	Reduction in arrears to suppliers;				
▪ Regulating mutual debts	2003	CMAR, MF, MED, MFE	Reduction in debtors' and creditor's debts of enterprises;				
▪ Approving limits for energy consumed by budget organisations, non-settled refugees and IDPs	2003-2005+	MF, MFE, SCRIDP	Limits approved and enforced; Payment of energy bills by budget organisations increased;				
▪ Preparing payment schedule for energy consumed by state enterprises	Ongoing-2003	MED, MFE, MF	Payment schedules prepared and enforced;				
▪ Providing meters to each consumer to ensure strict control over energy consumption	Ongoing-2005+	MFE, MED	Number of meters installed;				

				Financing (US$ thousand)			
▪ Increasing public awareness of energy saving policy and methods through the mass media	Ongoing-2005+	MFE, MED, MF, STRBC	Changes in the level of consumption of energy;				
▪ Introducing payment card system for payment of utility bills	2003-2005	MED, MFE, MF	Improved payment records.				
2 Implementation of structural reforms:							
▪ Continuing structural reforms in SOCAR, «Azerenerji» and «Azeriqaz»	Ongoing-2003	MFE; MED; MF, EU	Effective management ensured;				
▪ Providing social protection for redundancies resulting from the restructuring and privatisation process	Ongoing-2003	MED, MF, MFE, MLSPP					
▪ Transferring to the private sector the long-term management of regional gas distribution networks	2003-2004	MED, MFE, IDA	Sustainable and safe use of gas and electricity distribution networks ensured.				
3 Development of carbohydrate capacity:							
▪ Exploiting the remaining reserves in old fields, developing the geological-technical and technological measures ensuring a stable increase of oil and gas exploration	Ongoing-2005+	MFE					
3 Introducing efficient price policy:							
▪ Preparing new proposals on the prices of energy carriers (tariffs) and submitting them to the Tariff Council	Ongoing-2005+	MED, MFE	Cost-effectiveness increased and energy consumption savings increased. Reduction in losses.				
▪ Developing special cost norms in line with modern energy production	Ongoing-2005	MFE	Existing cost norms matched with modern requirements.				
2 Improving the energy supply system:							
▪ Expanding the integration of Azerbaijan into regional energy power systems with the neighbouring countries (Russia, Turkey, Georgia, Iran)	Ongoing-2005+	MFE, MED	Uninterrupted energy supply; Improved quality of energy.				
▪ Developing a national programme on utilisation of alternative energy resources.	2003	MFE, MENR					

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Labour Market and Employment							
1 Stimulating the demand for labour through promoting regionally-balanced employment growth in the non-oil sector							
▪ Developing micro-credit schemes for various sections of the population intending to set up business[4]	Ongoing-2005+	MF, MED, NB	Micro-credit funds established; Number of population taking up micro-credits;				
▪ Establishing entrepreneurship support centres (including women and family businesses) in different regions to promote development of entrepreneurship	Ongoing-2005+	MED, SCWA, relevant Ministries and organisations	Increase in numbers employed in private enterprises in regions;			100	100
▪ Preparing Regional and Sectoral Development Programmes	Ongoing-2003	MED, UNDP	Employment and wage levels improved in regions.	250		250	500
2 Helping to match labour supply with demand							
▪ Redesigning the system of vocational education	Ongoing-2005+	ME, MED, MF, LEB	Policy document on vocational education prepared; Number of graduates from vocational education employed;			2,085	2,085
▪ Organising training courses according to regional characteristics (carpet weaving, fruit-growing, sericulture, vegetable growing, etc) to reduce unemployment among women	2003-2005+	MED, SCWA, MLSPP	Number of women employed in skills offered by training courses;				
▪ Establishing regional wage coefficients	2003	CMAR, MLSPP, MED, MF	Increase minimum wage level and wages; Regional differences in wages.		6,000		6,000
2 Providing incentives to attract and retain well-qualified and motivated civil servants through civil							

[4] This is mentioned in Monetary Policy section.

				Financing (US$ thousand)			
service wage reform							
▪ Improving the wage structure for the public sector, including salary increases	Ongoing-2005+	CMAR, MLSPP, MF, MED, EU	New wage structure adopted and introduced.		56,200		56,200
2 Providing support to the unemployed through policies for facilitating their re-entry into the job market							
▪ Developing a strategy to cushion the effects of redundancies related to structural reforms	Ongoing-2005	CMAR, MLSPP, MED, MF, IDA	Strategy on redundancies prepared; implementation commenced;	400	59		459
▪ Improving management of the State Employment Service and capacity building for staff	Ongoing-2005+	MLSPP	Administrative structure and staff skills or State Employment Service improved;			800	800
▪ Establishing new Advisory Services and Labour Exchange Offices for the unemployed and other job seekers	Ongoing-2005+	MLSPP, SPF	Advisory Services and Labour Exchange Offices established in 5 regions;		106 (SPF)	152	258
▪ Improving the system of training and training services:	2003-2005						
▪ Development of a strategy		CMAR, MLSPP, ME, MED	Strategy published;			10	10
▪ Establishing regional centres		MLSPP, SPF	Regional centres established;		500 (SPF)	500	1,000
▪ Developing and implementing employment programmes	Ongoing-2005+	MLSPP, UNDP	Number of unemployed placed in jobs.	145	10,000	11,855	22,000
3 Regulation of Labour Relations							
▪ Preparing an action plan on the development of social dialogue between employers, employees and trade unions	2003	CMAR, MLSPP	Action Plan prepared.			10	10
2 Monitoring the labour market in order to make better-informed policy interventions							
▪ Establishing a national information system on the labour market and employment, as well as industrial safety norms and standards	Ongoing-2005	MLSPP, MH, SSC, SPF, PMU	Labour Force Survey introduced; Information system operated; New normative acts on safety adopted;		100 (SPF)	900	1,000

				Financing (US$ thousand)			
▪ Establishing efficient regulation of migration processes:							
▪ Developing a National programme	2003	CMAR, MLSPP, IOM	State Programme on Regulation of Migration adopted and information centre established.			50	50
▪ Establishing an information centre	2003 – 2004	MLSPP, IOM				300	300

SOCIAL POLICY AND HUMAN DEVELOPMENT

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Education policy							
1 Increasing equality of opportunity in basic education through provision of free text books to school children:							
▪ Providing free text-books to all public school students in grades 1-5 and to IDP and refugee students in grades 1-11;	2003	ME, MF	Provision of textbooks to students in relevant classes.		1,500		1,500
▪ Providing free text-books to all public students in grades 1-7, and IDP and refugee students in grades 1-11	2004	ME, MF			1,500		1,500
▪ Providing free text-books to all public school students in grades 1-11	2005	ME, MF			1,500		1,500
2 Improving the quality of teaching:							
▪ Improving school curriculum and developing standards in education;	Ongoing-2005+	ME, UNICEF	New curriculum introduced;		90	100	190
▪ Encouraging pro-active teaching methods in educational institutions;	Ongoing-2005+	ME, UNICEF	New teacher training programmes introduced;			200	200
▪ Improvement of in-service training for current teaching staff	Ongoing-2005+	ME	Number of teachers attending in-service training;			120	120
▪ Increasing teachers' salaries[5];	Ongoing-2005+	MF, ME	Salaries increased;				
▪ Improving performance-related award system	Ongoing-2005+	MF, ME	Performance-related award system introduced.				
1 Improving the material-technical base of education and ensuring equal access to secondary education:							
▪ Constructing 28 secondary schools with1296, 844, 694 and 422 and 300 classrooms (8 in Baku and 20 in other regions);	2003-2005+	ME, MED, MF, SF	Construction work completed;	11,500	13,020 (2, 511 from SOFAR[6])		24,520

[5] This is also indicated in the Social Protection Section

				Financing (US$ thousand)			
▪ Repairing 200 secondary schools (100 in Baku and 100 in other regions)	2003-2005+	ME, MED, MF	Repairing completed.		8,000		8,000
1 Improving equality of access to school education through assisting poor families with clothing for the children attending school: ▪ Establishing special Assistance Funds	2003-2005+	ME, MED, MF, LEB	Number of children from poor families provided with clothing and attending school.			19,200	19,200
3 Introducing new educational technologies: ▪ Creating Information Technology infrastructure in the basic school system	Ongoing-2005+	ME, MED, MF	Access of children from poor families to computers.		300	1,420	1,720
3 Improving life skills education of adolescents: ▪ Incorporating reproductive health, healthy lifestyle issues, and gender issues into school curriculum ▪ Supporting institutions dealing with extra-curricular activities and establishing resource centres for youth and adolescents.	2003-2004 2003-2005+	ME; UNFPA, UNICEF ME; MLSPP; UNICEF; SCRIDP	Relevant teaching materials developed and introduced; Number of young people attending extra-curricular activities and resource centres.			200 200	200 200
2 Promotion of Early Childhood Care and Development: ▪ Promotion of community pre-school facilities; ▪ Promotion of family-based pre-school facilities; ▪ Development of new teaching models for pre-school ▪ Training of pre-school staff in community and family-based facilities ▪ Information campaigns for parents on the importance of early child development	2003-2005+	ME; SCRIDP; UNICEF; ADB	Number of community based pre-school facilities; Number of family-based facilities; Number of children attending pre-school facilities; Number of pre-school workers trained; Information materials distributed to local communities.	250			250

[6] It is allocated for construction of 15 secondary schools for IDPs

				Financing (US$ thousand)			
3 Increasing equality of access to learning materials by improving the material and technical base of school libraries: ▪ Preparing new publications in Latin alphabet ▪ Introducing information technology	2003-2005	ME, MED, MF, UNICEF	New textbooks, books and scientific material in Latin alphabet published; School libraries provided with relevant children literature, classical and other publications; Specialised data base with access to internet created.			150	150
3 Introducing more flexible budget management systems for schools	2003-2005	MF, ME, IDA	Flexible budgeting system introduced.	250	37		287
2 Monitoring Quality and Access to Education: ▪ Development and implementation of system of student assessment ▪ Systematic collection and publication of school attendance rates, disaggregated by gender.	2003 – 2005+ 2003 – 2005+	ME ME; SSC; PMU	A new National system of student assessment for classes 1-11 introduced; Attendance rates, disaggregated by gender; Publication of the attendance rates.				

