



Azerbaijan Country Strategy

2019-2024

as approved by the Board of Directors on 25 April 2019



European Bank
for Reconstruction and Development

Table of Contents and Glossary



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Table of Content		Glossary of Key Terms		ICA	Industry, Commerce & Agribusiness
Executive Summary	3	ABI	Annual Business Investment	ICT	Information and Communication Technologies
Azerbaijan – EBRD Snapshot	4	ASB	Advisory Small Business	IFI	International Financial Institution
I. Implementation of Previous Strategy – 2014-2017	5	AZAFF	Azerbaijan Agricultural Finance Facility	IFRS	International Financial Reporting Standards
Key Transition Results Achieved during Previous Strategy Period	5	BEEPS	Business Environment and Enterprise Performance Survey	IPO	Initial Public Offering
Challenges to Implementation and Key Lessons	7	CEEP	Caucasus Energy Efficiency Programme	IPPF	Infrastructure Project Preparation Facility
II. Economic Context	8	CBAR	Central Bank of Azerbaijan	IsDB	Islamic Development Bank
Macroeconomic Context and Outlook for Strategy Period	8	CoOs	Countries of Operation	LCY	Local Currency
Key Transition Challenges	9	COP21	2015 United Nations Climate Change Conference	M&A	Mergers and Acquisitions
III. Government Priorities and Stakeholder Engagement	11	E&S	Environmental and Social	M&S	Manufacturing & Services
IV. Defining EBRD's Azerbaijan Country Strategy Priorities	12	EBRD	European Bank for Reconstruction and Development	Manat	Local Currency in Azerbaijan
V. Activities and Results Framework	13	ECM	Equity Capital Markets	MSME	Micro, Small and Medium Enterprise
VI. Mapping of International Partners' Complementarity in EBRD Business Areas	16	EE	Energy Efficiency	NDC	Nationally Determined Contribution
VII. Implementation Risks and Environmental and Social Implications	17	E5P	Eastern Europe Energy Efficiency and Environmental Partnership	NPL	Non-Performing Loans
VIII. Donor Co-Financing Assessment	18	EIB	European Investment Bank	OSCE	Organization for Security and Co-operation in Europe
Annex 1 – Political Assessment	20	ETI	Expected Transition Impact	ODIHR	Office for Democratic Institutions and Human Rights
		EU	European Union	PPP	Private-Public Partnership
		FDI	Foreign Direct Investment	PFI	Private Financial Institution
		FI	Financial Institution	PR2	Performance Requirements under Environmental and Social Policy
		FIMSA	Financial Markets Supervisory Authority	PTI	Portfolio Transition Impact
		FINTECC	Finance and Technology Transfer Centre for Climate Change	RE	Resource Efficiency
		GEFF	Green Economy Financing Facility	RSF	Risk Sharing Facility
		GET	Green Economy Transition	SGC	Southern Gas Corridor
		GHG	Greenhouse Gas	SME	Small and Medium Enterprise
		H&S	Health & Safety	SOB	State-Owned Bank
		IBA	International Bank of Azerbaijan	SOE	State-Owned Enterprise
				SOFAZ	State Oil Fund of Azerbaijan
				TC	Technical Cooperation

Azerbaijan's commitment to and application of the political principles as stated in Article 1 of the Agreement Establishing the Bank has, over the previous Country Strategy period, and in particular during 2014-2015, been marked by international concerns. Several positive steps were recently taken by the authorities, and cooperation with relevant international organisations has generally increased.

Relevant international organisations have been expressing concerns related to safeguarding checks and balances in the political system, strengthening democracy and the rule of law, ensuring respect for human rights and fundamental freedoms, as well as enabling an environment for civil society to operate in. Progress in these areas remain crucial for the development of an independent, stable and prosperous Azerbaijan. As a member of the United Nations, OSCE and the Council of Europe, Azerbaijan undertook to honour the ensuing international commitments. By launching negotiations on a new comprehensive agreement in February 2017, the EU and Azerbaijan re-affirmed their commitment to an ambitious and comprehensive agenda of cooperation and dialogue, including the above-mentioned areas of concern.

Azerbaijan's rapid economic growth between 2005 and 2014, on the back of favourable commodity prices did not translate into a change of the country's underlying economic structure, whose weaknesses were exposed by the end of the commodity super cycle. With the ensuing 2014-2015 banking crisis and economic recession afflicting much of the Bank's engagement under the previous Country Strategy a new momentum for economic reform has, however, opened avenues for closer cooperation with authorities in key sectors of the economy. Urgent reforms are most needed in spurring economic diversification beyond a small-scale agriculture and services sector and creating employment opportunities for under-served segments of the population. Transition challenges are particularly acute in **competitiveness** and **governance** (with an economy characterised by a low productive non-oil private sector, a large informal sector and state prevalence in key sectors of the economy), **resilience** (with a fragile banking sector and shallow financial markets), and **green** economy (with high energy intensity, low utilisation of renewable energy, and a lack of access to quality water and waste water services, especially in rural areas).

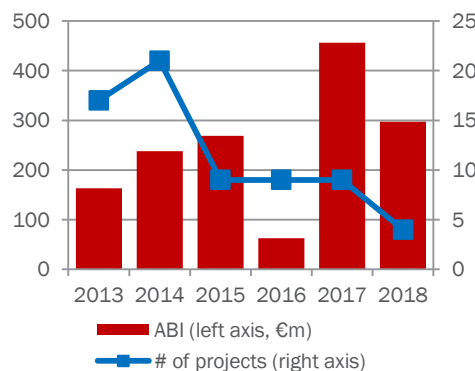
Given the ongoing fragilities in the economic system, the Bank will deepen its efforts to put the financial sector on a solid footing and restore lending activity. The Bank will equally continue its support for economic diversification through a two-pronged approach: supporting private sector development and strengthening governance in the public and private sectors while equally stepping up its support for the country's Green Economy Transition. Against this backdrop, key policy enablers will be continued efforts to reform the energy market and to create a level playing field for doing business. In addition, continued good relations with the EU as well as donor support in the form of technical assistance and grants (e.g. for energy efficiency) will be critical for the Bank to deliver on the following strategic priorities in Azerbaijan in 2019-2024:

- Promote Economic Diversification by Supporting **Competitiveness** and Good **Governance**;
- Strengthen **Resilience** by Developing Financial Markets;
- Support **Green** Economy Transition and Regional Connectivity.

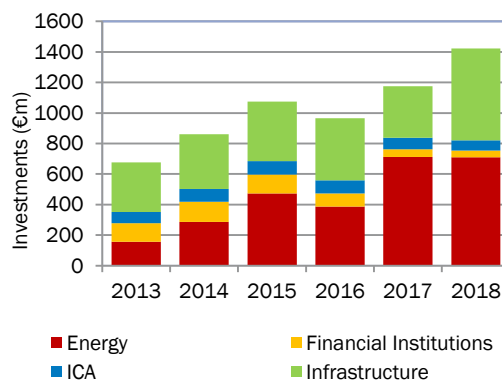
EBRD Investment Activities in Azerbaijan (end- Dec. 2018)

Portfolio	€1.4bn	Active projects	45
Equity (% , portfolio)	2%	Operating assets	€1027m
Private Share ¹	47%	Net cum. investment	€3.2bn

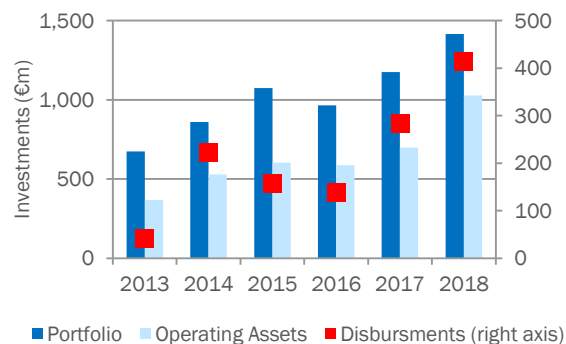
ABI and Operations



Portfolio Composition



Portfolio Dynamics



Transition Gaps²



Azerbaijan Context Figures

Population (m) ³	9.9	2018
GDP per capita (PPP, current international dollars) ⁴	17,955	2018
Global Competitiveness Index (WEF)	69 th Out of 140	2018
Ease of Doing Business (WB)	25 th Out of 190	2019
Corruption Perception Index (Transparency International)	152 nd Out of 180	2018
Youth unemployment (% , ILO est.) ⁵ <i>For comparison: Belarus (1.1%), Georgia (28.4%), Ukraine (22.4%)</i>	14.0%	2018
Female labour participation (% , ILO est.) ⁵ <i>For comparison: Belarus (58.2%), Georgia (58.0%), Ukraine (46.6%)</i>	62.8%	2018
Energy intensity, TPES/GDP (toe/thousand 2010 USD) ⁶ <i>For comparison: Belarus (0.42), Georgia (0.32), Ukraine (0.76)</i>	0.25	2016
Emission intensity, CO2/GDP (kgCO2/GDP in 2010\$) ⁶ <i>For comparison: Belarus (0.9), Georgia (0.58), Ukraine (2.0)</i>	0.55	2016

