

AZERBAIJAN ECONOMY IN 2015: NEW OPPORTUNITIES FOR FURTHER DIVERSIFICATION

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Abstract

The main objective of this research is to analysis the state of the economy of the Republic of Azerbaijan in 2015 and to define opportunities for further liberalization reforms. The paper concludes that 2015 was not easy for Azerbaijan economy due to sharp decline of crude oil price in the world market. The economic challenges, however, should be as an opportunity for Azerbaijan to promote economic diversification.

Key words: diversification, trade, exchange rate, economy, finance, development

JEL classification: L25

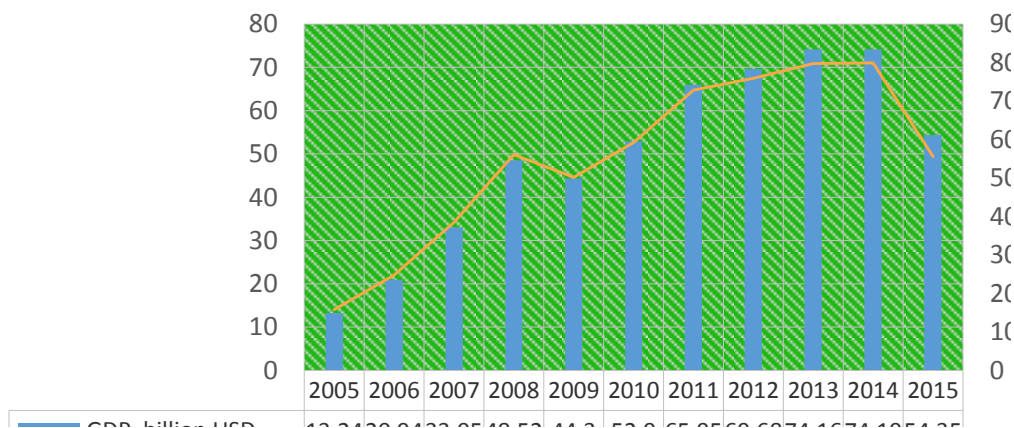
In 2015, the expansion of the US economy accompanied with improved employment rates led the FED to switch to contractionary monetary policy. On the other hand, the second largest economic power-China encountered a lower long-term economic growth rate with a fall in exports, and thereby adversely affecting global economic activity. Moreover, the rapid decline of prices in global fuel markets, owing to fundamental and political reasons, resulted in an economic downturn in countries reliant on their fuel exports, while importers experienced a higher economic activity in parallel with lower inflation expectations.

Possessing large oil revenues gives the Government of Azerbaijan a unique opportunity to effectively use this newfound wealth by investing in development programs that can provide a lasting benefit to its citizens' social welfare, economic growth, security, and overall quality of life. Given that the flow of oil revenues has become a major source of income, the Government of Azerbaijan is recommended to implement a long-term macroeconomic strategy, fiscal rule and implementation mechanisms that ensure that the oil money is saved in the most efficient way and that the benefits of the investments address high priority needs, are highly integrated, and sustainable.

Macroeconomic situation

The sharp decline in the international oil prices in 2015 has also influenced the economy of Azerbaijan, after the prolonged expansion owing to higher oil prices. In 2015, the value-added created in the economy increased by 1.1% in real terms, being 54.4 billion AZN. Nonetheless, as a result of the devaluation of national currency by 98.7% during the reporting year, the GDP in terms of USD experienced a 27.7% contraction compared to the previous year (75.2 billion USD, 2014, World Bank). That is to say, during last year the value-added created was 54.35 billion USD. [Akio Matsumoto, 2010]

Table 1. GDP and the dynamics of GDP per capita



Source: State Statistical Committee of the Republic of Azerbaijan, 2015

As illustrated in the Diagram above, the economy encountered two major contractions during last 11 years: the first in 2009 due to the Global Financial Crisis; and the second owing to the drastic fall in the international oil prices in 2015. [Richard Shediac, Rabih Abouchakra, Chadi N. Moujaes, Mazen Ramsay Najjar] Thus, both can be attributed to the drastic fall in oil prices. Notwithstanding, in 2015 economic depression was deeper leading to the devaluation of national currency.

