CURRENCY EQUIVALENTS
(as of 6 May 2019)

Currency unit – Azerbaijan manat (AZN)

<table>
<thead>
<tr>
<th>AZN1.00</th>
<th>$0.5882</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.00</td>
<td>AZN1.7000</td>
</tr>
</tbody>
</table>

ABBREVIATIONS

- ADB – Asian Development Bank
- CAPE – country assistance program evaluation
- CAREC – Central Asia Regional Economic Cooperation
- CPS – country partnership strategy
- DPC – development partner coordination
- EITI – Extractive Industries Transparency Initiative
- GDP – gross domestic product
- ICT – information and communication technology
- KPS – knowledge product and service
- MSMEs – micro, small, and medium-sized enterprises
- NDC – nationally determined contribution
- PPP – public–private partnership
- PSO – private sector operations
- RCI – regional cooperation and integration
- SDG – Sustainable Development Goal
- SMEs – small and medium-sized enterprises
- SOE – state-owned enterprise
- SOFAZ – State Oil Fund of Azerbaijan
- SRNEP – Strategic Roadmap on National Economy Perspectives
- TA – technical assistance
- TVET – technical and vocational education and training
- UMIC – upper middle-income country

NOTE

In this report, "$" refers to United States dollars.

Vice-President Shixin Chen, Operations 1
Director General Werner Liepach, Central and West Asia Department (CWRD)
Country Director Nariman Mannapbekov, Azerbaijan Resident Mission (AZRM), CWRD
Team leader Aziz Haydarov, Senior Portfolio Management Specialist, AZRM, CWRD
Team members Ichiro Aoki, Senior Investment Specialist, Private Sector Operations Department (PSOD)
Ana Paula Araujo, Environment Specialist, CWRD
Claudia Buentjen, Principal Public Management Specialist, Sustainable Development and Climate Change Department (SDCC)
Giap Minh Bui, Principal Natural Resources and Agriculture Economist, CWRD
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CONTENTS

COUNTRY AT A GLANCE

I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT 1

II. COUNTRY DEVELOPMENT CONTEXT 2

III. COUNTRY STRATEGY FRAMEWORK 7
   A. Lessons from Previous Strategy 7
   B. National Development Strategy 7
   C. Role of Development Partners 8
   D. ADB’s Strategic Objectives and Operational Priorities 9
   E. Priorities for Knowledge Support 13

IV. STRATEGY IMPLEMENTATION 13
   A. Indicative Resource Parameters 13
   B. Implementation Priorities 14
   C. Monitoring of Results 15
   D. Risks 15

APPENDIXES

1. Country Partnership Strategy Results Framework 16
2. Country Knowledge Plan 18
3. List of Linked Documents 22
### Economic

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
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<tbody>
<tr>
<td>GDP ($ billion, current)</td>
<td>75.2</td>
<td>53.0</td>
<td>37.9</td>
<td>40.9</td>
<td>46.9</td>
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<tr>
<td>GDP per capita ($, current)</td>
<td>7,990.8</td>
<td>5,561.5</td>
<td>3,928.6</td>
<td>4,198.5</td>
<td>4,780.1</td>
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<tr>
<td>GNI per capita ($, Atlas method)</td>
<td>7,700.0</td>
<td>6,550.0</td>
<td>4,760.0</td>
<td>4,080.0</td>
<td>...</td>
</tr>
<tr>
<td>GDP growth (%, in constant prices)</td>
<td>2.8</td>
<td>1.1</td>
<td>(3.1)</td>
<td>0.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>(2.6)</td>
<td>6.6</td>
<td>2.6</td>
<td>4.2</td>
<td>4.6</td>
</tr>
<tr>
<td>Industry(^a)</td>
<td>0.5</td>
<td>(1.9)</td>
<td>5.8</td>
<td>3.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Services</td>
<td>7.6</td>
<td>4.4</td>
<td>(0.8)</td>
<td>3.1</td>
<td>3.6</td>
</tr>
<tr>
<td>Gross domestic investment (% of GDP)</td>
<td>27.5</td>
<td>27.9</td>
<td>25.7</td>
<td>24.4</td>
<td>...</td>
</tr>
<tr>
<td>Gross domestic saving (% of GDP)</td>
<td>43.7</td>
<td>30.9</td>
<td>28.5</td>
<td>31.0</td>
<td>30.8</td>
</tr>
<tr>
<td>Consumer price index (annual % change)</td>
<td>1.4</td>
<td>4.0</td>
<td>12.4</td>
<td>12.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Liquidity (M2) (annual % change)</td>
<td>6.1</td>
<td>(50.2)</td>
<td>33.0</td>
<td>8.0</td>
<td>17.5</td>
</tr>
<tr>
<td>Overall fiscal surplus (deficit) (% of GDP)</td>
<td>(0.5)</td>
<td>(0.5)</td>
<td>(0.4)</td>
<td>(1.5)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Merchandise trade balance (% of GDP)</td>
<td>25.2</td>
<td>11.0</td>
<td>11.2</td>
<td>15.0</td>
<td>18.4</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>13.9</td>
<td>(0.4)</td>
<td>(3.6)</td>
<td>4.1</td>
<td>...</td>
</tr>
<tr>
<td>External debt service (% of exports of goods and services)</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>External debt (% of GDP)</td>
<td>8.6</td>
<td>19.8</td>
<td>20.3</td>
<td>22.8</td>
<td>19.0</td>
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### Poverty and Social

<table>
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<th>2018</th>
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</thead>
<tbody>
<tr>
<td>Population (million)</td>
<td>9.6</td>
<td>10.0</td>
</tr>
<tr>
<td>Population growth (annual % change)</td>
<td>1.2</td>
<td>0.9</td>
</tr>
<tr>
<td>Maternal mortality ratio (per 100,000 live births)</td>
<td>14.6</td>
<td>14.6</td>
</tr>
<tr>
<td>Infant mortality rate (below 1 year/per 1,000 live births)</td>
<td>10.2</td>
<td>11.1</td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td>74.2</td>
<td>75.4</td>
</tr>
<tr>
<td>Adult literacy (%)</td>
<td>100.0</td>
<td>99.9  [2016]</td>
</tr>
<tr>
<td>Primary school gross enrollment (%)</td>
<td>106.1</td>
<td>106.4 [2016]</td>
</tr>
<tr>
<td>Child malnutrition (% below 5 years old)</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Population below poverty line (%)</td>
<td>5.0</td>
<td>5.4  [2017]</td>
</tr>
<tr>
<td>Population with access to safe water (%)</td>
<td>88.9</td>
<td>89.2 [2015]</td>
</tr>
<tr>
<td>Population with access to sanitation (%)</td>
<td>94.1</td>
<td>94.3 [2015]</td>
</tr>
</tbody>
</table>

### Environment

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carbon dioxide emissions (tons)</td>
<td>52.0</td>
<td>50.7</td>
</tr>
<tr>
<td>Carbon dioxide emissions per capita (tons)</td>
<td>5.5</td>
<td>5.1</td>
</tr>
<tr>
<td>Forest area (million hectares)</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Urban population (% of total population)</td>
<td>53.1</td>
<td>52.9</td>
</tr>
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</table>

### ADB Portfolio (active loans)\(^b\)

<table>
<thead>
<tr>
<th></th>
<th>As of 31 December 2018</th>
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<tbody>
<tr>
<td>Total number of loans</td>
<td>10</td>
</tr>
<tr>
<td>Sovereign</td>
<td>6</td>
</tr>
<tr>
<td>Nonsovereign</td>
<td>4</td>
</tr>
<tr>
<td>Total loan amount ($ million)(^c)</td>
<td>2,425.4</td>
</tr>
<tr>
<td>Sovereign</td>
<td>1,648.3</td>
</tr>
<tr>
<td>Nonsovereign</td>
<td>777.1</td>
</tr>
<tr>
<td>Disbursements</td>
<td></td>
</tr>
<tr>
<td>Disbursed amount, total ($ million, 2018)</td>
<td>631.1</td>
</tr>
<tr>
<td>Disbursed amount, excluding PBL ($ million, 2018)</td>
<td>206.1</td>
</tr>
<tr>
<td>Disbursement ratio, excluding PBL (%)</td>
<td>35.44</td>
</tr>
</tbody>
</table>

\(^a\) Per the methodology of the Asian Development Outlook, industry includes mining, manufacturing, and construction.

\(^b\) Covers OCR financing for projects and programs, including policy-based lending and guarantees.

\(^c\) Net of droppages and cancellation.

I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT

1. **Binding constraints to growth.** Azerbaijan rose to upper middle-income country (UMIC) status in 2009 and is a major economic and energy power in the South Caucasus. It is strategically located on a transcontinental crossroad that connects large markets to the country’s north, south, and west. An oil price shock in 2014 led to sharp currency devaluation, a finance sector crunch, erosion of fiscal space, and a surge of public debt. It also revealed economic vulnerabilities, institutional inefficiencies, and the urgent need to accelerate economic diversification. Three factors bind the achievement of higher inclusive and sustainable growth in Azerbaijan: (i) low economic diversification because of a weak enabling environment for non-oil private sector development and inefficient finance sector; (ii) public sector inefficiency because of issues with fiscal policy, public financial management, and the public corporate sector; and (iii) inadequate infrastructure and human capital for a diversified and more competitive economy.¹

2. **Government development agenda.** The government made an earnest start to move toward non-oil-based economic growth model in 2012 with the adoption of a vision document for the country’s development up to 2020.² The 2014 oil price shock and the ensuing socioeconomic challenges required the government to focus on maintaining macroeconomic and finance sector stability through a countercyclical policy response in 2015–2016. Cognizant of the need for a more cohesive and accountable structural policy reform effort, in December 2016 the President of Azerbaijan approved the Strategic Road Maps on National Economy Perspective and Main Sectors, a development policy framework aimed at accelerated economic diversification, job creation, and productivity enhancement.³ Strengthening the country’s institutional framework to support economic diversification is an important element of the strategy.⁴ The country partnership strategy (CPS), 2019–2023 for Azerbaijan will reflect the Asian Development Bank’s (ADB) response to this new development policy and institutional strengthening context.