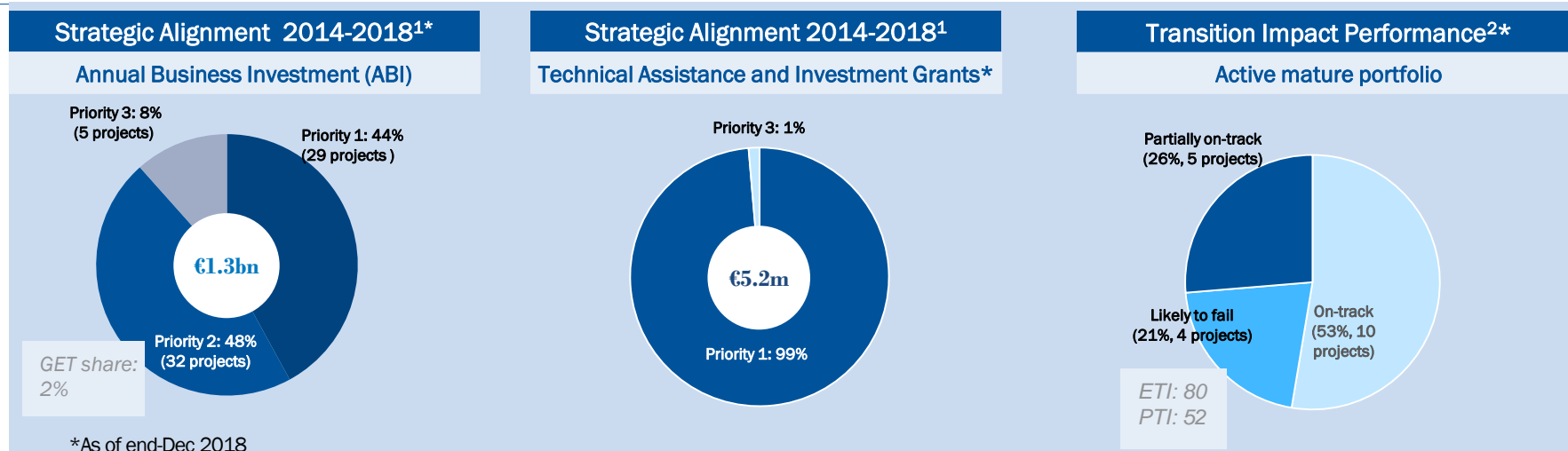
¹ 5-year rolling portfolio ratio ² Cf. EBRD Transition Report 2018-2019 ³ National statistical authorities ⁴ IMF WEO (Oct 2018), forecast ⁵ World Bank WDI ⁶ IEA

1. Implementation of Previous Strategy (2014-2018)



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1.1. Key Transition Results Achieved during Previous Strategy Period



Priority 1: Promoting market-driven diversification



1. Strategic priorities 2014-2017: 1) Promoting market-driven diversification; 2) Developing a sustainable financial sector to support private sector development; 3) Improving governance and the business environment
 2. Transition impact performance reflects how likely projects are to achieve the transition impact that was expected of them at signing. Calculated based on active mature portfolio (older than two years).

1. Implementation of Previous Strategy (2014-2018)



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1.1. Key Transition Results Achieved during Previous Strategy Period

Priority 2: Developing a sustainable financial sector to support private sector development

Key Transition Results

- **Supported financial intermediation to ensure efficient financing of the private sector:** Concluded 14 transactions for aggregate ABI of €41m with non-banking-FI and FI clients that enabled institutional development of financial intermediaries and ensured greater access to financing for MSMEs.
- **In 2014 started expanding product portfolio and enhanced lending methodologies of financial intermediaries; progress stalled as a result of the financial crisis.** Mugan Bank, a new client under the risk sharing facility RSF (former MCFF) programme was introduced in September 2014. The new Azerbaijani Agricultural Finance Facility (AZAFF) was agreed in April 2015 with active participation of the Ministry of Agriculture, EU and other donors and relevant organisations (but no PFIs active yet due to crisis 2015-2017).
- **Provided local currency lending for MSMEs that are most vulnerable to FX fluctuations (both via financial intermediaries and directly):** Supported FI sector in developing private sector MSMEs, particularly in underserved regions of Azerbaijan, by providing a €6m equivalent loan in LCY to FINCA Azerbaijan. Furthermore, LCY for the SME programme was adopted in 2017 to allow for tailored LCY financing for SME development (donor supported facility under First Loss Risk Cover of 12.5% at the portfolio level). Since its deployment, the Bank financed three transactions (Metak, Khalig Faigoluglu and Baku Electronics) under this programme.
- **Supported financial sector clients in the context of drastic Manat devaluation (see slide 8):** Arranged conversion of outstanding debts into LCY for three FI clients (Demir Bank, UniBank and Access Bank) in view of a deteriorating economic environment (devaluation, high dollarisation, and economic recession).
- **Participated in recapitalisation efforts and creating a solid regulatory environment:** Provided technical assistance to the investee banks to adapt to a new environment, incl. through supporting capitalisation (UniBank and Access Bank); agreed on course of action with the newly established financial regulator (FiMSA).
- **Launched policy engagement to advance local capital markets and non-bank financial sector development:** Produced a money market analysis for the authorities (FiMSA and CBAR) on LCY Money Markets. Ongoing efforts to develop institutional and legal framework for issuance of Manat-denominated bonds in the local market.

Priority 3: Improving governance and the business environment

Key Transition Results

- **Promoted IFRS reporting across EBRD projects, improving access to finance for client companies:** Promoted strengthened transparency across all EBRD projects by introducing IFRS accounting and improving financial management standards, incl. directly via AIP in ICA, FI clients and ASB MSME.
- **Engaged with SOEs and other government agencies on corporate governance:** Continued efforts in enhancing corporate governance, including *inter alia* within the scopes of \$500m TANAP project via a Compliance Action Plan at Borrower/SGC; \$330m Azerbaijan Road Agency via institutional strengthening, incl. a pilot performance-based maintenance contract (PBMC); initiated the pre-privatisation corporate governance enhancement programme of the International Bank of Azerbaijan (IBA); completed TC on improving corporate governance of SOEs overseen by the State Property Commission.
- **Supported improvements in the business environment and promoted a level playing field:** Ongoing discussions to establish the Azerbaijan TC Fund with the Ministry of Economy to support economic diversification (non-oil private sector development). Signed MOU with Ministry of Energy and deployed donor funded TCs to i) support establishment of an independent energy regulator; ii) enable renewable energy development.

1. Implementation of Previous Strategy (2014-2018)



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1.2. Challenges to Implementation and Key Lessons

Context for implementation: The Bank's efforts to promote market-driven economic diversification, develop a sustainable financial sector, and improve governance took place within a challenging operating environment as a result of significant devaluation, high NPL levels of partner banks, and economic recession. Amidst the country's banking crisis, the Bank's priority to develop a sustainable financial sector re-focused on mitigating short-term financial sector vulnerabilities (debt conversion, recapitalisation efforts, support to restructure financial regulation). The economic recession also led to a restructuring of the Bank's portfolio, which slowed down private sector lending compared to previously anticipated benchmarks. The regulatory environment proved challenging (e.g. grant registration issues in 2014) but the crisis also sparked reform momentum, opening avenues for closer cooperation with authorities in key sectors of the economy.

Implementation Challenges

- High level of state engagement in the economy limits opportunities to advance a competitive domestic market.
- A weak banking sector undergoing restructuring since 2015 has confined access to finance for non-oil private sector.
- Lack of bankable and scalable opportunities in the corporate and SME sectors as result of high concentration of private sector activity in low-productive and fragmented agriculture and service sector activities.
- Rapid pre-crisis credit growth and high levels of foreign-currency denominated lending served as key transmission channel of banking crisis to private sector activities.
- Persistent corporate governance challenges and high levels of informality in the economy hamper private sector productivity.
- Weak business environment deterring FDI entry and retention in the country.

Key Lessons & Way Forward

- Continued advocacy and support for private sector participation and SOE commercialisation; success of the Bank's support to IBA likely to determine avenues for further (pre-)privatisation efforts (e.g. in energy sector).
- Continuous advocacy and support for banking sector reforms in conjunction with investments in restructuring of systematically important banks and expanding the universe of partner financial institutions (PFIs).
- Leverage potential co-investment grants and TCs to selectively improve competitiveness of EBRD lending products, such as SME advisory to improve corporate governance and operating standards as well continuing targeted credit lines (e.g. SMEs and underserved segments, such as women and regions).
- Provision of LCY lending, particularly to SMEs; diversify financing channels by developing capital markets, and the money market specifically.
- Continue promoting corporate governance and an improved business environment at the project level and through high-level policy advocacy. Potential high-visibility projects (such as EBRD's corporate governance support of IBA and selected SOEs) can produce a significant demonstration effect.
- Help identify and support targeted measures to improve the country's business environment (incl. through enhanced dialogue between the public and private sectors); advocate for and support changes in the regulatory and legal framework for opening up selected sectors to foreign participation coupled with financing of select FDI.

2. Economic Context

2.1 . Macroeconomic Context and Outlook for Strategy Period



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Azerbaijan - Main macroeconomic indicators

	2015	2016	2017	2018
GDP growth (% y-o-y)	1.1	-3.1	0.1	1.4
CPI inflation (% avg.)	4.0	12.4	12.9	2.3
Government balance ¹ (% of GDP)	-4.8	-1.2	-1.7	4.8
Current account balance (% of GDP)	-0.4	-3.6	4.1	12.9
Net FDI (% of GDP) [neg. sign=inflows]	-1.5	-5.1	-0.7	1.7
External debt ² (% of GDP)	19.8	20.3	22.7	19.0
Total investment (% of GDP)	29.3	26.1	24.9	n.a.
General government gross debt ¹ (% of GDP)	35.0	50.7	54.1	48.4
Private sector credit (% of GDP)	40.0	27.2	16.8	16.3
Unemployment (%)	5.0	5.0	5.0	n.a.
Nominal GDP (USD bn)	53.0	37.8	40.8	46.9

Notes: ¹Includes central government: state budget and main extra-budgetary funds, including operations of the oil fund and the social protection fund. Figures for 2016 and 2017 are a projection. As reported by the IMF (WEO October 2018).

² Public and publicly guaranteed external debt outstanding.

³ Forecast from EBRD REP November 2018.

