



# Report and Recommendation of the President to the Board of Directors

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Project Number: 55073-001  
June 2021

## Proposed Countercyclical Support Facility Loan and Technical Assistance Grant Republic of Azerbaijan: COVID-19 Active Response and Expenditure Support Program

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 1 June 2021)

Currency unit	–	Azerbaijan manat/s (AZN)
AZN1.00	=	\$0.588235
\$1.00	=	AZN1.70000

## ABBREVIATIONS

ADB	–	Asian Development Bank
AIIB	–	Asian Infrastructure Investment Bank
CAREC	–	Central Asia Regional Economic Cooperation
CARES	–	COVID-19 Active Response and Expenditure Support
CBA	–	Central Bank of Azerbaijan
COVID-19	–	coronavirus disease
CPRO	–	COVID-19 pandemic response option
DSA	–	debt sustainability analysis
GDP	–	gross domestic product
IDP	–	internally displaced person
IMF	–	International Monetary Fund
M&E	–	monitoring and evaluation
MOF	–	Ministry of Finance
MSMEs	–	micro, small, and medium-sized enterprises
PFM	–	public financial management
SOE	–	state-owned enterprise
SOFAZ	–	State Oil Fund of Azerbaijan
TA	–	technical assistance
TSA	–	targeted social assistance
WHO	–	World Health Organization

## NOTES

- (i) The fiscal year (FY) of the Government of Azerbaijan and its agencies ends on 31 December. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2021 ends on 31 December 2021.
- (ii) In this report, “\$” refers to United States dollars.

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 55073-001	
<b>Project Name</b>	COVID-19 Active Response and Expenditure Support Program	<b>Department/Division</b>	CWRD/CWPF
<b>Country</b>	Azerbaijan	<b>Executing Agency</b>	Ministry of Finance
<b>Borrower</b>	Republic of Azerbaijan		
<b>Country Economic Indicators</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=55073-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=55073-001-CEI</a>		
<b>Portfolio at a Glance</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=55073-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=55073-001-PortAtaGlance</a>		
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Health</b>	Disease control of communicable disease		20.00
	Health system development		60.00
<b>Agriculture, natural resources and rural development</b>	Agricultural production		10.00
<b>Education</b>	Education sector development - social protection initiatives		45.00
<b>Finance</b>	Inclusive finance		10.00
<b>Industry and trade</b>	Industry and trade sector development		55.00
<b>Public sector management</b>	Public expenditure and fiscal management		20.00
	Reforms of state owned enterprises		30.00
	<b>Total</b>		<b>250.00</b>
<b>3. Operational Priorities</b>		<b>Climate Change Information</b>	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0.000
✓ Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ Promoting rural development and food security			
✓ Strengthening governance and institutional capacity		<b>ADB Financing</b>	
✓ Fostering regional cooperation and integration		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		<b>Cofinancing</b>	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
<b>Sustainable Development Goals</b>		<b>Gender Equity and Mainstreaming</b>	
SDG 1.3, 1.a, 1.b		Effective gender mainstreaming (EGM)	✓
SDG 2.3			
SDG 3.3, 3.8, 3.d		<b>Poverty Targeting</b>	
SDG 4.3		General Intervention on Poverty	✓
SDG 5.1			
SDG 8.1, 8.10, 8.3			
SDG 9.1, 9.3, 9.4			
SDG 10.2, 10.4			
SDG 16.6			
<b>4. Risk Categorization:</b>	Complex		
<b>5. Safeguard Categorization</b>	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
<b>6. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>250.00</b>	
Sovereign COVID19 Pandemic Response Option (Regular Loan): Ordinary capital resources		250.00	
<b>Cofinancing</b>		<b>100.00</b>	
Asian Infrastructure Investment Bank - COVID19 Pandemic Response Option (Not ADB Administered)		100.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>350.00</b>	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-OTHERS) in the amount of \$250,000.			
<b>Currency of ADB Financing:</b> US Dollar			

Source: Asian Development Bank

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of Azerbaijan for the COVID-19 Active Response and Expenditure Support (CARES) Program under the Countercyclical Support Facility COVID-19 pandemic response option (CPRO).<sup>1</sup> The report also describes proposed technical assistance (TA) for Supporting the COVID-19 Active Response and Expenditure Support Program, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The coronavirus disease (COVID-19) pandemic has adversely impacted Azerbaijan's economy and its population. To mitigate these impacts, the government has adopted emergency pro-poor countercyclical pandemic response measures to strengthen the health system, expand social protection, and support macroeconomic stabilization and job creation. The proposed program will support the government's measures and financing needs to help mitigate the adverse health, social, and economic impacts of the crisis, while targeting the poor and vulnerable groups and ensuring gender mainstreaming.<sup>2</sup>

3. Azerbaijan meets all the criteria required to access the CPRO under the Countercyclical Support Facility (Table 1 and Appendix 4). The program's support for the government's wide range of countercyclical health, social protection, and macroeconomic stabilization measures is fully aligned with the crosscutting operational priorities of Strategy 2030 of the Asian Development Bank (ADB), such as (i) addressing remaining poverty and reducing inequalities, (ii) accelerating progress in gender equality, (iii) promoting rural development and food security, (iv) strengthening governance and institutional capacity, and (v) fostering regional cooperation and integration.<sup>3</sup>

**Table 1: Compliance with Access Criteria for COVID-19 Pandemic Response Option**

Access Criteria		ADB Staff Assessment
1.	Adverse impact of exogenous shocks	As of 25 June 2021, 335,676 COVID-19 cases were reported with 4,965 deaths. The pandemic had a negative impact because of the lockdowns in 2020 and 2021; business closures; the downturn in trade, tourism, and remittances; and drop in consumer demand. Azerbaijan suffered from a twin supply shock resulting from the fall in oil prices, triggered by the pandemic-related global slowdown, and the cut in oil production under an agreement with the OPEC+. The impact of the conflict in 2020 was short-lived. The IMF's data indicates (i) a GDP contraction of 4.3% in 2020 (2.6% in non-oil GDP and 7.2% in oil GDP) compared to a pre-COVID-19 GDP growth projection of 2.1% in 2020, and a GDP growth projection of 2.3% in 2021, (ii) a widening of the budget deficit–GDP ratio from a surplus of 8.2% in 2019 to 6.4% in 2020 and projected 5.2% in 2021, (iii) a change in current account balance–GDP ratio from a surplus of 9.1% in 2019 to a deficit of 0.9% in 2020 and a projected small surplus of 1.1% in 2021, and (iv) an increase in inflation from 2.7% in 2019 to 2.8% in 2020 and projected 3.5% in 2021. SOFAZ assets reached \$43.56 billion in 2020, but are projected to decline to \$42.97 billion in 2021. The unemployment rate increased from 4.8% in 2019 to 6.5% in 2020 and is projected to reach 5.8% in 2021. The poverty rate increased from 5.3% in 2019 to 5.5% in 2020 (compared to the pre–COVID-19 estimate of 4.0%).
2.	Countercyclical development expenditures	On 27 February 2020, an interagency COVID-19 Task Force, chaired by the Prime Minister, was established under the Cabinet of Ministers. The government approved action plans on 30 January 2020 and 4 April 2020 followed by additional measures in August 2020. These action plans—comprising health, social protection, and macroeconomic stabilization measures—constituted the pro-poor countercyclical pandemic response package. State budget funds and other sources totaling AZN3.5 billion (\$2.06 billion, or 4.8% of GDP) were allocated in 2020 based on the President's Executive Decree on 19 March 2020. A pandemic

<sup>1</sup> Asian Development Bank (ADB). 2020. [ADB's Comprehensive Response to the COVID-19 Pandemic](#). Manila.

<sup>2</sup> ADB received the government's formal request for budget support for the pandemic on 4 February 2021.

<sup>3</sup> ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

Access Criteria		ADB Staff Assessment
		response package of AZN3,014.6 million (\$1,773.2 million or 3.6% of GDP), which builds on and continues from the 2020 action plans, was approved under the budget in 2021.
3.	Pre-shock record of generally sound macroeconomic management	Azerbaijan maintained a generally sound pre-shock record of macroeconomic management. The economy recovered from the 2015–2016 recession, triggered by the decline in oil prices, with GDP growth of 0.2% in 2017 to 1.5% in 2018, and 2.2% in 2019. Inflation fell from 12.8% in 2017 to 2.3% in 2018 and 2.7% in 2019. The pre-shock budget deficit–GDP ratios improved from a deficit of 1.4% in 2017 to a surplus of 5.5% in 2018 and 8.2% in 2019. International reserves averaged \$5.7 billion during 2017–2019. The public debt–GDP ratio improved from 22.5% in 2017 to 17.7% in 2019. SOFAZ assets reached \$43.32 billion in 2019. The current account surplus–GDP ratios were 4.1% in 2017, 12.8% in 2018, and 9.1% in 2019. Macroeconomic management during the pandemic has been on track.
4.	Structural reforms (health sector response)	The Ministry of Health approved the COVID-19 Country Preparedness and Response Plan, detailing the medium- and long-term national strategies for pandemic management, capacity building, and resource requirements. A special quarantine regime was introduced on 24 March 2020, including border closures; closure of businesses, airports, and transportation hubs; and strict social distancing measures. The restrictions were relaxed in stages beginning in May 2020. The quarantine regime has been recently extended until 1 August 2021. The government has undertaken medium- and long-term public health and preventive measures to (i) strengthen the capacity of medical facilities, (ii) procure medicines and medical equipment on an emergency basis, (iii) implement preventive activities against contagious diseases, (iv) provide additional payments for health care workers, and (v) implement mandatory health insurance nationwide to increase access to the health care system. While not covered under the CARES Program, a COVID-19 vaccination strategy was adopted. Public vaccination program began in January 2021.
5.	Debt sustainability	During the pandemic, the government requested a \$250 million budget support loan from ADB and a cofinancing loan of \$100 million from the Asian Infrastructure Investment Bank in 2021. The government will also borrow \$764.7 million domestically in 2021. Based on ADB's DSA, <sup>a</sup> the additional borrowing over the public debt stock of \$8.5 billion in 2019 will not significantly affect debt sustainability or annual debt service obligations. IMF projects that the public debt–GDP ratio increased from 17.7% in 2019 to 21.4% in 2020 and will increase to 30.9% in 2021, 31.4% in 2022, and 32.4% in 2023. Both the IMF's pre-shock DSA and ADB's recent DSA indicate that Azerbaijan has a <i>low</i> risk of debt stress because of favorable maturity structure, loans from international financial institutions, and its strong position in terms of official reserves and SOFAZ assets. The government has been implementing a medium-term debt management strategy to reduce its debt–GDP ratio and gradually shift from external to domestic borrowing with government securities.
6.	Coordination with the IMF	The government worked closely with the IMF, which supports its countercyclical measures, on the macroeconomic assessment during the Article IV consultation missions in 2021. The IMF provided its assessment letter on 1 April 2021, confirming sound macroeconomic management. <sup>b</sup> ADB effectively coordinated with the IMF, supporting the CARES Program.

ADB = Asian Development Bank, CARES = COVID-19 Active Response and Expenditure Support, COVID-19 = coronavirus disease, DSA = debt sustainability analysis, GDP = gross domestic product, IMF = International Monetary Fund, OPEC = Organization of the Petroleum Exporting Countries, SOFAZ = State Oil Fund of Azerbaijan.

<sup>a</sup> Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2).

<sup>b</sup> International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

4. **Health-related challenges.** World Health Organization (WHO) data<sup>4</sup> indicates that as of 25 June 2021, Azerbaijan had 335,676 confirmed COVID-19 cases with 4,965 deaths since the first COVID-19 case was reported on 28 February 2020. The growing number of COVID-19 cases strained initial diagnosis, prevention, and treatment capacity because of inadequate specialized medical facilities, staff, and equipment, despite earlier improvements in Azerbaijan's public sector-

<sup>4</sup> Data is accessible from [WHO Coronavirus \(COVID-19\) Dashboard](#).



led health care system, which provides universal basic medical care in public hospitals. Unbalanced geographical distribution of health services, recruitment and retention of medical staff in rural areas, and high out-of-pocket health expenditures have been longstanding issues.<sup>5</sup> There are qualitative differences between urban and rural areas, with well-equipped and staffed medical facilities concentrated in urban centers, particularly in Baku.<sup>6</sup> Essential health services for emergency care, chronic illnesses and surgical procedures have been challenged because of the priority placed on addressing the pandemic. The conflict in 2020 has also strained health services.

**5. Pre-shock record of generally sound macroeconomic management.** Azerbaijan has transformed itself into an upper middle-income country, with rapid economic growth averaging 5.6% per year during 1993–2019, fueled by oil and gas extraction. However, overreliance on hydrocarbons coupled with inadequate private sector development, an inefficient financial sector, and highly procyclical fiscal management have been identified as key development constraints. Because of the overreliance on hydrocarbons, the downturn in oil prices—from \$110 per barrel in 2014 to \$50 in 2015—led to a sharp fall in foreign currency earnings, a contraction in gross domestic product (GDP) of 3.1% in 2016, currency devaluation,<sup>7</sup> banking sector fragility due to high level of dollarization in liabilities, and erosion of fiscal space. The crisis revealed the urgent need to accelerate private sector-driven economic diversification into non-oil sectors. In response, the government provided countercyclical fiscal stimulus, and initiated a set of reforms affecting macroeconomic management, the financial sector, and public financial management (PFM), with support from ADB's Countercyclical Support Facility and two policy-based programs.<sup>8</sup> Tax reforms have been carried out since 2017 to reduce dependence on oil revenues. These efforts, along with a recovery in the oil price, expansion of the non-oil economy, and the onset of production at the Shah Deniz II gas field helped GDP growth recover to 0.2% in 2017, 1.5% in 2018, and 2.2% in 2019. Budget deficit–GDP ratios have improved from a deficit of 1.4% in 2017 to a surplus of 5.5% in 2018 and 8.2% in 2019. The Central Bank of Azerbaijan (CBA) has remained committed to price stability under a fixed exchange rate regime, and inflation declined from 12.8% in 2017 to 2.7% in 2019. The Financial Market Supervisory Authority was established to improve banking sector capital adequacy. Firmer oil prices have led to current account surpluses of 4.1% in 2017, 12.8% in 2018, and 9.1% in 2019; this resulted in an accumulation of foreign exchange reserves, averaging \$5.7 billion during 2017–2019. Supported by the strong net foreign asset position of the sovereign wealth fund—the State Oil Fund of Azerbaijan (SOFAZ)—and prudent fiscal management, the public debt–GDP ratio has declined from 22.5% in 2017 to 17.7% in 2019. As confirmed by the International Monetary Fund (IMF), Azerbaijan maintained a generally sound record of macroeconomic management leading up to the crisis.<sup>9</sup>

<sup>5</sup> Bonilla et.al. 2018. [Challenges on the Path to Universal Health Coverage: The Experience of Azerbaijan](#). *Universal Health Care Coverage Series* 28. Washington, DC: World Bank.

<sup>6</sup> In 2019, 64% of physicians and 155 out of 570 public hospitals were concentrated in Baku. State Statistical Committee. 2020. [Healthcare, Social Protection and Housing Conditions in Azerbaijan](#). *Statistical Yearbook*. Baku.

<sup>7</sup> The United States dollar–Azerbaijan manat exchange rate dropped from \$1 = AZN0.78 in 2014 to about \$1 = AZN1.60 in 2016. The exchange rate has been stable at about \$1 = AZN1.70 since March 2017.

<sup>8</sup> ADB supported Azerbaijan to strengthen (i) its medium-term debt management strategy to reduce the share of foreign currency borrowing and increase domestic borrowing; (ii) public budgeting with introduction of medium-term budget and expenditure frameworks, program-based budgeting, and other PFM reforms; (iii) management of fiscal risks, including contingent liabilities of state-owned enterprises (SOEs) and fiscal rule for countercyclical fiscal policy; (iv) corporate governance of SOEs and transparency of financial reporting; and (v) the business climate, including access to credit and economic diversification. The medium-term expenditure framework is implemented for three sectors (education, agriculture, and environmental protection) starting in 2021. ADB. 2016. [Azerbaijan: Countercyclical Support Facility Program](#). Manila; ADB. 2017. [Azerbaijan: Improving Governance and Public Sector Efficiency Program, Subprogram 1](#). Manila; and ADB. 2019. [Azerbaijan: Improving Governance and Public Sector Efficiency Program \(Subprogram 2\)](#). Manila.

<sup>9</sup> IMF. 2019. [Republic of Azerbaijan. Article IV Consultation – Press Release: Staff Report and Statement by the Executive Director for the Republic of Azerbaijan](#). *IMF Country Report* No. 19/301. Washington, DC (September).