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Culture							
2 Improving equity of access to cultural and art centres							
▪ Modernising National Libraries, the Library for the Blind and the State Art Museum	Ongoing-2005+	MC; MF; ARRA; EU	Digital catalogue, search and conservation systems and computer network established in the libraries and museum; Trained staff for the use of new system;	634.6[7] (650 Euro)	500	2,150	3,284.6
▪ Modernising regional theatres (Ganja, Sheki, Mingachevir, Lankaran, Salyan and Nakhchevan)	2003-2005+	MC; MF; LEB	Modern technologies (voice, lighting etc.) introduced; Audience number improved in regional theatres;			3,000	3,000
▪ Creating folk art schools and workshops in the capital city and other regions (Ganja, Nakhchivan, Lankaran, Guba, Ismailly, Shamakhi and Gobustan)	2003-2005	MC; MF; LEB	Appropriate houses of culture supplied with necessary equipment, folk art schools and workshops established; Number of students and teachers increased;			950	950
▪ Modernising "Azerneshr" state publishing house and publication of series of World Classics, schoolchildren's and Children's literature in Latin script	2003-2005+	MC; MF; MJ	Publishing house provided with flexible polygraphic basis, 5 thousand series of editions with total 175 volumes published;		300	2,050	2,350
▪ Development of dubbing through state orders	2003-2005	MC; MF	Mobile cinema-laboratory purchased; 20-30 feature films dubbed each year;		700	550	1,250

[7] Exchange rate used for October 25, 2002 (0.9763 USD per Euro)

				Financing (US$ thousand)			
			films dubbed each year;				
▪ Enhancing material and technical basis of choreographic as well as musical, art and painting schools for children	2003-2005	MC; MF	Relevant establishments provided with necessary modern equipment.		100	900	1,000
▪ Rehabilitating State Philharmony named after M. Magomayev	ongoing-2003	MC, MF	Completion of restoration.		11,900		11,900
1 Stimulating art workers and improving their skills							
▪ Increasing efficiency of the pay structure	2003-2005	MC, MF; MLSPP	Decompression of wages and performance-related pay structure introduced;				
▪ Improving personnel and information supply	2003-2005	MC; MF; MJ	Information-Resource Centre established.		100		100
3 Protection of cultural heritage							
▪ Reconstructing the second storey of Shirvanshahlar Palace and conservation of Divankhana (court house), rehabilitating Sheki Khan Palace, Momuna Khatun tomb and the tomb situated in Garabaghlar village.	Ongoing-2005	MC, IDA	Rehabilitation completed and number of visitors increased;	3,718	832		4,550
▪ Developing and Implementing of the general plan for the reconstruction of Icheri Shahar.	2003-2005+	MC; MF	Archaeological digging carried out in Ichari Shahar, rehabilitation and reconstruction of religious and civil buildings.			2,500	2,500

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Health							
1 Guaranteeing access to basic health services through strengthening of the Primary Health Care System (beginning in 10 regions): ▪ Rationalising health services through reduction of excessive number of beds; staff to be reallocated to outpatient services; ▪ Providing essential drugs and rational drug use through establishment of community revolving drug funds; ▪ Promoting community participation through establishment of community health councils.	Ongoing-2005+	MH, WHO, IDA, UNICEF, USAID	Reduction of hospital beds, and increase in outpatient services; Number of community revolving drug funds established and operating; Community health councils established.	5,000	290	5,000	10,290
1 Strengthening the material-technical base of health sector and expanding access to health services	2003-2005+	MH, MF, MED, ARRA, EU	Number of hospitals rehabilitated and new health facilities constructed.	4,051.6 (4,150 Euro)	4,468		8,519.6
1 Reducing infant and under 5 years mortality rates, as well as incidence of child disease, through expanding programme on immunisation and gradual increasing of state financing for its implementation: ▪ Purchasing vaccines and syringes; ▪ Strengthening and maintenance of cold chains system ▪ Putting in place safe immunisation practice (containers, burning ovens) ▪ Arranging training courses ▪ Promoting public awareness	Ongoing-2005+	MH, GAVI, UNICEF, ADB	Coverage of appropriate age groups with vaccinations; 100% state financing of vaccination programme (excluding hepatitis) starting in 2003; Number of health workers trained in immunisation procedures; Relevant literature and public training	248.6	1,217	473	1,938.6

				Financing (US$ thousand)			
			public training programmes.				
1 Promoting Safe Motherhood and Essential Care for the Newborn: ▪ Preparing the necessary legal and normative basis to promote breastfeeding ▪ Encouraging breastfeeding; ▪ Capacity building of health staff; ▪ Raising awareness of pregnant women; ▪ Raising awareness of adolescent girls on health risks of teenage births; ▪ Improving access to essential maternal health services; ▪ Promoting mother & baby-friendly environment at maternity units; ▪ Ensuring access to maternal services, especially for IDPs and the poor	Ongoing-2005	MH, UNICEF	Lower maternal, infant, under 5 mortality rates; A law promoting breastfeeding adopted and enforced; Increase in number of maternal units and outpatient clinics with exclusive breastfeeding; Reduction in teenage births; Increase in number of mothers using maternal and post natal services; Number of IDPs visiting, and quality of services.	500	500	1,500	2,500
2 Improving management of childhood illnesses: ▪ Providing essential drugs; ▪ Preparing health education material; ▪ Training of health personnel on case management;	Ongoing-2005	MH, UNICEF, WHO	Reduction in incidence of childhood illnesses; Education materials produced, distributed and displayed in health centers; Number of health workers trained in prevention and control of childhood illnesses; Number of trained personnel on case management.	300	200	700	1,200

				Financing (US$ thousand)			
▪ Providing training equipment; ▪ Raising public awareness.			Training equipment distributed; Relevant literature and public education made available.				
2 Preventing malaria and reducing malaria incidence: ▪ Training health and technical staff on malaria diagnosis; ▪ Strengthening health care services regarding malaria ▪ Providing disinfection facilities ▪ Providing laboratory equipment and reagents ▪ Carrying out information campaign to increase public awareness on malaria prevention and encourage community participation	Ongoing-2005+	MH, WHO, UNICEF	Training courses held; Reduction in cases of malaria; Number of health workers trained in malaria control; Number of disinfection facilities increased; Relevant materials prepared, published and distributed.	57.2	416.5	83.5	557.2
2 Reducing incidence of TB: ▪ Increasing provision of drugs; ▪ Training on TB management for health staff; ▪ Raising public awareness on TB. ▪ Reconstructing Bina Prison TBC Unit	Ongoing-2005+	MH, ARRA, WHO, GTZ, UNICEF, EU	Reduction in TB incidence; Number of health workers trained in TB control; Relevant materials prepared, published and distributed.	3,319.5 (3,400 Euro)	2,636	1,386	7,341.5
3 Providing access to contraceptives from reliable supply systems: ▪ Improving the system of delivering high quality contraceptives and medicines ▪ Facilitating the provision of relevant services to the public	Ongoing-2004	MH, UNFPA, UNICEF	New Centres for Family Planning established; Training on Family planning held within	550	50		600

				Financing (US$ thousand)			
to the public			planning held within primary health care system;				
2 Reducing Iodine Deficiency Disorders: ▪ Raising public awareness on the importance of consumption of iodised salt; ▪ Capacity building of health and education staff; ▪ Providing equipment for salt iodisation to factories. ▪ Strengthening laboratory services for monitoring and control; ▪ Preparing national standards and norms for monitoring the content and the process of iodisation.	Ongoing-2005	MH, UNICEF, ADB	Reduction in IDD; Universal iodisation and provision of access. Adopted law enacted; Number of trained staff; Equipment supplied and installed; Relevant standards and norms introduced.	950	29	285	1,264
2 Reducing health risks through promoting healthy lifestyle and health education to prevent substance abuse (tobacco, alcohol, drugs) and to reduce sexually transmitted infections and HIV/AIDS: ▪ Capacity building of health staff; ▪ Establishing a National Committee on prevention of substance abuse and reduction of STIs and HIV/AIDS; ▪ Establishing youth-friendly resource centres in the framework of existing Primary Health Care services ▪ Providing equipment and establishing medical genetic cabinets ▪ Raising public awareness ▪ Integrating The Prevention of Mother to Child Transmission of diseases into Mother and Child Health services	Ongoing-2005	MH, ARRA, UNDP, EU, Soros Foundaton, UNICEF, Global Fund, UNAIDS, WHO, UNFPA	Reduction inincidence of substance abuse, and of STIs, HIV/ AIDS; Number of youth resource centres established; Relevant literature and public education made available; Decline in the incidence of PMTCT.	2,017	250	2,030	4,297

				Financing (US$ thousand)			
2 Improving health information system: ▪ Shifting to internationally accepted health indicators and improving quality of health data collection	Ongoing-2005	MH, WHO, UNICEF, UNFPA, IDA, USAID, CIDA	New health indicators introduced.	150	180	1,050	1,380
2 Designing and introducing a system for monitoring access to safe drinking water: ▪ Assessing the access of population to safe drinking water	2003-2005	MH, UNICEF	Monitoring system introduced.			225	225
3 Improving budget efficiency and financial management in health sector: ▪ Establishing per capita cost of a basic package of primary health care, and using this as a basis for calculating budgets at national and regional levels; ▪ Increasing salaries of health sector employees[8]; ▪ Improving financial management in the health sector.	Ongoing-2005	MH, WHO, IDA, UNICEF	Cost of basic per capita package calculated; Increase in real wages; Legislation on flexible budgeting norms.	250	37	400	687

[8] This is also indicated in the Social Protection Section.

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Sport							
1 Improving children's health status through developing sport and improving the access of children from underprivileged families to sport centres:							
▪ Enhancing material and technical basis of Youth Sport Schools in regions	2003-2005+	MYST, MED, MF	Quality and availability of sports facilities;			3,610	3,610
▪ Rehabilitating Republican Lyceum of Olympia and Sport	2003-2004	MYST, MED, MF	Relevant sports centres rehabilitated.			2,200	2,200
▪ Rehabilitating Republican Lyceum of Olympia	2003-2004	MYST, MED, MF				210	210
2 Ensuring access of children from underprivileged families to health centres:							
▪ Repairing the National Child Recreation and Health Centre located in Shuvalan settlement	2003-2004	MYST, MF, MED	Health centres repaired.			60	60
▪ Repairing sport and health centre within Olympia and Sport Lyceum located in Nabran settlement	2003-2004	MYST, MF, MED				350	350
2 Reconstructing sport centres by re-accommodating refugee and IDP families temporarily settled in those buildings in new settlements:							
▪ Rehabilitating Mingachevir Rowing Sport Centre[9]	2003	SCRIDP, MED, MF, SOFAR	The relevant sports Centre rehabilitated.				

[9] This is mentioned also in the IDP Section

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Social Protection System and Pension Reforms							
1 Creating a system of targeted social assistance:							
▪ Developing a Social Assistance Strategy Paper based on models forecasting the social budget and a streamlined menu of social assistance benefits	2003	CMAR, MLSPP, MF, MED, SPF, IDA	Policy document on improvement of administrative structure and new structure established;	700	109		809
▪ Improving the administrative structure for an efficient management and delivery of social assistance policies beginning with targeted child benefits	2003-2005	CMAR, MLSPP, MED, MF, EU	New targeting mechanism for social assistance established;		120	1,080	1,200
▪ Developing a targeting mechanism for social assistance to identify the poor strata of the population	2003-2005	CMAR, PMU, MLSPP, MF, MED, SPF, EU				100	100
▪ Creating a system of adequate compensation from the state budget for the poorest section of the population for removal of utility subsidies[10]	2003-2004	CMAR, MLSPP, MF, MED, MFE, PMU, SPF	Targeted Compensation Payment System introduced;				
▪ Creating a monitoring and evaluation system for the development and implementation of targeted social assistance policies.	2003-2005	MLSPP, MF, MED, PMU	A system for monitoring and evaluation of social assistance policies introduced;		50	450	500
▪ Creating a mechanism for providing reimbursement for the expenditure on children's food for low-income families.	2003-2004	MLSPP, MF, SPF	Number of low-income families reimbursed.				
1 Reforming the pension and social insurance system:							
▪ Designing a new social insurance policy framework through use of forecasting models, improving the existing legislation and creating a monitoring and evaluation system	Ongoing-2004	MLSPP, MF, MJ, MED, SPF	Legislation improved; Forecasting results available; Monitoring plans ready;		50 (SPF)	450	500

[10] This is mentioned also in the Energy Section.