- **Azerbaijan was one of the fastest growing economies globally due to abundance of natural resources.** Between 1995 and 2015, real GDP increased approximately 6 times. GDP per capita in nominal terms increased from \$310 in 1995 to \$7,991 in 2014, before going down to \$4,780 in 2018 due to a major devaluation of manat. At the same time, rapid expansion of the oil and gas sector led to crowding out of other externally oriented industries and to a low diversification of the economy. In 2018, the share of oil in total GDP stood at 39.8% and the resource sector accounted for approximately 91.7% of exports.
- **A steep oil price decline in the second half of 2015 led to economic recession of the magnitude unseen in the recent past.** In 2016, GDP declined by 3.1% with non-oil GDP shrinking by 4.4%. Economic growth was nearly flat in 2017, helped by the recovery in non-oil GDP. In 2018, GDP grew by 1.4%. Near-term growth prospects are supported by a relatively stable oil price trend and ongoing expansion of gas production and export capacity. Recent moderate diversification gains augur well for medium-term economic growth but much more needs to be done to bolster the role of the non-oil economy. EBRD forecasts (Regional Economic Prospects, November 2018) the economy to expand by 3.5% in 2019.
- **After almost two decades of exchange rate stability, Azerbaijan devalued its currency by 50% in 2015.** Manat stabilised in 2017 amid stringent monetary conditions and a recovery in the oil price. More recently, manat flexibility has been called into question again because of a very narrow fluctuations band since April 2017. The devaluation led to balance sheet and asset quality concerns in the banking sector and to pressure on deposits. In 2018, loan portfolio contraction levelled-off and dollarization levels somewhat declined. Inflation fell from an average of 12.9% in 2017 to 2.3% in 2018 on the back of exchange rate stabilisation and generally tight monetary conditions.
- **Azerbaijan has maintained sizeable liquidity buffers.** As of end-2018, the combined assets of the State Oil Fund of Azerbaijan (SOFAZ) and of the foreign exchange reserves of the central bank stood at \$44.1bn, which is approximately equivalent to the country's GDP.
- **The oil price decline and manat devaluation exposed long-standing structural weaknesses that arise from the economy's reliance on the resource sector.** To stimulate development of the non-oil sector and mitigate the impact of the low oil price, the authorities undertook significant reforms in customs management, streamlined issuance of licenses and permits, simplified visa procedures, introduced moratorium on inspections until January 2021, set up new agencies to support the non-oil private sector, and initiated restructuring of the banking sector. Despite steps taken by the authorities to improve public services, institutional strength, transparency and governance standards require further improvement.

2. Economic Context

2.2 . Key Transition Challenges¹



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Competitive (3.7 out of 10)

- Difficult **business environment** deters entry of new firms and expansion of existing businesses, although steps have been taken to improve the regulatory framework.
- **Competition** is limited by regulatory and logistical barriers faced by exporting and importing companies.
- High **barriers to entry** contribute to excessive concentration in some industries.
- Non-oil sector **productivity** growth is constrained by low inflows of foreign investment and paucity of investment in human capital and R&D.
- **Export** complexity and diversification is low.
- **Labour market** challenges include high degree of labour informality, skills mismatches and weak system of vocational education.
- Underdeveloped financial sector limits **access to finance** for businesses in the non-oil sector, particularly for SMEs.
- **Innovation** is hindered by ineffective collaboration between universities and businesses as well as lack of requisite skills.

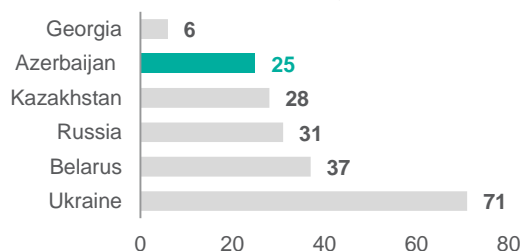
Well-governed (5.8 out of 10)

- **Public governance** is lacking accountable and effective institutions, transparent policy-making and effective institutional capacity to support policy implementation.
- Limited effectiveness of courts and lack of effective enforcement mechanisms pose **rule of law** challenges. Unreformed **tax administration** leads to unpredictable taxation.
- **Informality** is one of the major business environment challenges.
- Shortcomings in the structure and functioning of boards, in transparency and disclosure standards, and in internal controls weaken **corporate governance**.
- Low **corruption** perception rankings undermine investors' confidence.

Green (5.2 out of 10)

- **Renewable energy** utilization is low, with untapped potential from wind, solar and small hydro sources.
- **Policy and legislative framework** to support renewables development is missing.
- Energy usage is high in residential/commercial buildings and in the transport sector, leaving significant room for **energy efficiency** (EE) improvements.
- **Energy** generation, distribution and transmission systems require modernization to achieve EE targets and reduce fugitive GHG emissions.
- Rural areas, secondary and tertiary towns are **underserved** in terms of water treatment and solid waste management.
- Air and sea **pollution** poses a considerable challenge.

Ease of Doing Business
Rank out of 190, 2019



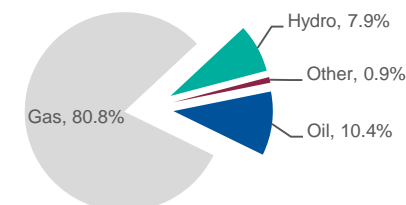
Source: World Bank Ease of Doing Business

Worldwide Governance Indicators
2017



Source: World Bank Worldwide Governance Indicators

Electricity Generation (GWh)
2016



Source: International Energy Agency

1. See EBRD Country Diagnostic for more details. Provisional transition scores measured on a 1-10 scale, where 10 represents the frontier – subject to change as methodology is finalised.

2. Economic Context

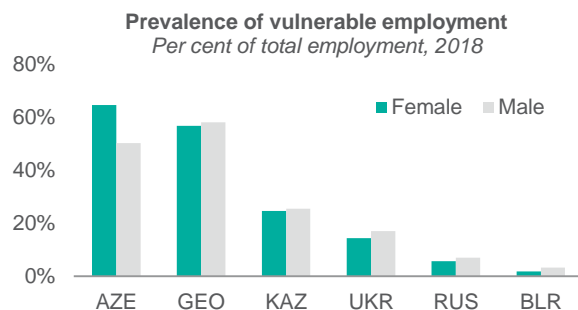
2.2 . Key Transition Challenges



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Inclusive (5.0 out of 10)

- Widespread **vulnerable employment** and **informality** present challenges to inclusive growth.
- Regional disparities in **formal employment** opportunities are large.
- Gender gap** in the labour market is significant: women are affected by lower labour participation rates, higher unemployment, higher vulnerable employment, significant gender pay gap, low representation in high-level occupations, very low likelihood of participation in firm ownership and very low rates of women entrepreneurship.
- Young entrepreneurs** lack access to financial means and trainings to establish their own businesses.
- Education system** does not cater well for the labour market needs with more pronounced skill shortages in higher value-added companies.



Source: World Bank's estimates based on ILO data

Resilient (4.0 out of 10)

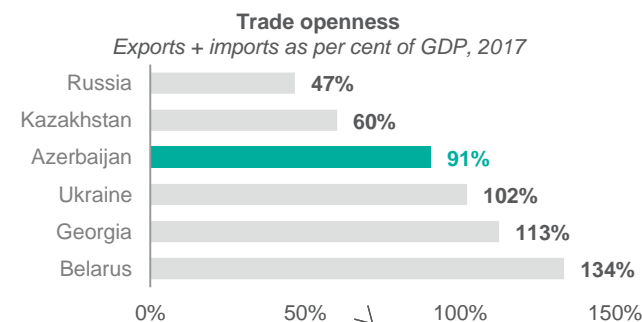
- Banking sector** suffers from weak albeit improving capitalization, high but declining dollarization, as well as high level of NPLs, currency mismatches, and concerns about governance standards.
- Restructuring of the banking system is incomplete and privatization of the systemic **state-owned bank** is key for lowering the state's contingent liabilities.
- Credit penetration** is shallow compared to regional peers.
- Heavy reliance on the **resource sector** exposes the economy to volatility in global oil prices and impedes economic diversification.
- Overwhelming state involvement in the domestic **energy system** fosters inefficiencies.
- Energy **tariffs** are not cost reflective. Capacity of the recently established **energy regulator** needs to be significantly strengthened.



Source: National statistical authorities and central banks

Integrated (6.0 out of 10)

- Openness to **international trade** has improved but is lagging behind some of the peers.
- External **integration** potential is held back by high cost and time required for trading across borders.
- FDI and portfolio **investment** inflows are underperforming.
- Cross-border trade is hindered by poor **logistics** service provision, including in the areas of international shipments, logistics quality and competence, tracking, tracing and timeliness.
- Remaining bottlenecks on the East-West and North-South **transport corridors** need to be addressed.
- Geographical disparities** in basic infrastructure provision are significant.
- Railway sector** is in need of sizable investments.



Source: World Bank World Development Indicators, EBRD calculations

3. Government Priorities and Stakeholder Engagement

3.1. Government Reform Priorities

The Government's **Strategic Road Maps for the National Economy and Key Economic Sectors** outline priorities for the short (by 2020), medium (by 2025) and long-term horizons (beyond 2025). With an overarching goal of rebalancing the economy towards higher value-added non-oil and private-sector driven activities, the strategic objectives include:

- **Macroeconomic stability:** Monetary policy based on floating exchange rates, prudent management of oil-sector revenues, fiscal sustainability, predictable economic policy, optimisation of domestic & foreign financing sources.
- **Productivity-based growth:** Increased private investments, shift to technology-intensive sectors, improved SOE performance and privatizations as a basis for a dynamic market economy.
- **Development of human capital and economic inclusion:** Skills upgrades and equal opportunities in the labour market, provision of high quality health and education to all segments of society, improved welfare through planned urbanisation.
- **Improvements in the business environment:** Judicial reforms and re-enforced rule of law to foster investors' confidence; improved legislation and its implementation; market liberalisation and free competition to attract FDI and encourage expansion.
- **Improved and integrated transport infrastructure:** Leveraging the geographical position to increase exports and decrease transportation costs; adoption of international standards and certifications, development of logistical centres in the regions.
- **Sector road maps** in oil & gas, agribusiness, SME, heavy industry/machinery, tourism, logistics/trade, housing, vocational education, financial services, ICT and utilities further translate these economy-wide goals into specific action plans.

3.2. EBRD Reform Areas Broadly Agreed with Authorities

- Strengthened **non-oil private sector**, including business and operating skills for small businesses.
- Improved **commercialisation of SOEs** and corporate governance improvements.
- Enhanced **financial and economic inclusion of youth, women and lagging regions**, including through SME support, microfinance and innovative technologies.
- Support for development of the **money and capital markets**, including a local currency bond market.
- Improved **energy efficiency and green economy** solutions, including regulatory support for renewables and energy efficiency.