3. **ADB strategic objectives.** The CPS will help address Azerbaijan’s binding development constraints. First, to help reduce the country’s dependency on oil exports and improve economic resilience, the CPS will support non-oil private sector development and improve access to finance. Second, to help rationalize the state’s role in the economy, ADB will support raising efficiency of the public sector by promoting more sustainable government expenditure and public corporate sector. Third, ADB will support infrastructure improvements and human capital strengthening to support the needs of a diversified economy. Under the CPS, ADB will also help accelerate progress in gender equality, tackle climate change and enhance environmental sustainability, strengthen governance and institutional capacity, and foster regional cooperation and integration (RCI). The CPS is based on Azerbaijan’s UMIC status, in line with the differentiated approaches to groups of countries under ADB’s Strategy 2030.⁵

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¹ Asian Development Bank (ADB). Forthcoming. *Azerbaijan Country Diagnostic Study*. Manila; and Inclusive and Sustainable Growth Assessment (accessible from the list of linked documents in Appendix 3).


³ Presidential Decree No. 1138 on 6 December 2016. *About Approval of Strategic Road Maps on National Economy Perspectives and Main Sectors of the Economy*. The main sectors are (i) oil and gas, (ii) agricultural production, (iii) small and medium-sized enterprises (SMEs), (iv) heavy industry and machinery, (v) tourism, (vi) logistics and trade, (vii) technical and vocational education, (viii) social housing, (ix) financial services, (x) information and communication technology, and (xi) utilities (electricity, water supply and sanitation, heating, and gas supply).


4. **ADB value addition.** In the short term, Azerbaijan’s project-related public borrowing is expected to remain tight given the increase of government foreign debt since 2014 because of the bailout of the ailing public corporate sector affected by the currency devaluation. Consequently, the early years of the new CPS will emphasize support for government through policy-based operations, technical assistance (TA), value-adding policy dialogue built on sound analytical work, and capacity development of key government institutions. New modalities such as project readiness financing can also be deployed during the initial years of the CPS. ADB will seek to restore its private sector operations (PSO) by strengthening its PSO presence in Azerbaijan and, in the initial years of the CPS, helping build the capability of selected finance sector players with significant financial inclusion potential. ADB will explore local currency finance options by tapping the domestic capital market and will seek to promote risk mitigation schemes. If, as expected, public borrowing space eases in the second half of the CPS period, ADB, while continuing to support structural policy reforms, can selectively extend financing for priority projects that involve innovation, high technology and transfer of international best practice.

II. **COUNTRY DEVELOPMENT CONTEXT**

5. **Overall socioeconomic context.** Azerbaijan has undergone significant economic transformation since independence in 1991. In the initial post-independence phase, the country suffered an economic collapse—gross domestic product (GDP) in 1995 was less than half of its 1990 level—mainly because of the Nagorno–Karabakh conflict. However, Azerbaijan has quickly transformed itself into an upper middle-income country with gross national income per capita (Atlas method) growing from $610 in 2000 to an annual average of $5,850 during 2008–2016 and a poverty rate of 4.9% in 2015. Since 2010, Azerbaijan has been categorized as a high human development country. In 2018, the country ranked third out of 74 developing countries in inclusive development. Economic expansion has been showing signs of leveling off since 2011, indicating that the oil-based economic model has exhausted its growth potential. However, the economy still depends on the extractives industries, albeit at a decreasing level, making development attainments vulnerable to oil price volatility.

6. **Oil price shock.** During 2014–2016, Azerbaijan’s economy was hit by plunging oil prices and economic slowdown in major trading partners. This led to sharp currency devaluation, a severe finance sector crunch, stark erosion of fiscal space, and a surge of public debt, revealing economic vulnerabilities and inefficiencies and slow progress in economic diversification. As a result, GDP growth slowed to 1.1% in 2015. In 2016, GDP contracted by -3.1% and poverty increased to 5.9%. Because of the stark devaluation and recession, GDP (in $ terms) fell from $75.2 billion in 2014 to $37.9 billion in 2016.

7. **Countercyclical policy response.** In response to this shock, the government (i) provided countercyclical fiscal stimulus covering social assistance, support for the non-oil economy, and job generation; (ii) shifted to a managed floating exchange rate regime; and (iii) initiated finance sector institutional reforms and banking industry consolidation. These efforts and oil price

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6 United Nations Development Programme. Human Development Reports.
8 GDP growth fell from an average of 5.5% during 2008–2012 to an average of 1.3% during 2013–2017. 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.
9 ADB supported the government through a $500 million countercyclical support facility approved in December 2016 (ADB. 2016. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Azerbaijan for the Countercyclical Support Facility Program. Manila).
recovery helped promote macroeconomic stability and a return to growth: GDP grew 0.2% in 2017 and 1.4% in 2018 (non-oil GDP grew 1.8%). Given this positive dynamic, poverty dropped to 5.4% in 2017 and inflation decelerated from 12.4% in 2016 and 12.9% in 2017 to 2.3% in 2018. The economy is forecast to grow 2.5% in 2019, driven by non-oil economy expansion and the start of production at the Shah Deniz II gas field, one of the largest gas fields in the world.10

8. Economic structure highlights. On the supply side, industry dominates the economy, contributing about 51% of GDP during 2013–2017, followed by services (36% of GDP) and agriculture (5.6% of GDP). During 2013–2017, the non-oil economy’s share increased to about 63.5% of GDP, reflecting the effect of the increased public investment, the oil shock in 2014–2016, and the initial progress in economic diversification. However, in 2017, mining (almost 90% was oil and gas extraction) contributed about 70% of total industrial output and more than 50% of gross capital formation, pointing to still limited diversification of the economy. On the expenditure side, private and government consumption were the major drivers of growth during 2013–2017. The share of investment in GDP increased from about 20% during 2008–2012 to about 26% during 2013–2017, mainly because of increasing public investment (70% of total investment).

9. Inequality and regional disparity. The oil-driven economic boom during 2003–2014 helped reduce inequality; the Gini index steadily decreased from 0.341 in 2003 to 0.227 in 2014 (the last year that the Gini index was reported). The oil price shock seems to have adversely affected the previously positive equality dynamic, as the share of the poorest quintile in national income decreased from 17.3% in 2008 to 15.4% in 2015. Baku, the country’s capital, generated 71.8% of national output and received 74.5% of total capital investments in 2016. Regions outside Baku represented 78% of the population and 62% of businesses but received only 17% of bank lending. Internet access in urban areas is also 10 percentage points higher than in rural areas.11 Urbanization has increased (especially after the oil price shock in 2014) because of better job opportunities in cities, particularly in Baku, posing an increasing challenge to the city’s infrastructure. Since 2017, the government has taken steps to decongest the capital by moving a petrochemical refinery and a shipyard to other parts of the country.

10. Employment. Since 2010, Azerbaijan’s unemployment rate has been low at about 5%.12 However, many jobs are temporary and many Azerbaijaniis work in low-wage and low-productivity sectors. The oil economy, which generates about one-third of GDP and offers high wages, employs only 1% of the labor force. On the other hand, agriculture employs about 36.0% of total labor but contributes only 5.6% to GDP. Agriculture and non-oil economy have large employment potential as they have the highest employment elasticities. In 2016, youth unemployment was 13.1% and underemployment was 28.0%. Young people between 15 and 29 years old made up 49.8% of all unemployed and 27.9% of them hold college and vocational degrees, indicating a skills mismatch in the labor market.13 Azerbaijan is among the countries with the highest percentage of 15–25-year-olds not in education, employment, or training.

12 During 2009–2018, 1,431,075 new jobs were created, including 1,016,071 permanent jobs.
13 Regional vocational training centers of Ministry of Labor and Social Protection’s State Employment Service and the primary vocational or secondary education institutions of the Ministry of Education provide vocational training courses for the employed and unemployed jobseekers.
11. **Gender equality.** In 2016–2017, the unemployment rate for women (6%) was higher than the rate for men (4%). In 2017, the women’s labor participation rate (72%) was lower than that for men (82%). Overall, women earned only 48% of what men earned in the labor market, and within similar positions women earned only 73% of what men earned. Only 25% of registered businesses were operated by women. While overall human development is steadily improving, women seemed to benefit less than men: Azerbaijan’s Gender Development Index worsened from 0.955 in 2014 to 0.949 in 2017 (footnote 6), and in 2017 the country’s gender gap score of 0.676 was the second lowest of the 26 countries in Eastern Europe and Central Asia. While women’s representation in Parliament and the municipal councils is gradually increasing, women remain underrepresented in the civil service (especially senior levels) and in the judiciary. On average, women spend 6 hours per day on unpaid labor while men spend only 2 hours (this difference is larger for rural women), putting women at a disadvantage economically. Women also experience wage penalties from taking time out to raise children. Azerbaijan has a high population of internally displaced persons because of the protracted Nagorno–Karabakh conflict, the majority of whom are women and children. The State Committee on Family, Women and Children Affairs leads the government’s policies and actions on promoting gender equality in Azerbaijan. 