In 2015, the GDP per capita was 5703.7 AZN or 5558.7 USD, which is 30.4% less than the previous year and nearly the same with 2010. However, in the context of oil revenues the GDP per capita increased fivefold during the period of 2005-2014.

Azerbaijan economy, being highly rich in hydrocarbon resources, can be divided into two sectors:

- (i) *Non-oil sector*
- (ii) *Oil sector*

In 2015, the non-oil sector constituted the 69.3% of the total value-added. This is 8.4 percentage points higher than in 2014 (60.9%, 2014). According to the State

Statistical Committee of the Republic of Azerbaijan, there was 4% rise in non-oil GDP. Notably, similar rise was recorded in 2001 (68.7%, SSCRA, 2016).

Foreign Trade

The foreign trade turnover in 2015 decreased by 33.4% compared to the previous year, being 20.6 billion USD. This noticeable contraction in foreign trade turnover was due to the shrinking of exports. In other words, the amount of exports decreased to 10.6 billion USD, or by 48.7% during 2015. The major reason of this plunge is the sharp drop in international oil prices. Comparing to 11 months' of 2014, in 2015 the volume of oil, oil products and gas exports diminished by 53.8%, being 9.1 billion USD (2014, 19.77 billion USD, SCCRA). [Regional Economic Diversity and Regional Economic Stability, 2003]

In contrast to exports, there was an increase in imports. That is to say, during 11 months' of 2015 the volume of imports rose by 1% from previous year, being 8.2 billion USD. Considering macroeconomic situation has not changed considerably at the last month of 2015, the final outcomes of 2015 can be grounded on 11 months' trend.

Table 2. Foreign trade turnover

Years	Million USD			
	Trade Turnover	Import	Export	Trade Balance
2005	8 558,4	4 211,2	4 347,2	136,0
2006	11 638,9	5 266,7	6 372,2	1 105,5
2007	11 771,7	5 713,5	6 058,2	344,7
2008	54 926,0	7 170,0	47 756,0	40 586,0
2009	20 824,5	6 123,1	14 701,4	8 578,3
2010	27 960,8	6 600,6	21 360,2	14 759,6
2011	36 326,9	9 756,0	26 570,9	16 814,9
2012	33 560,9	9 652,9	23 908,0	14 255,1
2013	34 687,9	10 712,5	23 975,4	13 262,9
2014	31 016,3	9 187,7	21 828,6	12 640,9
2015	20645.9	9221.4	11424.5	2203.1

Source: State Statistical Committee of the Republic of Azerbaijan, 2015

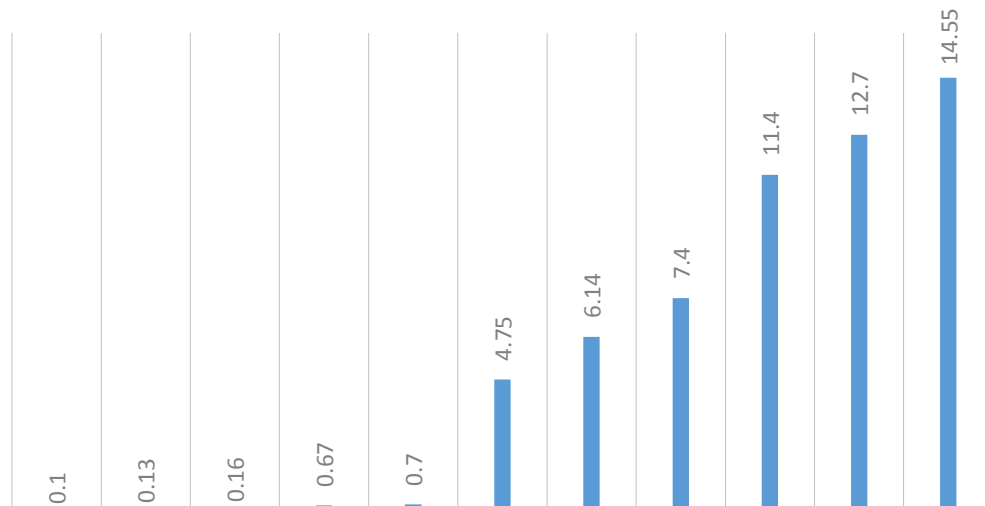
During the years following the opening of the BTC pipeline, the foreign trade turnover rose by 6.4 times and reached its peak in 2008 with 54.9 USD. While the increase in imports was 70% during the period, exports rose by 11 times. Thus, in

