



# Global Environment Facility

**Leonard Good**

Chief Executive Officer  
and Chairman

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May 12, 2005

Dear Council Member,

The World Bank, as the Implementing Agency for the project, ***Azerbaijan: Rural Environment Project***, has submitted the attached proposed project document for CEO endorsement prior to final approval of the project document in accordance with the World Bank procedures.

The Secretariat has reviewed the project document. It is consistent with the proposal approved by the Council in April 2005, and the proposed project remains consistent with the Instrument and GEF policies and procedures. The attached explanation prepared by the World Bank satisfactorily details how Council's comments and those of the STAP have been addressed. I am, therefore, endorsing the project document.

We have today posted the proposed project document on the GEF website at [www.theGEF.org](http://www.theGEF.org). If you do not have access to the Web, you may request the local field office of the World Bank or UNDP to download the document for you. Alternatively, you may request a copy of the document from the Secretariat. If you make such a request, please confirm for us your current mailing address.

Sincerely,

A handwritten signature in black ink, appearing to be "L. Good", written over the word "Sincerely,".

cc: Alternates, Implementing Agencies, STAP

# OFFICE MEMORANDUM

DATE: May 2, 2005

TO: Mr. Leonard Good, CEO/Chairman, GEF

FROM: Steve Gorman, GEF Executive Coordinator



EXTENSION: 35865

SUBJECT: **AZERBAIJAN: Rural Environment Project  
Submission for Final CEO Endorsement**

1. Please find attached the electronic file of the GEF Project Document for the above-mentioned project for your final review and endorsement. This project was approved for Work Program entry at the February 2005 Intersessional, under streamlined CEO endorsement procedures. We would appreciate receiving your response, so that we may finalize the Bank Board submission, by May 16, 2005.
2. The GEF Project Document is fully consistent with the objectives, scope, and overall cost of the proposal approved at the February 2005 Intersessional. Minor adjustments have been made during final preparation concerning the process for establishing the Shah Dag National Park, including the total expected area of the park. GEFSEC, STAP, and Council comments have also been addressed. Modifications to the Project Document and how comments have been addressed are summarized below, and detailed responses to the Council comments are attached (Attachment 1).

3. **Adjustments:**

(i) The total project cost has been increased to \$17.1 million, with an increase of the IDA Credit to \$8 million (GEF Grant remains unchanged);

(ii) the Project Brief called for the creation of two very large, multi-purpose national parks: Shah Dag National Park (SDNP, about 343,000 hectares) and an expanded Ordubad NP (ONP, about 137,000 ha). These total areas included all of the state-owned forest and pasture land in the project areas, as well as 97,000 ha of municipal and privately owned land which it was intended would eventually be brought into the parks through voluntary agreements (with about 25% of this total to be achieved during the 4-year project). However, questions persisted as to whether classification as a national park was consistent (in Azeri law or in the IUCN definitions) with the intention to allow livestock grazing on more than 60% and 90% of the areas (SDNP and ONP, respectively). Therefore a new model has been adopted which combines smaller core national parks (about 113,000 ha for SDNP; 43,300 ha for ONP) with the surrounding state areas designated as other types of Protected Areas (PAs). Most of this is expected to be designated as “zakazniks,” (sometimes translated as “nature preserves” or

“state natural parks”). As explained in the attached response to the Council member from Germany, *zakazniks* represent an appropriate PA classification for the combined conservation and sustainable use approach that has always been proposed for these large, economically and socially important pasture areas. On-the-ground investment will focus mainly on the national parks, but some support will also go to establishing, managing and monitoring the other PAs. The agreed approach is described in Sections B3, C(2) and D(2), Annex 4 and Annex 6, and is reflected in the monitoring indicators (Annex 3).

4. ***Responses to GEFSEC and Council comments (responses to STAP Reviewer comments were provided prior to Work Program entry):***

*GEFSEC Review Sheet comments (expected for CEO endorsement):* (i) Provide detailed costing by activity and sub-activity; (ii) provide letter of commitment for cofinance.

**Response:** a detailed cost breakdown is provided in Annex 5 of the Project Document and the memo confirming approval of the \$2.72 million Japanese Co-financing is attached (Attachments 2). This is a fully blended IDA/GEF project (\$ 5 million GEF Grant; \$ 8 million (SDR 5.4 million) IDA Credit).

*Summary of responses to main comments from Council members:*

**Comments:** concerns regarding long-term financial sustainability (of the national parks and of community investments) were still not adequately addressed, and that tourism was not likely to provide a sufficient revenue stream. **Response:** further discussion of the potential for revenue generation through a modest increase in tourism and other means (carbon finance, etc.) have been added to Sections C1, D1 and D2 of the Project Document. However, it must be noted that few if any PAs world wide are entirely or even mainly financially self-sufficient, and that Azerbaijan is an emerging middle income country that will be better able to maintain support for its PA system than many other countries where GEF provides similar investments for expanding PAs. Sections B3 and C4 and Annex 4 explain how community level investments will be targeted to ensure sustainability.

**Comment:** the areas should be classified as “protected landscape” or “biosphere reserves” rather than national parks. **Response:** this has in effect been done (see above).

**Comment:** the figure of 20% of households adopting improved livestock husbandry practices seems unrealistic. **Response:** Section D5 and Annex 10 of the Project Document have been expanded to better describe the results of public consultations which confirm a high degree of interest in improved livestock among local communities. Section C describes further socio-economic work that will ensure appropriate targeting of project investments.

**Comment:** need for more specific indicators of biodiversity impact. **Response:** available data limit the amount of specificity possible at this point. The discussion of Monitoring and Evaluation in the Project Brief has been expanded to better describe how baseline data will be established and indicators and targets developed.

5. Please let me know if you require any additional information to complete your review of the project document. We look forward to receiving your endorsement of the project for Bank Board approval.

Many thanks.

Attachments

cc: Messrs./Mmes. Ramankutty, GEF PROGRAM COORDINATION (GEFSEC); Kiss, Voegelé (ECSSD); *Battaglini (RC)*; *Mackinnon*, Khanna, Wedderburn, Aparakka (ENV); ENVGC ISC, Regional Files

**Attachment 1****Responses to Comments Received from GEF Council Members**

Note: the Project Brief reviewed by GEF Council was a pre-appraisal version. Most of the issues raised by Council members are addressed in the more thorough final version of the Project Document (PD). This information is summarized in the responses below.

**Comments from Germany**

***Comment: The issue of sustainable financing has not been sufficiently explored... mechanisms should be established to allow payments for environmental services and private (e.g. oil) company investments... the project places too much reliance on tourism as a source of financing for the national parks.***

**Response:** No ongoing (beyond project) external funding will be required for the community activities. Investments under Component 2 will be selected by communities from a menu of activities whose economic viability and sustainability has been demonstrated in similar circumstances (e.g. WB-financed Anatolia Watershed project), including small scale irrigation, fodder production, improvement of livestock and milk collection for dairy processing. The project is not introducing new economic activities but is helping to make the area residents' main existing source of livelihood more efficient, profitable and sustainable (e.g., see PD Sections B3, C4). Substantial technical assistance will be provided to assist communities to identify the investments that best meet their short and long term needs. Financial viability and sustainability are also strongly emphasized in start-up funding of rural enterprises to be supported under Component 3. Business advisory service providers will help prospective entrepreneurs evaluate market opportunities and develop viable business plans, which will be evaluated independently prior to approval of partial grant funding. Where longer term financing is required, this will be reflected and addressed in the business plans.

With respect to the national parks, the PD acknowledges and addresses the objective of developing some level of self-financing over the longer term. Tourism is identified as one likely contributor on a modest scale (contrary to the reviewer's comments, the project indicates only conservative targets for expected tourism growth). The PAD states that the technical assistance to be provided will include helping park authorities explore financing options such as carbon financing and corporate sponsorship in the future; however, it is not possible to provide further specifics at this time (see Sections C1, D1, D2 of PD). The potential for carbon financing will only become known after the detailed forest and pasture inventories are completed, early in the project. Payment for watershed services must be regarded as a long-term prospect in Azerbaijan. Attracting corporate sponsorship is more likely to be feasible after the parks have been successfully established. (Note, these two parks currently have

relatively low priority for environmental support from the petroleum industry, as neither is located near the path of the BTC pipeline or other proposed oil infrastructure).

This project aims to introduce an ecosystem management approach to biodiversity conservation, involving coordination across a landscape comprised of areas with different types of land use and varying levels of protection. This is expected to be more sustainable than the prevailing model of strict nature reserves, both because of the potential for some internal revenue generation (from tourism, grazing permits, harvesting of timber and non-timber products), and because the economic benefits will stimulate local and national political support. At the same time, it must be noted that very few if any PAs anywhere are fully or even mainly self-financing, either from tourism revenues or other sources. Substantial, long-term financial support from Governments is by far the rule and not the exception worldwide. Azerbaijan is in the process of becoming a middle-income country, and is therefore more likely to be able to support a substantial publicly-funded PA system than many other countries where GEF provides similar investment<sup>1</sup>. We fully agree with the STAP and other reviewers that tourism is likely to make only a partial contribution to financing the parks. The same applies for other sources of internal revenue generation, environmental service payments and private financing. Furthermore, over-emphasis on financial self-sufficiency can undermine the conservation objectives of PAs. For example, many PAs permit mineral or sand mining, off-take from water bodies, and harvesting of plant or animal species at destructive or unsustainable levels (or, at the least, without effective ecological monitoring to determine the impacts). Increasing financial sustainability over time is an important objective and will be included in the Park Charters. However, we feel it would be a mistake to raise expectations that these PAs will become self-financing, or to set specific financial goals at this time.

***Comment: the PA classification is confusing and does not match IUCN/UNEP categories...these “national parks” should rather be labeled “protected landscapes” or “Biosphere Reserves.”***

**Response:** The same concern prompted a reconsideration of the model during Appraisal, and a new model has been adopted which involves classifying the core areas (where there will be little economic use other than tourism and recreation and, in the future, possibly some sustainable timber harvesting) as national parks, and the surrounding areas (which will continue to be used mainly for livestock grazing) as other types of PAs. Most of that area is expected to be established as “zakazniks,” (sometimes translated as “nature preserves” or “natural parks”). Zakazniks are established through Decree of the Cabinet of Ministers and fall under the jurisdiction and administration of the Ministry of Ecology and Natural Resources (MENR). The Law on Specially Protected Natural Areas legislation identifies *zakazniks* as areas for the protection and rehabilitation of natural complexes, maintenance of ecological

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<sup>1</sup> Notes: (i) by law, Ministry of Finance is required to approve all PA staffing plans to confirm the Government’s commitment to meet the salary costs; (ii) this year, in addition to the regular budget for PA staffing and operations, Government provided an incremental budget of \$170,000 for rehabilitation of park infrastructure.

equilibrium, and pursuit of scientific, cultural and restricted economic activities. The specific activities that are permitted, regulated and prohibited in any given Zakaznik are determined by its Charter, which is approved by the MENR. Project investment will focus on the national parks but will also provide support for the establishment, management and monitoring of the surrounding PAs, as well as building institutional structures for coordinating biodiversity conservation, sustainable natural resource management and sustainable development at an ecosystem level across the entire project area. In effect, the project areas will indeed become “protected landscapes,” and be very similar to “biosphere reserves,” except that all the state-owned land (totaling almost 430,000 hectares), will be formally designated as PA of one category or another. The details are provided in PD Sections B3, C(2) and D(2), Annex 4 and Annex 6, and is reflected in the monitoring indicators (Annex 3).

***Comment: need to avoid reducing locally adapted agro-biodiversity (sheep and goat varieties) through introduction of hybrid dairy cattle.***

**Response:** As indicated in the Environmental Assessment and stated in the PD, this the national Committee on Biodiversity (Ministry of Ecology and Natural Resources) and the Academy of Sciences have confirmed that there are no specialized indigenous livestock varieties at risk. Furthermore, it is not expected that the project will result in complete replacement of sheep/goats with cattle, and at present there is little expressed interest in improving sheep/goat varieties (See Annex 10 of PD).

***Comment: the figure of 20% of 55 communities adopting modern livestock husbandry seems overly ambitious... local socio-economic and socio-cultural structures should be carefully examined before modern, high-input interventions are introduced, to determine whether rural communities wish to have them and are capable of implementing them.***

**Response:** As discussed in Section D5 and Annex 10 of the PD, extensive local consultations were carried out during project preparation and reviewed during appraisal. Community representatives expressed great interest in improving livestock quality through artificial insemination (not a very high-tech or high-input intervention), and fully recognized the implications (e.g. the need to produce fodder and improve stall conditions to support the improved varieties). Given the expressed demand, it is very likely that considerably more than 20% of households will invest in livestock improvement if given the opportunity. These communities are remote in location, but educational levels are relatively high (e.g. most villages have secondary schools with computers and some have internet access as well as satellite television). Most residents have relatives working in towns or outside the country and have been exposed to modern methods. Their poverty is mainly the result of inadequate infrastructure, and economic upheavals during the transition from the Soviet era (e.g. closing of local industries), not to a lack of sophistication or capability.

At the same time, we recognize the need for an additional, more detailed social impact assessment to further improve targeting of project benefits and to refine impact indicators and targets. This will be undertaken during the first year of the project (e.g., see Section C3 of PD).

***Comment: most “alternative livelihoods” initiatives have failed when implemented as “side programs” without proper monitoring and technical support...the selection of selection of persons with the required business potential is a critical success factor...there is a danger that enterprises become too project driven with the consequence of lack of entrepreneurial spirit.***

**Response:** The rural enterprise support component has been designed specifically to address these points. There will be a very substantial investment in business advisory services as well as follow-up/monitoring by a qualified NGO or company (engaged as Grant Administrator). Grant applicants will be self-selected, and will have the opportunity to work closely with business advisors to prepare comprehensive business plans, and will be required to make a substantial cash contribution to obtain the matching grants. Grant approval will be based on an independent evaluation of both the business plan and the financial and implementation capacity of the proposer. Implementation of the component will certainly benefit from the experience of the GTZ/BMZ program, among a number of other recent and ongoing programs aimed at stimulating and supporting the SME sector in Azerbaijan.

### **Comments from Switzerland**

***Comment: information on biodiversity of the selected areas is given only in broad terms, threats to biodiversity insufficiently identified, no analysis of the existing PA system. Existing institutional weaknesses are mentioned but not addressed through substantial capacity building activities.***

**Response:** The PD gives considerable detailed information on biodiversity values and description of threats (Sections A(1), B(3) and D(2), Annex 1). Other reviewers (STAP, GEF Secretariat, USA) commented favorably on this aspect. Similarly, the relevant limitations of the existing PA system are discussed, particularly the Soviet era legacy of small, fragmented, strict nature reserves with no participation and no responsibility to provide local or broader economic benefits. The documents note that individual PAs operate relatively autonomously in Azerbaijan, with no strong central PA authority. Therefore, operational capacity building is focused at the PA level. The Department of Biodiversity Conservation (Ministry of Ecology and Natural Resources), has a general planning and oversight role, and the project will support capacity building for the Department in that context (see Section C2, and Annex 6).

***Comment: no references are made in the project description to activities to support: objectives of improving connectivity of the PA system; carrying out the first***

***comprehensive forest inventory/status assessment since 1984; or providing compensation for short-term economic losses for local communities.***

**Response:** the connectivity objective (p. 5) relates to connectivity of the protected area system within the Greater and Lesser Caucasus mountains, rather than the national PA system of Azerbaijan. The project will contribute to this objective by establishing a large, new PA in the heart of the ecosystem, in a transboundary area. Forest and pasture inventories are listed among activities for Component 1 (see Section B3). The rural development activities supported under Components 2 and 3 are aimed at both compensating for potential short term economic losses and developing a basis for more sustainable economic development in the long term. Target villages and activities have been selected on this basis (see Sections B3, C4, and particularly C5; D4 and D6; Annex 10).

***Comment: alleged sustainability of the project is based on general assumptions and is purely speculative, e.g. financing of the National Parks is based on the simplistic assumption of [ unfounded expectations of ] revenues from tourism. The assumption that Government will adequately finance operation of the NPs appears purely hypothetical.***

**Response:** see response to first comment from Germany, above.

***Comment: lack of indicators to measure biodiversity impact (no baseline data; inadequate indicators for biodiversity; indicators such as dry biomass are of limited importance in assessing status of biodiversity).***

**Response:** Due to lack of available information, it is not possible to develop more specific biodiversity indicators or baseline figures at this time. As indicated in the project documents, this will be done on the basis of inventories to be carried out in the first year. In any case, the primary target is to increase the area under effective protection and management. Dry biomass is intended as an indicator for pasture restoration relating to improved grazing management, not for biodiversity *per se* (it is an indicator under Component 1 because sustainable natural resource use is an important objective of park management). The GEF tracking tools for PA management effectiveness and for biodiversity conservation in production areas will be used.

***Comment: the method and criteria for co-financing are not in line with GEF policy... If the whole baselines are taken as co-financing, further explanations are needed (reference to GEF/C.20/6/Rev.1).***

**Response:** all IDA funds are for activities which are essential for achieving the GEF objectives, as indicated in the ICA and Results Framework (Annex 3). The ICA follows the model of other fully blended IDA/GEF projects.

**Comments from USA**

Comments from the USA were generally positive and did not require response. The reviewer noted the importance of monitoring whether the new approaches are replicated in the future. There was a question regarding lessons learned from other projects, but this is addressed in Section B(4).

**Attachment 2**

**Confirmation of Japanese Co-Financing Grant Approval**

**From:** Omar Hayat on 01/25/2005 10:44 AM  
TFO

**To:** Frauke Jungbluth/Person/World Bank@WorldBank, Agi Kiss/Person/World Bank@WorldBank, Nathan M. Belete/Person/World Bank@WorldBank, Jean-Michel G. Pavy/Person/World Bank@WorldBank, Andres G. Pizarro/Person/World Bank@WorldBank

**cc:** B. Koshie Michel/Person/World Bank@WorldBank, Olgamarie Villa/Person/World Bank@WorldBank, Marjory-Anne Bromhead/Person/World Bank@WorldBank, Juergen Voegele/Person/World Bank@WorldBank, Samir M. Suleymanov/Person/World Bank@WorldBank, Andrew D. Goodland/Person/World Bank@WorldBank, Matrice Mangum/Person/World Bank@WorldBank, Natasha Hayward/Person/World Bank@WorldBank, Alexandra Orellana/Person/World Bank@WorldBank, Andreas Schliessler/Person/World Bank@WorldBank, Sajjad Ali Shah/Person/World Bank, Beverley M. Hyatt-Allen/Person/World Bank@WorldBank, Benaifer Kermani Devine/Person/World Bank@WorldBank, Isabel C. Mignone-Del Carril/Person/World Bank, Shirley Matzen/Person/World Bank@WorldBank, PHRD Unit

**bcc:**

**Subject:** FY05 Round 1: PHRD Grant Approvals

Dear All,

We are pleased to inform you that the following PHRD grant proposals have been approved by the Japanese government.

**Project Preparation:**

Paraguay: Road Maintenance Project (\$930,340)

**Project Cofinancing:**

Armenia: Rural Enterprise and Small-scale Commercial Agriculture Development (\$1,755,000)

Azerbaijan: Rural Environment Project (\$2,720,000)

Mongolia: Index Based Livestock Insurance Project (\$1,318,000)

Mozambique: Transfrontier Conservation Grant for Institutional Capacity Building (\$3,720,000)

Please refer to PHRD "Procedures for Processing PHRD TA Grants Documents" on the next steps. To access these procedures, please click on the link below.

<http://www.worldbank.org/rmc/phrd/PHRDProcedures.pdf>

Regards,

Omar Hayat  
Operations Officer  
Trust Fund Operations

Document of  
The World Bank

Report No:

PROJECT DOCUMENT  
ON A  
PROPOSED CREDIT  
IN THE AMOUNT OF SDR 5.4 MILLION  
(USD 8.0 MILLION EQUIVALENT)  
AND A GLOBAL ENVIRONMENT FACILITY GRANT  
IN THE AMOUNT OF USD 5.0 MILLION  
*AND A PHRD GRANT*  
*IN THE AMOUNT OF USD 2.72 MILLION*  
TO THE  
REPUBLIC OF AZERBAIJAN  
FOR A  
RURAL ENVIRONMENT PROJECT

April 29, 2005

## CURRENCY EQUIVALENTS

(Exchange Rate Effective March 31, 2005)}

Currency Unit = Special Drawing Rights  
SDR 1 = US\$1.50803  
US\$1 = SDR 0.66311

### FISCAL YEAR

January 1 – December 31

### ABBREVIATIONS AND ACRONYMS

AOP	Annual Operational Plan (national parks)
AREP	Azerbaijan Rural Environment Project
ARPF	Access Restriction Process Framework
AWP	Annual Work Plan
BAT	Business Advisory Teams
BTE	Baku-Tbilisi-Erzurum
CAS	Country Assistance Strategy
CBD	Convention on Biological Diversity
CENN	Caucasus Environmental NGO Network
CEPF	Critical Ecosystem Partnership Fund
CIS	Commonwealth of Independent States
DBCSPNA	Department of Biodiversity Conservation and Development of Specially Protected Natural Areas (within the Ministry of Ecology)
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECC	Ecological Coordinating Committee
EIA	Environmental Impact Assessment
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
GEF	Global Environment Facility
GO	Global Objective
GOA	Government of the Republic of Azerbaijan
ha	hectare
IUCN	The World Conservation Union
MENR	Ministry of Ecology and Natural Resources
METT	Management Effectiveness Tracking Tool
NEAP	National Environmental Action Plan
NGO	Non-governmental organization
NP	National Park
NSAPBC	National Strategy and Action Plan on Biodiversity Conservation
ONP	Ordubad National Park
ONPA	Ordubad National Park Administration
OPN	Operational Policy Note
OSCE	Organization for Security and Cooperation in Europe
PA	Protected Area
PAD	Project Appraisal Document

PDO	Project Development Objective
PHRD	Japan Policy and Human Resources Development Fund
PIM	Project Implementation Manual
PIU	Project Implementation Unit
PCU	Project Coordination Unit (field branch of PIU)
RECC	Environmental Centre for the Caucasus
SCAWM	State Committee of Amelioration and Water Management
SDNP	Shah Dag National Park
SDNPA	Shah Dag National Park Administration
SPNA	Specially Protected Natural Area
SDR	Special Drawing Rights
SME	Small and Medium Enterprises
SPPRED	State Program on Poverty Reduction and Economic Development
STAP	Scientific and Technical Advisory Panel
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VC	Village Cluster
WWF	World Wide Fund for Nature

Vice President:	Shigeo Katsu
Country Manager/Director:	Donna Dowsett-Coirolo
Sector Manager:	Juergen Voegele
Task Team Leader:	Agnes Kiss

**AZERBAIJAN**  
Rural Environment Project

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## **A. STRATEGIC CONTEXT AND RATIONALE**

### **1. Country and sector issues**

Azerbaijan is a mountainous country of 86,600 km<sup>2</sup> and a population of about 8 million people. It lies on the western coast of the Caspian Sea among the mountain ranges of the Greater and Lesser Caucasus and the Talish mountains. Mountains cover about 44% of the territory, and forests cover about 11%.

Azerbaijan is facing many of the same challenges as other CIS transition economies, including an agenda of policy and institutional reforms needed to redefine the role of the state and create essential underpinnings of a market economy. One of the six strategic pillars of the State Program on Poverty Reduction and Economic Development (SPPRED) is an enabling environment for income-generating opportunities. While the overall economy is improving as a result of oil development, this is not reflected in the mountain areas, where most people fall under the poverty line of US\$24 per month (average income is \$16 per month in villages above 2000 meters). With the end of reliable, highly subsidized gas and electricity following independence, many rural households have turned to wood from State forests for their energy needs. This is resulting in rapid deforestation as demand for wood fuel exceeds sustainable annual fuel wood yields by up to a factor of ten in some areas.

## **ENVIRONMENTAL MANAGEMENT AND NATURE PROTECTION**

Environmental management is recognized as an important right and obligation in the Constitution of the Azerbaijan Republic (1995). The National Environmental Action Plan (NEAP), completed in 1998, identifies priorities relating to reducing pollution damage from oil extraction and industry; halting the decline of sturgeon populations and water quality in the Caspian Sea; protecting biodiversity and improving the management of forests, pastures and agricultural lands; preserving cultural heritage; addressing ecological problems with regional or global impacts; and improving the institutional and policy framework for environmental management. The Ministry of Ecology and Natural Resources (MENR) was created in 2001 to integrate all aspects of environmental protection and management, including environmental assessment and monitoring (including reporting on the state of the environment), and management of forests and wildlife resources and of specially protected natural areas<sup>1</sup>.

A National Strategy and Action Plan on Biodiversity Conservation (NSAPBS), currently under preparation, stresses the preservation of key ecosystems and natural habitats through a well managed system of Protected Areas (PA), by enhancing and efficient management of protected areas, and sustainable usage of biodiversity to contribute to economic and social objectives. Currently the PA system covers about seven percent of the country<sup>2</sup>, but PAs are small and the system is fragmented and some important ecosystems are not well represented. . The Government of the Republic of Azerbaijan (GOA) signed the Convention on Biological Diversity in 2001, and has made a major commitment to protecting biodiversity, including

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<sup>1</sup> There is an independent Ministry of Environment and Natural Resources in the Nakhchivan Autonomous Republic, with similar responsibilities

<sup>2</sup> Comprised of 38 PAs: 14 Strict Nature Reserves, 20 sanctuaries, 4 national parks

maintaining and substantially expanding the nation's PA system to include under-represented ecosystems. Creation of the Shah Dag National Park (SDNP) and expansion of the Ordubad National Park (ONP) are among the highest strategic priorities. At the same time, management of existing PAs needs to be improved by building institutions, strengthening human resource capacity and increasing resources, while at the same time addressing issues of poverty and pressure for economic development in rural areas. The Law on Specially Protected Natural Areas and Objects (2000) includes provisions for taking into consideration social and economic factors and interests of local people, and for participation of the population and social organizations in preserving Protected Areas (PAs). However, the prevailing model for PAs in Azerbaijan, as in much of the CIS, is based on centrally controlled Strict Nature Reserves (Zapovedniks<sup>3</sup>). The GOA has begun to diversify the national PA system, by creating the country's first six national parks (NP) in 2003-2005. According to the Azerbaijan law, national parks include zones for tourism and for other limited economic activities. .

## NATURAL RESOURCE MANAGEMENT

**Forests:** Almost all natural forest in Azerbaijan is designated as Forest Fund land. Forest management capacity is weak due to lack of staff training and experience and resources. Since 2003, all forest cutting, for either commercial or sanitary purposes have been suspended by the MENR, and officially only forest residues are collected and sold. However, it is generally recognized that large quantities of standing trees continue to be cut illegally and forest cover continues to decline. A National Programme on the Rehabilitation and Extension of Forests (established on 18 February, 2003) aims to restore 25,000 ha of existing forest and plant some 44,700 ha of new forest, mainly in lowland areas. Due to insufficient funding, only about 3,000 ha of planting were completed in 2003.

**Meadows and Pastures:** High elevation summer pastures and a large proportion of mid-elevation winter pastures belong to the State. Some small pasture areas and hayfields belong to, or are under the management of, local municipalities. Municipal pastures are free for use, while grazing rights on State pastures are leased by the State Land and Cartography Committee, together with Rayon Executive Authorities and Ministry of Agriculture, to individuals or companies on the basis of grazing permits, usually with a duration of 10-15 years. While grazing rights are in principle allotted on the basis of numbers of animals, there are no specific legal provisions in the grazing contracts, and no monitoring on the part of authorities, to ensure that the official stocking rates are followed. In the Shah Dag area, it is estimated that the actual stocking rates are as much as five times higher than the official norm (totaling 2.5 million animals, as opposed to 500,000).

