

# AZERBAIJAN PUBLIC INVESTMENT POLICY AND EFFICIENCY PROJECT

## STATEMENT OF WORK --

### **I. Title**

“Azerbaijan Public Investment Policy and Efficiency Project”

### **II. Objectives**

The primary objective of this task order is to procure services to help strengthen the Government of Azerbaijan’s institutional capacity for long-term sectoral development and policy planning, capital-budget formulation, investment project preparation, and project appraisal.

Officials of Azerbaijan’s Ministry of Economic Development (MED) have requested assistance to assess and to improve the practices by government authorities in formulating and prioritizing the components of the Public Investment Program (PIP).<sup>1</sup> Thus, a central objective of the Contractor’s task is to assist the MED with its assessment and development of improved procedures for: formulation of the PIP; coordination of the investment plan with the government-wide consolidated budget and the medium-term expenditure framework; related development of sectoral development and policy plans for key infrastructure and social sectors; and review and approval of the PIP by the Cabinet of Ministers, the Parliament, and the public.

Because of the limited numbers of staff in the MED and the diverse character of investment projects in various sectors, the technical ministries and other governmental bodies play a critical role in determining the quality of the investment projects that are prepared and presented for approval by MED. Therefore, a second objective of the Contractor will be to assist selected technical ministries, other budget organizations, and their staffs to improve: the formulation of their sector-specific investment plans, their approach to preparation and justification of projects, and the commitment to appropriate policies (e.g., for cost recovery and maintenance for proposed investments) to achieve the projected benefits of the investments on a sustainable basis.

A third objective of the Contractor will be to assist the Minister and Deputy Minister of MED and others in their formulation of Azerbaijan’s long-term development plans (e.g., in the system for international transportation and for transit of goods through Azerbaijan) and in their efforts to identify and to overcome obstacles to the implementation of those plans.

### **III. Background**

Under the impetus of Production Sharing Agreements with oil companies initiated in the mid-1990s, Azerbaijan’s oil economy has been expanding vigorously and the levels of production and exports of oil and gas are projected to increase rapidly in the next few years. Thus far, the Government of

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<sup>1</sup> Primary responsibility for preparing the government’s annual Public Investment Program lies with the Ministry of Economic Development (MED) and its Department of Economic Policy and Forecasting. Within that Department, the Division for State Investment receives investment requests from all other units of government and recommends priority activities that are to be authorized as investments for inclusion in the state budget for the coming budget year. Current procedures for planning and authorizing public investment derive from the comprehensive Budget System Law of 2002 and its related decrees and amendments.

Azerbaijan (GOAz) has done an adequate job of managing this new source of revenue, but the challenge of handling rapidly rising oil revenue during 2004-12 -- and its later decline -- will become significantly more demanding. Compared to some of its Caspian neighbors, Azerbaijan's oil and gas reserves are more modest and government revenues from oil and gas exploitation are projected to follow a shorter cycle of investment, exploitation and decline. Since the oil boom will be relatively short lived, it is crucial that the GOAz create the legal structure, and develops the institutional capacity, to help transform the country's wealth into productive investments in appropriate non-oil sectors of the economy. The GOAz has taken major strides to create a legal framework that will support an open, market economy. Much of the formerly state-owned enterprise sector has been privatized and that process will continue. These are major achievements.

To maintain macroeconomic stability, the GOAz plan for management of its oil revenues entails both

1. an annual transfer of resources from the State Oil Fund (SOFAZ) toward the Consolidated Budget, to supplement ordinary tax and non-tax revenue of the government; and
2. the investment in securities (foreign assets) by SOFAZ of all other current oil revenue, to meet future needs of the country when oil production turns down.

To guard against undesirable volatility in the level of government spending over time, the GOAz is seeking, as a target, to maintain a relatively stable "non-oil deficit." At the time of approval of the budget for 2004, the target non-oil fiscal deficit for 2004-05 was about 12 percent of GDP<sup>2</sup> – mainly financed by the annual transfer from SOFAZ. This annual target will likely rise somewhat during 2006-2010.

