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Programming of the European Neighbourhood Instrument (ENI) - 2018-2020

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Single Support Framework for EU support to Azerbaijan

Single Support Framework

2018-2020

AZERBAIJAN

Introduction

The Republic of Azerbaijan (later referred to as Azerbaijan) is a middle income country with a GDP per capita of USD 4.140¹ in 2017 and a population of 9.8 million people.

In more than 25 years since its independence, Azerbaijan has made significant progress in terms of socio-economic development. In the period 2004-2014, annual GDP growth averaged 10%, income of the population increased by 5.2 times and the poverty rate decreased from close to 50% to 4.9%. Official unemployment rates have more than halved from 11.8% in 2000 to 5% in 2016. However, the Azerbaijani economy remained vulnerable to fluctuations in oil prices, which came to the fore in 2015 when global oil prices heavily dropped. For the first time, Azerbaijan noted negative GDP growth rates -3.1% in 2016 and practically zero growth (0.1%) in 2017². This slowdown has created renewed momentum around the economic diversification and structural reform agenda set out in the Strategic Roadmaps adopted at the end of 2016.

Important disparities remain, notably between the country's urban centres and its rural areas. Per capita income in regions lags behind the capital by a factor of more than four, while the poverty level in the regions is 6% compared to approximately 2% in the capital of Baku.

Despite the across the board improvements by the country in the World Bank's World Governance Indicators, notably government effectiveness and control of corruption, some governance challenges remain. This is particularly the case for the voice and accountability indicator which registered a net regression. Further efforts are also required in the area of rule of law, democracy and human rights.

In September 2016, a constitutional referendum approved amendments which strengthened the Presidential role and established the position of Vice Presidents. The last election of the President of Azerbaijan was held on 11 April 2018 and was monitored by the Office for Democratic Institutions and Human Rights (ODIHR) of the Organisation for Security and Co-operation in Europe (OSCE) to which the authorities of Azerbaijan displayed a positive attitude. According to OSCE/ODIHR, the April 2018 presidential elections were held within a restrictive political environment and under laws that curtail fundamental rights and freedoms, including freedom of assembly, expression and media. Further actions will be needed to protect and promote democracy and human rights during the renewed term in office of the President.

¹ <http://www.imf.org/external/datamapper/NGDPDPC@WEO/OEMDC/ADVEC/WEOWORLD/AZE>

² 2017 Article IV Mission to the Republic of Azerbaijan

1. EU Response

1.1. Strategic objectives of the EU's relationship with the partner country

The stabilisation and resilience building of neighbouring countries are the EU's main political priorities outlined in the **European Neighbourhood Policy (ENP)** review³ of November 2015 and in the Global Strategy for the European Union's Foreign and Security Policy of 29 June 2016. Azerbaijan is also part of the EU's **Eastern Partnership (EaP)**, the priorities of which were confirmed at the EaP Summit in Brussels in November 2017, including the "20 Deliverables for 2020"⁴.

The framework for EU-Azerbaijan relations is embodied in the Partnership and Cooperation Agreement (PCA) in force since 1999. In February 2017, negotiations were launched on a **comprehensive new agreement** between the EU and Azerbaijan, which is to replace the PCA and better take account the shared objectives and challenges the EU and Azerbaijan face today. EU-Azerbaijan **Partnership Priorities**, which aim to focus cooperation on commonly identified shared interests, have been endorsed by both sides on 28 September 2018.

EU's cooperation with Azerbaijan aims at supporting the country's reform agenda in particular in the domains of economic diversification, sustainable growth and social development, good governance and rule of law, and its connection with the EU through enhanced connectivity, mobility and people-to-people contacts.

1.2. Choice of sectors of intervention

The priority sectors and indicative allocations for financial assistance to be included in the Single Support Framework (SSF) are directly linked to the policy objectives outlined in the EU-Azerbaijan Partnership Priorities and are coherent with the EaP priorities, including the "20 Deliverables for 2020" as well as the **EU+ joint programming**⁵ in the area of Vocational Education and Training (VET).

The SSF identifies key actions within these priority areas and is aligned with the key global policy goals set by the **UN 2030 Sustainable Development Goals** and the **Paris Agreement on Climate Change**. The priority sectors selected below are also in full alignment with the national and sectorial **Strategic Roadmaps** adopted by Presidential Decree in December 2016.

Extensive **consultations** have taken place with the Government, Civil Society Organisations (CSOs), multilateral and bilateral donors including EU Member States, International Financial Institutions and International Organisations as well as the private sector.

The indicative budgetary allocations reflect the focus on delivering tangible and visible results for citizens and businesses. In order to maximize the impact of EU assistance, a cluster of interventions may be **focused on one or more specific regions** of Azerbaijan while recognising that there are development needs across the entire country. This will build upon

³ The ENP review highlighted the stabilization of neighboring countries as an important political priority, to be achieved through support to good governance, democracy, human rights and rule of law, economic governance, as well as cooperation on security and on migration and mobility.

⁴ European Commission/HRVP – Joint Staff Working Document of 9 June 2016 "Eastern Partnership – 20 Deliverable for 2020 Focusing on key priorities and tangible results" – SWD(2017) 300 final

⁵ EU+ Joint Programming is carried out in Azerbaijan for the VET sector by the EU, Germany (GIZ), UK (British Council), Norway, Switzerland and the European Training Foundation

previous EU assistance supporting regional and rural development in the Lankaran region of Azerbaijan.

