

PROGRAMMATIC APPROACH CONCEPT PAPER

1. The concept paper for this program was approved in 18 August 2017. In it, the broad objectives and scope of the various subprograms (and their logical link) was set forth. The concept paper resulted from extensive consultations with the Government of Azerbaijan, and formed the basis for the memorandum of understanding (MOU) that was finalized at the end of the fact-finding mission of September 2017. A logical route map on how expected outputs could help reach the target outcome was also embedded in the concept paper, and formalized in its design and monitoring framework. The MOU reflected in more detail the agreements reached over necessary policy reforms in the conditionality framework through a policy matrix and within an indicative rolling schedule.

2. **Broad objectives and scope of the proposed program.** The proposed program aims to strengthen governance in the public sector and to deepen the financial sector, in order to improve the allocative efficiency of public resources. This is to be achieved through the three-output scope of the program, which comprises the interventions described below¹:

- i. **Output 1: Rule-based fiscal planning introduced to improve allocative efficiency of public resources.** The objective of this output area is to promote discipline in fiscal policy making over the medium-term horizon. This will be achieved by improving multi-year budget formulation and forecasting, rationalizing public expenditures and improving management of public debt and fiscal risks.
- ii. **Output 2. SOEs restructured to improve legal and institutional arrangements and strengthen private sector participation in economic activities.** The actions under this output aim at strengthening corporate governance of SOEs, standardize financial reporting and practices, and allowing space for private sector participation in SOE economic activities.
- iii. **Output 3. Enhanced access to finance and a conducive business environment for diversification of the economy.** Under the program, the government prepared a detailed action plan highlighting key intervention areas for improving business conditions.²

Logical link between subprograms

3. **Initial Conditions, Desired end-state and Logical Link of the Program.** Constraints and the deep-roots of the development program are articulated in both the main text of this RRP, and in the Sector Assessment (linked document no. 2). The problem tree presented in the latter summarizes the relevant causal links to the development problem. The three-output scope summarized above aims to address the root-causes of the development problem, in a way that is represented in the design and monitoring framework (Appendix 2), with explicit indication of initial conditions and desired end-state at both output and outcome levels. The logical link of the

¹ Intended objectives and scope of each subprogram are described in detail in the main text of this RRP.

² As a credit enhancement measure, government has set up a Credit Guarantee Fund for the SMEs; as a measure to establish the legal framework for setting up credit bureaus, government has passed the supporting legislation to establish the creation of credit bureaus and defining their activities; to restore confidence in the banking sector, the ADIF, established to compensate depositors, and will see its financial position reinforced and operations strengthened. Amendments to the existing guidelines for the NFES are also being undertaken to make it more accessible to the SMEs.

program is explicitly articulated in the main text of this RRP, and subjected to further analysis in the economic analysis supplementary document.

4. **Rationale for programmatic approach.** As described earlier in the concept paper and in the main text of this RRP, structural reforms require a long-term time horizon during the implementation effort and in order to reach the intended outcomes. A programmatic approach helps establish, and in explicit terms, the needed chronological sequencing of reforms across a multi-year horizon, not least through its explicit framing of required policy actions and objectives. The proposed modality also plays a leveraging and catalyzing role in coordinating technical assistance provided by other development partners.³ Lessons from ADB's programmatic engagement in many other DMCs in the areas of public financial management, financial sector development and SOE reforms were taken into account during the specific policy dialogue of the program,⁴ as well as lessons from recent ADB interventions in Azerbaijan. Policy dialogue has highlighted the importance of supporting, with technical assistance, reform processes that have already been initiated, or planned. This helps establish a level of engagement and an openness to technical dialogue that is instrumental before advancing onto more ambitious reform proposals. Strong government ownership is demonstrated by the government's clear reform priorities and willingness to engage in a multi-year programmatic engagement process with ADB.

5. **Program costs.** The main text of this RRP articulates the development financing needs that were taken into account. The amount of the loan reflects the government's development financing needs and the strength and development impact of the proposed policy reforms over the two subprograms. Based on detailed discussions with the government officials, the following costs of reforms under the overall program were identified: (i) support ADIF for meeting the obligations of banks towards depositors; (ii) support NFES to help in SME development; (iii) operationalize Credit Guarantee Fund.

6. **Indicative implementation timeframe of the program.** The implementation period for subprogram 1 is October 2016 to November 2017. The implementation period for subprogram 2 is expected to be November 2017 to December 2018.

³ The mission is also coordinating closely with the International Monetary Fund in identifying and sequencing of the policy actions. Development partners in Azerbaijan focus mainly on transport, energy, water supply, and financial sector. World Bank supports strengthening business environment, improving public finance management and facilitating agriculture lending capacity. European Bank for Reconstruction and Development (EBRD) is supporting private sector through equity investments in financial institutions, direct lending, financial intermediation and capacity building in business administration. The European Union provides technical advice in the areas of PFM and governance. Funded by Swiss Cooperation Agency (SECO), IFC also supports financial institutions via investments and advisory services. IMF provides technical support on development of new fiscal rules and advises government on macroeconomic policy and exchange rate regime. Under this program, ADB is complementing implementation of fiscal rule being developed by the IMF and is consolidating medium term horizon of budget planning initiated by the World Bank.

⁴ Lessons for the successful development of public financial management, financially sustainable state-owned enterprises and financial sector development emphasize several crucial factors: (i) sound sequencing and realism in reform objectives; (ii) clear connection to local circumstances; and (iii) a sound, modern, reliable, and efficient institutional infrastructure. The program incorporates these lessons to varying degrees.