## BIODIVERSITY SIGNIFICANCE AND THREATS

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<sup>3</sup> The original terms "Zapovednik" and "Zakaznik" are used in this document because there is no clear consensus on the appropriate English translations. Zapovedniks are strict nature reserves where no economic uses or other disturbances are permitted. Zakazniks are nature reserves where specified economic and other activities may be prohibited or restricted as required to achieve the objectives of protected nature, ecological processes and species. These prohibitions and restrictions are specified in the charter of the Zakaznik

Azerbaijan's high biodiversity results from its location at the convergence of three biogeographic regions (Europe, Central Asia and Asia Minor). The Caucasus mountains area<sup>4</sup>, has been identified by the World Wide Fund for Nature (WWF) as a Global 200 Ecoregion, and by Conservation International as one of the world's 25 biodiversity "hotspots" (the only one in the ECA region). It is believed to contain more than twice the animal diversity found in adjacent regions of Europe and Asia, and a flora which is notable for its large number of endemic and relict species and as one of the world's richest gene banks of wild relatives of important agricultural and medicinal plants. 4500 of the more than 7,000 plant species of the Caucasus can be found in Azerbaijan, and seven percent of these are endemic to the country. A recently completed ecosystem profile and five year investment strategy for the Caucasus eco-region<sup>5</sup> identified 10 key corridors, five of which were selected as top priority for conservation action. The five include the Greater Caucasus (which encompasses the proposed SDNP) and the East Lesser Caucasus (encompassing the ONP). Both the SDNP and ONP include elements of important transboundary migratory corridors.

In addition to their significance as global, regional and national biodiversity assets, both the SDNP and ONP project areas represent important economic assets, due to their rich natural resources and tourism potential. Shah Dag is Azerbaijan's second highest mountain and serves as a watershed which provides much of the water for Baku and the Absheron Peninsula, which is home to nearly 30% of the country's population. The proposed expanded ONP contains a large proportion of all high elevation pasture in the Nakchchivan Autonomous Republic.

The Caucasus ecosystem profile identified deforestation, overgrazing and hunting as the three greatest direct threats to biodiversity. Underlying causes include poverty in rural areas, energy shortages following the end of importation of wood from other countries and decline in availability of natural gas supply in the area. Overgrazing of pastures has become a serious threat in the project areas since the late 1980's, as more people took up shepherding or increased their herds in response to growing unemployment and declining economic opportunities in other sectors, and there is clear evidence of overgrazing at all altitudinal levels (montane, sub-alpine and alpine). Traditionally, sheep were grazed in alpine meadows in the summer, with subalpine meadows reserved for fodder production and used during the winter months. However with traditional grazing areas in the north Caucasus (Dagestan, Georgia) no longer accessible, livestock is kept nearer to villages all year round, resulting in overgrazing and degradation of fragile subalpine woodland ecosystems.

## RELATION TO GEF OPERATIONAL PROGRAMS

Biodiversity conservation is the key focal area for the project. The project addresses GEF strategic priorities for biodiversity conservation through: (i) catalyzing sustainability of protected areas, (ii) mainstreaming biodiversity in production landscapes and sectors, and (iii) generating and disseminating best practices for addressing current and emerging biodiversity issues. Project activities will directly support innovative practical approaches called for by the 7th Conference

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<sup>4</sup> Total area of 500,000 km<sup>2</sup>, between the Black Sea and Caspian Sea, including parts of Georgia, Armenia, Azerbaijan, and small parts of Russia, Iran and Turkey.

<sup>5</sup>By the Critical Ecosystem Partnership Fund -- a joint initiative of Conservation International (CI), the Global Environment Facility (GEF), the Government of Japan, the MacArthur Foundation and the World Bank

of the Parties (COP-7) of the Convention on Biological Diversity (CBD) in its Decisions VII/1 “Forest Biological Diversity”, VII/11 “Ecosystem Approach”, and VII/28 “Protected Areas”.

The project follows the GEF Strategic Guidelines and incorporates elements of several GEF Operational Programs:

No. 3 (Forest Ecosystems): by supporting in-situ protection of ecologically mature temperate forest ecosystems under threat, and combining strict protection and multiple use to achieve sustainable forest management. Among other things, it will support the first comprehensive forest inventory and status assessment since 1984, making it possible to make sound management decisions.

No. 4 (Mountain Ecosystems): by supporting in-situ conservation and sustainable use of biological resources, expanding and improving connectivity of the protected area system in the Greater and Lesser Caucasus mountains, and combining productive, socioeconomic and conservation goals.

No. 12 (Integrated Ecosystem Management): by emphasizing the creation of an enabling environment for biodiversity conservation, forest and rangeland management, the strengthening of institutional capacities at local, regional and national levels as well as investments in sustainable natural resource management.

The GEF grant would finance costs of activities required to achieve global conservation benefits, which would be incremental to the baseline national program undertaken by the Government with support from the World Bank IDA credit and the PHRD grant (see Annex 15 - Incremental Cost Analysis).

## **2. Rationale for Bank involvement**

The Azerbaijan SPPRED highlights the importance of environmental management: in a recent Bank review of integration of environment in Poverty Reduction Strategy Papers, Azerbaijan was ranked 5<sup>th</sup> out of 53 countries worldwide<sup>6</sup>. The Country Assistance Strategy (CAS) for Azerbaijan<sup>7</sup> stresses the need to generate jobs and non-oil-based economic growth by improving the business environment, particularly in smaller urban and rural areas, and includes an IDA/GEF operation to support participatory approaches to sustainable forest, pasture and protected area (PA) management, and for promoting sub-regional cooperation in the globally significant ecosystems of the Caucasus mountains. The AREP will support CAS goals by enabling rural communities in the project areas to benefit from improved environmental management, adopt more profitable and environmentally sustainable livestock production systems, and initiate income-earning activities relating to natural resource use. The Bank’s support for rural development in Azerbaijan has largely focused on irrigated, arable land in low elevation areas, rather than the mountains. The AREP targets rural mountain areas, which are among the poorest in the country.

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<sup>6</sup> Bojo et al., 2004. Environment in Poverty Reduction Strategies and Poverty Reduction Support Credits. Environment Department Papers No. 102, The World Bank.

<sup>7</sup> FY03-05 CAS, April, 2003

In keeping with the NEAP, the Bank's strategy for assistance to Azerbaijan in the environment sector has two main pillars: (i) managing environmental challenges connected with development of the oil industry and broader economic development especially in coastal areas; and (ii) addressing sustainable natural resource management within the context of rural development and conservation of Azerbaijan's key ecosystems. The Azerbaijan Urgent Environmental Investment Project (AUEIP) and the regional Caspian Environment Program have focused on the first aspect, and also supported institutional strengthening for environmental management, including the creation of the Ministry of Ecology and Natural Resources (MENR). The AREP will continue this institutional support by helping MENR develop capacity for forest and pasture management and for PA management, including adoption of a participatory, multi-sectoral approach. This will help the GOA meet national objectives and international commitments. The AREP would be the first Bank-financed operation to support the NEAP objectives of improved pasture and forest management and biodiversity conservation. It offers the opportunity to bring to Azerbaijan a considerable body of knowledge and experience from numerous initiatives relating to protection and management of mountain forest and pasture ecosystems across the ECA region and elsewhere.

While there is considerable interest on the part of Government and within the donor community to develop rural tourism in the Caucasus region, existing programs involving Azerbaijan are small (less than \$1 million) and focus mainly on national policy and strategy, awareness raising, training, information and capacity building. For successful tourism development, this must be complimented by on-the-ground investment in park management and key infrastructure, which represents a substantial part of the proposed AREP.

### **3. Higher level objectives to which the project contributes**

The project will contribute to the restoration, protection and management of globally significant mountain forest and alpine meadow ecosystems, including a number of endemic and endangered species and transboundary migrants. The creation of the SDNP will greatly increase the area of the globally recognized ("hotspot") Caucasus eco-region under protection. By supporting the development of new approaches to PA management in Azerbaijan, it will help shift biodiversity and protected area policies and practices away from the highly centralized and exclusive model inherited from the Soviet era, towards a more modern, inclusive approach that combines biodiversity and ecosystem protection with providing economic and other benefits to local communities. The project will also introduce active management of pastures, and support the development of a participatory approach to natural resource management overall. Equally importantly, the project will contribute to lasting poverty alleviation in some of the poorest areas of Azerbaijan, by introducing and catalyzing the adoption of more modern, sustainable, and value-added approaches to natural resource use and agricultural production and diversification of economic activities, including development of rural/eco-tourism.

## **B. PROJECT DESCRIPTION**

### **1. Lending instrument**

Specific Investment Loan, GEF grant, PHRD grant

### **2. Project development objective and key indicators**

**2a. Project Development Objective (PDO):** The PDO is to improve biodiversity conservation and introduce more sustainable natural resource management and economic activities in two mountainous areas of Azerbaijan, to restore the ecological health and productivity of their natural forests and pastures.

**2b. Global Objective (GO):** The GO is to protect biodiversity in two globally significant biodiversity areas within the Caucasus and Zangezur mountains, and introduce and pilot an ecosystem-based approach for Protected Area (PA) management in Azerbaijan.

Key indicators for the PDO and GO are:

- Establishment of SDNP and enlargement of ONP, as indicated in the project document (see Section 3 and Annex 4), ;
- Development and initial implementation of zoning and management plans for SDNP and ONP, following a participatory process;
- Implementation of pilot community-based tree planting activities (covering 3000 ha by midterm, and 9,000 ha by the end of the project), in order to assist local communities to meet their need for fuelwood and other wood products;
- Adoption of more modern, productive and sustainable livestock husbandry practices by at least 20% of households in (55) participating villages;
- 150 or more environmentally friendly, financially sound, small/medium enterprises identified, initiated and publicized (all or most receiving small grants from the project as part of their overall financing package);
- Midterm and end-of-project surveys indicate significantly increased awareness and understanding of, and support for, multi-purpose national parks (and more broadly, for environmentally sustainable development and natural resource management) within the project areas.

### **3. Project components**

The project area consists of the areas of the proposed Shah Dag and enlarged Ordubad national parks and the surrounding areas, including: (i) state-owned lands that will be included in the parks; (ii) state-owned pasture land to be included in other types of PAs to be established around and adjacent to the national parks; and (iii) neighboring municipal and private lands that may in future be incorporated into the parks through agreement with their owners. The boundaries of the two parts of the project area are shown in Annex 17, and the villages included in (iii) are listed in Annex 18.

The main instruments for achieving the project objectives will be the establishment of the SDNP and enlarged ONP and the surrounding PA network, together with associated assistance for community economic development. The model of an ecologically coherent complex of different types of PAs will provide a mechanism for coordinated ecological management, while meeting the needs of local communities and other land owners and users. Over time it is anticipated that the area included within the national parks will increase, through incorporation of high priority state-owned land and through land owners agreeing to include their land in the park through various contractual agreements. Local communities and other stakeholders will participate in the preparation of the park zoning and management plans and in the preparation and implementation of a comprehensive and coordinated ecological management plan covering the entire assemblage of PAs. The community development aspects of the project aim to promote more sustainable livelihoods and economic activities in the project areas. In the short term the focus is on reducing pressure on natural resources and ecosystems and mitigating potential negative socio-economic impacts of increased restrictions on forest and pasture use, by helping local communities to develop alternatives and to improve the productivity and sustainability of their traditional economic activities, particularly livestock husbandry. The longer term objective is to promote a diversification of local economies, making them less dependent on mass consumption of natural resources.

**COMPONENT 1. Protected Areas Establishment and Management (US\$8.69 million):**

This component will support the establishment of Shah Dag National Park (SDNP) and expanded Ordubad National Park (ONP), and adjacent PAs. A three-phase process is envisaged for the creation of the parks:

Phase 1: the national parks are created on specified areas of state-owned lands, including existing SPNAs, all Forest Fund land and high elevation meadows of high biodiversity significance, most of which are not used for grazing<sup>8</sup>. Total anticipated area of SDNP is about 113,00 ha, and of ONP is about 43,000 ha. In accordance with Azerbaijan law, these parks can contain core conservation zones and areas for limited economic activity and other services (e.g. tourism, park administration infrastructure);

Phase 2: national parks are expanded through addition of some areas of state-owned pasture, identified based on their high biodiversity or ecological significance. Legislation will be amended as needed to make provisions for regulated grazing, resident and other economic uses in accordance with park management plans;

Phase 3: national parks and PAs are further expanded through incorporation of some areas of municipal or privately owned lands, without transfer of land ownership, based on voluntary agreements between park Administrations and the land owners. The main objectives are to reduce fragmentation of the park (e.g. incorporate lands that are enclaves within park boundaries), and increase local support for the park through direct participation in tourism development and other benefits.

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<sup>8</sup> Expansion of ONP in Phase 1 is expected to also include some pasture land currently within Zakazniks

Issuing of the Presidential Resolution establishing the SDNP is a condition of effectiveness for the project; the Resolution expanding ONP is expected to be issued prior to or soon after effectiveness. Phase 2 is expected to begin by the second year of the project, after completion of detailed forest and pasture inventories and local consultations. Phase 3 can in principle proceed in parallel with Phase 2, but is likely to require considerable prior awareness raising, education and negotiation. Only a small portion (about 25%) of this total potential area is expected to be added to the PA network during the project. Creation of the other PAs will proceed in parallel with the creation of the national parks, and is anticipated to be completed by the midterm of the project. Details of the envisaged process and target areas (hectares) are provided in Annex 4.

The project will support measures to modernize and improve park management, restore degraded areas, tourism development, and increase participation of stakeholders in park management. It will also support better sustainable management of biological resources in the other PAs to be established in the project areas, through direct investment (as appropriate) and by creating and supporting institutional structures and planning activities involving the key stakeholders. Specific activities to be financed under this component include: delineation and demarcation of park and other PA boundaries; technical assistance and training for institutional capacity building; forest and meadow inventories, preparation of park zoning and management plans and annual operating plans; implementation of management plans, including reforestation in high priority areas, rehabilitation and limited construction of critical infrastructure for park management and tourism, and provision of essential equipment; implementation of an ecological monitoring system; and incremental operating costs.

**COMPONENT 2. Community-level investment in sustainable agriculture and natural resource management (US\$4.48 million):** This component will assist residents of 55 villages inside or immediately adjacent to the two national parks and surrounding PAs<sup>9</sup> to shift their traditional agricultural and natural resource use practices towards more modern and efficient approaches that place less pressure on natural resources and ecosystems. The main focus is on promoting a shift away from low value livestock husbandry based primarily on grazing in vulnerable high-elevation pastures, to more intensive and productive methods based on fodder production. With the help of technical advisors, communities will develop village investment plans, drawing upon a menu of options (seeds, fertilizers, agricultural equipment, small scale irrigation, milk collection and storage facilities, artificial insemination services, fencing material for pasture management, etc.). Assistance will also be provided for restoring and improving the management of badly degraded municipal pastures close to villages. In addition to fodder production, access to agricultural machinery and irrigation will help villagers to increase production of potatoes and other marketable crops (rehabilitation of access roads under Component 1 will enhance access to markets). A committee comprised of representatives of the Ministry of Ecology and Natural Resources, Ministry of Agriculture, Ministry of Agricultural Development, the local Executive Committee, and each municipality included in the village cluster, will approve the village investment plans, to ensure that they are consistent with other local development plans and objectives.

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<sup>9</sup> Representing about half the population of the project areas, selected based on criteria discussed in Section C2 and Annexes 4 and 6.

To begin to close the gap between fuelwood demand and sustainable offtake from the natural forest, the project will support pilot scale community-based tree planting, and small scale demonstration of the benefits of more efficient wood-burning stoves for domestic heating. The experience gained through these pilots is expected to stimulate replication and expansion with significant positive impacts in the future.

Specific activities to be financed under this component include: technical assistance, small scale works (ponds and pipelines for irrigation; facilities for the implementing organizations); goods and equipment for the village investments and services; and operating costs for the implementing organizations chosen by the communities that will implement Component 2 activities.

**COMPONENT 3. Rural Enterprise Development (US\$1.95 million):** Component 3 aims to stimulate economic diversification in the project areas by assisting local entrepreneurs to start or expand environmentally sustainable small and medium commercial enterprises.

The project will fund small mobile business advisory teams to help interested clients identify and assess the viability of commercial ventures and prepare business plans. It will also provide matching grants (ca. \$2000-\$10,000) for start-up or expansion of small or medium enterprises, based on independent evaluation of the business plans. The grant will normally support up to 60 percent of the total project cost, with the grantee responsible for contributing the remaining 40% in cash, but in exceptional cases the grant proportion may be higher. Priority will be given to activities that are linked to national park objectives (including tourism-related enterprises, alternative energy and energy efficiency, and value-added processing of sustainably harvested natural products such as fruits, nuts and medicinal plants) and enterprises that support Component 2 objectives (e.g. value-added dairy products). Following technical and financial evaluation by a contracted Grants Administrator and PIU, grants will be approved by an Awarding Committee comprised of representatives of the Ministries of Ecology and Natural Resources; Agriculture; Youth, Sports and Tourism; Finance; and Economic Development.

Given the time and resources available, the objective is not to achieve a large scale transformation of local economies, but to catalyze a shift by stimulating interest, demonstrating and testing different types of business opportunities, building local understanding and capacity for business planning and development, and creating an environment that will encourage other SME programs and micro-credit institutions to increase their presence in the project areas.

**COMPONENT 4. Project Management, Monitoring and Evaluation, and Communications (US\$1.98 million):** This component will support overall project management and administration, including the staffing and operating costs of a central Project Implementation Unit and three field offices (Project Coordination Units, PCU): two in the Shah Dag area, one in the Ordubad area. The branch offices are needed because of the size, remoteness, difficulty of access and poor communications infrastructure of the project areas. This component also includes cross-cutting activities such as: Monitoring and Evaluation (M&E); the development and implementation of a communications plan (in collaboration with local authorities and NGOs) to increase awareness and knowledge of the project and its objectives and activities at all levels; detailed socio-economic studies to improve targeting of project benefits; and facilitating the

development of a cross-sectoral, multi-stakeholder tourism development plan for the greater Shah Dag area.

## Project Costs

	Component	Indicative Cost (US\$'000)	% of Total	Bank Financing (US\$'000)	% of Bank Financing	GEF Financing (US\$'000)	% of GEF Financing	PHRD Financing (US\$'000)	% of PHRD Financing	GOA Financing (US\$'000)	% of GOA Financing
1	Protected Areas establishment and management	\$8.69	50.8%	\$3.33	41.6%	\$2.12	42.4%	\$1.92	70.6%	\$1.32	95.6%
2	Community-level investment in agriculture and NR management	\$4.48	26.2%	\$3.15	39.3%	\$0.91	18.2%	\$0.40	14.7%	\$0.03	2.2%
3	Small enterprise development	\$1.95	11.4%	\$0.79	9.9%	\$0.76	15.2%	\$0.40	14.7%	\$0.00	0.00%
4	Project management, monitoring and evaluation, and communication	\$1.98	11.6%	\$0.73	9.2%	\$1.22	24.4%	\$0.00	0.0%	\$0.03	2.2%
	<b>Total Project Costs</b>	<b>\$17.10</b>	<b>100%</b>	<b>\$8.00</b>	<b>100%</b>	<b>\$5.00</b>	<b>100%</b>	<b>\$2.72</b>	<b>100%</b>	<b>\$1.38</b>	<b>100%</b>

## 4. Lessons learned and reflected in the project design

Based on experience with similar projects in the Europe/Central Asia Region and elsewhere, the following lessons have been incorporated into the project design:

- Project design should be focused, limited in terms of geographic area and types of activities; new approaches should be piloted before mainstreaming them at national level;
- Be realistic about what can be achieved within the available time frame and the capacity of implementing agencies, particularly when the project involves elements such as the introduction of new ideas, approaches and skills; substantial strengthening or establishment of new institutional structures; community mobilization and participation; or restriction of traditional access to natural resources<sup>10</sup>;
- Set specific and realistic objectives and interim targets, which can be used to evaluate progress and re-orient components or implementation approaches if needed;
- Combine enforcement and incentives for effective protection and sustainable management of biodiversity and natural systems;

<sup>10</sup> Which involves implementation of an Access Restriction Process Framework

- Involve key stakeholders early in the project design and in the preparation phase to ensure ownership and to ensure that the design and specific investments make sense in the country and local contexts;
- Combine financial assistance for SME start-ups/expansion with professional business advice and, to the extent possible, address constraints in the overall business environment (tax and other policies, regulatory processes, infrastructure, etc.);

These lessons are reflected in the project design. For example, the project will focus on the Shah Dag and Ordubad areas, rather than addressing the entire national PA system, with the objective of demonstrating approaches that can be replicated in other areas. Considerable effort has been made to involve local stakeholders in the preparation phase, including the establishment of local project offices, and the project includes measures to ensure communities have the opportunity, means, knowledge and incentives to participate in park management. Component 2 is strongly focused on livestock improvement and related economic activities, rather than supporting a broad menu of potential local development objectives. Implementation (see Annex 3) are based on a realistic implementation schedule that allows adequate time for key steps including recruiting personnel, procuring works and goods; carrying out community mobilization, awareness-raising and participatory planning activities; building institutional capacity; developing business plans; etc. The project includes a substantial investment in Technical Assistance (TA) for PA management, community mobilization and small enterprise development, because preparation studies identified a lack of such services in the project areas as a major potential constraint to success. However, the TA is primarily local, and structured to ensure an emphasis on capacity building and in-service training.

## **5. Alternatives considered and reasons for rejection**

The project will introduce and implement the concepts of biodiversity conservation and sustainable natural resource management on an ecosystem scale, in two large protected landscapes<sup>11</sup>, each with a national park at its core. An initial proposal for a broader project to create a coordinated national Protected Areas (PA) system was rejected, in view of weak institutional capacity and the need to pilot new approaches before embarking on a more ambitious expansion program. Another early proposal, to create a single park encompassing the Shah Dag area and the coastal area of Samur-Yalama, was rejected as impractical (the Samur-Yalama area is being developed as a separate PA). In Shah Dag, the highest priority biodiversity conservation sites are dispersed across large areas, surrounded by large areas of intensively used summer pasture. Alternative approaches that were considered but rejected included: (i) establishing a network of relatively small, disconnected PAs separated by unprotected areas; (ii) creating large, conventional national parks which would exclude human habitation and all economic activities other than tourism; and (iii) creating two large multi-purpose parks which would incorporate large areas of actively used pasture land and both state-owned and non state-owned land. The first option was rejected as operationally impractical and ecologically unsound, as it fails to address the linkages between the core conservation areas and surrounding areas. The second option was rejected as it would have involved relocating more than 60 villages (over 40,000 people) and taking large areas of valuable pasture and forest permanently

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<sup>11</sup> Note: this is a descriptive term, not necessarily meant to correspond precisely with the IUCN definition of a “Protected Landscape”

out of economic use. Both the first and second options would also have perpetuated the unsustainable and increasingly unacceptable *status quo* of isolating local communities from the valuable resources and economic potential of the PAs. The option of large, multi-purpose national parks, while becoming increasingly common in many countries, was deemed to be unfeasible due to a lack of local experience with the model and because the legal framework regarding substantial economic use such as widespread grazing within national parks is unclear. Therefore, the 3-phased approach described above was selected, whereby the parks will initially be created on a more traditional model, with the objective of moving towards a more comprehensive, multi-purpose and multiple-ownership approach.

Given the weak local technical and institutional capacity in relation to modern approaches to PA management, high value livestock production and commercial development, the option of a purely technical assistance/ capacity building project was considered. However, there is a strong demand and urgent need for interventions on the ground, and for demonstrating the viability and benefit of these new approaches. Therefore, the project was designed to combine a major investment in capacity building with on-the-ground investments, some of which are at a pilot/demonstration level. Alternative approaches to capacity-building were considered, particularly making less use of international Technical Assistance and relying primarily on training and local consultants. However, because local capacity is very limited, international TA is needed to introduce new approaches and modern methods, to fill the immediate need for skilled and experienced personnel to get activities moving, and to provide in-service training and capacity building for their counterparts. The international TA is structured with repeated visits of limited duration, in order to emphasize local capacity-building and avoid the risk of TA taking over line responsibilities.

## C. IMPLEMENTATION

### 1. Partnership arrangements (if applicable)

As part of the “hotspot” Caucasus ecoregion, Azerbaijan benefits from a number of regional programs by bilateral and multilateral donors and international NGOs, which complement the AREP objectives. For example, the Regional Environmental Centre for the Caucasus<sup>12</sup> (RECC,) and the Caucasus Environmental NGO Network supporting activities by regional and local NGOs relating to transboundary cooperation in natural resource management and conservation<sup>13</sup>. Agro- and eco-tourism is a particular focus (e.g.: a UNDP/GOA “pro-poor” tourism project (launched in 2004), a Eurasia Foundation project to develop transboundary hiking routes and agro-ecotourism, the World Bank-financed Cultural Heritage Project, the Trans-Caucasus Tourism Initiative co-financed by the World Bank and the Swiss Government, a WWF initiative on ecotourism development in the Caucasus supported by the German government; rehabilitation of cultural heritage sites in and around Sheki funded by Norway, and a rapid assessment of tourism potential undertaken in 2003 as the first phase of a program of the Organization for Security and Cooperation in Europe (OSCE) to support growth of the tourism sector in

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<sup>12</sup> supported by the European Union, Switzerland and the U.S. among others

<sup>13</sup> E.g.: a grant from RECC’s Swiss-financed Transboundary Grants Programme to the Azerbaijan Society of Ornithologists (and the Georgian Centre for Wilderness Protection) for conservation of highland ecosystems

Azerbaijan. Most of these programs are implemented with local NGO partners. Other likely partners in the future include USAID, and the Soros Foundation, which are supporting (capacity building for rural tourism in several other countries in the region. Recognizing the need for greater coordination and collaboration among these many and diverse supporters and initiatives, a Tourism Steering Group was established in Baku in March, 2004 to facilitate information flow.

While the local NGO sector is relatively poorly developed, particularly outside Baku, several NGOs that are active in the project areas have been involved in preparation of the AREP and/or are expected to participate in implementation. These include general environmental organizations concerned with environmental policy, protection, education and monitoring (e.g., the Information-Analytic Environmental Agency (ECORES); Azerbaijan Ecological Union; Xazri TETA; CENN); with biodiversity conservation (e.g. WWF-Azerbaijan; Birdlife; Azerbaijan Zoological Society; Azerbaijan Animal Protection Society, etc.), and with rural/sustainable development (e.g., Azerbaijan Mountain Regions Development Association (ADRIA); Rural Development Programme for Mountainous and Highland Areas). There will be several avenues for NGOs and other stakeholders to participate in or collaborate with the AREP, including direct contracting or collaboration with ongoing programs for providing rural advisory services and administration of small grants. The communications/outreach, social impact assessment and monitoring programs coordinated by the PIU will all be carried out in cooperation with NGOs and community groups.

Important partners among international NGOs include the World Wide Fund for Nature (WWF), which has been supporting and carrying out conservation activities in the Caucasus for over 10 years. This includes leading the development of an ecosystem profile for the Caucasus biodiversity hotspot, under the auspices of the Critical Ecosystem Partnership Fund (CEPF). This involved the participation of over 130 local and international experts, and provides a framework for inter-governmental and donor coordination based on agreed conservation priorities and targets. The CEPF itself may in future provide co-financing for some community-based conservation activities to be supported under the AREP.

The rural enterprise development component of the AREP will benefit from partnership with numerous organizations and initiatives involved in developing small and medium enterprises in Azerbaijan, such as the EU/EBRD-funded Business Advisory Services Programme and the Azerbaijan Business Development Program<sup>14</sup>. Also, as noted in Section B4, some enterprises applying for grants under Component 3 will require additional loan financing to be viable. The AREP will not provide credit, but will seek partnership with existing microfinance institutions.