Finally, the choice of sectors of intervention has been guided by a number of **lessons learned** during the implementation of the ENPI 2007-2013 and the ENI 2014-2017 as – amongst others – captured in the recent Evaluation of the EU's Cooperation with Azerbaijan:

- The recommendation of the Evaluation to continue to have "regional and rural development, justice sector reform and education and skills development (....) as the focus of a significant share of future EU assistance";
- The recommendation of the Evaluation to retain the current balance of instruments, with a strong emphasis on Twinnings and grants to Civil Society Organisations (CSOs);
- The need to ensure coherence and complementarity between interventions financed through the national, thematic, cross-border and regional envelopes;
- The need for projects that produce tangible results for citizens and provide high visibility for the EU, while fostering strategic communication on EU policies and support;
- The importance of a sustained policy dialogue;
- The importance of mainstreaming the key Principles of Public Administration Reform of the Organisation for Economic Cooperation and Development's programme 'Support for Improvement in Governance and Management' (OECD/SIGMA), including when appropriate the better regulation approach advocated at the EU level in sector programmes;
- The importance of mainstreaming cross-cutting issues, notably gender equality, support to vulnerable populations, civil society participation and environment and climate issues.

The sectors selected for support are:

Sector 1: Economic development and market opportunities (indicatively 25% of total budget)

The recent economic crisis has shown the vulnerability of the Azerbaijani economy to exogenous shocks, and has shifted focus towards economic diversification and identification of new sources of sustainable private led growth.

The EU will support Azerbaijan's efforts to **diversify the structure of its economy, its export potential and sources of income** with the aim of sustainable inclusive growth, derived from an increasingly smart, digital, green, circular and social economy able to create and sustain quality jobs.

Economic diversification and the growth in productivity and competitiveness of the non-oil sectors will call for a strong focus on **trade and trade facilitation**, given the small size of the Azerbaijani domestic economy. Azerbaijani non-oil exports remain below 7 % of total merchandise exports. However, an important condition for boosting trade is compliance with international standards, including those of the World Trade Organisation (WTO), especially in the case of agricultural products, with requirements relating to sanitary and phytosanitary standards.

Small and medium-sized enterprises (**SMEs**) constitute the backbone of the EU's economy, representing over 60% of both employment and value added. In contrast, according to the

2016 Small Business Act Assessment, SMEs in Azerbaijan represent only 4% of GDP and less than 8% of employment. *Access to finance* remains particularly challenging, constrained by high cost of loans and collateral requirements. Facilitating the operation of SMEs, including through supporting **improvements to the country's business environment** based on **macroeconomic stability, fair competition and a public sector applying the rule of law in an efficient, fair and impartial manner** will be key to unleashing the country's potential.

Agriculture remains the country's biggest employer, absorbing nearly 38% of the workforce while contributing only 5% of GDP in 2016. It remains the second largest export sector after oil and gas. **Rural/agricultural development** is one of the priority sectors in the government's Strategic Roadmaps. Rural and regional development has been a priority for EU cooperation with Azerbaijan in the past years and cooperation with the Ministry of Agriculture and the Ministry of Economy has been close. Support to strengthening productivity and competitiveness of agriculture and rural SMEs is not only important for economic diversification but needed also to ensure balanced and inclusive development by creating rural jobs. Self-employment remains at high levels (68.2% in 2016) and the share of informality is high, mainly in agriculture, but also in other sectors⁶.

In the context of diversification of the economy and given the country's demography, support to **(women and youth) employment and social measures** will ensure that the population and especially vulnerable groups can adapt to changes in the labour market, paving the way for inclusive growth.

Sector 2: Strengthening institutions and good governance (indicatively 15% of total budget)

Strong and accountable democratic institutions and respect for universal values such as human rights are key to underpinning the economic diversification agenda. As emphasized in the EU-Azerbaijan Business Climate Report, strengthened **rule of law** will enable the country to attract and retain businesses to invest in the economy. Since embarking on reform of its justice sector in the mid-2000s Azerbaijan has enacted several justice modernisation and anti-corruption programmes. While notable and necessary improvements have been achieved in the quantity and technical quality of court infrastructure, entry-level recruitment and training of judges and the modernisation of the penitentiary system, several core problems remain. These concerned, among others, the issue of judicial independence and access to justice, both of which are key for attracting and retaining potential investors to the country. The reform in the judiciary should ensure better access to justice and greater transparency and predictability of judgements and in the application of the laws. While the Strategic Roadmaps do acknowledge the need to establish alternative dispute resolution mechanisms, including with EU support, an overarching justice reform strategy is thus far still lacking.

Strengthened rule of law should also be seen in the wider context of **public administration reform** ensuring that the public administration is not only held accountable and better able to respond to its citizens' and business needs but also able to deliver the wide range of structural reforms and sector policies outlined in the Strategic Roadmaps. Advocating for / and supporting public administration reform to address a highly centralised and compartmentalised public administration will be quintessential for the success of the

⁶ Source: ETF, Country Fiche, Oct. 2017

economic diversification agenda. This process also includes the development and evaluation of **public policies based on evidence** provided by a **high quality statistical service** and input from both government and non-government stakeholders.

Support to **public financial management** and the **fight against corruption** is equally part of this process. Azerbaijan's ranking on Transparency International's Corruption Perception Index (CPI) has been gradually improving, though some crucial anti-corruption laws are lacking, such as regulating conflict of interest and bribery in the private sector and an asset declaration system for public sector employees. The country has been notably addressing petty corruption since 2012, through the establishment and expansion of the Azerbaijan Service and Assessment Network (ASAN) "one-stop shops" for citizens and increasingly also businesses to access a number of public services, designed to reduce contact points and provide efficient and transparent services. Still many businesses claim that monopolies and unfair treatment by administrations are main impediments for business and growth through healthy competition.

As any country witnessing increased connectivity, Azerbaijan would benefit from better mitigating **security** risks such as cybercrime, for which the country at present does not have an action plan or strategy.

Legitimate reforms, with broad stakeholder support, need both a **strong civil society**, including social partners, able to engage in policy dialogue and independent media. The complex legal framework regulating the set-up and functioning of NGOs and foreign funding has reduced the capacity and level of engagement of civil society over the past years. Despite the difficult operating environment, civil society is diverse, with organisations working in a variety of fields. The official numbers of registered CSOs (approx. 4,300 in 2016 for a population of 9.4 million) is still considered low overall, compared to neighbours (10,000 CSO in Georgia for a population of 4.5 million).

