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July 18, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Azerbaijan Republic—Recent Economic Developments and Selected Issues**

This paper provides background information to the staff report on the 2000 Article IV consultation discussions with Azerbaijan Republic, which was circulated as SM/00/168 on July 18, 2000 and is tentatively scheduled for discussion on Tuesday, August 1, 2000.

Mr. Owen (ext. 38811) and Mr. Prokopenko (ext. 38916) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

AZERBAIJAN REPUBLIC

Recent Economic Developments and Selected Issues

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Approved by European II Department

July 18, 2000

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Azerbaijan: Basic Data

Social and demographic indicators (1999)

Area (in sq. km)	86,600
Population (in thousands, 1999)	8,016
Percent urban	52
Percent rural	48
Population growth rate (in percent)	0.8
Life expectancy at birth (in years)	72
Infant mortality rate (per 1,000 population)	17
Physicians (per 1,000 population)	3.9
GDP per capita (in U.S. dollars, at average 1999 exchange rate)	521

	1994	1995	1996	1997	1998	1999
(In percent of GDP)						
Structure of GDP						
Industry and construction	28	31	35	37	39	33
Agriculture	32	25	25	20	20	22
Other	40	44	40	43	41	45
(Percentage change, unless otherwise indicated)						
Output and employment						
GDP (in billions of manats)	1,873	10,669	13,663	15,791	16,177	16,489
Real GDP	-19.7	-11.8	1.3	5.8	10.0	7.4
Employment	-2.2	-0.5	2.0	0.2	0.2	0.0
Prices and wages						
Consumer price inflation						
Average	1,664.0	412.0	19.7	3.5	-0.8	-8.5
End of Period	1,788.0	85.0	6.5	0.4	-7.6	-0.5
Average nominal wage	601.5	307.6	43.1	58.5	18.9	9.5
Real wage	-60.2	-20.4	19.5	53.1	19.9	19.6
(In millions of U.S. dollars)						
External sector						
Exports of goods	682	680	789	808	678	1,025
Imports of goods	845	955	1,338	1,375	1,724	1,433
Current account balance	-121	-318	-811	-915	-1,363	-600
(in percent of GDP)	-9.3	-13.2	-25.5	-23.1	-32.6	-15.0
(In percent of GDP)						
Government						
Total revenue	33.8	17.6	17.6	19.1	17.0	19.4
Total expenditure (including net lending)	45.9	22.5	20.3	20.8	21.1	24.9
Fiscal balance (- deficit)	-12.1	-4.9	-2.8	-1.6	-4.2	-5.4
Domestic financing	12.1	0.3	-0.2	-0.4	1.4	-2.0
(Percentage change, unless otherwise indicated)						
Financial markets						
Manat reserve money, end of period	642.8	129.7	33.6	35.1	-21.1	18.9
Manat broad money, end of period	486.1	122.2	25.8	29.2	-21.7	15.2
Manat velocity (ratio)	11.5	17.7	13.3	12.0	12.0	9.0
Exchange rate (manat/US\$)						
End of period	4,330	4,440	4,098	3,888	3,890	4,378
Period average	1,433	4,417	4,300	3,983	3,869	4,126

Source: Azerbaijan State Committee on Statistics, Azerbaijan National Bank, Ministry of Finance; and Fund staff estimates.

I. OVERVIEW OF RECENT ECONOMIC DEVELOPMENTS

A. Real Sector Developments

1. **Since 1995, Azerbaijan has been largely successful in eliminating its macroeconomic imbalances.** As a result of the authorities' reform program supported by the IMF and other IFIs, financial stability has been achieved and economic growth has been restored (Figure 1). This has also been helped by the cease-fire negotiated in 1994 with Armenia over Nagorno-Karabakh and by political stability.

2. **In 1999, real GDP growth was 7½ percent, largely driven by a continued expansion in oil production** (Table 1). Crude oil extraction has increased by almost 50 percent over the last two years and has reached the highest level since 1987 (Table 18). However, growth in oil output is likely to be modest in the short term before new developments begun to come on stream from 2005. This has also been reflected in a sharp reduction in net foreign direct investments in 1999, compared to 1998, most of which have been traditionally directed into the oil and oil-related sectors (Figure 5).

3. **Growth in non-oil sectors averaged 4¼ percent in 1999, although performance varied significantly across the sectors** (Table 16). A good grain harvest contributed to a solid growth in agriculture (7 percent). Growth in construction, an important oil-related sector, was flat reflecting a slow down in foreign direct investments. Non-oil industrial output, which played an important role in the economy of Azerbaijan over the 1980s, continued to decline. Much of manufacturing capacity is now at a standstill with previously dominant sectors such as metallurgy and machine building undergoing a 93-94 percent fall in output between 1992 and 1999 (Table 19).

Table 1. Output Developments

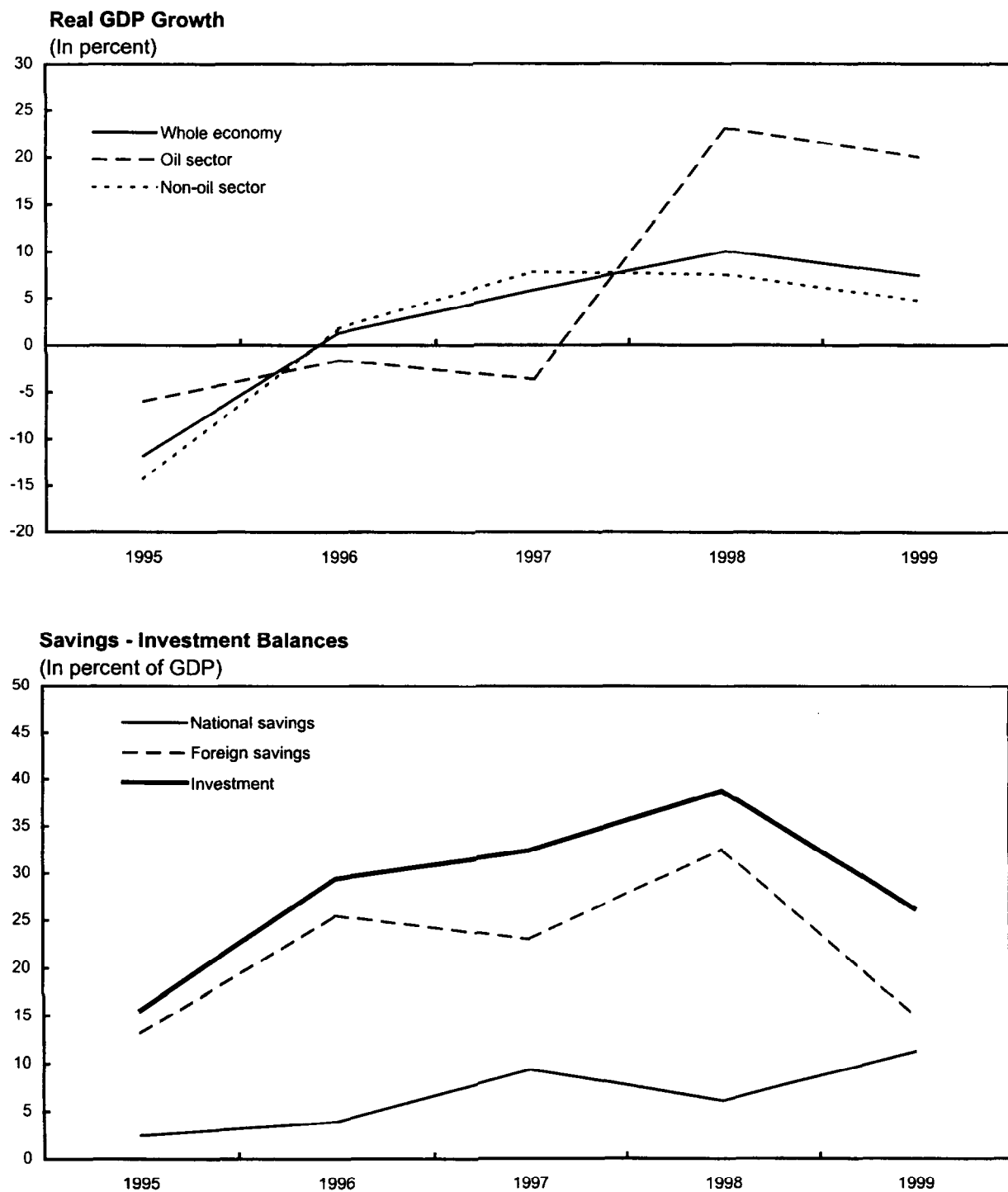
(Percentage change on a year earlier)

	1995	1996	1997	1998	1999
Real GDP	-11.8	1.3	5.8	10.0	7.4
of which:					
Oil	-6.0	-1.6	-3.6	23.1	20.0
Non-oil	-14.3	1.8	7.8	7.5	4.7

Source: Azerbaijan State Committee on Statistics; and Fund staff calculations.

4. **Preliminary data indicate that both oil production and overall GDP grew by 6½ percent in the first quarter of 2000** compared to the first quarter of 1999. During the same period, strong growth was recorded in communications, trade, and transportation. However, growth in employment-intensive sectors, such as manufacturing and agriculture, was low or even negative.

Figure 1. Azerbaijan: Selected Macroeconomic Indicators, 1995-99



Sources: Azerbaijan authorities; and Fund staff estimates.

5. **The failure of oil-driven output to stimulate the manufacturing sector is partly a result of the delays in implementation of structural reforms.**¹ In fact, Azerbaijan has become a two-speed economy. On one hand, there are dynamic oil and oil-related sectors (construction and services) which have been the motor of growth in recent years, supported by large inflows of foreign direct investments. On the other hand, the non-oil related sectors (especially manufacturing and to some extent agriculture) show little sign of recovery and require massive investments to bring them up to modern international standards.²

6. **The share of investment in GDP fell to 26¼ percent in 1999, from 38¾ percent in 1998, in tandem with a sharp decline in foreign direct investment** (Figure 1). Foreign savings contracted even more sharply, while gross national savings increased to about 11¼ percent of GDP in 1999, up from 6¼ percent in 1998. This reflected a recovery in both private and public savings following strong GDP growth and high oil revenues.

7. **The average CPI decreased by 8½ percent in 1999 reflecting tight financial policies and the impact of the Russian crisis** (Table 22). During the second half of 1999, monetary and exchange rate policies were eased, which resulted in a gradual increase in consumer price inflation to 1½ percent in the 12 months to May 2000 (Figure 2). Growth in food prices in the same period was 2¾ percent, while prices of non-food items increased by 1 percent. The GDP deflator declined somewhat less than the CPI (-5 percent in 1999) reflecting strong growth in oil and overall export prices.