While the operating costs of the parks are expected to be met mainly by Government and, in the future, partly from tourism revenues, the MENR and the Bank will also explore the possibility of partnership with the private sector. For example, the oil industry has already become involved in supporting conservation, environmental management and sustainable development in Azerbaijan and neighboring countries in the context of the Baku-Tbilisi-Ceyhan oil pipeline. Another avenue to be explored in future is partnership with downstream users of water from the SDNP watershed, including the city of Baku and the petroleum and other industries concentrated on the

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<sup>14</sup> likely to be funded by USAID

Absheron peninsula. Similarly, the project will explore opportunities for carbon financing (payment for reducing carbon emissions/sequestration of carbon).

## **2. Institutional and implementation arrangements**

A Project Implementation Unit (PIU), established by the Government of Azerbaijan for implementation of the World Bank-financed projects in the environmental sector, will have overall responsibility for project implementation and coordination, including planning, procurement<sup>15</sup>, financial management and accounting, monitoring and evaluation, progress reporting, training on project implementation procedures, and cross-sectoral coordination and government liaison. The PIU is administratively under the MENR, and is well experienced in project implementation, having served effectively for implementation of the Urgent Environmental Investment Project. For the AREP it is being strengthened including the addition of small, locally-based regional offices to facilitate implementation and communication with stakeholders in these large, remote areas. The regional offices will also serve as a home base for the long-term technical service providers under Components 2 and 3.

The Project Steering Committee which was established to facilitate cross-sectoral coordination and support during the preparation stage, will continue for the same purpose during implementation.

MENR, through its Department of Biodiversity Conservation and Development of Specially Protected Natural Areas (DBCDSNA, or Biodiversity Department) will have overall responsibility for implementation of Component 1. In accordance with Azerbaijan law, each national park will be established as a separate legal entity with its own Charter and Administration. The park Administrations will also have responsibility for monitoring and supporting conservation and sustainable management of biological resources within adjacent PAs, in coordination with other local authorities. Institutional structures such as a Stakeholder Advisory Group and an Ecological Coordination Committee will be established as mechanisms for coordinating among these agencies and for involving local communities and other stakeholders in PA management, and for promoting sustainable development and coordinated ecological and natural resource management across the project area as a whole.

The institutional mechanism (implementing agency) for implementation of Village Cluster Investment Plans under Component 2 will be selected by communities with the assistance of Technical Advisors (the Project Implementation Manual describes in detail the technical assistance to be provided to the communities). Participating villages will be grouped in Village Clusters (VC) with 3-5 villages each, for more efficient and cost-effective implementation. Because of limited time and resources, about half the villages within the project areas will participate directly in Component 2. These have been identified based on criteria such as population density, accessibility, availability of agricultural land for fodder crop production, and the extent to which the villages represent a source of pressure on the natural resources in the parks (and are likely to suffer negative impacts due to grazing restrictions). Each VC will prepare an investment plan. The PIU will establish an Investment Plan Approval Committee for

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<sup>15</sup> for all goods, works and services except those falling under community-based procurement, Component 2 and under Commercial Practices, Component 3

each VC to review and endorse VC investment plans. Community members will pay user fees to the implementing agency for some of the services (e.g. rental of agricultural machinery, artificial insemination). The fee structures will be decided by the communities as part of their overall investment plan.

In the absence of suitable service providers in the project areas, implementation of Component 3 will be contracted to business consulting firms or suitable NGOs<sup>16</sup>. One contract will be for establishment of small mobile business advisory teams, responsible for assisting prospective entrepreneurs to identify eligible and viable commercial opportunities, analyze market conditions, prepare business plans and submit grant applications, and, where appropriate, assist clients to identify credit providers and prepare loan applications for additional financing. A second contract will be awarded for administration of the matching grants program, including: evaluating proposals for their technical, financial, environmental and social viability and passing recommendations to an Awarding Committee (headed by the PIU); administering and monitoring the use of grant funds; and regular reporting to PIU on progress of implementation of these activities.

### **3. Monitoring and evaluation of outcomes/results**

Annex 3 provides the overall framework, indicators and initial targets for monitoring and evaluation of project outcomes. This will serve as the basis for development of a more detailed M&E plan during the first year of the project. The PIU will ensure that the M&E plan is integrated into project implementation for each component. A detailed socio-economic study will also be carried out during the first year, to supplement information from studies done during preparation. Outputs of this study will include: refining the socio-economic baseline data and social impact monitoring indicators and targets; recommendations for improved targeting of project benefits; and a Social Mitigation Plan to ensure that the elements of the Access Restriction Process Framework are fully incorporated into project activities. For biodiversity impact monitoring, the project will support detailed forest and rangeland inventories during the first year, and will make use of the WWF/World Bank Alliance/GEF Management Effectiveness Tracking Tool (METT) and “Tracking Tool for GEF Biodiversity Focal Area Strategic Priority Two: Mainstreaming Biodiversity in Production Landscapes and Sectors.”

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<sup>16</sup> The preference is for a single contract, but separate contracts for SD and Ordubad areas may be required

#### 4. Sustainability

The project aims to put in place systems for more sustainable use of natural ecosystems that are currently being overused and degraded, and to promote economic development that will reduce reliance on mass consumption of natural resources. In the short term this will be mainly through improved protection, but the longer term objective is develop community/user-based management systems and to trigger a shift from traditional, low-input livelihoods based on mining of natural resources (forests and pastures) towards more value-added economic activities that are less dependent on these resources or use them more efficiently. Because of the short time frame, the project can only serve as a catalyst for such a shift, by introducing new approaches, demonstrating opportunities, changing incentives, providing some start-up capital, and improving market access through rehabilitation of key access roads.

An ecosystem approach involving both national parks and less restrictive PAs is expected to be more sustainable in the long run than conventional, exclusive PAs because it will enjoy greater local and national support. The Government is committed to expanding its PA system and to providing the necessary recurrent budget, and the resources available for this purpose should increase over the next few decades with overall economic growth from oil revenues. At the same time, the scale of institutional development and capital investment is being limited to reduce operating costs. Over the longer term, the PA system will have the potential to generate revenues from tourism (entry fees, concessions, etc.) to help cover maintenance costs. At present the parks cannot legally retain revenues to supplement operating budgets, but changing this will be a key objective in modernizing the PA system over the next few years.

The community level investments to be supported under Component 2 are expected to be sustainable because they will be selected by the communities based on their own needs and priorities. Fees to be charged by local implementing agencies for the services under Component 2 will also contribute to the sustainability of the investments. To maximize viability and sustainability of small enterprises supported by the project, the matching grants will normally require applicants to present a long-term financing plan and provide at least 50% of start-up cost.

#### 5. Critical risks and possible controversial aspects

<b>Risk</b>	<b>Rating</b>	<b>Risk Mitigation Measures</b>
Unfamiliarity of the implementation of multiple-use park and cross-sectoral approach could lead to delays in establishing key institutional structures	M	Concept note regarding these aspects was circulated for review and approval by Government prior to appraisal; international TA and study tours will help to identify and adapt appropriate existing models for Azerbaijan conditions.
Continuing conflicts over use of resources between parks and traditional users could undermine efforts to build positive relationship and to improve park management	M/S	Awareness raising/outreach/education activities begun during preparation and continued throughout project; involvement of community leaders; participatory preparation of NP zoning and management plans; phasing in and piloting of new approaches; implementation of Access Restriction Process Framework
Reluctance of municipal and private land owners to include their land within the parks	S	2-phase approach, with parks being created/expanded initially on state-owned lands. TA will include expertise in existing initiatives worldwide giving landowners incentives to enter into partnerships with

		national parks. Incorporation of neighboring municipal and private lands will improve effectiveness of the parks but is not essential to achievement of substantial biodiversity and sustainability benefits. Park Charters will provide for flexibility to negotiate different arrangements with owners.
High rate of failure of small enterprise start-ups	S	TA to help prospective entrepreneurs evaluate commercial opportunities and prepare sound business plans as condition of awarding of small grants for enterprise start-ups; 40% cash contribution helps ensure seriousness and capacity of applicants
Negative environmental or social impacts of tourism development in the parks	M	Zoning of parks to protect high priority areas. Support for integrated tourism development planning; building tourism planning/management capacity in responsible institutions; impact monitoring. Scale of tourism development will be modest.
Delays in identifying and/or establishing local level implementing agencies for Village Cluster Investment Plans	M/S	Build on examples of other projects; build in support and flexibility for communities to choose best options; ensure local authorities involvement in preparation and approval of Investment Plans; obtain agreement of Government on basic principles during negotiations
Increase in livestock numbers and grazing pressure as a result in support for livestock development	M	Project interventions specifically designed to provide incentives for switching to more environmentally sound livestock production methods; introduction of better grazing management systems including restrictions on animal numbers; existing deterioration in pasture quality already recognized and providing incentives for users to support change

Risk Rating: H (High Risk); S (Substantial Risk); M (Modest Risk); N (Negligible or Low Risk)

## 6. Loan/credit conditions and covenants

### Effectiveness Conditions

The Borrower has opened a Project Account for the Project, in a bank on terms and conditions acceptable to the Association with an initial deposit in Manat equivalent to US\$ 50,000.

A Project Implementation Manual, acceptable to the Bank, has been finalized, approved by MENR and submitted to the Bank

GEF and Japanese Co-Financing Grant Agreements have been executed.

The legal instrument for establishing the SDNP has been issued. (Prior to the issuing of the instrument, the Borrower will prepare and submit for the Bank's review, a map of all state-owned land in the project area, indicating the boundaries of the national park and other proposed PAs that will be established, and will obtain the Bank's agreement that the proposed division of land uses will meet the objectives of the project, with regard to biodiversity conservation, sustainable natural resource management and sustainable economic development).

### Disbursement Condition

Disbursement of IDA and GEF funds for the following goods and works under Component 1 would be subject to approval by the designated agency of the Borrower/Recipient of the SDNP Charter, acceptable to the World Bank (criteria for acceptability will be included in Minutes of Negotiations): construction or rehabilitation of buildings for park administration or management; office equipment and furnishings; vehicles and equipment for park management

### **Dated Covenants**

By three months after Effectiveness, the Borrower, through the PIU, shall have appointed an auditor under terms of reference acceptable to the Association.

By three months after Effectiveness, the Borrower shall have hired Coordinators and Assistants to the Coordinators for the regional PIU offices.

### **Covenants**

The Borrower, through the PIU, shall establish and maintain a financial management system, including records and accounts, and prepare financial statements, in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

The Borrower, through the PIU, shall have the project financial statements audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association; and audit report furnished to the Association no later than six (6) months after the end of each year audited.

The Borrower, through the PIU, shall prepare and furnish to the Association Financial Monitoring Report (FMR), in form and substance satisfactory to the Association. The first FMR shall be furnished to the Association not later than 45 days after end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter. Thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter.

## **D. APPRAISAL SUMMARY**

### **1. Economic and financial analyses**

The economic analysis of the project suggests an economic rate of return of 26%, a net present value of US\$ 44 million and a cost:benefit ratio of 3.5. These figures exclude potentially significant long-term benefits from reduced flooding and sedimentation, and non-marketed benefits potentially accruing to expatriates and visitors to Azerbaijan and the international community as a whole through improved biodiversity. The financial analysis indicates a financial rate of return of 23%, a net present value of US\$ 36 million and a cost:benefit ratio of 3:1. Financial benefits will accrue from increased profit associated with tourist visitor expenditure, potential future park visitor fees, reversing pasture degradation with resulting

improvement in returns from sheep grazing over the long term, increased yields from cow milk, enhanced crop yields, sustainable wood harvesting and profits from new and enhanced small businesses. Other economic benefits not included in the above analysis include potentially significant long-term benefits from reduced flooding and sedimentation due to reduced meadow erosion and forest cutting. Net present value is calculated based on a 40 year period to obtain the economic benefits from long-term environmental improvements. Details of assumptions and estimates used for these calculations are provided in Annex 9, and the underlying model, assumptions and data are available in the project files.

Sensitivity analysis shows that the results are robust to the complete exclusion of crop yield benefits, tourism benefits and non-use benefits, with Internal Rates of Return (IRRs) falling only by a few percent respectively. However, the results are more sensitive to exclusion of the sheep revenues, with a decline in ERR to 14% and FRR to 10%. The long-term fiscal impact of the project is likely to be positive. The 8% Government contribution relates mainly to development of the proposed parks and to park staffing. Fiscal benefits to the Government will arise through increased tourism in the Park areas and significantly enhanced agricultural and business development, generating Government income through taxes. To enhance the long-term financial sustainability of the parks, continued Government and international assistance should be combined with maximizing opportunities for raising revenues through entry fees, park sales, and tax/concession type arrangements with organizations making money from sustainable use of the parks' resources (e.g. tourism, mining of minerals, collection of aggregates downstream of the parks, and water bottling operations). In addition, there is scope in the future for obtaining financial assistance from carbon funds, from payment for environmental services such as maintaining water supply and quality for downstream users (e.g. Baku), and corporate sponsorship (e.g. from BP).

The GEF Incremental Cost Analysis is attached (Annex 15).

## **2. Technical**

In Azerbaijan, as in most countries of the former Soviet Union, biodiversity conservation has been based mainly on a system of relatively small, exclusive PAs which make no provision for any economic or recreational use or community participation or benefit. Due to the limitations of this type of conservation model, the alternative approach of “ecosystem management” is increasingly popular, with numerous institutional models being implemented or explored in different countries. These models generally share some key features: (i) zoning of the overall area into smaller sectors which are managed for different uses (strict biodiversity protection, tourism development, low-intensity use of natural resources, sustainable agriculture, etc.); (ii) institutional mechanisms for planning and coordinating land and resource use across the whole area; and (iii) mechanisms to enable local communities to obtain economic benefits from the PA. In line with that approach, this project will support the creation of two large PA networks which will include national parks, as well as other types of PAs which allow a wider range of land and resource uses while still retaining objectives of protecting biodiversity and the natural environment. Institutional structures will be developed for involving local communities and other stakeholders and for enabling local communities to participate directly in economic

benefits such as tourism development (including, on a voluntary basis, agreeing land that they own to be managed as part of the national park or other PA).

There is a great diversity of institutional models for PAs and PA systems involving multiple types of land use and land ownership, reflecting different ecological, political, legal and cultural conditions. The challenge will be to develop an appropriate model for Azerbaijan, drawing upon the experience of other countries in the region and around the world. This model will have to take into account factors such as overlapping institutional responsibilities and interests (e.g. with regard to issuing of grazing permits), limited inter-sectoral coordination, and a physical environment which makes cooperation among stakeholders difficult (large area, remote villages with poor infrastructure for travel and communication).

The proposed 3-phase approach for establishing the national parks reflects the need to clarify and amend legislation to allow for different types of economic activities and land ownership within national parks. It also allows for bringing new areas into the park as their biodiversity and ecological significance becomes clear (based on detailed inventories and the development of park management plans), and as awareness and understanding of the benefits of being associated with the park increase and concerns regarding potential negative economic impacts are addressed. Establishing other types of PAs in the adjacent, heavily-used pasture areas provides a mechanism to begin introducing more sustainable use of those pastures, because it establishes a clear responsibility and mandate for the MENR to monitor the condition of these resources and define the conditions needed to protect and manage them. Specific restrictions and regulations can be defined in the Charter of a Zakaznik to confer needed protection on particular species, sites or ecosystems and to limit or regulate particular resource uses. However, the support, commitment and cooperation of other government agencies and stakeholders will be essential for improved management of these areas to become a reality. The project's awareness-raising, educational and communications activities will in turn be essential for building this support and commitment .

Technical and institutional capacity for forest and pasture management are weak in Azerbaijan. The project will help to fill this gap by providing technical assistance and training, including exposure to the experience of neighboring countries which have been dealing with similar challenges, in many cases under World Bank-financed projects (e.g. Turkey, Georgia).

In the short term, protection and management of the parks and other PAs will be dependent mainly on the financing provided by Government and donors (including international NGOs). Long term sustainability will require a more diverse financial base, through a combination of user fees and other sources such as carbon financing and transfer payments from downstream users of water or owners of infrastructure who have an interest in maintaining the watershed. The project will provide TA under Component 1 to explore such financing options and develop a long-term financial sustainability strategy for the parks.

For Components 2 and 3, the main challenge is that the economic productivity and competitiveness of the project areas is constrained by factors such as short growing seasons, soils vulnerable to erosion, limited surface water, difficult access to markets, etc. Livestock husbandry is both the prevalent economic activity and, along with tourism, probably the one for

which the areas have the greatest comparative advantage. At the same time, these activities are very dependent on the natural environment. The objective is to capitalize on these advantages by supporting enterprises that make use of the rich natural resource assets of the area, while putting measures in place to ensure that this does not stimulate over-harvesting of biodiversity or other negative impacts, such as ecological destruction due to poorly planned or unregulated tourism development. Another potential issue is ensuring that the economic opportunities provided by the project are well targeted to local communities, which are relatively poor and strongly dependent on the areas' natural resources. For example, preparation studies indicated that a substantial proportion of the livestock grazing in the project areas are owned by outside businessmen, but more work is needed to obtain reliable figures regarding local vs. outside livestock ownership and pasture use. Similarly, many of the existing tourism enterprises are owned by people from outside the area, and it is unclear what contribution they make to the local economy. The more detailed socio-economic study to be undertaken during the first year of the project will provide data on these and other issues relating to the distribution of project costs and benefits. This information will be used to prepare a Social Mitigation Plan to refine baseline indicators and improve targeting of project opportunities and benefits. Measures already taken include using socio-economic criteria to select the villages eligible to participate in Component 2, and limiting grants under Component 3 to residents of villages within the project area.

### **3. Fiduciary**

The financial management assessment concluded that the existing systems, including accounting, financial reporting, internal controls, staffing, credit/grant disbursements and auditing arrangements, at the central PIU within the Ministry of Ecology and National Resources satisfies minimum financial management requirements. The PIU staff have functional experience in managing World Bank projects, having implemented the ongoing Urgent Environment Project and GEF and PHRD grants. The 1C Accounting system at the PIU is operational, but requires further customization of the Chart of Accounts to accommodate all project components and sources of financing. The internal control systems and procedures are documented in the Project Implementation Manual. Strengthening of the minor weaknesses identified in the systems will be completed prior to Board presentation to ensure systems and controls are fully capable of satisfactorily recording transactions and balances, supporting the preparation of regular project financial statements, safeguarding the assets, and are subject to auditing arrangements acceptable to the Bank. Because of the multi-layered project implementation arrangements and capacity at the regional-level, close coordination and monitoring by the PIU within the Ministry of Ecology and National Resources will be critical to minimizing fiduciary risks associated with 'community-level investment and natural resource management' and 'rural enterprise development' components of the Project.

### **4. Social**

No villages or households will be relocated and land ownership and rights will not be affected, but the WB's Involuntary Resettlement Policy is triggered because the establishment/enlargement and improved enforcement of the two NPs will reduce access to pastures and forests that are traditionally important for local livelihoods. In the long term, restoration and sustainable management of these ecosystems will benefit the users, but the short term impacts will need to

be mitigated, through measures detailed in the Access Restriction Process Framework (ARPF), which forms part of the Project Implementation Manual. These include involving local users in park zoning and management planning, phasing in of grazing restrictions, and support for developing alternative livestock rearing methods, sources of wood, and income sources (including some employment in the parks themselves). Development assistance provided under Components 2 and 3 will be particularly targeted to villages that are most likely to be affected by resource access restrictions. Village Clusters to receive assistance under Component 2 were selected based on factors including their proximity to areas of the parks where stricter resource use restrictions are most likely to be implemented. Villages not included in the VCs are small, scattered and located in remote areas where resource restrictions are unlikely. The park management planning process and the Social Mitigation Plan (see below) will indicate whether any additional mitigation measures should be undertaken in these villages. Matching requirements for grants under Component 3 will be reduced or eliminated for applicants from the highest elevation (poorest and most vulnerable) villages, and for enterprises with particularly high social benefits. Preparation studies indicated that, although there are some Internally Displaced Persons in the Shah Dag project area, they are integrated into the local communities and do not require special provisions to ensure that they participate in project implementation and decision-making and have access to mitigation measures and project benefits.

The PIU will put in place a program to assess, monitor and mitigate socio-economic impacts. This will include: (i) a detailed socio-economic study during the first year (building upon work carried out during project preparation); (ii) preparation of a Social Mitigation Plan to ensure that project benefits are well targeted to those affected by resource access restrictions and any vulnerable groups within the communities, and optimally designed and implemented to help alleviate poverty in these remote, economically depressed areas; (iii) strengthening conflict resolution processes and ensuring adequate grievance procedures; and (iv) refining of socio-economic baseline and impact indicators and targets for the project.

## **5. Environment**

EIA Category: B

The project is expected to have an overall positive environmental impact by conserving globally and nationally significant biodiversity, protecting rare, transboundary ecosystems and enhancing the sustainability of natural resource use in the project areas. Other likely environmental benefits include: reduced soil erosion (improving downstream water quality), flood moderation (protecting downstream infrastructure such as roads, bridges and irrigation systems), and carbon sequestration in restored meadows and forests. Barn improvements (sanitation and ventilation) under Component 2 will improve environmental health conditions both for livestock and for the people who handle them.

The Environmental Assessment undertaken during project preparation identified the following issues:

- Impacts such as disruption of natural habitats or wildlife, soil erosion, etc. from construction and/or rehabilitation of infrastructure (small in scale and very limited in extent);
- Negative impacts of increased tourism/recreational use of the two areas (e.g., disturbance of wildlife, generation of solid waste, overuse or pollution of surface water, and social disruptions);
- Localized negative impacts associated with grants under Components 2 and 3 (e.g. pollution from liquid or solid waste, over-harvesting of vulnerable species, increased fertilizer use, etc).

Mitigation measures are outlined in the Environmental Management Plan, and will be incorporated into the Project Implementation Manual for Components 2 and 3. These include assessing proposed construction sites for potential biodiversity or environmental concerns, including waste management measures and site clean-up requirements in construction designs and contracts, environmental screening of micro-project proposals, etc. The EMP also lays out responsibilities of the MENR and other government agencies, the PIU and grant beneficiaries. These include carrying out the appropriate level of environmental screening or assessment, based on the type of activity in question, obtaining required clearances and environmental permits and monitoring compliance and impact. The EMP is fully consistent with World Bank requirements and with the Azerbaijan Law on Environmental Protection.

## Public Participation

Public consultation during project preparation included over 30 meetings in both project areas, involving over 700 local stakeholders, including local public officials, elected municipality leaders, NGOs, representatives of the scientific community and community leaders and members. These consultations contributed to project design and to preparation of the EA/EMP and ARPF. Discussion topics included issues related to: (i) basic services; (ii) land availability; (iii) level of agricultural mechanization; (iv) cropping pattern, crop production practices; (v) livestock production; (vi) marketing etc. The main concerns voiced by communities related to anticipated restrictions on access to pastures and their priorities for development assistance and delivery mechanisms. Villages commonly identified need for dairy and food processing facilities, for mechanization and irrigation, for improving livestock genetic materials as priorities. A second phase of public consultations took place in February 2005, when the final versions of the EA/EMP and ARPF were publicly disclosed at meetings in Baku and both project areas. This round of consultation focused on implementation of proposed mitigation measures and impact monitoring. The consultations were carried out by the PIU and PCUs. The PIU documented the meetings and the minutes are available at the PIU Office in Baku and two PCU offices.

## 6. Safeguard policies

<b>Safeguard Policies Triggered by the Project</b>	Yes	No
<a href="#">Environmental Assessment</a> (OP/BP/GP 4.01)	[x]	[ ]

Natural Habitats ( <a href="#">OP/BP 4.04</a> )	[x]	[ ]
Pest Management ( <a href="#">OP 4.09</a> )	[ ]	[x]
Cultural Property ( <a href="#">OPN 11.03</a> , being revised as OP 4.11)	[ ]	[x]
Involuntary Resettlement ( <a href="#">OP/BP 4.12</a> )	[x]	[ ]
Indigenous Peoples ( <a href="#">OD 4.20</a> , being revised as OP 4.10)	[ ]	[x]
Forests ( <a href="#">OP/BP 4.36</a> )	[x]	[ ]
Safety of Dams ( <a href="#">OP/BP 4.37</a> )	[ ]	[x]
Projects in Disputed Areas ( <a href="#">OP/BP/GP 7.60</a> )*	[ ]	[x]
Projects on International Waterways ( <a href="#">OP/BP/GP 7.50</a> )	[ ]	[x]

An Environmental Assessment/Environmental Management Plan has been prepared and disclosed prior to project appraisal (see Annex 10). The Natural Habitats policy and the Forest policy are triggered because the project areas include relatively pristine natural habitats, a large part of which is indigenous forest, for which management plans will be developed and implemented. However, the project will result in improved protection of these areas, not in destruction or increased exploitation. Natural areas with high biodiversity value, including the existing PAs, will be incorporated into the two new NPs as core conservation areas, and their protection is expected to improve as a result of the project. All management activities relating to natural forests and other natural habitats will be consistent with the WB policies. The Involuntary Resettlement policy is triggered because of anticipated new restrictions on access to forests and pastures. This is addressed by measures described in the Access Restriction Process Framework. The Pest Management policy is not expected to be triggered because the type of agricultural production that will be supported and promoted is unlikely to involve use of pesticides. Similarly, no impacts on cultural heritage sites or property are anticipated. However, as a precaution, both of these issues are addressed in the EA/EMP environmental screening checklist attached to the Project Implementation Manual. Since small scale irrigation systems will draw water from small secondary and tertiary streams which are not tributaries of rivers flowing into the Caspian Sea, the International Waterways policy is not triggered.

## 7. Policy Exceptions and Readiness

The legal framework for project implementation is based on the Law on Specially Protected Natural Areas (LSPNA), the Forest Code and the Land Code. Together these laws define the objectives, approaches and institutional responsibilities for managing state-owned forest and pasture lands, including the creation of different types of SPNAs. The Presidential Resolution establishing the SDNP (a condition of effectiveness for the project ) will be accompanied not only by the usual map showing the boundaries of the proposed national park, but also by a map of all the state-owned land in the project area, indicating how that land will be allocated to different kinds of PAs. Prior to issuing the decree, the Borrower will obtain the agreement by the Bank that the proposed constellation of PAs meets the objectives of the project, with regard to biodiversity conservation, sustainable natural resource use and sustainable development. The Government will also confirm its commitment to establish the other PAs within a reasonable period of time (project funds will be available to assist in this process).

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\* *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*

The Law on Specially Protected Natural Areas defines the objectives and administrative mechanisms for national parks, which can include zones for strict nature protection and for limited economic activities including tourism. However, between the LSPNA and the Land Code, it is not entirely clear which types of economic activities are permissible, or whether residences or other non-state owned land can be included within national parks. The legislative framework will need to be clarified, and amended as required, for the successful implementation of some aspects of the project, including “Phase 3” of establishment/enlargement of the national parks. The project will support technical assistance for this purpose. The necessary provisions will also have to be included in the national Park charters. Approval of an SDNP Charter acceptable to the Bank will be a condition of disbursement of project funds for goods and works to support the operation of the park (e.g., construction and rehabilitation of buildings for administration and management; vehicles and field equipment). Other elements of the project (TA for park management capacity building, TA and grants under Components 2 and 3) will not be subject to this condition of disbursement, either because these expenditures are needed to support the process of developing the Charter, or because implementation of the activities would contribute effectively to project objectives even before the park is formally established.

## **Annex 1: Country and Sector or Program Background**

### **AZERBAIJAN: Rural Environment Project**

Azerbaijan is a mountainous country of 86,600 km<sup>2</sup> and a population of about 8 million people. It lies on the western coast of the Caspian Sea among the mountain ranges of the Greater and Lesser Caucasus and the Talish mountains. Mountains cover about 44% of the territory, and forests cover about 11%.