6. **Economic impact of the pandemic.** The COVID-19 pandemic adversely impacted the economy because of the lockdowns in 2020 and 2021; business closures; the downturn in trade, tourism, and remittances; and the drop in consumer demand. Azerbaijan suffered from a twin supply shock resulting from the oil price decline, triggered by the pandemic-related global slowdown,<sup>10</sup> and a cut in oil production under an agreement with the Organization of the Petroleum Exporting Countries and other major oil producers in June 2020. The impact of the 44-day conflict in September–October 2020 was short-lived as the main infrastructure and economic base were not directly exposed to the conflict zone. According to the IMF, GDP contracted by 4.3% in 2020 in contrast to the pre-COVID-19 GDP growth projection of 2.1% for 2020.<sup>11</sup> GDP is projected to grow by 2.3% in 2021 with (i) improvements in domestic and external demand, (ii) higher global oil and gas prices,<sup>12</sup> (iii) support for farmers, and (iv) \$1.29 billion spending on post-conflict reconstruction. The prolongation of the pandemic carries the risk of delaying the recovery. On average, GDP contracted by 1% during 2020–2021, significantly below the average GDP growth of 1.6% during 2010–2019 despite negative growth rates in 2011 and 2016.

7. **Fiscal balance.** The IMF estimates that with the pandemic-related slowdown and fall in oil prices, revenues declined from 41.5% of GDP in 2019 to 33.9% of GDP in 2020, and 32.8% of GDP in 2021. As a result of countercyclical measures, expenditures increased from 33.3% of GDP in 2019 to 40.4% of GDP in 2020, and 38.0% of GDP in 2021. The fiscal balance turned into a deficit of 6.4% of GDP in 2020 and 5.2% of GDP in 2021 from a surplus of 8.2% of GDP in 2019.

8. **Finances of the State Oil Fund of Azerbaijan.** With the fall in oil prices and cut in production, SOFAZ revenues declined from \$11.19 billion in 2019 to \$5.51 billion in 2020 and further to the budgeted amount of \$4.71 billion in 2021. SOFAZ transfers to the state budget exceeded revenues by increasing from \$6.68 billion in 2019 to \$7.18 billion in 2020 and 2021, comprising nearly 50% of budget revenues. This further necessitated the government to use SOFAZ resources in a fiscally prudent manner so that assets are not rapidly depleted. SOFAZ assets (inclusive of the valuation effect of the investment portfolio) are projected to decline from \$43.56 billion in 2020 to \$42.97 billion in 2021. While SOFAZ assets are expected to grow over time, they have been heavily prone to valuation shocks from oil price fluctuations and procyclical budget transfers. To strengthen countercyclicality and long-term asset accumulation, a fiscal rule on SOFAZ transfers and budget expenditures was introduced in 2019, along with other fiscal and debt management reforms to prevent the overuse of oil revenues and limit the spending growth to 3% over the previous year's approved expenditures. Because of the pandemic, however, the implementation of the fiscal rule has been suspended until 2022.<sup>13</sup> While SOFAZ transfers and assets have enabled Azerbaijan to manage the shock with countercyclical support in 2020, as also emphasized by the IMF, the government has been vigilant about safeguarding an adequate portion of the exhaustible oil wealth for future generations. The risk of depletion of SOFAZ assets because of prolongation of the pandemic could jeopardize availability of resources for intergenerational equity, future investment in social sectors, and economic diversification. A

<sup>10</sup> Oil prices decreased by more than 60% in the first quarter of 2020, reaching \$26 per barrel by the end of March 2020, the lowest since 2001. Oil prices averaged just \$41.7 during 2020, remaining 25% below the 2019 average. IMF. 2020. *Regional Economic Outlook: Middle East and Central Asia*. Washington, DC (October).

<sup>11</sup> Country Economic Indicators (accessible from the list of linked documents in Appendix 2).

<sup>12</sup> Azerbaijan's fiscal breakeven oil price was \$65.0 per barrel, while current account breakeven oil price was \$69.5 per barrel in 2020. By early February 2021, the Brent oil price reached more than \$60.0 per barrel, effectively recovering to pre-COVID-19 levels. However, it is still below the 2021 fiscal breakeven price of \$82.5 and current account breakeven oil price of \$98.6. Breakeven oil prices increased because the Organization of the Petroleum Exporting Countries quotas have constrained Azerbaijan's oil production and exports amid high fiscal deficits. IMF. 2021. *Regional Economic Outlook: Middle: Middle East and Central Asia*. Washington, DC (April).

<sup>13</sup> Details on the fiscal rule are in Appendix 4; and Assessment of State Oil Fund of Azerbaijan (SOFAZ) and Fiscal Management Framework (accessible from the list of linked documents in Appendix 2).

strong position with respect to SOFAZ assets is critical for maintaining a stable monetary policy and fixed exchange rate, as the risk of sharp exchange rate adjustments after terms of trade shocks could hurt the banking sector, given high-liability dollarization. SOFAZ assets also support the country's good sovereign credit rating and debt absorption capacity.

9. **Current account and international reserves.** With the downturn in global trade and decline in oil and gas exports, the current account balance recorded a deficit of 0.9% of GDP in 2020. Exports contracted by 36.3% and imports by 10% in 2020. In 2021, a small current account surplus of 1.1% of GDP is projected. However, the 2020–2021 average current account surplus of 0.1% is significantly below the average current account surplus of 12.8% during 2010–2019. International reserves remained stable at \$6.26 billion in 2020 and 2021.

10. **Remittances.** The downturn in the Russian Federation, where nearly a million Azerbaijani migrant workers reside, affected the households relying on remittances. During the first quarter of 2020, remittances from the Russian Federation dropped by 40% compared to the same period in 2019. In 2020, remittances were projected to fall by 21.9% from \$1.22 billion in 2018.<sup>14</sup> The net migration rate is projected to drop from 0.097 per 1,000 population in 2019 to 0.048 in 2021.

11. **Inflation.** Inflation remained generally stable at 2.8% in 2020 compared with 2.7% in 2019, reflecting food inflation of 5%, while inflation for non-food and services remained low at 1.3%. Import-led inflation was curbed because of lower consumer demand, the stable exchange rate, and administered prices during 2020. In 2021, inflation is projected to increase to 3.5% with recovery in domestic demand and adjustments in fuel prices and utility tariffs.

12. **Monetary policy and exchange rate.** Inflation remained within the CBA's monetary policy target of 2%–6%. The CBA gradually reduced the policy rate to 6.25% from 7.25% during 2020. Decreasing demand for imports and CBA and SOFAZ foreign exchange sales (totaling nearly \$7.2 billion in 2020) have helped maintain the fixed exchange rate.<sup>15</sup> The exchange rate at \$1 = AZN1.70 is predicted to remain stable in 2021 along with the exchange rate policy.

13. **Banking sector.** Credit to the private sector contracted by 0.7% in 2020 from 15.2% growth in 2019 but it is projected to grow by 5.0% in 2021. The banking sector dollarization continued to be high with 34.6% of loans and 61.0% of deposits in foreign currency in 2019.<sup>16</sup> However, credit and guarantee support programs and easing of regulatory requirements as part of countercyclical support during the pandemic have facilitated local currency lending. While banking supervision was strengthened,<sup>17</sup> additional CBA vigilance is required to avoid risk of distress from relaxed lending standards. The sovereign credit rating is *BB+/B* with a revision in outlook from negative to stable in 2021 because of reduction in conflict-related security risks.

14. **State-owned enterprises.** State-owned enterprises (SOEs) dominate critical sectors and accounted for 18% of GDP in 2018 compared to 70% in 1995.<sup>18</sup> The government provided direct financial support to SOEs to cover their large operational losses during the pandemic.

<sup>14</sup> J. Villafuerte and A. K. Takenaka. 2020. [Tracking COVID-19's Devastating Toll on Asia's Remittances](#). Manila: ADB. Figure for 2018 remittance receipts is from the World Bank.

<sup>15</sup> World Bank. 2021. [Azerbaijan Monthly Economic Update](#). January. Washington, DC.

<sup>16</sup> ADB. 2020. [Asian Development Outlook 2020: What Drives Innovation in Asia?](#) Manila (April).

<sup>17</sup> Four banks, falling short of prudential requirements on capitalization were closed in 2020. Nonperforming loans declined from 8.3% of credit portfolio in 2019 to 6.1% in 2020. The banking sector risk-weighted capital adequacy ratio improved from 22% in 2019 to 25% in 2020. Profitability worsened with weak credit demand.

<sup>18</sup> World Bank. 2017. [Republic of Azerbaijan: Corporate Governance and Ownership of State-Owned Enterprises](#). Washington, DC (November).

15. **Micro, small, and medium-sized enterprises.** Despite efforts to promote the private sector,<sup>19</sup> the fragilities of micro, small, and medium-sized enterprises (MSMEs) have become evident during the pandemic. A 2020 United Nations report on socioeconomic assessment for COVID-19 found that out of 237,456 private sector MSMEs, 166,282 were estimated to be heavily impacted, and 528,570 employees became vulnerable to job losses during April–September 2020.<sup>20</sup> The income losses of the MSME workforce could reach up to \$189 million.

16. **Tourism.** Travel restrictions heavily impacted the hospitality and tourism sector. Airport passenger traffic dropped by 73% in 2020; and the number of foreign visitors declined from 3.2 million in 2019, with a spending of \$1.7 billion (6.5% of total exports) to 1.3 million visitors in 2020.<sup>21</sup> In 2019, prior to the pandemic, the travel and tourism sector accounted for \$3.5 billion (7.2% of GDP), contributing to 378,000 jobs (7.7% of employment).<sup>22</sup>

17. **Unemployment.** Most employment in Azerbaijan is in the low-productivity, low-wage informal sector, which was hard hit during the pandemic. Based on the United Nations report (footnote 20), of the 5.1 million workforce, 1.55 million are wage workers with formal contracts (880,000 with the state and 670,000 with non-state). The non-state workforce is projected to face an income loss up to \$646 million during April–September 2020 because of the pandemic. An estimated 1.6 million people are engaged in the informal sector without labor contracts and access to social protection. The self-employed workforce is highly prone to income shocks during economic downturns. The unemployment rate is projected to increase to 6.5% in 2020 and 5.8% in 2021 from 4.8% in 2019. Youth unemployment rose from 14.6% in 2019 to 15.7% in 2020.

18. **Poverty.** While the oil-driven growth helped reduce the national poverty rate from 49% in 2001 to 4.8% in 2019, loss of incomes and remittances have reversed this trend and exacerbated pre-existing inequalities and regional disparities. While Azerbaijan has a comprehensive social safety net, those working in the informal sector lack social protection. A household survey in eight regions (footnote 20) showed that 36% of respondents buy less food with nutritional value because of reduced household income and increased food prices. World Bank projections show that the poverty rate (measured at \$5.5 per day) will increase from 5.3% in 2019 to 5.5% (compared to the pre-COVID-19 estimate of 4.0%) in 2020 and to 5.2% (compared to the pre-COVID-19 estimate of 3.8%) in 2021.<sup>23</sup>

19. **Impact on women.** The pandemic has exacerbated gender-based inequalities in Azerbaijan.<sup>24</sup> A 2020 United Nations survey found about 55% of self-employed women and 48%

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<sup>19</sup> The government's efforts to diversify the economy have resulted in the non-oil sector's share of GDP rising from 51.5% of GDP in 2013 to 61.9% of GDP in 2020. MSMEs' share of GDP grew from 9.2% in 2016 to 23.3% (or 40.7% of non-oil GDP) in 2019. While access to finance was identified as a major constraint, credit to the private sector improved from 14.1% of GDP in 2017 to 15.2% of GDP in 2019 (ADB. 2020. [Azerbaijan: Moving Toward More Diversified, Resilient, and Inclusive Development](#). Manila [August]). Azerbaijan was ranked 34th out of 190 economies in 2020 in the World Bank's [Doing Business index](#), compared to 25th in 2019. Its ranking was high in obtaining credit (1st) and starting a business (9th), but low in protecting minority investors (105th), resolving insolvency (47th) and enforcing contracts (28th) in 2020. The government has promoted public and online services for entrepreneurs; established business courts, credit bureaus, and unified collateral registry; and carried out tax reforms since 2017.

<sup>20</sup> United Nations Azerbaijan. 2020. *Azerbaijan Socio-Economic Assessment for COVID-19*. Baku (August).

<sup>21</sup> ADB. 2021. [Impact of COVID-19 on CAREC Aviation and Tourism](#). Manila.

<sup>22</sup> World Travel and Tourism Council. 2020. [Azerbaijan. Annual Research Key Highlights](#). London.

<sup>23</sup> World Bank. 2020. [Poverty Projections for Armenia, Azerbaijan and Georgia due to the COVID-19 Outbreak](#). Washington, DC.

<sup>24</sup> Women in Azerbaijan have a lower labor force participation and lower earnings than men. Azerbaijan's gender inequality index was 0.323 in 2019, ranking 73rd out of 162 countries. United Nations Development Programme. 2020. [Human Development Report 2020. Azerbaijan](#). New York.

of women employees were severely affected by the lockdowns through reduced hours of paid work.<sup>25</sup> Women on leave without pay outnumbered men because women are mostly employed in low-wage service sector jobs and/or the informal sector, both of which are particularly impacted during the pandemic.<sup>26</sup> Women have been underrepresented as business owners (only 25% of registered MSMEs are owned by women), with inadequate access to higher skilled occupations and financial services.<sup>27</sup> The pandemic has further impeded women's economic empowerment.

20. **Impact on the vulnerable population.** The pressures on the health system caused by the pandemic have constrained routine services for mothers and children; the elderly; and those with chronic illnesses, disabilities, and special needs. School closures have affected 1.6 million school-age children, of which 46% are girls and nearly 613,000 were enrolled in rural areas. About 70% of families with school age children had access to distance education and the internet, while disadvantaged students with limited connectivity, mainly in rural areas, faced learning losses. Although internally displaced persons (IDPs) have received international aid and support from the government, their vulnerabilities have intensified because of inadequate housing, higher poverty incidence, job losses, and high dependence on social transfers.<sup>28</sup> The intensification of conflict in 2020 has increased the vulnerabilities of people living in border areas. Returning Azeri migrant workers and 254,000 migrant workers within Azerbaijan have faced large income losses at times of diminished job prospects and increased unemployment.

## **B. ADB Support through COVID-19 Pandemic Response Option, ADB's Value Addition, and Sustainability**

21. **Government of Azerbaijan's countercyclical pandemic response measures.** On 27 February 2020, an inter-agency COVID-19 Task Force, chaired by the Prime Minister, was established under the Cabinet of Ministers. Working groups were set up under key ministries. The government approved action plans on 30 January and 4 April 2020 followed by additional measures in August 2020. These action plans comprise health, social protection, and macroeconomic stabilization measures, and constitute a pro-poor countercyclical pandemic response package. Budget funds and other sources, totaling AZN3.5 billion (\$2.06 billion or 4.8% of GDP) were allocated in 2020 based on the President's Executive Decree on 19 March 2020. The 2020 measures (Appendix 4) have been generally effective in containing the spread of the disease, increasing health sector capacity, providing immediate relief to the unemployed and impacted businesses, and expanding coverage of the social safety net. According to initial estimates, without this support GDP could have contracted by an additional 0.5%–1.0% in 2020. As the pandemic revealed itself to be long-lasting with the risk of an enduring impact on the economy and the social and health-related wellbeing of the population, continuation of comprehensive anti-crisis efforts in 2021 became paramount, particularly to improve targeting and coverage of social safety nets and health insurance. The pandemic response measures approved under the 2021 budget build on and continue from the 2020 action plans. The CARES Program supports these measures in 2021 (Table 2) in total of AZN3,014.6 million (\$1,773.2 million or 3.6% of GDP) as summarized in paras. 22–24 and detailed in Appendix 4.

<sup>25</sup> United Nations. 2020. [Azerbaijan: The Impact of COVID-19 on Women's and Men's Lives and Livelihoods](#). Baku.

<sup>26</sup> In 2009, 42% of women in Azerbaijan held informal jobs. Women comprise 50% of employees in tourism, hospitality, and food services and earn 30.4% less pay in these sectors compared to the rest of the economy. United Nations World Tourism Organization. 2019. [Global Report on Women in Tourism](#). Second edition. Madrid.

<sup>27</sup> ADB. 2019. [Azerbaijan Country Gender Assessment](#). Manila (December).

<sup>28</sup> World Bank. 2020. [Implementation and Completion Results Report for IDP Living Standards and Livelihoods Project](#). Washington, DC (June).

**Table 2: Allocation of Countercyclical COVID-19 Pandemic Response Measures**

Item	Amount	
	AZN Million	\$ Million
<b>A. Health-related measures</b>	<b>1,378.6</b>	<b>810.8</b>
(i) Provision of additional payments to health care workers	100.0	58.8
(ii) Support for self-financed medical facilities for in-patient treatment during the pandemic	10.9	6.4
(iii) Services provided to individuals isolated in quarantine facilities	5.0	2.9
(iv) Operation of modular hospitals dealing with the COVID-19 patients	61.9	36.4
(v) Expenses related to medicines	125.0	73.5
(vi) Preventive activities on contagious diseases	6.5	3.8
(vii) Expenses related to medical equipment and inventories	80.0	47.1
(viii) Support to nationwide mandatory health insurance	989.3	581.9
<b>B. Social protection measures</b>	<b>1,142.5</b>	<b>672.1</b>
(i) Targeted social assistance to low-income households	257.0	151.2
(ii) Subsidies to flour producers (for each ton of flour sold)	9.0	5.3
(iii) Support for education lending to low-income families for higher education	80.0	47.1
(iv) State support to pensions	441.0	259.4
(v) Payments for monthly allowances and subsidies for utility services to internally displaced persons	355.5	209.1
<b>C. Macroeconomic stabilization measures</b>	<b>493.5</b>	<b>290.3</b>
(i) Support for temporary public jobs created during the pandemic	159.8	94.0
(ii) Interest rate subsidies on bank loans for businesses affected by the pandemic	12.0	7.1
(iii) Support for funding of subsidized mortgage loans	71.0	41.8
(iv) Subsidies to agricultural producers affected by increase in fuel prices because of tariff adjustment as of January 2021	36.1	21.2
(v) Support to selected state-owned enterprises (subway operator, airline company, and water/sanitation utility operator)	159.2	93.6
(vi) Support to State Tourism Agency	55.4	32.6
<b>Total (A+B+C)</b>	<b>3,014.6</b>	<b>1,773.2</b>

COVID-19 = coronavirus disease.

