

**ASIAN DEVELOPMENT BANK**

**TAR: AZE 36148**

**TECHNICAL ASSISTANCE**

**TO THE**

**REPUBLIC OF AZERBAIJAN**

**FOR**

**DEVELOPMENT OF A COMPETITION POLICY FRAMEWORK**

**June 2003**

## **CURRENCY EQUIVALENTS**

(as of 30 May 2003)

Currency Unit	–	Azerbaijan manat (AZM)
\$1.00	=	AZM4,916
AZM1.00	=	\$0.000203

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
DAP	–	Department of Antimonopoly Policy
MED	–	Ministry of Economic Development
TA	–	technical assistance

## **NOTE**

In this report, "\$" refers to US dollars.

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## I. INTRODUCTION

1. The Government of Azerbaijan (the Government) requested technical assistance (TA) from the Asian Development Bank (ADB) to strengthen the institutional capacity of the Department of Antimonopoly Policy (DAP) of the Ministry of Economic Development (MED), Azeri competition regulator, and to develop a competition policy framework appropriate for all economic sectors. In response, ADB fielded a mission to Baku, on 6-14 February 2003. The mission reached an understanding with the Government on the objectives, scope, terms of reference, cost estimates, financing plan, and implementation arrangements for the TA.<sup>1</sup> The TA framework is presented in Appendix 1.

## II. ISSUES

2. The structure of the Azeri economy is heavily affected by the dominant role of the energy sector.<sup>2</sup> The skewed economic structure is the major anomaly in the Azeri economy and development of the nonenergy sectors remains the country's main challenge. Manufacturing is very undeveloped, providing just 5% of gross domestic product, far below the share of that in oil producing countries and central asian republics. Although Azerbaijan's overall economic policy is fairly liberal, significant barriers impede the development of a sound, transparent, and competitive business environment. Despite heavy inflows of oil-related foreign direct investment, Azerbaijan remains fundamentally unattractive to foreign investors. A recent study by the United Nations Conference on Trade and Development (UNCTAD) ranks Azerbaijan 121<sup>st</sup> in foreign direct investment potential, measured by the structural determinants of the economy's long-term capacity to attract foreign investment. As for corruption, Transparency International's 2003 report<sup>3</sup> ranks Azerbaijan 95<sup>th</sup> out of 102 countries considered. In most of the economy, included the service and the agriculture sectors, few participants control large shares of the markets. Private and public anticompetitive practices, like collusion, violations of consumer rights, and the abuse of dominant positions, are widespread in the Azeri economy.

3. Competition policy issues are primarily regulated under four main laws: the Antimonopoly Law, the Law on Protection of Consumer Rights, the Law on Unfair Competition, and the Law on Natural Monopolies. These laws address all sectors, including financial services. Besides, two other laws deal specifically with competition issues within the financial sector: the Law on Financial Industrial Groups, adopted in 1996, and a commercial banking law that is about to be approved and contains a provision to deal with antitrust activities and ownership concentration. The new law prohibits banks from entering into agreements and carrying out concerted operations to monopolize banking services and limit competition in the banking industry. Compliance with regulations against monopolization of banking activity will be controlled by the central bank, which will mean a second, separate competition agency for the banking sector.

4. Recently, the responsibility for enforcing all competition policy laws was placed with DAP within the MED. DAP is at its initial stage of development and its goal is to become a modern regulatory body following modern standards for competition and related policies. The main functions of DAP include implementing measures to promote competition, preventing of both unfair competition and abuse by firms with dominant market positions, and protecting of consumer rights. DAP has a staff of only 21 people. One of the primary instruments through which DAP implements competition policy is its Register of Monopoly Enterprises; Azeri

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<sup>1</sup> The TA first appeared in *ADB Business Opportunities* in February 2003.

<sup>2</sup> In 2001, oil and gas represented one third of the Azerbaijan's gross domestic product, up from 10% in 1997; oil's share of total exports rose to 90% in 2001 from 58% in 1997.

<sup>3</sup> Transparency International. 2003. Global Corruption Report. Available: <http://www.globalcorruption.org>

enterprises that are deemed dominant—defined as having a market share of at least 35%—are listed on this register and must declare to DAP their prices and profits for approval.