Azerbaijan's economy declined significantly following independence in 1991, slipping to one of 7 lowest income countries in the ECA Region. Over the past five years there has been progress in many areas, and Azerbaijan is moving towards middle income status as benefits from increasing oil development start to flow. But the country faces continuing problems of regional income disparities. In the mountain areas targeted by this project, most people fall under the poverty line of US\$24 per month (average income is \$16 per month in villages above 2000 meters). In the past, about 80% of rural households, including most households in the project areas, were connected to the gas and electricity network and enjoyed a reliable and highly subsidized energy supply. Supplies are now erratic and expensive, and the households have largely turned to fuel wood for their energy needs. Prior to 1991, Azerbaijan also relied on cheap wood imports from Russia, but today wood supplies come exclusively from State forests, resulting in rapidly increasing deforestation. Demand for wood fuel exceeds sustainable annual fuel wood yields by up to a factor of ten in some areas.

Azerbaijan is facing many of the same challenges as other CIS transition economies, including an agenda of policy and institutional reforms needed to redefine the role of the state and create essential underpinnings of a market economy. One of the six strategic pillars of the State Program on Poverty Reduction and Economic Development (SPPRED) is an enabling environment for income-generating opportunities.

#### **ENVIRONMENTAL MANAGEMENT AND NATURE PROTECTION**

Environmental management is recognized as an important right and obligation in the Constitution of the Azerbaijan Republic (1995). In addition to guaranteeing environmental safety and ecological balance and calling for participation of the general public and civic organizations in environmental protection, it identifies biological diversity as a basic environmental principle. The Law on Specially Protected Natural Areas and Objects (2000) provides for the protection and preservation of natural areas, both for the protection of biological variety and ecology and to provide for tourism and recreation. The law includes provisions for taking into consideration social and economic factors and interests of local people, and for participation of the population and social organizations in preserving Protected Areas (PAs). The Ministry of Ecology and Natural Resources (MENR) was created in 2001 to integrate all aspects of environmental protection and management, including environmental assessment and

monitoring (including reporting on the state of the environment), management of forests and wildlife resources, and of specially protected natural areas<sup>17</sup>.

The National Environmental Action Plan (NEAP), completed in 1998, identifies priorities relating to reducing pollution damage from oil extraction and industry; halting the decline of sturgeon populations and water quality in the Caspian Sea; protecting biodiversity and improving the management of forests, pastures, and agricultural lands; preserving cultural heritage; addressing ecological problems with regional or global impacts; and improving the institutional and policy framework for environmental management. The NEAP also identifies specific biodiversity conservation priorities, including strengthening of the PA network through: (i) the adoption of national parks as instruments for the sustainable use of biodiversity, to complement the existing protected area network which emphasizes strict nature reserves; (ii) creation of new protected areas, and (iii) the implementation of pilot projects in sustainable uses of biodiversity which address rural poverty as a root cause of biodiversity degradation and loss.

The National Strategy and Action Plan on Biodiversity Conservation (NSAPBS), currently under preparation<sup>18</sup>, is built upon two main pillars: (i) preservation, improvement and rehabilitation of key ecosystems and natural habitats by enhancing and efficient management of protected areas; and (ii) optimal utilization of the country's economic and social potential at the national and regional level, including sustainable usage of the biological diversity of Azerbaijan. Currently PAs cover approximately 7% of the country<sup>19</sup>, but most are small and fragmented, and some important ecosystems are under-represented. The GOA signed the Convention on Biological Diversity in 2001, and has made a major commitment to protecting biodiversity, including maintaining and substantially expanding the nation's PA system to increase coverage of under-represented ecosystems. By 2010 the PA system is to be expanded from about 7% to about 10% of the national territory. Creation of the Shah Dag National Park (SDNP) and expansion of the Ordubad National Park (ONP) are among the highest priorities.

Management of existing PAs needs to be strengthened through building stronger institutions, human resource development and increasing resources available, as well as addressing issues such as poverty and pressure for economic development in surrounding areas. Furthermore, the prevailing model for PAs in Azerbaijan, as in much of the CIS, is based on centrally controlled, Strict Nature Reserves (Zapovedniks). In accordance with the NEAP and NSAPBC, the GOA has begun to diversify the national PA system, created the country's first four National Parks in 2003-2004<sup>20</sup>. National Parks have the status of PAs<sup>21</sup> but, unlike Zapovedniks, allow for zones of limited economic activity (primarily tourism).

## NATURAL RESOURCE MANAGEMENT

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<sup>17</sup> There is an independent Ministry of Environment and Natural Resources in the Nakhchivan Autonomous Republic, with similar responsibilities

<sup>18</sup> Preparation begun in 2003, by the State Committee for Ecology, in cooperation with stakeholders inside and outside Government (funding and Technical Assistance from GEF/UNDP)

<sup>19</sup> Comprised of 38 PAs: 14 Strict Nature Reserves, 20 sanctuaries, 4 national parks

<sup>20</sup> Ordubad, Shirvan, Ag-Gel and Absheron NPs

<sup>21</sup> Nature Protection Institution and Research Institution under the Ministry of Ecology and Natural Resources

**Forests:** Almost all natural forest in Azerbaijan belongs to the State and is designated as Forest Fund land. During the Soviet era, forest inventory and planning were centralized in Moscow and in the Caucasian Forest Stocks Projection Institute in Georgia, leaving little forest management capacity in Azerbaijan after independence. The Forestry Development Department and its Forest Protection and Rehabilitation Units (MENR) were established in 2002, but their staff lack training and experience. Since 2003, all forest cutting, for either commercial or sanitary purposes have been suspended by the MENR, and officially only forest residues are collected and sold. However, it is generally recognized that large quantities of standing trees continue to be cut illegally and forest cover continues to decline. A National Programme on the Rehabilitation and Extension of Forests (established in 18 February, 2003) aims to restore 25,000 ha of existing forest and plant some 44,700 ha of new forest, but due to insufficient funding, only about 3,000 ha of planting were completed in 2003.

**Meadows and Pastures:** All high elevation summer pastures and a large proportion of mid-elevation winter pastures belong to the State. Some small pasture areas and hayfields belong to, or are under the management of, local municipalities. Municipal pastures are free for use, while grazing rights on State pastures are leased by the State Land and Cartography Committee, together with Rayon Executive Authorities and Ministry of Agriculture, to individuals or companies on the basis of grazing permits, usually with a duration of 10-15 years. While grazing rights are in principle allotted on the basis of numbers of animals, there are no specific legal provisions in the grazing contracts, and no monitoring on the part of authorities, to ensure that the official stocking rates are followed. In the Shah Dag area, it is estimated that the actual stocking rates are as much as five times higher than the official norm (totaling 2.5 million animals, as opposed to 500,000).

## GLOBAL BIODIVERSITY SIGNIFICANCE

Azerbaijan lies at the convergence of three biogeographic regions (Europe, Central Asia and Asia Minor), resulting in high biodiversity. The Caucasus mountains have been identified by the World Wide Fund for Nature (WWF) as a Global 200 Ecoregion, and by Conservation International as one of the world's 25 biodiversity "hotspots" (the only one in the ECA region)<sup>22</sup>. The Caucasus "hotspot," which spans six countries, has one of the highest levels of endemism in the temperate world, and is believed to contain more than twice the animal diversity found in adjacent regions of Europe and Asia. It has been named a large herbivore hotspot by WWF's Large Herbivore Initiative, as eleven species of large herbivores, as well as five large carnivores, are found over a relatively small area. The flora is particularly rich in endemic and relict plants that escaped a series of glaciations in sheltered pockets. It includes over 7,000 plant species, of which 4500 can be found in Azerbaijan (along with 600 species of vertebrates and at least 14,000 species of insects). Seven percent (270) of Azerbaijan's plant species are endemic to the country. Almost half of the forest in Azerbaijan is found in the Greater and Lesser Caucasus regions. The vegetation of the Caucasus also represents one of the richest gene banks of plant species useful for agriculture and medicine. A recently completed ecosystem profile and five

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<sup>22</sup> The Caucasus hotspot spans 500,000 km<sup>2</sup> of mountains between the Black Sea and Caspian Sea, including parts of Georgia, Armenia, Azerbaijan, and small parts of Russia, Iran and Turkey.

year investment strategy for the Caucasus eco-region<sup>23</sup> identified 10 corridors that encompass the vast majority of conservation targets, including protection of most of the 51 globally threatened species. Five of these corridors were identified as top priority for conservation action, including the Greater Caucasus (which encompasses the proposed SDNP) and the East Lesser Caucasus (encompassing the ONP). Both the SDNP and ONP include elements of important transboundary migratory corridors.

In addition to their significance as global, regional and national biodiversity assets, both the SDNP and ONP represent important economic assets, due to their rich natural resources and tourism potential. The proposed expanded ONP contains a large proportion of all high elevation meadow in the Nakchchivan Autonomous Republic. Shah Dag is Azerbaijan's second highest mountain and serves as a watershed which provides much of the water for Baku and the Absheron Peninsula, which is home to nearly 30% of the country's population.

## THREATS TO BIODIVERSITY

The Caucasus ecosystem profile identified deforestation, overgrazing and hunting as the three greatest direct threats to biodiversity<sup>24</sup>. Increased demand on local forests, resulting from the end of importation of wood from other countries and decline in availability of natural gas, has contributed to rapid ongoing deforestation in the project areas. Forest edges are also being pushed back (to higher elevations) as a result of grazing pressure.

Overgrazing of pastures has become a serious threat in the project areas since the late 1980's, as more people took up shepherding or increased their herds in response to growing unemployment and declining economic opportunities in other sectors. There is clear evidence of overgrazing at all altitudinal levels (montane, sub-alpine and alpine), with a visible trend of replacement of the original grassland species by unpalatable or grazing-resistant species such as sedges, flatweeds, and mat-grass. In sub-alpine meadows, which serve as summer pastures, overgrazing and associated disturbance is contributing to declines in wild goats and chamois. In the lowland grasslands, where the same sheep herds go for winter pasture, severe overgrazing is significantly impacting the endemic flora and fauna of steppe ecosystems. Competition for grazing has contributed to the decline of Persian gazelle and, indirectly, striped hyena. Traditionally, sheep were grazed in alpine meadows, with subalpine meadows reserved for fodder production and used during the winter months. However, traditional grazing areas in the north Caucasus (Dagestan, Georgia) are no longer accessible, and livestock is kept nearer to villages all year round, resulting in overgrazing of subalpine meadows as well as degradation of fragile subalpine woodland ecosystems.

There is evidence of significant declines in populations of large mammals, particularly ungulates and predators such as wolf, lynx and brown bear. While there is little by way of concrete data, it is believed that illegal hunting has a significant impact, along with habitat loss and competition with domestic livestock.

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<sup>23</sup>By the Critical Ecosystem Partnership Fund -- a joint initiative of Conservation International (CI), the Global Environment Facility (GEF), the Government of Japan, the MacArthur Foundation and the World Bank.

<sup>24</sup> Poverty and political insecurity were identified as important underlying causes.

## RELATION TO GEF OPERATIONAL PROGRAMS

Biodiversity conservation is the key focal area for the project. The project addresses GEF strategic priorities for biodiversity conservation through: (i) catalyzing sustainability of protected areas, (ii) mainstreaming biodiversity in production landscapes and sectors, and (iii) generating and disseminating best practices for addressing current and emerging biodiversity issues. Project activities will directly support innovative practical approaches called for by the 7th Conference of the Parties (COP-7) of the Convention on Biological Diversity (CBD) in its Decisions VII/1 “Forest Biological Diversity”, VII/11 “Ecosystem Approach”, and VII/28 “Protected Areas”.

The project follows the GEF Strategic Guidelines and incorporates elements of several GEF Operational Programs:

No. 3 (Forest Ecosystems): by supporting in-situ protection of ecologically mature temperate forest ecosystems under threat, and combining strict protection and multiple use to achieve sustainable forest management. Among other things, it will support the first comprehensive forest inventory and status assessment since 1984, making it possible to make sound management decisions.

No. 4 (Mountain Ecosystems): by supporting in-situ conservation and sustainable use of biological resources, expanding and improving connectivity of the protected area system in the Greater and Lesser Caucasus mountains, and combining productive, socioeconomic and conservation goals.

No. 12 (Integrated Ecosystem Management): by emphasizing the creation of an enabling environment for biodiversity conservation, forest and rangeland management, the strengthening of institutional capacities at local, regional and national levels as well as investments in sustainable natural resource management.

The GEF grant would finance costs of activities required to achieve global conservation benefits, which would be incremental to the baseline national program undertaken by the Government with support from the World Bank IDA credit and the PHRD grant (see Annex 15 - Incremental Cost Analysis).

**Annex 2: Major Related Projects Financed by the Bank and/or other Agencies**

**AZERBAIJAN: Rural Environment Project**

<b>PROJECT/DATE</b>	<b>DONOR</b>	<b>SECTOR ISSUES ADDRESSED</b>	<b>OED Rating or IP/DO ratings from PSR (For WB-financed Projects)</b>
Urgent Environmental Investment Project	IDA	Building institutional capacity for environmental management (MENR),	S/S
Cultural Heritage Project (1999)	IDA	Restoring cultural heritage sites in Baku, Sheki and Khatum (Nakhchivan); supporting community-led tourism, training and capacity-building	S/S
Caspian Environment Programme	GEF/UNDP	Develop and implement strategies for restoring and managing biodiversity and environmental quality of the Caspian Sea (including a small grants program implemented by WB)	TBC
Trans Caucasus Tourism Initiative (Pilot Program)	WB/ Govt. of Switzerland	Development of infrastructure and capacity for community-based tourism	
Small CDD Grants Program	WB/Norwegian Trust Fund		
Preparation of Biodiversity Strategy, Action Plan and National Report	GEF/UNDP		
Caucasus Ecosystem Profile	Critical Ecosystem Partnership Fund	Identified priority conservation areas and targets; will provide small grants to NGOs to support implementation of the resulting strategy	
Transboundary Grants Programme	Swiss Government, through Regional Environment Center for Caucasus	Conservation of highland ecosystems, community-based natural resource management, protection of endangered species	

### Annex 3: Results Framework and Monitoring

#### AZERBAIJAN: Rural Environment Project

	Outcome Indicators	Use of Outcome Information
<b>PDO</b>		
<p>To improve biodiversity conservation and introduce more sustainable natural resource management and economic activities in two mountainous areas of Azerbaijan, to restore the ecological health and productivity of their natural forests and meadows.</p>	<p>Inclusion of grazing norms (number of animals per ha, entry and exit dates) into grazing permits</p> <p>Preparation of forest management plans based on updated inventories</p> <p>Adoption of improved livestock husbandry methods by at least 20% of residents of target villages</p>	<p>Introduction of grazing norms will help monitor changes in grazing practice</p> <p>The quality of forest management plans will indicate success of capacity building in forest management.</p> <p>The extent to which farmers in participating villages adopt improved livestock methods under the project will indicate whether a broader economic transition is likely to be successful in the longer term</p>
<b>Global Objective</b>		
<p>To protect biodiversity in two globally significant biodiversity areas within the Caucasus and Zangezur mountains, and introduce and pilot an ecosystem-based approach for Protected Area management in Azerbaijan</p>	<p>Substantial increase in the Protected Areas network of Azerbaijan, in areas of international significance</p> <p>Adoption of key elements of stakeholder participation and ecosystem approach in other PAs in Azerbaijan</p>	<p>Successful establishment of SDNP and expansion of ONP (Phases 1-3_ will indicate that this ecosystem scale approach feasible in the Azerbaijan context</p> <p>Successful involvement of stakeholders in park development activities will indicate that Azerbaijan is ready to move beyond the traditional centralized control model</p>

Intermediate Results One per Component	Results Indicators for Each Component*	Use of Results Monitoring
<p><b>Component 1 (Protected Area Establishment and Management)</b></p> <p>Establishment and increasingly effective management of two large National Parks (SDNP and ONP)</p> <p>Establishment of PAs covering other state-owned land in project areas</p>	<p>About 120,000 ha of additional state land legally designated as National Park (approval of SDNP and revised ONP charters)</p> <p>About 230,000 ha of additional state land legally designated as other categories of protected area</p> <p>100% of planned NP management positions, and 75% of planned staff positions filled with qualified personnel</p> <p>Ecological Coordinating Committees and Stakeholder Advisory Groups established</p> <p>Management and zoning plans completed for SDNP and ONP</p> <p>Increase in number of people entering SDNP park area, who indicate their primary purpose is tourism</p> <p>Percent increase in dry vegetation biomass in Priority 1 pasture conservation/management areas</p> <p>Increase in average value of ecological forest quality index for SDNP</p>	<p>Approval of SDNP charter will signal readiness to move into implementation of Component 1 activities</p> <p>Completion of park management and zoning plans will indicate that mechanisms for participatory planning and management are in place, and will trigger investment in infrastructure, equipment, etc.</p> <p>Increase in tourist entries to SDNP will indicate infrastructure investment and other support for tourism development is successful</p> <p>Improvements in measures of meadow and forest ecological quality will indicate that technical approaches are appropriate and institutional arrangements for coordination and natural resource management are functioning as intended</p>
<p><b>Component 2 (Community-level investment in sustainable agriculture and natural resource management)</b></p> <p>Traditional economic activities (particularly livestock husbandry) shifted towards more modern, value-added approaches that place less demand on natural resources</p>	<p>Hectares under forage crop production in the target village clusters</p> <p>Percent increase in average household income from dairy products in target village clusters</p> <p>Number of cows/village/year artificially inseminated in target village clusters</p>	<p>Adoption of forage crop production and artificial insemination, and preparation of pasture management plans, will confirm local farmers' commitment to shifting to more modern and sustainable livestock production</p> <p>Increase in average household income from dairy products will indicate strategies for transforming livestock production are successful</p>

	<p>Number of hectares of trees planted (on municipal &amp; unforested Forest Fund land)</p> <p>Number of village pasture management plans prepared (for municipal pastures)</p>	<p>and profitable</p> <p>Meeting tree planting targets will confirm local communities' commitment to become more self-sufficient in fuel production and reduce pressure on natural forest</p>
<p><b>Component 3 (Rural Enterprise Development)</b></p> <p>Opportunities for development of environmentally friendly local small/medium enterprises demonstrated (with particular emphasis on tourism)</p>	<p>Number of business plans developed with assistance of Mobile Business Advisory teams</p> <p>Percentage of the business plans that relate to tourism</p> <p>Number of grants awarded for small enterprises</p>	<p>Meeting the target for total number of business plans (200), and a high proportion of proposed enterprises (150) qualifying for grants, will confirm demand and commitment on the part of local entrepreneurs and indicate that the Business Advisory Teams are functioning well</p> <p>If a substantial proportion (30% or more) of business plans relate to tourism enterprises, it will confirm that tourism is regarded as a promising economic sector and strengthen the case that it can become a viable alternative to destructive natural resource use</p>
<p><b>Component 4 (Project Management and Monitoring)</b></p> <p>Project objectives and targets of multi-sectoral coordination and implementation achieved</p>	<p>Project Monitoring and Evaluation indicators identified and tracked</p> <p>Socio-economic impact indicators identified and tracked</p> <p>Survey results show significant increased local knowledge and understanding of, and support for, the two multi-purpose National Parks</p> <p>Shah Dag region tourism strategy and plan prepared and supported by broad stakeholder group</p> <p>Percent of activities in Annual Work Plans completed on schedule</p>	<p>Achievement of these targets will indicate the PIU is functioning effectively, and that there is commitment to cross-sectoral coordination.</p> <p>Results from the socio-economic impact monitoring may lead to changes in project design or implementation, aimed at avoiding negative impacts and maximizing local benefits</p>

\*Quantitative targets provided in results monitoring table

### Arrangements for results monitoring

Outcome Indicators	Baseline	Target Values				Data Collection and Reporting		
		YR1	YR2	YR3	YR4	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
<b>Results Indicators for Each Component</b>								
<b>Component One :</b> Approval of NP charters (SDNP and revised ONP)	0	2					Signed Charter	PIU
75% of NP planned management staff positions filled	0		100% dept. heads; 30% staff		100% dept. heads; 75% staff	Annual	Project Progress reports	MENR
Ecological Coordinating Committees established	0	1						PIU
Management and zoning plans completed	0	inventories; staff training	2 (SDNP and ONP)				Completed maps and park mangement plans	MENR
Increase in number of people entering park who indicate their primary purpose is tourism	TBD in Yr. 1 with survey	TBD		15% over baseline	25% over baseline		Survey	NP Administrations
Areas of state land within National Parks or equivalent strict nature reserve (Zapovednik) ONP SDNP	15,431 ha 21,014 ha	43,300 ha 112,814 ha					Presidential Resolution	PIU
Areas of state land within other (lesser types of PAs) ONP SDNP	27,869 63,138	105,230 167,000		105,230 167,000			Appropriate legal instruments	
Hectares of municipal and private land under park or other PA	TBD by NP management		Baseline determined		25%	NP management plans, M&E	Signed legal agreements	NP Administrations

adminstration	plan					reports		NP Administrations
Increase in biomass in highest priority pasture areas (as determined by management plans)	Determined by inventory in Yr. 1	Baseline determined				>0	Ecological surveys	
Change in average value of a forest quality index in SDNP	To be completed prior to GEF/CEO endorsement		Increase by 20%		Increase by 50%	End of year 2; end of project	Ecological surveys	NP Administrationsb
Overall rating in WB/WWF PA management effectiveness tracking tool (METT)							Completed METT form	

Outcome Indicators	Baseline	Target Values*				Data Collection and Reporting		
		YR1	YR2	YR3	YR4	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
<b>Component Two :</b> Hectares under forage crop production	Negligible (~ 0 ha)	TBD	TBD	TBD	TBD	Annual	Project progress reports	Rayon Executive Authority
Number of hybrid cows in project area	TBD	TBD	TBD	2000	5000			Rayon Executive Authority
Increase in average household income from dairy products in villages receiving assistance	TBD by appraisal			10% over baseline	20% over baseline	During 3 <sup>rd</sup> and 4 <sup>th</sup> year	Household income survey	PIU
Hectares of trees planted (municipal & deforested Forest Fund land)	0		3000 ha		9000 ha	Year 2 and Year 4	Project progress reports	Municipality & PIU
Number of village pasture management plans for municipal pastures	0		5	15	25	Annual	Project progress reports	PIU
<b>Component Three:</b> Mobile teams of business advisors hired and equipped	0 mobile teams	5 mobile teams					Progress reports	PIU
Business plans developed	0		100	200			Progress reports	Business Service providers
Grants provided for small enterprises	0			150			Progress reports	Grant Administrator/PIU
% of business plans related to tourism	0			30%			Progress reports	Grant Administrator/PIU

<b>Component Four:</b> Monitoring and Evaluation indicators identified and tracked	I.R. indicators identified	All indicators Identified; baselines completed	Tracking	Tracking	Tracking	Yearly	Progress reports	PIU
Increased knowledge, understanding and support for multiple-use parks	No info	Design survey & baseline	Interim survey		E.O.P. survey		survey	PIU
Socio-economic impact indicators developed and tracked	No info	Design survey & baseline	Interim survey		E.O.P. survey		survey	PIU
Shah Dag regional tourism strategy developed and supported by broad stakeholder group	General MoT strategy exists	Mechanism in place	Draft strategy and plan	Stakeholder endorsement			Progress reports	PIU
% of activities in annual work plans completed on schedule		80%	80%	80%	80%	annual	Progress reports	PIU

\* cumulative values

## **Annex 4: Detailed Project Description**

### **AZERBAIJAN: Rural Environment Project**

#### OVERVIEW

The project will support the restoration, protection and improved management of economically and biologically important forests, meadows and pasture land, much of which has become degraded through over-use. The main instrument for achieving this will be the establishment of the two large NPs and a surrounding cluster of other PAs. Based on biodiversity, ecological and economic criteria, the large, mainly contiguous area of state-owned land in each project area will be divided into different types of PAs, involving different types of specific management objectives and regimes. This cluster of PAs will make it possible to improve ecological and natural resource management across a large area. Over time, the objective is to also involve municipal and private owned lands, through voluntary agreements with the land owners to manage their land as part of the national park or other PA. The national park will be at the center of the PA clusters. They will provide for strong protection and restoration of the most important biodiversity and ecologically fragile areas and will serve as a main attraction for tourism development. The national park Administrations will also have specified responsibilities for biodiversity protection and natural resource management and monitoring in the surrounding areas, either directly or in collaboration with other authorities and land owners. Institutional structures involving key government agencies, local authorities and other stakeholders will be put in place to achieve this collaboration. The aim is to coordinate ecological and natural resource management and to promote sustainable economic development at an ecosystem scale, across a range of land uses and types of land ownership

In the short term the focus is on improved protection of high priority biodiversity areas (forests and high elevation meadows), on reducing pressure on degraded natural resources and ecosystems, and on mitigating potential negative socio-economic impacts created by limitations on forest and pasture use. Biodiversity protection will be accompanied by measures to help local communities that are currently using the resources in unsustainable ways to develop more sustainable alternatives. The emphasis in this respect is on improving the efficiency and sustainability of traditional economic activities that are best suited for mountain ecosystems, particularly livestock husbandry and processing of fruits and other tree products. The longer term objective is to promote a diversification of local economies, making them less dependent on mass consumption of natural resources. Tourism represents a sector in which biodiversity-rich areas, including mountains, have a comparative advantage, and there is growing interest in and support for transboundary tourism in the Caucasus ecoregion. While tourism prospects for the ONP area are limited at this time<sup>25</sup>, there is already a modest tourism industry in the Shah Dag area. If properly directed and supported, this could grow over time into a significant contributor to local economies and a source of sustainable financing for the park. Therefore, developing park infrastructure and management capacity for ecotourism, and assisting local communities to develop tourism-related economic activities, are also important project objectives.

*COMPONENT 1. Protected Areas Establishment and Management (US\$8.69 million):*

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<sup>25</sup> Due issues of access and security

This component will support the establishment of the national parks and the PAs surrounding and supporting the parks, development and implementation of appropriate zoning and management plans for the parks and natural resource development plans for the wider project areas, and strengthening of institutions and systems for PA management and for ecosystem-wide coordination..

The process of establishing the national parks and the adjacent PA clusters will involve three phases:

**Phase 1:** the creation of the new SDNP and the expansion of ONP will initially include only specified portions of the state-owned lands in each project area. The SDNP will include the existing Specially Protected Natural Areas (SPNA), Forest Fund lands and very high elevation meadows that are not currently used for grazing due to their inaccessibility. The state-owned summer pasture lands will be designated as State Nature Preserves (Zakazniks<sup>26</sup>) or other categories of PA, based on an evaluation of the required level of protection and management objectives. The same will apply to the expanded ONP, except that some of existing summer pasture lands may be included within the national park, through special provisions that are consistent with the park Charter. In addition to the usual maps of park boundaries that accompany the Presidential Resolutions establishing the national parks, the Government (SLCC with MENR) will prepare maps covering all of the state-owned land in the project areas, including the other types of PAs that are to be established. The total area of the Phase 1 SDNP is expected to be approximately 110,000 ha, and the Phase 1 ONP about 43,000 ha (see following table for details)<sup>27</sup>. An agreed map of the park and other PAs planned for the Shah Dag area, accepted by both Government and the Bank as meeting the biodiversity conservation and sustainable use objectives of the project, is a prerequisite for the Presidential Resolution establishing the park (which in turn is a condition of effectiveness for the project). In accordance with the Azerbaijan Law on Specially Protected Natural Areas and Objects, the national parks themselves will include core conservation zones, tourism zones, and zones for limited economic activities and for other services (e.g. tourism facilities, park administration. Approval of a park Charter for SDNP, acceptable to the Bank, is a condition of disbursement for project funds directly related to supporting park management, such as buildings and equipment for the SDNP and ONP Administrations. The process and timetable for establishing the surrounding PAs has not been specified or made a condition of effectiveness or disbursement. However, it is expected that this will be completed within the first two years of the project. Project funds will be available for mapping and other activities for this purpose.

