

PROJECT FICHE

Title	Support for the Improvement of the Investments and Export Promotion Climate		
Indicative cost	€ 3,000,000 <i>EC contribution- € 3,000,000</i>		
Aid Method	Centralised management		
DAC-code	25010	Sector	Business services

1. RATIONALE

1.1. Strategic framework

The proposed intervention is in line with the objectives of the Tacis National Indicative Programme for 2004-2006, notably with the specific objective under the 2nd area of cooperation, "Support to encourage economic development and diversification" and general EU objectives of co-operation with Azerbaijan as laid down in the Partnership and Co-operation Agreement. The PCA identifies cooperation in the field of trade in goods and services (Article 45) as one of the priority areas for technical assistance from the EU, and Article 48 on "Investment promotion and protection" states that cooperation between the Community and Member States shall aim to establish a favourable climate for private investment, both domestic and foreign, especially through better conditions for investment protection, the transfer of capital and the exchange of information on investment opportunities.

In recent years some projects have been focusing on creating a legal framework that would foster the establishment of a favourable climate for private investment. Nevertheless a lot remains to be done especially in the sectors of the Securities Market, Foreign Direct Investment (FDI) attraction, International Financial Reporting Standards (IFRS), SMEs development, but most importantly with regard to privatisation.

This project is therefore geared specifically towards some of these aspects. Privatisation being a central matter, it is important that other aspects of the economy directly or indirectly linked to it, are tackled at the same time. From experience in other countries, possible ways for privatisation is through public offering or through auction. Public offering nevertheless requires a legal framework to protect private investors, mainly foreign investors (as sometimes liquidity is not available locally). It is therefore essential that a project of this kind deals at the same time with the different governmental or semi-governmental entities responsible for the stock market and its legislation, FDI attraction and protection, and privatisation.

In Azerbaijan the major actors in charge of the above mentioned sectors are the State Committee for Securities (SCS) also responsible for the Baku Stock Exchange (BSE), the State Committee on Privatisation of State Property (SPSP), and the Azerbaijan Investment Promotion and Advisory Fund (AIPAF – recently renamed AZPROMO).

1.2. Lessons learnt

An EU Tacis project for the State Committee for Securities (SCS)–Development of the Capital Market was financed under the Action Programme 2000. This project that ended in November 2004 was overall successful. One of the targets was related to capacity building for the SCS

and the BSE which certainly created the basis for better absorption capacity of Technical Assistance on the beneficiary's side. However it emerged that further institutional support is necessary for SCS and BSE, since it will contribute to strengthen and further develop the initial achievements. This assistance, which is described in more details later, should be focused both at continuing the assistance to the SCS with regard to the regulatory framework and at equity listing.

Lessons learnt from the abovementioned project shows that it will take some time before Azerbaijan will have a developed Stock market. Although a market can be well established, it takes time for it to become liquid and to have a full range of products listed.

Only building on past achievements, as the successful issue of a *debt note* on the Baku Stock Exchange under the previous Tacis project, and continuing the support through other key elements will lead to the specific objective of creating a functioning BSE. It is therefore important that one of the objectives under the proposed project should address the issuing of an *equity note* on the stock market. This could be done through the privatisation of a large state owned company by reserving a certain percentage of the shares to be listed on the BSE.

It is important to understand that the only companies that have the adequate capital dimension to be traded on the stock market are the public or semi-public owned companies. Therefore it is essential that a project dealing with the development of the BSE tackles at the same time the important issue of privatisation. Moreover, another essential issue is the need to attract Foreign Direct Investment which in this context would allow possible foreign investors to participate in auctions and public stock offering.

1.3. Complementary actions

As already mentioned the EU has financed a project directed to the Securities market and is now focusing its assistance on Foreign Direct Investment attraction and on more specific training for the Baku Stock Exchange.

EU Tacis

a) The Project "Support to Azerbaijan Investment Promotion and Advisory Fund" was launched on 1 August 2005. It will last until the end of 2006.

