

AID-FOR-TRADE: CASE STORY

ISLAMIC DEVELOPMENT BANK

Aid for Trade Case Story: Silk Road Project Azerbaijan

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Introduction

The Republic of Azerbaijan is situated on the crossroad of major international arteries. The two main highway routes carrying international traffic are the 503km long East-West Baku – Georgian Border road (the “Silk Road”) and the 521km long North-South section stretching along the coastal areas of the Caspian Sea to the Iranian Border. The Silk Road Azerbaijan is part of the Greater Silk Road, a system of trade routes connecting China to Europe.

The main objective of the Silk Road Project Azerbaijan (the Project) was to provide a continuous, reliable, and direct land transport service between Baku, the capital of Azerbaijan, and the north-west of the country towards the border with Georgia. The Project aimed at rehabilitation and reconstruction of the Azeri part of the Silk Road which features prominently as part of the Transport Corridor Europe-Caucasus-Asia Program (TRACECA) linking it with the Trans European Networks (TENs) which, among other benefits, also enhances international trade.

Project Description

For the purposes of rehabilitation, the 503km long Silk Road was divided into 8 sections, each section jointly financed by a combination of multilateral and financial institutions including: Islamic Development Bank, the World Bank, the European Bank for Reconstruction and Development, OPEC Fund, Kuwait Fund for Arab Economic Development, the Saudi Fund for Economic Development and the Government of Azerbaijan.

The IDB is party to co-financing three of the eight sections for a total length of 187km along with other development partners it successfully brought in. Initial studies for the project started in 1992 when IDB approved a TA Grant for the preparation of a feasibility study and detailed design. The first road section financed by IDB was approved in January 1997 and was considered to be the first International Financial Institution (IFI) intervention in the Azerbaijan’s transportation sector after it gained its independence in 1991. Being the first donor, IDB played a catalytic role in attracting other partners to finance the Silk Road in this country.

Because of its role in the regional transport context, the Silk Road also features prominently as part of the Transport Corridor Europe-Caucasus-Asia Program (TRACECA) and CAREC initiatives as well as forming part of the so-called Trans-European Network (TEN).

Project Design and Implementation Arrangements

The design of this project was considered to be quite complex as the length of road stretched from the eastern end of the country, along the Caspian Sea to the North Western end of the country, bordering with Georgia for a total length of 503km. The road design also called for multiple terrestrial conditions including road sections consisting of four lane – dual carriage and two lane single carriage, bridges and pedestrian lanes.

The implementation of the Project was particularly challenging as the country had only recently gained its independence and had a relatively new Government, expectedly less-experienced with multi-lateral development and IFI setting. In addition, the scope and cost of the Project necessitated a large number of financing agencies, each with its own set of conditions.

The Project implementing agency was/is the Road Transport Services Department (RTSD) operating under the country's Ministry of Transport (MoT); the responsibilities of RTSD were taken over in February 2007 by AzerRoad Services (ARS) which continues to report to MoT.

Alignment with Strategies

The Silk Road Project in Azerbaijan is in line with IDB Vision 1440H which calls on the IDB to address nine strategic thrusts, one of which is "Prospering the People" through sustained economic growth. Within this framework, IDB developed an Infrastructure Strategic Plan (ISP) designed to address the strategic challenge of "securing strong and sustainable economic growth". Opening up the land locked member countries in the Commonwealth of Independent States (CIS) is among the top priorities in this strategic plan.

IDB's intervention in this road corridor is consistent with its Country Assistance Strategy for Azerbaijan (2000), specifically that sectoral priorities include the reconstruction of the motorways connecting Baku and the Georgian border, and of the Alyat-Gazi Mohamed section of the Transcaucasia route.

Issues Addressed

The initiative to rehabilitate the Silk Road in Azerbaijan was in line with the Transport Corridor Europe-Caucasus-Asia Program (TRACECA) initiative, which was launched in May 1993 with the aim of developing a transport corridor along the ancient Silk Route to bring together the original eight TRACECA countries comprising five Central Asian republics and three Caucasian republics. The idea was that such a corridor would:

1. Strengthen the political and economic independence of the republics by enhancing their capacity to access European and World markets through alternative transport routes
2. Encourage further regional cooperation among the partner states,
3. Use TRACECA as a catalyst to attract the support of International Financial Institutions (MDBs) and private investors and
4. Link the TRACECA route with the Trans - European Networks (TENs), focusing on improving alternative routes between Caucasus and Europe and ensuring good international trade relationships.

IDB's involvement in the Project was to assist Azerbaijan improve on its regional transportation which in turn would enhance trade policy and trade facilitation. The transportation strategy has a number of objectives: (1) establish competitive transport corridors, (2) facilitate movement of people and goods across borders and (3) develop safe, people-friendly and environmentally sustainable transport systems.