5. DAP and its predecessor have a limited record of interventions to enforce the competition laws. A few investigations have taken place, following the simple rules set out by the law, but the findings have not included recommending any cases for prosecution. Thus, there has been no real enforcement of the competition laws in Azerbaijan, and DAP has insufficient independence, administrative and technical skills, human and financial resources, and analytical capabilities to cope with the daunting tasks of applying the competition rules and intervening to effectively help a transition economy become a modern market economy.

6. Several factors and institutional limitations have prevented the effective implementation of legislation. Consolidation of monopolies and oligopolies has been fostered by indirect forms of protectionism; Azerbaijan's overall policy is fairly liberal, but poorly implemented with huge margins for discretion often exploited by vested interests, creating fertile ground for corruption. Incomplete and inconsistent legislation and regulation are also an issue. For instance, DAP cannot initiate investigations on its own; its actions must be requested by an entity whose legitimate interests are being damaged. Further, the authorities don't have the power to ensure firms adopt their decisions and have not yet developed a clear approach to dealing with mergers, etc. DAP's administrative capacity is inadequate and it lacks basic information on the market structures and the behavior of firms. For Azerbaijan, which is still transforming and opening its economy to foreign competition, the optimal firm size is still unknown and institutional capabilities and statistical information have to be developed further before market structure can be analyzed properly. Due to the constraints, DAP has not yet devoted significant time, or resources to promote an understanding of the benefits of competition in Azerbaijan.

7. The lack of understanding about competition issues when framing other laws and regulations, and when as well as deciding public policy actions, has resulted in inconsistencies between policies and in the economy, affecting issues such as market entry conditions, exit policies, trade measures (e.g. tariff and nontariff barriers), definition and regulation of natural monopolies, etc. For example, high import duties on goods that are not produced in Azerbaijan need to be addressed especially for goods that are crucial inputs for sectors with high export potential.

8. Considerable development of Azerbaijan's competition framework is needed before it will become an effective instrument to enhance market access for new competitors, protect markets from restrictive business practices, and foster economic efficiency and consumer welfare. Determination and implementation of competition policy in Azerbaijan still depends heavily on individuals rather than on institutions. DAP does not yet have the autonomy, skills, culture, and resources to achieve its objectives and is still struggling to define its role within the Azeri business community, civil society, and government institutions. The overall current institutional framework should be assessed to determine whether competition issues should be addressed at the sector level or economywide, and whether DAP's present set-up as a department within MED allows DAP to function properly.

9. The efficiency and the future prospects of the Azeri economy will be significantly affected by the willingness and ability of authorities overseeing competition to establish a sound governance environment and to enforce effective competition policies. MED intends to reorganize and to strengthen DAP, and the needed political will seems to be in place to start modernizing and strengthening the Azeri competition policy framework. Thus, the proposed TA is timely and the Government has received no other assistance on this matter.

### III. THE TECHNICAL ASSISTANCE

#### A. Purpose and Output

10. The TA aims to strengthen the institutional capacity of DAP and create a legal and regulatory framework for supporting a healthy policy environment for competition in all sectors. A well-designed policy framework and an effective competition authority will be instrumental in fostering an environment conducive to economic efficiency, consumer welfare, and investment and business activities in Azerbaijan. In particular, and in line with Government's request, special attention will be paid to the regulation of natural monopolies and to the prevention of cartels. The TA is in line with the strategic objective of ADB's assistance to promote good governance in Azerbaijan.

11. The expected main outputs of the TA are

- (i) identification of a strategy to improve DAP's effectiveness and institutional capacity, and
- (ii) identification of legal amendments and institutional and policy actions allowing DAP to become an effective regulatory authority following modern standards for competition and related policies.

#### B. Methodology and Key Activities

12. The TA will

- (i) analyze the main impediments to a modern competition policy framework in Azerbaijan;
- (ii) assess the adequacy of the present institutional arrangements to deal with competition issues, discuss the possible institutional solutions appropriate for a transition economy, and provide recommendations to support the strengthening of the institutional framework in competition policy;
- (iii) review the legal framework regulating competition and related policies and recommend legal measures to strengthen the laws and regulations and their implementation;
- (iv) draft amendments of the legal framework to regulate natural monopolies and cartels and to prevent unfair competition;
- (v) assess the political autonomy, administrative and analytical capacity, adequacy of financial and human resources, and availability of the relevant statistical and economic information for DAP to deal with competition policy issues in all of the economy;
- (vi) identify key areas where training is needed to improve the effectiveness and institutional capacity of DAP, and provide training for DAP staff; and
- (vii) organize a conference, open to the public, with relevant decision makers and with participants from other countries competition authorities, to disseminate the findings of the analyses, discuss key policy and legal issues, promote acceptance of the need for competition, and activate relationships with foreign competition and antitrust authorities.