12. **Climate change and disaster risk.** In 2017 Azerbaijan ranked 71st globally and sixth in Central and West Asia with respect to its resilience to climate change impacts. The greatest issue facing Azerbaijan’s 850-kilometer coastal area is the movement of the Caspian Sea’s level because of climate change. Azerbaijan is prone to floods, especially in the low-lying areas below sea level. A factor that contributes to flooding is the overflowing of the Kur and Araz Rivers because of increased precipitation. Natural hazard risks also increase because of land degradation and erosion arising from agricultural overuse, land conversion, forest destruction, and improper irrigation techniques.

13. **Regional cooperation and integration.** Substantial investments in north–south (from the Russian border to the Iranian border) and east–west (from the Absheron Peninsula to Georgia and then Turkey) road and rail connectivity have been made, and most projects are either completed or are well on track. As the largest economy in South Caucasus located on the trans-Caspian transport route between Central Asia and Europe, Azerbaijan is an important and active member of the Central Asia Regional Economic Cooperation (CAREC) Program. Implementation of the Law on Alat Free Economic Zone adopted in May 2018 and completion of the Baku International Sea Trade Port—important elements of the country’s aspiration of becoming a transport and economic hub in Central Eurasia—represent a good platform for the country to benefit from transport projects along CAREC corridors. Realization of the country’s role as a transport and logistics (and eventually economic) hub in Central Eurasia will generate significant positive externalities and regional public goods for CAREC countries and beyond. Rising momentum in the Middle Corridor of the Belt and Road Initiative and the signing of the Convention on the Legal Status of the Caspian Sea in August 2018 have opened new prospects for RCI. To seize these opportunities, it will be important to ensure an adequate level and efficiency of infrastructure investments and effective implementation of the Strategic Roadmap on Logistics and Trade (footnote 3).

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17 [Notre Dame Global Adaptation Initiative Index](https://nrgi.nd.edu/). It assesses the country vulnerability and readiness to climate change.
18 The Caspian Sea is located below sea level. Azerbaijan’s lowest point is 28 meters below sea level.
19 [Port of Baku](https://www.port-of-baku.az/). Central Eurasia refers to South Caucasus and Central Asia.
14. **Governance.** During 2007–2017, there were improvements in governance dimensions such as government effectiveness, regulatory quality, rule of law, and control of corruption. The country has taken significant steps toward combating corruption, one of the most problematic factors for doing business in Azerbaijan. Improvements have been observed as a result of the introduction of the Azerbaijan Service and Assessment Network initiative and customs system simplification and streamlining. In December 2018, amendments to the public procurement law were adopted that, among others, strengthened the link between procurement planning and the budgeting process, and introduced e-procurement and Code of Conduct for procurement staff.

15. **Extractive industries transparency.** Azerbaijan joined the Extractive Industries Transparency Initiative (EITI) in 2004 at the start of the initiative and was the first country to be validated as fully compliant with EITI standards in 2009. In March 2017, the EITI suspended Azerbaijan’s membership over concerns about the enabling environment for civil society. In response, Azerbaijan decided to withdraw from the EITI. The government has, however, remained committed to the principles of good governance, revenue transparency, and accountability in the extractive industries. In April 2017, the President of Azerbaijan signed a decree establishing the Commission on Transparency in Extractive Industries. The commission is operational, and implementation of the Roadmap for Beneficial Ownership Disclosure for the Extractive Industries in Azerbaijan adopted in December 2016 is ongoing.

16. **Binding constraints to growth.** The country diagnostic study conducted during 2017–2018 to inform the CPS helped identify three most pressing constraints to inclusive growth in Azerbaijan (footnote 1). These are highlighted in paras. 17–20.

17. **Low diversification and small non-oil private sector.** Azerbaijan’s product space is highly limited: in 2017 oil accounted for 82% of the country’s exports. Credit to the private sector, which predominantly comes from banks, sharply declined in 2016 and 2017. The asset quality of banks remains poor, capital adequacy needs to be rebuilt, and the cost of Azerbaijan manat finance is unaffordable to many private businesses. The share of nonbank credit institutions is only 3% of total credit to the economy. Given the urgency of easing access to finance to support non-oil economic growth, the resolution of nonperforming loans should be accelerated and the development of nonbank credit institutions prioritized, including through reforms to enable access to funding for lending to micro, small, and medium-sized enterprises (MSMEs) in agriculture, manufacturing, and tourism in the regions outside Baku. This—along with reducing market entry and exit costs, strengthening contract enforcement and property rights, and setting up an effective and coordinated government legal and institutional framework on private sector development—will be critical for meeting the government target to increase the share of small and medium-sized enterprises (SMEs) in the country’s GDP from 7.5% in 2015 to 15.0% by 2020 (footnote 3).

18. **Public sector inefficiency.** Expansionary budget spending during 2005–2014 contributed to an appreciation of the real exchange rate and hence adversely affected the non-oil

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22 Since 2001, Azerbaijan has been party to the Anti-Corruption Initiative for Asia–Pacific of ADB and the Organisation for Economic Co-operation and Development. It has been a member of the Council of Europe’s Group of States Against Corruption since 2005 and party to the regular monitoring exercise under the 2003 Istanbul Anti-Corruption Action Plan, a peer review mechanism to monitor United Nations Convention Against Corruption implementation.

23 [State Oil Fund of Azerbaijan (SOFAZ), Beneficial ownership](https://www.oilfund.az/en/).

24 Fitch Ratings assessed the share of nonperforming loans in total loans as having decreased from 21% in April to 17% in December 2018 (net of International Bank of Azerbaijan).
tradable sector. During 2015–2017, government expenditure in Azerbaijan averaged 36.7% of GDP against the average of 27.3% of GDP for Caucasus and Central Asian countries. Oil revenues—through transfers from the State Oil Fund of Azerbaijan to the budget—contributed to a significant rise of government expenditures, thereby fueling public investment. State-owned enterprises (SOEs) contribute 45% of GDP and play a dominant role in the areas of oil and gas, power generation and distribution, water supply and sanitation, railway, roads, air transport, and communication. Because of ineffective sector policies, many SOEs are saddled with inefficiencies and recurrent operational losses, resulting in periodic ex-post fiscal outlays. Sector-specific reforms and improved corporate governance are key to lifting the performance and profitability of the SOEs. Effective implementation of the SOE governance and accountability reforms initiated in 2016 and the fiscal rule and medium-term expenditure framework regulations adopted in August 2018 will be important to minimize oil dependency, reduce macroeconomic volatility, stimulate non-oil export growth, and raise efficiency of public resource use. Addressing weak institutional frameworks in public procurement as well as external and internal audit will be equally critical for improving public sector governance and efficiency.

19. **Inadequate infrastructure.** Because of sustained high public investments, the quality of overall infrastructure in Azerbaijan steadily improved during 2010–2018. Despite this, significant infrastructure constraints remain to be overcome to accelerate the development of manufacturing, agriculture, tourism, and information and communication technology (ICT), which are the expected drivers of non-oil growth and economic diversification. Inadequate provision of water supply and sanitation beyond the Absheron Peninsula constrains the expansion of the tourism industry. The country needs to continue upgrading its electricity and gas distribution networks and strengthen transport infrastructure in the rural areas to stimulate new businesses in non-oil segments such as manufacturing. Only 45% of potentially arable land in Azerbaijan is equipped for irrigation, and almost half of the irrigated agricultural land is salinized because of inadequate drainage. Access to and use of the internet varies significantly between urban and rural areas. Fixed broadband internet connection occurs predominantly through the landline telephone network. Expansion of the national broadband network, including through private sector participation, will improve digital connectivity for the country’s industrial parks and SMEs and enable growth of computer and digital companies (at the high productivity end of ICT). To fully seize the opportunities from the growing RCI momentum, the country needs to enhance and ensure financial sustainability of the substantial investments in road, rail, port, and air connectivity.

20. **Inadequate human capital.** An inadequately educated workforce has been among the top constraints for doing business in Azerbaijan. In human capital, Azerbaijan ranks 69th out of 157 countries (Kazakhstan ranks 31st and Georgia 61st) with the quality of schooling adversely

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25 SOFAZ, a sovereign wealth fund, was established in December 1999. During 2013–2017, SOFAZ transfers made up about 48% of total budget revenues. In end-2018, SOFAZ’s assets totaled $38.5 billion (82% of 2018 GDP).
27 ADB has supported these and other public sector reforms through programmatic policy-based lending (ADB. 2017. Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to the Republic of Azerbaijan for the Improving Governance and Public Sector Efficiency Program. Manila).
affecting the productivity of the next generation of workers. Government spending on education (as a share of non-oil GDP) decreased from 6.4% in 2010 to 4.0% in 2017, while the number of students increased. Primary and secondary enrollment rates are high, but the tertiary enrollment rate is relatively low: during 2014–2016, Azerbaijan’s tertiary education enrollment ratio averaged 25%, against 46% in Georgia and 47% in Kazakhstan. Although improving, the quality of technical and vocational education and training (TVET) is low; teaching quality is generally low and school buildings are poorly maintained and often lack modern equipment. Most existing facilities, equipment, curricula, textbooks, and other teaching materials are outdated. Hence, TVET schools are far from developing the skills needed for the modern labor market—the issue authorities have put high on their agenda to address. For infrastructure and human capital to adequately meet the needs of the diversified economy, it will be important to (i) adequately resource them to ensure sustainability and enhancement, (ii) establish an effective institutional setup and cohesive policy framework, and (iii) facilitate private sector participation focused on value for money.