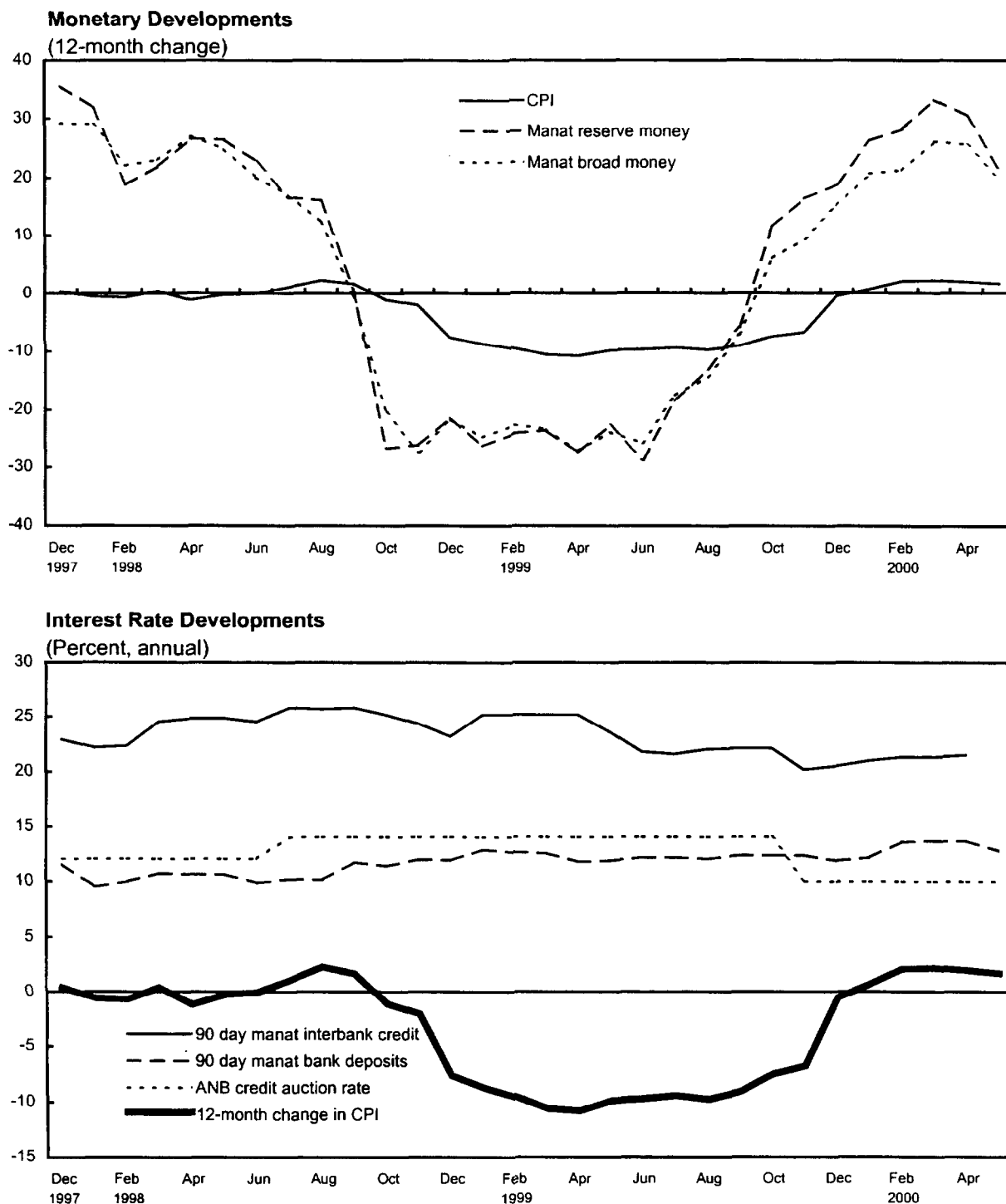
8. **The total number of persons employed in 1999 remained unchanged compared to 1998** (Table 21). The agricultural sector remains the largest employer accounting for around 30 percent of the total labor force, and the share of agriculture in GDP has been stable over the recent years at around 20 percent. On the other hand, the industrial sector (including oil) employs only 7 percent of the labor force but produces almost 24 percent of GDP. The unemployment rate increased slightly in 1999 to 14 percent.

9. **Average monthly wages increased in 1999 by 9½ percent in nominal terms and 19½ percent in real terms.** The average dollar wage remained stable at around US\$44-45. Wage dispersion across sectors continued to increase reflecting in part changes in relative productivity of the economic sectors. The ratio between average wages in agriculture (which are traditionally among the lowest in the economy), and the financial sector (the highest), has widened further in 1999, with the former representing now merely 11 percent of the latter (Table 20).

¹ Section E expands on this subject.

² For a detailed discussion on problems and prospects of investments in non-oil sectors in Azerbaijan, see SM/99/142, Chapter III.

Figure 2. Azerbaijan: Monetary Indicators, 1997-2000
(In percent per annum)



Source: Azerbaijan authorities.

B. Monetary, Exchange Rate, and Banking Sector Developments

10. **Monetary conditions eased during the second half of 1999** as confidence in the manat started to recover from the aftermath of the Russian financial crisis (Figure 2). Velocity declined sharply as monetary aggregates increased, with broad money rising by 22¼ percent by end-year (Table 30). Much of the rise in liquidity reflected intervention in the foreign exchange market by the Azerbaijan National Bank (ANB), as export earnings began to pick up following the recovery in oil prices. As a result, net international reserves of the central bank more than doubled, reaching US\$268 million by end-1999. At the same time, there was a sharp decline in domestic credit primarily reflecting a buildup of government deposits in the banking system; credit to the private sector, however, was about 11 percent higher than end-1998. In line with favorable external inflows, foreign currency deposits in the banking system also rose, with their share in broad money increasing from 29 percent to 33 percent.

11. **In the first quarter of 2000, reserve money declined moderately.** This reflected a decline in gross international reserves, as the central bank faced increased pressure to sell foreign exchange. Moreover, from January 1, 2000, substantial resources accruing to the government from the oil sector are no longer included in the international reserves. The share of foreign currency deposits in broad money increased to 38 percent at end-March 2000. In part, this may reflect declines in both nominal and real manat interest rates, as policy has been eased and inflation has picked up.

12. **While financial markets continue to be poorly integrated, interest rates, nonetheless, generally reflected the improved liquidity situation during 1999** (Table 31). In the six months to December 1999, interbank lending rates (three-month) declined by three percentage points, reaching 14½ percent, and bank deposit rates (3-month) fell slightly to 11¾ percent. In line with a more accommodating monetary stance, in early November the ANB lowered the bank refinance rate from 14 percent to 10 percent and the required reserve ratio from 12 percent to 10 percent.³

13. **The development of the treasury bill market is still very limited.** A total of twenty one auctions were held during 1999. The stock of treasury bills outstanding at the end of 1999 was less than 1 percent of GDP (manat 136 billion). While the treasury bill rate declined somewhat to around 17¾ percent by end-year, compared to 19¾ percent in mid-1999, the rate differential compared to the central bank's refinance rate has increased. Real interest rates on treasury bills declined from about 31 percent to 22 percent, as nominal interest rates fell and deflation subsided.

14. **Since mid-1999, the authorities have adopted a more flexible approach to exchange rate management.** Following the 7 percent depreciation in early July 1999, the

³ The new policies appear to have contributed to an increase in the multiplier during 1999.

manat was allowed to depreciate further against the U.S. dollar, by about 11 percent during 1999 as a whole (Figure 3). As a result, the real effective exchange rate has returned to around the level prior to the onset of the Russian financial crisis. With strong inflows of export earnings in the second half of 1999, the ANB was able to repurchase most of the foreign exchange used to support the manat earlier in the year.

15. By end 1999, the banking system of Azerbaijan comprised 70 banks, down from 180 in 1995. The banking sector is still dominated by four state-owned banks holding over 50 percent of total bank assets.⁴ While total assets of the banking system amounted to just over US\$1 billion at end-1999, a large proportion of these comprised loans to public enterprises—many of them non-performing—and fixed assets.⁵

16. Efforts to restructure the state-owned banks continued during 1999. In January 1999, the IBA was recapitalized through the issuance of government securities, restoring its capital adequacy; the bank is now slated for privatization. The remaining state-owned banks continued to suffer from low and even negative equity, reflecting their deteriorating loan portfolios. The bank restructuring effort is continuing with technical assistance from Fund and Bank staff aiming to merge the viable parts of the three state banks into a newly merged bank. The new bank is expected to begin operations in July or August 2000. All non-performing assets of the three banks are to be transferred to an asset collection agency.

17. The 66 privately-owned banks also remain in a precarious state. More than half of these banks have not been able to comply with the central bank's prudential criteria such as capital adequacy and minimum capital requirements.⁶ Competition is limited as the share of foreign capital in the banking system is constrained to 30 percent of total capital.

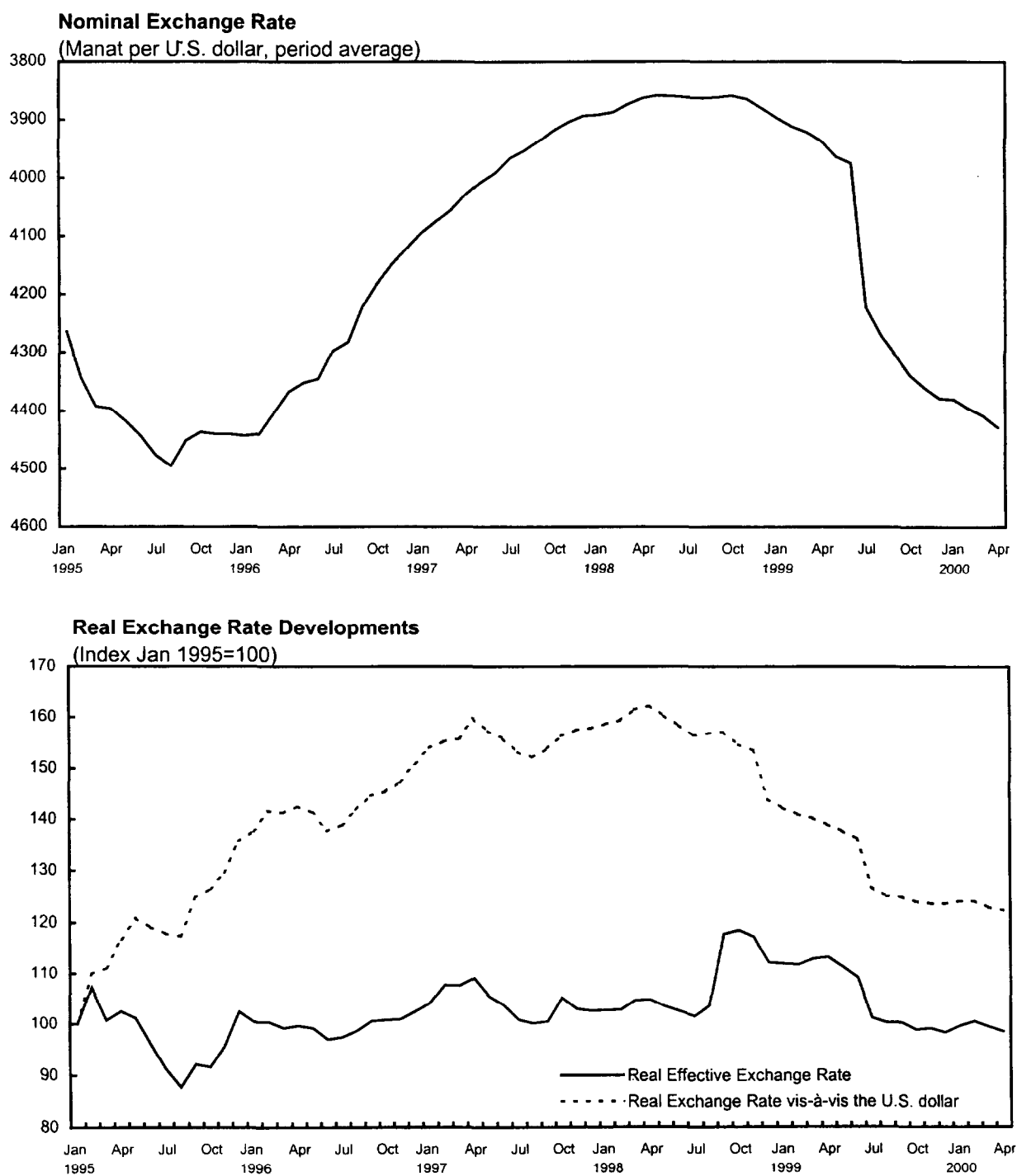
18. An external audit of the ANB's 1998 accounts was conducted in early 1999, as required by law. The authorities intend to publish the 1999 audit that is currently expected to be completed by end-July 2000. In addition, to strengthen safeguards regarding the use of Fund resources, the ANB intends to implement the major recommendations of the auditors concerning accounting practices and internal controls. Early in 2000, the ANB adopted a new chart of accounts methodology in the preparation of financial statistics.

