

ADB

Development
Effectiveness
Brief

Azerbaijan ▶

A Cradle of Humanity Embraces Modernity

Asian Development Bank

An aerial photograph of a city, likely Baku, Azerbaijan, showing a dense urban landscape with a mix of modern high-rise buildings and older, lower-rise structures. A large body of water, the Caspian Sea, is visible on the right side of the image, curving around the city. The sky is a clear, light blue. A large red curved shape is overlaid on the right side of the image, partially obscuring the city view.

ADB

Development
Effectiveness
Brief

Azerbaijan ▶

A Cradle of Humanity Embraces Modernity

Asian Development Bank



Contents

Azerbaijan and ADB: A Partnership at the Crossroads	1
ADB's Contribution to Development and Poverty Reduction	4
Transport: Moving Azerbaijan Forward	3
Agriculture: Driving Rural Growth	5
Energy: Lighting Up Azerbaijan	6
Private Sector Development: Leveraging the Power of Good Companies	7
Regional Cooperation: A Strong Member of a Dynamic Region	9
Operational Effectiveness: Improving Efficiency and Performance	11
Future Challenges	12

Azerbaijan

Development Indicators

Item	2009
Non-Millennium Development Goals	
Population (million, 2009)	8.90
Annual population growth rate (% , 2007–2009)	1.3
Adult literacy rate (% , 2007)	99.5
Percent of population in urban areas (2008)	51.9
Millennium Development Goals	
Population living on less than \$1.25 a day (% , 2005)	2.0
Population living below national poverty line (% , 2009)	11.0
Under-5 mortality rate per 1,000 live births (2008)	36.0
Population using an improved drinking water source (% , 2006)	78.0
Income and Growth	
GDP per capita (\$, current)	4,798.2
GDP growth (% , in constant prices)	9.3
Agriculture	3.5
Industry	10.6
Services	9.1
Savings and Investment (current and market prices, % of GDP)	
Gross domestic capital formation	18.3
Money and Inflation (annual % change)	
Consumer price index (period average) ^a	1.5
Broad money	(0.3)
Government Finance (% of GDP)	
Revenue and grants	29.9
Expenditure and onlending	30.6
Overall fiscal surplus (Deficit)	(0.7)
Balance of Payments	
Merchandise trade balance (% of GDP)	23.6
Current account balance (% of GDP)	23.6
Merchandise export growth (annual % change)	(31.0)
Merchandise import growth (annual % change)	(14.0)
External Payment Indicators	
Gross international reserves (\$ million)	5,363.8
(in months of merchandise imports)	9.9
Total external debt ^b (% of GDP)	7.9
Memorandum Items	
GDP (current prices, AZN million)	34,578.7
Exchange rate (period-average, AZN per US\$)	0.8
Population (million)	8.9

AZN = new manat, GDP = gross domestic product, \$ = US dollar.

^a Excluding oil fund.

^b Public and publicly guaranteed debt.

Sources: *Asian Development Bank and Azerbaijan Fact Sheet, 2009*; *Asian Development Outlook Update 2010*; IFS Online, IMF Azerbaijan Statistical Appendix (July 2008); *International Monetary Fund's Regional Economic Outlook and World Economic Outlook*; *Key Indicators 2010*; *National Bank of Azerbaijan*; and *State Statistical Committee*.

Azerbaijan and ADB: A Partnership at the Crossroads

Azerbaijan is considered a cradle of civilization. Evidence of human life in what is now Azerbaijan dates back 2 million years. The country hosts monuments and relics from almost every period of human evolution. In 1968, the lower jawbone of a Neanderthal man was found that was later determined to be 350,000–400,000 years old. Azikh Man, as the jawbone is called, is by some reports the fourth-oldest human relic ever found. In 1918, Azerbaijan became a republic, the first in the Muslim world and the first Muslim nation to grant voting rights to women.