### III. COUNTRY STRATEGY FRAMEWORK

#### A. Lessons from Previous Strategy

21. **Country assistance program evaluation.** The CPS incorporates recommendations of the country assistance program evaluation (CAPE), 2011–2017 that rated the ADB’s strategy and support overall successful. ADB’s sovereign operations were rated successful, while ADB’s nonsovereign operations were rated less than successful (on the borderline). At the strategic level, the CAPE recommends that ADB should (i) have greater focus on building human and social capital in parallel with developing and improving physical infrastructure and policy reform; (ii) use a broader range of instruments and modalities in crafting the new CPS; and (iii) as part of the support to economic diversification, do more analytical work, focus on non-tradable sectors, and more proactively involve in PSOs beyond simple onlending operations. At the operational level, the CAPE recommends that ADB should (i) step up its due diligence and preparatory work to handle expectations properly and avoid implementation delays or failures, and (ii) expand the policy dialogue based on an iterative and interpersonal approach that has proved valuable in fiscal and tariff reform areas.

#### B. National Development Strategy

22. **New development paradigm.** The state-led, oil-based development model of 2000–2013 has exhausted its potential for high inclusive and sustainable growth. The 2014 oil price drop and the subsequent economic slowdown have reconfirmed the urgency of accelerating the shift toward a private-sector-led and productivity-based development paradigm. Cognizant of this, in December 2016 the President of Azerbaijan approved the country’s new development framework, the Strategic Road Map on National Economy Perspectives (SRNEP) and Strategic Road Maps on 11 Main Sectors with the objective of accelerating economic diversification through reforms in four strategic areas: (i) strong fiscal sustainability and robust monetary policy, (ii) privatization and SOE reforms, (iii) human capital development, and (iv) development of a suitable business

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30 To raise labor quality, the government has developed 350 occupational standards and relevant training standards, including 52 occupational profiles and 63 specialty standards for tourism, manufacturing, construction, energy, agriculture, transport and service sectors.
31 Infrastructure needs for economic diversification may require annual investment of 6%–7% of GDP (footnote 1).
environment. The SRNEP envisages four major drivers of economic growth: (i) efficient institutions and policies, (ii) effective and inclusive financial intermediation, (iii) gains from becoming a regional economic and logistics hub in Central Eurasia, and (iv) higher productivity from a better-skilled labor force. The SRNEP also emphasizes strengthening women’s empowerment as a main factor for raising workforce competitiveness, and enhancing the social safety net to ensure comprehensive coverage of the vulnerable groups.

23. **Public debt policy.** Two waves of sharp devaluation of the Azerbaijan manat against the United States dollar in 2015, large state spending on the Shah Deniz Il gas field, and the bailout of a major state-owned bank almost tripled government foreign debt from 8.6% of GDP in 2014 to 22.8% of GDP in 2017. To curtail this trend and to gradually decrease the debt–GDP ratio to 12% in 2025, since 2017 the government has pursued the policy of no new foreign borrowing (sovereign or sovereign guaranteed) for conventional public investment projects in the short term. In the medium term, the government may consider foreign borrowing for projects that embed innovation and high technology. Implementation of this policy, along with proactive debt management, led to faster than expected reduction of government foreign debt, which dropped to 19.0% of GDP in 2018 against the projection of 22.5% of GDP for that year.

24. **Global development agendas.** Most of the Millennium Development Goal targets were achieved before 2015, and the United Nations recognized Azerbaijan as among 18 countries that succeeded in halving poverty. Azerbaijan endorsed the 2030 Agenda for Sustainable Development in 2015. In October 2016, the government established the National Coordination Council for Sustainable Development to coordinate the implementation of Sustainable Development Goals (SDGs) in Azerbaijan. In February 2019, the Council approved SDG targets and indicators that are relevant and priority for the country. In 2019, the government has scheduled to conduct the second voluntary national review of the implementation of the 2030 Agenda for Sustainable Development. The country ratified the Paris Agreement in January 2017; its nationally determined contribution (NDC) targets a 35% reduction in the level of greenhouse gas emissions by 2030 (relative to 1990 baseline).

C. **Role of Development Partners**

25. **Development partner coordination mechanism.** The United Nations Resident Coordinator’s Office facilitates development partner coordination (DPC) and holds overall coordination meetings at least semiannually. Five development coordination subgroups—private sector, social (education, health, and social protection), democracy and governance, agriculture, and energy and environment—meet regularly under the lead facilitation of a development partner.

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33 The SRNEP contains (i) a strategic vision for 2020 focusing on stabilizing the economy after the oil shock and deepening economic diversification; (ii) a long-term vision to 2025 aiming to strengthen competitiveness through inclusiveness and sustainable development with targeted average annual GDP growth of 3% and the creation of more than 450,000 jobs; and (iii) a post-2025 aspirational vision envisaging the development of a strong, competitive, and inclusive high-technology-based economy with GDP per capita income levels approaching those of Eastern European countries and more than 75% of the country’s total added value generated by non-oil economy.


36 The country is also party to the 1997 Kyoto Protocol and the 2003 Framework Convention for the Protection of the Marine Environment of the Caspian Sea.

37 Development Coordination Matrix (accessible from the list of linked documents in Appendix 3).
ADB is an active and contributing member of the development coordination subgroups. More recently, DPC has been enhanced through the active role of the Center for Analysis of Economic Reforms and Communication38 to better link the strategic road maps’ monitoring and evaluation process with the DPC mechanism. Selected government agencies have also stepped up their DPC role to raise the efficiency and effectiveness of development support and ensure better alignment with their institutional needs. Building on the momentum of stronger government-led DPC, ADB will continue to help improve coordination with development partners, including by efficiently reaching out to the government on key issues.

D. ADB’s Strategic Objectives and Operational Priorities

26. Country partnership strategy, 2019–2023 objectives. The overall objective of the CPS is to support diversified and inclusive growth in Azerbaijan in line with the government’s strategic road maps. As with many UMICs, Azerbaijan has access to market finance and has accumulated sizable oil savings,39 and ADB will focus on areas where it can add the most value to the country’s development agenda. The CPS will seek to support regional public goods and assist Azerbaijan in localizing and progressing toward the SDGs. The CPS is demand driven and selective, but it will also be flexible and adaptive to changing circumstances, drawing from (and combining, where necessary) the wide range of ADB’s instruments and modalities. ADB will expand its PSO in the country, predicated on suitable market conditions and viable opportunities.

27. Strategic pillars. ADB’s operations will be implemented under three interlinked strategic pillars: boosting private sector development, raising public sector efficiency, and improving infrastructure and strengthening human capital. The CPS pillars will focus on a subset of Strategy 2030 operational priorities (see figure). Pillar 1 relates to the operational priority on addressing remaining poverty and reducing inequalities (quality job generation), given its focus on developing non-oil private and finance sectors. Pillar 2 focuses on the operational priority on strengthening governance and institutional capacity (public management reforms, financial stability, and service delivery). Pillar 3 focuses on operational priorities on making cities more livable (providing integrated solutions), fostering regional cooperation and integration (enhancing connectivity and competitiveness), and addressing remaining poverty and reducing inequalities (improving education and training). The following operational priorities will be mainstreamed in all CPS pillars: strengthening governance and institutional capacity; tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability; accelerating progress in gender equality; and fostering RCI.

28. Phased and selective approach. Given the tight public borrowing stance and the fact that the private sector is still recovering from the impact of the oil price shock, engagement in the strategic pillars during the initial years of the CPS will focus on supporting the government through policy-based operations, analytical and advisory assistance (including for project preparation), and TA to strengthen the capacity of government institutions and the private sector. This upstream work will lay a platform for selective lending for high-technology and innovation projects in the later years of the CPS if, as expected, the public borrowing stance eases and the private sector recovers from the economic downturn. While maintaining the flexibility to respond to the country’s emerging needs, ADB will promote selectivity by focusing on areas that contribute most significantly to meeting the objectives of the CPS, building on ADB’s comparative advantages.

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38 The Center for Analysis of Economic Reforms and Communication was created under Presidential Decree no. 879 dated 20 April 2016. The Ministry of Economy acts as the repository of information on development partner activities.

39 Azerbaijan’s 2018 ratings are BB+ stable by Standard & Poor’s and Fitch Ratings (one notch below investment grade) and Ba2 stable by Moody’s Investors Service (two notches below investment grade).
arising from public and private sector operations as well as knowledge work, and synergizing with the work of other development partners. These areas include an inclusive finance sector and diverse private sector, SOE reform, enhanced infrastructure, and improved skills and productivity.

**Summary of Country Partnership Strategy, 2019–2023 for Azerbaijan**

**Operational priorities of Strategy 2030 covered under the CPS:**
-  🌋 = addressing remaining poverty and reducing inequalities;
-  🌍 = tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability;
-  🚀 = fostering regional cooperation and integration;
-  ⚡ = accelerating progress in gender equality;
-  🌟 = making cities more livable; and
-  🏭 = strengthening governance and institutional capacity.

