RISK ASSESSMENT AND RISK MANAGEMENT PLAN

Risk Description	Rating	Mitigation Measures	Responsibility
Reform Sustainability			
Leadership and political will to complete the reforms weakens because of vested interests	S	Government of Azerbaijan has been announcing and implementing reforms since mid-2015, and the implementing agencies of the proposed program (i.e., CBA, FMSA, MOE, and MOF) were strongly engaged in discussions with ADB and ADB TA experts over the most challenging reform needs under their respective mandates. This leadership and political will may weaken in the face of resistance by vested interests (e.g. resistance to change inside SOEs) or with turnover of key officials that upon being trained might not be retained. ADB's engagement will have to remain institutionally anchored at the MOF level, as both the natural and formal coordinator of the current reform drive, and political economy challenges identified upfront.	MOF and ADB
Government is not able to mobilize resources to continue supporting the financial costs of sector road maps (e.g., heavy industries, tourism, agriculture, telecommunications and IT, and financial services)	L	Even though a continuation of the weak economic outlook can adversely affect fiscal and resource-related revenues, or trigger unexpected outlays,[a] the fiscal outlook of Azerbaijan is stable and manageable.[b] A significant advantage for Azerbaijan's fiscal management with regard to other countries is that the large, foreign-currency-denominated financial assets of SOFAZ—equivalent to around 88% of GDP at the end of 2016—help counter any deterioration in tax revenues and will maintain the government's position as a significant net creditor. This net creditor position (defined as the difference between SOFAZ assets and the government's direct plus guaranteed debt) will remain close to 30% of GDP by the end of 2018.	MOF
Government is not willing to mobilize resources to support the fiscal implications of sector road maps (e.g., heavy industries, tourism, agriculture, telecommunications and IT, and financial services)	M	The government considers the development of heavy industries, tourism, agriculture, telecommunications and IT, and financial services a crucial pillar of its economic strategy to diversify the economy. Its ongoing financial support for the strategy has been and is expected to remain substantial. The most effective mitigating factor would be initial success in modernizing or promoting export success in these strategic activities. And that, to an important extent, depends on the institutional quality of the implementation of the sector road maps.	MOF
Regional geopolitical instability and reduced country economic growth affects Azerbaijan's social acceptance of reforms	M	Strong incentives exist to maintain oil and gas flows to Western markets through the Caucasus region. Turkey and Georgia in particular benefit from socially stable conditions in Azerbaijan, and Iran is prioritizing the development of transport connections to Azerbaijan in order to exploit its potential transit role from South Asia to Russia. These factors cooperate to generate a compact of	Outside stakeholders' control

Risk Description	Rating	Mitigation Measures	Responsibility
		geopolitical support for regional stability. Tension along key borders is not likely to alter the regional geopolitical equilibrium.	
Public Financial Management			
Azerbaijan's public financial management practices and capacity (i) are characterized by weak fiduciary controls and staff capacity for expenditure forecasting and rigorous budget analysis; (ii) limit planning effectiveness (e.g., between line ministries and sector agencies), including financial and project management, thus constraining the multiyear planning and execution of priority projects and reforms; and (iii) make public scrutiny of, e.g., public expenditures difficult	M	Overall, public financial management systems in Azerbaijan are effective for internal control, and other weaknesses are being addressed. For example, ongoing reform efforts include the following: (i) Introducing rule-based fiscal management, with ongoing efforts to build capability for medium-term expenditure and macroeconomic forecasting. A medium-term public debt management strategy is also being developed. (ii) Aligning sector strategies with long-term national development strategies, and strengthening public investments by improving feasibility and project management capacities. (iii) Integrating financial management systems and better analyzing planned and actual budget data through introduction of program budgeting. (iv) Strategic budgeting, based on multiyear rolling MTEFs and MTFFs, is being introduced to improve the allocation of public resources. (v) Strengthening the enforcement of accounting standards and introducing IT-based systems to eliminate widespread use of manual practices	MOF and ADB
Other			
Coordination between ADB and other development partners is inadequate	L	Coordination has been effective, also because of the small subset of stakeholders in each sector, the well-identified sector policy needs and issues, and the leadership of MOF and MOE in coordinating different stakeholders has been supportive.	MOF and MOE

ADB = Asian Development Bank, CBA = Central Bank of Azerbaijan, FMSA = Financial Market Supervisory Authority, GDP = gross domestic product, H = high, IT = information technology, L = low, M = moderate, MTEF = medium-term expenditure framework, MTFF = medium-term fiscal framework, MOE = Ministry of Economy, MOF = Ministry of Finance, S = substantial, TA = technical assistance.

[a] The weakening of Azerbaijan's fiscal and economic strength is driven by the ongoing impact of lower oil prices, the country's declining oil production potential, and a weak banking system. Weak economic conditions can also trigger contingent liabilities associated with, e.g., borrowings of state-owned enterprises.

[b] Moody's Investors Service expects the growth of additional direct debt and contingent obligations stemming from financial support to Azerbaijan's banking industry restructuring and its large hydrocarbon sector projects to level off by 2020, partly as a result of the implementation of a set of fiscal rules intended to shrink the government's non-oil budget deficit from 2018 onward (see https://www.moodys.com/printresearchdoctopdf.aspx).

Source: Asian Development Bank.