Sources: Budget documents of the Ministry of Finance.

22. **Health-related measures.** The government responded to the pandemic by introducing a special quarantine regime on 24 March 2020, including closure of borders, businesses, airports and transportation hubs, and strict social distancing measures. Starting 4 May 2020, restrictions have been relaxed in stages. In response to the number of COVID-19 cases, the quarantine regime was tightened on 19 June 2020 including the closure of borders until 1 August 2020. The regime was successively extended in stages—until 31 August 2020, 31 January 2021, 1 June 2021 and recently until 1 August 2021—with some easing of restrictions from one period to the next. The Ministry of Health approved the COVID-19 Country Preparedness and Response Plan detailing the national strategy for pandemic management, capacity building, and resource requirements. The government's wide-ranging health sector measures in 2020 helped contain the spread of the disease and strengthen the capacity and accessibility of the specialized health care services and staff. However, the prolongation of the pandemic requires continuation of these measures for prevention and treatment, particularly in the case of second and third waves of COVID-19, and for rollout of nationwide vaccination program. Mandatory health insurance was partially introduced in 2020, and its nationwide rollout is also critical to improve access to and affordability of health care services. Therefore, the government's health-related measures in 2021 include (i) additional payments for 64,038 health care workers at 35 public and private medical facilities; (ii) procurement of medicines, medical supplies, and equipment; (iii) compensation of private medical facilities for treatment of COVID-19 patients; (iv) provision of quarantine services and establishment of quarantine facilities at border crossings; (v) scaling up of medical facilities by covering the operational expenses of 12 modular hospitals set up in 2020; (vi) preventive activities for contagious diseases, including surveillance using mobile applications, disinfection of

public places, and increased availability of COVID-19 testing in 50 laboratories across the country; and (vii) nationwide rollout of mandatory health insurance by 1 April 2021, and provision of a subsidy of AZN90 per person for universal coverage of all citizens.<sup>29</sup> While not covered under the CARES Program, the government's health sector measures also include a comprehensive nationwide vaccination strategy for 2021–2022, which was approved on 16 January 2021.<sup>30</sup>

23. **Social protection measures.** The social safety net has been expanded to mitigate poverty. While AZN190 per month was allocated to 600,000 unemployed citizens and 200,000 public sector employees during the lockdowns in April–May 2020, targeted social assistance (TSA) continues to be provided with the number of low-income households increasing from 76,826 households (322,078 persons) in 2020 to 80,000 (335,200 persons) in 2021. TSA also benefits children. The average monthly allowance per household was increased from AZN239.9 in 2020 to AZN268.2 in 2021. In addition to the food assistance provided to nearly 100,000 low-income families and organized farmers' market selling directly to the public in 2020, a subsidy of AZN35 per ton to flour producers is provided in 2021 to stabilize food prices and ensure food security. In continuation of the reimbursement of tuition fees for students from socially vulnerable families and scholarships for vocational education and training students provided in 2020, interest-free lending to low-income families for higher education was provided in 2021. Old-age pension payments have increased from AZN249.25 per month before the pandemic to AZN291.5 to match the increase in monthly nominal wages. In 2020, 772,034 elderly people received pensions, 466,826 of whom were female. In 2021, AZN441 million has been allocated to support these pensioners. While the utility bill support to the general population was provided during April–May 2020, the government has continued to provide a monthly allowance of AZN33–AZN60 per person, and subsidies for utility services for 496,557 IDPs in 2021.

24. **Macroeconomic stabilization measures.** The government's measures have supported the most affected sectors and job creation. Tax benefits and exemptions for businesses in 2020 expired on 1 January 2021. Partial salary payments for 374,316 employees and support for 173,162 individual (micro) entrepreneurs were provided in 2020 during the lockdowns. In continuation of earlier employment support, AZN159.8 million has been allocated in 2021 for the creation of additional 17,438 temporary public jobs over the existing 38,000 jobs at municipal and social services and SOEs across the country. Following the AZN1.5 billion allocated in 2020 under the credit and guarantee support program through the Entrepreneurship Development Fund, AZN12 million was allocated in 2021 for interest rate subsidies on bank loans to businesses. To support the refinancing of mortgage loans through the Mortgage and Credit Guarantee Fund, AZN71 million was allocated in 2021 in continuation of the support provided in 2020. In 2021, to support the agricultural producers and ensure food price stability, fuel subsidies have been provided to cover fuel price adjustments of the Tariff Council since January 2021. Financial support has been provided to Azerbaijan Airlines, Baku subway, and the water utility operator (Azersu) to cover their increased operational losses. As part of the relief package to the tourism and hospitality sector, in 2021 the State Tourism Agency was supported to (i) cover the operational costs of tourism information centers in 11 regions and the Shahdag Tourism Center, (ii) promote Azerbaijan through the global broadcasting networks, (iii) organize events to raise awareness on Azerbaijan's tourism potential, and (iv) ensure post–COVID-19 tourism

<sup>29</sup> Details on the citizens' copayment of health insurance fees alongside the government subsidy are in Appendix 4.

<sup>30</sup> The vaccination strategy prioritizes vulnerable populations such as health care workers and elderly people above 65 years of age. The government allocated AZN85.5 million (\$50.3 million) for an initial 4 million doses of vaccines using the 2021 budget and the Coronavirus Response Fund. Nearly 1 million additional doses are planned to be acquired from a variety of suppliers during 2021. The vaccination program began in January 2021. According to [WHO](#), as of 12 June 2021, 2,774,693 vaccine doses were administered with 1,810,344 persons vaccinated with at least one dose.

development. The CBA adopted monetary policy measures in 2020 including extension of deposit insurance and restructuring of distressed loans. The CBA extended the regulatory easing on provisioning for nonperforming loans, loan restructurings, and capital buffers until 1 April 2021.

25. **ADB's value addition and sustainability.** The CARES Program design is based on ADB's policy dialogue with the government and is fully aligned with its development strategy for inclusive economic growth. The program's budget support has significant value addition by (i) providing fiscal space for countercyclical measures, (ii) helping reduce fiscal risks related to depletion of SOFAZ assets, and (iii) supporting macroeconomic stability and post-pandemic recovery through multisector support. Besides ADB's extensive countercyclical support experience under CPRO in other countries, the government preferred a budget support loan from ADB instead of other development partners because of ADB's well-established experience with PFM reforms in Azerbaijan. The attached TA (para. 33) strongly complements the CARES Program by helping support the continuous implementation of the medium-term debt management strategy, rule-based fiscal management, and effective medium-term budgeting so that these critical PFM reforms are not derailed by the pandemic. The TA will also help progress dialogue with the government to deepen the structural reforms. ADB has also helped catalyze a cofinancing loan from the Asian Infrastructure Investment Bank (AIIB) benefitting from its earlier institutional collaboration under CPRO in other countries. The combined ADB and AIIB financing with favorable terms and maturity supports prudent fiscal management during the pandemic. The program's budget support for the health sector, particularly for financing the subsidy for the nationwide rollout of mandatory health insurance, is another unique value addition to improve the health system's affordability, accessibility, capabilities, and resilience to future emergencies. The TA support will also help strengthen the coverage and implementation of the mandatory health insurance and inclusiveness and effective targeting of the social security system. The program complements two regional TA projects to (i) increase health cooperation in the Central Asia Regional Economic Cooperation (CAREC) countries and the Caucasus; and (ii) address the outbreak of COVID-19 and other communicable diseases.<sup>31</sup> The program helps implement CAREC 2030,<sup>32</sup> especially its operational cluster on human development and control of pandemic risks and communicable diseases, and supports the CAREC Health Strategy, currently under development. The program is fully aligned with ADB's ongoing and future country support to improve (i) private sector and tourism development in line with the CAREC Tourism Strategy 2030,<sup>33</sup> and access to finance; (ii) education and skills development; (iii) integration in energy and transport infrastructure; and (iv) regional cooperation and trade facilitation through CAREC corridors. These areas are critical for post-COVID-19 economic recovery and diversification.

26. **Lessons.** The program design incorporates lessons from the CPRO support in other developing member countries. These lessons include (i) the importance of adequate, timely, and flexible countercyclical support for fiscal sustainability; (ii) channeling support through the budget to ensure effective coordination, efficient execution and monitoring of expenditures; (iii) targeting social assistance for the poor and vulnerable population; (iv) mainstreaming gender inclusion and equity; (v) establishing governance risk mitigation, expenditure tracking and independent verification mechanisms through enhanced oversight and due diligence; (vi) providing TA to strengthen institutional capacity; and (vii) focusing on economic recovery through job creating, multisector support. The program design reflects lessons from ADB's multifaceted country

<sup>31</sup> ADB. 2020. [Technical Assistance for Addressing Health Threats in Central Asia Regional Economic Cooperation Countries and the Caucasus](#). Manila (TA 6535-REG); and ADB. 2020. [Technical Assistance for Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases](#). Manila (TA 9950-REG).

<sup>32</sup> ADB. 2017. [CAREC 2030: Connecting the Region for Shared and Sustainable Development](#). Manila.

<sup>33</sup> ADB. 2020. [CAREC Tourism Strategy 2030](#). Manila (December).



operations,<sup>34</sup> experience with budget support loans under the Countercyclical Support Facility,<sup>35</sup> and policy-based programs. These lessons underscore the need to continue structural PFM reforms on fiscal, debt, and financial risk management and effective budgeting; and economic diversification to strengthen Azerbaijan's resilience to external shocks. The attached TA helps to ensure that PFM reforms do not lose momentum despite the pandemic.

27. **Debt sustainability analysis.** The government requested a \$250 million budget support loan from ADB and a cofinancing loan of \$100 million from the AIIB in 2021. The government will also borrow \$764.7 million domestically in 2021. Based on ADB's debt sustainability analysis (DSA),<sup>36</sup> this additional borrowing over the public debt stock of \$8.5 billion in 2019 will not significantly affect debt sustainability or annual debt service obligations. Based on IMF projections, the public debt–GDP ratio increased from 17.7% in 2019 to 21.4% in 2020 and will increase to 30.9% in 2021, 31.4% in 2022, and 32.4% in 2023. Both the IMF's pre-shock DSA under the Article IV consultation report in September 2019 (footnote 9) and ADB's recent DSA indicate that Azerbaijan's debt carries *low* risk of debt stress because of its strong position due to official reserves and SOFAZ assets, and favorable maturity structure and loans from the international financial institutions, which partly offset the risk from foreign currency-denominated debt.

28. **Coordination with the International Monetary Fund and development partners.** ADB has effectively coordinated with development partners on pandemic-related assistance, which focused on budget support, strengthening of health sector, economic stabilization and employment, and expanding social protection.<sup>37</sup> The United Nations Resident Coordinator's Office held coordination meetings at least semiannually. The government coordinated extensively with the IMF during the Article IV consultation missions.<sup>38</sup> ADB, the IMF, and the World Bank have maintained close coordination for the CARES Program. The government requested a cofinancing loan of \$100 million from AIIB, expected to be approved after the CARES Program. The European Union provided multisector support of €31.6 million in 2020 to (i) strengthen the State Agency for Mandatory Health Insurance, (ii) provide emergency grants to vulnerable citizens, and (iii) support MSMEs and the self-employed. In 2021, the European Union provided support under regional TA to the Ministry of Health on rollout of COVID-19 vaccination program. In 2020, the World Bank approved a \$100 million loan for self-employment and vocational training for the vulnerable population and a \$50 million additional financing loan for judicial infrastructure. Discussions are underway with the World Bank on health sector and social protection support in 2022. In 2020, the European Bank for Reconstruction and Development provided \$23.6 million in direct lending for private sector businesses. The International Finance Corporation, along with the State Secretariat for Economic Affairs of Switzerland, supported the enabling business climate. WHO, the United Nations agencies, and other development partners have provided in-kind support for medical supplies and equipment; improvement of pandemic surveillance capacity; cash transfers; and in-kind social relief for vulnerable population, including those affected by the conflict.

### C. Expected Outcome of ADB Program

29. The program provides budget support to meet development financing needs arising from the pandemic response measures. The program is aligned with the country's overarching development objective to mitigate the adverse impacts of COVID-19 on (i) the population's health,

<sup>34</sup> ADB. 2018. [Country Assistance Program Evaluation: Azerbaijan, 2011–2017](#). Manila.

<sup>35</sup> ADB. 2019. [Completion Report: Azerbaijan: Countercyclical Support Facility Program](#). Manila.

<sup>36</sup> Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2).

<sup>37</sup> Development Coordination (accessible from the list of linked documents in Appendix 2).

<sup>38</sup> The IMF Assessment Letter (accessible from the list of linked documents in Appendix 2), provided on 1 April 2021, confirmed the sound macroeconomic management and supported government's pandemic response measures.

incomes, and economic opportunities; and (ii) the country's macroeconomic stability. The program has three outputs: (i) COVID-19 response and health system strengthening measures implemented, (ii) social protection for the poor and vulnerable households expanded, and (iii) affected sectors supported to prevent job losses from the economic downturn. The program identifies the risk that the prolonged COVID-19 pandemic, global economic slowdown, and fall in oil prices could hurt growth prospects and thus require more financial resources than originally envisaged. Based on the program's theory of change, the outputs contribute to achievement of the expected outcome that COVID-19 outbreak is more effectively managed and its adverse social and economic impacts are reduced.<sup>39</sup> The program is aligned with the ADB's country partnership strategy, 2019–2023 for Azerbaijan<sup>40</sup> and the government's development strategy.<sup>41</sup>

#### D. Development Financing Needs and Budget Support

30. According to IMF estimates in Table 3, the budget deficit will increase to \$2.6 billion (5.2% of GDP) in 2021 compared with the pre-COVID-19 estimate of a budget surplus of \$1.3 billion (2.7% of GDP) in 2021. Although the government responded to the pandemic in 2020 by predominantly using domestic resources, given the prolongation of the pandemic and fiscal pressure, the government decided to request budget support loans from ADB and the AIIB (cofinancing, not administered by ADB) to supplement domestic financing resources (Table 3). The government will fully use the domestic debt ceiling of AZN1.3 billion (\$764.7 million) under 2021 budget for domestic financing of the fiscal deficit using debt securities. Of the external debt ceiling of AZN1.2 billion (\$705.9 million) under the 2021 budget, foreign financing of \$350 million (13.5% of the fiscal deficit) will be undertaken in line with the debt management strategy, aimed at reducing foreign borrowing.

**Table 3: Development Financing Needs and Budget Support**  
(\$ million)

Item	2020		2021	
	Pre-COVID-19 <sup>a</sup>	Post-COVID-19 <sup>b</sup>	Pre-COVID-19 <sup>a</sup>	Post-COVID-19 <sup>b</sup>
I. Revenues	18,087.6	14,458.2	18,309.4	16,394.7
II. Expenditures	16,538.8	17,195.3	17,000.0	18,981.2
III. Fiscal deficit (I–II)	1,548.8	(2,737.1)	1,309.4	(2,586.5)
IV. Domestic financing <sup>c</sup>		2,737.1		2,236.5
Of which: Domestic debt securities		166.8		764.7
V. Foreign financing				350
(i) ADB CARES Program				250
(ii) Cofinancing loan from AIIB				100

( ) = negative, ADB = Asian Development Bank, AIIB = Asian Infrastructure Investment Bank, CARES = COVID-19 Active Response and Expenditure Support, COVID-19 = coronavirus disease, IMF = International Monetary Fund.

<sup>a</sup> Pre-COVID-19 fiscal projections are from IMF, 2019. [World Economic Outlook](#), Washington, DC (October).

<sup>b</sup> Post-COVID-19 fiscal projections are from IMF, 2021. [World Economic Outlook](#), Washington, DC (April).

<sup>c</sup> Domestic financing sources include reprioritization of budget expenditures, domestic debt securities, privatization proceeds and sale of government assets, government deposits in the Central Bank of Azerbaijan, residual balance from the single treasury account from previous year, and asset reductions from the State Oil Fund of Azerbaijan.

Sources: Government of Azerbaijan, Ministry of Finance; IMF; and ADB estimates.

31. The government has requested a regular loan of \$250,000,000 from ADB's ordinary capital resources to help finance the program. The loan will have a 10-year term, including a grace period of 3 years; an annual interest rate determined in accordance with ADB's London interbank

<sup>39</sup> The indicators reflecting pandemic response measures are in the design and monitoring framework (Appendix 1).

<sup>40</sup> ADB, 2019. [Country Partnership Strategy. Azerbaijan, 2019–2023—Promoting Diversified and Inclusive Growth](#). Manila.