⁴ The four state-owned banks are International Bank of Azerbaijan (IBA), Agroprombank, Prominvestbank, and Savings Bank.

⁵ For an assessment of the vulnerability of the Azerbaijan banking system, see Chapter II.

⁶ The minimum capital requirement for existing banks was raised to US\$1.5 million as of January 1, 1999 and US\$2 million as of January 1, 2000.

Figure 3. Azerbaijan: Exchange Rate Developments, 1995-2000 1/



Sources: Azerbaijan authorities; and Fund staff estimates.

1/ An upward movement indicates appreciation.

C. Fiscal Sector Developments

19. Reflecting the stabilization effort which began in 1995, the **fiscal deficit** declined from a high of 15 percent in 1993 to less than 2 percent in 1997, through tight controls on cash expenditure and some accumulation of arrears. The overall deficit rebounded in 1998 to 4 percent of GDP on account of lower oil prices and problems with tax compliance. In 1999, the deficit increased further, despite improvements in tax administration and higher oil prices, largely driven by rapidly disbursed foreign project loans (Figure 4).

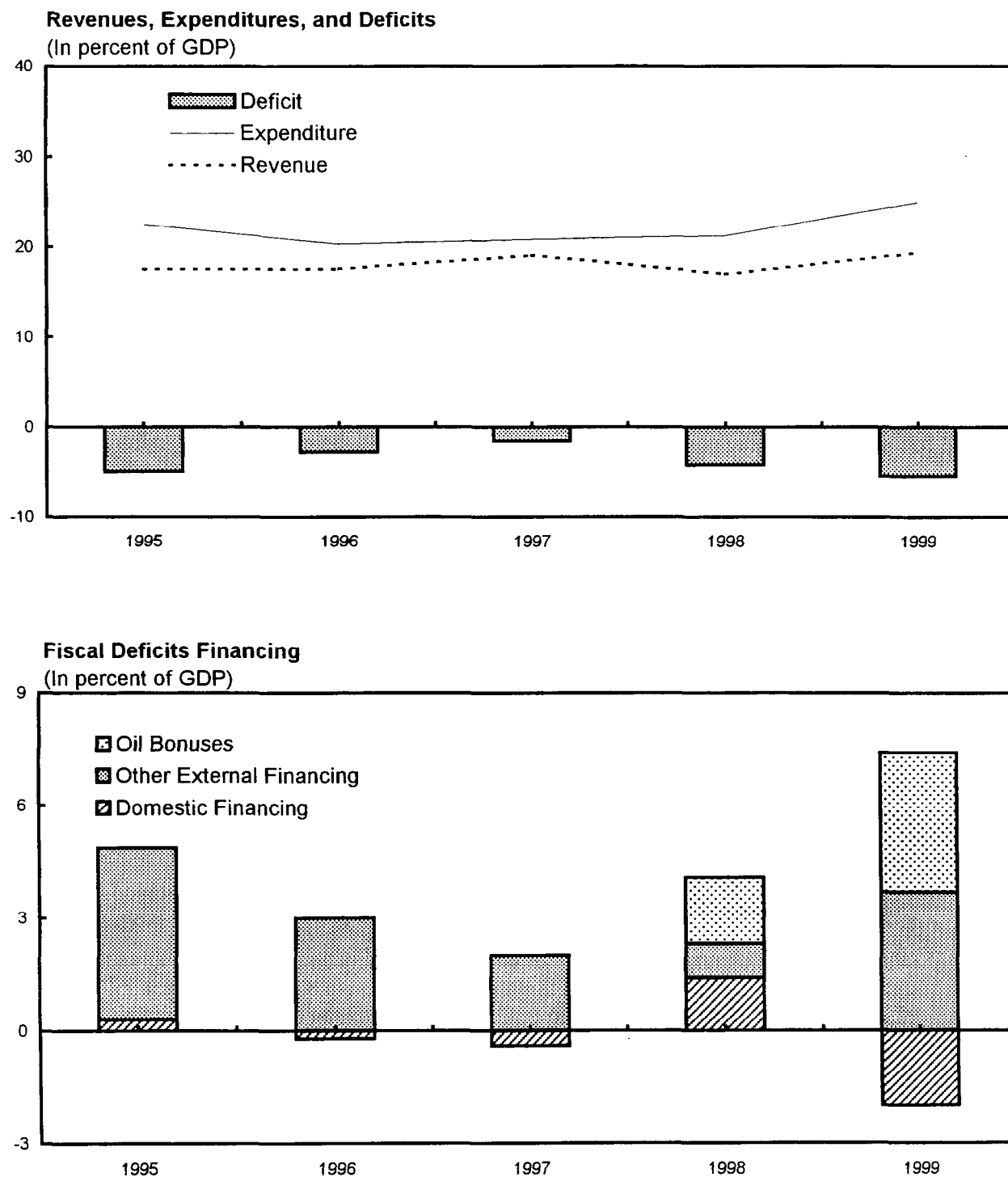
Table 2. Fiscal Deficits and Financing

(In percent of GDP)

	1993	1994	1995	1996	1997	1998	1999
Overall deficit	15.3	12.1	4.9	2.8	1.6	4.2	5.4
Domestic financing, net	15.3	12.1	0.3	-0.2	-0.4	1.4	-2.0
Net borrowing from ANB	...	...	...	...	-1.3	0.8	-2.0
Net borrowing from commercial banks	...	...	...	...	0.8	0.0	0.2
T-bills held outside banking system	...	...	...	...	0.0	0.0	0.0
Bank restructuring	...	...	...	...	0.0	0.0	-0.8
Privatization proceeds	...	...	...	...	0.1	0.7	0.7
Foreign financing, net	0.0	0.0	4.6	3.0	2.0	2.7	7.4
Disbursements	...	...	...	...	3.5	2.7	7.5
Project loans	...	...	...	...	...	0.9	2.8
Oil bonuses	...	...	...	...	...	1.8	3.7
World Bank SAC	...	...	...	...	...	0.0	1.0
Repayments	...	...	...	...	1.4	0.0	0.1
Memorandum items:							
Deficit excluding foreign project spending	15.3	12.1	1.1	2.2	1.0	3.4	2.7
Non-oil deficit	18.3	14.0	6.2	4.5	5.0	5.8	7.5

Sources: Ministry of Finance; and Fund staff estimates.

Figure 4. Azerbaijan: Fiscal Indicators, 1995–99



Sources: Azerbaijan authorities; and Fund staff estimates.

Table 3. Fiscal Revenue Trends

(In percent of GDP)

	1993	1994	1995	1996	1997	1998	1999
Total revenues	40.6	33.8	17.6	17.6	19.1	17.0	19.4
<i>Of which:</i>							
Individual income tax	2.4	1.5	1.1	1.6	2.1	2.5	2.7
Enterprise profits tax	8.5	5.2	3.8	4.3	2.8	2.0	2.2
Social security contributions	9.6	4.2	2.3	2.3	2.5	2.5	2.6
Value-added tax	8.1	3.3	1.7	3.4	4.1	4.4	4.8
Excise taxes	4.0	2.0	0.8	1.5	1.4	0.6	0.7
Land tax	0.0	0.0	0.0	0.0	0.1	0.2	0.3
Property tax	0.0	0.0	0.0	0.0	0.2	0.1	0.3
Royalties	0.0	0.0	0.0	0.3	2.2	1.1	1.1
Customs revenue	0.8	0.7	0.6	0.8	1.5	1.8	1.9
Other revenues	7.3	16.9	7.1	3.4	2.3	1.8	2.9
<i>Of which:</i>							
Strategic export tax	0.0	0.0	1.8	0.9	0.4	0.0	0.0
Foreign exchange revenue	4.6	13.4	3.0	0.0	0.0	0.0	0.0
Road Fund	0.0	0.0	0.0	0.2	0.3	0.3	0.6
State Duties	0.0	0.0	0.0	0.0	0.2	0.3	0.4
Azerbaijan National Bank Profits	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Grants	0.0	0.0	0.0	0.0	0.0	0.1	0.4
Memorandum items:							
Oil Revenue	...	...	...	1.8	3.3	1.7	2.1
SOCAR payments of profit tax	...	...	...	1.5	1.2	0.6	1.0
Royalties on crude oil	...	...	...	0.3	2.2	1.0	1.1
Overall SOCAR tax payments 1/	...	...	...	5.5	6.7	3.8	4.4

Sources: Ministry of Finance; and Fund staff estimates.

1/ SOCAR tax payments include: VAT, royalties, excise taxes, income taxes on wages, and others.

20. **Since 1995, the deficit has been mostly foreign financed, allowing the government to accumulate domestic assets.** In 1998, shortfalls in revenues led to an increase in the deficit financed by a drawdown of accumulated domestic assets. However, this was again reversed in 1999, when financing from oil bonuses amounted to 3¼ percent of GDP, up from 1¾ percent in 1998, while external financing for project spending increased from 1 percent of GDP in 1998 to 2¾ percent in 1999 (Table 2).

21. **Revenues increased to 19½ percent of GDP in 1999 from 17 percent of GDP in 1998,** on account of higher oil prices and increased collections of some indirect taxes, especially VAT. Direct taxes such as income taxes and social security contributions rose

slightly, while other revenues increased to 3 percent of GDP in 1999, up from 1¾ percent in 1998, mostly reflecting increases in central bank profits, Road Fund revenues, and an EU food security grant (Table 3). Collection of state duties—including fees from the Ministry of Justice, arbitration, courts, and foreign affairs—have increased over the past three years.