Azerbaijan soon became part of the Soviet Union. In 1990, the country declared sovereignty and elected a national government. Azerbaijan has always been blessed by generous oil and

gas reserves—in ancient times it was called “the land of fire” because of its burning gas vents. The riches under its soil, and its strategic location along key trade routes, also made it a coveted prize for larger nations and added to its turbulent history.

Today’s Azerbaijan is a modern republic grappling with how best to develop its economy in an equitable way while making the most of its vast oil and gas reserves. The country is resolving development issues through

Azerbaijan has always been blessed by generous oil and gas reserves—in ancient times it was called “the land of fire”

ADB Loan and Technical Assistance Portfolio in Azerbaijan

	1968–2003	2004	2005	2006	2007	2008	2009	as of September 2010
Approvals (\$ million)	27	33	55	0	200	217	76	0
OCR loans	–	10	49	–	190	215	75	–
ADF loans	22	20	3	–	10	–	–	–
TA projects	5	3	3	0.4	–	1	1	–
Contract Awards (\$ million)	–	–	1	21	31	32	149	4
OCR loans	–	–	–	3	28	8	145	3
ADF loans	–	–	1	18	3	24	4	0.2
Disbursements (\$ million)	–	–	0.5	4	15	21	59	6
OCR loans	–	–	–	0.03	1	12	43	3
ADF loans	–	–	0.5	4	13	9	15	3
Disbursement Ratio ^a (%)	–	–	2.1	4.0	14.4	7.2	12.1	1.2

– = not available, ADF = Asian Development Fund (concessional loans and grants), OCR = ordinary capital resources, TA = technical assistance.

^a The ratio of total disbursement in a given year over the net loan amount available at the beginning of the year, plus loans that have become effective during the year, less cancellations made during the year.

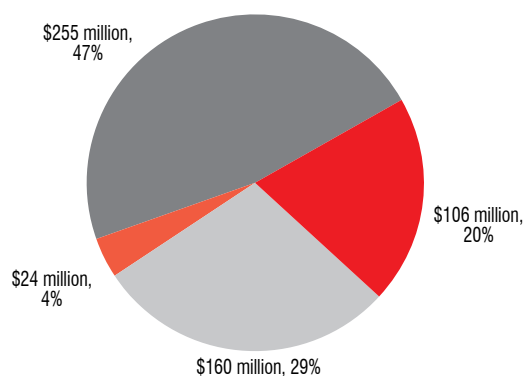
Source: ADB.



Today's Azerbaijan is a modern republic grappling with how best to develop its economy in an equitable way while making the most of its vast oil and gas reserves.

ADB Loan and Grant Portfolio to Azerbaijan (as of December 2010)

Total = \$545 million (8 loans)



- Energy
- Environment and natural resources
- Transport and communications
- Urban services (water supply and sanitation)

Source: ADB.

the State Program on Poverty Reduction and Sustainable Development for 2008–2015. The target is sustainable economic growth through macroeconomic stability and balanced development of the non-oil sector. Azerbaijan also aims to cut poverty, assist vulnerable groups (including refugees), improve and expand access to education and health systems, protect the environment, support gender equality, and accelerate reforms.

In 2009, the World Bank's ease of doing business index ranked the country as one of the world's top reformers in terms of streamlining business regulations.

Azerbaijan joined the Asian Development Bank (ADB) in 1999 and, in 2004, ADB opened the resident mission in the capital, Baku. Although the country enjoys a dynamic oil-driven economy, its development needs are tremendous. Since financing is not Azerbaijan's greatest need, ADB is working to become a source of knowledge for policy and structural reforms, strategy implementation, innovative project design, and sound implementation. ADB is helping establish sustainable long-term



Azerbaijan's development efforts are bolstered by a strong, although narrowly based economy. The oil sector accounts for about 55% of gross domestic product.

development by exposing the country to best practices in social safeguards, procurement, and project implementation.