<sup>41</sup> The Presidential Decree No. 1897 on "Primary Directions of Strategic Roadmaps for National Economy and Main Sectors of Economy" signed on 16 March 2016.

offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average loan maturity is 6.75 years, and there is no maturity premium payable to ADB. The loan is expected to be disbursed in August 2021. The loan size is based on the financing needs and countercyclical expenditures.

## E. Implementation Arrangements

32. The Ministry of Finance (MOF) will be the executing agency. The MOF, through a dedicated monitoring and evaluation (M&E) unit, will monitor the activities and expenditures under the program, submit quarterly reports to ADB until 6 months after the loan effectiveness date, and continue dialogue with ADB on (i) the macroeconomic situation and financial sector conditions; (ii) implementation of the government's countercyclical measures under the COVID-19 pandemic response package; (iii) budget execution, flow of funds, and expenditures made from the state budget to support the countercyclical measures, including (a) health sector response, (b) macroeconomic stabilization measures for affected sectors and job creation, and (c) social protection; and (iv) tracking of beneficiaries of social assistance programs, with gender indicators (with sex-disaggregated data). A national M&E specialist under the attached TA (para. 33) will work closely with the M&E unit at the MOF to support timely implementation and reporting. The existing sex-disaggregated databases at the line ministries, including for employment, pensioners, and the social protection system; the government's household registries; and household surveys of the United Nations and the World Bank will be leveraged for oversight of expenditures, targeting of beneficiaries, and distributing social benefits. The MOF's periodic budget reports will be used for tracking public funds for COVID-19-related expenditures. There will be close coordination with development partners during the review of quarterly progress.<sup>42</sup> The program's expected implementation period is 1 July 2021–31 December 2021. The loan closing date is 31 December 2021. The proceeds of the loan will be withdrawn in a single disbursement in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

## III. ATTACHED TECHNICAL ASSISTANCE

33. The TA is estimated to cost \$260,000, of which \$250,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support in the form of counterpart staff, office space and facilities for consultants, and other in-kind contributions. The executing agency is the MOF, and the implementing agencies are the MOF and its Debt Management Agency, the Ministry of Labor and Social Protection of the Population, the Ministry of Health, and the State Agency for Mandatory Health Insurance. The TA project's outputs comprise (i) CARES Program implementation monitored and reported on time, (ii) national fiscal management capacity improved, (iii) national debt management system strengthened, (iv) social security system strengthened, and (v) mandatory health insurance system strengthened. A total of 14 person-months of individual consultancy services will be engaged following the ADB Procurement Policy (2017, as amended from time to time).<sup>43</sup>

<sup>42</sup> List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

<sup>43</sup> The consultants comprise (i) a national M&E specialist for monitoring the CARES Program; (ii) international and national fiscal management specialists for supporting rule-based fiscal management and gender-sensitive medium-term budgeting; (iii) international and national debt management specialists for supporting implementation of medium-term debt management strategy; (iv) international and national social security system specialists for supporting effective targeting of social security system; and (v) international and national health insurance system specialists for supporting strengthening of the coverage and effectiveness of the mandatory health insurance system. ADB. 2019. [Supporting Public Sector Governance Reforms](#). Manila (TA 9876-AZE) is also providing complementary TA resources for additional PFM reforms and for preparing a new policy-based program.

#### IV. DUE DILIGENCE

34. **Governance.** A governance risk assessment was undertaken in 2019 to inform the preparation of ADB's country partnership strategy for Azerbaijan, 2019–2023 (footnote 40) in line with ADB's Second Governance and Anticorruption Action Plan.<sup>44</sup> The government is committed to combating corruption and improving governance; and these institutional weaknesses have been identified as main obstacles to structural reforms and enabling business climate.<sup>45</sup> The latest public expenditure and financial accountability assessment in 2014 showed generally good PFM performance in terms of orderliness in the annual budget process and predictability of expenditure fund availability.<sup>46</sup> The public procurement law was amended in 2018 and an electronic procurement system was introduced in 2019. ADB supported strengthening of procurement systems, safeguards compliance, and project management capacity. Under policy-based programs (footnote 8) and TA projects, ADB also supported medium-term budgeting and rule-based fiscal management. The IMF regularly supported improving macro-fiscal management, the budget law, and national income accounting and statistics. The World Bank supported strengthening of internal and external audit systems and expansion of their coverage to improve compliance with international standards. The World Bank also supported public sector accounting, auditing, the medium-term expenditure framework, and the judicial services.<sup>47</sup>

35. **Poverty and social considerations.** The program supports poverty alleviation measures to safeguard the health of citizens, maintain jobs, and expand the social safety nets (paras. 21–24), given the pandemic's adverse poverty and social impact (paras. 17–20).<sup>48</sup>

36. **Gender.** The program is categorized effective gender mainstreaming.<sup>49</sup> It supports (i) continuous supply of appropriately sized personal protective equipment to at least 64,000 health care workers dealing with COVID-19 patients, including individual packages for female health care workers; (ii) provision of additional payments (in the range of a three- to five-fold increase in monthly wages) to at least 64,000 health care workers dealing with COVID-19 patients, of which at least 65% are women; (iii) coverage of at least 90% of the population under the mandatory health insurance, of which 50% are women; (iv) increase in the number of low-income households receiving support under TSA to at least 80,000, covering 335,000 individuals, of which 50% are women; (v) increase in average monthly old-age pension payments by at least 15% and continuous provision of pensions to more than 742,000 old-age pensioners, of which at least 63% are women; (vi) provision of interest-free loans for higher education to students from low-income families, of which at least 50% are girls; (vii) payment of monthly allowances of AZN33–AZN60 per person and subsidies for utility services to at least 495,306 IDPs, of which at least 50% are women; (viii) creation of at least 17,000 additional temporary public jobs, of which at least 40% are provided to women; and (ix) provision of an at least 10% interest rate subsidy on bank loans to at least 1,990 MSMEs, of which at least 25% are owned by women.

<sup>44</sup> ADB. 2006. [Second Governance and Anticorruption Action Plan \(GACAP II\)](#). Manila.

<sup>45</sup> According to World Bank's [Worldwide Governance Indicators](#), from 2009 to 2019, Azerbaijan's rankings (i) improved on: (a) control of corruption: 9.51% to 19.71%; (b) rule of law: 20.85% to 30.29%; (c) regulatory quality: 43.06% to 43.75%; and (d) government effectiveness: 30.62% to 46.15%; and (ii) declined in (a) voice and accountability: 13.27% to 7.39%; and (b) political stability and absence of violence and/or terrorism: 35.55% to 21.90%.

<sup>46</sup> While making progress compared to 2008, challenges existed in credibility of budget outturns and budget classification, management of cash balances, debt and guarantees, fiscal planning, expenditure policy and budgeting, procurement, and internal and external audit. PEFA Secretariat. 2014. [Azerbaijan Public Expenditure and Financial Accountability \(PEFA\) Performance Report: Repeat assessment](#). Washington, DC: World Bank.

<sup>47</sup> Assessment of Public Financial Management System in Azerbaijan (accessible from the list of linked documents in Appendix 2).

<sup>48</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

<sup>49</sup> Gender Monitoring Matrix (accessible from the list of linked documents in Appendix 2).

37. **Safeguards.** In compliance with ADB’s Safeguard Policy Statement (2009), the program is classified category *C* for environment, involuntary resettlement, and indigenous peoples. It is not expected to have any environmental or social safeguard impacts.<sup>50</sup>

38. **Risk mitigating measures.** Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>51</sup>

**Table 4: Summary of Risks and Mitigating Measures**

Risk	Mitigation Measures
Prolongation of the pandemic, a global economic slowdown, and a decline in oil prices could hurt growth prospects, necessitating more financial resources than originally envisaged.	The government has undertaken proactive measures to (i) improve the health care system, including a COVID-19 vaccination strategy; (ii) support affected sectors and employment; (iii) expand social protection; and (iv) strengthen recovery. The government engages with development partners, including ADB, to obtain financial and technical support.
Corruption; poor governance; and weak PFM, procurement, and internal and external audit capacity undermine transparent, efficient, and cost-effective allocation of public resources and implementation of countercyclical measures.	With support from ADB and development partners, PFM, internal and external audit systems, anticorruption, and governance have been improving. An e-procurement system was launched in 2019 to increase transparency. The CARES Program will be monitored by the national M&E specialist under the attached TA. Quarterly reports will be submitted by the MOF on countercyclical expenditures from the budget.

ADB = Asian Development Bank, CARES = COVID-19 Active Response and Expenditure Support, COVID-19 = coronavirus disease, M&E = monitoring and evaluation, MOF = Ministry of Finance, PFM = public financial management, TA = technical assistance.

Source: Asian Development Bank.

39. ADB’s Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOF.

## V. ASSURANCES

40. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, financial management, and disbursement, as described in detail in the loan agreement.

## VI. RECOMMENDATION

41. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$250,000,000 to the Republic of Azerbaijan for the COVID-19 Active Response and Expenditure Support Program, from ADB’s ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB’s London interbank offered rate (LIBOR)-based lending facility; for a term of 10 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa  
President

29 June 2021

<sup>50</sup> Safeguards Assessment Matrix (accessible from the list of linked documents in Appendix 2).

<sup>51</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## DESIGN AND MONITORING FRAMEWORK

<b>Country's Overarching Development Objective</b>			
Adverse impacts of COVID-19 on (i) the population's health, incomes, and economic opportunities, and (ii) the country's macroeconomic stability, mitigated. <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<p><b>Outcome of the Program</b></p> <p>COVID-19 outbreak more effectively managed and its adverse social and economic impacts reduced<sup>b</sup></p>	<p>By 31 December 2021:</p> <p>a. COVID-19 testing capacity reached at least 10,000 tests per day and at least a cumulative of 2.6 million tests completed (2019 baseline: none)</p> <p>b. National poverty rate maintained at or below the average of pre-COVID-19 levels (2016–2019 average baseline: 5.3%)</p> <p>c. Output of MSMEs as a share of GDP maintained at or above pre-COVID-19 level (2019 baseline: Output of MSMEs as a share of GDP at 23.3%)</p>	<p>a. Cabinet of Ministers Special Taskforce for COVID-19, the State Agency for Mandatory Health Insurance, Ministry of Health and World Health Organization country reports</p> <p>b. State Statistics Committee</p> <p>c. State Statistics Committee</p>	<p>Prolongation of the pandemic, a global economic slowdown, and a decline in oil prices could hurt growth prospects, necessitating more financial resources than originally envisaged.</p>
<p><b>Outputs</b></p> <p>1. COVID-19 response and health system strengthening measures implemented</p>	<p>By 31 December 2021</p> <p>1.1 Appropriately sized personal protective equipment continuously supplied to at least 64,000 health care workers dealing with COVID-19 patients, including individual packages for female health care workers<sup>c</sup> (2019 baseline: Personal protective equipment not provided)</p> <p>1.2 The government provided additional payments (in the range of a three- to five-fold increase in monthly wages) to at least 64,000 health care workers dealing with COVID-19 patients, of which at least 65% are women (2019 baseline: None)</p>	<p>1.1 Ministry of Health and State Statistics Committee</p> <p>1.2 Ministry of Finance and Ministry of Health</p>	<p>Corruption; poor governance; and weak public financial management, procurement, and internal and external audit capacity undermine transparent, efficient, and cost-effective allocation of public resources and implementation of countercyclical measures.</p>

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>1.3 At least 12 modular hospitals with a total of 4,700 hospital beds operationalized for treatment of COVID-19 patients (2019 baseline: None)</p> <p>1.4 At least 90% of the population covered under the mandatory health insurance, of which 50% are women (March 2020 baseline: 66% of the population)</p>	<p>1.3 Ministry of Health</p> <p>1.4 State Agency for Mandatory Health Insurance and Ministry of Health</p>	<p>Weak coordination within the government and with development partners, gaps in the government's technical and institutional capacity, and overstretched staff responding to the COVID-19</p>
<p>2. Social protection for the poor and vulnerable households expanded</p>	<p>2.1 The number of low-income households receiving support under targeted social assistance increased to at least 80,000, covering 335,000 individuals, of which 50% are women (2019 baseline: 72,170 households)</p> <p>2.2 Average monthly old-age pension payments increased by at least 15%, and more than 742,000 old-age pensioners continuously provided pensions, of which at least 63% are women (2019 baseline: Average monthly old-age pension payment AZN249.25 provided to 756,136 old-age pensioners, of which at least 63% were women)</p> <p>2.3 Students from low-income families provided interest-free loans for higher education, of which at least 50% are girls (2019 baseline: No interest-free loans for higher education)</p> <p>2.4 Monthly allowance of AZN33–AZN60 per person and subsidies for utility services paid to at least 495,306 internally displaced persons, of which at least 50% are women (2019 baseline: AZN22–AZN40 per person for 495,306 internally displaced persons)</p>	<p>2.1 State Statistics Committee and Ministry of Labor and Social Protection of the Population</p> <p>2.2 State Statistics Committee, Ministry of Labor, and Social Protection of the Population reports; and State Social Protection Fund</p> <p>2.3 State Statistics Committee reports and Ministry of Education</p> <p>2.4 Ministry of Finance, and State Committee for Affairs of Refugee and Internally Displaced Persons</p>	<p>pandemic delay timely delivery of planned response measures and undermine the achievement of results.</p>
<p>3. Affected sectors supported to prevent job losses from the</p>	<p>3.1 At least 17,000 additional temporary public jobs created, of which at least 40% are provided to women (2019 baseline: 38,000 temporary jobs)</p>	<p>3.1 Ministry of Labor and Social Protection of the Population</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
economic downturn	<p>3.2 At least 10% interest rate subsidy on bank loans provided to at least 1,990 MSMEs, of which at least 25% are owned by women. (2019 baseline: Subsidies for interest rate not provided)</p> <p>3.3 Number of subsidized mortgage loans increased by at least 20%. (2019 baseline: 2,652)</p> <p>3.4 Credit available to the private sector as a share of GDP maintained at or above 16.1%. (2019 baseline: 16.1%)</p> <p>3.5 Operational costs of 11 tourism information centers across the country covered by the State Tourism Agency (2019 baseline: None)</p>	<p>3.2 Ministry of Economy, Entrepreneurship Development Fund and CBA</p> <p>3.3 Mortgage and Credit Guarantee Fund and CBA</p> <p>3.4 CBA</p> <p>3.5 Ministry of Culture and Tourism and State Tourism Agency</p>	
<p><b>Budget Support</b></p> <p>Asian Development Bank: \$250 million loan (ordinary capital resources)</p> <p>Asian Infrastructure Investment Bank: \$100 million loan (cofinancing)</p>			

CBA = Central Bank of Azerbaijan, COVID-19 = coronavirus disease, GDP = gross domestic product, MSMEs = micro, small, and medium-sized enterprises.

<sup>a</sup> The President of Azerbaijan's Decree No. 1897 "Primary Directions of Strategic Roadmaps for National Economy and Main Sectors of Economy", approved on 16 March 2016, and the President's Decree No. 1138 "Strategic Roadmaps for National Economy and Main Economic Sectors", approved on 6 December 2016. The road maps set targets (to be achieved by 2025) to accelerate economic diversification through reforms in (i) fiscal sustainability and robust monetary policy, (ii) privatization and state-owned enterprise reforms, (iii) human capital development, and (iv) development of business environment. The road maps also emphasize women's empowerment and the social safety net to ensure comprehensive coverage of the vulnerable groups.

<sup>b</sup> it is not currently possible to set more specific and realistic effects of the program targets than those presented in the design and monitoring framework, because of (i) uncertainties regarding how the COVID-19 outbreak and its economic effects; and (ii) the need for government responses to be flexible, given the evolving situation and the development and evolution of new data collection and reporting systems to monitor the crisis. Additional indicators to measure the effects will be identified over time and used to report as comprehensively as possible on the program's effectiveness in the project completion report.

<sup>c</sup> Menstrual hygiene kits in adequate number and quality.

Source: Asian Development Bank.



**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=55073-001-3>

1. Loan Agreement
2. Development Coordination
3. Country Economic Indicators
4. International Monetary Fund Assessment Letter
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. List of Ineligible Items
8. Attached Technical Assistance Report
9. Debt Sustainability Analysis
10. Gender Monitoring Matrix
11. Safeguards Assessment Matrix

**Supplementary Document**

12. Assessment of State Oil Fund of Azerbaijan (SOFAZ) and Fiscal Management Framework
13. Assessment of Public Financial Management System in Azerbaijan

## DEVELOPMENT POLICY LETTER



### MINISTRY of FINANCE REPUBLIC of AZERBAIJAN

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*27 May* 20*21*

No. *UHO/4.1-2-2021-1181*

To: Mr. Masatsugu Asakawa

President  
The Asian Development Bank

## DEVELOPMENT POLICY LETTER

Dear Mr. Asakawa,

On behalf of the Government of the Republic of Azerbaijan, I would like to express my gratitude to the Asian Development Bank (ADB) for its strong and continued support to our country's efforts to overcome the extraordinary health, economic and social challenges brought by the COVID-19 pandemic. This Development Policy Letter signifies our interest in attracting the loan in the amount of a \$250 million under the COVID-19 Active Response and Expenditure Support Program (the "Program") that is provided under ADB's Countercyclical Support Facility COVID-19 Pandemic Response Option ("CPRO").