Considering that overall Azeri economic activity has been rising at about a 10 percent annual rate in recent years and is likely to continue to grow rapidly for the rest of the decade, this fiscal scenario will allow the GOAz to increase dramatically the level of annual spending on its public investment program as well as on current services and transfers. As envisioned in the State Program on Poverty Reduction and Economic Development, 2003-05, or SPPRED, the PIP "will allow for both

- increased social security (through rehabilitating schools, resettling refugees, etc.) and
- faster economic growth (through rehabilitating infrastructure).<sup>3</sup>

At the outset of the SPPRED program, government capital expenditure, including major rehabilitation of existing infrastructure and building new infrastructure was planned to rise from 17 percent in 2001 to 21 percent of the consolidated budget in 2005.

To manage the GOAz's rapid-but-controlled public investment program over the next 10 years, the GOAz must strengthen greatly its institutional capacity in the areas of long term planning, budget formulation, project preparation, project appraisal, and project implementation. This involves first a need for improved capacity at the Ministries of Finance and Economic Development for preparing the annual Consolidated Budget, the rolling Medium Term Expenditure Framework (MTEF), and the PIP. Moreover, each technical Ministry, autonomous government organization, and district government seeking support from the Consolidated Budget must develop their capacity to prepare projects for the PIP each year, in accordance with modern norms of economic feasibility. This in turn needs to be carried out within the context of a rationalized sectoral development and policy planning framework at the ministerial and government-wide level.

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<sup>2</sup> However, in a break from past practice, the GOAz submitted and the Parliament passed in June 2004 a mid-year, supplemental budget, amounting to about 1.5 percent of GDP – raising the expected non-oil deficit for 2004 to more than 13 percent of GDP.

<sup>3</sup> SPPRED Report, Appendix 2. Medium-Term Expenditure Framework, Part II.

In turn, the Parliament (Milli Majlis) should have the capacity to analyze the Consolidated Budget and the PIP capital expenditures program when they are submitted each fall by the Cabinet of Ministers. Finally, there are oversight and watch-dog functions that need to be developed in civil society, in the media, and in the audit units of the Ministry of Finance and the Chamber of Accounts.

### ***The Budget System***

A comprehensive Budget System Law (BSL) was enacted in 2002 and has been elaborated in subsequent presidential decrees and amendments. It defines the country's budgetary system and sets out the procedure for preparing, approving and administering public resources on an annual basis. The BSL is comprehensive, encompassing all previously separate budgets in a Consolidated Budget, including: "off-budget" or "extra-budgetary" expenditures, "implicit subsidies," the budget of Nakhchivan Autonomous Region, as well as any future special purpose budgets. Unity in the Consolidated Budget will be achieved by using the same budget nomenclature, documents and forms as well as reports for all elements of the system. Municipalities are recognized as fully self-governing entities that are responsible for preparing, approving and executing their own budgets, provided that they can do so from their own revenue resources. To the extent that municipalities (small units numbering more than 2,000) or state-owned enterprises seek subsidies from the State, they become in principle subject to the government's procedures and priorities for financing.

A simplified calendar for the State budget, as set out in the BSL, is presented below. Work begins approximately 11 months before the beginning of the budget year, approximately February 1, for the following budget year beginning January 1.

#### **A. Consolidated Budget Preparation (led by the Ministry of Finance).**

1. The Executive (MOF and MED) specifies the medium term economic and social development program objectives by the end of February.
2. A draft framework of the state budget and investment program is prepared by MOF and submitted to the Cabinet of Ministers by April 15.
3. MOF prepares and distributes budget instructions for Ministries and other organizations.
4. Municipalities that require financial support from the State budget submit their requests by May 1.
5. Based upon the submissions of the Ministries, the MOF prepares a draft consolidated budget for the Cabinet of Ministers before July 1. MOF prepares a medium term budget forecast (revenues, expenditures, deficit) and the investment program (budget year plus 3 out years).
6. The draft Consolidated State Budget is submitted to the Parliament (Milli Majlis) not later than October 15<sup>th</sup> and includes: the draft law on the state budget, economic and social indicators, description of fiscal policy, information on debt, a comparison of revenue and expenditure forecasts with actual achievements in prior years. The BSL also requires the publication of the Consolidated Budget in the press, 10 days after submission to Parliament.

#### **B. Public Investment Program (PIP) Budget Preparation (led by the Ministry of Economic Development).** The BSL requires that all capital expenditures must be included in the PIP<sup>4</sup> and that all budgetary expenditures must be executed by the Treasury.