This project provides assistance in the following areas:

- Institutional and organizational strengthening - structure, strategy, tasks, etc.
- Marketing support – marketing tools, brochures etc.
- Policy advocacy – lobbying, governmental liaison etc.
- Operational support – optimizing daily activity

The project should assist AIPAF/AZPROMO to foster export and investment promotion, to have a stronger position and to achieve sustainability. The government recently approved new funding for the entity which should be interpreted as a serious commitment of the authorities to this sector. Sustainability is now well underway and it is essential to continue support to AIPAF/AZPROMO which in turn, could create the prerequisites to attract Foreign Direct Investment.

b) Recently the EU started a small project "Support to the Baku Stock Exchange" with two objectives. The first objective is to establish the analytical guidelines for gathering, evaluating and presenting corporate information. The second should focus on on-the-job training to

prepare the staff of the BSE in understanding ratings, ratings systems and services and their future relevance to the BSE.

Other Donors

Many donors have given support of various importance to the AIPAF/AZPROMO.

The Azerbaijan Corporate Governance Project (ACGP) is being implemented by the International Finance Corporation (IFC) and is funded with the generous support of the State Secretariat for Economic Affairs of Switzerland (SECO). The project goal is to improve the corporate governance practices in Azerbaijani joint stock companies (JSCs), including commercial banks, with the hopes this will assist them to gain access to capital.

UNDP has been financing administration and running costs of AIPAF/AZPROMO. It makes contribution to PR activity, awareness raising, conferences etc. Alongside with UNDP a few private donors also support mentioned costs: Azercell, Bakcell, Garadagh Cement etc. Basically UNDP covers at present most of the AIPAF's/AZPROMO operational costs.

The German donor GTZ provided limited start-up support to the AIPAF/AZPROMO in 2003. They also organised jointly a major Azerbaijani-German Business-to-Business event in Stuttgart, Germany in April 2004. GTZ is further committed to support future joint projects with AIPAF/AZPROMO.

Swiss Development Agency (SDA) also provides funding for events and publications. In addition SDA assists AIPAF in financing other activities for example a strategy study carried out by the WB subcontractors.

The Foreign Investment Advisory Service (FIAS) helped the AIPAF to define its optimal financing and staffing needs, concepts and strategy, prioritise its objectives, roles and actions and develop a 3-year action plan.

Under the current project a Steering Committee has been created both to monitor the project and to coordinate all the above mentioned donor's actions.

1.4. Donor coordination

The Poverty Reduction Strategy Paper (PRSP) is the basic document for discussions on areas of cooperation for international donors.

A new "Long-term Poverty Reduction and Sustainable Development Strategy" for 2006-2015, which will provide the main focus for donor coordination, is currently under preparation.

At the same time, the GoAz recognises that the donor coordination process needs improved institutional mechanisms. Most likely, the Ministry of Economic Development will take on some of these functions after it has been restructured.

2. COUNTRY CONTEXT

2.1. Cooperation related policy of beneficiary country

The GoAz treats the EU as its strategic partner and sets EU integration as its priority. The state Commission for Azerbaijan's Integration into the EU was established in June 2005 chaired by the Vice Prime Minister with two deputies: Minister of Foreign Affairs and Minister of Economic Development (National Coordinator of the EU Technical Assistance Programmes for Azerbaijan). The GoAz has declared its commitment to the ENP process. The PCA implementation further establishes the strategic framework for EU-Azerbaijan cooperation.

2.2. Sector context

Taking into consideration the current high GDP growth rate and increasing revenues from the oil industry, the GoAz has clearly expressed its intention to develop its non-oil sector as a priority. Special emphasis has been given to improve the investment climate, including Foreign Direct Investment (FDI) and local investments, develop export oriented marketable goods and to strengthen export capacity of the non-oil sector. There is a need to remove major obstacles to the development of FDI. There is a significant need for a long-term strategy and policy formulation for export promotion and FDI attraction in the non-oil sector.