22. **The recovery in fiscal revenues in 1999 was partly related to improvements in tax administration.** Improved procedures included identifying unregistered taxpayers, and improved taxpayer procedures such as simplification of taxpayer forms, avoidance of personal contact between taxpayers and tax officials, enforcement of tax penalties and sanctions, improved control of cash registers, and establishment of a legal department in each local office. The State Tax Inspectorate was strengthened and transformed into a ministry in early 2000, and presidential decrees have called for improved taxpayer compliance.

23. **Oil related revenues have mostly come from the state oil company, SOCAR, which has become not only the largest taxpayer but also the largest tax debtor.** The main reason for this is that SOCAR provides the electricity company, Azerenergy, with fuel oil for which it does not receive payment. Azerenergy, in turn, has a very low collection rate, as it does not receive payment for much of the electricity it provides to residential, governmental, and other consumers. The large implicit subsidy is financed by depleting the oil wealth of Azerbaijan and indirectly by the budget.

24. **Some changes in tax rates took place in early 2000.** In particular, the average effective income tax rate was reduced, as the initial taxable threshold was increased and the highest tax rate reduced from 40 percent to 35 percent. The corporate profit tax was reduced from 30 percent to 27 percent, and employer contributions to the social protection fund were reduced from 35 percent to 33 percent (25 percent to 23 percent for the agriculture sector). Additional changes to VAT, profit tax, and social security contributions are expected to become effective in 2001 with the passage of the new tax code.

25. **Overall expenditures (including foreign-financed project spending) have steadily increased from a low of 20½ percent of GDP in 1996 to 25 percent of GDP in 1999** (Table 4). The amount spent on wages and salaries and transfers to households has increased markedly over the last three years. Capital expenditures have also increased steadily, with most investment projects financed from foreign sources. Purchases of goods and services and other current expenditures have remained broadly stable.

26. **The rise in the wage bill reflects increases in wages but also increases in the size of the already overstuffed public sector work force.** Public sector wages continue to be very low relative to those in the private sector despite substantial sector-specific wage adjustments. Low wages continue to encourage workers to hold multiple positions, and lead to demands for bribes. Employment in the budget sector increased by 7½ percent between 1995 and 1999.

27. **Military spending** has been maintained at about 2¼–2½ percent of GDP since 1996, while **spending on education** has increased from around 3¾ percent of GDP in 1996-98 to 4¾ percent in 1999, mostly reflecting higher wage payments. **Spending on health** is currently only about 1 percent of GDP; most of it takes place in hospitals, with the bulk of resources going to acute care facilities staffed by specialized doctors. The education and health sectors combined accounted for 89 percent of budgetary sector employment, with education sector employment expanding over the recent years.⁷ **Budgetary subsidies** fell sharply in 1997 with the elimination of explicit communal service subsidies. However, as mentioned above, implicit subsidies from the energy sector are high.

Table 4. Azerbaijan: Fiscal Expenditure Trends

(In percent of GDP)

	1993	1994	1995	1996	1997	1998	1999
Total expenditures	55.9	45.9	22.5	20.3	20.8	21.2	24.9
Wages and salaries	0.0	4.6	3.7	3.5	4.4	5.0	5.8
Purchases of goods and services	10.4	6.4	6.9	6.9	7.4	5.8	6.3
Interest payments	0.0	0.0	0.1	0.3	0.1	0.1	0.1
Transfers to households	16.6	8.6	5.1	6.4	6.2	6.8	8.1
Subsidies	4.6	5.4	2.2	2.1	0.7	0.1	0.1
Other current expenditures	21.0	20.0	0.1	0.0	0.1	0.1	0.2
Capital investment	3.1	0.9	0.7	0.5	1.3	1.1	1.6
Other	...	...	0.0	0.0	0.0	1.3	0.0
Foreign financed project spending	...	...	3.8	0.6	0.6	0.8	2.7
Government project spending	...	...	0.0	0.0	0.0	0.0	0.3
Net lending	...	...	3.8	0.6	0.6	0.8	2.5
Memorandum items:							
Military expenditure	...	...	4.2	2.2	2.3	2.4	2.6
Education expenditure	...	...	4.5	3.7	4.1	3.5	4.8
Health expenditure	...	...	2.1	1.4	1.6	1.0	1.1
Social safety nets 1/	...	...	3.2	3.3	3.3	3.0	3.4

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes allowances from the budget, Social Protection, Disability and Employment Funds, and scholarships.

⁷ Chapter III expands on this subject.

28. **Overall capital expenditures (including foreign-financed project spending) have steadily increased from a low of 1 percent of GDP in 1996 to nearly 4½ percent in 1999,** of which 2¾ percent was accounted for by foreign financed projects. A large share of these investments was directed to the energy sector, which remains largely unreformed. The contracting of new debt increased by over 50 percent between 1998 and 1999.

29. **Transfers to households, mostly accounted for by pensions paid by the Social Protection Fund, have increased steadily over the past three years.** This increase resulted from measures taken in 1997 to (i) reduce pensions to working pensioners, which encouraged more workers to resign and collect their full pension, and (ii) increase pensions of those who retired prior to the inflationary period in line with recent retirees. The retirement age has been increasing every year by half year, from 54 to 57 for women and from 59 to 62 for men.⁸ The net effect of these changes was that pension payments increased from 2¾ percent of GDP in 1997 to 4¼ percent of GDP in 1999. Other transfers to households include student stipends, and allowances for groups of the population considered vulnerable, including a basic child and a non-pensioner allowance aimed at poverty alleviation. These transfers to households have increased only slightly over the past three years (as detailed in Table 25).

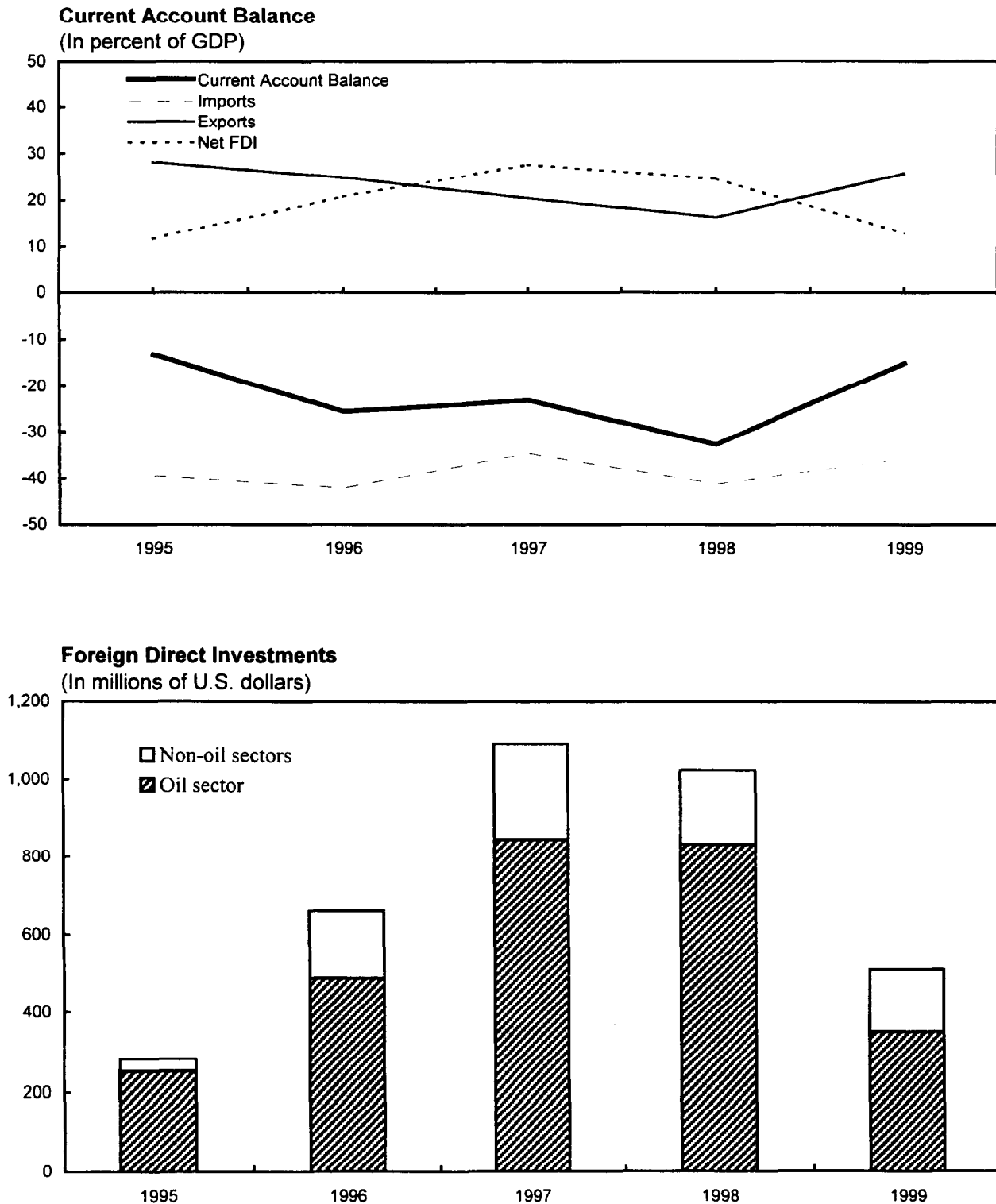
30. **Budgetary arrears for goods and services, particularly for public utilities, remain a serious problem.** Owing to the development of the treasury system since the beginning of 1997, public expenditure control has improved. Commitment controls were introduced in 1999, which has allowed the treasury to measure the flow of arrears for the first time. Although wage and pension arrears were eliminated in the first nine months of 1999, arrears on goods and services, particularly on utility and communal services, remain high. Despite the introduction of commitment controls, further accumulation of arrears in 1999 on goods and services was observed. In particular, arrears on food products and utilities remained large at end-1999. The sectors with highest arrears accumulation included the courts and law enforcement agencies and the education sector.

D. External Sector Developments

31. **Following a steady increase in 1995-98, the external current account deficit fell significantly in 1999 to 15 percent of GDP, from 32½ percent of GDP in 1998** (Figure 5, Table 33). This was largely a result of an increase in oil export earnings, reflecting higher production (Figure 6) and the doubling of world oil prices in the second half of 1999. On the other hand, oil-related imports declined, in line with a reduction in foreign direct investments, while non-oil related imports also declined, partly in response to exchange rate depreciation (Table 5). Preliminary estimates of the balance of payments for the first quarter of 2000 indicate that the current account deficit continues to fall as both the oil prices and the volume of oil exports remain high.