**Focus areas within operational priorities:**
1. (a) generating quality jobs [36],
2. (b) supporting public management reforms and financial stability [61] and strengthening service delivery [62],
3. (c) providing integrated solutions [54],
4. (d) enhancing connectivity and competitiveness [64], and
5. (e) improving education and training [37].

Numbers in square brackets refer to paragraphs in Strategy 2030’s chapter IV on operational priorities.

**Implementation principles of Strategy 2030:**
-  🌋 = expanding private sector operations,
-  🚀 = strengthening know ledge services,
-  ⚡ = catalyzing and mobilizing financial resources,
-  🏭 = One ADB approach.

**Source:** Asian Development Bank.

29. **Strategic pillar 1: boosting private sector development.** ADB will facilitate private sector development and investment to support the expansion and competitiveness of non-oil tradable goods and services. On the public sector side, this will involve supporting reforms to

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40 Economic diversification is key to reducing the impact of the implementation of response measures on restructuring toward "greener" systems of production and consumption undertaken globally under the climate change agreements. Broadening the export basket of goods and services beyond those at risk from climate change measures helps reduce the vulnerability of countries that have a significant share of their exports concentrated in a few products or services and demand for those few products or services is likely to drop as a result of climate change mitigation measures in other countries (United Nations Conference on Trade and Development. 2018. *Climate Policies, Economic Diversification and Trade*. Geneva).
improve the business and investment regulatory environment, facilitate SME development and finance, and strengthen government institutions on private sector development. To address the constraint on access to finance, ADB will continue supporting finance sector reforms, including strengthening the sector’s governance and oversight, introducing new instruments to raise resilience against external shocks, and developing domestic capital and insurance markets. Through its PSO, ADB will seek to support MSMEs via eligible financial intermediaries, including nonbank financial institutions. ADB may also engage directly with eligible SMEs and SOEs to crowd in private capital. In the initial years of the CPS, ADB’s PSO approach will focus on restoring services to MSMEs that were clients of ADB financial intermediary borrowers and were severely affected by the financial crisis in 2015–2016 and saw their operations scaled back, particularly in rural areas. In the later years of the CPS, ADB may provide loans or equity investments in banks and nonbank financial institutions as the finance sector recovers to support MSMEs, especially those involved in areas such as food production and processing, and other underserved client segments. Through its trade finance program, ADB will seek to provide guarantees and loans to local banks, aiming at closing market gaps and promoting non-oil trade. ADB will seek to provide Azerbaijan manat financing to micro enterprises, farmers, and SMEs via suitable financial intermediaries that may include banks and nonbank credit organizations to support economic diversification, focusing on regions and on agriculture, tourism, ICT, and manufacturing.

30. **Strategic pillar 2: raising public sector efficiency.** ADB will continue supporting macroeconomic stability and a growth-friendly, and sustainable fiscal policy in Azerbaijan. This will involve supporting the rollout of the medium-term expenditure framework and the fiscal rule to optimize the use and raise the intergenerational equity of the oil rents, strengthening public financial management and procurement systems, and ensuring the fiscal sustainability of infrastructure investments. ADB will also continue supporting improvements in the efficiency of the public corporate sector to transform it from a drag to an agent of Azerbaijan’s development. At the level of selected SOEs (e.g., in the energy or transport sectors), ADB’s engagement will be strategically oriented toward enabling stand-alone access of the entities to credit and capital markets to meet their financing needs, including by potentially accessing ADB’s nonsovereign operations. Cognizant of the SOEs’ financing needs during restructuring and sector reforms, as well as the importance of maintaining SOEs’ provision of public services, ADB will stand ready to provide tailored support solutions to SOEs. Special attention will be paid to strengthening the institutional governance of SOEs and raising the independence and capacity of utility regulators. ADB will also support the government in implementing the national anticorruption action plan through capacity building and knowledge sharing.

31. **Strategic pillar 3: improving infrastructure and strengthening human capital.** ADB will help strengthen the sustainability of the existing infrastructure stock and enhance the access to and quality of infrastructure and public services in sectors and areas important for economic diversification and regional equality by combining selective infrastructure investments with regulatory, tariff, institutional, and governance reforms. ADB will help promote quality services by facilitating the use of modern ICT and digital public services in the regions to raise resilience in infrastructure and will seek to leverage international climate finance, if and as applicable.

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41 Following the One ADB approach, ADB’s public sector support—through policy-based lending and associated TA—will help tackle the pertinent constraints on the business environment.

42 In February 2019, the government provided the required approvals for issuing debt instruments Azerbaijan manat in the domestic or foreign capital markets. Azerbaijan manat financing will be subject the availability of suitable risk mitigation structures to support the feasibility of nonsovereign funding from a risk perspective and make such financing affordable to the borrowers and their MSME beneficiaries.

43 Such solutions may involve a combination of public and private finance, credit enhancement, cofinancing, TA, and transaction advisory services to structure projects for private sector participation.

44 ADB will promote integration of climate adaptation and resilience in infrastructure and will seek to leverage international climate finance, if and as applicable.
accountability of public utilities and reduce transaction costs to the private sector. ADB will continue supporting government programs on promoting domestic and regional transport connectivity and energy sector reforms. Building on previous experience, ADB will seek to provide integrated and region-specific solutions for improving urban and rural infrastructure. In infrastructure and subject to viable opportunities, ADB PSO may support public–private partnership (PPP) projects through equity or debt finance. Drawing on innovative approaches in the region, ADB will strengthen the education sector, including TVET, by building links between education, science, and the private sector; promoting the private delivery of public education services and infrastructure; and raising the private provision of education through innovative demand-based instruments. In addition to the CPS’s three strategic pillars, ADB operations will emphasize the five crosscutting priorities outlined in paras. 32–36 that explicitly address four of Strategy 2030’s seven operational priorities.

32. **Gender equality.** ADB will help address gender disparities in accessing economic opportunities by (i) enhancing the business climate and access to credit for female entrepreneurs; (ii) mainstreaming gender responsiveness and enhancing women’s voice during the design, implementation, and monitoring of infrastructure projects; (iii) promoting gender-sensitive occupational skills and educational programs aimed at increasing gender awareness; and (iv) promoting gender-responsive budgeting as a tool that integrates gender and other social dimensions into decision making about public resource allocation. The proposed interventions to improve public sector efficiency are expected to have significant positive effects on gender equity.

33. **Climate change and environmental sustainability.** ADB will facilitate implementation of NDC at national and subnational levels, and promote low-carbon interventions in the energy and transport sectors, including phasing out old technologies and equipment. ADB will also support the government’s aspiration to diversify its energy mix away from mostly gas-based energy generation to more renewable sources (e.g., solar power generation). As part of the support to boosting private sector development, ADB will seek to facilitate policies and initiatives on low-carbon and climate-adaptive goods and technologies.

34. **Regional cooperation and integration.** ADB will support investments in regional transport connectivity and facilitate the sharing of experiences, best practices, and innovation, especially in global and regional public goods, such as climate change, and technology adoption. ADB will leverage the scope of CAREC 2030’s strategy adopted in 2017 to support the development of the north–south and east–west economic corridors. ADB will also support the government in expanding regional cooperation to the new areas of cooperation in CAREC 2030 including economic and financial stability, tourism, agriculture and water, and human development. Subject to legal due diligence and compliance with its environment and social safeguards, ADB can support trans-Caspian RCI initiatives that may follow the effectivity of the Convention on the Legal Status of the Caspian Sea.

35. **Strengthening governance through information and communication technology.** ADB will mainstream ICT and digital technologies in its operations to improve the quality of public service delivery. Special attention will be paid to further strengthening e-government systems; fostering digital MSMEs; increasing the use of ICT in TVET; promoting e-agriculture concepts and systems (e.g., smart villages and digital technologies in food safety); facilitating cross-border e-commerce; and strengthening the enabling environment for the digital economy. ADB will seek to improve ICT infrastructure and services in the regions and support private sector participation in expanding the country’s ICT backbone infrastructure.

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45 ADB. 2017. **CAREC 2030: Connecting the Region for Shared and Sustainable Development.** Manila.
36. **Public–private partnerships.** Building on ongoing assistance for the establishment of an enabling environment, fiscal risk management, and the preparation of pilot PPP projects, ADB will continue to support strengthening the government’s legal, regulatory, and institutional frameworks and capacity for PPPs, as well as help develop an initial pipeline of projects to bring to market. Depending on the enabling environment reforms and pipeline maturity, ADB can assist in setting up government support mechanisms to raise the bankability of PPP projects.

37. **Knowledge solutions.** ADB intends to scale up its knowledge work in Azerbaijan to support this UMIC’s knowledge and analytical needs. ADB is seen in Azerbaijan as a unique source and facilitator of transfer of public and private sector knowledge and experiences from countries in Asia and the Pacific. Based on demand, ADB will offer knowledge products and services (KPSs) to support the CPS pillars. This will be facilitated by dedicated TA that will draw on ADB’s vast country and regional knowledge from past and ongoing operations. ADB will mainstream knowledge sharing in its operations and will facilitate twinning partnerships for selected newly created government institutions. ADB will continue the provision of demand-based just-in-time knowledge creation and transfer and policy advice to selected key government agencies and involve Azerbaijan in regional TA. The country director of the Azerbaijan Resident Mission, as ADB’s knowledge custodian, will ensure coordination and promote knowledge solutions following the One ADB approach.