				Financing (US$ thousand)			
▪ Improving the administrative structure for efficient management of the pension system	2003-2005	CMAR, MLSPP, SPF	New administrative structure and training of staff completed;		100 (SPF)	900	1,000
▪ Developing and implementing an automated system for the management of pensions based on individual accounts.	2003-2005	SPF	Automated system and individual accounts introduced.		1,400 (SPF)	12,600	14,000
2 Improving the legislative framework:							
▪ Monitoring and improving the legislation on labour and social issues including remuneration of labour, labour relations, employment, migration, social security and social assistance	Ongoing-2005+	CMAR, MLSPP, MJ, IOM	Improved monitoring and legislation;			100	100
▪ Improving the necessary legislative framework relating to the introduction of targeted social assistance	2003-2005+	CMAR, MLSPP, MJ, MED, MF	Monitoring of national legislation carried out and normative acts prepared;				
▪ Preparing for membership of the European Social Charter	Ongoing-2004	CMAR, MLSPP, MJ, MF, MED, MYST, MH, MFA, ME, SPF	State programme on introduction of the norms envisaged in the European Social Charter prepared;				
			Ratification of European Social Charter.				
3 Population Development:					75		75
▪ Developing and implementing a State Programme on demographic and population development	2003-2005+	CMAR, MLSPP	State programme prepared and implemented;				
▪ Establishing a State Council for Coordination of the issues on population development	2003	CMAR, MLSPP, MH	State Council established;				
▪ Establishing a Population Development Research Centre	2003-2004	MLSPP, UNFPA	National Population Development Research Centre established;				
			A comprehensive data base on country's population development established.				
1 Social Integration of the most vulnerable groups of the population:							
▪ Developing a national strategy directed at the protection of children, women, the disabled and the elderly rights and improving	2003-2005+	CMAR, MLSPP, ME, MH, MJ, MYST	Increased social protection of children, women, the disabled,			50	50

				Financing (US$ thousand)			
the regulatory framework governing the protection of child rights		UNDP, UNICEF	elderly, and people living alone; Relevant policy document adopted;				
▪ Establishing a systematic database for monitoring and evaluating existing child and woman policies	2003-2004	MLSPP, MYST, SCRIDP, MH, ME, MIA, SSC, UNDP	Monitoring of child rights carried out;			150	150
▪ Developing an action plan to improve social re-integration of children that need special care, including the disabled and street children	2003	CMAR, MYST, MLSPP, MH, ME, MIA	Action plan developed;				
▪ Undertaking relevant measures to re-integrate children in institutions to their biological or fostering families;	2003-2005+	CMAR, MYST, MLSPP, SCWA, MH, ME, MIA, UNICEF, EU	Reduction of numbers of children in institutional care;				
▪ Creating alternative child care centres and organising family support services to poor families.	2003-2005+	CMAR, MLSPP, ME, MH, MYST	Number of children returned to their families.or to foster families;				
▪ Developing a social care system for families with children that need special care.	2003-2005	CMAR, MLSPP, ME, MH, MYST, UNICEF, EU	Social workers trained; Number of poor families receiving child care support;				
▪ Establishing a State Coordination Council on Child Problems	2003	CMAR	Number of child problem cases referred to the Council;				
▪ Improving education and training system for social workers, including the employees working in child care institutions.	2003-2005+	MLSPP, MH, ME					
▪ Rehabilitating Disabled Children Centres and orphanages	Ongoing-2004	ME, MLSPP, ARRA, EU	Number of centres and orphanages rehabilitated	1,708.5 (1,750 Euro)	701		2,409.5
▪ Developing methodical and organisational base for medical-social rehabilitation within individual rehabilitation programmes for the disabled	2003-2004	MLSPP, MH, ME, MF, MED, UNDP	New rehabilitation programmes available;		10	20	30
▪ Establishing a common information system on the disabled	2003-2004	MLSPP, UNDP	Information system established;		10 (SPF)	120	130
▪ Constructing houses for the disabled	Ongoing-2005+	MLSPP, MF, MED, SPF, LEB	Facilities/ equipment for the disabled installed in public places and houses		500 (SPF)		500 (SPF)

				Financing (US$ thousand)			
▪ Installing necessary facilities for disabled people in transport and public places	2003-2005+	CMAR, MLSPP	public places and houses constructed;				
▪ Creating Para Olympic health-sport centres for the disabled	2003-2005	PC, MLSPP	Number of disabled children attending mainstream schools and sport facilities increased; Sport-health centre established;			3,000	3,000
▪ Strengthening targeted social protection of the disabled who need care and assistance, including disabled women, disabled people living alone, and for families with two or more disabled members	2003-2005+	MLSPP, SPF, SCWA, MF	Package of measures developed and implemented				
▪ Creating guidance centres to provide medical, pedagogical and psychological assistance to the parents of mentally retarded children	2003-2005	ME, MH	Guidance Centres established; Number of referrals;			50	50
▪ Creating regional rehabilitation centres for the disabled	Ongoing-2005+	MLSPP, MF, SPF	Regional rehabilitation centres created;		3,000	8,000	11,000
▪ Establishing a psychological rehabilitation centre	2003-2005	MLSPP, ME, MH, MF, UNDP	Psychological rehabilitation centre created;			1,000	1,000
▪ Improving social services for the elderly and people living alone	2003-2005+	MLSPP MF, SPF	Special programmes to improve social services for the elderly and people living alone introduced;			50	50
▪ Solving the problems of illegal migrants and preventing human trafficking and human trade	2003-2005+	CMAR, MLSPP, MFA, MF, MED, MIA, MJ, IOM	Action plan developed and implemented; Repatriation programme introduced.				

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Refugees and IDPs							
1 Returning the IDPs to their permanent place of residence:							
▪ Developing new Repatriation Programme ("Great Return")	2003	SCRIDP, IOM					
▪ Rehabilitating the liberated areas	Ongoing-2005	SCRIDP, MF, ARRA, IDA, ADB		11,300	895		12,195
1 Improving the social living conditions of refugees with no permanent place of residence and the IDPs in the worst living conditions:							
▪ Housing for refugee families with no permanent place of residence as a result of the Armenian conflict :	2003	SCRIDP, MF, SOFAR, ARRA	New settlements completed;		4,120 (SOFAR)		4,120
▪ Constructing 98 houses in Nakhchivan Autonomous Republic, 126 in Shamkir region, 160 in Sabunchu district of Baku, 58 in Absheron region, 17 in Agkhstafa region, 65 in Yevlakh region and 51 in Ismailly region			Number of households in those categories resettled in the new settlements;				
▪ Completing the construction of 322 houses unfinished since 1995							
▪ Constructing new settlements (excluding schools, nurseries and health facilities) aimed at resettlement of 5,019 IDP families (22,841 individuals) currently housed in tent camps and railway cars:	2003	SCRIDP, MF, SOFAR, ARRA, SDFIDP	New settlements completed;		25,000 (SOFAR)		25,000
▪ Constructing 10 settlements in Fizuli region, 4 settlements in Aghdam region and 13 settlement in Bilasuvar			Number of households in those categories resettled in the new settlements;				
▪ Reconstructing 1000 houses damaged during the war	2003-2004	SCRIDP, ARRA	Number of houses reconstructed;			5,800	5,800

				Financing (US$ thousand)			
during the war			reconstructed; Number of settled households;				
▪ Providing land plots and financial grant assistance to 6,741 refugee and IDP families to be settled used for agricultural production	2003	SCRIDP, MF, MED, MA, SCSM, LEB	Households provided with land plots and financial grant assistance.		1,300 (SOFAR)		1,300 (SOFAR)
▪ Repairing 37 buildings in densely inhabited IDP settlements in Baku, Sumgait and Ganja with 2,960 households	2003	SCRIDP, MF, LEB				2,000	2,000
▪ Re-settling of 412 IDP households which have been living in rowing / sports centres and schools in Mingachevir in new settlements	2003	SCRIDP, MED, MF, LEB, ADB		2,500	96		2,596
▪ Replacing the exemption from utility payments with direct compensation for non-settled refugees and IDPs	2003-2005	SCRIDP, MF			60,000		60,000
1 Upgrading the infrastructure in IDP camps consisting of prefab houses:	2003-2004	SCRIDP, MF, ARRA, SDFIDP, LEB, EU, IDA, IDB		5,638		10,340	15,978
▪ Replacing the old electricity distribution lines and 70 transformers			Improved distribution lines and transformers in place;				
▪ Installing 57 water pumps;			Water pumps installed;				
▪ Repairing 54 km. roads in settlement areas;							
▪ Purchasing 32,000 kerosene/ gas stoves for heating during winter			Roads repaired and gas stoves purchased;				
▪ Purchasing kerosene fuel for 92,000 İDP families for autumn/winter seasons			Fuel provision of IDP families improved;				
▪ Constructing irrigation complex in Fizuli and Aghdam			Industrial and drinking water supply improved;				
▪ Rehabilitating 205 artesian wells in Aghdam, Tartar, Goranboy and Agjabadi							
▪ Rehabilitating enerji supply system of Tartar, Goranboy, Agjabedi, Gazakh and Gadabay			Electricity provision improved.				
1 Addressing the employment problems of IDPs:							
▪ Promoting micro-credits provision for SME development	2003-2005	SCRIDP, SDFIDP, IDA	Number of credits issued to IDP households;	2,100			2,100

				Financing (US$ thousand)			
development		SDFIDP, IDA	to IDP households;				
▪ Extending soft credits to 20,000 IDPs who have temporarily rented land plots	2003-2005	SCRIDP, MF, MA, SCSM	Number of employed IDPs;			8,000	8,000
▪ Providing technical and financial assistance to 29 agro-businesses and farms owned by the State Committee for Refugees and IDPs	2003-2005	SCRIDP, MF, MA	Technical & financial assistance provided;			120	120
▪ Providing soft credits and fuel supply to 611 farms set up by IDPs	2003-2005	SCRIDP, MF, MFE	Fuel supply improved;			1,260	1,260
▪ Establishment of small production facilities (carpet weaving, textile weaving, knitting) in densely inhabited residencies of IDPs	2003-2005	SCRIDP, MED, MLSPP, MF	Production facilities established.			2,000	2,000
1 Providing education to IDPs' children:							
▪ Constructing 15 schools in new settlements[11]	2003	SCRIDP, ME, MF, SOFAR, SDFIDP, ARRA, EU	Number of schools constructed;				
▪ Constructing 14 pre-school facilities (1,240 places) in new settlements	2003	SCRIDP, ME, MF, SDFIDP	Number of pre-schools facilities constructed;		1,856 (SOFAR)		1,856
▪ Enhancing the material and technical base of existing schools	2003-2005	SCRIDP, ME, MF, LEB	Number of students attending schools.			3,300	3,300
1 Improving health care services to refugees and IDPs:							
▪ Constructing 15 health care facilities in new settlements	2003	SCRIDP, MF, SOFAR, MH, ARRA, SDFIDP	Number of new medical facilities;		614 (SOFAR)		614
▪ Improving the existing health care services and facilities in IDP settlements	2003-2005	SCRIDP, MF, MH, SDFIDP, LEB	Reduction in incidence of decease amongst refugees and IDPs; Infant and maternal mortality rate amongst refugees and IDPs.			4,124	4,124
1 Improving food provision to IDPs:							
▪ Providing the monthly compensation to 519,000 IDPs for food (bread) expenditure	2003-2005	SCRIDP, MF, LEB	Number of IDP households receiving food aid;		91,790	2,510	94,300
▪ Providing monthly supply of food to 214,258 IDPs previously having access to food	2003-2005	SCRIDP, MF, SOCAR, LEB	Malnutrition incidence amongst children, elderly		18,116 (SOCAR)	6,532	24,648

[11] This is mentioned also in the education section.