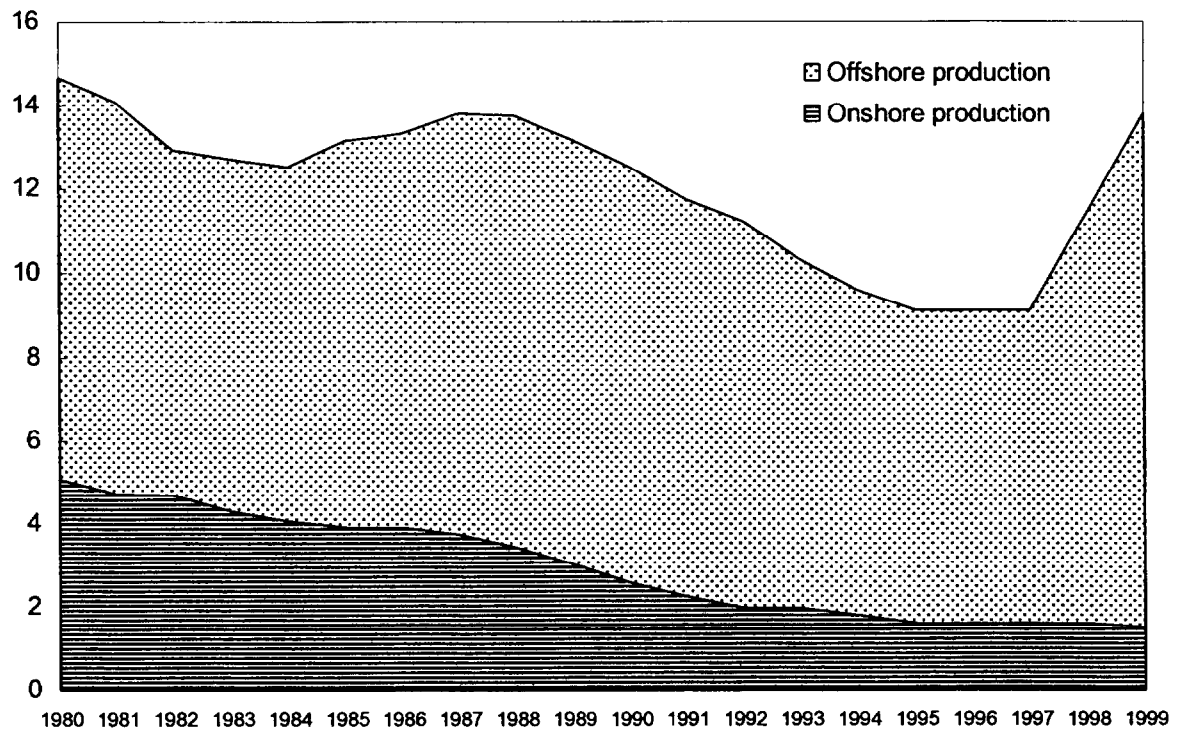
⁸ At the beginning of 2000, it stood at 56½ years for women and 61½ for men.

Figure 5. Azerbaijan: External Developments, 1995–99



Sources: Azerbaijan authorities; and Fund staff estimates.

Figure 6. Azerbaijan: Crude Oil Production, 1980-99
(In million tons)



Sources: Azerbaijan State Committee on Statistics, and State Oil Company of the Azerbaijan Republic.

32. **Since the early 1990s, Azerbaijan has followed a policy of diversifying its external trade partners.** This trend continued in 1999, as the share of trade with the CIS countries declined to only 26 percent of total trade, from 54 percent in 1994 (Table 35). In addition, there is considerable "shuttle trade" with Turkey and the porous north Iranian border, where more than 20 million Azeri diaspora reside, which may not be fully captured in the statistics.

33. **Due to strong growth in oil prices and production, exports in 1999 were dominated by oil more than ever before:** the share of oil and petroleum products in total exports increased to around 79 percent in 1999, up from 69 percent in 1998, at the expense of cotton and other non-oil-related exports. On the import side, machinery and equipment, which represent essentially the oil-related imports, accounted for about one half of total imports in 1999, as in the year earlier (Table 34).

34. **The services account deficit contracted in 1999 in line with the decline in oil-related imports. Current transfers increased slightly,** reflecting disbursements by international agencies (UNICEF, World Food Program) and by the European Union (EU food security grant).

Table 5. Balance of Payments: Selected Indicators

(In percent of GDP, unless otherwise indicated)

	1995	1996	1997	1998	1999
Current account	-13.2	-25.8	-23.1	-32.6	-15.0
Trade balance	-11.4	-17.3	-14.3	-25.0	-10.2
Exports, of which:	28.1	24.8	20.4	16.2	25.6
Oil (crude and products)	10.6	12.6	11.3	10.4	20.0
Imports, of which:	-39.5	-42.1	-34.7	-41.2	-35.9
Oil sector	-1.2	-6.7	-6.5	-8.5	-8.1
Services balance, of which:	-5.8	-8.7	-9.7	-8.8	-5.7
Oil sector	-2.8	-5.2	-8.1	-6.8	-4.7
Capital inflows, of which:	13.2	23.3	25.5	30.3	20.7
Oil sector direct investment	10.4	15.3	21.3	19.9	8.8
Gross reserves					
In months of imports (incl. oil sector)	0.8	1.2	2.3	2.8	4.0
In months of imports (excl. oil sector)	4.5	7.3	3.1	3.8	5.4
External debt	...	...	...	15.9	24.2

Sources: Azerbaijan authorities; and Fund staff estimates.

35. **Capital inflows declined in 1999 by about US\$0.4 billion, to US\$0.8 billion,** reflecting a drop in net foreign direct investments from US\$1 billion in 1998 to only

US\$0.5 billion in 1999. The sharp reduction in net foreign direct investments was partly due to the large cost recovery by the AIOC oil consortium.⁹ In 1999, the AIOC was able for the first time to recover not only its operating costs of the year but also the unrecovered operating costs of previous years.

36. Uncertainties and delays in the negotiations regarding the main export pipeline, as well as the postponement of investments under several production sharing agreements (PSAs), were among the other reasons for a reduction in foreign direct investment. Nonetheless, three new PSAs were signed in 1999 and one more PSA has been signed so far in 2000, accompanied by oil bonuses of US\$155 million and US\$95 million respectively. In total, 20 PSAs have been signed through June 2000, most of which are for exploration of new oil fields.

37. Medium- and long-term official flows increased significantly in 1999 due to large concessional disbursements of project loans. This, together with substantial Fund disbursements, led to a rapid build up of external debt, which increased by about US\$300 million to US\$960 million by the end of 1999. Reflecting these disbursements and the 11 percent depreciation of the manat during 1999, the external debt to GDP ratio reached 24 percent by the end of 1999. A significant portion of the external borrowing is on concessional terms, with debt service expected to amount to 7½ percent of exports in 2000.

38. The overall balance of payments in 1999 was again dominated by the oil sector and turned from a deficit in 1998 to a surplus in 1999. This, combined with Fund purchases, permitted the central bank to increase its gross international reserves by US\$227 million during the year to US\$676 million, the equivalent of four months of next year's imports.

E. Private Sector Development

39. Recent progress on privatization has been slow. Sales of small-scale enterprises for cash have been completed and privatization of agricultural land and issuance of land titles are nearly completed. However, sales of medium and large enterprises have stalled, while the authorities attempt to address the lack of transparency and the corruption which have discredited the privatization process. A new privatization program is still under discussion within the government.

⁹ The AIOC (Azerbaijan International Operating Company) is presently the only foreign consortium that produces oil in Azerbaijan. It includes BP/Amoco, TPAO (Turkey), Exxon, SOCAR (the State Oil Company of Azerbaijan), Unocal, Lukoil, Statoil, Pennzoil, Itochu, Ramco, and Delta Hess.

40. **Enterprise restructuring and improvement of corporate governance have been drifting over the recent years.** The government remains reluctant to reinforce the bankruptcy process, which could entail high social costs. The lack of a bankruptcy mechanism, which could allow transfer of enterprises to more efficient owners, makes the economy more dependant on oil and contributes to the severe non-payments problem. No attempt has yet been made to restructure the large public utilities in the water and energy sectors, nor the state oil company, SOCAR. In general, the energy sector is characterized by significant distortions, which are likely to hinder growth and undermine macroeconomic stability.

41. **Growth of the private sector is hampered by an unfriendly business environment.** Various licensing requirements and an excessive bureaucracy foster corruption. This presents problems for doing business in Azerbaijan not only for existing businesses but also for potential investors. Foreign investment into non-oil related sectors has remained very low, partly as a result of the adverse business climate.

42. **On balance, the achievements in terms of private sector development have been modest over recent years.** The lack of an effective supporting infrastructure—in terms of the legal framework and capital market institutions—remains a major impediment to the successful realization of privatization and enterprise restructuring. Moreover, the lack of transparency and the influence of vested interests further undermine structural reform process.

II. HOW VULNERABLE IS THE BANKING SYSTEM?

A. Introduction and Background

43. This chapter examines the extent of financial vulnerability of the banking system. The assessment is based on data from the consolidated balance sheet of the commercial banks and on quantitative and qualitative information gathered from financial sector surveillance questionnaires provided by the authorities.¹⁰ Although a full-fledged financial sector assessment would require an in-depth analysis of individual banks, the approach followed here, based on aggregate data, should provide a broad indication of how fragile the banking sector is to conventional risk factors.

44. **The Azerbaijan banking system at end-1999 comprised 70 banks, down from 180 in 1995.** Four state-owned banks dominate the sector, holding about 53 percent of total bank assets (Table 6). Total assets of the banking system amounted to just over US\$1 billion at

¹⁰ However, a caveat should be noted on banking statistics in Azerbaijan which may be somewhat inaccurate because of poor accounting practices, classification problems, and other methodological weaknesses.

end-1999. About 65 percent of these comprised loans to public enterprises and fixed assets.¹¹ The Azerbaijan National Bank (ANB) is the regulatory authority.

45. **Recognizing the fragility of the system, and in particular the precarious position of the state-owned banks, the authorities have for several years been seeking to restructure the operations of the state-owned banks.** In January 1999, the International Bank of Azerbaijan (IBA) was partially recapitalized through the issuance of government securities, restoring its capital adequacy. The bank is now slated for privatization, though discussions with EBRD regarding its proposed purchase of a significant stake in the bank are proceeding very slowly. In December 1998 and March 1999, ministry of finance claims on the Savings Bank were converted into equity, which largely restored the solvency of this bank.

Table 6. Azerbaijan: Structure of the Banking System, 1993-99

(End of Period)

	1993	1994	1995	1996	1997	1998	1999
Total assets, as percent of GDP	127.3	112.5	33.0	29.3	28.9	25.0	27.6
Total loans, as percent of GDP	43.8	39.4	14.5	14.0	13.5	13.7	14.3
Composition of domestic claims	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Claims on government	0.5	7.0	0.8	1.7	2.5	1.4	3.0
Claims on public enterprises	77.6	84.5	91.0	90.0	78.8	74.8	73.2
Claims on private sector	21.9	8.5	8.2	8.3	18.6	23.9	23.8
Credit from ANB (percent of Total deposits)	72.7 --	22.3 --	191.8 180	140.3 136	165.9 99	134.2 79	134.5 70
Number of banks							
Majority state-owned	--	--	4	4	4	4	4
Majority foreign-owned	--	--	5	6	6	6	4
State owned banks' share of total assets	78.0	82.0	80.5	77.6	72.6	65.5	52.6

Sources: Consolidated balance sheet of DMBs; and Azerbaijan authorities.

