



**EUROPEAN NEIGHBOURHOOD AND PARTNERSHIP
INSTRUMENT**

AZERBAIJAN

**NATIONAL INDICATIVE PROGRAMME
2007-2010**

Contents:

1.	Introduction.....	3
2.	Main priorities and goals	3
3.	Indicative budget 2007-2010	4
4.	Priority Area 1: Support for Democratic Development and Good Governance	5
	4.1. Strategic context/justification	5
	4.2. Sub-priorities.....	7
	4.2.1. Sub-priority 1: Public administration reform and public finance and tax management, including Public Internal Control and External Audit.....	7
	4.2.2. Sub-priority 2: Rule of law and judicial reform.....	8
	4.2.3. Sub-priority 3: Human rights, civil society development and local government	9
	4.2.4. Sub-priority 4: Education, science and people-to-people contacts/exchanges.....	10
5.	Priority Area 2: Support for socio-economic reform (with emphasis on regulatory approximation with the EU <i>acquis</i>), fight against poverty and administrative capacity building	12
	5.1. Strategic context/justification	12
	5.2. Sub-priorities.....	13
	5.2.1. Sub-priority 1: Promoting mutual trade, improving the investment climate and strengthening social reform, including that of social insurance and pension systems	13
	5.2.2. Sub-priority 2: Supporting the implementation of the SPPRED/SPPRSD, of the State Programme for Regional Development and of government plans for the non-oil sector (strengthened competitiveness and diversification of the economy).	14
	5.2.3. Sub-priority 3: Sector-specific regulatory aspects, including public accounting and capital market	15
6.	Priority Area 3: Support for legislative and economic reforms in the transport, energy and environment sectors.....	16
	6.1. Strategic context/justification	16
	6.2. Sub-priorities.....	17
	6.2.1. Sub-priority 1: Energy, including reforms of the domestic legislative framework and markets.....	17
	6.2.2. Sub-priority 2: Transport, including reforms of the domestic legislative framework and markets.....	18
	6.2.3. Sub-priority 3: Environment.....	19
7.	Implementation	20
8.	Risks and assumptions	21
9.	Alignment, harmonisation and consultation	21
	9.1. Dialogue with the government and alignment with national policies	21
	9.2. Harmonisation and coordination with Member States, other donors and civil society	22

1. Introduction

In recent years Azerbaijan has been slowly (although not always coherently) pursuing an “evolutionary” reform strategy to develop democracy and a market economy in the country and to bring Azerbaijan closer to the EU. However, much remains to be done in the coming years.

The principal objective of cooperation between the EU and Azerbaijan is to support the Country’s reform agenda and to develop an increasingly close relationship, principally within the framework of the policy objectives defined in the Partnership and Cooperation Agreement (PCA) of June 1999 and the EU-Azerbaijan ENP Action Plan of 14 November 2006.

In this context, the EC-Azerbaijan Country Strategy Paper (CSP) for 2007-2013, which was adopted by the Commission on 07.03.07, provides a comprehensive overview of future EC assistance priorities encompassing all instruments and programmes, and is based on the structure of the joint EU-Azerbaijan Action Plan which is divided into ten main priority areas.¹

This National Indicative Programme (NIP) for 2007-2010 defines in greater detail the focus of operations under the national envelope of the new European Neighbourhood and Partnership Instrument (ENPI). It is intended to guide planning and project identification by defining a limited number of priority areas, together with the objectives and results to be achieved.

2. Main priorities and goals

Assistance provided under this National Indicative Programme for Azerbaijan should focus on three priority areas. However, depending on developments regarding the peaceful settlement of the conflict over **Nagorno-Karabakh**, the EC will be ready to provide **specific assistance** related to all aspects of conflict settlement and settlement consolidation.

¹ These are: 1) Contribute to a peaceful solution of the Nagorno-Karabakh conflict, 2) Strengthen democracy in the country, including through fair and transparent electoral process, in line with international requirements, 3) Strengthen the protection of human rights and of fundamental freedoms and the rule of law, in compliance with international commitments of Azerbaijan (PCA, CoE, OSCE, UN), 4) Improve the business and investment climate, particularly by strengthening the fight against corruption, 5) Improve functioning of customs, 6) Support balanced and sustained economic development, with a particular focus on diversification of economic activities, development of rural areas, poverty reduction and social/territorial cohesion; promote sustainable development including the protection of the environment, 7) Further convergence of economic legislation and administrative practices, 8) Strengthening EU-Azerbaijan energy and transport cooperation, in order to achieve the objectives of the November 2004 Baku Ministerial Conferences, in particular with a view to developing regional transport networks and energy markets in the region and integrating them with EU networks and markets, 9) Enhancement of cooperation in the field of Justice, Freedom and Security, including in the field of border management and 10) Strengthen regional cooperation.