				Financing (US$ thousand)			
IDPs previously having access to food assistance provided by International humanitarian organisations and lately deprived from the support due to the termination of their activity		SOCAR, LEB	amongst children, elderly people reduced.		(SOCAR)		
▪ Providing monthly food supply to 143,000 IDPs	2003-2005	SCRIDP, UN WFP		20,000			20,000
▪ Providing one meal-a- day to 1,500-2,500 IDPs' school children	2003-2005	SCRIDP, UN WFP		500			500
▪ Providing food aid to 300,000 IDPs having no food provision from International humanitarian organisations since 1993	2003-2005	SCRIDP, MF, LEB				35,600	35,600
3 Ensuring financial transparency through explicit budget allocations	2003-2005	MF, SCRIDP	All transfers/ aids to IDPs specified in budget documents, including transfers made through SOCAR and relevant ministries.				

REGIONAL POLICY AND INFRASTRUCTURE DEVELOPMENT

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Public Investment in Utilities and Infrastructure							
2 Transport:							
▪ Rehabilitating transport infrastructure:			Regional transport system improved.				
▪ Reconstructing motor-roads	Ongoing-2005+	MED, MTr, IDA, EU, EBRD, KF, ADB, ADF, SF, IDB		90,200	32,471	156,600	279,271
▪ Reconstructing Trans-Caucasus railway	Ongoing-2003	MED, MTr, EU, EBRD		5,700			5,700
▪ Construction of new railway road Astara (Iran) – Astara (Azerbaijan)	2003-2005+	MED, MTr				40,000	40,000
▪ Reconstructing Baku Sea Port	2003-2005	MED, MTr, EBRD		16,000			16,000
▪ Reconstructing Nakhchevan airport	Ongoing-2003	MTr, MED, MF			22,500		22,500
▪ Completing Hazi Aslanov Metro Station	Ongoing-2003	MED, MF, ARRA, EU		3,954 (4,050 Euro)	1,278.3		5,232.3
▪ Rehabilitating car fleet of Metro	2003-2005+	MED, MF			31,665		31,665
1 Water and sewerage:							
▪ Reconstructing Great Baku water supply system	Ongoing-2005+	MED, ARWC, IDA	Drinking water supply improved;		1,290	13,000	14,290
▪ Reconstructing sewerage system in Baku city	2003-2005+	MED, BEP, BSSD	Sewerage systems reconstructed.		1,358		1,358
▪ Rehabilitation of purification facilities in Baku city	2003-2005+	MED, BEP				55,161	55,161
▪ Reconstructing and completing of sewage system in Nakhchevan city (Nakhchevan AR)	2003-2005+	MED, CMNAR			700	3,445	4,145
▪ Completing sewerage purification system in Ganja city	2003-2005+	MED, SCCA, MENR, LEB			804		804
▪ Reconstructing and completing of sewage system in Shahbuz district (Nakhchevan AR)	2003-2005	MED, CMNAR			140		140

				Financing (US$ thousand)			
system in Shahbuz district (Nakhchevan AR)							
▪ Rehabilitating water supply systems in urban and rural settlements	2003-2005+	MED, SCAC, ADB, KfW		22,000	6,700	46,000	74,700
▪ Urgent assistance to utility infrastructure	2003-2005	MED, MF, SCCA, KfW		12,800			12,800
1 Melioration and Irrigation:							
▪ Ensuring soil protection from wind and water erosion (823, 000 ha)	2003-2005+	SCSM, MA	Increase in arable land;			3,960	3,960
▪ Treating the soil salinity (1,700,000ha)	2003-2005+	SCSM, MA	Number of ha of land treated for salinity; Improvement in soil quality and use of soil;			30,000	30,000
▪ Reconstructing and rehabilitating of irrigation and drainage infrastructure	Ongoing-2005+	SCAI, IDA	Irrigation of land.	31,751	3,086		34,837
▪ Constructing Khanark canal (I phase)	Ongoing-2003	SCAI, IDB		1,633	451		2,084
▪ Constructing Khanark canal (II phase)	Ongoing -2004	SCAI, IDB		8,432	2,497		10,929
▪ Constructing Shamkir-Mashin canal	2003-2005+	SCAI, ARRA, EU		2,255.3 (2,310 Euro)	1,336	7,458	11,049.3
▪ Reconstructing and development of water reservoirs							
▪ Constructing Vayxir reservoir and irrigation of land	2003-2005+	SCAI, MED, ARRA, EU		1,415.6 (1,450 Euro)	26,700		28,115.6
3 Energy:							
▪ Constructing of gas pipeline from Garadakh to Severnaya Power Station and gas compressor unit in Garadakh	Ongoing-2004	MFE, JBIC		45,032			45,032
▪ Reconstructing underground gas storages and increasing gas capacity	Ongoing-2005	MFE	Gas storage capacity brought up to 3.5 billion m^3 ;			160,000	160,000
▪ Rehabilitation of system of gas provision in Nakhchevan AR	2003-2005+	MFE			24,256		24,256
▪ Increasing export potential of oil and gas	Ongoing-2005+	MFE					
▪ BTC main export oil pipeline			Oil export capacity increased up to 50 billion ton;				

				Financing (US$ thousand)			
▪ BTA gas export pipeline			Gas export capacity increased up to 7 billion m^3 per annum;				
▪ Northern and Southern export pipelines							
▪ Increasing the existing power capacity and constructing new energy blocks			Additional 2,600 MWt power capacity ensured by 2005 to existing 5,000 MWt.				
▪ Constructing the 9th block of AzDRES; capital repair of the 1st and 8th blocks	2003-2005+	MFE, MED, MF, EBRD, IDB, KF, SF, ADF		100,000	10,000		110,000
▪ Constructing power unit at Sumgait Heat-Power Centre	2004-2005+	MFE, MED, MF				180,000	180,000
▪ Constructing II 400MWt Unit in Severnaya Power Plant	Ongoing-2005+	MFE, JBIC		40,000			40,000
▪ Reconstructing Power Station in Nakhchevan	2004-2005+	MFE, MED, MF, SF, ADF		24,000			24,000
▪ Constructing 100MWt power stations in each of 3 most needy regions of the country	2003-2005+	MFE, MED, MF				130,000	130,000
▪ Rehabilitating the power transmission lines	2003-2005+	MFE, MED, MF, KfW		17,338	1,830		19,168

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Rural Development: Agriculture, irrigation, land protection and water resources[12]							
1 Development of a Rural Development Strategy	2003-2004	CMAR, MED,MA, SCAI, SCSM, MENR, EU, IDA, UNDP, USAID, MASHAV	Strategy is developed and discussed; Capacity of Government to formulate strategies for agricultural sector increased.				
3 **Institutional reform of agrarian institutions** ▪ Creation of an Inter-Ministerial commission to prepare comprehensive proposal for institutional reform	2003-2004	CMAR, MA, SCAI, SCSM, MENR, MED	Inter-Ministerial commission created.				
1 Agricultural development and access to credit facilities: ▪ Developing the land market ▪ Strengthening the Land Committee Regional Cadastre Centres ▪ Putting in place a self-sustainable rural financial system	Ongoing-2005+	MA, IDA	Unification of registration system for all land and real estate categories implemented in Nakhchivan; System in place to register agricultural land titles and land transactions in regional centres; Number of credit cooperatives established; Number of smallholders receiving credit; Level of credit repayment	32,300	1,400		33,700

[12] Other aspects of rural development are covered in the investment policy and public investment sections

				Financing (US$ thousand)			
▪ Developing extension services			improved; Number of trained farmers.				
1 Regulating credit provision, insurance policy and customs duties for rural areas	Ongoing-2004	MA, IDA, EU	Number of farmers and entrepreneurs in the regions received credits; Rural Investment Foundation further developed.	21,176	800		21,976
2 Development of mountain areas: ▪ Improving marketing channels ▪ Improving access of small farmers to pasture land ▪ Improving animal husbandry services ▪ Providing and improving essential public services	Ongoing-2005+	MA, IFAD	Development of agriculture in mountain areas while protecting ecological balance.	8,090	305		8,395
1 Land protection and soil quality:							
▪ Defining a comprehensive and unified National Programme for Soil Conservation including specific measures for soil protection from wind and water erosion	2003-2004	SCSM, MA	Policy document prepared;			9	9
▪ Preparing projects on re-cultivation of land	2003-2004	SCSM, MA	Number of ha of re-cultivated land.			400	400
1 Regulation of pasture shares ▪ Updating the review of actual conditions of pastures. Rehabilitating summer and winter arability of pasture lands and protecting them from erosion	2003-2005+	MA, SCAI, SCSM	Improved management of pasture shares; Improved access to common pasture land.			29,400	29,400
2 Strengthening national veterinary and plant control services: ▪ Improving the supply of veterinary products	2003-2004	MA, MED	Reconstructing the biological complex in Khanlar; Improved provision with vaccines; Share of livestock			415	415

				Financing (US$ thousand)			
			covered by vaccination increased;				
▪ Improving measures for epizootic and phytosanitary control on main public health and production threatening	2003-2004	MA	Modernising the equipment of the national diagnosis laboratory; Establishment of 3 regional veterinary and plant quarantine laboratories; Number of cases of human brucellosis reduced;			2,000	2,000
▪ Introducing private firms into veterinary services	2003-2005+	MA	Number of private veterinaries and private pharmacies.				
2 Increasing farmers' managerial and technical skills: ▪ Further extension of information advisory services ▪ Modernisation of farmer-oriented agricultural knowledge system	2003-2005	MA	Training courses held; Number of farmers receiving training; Publication of brochures increased.			1,346	1,346
2 Capacity development in applied agrarian science: ▪ Modernising the Agrarian Academy ▪ providing scholarships for higher education studies abroad	2003-2005	ME, MA, AA				3,000	3,000
1 Improving Irrigation:							
▪ Further developing Water Users Associations	Ongoing-2005+	SCAI	Improved supply of water and irrigation to rural areas;				
▪ Repairing and constructing irrigation objects within farms through government subsidies	Ongoing-2005+	SCAI, MED	Regular water supply to agricultural land; Improved amelioration of land.			31,900	31,900
2 Flood protection:							

				Financing (US$ thousand)			
▪ Constructing protective dams for flood protection	Ongoing-2005+	MED, SCAI, ARRA, ADB, EU	Decrease in flooding incidence.	12,218.7	3,543		15,761.7
3 Improving the provision of nitric and phosphoric fertilizers:							
▪ Reconstructing Sumgait superphosphate plant through privatisation	2003-2004	MA, MED	Increase in supply of mineral fertilizers.				
2 Development of whole sale, agro-business and market access systems:							
▪ Encouraging the private sector involvement in whole-sale, agro-processing and other relevant activities	2003-2005	MA, MED	Share of non-agricultural employment in rural areas; Increase in sales; Increase in exports.			2,469	2,469
▪ Encouraging private sector involvement in supply of technical equipment and chemical services to farmers	2003-2005	MA, MED				958	958