3.3. Key Messages from Civil Society to EBRD

- The Bank's engagement in Azerbaijan should account for political, social and governance risks in a traceable manner.
- More stringent due diligence, additional stakeholder engagement safeguards at the project level recommended.
- Bank's support for economic diversification and SMEs is welcome.
- EBRD should help facilitate meaningful CSO dialogue with the government (e.g. in EITC) and with the private sector.
- Significant challenges for independent CSOs' ability to operate freely reported, concerns about: freedom of expression/association/assembly, about respect for fundamental rights and freedoms and about the restrictive political system.
- Reform needed to strengthen judicial independence and address citizens' limited access to legal representation/aid; concerns about functioning of criminal justice system and disbarment of lawyers.
- Grand corruption and unsatisfactory transparency remain among challenges, mainly for the extractive sector and public procurement

4. Defining Azerbaijan's Country Strategy Priorities

What needs to change? (Section 2)	Can it be changed? (Section 3)	What can the Bank do? (Section 4)	Strategic Priorities (2019-2024)	What We Want to See in 2024
<ul style="list-style-type: none"> • Low economic diversification coupled with low productive fragmented agriculture and services sectors. • Low complexity and diversification of exports. • High barriers of access to finance for the non-oil sector, particularly SMEs. • Lack of business skills and standards in the corporate sector; weak corporate governance. • High levels of informality and regional disparities. • Poor logistics service provision, including in the areas of international shipments, logistics quality, tracking, tracing and timeliness. • SOE dominance in strategic sectors. 	<ul style="list-style-type: none"> • Economic reform momentum to boost private sector growth and diversification (2016 Strategic Economic Roadmaps). • Recovering financial sector provides opportunities to support SME growth. • Agribusiness sector identified by government as a strategic priority for economic inclusion. • Government focus on developing logistical centres in the regions; ongoing developments of the Alat port and Free Trade Zone (FTZ). • Government's plans to prepare select SOEs for privatisation (e.g. IBA) & reform projects in the energy and railways sector. 	<ul style="list-style-type: none"> • TC fund for economic diversification efforts subject to signing by authorities. • Well-tailored products to support SMEs and corporates (credit lines [incl. AZAFF], advisory network, LCY). • Effective instruments to help increase corporate & business skills (WiB, ASB) and track record in strengthening corporate governance. • Established track record in supporting logistics improvement. • Strong track record in supporting SOE commercialisation and/or improved corporate governance as well as PSP (e.g. IPPF). • Extensive experience of railway sector reform across the Bank's region. 	<p>Promote Economic Diversification by Supporting Competitiveness and Good Governance</p>	<ul style="list-style-type: none"> • Enhanced value chains and linkages of the non-oil sector through improved operating standards and business skills and greater integration in regional value chains • Increased access to finance and entrepreneurship for underserved segments • Increased competition and levelled playing field for doing business and private sector participation
<ul style="list-style-type: none"> • Fragile banking sector (weak sector capitalization & corporate governance, high levels of foreign currency lending and NPLs). • Significant albeit decreasing state dominance in the banking sector with weak governance. • Shallow financial system characterised by a lack of different modes of access to finance. 	<ul style="list-style-type: none"> • Financial sector reform as key government priority. • Restructuring and privatization of International Bank of Azerbaijan (IBA) singled out as a priority by authorities. • Azerbaijan recently joined the SME Local Currency Framework. • Slow albeit steady recovery of the banking sector open up opportunities to revive intermediary lending and TFP. 	<ul style="list-style-type: none"> • Sizable experience in supporting banking sector consolidation and restructuring. • Expertise in improving corporate governance in the banking sector. • Strong track record in capital markets development. • Wide range of dedicated products to encourage lending to underserved segments. 	<p>Strengthen Resilience by Developing Financial Markets</p>	<ul style="list-style-type: none"> • Strengthened resilience of financial sector including capitalisation, sustainable funding structure and sound risk management practices of banking sector • Increased variety of non-banking financial products and services
<ul style="list-style-type: none"> • Low levels of energy diversification & renewables share in energy mix (0.4%). • Lack of renewable energy regulation. • Dated energy generation (incl. district heating), distribution and transmission systems. • High energy usage in residential /commercial buildings and in the transport sector. • Significant state involvement in the domestic energy system. • Insufficient lack of access to clean water and solid waste disposals, especially in rural areas. 	<ul style="list-style-type: none"> • Government commitment to deliver on NDCs under COP21. • Renewable energy regulatory framework being developed. • Opportunities to generate competitively priced RE from wind, solar and hydro. • Significant EE potential in residential and commercial buildings. • National solid waste strategy being adopted. • Increased MEI opportunities, especially in Baku and secondary cities. 	<ul style="list-style-type: none"> • EBRD's expertise in championing innovative green technologies (FINTECC). • Experience in supporting regulatory and institutional framework for (renewable) energy. • Dedicated products to finance GET (e.g. through tailored credit lines, Green Cities framework). • EBRD can fund energy connectivity, including networks. • Considerable experience in MEI with explicit environmental and resource-efficiency objectives coupled with opportunity to access E5P. 	<p>Support Green Economy Transition and Regional Connectivity</p>	<ul style="list-style-type: none"> • Increased renewable energy capacity, more diversified energy mix, and greater private sector participation in the energy sector • Increased energy efficiency and connectivity, and resource efficiency • Reduced carbon emissions through greener transport and municipal infrastructure

5. Activities and Results Framework

Priority 1: Promote Economic Diversification by Supporting Competitiveness and Good Governance

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Enhanced value chains and linkages of the non-oil sector through improved operating standards and business skills and greater integration in regional value chains	<ul style="list-style-type: none"> • Provide direct and indirect financing and advisory to corporates and SMEs with a focus on agribusiness, manufacturing & services, property and tourism, power and transport as well as improvements in operating standards for SMEs. • Support domestic companies in adopting innovative practices and technologies and expansion through direct financing and targeted long-term advisory (e.g. Blue Ribbon), including for companies in the Free Trade Zone. • Finance FDI and domestic anchor investors, with a focus on regional value chains, including women-owned businesses. • Support development of new capacity in the port and logistics sectors, including investment in intermodal solutions. • Scale up the Trade Finance Programme. 	<ul style="list-style-type: none"> • Number/volume of SME sub-loans provided by PFIs • Number of ASB clients reporting increased turnover
Increased access to finance and entrepreneurship for underserved segments of society	<ul style="list-style-type: none"> • Roll out the “Women in Business” programme (access to finance, business advisory services, training, networking and mentoring for women-led SMEs). • Develop skill-enhancing solutions together with corporate clients (focus on agribusiness, M&S tourism sectors) targeting improved employability and skills (including business skills). • Explore sustainability of the microfinance sector as well as business opportunities with local microfinance operators. 	<ul style="list-style-type: none"> • Number of women-led businesses accessing finance and/or advisory services
Increased competition and levelled playing field for doing business and private sector participation	<ul style="list-style-type: none"> • Support SOE commercialisation (financial, operational and corporate governance improvements), through policy advice and investments with a focus on the energy (electricity), banking, transport and municipal sector. • Promote private sector participation (e.g. through PPP, concessions), with a focus on infrastructure and infrastructure services in the transport, municipal and energy sectors, incl. via IPPF fund. • Facilitate privatisations, including through pre-privatisation investments and corporate governance improvements (e.g. energy and banking sector). • Promote energy market reform, including establishment and capacity building for an independent energy regulator. 	<ul style="list-style-type: none"> • Number of clients implementing commercialisation/re-structuring

5. Activities and Results Framework

Priority 2: Strengthen Resilience by Developing Financial Markets

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Strengthened resilience of the financial sector including capitalisation, sustainable funding structure and sound risk management practices of banking sector	<ul style="list-style-type: none"> Advocate restructuring and improved corporate governance of International Bank of Azerbaijan, including potential (pre-)privatisation financing and/or equity. Support banking sector consolidation through assisting restructuring of bank balance sheets and potential participation in merger and acquisitions if opportunities arise. Provide dedicated credit lines and risk-sharing frameworks to partner banks to encourage lending to underserved segments and areas (e.g. with special focus on women, energy efficiency, small-scale agribusiness), complemented by assistance focusing on risk management and corporate governance. Assist in the development and deployment of an agriculture credit scoring tool for financial institutions. 	<ul style="list-style-type: none"> Improvement in financial performance ratio of partner financial institutions Number/volume of sub-loans provided by PFIs to underserved segments
Increased variety of non-banking financial products and services	<ul style="list-style-type: none"> Explore investments in short-term corporate bonds, selected equity (directly & through PE funds) with focus on agribusiness and M&S, and when appropriate facilitate IPOs of EBRD investees and/or corporate bond issuance of EBRD clients. Support development of an active and effective money market. Support improvements in the regulatory environment for local currency financing (incl. bond issuance) and hedging instruments. Subject to recovery of local financial institutions and markets, in the longer-term consider selective engagement in products/segments such as factoring, leasing and insurance. 	<ul style="list-style-type: none"> Expanded number of new financial market products/services launched Legal / Regulatory/ Institutional frameworks to promote IFI bond issuance, improved money market liquidity and derivative product development