Sector 3: Connectivity, energy efficiency, environment and climate change (indicatively 15% of total budget)

Azerbaijan's diversification strategy draws amongst others on its favourable position at the crossroads of transport connections linking North and South and East and West. The country has initiated several important infrastructure projects to make better use of its location, e.g. the finalisation of the Baku-Tbilisi-Kars Railway, the development of the Port of Baku, as well as the development of the Astara (Azerbaijan) – Astara (Iran) railways. To increase Azerbaijan's ability to operate as logistics and transport hub, **strengthened governance of the logistics and transport sector**, in addition to infrastructure investment is required. Azerbaijan would need a comprehensive approach to develop the transport sector of the country which will need to include coordination mechanisms among modes of transport in terms of vision, planning, investments, tariffs, accessibility and operations. This also includes an enabling regulatory environment supported through legal and institutional reforms, while strengthening the border management and transit systems. At the same time in **road safety** Azerbaijan faces significant challenges, as every year more than 1100 people are killed in road traffic accidents.

While making an effort to diversify its economy, Azerbaijan should also look for ways to **improve the functioning of its energy sector**, including through improved energy efficiency and promoting renewable energy. Doing so has the potential to bolster the country's resilience and its transition towards green and sustainable economic development and to contribute to climate change objectives.

In the same vein support in **environmental governance**, sustainable management of resources and the country's transition towards a green and circular economy are essential to achieve sustainable development. The country could benefit from further cooperation with EU on environment, while implementing Environmental Impact Assessments (EIAs) and Strategic Environmental Assessments (SEAs) in a more structured way.

Sector 4: Mobility and people-to-people contacts (indicatively 25% of total budget)

Mobility and people-to-people contacts are fundamental for encouraging the flow of knowledge and expertise. With 40% of the population below 25 years, **education** (including vocational education and training) is a key investment for long-term economic resilience of the country. A particular challenge is the mismatch between the *skills* supplied by the education system and those demanded by the economy; this seriously affects the labour market and is the reason for productivity constraints. The same is true for the lack of formal training: Only 32.5% (30.4% for female) in employment have vocational qualifications, while every year, around 40% of secondary school graduates enter the labour market with no vocational qualifications. The youth unemployment rate (15-29 years) in 2016 remained high at 9.4% with 7.7% rate for males and 11.1% for females. Neither the quality of academic education, nor that of vocational education complies with employers' expectations. Development of stronger ties between the labour market and the education system should be further enhanced in Azerbaijan to support smart and sustainable economic development.

EU+ partners already work together to modernise the **vocational education and training (VET)** sector in line with EU best practice and standards, with the view to reducing the skills mismatch between the educational outcomes and the demands of the economy. Work on increasing the participation of Azerbaijani entities in the Horizon 2020 Programme for **research and innovation** and moving Azerbaijan closer to the European Research Area is ongoing.

Measures aimed at improving people-to-people contacts also include the expansion of education cooperation and mobility opportunities for undergraduate and graduate students. By joining the Bologna process in 2005 the country has since progressed with the implementation of certain 'Bologna' tools and notions, and has made a commitment to become part of the European Higher Education Area (EHEA), which was officially established in 2010.

The Mobility Partnership aims at effective migration management and contributes to the mobility of citizens in a secure and well-managed environment. In this context, the full implementation and smooth functioning of the EU-Azerbaijan Visa Facilitation and Readmission Agreements also has to be ensured. Overall, **migration governance** needs a more strategic and holistic approach which requires greater coordination among the concerned institutions and strengthened capacities to collect and analyse data on people's movements, including through improvements in the legal and institutional framework for document security, border management as well as migration and asylum policy.

Complementary support for capacity development/institution building and strategic communication (indicatively 10% of total budget)

The complementary provision for capacity development and institution building activities will address the implementation of priority commitments deriving from agreements with the EU including, but not limited to, those under the four priority sectors. Capacity development and institution building activities – either through sector-related assistance or from this complementary provision – may also address participation in EU programmes and in the work of EU agencies. Furthermore, through this complementary support communication on EU policies and assistance will be fostered, with a focus on effective and integrated communication approach with various audiences.

Complementary support for civil society development (indicatively 10% of total budget)

Additional measures to support civil society, including but not limited to the four priority sectors, will be made available under this complementary envelope, geared towards strengthening the role of civil society in policy processes, accountability systems, and sustainable socio-economic development. This can include measures aiming to strengthen the CSOs' overall organisational capacity and skills, to improve CSOs' financial sustainability through diversification of funds and capacity building, to promote purposeful and effective interaction between CSOs and other stakeholders, including reach out to their constituencies, and networking, and to improve CSOs' performance in terms of service provision, engagement with beneficiaries, and promotion of civic engagement.

2. Financial overview

The indicative bilateral allocation for the programming period 2018 - 2020 is EUR 42 million to EUR 51 million. The indicative breakdown by sector is the following:

	<i>Indicative amounts</i>	<i>Indicative % of total bilateral allocations</i>
<i>Sector 1 Economic development and market opportunities</i>	<i>EUR 10.5 – 12.75 million</i>	<i>25%</i>
<i>Sector 2 Strengthening institutions and good governance</i>	<i>EUR 6.3 – 7.65 million</i>	<i>15%</i>
<i>Sector 3 Connectivity, energy efficiency, environment and climate change</i>	<i>EUR 6.3 – 7.65 million</i>	<i>15%</i>
<i>Sector 4 Mobility and people-to-people contacts</i>	<i>EUR 10.5 – 12.75 million</i>	<i>25%</i>
<i>Complementary support for capacity development/institution building and strategic communication</i>	<i>EUR 4.2 – 5.1 million</i>	<i>10%</i>

<i>Complementary support for civil society development</i>	<i>EUR 4.2 – 5.1 million</i>	<i>10%</i>
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3. EU support per sector

3.1 Economic development and market opportunities (25%)

3.1.1 The following overall and specific **objectives** will be pursued:

The overall objective is to enhance economic diversification, export potential, and sustainable and inclusive private sector led growth.