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Environmental Safety							
2 Air:							
▪ Development of monitoring system for emissions from transport and other sources	2003-2005	MENR, MIA	Air pollution level defined.		50	450	500
1 Water and sewerage:							
▪ Preparing project documents on expansion of purification units in Baku	2003-2004	MED, SCCA, MENR, BEP	Documents prepared.				
▪ Preparing project documents on reconstruction of purification units and sewerage system in Sumgait	2003-2004	MED, SCCA, MENR, LEB					
▪ Environmental protecting Jeyranbatan Dam	2003	MENR, ARRA, EU		1,449.8 (1,485 Euro)			1,449.8
2 The Caspian Sea:							
▪ Preparing the national action plan	2003	MENR, GEF, UNDP, IDA, UNEP, EU	Sources polluting the Caspian Sea treated; Biological resources of Caspian sea preserved.				
2 Soil:							
▪ Re-cultivating oil polluted soil in the territory of Absheron region (UEIP)	2003-2005+	MENR, MFE, LEB, IDA	Reduction of oil contamination;		300	2,700	3,000
▪ Treating Mercury waste (UEIP)	2003-2004	MENR, IDA	Reduction in mercury contamination of land;	8,000	65		8,065
▪ Introducing Waste Management (UEIP)	2003	MENR, IDA	Efficient waste management.	800			800
3 Fauna and Flora (Biodiversity)							
▪ Giving traditional sturgeon hatchery areas in Kur and Araz rivers the status of officially protected areas	2003-2004	CMAR, MENRP	New protected areas established;				
▪ Constructing sturgeon hatchery plant (UEIP)	2003	MENR, MF, IDA	Increase in number of sturgeons;	6,100	2,500		8,600
▪ Creating biological stations and nurseries for rare and endangered species of animals	2003-2005	MENR, MA, LEB	4 nurseries and 5 biological stations created;			2,000	2,000

				Financing (US$ thousand)			
			created;				
▪ Planting long-life endogenous plants	2003-2005+	MENR, LEB	Planting in 4500 ha area;		600	5,400	6,000
▪ Planting forests along the Kura and Araz river coasts	2003-2005+	MENR, LEB	Forest planted in 5000 ha area;		600	5,400	6,000
▪ Concentrated planting of the forest	2003-2005+	MENR, LEB	Planting in 6,000 ha area.		300	2,700	3,000
▪ Restoring Shahdag National Park	2003-2005+	MENR, LEB, IDA		6,200	830		7,030
▪ Establishing new protected areas (Ordubad, Shahbuz, Talysh and others)	2003-2005	CMAR, MENR					
3 Studying the opportunities for expanding the introduction of alternative energy sources[13]	2003-2005	MENR, MFE	Gradual increase in the energy from inexhaustible energy sources.				
2 Radioactive pollution:							
▪ Treating radioactive coal storages at Ramany, New- Surakhany and Neftchala iodine-processing plants	2004-2005	MENR	Radioactive pollution sources discovered and liquidated.			4,000	4,000
▪ Refurbishing and expanding İSOTOP Centre for storage and treatment of radioactive sources	2003-2005	MENR, ARRA, EU		3,905.2 (4,000 Euro)			3,905.2
3 Institutional development:							
▪ Providing necessary equipment to regional laboratories;	2003-2005	MENR	Environmental management improved;		30	270	300
▪ Improving Geographic Information System	2003-2005+	MENR			30	70	100
▪ Preparing educational programmes and public awareness campaigns	2003-2005+	ME, MENR	Environmental issues incorporated into the curriculum of secondary schools.		30	70	100
▪ Involving the public in assessment of environmental impact	2003-2005+	MENR, LEB			30		30

[13] This is mentioned also in energy section.

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Tourism							
2 Creating an enabling investment environment for development of tourist businesses: ▪ Simplifying licensing in tourism industry ▪ Creating a more favourable tourist visa regime	2003 2003-2004	CMAR, MYST CMAR, MYST, MFA, MNS, MIA, SCC	Licensing rules prepared and approved; Tourist entry and exit procedures improved; Increase in the number of foreign tourists.				
3 Improving the advertising and publicity in the tourism sector: ▪ Establishing centres for advertising, publicity and coordination in Baku, Sheki, Ganja, Lankaran, Shamakhi, Nakhchevan, Guba and Khachmaz	2003-2004	MYST, UNDP	Information centres established in Baku and in 7 regions.	64	64		128
3 Training and upgrading in tourism skills	2003-2004	MYST, ME, UNDP	Increase in the number of trained specialists; Increased participation of women in the trainings.	56	56		112
1 Allocating funds for improvement of tourist infrastructure (roads, telecommunications, electric power, gas and etc.) through Public Investment Programme	2003-2005+	MED, MF, MYST	Regional and rural infrastructure improved.				
3 Development of tourism in regions: ▪ Developing green and rural tourism in Gusar, Guba, Shamakhi, Sheki, Ismayilly, Lankaran, Ganja, Khizi, Lerik, Masalli, Zagatala, Khachmaz, Gazakh, Gabala, Oghuz and Nakhchevan	2003-2004	MYST, MF, MED	New jobs created; Tourism potential of regions re-activated.			950	950

INSTITUTIONAL REFORMS AND CAPACITY BUILDING

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Juridical Reforms							
1 Increasing the awareness of the poor regarding their civil rights: ▪ Establishing Legal Advisory Services centres in 20 regions	2004-2005+	MJ	Legal awareness of the poor increased; Free advisory services for underprivileged families established.		100	300	400
2 Upgrading and capacity building of legal profession: ▪ Enhancing material and technical basis of Legal Training Centre and training of legal professionals through consideration of gender factor	Ongoing-2005	MJ, EU	Training process in line with modern requirements in Legal Training Centre; Skills in legal proceedings in courts improved; Number of women trained.	1,460	15	45	1,520
3 Improving legal expertise of laws: ▪ Capacity building in Legislation and Legal Public Awareness Departments within the Ministry of Justice	2003-2005+	MJ	Laws in line with international standards designed and passed expertise.		22	23	45
3 Improving legal awareness and living conditions of the accused and prisoners and securing their health care rights:							
▪ Adjusting the penitentiaries to acceptable hygienic and sanitary norms	2003-2005	MJ, MH			17	68	85
▪ Improving the health care in special medical facilities within the penitentiaries with a view to providing modern health care and	2003-2005	MJ, MH				103.5	103.5

				Financing (US$ thousand)			
treatment for sick prisoners ▪ Organising courses for legal training of prisoners	2003-2005	MJ					
3 Ensuring the re- integration and adaptation of prisoners to the society: ▪ Ensuring professional qualifications for income-bearing jobs to prisoners both in penitentiaries and after their release	2003-2005	MJ, MLSPP				1,035	1,035
2 Ensuring equal access to legal institutions: ▪ Construction of court buildings in Astara, Gobustan, Agsu regions	2003-2005	MJ, MED, MF	Court buildings constructed in 3 regions.		153		153

Measures and Actions	Date of implementation	Responsible Bodies	Indicators	Financing (US$ thousand)			
				Committed External Funding	Budgeted Domestic Financing	Financing Gap	Total
Poverty Monitoring							
1 Increasing capacity for monitoring poverty in the country:							
▪ Setting up a Poverty Monitoring Unit (PMU) at the SPPRED Secretariat	2003-2005+	SPPRED Secretariat, MED, UNDP	PMU established;	160		414	574
▪ Providing training to staff of the Poverty Monitoring Unit in poverty analysis techniques, as well as use of statistical programmes for analysis of survey data	2003-2005+	SPPRED Secretariat, MED, SSC, UNDP, IDA	Trainings held.	400	55		455
1 Preparing annual data base from HBS for use by Poverty Monitoring Unit, other local experts, and international organisations:							
▪ Preparing documentation on database for users	2003	SSC, SPPRED Secretariat, MED	Annual data base from HBS accessible on internet and on CD Rom.			36	36
▪ Making the annual data base available on website of SSC and on CD Rom	2003-2005+	SSC, SPPRED Secretariat, MED				20	20
1 Integration of information from FSIS Unit at the SSC into the regular poverty monitoring carried out at the PMU in coordination with the inter-ministerial working group on food security	2003-2005+	SSC, MED, SPPRED Secretariat; PMU, EU	Quarterly bulletins.				
▪ Publication of quarterly bulletins on food security vulnerability and food security assessment							
1 Publishing and improving poverty monitoring indicators on an annual basis:							
▪ Reviewing poverty indicators and inequality measurements on an annual basis	Ongoing-2005+	MED, SPPRED Secretariat, PMU	Publication of annual review;				
▪ Publishing poverty results and poverty profile, using the same poverty lines and indicators as in the current SPPRED document on an annual basis	Ongoing-2005+	MED, SPPRED Secretariat, PMU, SSC,	Publication of annual poverty bulletin.			20	20
2 Using the results from the periodic Multiple Indicator Cluster Surveys (MICS) to monitor health	2005+	MED, MH, ME, PMU, SSC,	Incorporation of results into annual poverty	150			150

				Financing (US$ thousand)			
and education indicators and the links between these and income poverty in the country		UNICEF	bulletin.				
1 Carrying out regular a Labour Force Survey to monitor employment in the formal and informal sectors of the economy:							
▪ Implementing labour force survey on an annual basis	2003-2005+	MED, MLSPP, SSC, SPPRED Secretariat, PMU	Labour force survey conducted;			145	145
▪ Analysing of the survey data on an annual basis	2003-2005+	MED, SPPRED Secretariat, PMU	Annual results published.			15	15
1 Carrying out a annual survey of the refugee and IDP population to monitor changes in their conditions	Ongoing-2003	MED, PMU, SSC, SCRIDP, IDA	Incorporation of results into annual poverty bulletin.	50			50
2 Developing gender disaggregated statistics and publication of annual bulletin with focus on gender disaggregated statistics derived from survey and administrative data	2003-2005+	SSC, SCWA, MED, SPPRED Secretariat	Publication of annual bulletin for gender statistics.			35	35
3 Carrying out new surveys on gender and poverty using qualitative and quantitative methods	Ongoing-2005+	SCWA, SPPRED Secretariat	Information published.			95	95
1 Carrying out regular qualitative/ participatory work on population's perceptions of the definition of and reasons for poverty in the country	2003-2005+	SPPRED Secretariat	Incorporation of results into annual poverty bulletin.			40	40
3 Monitoring and improving the legislative base on minimum living standard	2003-2005	MED, MLSPP, MJ	Relevant normative documents prepared.			150	150

Notes on Policy Matrix

Priorities

Priorities are indicated for each policy action (1-high, 2-medium and 3-low priority). These priorities refer to the relevance and importance of the action in the strategy to reduce poverty. At this stage, the priorities have been ranked within each section of the policy matrix. Thus an action marked as high priority, is considered high priority within the range of actions listed for that section, but does not necessarily have the same priority as an action marked as high priority in a different section. Thus, the priority of actions cannot be compared across sections.

Note also that all items which have budgeted domestic financing, or committed external financing, will take place. Some of the actions in the policy matrix are included, because they are already in process, or have been agreed with donors before the formulation of the SPPRED. In the implementation phase, there will be an annual review of ongoing policy actions, and their priority will be re-evaluated in accordance with the effect they are considered to be having on the achievement of the key poverty reduction strategies identified in the SPPRED.

Date of Implementation

"Ongoing" means that the program was already underway as of 2003, while "2005+" means that the program will continue indefinitely, or will conclude after 2005. For example:

- 2003 – 2004: Program implementation will begin in 2003 and will be concluded in 2004
- 2003 – 2005+: program implementation will begin in 2003, and will continue indefinitely, or will be concluded after 2005.
- ongoing – 2004: the program is already underway as of mid-2002, and will continue to 2004
- ongoing – 2005+: the program is already underway as of mid-2002, and will continue indefinitely, or will be concluded after 2005.

Responsible Bodies

The first agency listed is the lead agency.

Indicators

Indicators may be either a monitoring indicator, to be used to assess the impact of the policy action, or may be outcome indicators, used to judge whether the policy action has been completed.

Financing

The first two columns indicate the total amount of funding which is already committed and budgeted, from external and domestic sources respectively. The third column indicates an expense associated with the policy action which for which financing has not been identified. Financing may be allocated from domestic sources (i.e. the state budget, or State Oil Fund), or international finance may be sought. The final column indicates the total cost of the action.

In cases where financing from domestic sources is indicated, that financing is fully compatible with the medium term expenditure framework. The relationship between the policy matrix and the MTEF is explained in appendix 2.