Priority Area 1: Support for Democratic Development and Good Governance

Sub-priority 1: Public administration reform and public finance management

Sub-priority 2: Rule of law and judicial reform

Sub-priority 3: Human rights, civil society development and local government

Sub-priority 4: Education, science and people-to-people contacts/exchanges

Priority Area 2: Support for socio-economic reform (with emphasis on regulatory approximation with the EU acquis), fight against poverty and administrative capacity building

Sub-priority 1: Promoting mutual trade, improving the investment climate and strengthening social reform

Sub-priority 2: Supporting the implementation of the SPPRED/SPPRS, of the State Programme for the Regional Development and of government plans for the non-oil sector (strengthened competitiveness and diversification of the economy).

Sub-priority 3: Sector-specific regulatory aspects, including public accounting

Priority Area 3: Support for legislative and economic reforms in the transport, energy and environment sectors.

Sub-priority 1: Energy, including reforms of the domestic legislative framework and markets

Sub-priority 2: Transport, including reforms of the domestic legislative framework and markets

Sub-priority 3: Environment

3. Indicative budget 2007-2010

Financial resources available for Azerbaijan under the National Indicative Programme for 2007-2010 are estimated at €2 million. It should be noted that these indicative allocations cover the entire 4-year period of the present indicative programme, and it is therefore likely that individual Annual Action Programmes will contain differing allocations in each given year. Finally, this allocation may be increased through allocations under the “Governance Facility”, which will reward those ENP countries which show the best performance in relation to governance issues.

The indicative breakdown of resources should be as follows:²

<u>Priority Area 1:</u> Support for Democratic Development and Good Governance	€30m
<u>Priority Area 2:</u> Support for socio-economic reform (with emphasis on regulatory approximation with the EU acquis), fight against poverty and administrative capacity building	€2m
<u>Priority Area 3:</u> Support for legislative and economic reforms in the transport, energy and environment sectors	€30m
Total	€62m

Depending on developments regarding the peaceful settlement of the conflict over Nagorno-Karabakh, the EC will provide specific assistance related to all aspects of conflict settlement and settlement consolidation.

4. Priority Area 1: Support for Democratic Development and Good Governance

4.1. Strategic context/justification

Strengthening democracy and good governance are key priorities of the Azerbaijani government and will require sustained support from the EC. This links up directly with the priorities of the ENP Action Plan, as specified in particular in priorities 2, 3 and 4.³

EC support in this area will build on earlier and ongoing operations as the EC is already providing substantial assistance under current programmes. However, the still significant needs justify continuing to provide priority support to this area.

Governance issues, human rights and fundamental freedoms, including freedom of the press and of assembly, will remain fundamental priorities with a view to contributing to Azerbaijan's further democratisation.

Public administration reform and improved public finance and tax management are crucial to enhancing institutional capacity and improving the transparency and public accountability of state and administrative structures at all levels. Reforms in these sectors

² Re-allocations between priority areas will be possible within the limits allowed by the relevant legal basis.

³ 2) Strengthen democracy in the country, including through fair and transparent electoral process, in line with international requirements, 3) Strengthen the protection of human rights and of fundamental freedoms and the rule of law, in compliance with international commitments of Azerbaijan (PCA, CoE, OSCE, UN), 4) Improve the business and investment climate, particularly by strengthening the fight against corruption.

are all the more important since Azerbaijan will benefit from sizeable revenues from oil and gas exploitation, resources that will have to be managed in an accountable and transparent way, principally to address the poverty problem and encourage the development of the non-oil sector and of the regions outside Baku. This is also vital to ensuring the effectiveness of the fight against crime and corruption. In this context, Azerbaijan's adhesion to the Extractive Industry Transparency Initiative (EITI)⁴ was a positive step and its continued implementation is to be encouraged.

Linked to this, further assistance for judicial reform will be required to pursue the Action Plan's objectives of guaranteeing the independence of the judiciary and strengthening its administrative capacity and to ensure the impartiality and effectiveness of prosecution.