38. **Knowledge partnerships.** ADB will facilitate knowledge partnerships within Azerbaijan and across the region. ADB will work more closely and effectively with think tanks, universities, and civil society organizations in designing, implementing, and monitoring ADB-supported projects, as well as developing new KPSs. Collaboration with the Asian Development Bank Institute and local think tanks will facilitate cross-country knowledge sharing to inform Azerbaijan’s development policy priorities. ADB will raise Azerbaijan’s benefit from vast knowledge work under the CAREC program and promote the country’s participation in the research and capacity building activities of the CAREC Institute.

IV. **STRATEGY IMPLEMENTATION**

A. **Indicative Resource Parameters**

39. Azerbaijan is a group C country with access to ordinary capital resources only. Given the CPS’s phased approach, and to ensure ADB’s ability to respond flexibly to public and private sector needs, ADB’s total resource availability will move from an annual to a 3-year ordinary capital resource allocation to enable backloading. ADB’s sovereign and nonsovereign lending to Azerbaijan for 2019–2023 is estimated at about $0.9 billion. Demand for sovereign resources is currently estimated at about $0.8 billion for the CPS period, with the focus on policy-based lending in the initial years and the expected resumption of project lending in the later years of the CPS.

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46 The country knowledge plan is in Appendix 2.
48 During 2014–2018, ADB’s sovereign and nonsovereign approvals totaled $3.04 billion. A significant part of this was from one-off factors, such as the $0.5 billion Countercyclical Support Facility Program in 2016 and the $1.25 billion total funding for the Shah Deniz II Project. Without these projects, approvals totaled $1.29 billion during 2014–2018.
49 An indicative sovereign lending program of $295.0 million and TA program of $5.5 million are envisaged for 2020–2022. *Country Operations Business Plan* (accessible from the list of linked documents in Appendix 3).
The cost-sharing parameters will remain unchanged, with ADB financing covering up to 75% of loan project costs on an overall portfolio-wide basis. ADB will strive to provide support from its PSO for at least one project every year, subject to market conditions. ADB will endeavor to leverage its support through partnerships (official and commercial cofinancing, and knowledge) with other development partners; the private sector; and with emerging donors such as philanthropic institutions, private donors, and global funds.

B. Implementation Priorities

40. Support instruments. Azerbaijan’s evolving challenges, the tight foreign borrowing space, and the country’s development stage require smart and integrated financing solutions that draw on the full spectrum of ADB’s instruments and modalities instead of being a mostly project loan provider.\(^{50}\) Given the government’s interest in ADB’s further support for structural reforms, the CPS envisions continuation of programmatic policy-based financing for the next phase of structural reforms. To expand policy advice, institutional strengthening, and capacity building assistance, ADB will draw from various support options, including regional TA of its knowledge departments. Through the project readiness financing modality, ADB will support the preparation of smart and innovative projects (that may involve private participation) by engaging high-quality advisors. ADB will also support non-oil MSMEs in the regions through financial intermediation lending to eligible financial institutions. ADB will seek to provide such financing in local currency.

41. Flexibility and synergy between sovereign and nonsovereign operations. Oil prices recovery, economic growth, and progress in public corporate sector reforms may create prospects for additional headroom in public external borrowing. Given this, and guided by the CPS’s strategic pillars, ADB will follow a flexible (stand-by) approach so it can mobilize support quickly. The demand for greater focus on nonsovereign financing reflects Azerbaijan’s needs as a UMIC with due consideration of country and obligor risks. ADB will foster synergies between its sovereign and nonsovereign operations by (i) supporting an improved enabling environment for MSMEs and PPPs, (ii) helping raise government capacity to prepare and transact PPP projects, (iii) developing relationships with SOEs to identify new business opportunities, (iv) working toward blended finance solutions,\(^{51}\) and (v) exploring synergies between sovereign and nonsovereign operations to support risk resilience and raise affordability to the beneficiaries.

42. Sustaining portfolio performance. ADB’s sovereign country portfolio performance is satisfactory, with disbursement and contract award ratios above ADB-wide averages and no loans at risk. Portfolio management is a continuous process led by the resident mission comprising annual and quarterly portfolio performance reviews and weekly updates on project issues enabling proactive detection and mitigation of project implementation risks. The envisaged project readiness financing will seek to facilitate faster start-up by ensuring the procurement readiness of projects. To raise accountability, ADB will promote more active involvement of civil society in the preparation and implementation monitoring of its operations. The asset quality of ADB’s nonsovereign investments has been adversely affected by the financial crisis in 2015, but ongoing remedial measures are expected to improve the nonsovereign portfolio performance.

43. Strengthening presence in the field. The composition of the resident mission’s staff will be adjusted continuously during the CPS period to meet the operational and country priorities. This will include strengthening AZRM’s capacity to facilitate PSO and deliver the expected

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\(^{51}\) Blended finance (to private and public corporates) involves a combination of sovereign lending, credit enhancement, and TA with private finance to lower the overall cost of finance and leverage private investment.
knowledge work. ADB will recruit staff to AZRM to be the on-the-ground focal for facilitating financial solutions through a coordinated and comprehensive response across different ADB departments and offices to the country’s public and private sector needs. ADB will regularly review the number of the resident mission’s national and international staff and out-post staff from headquarters to ensure the presence of an adequate mix of skills to implement the CPS effectively. When needed, ADB will also draw on the staff of other resident missions.

C. Monitoring of Results

44. The CPS results framework (Appendix 1) is closely aligned with the SRNEP and the concerned main sectors’ strategic road maps. ADB will monitor the implementation of the results framework annually during country portfolio and programming missions, drawing on the semiannual and annual reports on monitoring and evaluation of the strategic road maps conducted by the Center for Analysis of Economic Reforms and Communication. ADB will systematically monitor the gender equality results of projects classified gender equity and effective gender mainstreaming. Monitoring of the results framework will inform the country programming exercise.

D. Risks

45. Fiduciary risk to budget support operations is moderate and will be effectively mitigated through the ADB-supported public financial management reforms and TA. PSOs are subject to significant country, market, and obligor risks as illustrated by the financial crisis that followed the sharp devaluation of Azerbaijan manat in 2015. All PSO will therefore require in-depth risk analysis and effective mitigation. Increased PSOs may not materialize if exogenous shocks resurface or if finance sector recovery is slow. Policy-based and TA support for improving the business and investment environment and strengthening of the resident mission’s PSO capacity will also help mitigate such risk.

46. Key risks that emerged from the governance and procurement risk assessments prepared to inform the CPS include (i) limited oversight and corporate governance of SOEs; (ii) weak regulatory framework for public utilities; (iii) weak external and internal audit systems and capacity; (iv) an inefficient public procurement framework; and (v) weak systems on preparation, appraisal, monitoring, and evaluation of public investment projects. To mitigate these risks, ADB will (i) continue supporting public sector reforms through policy-based loans and TA, (ii) provide focused TA to address inefficiencies and reduce the fiscal cost of the SOEs, (iii) facilitate regional TA support to Azerbaijan in public procurement (including e-procurement) and anticorruption, (iv) help improve public investment management systems through project readiness financing, and (v) mainstream institutional strengthening and capacity building across its operations. ADB will continue to ensure open competitive bidding and other best practices in fiduciary aspects under ADB-financed projects, including full disclosure of information, transparency in decision making, and regular audits. ADB will seek to use alternative procurement arrangements, subject to satisfactory assessment of the fiduciary risks and mitigation measures.

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52 Some indicators in the results framework require sex-disaggregated data, and all efforts will be made to collect these.
53 This involves (i) the lack of an empowered and competent public procurement agency, and (ii) the low level of competency and absent institutionalization of the procurement function in government agencies.
**COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK**

**Country Development Impact Indicators with which the CPS is Aligned**
1. Non-oil economy’s direct foreign investment as share of non-oil GDP increased from 2.6% in 2015 to 3.7% in 2023a
2. Non-oil exports per capita increased from $170 in 2015 to at least $370 in 2023a
3. An additional 120,000 jobs established in the non-oil tradable sectors by 2023a