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<sup>4</sup> Article 11.9.5 of the BSL states that the budget shall contain "the amount of expenditures on investment programs for the next year and for the following three years with indication of the financing source and breakdown by functional and economic paragraphs."

1. Requests for public investments are submitted to the Ministry for Economic Development by technical ministries (by April 15), the district governments, and municipalities. In general, each submission should include a feasibility study, current cost estimates, and a financing plan.
2. Through negotiations, the MED Department of Economic Policy and Forecasting winnows down these requests to a level consistent with the overall investment program level in the draft consolidated budget. The combined, four-year Public Investment Program is then submitted to the Cabinet of Ministers (by September 10, 2004 for the upcoming budget year), to be incorporated into the Consolidated Budget.
3. It seems that the BSL intends that the Cabinet of Ministers should also submit the PIP to Parliament as part of the budget presentation.<sup>5</sup> However, reportedly, the Consolidated Budget that was sent to Parliament in October 2003 was in a format that divided expenditures by “spending unit” only – not by function. In addition, the MTEF presented to Parliament in the fall of 2003, covering both current and capital expenditures, was only a single summary page.

#### C. Parliamentary consideration.

1. The Executive defends the budget according to the rules of the Parliament.
2. Parliament requires itself to review the budget in more detail than in the past, including approving expenditure and deficit ceilings. The Parliament approves the budget by December 20.
3. Parliament’s approval includes important parameters including, *inter alia*, total revenues, tax rates, expenditures by functional paragraph, amount of the reserve fund, borrowing limits, budget deficit ceiling, etc.

### **IV. Needs Assessment and Illustrative Activities of Contractor**

#### ***(a) Evolution and Annual Preparation of the Public Investment Program***

As described in SPPRED program, approved by the President in February 2003,

*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 prioritize 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. (Main report, Section 4.2, p. 116.)*

The MED prepared its first PIP during 2003 to cover the period 2004-07; the second PIP is now under preparation, to cover the period 2005-08. The PIP includes all investment projects that are proposed to receive funds from the Consolidated Budget or, alternatively, from co-financing that is expected for those projects from donor, foreign debt finance, or own funds of state-owned enterprises. To develop the PIP, MED prepared a questionnaire to collect from the technical ministries a standard set of information about proposed investment projects. For the budget process during 2005, the MED is also

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<sup>5</sup> Article 12.1.5 states that the draft state budget to parliament should include proposed “expenditure with breakdown by functional, economic, and organizational items.”

seeking Presidential approval for a set of “Rules for Formulation of the Public Investment Program.” The head of MED’s Division for State Investment would like to refine and improve the questionnaire and rules for submission, based on good practices of other developing or transition countries, such as Azerbaijan, where a large share of utility and infrastructure investment is conducted by the public sector.

In principle, the MED would like to include in the PIP all new investments (e.g., new schools), additions to existing investments (e.g., new classrooms), and major capital repairs or rehabilitation (e.g., new roofs, plumbing, or boilers for schools). However, this is not systematically done for all sectors at present. In addition, major new investments to be undertaken by state-owned enterprises with their own resources, and without financing from the Consolidated Budget or from foreign sources, were apparently not included in the PIP for 2004-07.

During 2003 and early 2004, an initial donor assistance activity was delivered, toward strengthening the Division for State Investment – as had been proposed in the SPPRED program (see excerpt above). However, that intermittent assistance activity, obtained through the World Bank’s IBTA-II program has been viewed by the MED as unsuccessful in helping to build its ongoing institutional capability.

Moreover, there is a need by MED to recruit appropriate new staff, to fill numerous vacant positions in the Division and to train them to work effectively. As in most GOAz ministries, recruitment of well-qualified staff is difficult, given the low levels of public sector salaries in comparison to those for technically skilled staff in the private sector.

Specific activities of the USAID Contractor to assist with the development by MED of the annual budget (and MTEF) for the PIP, and in conjunction with this process to elucidate sectoral development and policy plans in key infrastructure and social sectors, will be developed between USAID and MED at the commencement of the project and at annual consultations. Beginning the second year of the project, a number of sectoral Ministries will be identified to assist with proposal development. During the life of the project a maximum of six sectoral Ministries will be assisted in the development of sectoral public investment proposals.