5. Activities and Results Framework

Priority 3: Support Green Economy Transition and Regional Connectivity

Key Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Increased renewable energy capacity, more diversified energy mix, and greater private sector participation in the energy sector	<ul style="list-style-type: none"> Provide direct and intermediated financing of renewable energy projects (wind, solar, hydro, and biomass), and support their integration into the grid. Explore investments in sustainable investment projects targeting reduction of GHG emissions, incl. gas flaring reductions as well as other green technology investments, and improvement of local environmental and health and safety standards and practices. Support the development of the renewable energy regulatory framework to attract private sector finance and investment into the RE sector. 	<ul style="list-style-type: none"> Total renewable electricity installed (MW) Improved legal / regulatory framework for an independent energy regulator based on the key principles of the EU 3rd Energy Package
Increased energy efficiency and connectivity, and resource efficiency	<ul style="list-style-type: none"> Provide energy and resource efficiency credit lines through partner banks with focus on SMEs as well as the commercial and residential sectors. Develop and finance supply-side resource efficiency investments (e.g. modernisation of gas-fired generation capacity, cleaner and more efficient technologies in the extractive value chain). Support network upgrade including through smart metering / smart grid systems, regional interconnection and storage capacity. Support enhanced energy connectivity, power network reliability and international corridors. Support development of the solid waste sector across the waste management cycle, including collection, recycling, and waste-to-energy solutions, and explore financing of regional solid waste projects. Provide support for the regulatory framework for district heating. 	<ul style="list-style-type: none"> Volume of EE or Resource Efficiency loans extended by PFIs supported by EBRD Energy saved (GJ/y) Target infrastructure network extended as measured by increase in network capacity
Reduced carbon emissions through greener transport and municipal infrastructure	<ul style="list-style-type: none"> Support enhanced transport connectivity through financing development of green and integrated transport solutions & services (including urban transport assisting with technological enhancements (e.g. e-logistics platform), green railway and port elements. Promote sustainable municipal investments helping cities to address environmental challenges, including CO2 emissions (e.g. district heating, urban transport, energy efficiency), where relevant under the Green Cities Framework and/or leveraging E5P. 	<ul style="list-style-type: none"> Mobilised and direct financing for supporting environmental issues (e.g. resource efficiency) Total CO2 reduced (ton/y)

6. Mapping of International Partners Complementarity in EBRD Business Areas



European Bank
for Reconstruction and Development

EBRD BUSINESS AREAS																								
		Sectors															Cross-Cutting Themes							
		Corporate				Energy		Infrastructure				Financial					Green Transition			Inclusion				
Indicative average investments/ grants (€m, 2014-2018)		Agribusiness	General Industry	Property & Tourism	ICT	Natural Resources	Electric Power	Water & Wastewater	Urban Transport	Roads	Railways	Banking	Insurance & financial services	MSME Finance	Private Equity	Capital Markets	Water Efficiency	Materials Efficiency	Sustainable Energy	Gender	Youth	Region	Investment climate	
ADB	847					€P	€P	€P		€	€P			€P							€P		€P	
WB	86				€P	€P		€P		€P												€P		
AFD	113*										€													
IsDB	47									€		€P												
BSTD	26.5		€			€						€		€										
EIB	19		€									€		€										
SECO	17.5			€				€P				€		€		P				P		€	P	
EU	15.5	€P	P											P			P		€P	€P	€P	€P	P	
IFC	6											€		€									P	
EBRD	272	€	€	€		€P	€P	€P	€P	€P	€P	€P		€	€	€P	€P		€P	€	€	€	P	

€

Area of significant investments

P

Area of significant policy dialogue

Focus mostly on private sector

Focus mostly on public sector

€ Area of significant investments

P Area of significant policy dialogue

● Focus mostly on private sector

○ Focus mostly on public sector

Areas for Future Cooperation



Competitive:

Partner with the EIB & IFC to co-finance bankable private companies in non-oil sectors; advance investment climate reforms with the EU, SECO, and IFC; Provide large scale infrastructure financing with the ADB & World Bank.



Resilient:

Coordinate MSME on-lending frameworks with the ADB, EIB & IFC; cooperate with the EU to improve access to finance in the agribusiness sector



Green:

Promote energy reforms, facilitate improvement of solid waste systems and co-invest in responsible natural resources projects with the ADB & World Bank

Note: IFI activity mapping based on publicly available information – excluding budget support. Significant IFI investment defined as projects exceeding 5% of investment signed between 2014-2018. *2017 only

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7. Implementation Risks, Environmental and Social Implications

Risks to the Strategy Implementation	Probability	Effect	Environmental and Social Implications
<ul style="list-style-type: none"> Limited scope for the Bank to engage in sovereign-related activities with potential (negative) spill-overs into the Bank's private sector activities. Insufficient political reform progress, transparency and governance challenges could negatively impact investment activities. Commodity price volatility could halt nascent recovery and stall/reverse progress in banking sector consolidation/restructuring. Recovery of the oil price and/or weak administrative capacity could delay reform implementation. Volatile regional security situation could undermine investor confidence. Insufficient progress on addressing banking sector restructuring and lending distortions could slow down EBRD's lending volumes. Insufficient donor co-financing and grant levels could undermine competitiveness of key EBRD products. 	<ul style="list-style-type: none"> High Medium Medium High Medium Medium Low 	<ul style="list-style-type: none"> High High High Medium High Medium Medium 	<ul style="list-style-type: none"> Assessment and Management of Environmental & Social Impacts, Stakeholder Engagement: Ensure that direct, indirect and cumulative impacts of projects are appropriately assessed and mitigated, and work with clients to ensure they have adequate implementation capacity. EBRD will work to improve knowledge and practice of CSR and stakeholder engagement. Labour and Working Conditions: Ensure that clients' HR policies and labour practices comply with EBRD PR2. EBRD will pay particular attention to potential discrimination towards women, minority groups and migrant workers. Retrenchment may be associated with the privatisation of SOEs and will require specific retrenchment planning. Resource Efficiency and Pollution Prevention and Control: Support the development of circular economy and waste management projects, including infrastructure and systems to encourage separation at source and recycling. Health and Safety: Improve occupational and community health and safety culture and practice. Road safety is a priority issue for transport projects and client fleet management and may require TC funds. Land Acquisition, Involuntary Resettlement and Economic Displacement: Legislation is well-aligned with EBRD Performance Requirements. The EBRD will encourage clients to improve consultation and information provision with affected people. Where occupiers have no legal titles, clients will need to ensure compensation and livelihood restoration are provided in accordance with the Bank's requirements. Biodiversity Conservation and Sustainable Management of Living Natural Resources: Renewable energy and transport infrastructure projects may have impacts through encroaching or fragmenting sensitive habitats, including marine habitats in the case of port developments. To avoid or minimise such impacts, ensure that robust biodiversity impact assessments of projects in sensitive locations are carried out and provide TC support where needed. Cultural Heritage: Work with clients to identify and consult with key stakeholders and protect sensitive cultural heritage. Financial Intermediaries: Ensure that FI partners have adequate E&S capacity and risk management procedures in place. Monitoring and supervision: Work with existing clients to monitor environmental and social performance and address legacy issues associated with the Bank's portfolio.

8. Donor Co-Financing Assessment

8.1. Grant Needs Assessment for the New Country Strategy Period

Grant funding will be required to achieve the strategic objectives of the Country Strategy, including support for:

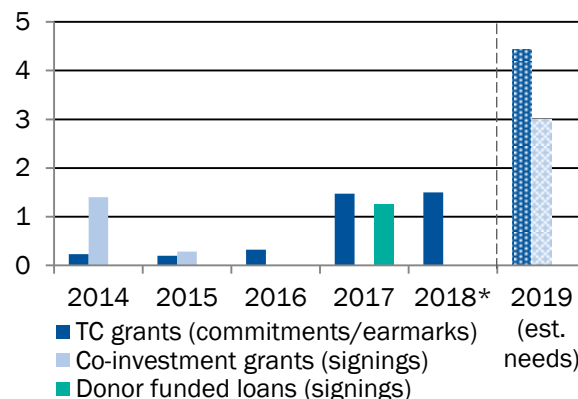
- Pre-privatisation, commercialisation and restructuring assistance for public entities; PPP Capacity Enhancement
- Infrastructure facilities with a focus on energy efficiency improvements
- Overall SME sector support, including funds for first loss risk cover to women led-businesses through the Eastern Partnership Women in Business Framework;
- Policy engagement & legal reforms;
- Energy market reform, including increased private sector participation, and capacity building of an independent energy regulator

Selected Affordability Indicators

		EBRD regional percentile rank ¹
GDP per capita (PPP, current. \$) ²	17,493	47 th (CoOs)
ODA Country	YES	N/A
ODA as share of Gross National Income (%) ³	0.3	16 th
ODA per capita (\$ - current prices) ³	11.71	16 th

Sources: ² IMF (2017), ³ OECD (2017)

Donor finance during last strategy (€m)⁴

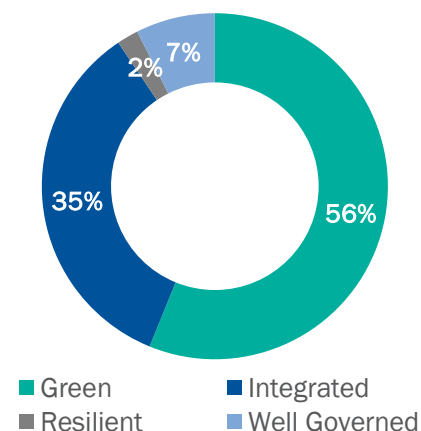


* 2018 data is tentative

8.2. Potential Sources of Grant Funds

- The **EU** remains a very important source of grant funding through multiple funding instruments with the main facility being the Neighbourhood Investment Facility East.
- The **EBRD Shareholder Special Fund** will remain an important grant provider.
- The **EBRD Small Business Impact Fund (SBIF)** and **SME Local Currency Special Fund** will continue to be used to support SME development in the country.
- Azerbaijan is eligible for the **EBRD Early Transition Countries fund**
- The **Eastern Europe Energy Efficiency and Environmental Partnership Fund** will also endeavour to operate in Azerbaijan.
- Support via **bilateral** EBRD accounts for strengthening resilience of the financial system and enhancing competitiveness of private firms will be sought.
- EBRD will explore opportunities to attract additional grant funds including from **new donors**, including from Azerbaijan itself.

Grant Funding Needs⁵



1. Simple percentile rank reported as the share of EBRD countries (ODA CoOs in the case of ODA indicators) that are represented below Azerbaijan.

4. The 2014-2015 TC data is based on commitments as at the end of March 2016 (the latest available date before data migration to a new Donor Funds System). 2016-2018 TC data is based on earmarks at the project level. Co-investment grants and donor funded loan amounts are based on client signings.