**Phase 2:** over the next few years, it is expected that the two national parks will be expanded by incorporating some additional areas of pasture, which are identified through

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<sup>26</sup>See definitions of Zapovednik and Zakaznik on p. 2.

<sup>27</sup> Estimates based on assumption that existing Zapovedniks are included in SDNP, and existing Zapovedniks and Zakazniks are included in the expanded ONP.

detailed inventories as being particularly important for biodiversity protection or ecological functions (erosion control, ecological restoration, migration corridors, etc.) and requiring a higher degree of protection. At the same time, it is expected that the relevant legislation (Law on Specially Protected Natural Areas, Land Code, etc.) will be amended to include specific provisions to allow grazing, residence and other land uses within national parks, in accordance with PA management plans and regulations. This will create the legal basis for Phase 3.

Phase 3: after the legal framework has been established, the national parks and/or other PAs may be further expanded by including municipal and/or privately owned lands, based on voluntary agreements negotiated between the land owners and the park Administrations to manage these lands as part of the park (without transfer of ownership). The main objective would be to improve effectiveness of park management by reducing fragmentation (e.g., in cases where the municipal and private lands are enclaves within the park boundaries). Municipal and privately owned lands within the proposed park areas total about 80,000 ha for SDNP, and 16,600 ha for ONP. If all of this additional area is successfully brought in to be managed as part of the park (without transfer of ownership), the PA system could eventually cover 343,000 ha in the Shah Dag area and 137,000 in the ONP area. However, it is not expected that this process would be completed during the life of the project: the target for the project is to incorporate 25% of this land.

The areas of existing and proposed additional PA are summarized in the following table:

Area Indicators for Shah Dag National Park and  
Expanded Ordubad National Park  
(Hectares)

	SDNP	ONP	Total
Existing (Zapovedniks)	21,014	15,431.	36,445
(Forest)	(12,800)	(1155)	
(Meadow)	(8,200)	(14,276)	
Existing (Zakazniks)	63,138	27,869	91,007
Land currently not in SPNA, to be included in National Parks	91,800	0	91,800
(Forest)	(80,000)		
(Meadow)	(11,800)		
<b>ESTIMATED TOTAL NATIONAL PARK AREA, PHASE 1*</b>	<b>112,814</b>	<b>43,300</b>	<b>156,144</b>
State pasture to be included in PA network (outside National Parks)	167,000	105,230	
<b>TOTAL PA NETWORK (Phase 1 &amp; 2)</b>	<b>279,814</b>	<b>148,530</b>	<b>428,344</b>
Municipal/private land added by end	20,100	4,150	24,250

of project (25% of long term target)			
TOTAL TARGET PA NETWORK AREA FOR PROJECT PERIOD	299,914	152,680	452,594
Municipal/private lands managed as part of the park (long term target)	80,400	16,600	97,000
FINAL (LONG TERM) PROPOSED PA NETWORKS	360,214	169280	525,344

\* Phase 1: assumes only existing Zapovedniks are included in SDNP; existing Zapovedniks and Zakazniks are included in ONP

Residents of sixteen Districts (rayons) in the Shah Dag area, and four rayons in the ONP area, hold grazing rights within the summer pastures that will be established as PAs. A number of central government Ministries and agencies also have mandates and programs in the area. The project will provide technical and financial support to establish institutional structures to provide for the effective participation and coordination of all these stakeholders (see Annex 6). The MENR will provide appropriate staffing for the two national parks Administrations, which will also be responsible for management of the neighboring Zakazniks (and potentially other PAs, depending on their categories). This will include sections for forest and rangeland management; socio-economics, community participation and education; park planning and ecological monitoring; tourism development; enforcement; etc. The project will support measures to modernize and improve park and other PA management capacity and increase participation of stakeholders in both parks.

Specific activities to be financed under this component include: delineation and demarcation of park and other PA boundaries; technical assistance and training for institutional capacity building; forest and meadow/pasture inventories, preparation of zoning and management plans and annual operating plans for the park and ecological management plans for the PA networks; implementation of management plans, including rehabilitation and limited construction of critical infrastructure needed for park management and supporting activities (e.g. tourism) and essential equipment; establishment and implementation of an ecological monitoring system; and operating costs. Incremental GEF resources provide the opportunity to establish and test new institutional structures and address new mandates, such as building partnerships with local communities and other stakeholders). The component will be implemented by the Ministry of Ecology, Department of Biodiversity Conservation and Development of Specially Protected Natural Areas (DBCDSNA), and the SDNP and ONP Administrations, with support and assistance from the Project Implementation Unit (PIU).

*COMPONENT 2. Community-level investment in sustainable agriculture and natural resource management (US\$4.48 million):*

This component will assist communities in the project area to shift their traditional agricultural and natural resource use practices towards more modern and efficient approaches that place less pressure on natural resources and natural ecosystems. The main focus is on livestock husbandry, which is the economic mainstay of local communities, and also one of the greatest threats to the area's biodiversity and ecological systems, particularly in the vulnerable high elevation summer

pastures. In particular, the aim is to promote dairy cattle, which are typically kept close to home and also offer the greatest potential for a return on investment. Assistance will also be provided for restoring and improving the management of badly degraded municipal pastures close to villages. Communities will develop village investment plans, drawing upon a menu of options (fodder seeds, fertilizers, agricultural equipment, small scale irrigation, milk collection and storage facilities, artificial insemination services, fencing material for pasture management, etc.). In addition to fodder production, access to agricultural machinery and irrigation will help villagers to increase production of potatoes and other marketable crops.

Local demand for wood in the SDNP area is estimated to be as much as 20 times the sustainable off-take level<sup>28</sup>, with the gap being met through illegal, unsustainable cutting. The project will support community-based reforestation and management of currently treeless or badly degraded municipal and State forest lands as an alternative source of wood, and will support demonstrations of the benefits of more efficient heating stoves and development and promotion of alternative sources of energy.

The project will target 55 villages, representing about half of the total population in the two parks<sup>29</sup>. The villages have been selected on the basis of criteria, including their dependence on the natural resources of the park areas (and consequently the threat they currently represent to the park and their potential to be negatively affected by access restrictions imposed by park management); the amount of cultivatable land potentially available for forage production, etc. The selected villages have been grouped into Village Clusters (VC) to facilitate project implementation (see Annex 6). The VC will receive Technical Assistance and funding, in the form of block grants, to prepare and implement VC Investment Plans, drawing upon the menu of options described above. The VC Investment Plans will be approved by committees comprising representatives of local and national governments, and implemented by locally based implementing agencies selected by the communities in accordance with criteria set out in the Project Implementation Manual. In addition to support for implementation of the VC Investment Plan, two fuel-efficient stoves would be allocated to each village, to be put in appropriate public buildings as a demonstration of their practicality and potential for saving on fuel expenses.

Specific activities to be financed under this component include: technical assistance for preparation of the VC Investment Plans; small scale works, goods and services required to implement the Investment Plans, provision of fuel-efficient stoves, and facilities and operating costs for the local implementing agencies.

### *COMPONENT 3: Rural Enterprise Development (US\$1.95 million)*

In the past there were some medium-sized factories and workshops for carpet-making, leather work and other handicrafts, juice-processing, etc. in the project areas, but these activities have virtually disappeared since independence. Tourism is also very limited, with few modern accommodations and services (mainly owned by people from outside the area). Component 3

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<sup>28</sup> 100,000 m<sup>3</sup> per year, compared with 5,000 m<sup>3</sup> per year.

<sup>29</sup> Including 67% of the population inside the proposed SDNP, and 29% of the population of villages inside or close to the boundaries of the proposed ONP

aims to stimulate economic diversification in the areas by assisting local entrepreneurs to obtain the technical and business information and advice and the financing they need to start or expand small and medium commercial enterprises. The information and advice will be provided by small mobile business advisory teams funded by the project that will assist interested clients to identify and assess the viability of commercial ventures, prepare business plans and obtain financing. These teams will also help PIU and Government to identify and alleviate policy, regulatory and other types of constraints to SME development.

The project will provide matching grants of about \$2000-\$10,000, based on an independent evaluation of the business plans. When the business plans call for a larger amount or longer term financing, the advisors will help the prospective entrepreneurs apply for loans from existing banks or other credit institutions. The grants will be evaluated for technical and financial feasibility by a Grant Administrator contracted by the PIU, and for environmental soundness by MENR, and will be approved by an Awarding Committee comprised of representatives of MENR, the Ministry of Economic Development (Agency for Support of Entrepreneurship), the Ministry of Agriculture (Agricultural Credits Agency), the Ministry of Youth, Sports and Tourism, and the Ministry of Finance. For both the technical assistance and matching grants, priority will be given to activities that are linked to national park objectives, including tourism-related enterprises, alternative energy and energy efficiency, and value-added processing of sustainably harvested (non-threatened) natural products such as fruits and nuts. Enterprises that support Component 2 objectives (e.g. processing of dairy products) will also be particularly encouraged. Proposals from the poorest villages, or with a strong public goods element, will receive a higher proportion of grant financing, up to 100% in some cases.

Given the time and resources available, the objective is not to achieve a large scale transformation of local economies, but to catalyze a shift by stimulating interest, demonstrating and testing different types of business opportunities, building local understanding and capacity for business planning and development, and creating an environment that will encourage other SME programs and micro-credit institutions to increase their presence in the project areas. The evaluation criteria for grant proposals will include the objective of achieving a good geographic distribution of the funds within the project areas.

*COMPONENT 4: Project Management, Monitoring and Evaluation, and Communications (US\$1.98 million)*

This component will support overall project management and administration, including the staffing and operating costs of a central Project Implementation Unit and three regional PCUs (two in Shah Dag area, one in Ordubad area). The branch offices are needed because of the size, remoteness, difficulty of access and poor communications infrastructure of the project areas. The PIU will be responsible for procurement, financial management and general administration, including facilitating inter-Ministerial and inter-agency coordination, for developing and implementing a Monitoring and Evaluation (M&E) system addressing both project operations and impacts, for ensuring the implementation of the project Environmental Management Plan and the Social Mitigation Plan that will be developed during the first year; and for progress reporting. For Component 1, the M&E system will make use of GEF tracking tools for Protected Area management effectiveness and for biodiversity conservation in production landscapes.

The PIU will also coordinate several cross-cutting activities. The first is the development and implementation of a communications plan (in collaboration with local authorities and NGOs) to increase awareness and knowledge of the project and its objectives and activities at all levels. The second is a detailed socio-economic study, to be carried out in the first year (with a shorter follow-up at the mid-term), which will carry further the assessment work undertaken during project preparation and enable the PIU to refine the baseline data and targets for socio-economic impacts of the project. The study will also assess the effectiveness of project design and implementation structures for targeting project benefits and mitigation measures to potentially affected people, and will develop a Social Mitigation Plan as required to ensure that such measures are effectively integrated into project implementation and monitoring. The third activity, to be carried out in close collaboration with the Ministry of Youth, Sports and Tourism, will be facilitating and coordinating the development of a cross-sectoral tourism development plan for the greater Shah Dag area. This process will involve all key stakeholders, including the SDNP Administration, local government, the private sector and NGOs.

**Annex 5: Project Costs**  
**AZERBAIJAN: Rural Environment Project**

Project Cost By Component and/or Activity	Local US \$million	Foreign US \$million	Total US \$million
1. Protected Areas establishment and management	5.44	2.35	7.79
2. Community-level investment in agriculture and natural resource management	2.72	1.24	3.96
3. Small enterprise development	1.74	0.16	1.90
4. Project management, monitoring and evaluation, and communications	1.56	0.29	1.85
Total Baseline Cost	11.46	4.04	15.50
Physical Contingencies	0.45	0.11	0.56
Price Contingencies	0.82	0.22	1.04
<b>Total Project Costs<sup>1</sup></b>	12.73	4.37	17.10
Front-end Fee			
<b>Total Financing Required</b>	12.73	4.37	17.10

**Component and Sub-Component Budget Breakdown**

<b>COMPONENT 1</b>	<b>US\$ mln.</b>
<b>National Park Establishment and Management</b>	
Establish legal and regulatory framework	0.12
Build capacity of National Parks	1.35
Training for park staff	0.22
PA infrastructure	2.61
PA equipment (vehicles, uniform, office equipment etc.)	1.56
Preparation of NP management and zoning plans	0.60
Implementation of NP management and zoning plans	0.99
Tourism marketing	0.15
Feasibility study for breeding center for endangered species	0.05
Incremental costs	0.73
PA staff	0.31
<b>SUB-TOTAL COMPONENT 1</b>	<b>8.69</b>
<b>COMPONENT 2</b>	
<b>Community Investments in Agriculture and NR Management</b>	
TA for establishment of Village Cluster Groups	0.52
Village Cluster investment plan activities	
• Increased forage crop production	0.41
• Agricultural machinery centers	0.55
• Agricultural advisor	0.33
• Artificial insemination	0.34

• Barn improvement	0.44
• Milk collection	0.08
• Small scale irrigation	0.80
• Village rangeland improvement	0.68
• Community afforestation	0.31
• Fuel efficient stoves demonstration	0.02
<b>SUB-TOTAL COMPONENT 2</b>	<b>4.48</b>
<b>COMPONENT 3</b>	
<b>Small Enterprise Development</b>	
Mobile business advisory service	0.72
Grants for business development	1.00
Grant administration service	0.24
<b>SUB-TOTAL COMPONENT 3</b>	<b>1.96</b>
<b>COMPONENT 4</b>	
<b>Project management and monitoring</b>	
Increase public awareness	0.07
Project monitoring and evaluation	0.26
Development of regional tourism development plan	0.12
PIU/PCU staffing, training & operations	1.38
Audit	0.13
<b>SUB-TOTAL COMPONENT 3</b>	<b>1.98</b>
<b>TOTAL</b>	<b>17.10</b>

## **Annex 6: Implementation Arrangements**

### **AZERBAIJAN: Rural Environment Project**

Detailed implementation arrangements for all project components will be outlined in a Project Implementation Manual (PIM), which will be referenced in the Grant and Credit Agreements. A draft PIM will be reviewed at appraisal, and completion and approval of the PIM by MENR and the World Bank will be a condition of effectiveness of the project.

#### **Component 1**

The Department of Biodiversity Conservation and Development of Specially Protected Natural Areas (DBCDSRNA, or Biodiversity Department) within MENR has overall responsibility for Specially Protected Nature Areas (SPNA) in Azerbaijan. However, Biodiversity Department is a small, central policy and coordination unit, not an implementing body. In Azerbaijan, each SPNA is established as a separate legal institution with its own Charter, which lays out its objectives, rules and regulations and legally establishes its management body (here called the park Administration). Zakazniks are often placed under the responsibility of the Administrations of adjacent Zapovedniks or national parks, while other types of PAs are administered through different mechanisms based on their category and how they are established. The MENR has responsibilities for all types of specially protected natural areas, even where it is not directly responsible for administration.

The park Administrations for SDNP and the expanded ONP (SDNPA and ONPA, respectively) will face new types of management challenges associated meeting new objectives such as tourism development and community participation, and coordinating ecological management over the expanded area. The ONPA will be strengthened with some additional staff as well as training and technical assistance. Because of the large area of the SDNP, it is envisaged that it will be divided into two or three sub-regions, each with a Deputy Director reporting to the overall park Director. One of the sub-regional headquarters will also serve as the overall park headquarters.

The existing SPNAs in the project areas will be dissolved as separate legal entities and incorporated into the SDNP and ONP, in most cases as core conservation areas, along with their staff and facilities, based on an evaluation of needs and capacities. Similarly, the six State Enterprises for Forest Conservation and Restoration<sup>30</sup> in the SDNP area will be dissolved and responsibility for managing these forests (along with some or all of the existing Department staff) will be transferred to a forest management unit within SDNP Administration structure. The management structures for other PAs to be established in the project areas will be determined in accordance with the Law on Specially Protected Natural Areas, based on their legal categories and objectives and the types of land and resources they include.

In each project area, a Stakeholder Advisory Group (SAG) will be established to provide a mechanism for stakeholder participation in the preparation of park management plans, including

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<sup>30</sup> official management units of the State forest, under the MENR Department of Forest Extension and Development

infrastructure development, tourism and other use, and identification of additional areas to be included in the park. In addition, an Ecological Coordination Committee (ECC) will be established for the PA network in each project area. The ECC members will include (in addition to the park Directors) key stakeholders such as local representatives of the Ministry of Ecology and Natural Resources, Ministry of Agriculture, State Land and Cartography Committee and Ministry of Youth, Sport and Tourism; the Rayon Executive Authorities, the municipalities, NGOs and the private sector. Its role will be to develop approaches and plans for improving natural resource management at the ecosystem level, in order to achieve compatibility and synergy between management of the parks, the other PAs and the municipal and privately owned lands in the project area. The purposes, roles and responsibilities of the ECC and SAG will be detailed in the Project Implementation Manual

As is the case for all SPNA, the salaries and basic operating costs of the ONP and SDNP Administrations will be the responsibility of Government. However, the project will provide capital investment (additional facilities and equipment), training and technical assistance, and incremental operating costs associated with building their capacity to increase their effectiveness. Training will also be provided for members of the SAGs and EMCCs.

## **Component 2**

Because villages in the project area are small and scattered, it is not cost-effective to deliver goods and services to them individually. Furthermore, a critical mass of users is needed to make some types of investments (e.g. agricultural mechanization centers, milk collection equipment) economically viable and sustainable. Therefore, the 55 villages that will participate in Component 2 of the project have been grouped into 15 Village Clusters (VCs), each comprised of 3-5 villages. With three Technical Advisory teams working for 3 years, each VC will receive four months of TA support for preparation of its VC Investment Plan. The 11 VCs in the SDNP area four VCs in the ONP area have been selected based on criteria such as population density, ease of access, availability of agricultural land for fodder crop production, and the extent to which the villages depend on the natural resources of the parks (and therefore represent a source of pressure, and at the same time are more likely to be affected by restricted access to these resources). Annex 17 provides the list of the VCs and member villages for Component 2.

The institutional mechanisms for implementing the VC Investment Plans (implementing agencies) will be selected or established by communities with assistance of Technical Advisors, in accordance with criteria set out in the Project Implementation Manual (e.g. representative of and accountability to the communities, non-commercial, with the legal status to maintain a bank account and hold assets on behalf of the communities). The project support for implementation of VC Investment Plans will be in the form of grants provided to the VC implementing agency, based on a grant agreement signed with the PIU. The agencies will be responsible for procurement of goods and services, following the World Bank's Guidelines for Community Level Procurement. The project will provide facilities and other support required for the operations of the implementing agency, including training in procurement, accounting and key technical skills. The PIU will advise, support and monitor the implementing agencies to ensure they meet Bank and Government procurement and accounting requirements.

The project will meet related capital and operating costs of the implementing agencies for 18 months. The agencies will charge modest fees (to be indicated in the Village Investment Plans) for use of agricultural machinery, artificial insemination and milk collection. For other investments, the communities will decide whether or not to charge fees. Any fees collected by the implementing agencies during the 18 months of project support will remain in the agency's bank account, to provide seed funds for future operations. The method for allocating investments benefiting primarily individual farmers or small groups of farmers, such as barn improvement and small scale irrigation, will be agreed as part of the VC Investment Plan. As a general guideline, only about 25-30% of the resources should be for investments benefiting individual farmers or small groups, so that most of the resources benefit the community at large.

### **Component 3**

Implementation of Component 3 will be contracted to business consulting firms or suitable NGOs. While it would in principle be preferable to work with and build capacity among local (long-term) technical and financial service providers, no appropriate organizations have been identified in or close to the project areas, and it is beyond the scope of the project to support their establishment.

One contractor will be engaged to establish five 2-person mobile business advisory teams (BAT), whose responsibilities will include: (i) preparation and dissemination of awareness-raising and instructional materials; (ii) one-on-one support to interested clients to identify business opportunities and prepare business plans and grant applications; and (iii) where appropriate, assisting clients to identify credit providers and prepare loan applications. It is not expected that the BATs will continue beyond the project: sustainability will lie in the capacity they have built among their client base.

A second contract will be awarded for administration of the matching grants program. The company or NGO selected to be the Grant Administrator will be responsible for evaluating proposals for their technical, financial, environmental and social viability<sup>31</sup> and passing recommendations to an Awarding Committee (headed by the PIU); administering and monitoring the use of grant funds; and regular reporting to PIU on progress of implementation of these activities.

### **Component 4 (Overall Project Administration)**

A Project Implementation Unit (PIU), established by the MENR for implementation of the World Bank-financed projects in the environmental sector, will have overall responsibility for project implementation and coordination. The PIU is well experienced in matters such as project administration and inter-governmental coordination, having served effectively for

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<sup>31</sup> Assigning an EA category, and approving Environmental Impact Assessments (issuing environmental passports for proposed projects) is the responsibility of MENR, but the Grant Administrator will be responsible for ensuring that grant proposals meet the environmental and social criteria set out in the EA/EMP, which forms part of the Project Implementation Manual.

implementation of the Urgent Environmental Investment Project. During preparation of AREP two Regional Project Coordinators were engaged (one based in the Shah Dag area, one in the Ordubad area) to enhance communication and consultation with local stakeholders. In view of the size and remoteness of the project areas, during the implementation stage this will be expanded to three regional offices (in Guba, Ismailli or Shemaha, and Ordubad Rayons). The Baku-based central PIU will provide project-wide services such as planning, procurement (for all goods, works and services except those falling under community-based procurement, Component 2, and under Commercial Practices, Component 3), financial management and accounting, monitoring and evaluation, progress reporting, training on project implementation procedures, and cross-sectoral coordination and government liaison. It will also be responsible for implementation of cross-cutting activities under Component 4 (socio-economic impact assessment and preparation and implementation of a Social Mitigation Plan; coordinating development of an integrated tourism development plan for the Shah Dag area, etc.). The regional offices will consist of a local coordinator and an assistant, and will be responsible for awareness raising and communications at the local level, day-to-day implementation support (including disbursement of grant funds under Component 2), organizing field visits, data collection for monitoring, organizing meetings of the VC Investment Plan Approval Committees, etc. These offices will also serve as a home base for the long-term technical service providers under Components 2 and 3.

**Annex 7: Financial Management and Disbursement Arrangements**  
**AZERBAIJAN: Rural Environment Project**

**A: Financial Management Arrangements**

**1. Summary of the Financial Management Assessment**

**Executive Summary and Conclusion**

An assessment to determine whether financial management arrangements at the central Project Implementation Unit (PIU) within the Ministry of Ecology and Natural Resources (MENR) are acceptable to IDA was undertaken in February 2005. The PIU staff have functional experience in managing World Bank projects, having implemented the ongoing Urgent Environment Project and GEF and PHRD grants. The assessment concluded that the existing central PIU that will have the overall responsibility for Project financial management, including consolidated accounting and financial reporting, Credit and Grants disbursements, internal controls, and auditing arrangements satisfies minimum financial management requirements. However, to further strengthen the existing IC Accounting system, further customization of the Chart of Accounts for the proposed project will be required to accommodate all project components before the system is considered capable of satisfactorily recording all transactions and balances, supporting the preparation of regular and reliable project financial statements,, safeguarding the assets, and are subject to auditing arrangements acceptable to the Bank. A summary of financial management risk assessment is presented in Table 1.

A detailed financial management assessment questionnaire is included in the project files. A report on the Review of Financial Management Systems is also included in project files.

**Country Issues**

The Azerbaijan Country Financial Accountability Assessment diagnostic work carried out in 2002 recommended accounting and auditing regulatory and institutional reforms to increase accountability and good governance in the country. The proposed reforms are addressed in the proposed three Poverty Reduction Strategy Credits (PRSCs). In particular, enactment of the new Accounting Law and related secondary regulation mandating use of International Financial Reporting Standards (IFRS) for public interest entities and governmental enterprises and International Public Sector Standards (IPSA) for the public sector. The Law will assure greater transparency and accountability of public funds. In parallel, the enactment of the new Audit Law and establishment of regulatory and institutional frameworks for the Chamber of Accounts, the Country's Supreme Audit Institution and the Chamber of Auditors, the audit profession regulators, and standard-setters will provide greater transparency and comparability of financial transactions.

**2. Financial Management Assessment**

### **(a) Implementation Arrangements**

The IDA Credit would be lent to the Government of Azerbaijan. The Credit would be supplemented with GEF and PHRD Grants that would be administered by IBRD for project implementation. The PIU within the Ministry of Ecology and Natural Resources will have the overall responsibility for project implementation and coordination. Specifically, the PIU will be responsible for: (i) financial management arrangements including preparing and maintaining consolidated project accounts, and financial reporting; (ii) Credit and Grants disbursements including administration of the Special Account(s) for the Credit and the Grants, Project Account for counterpart funds, and local bank accounts to be opened in the three participating regions; (iii) auditing arrangements; (iv) procurement arrangements; and (v) monitoring, evaluation and providing supervision support to the regions during project implementation. In order to ensure focused attention on the community-level investment in sustainable agriculture and natural resource management, Regional Offices (Project Coordination Units: PCU) will be opened (two in the Shah Dag area, one in the Ordubad area). For implementation of community activities under Component 2, the project will provide grants to the local implementing agencies identified by Village Cluster Committees to implement their VC Investment Plans, on the basis of contracts signed between the identified implementing agency and the PIU. For Component 3, the PIU will contract a firm or a Non-Governmental Organization (NGO) to serve as the Grant Administrator on its behalf. The PIU will be responsible for the coordination of the day-to-day activities of the Regional Offices, the VC implementing agencies and the Grant Administrator. It will maintain proper books of accounts for the project, allocate funds to the decentralized locations based on identified and justified implementation needs, and closely supervise and monitor this decentralized flow of funds.

### **(b) Staffing**

The central PIU is a fully operational central unit with competent and experienced staff, including: PIU Director/Project Manager, two Component Managers (one for Component 1, one for Components 2 and 3), Chief Accountant, Procurement specialist, Accounting Assistant, and Procurement Assistant, all with extensive expertise and experience in implementing World Bank projects. Other PIU staff include a Communications Specialist, Interpreter/Translator, Director's Assistant/Secretary and two drivers. Each of the three PCUs will be staffed by a PCU Coordinator and an Assistant, two of whom will have skills in financial management and one in engineering/civil works or another appropriate technical area. The PCUs will perform project financial management work on the community-level operations – check and verify invoices, submit full documentation to the PIU for payment, and prepare and submit periodic reports to the PIU. Financing mechanism and reporting formats for the Project and community driven activities will be agreed with the PIU and the Regions and included in the Project Implementation Manual. The risk of Regional Offices staff not performing a strong monitoring role is high. To mitigate this risk, technical advisors and focused training will be provided to the Regional staff in the initial stages to bring them up-to-date on the Bank and Project requirements. Additional training in financial management and disbursements will be provided to the PIU staff during project implementation.

### **(c) Flow of Funds**

The IDA Credit of US\$8.0 million, GEF Grant of US\$5.0 million, and PHRD Grant of US\$2.72 million would be disbursed under Bank's traditional disbursement procedures. In most cases, payments for contracts would be financed from one source when normal procedures for payment would apply. However, there would be cases when contracts need to be paid from more than one source when it would be necessary to transfer funds from the respective Special Accounts to the sub-account (Transit Account), and make payments from that account. It would therefore be critical that the funds flow and transaction details are clear and the payment out of the transit account to the contractor/supplier is made within a day or two of the funds coming into the Transit Account from Special Accounts funds. Funds flow arrangements are clearly written up in detail in the Project Implementation Manual. At the time the PIU submits withdrawal applications for replenishment of the Special Accounts, they would be required to provide not only the bank statement showing the transaction from the Special Accounts to the transit account, but also the bank statement of the transit account showing the multiple transactions into it that led to the single transaction out of it for payment to a supplier or provider. In addition to the Special Accounts and Transit Account, a Project Account for Government counterpart funds (US\$1.39 million), would be opened at the IBA for project implementation. To facilitate implementation of community-level activities, three local bank accounts will be opened in the local branches of the IBA, one in each participating region. The implementing agencies responsible for the implementation of the community-level investment activities under Component 2 will manage the local bank accounts to finance capital investment and operations costs on behalf of the village clusters. The recipients of matching grants under Component 3 will open bank accounts for into which both the grant funds and their matching contributions are to be deposited.