Note that some items have no costs associated with them. This may mean that there is little or no cost associated with the action (changes in regulation or administrative procedure, for example), or may mean that it has not been possible to quantify the cost.

Note also that for some actions there are discussions ongoing with international financial institutions/donors on financing the action.

Financing estimates are for the period 2003 – 2005 only.

Appendix 2. Medium Term Expenditure Framework (MTEF)

Introduction to Expenditure Policy and MTEF

The reduction of poverty, from an economic perspective, is dependent upon two sets of conditions: economic stability and economic growth. As noted in the chapters 2 and 4 stability has largely been achieved. The MTEF will ensure that such stability is maintained, and that expenditures facilitate opportunities for economic growth.

In order to succeed it is necessary to spend prudently, in keeping with internal revenues and achievable and sustainable levels of borrowing. At the same time, it is necessary to avoid resorting to monetary financing (which would give rise to a growth in inflation).

As is noted in Chapter 4, the government will begin preparing a medium term fiscal framework with the annual budget, in keeping with the "Budget System Law" of the Republic of Azerbaijan. Lengthening the forecasting period will help the government to manage its resources better, as all policy makers will have a better idea of the constraints under which they will be operating in years to come. This will contribute significantly to increasing the effectiveness of expenditure in Azerbaijan. The medium term expenditure framework will be consistent with the poverty reduction strategy and will be updated annually.

This appendix is divided into four parts. First, the resource envelope is described. Second, the strategy which informs expenditure planning is outlined. The detailed expenditure plans are then explained. Finally summary tables showing forecasts of economic growth and Consolidated and State Budget revenues and functional and economic classifications of expenditures are presented.

Part I. Resource Envelope

Growth in revenue is largely a function of growth in the economy. In order to ensure sustainability of expenditures, a projection of macroeconomic growth has been made. In total, growth of the gross domestic product is expected to average about 11% annually in real terms for the period 2003 - 2005[1]. The oil sector is forecast to grow very strongly, averaging 15% annually. The non-oil economy is also forecast to perform well with growth averaging 10% annually.

It is necessary to note that these growth rates will not be evenly spread throughout the 2003 – 2005 period. Major spending on oil developments will not begin until 2005.

[1] Inflation is forecast to be 2.5% annually. Unless otherwise noted, as here, all figures are nominal.

Table 1: Economic Growth Forecast

	2002e	2003f	2004f	2005f	Average 2000 - 2002	Average 2003 - 2005
Real						
GDP	9.2%	9.5%	7.5%	16.0%	10.1%	11.0%
Oil GDP	8.9%	5.1%	-0.6%	41.0%	6.4%	15.2%
Non oil GDP	9.5%	11.3%	10.6%	7.3%	11.1%	9.7%
Nominal						
GDP	9.3%	13.9%	8.5%	16.6%	15.1%	13.0%
Oil GDP	3.3%	13.5%	1.4%	41.0%	19.4%	18.7%
Non oil GDP	11.9%	14.1%	11.3%	8.0%	12.0%	11.1%

On the basis of this growth forecast, an estimate of tax and non-tax revenues has been prepared. These estimates show that the growth of tax revenues will be strong, averaging 10% per annum in real terms. These estimates are based on the following assumptions, which are supported in Chapter 4:

- There will be increases in revenue collections at the Ministry of Taxes and State Customs Committee, by virtue of better administration, as outlined in Chapter 4.
- In order to encourage entrepreneurship and the growth of employment, the taxes on businesses will be lowered, as explained in Chapter 4. Changes will be made to the rate of profit tax, and the simplified tax system.
- The forecast is based on a declining rate of social contributions. In 2003 the employers' contribution rate will be reduced from 29% to 27%. This will reduce flows to the social protection fund by 210 bln AZM from 2003 – 2005, although this is largely offset by increased collections from more highly paid public employees.
- Non-tax revenues are forecast to grow in line with growth of the economy as a whole.
- Beginning in 2003 some extra-budgetary funds of budgetary organisations will be eliminated. Those that remain will be included as part of the state budget.
- No profit tax will be paid to the State budget from foreign oil companies (although estimates have been made of employees' income tax, and payments by foreign oil companies to the State Oil Fund).
- It is forecast that SOFAR's financing of pro-poor capital projects will increase substantially
- Utility subsidies will be included as part of the consolidated budget from 2003. No estimate was made of additional payments to the State Budget from SOCAR, Azerenergi and Azerigas resulting from increased financial discipline for provision of utilities.

The government remains committed to honouring its limit on contracting external debt. New external debt will be limited to USD 200 million in 2003, and USD 250 million annually thereafter, and all borrowings will be on concessional terms. It is assumed that USD 100 million of new loans will be contracted each year during 2003 – 2005, and that a USD 60 million Poverty Reduction Support Credit will be agreed with the World Bank. With existing loans, funds will be disbursed as follows:

Table 2: External Financing (USD millions)

	2002f	2003f	2004f	2005f	Average 2003 - 2005
Foreign loans for deficit financings (SAC II, PRSC)	30	30	30	30	30
Net project loans	205	113	198	195	169
Loans to the government	69	54	27	39	40
Net loans on-lent to state-owned enterprises	137	58	171	156	128
Disbursements	148	70	183	168	140
contracted	148	70	123	68	87
New	0		60	100	53
Repayments	11	12	12	12	12
contracted	11	12	12	12	12
New	0	0	0	0	0
Total external financing (bln AZM)	1142	714	1176	1180	1023
Memo: new loans contracted	60	100	160	100	120

Until banking sector reform has progressed substantially, there will remain limited capacity for additional domestic borrowing.

Table 3: Domestic Financing (AZM billions)

	2002f	2003f	2004f	2005f	Average 2000 – 2002	Average 2003 - 2005
T-bills	36	40	40	40	47	40
State Lottery Bonds	20	10	10	10	8	10
Privatisation Receipts	150	130	100	100	124	110
Total Domestic Financing	206	180	150	150	179	160

The "resource envelope" is the sum of the government's tax and non tax revenues, flows from the SOFAR, and financing, as shown below:

Table 4: Resource Envelope (AZM billions)

	2002f	2003f	2004f	2005f	Average 2003 - 005
Tax and Non tax Revenues	5674	6310	6906	7553	6923
Transfers from State Oil Fund	336	642	515	525	561
Domestic and External Financing	1338	894	1326	1330	1183
Total	7347	7845	8747	9408	8667
Annual change		6.8%	11.5%	7.6%	8.6%

Table 5: Deficit Measures (AZM billions)

	2002f	2003f	2004f	2005f	Average 2000 - 2002	Average 2003 - 2005
State Budget Revenues (*)	4780	6092	6621	7198	4091	6637
State Budget Expenditure (*)	5130	6423	6925	7505	4329	6951
State Budget Deficit	-350	-331	-304	-308	-238	-314
State Budget Deficit (% of GDP)	-1.2%	-1.0%	-0.9%	-0.7%	-0.9%	-0.9%
General Government Revenues	5674	6810	7421	8078	4903	6923
General Government Expenditure	7010	7704	8747	9408	5810	8620
General Government Deficit	-1336	-895	-1326	-1330	-907	-1183
General Government Deficit (% of GDP)	-4.6%	-2.7%	-3.7%	-3.2%	-3.4%	-3.2%
Consolidated Revenues	6455	7224	7655	8570	6001	7816
Consolidated Expenditure	7347	7845	8747	9408	5923	8667
Fiscal Deficit	-892	-622	-1091	-838	78	-851
Fiscal Deficit (% of GDP)	-3.1%	-1.9%	-3.1%	-2.0%	0.5%	-2.3%

(*) from 2003 including SOFAR transfers to the budget and extrabudgetary revenues and expenditures of budgetary organisations

Part II. Overview of Expenditure Strategy

Although the government has achieved economic stability, there remains much to be done in restructuring public expenditures in order to have a better focus of poverty reduction. After the initial years of independence, economic decision-making was focused on achieving and maintaining stability, by prudently forecasting revenues and expenditures on a year-by-year basis, and by reducing and eventually eliminating budgetary financing by the National Bank. This short-term view was helpful in stabilising the economy, but was not complemented by a longer-term strategic view of appropriate expenditures. While focusing on stabilisation, the government applied indiscriminate across-the-board increases to many functional and economic[2] categories of expenditure.

Well-intentioned increases in expenditure have not improved the quality of public services. Instead, additional funds have been matched by deteriorating outputs, as outlined in Chapter 1. For example, the public sector wage bill has risen, but restructuring has been slow. There remain too many public servants, many of whom are paid less than the absolute poverty line referred to in Chapter 1 (120,000 AZM, or 25.8 USD per month). As the same time, while total spending on social assistance has risen, there has been little success in targeting the spending on needy households. A large portion of the population, including those not in need, receives assistance, and the amount paid is often too low to provide any meaningful support.

The government will overcome these problems by directing funds in a much more strategic and targeted manner, and by beginning and moving forward with programs of restructuring. As noted above, the government's resources will expand considerably over the next three years, by about 9% on average. The government will direct the bulk of this new expenditure to those areas which are in need of additional resources, which will help to reduce poverty, and where restructuring is occurring.

The government's medium term expenditure framework for the years 2003-2005 is based around the following principles:

1. All expenditure reform will be consistent with macroeconomic stability. Stability and the prospects for growth will not be endangered by unsustainable increases in expenditures.
2. The system of public sector pay will be reformed. The government will work towards unification of pay scales for employees and rationalise the public sector workforce. This means that lower paid sectors (health, culture and agriculture) will have their pay increased more rapidly than higher paid sectors. Productivity will be improved by increasing pay for remaining employees, and decompressing wages in order to provide better incentives.
3. Rationalisation of expenditure on health care, education, and social assistance will occur:

[2] Expenditures are classified into two different sets of categories: functional and economic. Functional classifications describe the purpose or objective of government spending (for example, spending on health or education). Economic classifications are describe the nature or economic effect of the spending (for example, wages or capital expenditure).

- The education budget will increase only modestly, as the emphasis will be on increasing the efficiency of resource use. Resources will be used to ensure equally high quality education, better teaching and facilities for all children.
- Health care expenditure will be increased, in recognition of the decline of expenditure over the last decade. Funds will be used more efficiently, as a result of programmes outlined in Chapter 3. There will be an increased provision of primary health care (which is the main component of structural reform and which will result in more cost-effective delivery of basic health services) to ensure that there is universal access to basic health care, and to increase the quality of care by increasing incentives to health care workers.
- The government will begin to reform the social assistance and social security systems, introduce targeted social benefits, and prepare a programme of active and passive labour market policies to help cushion the effect of redundancies. These reforms will rationalise existing budget allocations, while additional allocations will help with the implementation of reform measures. In the short-term, there is a need to increase pensions and to provide compensation to households in line with the increases in utility collection rates/prices envisaged in the energy sector reform program.

4. In order to support economic growth, the government will substantially increase expenditure on economic services. Economic services includes expenditure on housing and public affairs; fuel and energy; agriculture, forestry and fisheries; industry and construction; and transport and communications. Much of this expenditure is by its nature pro-poor, being either capital expenditure on building or rehabilitating infrastructure, or spending on programs to support the poor, such as provision of subsidised credit to farmers and entrepreneurs.
5. Government expenditure on capital goods will be based on the Public Investment Program. The PIP will allow for both increased social security (though rehabilitating schools, resettling refugees, etc.) and faster economic growth (through rehabilitating infrastructure).
6. Expenditures on operational costs will be increased, in order to allow for increased payment for utilities by budgetary organisations. This is in keeping with the energy sector reform program.