The COVID-19 outbreak has reached 305,933 confirmed cases in Azerbaijan with 4,235 deaths as of 22 April 2021 based on World Health Organization (WHO) data. Because of the nationwide containment measures, the number of daily new confirmed COVID-19 cases has been largely brought under control with a reduction in daily new confirmed cases from a peak in December 2020. We are very cautious about the risks of a second and third wave of the virus. The Ministry of Health (MOH) in further cooperation (since 2021) with the State Agency on Mandatory Health Insurance, has been taking all the necessary measures to increase the preparedness of our health system while closely monitoring the situation and obtaining technical and financial support from the WHO and development partners.

I would like to brief you on the decisive actions the Government of Azerbaijan has taken to contain the COVID-19 outbreak and to help the citizens of Azerbaijan cope with

the unprecedented impact of the pandemic. In order to ensure the operative implementation of the preventive and urgent measures related to the spread of coronavirus disease in the territory of Azerbaijan, the Task Force (Operational Headquarters) under the Cabinet of Ministers consisting of heads of the appropriate government agencies and institutions and chaired by the Prime Minister of the Republic of Azerbaijan was established on February 27, 2020. Apart from that, according to the Decree of the President of the Republic of Azerbaijan of March 19, 2020, the Coronavirus Response Fund was established for the purpose of providing additional financing of the countermeasures against the pandemic.

Immediately after the earliest cases of COVID-19 had been identified, the Task Force responded to the emergency by introducing a special quarantine regime on 24 March 2020 with measures including (i) border closures, (ii) prohibition of mass gatherings, (iii) restrictions on domestic movements, (iv) closure of restaurants and other businesses, (v) closure of airports, and transportation hubs, (vi) strict social distancing, and (vii) disinfection of public spaces. Face masks were required in public places with restrictions on public transportation and screenings at ports of entry. Some restrictions have been relaxed during 2020 and 2021 in stages, enabling reopening of businesses and public spaces, and resuming of travel between cities and districts. Domestic and international flights to selected destinations resumed by July 2020. Depending on the dynamics of COVID-19 cases, the special quarantine regime was extended in stages including closure of educational institutions, closure of borders, permit requirements for people to leave their homes. With the rise in COVID-19 cases starting in March 2021, the special quarantine regime was recently extended until June 1<sup>st</sup>, 2021.

**Government of Azerbaijan's countercyclical pandemic response measures.**

The government approved action plans on 30 January 2020 and 4 April 2020 followed by additional measures in August 2020. These action plans, comprising health, social protection, and macroeconomic stabilization measures, constituted the pro-poor countercyclical pandemic response package. Budget funds and other sources, totaling AZN 3.5 billion (\$2.06 billion or 4.8% of GDP) were allocated in 2020 based on the President's Executive Decree on 19 March 2020. The 2020 measures have been generally effective in containing the spread of the disease, increasing the health sector capacity, providing immediate relief to the unemployed and impacted businesses, and expanding coverage of the social safety net. As the pandemic revealed itself to be long-lasting with the risk of an enduring impact on the economy and social and health-related wellbeing of the citizens, the continuation of the comprehensive anti-crisis efforts in 2021 has become paramount, particularly to improve targeting and coverage of the social safety nets and health insurance. Building on and in continuation of 2020 action plans, the pandemic response measures in total of AZN 3,014.6 million (\$1,773.2 million or 3.6% of GDP) was approved under the budget in 2021. The pandemic response, as presented below, comprises health-related measures (\$810.8 million), social protection measures (\$672.1 million), and macroeconomic stabilization measures (\$290.3 million).

**Health-related measures.** The MOH has been strengthening the capacity and readiness of the healthcare system in Azerbaijan. The MOH approved the COVID-19 Country Preparedness and Response Plan, detailing the medium and long-term strategy for a robust national pandemic preparedness as well as the capacity building and

resource requirements in line with WHO's Strategic Preparedness and Response Plan. The government's wide-ranging health sector measures in 2020 helped contain the spread of the disease and strengthen the capacity and accessibility of the specialized healthcare services and staff. Over 20 state hospitals with over 10,000 beds have been serving COVID-19 patients. Including the private hospitals, a total of 35 hospitals in Baku and regions have been designated for treatment of COVID-19 cases. The government has scaled up the medical capacity with establishment of 12 new modular hospitals with a total capacity of 4,700 hospital beds. A single unified database for COVID-19 was developed to collect information on COVID-19 cases. A total of 50 laboratories have been designated across the country to test for COVID-19, including 3 private sector laboratories and 1 food safety agency laboratory and as of February 2021, nearly 2.6 million tests have been performed. Consequently, the health expenditures as a share of state budget have increased from 3.6% in 2019 to 6.4% in 2020 and this figure is estimated to be equal to 4.9% in 2021.

The prolongation of the pandemic requires continuation of these measures in case of second and third waves of COVID-19 for prevention and treatment, including rollout of nationwide vaccination. As the mandatory health insurance was partially introduced in 2020, its nationwide rollout is also critical to improve the access and affordability of healthcare services. Therefore, the government's health-related measures in 2021, includes (i) procurement of essential medicines, medical supplies and equipment for COVID-19, (ii) compensation of private medical facilities for treatment of COVID-19 patients, (iii) provision of quarantine services and establishing quarantine facilities at border crossings, (iv) continuation of additional payments (3-5-fold increase in monthly wages) to approximately above 64,000 healthcare workers involved in the treatment of the COVID-19 patients at 35 public and private medical facilities in 2020, (v) scaling up of medical facilities by covering the operational expenses of 12 modular hospitals, set up in 2020, (vi) preventive activities on contagious diseases, including surveillance using mobile application, disinfection of public places and increasing the availability of COVID-19 testing in 50 laboratories across the country, and (vii) completion of the nationwide rollout of the mandatory health insurance by 1 April 2021 and providing a subsidy of AZN 90 per person for universal coverage of all citizens under the budget. The mandatory health insurance system includes 2,550 different types of medical services. While not covered by the Program, the government's health sector measures also include a comprehensive nationwide vaccination strategy for 2021–2022, approved on 16 January 2021. The vaccination strategy offers free COVID-19 vaccination, prioritizing the vulnerable population such as healthcare workers, elderly population above 65 years of age, etc. The government allocated \$50.3 million for 4 million doses of vaccines using 2021 state budget and the Coronavirus Response Fund. Additional doses will also be acquired from variety of other suppliers during 2021. Vaccinations have started as of end January 2021. Based on WHO data, as of 17 April 2021, 1,337,351 vaccine doses were administered in Azerbaijan with 889,212 persons vaccinated with at least one dose.

**Social protection measures.** The government has emphasized the social protection to mitigate the risks of rising poverty. The existing social safety nets have been expanded to include women and vulnerable population. In addition to the budget, resources from the State Social Protection Fund and the Unemployment Insurance Fund were mobilized. After introduction of special quarantine regime, the government provided

a temporary allowance of AZN 190 during the quarantine in 2020 to 600,000 unemployed citizens. These temporary allowances were not continued in 2021 with the gradual opening of the economy. However, to increase the inclusiveness rate and ensure that more families would receive state's support under the targeted social assistance (TSA) program, the government simplified procedures and eased conditions for acceptance of applications. The TSA coverage increased to 76,826 low-income households (322,078 persons) in 2020 and further to 80,000 households (335,200 persons) in 2021. TSA also benefitted the children. The average monthly TSA allowance per household was increased from AZN 239.9 in 2020 to AZN 268.2 in 2021. In addition to the food assistance provided to nearly 100,000 low-income families and organized farmers' market selling directly to the public in 2020, a subsidy of AZN 35 per ton to flour producers will be provided during 2021 to stabilize food prices and ensure food security. In continuation of the reimbursement of tuition fees for students from socially vulnerable families and scholarships for vocational education and training students provided in 2020, interest-free lending to low-income families for higher education will be availed in 2021. The old-age pension payments per month have been adjusted to AZN 291.5 from AZN 249.25 before the pandemic to match the increase in monthly nominal wages. In 2020, 772,034 elderly people received pensions, of which 466,826 were for females, and these pensioners will continue to be supported in 2021. While the utility bill support to general population was provided only during April–May 2020, the government continues to provide a monthly allowance of AZN 33–AZN 60 per person and subsidies for utility services for 496,557 IDPs in 2021.

**Macroeconomic stabilization measures.** A wide range of measures have been undertaken to strengthen the MSMEs, support affected sectors and critical state-owned enterprises (SOEs) and promote pro-poor and gender-inclusive job creation. On 2 June 2020, the President approved the amendments to the Tax Code, providing tax benefits to businesses most affected by the COVID-19 pandemic in retail trade, tourism and hospitality services, transportation, healthcare, and education for one-year beginning 1 January 2020 until 1 January 2021. Partial salary payments for 374,316 employees and support for 173,162 individual (micro) entrepreneurs were provided in 2020 during the lockdowns. In continuation of earlier employment support, 2021 budget includes support for the creation of more than 17,000 additional temporary public jobs over the existing 38,000 jobs at municipal and social services and SOEs across the country. Following the AZN 1.5 billion allocated in 2020 under the support program through the Entrepreneurship Development Fund to help businesses get loans with preferential terms, AZN 12 million was allocated in 2021 budget for interest rate subsidies on bank loans to businesses. To support the refinancing of mortgage loans through the Mortgage and Credit Guarantee Fund (MCGF), AZN 71 million was allocated in 2021 in continuation of the earlier support provided in 2020. The MCGF has also expanded its programs on guarantees and interest subsidies. In 2021, to support the agricultural producers and ensure food price stability, fuel subsidies have been provided to cover fuel price adjustments of the Tariff Council since January 2021. Given that SOEs dominate critical sectors in Azerbaijan, financial support has been provided to the Azerbaijan Airlines, Baku subway and the water utility operator, Azersu, to cover their increased operational losses during the pandemic. As part of the relief package to the tourism and hospitality sector, in 2021, the State Tourism Agency was supported (i) to cover the operational costs of tourism information centers in 11 regions and the Shahdag Tourism Center and (ii) to ensure post-COVID-19 tourism

development. The Central Bank of Azerbaijan (CBA) adopted monetary policy measures in 2020 including extension of deposit insurance and restructuring of distressed loans while safeguarding the financial sector stability. On 24 April 2020, capital requirements for banks, countercyclical capital buffer, and risk ratio on mortgage loans issued by banks were reduced until 1 January 2021. Additional measures until 30 September 2020 were introduced including suspension of inspections of credit institutions, moratorium on late fees and interest rate penalties, restructuring of mortgage loans issued at the expense of the MCGF, and deferral of insurance premium payments. The CBA extended the regulatory easing on provisioning for non-performing loans, loan restructuring and capital buffers until 1 April 2021.

**Economic outlook.** The pandemic had a negative impact due to the lockdowns in 2020 and 2021, business closures, downturn in trade, tourism, and remittances, and drop in consumer demand. Azerbaijan suffered from a twin supply shock with the fall in oil prices, triggered by the pandemic-related global slowdown and cut in oil production under an agreement with the OPEC+. The conflict in 2020 had a short-lived impact. According to the latest figures, the GDP contracted by 4.3% in 2020 (3.0% in non-oil GDP and 7.0% in oil GDP) compared to a pre-COVID-19 GDP growth of 2.2% in 2019, but GDP growth is projected to resume at 2.3% in 2021. While fixed exchange rate regime was maintained, inflation increased from 2.6% in 2019 to 2.8% in 2020 and is expected to reach 3.5% in 2021, partly driven by increase in food prices. The assets of the State Oil Fund of Azerbaijan (SOFAZ) reached \$43.56 billion in 2020 but are projected to decline to \$42.97 billion in 2021. The fragilities of micro, small and medium-sized enterprises (MSMEs) have become evident during the pandemic. The pandemic worsened the unemployment rate from 4.8% in 2019 to 6.5% in 2020 and it is expected to drop to 5.8% in 2021. The loss of incomes and remittances have reversed the poverty alleviation trend and exacerbated pre-existing inequalities and regional disparities. The health-related pressures and economic hardship due to pandemic have intensified the vulnerabilities of the women, children, elderly, internally displaced persons (IDPs), migrant workers, among others.

**Fiscal situation.** The MOF has confirmed the challenging fiscal situation caused by the COVID-19 pandemic. As the budget revenues have fallen while the budget expenditures have increased with countercyclical pandemic response measures, the fiscal deficit reached \$2.7 billion (6.4% of GDP) in 2020. Based on the IMF estimates, the large budget deficit is expected to continue in 2021: the budget deficit will reach \$2.6 billion (5.2% of GDP) compared with the forecasted budget surplus of \$1.3 billion (2.7% of GDP) for 2021 before the pandemic. We are fully aware that the final magnitude of economic and fiscal losses could be even higher if the pandemic is prolonged worldwide. Although the government responded to the pandemic in 2020 using predominantly domestic resources, given the prolongation of the pandemic and fiscal pressure, the government decided to request budget support loans from international financial institutions to supplement domestic financing resources. The government will fully utilize the domestic debt ceiling of \$764.7 million under 2021 budget for domestic financing of the fiscal deficit using debt securities. Of the external debt ceiling of \$705.9 million under the 2021 budget, foreign financing at \$350 million (13.5% of the fiscal deficit) will be undertaken in line with the prudent debt management strategy.

Therefore, the budget support loan of \$250 million under ADB's Program along with the co-financing loan of \$100 million from the Asian Infrastructure Investment Bank is extremely critical for our ability to (i) effectively contain the pandemic; (ii) improve the capacity and coverage of our health care system to safeguard the health of our citizens; (iii) stabilize our economy and ensure recovery while maintaining fiscal sustainability; (iv) preserve the incomes and livelihoods of our citizens; and (v) expand the social safety nets for the poor and vulnerable population. The Program will help finance the urgent near-term financing needs and address the economic and social fallout from the pandemic by providing resources to finance the growing budget deficit and undertake the countercyclical pandemic response measures at the same time.

We continue to spare no effort to protect lives and livelihoods from the COVID-19 pandemic, which has inflicted heavy damage to the health of our people and to our economy. We took swift and resolute measures to slow the epidemic, and with help of our development partners, we are committed to allocate financial and administrative resources to take concrete and comprehensive measures to respond to the COVID-19 pandemic. The government remains committed to the macroeconomic management reforms in close coordination with the IMF, ADB and other development partners. We are fully committed to continue the public financial management reforms such as implementation of rule-based fiscal management, medium-term debt management strategy, medium-term expenditure and budget frameworks that were initiated under ADB's Countercyclical Support Facility and two policy-based programs. Furthermore, the government will strengthen the coverage, implementation, and fiscal sustainability of the social security system and the recently introduced mandatory health insurance system. ADB's technical assistance support under the Program will ensure that critical public financial management reforms are not derailed and targeting of the vulnerable population under the social safety nets is strengthened during the pandemic.

As with the rest of the world, while the extent of the devastating health, economic, and social impacts of the COVID-19 pandemic on Azerbaijan are unfolding, we appreciate ADB's assistance under the proposed Program and we are fully committed to its implementation for the purposes intended. We look forward to furthering our cooperation in advancing Azerbaijan's developmental agenda.