5. Estimated grant funding needs are based on the operational needs reported by banking teams for projects to be started in 2019. Estimated funding needs generally exceed actual grant use as some needs may not materialise, may be delayed, or may be split into several years of fundraising efforts due to operational needs and realities.



ANNEX

Azerbaijan's commitment to and application of the political principles as stated in Article 1 of the Agreement Establishing the Bank has, over the previous Country Strategy period, and in particular during 2014-2015, been marked by international concerns. Several positive steps were recently taken by the authorities, and cooperation with relevant international organisations has generally increased.

The political system of Azerbaijan has continued to operate in a centralised manner with significant power concentrated in the presidency. Following the constitutional referendum on 26 September 2016, the presidential powers have been strengthened further.

The constitutional provisions for the separation of powers and the exercise of fundamental rights and freedoms are in place. As a member of the United Nations (UN), OSCE and the Council of Europe, Azerbaijan undertook to honour the ensuing international commitments. The EU-Azerbaijan relations have in the past two years been renewed and intensified, including the launch in February 2017 of negotiations on a new comprehensive agreement, to replace the 1999 Partnership and Cooperation Agreement, and the end in July 2018 of negotiations of the Partnership Priorities for 2018-2020. Through this, the EU and Azerbaijan have re-confirmed their commitment to an ambitious and comprehensive agenda of cooperation and dialogue, including respect for human rights, democracy, the rule of law and dialogue with civil society.¹ The new Council of Europe Action Plan for Azerbaijan for 2019-2021 was adopted in November 2018, to ensure the continuation of cooperation in a number of areas, including the reform of the judiciary, fight against corruption and money laundering, and dialogue with civil society. In his address to the people of Azerbaijan in March 2019, President Ilham Aliyev pledged that political reforms and reforms in the judicial system will continue.

Over the previous Country Strategy period, relevant international organisations and their monitoring bodies have, however, been expressing concerns about the significant challenges related to safeguarding checks and balances in the political system, to democracy and the rule of law, and to ensuring respect for human rights and fundamental freedoms, including freedom of expression and association, as well as an enabling environment and legislation for civil society to operate.² The EU in particular underlined that strengthening of the rule of law, fundamental rights and democratic institutions as well as engaging meaningfully with the civil society, are crucial for the development of an independent, stable and prosperous country.³ While the recent efforts to strengthen the independence of the judiciary have been welcomed, more determined and effective measures are needed. Corruption remains a serious challenge, although fighting corruption is a stated priority for the authorities and some steps have been taken to reduce it.

Azerbaijan is situated at an important crossroads connecting Europe and Asia. It plays an essential role in the diversification of the supply of energy resources and as a transport hub. The country's regional and geopolitical context is, however, complex. The conflict with Armenia over Nagorno-Karabakh remains unresolved, and efforts at international mediation by the OSCE Minsk Group, co-chaired by France, Russia and the United States, continue.

1. European External Action Service (EEAS): Press releases on Federica Mogherini's meeting with the Foreign Minister of Azerbaijan, Brussels, 14 May 2018; and on Partnership Priorities between the EU and Azerbaijan, Brussels, 11 July 2018.

2. See for example, UN Human Rights Council (UN HRC): Compilation on Azerbaijan – Report of the Office of the United Nations High Commissioner for Human Rights, 16 March 2018; European Commission and High Representative of the Union for Foreign Affairs and Security Policy (EC/HR): Joint Staff Working Document, Report on EU-Azerbaijan relations in the framework of the revised ENP, Brussels, 11 March 2019, and 19 December 2017; Council of the European Union: EU Annual Report on Human Rights and Democracy in the World in 2016, Luxembourg, 16 October 2017, pp. 70-73; Parliamentary Assembly of the Council of Europe (PACE): Resolution 2184 (2017) of 11 October 2017 on "The functioning of democratic institutions in Azerbaijan" and the report accompanying it.

3. EU-Azerbaijan Cooperation Council: Main results, 9 February 2018.

Free Elections and Representative Government

Free, fair and competitive elections

The Constitution provides for a sovereign right of the people of Azerbaijan to establish their own form of governance through their representatives elected based on universal, equal and direct suffrage by way of free, secret and personal ballot. Since its independence in 1991, international observer missions have found shortcomings in the country's electoral processes.

The last presidential election was held in April 2018. It was an early election. The OSCE/ODIHR-led International Election Observation Mission concluded that the 11 April 2018 early election “took place within a restrictive political environment and under a legal framework that curtails fundamental rights and freedoms, which are pre-requisites for genuine democratic elections. Against this background and in the absence of pluralism, including in the media, this election lacked genuine competition.” While acknowledging that authorities were cooperative and that the election administration was well-resourced and prepared the election efficiently, international observers reported “widespread disregard for mandatory procedures, lack of transparency, and numerous serious irregularities, such as ballot box stuffing” on election day.⁴ Incumbent president Ilham Aliyev was competing against seven other registered candidates. Several opposition parties boycotted the election, referring to a *de facto* non-competitive environment, while others did not put forward candidates, stating that the early election date provided insufficient time to meaningfully participate.⁵

The last parliamentary elections took place in November 2015 but could not be fully assessed, as the OSCE/ODIHR cancelled the deployment of its election observation mission due to the restriction on the number of observers introduced by the authorities.⁶

Separation of powers and effective checks and balances

The Constitution of the Republic of Azerbaijan proclaims that state power is based on a principle of division of powers.

Azerbaijan has a presidential form of government. Executive power belongs to the president, with the presidency exercising wide constitutional powers relative to the legislature and the judiciary. The president appoints and dismisses prime-minister and members of Cabinet of Ministers and establishes central and local executive authorities. The president proposes the judges of the Constitutional Court, Supreme Court and the Courts of Appeal for parliamentary approval, and appoints judges of other courts. By consent of the parliament, the president also appoints and dismisses the prosecutor general.

Legislative authority is vested in the unicameral parliament – *Milli Majlis* – of 125 MPs elected for a five-year term under a majoritarian system from single-mandate constituencies. The presidential New Azerbaijan Party (*Yeni Azərbaycan Partiyası*) retains a dominant position in the legislature and in the political system.

4. OSCE/ODIHR: *Republic of Azerbaijan, Early Presidential Election, 11 April 2018, Final Report, Warsaw, 18 July 2018, pp. 1.*

5. *Ibid.*

6. OSCE/ODIHR: “Restrictions imposed by Azerbaijan compel cancellation of parliamentary election observation mission”, *Statement, 11 September 2015.*

The constitutional referendum on 26 September 2016 has increased the president's powers. 29 articles of the Constitution were amended (approved by 90-95% of voters with around 70% voter turnout officially reported). The amendments included the extension of the presidential term of office from five to seven years, additional powers of the president to dissolve parliament, and the establishment of new posts of first vice-president and vice-presidents appointed and dismissed by the president. The Venice Commission of the Council of Europe assessed negatively the proposed institutional changes, seeing them as reducing political accountability of the president and weakening parliament further. The EU invited Azerbaijan to take account of the Venice Commission's findings during the process of implementation of the amendments.⁷

Effective power to govern of elected officials

The key political decision-maker in Azerbaijan is the president, who is elected in a direct national election. President Ilham Aliyev has been in office since October 2003. Since coming to power, President Aliyev has been re-elected three times, in 2008, 2013 and 2018. The military is under civilian control and does not play a decisive role in the country's political decision-making process. Law enforcement and security services report to the president. Although big businesses play an important role in the country, it does not possess excessive powers to influence elected officials.

Civil society, Media and Participation

Scale and independence of civil society

According to the official data, the number of registered civil society organisations (CSOs), including non-governmental organisations (NGOs), stands at over 4,300.

Reportedly, however, in the period since the adoption of the previous Country Strategy the legislative environment for CSO operation has become more restrictive, including registration, funding and reporting requirements and harsh penalties for their violation. Further to the restrictive amendments to the laws governing national and international CSOs implemented by the authorities in 2013-14 and assessed critically by the Venice Commission of the Council of Europe,⁸ new complex rules were enacted in 2015, requiring CSOs to register domestic and foreign grants with the Ministry of Justice and requiring foreign donors to undergo approval with the Ministry of Justice and to receive approval for each grant from the Ministry of Finance. Given this constrained operational environment and decline in access to funding, particularly from foreign sources, many CSOs have had to suspend, scale down or move their operations abroad.

The Council on State Support to NGOs under the President of Azerbaijan is tasked to provide state financial support to CSOs and facilitate cooperation with civil society. The Council financed over 480 NGO projects in 2017. The general perception among independent CSOs is, however, that the Council gives preference to organisations supportive of the government.⁹

7. Council of Europe Venice Commission (VC): Azerbaijan. Opinion on the draft modifications to the Constitution Submitted to the Referendum of 26 September 2016, Venice, 14-15 October 2016, p.18; EU: Statement by the Spokesperson of the HR/VP, 27 September 2016.

8. VC: Opinion on the Law on non-governmental organisations (public associations and funds) as amended of the Republic of Azerbaijan, Strasbourg, 15 December 2014, pp. 20-21.

9. World Bank: Azerbaijan Systematic Country Diagnostics, June 2015, p. 65.

International organisations, in particular the UN and the Council of Europe, have expressed concerns over the overall deterioration of the working conditions of independent CSOs, including the reported criminal prosecution and detention of CSO leaders, travel bans, and closure of CSOs' bank accounts.¹⁰

In May 2016, the Open Government Partnership (OGP) initiative designated Azerbaijan as inactive member due to constraints on the operating environment for NGOs.¹¹ In March 2017, the Board of the Extractive Industries Transparency Initiative (EITI) suspended Azerbaijan's membership on the grounds that the country had "not fully met the corrective actions related to civil society space set by the Board in October 2016."¹² Subsequently, the Azerbaijani authorities decided to withdraw from the EITI. In a resource-rich country like Azerbaijan, revenue reporting is vital in combating corruption. Since joining the EITI in 2003, 20 reports were reconciled and disclosed in Azerbaijan. Having withdrawn from the EITI in March 2017, Azerbaijan has nevertheless pledged its continued commitment to the principles of international transparency and accountability in the extractive industries and has established the national Extractive Industries Transparency Commission.