As the table below shows, the consolidated budget is already very much oriented towards spending which is poverty-focused. In 2001 about 30% of consolidated expenditure was directed towards households as transfers, for example, while 17% was used for new capital works and maintenance of existing facilities. Fully 50% of the consolidated budget was spent on health, education, and social protection, while only 10% was spent on defence. However, as noted above, these funds are not always used effectively.

Over the next three years, the pattern of expenditure will change, in line with the reform strategy outlined above. Comparing 2005 with 2001, the following key changes are planned:

- Capital expenditure, which includes major rehabilitation of existing infrastructure, and building new infrastructure, will rise from 17% to 21% of total spending. This

rise in capital expenditure is also reflected by a change in the share of expenditure on economic services, which will rise from 22% to 27% of total expenditure[3].

- Health expenditure will rise from 4% to 5% of total expenditure, in recognition of serious underfunding in recent years;
- Education expenditure will fall from 17% to 15% of total expenditure. This allows for greater expenditure on other areas, and reflects the expectation of savings resulting from reform of the teaching profession. Within the education sector, wages and salaries will drop from 82% to 79% of total expenditures, while spending on goods and services will increase from 15% to 18%.
- Expenditure on social insurance and social assistance will fall from 29% to 27% of total expenditure. Better use will be made of existing resources. Again, relatively less expenditure increase in these areas will allow for greater spending on other areas.

Table 6: Structure of Consolidated Expenditure

	2001	2005	2001	2005	Growth		
			% in total	% in total	bn AZM nominal	% nominal	real
Total	**5467**	**9408**	**100%**	**100%**	**3941**	**72%**	**56%**
Economic items							
Personnel Emoluments and Transfers to households	2828	4497	52%	48%	1669	59%	44%
Personnel Emoluments	1195	2008	22%	21%	813	68%	52%
Transfers to households	1633	2489	30%	26%	856	52%	38%
Purchases of goods and services	1196	2183	22%	23%	987	82%	65%
Capital expenditure	954	2015	17%	21%	1061	111%	91%
Other	489	714	9%	8%	225	46%	32%
Functions							
State operating functions	1265	2038	23.1%	21.7%	773	61%	46%
Social and welfare functions	2821	4635	51.6%	49.3%	1814	64%	49%
Education	931	1432	17.0%	15.2%	501	54%	39%
Health	210	505	3.8%	5.4%	295	140%	118%
Social protection and social security	1570	2490	28.7%	26.5%	920	59%	44%
State Budget	216	354	3.9%	3.8%	139	64%	49%
Social Protection Fund	1354	2136	24.8%	22.7%	782	58%	43%
Culture, arts and religion	110	208	2.0%	2.2%	98	89%	71%
Economic Services	1177	2562	21.5%	27.2%	1384	118%	97%
Investment	791	1638	14.5%	17.4%	847	107%	88%
Other items	205	178	3.8%	1.9%	-27	-13%	-21%

The challenge, then, is not to spend a greater percentage of the budget on pro-poor items (although this will be an outcome of the government's MTEF), but to improve the impact of existing spending.

III Part. Sectoral Expenditure Plans

Wages and Salaries

Public sector wages have a great impact upon the quality of services being provided by the state. Low wages provide poor incentives for public employees to provide high quality services (the poorest paid employees, who occupy the first grade on the pay scale, are paid only 27,500 AZM per month). This encourages corrupt behaviour. Health care workers, for

[3] Most capital expenditure (an economic classification), is classified within Industry and Construction (as Investment expenditures), which is an economic service (functional classification).

example, simply cannot survive on their average monthly wage of about 51,000 AZM. They must either take second jobs (and so often be absent from their main place of employment), or solicit extra payments from patients in order to make ends meet. Of course, it is very difficult to retain good people in the public service with low wages. This is especially true of employees who have very marketable skills, such a tax specialists, lawyers, accountants, etc. A World Bank paper[4] suggests that public sector wages should be not more than 80 – 95 percent of private sector wages. By this measure, public sector wages, which average less than 30% of private sector wages, are not providing adequate incentives in Azerbaijan.

The public sector wage bill will be increased within the budgetary constraint. A wage increase is planned for 2003, but devising new pay scales will take some months. Therefore, the increase in pay will not be effective until about the middle of 2003. The total wage bill will increase 7% in 2003, 15% in 2004 (this is mostly the effect of implementing the wage increase midway through 2003), and 9% in 2005. Part of these increases will not be reflected in rising real wages, as the cost of living is expected to increase in line with increased utility collection rates. Such an increase will not be adequate to attract and retain motivated employees. Further increases will depend upon a significant pay reform program.

The reform plan will move forward on three fronts. First, **pay scales will be unified**. A unified pay system was introduced in 1996. Since that time, ad hoc and sector specific changes have been introduced, and the system has become highly fragmented. An important effect of this unification will be to raise the wages of workers in sectors which are now very poorly paid, notably those in health, agriculture, culture and arts. This is a prerequisite for decompression, as noted below.

The result of increases on average pay is shown below:

Table 7: Public Sector Wages

	2001	2005	Growth		
			bn AZM nominal	% nominal	real
Wages and salaries, total bn AZM	**1187**	**1992**	**805**	**68%**	**52%**
Education	593	895	303	51%	37%
Health	87	245	157	180%	154%
Culture, arts and religion	29	60	31	108%	88%
Agriculture, Forestry and Fishing	29	62	33	114%	94%
General State Service	140	249	109	78%	61%
Average monthly wage, AZM	**133730**	**238967**	**105236**	**79%**	**62%**
Education	158314	239181	80867	51%	37%
Health	50 649	165373	114725	227%	196%
Culture, arts and religion	79087	164408	85321	108%	88%
Agriculture, Forestry and Fishing	79 596	170218	90621	114%	94%
General State Service	378 129	673041	294913	78%	61%

Regional coefficients will be introduced, beyond those which now exist for employees in mountainous regions. This is in recognition of the difficulty in attracting skilled employees to work outside of the major centres, and to support regional development.

[4] Salvatore Schiavo-Campo, et. al, "An International Statistical Survey of Government Employment and Wages," Policy Research Working Paper No. 1806. World Bank, 1997.

Secondly, the government will **rationalise employment** in each sector. Progress has been made in rationalising the number of public sector employees: in 1997 there were 592,926 employees[5]; this had fallen by 18% to 483,562[6] in 1999. The large numbers of employees makes it impossible to raise public sector pay, and to provide resources for productive nonwage expenditure. The reform plans for the general state services and health care workers are discussed below. It is expected that these will be followed by a rationalisation plan for the education sector. Such plans will be supported by preparation of quarterly reports on payments to employees from the State Treasury.

Finally, the government will begin to **decompress the salary scale** within each sector, so that highly skilled and highly productive employees are rewarded. In some sectors, such as health, agriculture, and culture and arts wages are too low to allow for decompression now. These workers now earn less than the absolute poverty line (120 000 AZM or 25.8 USD per month). Decompression will only be possible with additional funds in order to raise some salaries, while keeping others constant.

Education

Overall expenditure on education will increase by at least 12% in 2003, 10% in 2004 and 7% in 2005. Expenditure may be more, depending upon the outcome of the Public Investment Programme, as described below. In 2001, education expenditure occupies 17% of total consolidated government expenditure. This will fall to 15% of total expenditure in 2005.

Table 8: Educational Expenditures (billions AZM)

Education expenditure	2001	2001 % in total	2002	2003	2004	2005	2005 % in total	Growth % Nominal	Growth % Real
Total	**931**	**100%**	**1082**	**1216**	**1339**	**1432**	**100%**	**54%**	**39%**
Personnel Emoluments and Transfers to households	782	84%	897	933	1105	1160	81%	48%	34%
Personnel Emoluments	768	82%	879	912	1083	1137	79%	48%	34%
Transfers to households	14	2%	18	21	22	23	2%	62%	46%
Purchases of goods and services	138	15%	174	202	222	259	18%	88%	70%
Capital expenditure	11	1%	11	81	12	13	1%	16%	5%

The most important single determinant of education spending in Azerbaijan is pay for teachers and administrators. In 2001, there were more than 312,000 public employees in public education sector. Total expenditure on education in 2001 was 931 billion AZM, of which 82% or 768 billion AZM was for personal emoluments. Only 15% of the total was spent on other goods and services, such as textbooks, utility payments and maintenance of schools and facilities.

At the same time, employees in education are relatively well paid, compared to employees working in the health care and agricultural sectors. The average monthly wage in the education sector in 2001 was about 158,000 AZM, compared to about 80,000 AZM in the agriculture sector, and only 51,000 AZM in the health sector. This is despite working

[5] State Statistics Committee

[6] Schiller, Christian, Gabriela Inchauste and Jan Walliser, "Azerbaijan: Continuing Public Expenditure Reforms". IMF, August 2000, p. 10.

conditions which do not permit teachers to achieve as high a level of productivity as their colleagues in other countries. Today, the average teacher works only twelve hours a week in the classroom, and teaches an average of only 10 students.

The appropriate policy, then, is do not allocate expenditure only for salaries and wages, but also towards the purchase of goods and services over the next three years.

It is recognised that the budget for other goods and services has been inadequate, and has been sacrificed to maintain the high spending on public sector wages. It is proposed to substantially increase the budget for school books, materials, utility payments, etc., by increasing the allocation for other goods and services. Specifically, a program of providing free textbooks for schoolchildren will be implemented, so that by 2005 all students will receive free textbooks.

Capital expenditure, at 11 billion AZM, accounted for just over 1% of the education budget in 2001 (although there was also a capital expenditure of 16 billion AZM from extrabudgetary funds and investment expenditure). The very low allocation for maintenance of schools has resulted in considerable decay of schools and buildings, and almost no new schools have been built in the last ten years. Funds will be provided to repair 200 schools between 2002 and 2005. Like health, social protection, and economic services, the education sector will also be able to bid for additional capital funds as part of drawing up the public investment program, as explained in Chapter 4. Funds have been allocated sufficient to build 28 new schools.

Health

Spending on health care has been inadequate to provide for the needs of the poor. The state budget for health expenditure totalled 210 billion AZM, or about 0.8% of GDP in 2001 (extrabudgetary and investment expenditure and allocations from the reserve fund of the state budget was worth an additional 26 billion AZM), compared with an average level of 1.2% of GDP for low-income countries[7]. This will increase to 1.2% of GDP by 2005. From its low base of only 3.8% of total expenditure in 2001, expenditure will be increased to at least 5.4% of total expenditure by 2005.

Table 9: Health Expenditures

	2001	2001 % of total	2002	2003	2004	2005	2005 % of total	Growth % Nominal	Real
Total	**210**	**100%**	**270**	**301**	**390**	**505**	**100%**	**140%**	**118%**
Personnel Emoluments	114	54%	142	148	222	311	62%	174%	148%
Purchases of goods and services	89	43%	117	135	149	173	34%	94%	76%
Capital expenditure	7	3%	11	17	19	21	4%	185%	158%

It is recognised that there is a need to refocus health expenditure on providing primary health care (in 2001, 63% of total health expenditure was associated with hospitals). As outlined in Chapter 3, the government and Ministry of Health intend to refocus expenditure away from tertiary, and towards primary health care. The government intends to enhance its cooperation

[7] Schiller, Christian, Gabriela Inchauste and Jan Walliser, "Azerbaijan: Continuing Public Expenditure Reforms". IMF, August 2000.

with UNICEF and the World Bank, by providing 10% (1 bln AZM) of the cost of a ten district pilot project aimed at improving the quality of primary healthcare. The government will also provide additional funding in support of the national policy on the Expanded Programme on Immunisation. As described in Chapter 3, the program was initially entirely funded by UNICEF, but the government will contribute 10% of total costs in 2002, and starting from 2003 100% (excluding Hepatitis B). The government also intends to finance programs in malaria and tuberculosis reduction, child and maternal health, and healthy lifestyles.