Sincerely,



**Samir Sharifov**

**Minister of Finance and  
ADB Governor**

**ASSESSMENT OF COMPLIANCE WITH THE ACCESS CRITERIA FOR THE COUNTERCYCLICAL SUPPORT FACILITY  
COVID-19 PANDEMIC RESPONSE OPTION**

<b>Access Criteria</b>	<b>Asian Development Bank Assessment</b>
1. Adverse Impact of Exogenous Shocks	<p><b>Health impact.</b> Since the first COVID-19 case was reported on 28 February 2020, based on WHO data, as of 25 June 2021, Azerbaijan had 335,676 confirmed COVID-19 cases with 4,965 deaths. Azerbaijan has improved its public-sector-led health care system, providing universal basic medical care for citizens in public hospitals over the years with renovation of medical facilities, wider access to no-cost inpatient care and medicines for eligible population, establishment of the State Agency for Mandatory Health Insurance in 2016 and the launch of the electronic health card for citizens. Azerbaijan received support from the WHO and the World Bank in primary health care management and health financing and planning. The government allocated 3.6% of state budget on health care expenditures in 2019. The <a href="#">Universal Health Coverage effective coverage index</a> measured by the Institute for Health Metrics and Evaluation improved from 40.3 (out of 100) in 2010 to 48.2 in 2019. Azerbaijan also reduced the incidence of communicable diseases such as tuberculosis per 100,000 population from 80 in 2000 to 60 in 2019 and achieved vaccination coverage of 97.3% for measles.</p> <p>Despite these improvements, the growing number of COVID-19 cases during a health emergency of such nature has placed strains on the initial diagnosis, prevention, and treatment capacity because of inadequate specialized medical staff, facilities, and medical equipment and testing capacity during the pandemic. Azerbaijan ranks 151st out of 195 economies in its capacity to rapidly respond to and mitigate the spread of the epidemic, with a score of 25.5 out of 100 based on the <a href="#">Global Health Security Index</a> in 2019. Azerbaijan's overall score (comprising prevention, detection and reporting, rapid response, health system, compliance with international norms and risk environment) is 34.2 out of 100, ranking it 117th out of 195 economies in 2019. With limited infection specialists, health professionals from other fields of expertise were initially involved. Unbalanced geographical distribution of health care services and recruitment and retention of medical staff in rural areas have been a long-standing issue. There are also qualitative differences between urban and rural areas given that well-equipped and staffed medical care facilities and pharmacies are primarily concentrated in urban centers, particularly in Baku. In 2019, Azerbaijan had 31,829 physicians, of which 65% were women, 55,650 paramedical staff, and 570 public hospitals with 44,278 beds (44.5 beds per 10,000 population). In 2019, 64% of physicians, 40% of paramedical staff, 155 hospitals and 18,541 hospital beds were concentrated in Baku. In 2015, there were 656 private hospitals. Maintaining essential health services and capacities for emergency care, patients with chronic illnesses and surgical procedures have become challenging when resources were prioritized for the pandemic. The casualties from the armed conflict in 2020 has strained the health services.</p> <p><b>Economic impact of the pandemic.</b> The pandemic has had a substantial negative economic impact on Azerbaijan because of the lockdowns in 2020 and 2021, business closures, downturn in trade, tourism, and remittances, and drop in consumer demand. Azerbaijan also suffered from a twin supply shock with the decline in oil prices, triggered by the pandemic-related global economic slowdown, and cut in oil production (from 0.75 million barrels per day in 2019 to 0.71 million barrels in 2020 and 0.68 million barrels in 2021) under an agreement with the Organization of the Petroleum Exporting Countries and other major oil producers (OPEC+) in June 2020, which further deepened the economic downturn. The oil prices tumbled by more than 60% in the first quarter of 2020, reaching \$26 per barrel by</p>



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	<p>the end of March 2020, the lowest since 2001. Oil prices averaged only \$41.7 during 2020, remaining 25% below the 2019 average. Azerbaijan's fiscal breakeven oil price was \$65 per barrel while current account breakeven oil price was \$69.5 per barrel in 2020. The impact of the 44-day conflict in September–October 2020 was short-lived and the main infrastructure and economic base of the country were not directly exposed to the conflict zone. The expenditures for the conflict were financed from the defense and national security budget of AZN4.43 billion (\$2.6 billion or 17% of state budget revenues) in 2020, which increased from AZN3.16 billion (\$1.9 billion or 13% of revenues) in 2019. The defense and national security budget for 2021 is AZN4.59 billion (\$2.7 billion or 16% of total revenues), which are utilized for securing the safety of the former conflict zones and clearing these areas for facilitating the reconstruction efforts and return of the IDPs. According to the IMF, in contrast to the pre-COVID-19 GDP growth projection of 2.1% for 2020, the economy contracted by 4.3% in 2020 (contraction of 2.6% in non-oil GDP and 7.2% in oil GDP) with a downturn of 5.6% in industry and of 3.8% in services. Gross domestic investment as a share of GDP declined from 20.1% in 2019 to 17.4% in 2020. Azerbaijan's GDP growth is projected to rebound to 2.3% in 2021 (compared to pre-COVID-19 growth estimate of 2.2% for 2021), because of (i) improvements in both domestic and external demand (IMF predicts the global GDP growth at 5.4% in 2021), (ii) higher global oil and gas prices, (iii) support for farmers, and (iv) budgeted AZN2.2 billion (\$1.29 billion) spending on post-conflict reconstruction. However, risks related to prolongation of the pandemic due to new virus strains cause global concerns for the delays in normalization and recovery prospects. By early February 2021, Brent oil price reached over \$60 per barrel, recovering to pre-COVID-19 levels, however it is still below Azerbaijan's fiscal breakeven oil price of \$82.5 and current account breakeven oil price of \$98.6 in 2021. The OPEC+ quotas lower Azerbaijan's oil exports from 0.63 million barrels in 2019 to 0.58 million barrels in 2020 and 0.54 million barrels per day in 2021. With high level of fiscal deficits, this has increased the fiscal and current account breakeven oil prices of Azerbaijan.</p> <p><b>Fiscal balance.</b> Based on IMF's estimates, revenues declined sharply from AZN33.9 billion (\$20.0 billion or 41.5% of GDP) in 2019 to AZN24.6 billion (\$14.5 billion or 33.9% of GDP) in 2020 and AZN27.9 billion (\$16.4 billion or 32.8% of GDP) in 2021. Expenditures increased from AZN27.2 billion (\$16.0 billion or 33.3% of GDP) in 2019 to AZN29.2 billion (\$17.2 billion or 40.4% of GDP) in 2020 and AZN32.3 billion (\$19.0 billion or 38.0 % of GDP) in 2021 to mitigate the impact of pandemic through countercyclical measures. The fiscal balance widened from a surplus of AZN6.7 billion (\$3.9 billion or 8.2% of GDP) in 2019 to a deficit of AZN4.7 billion (\$2.7 billion or 6.4% of GDP) in 2020 and AZN4.4 billion (\$2.6 billion or 5.2% of GDP) in 2021. Non-oil primary deficit as a share of non-oil GDP increased from 27.2% in 2019 to 30.1% in 2020 and 31.5% in 2021.</p> <p><b>Finances of SOFAZ.</b> With the fall in oil prices and cut in production, SOFAZ revenues, comprising primarily proceeds from the sales of Azerbaijan's share of oil and gas, and revenues from the management of its assets, declined from AZN19.03 billion (\$11.19 billion) in 2019 to AZN9.36 billion (\$5.51 billion) in 2020 and further to the budgeted amount of AZN8 billion (\$4.71 billion) in 2021. SOFAZ transfers to the budget increased from AZN11.36 billion (\$6.68 billion) in 2019 to AZN12.20 billion (\$7.18 billion) in 2020 and 2021. SOFAZ 2020 budget as approved on 29 December 2019 had AZN11.35 billion (\$6.68 billion) for transfers but the amount was revised upward to AZN12.20 billion (\$7.18 billion) with the SOFAZ budget amendment based on the President's Decree on 31 August 2020.</p>

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	<p>During the pandemic, 99% of the SOFAZ expenditures were SOFAZ transfers to the budget and SOFAZ expenditures exceeded the revenues. This necessitated the government to use SOFAZ resources in a fiscally prudent manner, so that assets are not rapidly depleted given the risk of prolongation of the pandemic. SOFAZ transfers as a share of state budget revenues increased from 46.9% in 2019 to 49.4% in 2020 and 48.0% in 2021 during the pandemic. SOFAZ assets have continued to grow over the years, from \$33.57 billion in 2015 to \$43.32 billion in 2019. Due to declining revenues and increasing transfers, SOFAZ asset (inclusive of valuation effect of the investment portfolio) reached \$43.56 billion in 2020 but are projected to decline to \$42.97 billion in 2021. While SOFAZ assets are expected to grow over time with the production in Shahdeniz II gas field, spurring 28% increase in gas production and completion of planned Trans Adriatic Pipeline connecting hydrocarbon exports to Europe, the SOFAZ assets has been heavily prone to valuation shocks from oil price fluctuations and procyclical budget transfers. To strengthen countercyclicality and long-term asset accumulation for SOFAZ, a fiscal rule on SOFAZ transfers and budget expenditures was introduced in 2019 along with other fiscal and debt management reforms to prevent the overuse of oil revenues and limit the spending growth to 3% over the previous year's approved expenditures.</p> <p>The objective of the fiscal rule is to gradually reduce the SOFAZ transfers as a share of budget revenues. The IMF Article IV report in 2019 and IMF Assessment Letter point out the importance of growth-friendly fiscal consolidation achieved by mobilizing higher non-oil revenues, improving efficiency of spending, and improving revenue administration to save an adequate portion of the exhaustible oil wealth for future generations. The fiscal rule ensures spending discipline and reduces procyclicality. The fiscal rule is countercyclical on oil price increases, allowing for net financial asset accumulation while during oil price downturns, the rule allows partial adjustment of expenditures to cover shortfalls in oil revenues, thus safeguarding SOFAZ assets for future generations. Due to the pandemic, however, the implementation of the fiscal rule has been suspended until 2022.</p> <p>While SOFAZ transfers and assets have enabled to manage the shock with countercyclical support in 2020, as also emphasized by the IMF, the government has been vigilant about safeguarding adequate portion of the exhaustible oil wealth for future generations. The risk of depletion of SOFAZ assets due to the prolongation of the pandemic could jeopardize the availability of resources for intergenerational equity and future investment in social sectors and diversification for non-oil economy. A strong position with SOFAZ assets is critical to maintain stable monetary policy and fixed exchange rate as the risk of sharp exchange rate adjustments after terms of trade shocks could hurt the banking sector given the high liability dollarization. SOFAZ assets also support the country's good sovereign credit rating for debt absorption capacity.</p> <p><b>Current account and international reserves.</b> Azerbaijan's external position depends heavily on oil and gas exports, comprising 90% of total exports. With the downturn in global trade and decline in hydrocarbon exports, the current account balance recorded a deficit of 0.9% of GDP in 2020, following the surplus of 9.1% in 2019. Exports contracted by 36.3% and imports by 10% in 2020. Oil exports contracted by 40.3% in 2020. In 2021, a small current account surplus is projected at 1.1% of GDP. Gross international reserves have remained stable at \$6.26 billion, corresponding to 5.7 months of imports in 2020.</p>

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	<p><b>Remittances.</b> Downturn in the Russian Federation where nearly a million Azerbaijani migrant workers reside, has affected the households that rely on remittances. During the first quarter of 2020, remittances from the Russian Federation dropped by almost 40% compared to the first quarter of 2019. In 2020, total remittances were projected to fall by 21.9% from the 2018 remittance receipts of \$1.22 billion. According to United Nations, net migration rate dropped from 0.097 per 1000 population in 2019 to 0.073 in 2020 and is projected to drop further to 0.048 in 2021.</p> <p><b>Inflation.</b> Inflation remained generally stable at 2.8% in 2020 compared with 2.7% in 2019, reflecting food inflation by 5%, while inflation for non-food and services remained low at 1.3%. To limit food price inflation, the government has organized produce markets to let farmers sell directly to the public. Import-led inflation was curbed because of lower consumer demand, stable exchange rate and administered prices during 2020. In 2021, inflation is projected to increase to 3.5% with recovery in domestic demand and adjustments in fuel prices and utility tariffs.</p> <p><b>Monetary policy and exchange rate.</b> Inflation remained within the monetary policy target of 2%–6% of the CBA, which gradually reduced the policy rate to 6.25% from 7.25% during 2020. Decreasing demand for imports and foreign exchange sales from CBA and SOFAZ (nearly \$7.2 billion in 2020) helped maintain the fixed exchange rate. The exchange rate at \$1 = AZN1.70 is predicted to remain stable in 2021 along with the exchange rate policy. The CBA has closely monitored the internal and external pressures on exchange rate and intervened in the market.</p> <p><b>Banking sector.</b> Credit to private sector contracted by 0.7% in 2020 compared to 15.2% growth in 2019 but it is projected to grow by 5.0% in 2021. The legacy of dollarization in the banking sector continued, with nearly 34.6% of loans and 61.0% of deposits in foreign currency in 2019. However, credit and guarantee support programs through the EDF and the MCGF and easing of regulatory requirements on bank lending as part of countercyclical support have facilitated local currency-based loans to support the private sector during the pandemic. Share of deposits in foreign currency fell to 56.3% and loans denominated in foreign currency fell to 29.7% in 2020. The banking supervision was strengthened. The non-performing loans declined from 8.3% of credit portfolio in 2019 to 6.1% in 2020. Four banks, falling short of prudential requirements on capitalization were closed in 2020. Risk-weighted capital adequacy ratio of the banking sector improved from 22% in 2019 to 25% in 2020, however improvements have not been uniform, with capital adequacy deteriorating in weaker banks. Bank profitability worsened with weak credit demand. Additional CBA vigilance is required to avoid risk of distress from relaxed lending standards. Azerbaijan's sovereign credit rating is BB+/B with a revision in outlook from negative to stable in 2021 due to reduction in conflict-related security risks.</p> <p><b>State-owned enterprises.</b> Azerbaijan's SOEs account for 18% of GDP in 2018 compared to 70% in 1995. The 20 largest SOEs dominate critical sectors such as oil and gas, power generation and distribution, water supply and sanitation, railway, roads, air transport, and communication. Triggered by fall in revenues and increasing expenditures, the government provided direct financial support to SOEs to cover their large operational losses during the pandemic.</p> <p><b>Micro, small, and medium-sized enterprises.</b> Limited financial market development, access to credit, inefficient labor, product and service markets, skills gap in the labor force, high informality, weak entrepreneurship, and weaknesses in governance have constrained the private sector and MSME development before the pandemic. With</p>

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	<p>the government's efforts to create an enabling environment and promote private sector development and diversification of the economy, the share of non-oil sectors had gradually risen from 51.5% of GDP in 2013 to 61.9% in 2020. The share of MSMEs grew from 9.2% of GDP in 2016 to 23.3% of GDP (or 40.7% of non-oil GDP) in 2019. As access to finance was identified as a constraint, credit to private sector improved to 15.2% of GDP in 2019 from 14.1% of GDP in 2017. The MSMEs in Azerbaijan need continuous support to reach their full potential and their fragility has become more evident during the pandemic. Based on the United Nations report on socio-economic assessment for COVID-19 in 2020, out of 237,456 private sector MSMEs, 166,282 MSMEs were estimated to be heavily impacted, in which 528,570 employees have become vulnerable to job losses during April–September 2020. The income losses of the workforce in private sector MSMEs could reach up to AZN320.7 million (\$189 million). With business closures, MSMEs in Baku have been impacted up to 15% more than other regions.</p> <p><b>Tourism.</b> Tourism has been a growing priority sector for the government for promoting economic diversification. In 2017, Azerbaijan improved in the rankings of the World Economic Forum's Travel and Tourism Competitiveness Index, rising 13 places to rank 71st among 146 countries. Travel restrictions heavily impacted the hospitality and tourism sector. Airport passenger traffic dropped by 73% in 2020 and the number of foreign visitors declined from 3.2 million in 2019, corresponding to a spending of \$1.7 billion (6.5% of total exports) to 1.3 million visitors in 2020. Prior to the pandemic, in 2019, travel and tourism sector accounted for \$3.5 billion (7.2% of GDP), contributing to 378,000 jobs (7.7% of employment).</p> <p><b>Unemployment.</b> In Azerbaijan, employment mostly rests with the country's low-productivity, low waged, and large informal sector, which was hit hard during the pandemic. The oil sector employs 1% of the labor force, whereas agriculture about 36.0%. Based on the United Nations report, of the 5.1 million workforce, 1.55 million are wage workers with formal contracts (880,000 with state and 670,000 with non-state). The report projects that the non-state workforce faces an income loss up to AZN1,098 million (\$646 million) during April–September 2020 due to the pandemic. An estimated 1.6 million people engage in informal sector without labor contracts and access to social protection. The self-employed workforce is highly prone to income shocks during economic downturns. The unemployment rate is projected to increase to 6.5% in 2020 and 5.8% in 2021 from 4.8% in 2019. The pandemic has worsened the youth unemployment, which has increased from 14.6% in 2019 to 15.7% in 2020.</p> <p><b>Poverty.</b> While the oil-driven economic growth had helped Azerbaijan reduce the share of population living below the national poverty line from 49% in 2001 to 5.1% in 2018 and 4.8% in 2019, the loss of incomes and jobs and the fall in remittances due to the pandemic has exacerbated pre-existing income inequalities and regional disparities. The poverty rate in rural areas is twice as high as urban areas. National poverty line, computed based on the cost of a minimum food consumption basket, which guarantees a daily calorie intake of 2,200 kilocalories for an average person, was set at AZN185.5 per month (\$3.64 a day) in 2019. While Azerbaijan's HDI value stood at 0.756 in 2019, putting the country in the high human development category (88th out of 189 countries and territories), female HDI was lower at 0.730 compared to 0.774 for males and inequality adjusted HDI was 0.684, indicating a loss of 9.5% due to inequality in 2019. Azerbaijan's Gini index was 28.6 % in 2018.</p>