¹¹ In effect, the total asset figure may be as low as US\$650 million, since most of the loans by Agroprom and Prominvest are unrecoverable and many private banks are not adequately provisioned.

However, Agroprom and Prominvest banks remain deeply insolvent, reflecting large losses on their loan portfolio. The bank restructuring effort is continuing, with technical assistance from both Fund and Bank staff, with the aim of merging the viable parts of Agroprom and Prominvest Banks with the Savings Bank. All non-performing assets of these banks are to be transferred to an asset collection agency (ACA).¹²

46. **More than half of the 66 privately owned banks have failed to comply with the central bank's prudential criteria such as capital adequacy and minimum capital requirements.** Many are insolvent, and their continued operation undermines confidence in the banking system and places considerable strain on the already scarce supervisory capacity.

47. The remainder of the chapter establishes a framework for assessing the banking system's vulnerability; evaluates the impact of the macroeconomic environment in recent years; and appraises developments in key banking system indicators. In addition, highlights of the institutional and regulatory features of the banking system are discussed with the aim of assessing the need for further action.

B. A Framework for Analysis

48. In evaluating the soundness of a banking system, three major factors need to be assessed: (i) the macroeconomic environment within which banks operate; (ii) the financial and lending strength of the system; and (iii) the effectiveness of the regulatory and institutional framework, including the availability of systemic liquidity arrangements.¹³

- Regarding the **macroeconomic environment**, sustained economic growth lowers the risk of defaults on loans, while encouraging profitable lending activities by banks. A stable non-inflationary environment, with predictable movements in interest and exchange rates, protects bank assets from unwarranted exposure.
- The **banking system's resilience** to unexpected financial shocks largely depends on factors such as its profitability, capital adequacy, liquidity, and the sectoral concentration of its lending activities.
- To discourage excessive risk taking and the erosion of the system's capital base, banking activity needs to be supported by a well staffed **supervisory authority** which is able to enforce an effective **regulatory framework**. In addition, institutional

¹² The precise nature and the structure of the ACA is to be determined in the course of a detailed analysis of the assets and liabilities of all three state owned banks.

¹³ For a more detailed discussion, see L. Carl-Johan, G. Garcia, and M. Saal (1996), "Bank Soundness and Macroeconomic Policy", IMF.

arrangements are necessary to ease the banking system's liquidity needs and to enhance **asset and liability management**, particularly during periods of uncertainty.

C. Macroeconomic Environment

49. **Since 1996, the Azerbaijan authorities have made significant strides in achieving non-inflationary growth and providing a stable environment for banking sector activity.** Following sharp declines in output during the five-year period ending in 1995, growth has since averaged 6 percent a year (Figure 7). While much of this growth can be attributed to rising oil production, related activities such as construction and transportation in the non-oil sector have also contributed. Tight financial policies have kept inflation low, and the exchange rate has been relatively stable. However, real interest rates have remained high, particularly during much of 1999, which has limited the demand for loans. The intermediation margin¹⁴ of banks has averaged above 10 percentage points.

50. **While the authorities' determination to maintain a stable manat-dollar exchange rate has reduced the risk of currency exposure for the banking system, lower oil prices and the Russian financial crisis in 1998 contributed to a general deterioration of bank profitability.** As external competitiveness declined, followed by price deflation and lower output growth, the banking system's profitability suffered, with return on equity (ROE) falling from 11 percent at end-1997 to around 6 percent at end-1998. By the end of second quarter of 1999, quarterly net profits of the banking system reached a low of manat 8 billion, down from manat 91 billion at end-1997 (Figure 8). This period also witnessed a sharp rise in non-performing loans (Table 7).

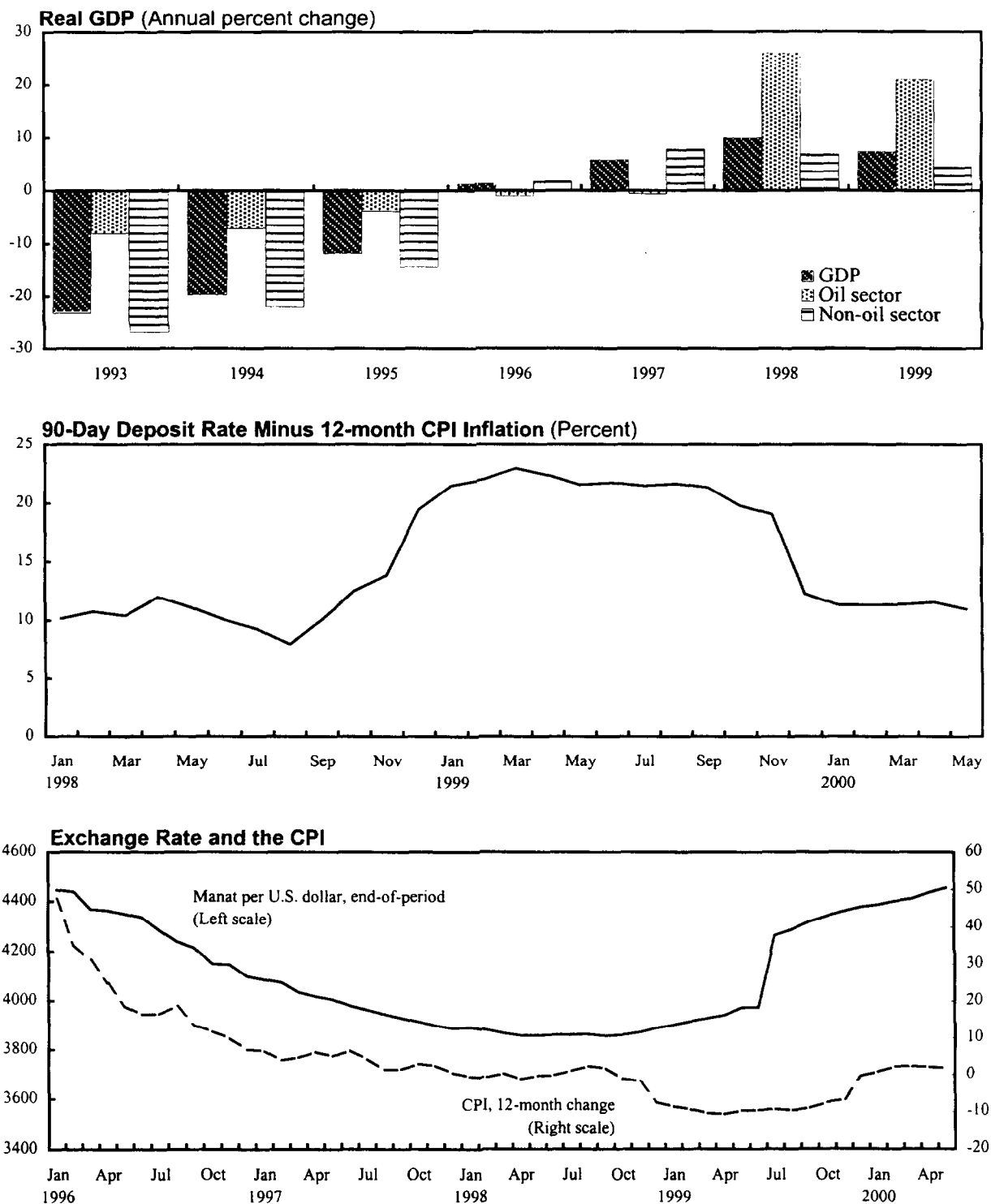
D. Indicators of Banking System Soundness

51. The banking system's ability to absorb unexpected losses or shocks largely depends on its profitability, the size of its capital base, exposure to foreign exchange risk, sectoral credit concentration, and the quality of assets. The following paragraphs discuss the extent of vulnerability of Azerbaijan's banking system, based on measures derived from aggregate banking statistics and other related indicators.

52. **The total assets of the banking system have increased by around 29 percent during the past four years, and banks' core capital has increased from 3 percent to 15 percent of total assets during the same period.** On the face of it, this appears to be a positive development. However, as noted above, there has been a marked decline in profitability as measured by both the return on equity (ROE) and the return on assets (ROA), despite the stable macroeconomic environment and high margins of intermediation for both

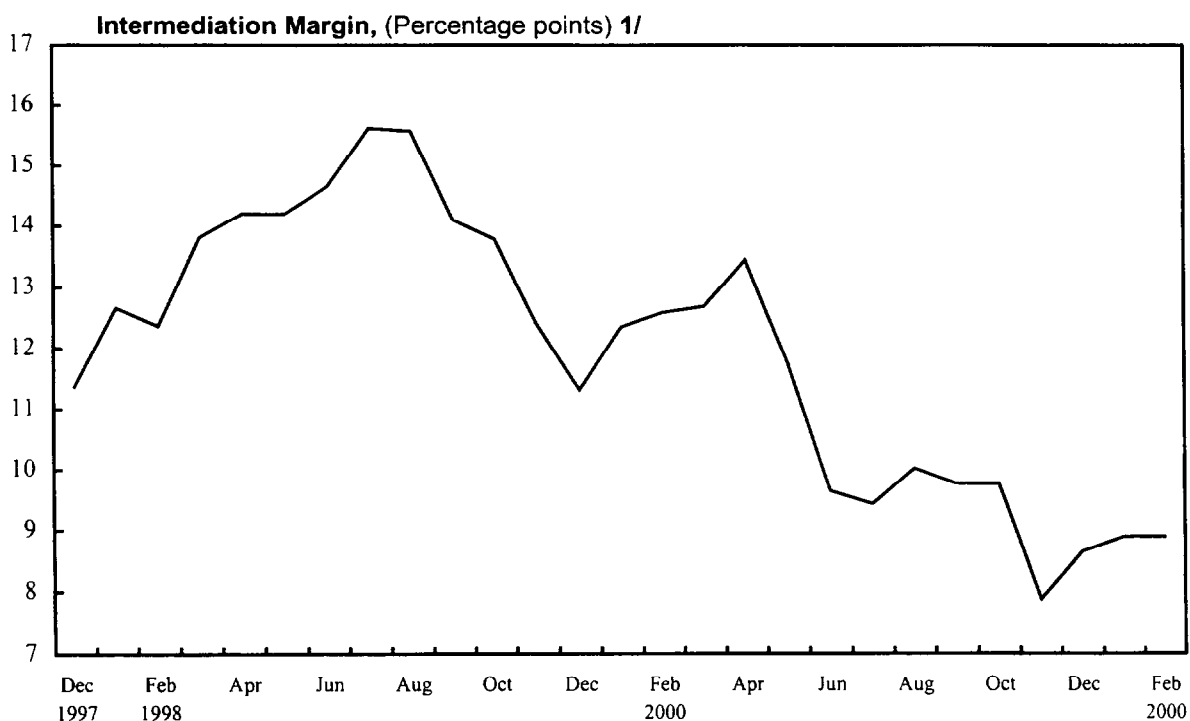
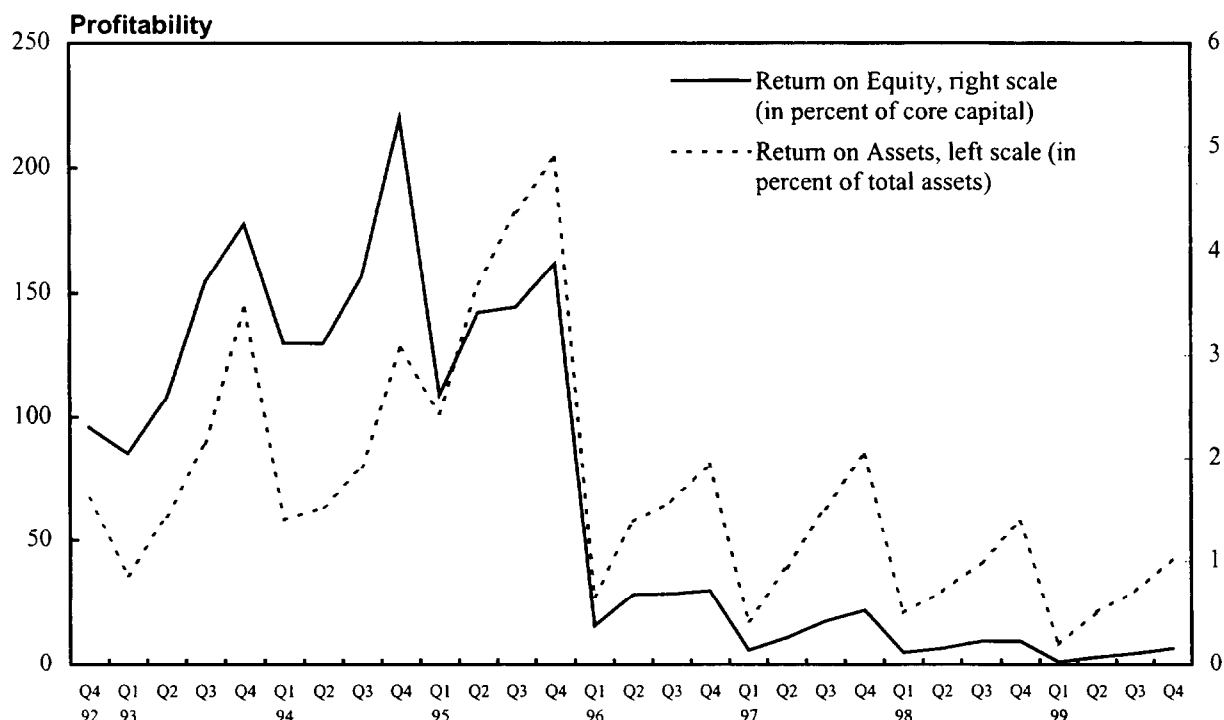
¹⁴ Defined here as the difference between three-month lending and deposit rates in manat.