The Project had come due to a long period of inadequate funding caused by competing priorities resulting in a significant maintenance backlog. In addition, a poor safety record, inefficient cross-border and transit facilities and limited institutional capacity were also identified as the key sectoral challenges. All four components of the Project aimed at providing continuous, reliable, and direct land transport service between Baku, the capital of Azerbaijan located on the shores of the Caspian Sea, and the north-west of the country towards the border with Georgia.

In terms of the economic rationale, the Project sought to reduce vehicle operating costs and road maintenance expenditure and to reduce the frequency and severity of traffic accidents. IDB, through promoting developmental objectives, sought to:

- provide continuous, reliable, and direct land transport service from Baku, the capital of Azerbaijan, towards the border with Georgia;
- serve rural communities by increasing the capacity of the road linking the densely populated capital and major port city (Baku) with the sparsely populated agricultural and industrial areas in the middle and western part of the country;
- facilitate the transport of agricultural and industrial products; and generate income for construction workers.

Lessons Learned

The Project was jointly evaluated by the Group Operations Evaluations Department (GOED), IDB and the Evaluations Department, EBRD which produced a joint Operations Performance Evaluation Review (OPER) report evaluating four of the eight road sections along the Silk Road in Azerbaijan that was funded by IDB and EBRD that had, at the time, had considerable implementation or was complete. The road sections are: Hajigabul – Kyurdamir (funded by EBRD), and Alyat – Hajigabul, Ujar – Yevlakh and Yevlakh – Ganja (all funded by IDB and other co-funders, as appropriate). The remaining segments were financed by other financiers.

This joint evaluation was conceived to contribute to the harmonization agenda under the *Paris Declaration* of 2005 and comply with the aspirations of the Evaluation Cooperation Group (ECG). The main lessons learned could be summarized in the following areas:

1. Planning Timescales

The Project experienced delays due to “exceptionally bad weather” conditions. As a consequence, the previously agreed timescales had to be extended to allow for the delays in execution of projects:

❖ Lessons learned:

Adverse seasonal weather conditions need to be factored into implementation schedules. The recommendation for future projects to have the contractual durations adjusted to the historic weather conditions.

2. Covenant Adequacy and Monitoring

Some of the covenants stipulated under the EBRD loan have not been fully achieved, namely the covenants concerning:

- *Formation of a Road Advisory Board.* This covenant has not been achieved. This covenant is now included as part of the Loan Agreement for the Baku – Samur road with an associated TC.
- *Finalization and adoption of a SLA between MOT and ARS.* This covenant is partly achieved. The SLA was signed in 2005 but is yet to be implemented on a daily basis.
- *IFRS reporting.* This covenant has not been achieved.

Complying with the “hard-side” loan covenants (i.e. mandating the manner of investment execution, timescales and quality for the delivery of infrastructure) seems disproportionately easier in comparison to complying with the “soft-side” loan covenants (i.e. related to the institutional reforms). That should not be surprising given the considerable amount of change required by the institutional covenants.

❖ **Lessons learned/recommendation:**

Institutional capacity analyses are a key appraisal due diligence element and need to cover the entirety of a project intervention, i.e. also including envisaged institutional and sector reform agendas.

3. Long Term Sustainability of the Project

The Evaluation Team concluded that the long term sustainability of the Project is at risk from: (i) Inadequate road maintenance and (ii) lack of enforcement of axle load control on the road network. There seems to be less focus on project sustainability – in the case at stake – on asset maintenance, i.e. on sufficient and effectively used operation expenditures (opex).

❖ **Lessons learned and Recommendation:**

Sustainability of the investment needs to be enhanced through sufficient routine maintenance and repair. It is recommended that future road project designs include, apart from ensuring the sufficiency of adequate maintenance resources per se, provisions for ensuring appropriate execution of maintenance work.

4. Coordination among MDBs

The Evaluation Review Report noted that the Project lacked good coordination among the MDBs and could have benefitted from potential synergies. The MDB landscape in Azerbaijan includes AsDB, EBRD, IDB, World Bank, OPEC Fund, Saudi Development Fund and Kuwait Fund for Arabic Economic Development and possibly other International Financial Institutions (IFIs), and also involves a number of key Donors all of which are involved in the country's road sector, many of them were parties in the Silk Road rehabilitation.

❖ **Lessons learned:**

In multi-financier project participation, the success of loan execution and institutional reform is considerably enhanced through close coordination amongst these stakeholders, eventually with one party taking the lead in the coordination processes. Given the often notable differences between MDB mandates, project loan agreements, pertinent procurement rules and other differences, establishing of a coordinating forum, eventually lead by the party with the highest leverage potential, ensures a better overall project outcome than a fragmented approach by each intervention party individually.