2008 the trade balance was 40.6 billion USD. The fall in the price of energy resources led the trade balance to decrease to 8.6 billion USD. The end of the oil boom in 2011 and corresponding decline in oil production are the main factors bringing about lower exports, and therefore decreasing trade balance [Merlin Hackbart and Donald Anderson, 1978]. Moreover, increasing government expenditure and accompanied infrastructure projects during 2013 resulted in 1 billion USD more imports from previous year.

Oil income contribution to the State Budget

The State Oil Fund of the Republic of Azerbaijan projected to have 13.06 billion USD in revenues, and 15.06 billion USD in expenses (with official exchange rate on 30.12.2014), based on average annual price of 90 USD per barrel in 2015. However, in 2015 the average annual oil price was 53.4 USD that meant a serious decline in revenues of the Fund. Consequently, expenses were cut in order to reduce budget deficit and to retain the reserves of the Oil Fund. During 9 months of 2015, the revenues of the Fund were 5.25 billion USD, while the expenses were 6.06 billion. During the period, the amount of the transfers from the Fund to the budget was 5.35 billion USD (converted as 1 USD=1.05 AZN, since the Oil Fund had completed its annual transfers to state budget before the second devaluation). Thus, the projected revenues and expenses of the Fund reduced significantly. According to the Ministry of Finance, transfers of the Fund to state budget during 2015 constitute 7.7 billion USD, which is 41.8% lower than the projected number. Although, devaluation that happened in February 2015 reduced the financial burden of the Fund, for the first time, the Oil Fund failed to meet its obligation before the state budget. As a result, revenues of the state budget were 11.8% lower.

Table 3. Transfers from the SOFAZ to state budget



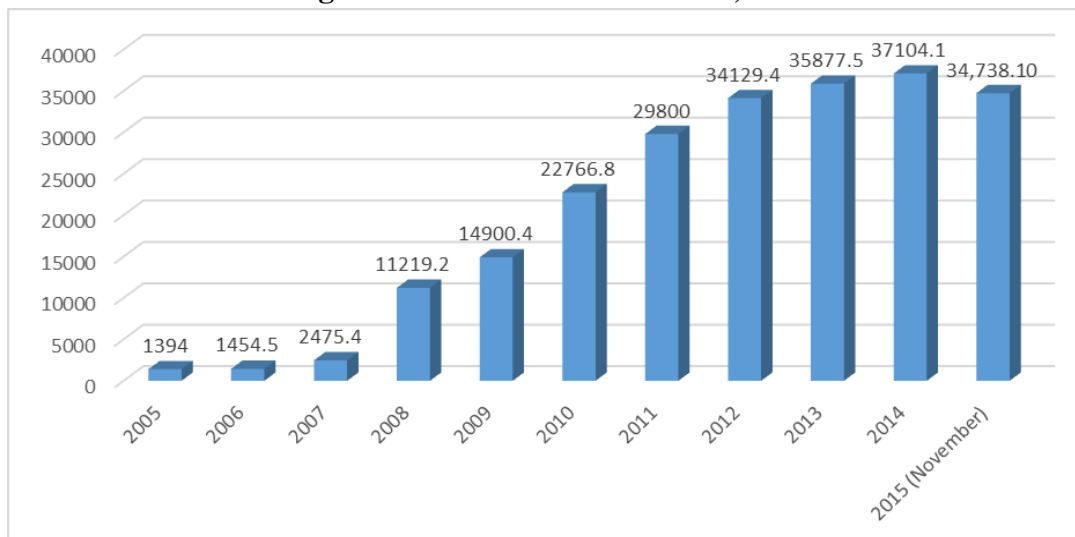
Source: The State Oil Fund of the Republic of Azerbaijan, 2016

Therefore, the amount of transfers to the state budget was reduced by 4.27 billion USD, or by 35.2% in 2015 compared with previous year.