Illustrative activities of the Contractor are expected to include:

- Reviewing assessing, jointly with MED personnel, the specific project proposals that are presented to MED by technical ministries early in the annual budget preparation cycle;
- Identifying additional material needed from technical ministries or other sources in order to complete the MED’s analysis and prioritization of specific investment project or program proposals;
- Developing jointly with MED and relevant pilot ministry personnel a systematic, comprehensive and prioritized public investment and related sectoral development and policy plan for the annual and multi-year budget cycle, for full incorporation into the MTEF, which covers a minimum of three additional sectors annually);
- Providing formal training in project economic analysis and project appraisal. Such training would be focused, to the degree practicable, for staff of the MED and of prioritized technical ministries and municipal government units, primarily during the October-December period of each year – when work demands relating to preparation of the annual PIP budget are relatively light. A minimum of 15 training modules covering core cost benefit analysis principles and techniques and related sectoral development objectives and strategies would be offered annually, to a minimum of 200 participants.

- Seminars, courses, or training modules will need to be presented in the Azerbaijani language, should be delivered in an interactive style, and should include the use of case studies.<sup>6</sup> A U.S. sub-contractor might be utilized to develop the basic course materials for a multi-week course or set of modules. English-speaking instructors from local universities or institutes might also participate as trainers or otherwise might be encouraged to develop or integrate such a course and materials into degree programs at local universities.
- Assisting the MED with recruitment of permanent staff for the Division for State Investment – which may include helping to draft position descriptions and desired qualifications, interviewing job candidates, and assessment of training needs for new staff.
- Identifying needs or opportunities for “contracting out” some elements of the PIP review process that might be performed by private consultants or consulting firms.

The ultimate objectives of the project would be to ensure that rationalized and systematic public investment plans reflecting (1) appropriate application of rigorous cost/benefit analysis principles, and (2) a related sectoral development and policy framework which promotes core economic growth and equity goals, would be systematically and transparently incorporated into the annual and multi-year budget process. This would entail reform of public investment and sectoral development and policy framework planning on a pilot basis in key ministerial units over the three year period of program implementation period; with the goal being to ensure that the public investment and related sectoral development and policy planning processes in all 10 major sectoral areas included in the budget and in accordance with the Poverty Reduction Strategy Program are effectively transformed and rationalized by the end of the three year implementation timeframe of the program.

It would also include the conduct of related technical support and training activities at the municipal level, to ensure that local governments that are receiving project financing support from the national level are incorporating rationalized investment and sectoral policy planning principles into their budgetary formulation processes. The achievement of these objectives will require the full and effective integration of this process with both the MTEF process under the guidance of the MOF; as well as with the SPPRED and RDP program functions within the MED. Thus the project will be expected to promote the development and operate within the context of transparent and clear inter-institutional linkage points which ensure appropriate incorporation of the investment and sectoral development and policy planning process within the broader annual and multi-year budgetary planning context.

***(b) Sector Assessments for Investment Planning***

The Public Investment Program is divided into ten sectoral or functional areas. Of these, as shown in the attached table, five sectors account for more than 90 percent of the proposed expenditures – energy, transportation, communal infrastructure, irrigation, and social infrastructure. Financing from foreign donors and lenders is extremely important – and, by estimate of the GOAz budget organizations, was projected to amount to two-thirds (1,038 billion manat) of total financing for the 57 PIP projects that were identified and approved for funding during 2004. (However, as estimated in the fall of 2003 by budget analysts of the IMF, the foreign-financed components of the government’s investment expenditures for 2004 were expected to amount to only about 40 percent of total public sector investment.)

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<sup>6</sup> A good illustration of topics and case studies that might be covered in such training events is provided by the syllabus for a five-week course in “Program on Investment Appraisal and Risk Analysis” that was led by Professor Glenn Jenkins at Queens University, Ontario, during June-July 2004.

Azerbaijan suffered widespread deterioration of its utilities and other public infrastructure during the 1980s and 1990s, so that almost every sector of Azerbaijan's infrastructure now cries for rehabilitation or new investment. Nevertheless, priority "economic needs" have to be evaluated across sectors. One clear priority has been the need to improve the availability of electricity for enterprises and for households – especially during the winter months and for all regions of the country except central Baku. As highlighted in a recent World Bank report,<sup>7</sup> EBRD-World Bank surveys in 2002 of enterprises across Eastern Europe and former Soviet states revealed that power interruptions were particularly common and severe in Azerbaijan – both in comparison to the conditions in other countries and to the severity of the problems in Azerbaijan relating to access to water or telephone service. So, it seems appropriate that foreign donors and the GOAz have recently concentrated major resources upon projects to rehabilitate and expand the electric power sector (and to improve the availability of gas – whose shortage during the winter months exacerbates the seasonal peak demand for electricity).