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	<p data-bbox="527 228 1898 407">During 2014–2017, state budget spending on various types of social protection measures averaged 11.8% of the budget. Nearly 2.8 million people (about 28.3% of population) benefitted from the state social protection system in 2017. According to World Bank’s Azerbaijan Living Conditions Assessment Report (2010), Azerbaijan’s system of social transfers is extremely important for poverty reduction. Without these social transfers, the overall poverty incidence would increase. According to their estimates, expenditures on social assistance equivalent of 1% of GDP decreases poverty incidence by 2.5 percentage points.</p> <p data-bbox="527 440 1898 651">While Azerbaijan has a comprehensive social safety net, those working in the informal sector lack adequate social protection. According to IMF, estimated size of Azerbaijan’s informal economy was nearly 45% of GDP in 2018. The World Bank projections show that trend in poverty alleviation has been reversed during the pandemic with the poverty rate (measured at \$5.5 per day) increasing from 5.3% in 2019 to 5.5% in 2020 (compared to pre-COVID-19 estimate of 4.0% in 2020). The poverty rate is projected to reach 5.2% in 2021, well above the pre-COVID-19 estimate of 3.8% for 2021. A household survey in 2020 by the United Nations covering 8 regions reported that 36% of respondents bought less food with nutritional value due to reduced household income and higher food prices during the pandemic.</p> <p data-bbox="527 683 1898 959"><b>Impact on women.</b> The pandemic has exacerbated the gender-based inequalities because of loss of income, decreased paid work and increasing economic dependence as women have lower labor force participation (68.6%) compared to men (73.9%) in 2018 and their average earnings have been lower. The gender inequality index was 0.323 in 2019, ranking 73rd out of 162 countries. In 2017, women’s unemployment rate was higher (5.9%) than men (4.1%), comprising 58% of the unemployed. Education, health, and social services have employed 55% of women participating in the labor force with about 42% in the agriculture sector. The share of women in the informal sector jobs was 42% in 2009. While Azerbaijan’s laws ensure equal pay for both men and women, the country still has a relatively high gender wage gap with women earning only 50.6% of what men earn in the labor market as of 2017. Women have been concentrated in service sector and comprised less than 20% in higher-paid sectors.</p> <p data-bbox="527 992 1898 1292">According to the United Nations survey in 2020, about 55% of self-employed women and 48% of women employees were severely affected by the lockdowns through reduced paid work hours. Women also outnumbered men in leave without pay during the pandemic because they are mostly employed in the low-wage service sector jobs impacted by lockdowns. More than 15% of female respondents said they lost their jobs and another 41% faced decreased paid-work hours. As more women shifted to home-based work, 47% of women reported increased time spent on unpaid care work. Women, comprising 50% of employees in the tourism, hospitality and food services and earning 30.4% less pay in these sectors compared to the rest of the economy, were especially hit hard. Women have been underrepresented as business owners in Azerbaijan with only 25% of registered MSMEs owned by women. Women have also had inadequate access to higher skilled occupations and financial services. Thus, the pandemic has led to a major set-back in women’s economic empowerment.</p> <p data-bbox="527 1325 1898 1411"><b>Impact on the vulnerable population.</b> The pressures on the health care system capacity have constrained the routine health services for the mothers and children, the elderly, and the people with chronic illnesses, disabilities, and special needs. The school closures have affected over 1.6 million school-age children, of which 46% are girls and</p>

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	<p>nearly 613,000 were enrolled in rural areas. About 70% of families with school age children had access to distance education and internet (530,000 active users of virtual school platform), while disadvantaged students with limited connectivity, mainly in rural areas faced learning losses.</p> <p>Azerbaijan had 651,000 IDPs as of end 2019. Although IDPs have received international aid, social assistance and medical support from the government, their vulnerabilities have intensified with the pandemic because of (i) communal and/or temporary housing arrangements with inadequate standards, (ii) higher poverty incidence (8%), making them prone to poor health and malnutrition, (iii) job losses, and (iv) high dependence on social transfers. The intensification of conflict in 2020 has increased the vulnerabilities of the people living in border areas. Returning Azeri migrant workers and 254,000 migrant workers within Azerbaijan reported as of 2019, have faced large income losses at times of diminished job prospects and increased unemployment. Migrant workers comprise 52% women and come primarily from Armenia and Georgia as neighboring countries, the Russian Federation, Uzbekistan, and Kazakhstan.</p>
2. Countercyclical Development Expenditures	<p>On 30 January 2020, the Cabinet of Ministers approved the “Action Plan on Prevention of the Spread of New Coronavirus Disease in the Republic of Azerbaijan”. An inter-agency COVID-19 Task Force (the Operational Headquarters) were established under the Cabinet of Ministers, chaired by the Prime Minister, on 27 February 2020. Working groups were formed under the Ministry of Economy, MOF, MOH, the Ministry of Labor and Social Protection of the Population, the Ministry of Internal Affairs, the State Agency for Mandatory Health Insurance, and the CBA.</p> <p>Another action plan was approved on 4 April 2020 followed by additional measures in August 2020. The action plans approved in January and April 2020, including additional measures in August 2020 are comprised of health, social protection, and macroeconomic stabilization measures and they constituted the pro-poor countercyclical pandemic response package of the government. Following the President’s Executive Decree on 19 March 2020, state budget funds (AZN2.5 billion) and other sources in total of AZN3.5 billion (\$2.06 billion or 4.8% of GDP) were allocated for the implementation of the action plans during 2020. According to the Decree on 19 March 2020, the government also established the parallel Coronavirus Response Fund and transferred AZN20 million from the President’s Contingency Fund. With additional contributions and donations from the public and private sector, the Corona Response Fund reached approximately AZN114 million as of 20 July 2020.</p> <p>Building on and in continuation of these action plans, in 2021, the pandemic response package of \$1,773.2 million (3.6% of GDP) has been approved under the state budget, comprising health-related measures (\$810.8 million), social protection measures (\$672.1 million) and macroeconomic stabilization measures (\$290.3 million). The following section explains the key countercyclical response measures in 2021, including the measures that have been completed in 2020 and/or continuing into 2021.</p> <p><b>A. Health-related measures.</b> The government has undertaken measures for (i) strengthening the capacity of medical facilities; (ii) emergency procurement of the necessary medicines and medical equipment; (iii) preventive activities on</p>

contagious diseases; (iv) additional payments for the health care workers, and (v) nation-wide implementation of the mandatory health insurance (details on health sector related expenditures are provided under Criteria 4).

**B. Social protection measures.** During the pandemic, the government has continued to deliver the existing social protection schemes for the poor and the vulnerable population without any disruptions. According to [Ministry of Labor and Social Protection of the Population](#), the existing and new social safety nets in 2020 covered over 4.8 million people, comprising (i) 1.665 million persons under various job and business protection initiatives (924,000 in state sector and 741,000 in private sector); (ii) nearly 2 million persons receiving old-age, disability and loss of family head pensions, and various social allowances and grants, (iii) 322,000 persons receiving TSA, (iv) 600,000 persons receiving a one-time unemployment payment, (v) 90,000 persons employed in public works, (vi) 12,000 families supported in self-employment program, (vii) 20,000 receiving unemployment insurance, and (viii) 100,000 families receiving food assistance. In addition to the budget, resources from the State Social Protection Fund and the Unemployment Insurance Fund were mobilized. A summary of key social protection measures during the pandemic is provided below.

**Unemployment support.** After introduction of special quarantine regime, the government provided a temporary allowance of AZN190 during April–May 2020 to 600,000 unemployed citizens. The unemployment insurance for laid-off workers also included the unemployed receiving vocational training by the State Employment Service and those with expired unemployment insurance benefits for the period of April–May 2020. Most of these individuals received a total of six such payments throughout the year, as the rising number of the COVID-19 cases led the government to impose mandatory lockdowns. In total, the government spent AZN450 million for this purpose in 2020. For the employees, who have a salary higher than the monthly average, the upper limit of this social assistance was set at AZN712. The eligibility criteria included being registered as unemployed with the State Employment Service, and that the person is not receiving (i) TSA, (ii) labor pension, (iii) monthly allowance, (iv) unemployment insurance, (v) stipend for vocational education, or (vi) subsidy for agriculture works, and that either husband or wife should not have active Tax ID or have active labor contract. The unemployment support was not continued in 2021 with the gradual opening of the economy.

**Paid-in compulsory leave.** To protect employment in the public sector and avoid the risk of unemployment, a lumpsum cash payments of AZN190 – equal to country’s living wage – have been made for two months in April–May 2020 to over 200,000 civil servants discharged during quarantine. The payment amounted to AZN76 million in 2020. The paid-in compulsory leave was not continued in 2021 with the gradual opening of the economy.

**Targeted social assistance.** The TSA is a social assistance package through cash transfers for low-income families based on a needs criterion with a duration set for 2 years. Prior to pandemic, almost 69,000 low-income families (or around 270,000 members of these families) have been receiving the TSA. To increase the inclusiveness and ensure that more families would receive state’s support under the TSA program, the government simplified the procedures and eased the conditions for acceptance of applications. The TSA coverage increased to 76,826 low-income households (322,078 persons) in 2020 and further to 80,000 households (335,200 persons) in 2021. An additional 165,728 children benefited from the TSA in 2020 with AZN36.4 provided on average.

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	<p>Average monthly TSA allowance per household has been increased from AZN239.9 in 2020 to AZN268.2 in 2021. Official subsistence minimum was also raised from AZN160 in 2020 to AZN170 in 2021. In 2020, AZN216 million was allocated in the state budget for TSA and in 2021, the amount was raised to AZN257 million in the budget.</p> <p><b>Food security.</b> The agriculture production was stable during the pandemic. In 2020, food assistance was provided to 100,000 low-income families and the government organized farmers' markets to sell directly to the public. To stabilize the food prices and ensure food security in 2021, subsidy of AZN35 per ton to flour producers is provided in 2021.</p> <p><b>Education support.</b> In 2020, AZN40 million was allocated to reimburse tuition fees for students who are members of families belonging to socially vulnerable groups. A scholarship amount (AZN250 per month) was paid to around 4,000 people enrolled in vocational education and training. In 2021, education support continued in the form of AZN80 million allocated in the budget for interest-free lending to low-income families for higher education.</p> <p><b>Old-age pensioners.</b> The pension payments per month have been adjusted from AZN249.25 in 2019 to AZN291.5 in 2020 to match the increase in average monthly nominal wages. In 2020, 742,034 old people received pensions, of which 275,208 were for males and 466,826 were for females. AZN441 million has been allocated in 2021 to support the pensioners. Disability benefits also continued during the pandemic. In 2020, 383,993 persons received disability pensions.</p> <p><b>Support for utility bills.</b> The government increased the limits for discounted electricity use by 100 kWh from 300 to 400 kW/h at an estimated AZN10 million during the lockdowns in April–May 2020. Discounted electricity use for the public was not continued under 2021 measures.</p> <p><b>Internally displaced persons.</b> The government continues to provide monthly social allowances and utility subsidies for IDPs in total of AZN355.5 million in 2021 in continuation of 2020 support. Monthly allowance of AZN33–AZN60 per person and subsidies for utility services are paid to 496,557 IDPs. The monthly allowances have been increased from AZN22–AZN40 per person in 2019.</p> <p><b>C. Macroeconomic stabilization measures.</b> The government has rolled out countercyclical macroeconomic stabilization measures to strengthen the MSMEs, support affected sectors and critical SOEs, particularly operating in transport sector, and promote pro-poor and gender-inclusive job creation.</p> <p><b>Tax measures.</b> On 2 June 2020, the President approved the amendments to the Tax Code, providing tax benefits to businesses most affected by the COVID-19 pandemic in retail trade, tourism and hospitality services, transportation, health care and education for one-year beginning 1 January 2020 until 1 January 2021, such as (i) tax benefits in the amount of 75% of the profits for corporate income taxpayers; (ii) a 50% discount on the simplified tax rate (from 2% to 1%) for small businesses and entrepreneurs as well as taxpayers engaged in public catering and passenger transportation; (iii) exemption from property and land taxes; (iv) reduction in withholding tax (from 14% to 7%) on real estate lease for individuals; (v) extension of tax payment deadline until 1 September 2020; (vi) postponement of</p>



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	<p>interest on unpaid taxes, social and unemployment insurance premiums until 1 January 2021; and (vii) temporary exemption from value-added tax on certain types of goods essential for food and medical needs of the population. Tax exemption measures were not continued in 2021 with the gradual opening of the economy.</p> <p><b>Support for entrepreneurs and wage earners.</b> In April 2020, the government provided financial support of AZN215 million for the partial salary payments to 374,316 employees and AZN80 million for 173,162 individual (micro) entrepreneurs working in the sectors negatively affected from the pandemic during 2020. The minimum amount to be paid to entrepreneurs was AZN250 and the maximum amount was AZN5,000. In the wake of another strict lockdown in December 2020, the government allocated AZN52.5 million for partial salary payments, benefitting 200,000 employees and AZN30.5 million for nearly 90,000 entrepreneurs. The support for entrepreneurs and wage earners was not continued in 2021 with the gradual opening of the economy.</p> <p><b>Employment through public jobs.</b> To support employment during the pandemic, AZN159.8 million has been allocated in 2021 budget for creation of additional 17,438 temporary public sector jobs. The state budget will cover approximately 56,000 temporary public sector jobs, including the existing 38,000. These public jobs are spread over almost every region of the country covering areas such as municipal and social services, employment in SOEs, etc.</p> <p><b>Enabling access to credit for businesses.</b> In April 2020, AZN1.5 billion was allocated under the credit and guarantee support program through the EDF to help businesses get loans with preferential terms. The government has provided state guarantees amounting to AZN500 million for 60% of newly issued loans, and 50% interest subsidy on state guaranteed loans to support debt service of MSMEs. The guarantee ceiling of these loans was 15% and half of the payments were subsidized through the budget. The program also supported existing loan portfolios of entrepreneurs in the COVID-19 affected sectors such as trade, tourism, services, transportation, etc. by allocating AZN1 billion as a 10% interest expense subsidy on the existing loan portfolio for one year. An additional AZN50 million was allocated to the EDF and AZN30 million to Agrarian Credit and Development Agency for unsecured microloans in the agriculture sector. The EDF provided AZN33 million interest subsidy on bank loans totaling AZN483 million loans for 1,992 MSMEs in 2020. In continuation of the 2020 support for access to credit, AZN12 million was allocated in 2021 budget for interest rate subsidies on bank loans to businesses, including those affected by the pandemic.</p> <p>The MCGF has also amended its support program to (i) provide guarantees and interest subsidies for fully unsecured loans in addition to secured and semi-secured loans, (ii) increase the limit on guarantees to banks from 7% to 10%, (iii) increase the maximum coverage rate from 75% to 85%, (iv) reduce commission fees on guarantees, and (v) introduce new mechanisms for short-term guarantees.</p>

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	<p>Regulatory incentives were given to banks to boost business lending at preferential terms and provide relieve to the distressed borrowers. In 2020, the volume of loans guaranteed by the MCGF has increased by 3.1 times compared to 2019, totaling AZN231 million and the accrued subsidy for interest on loans have reached AZN30 million.</p> <p><b>Housing sector support.</b> To refinance mortgage loans through the MCGF, the government has allocated AZN161.2 million in the budget in 2020 and further AZN71 million in the budget of 2021. The MCGF, an extrabudgetary state fund established in 2005, refinances the mortgage loans made to eligible borrowers through the partner commercial banks and provides (i) conventional mortgage loans up to AZN150,000 with a maturity of 25 years with 7% interest rate under state guarantee using funds raised by issuing securities in domestic capital markets, and (ii) preferential mortgage loans up to AZN100,000 with a maturity of 30 years with 3.7% interest rate under state guarantee using funds from the state budget. Since its inception until March 2021, the MCGF has extended 32,581 mortgage loans, totaling AZN1,715.4 million. In 2019, 2,652 subsidized mortgage loans of AZN174 million were provided.</p> <p><b>Support for agricultural producers.</b> The Tariff Council under the Cabinet of Ministers increased the diesel fuel prices to AZN0.8 from AZN0.6 on 4 January 2021, which affected the costs of agricultural producers and consequently, the consumer prices for agricultural products. To mitigate the increase in agricultural prices and support the agricultural producers, the government provided additional diesel fuel subsidies in total of AZN36.1 million to the producers in 2021 budget to cover fuel price increases. Base subsidy per acre has increased up to 40% based on the crop type.</p> <p><b>Support for state-owned enterprises.</b> The government provided AZN159.2 million in 2021 budget to subsidize the selected SOEs that have been heavily hit during the pandemic. Border closures have reduced Azerbaijan's airport passenger traffic by 73% in 2020 and thus increased the losses of Azerbaijan Airlines, the national airline operator. The Baku subway has been closed for almost a year since 31 March 2020 due to quarantine restrictions, which has led to operational losses. Similarly, despite the recent adjustments in water tariff, the water utility operator, Azersu, has incurred losses and was not able to cover its costs without a state subsidy.</p> <p><b>Sustaining tourism.</b> To mitigate the adverse impact of the travel restrictions on the tourism sector, hotels, travel agencies and tour operators received a relief package from the government in 2020. The Azerbaijan Tourism Board also developed a four-phase plan, including creation of digital content, development of domestic tourism, and rolling out a communication campaign to put the tourism sector back on track after the pandemic. To boost Azerbaijan's tourism potential further and to improve the business climate for domestic and foreign investment in the tourism sector, the government allocated AZN55.4 million in 2021 to the State Tourism Agency (i) to cover the operational costs of 11 tourism information centers in Baku, Guba, Khachmaz, Shamakhi, Ismayilli, Gabala, Zagatala, Ganja, Barda, Zagatala, and Sheki as well as the Shahdag Tourism Center, a popular ski resort, (ii) to promote Azerbaijan through commercials in leading global broadcasting networks, (iii) organize conferences and events to raise awareness on the country's tourism potential, and (iv) develop the tourism sector in the post-COVID-19 period.</p> <p><b>Monetary measures.</b> The CBA adopted monetary policy measures to provide relief to the distressed borrowers. On 19 March 2020, the deposit insurance guarantee was extended until 4 December 2020. On 24 April 2020, capital</p>