While acknowledging that the registration process was complicated before, the authorities consider that the recent steps taken help address the issues of concern. In October 2016, President Aliyev signed a decree aimed at simplifying the registration of foreign grants through the principle of a "single window", and the Cabinet of Ministers simplified certain technical procedures in January 2017. Following an exemption awarded under bilateral financing agreements, the EU reports that **most of** its grants in the area of education and rural/regional development, awarded in 2017-18, have been registered. Nevertheless, foreign donors still need to request the right to award grants and the process reportedly remains difficult and time-consuming, while the space in which CSOs can operate remains confined.¹³ International bodies continue to call on Azerbaijan to amend its legislation and remove undue restrictions on CSOs.¹⁴

Independence and pluralism of media operating without censorship

While a range of media outlets operate in Azerbaijan (including 11 TV stations with nation-wide coverage, radio channels, newspapers and internet providers), access to pluralistic views and impartial information is assessed by relevant international bodies as limited. According to international reports, the media environment has, during the previous Country Strategy period, been impacted by restrictive legislation and arbitrary arrests and detentions, criminal prosecutions, defamation lawsuits and other forms of pressure on journalists. Activities of a number of media outlets have been suspended, including the Azerbaijani service of *Radio Free Europe/Radio Liberty*. Several websites have been blocked by court decisions, while a responsible ministry is authorised by law to temporarily block websites without prior court decision.

10. UN Human Rights Committee: *Concluding Observations on the fourth periodic report of Azerbaijan*, 16 November 2016, p. 9; UN HRC: *Report of the Special Rapporteur on the situation of human rights defenders on his mission to Azerbaijan*, 20 February 2017, pp. 6-7, 11-12, 21-22; PACE: *Resolution 2184 (2017)* of 11 October 2017 and the report accompanying it; *Resolution 2096 (2016)* of 28 January 2016 on "How can inappropriate restrictions on NGO activities in Europe be prevented?"; *Resolution 2062 (2015)* of 23 June 2015 on "The functioning of democratic institutions in Azerbaijan"; Council of Europe Commissioner for Human Rights (CommHR): "The shrinking space for human rights organisations", Strasbourg, 4 April 2017; EC/HR: *Joint Staff Working Document, Implementation of the European Neighbourhood Policy in Azerbaijan: Progress in 2014 and recommendations for actions*, Brussels, 25 March 2015, pp. 4-5; European Parliament: *Resolution on Azerbaijan (2015/2840(RSP))* of 10 September 2015.

11. Open Government Partnership: *Azerbaijan to maintain its inactive status in the Open Government Partnership*, Washington, D.C., 29 June 2017.

12. EITI: *Statement*, 2017-15/BM-36/BP-36-5-A, 9 March 2017.

13. EC/HR: *Joint Staff Working Document, Report on EU-Azerbaijan relations in the framework of the revised ENP*, Brussels, 19 December 2017, p. 5; OSCE/ODIHR: *Republic of Azerbaijan, Early Presidential Election*, 11 April 2018, *Final Report*, Warsaw, 18 July 2018, p. 6.

14. PACE: *Resolution 2226 (2018) on New restrictions on NGO activities in Council of Europe member States*, 27 June 2018; European Parliament: *Recommendation on Negotiations on the EU-Azerbaijan Comprehensive Agreement*, 4 July 2018, p. 6.

The OSCE Representative on Freedom of the Media (RFoM) has called on authorities to reform the laws and regulations affecting media.¹⁵

The OSCE RFoM and the Council of Europe Commissioner for Human Rights have also repeatedly drawn attention to the cases of to a number of journalists, bloggers and social media activists in prison and called on authorities to end restrictive measures detrimental to journalists' freedom and safety. The European Court of Human Rights (ECtHR) has ruled on several occasions on unlawful restrictions on journalists' freedom of assembly and their ill-treatment whilst in detention. The Council of Europe Committee of Ministers has adopted several resolutions to that extent.¹⁶

Defamation remains a criminal offence, both in print and online media, and the application of criminal provisions on slander and insult has been expanded, although relevant international bodies have recommended that criminal defamation be repealed in favour of civil sanctions.

Multiple channels of civic and political participation

The government is required by law to provide citizens with information regarding policies and subjects that affect them. However, broad exceptions to the right of access to information and lack of sanctions for violations remain a subject of concern.¹⁷ Although the government refers to different dialogue platforms where civil society and governmental bodies act jointly, CSOs point to limited opportunities to participate in public consultation and in discussions on government policy. The establishment in November 2016 of a Government – Civil Society Dialogue Platform to strengthen cooperation, communication and partnership among state bodies and CSOs in Azerbaijan has nevertheless been welcomed.

Freedom to form political parties and existence of organised opposition

The Constitution ensures the right to establish political parties. Azerbaijan has more than fifty registered political parties, but the overall political situation is marked by the lack of a truly pluralistic political landscape.¹⁸ The ruling New Azerbaijan Party dominates the legislature and the overall political system. The political opposition exists and is organised but seems unable to present a strong challenge to the president and the ruling party. While more than a dozen political parties ran in the last parliamentary elections in November 2015, the main opposition parties boycotted the elections. The extra-parliamentary opposition conducts its activities in a restrictive climate, and international bodies raised doubts about the ability of political parties to campaign freely.¹⁹

15. OSCE Representative on Freedom of the Media (RFoM): Statement of 10 August 2018.

16. OSCE RFoM: Statements of 12 January 2018, 18 December, 25 August and 6 March 2017, 23 and 17 November 2016, and other; Council of Europe Committee of Ministers (CM): CM/ResDH(2014)183, CM/ResDH(2015)250 and CM/ResDH(2016)145; CommHR: Statement "Azerbaijan should release all persons detained because of their views expressed or legitimate civic activity", 17 May 2017; See also: PACE: Resolution 2141 (2017) of 24 January 2017 on "Attacks against journalists and media freedom in Europe", p. 3, and Resolution 2184 (2017), p.2; European Parliament: The case of Afgan Mukhtarli and situation of media in Azerbaijan, Resolution of 15 June 2017 (2017/2722(RSP)); OSCE/ODIHR: Republic of Azerbaijan, Early Presidential Election, 11 April 2018, Final Report, pp. 2-3, 15-17.

17. UN HRC: Report of the Special Rapporteur on the situation of human rights defenders on his mission to Azerbaijan, pp. 10-11; OECD: Anti-Corruption Reforms in Azerbaijan. Fourth Round of Monitoring of the Istanbul Anti-Corruption Action Plan, Paris, 16 September 2016, p. 8.

18. Council of Europe Group of States against Corruption (GRECO): Third Evaluation Round. Second Addendum to the Second Compliance Report on Azerbaijan, "Transparency of Party Funding", Strasbourg, 24 March 2017, p. 8.

19. PACE: Resolution 2184 (2017), p. 3; OSCE/ODIHR: Republic of Azerbaijan – Early Presidential Election, 11 April 2018, Final Report, p. 14.

Rule of Law and Access to Justice

Supremacy of the law

The Constitution is the supreme law of the country. The right to a fair trial is envisaged in the legislation, although the strong position of the prosecutor and the shortcomings in the judiciary continue to affect this right. While progress has been achieved regarding appraisal, training and ethics of prosecutors, concerns have remained about the direct presidential oversight of the prosecutor's office. The ECtHR has been drawing attention in particular to concerns over prosecutors' actions, ineffective investigations and non-respect for presumption of innocence. The prosecutor general retains a prominent role with regard to pre-trial detention, and there have been allegations of the arbitrary application of criminal law and cases of selective justice.²⁰

Independence of the judiciary

Independence of judges is enshrined in the Constitution. The recent measures to increase the role of the Judicial Legal Council (JLC) and to ensure the independence of the judiciary as a whole have been welcomed by relevant international bodies. Those measures have included more extensive powers granted to the JLC in matters related to financial independence and self-governance of courts, such as the appointment, promotion and disciplining of judges, as well as improvements in the selection procedure and evaluation of judges. The electronic court system is in the process of development.

Despite these positive developments, concerns remain regarding the JLC composition, making it subject to undue interference by the executive branch, and regarding independence and impartiality of the justice system overall. The executive continues to retain excessive prerogatives for key appointments in the judiciary. Allegations of corruption within the judiciary continue to be reported. More determined and effective measures need to be taken to strengthen judicial independence and to restore public confidence in the judicial system.²¹

Government and citizens equally subject to the law

The Constitution guarantees the equality of all citizens before the law. The authorities have, however, not always taken steps to prosecute officials alleged to have committed human rights abuses.

Effective policies and institutions to prevent corruption

Azerbaijan has made progress in preventing corruption in several sectors, such as public services (the establishment of ASAN service centres), traffic police and education, and has started reforms in customs and business licencing. The National Action Plan on Promotion of Open Government 2016-2018 was adopted by the government in April 2016, with mainly preventive focus.

20. GRECO: Fourth Evaluation Round, Compliance Report on Azerbaijan, "Corruption prevention in respect of members of parliament, judges and prosecutors", Strasbourg, 17 March 2017, pp. 12-19 and 20; PACE: Resolution 2184 (2017), pp. 1-3 and the report accompanying it, pp. 7-8, and Resolution 2185 (2017) of 11 October 2017 on "Azerbaijan's Chairmanship of the Council of Europe: what follow-up on respect for human rights?", p. 1 and the report accompanying it, pp. 16-17.

21. GRECO: Fourth Evaluation Round, Compliance Report on Azerbaijan, pp. 6-12, 19-20; UN Human Rights Committee: Concluding Observations on the fourth periodic report of Azerbaijan, p. 6; PACE: 2184 (2017), pp. 1 and 3 and the report accompanying it, pp. 7-8.