Such top-down measures should be accompanied by a bottom-up approach promoting citizens' rights and public participation in the political, economic and social spheres and leading to greater participation by citizens in public life and in the control of institutional bodies and law enforcement agencies and services, including at local level. This may also entail actions to further underpin and secure freedom of expression and freedom of the media. Improved access to justice and legal aid and a regulatory framework for civil society are further important factors in this context.

Assistance for reforming and upgrading the education system, including through exchange programmes, with a view to working towards convergence with EU standards and practices, will be essential to support democratic development, social stability and economic competitiveness. Specific action promoting information initiatives on the EU in Azerbaijan (and vice versa) should also be eligible for assistance.

Support for scientific and technological cooperation will also be important in terms of contributing to the sustainable and equitable economic development of Azerbaijan.

⁴ The Extractive Industry Transparency Initiative was announced by UK Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg, September 2002. Its aim is to increase transparency over payments by companies to governments and government-linked entities, as well as transparency over revenues by those host country governments. This will help to ensure that natural resources and the wealth they generate are governed well. EITI is supported by a strong and varied coalition from industry, governments, donors, international financial institutions, institutional investors and NGOs. Nigeria, Azerbaijan and Ghana are the first three countries to have adopted the EITI principles and actions. 22 countries are committed to implementing the initiative.

4.2. Sub-priorities⁵

4.2.1. Sub-priority 1: Public administration reform and public finance and tax management, including Public Internal Control and External Audit

a) Long-term impact

The expected long-term impact will be to develop a modern state geared towards meeting the needs of citizens and capable of managing future oil and gas wealth in an accountable, transparent and efficient manner.

b) Specific objectives

The specific objectives are to:

- Improve the quality and efficiency of service delivery by the public administration, including by fighting corruption, and of external audits and enhance public finance and tax management and internal control, including at local government level;
- Increase the effectiveness of programming, the implementation of assistance programmes and the coordination of donor activities.

c) Expected results

- Administrative and civil service reform plans developed, including the implementation of anti-corruption measures
- Implementation of reform plans underway in selected ministries and state agencies
- Increased effectiveness of use of information and communication technologies in government bodies, thus removing bureaucratic impediments and facilitating access by the public to these bodies
- Enhanced capacity of NCU and Ministry of Economic Development in the coordination of donor activities
- Increased quality of programming and implementation of assistance programmes
- Plans for more transparent and predictable public finance management developed
- Plans for improved public finance management tested in selected policy areas (e.g. social security systems)
- Approximation of public internal control and external audit with international standards
- Approximation of public accounting standard and procedures with EU and international norms and practices

⁵ As far as possible the expected long-term impact, specific objectives and results mirror the objectives specified in the EU-Azerbaijan ENP Action Plan. Objectives may have to be adjusted in line with the results from monitoring implementation of the Action Plan.

d) Indicators of achievement

Long-term impact

- Positive assessments/progress reports by the EU and other donors on the situation concerning the efficiency and transparency of public administration, public finance management and anti-corruption measures.

Specific objectives

- Better quality of public services demonstrated by service delivery surveys
- More efficient use of public resources demonstrated by annual budgets.

4.2.2. Sub-priority 2: Rule of law and judicial reform

a) Long-term impact

The expected long-term impact will be to strengthen democracy, the rule of law, the independence of the judiciary and the protection of human rights and fundamental freedoms.

b) Specific objectives

The specific objective is to guarantee the effectiveness, independence and transparency of the judiciary and to strengthen its administrative capacity and to ensure the impartiality, effectiveness and independence of prosecution.

c) Expected results

- Improved efficiency, knowledge and integrity of members of the judiciary (judges, prosecutors, officials within the Ministry of Justice and the penitentiary system), including through in-service education and training
- Implementation of reforms relating to civil, criminal and administrative codes and codes of procedure, based on European standards
- Improved working and cooperation methods of law enforcement agencies and prosecution
- Implementation of reforms of the court system
- Simplified legal procedures and easier access to justice for citizens and economic operators, including improvement of the legal aid system
- Improvement of the transparency, predictability and enforcement of judicial acts
- Improved infrastructure of tribunals, courts and judiciary administration
- Increased awareness within the judiciary and law enforcement agencies of human rights issues and fundamental freedoms, as well as obligations and commitments deriving from international law.

d) Indicators of achievement

Long-term impact

- Positive assessments/progress reports by the EU and other donors on the situation concerning democracy, the rule of law, human rights and fundamental freedoms.