The SME sector is developing at a much too slow pace and only in the region of Baku. The discrepancies in regional development are big and exporters face important obstacles within their companies, within Azerbaijan and on potential export markets. This sector therefore requires assistance directed to business advisory services and export oriented activities.

Azerbaijan has a number of strategic comparative advantages which auger well for the development of its economy. The main ones are differentiated agricultural conditions, a strategic location in the South Caucasus, major natural resources of oil and gas, high degree of educated workforce, low labour costs, and potential for tourism.

At present the main public entity directly dealing with the export and investment promotion, is the AIPAF/AZPROMO. This entity has been very active in promoting Azerbaijan products and in informing foreign investors on local market opportunities.

Larger industries on the other hand need to be restructured and above all privatised. The privatisation process in Azerbaijan has been underway for 8 years, in two stages, with 30,000 small enterprises having been privatised and 1500 medium and big enterprises turned into joint stock companies. As part of the 1999 land reform, all state-owned farms have been privatised. The second wave of privatisation law enacted in 2000, allows for privatisation of the remaining large-scale state enterprises, but overall progress remains slow. There is a strong need for privatisation of large state companies, especially in the utility sectors. Improving transparency and accountability is an important first step.

The relaunch of the privatisation process is of central importance for the Government of Azerbaijan and strongly supported by the EU. This is clearly indicated in the Presidential decree adopted in September 2005 on the creation of the State Committee on Privatisation of State Property. This is also reiterated by the EU in the draft Programmes on future assistance (ENPI).

The privatisation process could also be promoted by using the existing local stock market, the Baku Stock Exchange. The BSE which is in place since 2000 has in recent years been successful in listing several products. Since this year the entity is financially self-sufficient. It is nevertheless clear that a new momentum is necessary in promoting and reorganising its activities. The future objective is of course to increase the number of tradable products but most importantly to issue the first equity note. The entity which regulates the securities market is the State Committee for Securities (SCS). This Committee also has the responsibility for the protection of investors and to improve conditions for an efficient development of the market.

3. DESCRIPTION

3.1. Objectives

Wider objective: To improve economic development of the Republic of Azerbaijan and reduce its dependence on the oil sector.

Specific objective: To support and strengthen the development of portfolio investment and entrepreneurial local investment to foster exports in the Republic of Azerbaijan through Foreign Direct Investment (into non-oil sector assets), enhancement of the privatisation process, and equity listing.

3.2. Expected results and main activities

The following are some of the expected results:

- Appropriate legislation on securities market (for development of portfolio investments), FDI and export promotion prepared;
- Definition of long-term strategy for equity listing;
- Preparation of a Business Plan to be adopted by the government for the privatisation (a certain percentage will have to be indicated) of at least one large state owned company through public offering of its share both to potential large investors and on the stock market;
- Mechanisms are proposed to make the Privatisation process more transparent;
- Strategy for export and investment promotion are drafted;
- Institutional strengthening of AIPAF/AZPROMO;
- Real dialogue is created between the State Committee for Securities, the Baku Stock Exchange, the State Committee on Privatisation of State Property, and AIPAF/AZPROMO.

To address these issues and achieve its objective the project will comprise activities in three main domains:

1. Support to the State Committee on Privatisation of State Property.

The State Committee on Privatisation of State Property (SPSP) is a newly constituted entity. It is therefore important that the SPSP is assisted in order to ensure the best organisational and institutional structure. This will allow in the short-run the correct implementation of the privatisation on open market. On the other hand a long-run strategy for the privatisation process should also be supported based on a transparent dialogue with other stakeholders.

2. Support to State Committees for Securities and Baku Stock Exchange in the development of portfolio investments

The technical assistance should cover 3 main directions including a) the improvement of legislation and support in the preparation of amendments for improving existing legislation and regulation in the sphere of capital markets; b) the improvement of these entities' capacity to work with the capital market's players through organisational and institutional support, assistance to encourage promotion of investment institutions, dialogue with the government on the implementation of privatisation on the open market, and development of the entire chain of activities linked to investment; c) public awareness campaign to provide the public with relevant information concerning stock market, cooperation with relevant local Educational Institutions/Universities and foreign similar bodies in preparation of the methodology on courses on securities, providing lectures and seminars for students.