### **C. Cost and Financing**

13. The estimated total cost of the TA is \$320,000 equivalent, comprising \$224,000 in foreign exchange and \$96,000 equivalent in local currency cost. The Government has requested ADB to finance the entire foreign exchange cost and \$26,000 equivalent of the local currency costs. The TA will be financed on a grant basis by ADB's TA funding program. The Government will finance the remaining \$70,000 equivalent for remuneration and per diem of counterpart staff, office accommodation, and contingencies. Detailed cost estimates and a financing plan are provided in Appendix 2.

### **D. Implementation Arrangements**

14. MED will be the Executing Agency for the TA. MED will provide office accommodation for the consultants (suitably furnished and with access to communication facilities), counterpart staff, and venue and facilities for workshops and training activities. ADB will review and monitor the implementation of the TA through missions and consultants' reports.

15. A team of four individual consultants, two international and two domestic, will be assembled by ADB to implement the TA, for a total of 14 person-months (outline terms of reference are included in Appendix 3). The two international consultants will include a competition policy expert (4 person-months) and a legal and economic competition expert (4 person-months). The domestic consultants will have had legal experience and will be engaged for 6 person-months. The consultants will be selected and recruited in accordance with ADB's Guidelines on the Use of Consultants and other arrangements satisfactory to ADB for the engagement of domestic consultants. The team leader will submit (i) an inception report (inclusive of terms of reference for the domestic consultants) 3 weeks after commencement of their services; (ii) draft final report before the conclusion of the contract; and (iv) final report 3 weeks after incorporating comments from the MED and ADB. The TA is expected to commence in September 2003 and to be completed in September 2004.

## **IV. THE PRESIDENT'S DECISION**

16. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$250,000 on a grant basis to the Government of Azerbaijan for Development of a Competition Policy Framework, and hereby reports this action to the Board.

## TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<b>Goal</b> Create an environment conducive to economic efficiency, consumer welfare, and investment and business activities in the country.	Satisfactory legal and regulatory policy framework introduced.  Satisfactory activity record of the Department of Antimonopoly Policy (DAP) (number of investigations prosecuted, etc)	Asian Development Bank (ADB) missions.	Political and macroeconomic stability.
<b>Purposes</b> Create a modern and effective competition policy framework.  Strengthen the institutional capacity of DAP.	Government acceptance of the proposed strategy, including legal, regulatory and institutional requirements.	Technical assistance (TA) completion report.  ADB missions.	Government commitment to adopt, develop, and enforce a competitive policy framework for all sectors.
<b>Outputs</b> Identification of a strategy to improve the effectiveness and institutional capacity of the competition authority.  Drafting of legal amendments and recommendations for institutional and policy actions allowing DAP to become an effective regulatory authority following modern standards for competition and related policies.	Adequate procedures established at DAP to carry out active monitoring of markets and firms' behavior  Adoption of recommendations to strengthen the institutional capacity of DAP.  Adoption of laws and regulations to establish a modern competition policy framework.	Consultants' reports and TA completion report.  ADB missions.	Government commitment to deploy human and financial resources to support the development of an autonomous and effective competition authority.
<b>Activities</b> Analysis of current main impediments for a modern competition policy framework.	Draft laws and regulations to establish a modern competition policy framework.	Progress reports.  ADB missions.	Timely recruitment of consultants.  Adequate supervision by ADB staff.





**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Asian Development Bank Financing</b> <sup>a</sup>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	170.0	0.0	170.0
ii. Domestic Consultants	0.0	9.0	9.0
b. International Travel	13.0	0.0	13.0
c. Conference	15.0	5.0	20.0
d. Translations and publication	0.0	7.0	7.0
e. Equipment	6.0		6.0
2. Contingencies <sup>b</sup>	20.0	5.0	25.0
<b>Subtotal (A)</b>	<b>224.0</b>	<b>26.0</b>	<b>250.0</b>
<b>B. Government Financing</b>			
1. Remuneration and Per Diem of Counterpart Staff	0.0	35.0	35.0
2. Office Accommodation	0.0	25.0	25.0
3. Contingencies	0.0	10.0	10.0
<b>Subtotal (B)</b>	<b>0.0</b>	<b>70.0</b>	<b>70.0</b>
<b>Total</b>	<b>224.0</b>	<b>96.0</b>	<b>320.0</b>

<sup>a</sup> Financed on a grant basis from Asian Development Bank's technical assistance funding program.