Specific objectives

- Higher levels of independence demonstrated by surveys of lawyers and litigators and enhanced administrative capacities of the judiciary, as demonstrated by fewer court cases going to appeal and ultimately being annulled by higher courts
- Development of out-of-court systems to speed up and cut costs of small civil cases
- Increased access to the legal system for citizens.

4.2.3. Sub-priority 3: Human rights, civil society development and local government

a) Long-term impact

The expected long-term impact will be to strengthen democracy, the rule of law, human rights and fundamental freedoms.

b) Specific objectives

The specific objectives are to:

- Ensure respect of human rights (including children's and gender equality) and fundamental freedoms, including in economic and social spheres, in line with international and European standards
- Enhance the involvement of citizens in decision-making processes and controls, including through civil society organisations
- Improve the quality of electoral processes and their approximation with international standards (EU, CoE, OSCE/ODIHR)
- Secure freedom of expression, freedom of assembly and freedom of the media
- Promote and enhance cooperation between governmental and non-governmental players, e.g. in the sectors of the environment, education, etc.; more generally, encourage the overall growth of civil society
- Strengthen local government structures in line with the standards contained in the European Charter on Local Self-Government
- Foster active social dialogue between social partners as well as civil dialogue between private, public and civil society stakeholders
- Develop a National Action Plan for Children's Rights.

c) Expected results

- Enhanced training and increased levels of awareness on elections, human rights and fundamental freedoms, including core labour standards within law enforcement bodies
- Increased public awareness of decision-making structures and procedures and stronger capacity of civil society organisations
- Improved quality of electoral processes
- Improved and enforced legal and administrative framework to ensure respect of media freedom including journalists' rights and the establishment of a truly independent Public Broadcasting Service
- High-quality support for implementation of national administrative reform plans to strengthen local government in line with European standards
- Institutionalised dialogue between the relevant players with a view to ensuring sustainable environmental, economic and social development.

d) Indicators of achievement

Long-term impact

- Positive assessments/progress reports by the EU and other donors on the human rights situation and level of citizens' involvement in policy areas such as the environment.

Specific objectives

- Greater levels of respect of human rights and fundamental freedoms, as demonstrated by a reduction of donor reports and media coverage of cases of human rights violations
- Greater public participation in processes, as demonstrated, for example, by case studies on major infrastructure projects or through the development of consumer structures
- Fully sustained levels of freedom of expression and media freedom, as demonstrated by independent assessments, NGO reports etc.
- Stronger local government structures, as demonstrated by better management of local authorities and greater ownership of local authorities by their citizens, measured from donor reports, surveys of civil society structures and citizens' panels
- Stronger social dialogue structures, as demonstrated by the existence of effective tripartite cooperation and collective bargaining.

4.2.4. Sub-priority 4: Education, science and people-to-people contacts/exchanges

a) Long-term impact

The expected long-term impact will be to strengthen democratic development, economic competitiveness and social stability in Azerbaijan.

b) Specific objectives

The specific objectives are to:

- Reform and upgrade education and training systems, including through exchange programmes, and allow further integration of Azerbaijan into the European Research Area
- Continue to improve the quality of the educational system and adjust it to the needs of the economy, with particular emphasis on the development of entrepreneurial spirit.

c) Expected results

- Improvements in the quality, capacities, accountability and good governance of education and training systems and their convergence with EU standards and practices, including greater participation in relevant exchange programmes
- Interaction of the education and training sector with the National Employment Strategy with a view to pursuing and achieving functional integration of employment and education policies
- Enhanced quality of Vocational Training, including through the development of specific skills in the Services sector (for instance tourism, etc.)
- Greater capacity of research structures (human and material resources) with the focus on scientific excellence
- Stronger links between scientific and research communities in the EU and Azerbaijan, including educational institutions and networks.
- An improved connection of the Azerbaijan National Research and Education Network (AzRENA) to the European backbone GÉANT2, which will bring benefits to the entire science and education sector of Azerbaijan.

d) Indicators of achievement

Long-term impact

- Positive assessments/progress reports by the EU and other donors on social and enrolment indicators and standards of education systems.

Specific objectives

- Improved education and training systems, as demonstrated by studies assessing progress of reforms and convergence with EU standards and practices
- Increased participation by Azerbaijani nationals in the relevant EC students and researcher exchange programmes
- Closer integration of Azerbaijan into the European Research Area, as demonstrated by a higher number of joint activities and projects.
- The direct linking of the Azerbaijan National Research and Education Network (AzRENA) to the European backbone GÉANT2.