Specific objectives are (1) to promote non-oil sector development, including through enhancing compliance with international/WTO standards, trade facilitation, SME development, support to the digital, green and circular economy and improvement of the competitiveness of the agricultural and agro-business sector; (2) to improve the enabling environment for business development, innovation, investment promotion and employment generation across economic regions of Azerbaijan, especially for the country's rural youth and women; (3) to enhance institutional capacity & efficiency in rural and regional development, and improve rural livelihoods and the quality of life in Azerbaijan's rural areas, in particular in pilot region(s) to be selected for this purpose; (4) to promote a social protection system according to EU standards.

3.1.2. For each of the specific objectives the respective main expected **results** are: (1) increased non-oil trade, increased integration of Azerbaijan's non-oil trade in regional and international markets, further development of the digital economy, increased competitiveness and export performance of SMEs; (2) improved business environment and investment climate; increased employment in the regions; (3) more balanced and inclusive economic development in the regions and decreased regional disparities; (4) a more efficient and inclusive social protection system.

3.1.3. The main **indicators** for measuring each result are provided in the sector of intervention framework in Attachment 1.

3.1.4. Donor coordination and policy dialogue

In addition to the EU, the Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ), the Kreditanstalt für Wiederaufbau (KfW), Asian Development Bank (ADB), United States Agency for International Development (USAID), United Nations Development Programme (UNDP), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), World Bank (WB), International Finance Cooperation (IFC) and Swiss Agency for Development and Cooperation (SDC) are supporting SME, trade facilitation and private sector development in Azerbaijan. In the field of rural and regional development, besides the EU main donors are the WB and USAID targeting agribusinesses, GIZ supporting local-self-governance reform, the EBRD supporting access to finance for agri-businesses and SDC which focuses on enhancing economic regional development, while International Fund for Agricultural Development (IFAD) supports disadvantaged rural communities. In the field of social protection, main donors in complement to the EU are the WB, GIZ, UNDP and UNICEF. Furthermore, multilateral / regional actions under EU4Business and EU4Digital

complement bilateral support related to the private sector development and promotion of the digital economy respectively.

Together with the Ministry of Agriculture, the EU co-chairs the sectoral donor coordination group on agriculture. Intra-donor groups on private sector development/trade and social sector are respectively co-chaired by EBRD/SDC and UNDP/UNICEF.

3.1.5. Azerbaijan's **financial and policy commitments**

Specific objectives proposed under this priority are in line with the government of Azerbaijan policy, and notably the Strategic Roadmaps on: SME development, financial sector, agriculture, industry, tourism and logistics and trade network. This includes commitments in support for further improvements of the country's business environment, modernisation and restructuring of the agricultural sector and broader (and more comprehensive) support to SME development, including enhanced access to finance and Azerbaijan's integration into regional and international markets as well as the development of tourism zones.

Specific relevant sectorial commitments, in addition to the Strategic Roadmaps, include the Law on Agricultural Cooperation of June 2016 which regulates the process of formation of agricultural cooperatives and, more recently (June 2017) the adoption of a State Programme for the development of agricultural cooperatives 2017-2022. Similarly, the Government has started new policy measures targeting small farmers under the ABAD scheme (the Azerbaijani full name of ABAD translates into Easy Support to Family Business) introduced by the State Agency for Public Service and Social Innovations (ASAN). The Government also adopted the Socio Economic Development Programme of Azerbaijani Regions 2014-2018 and is currently working on a successor programme, with support from the EU.

In June 2017, a presidential decree was adopted on additional measures in relation to the improvement of the country's business environment, while the government is currently finalising the Azerbaijan National Employment Strategy 2018-2030.

The Concept on the Pension Provision System Reform in 2014-2020 adopted in 2014 foresees measures for creating a long-term reliable social protection of the pensioners. The new Unemployment Insurance Law from June 2017 should allow for increased funding for passive and active labour market policies, notably through a levy on payrolls. A new Concept for Health Financing Reform and Introduction of Mandatory Health Insurance as well as an Action plan for its implementation have been developed, and their implementation is being supported by the EU.

3.1.6. When needed, the appropriate type of **environmental assessment** (Strategic Environmental Assessment - SEA or Environmental Impact Assessment - EIA) will be carried out according to EU standards. The use of specific environmental assessment methodologies will be used where necessary with a view to ensure approach to implementing EU financing actions in environmentally sustainable and resource efficient way while contributing to development.

3.1.7. The overall **risk assessment** of the sector intervention

The main risk to achieving the objectives is the lack of effective implementation of the various government commitments in this sphere, as well as reduced commitment to the overall economic diversification agenda should global oil prices increase again. While the

Strategic Roadmaps have been costed, there is no link to the budget (yet) and there is subsequently no clarity as regards further prioritisation of reforms. Implementation mechanisms and effective reporting and monitoring mechanisms by different levels and sectors of government have not yet been put in place, although the Centre for Economic Reforms has started to produce bi-annual progress reports. Limited capacity of key stakeholders, such as government, enterprises, their associations, youth, academia and civil society, poses a further risk. Overall, any further regional tensions and conflict could undermine socio-economic stability in Azerbaijan and therefore also constitute a risk on achievement of the objectives within the sector.