3. Support to the institutional development of AIPAF/AZPROMO and development of strategy for export and investment promotion.

With regard to this domain technical assistance should cover a) the drafting of a strategy aiming at encouraging export activities and attract investment for the development of the non-oil sectors; b) further support to AIPAF/AZPROMO on institutional strengthening including staff training and creating separate structures for investment and export, introducing self funding elements to cover running costs, introduction of marketing tools, and establishing working relations between the AIPAF/AZPROMO and similar bodies within the European Union.

3.3. Stakeholders

The stakeholders of the project are:

- The central Government, line ministries and especially MED, as the ministry leading the economic reform and development process;
- Business community, especially small and medium businesses involved in production, handling and processing of non-oil sector goods;
- The State Committee for Property Management;
- Private and corporate investors;
- Actors of stock market, investment institutions, etc.;
- Local Educational Institutions/Universities in field of economics;

The beneficiaries of the project shall be the State Committee for Securities, Baku Stock Exchange, the State Committee on Privatisation of State Property, and AIPAF/AZPROMO.

The State Committee for Securities is in charge of the protection of investors and has the responsibility to improve conditions for an efficient development of the securities market. The activities of the SCS include the preparation and implementation of securities laws, drafting and implementation of rules and regulations (some of them prepared by the BSE or the National Depository Centre), to stimulate trading in securities and to train professionals.

The Baku Stock Exchange was established in February 2000 by a group of 18 shareholders-legal entities, the Country's leading banks and financial institutions which form its shareholders' base. The BSE is responsible for Treasury Bills auctions for the Central Bank and has, since the beginning of 2004 with guidance from TACIS assistance, been active in introducing a range of corporate debt instruments. The BSE now needs to improve its own internal capabilities in offering support and advice to its members and future investors.

State Committee on Privatisation of State Property was newly created in September 2005. Until then activities linked to the privatisation process was under the responsibility of the Ministry of Economic Development. The aim is to create a more transparent privatisation process that will be under the direct supervision of the president.

The AIPAF/AZPROMO was created in July 2003 as a not-for-profit foundation under Azeri law¹. The founder of AIPAF is the Ministry of Economic Development (MED). However, the AIPAF/AZPROMO is designed as a Public Private Initiative and is governed by the Board of Trustees composed of a number of entities involved in investment activities: key economic ministries and state agencies, international financial institutions and donor organisations present in Azerbaijan, local and foreign investors and diplomatic missions.

¹ Law on Non-Governmental Organisations (Public associations and foundations) of June 13, 2000

Following the MED's initiative, the Board of Trustees recently adopted a new charter for AIPAF including additional responsibility for Export promotion. Accordingly, its name was changed to Azerbaijan's Export and Investment Promotion Foundation or AZPROMO.

3.4. Risks and assumptions

Risks:

- disruptive political instability in the country or in the region /oil price issues /stalling of the reform process;
- lack of adequate government support for AIPAF/AZPROMO;
- lack of adequate government commitment to privatisation;
- lack of adequate financial resources or sufficient skilled staff (absorption capacity) for the SCS, BSE, SPSP, and AIPAF/AZPROMO;
- Insufficient co-ordination and dialogue between all the beneficiaries, between the beneficiaries and other stakeholders, between the beneficiaries and the government.