The interventions supported in the area of education and training will be implemented in close coordination with the Tempus programme, which will be funded out of the ENPI

Inter-Regional programme. The dissemination and exchange of best practice in these areas will be further enhanced.

5. Priority Area 2: Support for socio-economic reform (with emphasis on regulatory approximation with the EU *acquis*), fight against poverty and administrative capacity building

5.1. Strategic context/justification

The EC will offer assistance to enable further progress on the establishment of a fully functioning and balanced market economy and to ensure that oil and gas revenues are managed in an accountable and transparent way; this will include support for the diversification of the economy, and will be to the benefit of the whole country. The EC will also support further advances in the gradual approximation of laws and regulations with those of the EU (as envisaged in the PCA and the ENP Action Plan) and effective implementation thereof and also the improvement of the investment climate by ensuring transparency, predictability and simplification of procedures. Furthermore, assistance will be provided with the aim of strengthening social reform, fighting corruption and encouraging approximation with EU social standards, thus contributing to poverty reduction and improving the situation of legal employment in Azerbaijan, including through education and vocational training. Reducing regional imbalances and improving local development capacities are further important issues in this respect as is the promotion of sustainable development and mainstreaming it into all the relevant sectoral policies. Finally, the EC will support Azerbaijan in its WTO accession process.

The EC is uniquely well-equipped to support the approximation process as it can build on extensive experience gained in the process of the accession of the ten new EU Member States. In designing support in this area emphasis should be placed not only on technical advice on approximation of legislation and alignment of procedures but also, equally importantly, on administrative capacity building at all levels (in particular support for trade and economic ministries and tax, statistics and customs authorities) to ensure national ownership and effective enforcement of approximated rules and regulations.

The EU-Azerbaijan Action Plan defines a considerable number of priority areas for trade and market-related regulatory reforms, in particular trade facilitation issues, including customs legislation and procedures, technical regulations, standards and conformity assessment, sanitary and phyto-sanitary (SPS) issues, consumer protection, right of establishment and company law, financial services and markets, taxation, competition policy, enterprise and SME policy, intellectual and industrial property rights, public procurement and statistics.

EC support in this area thus links up directly with the priorities of the ENP Action Plan, as specified in particular in priority areas 4, 5, 6 and 7⁶ and sections 4.4 and 4.5.⁷ The priorities mentioned in these sections also reflect the recommendations made by the World Bank in its 2003 "Integrated non-oil trade and investment strategy" for Azerbaijan.

As a general rule, maximum flexibility will be required in order to respond efficiently to evolving needs during implementation of the current Action Plan and beyond.

5.2. Sub-priorities

5.2.1. Sub-priority 1: Promoting mutual trade, improving the investment climate and strengthening social reform, including that of social insurance and pension systems

a) Long-term impact

The expected long-term impact will be an improvement in the investment climate, progress in economic and social reform and development and the gradual alignment of Azerbaijan with the EU's internal market and social standards.

b) Specific objectives

The specific objective is to facilitate trade and to improve the investment climate and the employment and social situation in a sustainable manner.

c) Expected results

- Market and regulatory reforms in the form of approximation of legislation and alignment of procedures (in particular in the areas of trade facilitation including customs legislation and procedures, technical regulations, standards and conformity assessment, sanitary and phyto-sanitary (SPS) issues, consumer protection, right of establishment and company law, financial services and markets, taxation, competition policy, enterprise and SME policy, intellectual and industrial property rights, public procurement and statistics) based on the implementation of the ENP Action Plan and of reforms in the areas of trade and investment promotion, including through removal of many of the existing barriers, the approximation of Azerbaijani legislation in areas such as phyto-sanitary and food products, and the reform of the tax system and administration

⁶ Respectively: Improve the business and investment climate, particularly by strengthening the fight against corruption, Improve functioning of customs, Support balanced and sustained economic development, with a particular focus on diversification of economic activities, development of rural areas, poverty reduction and social/territorial cohesion; promote sustainable development including the protection of the environment and Further convergence of economic legislation and administrative practices.

⁷ Respectively: Economic and social reform, poverty reduction and sustainable development and Trade-related issues, market and regulatory reform, with all their subsections.

- Enhanced administrative capacity of the customs administration and improved customs legislation, with a view to facilitating trade and securing the international trade supply chain (World Customs Organisation Framework of Standards)
- Implementation of legislative and policy reforms in the employment, social and health areas targeting modernisation of the system and approximation with EU standards and practices
- Enhanced administrative capacity to ensure national ownership and effective enforcement of approximated rules and regulations.

d) Indicators of achievement

Long-term impact

- Economic and social development indicators and degree of internal market alignment as measured and assessed by the EU in relevant progress reports.