The above mentioned risks need to be carefully monitored. Risk mitigation may include:

- Close cooperation and ongoing policy dialogue with the government, especially on joint priorities to be agreed within the new agreement between the EU and Azerbaijan as well as on the need to ensure better linkage between reform commitments and the budget and to advocate for and provide support to public administration reform – including through establishment of appropriate implementation and monitoring and evaluation mechanisms for the reforms;
- Engaging not only with the government, but also with the main target groups such as (rural) SMEs and their associations, youth groups and academia and civil society organisations. Capacity building support and knowledge transfer to them;
- Effective use of various aid modalities, such as twinning, technical assistance and grants.

3.2 Strengthening institutions and good governance (15%)

3.2.1 The following overall and specific **objectives** will be pursued:

The overall objective is to promote good governance, democracy, the rule of law, human rights, to enhance resilience to security threats, and to decrease the level of corruption.

Specific objectives are (1) support governance through more effective and accountable justice system and public administration reform at national and local level, including development of statistics to support evidence-based decision-making; (2) to strengthen measures safeguarding democracy and respect for human rights; (3) to enhance resilience to mitigate identified security risks such as lack of cybersecurity, cybercrime, organized crime and terrorism; (4) to support the fight against corruption; (5) to improve efficiency of public expenditures and revenue collection by the Government and to enhance budget scrutiny and transparency; (6) to promote an enabling environment for independent media and civil society engagement, including for social partners' organisations, in societal development and policy dialogue.

3.2.2. For each of the specific objectives the main expected **results** respectively are: (1) enhanced independence, effectiveness, predictability and accountability of the justice system and public administration; public administration reform agenda is developed and being implemented addressing key areas of the OECD/SIGMA Principles of Public Administration; institutional and administrative capacity of public administration institutions strengthened; (2) enhanced protection of human rights and democratic governance; (3) strengthened capacities to address security risks; (4) effective systems are in place to fight corruption at all levels; (5) strengthened public finance management and improved budget transparency; (6) strengthened capacities and engagement of independent media and civil society.

3.2.3. The main **indicators** for measuring each result are provided in the sector of intervention framework in Attachment 1.

3.2.4. **Donor coordination and policy dialogue**

Besides the EU, other major development partners continue to be involved in supporting this sector. Structural reforms and capacity development in public administration reform and public financial management is supported by EU, Germany, UNDP, the International Monetary Fund (IMF), WB and SDC. To strengthen the independence and efficiency of the judiciary – including anti-corruption efforts, support is provided by the EU, WB, Council of Europe (CoE), UNICEF (supporting juvenile justice) and GIZ. In the area of democratic governance – including support to civil society and human rights – besides the EU, key donors are USAID, UNDP, CoE, Office of the United Nations High Commissioner for Human Rights (OHCHR) and UNICEF.

There is a thematic donor coordination group covering PFM, governance/public administration reform, democracy and rule of law co-chaired by the Council of Europe and USAID. It gathers the above mentioned donors (as well as ADB, International Organisation for Migration (IOM), United Nations High Commissioner for Refugees (UNHCR) and the German Embassy) with the primary purpose of information exchange on ongoing/planned cooperation and latest developments in the broad field covered by this group.

3.2.5. Azerbaijan's **financial and policy commitments**

In the area of justice no single overarching reform document exists. However, the Strategic Roadmaps on SME development emphasises the importance of building up capacity for mediation. In order to contribute to an increased protection of the business environment in Azerbaijan, a Presidential decree was issued in February 2016, establishing a remedy mechanism for the restoration of violated rights and interests of businesses by different state bodies or their officials.

Also, on 10 February 2017, the President issued an Executive Order on the modernisation and organisation of a more effective administration of the country's penitentiary service while creating opportunities for the establishment and functioning of a probation system, for which the EU is supporting the Ministry of Justice.

Based on the weaknesses identified in the Public Expenditure and Financial Accountability (PEFA) assessment report, a Public Finance Management Action Plan 2015-17 has been adopted in 2015 and is currently being updated and implemented with EU and WB support. EU and WB also plan to carry out the follow-up PEFA in 2019 as agreed with the Ministry of Finance.

There is as of yet no overall Public Administration Reform Strategy nor is there a single public body assigned for overall public administration management. Currently the State Examination Centre is the only public institution dealing with civil service but it has restricted authorities in organisation and management of the civil service.

3.2.6. When needed, the appropriate type of **environmental assessment** (SEA or EIA) will be carried out according to EU standards as part of annual programming of financing actions under this priority sector.

3.2.7. The overall **risk assessment** of the sector intervention

The main risks to achieving the objectives include the lack of genuine government commitment to comprehensive reforms in public administration in line with the Principles of Public Administration, the judicial sector, fighting corruption and promoting human rights/democratic governance, including the establishment of a more conducive enabling environment for CSOs. Risk mitigation can include enhanced policy dialogue with the government and close coordination with EU Member States, development partners and other stakeholders involved in this sector, as well as strategic communication of the EU role and support in the sector.

3.3 Connectivity, energy efficiency, environment and climate change (15%)

3.3.1 The following overall and specific **objectives** will be pursued:

The overall objective is to enhance connectivity, capacity and governance in the energy and transport sectors, and to promote energy efficiency and environmental protection and resilience.

Specific objectives are: (1) to support enhanced connectivity in the energy and transport areas, including through support to enhanced governance of and reforms in the energy and transport sector; (2) to increase energy efficiency, the deployment of the renewable energy sources and green growth and to contribute to climate change objectives; (3) to support improvements in environmental protection and governance.

3.3.2. For each of the specific objectives, the main expected **results** are: (1) increased connectivity in the energy and transport areas, including through improved and better capacitated institutional structures in the energy and transport sector; improved road safety; increased competitiveness of the transport/logistics sector; (2) improved energy efficiency; increased share of renewable energy in the country's energy portfolio; enhanced participation in green growth; (3) enhanced environmental governance and protection; improved resource management.

3.3.3. The main **indicators** for measuring each result are provided in the sector of intervention framework in Attachment 1.