Azerbaijan's development efforts are bolstered by a strong, although narrowly based, economy. The oil sector, as recorded in national accounts rather than gross production,

accounts for about 55% of gross domestic product (GDP). In the first half of 2010, GDP growth slowed to 3.7%, and the oil sector grew by only 2.3% despite higher global oil prices and improving external demand, according to ADB's *Asian Development Outlook*. The economy is expected to grow by 3.5% in 2011, down from a previous forecast of 9.7%.

ADB's Contribution to Development and Poverty Reduction

ADB's operations in Azerbaijan support the government's priority areas of water supply and sanitation, energy, and transport. Since joining ADB, the country has received \$660.4 million in loan assistance. Developing the private sector has also been a key priority of both the government and ADB.

ADB has supported inclusive growth, including by administering a \$2.5 million grant from the Japan Fund for Poverty Reduction to assist people in Mingechavir. The project improved housing for more than 412 families and created jobs, benefiting more than 12,000 people, about 73% of whom were poor.

Transport: Moving Azerbaijan Forward

The government recognizes that the country needs connectivity, both domestically and internationally, to encourage sustainable development. The entire road network is 25,000 kilometers (km) and is the dominant mode of passenger transport and the second major mode of freight transport. Currently, about 70% of the road network is in poor condition, resulting in high transport costs, long delivery periods, and traffic accidents. Inadequate funding and overloading have caused rapid pavement deterioration. The road network is insufficient to meet the needs of the rapidly expanding economy.

The government also sees the need to develop a transport network that will connect the main

Active Technical Assistance Portfolio as of December 2010

Sector	Outputs Achieved 2009
Energy	
Transmission lines installed or upgraded (kilometer)	482
Transport	
National highways; provincial, district, and rural roads built or upgraded (kilometer)	447
Beneficiaries of road projects (number)	9,000,000
Water Supply and Sanitation	
Land improved through irrigation services, drainage, and flood management (hectare)	100,000

Source: ADB.

regional population centers with markets in Baku, neighboring countries, and Europe. ADB's initial assistance to the transport sector supported basic needs and targeted physical rehabilitation of the main highway network connecting Azerbaijan to its neighbors. The first project, approved in 2005, upgraded part of the main east-west road connecting Baku to Georgia's capital, Tbilisi. This vital link passes through—and spreads the road's economic impact to—key population centers in Azerbaijan.

For Zabitov Gubeniz, the ADB-supported road project has literally been a lifesaver. She is a



Zabitov Gubeniz, a midwife in Nariman village, says the ADB-supported upgrade of the road in her area has helped people get to medical care more quickly and saved lives.

midwife in Nariman village. Before the main road there was upgraded, it was so rutted and damaged that it was impassible during heavy rain. Although she is a midwife, not a doctor, Gubeniz often had to treat medical emergencies because people could not get to the hospital. One woman had to deliver her baby in a vehicle because she was stuck on the old road. Now, people can make it to the hospital emergency room and receive the care they need.

"It was very hard on us before," she said. "We had urgent cases coming to our home at night. This road has been everything to this community."

The \$52 million East–West Highway Improvement Project rehabilitated 127 km of the Yevlakh–Ganja and Qazakh–Georgian border sections of the highway and 65 km of connecting local roads. It also supported policy reform by strengthening institutional capacity in the transport sector.

Leyla Ibrahimov, who operates a farm along the project road with her husband Ibrahimov Nazim Ali, said she has directly felt the impact. What used to be a grueling, hours-long journey



Leyla Ibrahimov, who operates a farm in Nariman village with her husband, notes that what used to be a grueling, hours-long journey to get her vegetables to market is now a quick 15-minute ride after the ADB-supported road upgrade.

to get her vegetables to market is now a quick 15-minute ride. She also noted that the family has saved money because they do not have to constantly repair their vehicle after traversing the road.



Mammadov Abdulla, a 58-year-old farmer who operates a 2-hectare watermelon patch along the Qazakh–Georgian highway, has seen his sales increase 30% since the road was upgraded and traffic increased.

“We are earning more,” she said. “But it has also made our lives more comfortable. We feel more connected to our community now.”