The following Grant disbursement procedures for the community-level investment component will be applied:

- (i) The implementing agencies for the community level operations will manage the local bank accounts in their respective regions to finance capital investments for the village clusters and operating costs.
- (ii) Initial advance to the local bank accounts and replenishment of the accounts would be made based on agreed milestones to be specified in the Investment Plan and the Grant Agreement between the PIU and the implementing agency .
- (iii) Replenishment to the local bank accounts would be made on basis of simplified reports showing sources and uses of funds, supporting documents including bank statements. The replenishment package would be verified by the Regional Offices and endorsed by the PIU before replenishment of the local bank accounts. Detailed instructions on flow of funds to the community level outlined in the Project Implementation Manual

For the rural enterprise development component, the PIU will award and manage contracts for providing the mobile business advisory teams (BAT) and for administration of the matching grants program. The Grant Administrator will receive two contracts: one for the administration fees and one for the grant funds themselves. This will make it possible to separate the funds according to their purpose, and to ensure that only the grant administration fees are subject to taxation.

As a result of multi-layered control system and managing community driven development operations, the risks associated with flow of funds is high. However, the actual implementation of controls would be monitored very closely by the central PIU, technical advisors, and Bank supervision missions. An operational review carried out by independent consultants/auditors under terms of reference acceptable to IDA would be carried out during the project Mid-term Review. The main objective of the operation review would be to: (i) assess operations controls relating to the effectiveness and efficient of the use of resources; (ii) financial reporting controls relating to the preparation of reliable financial reports; and (iii) compliance controls relating to the implementing agencies' compliance with applicable regulations and procedures as outlined in the Cooperation Agreement and in the Project Implementation Manual. The PIU would have the overall responsibility for operation, maintenance and administration of the Special Accounts, the Project Account, and the transfer of funds to the local bank accounts. Detailed procedures on the flow of funds and documentation are outlined in the Project Implementation Manual.

#### **(d) Accounting and Reporting System**

The central PIU has installed a financial accounting and reporting software (1C, Version 7.7) that is successfully used in the ongoing Project<sup>32</sup> and in accounting and reporting of the two preparation grants for the proposed Rural Environment Project. The Chart of Accounts will however require further customizing to accommodate all project components. It will classify the project by components, reflect the sources of funds by financier and different types of expenditures to enable the PIU to provide information on the receipts and uses of funds and produce financial reports comparing budget with actual sources and uses of funds at any given time. The system will have adequate security levels and fully meet Bank's reporting requirements. The existing format of the Financial Monitoring Reports (FMRs) will also be updated include all project components classified in the Chart of Accounts. A system that fully meets Bank requirements will be in place prior to Board.

The PIU Regional Offices will prepare and maintain simple accounts and financial reporting in a format to be agreed with the PIU and the Bank. They will submit full documentation and simple reports on monthly basis which would be verified by the PIU for completeness, eligibility, and then recorded in the PIU's accounting system. Thus, the PIU's books of accounts would reflect consolidated accounting for the project activities.

#### **(e) Accounting Policies and Procedures**

Accounting policies and procedures are set out in the existing Financial Management Manual. This Manual will be updated to include implementation procedures for the proposed Rural

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<sup>32</sup> IDA-financed Urgent Environmental Investment Project

Environment Project and will form part of the Project Implementation Manual. The updated procedures will include flow of funds, flow of accounting information and records between the PIU, the Regional Offices, and the implementing agencies for the community level operations (to be determined).

#### **(f) Internal Controls**

The PIU has the overall responsibility to ensure accounting and administration controls are adhered to, and are in accordance with the guidelines outlined in the POM. All project expenditures payments (except operating costs for the community-level investment component) will be made at the PIU level, and all procurement procedures including contract awards will be carried out at the PIU, thus minimizing control risks. The risk associated with internal control (the effectiveness and efficiency of operations and compliance with laws and regulations) is assessed as high at this stage. Initial frequent monitoring and supervision of Regional Offices and implementing agencies will assure provide greater assurance on reliability and effectiveness of controls.

#### **(g) Planning and Budgeting**

The PIU will prepare the annual budget for the project, as part of the Annual Work Plan (AWP), which will be reviewed and approved by the World Bank. The Component Managers will be responsible for ensuring that the activities under their respective components are reflected in the AWP and in progress reports, including the Annual Operational Plans of the Shah Dag and Ordubad national parks, the Village Cluster Investment Plans and the portfolio of grants provided under Component 3.

### **3. Auditing Arrangements**

**Internal Audit.** The PIU has no properly functioning internal audit function in the real sense of examining, evaluating and monitoring the adequacy and effectiveness of accounting and internal control systems.

**External Audit.** The project financial statements will be audited annually by independent auditors in accordance with standards and terms of reference acceptable to IDA. Acceptable auditing standards are International Auditing Standards (IAS) issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The scope for the audit will be determined by the Borrower in agreement with IDA, adapted to project risks, and will include audit of the Project Financial Statements, the Special Accounts, disbursements made on basis of Statements of Expenditure (SOEs), the PHRD and GEF Grants and the PIU internal controls. The audit report will be submitted to the Bank no later than six months after end of each year audited. The contract for the audit would be awarded during the first year of project implementation and extended subject to satisfactory performance. The cost of the audit will be eligible for financing under the Credit.

### **4. Reporting and Monitoring**

The PIU would maintain separate financial records for the Rural Environment Project, and would ensure appropriate accounting for the funds provided. They would prepare and submit quarterly Financial Monitoring Reports (FMRs) in an agreed format 45 days after end of each quarter. ***The format and timing is to be agreed at negotiations.***

The FMRs would include:

1. Project Sources and Uses of Funds Statement
2. Uses of Funds by Project Component Statement
3. Project Balance Sheet
4. Special Account Statement, and Local Bank Account Statement
5. Reconciliation of Credit Accounts Balances Statement
6. Output Monitoring Reports
7. Procurement Process Monitoring (Consultants) Statement
8. Procurement Process Monitoring (Goods and Works) Statement

## 5. Risk Analysis

From a financial management perspective, the proposed project is considered a medium-risk project. A summary of consolidated risk assessment for the project are outlined in Table 1 below. The key staff of PIU have experience in implementing Bank-financed projects having implemented the ongoing Urgent Environmental Project and project implementation grants. A set of appropriate accounting procedures and internal controls including authorization and segregation of duties have been instituted and documented in the Operational Manual, but require updating for the proposed project. The PIU experience and support of the technical advisors will mitigate risks any risks that might adversely affect project implementation.

**Table 1: Summary of Risk Assessment**

<b>Description</b>	<b>Risk</b>	<b>Comments</b>
<b>Inherent Risk</b>		
1. Country Financial Management	High	Based on CFAA, there is low financial management capacity and accountability in the public sector. The PRSC legal and regulatory reforms are aimed at increasing accountability and efficiency in the public sector.
2. Project Financial Management/ Counterpart funds	Moderate	Overall borrower improvement in providing counterpart funding on timely basis. Proper budgeting has mitigating counterpart funds delays in the ongoing project, and these measures will be taken in the implementation of Rural Environment Project.
3. Banking Sector	High	Weak banking sector. Policy reforms under way.
4. Accountability and Governance	High	Regulatory and institutional reforms to improve accountability and governance addressed under PRSC 1.

<b>Overall Inherent Risk</b>	<b>High</b>	
Control Risk		
1. Implementing Entity	Moderate	The central PIU has experience in implementing Bank-financed projects.
2. Funds Flow	High	Grant administration arrangements and availability of counterpart funds to be confirmed and risk re-assessed.
3. Staffing	Low	Adequate capacity of key PMU staff.
4. Accounting Policies and Procedures	Low	Procedures in place and documented in an existing Accounting and Procedures Manual, but to be updated for the new project.
5. Internal Audit	High	The PIU has no internal audit function. However, weak overall internal audit function in the country is being addressed under PRSC policy reforms.
6. External Audit	Moderate	Independent auditors to be selected under terms of reference acceptable to IDA.
7. Reporting and Monitoring	Moderate	Quarterly FMRs to be agreed at Negotiations.
8. Information Systems	Moderate	IC accounting system in place, but Chart of Accounts requires further customization to accommodate all project components.
<b>Overall Inherent Risk</b>	<b>Moderate</b>	

The following financial management risks could adversely affect project implementation:

1. Low implementation capacity at the region level.
2. Wherever possible local bank accounts would be opened and maintained at the local branches of International Bank of Azerbaijan (IBA). Where no local branches of IBA are present, the weak banking facilities at other commercial banks would have a negative impact to the implementation of the community-level project activities

**6. Impact of Procurement Arrangements** - Based on diagnostic work carried out under the Country Procurement Assessment Report (CPAR) issued in 2002, the following key factors have a direct effect on the financial management arrangements:

*Legal Framework and Enforcement Regime.* Azerbaijan has introduced a new Public Procurement Law (PPL) that is based extensively on the United Nations Commission for International Trade Law (UNCITRAL) model. The PPL has set up a three-tier review system that consists of an internal administrative review by the State Procurement Agency (SPA) and judicial review. Perception of the courts' ability to deal with procurement disputes is poor, thus jeopardizing the SPA's level of confidence and overall transparency in the review process.

*Regulatory Functions.* The SPA has been vested with the procurement regulatory functions and has shown willingness to ensure compliance with the Public Procurement Law (PPL). The SPA has competent and well-trained staff.

*Institutional Capacity.* The country lacks a planned training system for procurement. Staff who undertake procurement tasks often do so without sufficient or any formal training.

**7. Supervision Plan** - Financial Management supervision would be conducted every six months to monitor progress of project implementation. The risk-based financial management supervision would pay particular attention to: (i) flow of funds arrangements to effectively support the project's objectives; (ii) review of Projects FMRs and audited financial statements, including follow up on any remedial actions recommended in the Management Letter issued by the Auditors.

### **B: Disbursement Arrangements**

The Credit and Grants funds would be disbursed over a period of four years. Disbursements would be based on the new Country Financing Parameters for the Republic of Azerbaijan, and disbursed under the Bank's traditional disbursements methods (reimbursements with full documentation, Statements of Expenditure (SOEs), direct payments to third parties and special commitments). The allocation of Credit and Grant proceeds are detailed in the tables below.

**Table A: Allocation of IDA Proceeds**

Expenditure Category	Amount in US\$ million	Financing Percentage
Works and Goods in Component 1 subject to approval of <u>SDNP Charter</u>	1,610,000	81%
Other Works and Goods	1,710,000	81%
Training and Incremental Operating Costs	610,000	100%
Village Cluster Grants	2,930,000	100%
Business Enterprise Grants	750,000	100%
Unallocated	390,000	
Total	8,000,000	

**Table B: Allocation of GEF Proceeds**

Expenditure Category	Amount in US\$ million	Financing Percentage
Works and Goods in component 1 subject to approval of SDNP charter	460,000	81%
Other Works and Goods	525,000	81%
Consulting Services	1,840,000	100%
Training and Incremental Operating Costs	1,000,000	100%
Village Cluster Grants	735,000	100%
Business Enterprise Grants	200,000	100%
Unallocated	240,000	
Total	5,000,000	

**Table C: Allocation of PHRD Proceeds**

Expenditure Category	Amount in US\$ million	Financing Percentage
Consulting Services	2,720,000	100%
Total	2,272,000	

**Conditions for Withdrawal of Funds**

Payments made for expenditures made prior to the date of the Agreements will be eligible only insofar as this is specified in the legal agreements, through a clause for retroactive financing in Schedule 1. The decision as to whether to provide for retroactive financing, as well as the dates, total amounts and categories to which such retroactive financing will apply, will be agreed at negotiations.

Payment made for expenditures for goods and works for national park management (Category 1(a) in Schedule 1) will be conditional on the Borrower having approved the charter of Shah Dag National Park, acceptable to the Association. The criteria for acceptability will be agreed at negotiations and recorded in the Minutes of Negotiations.

### **Special Account(s)**

To facilitate timely project implementation, the PIU would maintain three Special Accounts and one sub-account to the Special Accounts (Transit Account) in a commercial Bank acceptable to the Bank<sup>33</sup> to finance project expenditures from the IDA Credit, the GEF Grant and the PHRD Grant. In addition, the Borrower would open a Project Account for Government counterpart funds.

*Authorized Allocations.* The ‘Authorized Allocation’ of each of the Special Accounts should generally not exceed 10% of the total Credit/Grants amount, and would be set as follows:

- *IDA Credit.* Authorized Allocation to the Special Account would be set at US\$ 800,000 to be withdrawn from the IDA Credit Account and deposited into the Special Account pursuant to paragraph 1(c) Schedule 5 of the Credit Agreement. However, the Authorized Allocation would initially be limited to US\$ 400,000 until the aggregate amount of withdrawals from the Credit Account plus the total amount of all outstanding special commitments are equal to or exceed the equivalent of US\$ 1.5 million [TO BE CHANGED TO SDR EQUIV LATER].
- *GEF Grant.* Authorized Allocation to the Special Account would be US\$ 500,000 to be withdrawn from the GEF Grant Account and deposited into the Special Account pursuant to paragraph 1(c) Schedule 5 of the Grant Agreement. However, the Authorized Allocation would initially be limited to US\$ 250,000 until the aggregate amount of withdrawals from the Grant Account plus the total amount of all outstanding special commitments are equal to or exceed the equivalent of US\$ 1 million ..
- *PHRD Grant.* Authorized Allocation to the Special Account would be US\$250,000 to be withdrawn from the PHRD Grant Account and deposited into the Special Account pursuant to paragraph 1(c) Schedule 5 of the Grant Agreement.

Community level activities would be financed through Grants from IDA and GEF. Funds would be transferred from the respective Special Accounts to local bank accounts to be opened in the local branches of the IBA, in the participating regions.

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<sup>33</sup> All World Bank credits, loans and grants are opened by the Ministry of Finance at the International Bank of Azerbaijan.

## **Statements of Expenditures (SOEs)**

SOE procedure would be used for contracts for: goods costing less than US\$ 100,000; (ii) services of consulting firms costing less than US\$ 100,000 equivalent, and individual consultants costing less than US\$ 50,000; (iii) incremental operating costs; and (vi) eligible social charges, all under such terms and conditions as the Association shall specify. The required supporting documentation would be retained by the PIU, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Grant/Credit Account was made. The documentation would be made available for review by the auditors and by visiting IDA staff upon request.

## **Financial Covenants**

The PIU would maintain adequate financial management systems and furnish to IDA quarterly Financial Monitoring Reports (FMRs) on financial, monitoring and procurement management activities. Independent auditors under terms of reference acceptable to IDA would audit the Project Financial Statements, the Special Account and SOEs. The audit report and accompanying audited financial statements would be submitted to IDA no later than six months after end of each fiscal year audited.

## **Annex 8: Procurement**

### **AZERBAIJAN: Rural Environment Project**

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004; and the provisions stipulated in the Legal Agreement. The various items under different expenditure categories are described in general below. For each contract to be financed by the Credit, the different procurement methods or consultant selection methods, the need for pre-qualification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

**Procurement of Works:** Works, estimated to cost US\$600,000 and more will be procured through International Competitive Bidding (ICB). Works estimated to cost less than US\$600,000 and more than US\$100,000 will be procured through National Competitive Bidding (NCB). Smaller works estimated to cost less than US\$100,000 each will be procured through Shopping procedures.

**Procurement of Goods:** Goods estimated to cost US\$100,000 or more will be procured through ICB. Goods estimated to cost less than US\$100,000 will be procured through Shopping on the basis of at least three written quotations obtained from qualified suppliers.

**Selection of Consultants:** Short lists of consultants for services estimated to cost less than US\$100,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines. Consultancy services to be provided by consultancy firms estimated to cost US\$200,000 or more will be procured through Quality and Cost Based Selection (QCBS) method. Consultancy services to be provided by consultancy firms estimated to cost less than US\$200,000 may be procured through Consultants' Qualifications (CQ) method, or by other methods ( Selection Under a Fixed Budget, Least-cost Selection, Single Source Selection) for services which the Bank agrees meet the relevant criteria under the Bank's Consultant Guidelines. The consultancy firm for project audit will be selected through Least Cost Selection (LCS) method. The contract for design and implementation of public awareness campaign will be awarded through Fixed Budget Selection (FBS). Individual Consultants will be selected in accordance with Section V of the Consultancy Guidelines.

**Community Participation Procurement (CPP):** Procurement of goods, works and services for community level investments (Component 2) to be implemented by the communities in each Village Clusters shall be carried out by Community Participation Procurement method in accordance with paragraph 3.17 of the Procurement Guidelines and in accordance with procurement procedures defined in Project Implementation Manual, prepared in accordance with the Manual for Conducting Very Small Value Procurements under World Bank/IDA/ Small Grants, Loans, Credits (June 2004).

**Commercial Practices (CP):** Procurement of goods, works and services for rural enterprise development (Component 3) to be implemented by individual entrepreneurs or small and medium sized enterprises shall be carried out through Commercial Practices established in the country in accordance with paragraph 3.12 of the Procurement Guidelines and in accordance with procurement procedures defined in Project Implementation Manual.

The PCUs, with support from the PIU, will provide advice and hands-on training to the beneficiaries and will also provide standard documents and contracts for their use. The PCU will prior review the first five contracts from each Village Cluster and all contract estimated to cost more than \$10,000. The PCUs will also carry out ex-post review of contracts carried out by beneficiaries, not only regarding procurement, but also technical and financial aspects. The PIU will supervise the work carried out by the PCUs and provide prior reviews on any contract estimated to cost above \$50,000.

**Operating Costs:** Operating costs for the PIU, PCUs and National Park Administrations, covering office rent, supplies, utilities, operating and maintenance expenditures of office equipment and vehicle, per diems and local travel costs, costs of consultative meetings or workshops, communications costs, etc. and will be disbursed on the basis of annual budgets to be prepared by the implementing agencies and agreed with the World Bank.

The Bank's Guidelines, Standard Bidding Documents to be used for each procurement method, as well as Consultant Selection documents were provided to the implementing agency during the appraisal mission and the updated documents are available in the Bank's external web-site.

## **B. Assessment of the agency's capacity to implement procurement**

A Project Implementation Unit (PIU) established under the Ministry of Ecology and Natural Resources (MENR) will have the overall responsibility for project implementation and coordination including planning, procurement, financial management, monitoring and evaluation etc. The PIU is well experienced in project management and implementation, having served for the implementation of ongoing Urgent Environmental Investment Project financed by the Bank. The PIU is staffed by qualified experts on planning, monitoring and evaluation, procurement, financial management and technical coordination. The procurement activities will be under the responsibility of PIU, which has one full-time procurement expert and one full-time procurement assistant recruited on competitive basis as individual consultant and they will be working closely with procurement staff assigned by the Ministry.

An assessment of the capacity of the Implementing Agency to implement procurement actions for the project has been carried out by Elmas Arisoy, Sr. Procurement Specialist in March 2005. The assessment reviewed the organizational structure of MENR for implementing the project and possible implementation arrangements.

The key issues and risks concerning procurement for implementation of the project have been identified and include the following:

(a) At the country level, a comprehensive analysis of the public procurement system in Azerbaijan was carried out during the Country Procurement Assessment review (CPAR) in June 2003. The Public Procurement Law was adopted on December 27, 2001. The Law is inspired to a great extent by UNCITRAL model law and consistent with international best practices. Based on the analysis of legislative framework, effectiveness of regulatory institutions, the strengths of enforcement regime, the capacity of institutional and human resources, performance of Bank financed projects and the threat of corruption, the CPAR found that the public procurement environment in Azerbaijan is medium to high risk.

(b) PIU has experience in implementation of Bank financed project (namely Urgent Environmental Investment Project). MENR will also assign at least one person for procurement, who will be working with procurement staff in PIU. This arrangement would help capacity building within the Ministry and will also help mainstreaming with the existing structure of the Government.

(c) The overall project will be managed by the Project Implementation Unit (PIU) established in MENR and the PIU will be responsible for the procurement activities except the following components:

- Component 2: Procurement under community level investments will be implemented by the implementing agencies chosen by the communities, and
- Component 3: Procurements under rural enterprise developments will be implemented by beneficiary enterprises.

The corrective measures which have been agreed are as follows:

(a) The procurement file containing up to date procurement documents (guidelines, manuals, templates of procurement notices, standard bidding documents for procurement of goods and works, standard request for proposal documents for consultants' services, evaluation report formats, regional and simplified procurement documents etc.) is provided to PIU at the time of Appraisal Mission. The PIU is recommended to visit the Bank's web-site frequently to ensure using the most updated procurement documents.

(b) The Project Launch Workshop will have a specific session on Procurement Training for the PIU staff.

(c) The procurement staff of PIU and the Ministry will attend procurement trainings on Bank's procurement procedures given by ILO in Turin and/or by the Bank at the beginning of the project and will attend additional courses to improve and update their procurement knowledge, especially in Community Participation Procurement.

(d) Bank procurement specialist will be a member of the project team throughout the project cycle. During project implementation, the Bank procurement specialist shall involve in the supervision missions.

The overall project risk for procurement is high risk.

### C. Procurement Plan

The Borrower developed a procurement plan for project implementation which provides the basis for the procurement methods. This plan has been agreed between borrower and the task team during appraisal. The procurement plan is available in the project's database and in the Bank's external website. The Procurement Plan will be updated in agreement with the task team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

### D. Frequency of Procurement Supervision

In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended every six months supervision missions to visit the field to carry out post review of procurement actions.

### E. Details of the Procurement Arrangements Involving International Competition

#### 1. Goods, Works, and Non Consulting Services

(a) List of contract packages to be procured following ICB and direct contracting:

1	2	3	4	5	6	7	8
Ref. No.	Contract Description	Estimated Cost (\$)	Number of Contracts	Procurement Method	Domestic Preference (yes/no)	Review by Bank (Prior / Post)	Expected Bid-Opening Date
1	Various vehicles for NPs	600,000	2	ICB	Yes	Prior	
2	Satellite images and aerial photography	300,000	2	ICB	No	Prior	

(b) All ICB goods and works contracts, NCB works contracts estimated to cost above US\$200,000 per contract, and all direct contracting, will be subject to prior review by the Bank.

#### 2. Consulting Services

(a) List of consulting assignments with short-list of international firms.

1	2	3	4	5	6	7
Ref. No.	Description of Assignment	Estimated Cost (\$)	Number of Contracts	Selection Method	Review by Bank (Prior / Post)	Expected Proposals Submission Date
1	TA to establish legal and regulatory framework for SDNP and ONP	105,000	1	CQ	<b>Prior</b>	
2	TA to build capacity of National Park Administrations	1,350,000	1	QCBS	<b>Prior</b>	
3	Preparation of Village Development Plans for Village Clusters	510,000	1	QCBS	<b>Prior</b>	
4	Business Advisory Services	715,000	1	QCBS	<b>Prior</b>	
4	Grant Administrators for SDNP and ONP	220,000	2	CQ	<b>Prior</b>	
5	Monitoring Socio-economic and attitude indicators	215,000	1	QCBS	<b>Prior</b>	
6	TA for preparation of tourism development plan	125,000	1	CQ	<b>Prior</b>	

(b) Consultancy services (firms) estimated to cost above US\$100,000 per contract, consultancy services (individuals) above \$50,000, all single source selection of consultants, and TORs for all consultancies regardless of cost, will be subject to prior review by the Bank.

(c) Short lists composed entirely of national consultants: Short lists of consultants for services estimated to cost less than US\$100,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

## **Annex 9: Economic and Financial Analysis**

### **AZERBAIJAN: Rural Environment Project<sup>34</sup>**

The economic analysis of the project suggests an economic rate of return of 26%, a net present value of US\$ 44 million and a cost:benefit ratio of 3.5. These figures exclude potentially significant long-term benefits from reduced flooding and sedimentation, and non-marketed benefits potentially accruing to expatriates and visitors to Azerbaijan and the international community as a whole through improved biodiversity. The financial analysis indicates a financial rate of return of 23%, a net present value of US\$ 36 million and a cost:benefit ratio of 3.1. Financial benefits will accrue from increased profit associated with tourist visitor expenditure, potential park visitor fees, maintenance of revenues from sheep grazing over the long term (as pasture degradation is halted and reversed), increased yields from cow milk, enhanced crop yields, sustainable wood harvesting and profits from new and enhanced small businesses.

The increased profit associated with tourist visitor expenditure assumes that currently there are 250,000 visits to the Shah Dag National Park area each year, and 50,000 to the Ordubad NP. increasing by 2.5% per year specifically as a result of the project, with a 20% profit level and a 5% increase in spend per visit due to the project. This results in a present value of US\$ 5.6 million over a 40-year period. Over the same 40-year period and assuming the same visitor numbers, potential present value park visitor fees (excluding collection costs) could be around US\$ 1.8 million. This assumes visitor fees of US\$ 0.5 per national and US\$ 5 per international visitor introduced 3 years after project completion. It is assumed possible to capture fees only for 50% of all park visits, and that collection costs are 50% of collected visitor fees.

Assuming that the project results in significantly improved pasture grazing controls, returns from sheep grazing will be retained rather than continuing to decline. The resulting retained revenues from sheep grazing over 40 years could be in the order of US\$ 40 million (present value). This is based on the estimate of 2.5 million sheep currently grazing in the pastures. It also assumes that “without the project” sheep grazing numbers will initially continue to grow at 5% per year for 4 years, and then decline by 10% per year, due to decreased productivity of degraded pastures. With the project, sheep numbers are projected to continue to grow at 2% per year for 4 years, and then decline by 5% per year as a result of measures to reduce the total numbers down to a sustainable carrying capacity. Returns on sheep grazing on overgrazed (degraded) pastures are assumed to US\$ 17.6 per sheep. A 5% increase in returns per sheep is assumed for sheep grazing on better managed pastures (reduced grazing pressure).

Under Component 2, improved pasture restoration and other agricultural provisions (e.g. seed, fertilizer, machinery centers, artificial insemination, barn improvements, milk collection facilities, small scale irrigation etc) are assumed to improve production of fodder to feed the enhanced progeny of artificially inseminated cows and to reduce the grazing pressure on mountain pastures. They should also enable some land that used to be cultivated in the past, to

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<sup>34</sup> The economic analysis was carried out for an earlier version of the project concept, and may therefore not entirely reflect the final version, in relation to the areas to be covered by the national parks versus other types of PAs. However, this does not effect the economic and financial outcomes and projections.

be cultivated again to grow crops and some existing cultivated land to be enhanced, thereby improving crop yields. Increased milk revenues from 5,000 artificially inseminated cows, improved crop and fruit output from 285 ha, and improved rangelands of 1000 ha could result in present value benefits of US\$ 370,000, US\$ 1.5 million and US\$ 240,000 respectively.

The project will also fund 9000 ha of community afforestation as pilot schemes to demonstrate the potential to harvest wood on a sustainable basis. Assuming wood can be harvested 10 years after planting at a sustainable yield of 1.6m<sup>3</sup> wood/ha/year, with a margin of US\$ 3.4 per m<sup>3</sup> wood, this gives a present value benefit over 40 years of US\$ 70,000. In addition, a total of 240 fuel-efficient stoves will be given for free to schools and households in the park area. These will help show that such stoves can save on fuelwood and hence reduce the pressure on forests. No estimates are made of financial or economic benefits resulting from provision of the stoves.