Assumptions:

- Political and economic stability inside Azerbaijan. Commitment to democratic, and market economy reforms on the part of the GoAz;
- Commitment to the privatisation process on the part of the GoAz;
- Commitment to administrative reforms on the part of the government in general and of the Minister of Economic Development and senior officials in particular;
- The State Committee for Privatisation of State Property, AIPAF/AZPROMO, State Committee for Securities, and the Baku Stock Exchange are significantly strengthened both financially and staffing-wise;

3.5. Conditionalities

The following conditionalities should be fulfilled:

- The GoAz should show its commitment to continue the privatisation process;
- All activities related to this project will have to be coordinated between the beneficiaries of the project. That is the State Committee for Securities, Baku Stock Exchange, the State Committee on Privatisation of State Property, and AIPAF/AZPROMO. A Steering Committee shall be created and one high ranked official with discretionary powers from each entity should be nominated to participate in its meetings and to take adequate decisions;
- The GoAz will clearly indicate the annual budget committed to the AZPROMO from the State Budget. This budget should be superior to the amount committed in 2006;
- All relevant entities directly benefiting from this project shall be adequately staffed and equipped before the start of the project. Moreover sufficient and functional office space will have to be made available for the project team without prior refurbishment.

3.6. Crosscutting issues

The project is of relevance to good governance, legislative reform, economic growth and improved business climate.

4. IMPLEMENTATION ISSUES

4.1. Implementation method

Centralised management.

4.2. Budget and calendar

The indicative budget is € 3 million, including an indicative amount of € 0.2 million for supplies.

It is indicatively foreseen to launch the tender during the first semester 2007.

The contribution of the beneficiaries will be in kind, i.e. provision of office space and/or accommodation and the necessary time of government staff or from staff of other publicly funded institutions involved in the project.

The foreseen indicative duration of the project is 36 months subject to review during preparation of Terms of Reference.

4.3. Procurement procedures

All contracts implementing the financing agreement must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

All programme estimates must respect the procedures and standard documents laid down by the Commission, in force at the time of the adoption of the programme estimates in question.


4.4. Performance monitoring

Performance will be monitored monthly, quarterly and on ad-hoc basis by the Programme Manager, who will review the corresponding reports.

4.5. Evaluation and audit

Evaluations will be based upon progress in the achievement of benchmarks and mandatory results, as laid down in the Terms of Reference.

All contractors will be required to submit audit certificates with their request for final payment in accordance with the requirement of the "Practical Guide to contract procedures for external assistance financed from the general budget of the European Communities".

	<p align="center">Logical framework</p>	<p>Project no: Support for the Improvement of the Investments and Export Promotion Climate</p>	<p>Country: Azerbaijan Project duration: 36 months Prepared on: February 2006</p>
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Intervention logic	Objectively verifiable indicators	Sources of verification	Assumptions
<p>Overall objectives: To improve economic development of the Republic of Azerbaijan and reduce its dependence on the oil sector</p>	<ul style="list-style-type: none"> • Increased contribution to the Azeri GDP of the non-oil sector • Increase of the Foreign Direct Investments 	<p>Economic Indicators produced by the Azerbaijan State Committee for Statistics and other international organisations</p>	<p>No disruptive political instability in the country or in the region /oil price issues /stalling of the reform process</p>
<p>Project purpose: To support and strengthen the development of portfolio investment and entrepreneurial local investment to foster exports in the Republic of Azerbaijan through Foreign Direct Investment (into non-oil sector assets), enhancement of the privatisation process, and equity listing</p>	<ul style="list-style-type: none"> • Portfolio investment promoted • Recommendations produced by the project • Increase in the number of enterprises exporting • Privatisation process is re-launched 	<ul style="list-style-type: none"> • Project progress reports/ other donors' relevant reports • Government, SCS, BSE, SPSP, and AIPAF/AZPROMO decisions relating to the implementation of recommendations/policies/strategies 	<ul style="list-style-type: none"> • All actors (SCS, BSE, SPSP, and AIPAF/AZPROMO) involved in the project are ready to cooperate in an efficient and transparent manner • Adequate government support for AIPAF/AZPROMO • Commitment to the privatisation process on the part of the GoAz • Adequate financial resources from state budget and sufficient skilled staff (absorption capacity) for the SCS, BSE, SPSP, and AIPAF/AZPROMO;