3.3.4. Donor coordination and policy dialogue

The EU, Germany (KfW and GIZ), France, EBRD, EIB, USAID, World Bank, ADB and UNDP are the main development partners supporting the improvement of energy efficiency, production of renewable energy sources, green growth and support to the transport sector. A thematic intra-donor coordination group is co-chaired by the EU and UNDP. Particularly in the transport sector, there is a need to further develop intra-governmental coordination mechanisms among modes of transport in terms of vision, planning, investments, tariffs, accessibility and operations.

3.3.5. Azerbaijan's financial and policy commitments

Specific objectives under this priority are in line with the government of Azerbaijan policy, including notably the Strategic Roadmaps on development of Logistics and Trade and the one on energy. The country has financed several key infrastructure projects in both the energy and transport. It is a party to the Paris Climate Agreement.

3.3.6. When needed, the appropriate type of **environmental assessment** (SEA or EIA) will be carried out according to EU standards as part of annual programming of financing actions under this priority sector.

3.3.7. The overall **risk assessment** of the sector intervention

In the transport sector, one of the main risks is the lack of realistic forecasts to adequately appraise costs/benefits of key investments in the sector. This is further compounded by the lack of an overarching coordination mechanism among modes of transport. For both energy efficiency and road safety, the main risk is related to lack of genuine political commitment to undertake the necessary reforms, including in the governance of the sector. Mitigation of these risks can include enhanced policy dialogue with and support to the government on transport/energy governance and close coordination with EU Member States, development partners and other stakeholders involved in this sector.

3.4 Mobility and people-to-people contacts (25%)

3.4.1 The following overall and specific **objectives** will be pursued:

The **overall objective** is to make lifelong learning opportunities better responsive and adapted to labour market trends and skills needs, and to enhance the mobility of citizens in a secure and well-managed environment.

Specific objectives are (1) to contribute to the modernisation and quality assurance of the education system including the vocational education and training, taking into consideration the needs and rights of the most disadvantaged groups (including people with disabilities); (2) to promote a holistic approach, strengthened capacities and coordination among the institutions dealing with migration governance, in particular through the full implementation and smooth functioning of the Visa Facilitation and Readmission Agreements and future potential visa liberalisation dialogue and to foster the effective implementation of the Mobility Partnership.

3.4.2. For each of the specific objectives the main expected **results** are: (1) enhanced education and training sector, relevant to the needs of the labour market; competency-based education standards for all defined occupations of strategic economic sectors are aligned with occupational standards and in use; curricula and teaching/training materials are developed, piloted and implemented; (2) improved migration management connected to Integrated Border Management system in place; increased cooperation between the EU and Azerbaijan with regard to future potential visa liberalisation dialogue.

3.4.3. The main **indicators** for measuring each result are provided in the sector of intervention framework in Attachment 1.

3.4.4. Donor coordination and policy dialogue

In addition to the EU, which is the main donor in education, other donors involved in the sector are UNICEF, GIZ, British Council, the Swiss Economic Cooperation Office (SECO) and UNDP. In vocational education and training (VET), it is mainly GIZ, the British Council, SECO, Norway and the European Training Foundation. These EU+ partners also work together in EU+ Joint Programming in VET through cooperating more closely together,

including the development of a joint analysis to be finalised in 2018 and increasingly speaking with one voice with the authorities. The Ministry has started in 2016 to more actively coordinate donors in the education sector.

In addition, UNICEF and UNDP jointly organise bi-annual donor coordination meetings for the broader social sectors, including education, health and social protection.

On migration management, three donor coordination mechanisms already exist at country level: donor coordination on good governance and rule of law, on social issues, and an interagency working group on combating trafficking. The EU together with UN agencies, Member States, USAID and other local donors is engaged in these processes.

Multilateral / regional actions under EU4Youth and EU4Innovation as well as EU programmes Horizon2020 and Erasmus+ provide complementary support promoting people-to-people contacts and cooperation in research and innovation.

3.4.5. Azerbaijan's **financial and policy commitments**

Specific objectives under this priority are in line with the government of Azerbaijan policy, including notably the Strategic Roadmaps on Vocational Education and Training as well as the government's education strategy and action plan. In the field of migration, the country has signed the Visa Facilitation and Readmission Agreements with the EU and is implementing a National Action Plan to Combat Human Trafficking (2014-2018).

3.4.6. When needed, the appropriate type of **environmental assessment** (SEA or EIA) will be carried out according to EU standards as part of annual programming of financing actions under this priority sector.

3.4.7. The overall **risk assessment** of the sector intervention is:

The main risk to achieving the objectives is the lack of government commitment to undertake the necessary reforms, especially regarding the future potential visa liberalisation dialogue which is likely to include document security, irregular migration, public order and security (e.g. anti-corruption, money laundering, international legal cooperation and data protection) and fundamental rights. Mitigation of these risks can include enhanced policy dialogue and close coordination (in the case of VET) with EU+ partners and other stakeholders involved in this sector.

4. **Complementary support for capacity development/institution building and strategic communication**

Capacity development and institution building measures will be integrated into sector reforms where necessary. In addition to sector-related assistance, this complementary provision for capacity development and institution building activities will address the implementation of priority commitments deriving from EU agreements or emerging challenges including, but not limited to, those covered under the four priority sectors.

Capacity development and institution building activities – either through sector-related assistance or from this complementary provision – may also address participation in EU programmes and in the work of EU agencies.

5. Measures in favour of civil society

Additional measures to support civil society, including but not limited to the four priority sectors, will be made available under this complementary envelope, geared towards strengthening the role of civil society in policy processes, accountability systems, and sustainable socio-economic development. This can include measures aiming to strengthen the CSOs' and social partners' overall organisational capacity and skills, to improve CSOs' financial sustainability through diversification of funds and capacity building, to promote purposeful and effective interaction between CSOs and other stakeholders, including reach out to their constituencies, and networking, and to improve CSOs' performance in terms of service provision, engagement with beneficiaries, and promotion of civic engagement.