Component 3 should give rise to 150 small enterprise development grants worth US\$ 1 million that could result in potential profits of US\$ 4.8 million.

In addition to the above financial benefits, further economic benefits potentially accrue to the Azerbaijan economy. These include the national visitor consumer surplus (i.e. enjoyment over and above that paid for) associated with visiting the parks. This could give rise to present value benefits of around US\$ 700,000 million. This assumes existing consumer surplus values of US\$ 0.75 and US\$ 1.5 per visit for nearby local Azeris and national Azeris respectively. Furthermore, a 40-year present value non-use benefit of US\$ 6.4 million may exist for the Azerbaijan adult population. This represents the value or enjoyment accruing to residents as a result of simply knowing that the parks exist to maintain the country's biodiversity and landscape. The value is based on an assumed non-use value of US\$ 0.1/adult/year after the project starts and US\$ 0.2/adult/year five years after the project has been completed, as the biodiversity begins to improve. These non-use values are based on non-use values calculated elsewhere and adjusted accordingly.

Other economic benefits not included in the above analysis include potentially significant long-term benefits from reduced flooding and sedimentation due to reduced meadow erosion and forest cutting. In addition, significant non-use values are also likely to accrue to expatriates and international visitors to Azerbaijan (potentially US\$ 7 million over 40 years) as well as the international community as a whole.

Sensitivity analysis shows that the results are fairly robust to the complete exclusion of crop yield benefits, tourism benefits and non-use benefits, with IRRs falling only by a few percent respectively. However, the results are more sensitive to exclusion of the sheep revenues, with a decline in ERR to 14% and FRR to 10%. Furthermore, under the "without project" scenario, if the severe pasture deterioration occurs after 8 years instead of after 4 years, with the other assumptions remaining constant, there would actually be an overall sheep revenue loss from the project rather than a gain. This highlights the significant sensitivity of the sheep revenue assumptions

The most significant potential financial and economic risk associated with the project relates to the fact that the agricultural intensification package (component 2) could in fact result in

increased mountain pasture grazing pressure. This is likely to be the case if strict grazing controls and incentives are not put in place and appropriately enforced. This would result in increased erosion, loss of biodiversity and potentially an ultimate collapse in sheep grazing.

Furthermore, the attainment of economic and financial benefits relating to the agricultural output (e.g. crops and milk), small businesses and tourism related profits are also significantly dependent upon i) good management and ii) there being a market for the products. The park areas are currently rich in resources and products, but suffer severely from lack of markets to sell the output to.

The long-term fiscal impact of the project is likely to be positive. The project has intentionally been designed to achieve maximum impact with the smallest possible loan size. Government contributions relate to development of the proposed Park Authorities and the Park staff. Fiscal benefits to the Government will arise through increased tourism in the Park areas and significantly enhanced agricultural and business development. This will generate Government income through taxes on tourists, goods, services and salaries.

The long-term financial sustainability of the Parks could potentially be a problem if the Park Authorities are not managed appropriately. However, there is a range of potential sources of finance that the Parks can potentially tap into. In particular the Parks must make a case for continued Government and international community assistance, and maximize the opportunities for raising revenues through entry fees, park sales, and tax/concession type arrangements with organizations making money from the park resources (e.g. tourism, mining of minerals, collection of aggregates downstream of the parks, and water bottling operations). In addition, there is scope for obtaining financial assistance from carbon funds and corporate sponsorship (e.g. from BP).

## **Annex 10: Safeguard Policy Issues**

### **AZERBAIJAN: Rural Environment Project**

#### **Environmental Assessment (OP 4.01)**

The project is expected to have an overall positive environmental impact by conserving globally and nationally significant biodiversity, protecting rare, transboundary ecosystems and the enhancing the sustainability of natural resource use in the project areas. Other likely environmental benefits include: reduced soil erosion (improving downstream water quality), flood moderation (protecting downstream infrastructure such as roads, bridges and irrigation systems), and carbon sequestration in ecologically restored meadows and forests. Barn improvements (sanitation and ventilation) under Component 2 will improve environmental health conditions both for livestock and for the people who handle them.

Safeguard related-risks and measures to address them. The project aims to put in place systems for more sustainable use of natural ecosystems that are currently being overused and degraded, and to promote economic development that will reduce reliance on mass consumption of natural resources. In the short term this will be mainly through improved protection, but the longer term objective is to develop community/user-based management systems and to trigger a shift from traditional, low-input livelihoods based on mining of natural resources (forests and pastures) towards more value-added economic activities that are less dependent on these resources or use them more efficiently. This shift can involve some risk of negative impacts, such as unregulated tourism development or increased pressure on particular species of high commercial value. While the direct, short-term impacts of the project will be limited by the relatively small scale of the interventions, the project is intended and expected to catalyze change on a much larger scale in the longer term.

The risk of negative longer term impacts is mitigated by the establishment of the national parks and PAs. This provides a (currently absent) legal and institutional mechanisms for planning and regulating development, as MENR has a clear mandate to ensure that conservation and environmental sustainability objectives are met. The creation of a Coordinating Committee, including relevant government agencies, local authorities, local communities, environmental organizations and other interested stakeholders, will support this mandate, as will educational/outreach and monitoring programs supported by the project. The project will also support the preparation of an integrated tourism development plan for the Shah Dag area, coordinated by the Ministry of Ecology and Natural Resources. Environmental sustainability will be a key criterion for selection and design of community and small enterprise development activities under Components 2 and 3, allowing them to serve as models and demonstrations for future development.

Safeguard-related impacts. The Environmental Assessment (OP 4.01) undertaken during project preparation identified the following environmental impacts that could result during implementation of the proposed project:

- Construction and/or rehabilitation of infrastructure within the National Parks, including checkpoints and guard stations, visitor centers, roads and trails, etc. could have direct impacts on flora and fauna at the construction sites or result in erosion, and generate wastes requiring disposal. However, these works will be small scale, limited in extent, and based on approved park management plans;
- Increased tourism/recreational use of the two areas could result in impacts such as disturbance of wildlife, generation of solid waste, overuse or pollution of surface water, and various social disruptions;
- Some micro-projects under Components 2 and 3 (e.g., small scale irrigation, marketing of non-forest timber products) could lead to environmental impacts associated with construction, waste disposal, over-harvesting of vulnerable species, etc.

Mitigation measures. Mitigation measures to address these impacts are outlined in the project's Environmental Management Plan (EMP), which was completed and disclosed (in-country and in the Bank's InfoShop) prior to appraisal, and have been incorporated into the Project Implementation Manual. These include assessing proposed construction sites for potential biodiversity or environmental concerns, including waste management measures and site clean-up requirements in construction designs and contracts, environmental screening of micro-project proposals, etc. The EMP also lays out responsibilities of the MENR and other government agencies, the PIU and grant beneficiaries. These include carrying out the appropriate level of environmental screening or assessment, and obtaining required clearances and environmental permits from MENR in accordance with the Law on Environmental Protection, and monitoring of compliance and impact.

### **Involuntary Resettlement (OP 4.12)**

Safeguard-related impacts. Creation/expansion of the two national parks and surrounding PAs will result in some restrictions on natural resource use on the state-owned forests and pastures, compared with the current situation. Some additional areas that are particularly rich in biodiversity or vulnerable to erosion will be declared fully protected core conservation zones (closed to any habitation or economic use), some other areas will be temporarily withdrawn from use for purposes of ecological restoration, and some areas will be subject to increased regulation in the interests of long term sustainability.

All of the state forest land in the Shah Dag area will be included within the SDNP and, while detailed forest inventories will need to be carried out, it is expected that most of the forest will be established as core conservation and ecological restoration zones. Total permissible (sustainable) wood off-take from the forest will therefore be very limited. By contrast, most of the pasture in both project areas will continue to be available for grazing. In the Shah Dag area, only those areas which are within existing Specially Protected Natural Areas, plus high elevation meadows that are not used for grazing due to inaccessibility, will be included within SDNP in the first phase, while some areas of high biodiversity and ecological priority will be

added in the second phase (see Section 3 and Annex 4). The expansion of ONP may include some actively used pasture land, which could continue to be used for grazing in a regulated manner, in accordance with the provisions of the park Charter. The remaining state-owned pastures in both project areas will be established as other types of PAs which are less restrictive than national parks, in that they allow economic use of the biological resources, but which are legally designated as areas for protection of ecological quality and biodiversity (see Annex 4 for details). While continued use is intended, restoring degraded pastures to good ecological quality and moving towards sustainable use will involve changes, such as restricting the number of animals per hectare and shortening the grazing season to avoid damaging fragile plants in the early Spring. Such restrictions will have impacts on local communities, whose livelihoods and economies depend very heavily on the pastures. However, this impact will be limited by the fact that improved management will be introduced gradually (with a target of only about 20 percent of the total available pasture being subject to increased regulation by the end of the project).

Mitigation measures. Although no villages or households will be relocated and land ownership and rights will not be affected, the World Bank's Involuntary Resettlement Policy (OP 4.12) is triggered because the establishment/ enlargement and improved enforcement of the two National Parks and the establishment of the other adjacent Pas will reduce access to forest and pasture resources that are traditionally used and economically very important both for local communities and other livestock owners with legal summer grazing rights in these areas. . In the long term restoration and sustainable management of these ecosystems will benefit the users, but the short term impacts need to be mitigated, as detailed in the project's Access Restriction Process Framework which was disclosed prior to appraisal. An additional detailed socio-economic study will be undertaken during Year 1, with a follow-up at midterm, to: (i) refine baseline data and impact indicators and targets; (ii) strengthen project measures for targeting mitigation and benefits to potentially affected communities and individuals; and (iii) prepare a Social Mitigation Plan to ensure that mitigation measures called for in the ARPF are effectively integrated in project implementation. These include involving local users in zoning and management planning of the parks and other Pas, phasing in of grazing limitations over time, and support for developing alternative livestock rearing methods, sources of wood, and income sources (including some employment in the parks themselves). The menu for development assistance provided under Components 2 has been created based on consultations with potentially affected communities, and the villages to receive assistance have been selected based on criteria which include the likelihood that they will be affected by resource access restrictions. Matching requirements for grants under Component 3 will be reduced or eliminated for applicants from the highest elevation (poorest and most vulnerable) villages, and for enterprises with particularly high social benefits.

Alternatives to minimize safeguard-related impacts. The current project design represents the best alternative for minimizing the impacts associated with the Involuntary Resettlement safeguard. An alternative design that was rejected, would have created two large, conventional strict nature reserves that exclude human habitation and all economic activities other than tourism. This design was rejected because it could have involved relocating up to 60 villages (over 40,000 people), transferring ownership of private lands to the MENR, and taking large areas of valuable pasture and forest permanently out of economic use, perpetuating the unsustainable and increasingly unacceptable *status quo* of isolating local communities from the

valuable resources and economic potential of the Protected Areas (PAs). The current project design minimizes negative impacts on the local population. Specific measures are being taken to ensure that local users are provided development assistance to compensate for any reduced access to pasture and forest resources.

### **Natural Habitats policy ([OP 4.04](#)) and the Forest policy ([OP 4.36](#))**

Safeguard-related impacts and mitigation measures. The Natural Habitats and Forest policies are triggered because the project areas include relatively pristine natural habitats, a large part of which is indigenous forest, for which management plans will be developed and implemented. However, the project will result in improved protection of these areas, not result in any destruction or increased exploitation. Natural areas with high biodiversity value, including the existing PAs, will be incorporated into the two new National Parks as core conservation areas, and their protection is expected to improve as a result of the project. All management activities relating to natural forests and other natural habitats will be consistent with the World Bank policies. Support for livestock husbandry are not expected to increase livestock numbers in the area, as it will introduce and support methods that promote intensified (fodder and stall-fed) rather than extensive grazing approaches. There are no important endemic local livestock or crop varieties at risk of being displaced by introduction of improved varieties.

### **Public Consultations on Safeguard-related Impacts**

An Environmental Assessment/ Environmental Management Plan (EA/EMP) and an Access Restriction Process Framework (ARPF) were prepared during the preparation phase of the project, in accordance with World Bank requirements. Extensive public consultations were held during preparation of these documents to obtain stakeholders feedback on the project design, and again to review the final versions prior to appraisal. The documents are also publicly available in-country and in the Banj Infoshop.

Public consultation during project preparation included over 30 meetings in both project areas, involving over 700 local stakeholders. Consultants preparing the project EA/EMP and the ARPF met with local public officials (local representatives of the Rayon Executive Authorities, local staff of concerned Ministries, Directors of Ismailly and Pirkuli Nature Reserves (Zapovedniks) and of six Forestry Units), elected municipality leaders, NGOs, representatives of the scientific community, school directors and teachers and other community members including elders (*aksakkals*), shepherds, farmers, small business owners, handicraft makers, youth and women. Discussions included communities' perceptions and concerns, which mainly focused on restrictions on access to pastures, their priorities for development assistance and mechanisms for project implementation at the local level. Common priorities identified by communities during discussion included need for dairy and food processing facilities, for agro-mechanization and irrigation services, improving livestock genetic materials. Most of the consultants undertaking preparation studies also met with local stakeholders to discuss the specific aspects of the project with which they were concerned, as did members of the World Bank task team during preparation support missions.

A second phase of public consultations took place in February, 2005 (prior to appraisal), when the final versions of the EA/EMP and ARPF were publicly disclosed, in accordance with WB Safeguard policies. This round of consultations focused on proposed mitigation and management options. The consultations were carried out by the Project Implementation Unit and the PCUs, in Baku and both project areas. The minutes of the meetings, including lists of participants, are available at the PIU.

Public involvement and participation will continue during project implementation. The project has been designed so that local populations can, to the extent feasible, participate in all aspects of park management planning, including the delimitation and demarcation of park boundaries, zonation of park areas, the determination of resource-use restrictions and compensatory measures, and in the monitoring of both socio-economic and biological changes due to project interventions. The PIU will prepare and implement an outreach strategy, and will have local offices in the project areas to facilitate communication with beneficiaries and stakeholders.

### **Institutional responsibilities for implementing and monitoring mitigation plans**

During project implementation, the Borrower, through MENR and other institutions implementing the project, will carry out project-specific EAs as needed under each project component. Specific EAs will be prepared for the infrastructure construction and rehabilitation activities carried out under Component 1. The Village Cluster Investment Plans (Component 2), and the project proposals/business plans (Component 3) will be subject to environmental screening, with preparation of environmental assessments and environmental mitigation and monitoring plans where required. In accordance with Azerbaijan law, the project proponents (park Administrations under Component 1; organizations selected to implement the VC Investment Plans for Component 2; grant applicants for Component 3) will be responsible for proposing an EA Category and preparing mitigation/monitoring plans, while MENR (Ecological Expertise section) is responsible for deciding the EA category and reviewing/approving the EAs and mitigation plans, and issuing any required environmental passports for the activities. PIU will assist project proponents to fulfill their responsibilities, either directly or through providing short term consultant services, and will be responsible for ensuring all necessary environmental procedures have been followed and all permits obtained before disbursing funds for these activities. . . . The requirements and procedures for environmental and social impact screening and assessment will follow Government laws (e.g. the Law on Environmental Protection, EIA Handbook which specifies EA screening and approval procedures), and World Bank requirements. They are detailed in the Project Implementation Manual which will be approved by the Bank prior to project effectiveness.

The Project Implementation Unit (PIU), on behalf of the Borrower, will report on the status of all EAs carried out under the project. The PIU will also put in place a program to monitor socio-economic impacts of the project. The results will be used to modify project components and implementation where needed, for example to address the needs of any subgroups (e.g. women, youth, internally displaced people) that are identified as particularly vulnerable.

**Annex 11: Project Preparation and Supervision**  
**AZERBAIJAN: Rural Environment Project**

	Planned	Actual
PCN review	10/10/2001	10/10/2001
Initial PID to PIC	10/24/2001	10/24/2001
Initial ISDS to PIC	01/15/2002	01/15/2002
Appraisal	03/01/2005	03/01/2005
Negotiations	04/11/2005	04/25/2005
Board/RVP approval	06/09/2005	
Planned date of effectiveness	01/01/2006	
Planned date of mid-term review	03/01/2008	
Planned closing date	12/31/2009	

Key institutions responsible for preparation of the project:

Ministry of Ecology and Natural Resources

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Konrad Von Ritter	Team Leader	ECSSD
Philip Brylski	Team Leader	ECSSD
Agi Kiss	Team Leader	ECSSD
Gulana Hajiyeva	Environmental Affairs Officer	ECSSD
Samir Suleymanov	Operations Officer	ECSSD
Elmas Arisoy	Procurement Specialist	ECSPS
Ida Njeri Muhoho	Financial Management Specialist	ECSPS
Junko Funahashi	Lawyer	LEGEC
Gail Lee	Task Assistant	ECSSD
Nedret Durutan	Consultant	ECSSD
Charis Wuerffel	Consultant	ECSSD
Amy Evans	Consultant	ECSSD
Olaf Malver	Consultant	ECSSD
Murad Bagirzadeh	Consultant	ECSSD

Bank funds expended to date on project preparation (**P066199**):

Bank resources:	398,017.87
Trust funds:	122,988.51
BBFAO	131,800.00
<b>Total:</b>	<b>652,806.38</b>

Estimated Approval and Supervision costs: **837,200.00**

Up to approval	437,200.00
Supervision (4 yrs)	400,000.00

Remaining costs to approval:	39,182.13
Estimated annual supervision cost:	80,000.00

**GEF (P077031):**

BBGEF:	164,108.53
Trust funds:	0
<b>Total:</b>	<b>164,108.53</b>

Estimated Approval and Supervision costs: **350,000.00**

Up to approval	190,000.00
Supervision (4 years)	160,000.00

Remaining costs to approval:	25,891.47
Estimated annual supervision cost:	40,000.00

**Annex 12: Documents in the Project File**  
**AZERBAIJAN: Rural Environment Project**

World Bank reports and documents

Integrated Safeguards Datasheet

Project Information Document

Government Reports

National Environmental Action Plan. State Committee on Ecology and Control of Natural Resources Utilization

Minutes of Consultation Meetings on EA and ARPF

Consultant Preparation Reports

Access Restriction Process Framework. Gordon Appleby

Environmental and Social Impact Assessment. ACEP

Economic and Financial Analysis for Azerbaijan Rural Environment Project. Jacobs GIBB LTD

Assessment of Energy Consumption Patterns in Shah Dag and Strategies for Reduce Wood Fuel Use. Environmental Resources Management RM, funded under TACIS-JEP Program.

Identification and Analysis of Possible Institutional Models for Implementation of Shah-Dag National Park. Piotr Gorbunenko, Jacobs GIBB LTD

Analysis of Potential Partners for Business Development and Identification of Business Opportunities in the Project Areas. Liviu Gumovschi

Rural Enterprise Development within the Sustainable Rural Livelihoods Component. Igor Gorashov

Review of Potential in Development of Community Based Small Economic Activities. AFCON Consultants

Spatial Analysis of Potential Residential Deforestation in Azerbaijan. GeoData Institute

Grazing and Pasture Management Component Identification Study. RDP Livestock Services B.V.

Ecotourism in National Parks of Shah Dag and Ordubad. Guy Delannay

Forest Management Component – Final Preparation Report. GFA Terra Systems Consultants

Review of Policy and Legislation Relating to National Parks. Ekodenge Consultants

Assessment of Investment and Technical Assistance Needs for Grants and Support Services.  
G&G Consulting

**Annex 13: Statement of Loans and Credits**  
**AZERBAIJAN: Rural Environment Project**

Project ID	FY	Purpose	Original Amount in US\$ Millions				Cancel.	Undisb.	Difference between expected and actual disbursements	
			IBRD	IDA	SF	GEF			Orig.	Frm. Rev'd
P089751	2005	IDP ECON DEVT SUPPORT	0.00	11.50	0.00	0.00	0.00	11.30	0.00	0.00
P081616	2005	FIN SERVS DEVT	0.00	12.25	0.00	0.00	0.00	12.91	0.00	0.00
P049892	2004	PENSION & SOC ASST	0.00	10.00	0.00	0.00	0.00	10.09	1.03	0.00
P076234	2004	RURAL INVSMT (AZRIP)	0.00	15.00	0.00	0.00	0.00	15.05	-0.16	0.00
P008286	2003	IRRIG DIST SYS & MGMT IMPROVMT	0.00	35.00	0.00	0.00	0.00	38.09	2.01	0.00
P070989	2003	ED SECT DEV (APL #1)	0.00	18.00	0.00	0.00	0.00	17.99	2.82	0.00
P066100	2002	IBTA 2	0.00	9.45	0.00	0.00	0.00	7.28	1.29	0.00
P040716	2001	HIGHWAY	0.00	40.00	0.00	0.00	0.00	33.05	21.03	0.00
P070973	2001	FIN SCT TA	0.00	5.40	0.00	0.00	0.00	1.28	-4.97	0.00
P069293	2001	HEALTH REF LIL	0.00	5.00	0.00	0.00	0.00	1.63	-4.06	0.00
P008284	2000	IRRIG/DRAINAGE REHAB	0.00	42.00	0.00	0.00	0.00	22.55	13.75	0.00
P058969	1999	CULT HERITAGE PRSV	0.00	7.50	0.00	0.00	0.00	1.96	1.49	-0.20
P035813	1999	AGRIC DEVT & CREDIT	0.00	30.00	0.00	0.00	0.00	3.50	2.16	-4.80
P035770	1999	PILOT RECON	0.00	20.00	0.00	0.00	0.00	3.08	-8.52	1.59
P055155	1998	URG ENV INVST	0.00	20.00	0.00	0.00	0.00	4.74	3.39	3.61
P008288	1995	BAKU WS	0.00	61.00	0.00	0.00	0.00	9.22	2.93	2.91
Total:			0.00	342.10	0.00	0.00	0.00	193.72	34.19	3.11

**AZERBAIJAN**  
**STATEMENT OF IFC's**  
**Held and Disbursed Portfolio**  
**In Millions of US Dollars**

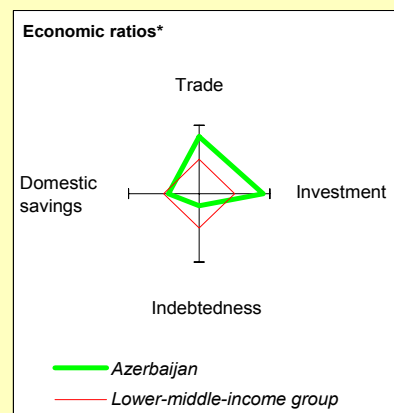
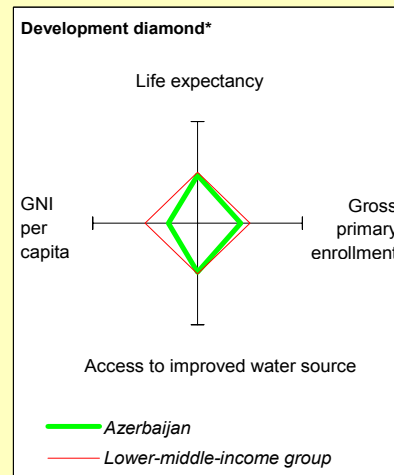
FY Approval	Company	Committed				Disbursed			
		IFC		Quasi	Partic.	IFC		Quasi	Partic.
Loan	Equity	Loan	Equity						
2004	Amerada Hess ...	1.68	0.00	0.00	1.68	1.68	0.00	0.00	1.68
1998/04	Azerb. JV Bank	0.00	0.40	0.00	0.00	0.00	0.40	0.00	0.00
2003	Azerigazbank	1.20	0.00	0.00	0.00	1.20	0.00	0.00	0.00
2004	BP Corp NA	10.00	0.00	0.00	10.00	10.00	0.00	0.00	10.00
1998	Baku Coca Cola	0.58	0.00	0.00	0.00	0.58	0.00	0.00	0.00
1999	Baku Hotel	5.83	0.00	0.00	0.00	5.83	0.00	0.00	0.00
2002	MFB Azerbaijan	0.00	1.75	0.00	0.00	0.00	1.75	0.00	0.00
2003	Rabitabank	1.20	0.00	0.00	0.00	1.20	0.00	0.00	0.00
2004	Statoil	8.75	0.00	0.00	8.75	2.50	0.00	0.00	2.50
2004	Unocal - Unio...	10.00	0.00	0.00	10.00	10.00	0.00	0.00	10.00
Total portfolio:		39.24	2.15	0.00	30.43	32.99	2.15	0.00	24.18

		<b>Approvals Pending Commitment</b>			
FY Approval	Company	Loan	Equity	Quasi	Partic.
2001	Azer JV Increase	0.00	0.00	0.00	0.00
Total pending commitment:		0.00	0.00	0.00	0.00

## Annex 14: Country at a Glance

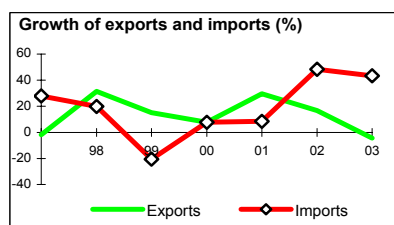
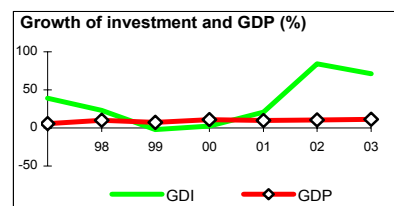
### AZERBAIJAN: Rural Environment Project

POVERTY and SOCIAL	Europe & Central Asia		Lower-middle-income		
	Azerbaijan	Asia			
<b>2003</b>					
Population, mid-year (millions)	8.2	473	2,655		
GNI per capita (Atlas method, US\$)	820	2,570	1,480		
GNI (Atlas method, US\$ billions)	6.7	1,217	3,934		
<b>Average annual growth, 1997-03</b>					
Population (%)	0.8	0.0	0.9		
Labor force (%)	1.8	0.2	1.2		
<b>Most recent estimate (latest year available, 1997-03)</b>					
Poverty (% of population below national poverty line)	50	..	..		
Urban population (% of total population)	50	63	50		
Life expectancy at birth (years)	65	69	69		
Infant mortality (per 1,000 live births)	76	31	32		
Child malnutrition (% of children under 5)	17	..	11		
Access to an improved water source (% of population)	78	91	81		
Illiteracy (% of population age 15+)	..	3	10		
Gross primary enrollment (% of school-age population)	93	103	112		
Male	93	104	113		
Female	92	102	111		
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	<b>1983</b>	<b>1993</b>	<b>2002</b>	<b>2003</b>	
GDP (US\$ billions)	..	4.0	6.2	7.1	
Gross domestic investment/GDP	..	21.8	32.1	49.1	
Exports of goods and services/GDP	..	57.4	42.8	42.8	
Gross domestic savings/GDP	..	3.2	24.7	25.1	
Gross national savings/GDP	..	4.9	19.6	20.8	
Current account balance/GDP	..	..	-12.3	-28.3	
Interest payments/GDP	..	0.0	0.4	0.3	
Total debt/GDP	..	0.9	23.1	19.9	
Total debt service/exports	..	..	5.5	5.4	
Present value of debt/GDP	..	..	17.8	..	
Present value of debt/exports	..	..	38.6	..	
	<b>1983-93</b>	<b>1993-03</b>	<b>2002</b>	<b>2003</b>	<b>2003-07</b>
(average annual growth)					
GDP	..	4.9	10.6	11.2	15.2
GDP per capita	..	3.9	9.7	10.4	9.8
Exports of goods and services	..	10.9	16.7	-4.4	28.8