Specific objectives

- Increased and (in terms of products) more diversified trade, as demonstrated by trade statistics from government and other sources
- Improved investment climate, as demonstrated by increased FDI, surveys among investors and assessments/reports by the EU and other institutions
- Improved employment and social situation, as demonstrated by data on job creation and provision of social services
- Further reform of the State insurance and pension system.

5.2.2. Sub-priority 2: Supporting the implementation of the SPPRED/SPPRSD,⁸ of the State Programme for Regional Development and of government plans for the non-oil sector (strengthened competitiveness and diversification of the economy)

a) Long-term impact

The expected long-term impact will be to improve the competitiveness of the Azerbaijani economy by strengthening the relevant sectoral markets, notably in the transport, energy,⁹ environment, agriculture, tourism and financial sectors and the information society, to diversify the economy (including by development of clusters in several non-oil sectors), to develop the legislative and administrative framework for SMEs across all sectors.

b) Specific objectives

The specific objective is to address the poverty problem in the country, including by supporting the development of the non-oil sector of the economy and by reducing

⁸ SPPRED is the State Programme on Poverty Reduction and Economic Development, which will be replaced by the State Programme on Poverty Reduction and Sustainable Development – SPPRSD, to be adopted presumably in late 2006.

⁹ This includes promoting the convergence of technical norms and standards with those of the EU.

geographical imbalances in the distribution of wealth between the Baku region and the rest of the country.

c) Expected results

- Successful implementation of the State Programme for Poverty Reduction and Sustainable Development
- Sector-specific regulatory reform and institution building in line with the priorities in the Action Plan and detailed sectoral strategies, including in the non-oil sector and regional development
- Enhanced administrative capacities in ministries or state structures for the relevant sectors to ensure national ownership and effective enforcement.

d) Indicators of achievement

Long-term impact

- Increased level of reforms in key sectors as assessed by the EU in relevant studies/progress reports.

Specific objectives

- Reduction in the percentage of the population living below the poverty threshold
- Increase in the non-oil sector contribution to national GDP
- Reduction in the disparities in the main socio-economic indicators between the Baku region and the rest of the country
- Level of regulatory convergence with the EU in key sectors, as assessed by the EU in relevant studies/progress reports.

5.2.3. Sub-priority 3: Sector-specific regulatory aspects, including public accounting and capital market

a) Long-term impact

Increased alignment of Azerbaijan on the EU's internal market and international standards.

b) Specific objectives

The specific objective is to enhance trade and to improve the investment climate, the employment and social situation in a sustainable manner.

c) Expected results

- Market and regulatory reforms in the form of approximation of legislation and alignment of procedures, including technical regulations, conformity assessment

procedures and standards, and statistical standards, based on implementation of the PCA and the ENP Action Plan in order to achieve conformity with EU and international requirements

- Improvement in the operation of Azerbaijan's standardisation, certification and accreditation systems and enhanced capacity of the local organisations responsible for these functions
- Implementation of reforms in the areas of trade and investment promotion, including through removal of many of the existing barriers and the approximation of Azerbaijani legislation in areas such as phyto-sanitary and food products
- Enhanced development of the securities market, including from an institutional point of view and enhanced conformity of Intellectual Property Rights (IPRs) to PCA and ENP Action Plan requirements
- Strengthened capacity of Azerbaijan's body responsible for the regulation and certification of locally produced foodstuffs and other products, with a view to ensuring the alignment of local quality standards and conformity certification to European standards
- Implementation of legislative and policy reforms in the employment, social and health areas aimed at modernisation of the system and at approximation with EU standards and practices
- Enhanced administrative capacity to ensure national ownership and effective enforcement of approximated rules and regulations.

d) Indicators of achievement

Long-term impact

- Economic and social development indicators and degree of internal market alignment as measured and assessed by the EU in relevant progress reports.

Specific objectives

- Level of regulatory convergence with the EU in key sectors, as assessed by the EU in relevant studies/progress reports.

6. Priority Area 3: Support for legislative and economic reforms in the transport, energy and environment sectors

6.1. Strategic context/justification

In the energy sector, Azerbaijan is a key strategic partner for the EU, both as a producer and transit country. Assistance to reform the domestic energy market and the legislative framework will be provided on the basis of the priorities defined in the ENP Action Plan and the Memorandum of Understanding (MoU) aimed at establishing a partnership on energy between Azerbaijan and the EU, signed in Brussels on 7 November 2006. Other

important areas are improving energy efficiency and promoting new and renewable energy sources.