ADB expanded its involvement in transport with an October 2007 decision to help finance a comprehensive road network program that will ensure sustainable economic expansion by increasing trade flows and lowering transport costs. ADB will support the Azerbaijan Ministry of Transport’s Road Network Development Program 2006–2015, which is estimated to cost \$3.4 billion.

The program includes constructing, upgrading, and rehabilitating about 9,500 km of 124 priority roads. It will also assist in developing regulations and operational procedures;

ADB worked with the government to construct physical control measures in conjunction with nonstructural measures, as part of the December 2003 Flood Mitigation Project

encouraging private sector participation in construction and maintenance; and building capacity for planning, monitoring, evaluation, and reporting.

ADB will provide a \$500 million loan facility that will be available in stages. The first tranche, amounting to \$200 million, involves constructing 59 km of a new expressway between Masalli and Astara on the southern corridor, rehabilitating local roads in the project area, installing a vehicle-weighting station along the new expressway, and providing project support and building capacity for road network management.

Agriculture: Driving Rural Growth

Agriculture is the primary engine of rural growth in Azerbaijan and is highly dependent on water resource control and management. Irrigation and drainage systems need to be



ADB's operations in Azerbaijan support the government's priority areas of water supply and sanitation, energy, and transport.

developed and rehabilitated. Failure to protect watersheds has worsened flooding, and the heavy sediment load of floodwaters has diminished agricultural productivity.

ADB worked with the government to construct physical control measures in conjunction with nonstructural measures, as part of the December 2003 Flood Mitigation Project. A \$22 million loan from ADB was used to protect 12 districts in 4 flood-prone areas, where poverty was significantly higher than the national average. The project protected 5 towns and 43 villages, and supported the livelihoods of more than 200,000 people living on more than 100,000 hectares of floodplains. The project was designed to allow communities to break out of the cycle of periodic asset replacement, which was pushing many households below the poverty line.

ADB's project completion report stated that the project increased confidence in using flood-protected land; reduced damage to assets; reduced the labor required to protect homes and land; and improved water quality and hygiene, as well as agricultural output. The

report rated the project *successful*, noting that the physical works exceeded the targets despite initial delays, problems with the consulting services, and poor progress in the nonstructural measures.

Energy: Lighting Up Azerbaijan

ADB's Power Transmission Enhancement Project is helping Azerbaijan modernize its aging power transmission facilities with a \$160 million loan approved in 2008. The 25-year loan is helping build a double-circuit 220-kilovolt transmission line and associated substation facilities, replacing two lines that have been in use for about 60 years by the state-owned power company, Azerenergy.

Over one-fifth of the country's power equipment and more than half of its network facilities are operated beyond their

recommended life, resulting in frequent power failures, system losses, and the threat of grid collapse.

The unreliable and inefficient power network has hobbled sustained economic growth. The upgrade program has resulted in energy savings and increased reliability. When fully implemented, it will remove transmission choke points, lower system losses, and provide a more stable power supply, especially in the key industrial hub near Baku.

The project will also cut the need for imported electricity, optimize the country's hydropower resource, and reduce fossil fuel consumption and pollution. The gas and oil saved will be exported, giving a boost to government coffers.

The project is also expected to increase industrial production, provide opportunities to expand small and medium-sized enterprises, raise living standards, and create local jobs.

Improved power supply will particularly benefit rural dwellers, who make up nearly 50% of the 8.5 million population suffering from unreliable supply of basic services.

The energy sector plays a central role in the economy. But unlike oil and gas, the power transmission and distribution industry has suffered from meager investment.

ADB's loan will support the government's priority program of reforming and developing the power sector to protect the country's energy security. The loan could also catalyze private sector investment.

ADB provided 20 million euros to an integrated cement plant to expand its output and improve fuel efficiency. The loan marked ADB's first private sector infrastructure investment in the country

Private Sector Development: Leveraging the Power of Good Companies

ADB has actively supported the private sector in Azerbaijan. ADB has helped strengthen the undercapitalized banking sector and develop private infrastructure. As private banks are a key source of small loans, especially for individual entrepreneurs and small and medium-sized enterprises, the government has recognized them as critical to the economy.