Attachments

1. Sector of intervention framework and performance indicators (see template in annex)
2. Indicative timetable for commitment of funds (see template in annex)

Attachment 1. Sector of intervention framework

Sector 1: Economic development and market opportunities

Specific objective 1: to promote non-oil sector development, including through enhancing compliance with international/WTO standards, trade facilitation, SME development, support to the digital, green and circular economy and improvement of the competitiveness of the agricultural and agri-business sector

<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Increased non-oil trade, increased integration of Azerbaijan non-oil trade in regional and international markets, further development of the digital economy	<p>1) Non-oil trade as percentage of total exports (baseline 2016: 12.6%)</p> <p>2) Volume of non-oil exported goods (baseline 2016: USD 1.15 billion)</p> <p>3) Percentage and amount of trade with neighbouring countries (baseline 2016: 27.8 %, USD 4.9 billion)</p> <p>4) Percentage of trade with the EU (baseline 2016: 48.6%)</p> <p>5) Share of Information and Communications Technology (ICT) sector in GDP (baseline 2015: 1.8%)</p> <p>6) Trade balance for agri-food products (baseline 2017: - EUR 862 million)</p>	<p>State Statistics Committee</p> <p>EUROSTAT</p> <p>Ministry of Transport, Communications and High Technologies reports</p> <p>EU4Digital reports</p> <p>State Statistics Committee</p>
b) Increased competitiveness and export performance of SMEs	<p>1) Percentage of SME contribution to GDP (baseline 2015: 4%)</p> <p>2) Percentage of SMEs exporting directly or indirectly (baseline 2014: 4.1%)</p>	<p>State Statistics Committee</p>

	3) SME Policy Index: i) enhanced regulatory framework for SMEs, ii) support services to SMEs, and iii) access to finance, iv) internationalisation of SMEs (baseline 2015: i) 2.47, ii) 2.98, iii) 2.7, iv) 2.5	EaP SME Policy Index
<p>Specific objective 2: to improve the enabling environment for business development, innovation, investment promotion and employment generation across economic regions of Azerbaijan, especially for the country's rural youth and women</p>		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Improved business environment and investment climate	1) WB Doing Business ranking (baseline 2017: 65 out of 190) 2) EU Azerbaijan Business Climate Report (baseline: 2017)	WB Doing Business Report EU Business Climate Report on Azerbaijan
b) Increased employment in the regions	1) Share of regions in created new job places (baseline 2015: 60%) 2) Percentage of entrepreneurs being woman outside of Baku (baseline 2016: 18.5%)	State Statistics Committee Ministry of Economy reports
<p>Specific objective 3: to enhance institutional capacity & efficiency in rural and regional development, and improve rural livelihoods and the quality of life in Azerbaijan's rural areas, in particular in the pilot region(s) to be selected for this purpose</p>		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) More balanced and inclusive economic development in the regions and decreased regional disparities	1) Disparity ratio between the capital and regions on output production per capita in the non-oil sector (baseline 2015: 3.6) ⁷	State Statistics Committee

⁷ Output production per capita in Baku : output production per capita in non-Absheron regions = disparity ratio (10300 AZN : 2900 AZN = 3.6 times)

Specific objective 4: to promote a social protection system according to EU standards.		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) A more efficient and inclusive social protection system	<p>1) Job seekers finding a job through the State Employment Service as a percentage of total unemployed (baseline 2017: 19%)</p> <p>2) Percentage of people with disabilities having employment (baseline 2015: 5%)</p>	State Statistics Committee

Sector 2: Strengthening institutions and good governance

Specific objective 1: to support governance through more effective and accountable justice system and public administration reform at national and local level, including development of statistics to support evidence-based decision making

<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Enhanced independence, effectiveness, predictability and accountability of the justice system and public administration	<p>1) Judicial independence (baseline 2016/17: 3.7)</p> <p>2) Rule of Law (baseline 2015: 31.25 percentile rank)</p> <p>3) Efficiency of legal framework in settling disputes (baseline 2016/17: 4.2)</p> <p>4) Use of Judicial Mediation and Alternative Dispute Resolution (ADR) (baseline 2012: 5397 cases)</p> <p>5) Number of practicing</p>	<p>Global Competitiveness Report</p> <p>World Bank World Wide Governance Indicators Report</p> <p>Global Competitiveness Report</p> <p>Government of Azerbaijan statistics</p> <p>European</p>

	<p>lawyers per 100.000 inhabitants (baseline 2012: 9)</p> <p>6) Caseload first instance courts on civil and economic cases (baseline 2015: 313 892)</p>	<p>Commission for the Efficiency of Justice (CEPEJ)</p> <p>Ministry of Justice data</p>
b) Public administration reform agenda is developed and being implemented addressing key area of the OECD/SIGMA Principles of Public Administration	1) Availability of Public Administration Reform Strategy and its implementation	<p>Government reports</p> <p>SIGMA mission reports</p>
c) Institutional and administrative capacity of public administration institutions strengthened	<p>1) Regulatory Quality (baseline 2016: 43.75 percentile rank)</p> <p>2) Government Effectiveness (baseline 2016: 49.04 percentile rank)</p> <p>3) Number of implemented recommendations from the 2017 Adapted Global Assessment of the National Statistical System of Azerbaijan by Eurostat</p>	<p>World Bank World Wide Governance Indicators</p> <p>Monitoring reports of Eurostat</p>
Specific objective 2: to strengthen measures safeguarding democracy and respect for human rights		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Enhanced protection of human rights and democratic governance	<p>1) Global Gender Gap Index (baseline 2017: 0.676, rank 98 out of 144)</p> <p>2) Number of implemented recommendations from the UN Human Rights Council Universal Peer Review, relevant treaty bodies and special procedures</p> <p>3) Voice and Accountability (baseline 2016: 7.39)</p>	<p>World Economic Forum Report</p> <p>UN/Council of Europe/ OSCE / EU reports</p> <p>World Bank World</p>