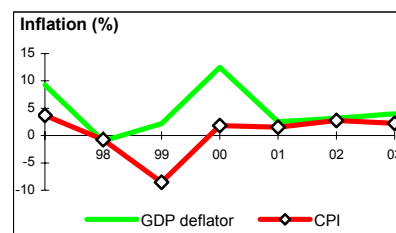
#### STRUCTURE of the ECONOMY

	1983	1993	2002	2003
(% of GDP)				
Agriculture	..	28.5	15.0	14.3
Industry	..	33.8	50.2	54.5
Manufacturing	..	29.0	18.8	23.3
Services	..	37.7	34.8	31.1
Private consumption	..	66.2	62.9	63.2
General government consumption	..	30.1	12.4	11.7
Imports of goods and services	..	76.0	50.0	66.8
	<b>1983-93</b>	<b>1993-03</b>	<b>2002</b>	<b>2003</b>
(average annual growth)				
Agriculture	..	3.4	6.4	5.6
Industry	..	8.4	28.6	18.1
Manufacturing	..	..	..	..
Services	..	18.6	2.5	6.9
Private consumption	..	8.4	8.6	17.3
General government consumption	..	8.8	3.1	6.6
Gross domestic investment	..	35.0	84.2	71.2
Imports of goods and services	..	16.0	48.4	43.5



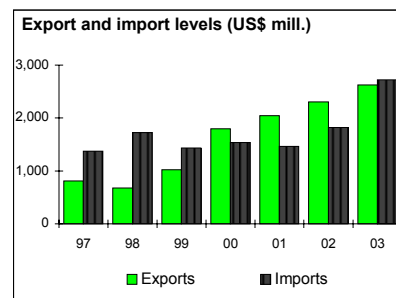
## PRICES and GOVERNMENT FINANCE

	1983	1993	2002	2003
<b>Domestic prices</b>				
<i>(% change)</i>				
Consumer prices	..	1,129.0	2.8	2.2
Implicit GDP deflator	..	747.6	3.2	4.0
<b>Government finance</b>				
<i>(% of GDP, includes current grants)</i>				
Current revenue	..	..	27.3	27.5
Current budget balance	..	..	5.2	4.4
Overall surplus/deficit	..	..	-0.5	-1.2



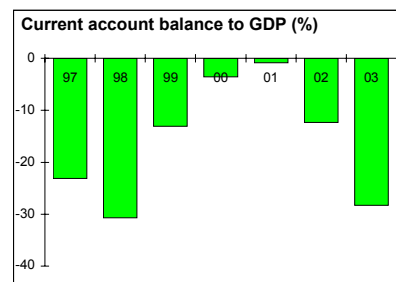
## TRADE

	1983	1993	2002	2003
<i>(US\$ millions)</i>				
Total exports (fob)	..	..	2,305	2,625
Crude oil	..	..	1,614	1,836
Petroleum products	..	..	432	402
Manufactures	..	..	153	279
Total imports (cif)	..	..	1,823	2,723
Food	..	..	238	238
Fuel and energy	..	..	336	1,109
Capital goods	..	..	519	519
Export price index (1995=100)	..	..	128	157
Import price index (1995=100)	..	..	80	85
Terms of trade (1995=100)	..	..	161	185



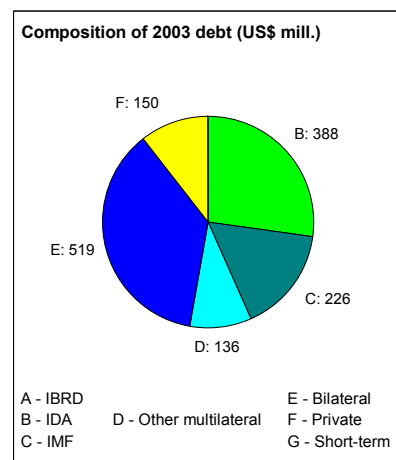
## BALANCE of PAYMENTS

	1983	1993	2002	2003
<i>(US\$ millions)</i>				
Exports of goods and services	..	..	2,667	3,055
Imports of goods and services	..	..	3,121	4,768
Resource balance	..	..	-454	-1,712
Net income	..	..	-386	-442
Net current transfers	..	..	70	134
Current account balance	..	..	-769	-2,021
Financing items (net)	..	..	990	2,257
Changes in net reserves	..	..	-221	-237
<b>Memo:</b>				
Reserves including gold (US\$ millions)	..	..	721	803
Conversion rate (DEC, local/US\$)	..	39.5	4,860.8	4,911.2



## EXTERNAL DEBT and RESOURCE FLOWS

	1983	1993	2002	2003
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	..	36	1,443	1,419
IBRD	..	0	0	0
IDA	..	0	314	388
Total debt service	..	0	159	176
IBRD	..	0	0	0
IDA	..	0	2	4
Composition of net resource flows				
Official grants	..	0	18	20
Official creditors	..	0	185	139
Private creditors	..	0	-50	-39
Foreign direct investment	..	..	..	..
Portfolio equity	..	..	..	..
World Bank program				
Commitments	..	0	69	53
Disbursements	..	0	57	75
Principal repayments	..	0	0	1
Net flows	..	0	57	74
Interest payments	..	0	2	3
Net transfers	..	0	55	71



## **Annex 15: Incremental Cost Analysis**

### **AZERBAIJAN: Rural Environment Project<sup>35</sup>**

#### ***1. Overview***

The project's global objective is to restore and protect biodiversity in two globally significant biodiversity areas in the Caucasus (Shah-Dag) and Zangezur (Ordubad) mountains through the establishment of an inclusive model of Protected Area management. The project will allow the GoA to pioneer a new model of Protected Area in Azerbaijan that will help shift biodiversity and protected area policies and practices away from the highly centralized and exclusive model inherited from the Soviet era towards a more modern, inclusive approach that combines the objectives of biodiversity and ecosystem protection with the objectives of providing economic and other benefits to local communities. The project will also contribute to lasting poverty alleviation in the project areas by introducing and supporting the adoption of more modern, sustainable, and value-added approaches to natural resource use and agricultural production and diversification of economic activities (particularly the development of rural/eco-tourism).

The cost of achieving the GEF alternative is US\$16.88 million, of which US\$8.99 is for baseline activities and US\$7.89 is for incremental activities. GEF financing is requested to cover US\$5.00 million of the incremental costs. The remaining US\$2.89 million in incremental costs is financed by a PHRD technical assistance grant (US\$1.70 million) and the government counterpart contribution (US\$1.19 million).

#### ***2. Context and Broad Development Goals***

Azerbaijan is a mountainous country of 86,600 km<sup>2</sup> that lies on the western coast of the Caspian Sea among the mountain ranges of the Talish mountains and Greater and Lesser Caucasus. The Caucasus have been identified by the World Wide Fund for Nature as a Global 200 Ecoregion, based on selection criteria such as species richness, levels of endemism, taxonomic uniqueness, unusual evolutionary phenomena, and global rarity of major habitat types. It is also one of Conservation International's 25 global biodiversity "hot spots."

The proposed Shah Dag National Park, located in the Greater Caucasus mountain range, is in a watershed that drains to the Caspian Sea. The area encompasses the highest peaks of the Greater Caucasus, and the highest peak (Shah Dag Mountain) in Azerbaijan. The proposed park and its surrounding buffer zone form a microcatchment that serves as a conservation unit containing essential elements of the Caucasus mountain ecosystem. The natural habitats, which consist mainly of broadleaf forests and rangeland (mostly alpine and subalpine meadows), play a critical role in watershed protection, and contribute to local economy and subsistence.

The recently established Ordubad National Park covers 12,200 ha in the southern slopes of the Zangezur mountains, located in the Nakhichevan Autonomous Republic, which is adjacent to

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<sup>35</sup> This analysis was prepared in relation to an earlier version of the project document, which involved creation of two large, multi-purpose national parks. This has been replaced by the two park-centered PA networks described in the current document. However, the incremental cost analysis is not affected by this change.

Armenia and Iran. The park is rich in biodiversity, with a number of endemic and endangered or threatened species of mammals, birds, reptiles and plants, and represents an important area for transboundary migratory wildlife. The proposed Park extension covers an additional 125,000 ha.

In recent years, large parts of the park's forest and pasture land have become badly degraded through over-use. While grazing land is allocated on a permit basis, there is no management, monitoring or enforcement of grazing activities, resulting in pastures that are heavily over-utilized and deteriorating. Similarly, lack of access to affordable energy has led to an increase in harvesting for fuelwood by the local population, resulting in degraded forest lands. The over-use and degradation of the forests and pastures presents an important economic problem, due to declining productivity, and a serious threat to globally significant biodiversity.

### ***3. Baseline Scenario***

The Government recognizes the negative trend in natural resources management, and has prepared analyses and actions plans to address them, including a National Environmental Action Plan (1998) and Biodiversity Strategy and Action Plan (2000). In addition to these priority setting and consensus building activities, the GoA has: (i) created a Ministry of Environment and Natural Resources, which was recently elevated from state committee status as a means to integrate forestry, range management, and protected areas management functions; (ii) enacted several codes for natural resource conservation and use (forests, fisheries, wildlife); and (iii) collaborated with FAO and counterparts in Turkey and Georgia as a first step in understanding how other countries in the region are dealing with these problems.

The Government has made a major commitment to conserving biodiversity, including substantially increasing the network of Protected Areas (PAs) in the country. However, the prevailing model for PAs in Azerbaijan, as in much of the CIS, is based on centrally controlled, Strict Nature Reserves (Zapovedniks). These strict reserves can be useful for protecting small areas of high value and vulnerable ecosystems, but are insufficient for the long term conservation of the region's biodiversity. Moreover, management of the PAs is generally ineffective, due to: (i) poverty and pressure for economic development; (ii) gaps in legislation and institutional and governance weaknesses; and (iii) inadequate staffing, lack of modern management plans, and lack of financial resources for effective administration.

Under the Baseline scenario, the following outputs would be expected:

**Establishment and management of National Parks** along the lines of the traditional system of protected areas. Parks would focus primarily on strict nature reserves and would not incorporate biodiversity conservation on a broader, multiple- use, landscape level. Forest and meadow inventories/assessments would be carried out over several years (rather than through a rapid assessment), limiting the ability of the park managers to establish and implement effective management plans. As a consequence, forest areas would continue to decline as the local population continued to cut down trees and branches for fuelwood. Over-grazing on alpine pastures outside of the Parks' core reserve areas would also continue, resulting in reduced grass cover, erosion, increased flooding and sedimentation downstream, and loss of biodiversity. Overall, biodiversity would continue to decline due to the loss of

forests, overgrazing, uncontrolled hunting and collection of non-timber forest products, and unregulated, increased development.

**Community livestock intensification**, resulting in increased numbers of hybrid cattle and improved and increased dairy production. However, intensifying livestock production without sufficient environment management could easily result in increased pressure on the Parks' resources, especially sensitive high alpine summer pastures, and further degradation of community pasture lands.

**Increased development of enterprises** in and around the Park based on Park amenities and natural resources, without environmental management. Focus on tourism-based business results in the establishment of additional resorts, restaurants and recreational activities without appropriate zoning or development regulation to ensure that impacts on natural resources and biodiversity are controlled.

While the baseline scenario would generate domestic benefits, it would have very limited global impacts. It would not be sufficient to address the existing threats to the most critical areas of the highest biodiversity and international conservation importance. Moreover, it would not adequately integrate biodiversity conservation on a broader, landscape-level, which is necessary for long-term ecosystem management and biodiversity conservation. Total expenditures under the Baseline are estimated at US\$8.99 million.

#### ***4. Alternative Scenario***

The GEF Alternative Scenario would build on the baseline by supporting incremental activities in the project areas needed to achieve global environmental benefits. The proposed alternative would strengthen management capacity for biodiversity conservation by expanding protected area management from small, strictly protected reserves, to broad, multi-purpose national parks. The model of large, multi-purpose parks with diverse land ownership and management zones is well established in many western and central European countries, but it is quite new to Azerbaijan. There is as yet no national park that encompasses a variety of land and resource uses, or has a substantial resident human population. The multiple-use model being introduced under the GEF Alternative will create a mechanism for involving local communities and other key stakeholders in park management, and ensuring that they benefit from the conservation and improved management of the park's valuable natural resources.

The multiple-use protected areas will be implemented by establishing different management zones with different levels of management intervention, from *core conservation zones* (where biodiversity is main maintained in a natural state with no intrusive use or management) to *sustainable natural resource management zones* (where controlled grazing and timber harvesting is allowed, based on ecological targets and monitoring). The park will also include tourism, residential and economic development zones.

In addition to the direct global benefits resulting from the increased protection of the internationally significant ecosystems, the project will establish strategic partnerships with local land owners, land users, and communities which would greatly contribute to the long-term

sustainability of the conservation effort. The community natural resource activities and small business development assistance are expected to be instrumental in strengthening the partnership with and commitment of local land owners, land users, and communities to conservation of the Park's natural and globally important resources.

Specifically, the GEF Alternative would support the following activities:

**Establishment and management of National Parks** through pioneering a new, multi-purpose model of Protected Area that not only conserves biodiversity through core conservation zones, but also protects and enhances biodiversity over a larger area by combining the objectives of biodiversity and ecosystem protection with the objectives of providing economic and other benefits to local communities. Under the GEF Alternative, the parks will have larger core conservation zones, better monitoring and increased stakeholder participation. Meadow and forest assessments will be undertaken rapidly, to allow park managers to prepare and implement management plans within the first year or two of park establishment.

**Improved community-level livestock management.** The GEF Alternative will build on the baseline by incorporating environmental practices into livestock management, including demonstrating the value of pasture restoration through pasture management trials. Over the long-term, the increased income from improved livestock management should reduce the communities' dependence on traditional livestock, thereby reducing grazing pressure, particularly the high-altitude summer meadows with highest biodiversity values.

**Support for developing small enterprises** that improve livelihoods for the local population while reducing impacts on the Park's natural resources and biodiversity. Technical assistance will identify and encourage business ideas that are linked to conservation objectives. Specific focus will be given to ecotourism development (versus mainstream tourism development) that intentionally limits visitor impacts on park resources and strives to preserve the Park's globally important ecosystems and associated biodiversity.

**Project management, monitoring and evaluation and communications.** The GEF Alternative will support implementation of project activities with global values. It will improve monitoring and evaluation of project activities and measure the project's environmental and social impact. A communications program will increase public awareness and understanding of biodiversity conservation and, in particular, the role of multiple-use national parks in protecting, conserving and managing the country's unique biodiversity.

Total expenditures under the Alternative Scenario are estimated at US\$16.88 million.

## ***5. Incremental Costs***

The estimated *Baseline* and *GEF Alternative* project costs are summarized in the Incremental Cost Matrix below. The difference between the costs of the *Baseline* (\$8.99 million) and the cost of the GEF Alternative (\$16.88 million) is \$7.89 million, of which \$5.00 million are GEF costs. This represents the incremental cost for achieving global environmental benefits. A GEF grant

of \$5.00 million is requested. The remainder of the incremental costs will be financed by the PHRD grant (\$1.70 million) and the Azerbaijan Government (\$1.19 million).

## Incremental Cost Matrix

Component	Category	Cost (US\$ million)	Domestic Benefits	Global Benefits
<b>National Parks establishment and management</b>	<b>Baseline</b>	<b>3.97</b>	<ul style="list-style-type: none"> <li>Improved infrastructure and equipment for park.</li> <li>Technical assistance to improve park management.</li> <li>Less stakeholder participation in park management.</li> <li>Increased recreation and tourism and associated benefits (e.g. recreational enjoyment, expenditure, profits and economic development), but potential for uncontrolled development that damages natural resources.</li> </ul>	<ul style="list-style-type: none"> <li>Increased area under protection, but managed through traditional models of strict reserves, resulting in limited protection of biodiversity</li> </ul>
	<b>GEF Alternative</b>	<b>8.72</b>	<p>Same as above, plus:</p> <ul style="list-style-type: none"> <li>Increased technical capacity to manage multi-use National Parks</li> <li>Recreation and tourism opportunities managed for environmental benefits</li> <li>Reduced erosion of the meadows and associated reduction in mudslides, downstream flooding, and downstream sedimentation in irrigation systems.</li> <li>Increased stakeholder participation in park management planning.</li> </ul>	<p>Same as above, plus:</p> <ul style="list-style-type: none"> <li>Conservation of globally significant biodiversity mainstreamed into management of multi-use National Parks</li> <li>Larger core conservation zones and larger overall park area under some form of protection and management.</li> <li>Rapid assessment of forest and meadow resources allow management regimes to be put in place quickly.</li> </ul>
	<b>Incremental Costs</b>	<b>4.75</b>		
<b>Community-level investment in sustainable agriculture and natural resource management</b>	<b>Baseline</b>	<b>3.11</b>	<ul style="list-style-type: none"> <li>Increased livestock intensification without environmental management.</li> <li>Improved livelihoods from improved livestock and increased dairy production.</li> </ul>	None.

Component	Category	Cost (US\$ million)	Domestic Benefits	Global Benefits
	<b>GEF Alternative</b>	<b>4.42</b>	Same as above, plus: <ul style="list-style-type: none"> <li>Additional indirect benefits from reduced grazing pressure and new forest growth (e.g. watershed protection, erosion and sedimentation control).</li> </ul>	<ul style="list-style-type: none"> <li>Shift from traditional livestock production to hybrid livestock reduces pressure, especially high-alpine meadows with global biodiversity</li> </ul>
	<b>Increment</b>	<b>1.31</b>		
<b>Rural enterprise development</b>	<b>Baseline</b>	<b>1.29</b>	<ul style="list-style-type: none"> <li>Increased revenues, income and jobs for local people.</li> <li>Indirect and induced economic benefits as purchases of raw materials and spending of incomes flow through the local economy.</li> </ul>	<ul style="list-style-type: none"> <li>Increased tourism services for international visitors.</li> </ul>
	<b>GEF Alternative</b>	<b>1.95</b>	Same as above, plus: <ul style="list-style-type: none"> <li>Environmentally sensitive businesses maintain Park resources for local and national benefits (recreation, environmental services).</li> </ul>	Same as above, plus: <ul style="list-style-type: none"> <li>Environmentally sensitive businesses reduce pressures on natural resources of Park, resulting in conservation of globally significant biodiversity.</li> </ul>
	<b>Increment</b>	<b>0.66</b>		
<b>Project management, monitoring and evaluation, and communications</b>	<b>Baseline</b>	<b>0.62</b>	<ul style="list-style-type: none"> <li>Park activities carried out efficiently.</li> </ul>	<ul style="list-style-type: none"> <li>Some increased knowledge of ecological areas of global significance.</li> </ul>
	<b>GEF Alternative</b>	<b>1.78</b>	Same as above, plus: <ul style="list-style-type: none"> <li>Better monitoring and evaluation of social and environmental impacts.</li> <li>Increased recreational consumer surplus and non-use values as people's understanding of wildlife and features in the National Parks improves.</li> </ul>	Same as above, plus: <ul style="list-style-type: none"> <li>Increased awareness of global values of critical biodiversity and ecosystems in new National Parks</li> <li>Increased support for conservation of globally significant areas.</li> </ul>
	<b>Increment</b>	<b>1.16</b>		
<b>TOTAL</b>	<b>Baseline</b>	<b>8.99</b>		
	<b>GEF Alternative</b>	<b>16.88</b>		
	<b>Increment</b>	<b>7.89</b>		
<b>Requested from GEF:</b>		<b>5.00</b>		

**Annex 17: List of Villages in Project Areas**  
**AZERBAIJAN: Rural Environment Project**

All villages in Project Area (Residents eligible for grants under Component 3)

Shah Dag

<b>Gusar</b>	37. Gamarvan
1. Yukhari Tahirjal	38. Kusnat
2. Yukhari Galankhur	39. Durja
3. Sudur + Guhur	<b>Ismaili</b>
4. Guhur	40. Lahij
5. Ajakhur	41. Ahan
6. Gilah	42. Khimran
7. Ukur	43. Goydan
8. Hazra	44. Duvaryan
9. Ashaqi Galankhur	45. Haftasov
10. Khylug	46. Chandakhar
11. Guzun	47. Burovdal
12. Zindanmurug	48. Zarnava
13. Laza	49. Sardahar
14. Anykh	50. Gandov
15. Nejafkend	51. Mushkemir
16. Zukhul	52. Istisu
<b>Guba</b>	53. Chaygovushan
17. Alik	54. Galajig
18. Budug	55. Khanagah
19. Zeyd	56. Mudru
20. Haput	57. Nanyj
21. Jek	58. Vasha
22. Gyryz	59. Namazgah
23. Kusnat-Gazma	60. Bakali
24. Kusnat	61. Zarat
25. Ruk	62. Taglabiyan
26. Garkhun	63. Muju
27. Adur	64. Arakit
28. Khinalig	65. Varna (not populated)
29. Galeykhudat	<b>Shamakhi</b>
30. Gayadaly	66. Avakhil
31. Derk	67. Safaly

32. Talish	68. Damirchi
33. Sohub	69. Zarat Heybeli
34. Gyryzdehne	70. Pirkulu (Yusif Memmedeliyev)
<b>Oguz</b>	71. Archiman
35. Bash dashagil	72. Sis
<b>Gabala</b>	73. Nagarakhana
36. Laza	74. Talyshnuru

### Nakhchivan

<b>Ordubad</b>	28. Hoskesin
1. Anabad	29. Milax
2. Nus-nus	30. Teyvaz
3. Genze	31. Erefse
4. Dirnis	32. Leketag
5. Keleki	33. Beyahmat
6. Mezre	34. Gall
7. Ustupu	35. Shurut
8. Bilev	
9. Behrud	
10. Paraga	
11. Unus	
12. Tivi	
13. Bist	
14. Paragachay	
15. Chenneh	
16. Kurs	
17. Elehi	
18. Neservaz	
19. Nurgut	
<b>Shahbuz</b>	
20. Y.Kislag	
21. A.Kislag	
22. Gomur	
23. Agbulah	
24. Bichenek	
25. Kecili	
26. Kulus	
<b>Djulfa</b>	
27. Hanaga	

Village Clusters in Shah Dag (eligible for assistance under Component 2)

		<b>Gusar</b>
VC- 1	1	Yukhari Tahirjal
	2	Yukhari Galankhur
	3	Sudur
	4	Guhur
VC- 2	5	Guzun
	6	Zindanmurug
	7	Laza
		<b>Guba</b>
VC- 3	8	Alik
	9	Haput
	10	Jek
	11	Budug
	12	Zeyd
VC-4	13	Ruk
	14	Garkhun
	15	Adur
VC-5	16	Derk
	17	Talish
	18	Gayadaly
	19	Sohub
		<b>Ismaili</b>
VC-6	20	Istisu
	21	Chaygovushan
	22	Galajig
VC-7	23	Zarnava
	24	Sardahar
	25	Gandov
VC-8	26	Taglabiyan
	27	Muju
VC-9	28	Mudru
	29	Nanyj
	30	Vasha
	31	Namazgah
	32	Bakali
		<b>Shamakhi</b>
VC-10	33	Avakhil
	34	Safaly
	35	Damirchi

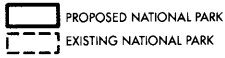
	36	Zarat Heybeli
	37	Pirkulu (Yusif Mammadaliyev)
	38	Archiman
VC-11	39	Nagarakhana
	40	Talyshnuru

Village Clusters in Nakhchivan (Eligible for assistance under Component 2)

		<b>Ordubad</b>
VC-1	1	Bilev
	2	Behrud
	3	Paraga
VC-2	4	Tivi
	5	Bist
	6	Paragachay
VC-3	7	Kurs
	8	Elehi
	9	Neservaz
	10	Nurgut
		<b>Shahbuz</b>
VC-4	11	Y.Kislag
	12	A.Kislag
	13	Gomur
	14	Agbulah
	15	Bichenek

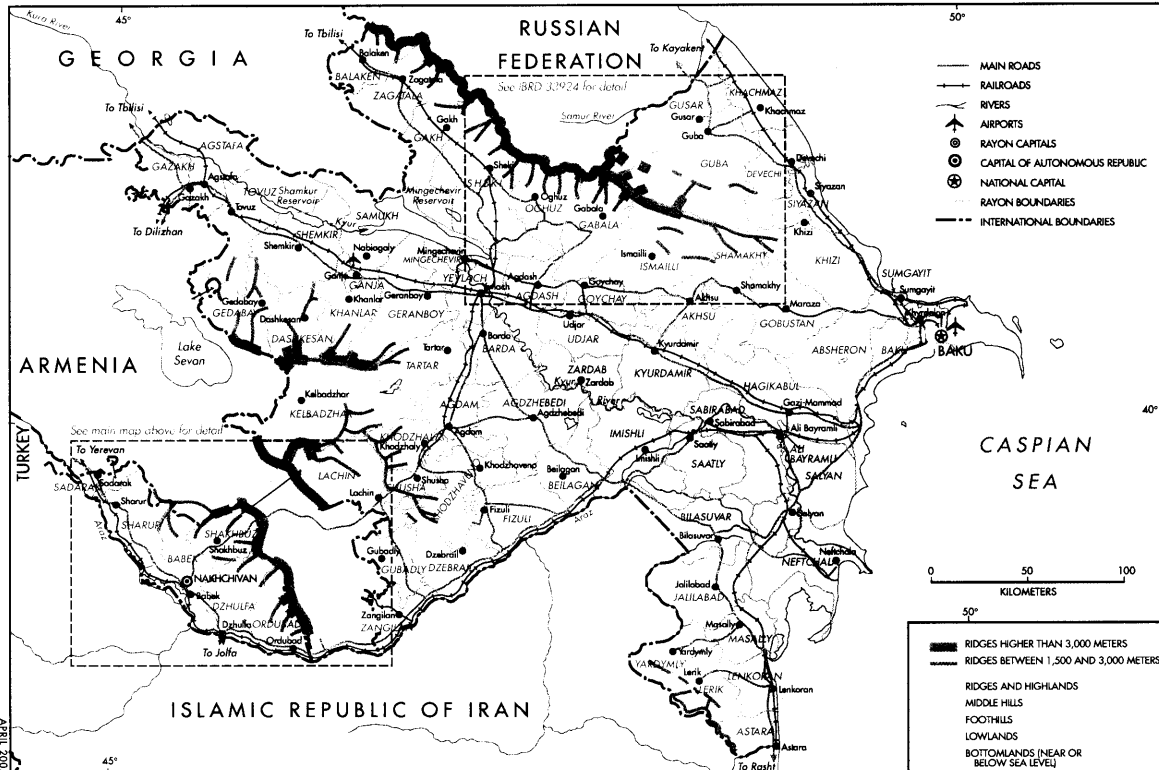
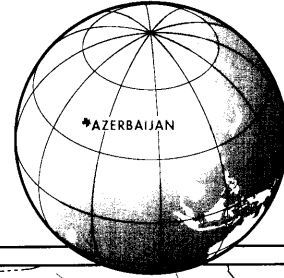
**Annex 18: Maps of Project Area**  
**AZERBAIJAN: Rural Environment Project**

# AZERBAIJAN RURAL ENVIRONMENT PROJECT ORDUBAD NATIONAL PARK PROJECT AREA



- DISTRICT BOUNDARIES
- - - INTERNATIONAL BOUNDARY
- DISTRICT CAPITALS
- MAJOR ROADS
- MAJOR RAILROADS

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# AZERBAIJAN RURAL ENVIRONMENT PROJECT SHAH DAG NATIONAL PARK PROJECT AREA

- INITIAL PROPOSED NATIONAL PARK AND SURROUNDING PROTECTED AREAS
- FINAL PROPOSED NATIONAL PARK BOUNDARY AND SURROUNDING PROTECTED AREAS
- DISTRICT BOUNDARIES
- INTERNATIONAL BOUNDARY
- DISTRICT CAPITALS

- MAJOR ROADS
- MAJOR RAILROADS
- FOREST
- PASTURE
- ROCK/SNOW/ICE

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