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<th>CPS Strategic Objectives</th>
<th>Priority Areas b</th>
<th>Key Outcomes that ADB Contributes to</th>
<th>Outcome Indicators</th>
<th>CPS Resources</th>
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<tr>
<td>Boosting private sector development</td>
<td>Promoting private sector development in the regions c</td>
<td>Business environment and sustainability strengthened</td>
<td>By 2023: Azerbaijan’s score in the World Bank’s Doing Business report improved to at least 80.00 (2018 baseline: 78.64)</td>
<td>Ongoing portfolio (as of 31 December 2018) h Six active sovereign operations totaling $1,648 million: (i) four investment projects totaling $900 million, (ii) one policy-based loan totaling $250 million, and (iii) one partial credit guarantee for total exposure of $498 million (55% in transport and 45% in energy)</td>
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<td>Strengthening the finance sector and capital markets c</td>
<td>Stability, outreach, and depth of the finance sector restored</td>
<td>Nonbank credit organizations’ local currency lending increased by at least 10% (2017 baseline: AZN413.9 million) Agriculture credit as a share of bank and nonbank lending increased to at least 5% (2016 baseline: 3% of bank and nonbank lending)</td>
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<td>Restoring financial services for micro, small, and medium-sized enterprises c</td>
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<td>Raising public sector efficiency</td>
<td>Strengthened sustainability and diversification and competitiveness orientation of fiscal policy d</td>
<td>Rule-based fiscal planning and medium-term expenditure framework implemented effectively</td>
<td>By 2023, share of SOFAZ transfers to state budget revenues decreased to 40% (2015 baseline: 50%) a By 2022, fiscal outlays to SOEs reduced by at least 0.2 percentage points (2016 baseline: 1.1% of GDP) Gender-based budgeting pilot-tested in at least one agency by 2023 (2018 baseline: not applicable) Revenue collection in the national power distribution company increased to 95% by 2022 (2014 baseline: 70%) Public service obligation contracts in the rail subsector introduced by 2021 (2016 baseline: not applicable)</td>
<td>Sovereign TA: nine projects totaling $8.6 million: 34% in public sector management, 33% in energy, 27% in transport, and 6% in finance Four active nonsovereign operations totaling $777.1 million: (i) two projects totaling $750 million in the energy sector, and (ii) two projects totaling $27.1 million in the finance sector Nonsovereign TA: one project totaling $0.75 million in the finance sector Planned operations and contribution (3-year pipeline as per the latest COBP):</td>
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<td></td>
<td>Strengthened efficiency of public expenditure and financial management frameworks d</td>
<td>Public debt management, sustainability, and development effectiveness strengthened</td>
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<td></td>
<td>Improved efficiency and strengthened sustainability of public corporate sector d</td>
<td>Public corporate sector oversight, governance, and performance-based management strengthened</td>
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<td>Improved delivery of public services d</td>
<td>Utility regulation and tariff reform in the rail and power subsectors implemented</td>
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<td>Improving infrastructure and strengthening human capital</td>
<td>More efficient and sustainable infrastructure provision e</td>
<td>Logistics and trade hub capacity of the country increased</td>
<td>By 2022, average freight speed on the Baku–Russia border part of the north–south railway corridor</td>
<td>Planned operations and contribution (3-year pipeline as per the latest COBP):</td>
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<tr>
<td>CPS Strategic Objectives</td>
<td>Priority Areas(^b)</td>
<td>Key Outcomes that ADB Contributes to</td>
<td>Outcome Indicators</td>
<td>CPS Resources</td>
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<td>Increased private participation in infrastructure(^a)</td>
<td>Connectivity improved, linking cities and rural areas</td>
<td>increased to 60 km/h (2016 baseline: 25 km/h)</td>
<td><strong>Sovereign</strong> Lending ($280 million of OCR for 2020–2022)</td>
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<td>Improved labor skills and productivity(^c)</td>
<td>Urban and regional infrastructure improved</td>
<td>By 2021, freight traffic on the motorway corridors on the Baku–Iranian border and Baku–Georgian border increased 35% (2010 baseline: 11,325 million ton-km)</td>
<td><strong>TA</strong> Nonlending ($1.8 million per year)(^g)</td>
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<td>Efficiency of the energy sector raised</td>
<td>By 2022, average annual unserved energy from outages reduced to less than 1% of energy sales (2014 baseline: 7%)</td>
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<td></td>
<td>Performance of the technical and vocational education subsector improved</td>
<td>By 2023, at least two PPP projects passing fiscal affordability and value-for-money test brought to bidding (2018 baseline: 0)</td>
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<td>By 2023, the objectives of the State Program on the Socioeconomic Development of Regions, 2019–2023 implemented in ADB-supported areas (2018 baseline: not applicable)</td>
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<td>By 2021, number of students of vocational education schools increased 50% (2015/16 baseline: 85,892)</td>
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ADB = Asian Development Bank, COBP = country operations business plan, CPS = country partnership strategy, GDP = gross domestic product, km = kilometer, km/h = kilometer per hour, OCR = ordinary capital resources, PPP = public–private partnership, SOE = state-owned enterprise, SOFAZ = State Oil Fund of Azerbaijan, TA = technical assistance.

\(^a\) Presidential Decree No. 1138 on 6 December 2016. *About Approval of Strategic Road Maps on National Economy Perspectives and Main Sectors of the Economy.* Baku. The Strategic Road Map on National Economy Perspective has the following targets in 2025: (i) non-oil economy’s direct foreign investment as share of non-oil GDP increased to 4%, (ii) non-oil exports per capita increased to at least $450, (iii) share of SOFAZ transfers to the public budget decreased to below 15%, and (iv) 150,000 jobs established in the non-oil tradable sectors.

\(^b\) CPS sector coverage may be adjusted during implementation to respond to country needs, ensuring that any adjustment will generally fall within the CPS priority areas.

\(^c\) Aligned with Strategy 2030’s operational priority 1 on addressing remaining poverty and reducing inequality.

\(^d\) Aligned with Strategy 2030’s operational priority 6 on strengthening governance and institutional capacity.

\(^e\) Aligned with Strategy 2030’s operational priority 4 on making cities more livable and operational priority 7 on fostering regional cooperation and integration.

\(^f\) Strategic Road Map on the Development of Vocational Education and Training.

\(^g\) The TA amount is an estimate and TA allocation is done annually. ADB will explore TA cofinancing and funding from other sources.

\(^h\) Active committed sovereign and nonsovereign portfolios. Sovereign TA portfolio includes a $1.5 million transaction TA project financed by the Asia Pacific Project Preparation Facility. For nonsovereign operations, totals refer to outstanding balances and undisbursed commitments. At the request of the borrower, ADB cancelled the nonsovereign loan of $500 million for the Shah Deniz Gas Field Expansion Project effective 7 February 2019.

Sources: Asian Development Bank.
COUNTRY KNOWLEDGE PLAN

A. Knowledge Needs

1. Knowledge (along with financing and partnerships) is an important Asian Development Bank (ADB) value addition. ADB seeks to integrate the generation, capture, and dissemination of knowledge with financing, capacity building, innovative approaches, application of improved technology, and strategic thinking. Strengthening ADB’s role as a knowledge institution is particularly important for remaining relevant in upper middle-income developing member countries such as Azerbaijan, where ADB is seen as a uniquely placed facilitator of knowledge sharing and builder of links with public and private sector stakeholders from Asia and the Pacific. This country knowledge plan details the key elements and implementation arrangements for selective and high-quality provision of knowledge products and services (KPSs) during the country partnership strategy (CPS), 2019–2023, guided by Strategy 2030’s operational priority plans and ADB’s Knowledge Management Action Plan. ADB’s country director for Azerbaijan will serve as knowledge custodian.

2. The country knowledge plan envisages the creation, dissemination, and consumption of demand-driven KPSs as value assets (of the same importance as operations) and integral elements of ADB support under the CPS’s three strategic pillars: (i) boosting private sector development, (ii) raising public sector efficiency, and (iii) improving infrastructure and strengthening human capital. The knowledge needs of the pillars are outlined in paras. 3–5.

3. Pillar 1: Boosting private sector development. Azerbaijan’s economy is heavily reliant on oil. This is not a sustainable economic model given the finite supply of oil and the volatility of oil prices. The government aims to diversify the economy by developing the non-oil private sector. There is a wide array of knowledge needs to promote diversification, which can be grouped into three main categories. First, the government requires strong analytical work and practical policy advice over a sustained period on accelerating and deepening diversification in the medium and long term. Diversification and competitiveness need to be adequately measured and monitored. Second, small and medium-sized enterprises (SMEs) and non-oil tradable sectors (agriculture, manufacturing, tourism, and information and communication technology) need to become more globally competitive through greater innovation and adoption of technology. Efforts are needed to raise agriculture productivity and boost agriculture production and exports, including through better food safety systems. Third, the finance sector lacks depth and is dominated by banks, and thus there is a need to support microfinance institutions and introduce more finance sector instruments and risk mitigation schemes to improve financial inclusion.

4. Pillar 2: Raising public sector efficiency. Azerbaijan’s public sector exhibits numerous inefficiencies for which knowledge support is needed. First, the state budget remains heavily dependent on oil revenue and is therefore vulnerable to oil-related economic shocks. Azerbaijan requires knowledge support in implementing the fiscal rule and the medium-term expenditure framework adopted in August 2018 and in improving public financial management systems. Second, the inefficiency and underperformance of state-owned enterprises (SOEs) lead to economic losses. Knowledge support is needed to further the SOE reforms (at sector and entity levels) and improve the efficiency of SOEs to make them productive corporations that will not be a drag on the state budget. Public corporate governance is weak and below international standards, and the public sector needs knowledge support to introduce or more deeply entrench

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international governance standards. Third, the government has successfully introduced a package of government services on citizen-related transactions through the Azerbaijan Service and Assessment Network (ASAN) centers, but more digital technologies need to be applied for greater efficiency and for expansion of services to other types of beneficiaries and sectors to further improve public sector governance and performance.\(^3\)

5. **Pillar 3: Improving infrastructure and strengthening human capital.** Despite the widespread provision of physical infrastructure and high literacy and education enrollment rates, Azerbaijan’s physical and human capital require strengthening. Physical infrastructure needs to become more efficient and sustainable, which will require knowledge support to improve infrastructure delivery; introduce higher technology and innovation, cost-recovery mechanisms, and tariff reforms; and build the capacity of state agencies. In terms of human capital, Azerbaijan critically needs to increase the availability and sophistication of labor skills to globally competitive levels and improve labor productivity.\(^4\) The government has not invested sufficiently in technical and vocational education and training (TVET), thereby affecting the availability of needed technical skills in the labor market. The government needs knowledge support to learn about successful TVET models from other countries in Asia and the Pacific. Ongoing government efforts to strengthen the efficiency of the social transfers, promote alternative social insurance schemes, and roll out compulsory medical insurance may also benefit from focused knowledge support.