Meanwhile, in some sectors, the economic needs for investment may be extreme, but institutional factors may make it difficult to implement investments in an efficient way or in a way that truly serves the needs of the population. Problems of corruption occur in many areas in Azerbaijan and may be more extreme in some sectors than in others. Other institutional factors, such as the will to adapt or to follow best practices for investment planning and project preparation, also differ among various governmental units. The MED and other central organs of Azeri economic and budget policy therefore have taken, and will continue to take, these factors into account as they develop the annual budget and MTEF.

Within sectors there is also a need to consider alternative approaches or least-cost solutions to achieving goals. For example, to deal with domestic water needs of the Baku region, one could pursue two alternative approaches. One approach is to rationalize consumption by replacing leaky water mains and introducing metering and economic charges for the consumption of domestic water and related sewer services. An alternative approach is to begin construction of a very costly pipeline to bring new water supplies from 315 km away. The PIP for 2004-07 contained recommendations to approve projects to implement both approaches.

Thus, apart from the need for skills to appraise or evaluate an individual project in isolation, the staff in the MED's Division for State Investment and in other central ministries need to deepen their knowledge and understanding of sector-wide strategies. In many areas, good sector studies for Azerbaijan and suggested sector strategies may already exist. For example,

- For the national irrigation system, a comprehensive benchmark study – with a detailed set of recommended options for future investment and rehabilitation was prepared by a German consulting firm in 1995-96. That study has provided the basis for the two World Bank funded irrigation projects that have subsequently been implemented or begun in the country. Other, more focused sector studies in the irrigation sector have also been produced.
- For the energy sector, Japan's Bank for International Cooperation and Tokyo Electric Power consultants have completed in 2004 an important set of studies of Azerbaijan's power generation and transmission sector, while the European Union and Azerigas have completed a recent study of the system for gas transit and storage. In addition, a USAID contractor, PA Consulting, is now conducting an analysis of the (mainly non-functioning) central heating plants that are in place in many Azerbaijani cities and towns.
- For the transportation sector, the EU-TACIS program is said to have conducted an important study of primary roads in Azerbaijan during the late 1990s, although this study does not seem

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<sup>7</sup> Azerbaijan Building Competitiveness – An Integrated Non-Oil Trade and Investment Strategy (INOTIS Report), November 2003, pp. 35-41.

to be readily available in Baku. (However, certain traffic studies and other feasibility work was subsequently done by EU consultants, to guide the recent rehabilitation and upgrading of the primary roads connecting Baku, Tbilisi, and Yerevan. Several international donors have contributed to the subsequent construction works within Azerbaijan.)

- In the water and wastewater sector, it is reported that the French government prepared a study that led to a project proposal for a sewage treatment plant for Baku (not yet available in English) and that may provide valuable information about major parts of the sector.

Some of the foregoing studies may be available in the MED's Division for State Investment; most are not. Thus, the MED needs to develop and improve its "library" of such sector studies – in English and Azerbaijani. Similarly, many project-level "feasibility studies" that have been done by Western consultants during the past decade for proposed projects in Azerbaijan need to be collected in the MED (and perhaps also at other libraries or focal points for project preparation in ministries or state committees) to provide histories and models for the preparation of future projects. These documents will supplement the library of project proposals and justifications that MED has received in support of PIP investment project proposals that have been vetted during 2003-04.

Illustrative activities for the USAID Contractor to assist with sector assessments and improved preparation of projects by selected technical ministries might include:

- Organizing or participating in inter-ministerial work groups and seminars on large, controversial projects, where participants might include officials of the affected technical ministry, the MED, and outside experts (such as consultants and technical staff of donor organizations who periodically visit Azerbaijan);
- Establishment or enhancement of libraries of sector studies and project files at the MED, in paper and electronic form. Important reference documents, manuals for project preparation, or sector studies may also need to be supplied to selected technical ministries – to improve the quality of their libraries;
- Conducting and disseminating new "sector studies" or analysis of key issues for Azerbaijan that are important for guiding the PIP but have not been adequately addressed through other studies have been done by foreign or local sector experts.