Results:			
<ul style="list-style-type: none"> ➤ Appropriate legislation on securities market (for development of portfolio investments), FDI and export promotion prepared; ➤ Definition of long-term strategy for equity listing; ➤ Preparation of a Business Plan to be adopted by the government for the privatisation (a certain percentage will have to be indicated) of at least one large state owned company through public offering of its share both to potential large investors and on the stock market; ➤ Mechanisms are proposed to make the Privatisation process more transparent; ➤ Strategy for export and investment promotion are drafted; ➤ Institutional strengthening of AIPAF/AZPPROMO; ➤ Real dialogue is created between the State Committee for Securities, the Baku Stock Exchange, the State Committee on Privatisation of State Property, and AIPAF/AZPPROMO. 	<ul style="list-style-type: none"> • Legislation on securities market is drafted and discussed with all relevant actors • Policy/strategy is formulated and drafted for FDI and export promotion • Discussion and long-term strategy for equity listing is prepared • Business Plan for privatisation is prepared with all stakeholders involved • Recommendation on mechanism for transparent Privatisation process • AIPAF/AZPPROMO activities are reinforced and staff is able to operate independently • A restricted and efficient forum is created between SCS, BSE, SPSP, and AIPAF/AZPPROMO 	<ul style="list-style-type: none"> • Minutes of relevant meetings • Policy/strategy paper for FDI and export promotion • Long-term strategy for equity listing distributed • Business Plan for privatisation prepared • Paper on Mechanism for transparent Privatisation process proposed • Report on general and on-the-job training to AIPAF/AZPPROMO staff and other stakeholders • Forum/Steering Committee for dialogue minutes of meetings held • Project's progress reports/ other donors relevant reports 	<p>Availability and receptiveness of staff at different levels of each counterpart SCS, BSE, SPSP, and AIPAF/AZPPROMO</p> <p>Active collaboration of the SCS, BSE, SPSP, and AIPAF/AZPPROMO to the efficient development of all activities and reaction/approval of recommendations from the project</p>

Activities:	Specification of inputs <i>To be determined in the Terms of Reference</i>	Specification of costs <i>To be determined in the Terms of Reference</i>	Good co-ordination with other donors on-going projects or programmes Wide participation of all stakeholders to investment recommendations
<ul style="list-style-type: none"> ➤ Support to the State Committee on Privatisation of State Property (SPSP) to ensure the setting up of the best organisational and institutional structure. ➤ Long-run strategy for the privatisation process should also be supported based on a transparent dialogue with other stakeholders ➤ Improvement of legislation and support in the preparation of amendments for improving existing legislation and regulation in the sphere of capital markets ➤ Improvement of the SCS and BSE capacity to work with the capital market's players through organisational and institutional support, assistance to encourage promotion of investment institutions, dialogue with the government on the implementation of privatisation on the open market, and development of the entire chain of activities linked to investment; ➤ Public awareness campaign to provide the public with relevant information concerning stock market, cooperation with relevant local Educational Institutions/Universities and foreign similar bodies in preparation of the methodology on courses on securities, providing lectures and seminars for students. ➤ Drafting of a strategy aiming at encouraging export activities and attract investment for the development of the non-oil sectors ➤ Support to AIPAF/AZPROMO on institutional strengthening including staff training and creating separate structures for investment and export, introducing self funding elements to cover running costs, introduction of marketing tools, and establishing working relations between the AIPAF/AZPROMO and similar bodies within the European Union 			

Preconditions:

- The GoAz should show its commitment to continue the privatisation process
- All activities related to this project will have to be coordinated between the State Committee for Securities, Baku Stock Exchange, the State Committee on Privatisation of State Property, and AIPAF/AZPROMO
- A Forum/Steering Committee shall be created and one high ranked official with discretionary powers from each entity should be nominated to participate in its meetings and to take adequate decisions;
- The GoAz will clearly indicate the annual budget committed to the AZPROMO from the State Budget. This budget should be superior to the amount committed in 2006;
- All relevant entities directly benefiting from this project shall be adequately staffed and equipped before the start of the project
- Sufficient and functional office space will have to be made available for the project team without prior refurbishment