ADB began its private sector activities in Azerbaijan in 2006 with the approval of a loan and equity investment totaling \$10 million to selected private commercial banks. In 2007, ADB approved three loans totaling \$56 million to several leading banks. A \$6 million loan to the Bank of Baku is providing increased access to financing by small and medium-sized enterprises. A \$10 million subordinated loan to Bank Respublika will strengthen its capital base, and a \$40 million subordinated loan to the International Bank of Azerbaijan is helping expand its lending, providing greater financing intermediation.

In April 2010, five banks in Azerbaijan—AccessBank, Azerigazbank, Bank Respublika, DemirBank, and Bank of Baku—signed trade finance agreements with ADB under the Trade Finance Facilitation Program, a move that will help local companies conduct more international trade and become more closely integrated into regional and global business networks.

The Trade Finance Facilitation Program offers loans and guarantees through and in conjunction with international banks and ADB's developing member country banks to support international



High-quality, locally made cement will help the government and the private sector complete the infrastructure needed to boost regional trade and tourism and diversify the country's sources of economic growth beyond the oil and gas sector—a key government priority.

trade transactions. The program was created because companies in developing member countries, particularly smaller firms, typically find it difficult to access trade finance.

The program is allowing local companies to do more business and grow, which encourages the hiring of more workers, boosting incomes and reducing poverty.

In June 2010, ADB provided 20 million euros to an integrated cement plant in Azerbaijan to expand its output and improve fuel efficiency. The loan marked ADB's first private sector infrastructure investment in the country.

The loan is helping Garadagh Cement raise its cement production capacity by around 30% to 1.7 million tons per year. At the same time, the replacement of the four wet kilns with a single, more efficient dry kiln will significantly reduce the plant's fuel consumption, cut water consumption and effluent discharge,

and bring the plant in line with international environmental standards.

With Azerbaijan's fast-growing economy, the resulting sustained commercial construction, and the government's wide-ranging infrastructure program, Garadagh Cement estimates that demand will grow by 5%–8% per year. With limited domestic production, Azerbaijan is currently forced to import much of its cement.

The additional supply of high-quality, locally made cement will help the government and the private sector complete the infrastructure needed to boost regional trade and tourism and diversify the country's sources of economic growth beyond the oil and gas sector—a key government priority.

Garadagh Cement is majority owned by Switzerland-based Holcim. The plant, 35 km from Baku, is the only integrated cement producer in the country.

Regional Cooperation: A Strong Member of a Dynamic Region

Azerbaijan is an important player in the Central Asia Regional Economic Cooperation (CAREC) Program, particularly in developing a road network that will link the region with the People's Republic of China, the Russian Federation, Europe, the Middle East, and South Asia.

Central Asia was crisscrossed by multiple routes linking east and west, known as the Silk Road and dating back more than 2,000 years. It was an important economic artery that stretched more than 10,000 km, from the Mediterranean to the Yellow River Valley in what is now the People's Republic of China.

Even though Central Asia lies at the center of the Eurasian continent, less than 1% of all trade between Europe and Asia currently goes through

the region. Inadequate transport infrastructure and cumbersome border processes have resulted in nearly all trade going by sea.

In November 2007, eight countries, including Azerbaijan, agreed to invest \$18 billion in six new transport corridors, mainly roads and rail links, and in airports and seaports to make the region a vital transit route for trade between Europe and Asia—a modern-day equivalent of the ancient Silk Road. About half of the funds are expected to come from multilateral organizations such as ADB, while the rest will come from the participating countries.

In April 2010, the ADB Board of Directors approved a \$600 million multitranchise financing facility to support the CAREC plan that will improve a key highway giving Uzbekistan and other Central Asian countries direct access to the Caspian Sea via Aktau, and eventually the Black Sea, via corridors to be built in Azerbaijan and Georgia.