Nevertheless, serious and complex corruption challenges have yet to be tackled.²² According to Transparency International's Corruption Perceptions Index 2018, Azerbaijan is ranked 152nd out of 180 countries – a significant drop compared to 2017 and following a positive dynamic in Azerbaijan's position over the previous five years. In its latest Fourth Round Evaluation Report on corruption prevention in respect of members of parliament, judges and prosecutors, published in March 2017, the Group of States against Corruption (GRECO) concluded that Azerbaijan implemented satisfactorily 11 out of 21 recommendations (of the remaining recommendations, four have been partly implemented and six have not been implemented). Having noted that Azerbaijan is making clear efforts to implement the recommendations by the Group, it has encouraged the country to pursue the reforms, bearing especially in mind that none of the recommendations concerning integrity rules for members of parliament have been fully implemented.²³

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

A member of the UN, the OSCE and the Council of Europe, Azerbaijan has ratified the core international treaties in the area of the protection of civil and political rights. The Constitution of the Republic of Azerbaijan also guarantees fundamental rights and freedoms.

In 2018, Azerbaijan has completed the third cycle of the UN Human Rights Council's Universal Periodic Review (UPR). Of the 259 received recommendations, Azerbaijan accepted 179 recommendations for implementation and took note of 66 recommendations, while did not support 8 recommendations and expressed the view that it will not consider 6 recommendations by submitting an explanation.²⁴ At the 35th session of the UN Human Rights Council in June 2017, Azerbaijan was cited among the 33 countries that were fully up to date with their Treaty Body reporting. A Working Group was established by the Order of the President of the Republic of Azerbaijan in September 2018 for the preparation of periodic reports of Azerbaijan and for the monitoring of implementation of the recommendations within the framework of the Treaty Bodies of the UN on human rights and the UPR mechanism. The establishment of the Working Group was welcomed by the UN High Commissioner for Human Rights.

The reporting process, however, shows, including in the UPR framework, that civil and political rights are restricted at the legislative level and in practice. Freedom of speech and freedom of assembly in particular have been quoted frequently as areas where extensive restrictions are applied,²⁵ including reports of intimidation and harassment, such as arbitrary arrest and detention, ill-treatment and conviction of human rights defenders, civil society leaders, youth activists, political opponents, independent journalists and bloggers. While legislation only requires advance notification of a peaceful assembly, a system of authorisation is applied in practice. There have been cases of public assemblies being banned or dispersed by force, and administrative and criminal penalties have been imposed against persons participating in peaceful protests.²⁶

22. OECD: *Anti-Corruption Reforms in Azerbaijan. Fourth Round of Monitoring of the Istanbul Anti-Corruption Action Plan*, pp. 6-11.

23. GRECO: *Fourth Evaluation Round, Compliance Report on Azerbaijan*, pp. 19-20.

24. UN HRC: *Report of the Working Group on the Universal Periodic Review – Azerbaijan*, 11 July 2018, and *Addendum to the Report (advance unedited version)*, 10 September 2018.

25. Council of the European Union: *EU Annual Report on Human Rights and Democracy in the World in 2016*, Luxembourg, 16 October 2017, p. 70.

26. UN Human Rights Committee: *Concluding Observations on the fourth periodic report of Azerbaijan*, pp. 8-9; PACE: *Resolution 2184 (2017)*, p. 3; and *Resolution 2185 (2017) and the report accompanying it*, p. 12.

The UN Human Rights Council Working Group on Arbitrary Detention concluded after its mission to Azerbaijan in May 2016 that the situation in the country “presents several matters of concern, particularly in regard to the deprivation of liberty on health-related grounds, in the context of the criminal justice as well as the detention of individuals expressing opinions that are not in line with those of the government.”²⁷ More than 120 judgments of the ECtHR against Azerbaijan have not yet or only partially been implemented, in particular those concerning freedom of expression, assembly and association, as well as concerning ill-treatment and violations of the right to a fair trial.²⁸

In March 2019, President Aliyev pardoned over 50 representatives of political parties, CSOs, journalists and bloggers. International community welcomed the step as a positive development, as well as the earlier release of opposition politician Ilgar Mammadov in August 2018 and the pardon or conditional release of several high-profile opposition and civil society activists and journalists in March-May 2016 and in September 2017. At the same time international bodies continue to call on the Azerbaijani authorities to follow with similar steps in the future and unconditionally release and rehabilitate all those imprisoned or under restriction of movement on political grounds, in line with Azerbaijan’s international commitments.²⁹ International and local CSOs also draw attention to cases of human rights lawyers having been disbarred or suspended from the Bar Association of Azerbaijan.

The overall situation of civil and political rights in Azerbaijan has therefore been a subject of consistent international concern.³⁰ The authorities, on the other hand, consider that some of international reporting fails to reflect positive developments and creates a wrong impression on the real situation on the ground, and that fundamental freedoms are guaranteed in the country.³¹

Political inclusiveness for women, ethnic and other minorities

The law provides for the equality of rights between women and men, and prohibits discrimination based on race, gender, disability, language or social status.

Azerbaijan cherishes its role in promoting intercultural dialogue, religious tolerance and cultural diversity. 2016 was declared the year of multiculturalism in Azerbaijan and Baku hosted the 7th UN Alliance of Civilisation Global Forum. Since 2011, Baku has been hosting the biannual World Forum on Intercultural Dialogue. The 4th such event was organised in May 2017.

Although Azerbaijan features higher than its neighbours in terms of women represented in the parliament, its score of almost 17% (an increase of about 6% compared to 2008) falls short of the European average of 26%. At the same time, the tally of women in junior and senior ministerial positions stands just at 3%, while the European average is 22%. In February 2017, the first lady was appointed to the newly established position of Azerbaijan’s first vice-president.³²

27. UN HRC: *Report of the Working Group on Arbitrary Detention on its mission to Azerbaijan*, 2 August 2017, pp. 15-16.

28. PACE: *Resolution 2184 (2017)*, p.2.

29. PACE: *Resolution 2184 (2017)*, p.3; EEAS: *Statement by the Spokesperson*, Brussels, 17 March 2019, 14 August 2018, and 4 June 2017.

30. UN HRC: *Compilation on Azerbaijan – Report*, 16 March 2018; EC/HR *Report on EU-Azerbaijan relations*, 11 March 2019 and 19 December 2017; European Parliament: *Recommendation on Negotiations on the EU-Azerbaijan Comprehensive Agreement*, 4 July 2018, pp. 3-7; PACE: *Resolution 2184 (2017)* of 11 October 2017 and the report accompanying it; EC/HR: *Implementation of the European Neighbourhood Policy in Azerbaijan: Progress in 2014 and recommendations for actions*, Brussels, 25 March 2015.

31. UN HRC: *Report of the Special Rapporteur on the situation of human rights defenders on his mission to Azerbaijan: Comments by the State*, 23 February 2017, pp. 1-14.

32. Council of Europe Gender Equality Commission: *Balanced Participation of Women and Men in Decision-Making, Analytical Report – 2016 Data*, September 2017, pp. 23-24.

Azerbaijan improved its ranking in the Global Gender Gap Index from 98 out of 144 in 2017 to 97 out of 149 in 2018, due to progress in narrowing the gender gap in earned income as well as in better women representation in several professions and in the parliament.³³ Nevertheless, the UN Human Rights Committee remains concerned about the continued underrepresentation of women in public and political life, patriarchal attitudes and deep-rooted stereotypes regarding the roles, responsibilities and identities of women and men in society, as well as about cases of violence against women.³⁴

International bodies have been also concerned that the existing legal framework for countering discrimination on different grounds in Azerbaijan is not comprehensive and does not explicitly prohibit discrimination on the basis of sexual orientation and gender identity, as well as about impunity for reported acts of discrimination and violence.³⁵

Freedom from harassment, intimidation and torture

Azerbaijan is a signatory of the UN Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment. The Constitution and Criminal Code also prohibit these acts. International monitoring bodies have, however, reported consistently the excessive use of pre-trial detention and instances of ill-treatment and torture by law enforcement. In July 2018, the Council of Europe's Committee for the Prevention of Torture and Inhuman and Degrading Treatment or Punishment (CPT) has published reports on six of its visits to Azerbaijan (in 2004, 2012, 2013, 2015, 2016 and 2017). The CPT's overall impression of the situation in Azerbaijan is that torture and other forms of physical ill-treatment by the police, other law enforcement agencies and the army "remain systemic, widespread and endemic." The Committee has also noted a "serious problem" of impunity and lack of proper investigations of ill-treatment allegations. At the same time, the CPT has welcomed the decision of the Azerbaijani authorities to publish all these reports (which have so far remained confidential) as a signal of a new commitment to transparency.³⁶

In February 2017, the president of Azerbaijan issued an executive order on improvement of operation of penitentiary, humanisation of penal policies and extension of application of alternative sanctions and non-custodial preventive measures, launching a welcomed reform.³⁷ In December 2017, a number of legislative amendments were introduced by the parliament in the Criminal Code, Criminal Procedure Code and Administrative Procedure Code, in implementation of the reform. The president also issued an executive order on the establishment of a Probation Service.

33. *World Economic Forum: The Global Gender Gap Report 2017*, pp. 72; *World Economic Forum: The Global Gender Gap Report 2018*, pp. 78

34. *UN Human Rights Committee: Concluding Observations on the fourth periodic report of Azerbaijan*, pp. 3-4.

35. *Ibid.*, p. 2. See also: *EC/HR Report on EU-Azerbaijan relations in the framework of the revised ENP*, Brussels, 19 December 2017, p. 6.

36. *Council of Europe: Press Release "Azerbaijan: torture, impunity and corruption in law enforcement remain systemic and widespread – new anti-torture committee publications"*, Strasbourg, 18 July 2018; see also: *UN Human Rights Committee: Concluding Observations on the fourth periodic report of Azerbaijan*, p. 5; *UN HRC: Report of the Working Group on Arbitrary Detention on its mission to Azerbaijan*, pp. 1-20.

37. *PACE: Resolution 2184 (2017)*, p. 1; *UN HRC: Report of the Working Group on Arbitrary Detention*, pp. 15-20.