Figure 7. Azerbaijan: Selected Economic Indicators, 1993-99



Sources: Azerbaijan authorities; and Fund staff estimates.

Figure 8. Azerbaijan: Banking System Profitability, 1992-99



Sources: Azerbaijan authorities; and Fund staff estimates.

1/ Average manat interbank credit rate minus deposit rate, 90 days.

manat- and dollar- denominated lending activities. This largely reflects the increase in non-performing loans.

Table 7. Azerbaijan: Indicators of Banking System Soundness, 1993-99

(End of Period)

	1993	1994	1995	1996	1997	1998	1999
Core capital (percent of total assets)	1.9	1.4	3.0	6.5	9.3	14.6	15.4
Risk weighted capital/asset ratio	--	--	83.2	84.3	78.4	75.6	51.7
Liquidity (high liquid assets in percent of total)	16.8	27.9	29.4	20.4	18.9	12.4	15.4
Loan/deposit ratios (total)	1.4	0.8	1.9	2.1	2.0	2.3	2.1
Manat	1.9	1.8	2.5	2.5	3.0	3.4	3.7
Foreign currency	0.0	0.5	1.1	1.5	1.1	1.3	1.1
Nonperforming loans, NPL (percent of total)	27.0	16.0	22.2	20.2	19.9	51.6	61.9
Provisioning (percent of NPL)	--	--	9.3	4.8	19.6	10.3	17.7
Foreign position (percent of total capital)	102.5	311.8	212.1	61.8	54.1	21.1	35.2
Return on assets	3.5	3.1	4.9	1.9	2.0	1.4	1.0
Return on equity	177.7	220.0	162.0	29.9	21.9	9.6	6.7

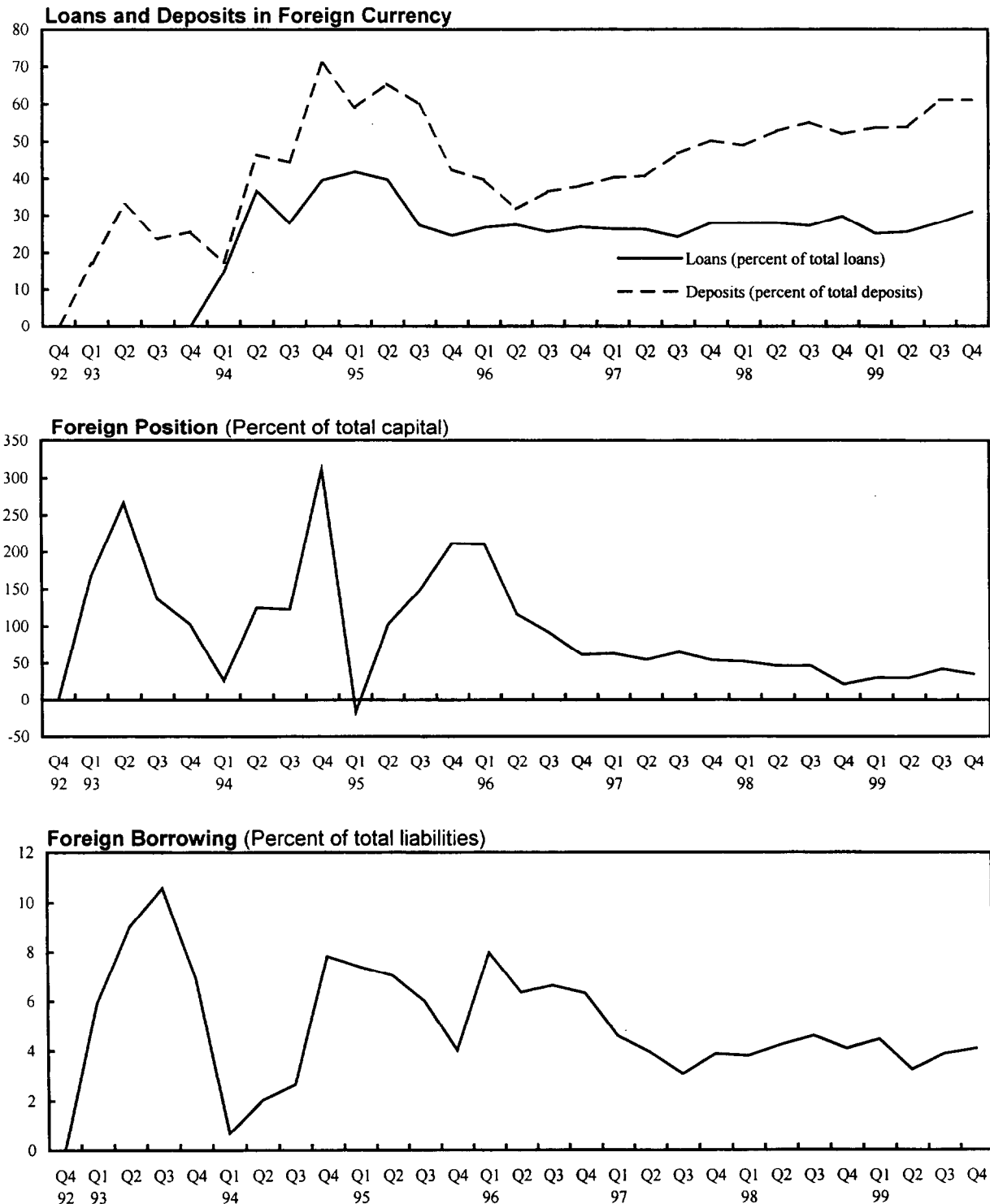
Source: Consolidated balance sheet of DMBs; Azerbaijan authorities.

53. **The banking system has benefited from a stable exchange rate, which has minimized the risk of foreign currency exposure.** Nonetheless, the banking system's foreign open position, at about 35 percent of total capital, is high (Figure 9). Dollarization has increased since the 1998 Russian crisis, with foreign currency deposits accounting for 38 percent of broad money at end-March 2000. Loans denominated in foreign currency have remained at between 25–30 percent of total loans, and the ratio of loans to deposits in foreign currency has been around one. However, almost all foreign currency denominated loans are to public enterprises, which, depending on their viability and ability to generate foreign exchange, may expose banks to unwarranted risk.

54. **Information from the ANB supervision department indicates that the level of non-performing loans for the banking system as a whole has tripled since 1996, reaching 62 percent of total loans outstanding at end-1999¹⁵.** The data also show that only about 18 percent of total loan losses were provisioned for in 1999. Consistent with this information, external consultants, in analyzing the balance sheets of the three state-owned banks that are to be merged, found that the level of non-performing loans in these banks' portfolio alone has reached about manat 600 billion, 28 percent of the banking system's outstanding loans at end-March 1999. In the absence of consistent application of the loan

¹⁵ This may partly reflect improved monitoring of nonperforming loans due to recent improvements in disclosure and information requirements.

Figure 9. Azerbaijan: Banking System Foreign Currency Exposure, 1992-99



Sources: Azerbaijan authorities; and Fund staff estimates.

classification and loan loss provisioning regulations by banks, the recorded data for non-performing loans may understate the level of risk in the system.

55. **Probably the most critical risk faced by Azerbaijan's banking sector is the continued concentration of loans to public enterprises.** Outstanding loans to public enterprises comprised about 75 percent of the banking system's loan portfolio at end-1999, down from 90 percent at end-1995. A large amount of these loans have been extended by the state-owned banks to loss-making public enterprises. A recent Bank/MAE mission found that more than 90 percent of the loan portfolios of Agroprombank and Prominvest Bank are non-performing, and that these banks have virtually ceased all lending activities. Partly as a result, the share of total loans going to the private sector has increased, from about 8 percent in 1996 to 24 percent in 1999. Nonetheless, the lack of progress in commercializing or privatizing loss-making state-owned enterprises is likely to continue to adversely affect the health of the banking system and endanger its solvency.

56. **Falling liquidity ratios in the commercial bank balance sheets is an additional indicator of financial distress.** The ratio of liquid assets to total assets has fallen to about a half in the past five years. Similarly, liquid assets now cover only about 67 percent of demand liabilities compared to about 120 percent at end-1996. The lack of public confidence in individual banks hampers the banking system's ability to mobilize deposits, particularly manat-denominated deposits: at end-1999, total deposits were only about 6 percent of GDP compared with total loans of about 14 percent. As a result, the banks have had to rely heavily on credit from the ANB to finance loan expansion.