	percentile rank)	Wide Governance Indicators Report
Specific objective 3: to enhance resilience to mitigate identified security risks such as lack of cybersecurity, cybercrime, organized crime and terrorism		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Strengthened capacities to address security risks	1) Global cybersecurity index (baseline score 2017: 0.559) 2) Global Terrorism Index (baseline score 2017: 1.153)	International Telecommunication Union Global Cybersecurity Index Institute for Economics & Peace Global Terrorism Index
Specific objective 4: to support the fight against corruption		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Effective systems are in place to fight corruption at all levels	1) Corruption Perception Index (baseline 2016: 30; rank 123 out of 176) 2) Control of Corruption (baseline 2015: 20.19 percentile rank)	Transparency International Report World Bank World Wide Governance Indicators Report
Specific objective 5: to improve efficiency of public expenditures and revenue collection by the Government and to enhance budget scrutiny and transparency		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Strengthened public finance management and improved budget transparency	1) Score of PEFA report (baseline 2014) 2) Open Budget Index (baseline 2016: 34)	PEFA report OBI reports
Specific Objective 6: to promote an enabling environment for independent media and civil society engagement, including for social partners' organisations, in societal development and policy dialogue.		

<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Strengthened capacities and engagement of independent media and civil society	1) Score on USAID CSO sustainability index (baseline 2016: 5.9)	CSO sustainability report

Sector 3: Connectivity, energy efficiency, environment and climate change

Specific objective 1: to support enhanced connectivity in the energy and transport areas, including through support to enhanced governance of and reforms in the energy and transport sector;

<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Increased connectivity in the energy and transport areas, including through improved and better capacitated institutional structures in the energy and transport sector	1) Prioritized and comprehensive transport infrastructure investment plan approved and implemented by the government	Government Reports
b) Improved road safety	1) Number of fatalities per 100.000 (baseline 2015: 9.1) 2) National Road Safety Plan adopted and implemented by government	State Statistics Committee Government Reports
c) Increased competitiveness of the transport/logistics sector.	1) Share and volume of transit cargo by rail (baseline 2015: 3.9 million tonnes, 23%) 2) Share and volume of transit cargo by port (baseline 2017: 6.9 million tonnes, 83%)	State Statistics Committee

Specific objective 2: to increase energy efficiency, the deployment of the renewable

energy sources and green growth and to contribute to climate change objectives		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Improved energy efficiency	1) Energy intensity of i) industrial sector, ii) agricultural sector and iii) residential sector (baseline 2014: i) 0.9385; ii) 3.09, iii) 59.09	State Statistics Committee
b) Increased share of renewable energy in the country's energy portfolio	1) Share of renewables in total power generation (baseline 2014: 5.9%)	International Energy Agency
c) Enhanced participation in green growth	1) SME Policy Index: SMEs in a green economy indicator (baseline 2016: 1.54)	EaP SME Policy
Specific Objective 3: to support improvements in environmental protection and governance		
a) Enhanced environmental governance and protection; improved resource management.	1) Environmental performance index score (baseline 2014: 55.47)	Environmental Performance Index

Sector 4: Mobility and people-to-people contacts

Specific objective 1: to contribute to the modernisation and quality assurance of the education system including the vocational education and training, taking into consideration the needs and rights of the most disadvantaged groups (including people with disabilities)

<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Enhanced education and training sector, relevant to the needs of the labour market	1) Share of economically active population with formally recognized professional qualifications (baseline 2016: 32.5%) 2) Share of economically active female population with formally recognized	State Statistics Committee

	<p>professional qualifications (baseline 2016: 30.4%)</p> <p>3) Youth unemployment (15-29 years) (baseline 2016: 9.4%)</p> <p>4) Female youth unemployment (15-29 years) (baseline 2016: 11.1%)</p>	
b) Competency-based education standards for all defined occupations of strategic economic sectors are aligned with occupational standards and in use	1) Number of Education (Qualification) Standards (baseline 2017: 63)	Ministry of Education
c) Curricula and teaching/training materials are developed, piloted and implemented	1) Number of learning outcome-based curricula and modular training materials (baseline 2017: 67)	Ministry of Education
<p>Specific objective 2: to promote a holistic approach, strengthened capacities and coordination among the institutions dealing with migration governance, in particular through the full implementation and smooth functioning of the Visa Facilitation and Readmission Agreements and future potential visa liberalisation dialogue and to foster the effective implementation of the Mobility Partnership</p>		
<u>Expected Results</u>	<u>Indicators</u>	<u>Means of verification</u>
a) Improved migration management connected to Integrated Border Management system in place	<p>1) Regional trade flows (baseline 2016: USD 4.9 billion)</p> <p>2) Share of EU businesses doing business in Azerbaijan that are satisfied with Azerbaijan's migration policies (baseline 2018: 37%)</p>	<p>Data from the State Migration Service</p> <p>EU Business Climate Report on Azerbaijan</p>
b) Increased cooperation between the EU and Azerbaijan with regard to future potential visa liberalisation dialogue.	<p>1) Action Plan for Visa Liberalisation granted for Azerbaijan</p> <p>2) Number of Visa Liberalisation criteria met</p>	EU-Azerbaijan Visa Facilitation and Re-admission Meeting Reports

Attachment 2. Indicative timetable for commitments

SECTOR OF INTERVENTION	Indicative allocation in MEUR			
	2018	2019	2020	Total
Economic development and market opportunities		X	X	
Strengthening institutions and good governance		X		
Connectivity, energy efficiency, environment and climate change		X		
Mobility and people-to-people	X	X		
Complementary support for capacity development and institution building		X		
Complementary support in favour of civil society			X	
Total Commitments				