At the same time, the allocation for personal emoluments will be sharply raised. In 2001, 54% of the budget for health was used to pay employees. This will increase to 62% of the very much larger overall allocation by 2005. Wages and salaries for public employees in the health sector will increase by about 50% in 2003 (from the middle of the year), 25% in 2004 and 40% in 2005. In other words, by 2005 the wage component will be 2.7 times that which it was in 2001.

Some rationalisation in the number of employees will take place. The pilot projects on primary healthcare will assist in developing a program of downsizing the workforce. This will further boost the average wage in the sector. It is forecast that average monthly wages will rise from the 2001 current level of 51,000 AZM, to 165,000 AZM. Such a sharp increase in pay will have very positive effects upon staff morale, and is expected to result in notable reductions in corruption and an increased quality of service.

Like education, social protection and economic services, the health sector will be eligible to bid for extra funds for capital expenditure. This may increase overall spending on this sector.

Social Insurance and Social Assistance

Over 30% of the consolidated budget is already earmarked for transfers to households. By any standard this is a very large proportion of the budget. As explained in Chapter 3, it includes many transfers which benefit the poor, but few of which are specifically targeted towards them. It also includes payments to IDPs, and payments to compensate privileged groups (such as war veterans) for the loss of their free access to utilities. Large increases would only limit the scope for additional spending on other pro-poor areas, such as health and education. The emphasis on social insurance and social assistance, then, must not be on rapid increases in budgets. Instead, more careful targeting of the spending must be undertaken, so that funds are directed towards the truly needy, and not disbursed to the relatively better off members of the community.

The government recognises this need, and has begun working on a major reform program for social insurance and social assistance. As explained in Chapter 3, a concept paper for reform of the pension and social insurance system was approved in July 2001, while a concept paper and pilot project have been prepared for social assistance.

Realistically though, these reforms will take many years to complete, and as the programs are still be finalised, it has not been possible to estimate their cost. In the medium term, the overall expenditure on social protection and social security will increase by 12% in 2003, 9% 2004, and 8% in 2005. These funds have been allocated to child allowances and pensions, both of which are relatively well targeted towards low income households.

Certain privileged groups used to benefit by not paying for their utilities. These privileges were eliminated in 2002, and replaced with direct payments as compensation. An allocation has been made to finance these payments; this allocation will be revised annually as necessary.

It is intended to review expenditure on social assistance and social insurance as the reform plans develop, as part of the annual budget.

Again, like health, education and economic services, there may be additional allocations made for spending on capital works for social protection and social security. This will depend upon projects being put forward for public investment.

Economic Services

"Economic services" includes a whole range of functional classifications, including expenditure on housing and public affairs; fuel and energy; agriculture, forestry and fisheries; industry and construction; and transport and communications. Much of this expenditure is by its nature pro-poor, being either capital expenditure on building or rehabilitating infrastructure, or spending on programs to support the poor. Examples include spending to provide veterinary services, and payments to maintain and operate irrigation systems. These sorts of expenditures often promote the establishment of small and medium enterprises, by providing the infrastructure needed in order to participate actively in the market economy.

Overall expenditure on economic services will increase rapidly, from 4.5% of GDP in 2001 to 6.2% in 2005.

The wages and salaries for the public employees in agriculture, fishing and forestry will be increased by 50% nominally in 2003, implemented from about the middle of the year, 15% in 2004 and 10% in 2005. As workers in these sectors are amongst the poorest paid public servants, the move to unify public sector wages will result in large wage increases.

Capital spending will be allocated through the mechanism of the PIP. Although shown as expenditure on economic services, the PIP will reallocate capital expenditure away from economic services, and towards health, education and social assistance.

Capital Expenditure

For a country of its present per capita income Azerbaijan has a relatively well-developed physical infrastructure – in transport, irrigation, health and education. This is largely a legacy of the Soviet period, and it has suffered degradation through lack of maintenance. This decline in the quality of infrastructure affects the poor both directly and indirectly. As health facilities and schools have become run down, the quality of health and education has deteriorated, having a direct impact upon the poor. At the same time, inefficient irrigation canals, poor roads, and unreliable telecommunication links make life difficult for all businesses – slowing their growth, limiting their ability to hire new employees, and curtailing opportunities for entrepreneurs.

The emphasis for capital spending, then, must be on repair and rehabilitation of existing infrastructure, rather than on expansion of existing facilities. Capital spending does not only include new construction – it also includes major works of maintenance and upgrading of facilities.

In recent years, major capital works have been financed by concessional, external lending. This is expected to continue, but a new source of financing is now available: the State Oil Fund of Azerbaijan (SOFAR). It is expected that in addition to any expenditure related directly to oil investments (such as possible financing of the Baku-Tbilsi-Ceyhan Pipeline), SOFAR will spend money for projects directly related to social protection and economic development. In 2002, this spending was in support of IDPs, and resulted in the construction of new housing. It is intended to allocate more funds for the voluntary resettlement of IDPs currently living in ten camps.

Capital expenditure will not be increased equally for all sectors. Those sectors which are not poverty-related, such as defence, receive increases of 2% per annum in 2004-2005 following the sharp increase in 2003. The allocation for the four key pro-poor functions – education, health, social protection and social security, and economic services – will almost double by 2005.

Table 10: Capital Expenditure (bn AZM)

	2000-02	2003-05	2003-05/2000-02	
			nominal	%
Total expenditure	17769	26001	8232	46%
Total capital expenditure	3389	5470	2081	61%
Domestically financed	1347	2863	1516	113%
Budgetary	1007	1181	174	17%
Oil Fund	340	1682	1342	395%
Foreign financed project loans	2042	2607	565	28%
Government loans	470	616	146	31%
Net On- lend loans	1572	1992	419	27%
Total capital expenditure, % to GDP	4%	5%	1%	
Capital expenditure on education, health, social protection and economic services	3262	5192	1930	59%
Other	127	278	151	120%

Allocation between these sectors will be defined by the public investment program, as explained in Chapter 4. In brief, projects will be financed insofar as they are pro-poor. As financing is limited only the most attractive projects will be funded. These projects will be poverty focused or will provide opportunities for businesses to grow and employ more people.

State operating functions and other expenditure

State operating functions and other expenditure refers to those functions which have not been specifically mentioned above, such as general state services; defence; courts, law enforcement and security; culture, arts and religion; and some other items including repayment of debt. Expenditure on these functions will grow slowly, with the exception of wages for civil servants, and employees in the science, culture and arts.

A reform plan for public sector pay in the general state service is already in place, and will be continued over the next two years. This will result in continued reform and rationalisation of central government agencies (such as the Cabinet of Ministers and Presidential Office) and

will result in substantial wage decompression, and pay increases for those employees remaining in their posts.

For law enforcement and defence officials, a substantial pay increase will be granted in the 2003 budget. In recognition of this increase, there will be no wage increases in 2004, and a 5% increase in 2005. This will compensate these employees for the increases cost of living associated with increased utility collections.

Funds have been allocated to finance the establishment of Legal Advisory Service centres in twenty regions and to build three new courthouses – both of these activities will increase the access to legal institutions by poor populations. Skills of judicial officials will be enhanced by providing additional funds for the Legal Training Centre and Ministry of Justice, as outlined in Chapter 5.

Utility Reforms

The reform program for utility collections has been outlined in chapters 2 and 4. As explained, this program is not yet complete. A key element of this program is increasing financial discipline for users of utilities. The program will begin with a focus on budgetary organisations. In order to encourage greater efficiency of utility use, these agencies will be limited to using only the amount of water, electricity and gas for which they can pay. Additional allocations have been made for this purpose.

Data on energy provision and payments are being collected throughout 2002. It is not expected that all households and enterprises will be in a position to pay fully for their utility use until after 2005. In order to improve the budgeting process, and enhance transparency, the government will include in the budget a statement of implicit subsidies which are being provided to consumers. Until these data are gathered and analysed, it is not possible to include them in the budget or MTEF.

Thus, the estimations presented in this document do not take into account all of the effects of increased utility collection rates or increased fiscal discipline. These effects will take two forms:

- Additional revenues will be received by the State budget as consumers pay Azerenergy and Azerigas for utilities consumed, and as these two agencies pay SOCAR for their inputs. SOCAR itself will be able to pay additional amounts to the State budget in the form of taxes (SOCAR now does not pay its full tax obligation). Furthermore, arrears will be restructured and accounted for, which will eventually bring about additional revenues (and possibly expenditures) for the budget. These changes have not been reflected in the revenue forecast.
- There is a need to increase public sector wages to reflect the higher cost of living associated with increased utility collection rates. Allocations for salaries and wages have been increased in recognition of this.

Table 11: Growth forecast

	2000	2001	2002f	2003f	2004f	2005f
Nominal output						
Nominal GDP	23,590	26,342	28,797	32,800	35,600	41,500
o/w oil sector nominal GDP	7,021	7,759	8,012	9,094	9,217	12,994
o/w non-oil sector nominal GDP	16,569	18,583	20,785	23,706	26,383	28,506
Nominal GDP growth, %	24.6%	11.7%	9.3%	13.9%	8.5%	16.6%
o/w oil sector nominal GDP growth	90.1%	10.5%	3.3%	13.5%	1.4%	41.0%
o/w non-oil sector nominal GDP growth	8.8%	12.2%	11.9%	14.1%	11.3%	8.0%
Prices						
GDP deflator (annual change, %)	12.0%	1.6%	0.1%	4.0%	1.0%	0.5%
Oil Price	$28.90	$24.80	$23.00	$19.50	$20.00	$20.00
Exchange rate: average USD/AZM	4474	4656	4850	5000	5150	5250
Real output						
GDP growth, real	11.1%	9.9%	9.2%	9.5%	7.5%	16.0%
o/w oil sector	2.1%	7.9%	8.9%	5.1%	-0.6%	41.0%
o/w non oil sector	13.2%	10.7%	9.5%	11.3%	10.6%	7.3%

Table 12: Revenue and Financing Forecast – Resource Envelope (billions of AZM)

	2000	2001	2002	2002e	2003f	2004f	2005f
VAT	957	1266	1635	1635	1909	2252	2554
Income tax	476	474	530	530	580	678	758
Profit tax	629	588	700	700	770	810	881
Royalty	251	238	420	420	640	597	610
Excises	114	554	495	495	300	341	387
Import duty	312	260	290	290	300	314	315
NBA dividend	100	140	140	140	100	101	102
EC Grant	111	28	47	47	50	52	26
Other	622	372	523	523	642	712	789
Extrabudgetary revenues of budgetary organisations					301	250	250
Oil Fund Transfer to Budget					500	515	525
State Budget	**3572**	**3920**	**4780**	**4780**	**6092**	**6621**	**7198**
Extrabudgetary revenues of budgetary organisations	202	209	250	250			
Private sector payments to SPF	523	530	643	643	718	800	881
Disability & Employment funds	42	39					
General Government Revenues	**4379**	**4784**	**5674**	**5674**	**6810**	**7421**	**8079**
Oil Fund / Oil Bonus Transfer to Budget	128	4	336	336	142		
Receipts from borrowing			1188	1188	764	1226	1230
Privatisation Fund revenues	40	86	150	150	130	100	100
Resource Envelope			**7348**	**7347**	**7845**	**8747**	**9408**