<sup>b</sup> If required, contingencies might also be used to cover the travel expenses of a representative of the executing agency for contract negotiations.

Source: Asian Development Bank estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

### A. International Experts

1. A team of two international specialists, to be recruited as individual consultants, will assist Ministry of Economic Development (MED). The terms of reference outline indicative tasks, and the consultants will undertake any other related task needed to attain the objectives of the technical assistance (TA). The team leader will formulate detailed terms of reference for the domestic experts and oversee the whole TA. The two international specialists will provide consulting services for 8 person-months.

#### 1. Competition Policy Expert and Team Leader (4 person-months)

2. The team leader will have advanced qualifications in law and/or economics, and relevant background in competition economics. The expert will be able to explain competition issues to noneconomists. The expert will also have relevant knowledge of competition law and regulation and extensive experience in implementing competition policies. Significant work experience in countries comparable to Azerbaijan will be an advantage.

3. The expert will carry out the following tasks:

- (i) Provide an overview of the international institutional experience in regulating competition. In particular, describe the principal functions of the competition regulator, its institutional form and level of autonomy, how it exercises its discretion, and how competition policy is enforced.
- (ii) Provide a broad assessment of the institutional capacity of the Department of Antimonopoly Policy (DAP). Focus on the administrative and analytical capacity, availability of relevant statistical and economic information, political autonomy, and adequacy of financial and human resources of DAP to deal with competition policy issues in all economic sectors.
- (iii) Identify, within the present Azeri institutional and legal framework, key areas where training activities are needed and organize and conduct training for the staff of DAP. Training activities should absorb about 50% of the time of the international expert.
- (iv) Participate and organize a conference with relevant decision makers to disseminate the findings of the analyses, and discuss key policy and institutional issues.
- (v) Based on the findings of the analyses and discussion at the conference, recommend measures to improve the effectiveness and strengthen the institutional capacity of DAP to implement and enforce the relevant laws and regulations.
- (vi) Formulate the detailed terms of reference and tasks for domestic consultants.

## **2. Legal and Economic Competition Expert (4 person-months)**

4. The expert will have advanced qualifications in law and/or economics and will have relevant background in competition economics and law. Relevant experience in transition economies will be an advantage.

5. The expert will carry out the following tasks:

- (i) Identify main impediments to a competitive structure within the Azeri economy, and critically evaluate the existing legal framework for regulating competition in Azerbaijan. Review the legal framework in the area of unfair competition, state aid policy, and protection of consumer rights.
- (ii) Provide a critical review of the existing legal framework pertinent to regulating natural monopolies and draft relevant legal and regulatory amendments and internal guidelines.
- (iii) Provide a critical review of the existing legal framework pertinent to preventing monopolistic arrangements and cartels and draft relevant legal and regulatory amendments and internal guidelines on these matters.
- (iv) Identify, within the present Azeri institutional and legal framework, key areas where training activities are needed and organize and conduct training for DAP staff in relevant legal areas. Training activities should absorb about 25% of the time of the international legal expert.
- (v) Organize and participate in a conference with relevant decision makers and with participants from other countries' competition authorities to disseminate the findings of the conducted analyses, discuss key policy and legal issues.
- (vi) Based on the findings of the analyses and discussion at the conference, recommend measures to strengthen the laws and regulations as well as their implementation, and propose drafts of the legal amendments.

## **B. Domestic Consultants (6 person-months)**

### **1. Assistant to the Team Leader (4 person-months)**

6. The assistant team leader will possess experience in competition policy. Under the direction of the team leader, the assistant team leader will

- (i) provide logistic support to the team,
- (ii) help collect relevant information on Azerbaijan and become familiar with the TA,
- (iii) research and translate relevant documents; and
- (iv) carry out other activities as required.

**2. Domestic Legal Consultant** (2 person-months)

7. The consultant will be recruited to assist the international legal expert and is expected to possess experience in relevant legal issues for competition policy. Under the direction of the two international consultants, the domestic legal consultant will

- (i) help collect the relevant legal information and translate relevant documents;
- (ii) assist the international legal expert in reviewing and drafting relevant legislation, and
- (iii) carry out other activities as required.