6. **Crosscutting knowledge priorities.** The government is seeking knowledge support in selected crosscutting areas, such as establishing a fiscally sustainable enabling environment for public–private partnerships (PPPs), deepening regional economic cooperation and integration, benefiting from knowledge sharing under the Central Asia Regional Economic Cooperation (CAREC) Program, and supporting transparency in the extractive industries.

B. **Scope of ADB’s Planned Knowledge Operations**

7. ADB intends to scale up its knowledge work in Azerbaijan to help address the binding constraints to growth and raise the country’s readiness for the fourth industrial revolution, including through leapfrogging.\(^5\) Based on demand and purpose, ADB will offer KPSs using the most suitable modality at the country or regional levels. A key aspect of implementing the plan will be the provision of a technical assistance (TA) project to succinctly capture and draw out the extensive available (or under-preparation) knowledge that goes untapped because it is in the form of voluminous reports or produced under different ADB units. The TA project, which will be administered by the Azerbaijan Resident Mission, will help address this gap by ensuring all KPSs relevant to Azerbaijan are collected, synthesized, monitored, screened, and—upon consultation with the government as part of the annual country programming exercise—prioritized and consolidated for production, delivery, and outreach in an applicable KPS modality, including via dissemination at an annual anchor country knowledge event.\(^6\)

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\(^3\) The Azerbaijani word asan means “easy” in English. To date, 13 ASAN service centers (five of which are in Baku) operate in the country and employ a one-stop-shop principle, where state entities and private companies provide more than 250 services.

\(^4\) Azerbaijan’s labor productivity is seven times lower than the European Union’s average, about three times lower than in Turkey, and two times lower than in Russia.

\(^5\) The Fourth Industrial Revolution refers to the fourth major industrial period since the first Industrial Revolution of the 18th century. This latest industrial revolution is expected to see the adoption of robotics and artificial intelligence by industry and services with potential disruptive effects to the labor market. Leapfrogging implies a nonlinear transition from the yesterday’s to tomorrow’s state of development by jumping over the state of development today.

\(^6\) The TA will also include developing a methodology to estimate the asset value of KPSs and strengthening Azerbaijan’s own knowledge management systems as a learning cycle to inform the country’s development planning.
8. Given the limited TA country allocation, ADB will tap TA funds administered by ADB knowledge departments. It will do this selectively and in a just-in-time manner (i.e., for specific knowledge and capacity needs closely aligned with CPS strategic pillars or for reflecting the government’s high-priority reforms). The knowledge support described in paras. 9–12 complements ADB operations under the CPS’s strategic pillars and corresponds to the priority knowledge needs in paras. 3–6.

9. **Pillar 1: Boosting private sector development.** Knowledge support for this pillar will focus on three targeted areas to help accelerate economic diversification: (i) knowledge, policy advice, and institutional strengthening on structural reforms; (ii) development of SMEs; and (iii) finance sector deepening. Knowledge outputs under this pillar will include policy advice and reforms that will open more opportunities for economic diversification, and capacity building to strengthen government institutions responsible for economic policy and the business enabling environment. To increase SMEs’ role in the economy (an important contributor to diversification), KPSs will focus on policies, regulatory reforms, and assessments for SME development, and on knowledge solutions for leveraging finance for SME development. An important counterpart in this work will be the newly created Small and Medium Business Development Agency. A stronger, deeper, more inclusive, and efficient finance sector is required to stimulate new, diverse businesses and expand existing ones. KPSs for the finance sector will focus on improving the legal and regulatory framework for nonbank financial institutions; introducing or expanding capital markets, leasing, microinsurance, and financial risk mitigation; and improving the efficiency of the finance sector through digital technologies such as mobile money and digital payments.

10. **Pillar 2: Raising public sector efficiency.** Under this pillar, KPSs will be designed and delivered to strengthen public sector resource management and improve the efficiency and governance of SOEs. Public sector management knowledge initiatives will aim to improve fiscal policy, public financial management, tax administration, e-procurement, governance and transparency (including for the extractive industries), and national statistics. Other knowledge activities will assist the government in rolling out ASAN e-government services to SMEs under a digital single window. Knowledge support for SOEs will include public corporate management and reforms based on experiences from successful countries.

11. **Pillar 3: Improving infrastructure and strengthening human capital.** Knowledge support for this pillar aims to improve the delivery and operation of infrastructure and upgrade skills for the labor force. Most of the work on ADB’s tacit knowledge under the TA project noted in para. 7 will be under this pillar, particularly from ADB operations in transport, urban development, and energy. New KPSs related to infrastructure will consist of policy advice, sector-related studies, knowledge solutions for innovative infrastructure delivery and sustainability, and knowledge transfer and capacity building for solar power and urban and rural infrastructure management, which would be new to Azerbaijan. To address the critical gap between the labor force’s current skills and the skills needed for a modern and diversified economy, ADB will offer knowledge support to government agencies and employers to produce higher quality demand-

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The TA will draw from the relevant studies of ADB’s Independent Evaluation Department and build on the value addition of ADB’s sector and thematic groups. The TA will also include limited funding for rapid response policy advice and a country knowledge coordinator per the terms of reference of knowledge coordinators (ADB. 2004. *Knowledge Management in ADB. Appendix 6. Manila*). The Azerbaijan Resident Mission will closely coordinate with ADB’s Knowledge Advisory Services Center during TA preparation and implementation.

The government sees agriculture development as a principal factor of economic diversification. Thus, the selected knowledge activities for agriculture—supported through regional TA—will center on developing value chains, sharing knowledge on modern irrigation techniques, and strengthening the newly created Food Safety Agency.
based TVET programs. Through regional TA and given its priority for the government, ADB could offer targeted policy advice in the social protection and compulsory medical insurance areas.

12. **Crosscutting themes.** Crosscutting KPSs will initially focus on PPPs, regional economic cooperation, and extractive industry transparency, which are government priorities. As PPPs are new in Azerbaijan, ADB will support strengthening institutional capacity, improving the enabling environment for PPPs, and preparing a pipeline of PPP projects to bring to market. In regional cooperation, ADB’s support of the CAREC Program will enable Azerbaijan to participate in sector-related capacity building and regional sector or thematic studies, and acquire knowledge on such regional initiatives as economic corridors. ADB will continue supporting measures to implement the road map on beneficial ownership disclosure to improve transparency of extractive industries.8

13. ADB will coordinate with the government on the preferred modality for each KPS. Based on resource availability, prioritization, and readiness, ADB will program the KPSs in the annual country operations business plans. ADB will work closely with a local knowledge partner to hold an annual knowledge anchor event, likely in the fourth quarter of each year, to promote and help disseminate the knowledge products produced for that year. ADB’s Department of Communication will be actively involved in knowledge production, publication, and dissemination.

C. **Areas of Collaboration with Partners**

14. ADB will work closely with all in-country development stakeholders to develop and deliver innovative knowledge solutions. Civil society organizations and the private sector will be involved in KPS preparation and dissemination. ADB will seek to support knowledge cooperation arrangements with local universities and will facilitate dialogue between selected local universities and universities in Asia and the Pacific. Regional knowledge products and activities will be conducted with the Asian Development Bank Institute (ADBI) and the CAREC Institute. ADB and Azerbaijan will collaborate with these institutes on regional research and capacity building activities that will mobilize best international expertise and best practices. ADBI is expected to work closely with Azerbaijan on economic diversification related knowledge support. Azerbaijan will be an active participant in the CAREC Institute’s research and capacity initiatives for the member countries on CAREC 2030’s five operational clusters.9

D. **Resource Allocation**

15. Knowledge work under the CPS, 2019–2023 is estimated to cost $10 million, comprising TA projects, lending operations, staff consultants, and staff time. Regional TAs will be used in addition to the TAs allocated to the country. Development partner cofinancing and government cost sharing will also be leveraged to support knowledge activities. Staff consultancy from ADB will be used to engage experts for KPS preparation and delivery.

E. **Knowledge Competence or Expertise**

16. Azerbaijan has relevant experience to share, such as the successful rollout of the ASAN Service and the management of a sovereign wealth fund—the State Oil Fund of Azerbaijan. ADB will facilitate knowledge sharing on such experiences through the CAREC Program and ADBI.

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8 State Oil Fund of Azerbaijan. [Beneficial ownership](https://www.adb.org/carec/2030).

9 ADB. 2017. **CAREC 2030: Connecting the Region for Shared and Sustainable Development.** Manila. CAREC 2030 has five operational clusters: economic and financial stability; trade, tourism, and economic corridors; infrastructure and connectivity; agriculture and water; and human development. The first CAREC Institute Rolling Operational Program will be implemented in 2019.
LIST OF LINKED DOCUMENTS
http://www.adb.org/Documents/CPS/?id=AZE-2019

1. Inclusive and Sustainable Growth Assessment
2. Development Coordination Matrix
3. Country Operations Business Plan