In the past, the EC has been active in this area mainly through its regional or cross-border programmes and it will continue to address issues with a genuinely regional/cross-border dimension under a trans-national framework. Where appropriate, assistance will, however, also be provided on a national basis, including at regional and local level.

In the transport sector, Azerbaijan, houses the headquarters of the TRACECA General Secretariat. TRACECA has been the main tool for collaboration in the field of transport between the EU and twelve countries of Eastern Europe and Central Asia since 1993. It is also worth mentioning that, together with other Eastern European countries, Azerbaijan has been constructively involved in the work of the High Level Group (HLG) on the extension of the major trans-European transport corridors to neighbouring countries and regions and also to the regional cooperation on the implementation of the TRACECA corridor. Assistance in this area will focus on priority routes and projects identified by the HLG, notably on the TRACECA corridor, and supported by the Commission in its upcoming Communication on the report of the HLG.

Azerbaijan played an active part in the EU-Black Sea-Caspian Basin Ministerial Energy and Transport Ministerial Conferences held in Baku on 14 November 2004 and continues to play an active role in their follow-up Working Groups.

With regard to the development of environmental infrastructure, specific needs have been identified at national level, particularly in the areas of waste management, water management and ecological protection.

6.2. Sub-priorities

6.2.1. Sub-priority 1: Energy, including reforms of the domestic legislative framework and markets

a) Long-term impact

The expected long-term impact will be to strengthen the competitiveness of the Azerbaijani energy system by supporting the provision of improved and financially viable services.

b) Specific objectives

The specific objective is to carry forward legislative and economic reforms in the energy sector, promote high levels of safety and security in the energy infrastructure and to encourage energy efficiency, energy savings and the use of renewable energy sources in Azerbaijan.

c) Expected results

- Increased market convergence and structural reforms in the Azerbaijan's energy market
- Development of a comprehensive energy demand management policy
- Elimination of domestic energy price distortions on the basis of market economy principles and overall improvement of the financial viability of the electricity and gas sectors.

d) Indicators of achievement

Long-term impact

- Economic development indicators and improved service delivery as assessed by the EU/other institutions, user surveys.

Specific objectives

- Improved and more efficient energy domestic market, as demonstrated by technical reports/assessments.

6.2.2. Sub-priority 2: Transport, including reforms of the domestic legislative framework and markets

a) Long-term impact

The expected long-term impact will be to strengthen the competitiveness of the Azerbaijani transport system by supporting the provision of improved and financially viable services.

b) Specific objectives

The specific objective is to carry forward legislative and economic reforms in the transport sector and to support legislative and technical standards approximation in Azerbaijan and to promote high levels of safety and security for all transport modes.

c) Expected results

- Increased market convergence, institutional and structural reforms in Azerbaijan's transport sector, benefiting from EU best practices
- Implementation of legislative and institutional reforms benefiting from EU best practices.

d) Indicators of achievement

Long-term impact

- Economic development indicators and improved service delivery as assessed by the EU/other institutions, user surveys.

Specific objectives

- Improved and more efficient transport domestic sector, as demonstrated by technical reports/assessments.

6.2.3. Sub-priority 3: Environment

a) Long-term impact

The expected long-term impact will be to have environmental and sustainable development considerations integrated into the country's sectoral policies.

b) Specific objectives

The specific objective is to improve the legislative and administrative management of environmental challenges in Azerbaijan, taking into consideration EU best practices and experience.

c) Expected results

- Development of an efficient reporting system on the state of environment
- Development of sectoral environmental plans (waste and water management, air pollution, etc.), to be incorporated in government policies
- Improved procedures and structures for environmental impact assessment
- Approximation of Azerbaijan's environmental legislation and standards with the EU's;
- Strengthening of management capacity through integrated environmental authorisation.

d) Indicators of achievement

Long-term impact

- Improved state of environmental protection, as assessed by the EU/other institutions, user surveys.

Specific objectives

- Successful integration of the environment and sustainable development into public sectoral policies and private business.

7. Implementation

The general principle underlying the programme is partnership to achieve joint policy objectives. To achieve the level of ownership this requires, the Azerbaijani counterparts should be drawn as far as possible into the design of operations, thus emphasising even further the clear link that must be formed between joint policy objectives and assistance cooperation. This includes exploring possibilities for co-funding by Azerbaijan, thus demonstrating its commitment.