As noted earlier, a key (and ultimately the most important) objective of the support program should be to ensure that rationalized sectoral development and policy frameworks are established and that systemic public investment planning activities are carried out in a manner consistent with these frameworks. These in turn must be effectively linked to SPPRED and RDP planning activities; and firmly integrated within the MTEF process.

### ***(c) Improved Integration of Economic, Financial, and Engineering Analysis***

Many Western analysts in Azerbaijan and younger or reform-oriented Azerbaijani professionals have commented to USAID about the need in Azerbaijan to reevaluate Soviet-era engineering standards and designs. In the construction industry, standards of strength and weight for structures and equipment seem to have a bias toward "over-engineering." Awareness is now growing that the true or economic costs of many materials (steel and concrete) and ongoing inputs (fuel) are far higher than were recognized under the artificial relative prices that prevailed in Soviet times. Therefore, old standards and rules of thumb for investment projects need to be revised.

Similarly, prices paid by consumers for services supplied through public infrastructure were often negligible in the Soviet era and throughout the 1990s – and such prices did not provide appropriate



incentives for avoiding waste and for allocating scarce resources to the “best” uses. As in other former Soviet states, Azerbaijan is now making a gradual transition in many sectors toward a system of prices (and toward metering systems to measure units consumed). But, mentally, most consumers and many government officials have not accepted the wisdom of the new approach and, as in all countries, consumers resist paying more for any good or service that is provided by the state. As a result, when price and cost considerations are considered by officials, the tendency in most technical ministries is often to look for the “least-cost” solution for investments and to neglect or under-value both

- The financial, cost-recovery elements of a proposed project and
- The future operation and maintenance costs that will need to be provided for (and which, in Azerbaijan’s future market economy, will increasingly only be provided for if a good system of user fees has been put in place).

One factor that may compound the tendencies noted above (toward over-engineering and toward neglect of financial cost recovery) is that most of the responsible investment-planning staff in the technical ministries are engineers, rather than economists, accountants, or business graduates. Thus, for all of the “infrastructure” sectors, Azerbaijan’s economic ministries – especially the Ministry of Economic Development and the Ministry of Finance – have an important role to play in educating their colleagues in the technical ministries on the need and rationale for applying improved economic and financial criteria to the preparation and analysis of alternative projects.

In Azerbaijan, the Ministry of Economic Development also has other policy responsibilities that complement its role in “educating” the technical ministries on better incorporation of financial and economic criteria into project planning. It is the home ministry for the Department of Enterprise and Management of State Property. Thus, for those sectors that may be privatized in the future, the MED needs to keep an eye to the future, when the current operating entities should become financially profitable – so that they can be saleable to prospective private owners. In addition, the MED’s Department of Economic Policy and Forecasting also provides staff support to the inter-ministerial Tariff Council – which has a critical role in guiding Azerbaijan’s transition from subsidized to market pricing of services of state-owned infrastructure entities.

The proposed USAID technical assistance project staff can play an important part in helping these different elements of the Ministry of Economic Development to “reorient” the approaches used by technical ministries – so that the latter will better integrate economic and financial analysis into the preparation and evaluation of their proposed investment programs for the PIP.

***(d) Monitoring and Assessment of Investment Project Results***

In addition to responsibilities for vetting investment proposals that are incorporated into the forthcoming budget year and MTEF, the MED may have responsibilities for monitoring and evaluation of the subsequent execution of the investment budget and the results or impact of such investments. It would be a tall order for MED to develop a capability to collect and critically evaluate the implementation of investment projects and their results. The staff and resource requirements – if applied on a broad scale to many projects within the PIP – could be very substantial.

However, this is a role that the MED may be asked by the GOAz to undertake. Alternatively, certain responsibilities for monitoring implementation or the results of the PIP investment program may fall to the Milli Majlis, the Chamber of Accounts, or management and audit units within the Ministry of Finance.

In any of these events, the USAID Contractor team for the PIPE project may be asked to assist with the collection of data and/or analysis of the impact of such investments.