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	<p>requirements for banks, countercyclical capital buffer, and risk ratio on mortgage loans issued by banks were reduced until 1 January 2021. Additional measures until 30 September 2020 were introduced including suspension of inspections of credit institutions, moratorium on late fees and interest rate penalties, restructuring of mortgage loans issued at the expense of the MCGF, and deferral of insurance premium payments. The CBA extended the regulatory easing on provisioning for non-performing loans, loan restructuring and capital buffers until 1 April 2021. Private businesses, including individual entrepreneurs have been given the opportunity to restructure their loans under MCGF, the EDF, and the Agrarian Credit and Development Agency in case of force majeure or delay in repayment without any negative impact on the borrowers' credit history until 30 September 2020. In 2020, the banks restructured loans reached AZN1.2 billion for 50,000 borrowers, of which 87% were business loans, 9% were consumer loans and 4% were mortgage loans. In addition, the CBA launched a free package of basic banking services for low-income population, benefiting 600,000 citizens.</p>
<p>3. Pre-shock Record of Generally Sound Macroeconomic Management</p>	<p>After gaining independence, Azerbaijan registered rapid economic growth, fueled by oil and gas extraction (contributing to about 51% of GDP as of 2013), and transformed itself into an upper middle-income country. Azerbaijan's GDP growth averaged 5.6% per annum during 1993-2019 (6.4% during 1993-2013). However, overreliance on hydrocarbons coupled with low economic diversification and inadequate private sector development, inefficient financial sector, and highly procyclical fiscal management have been identified as key development constraints for the country. Because of sharp downturn in oil prices from \$110 per barrel in 2014 to \$50 in 2015 and economic slowdown in major trading partners, leading to a significant fall in the country's earnings, Azerbaijan's economy was hit during 2015-2016, causing a GDP contraction of 3.1% in 2016, a currency devaluation, banking sector fragility due to a high level of dollarization in liabilities and erosion of fiscal space. The exchange rate devalued from \$1 = AZN0.78 in 2014 to about \$1 = AZN1.60 in 2016. In response to this shock, the government provided countercyclical fiscal stimulus, and initiated financial sector reforms. These efforts, along with oil price recovery, non-oil economy expansion, and start of production at the Shah Deniz II gas field, spurring 28% increase in gas production, helped stabilize the economy and the banking sector. GDP achieved a three-year consecutive growth of 0.2% in 2017, 1.5% in 2018 and 2.2% in 2019. The CBA has been committed to price stability with the exchange rate (fixed at 1.7AZN/\$ since 2017) as the nominal anchor of monetary policy. Inflation has decelerated from 12.8% in 2017 to 2.3% in 2018 and 2.7% in 2019. To support fiscal consolidation, the government adopted revenue administration and new tax policy measures since 2017 aimed at reducing informality and broadening the tax base as well as fiscal rules and PFM reforms. The tax and customs revenues increased from AZN9.4 billion in 2017 to AZN10.6 billion in 2018 and AZN11.8 billion in 2019, indicating over 10% growth each year. The share of non-oil revenue as a share of non-oil GDP improved from 22.7% in 2018 to 24.5% in 2019. The budget deficit-GDP ratios have improved from a deficit of 1.4% in 2017 to a surplus of 5.5% in 2018 and 8.2% in 2019. To address banking sector weaknesses, the Financial Market Supervisory Authority has strengthened the financial supervision framework. The capital adequacy ratio of the banking sector has improved, including the restructuring of the largest state-owned bank and update of prudential regulations. The current account surpluses at 4.1% in 2017, 12.8% in 2018 and 9.1% in 2019 on firmer oil prices resulted in the accumulation of foreign exchange reserves, averaging \$5.7 billion during 2017-2019. The size of the SOFAZ assets reached \$43.32 billion in 2019, providing 46.9% of state budget revenues. Given its strong pre-shock net foreign asset position, the public debt-GDP ratio has been declining from 22.5% in 2017 to 17.7% in 2019. As confirmed by the IMF's Article IV report in 2019, Azerbaijan has maintained a sound record of macroeconomic</p>

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	<p>management leading up to the crisis. The macroeconomic management during the pandemic has also been on track. The government remains committed to implementation of macroeconomic structural reforms and PFM reforms to improve the effectiveness of the countercyclical pandemic response measures.</p>
<p>4. Structural Reforms (Health Sector Response)</p>	<p>The government has promptly responded to the COVID-19 pandemic by introducing strict nationwide containment measures to prevent the community transmission and undertaking structural health sector reforms that are pro poor with gender focus for strengthening public health capacity and readiness of the health care system over the medium and long-term for the pandemic and other future health emergencies. These measures included (i) social distancing and containment measures, (ii) strengthening institutional framework to fight the pandemic, and (iii) health care measures covering strengthening the capacity of medical facilities; emergency procurement of the medicines and medical equipment; preventive activities on contagious diseases; additional payments for the health care workers; and implementation of the mandatory health insurance to increase access to health care system. The government's wide ranging health sector measures helped contain the spread of the disease and strengthen the capacity and accessibility of the specialized health care services and staff in 2020. However, prolongation of the pandemic requires continuation of these health-related measures for prevention and treatment. Details are provided below.</p> <p><b>Social distancing and containment measures.</b> To prevent community spread, the government imposed a special quarantine regime on 24 March 2020 with measures including (i) border closures, (ii) prohibition of mass gatherings, (iii) restrictions on domestic movements, (iv) closure of restaurants and some other businesses, (v) closure of airports, and transportation hubs, (vi) strict social distancing, and (vii) disinfection of public spaces. Face masks were required in public places with restrictions on public transportation and screenings at ports of entry. Starting 4 May 2020, restrictions have been relaxed in stages, enabling reopening of businesses and public spaces, and resuming of travel with private vehicles between cities and districts. On 19 June 2020 as the new COVID-19 cases rose, the quarantine regime was tightened including the closure of borders until 1 August 2020, and permit requirements were introduced for people to leave their homes. While domestic and international flights to selected destinations resumed, on 17 July 2020, the special quarantine regime was extended in 13 cities and districts until 31 August 2020. Depending on the increase in COVID-19 cases, the quarantine regime has been reextended in stages—until 31 August 2020, 31 January 2021, 1 June 2021 and recently until 1 August 2021—with some easing of restrictions from one period to the next. Some restrictions on businesses have been eased starting from 25 January 2021. Educational institutions have been closed until end August 2020, and later again closed in October 2020 with higher COVID-19 cases.</p> <p><b>Institutional framework of health sector measures.</b> The MOH approved the COVID-19 Country Preparedness and Response Plan and identified 10 priority areas to manage the pandemic. The CPRP details the medium and long-term strategy for a robust national pandemic preparedness, as well as the capacity building and resource requirements for (i) surveillance and detection; (ii) early diagnosis, isolation, and case management; (iii) infection prevention and control in health facilities and communities; (iv) risk mitigation; and (v) resource allocation for logistics and procurement for emergency responses in line with WHO's Strategic Preparedness and Response Plan. In partnership with the Heydar Aliyev Foundation, MOH, State Agency for Mandatory Health Insurance, Management Union of Medical Territorial Units (TABIB), the WHO has been implementing the Rapid Scale-up of Essential Capacities for COVID-19 (REACT-C19) project to strengthen response capacities. The government provided AZN8.5 million (\$5 million) to the</p>

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	<p>Coronavirus Response Fund as part of the WHO's Strategic Preparedness and Response Plan. In 2020, using the WHO Hospital Readiness Checklist, a team of doctors under REACT-C19 made an assessment in selected hospitals, prepared a joint action plan with the hospital management, and started activities to address them. More than 400 health care workers including doctors, nurses, and auxiliary personnel in hospitals (like cleaning staff, porters, cooks, etc.) attended hands-on trainings. Through WHO and UN agencies, Azerbaijan has maintained access to international epidemiological expertise and received advice on risk communication.</p> <p><b>Implementation of health sector measures.</b> The health expenditures as a share of state budget increased from 3.6% in 2019 to 6.4% in 2020 and 4.9% in 2021. Based on the CPRP, the MOH has been strengthening the capacity of medical facilities and carrying out the health-related pandemic response measures with a gender focus. Additional payments (3-5-fold increase in monthly wages) to 64,038 health care workers involved in the treatment of the COVID-19 patients have been provided at 35 public and private medical facilities in 2020 and these payments are continued in 2021. Private medical facilities are compensated from the state budget in 2021 for their financial losses due to treatment of the COVID-19 patients. To strengthen surveillance and early detection, COVID-19 surveillance sites in airports, and borders have been established. At border crossings special quarantine facilities were organized to isolate the travelers for 14-days. COVID-19 related compliance standards of the immigration centers have been improved in line with the requirements of the WHO and the COVID-19 Operational Headquarters of the Cabinet of Ministers. A total of 3,190 people has been placed under quarantine in 2020. Costs related to testing and treatment, accommodation of the COVID-19 patients in the quarantine facilities are covered under the state budget in 2021.</p> <p>Over 20 state hospitals with over 10,000 beds have been serving COVID-19 patients. Including the private hospitals, a total of 35 hospitals in Baku and regions have been designated for treatment of COVID-19 cases. The 575-bed "New Clinic", and three new city hospitals (with 500 beds) were opened in March 2020 and made available to COVID-19 patients. Two hospitals have been transformed into quarantine hospitals. As of 2020, there were 1,045 intensive care unit beds and 267 ventilators. 210 ICU specialists and 4,169 emergency care doctors have been involved in COVID-19 treatment in hospitals. The government has scaled up the medical capacity with establishment of 10 new modular hospitals in 10 districts in 2020 with a capacity of 200 hospital beds in each. Moreover, two of the olympic sports centers in two districts were transformed into modular hospitals. The pandemic response package in 2021 includes the operational expenses of the 12 modular hospitals that have a total capacity of 4,700 hospital beds.</p> <p>During the pandemic, the MOH has purchased the medicines and medical equipment for treatment of the COVID-19 patients in coordination with development partners. AZN125 million has been allocated for medicines in 2021 budget along with AZN80 million for expenses related to medical equipment and inventories. Azerbaijan did not experience any serious shortage of PPEs for health care workers. Local production plants for medical masks (200,000 masks daily), disposable protective clothing, disinfectants, sanitizers, etc. were opened to help cover the national needs. Surveillance is conducted jointly by TABIB under the State Agency for Mandatory Health Insurance and the MOH. A single unified database for COVID-19 was developed to collect information. A new e-TABIB mobile application was introduced to track of COVID-19 cases. A notice is sent to those likely to have been exposed to COVID-19 to conduct testing. As of February 2021, 2,591,235 tests have been conducted in Azerbaijan to identify COVID-19 infections. A</p>

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	<p>total of 50 laboratories have been designated across the country to test for COVID-19, including 3 private sector laboratories and 1 food safety agency laboratory. By 17 March 2021, the weekly number of tests performed in Azerbaijan was 57,000. Along with the tests, disinfection of public spaces and other preventive activities to contain contagious diseases continue to be financed from the state budget in 2021.</p> <p>The State Agency for Mandatory Health Insurance was established in 2016 with the purpose of increasing quality and affordability of health care services provided to the population. Since out-of-pocket health expenditures has been high (72.8% as a share of current health expenditure in 2018), the government carried out pilot projects in 3 regions (Mingachevir, Yevlakh, and Aghdash) during 2016–2018, with the intention of expanding the mandatory health insurance (MHI) across the country beginning 2020. As of March 2020, the MHI scheme covers 6.58 million people in 59 administrative districts and the final stage of the rollout has been scheduled to be completed by 1 April 2021, when Baku, Absheron, Sumgayit, Khankendi, Gubadli, Zangilan and Shusha are added to the scheme. Thus, the MHI is introduced throughout Azerbaijan in 2021. The MHI’s package includes 2,550 different types of medical services, including first aid, emergency medical care, specialized outpatient care, laboratory services, physiotherapy services, invasive radiology services, institutional treatment and over 1,100 surgical operations. Institutional treatment of diseases widespread in the country with a high risk of disability and death such as cardiovascular diseases, infections, injuries etc. as well as treatment during pregnancy and childbirth will be carried out under the MHI.</p> <p>The MHI system provides a government subsidy of AZN90 per person for universal coverage of all citizens. The phased payment has been envisaged through the state budgets in 2020 and 2021. AZN989.3 million has been allocated in 2021 budget. The system also involves copayments of MHI fees by citizens. Those working in the state and oil sectors, non-state and non-oil sectors, individuals performing work (services) based on civil contracts of a legal nature, and individuals engaged in entrepreneurial activity will pay the MHI fees from 1 January 2021. Employers and employees working in the state and oil sectors will pay a monthly fee in the amount of 2% of the monthly wage up to AZN8,000 and 0.5% of the monthly wage over AZN8,000. Employers and employees working in the non-state and non-oil sectors will pay a monthly MHI fee in the amount of 1% of the monthly wage up to AZN8,000 and 0.5% of the monthly wage over AZN8,000. From 2022, employers and employees involved in this sector will pay a monthly MHI fee in the amount of 2% of the monthly wage up to AZN8,000. The MHI fee has been set for individuals who perform services based on civil contracts at 2% of their monthly income up to AZN8,000 and 1% of their monthly income over AZN8,000. Except for temporary suspension of entrepreneurship or other taxable transactions, MHI fee has been set at 4% of the minimum monthly wage for individuals (individual entrepreneurs, private notaries, members of the bar association) who are registered as taxpayers. In addition to the above-mentioned persons, others pay MHI fees in the amount of 48% of the minimum monthly salary from 1 January 2024. Under the MHI, the citizens’ copayments for medical services range from AZN5 to AZN90 when using outpatient, laboratory, or functional-diagnostic medical services without applying to the primary health care, and/or when applying to a public medical facility outside the regional medical division.</p> <p>On 16 January 2021, with the Cabinet of Ministers Order No.48s, the vaccination strategy against COVID-19 in the Republic of Azerbaijan for 2021–2022 was approved. The vaccination strategy prioritizes the vulnerable population</p>

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	such as health care workers, elderly population above 65 years of age, law enforcement and military personnel, employees of education and social sector, employees of public transport and telecommunications, banking sector, among others. While not covered by the CARES Program, the government allocated AZN85.5 million (\$50.3 million) for initial 4 million doses of vaccines using the 2021 state budget and the Coronavirus Response Fund. Nearly one million additional doses are planned to be acquired from variety of suppliers during 2021. The vaccination program has started in January 2021. According to WHO, as of 12 June 2021, 2,774,693 vaccine doses were administered with 1,810,344 vaccinated with at least one dose.
5. Debt Sustainability	During the pandemic, the government requested a \$250 million budget support loan from ADB and a cofinancing loan of \$100 million from the Asian Infrastructure Investment Bank in 2021. The government will also borrow AZN1.3 billion (\$764.7 million) domestically in 2021. Based on ADB's recent DSA, the additional borrowing over the public debt stock of \$8.5 billion in 2019 will not significantly affect the debt sustainability and the annual debt service obligations. Based on the IMF projections, the public debt–GDP ratio increased from 17.7% in 2019 to 21.4% in 2020 and will increase to 30.9% in 2021, 31.4% in 2022 and 32.4% in 2023. Both the IMF's pre-shock DSA under the Article IV consultation report in September 2019 and ADB's recent DSA indicate that Azerbaijan's debt carries <i>low risk of debt stress</i> because of its strong position due to official reserves and SOFAZ assets as well as favorable maturity structure with nearly half of public debt consisting of loans from the international financial institutions that have long maturities and fixed interest rates. This partly offsets the currency risk from foreign currency denominated debt, comprising about 80% of public debt. In comparison to the public debt, large SOFAZ assets of \$43.56 billion in 2020 and \$42.97 billion projected in 2021 as well as gross official reserves of \$6.26 billion provide debt absorption capacity. The government has also been implementing reforms based on medium-term debt management strategy with the aim of reducing debt–GDP ratio below 20% and gradually shifting from external to domestic borrowing with longer maturities by developing government securities market.
6. Coordination with the International Monetary Fund	The government coordinated extensively with the IMF on (i) assessment of the macroeconomic developments, including the impact of the pandemic, (ii) strengthening the macroeconomic management and government finances, and (iii) the policy advice for countercyclical pandemic response measures during the Article IV consultation missions. The latest IMF Article IV consultation report was published in September 2019 and the next one is expected to be completed by 12 July 2021. The IMF confirmed the sound macroeconomic, fiscal, debt and public financial management and supported the government's countercyclical pandemic response measures. The IMF Assessment Letter, provided on 1 April 2021, is accessible from the list of linked documents in Appendix 2. ADB, the IMF and the World Bank have maintained close coordination during the design of the ADB's CARES Program. Azerbaijan continues to benefit from IMF's TAs, particularly in areas related to the fiscal rule, public financial management, macroeconomic management, exchange rate policy, financial sector supervision and national statistics.

ADB = Asian Development Bank, CARES = COVID-19 Active Response and Expenditure Support, CBA = Central Bank of Azerbaijan, COVID-19 = coronavirus disease, CPRP = Country Preparedness and Response Plan, DSA = debt sustainability analysis, EDF = Entrepreneurship Development Fund, GDP = gross domestic product, HDI = human development index, IDP = internally displaced person, IMF = International Monetary Fund, MCGF = Mortgage and Credit Guarantee Fund, MHI = mandatory health insurance, MOF = Ministry of Finance, MOH = Ministry of Health, MSMEs = micro, small and medium-sized enterprises, OPEC = Organization of the Petroleum Exporting Countries, PFM = public financial management, PPE = personal protective equipment, SOE = state-owned enterprise, SOFAZ = State Oil Fund of Azerbaijan, TSA = targeted social assistance, WHO = World Health Organization.

Source: Asian Development Bank.