As presented in the Diagram above, starting from 2006, the amount of transfers from the Fund to the state budget rose rapidly, and reached its maximum in 2013. To put it another way, during the period 2005-2013 the volume of transfers increased by 91 times. In 2014 the government reduced the amount of transfers with the purpose of saving. Yet, the sharp decline in fuel prices in 2015 necessitated the reduction.

Based on the information available on 2015 October 1, in the year 2015 the assets of the Fund decreased by 6.38%, being equivalent to 34.7 billion USD (01.01.2015, 37.1 billion USD, SOFAZ, 2016). Taking into consideration that only the transfers to state budget from the Fund constituted 2.35 billion USD in the last quarter of the year the depletion of assets continued in the fourth quarter as well.

Diagram 7. Assets of the Oil Fund, billion USD



Source: the State Oil Fund of the Republic of Azerbaijan, 2016

Economic crisis and reforms

Notwithstanding severe social and economic consequences, the crisis called for new challenges, especially the necessity of economic reforms in the country. The country has diverged from free market principles as monopolistic tendencies and civil servants in business environment have been dominant for a long period.

Possessing large oil revenues gives the Government of Azerbaijan a unique opportunity to effectively use this newfound wealth by investing in development programs that can provide a lasting benefit to its citizens' social welfare, economic growth, security, and overall quality of life. [Labour market reforms since the crisis]

On the other hand, the oil reserves and oil that has already been turned into liquid assets carries with itself risks of inefficiency and misuse due to the lack of institutional capacity created by traditions of bottom-up control and the legacy formed by years of participation in a centralized economy. Given that the flow of oil revenues has a finite life expectancy, the Government of Azerbaijan must implement a long-term macroeconomic strategy, fiscal rule and implementation mechanisms that ensure that the oil money is saved in the most efficient way and that the benefits of the investments address high priority needs, are highly integrated, and sustainable.

Thus, 2015 can be considered to mark the beginning of economic reforms. Mr. President İlham Aliyev has underlined paying more attention to real sector, removing external barriers to business, and restraining the extent of activities of civil servants. The withdrawal of licensing rights from various authorities; as well as the elimination of some, and the transfer of the other to the State Service for Public Service and Social Innovations under the President of the Republic of Azerbaijan (ASAN service) can be considered a first attack to monopolistic tendencies. In other words, when provided by previous authorities, licensing procedures were associated with subjective approaches and leading to the creation of monopolies, while new rules intend to overcome this.

The elimination of monopolies in customs is considered to be an important consequence of the crisis. It should be noted that, the country relied on imports in terms of raw materials and final consumption products, in which the presence of monopolies caused serious losses for citizens and real sector.

In general, reforms such as economic liberalization, improving non-oil sector, creating efficient operating environment for internal and external investors by restoring confidence, eliminating monopolies and minimizing bureaucrat-business relations, structural reforms are considered to be the ways out of crisis [Luetkepohl Helmut, 2011]

Conclusion

In conclusion, although the year 2015 was not easy for the economy of the country, there are some opportunities for further diversification reforms. Plunging oil prices in the world markets were reflected in macroeconomic indicators in the short-term. In fact, the exchange reserves of the Central Bank decreased by 8.74 billion USD, being around 5 billion for the first time since August, 2009. To put it another way, the amount spent by the Central Bank in 2015 alone, was equivalent to what had been accumulated during 5 years.

However, this economic crisis called for first-hand reforms. Unless large-scale economic and structural reforms are implemented, the crisis is anticipated to be aggravated, and therefore, the global status of the country to fall behind. At the same

time, the government should reverse contractionary policies that aim to defend the national currency, with expansionary policy. Expansionary policies will positively affect to economic activity and aggregate demand, and eventually led to potential acceleration of non-oil sector growth, increasing employment, as well as decreasing social burden of government.

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