*(e) Strategic Long-Term Planning for Economic Development*

In addition to strengthening the contents and general coherence of the Public Investment Program, the Minister of Economic Development has a wider mandate to help define and to promote sound strategies for Azerbaijan's future economic development. This may involve the development of new strategic initiatives that cut across the responsibilities of various technical ministries. It may also involve the development of effective plans to reevaluate and/or to implement strategic initiatives that have already been defined or approved by the government, such as

- The State Program for Social and Economic Development of Regions of the Republic of Azerbaijan (2004) and
- Enhancement of Azerbaijan's development as a regional transportation hub.

In the latter area, the MED has noted that Azerbaijan is a member of TRACECA, a regional Black Sea and Caspian/Central Asian country group that is particularly concerned with regional transportation issues and that – since its founding in 1998 – has been supported by the European Union.

For the USAID Contractor, illustrative activities that could contribute toward improved long-term planning efforts in the two areas above might be

- An assessment of the potential roles of municipalities and rayons for setting and implementing critical investment projects outside the main cities or
- Surveys of critical bottlenecks impediments faced by cross-border shippers – to/from Azerbaijan or for goods in transit between third countries – and formulation of tactics to relieve such bottlenecks.

However, these are strictly illustrative ideas and it may be these issues are already being studied adequately or are ones that the MED would not want to select for other reasons. Ultimately, the goal of these planning efforts would be the transformation of sectoral development and policy planning frameworks across all key sectors; in a manner which promotes full integration of public investment planning activities within the MTEF process. This will require intensified institutional collaboration with other units within the MED; as well of course with the budget planning unit within the MOF.

As indicated earlier, this coordination effort will require close Ministry and Government agencies as well as donor coordination. It is anticipated that this will be achieved through sectoral working groups to ensure collaboration and to ensure duplication of efforts is reduced to a minimum.

**V. Illustrative Indicators to Measure Results:**

The development of a final set of indicators consistent with Strategic Objective -SO 1.3; IR: 1.3.1.3 - Improved Efficiency and Effectiveness of Policy Implementation will be developed to measure project results in collaboration with USAID and the stakeholders as part of the Contractor's annual work plan. Generic institutional development indicators have been provided below to guide the contractor in the direction that is anticipated to ascertain administrative processes required for formulation of the PIP, strengthening institutional capacity at the MED and key sectoral Ministries, and training in order to qualify how training, an outcome indicator, will assist us in demonstrating how USAID-sponsored training programs can improve the quality of MED service. A set of generic indicators and a brief description are provided below:

**Indicator #1:** Progress in reengineering the components of the Public Investment Program. The selected administrative processes are the formulation of the PIP, coordination of the investment plan with the government-wide consolidated budget, and review/approval of the PIP by the cabinet of Ministers, the Parliament and the public. Each process passes through distinct and consecutive phases. Progress toward completing all three phases is scored on a 100-point scale. The three phases are: (a) convene technical group (maximum 20 points); (b) develop action plan (maximum 20 points); and (c) implement process changes (maximum 60 points). Partial scores can be allocated to a given step depending on how much progress has been made towards completing that stage. This is a milestone indicator measuring progress towards completion of the final stage. Achievement of 100 points is a direct measure of an improved operational environment in MED.

**Indicator #2:** Level of institutional capacity of MED and other technical ministries. Institutional capacity is defined along set dimensions. For each dimension, an assessment must be made along the ranking scale (1 = low capacity; 5 = high capacity), within the following broad guidelines: 1 = Low capacity: General training programs for staff implemented; 3 = Improving capacity: Several training programs designed and implemented for improved practices for investment planning and project preparation/appraisal; 5 = High capacity: Demonstrated improvement and use of new operational procedures, demonstrated improvement in personnel's knowledge of operational procedures.

Bureaucratic inefficiency, lack of transparency and will to adopt best practices in investment planning are cited as critical constraints to efficient implementation of investment projects in Azerbaijan. Strengthening the capacity level of the MED and other technical ministries personnel – such as improving personnel's knowledge/skill base in order to create better investment decisions – should improve efficiency and transparency and thereby increase confidence.

Baseline capacity level will have to be determined at the start of the activity. For example, baseline levels of personnel's knowledge/skills could come from training needs assessments, and then improved personnel's knowledge could be measured through post-training evaluations. The expert conducting the baseline assessment should also be asked to develop a refined set of criteria that can be applied to subsequent monitoring.