If too many small, stand-alone measures were to be taken, this would result in administrative overload and delay implementation in general. Instead, programmes should contain a limited number of components with in-built flexibility. While detailed implementation mechanisms will be worked out action by action, support for Sector Programmes, including the use of pool funding and/or sector budget support, is encouraged wherever the requisite conditions are met. In such a context, the list of sub-priorities mentioned in the present document is to be understood as indicative. The Commission, in close cooperation with the partner country, will duly conduct a regular identification exercise, in order to select among the indicative list of the NIP, those sub-priorities that appear best justified, in the light of the elements usually considered in this kind of analysis.

New cooperation tools, such as Twinning and TAIEX, are expected to be particularly useful in the areas of regulatory reform and administrative capacity building and should be fully exploited. Flexibility will be particularly important in these areas if EC assistance is to be adapted to evolving policy priorities. As appropriate, Azerbaijan will also be supported with participation in Community programmes, agencies and networks, insofar as these are open to the country. This should also include support to the final beneficiaries so as to make them able to benefit from the opportunities offered under the open programmes.

As far as support for infrastructure development is concerned, EC assistance should be implemented in close collaboration with the EIB, EBRD and other IFIs and may include support for investment preparation, environmental and social impact assessments, and grant funding of specific investment components. EC support for any form of infrastructure development will be subject to full compliance with the relevant requirements of the EU *acquis*.

Interest rate subsidies can leverage investments by international financing institutions in the fields of environment, energy and transport sectors, as explained in the Country Strategy Paper.

An appropriate mechanism will be necessary to foster the development of civil society, including for support at local community level.

8. Risks and assumptions

The key assumption underlying this Indicative Programme is continuous commitment to the reform agenda and policy objectives contained in the jointly agreed EU-Azerbaijan ENP Action Plan and in the Partnership and Cooperation Agreement (PCA). Should this assumption no longer hold true, as a result of major policy changes on the part of Azerbaijan, the priorities under this Indicative Programme and the underlying Country Strategy Paper might have to be subject to an early review.

As far as the move to new delivery mechanisms and financing methods such as budgetary support is concerned, the assumption is that direct budgetary assistance in support of macroeconomic or sectoral reforms will only be granted where:

- (a) Public expenditure management is sufficiently transparent, accountable and effective
- (b) Well-defined macroeconomic and sectoral policies established by the country itself and agreed to by its main donors and the International Financial Institutions are in place
- (c) Public procurement is open and transparent, and
- (d) Precise objectives for direct budgetary assistance, including related benchmarks for their impact, are defined.

Disbursement of such support will be conditional upon the fulfilment of clear and measurable macroeconomic performance and structural adjustment criteria, based on the economic programmes of the beneficiary countries and the achievement of the objectives for the support, which have to be monitored according to defined benchmarks.

One final assumption is that the Azerbaijani government manages to implement certain reforms in the institutional division of labour between central and regional/local levels. The Azerbaijani state is extremely centralised at present, and virtually no real power is left to local administrations. This gives rise to a number of problems, including corruption. A thorough reform of the relationship between central and local administrations (also indicated as a priority in the ENP Action Plan) is to be considered as another pre-condition for successful implementation of the present assistance programme.

9. Alignment, harmonisation and consultation

9.1. Dialogue with the government and alignment with national policies

The policy objectives set in the EU-Azerbaijan Action Plan were agreed formally by the two sides on 14 November 2006.

Consultations with the Azerbaijani authorities on this Programme and the underlying Country Strategy Paper began during a programming mission in July 2006. It was agreed at that stage that the future assistance strategy has to be based on the jointly agreed policy objectives while selecting a limited number of priority areas where EC financial

assistance can be expected to have most impact. Azerbaijan noted with satisfaction that the future ENPI will provide a more flexible instrument and that technical assistance will no longer be the predominant channel of EC assistance.

9.2. Harmonisation and coordination with Member States, other donors and civil society

Member States were briefed, and invited to comment, on the Programme.

Intensive contacts have been maintained in Baku and Brussels with all other relevant donors, including the EIB, EBRD, World Bank, UNDP and USAID.

In the spirit of the Paris Declaration on Aid Effectiveness, attention will need to be paid in the period ahead to closer donor coordination, particularly in the context of preparing and implementing sector-wide support programmes.