In 2009, among the Central Asian countries, Azerbaijan had the highest proportion (29%) of ADB projects supporting regional cooperation and integration, according to ADB's Results Management Unit.

Operational Effectiveness: Improving Efficiency and Performance

One of ADB's key challenges in Azerbaijan is staying relevant in a country with a large budget surplus and little need for external funding. The current account balance ran a surplus of 32% of GDP in the first quarter of 2010. With oil and gas earnings higher than projected, ADB's *Asian Development Outlook* forecast a 27% current account surplus in 2011.

In 2008, Azerbaijan stopped seeking funds from ADB's concessional lending instrument, the Asian Development Fund, and chose instead to seek assistance from ADB's ordinary capital resources, which are lent at higher interest rates but with fewer reporting requirements.

ADB is competing with internal funding. As a result, it is under pressure to maintain highly efficient operational procedures and offer more value than simply project finance.

In 2008, Azerbaijan stopped seeking funds from ADB's Asian Development Fund and chose instead to seek assistance from ADB's ordinary capital resources

According to ADB's Results Management Unit, which monitors the effectiveness of ADB's work in member countries, ADB projects averaged 20 months from initial approval to actual disbursement during 2004–2008. This is the longest processing time of any country in Central Asia.

Although ADB needs to streamline its project processing procedures, its work has also received good marks. In September 2010, ADB's Independent Evaluation Department conducted a validation study of the effectiveness of ADB's Flood Mitigation Project in Azerbaijan. Although it noted problems, the department rated ADB *satisfactory*, and in terms of achieving the outcomes and outputs for the project, it rated ADB *efficient*.

The impact of ADB's operations can be felt on the ground as well. Pawan Karki, a project leader with the ADB-supported East–West Highway Improvement Project, noted: "I'm a professional engineer but when I'm working on an ADB project, I need to think about much more than engineering. When working on a road project with ADB, I'd be in trouble if I didn't do HIV awareness. I'd be in trouble if I didn't carefully conduct environmental and social impact reports. That is how ADB operates and that is how I operate when I work with ADB."

Future Challenges

Azerbaijan is at a critical juncture in its development. The economy is expanding rapidly, but it is driven almost solely by oil revenues. Poverty rates remain high and economic opportunities are unevenly spread. The oil sector gives Azerbaijan an advantage in dealing with the post-Soviet collapse of its industrial base, the deterioration of physical infrastructure and social services, and the lingering environmental damage.

But the oil revenues have also raised people's expectations, placing pressure on the government to increase spending. The country's main development challenge in the years ahead is to ensure that the windfall from the oil sector benefits the population evenly, without undermining macroeconomic stability.

ADB is assisting Azerbaijan with the development of its non-oil sector by improving

infrastructure, making social development more inclusive by reducing economic disparities among regions, promoting good governance, and improving the climate for private sector growth.

ADB is also at a critical crossroads in Azerbaijan. It must add value to its projects beyond simple financing and act as a catalyst for best practices and reform. Otherwise, it could become irrelevant in the oil-rich years ahead.

.....
Text by Floyd Whaley.

The cover shows Baku, the capital of Azerbaijan.

Photographs on the cover and pages 2, 3, and 9 by Dena Bermas. Photographs on pages 5–7 by Rena Effendi.

For more information, please visit <http://adb.org/Azerbaijan/main.asp> or contact Olly Norojono, country director, Azerbaijan Resident Mission (onorojono@adb.org).
.....

Development Effectiveness Brief: Azerbaijan

The Asian Development Bank (ADB) has been a key partner in supporting the development agenda of Azerbaijan, as well as its economic growth and reform program. Azerbaijan has been a member of ADB since 1999 and in 2004, ADB opened a resident mission in the capital, Baku.

Operations in the country are closely aligned with the government's priorities, including diversifying the economy beyond the oil sector. ADB's work in Azerbaijan has focused on promoting inclusive economic growth, as well as supporting regional cooperation efforts. ADB has developed a strong and growing relationship with Azerbaijan.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.