**Indicator #3:** Number of direct beneficiaries of training and technical assistance under this activity. The proportion of trained personnel that demonstrate proficient application of new skills, knowledge, and practices. This indicator will be measured in a manner described for indicator #2. This outcome indicator demonstrates how USAID-sponsored training program is improving the quality of MED service.

## **VI. Technical Approach and Key Personnel**

While the Contractor may propose an alternative technical approach and staffing, an illustration of probable requirements is shown below. The Contractor shall present a list of key personnel to conduct the key tasks indicated below. The Contractor shall assemble and engage a team of competent professionals and support staff. The Contractor is responsible for the composition of the task order team members and the appropriate number of team members. The Contractor shall at all times provide the team with competent management, financial and administrative support staff sufficient to facilitate the timely performance of this task order.

## Illustrative Staffing and Subcontracting for Public Investment Policy and Efficiency Project

|                                                                    | Year 1       | Year 2 | Year 3 |
|--------------------------------------------------------------------|--------------|--------|--------|
|                                                                    | Person Days  |        |        |
| <b>Long-term TA (Expatriate)</b>                                   |              |        |        |
| COP - Economist Level I                                            | 230          | 230    | 173    |
| Training Coordinator                                               | 230          |        |        |
| <b>Short-term TA</b>                                               |              |        |        |
| Senior Experts - Economists/engineers in key sectors               | 200          | 200    | 150    |
| Level II Experts - Economists/engineers in key sectors             | 100          | 100    | 75     |
|                                                                    | Person Years |        |        |
| <b>Local TA</b>                                                    |              |        |        |
| Dep COP - Economist/Engineer                                       | 1            | 1      | 0.75   |
| Other sector experts in key sectors, bilingual                     | 2            | 2      | 1.50   |
| Office manager                                                     | 1            | 1      | 0.75   |
| Translators and support staff                                      | 6            | 6      | 4.50   |
| <b>Illustrative Grants and Subcontracting</b>                      |              |        |        |
| Consultancy subcontracting, local or international                 | 1            | 1      | 0.5    |
| Subcontractor for multi-week Course in Investment Project Analysis | 1            | 1      | 0.5    |

### Key Personnel

- (a) Members of the project team shall include a team leader with overall authority and responsibility to act for the Contractor with respect to the subject matter of this contract. The team leader shall have primary responsibility for communicating and otherwise coordinating with USAID. The team leader is responsible on behalf of the Contractor for the timely submission of all written reports and other deliverables and for ensuring quality control and overall responsiveness of the project team members to the accomplishment of the project objectives, in accordance with its terms and conditions. In the temporary absence or unavailability of the team leader, the team leader shall designate an alternate to act in place of the team leader in communicating with USAID and managing the work of the task order team.
- (b) Key personnel shall be identified by name in the Contractor’s proposal. The Contractor shall not replace any key personnel without the prior written consent of the CTO, which shall not be unreasonably withheld provided that a person with comparable experience and expertise is nominated as the replacement. The Contractor shall keep the CTO informed of the composition of key personnel. Any changes in key personnel shall be highlighted in each monthly progress report.
- (c) For the purpose of this contract, expatriate key personnel include the Chief of Party and a training coordinator (for the first year of project implementation). At least two other senior expatriate experts, that will provide substantial, intermittent short-term assistance in Azerbaijan, will be required who have the required expertise and experience in the main infrastructure and related areas that are relevant for Azerbaijan’s Public Investment Program. Local sector experts may be included in key personnel.

### VII. Subcontractors and Grantees

The Contractor shall provide one long-term expatriate training coordinator that will be responsible for managing the coordination of training programs as required. This team member will be on staff for the first year of the project. The Contractor will also identify U.S., local, and/or third-country partner institutions or Azerbaijani personnel who will participate in the development of the training program

and its implementation. The Contractor is encouraged to make substantial use of local consultants or personnel who have strong technical skills, language skills, and experience that are relevant for the project.

The Contractor may propose other grants or subcontracts for training, public debate of investment policies, etc. that are not specified in the illustrative staffing and subcontracting table, above.

**VIII. Period of Performance**

The period of performance will start o/a January 31, 2005 and end o/a October 30, 2007.