E. Institutional Factors

57. **A financially sound banking system operating within a stable macroeconomic environment requires a capable supervisory body, strong banking legislation and adequate facilities to support the banking system's liquidity management.** A strong legal, regulatory, and institutional infrastructure will discourage banks from taking excessive risks which may contribute to a weakening of their capital base and limit their ability to absorb unanticipated losses or shocks. Similarly, well-developed money and foreign exchange markets will help banks to better manage their liquidity positions and foreign exchange exposure. This section provides an assessment of the current system and points out the major areas requiring reform.

58. **Bank regulation and supervision were enhanced with the enactment of new bank legislation in June 1996.** New bank licensing and prudential regulations were issued in November 1996 and June 1997, respectively. More recently, a framework for assessing the overall financial condition of banks, and comprehensive capital adequacy, liquidity management, and asset classification regulations, have been developed. Also, the central bank is currently reorganizing the bank supervision function with the aim of improving its efficiency and effectiveness. Some progress has also been made in training supervisory staff. A

comprehensive bank reporting system has been developed, but has yet to be automated and fully implemented.

59. **Nonetheless, weak supervision and uneven enforcement of prudential regulations has contributed to the erosion of public confidence in Azerbaijan's banking system, as non-compliant banks have been allowed to continue to operate.** Several critical steps need to be taken if the central bank's capability to supervise commercial banks in line with international best practices is to be further strengthened. These include the development and implementation of the IAS-based accounting standards; improvement of the regulatory reporting and analytical capability to allow for a more meaningful and comprehensive off-site analysis; enhancing the quality of on-site inspections such that the focus would be on evaluating the bank's financial condition and not be limited to compliance checks; increasing the coordination between supervisory departments; and consistent application of progressively more stringent measures in the face of non-compliance, including the revocation of banking licenses in cases specified by law. The central bank needs to intervene at the first sign of emerging difficulties and move forcefully against problem banks. The ANB should also be more proactive in enforcing capital requirements; undercapitalized banks should either be required to raise additional capital within clearly defined time frames or merge with other healthier financial institutions.

60. **While much has been done to improve the effectiveness of banking legislation in recent years, more remains to be done.** In particular, provisions for the issuance and revocation of banking licenses, conservatorship, corporate governance, and enforcement measures need to be introduced or expanded. To enhance the ANB's ability to take timely corrective action, the banking law should also expand the range of enforcement remedies to include suspension of dividend payments, and a substantial increase in fines in clearly specified circumstances. The law should also give exclusive powers to the ANB to appoint a liquidator and initiate bankruptcy procedures in the banking sector.

61. **There is also a need to develop the basic infrastructure for liquidity management.** First, the lack of consolidated accounting within many commercial banks impedes the delivery of efficient payment services, which in turn limits liquidity management, requiring the maintenance of high levels of reserves. In this regard, the central bank is in the process of implementing payment system reform, with the assistance of a peripatetic MAE expert. Second, effective liquidity management by banks requires the development of financial market instruments and a broad and deep foreign exchange market.

62. **While private financial market instruments may take time to develop, steps could be taken to improve the functioning of the treasury bill market.** In addition to the obvious benefits of an effective government securities market for budgetary and monetary management, banks can use securities to manage liquidity and reduce the cost of intermediation. Also, government securities, by serving as liquid collateral, can encourage the development of different financial products and secondary markets. To encourage the treasury bill market, the government has begun to accept all bids at the primary auctions regardless of

price; previously, the ministry of finance intervened in the market by rejecting some bids to prevent interest rates rising too high. Allowing broader participation in the market and ensuring a steady and sizable supply of securities on a pre-announced schedule would help increase investor interest.

63. **Foreign exchange market transactions are currently dominated by the IBA and central bank intervention activities.** While the central bank has recently taken steps to unify the various segments of the forex market, further measures need to be implemented to remove administrative and other constraints which limit market participation. Also, the ANB should develop a code of conduct for professional forex dealers, improve and streamline settlement procedures, and encourage the capacity of forex risk management in banks. The broadening and deepening of the foreign exchange market will also strengthen the ANB in effecting monetary management policies.

F. Conclusion

64. The above discussion reveals the vulnerability of the Azerbaijan banking system to conventional risk factors. In this regard, the following observations can be made:

- despite a generally stable macroeconomic environment and high margins of intermediation, the profitability of the banking system is on the decline, primarily due to the high and rising level of non-performing loans;
- liquidity ratios have been declining sharply; and the banking system's ability to attract manat-denominated deposits is limited, with loan expansion primarily being financed by the central bank;
- the high level of non-performing loans, reflecting the high concentration of loans to unstructured public enterprises, indicates a serious default risk and a potential future cost to the budget; in this regard, the lack of progress in restructuring and commercializing the public enterprises clearly endangers the solvency of the banking system.
- while progress has been made in recent years to develop the regulatory framework and initiate institutional reforms, confidence in the system has been undermined by uneven enforcement of prudential regulations;
- banks' liquidity management is hampered by the lack of developed financial markets.

65. Progress on a broad range of structural reforms, including institutional and banking sector reforms, steps to restructure, privatize, or liquidate loss-making public enterprises, and measures to broaden and deepen financial markets, are needed to strengthen the solvency and stability of the banking system.

III. POVERTY AND SOCIAL SPENDING

A. Introduction

66. Poverty and inequality influence the rate and quality of economic growth. At the same time, poverty can decline with economic growth under certain conditions, notably when (i) growth occurs in sectors where there is a large proportion of poor (e.g. agriculture); (ii) gender and ethnic inequality are not prevalent; (iii) there is peace; and when (iv) corruption does not prevent the benefits of growth from being spread to the poor.¹⁶ Some of these factors are clearly at play in Azerbaijan; even if high growth is achieved, poverty will not necessarily fall. Targeted policies are necessary to remove existing obstacles and improve the provision of basic services for the poor while maintaining macroeconomic stability.

67. *Following a decade of economic difficulties associated with the transition toward a market oriented system, poverty reduction has recently assumed a more important position in the reform agenda in Azerbaijan. The authorities are in the process of drafting an interim poverty reduction strategy paper which will guide their efforts at reducing poverty within a participatory framework. This chapter reviews poverty and inequality in Azerbaijan and examines recent social spending patterns with the objective of pointing to the major obstacles and needed improvements.*¹⁷

B. Recent Poverty and Inequality Trends

68. The latest poverty assessment for Azerbaijan, published in 1997 by the World Bank, was based on a 1995 survey. It notes that poverty increased substantially during the 1990s due to the decline in output following the breakup of the Soviet Union, and as a result of the conflict with Armenia. As shown in Table 8, over 60 percent of the households surveyed were classified as poor based on their food expenditures in 1995. About 20 percent of total households were classified as "very poor" as they had less than half of the minimum food consumption. While real GDP growth has averaged almost 6 percent in recent years, mostly due to growth in the oil sector, changes in poverty are unclear. The World Bank is currently working on a new poverty assessment.

69. **Who are the poor?** According to the 1995 World Bank survey, 75 percent of *internally displaced populations (IDPs) were considered poor, a much higher rate than the average household*. In addition, the depth of poverty as measured by the food gap is greater for the IDPs when compared to the rest of the country. The P2 measure, which is more

¹⁶ For a discussion of these ideas, see the 2000/2001 World Development Report at: <http://www.worldbank.org/poverty/wdrpoverty/draft100.htm>

¹⁷ Whereas this chapter reports available data, it is recognized that there are significant weaknesses in the statistics for poverty and social spending programs.

distributionally sensitive, shows that IDPs are relatively poorer than the rest of the population.¹⁸ More generally, poor households are characterized by larger households, more children, and a lower likelihood of owning a home (Table 9). The poor are characterized by household heads that are more likely to be unemployed or in the informal sector, and have lower levels of education than the non-poor.

Table 8. Azerbaijan: Poverty Rates Nationally for Households and by Sub-Groups 1/

	Very Poor	Poor	Non-poor	Food Poverty Gap 2/	P2 3/
All households	20.4	61.5	38.4	24.3	12.6
Baku	19.6	59.6	40.4	23.9	12.2
Outside Baku	16.8	59.3	40.7	21.9	10.8
Internally displaced people	37.5	74.5	25.5	35.1	20.9
All individuals	23.8	68.1	31.9	27.6	14.4
Baku	24.9	67.0	33.0	28.2	14.7
Outside Baku	19.7	66.0	34.0	25.1	12.6
Internally displaced people	40.1	79.2	20.8	38.1	22.8

Source: 1997 Azerbaijan Poverty Assessment, p. 3. Refers to survey carried out in 1995.

1/ Households were ranked by comparing total food expenditures (including imputed value of home production).

2/ Food poverty gap measures the depth of poverty, taking the average shortfall of household food expenditure as a percentage of the value of the food poverty line.

3/ Same principle as the food poverty gap, but gives higher weights to poorer households (to capture the severity of inequality among the poor).

70. **Internally displaced population.** As a result of the conflict with Armenia and due to ethnic riots started in 1988 there were approximately 576,300 internally displaced citizens in 1998. The World Bank survey found that IDPs were 25 percent more likely to be poor, and around twice as likely to be very poor. This is partly due to the lack of land ownership, and lower stock of assets. Although most refugees were farmers prior to their displacement, few were working at all in 1995. In particular, among IDPs, only 36 percent of working age men were employed in 1995, and half of that for women. In general, IDPs living spaces are significantly smaller and in more dilapidated conditions than those of the rest of the population, making them more vulnerable to health and other problems. A recent World Food Program survey shows that 75 percent of IDPs cannot meet their basic needs, while recent surveys of subsets of the displaced population conducted by World Vision found that 79 percent of

¹⁸ For a discussion on the different measures of poverty, see Ravallion, *Poverty Comparison*, 1993.

surveyed non-pregnant women were anemic and 30 percent of surveyed children were malnourished (UNDP, 1999).

Table 9. Azerbaijan: Poverty by Demographic Status

	Very Poor	Poor	Non-Poor
(number of people)			
Average household size	5.7	5.4	4.1
Average number of children	2.1	1.9	1.1
Average number of pensioners	0.6	0.6	0.6
(In percent of poverty category)			
Land ownership			
Percent who own a home	48.4	58.4	68.2
Percent who own land	37.8	56.7	53.1
(In percent of total population)			
Poverty rates by head's employment status			
Working	19.4	63.8	36.2
Unemployed	23.3	64.7	35.3
Pensioner	21.3	55.1	44.9
Working pensioner	19.0	49.3	50.7
Other	29.0	62.6	37.4
Poverty rate by head's years of education			
3-8 years of education	25.4	64.3	35.7
9-10 years of education	22.3	61.7	38.3
11-15 years of education	18.2	63.3	36.7
16+ years of education	15.3	50.8	49.2

Source: 1997 Azerbaijan Poverty Assessment, pp. 5, 6, and 7.

71. **Inequality** has increased since the breakup of the Soviet Union, a result documented across transition countries.¹⁹ The Gini coefficient was 0.35 for total adult equivalent expenditure and 0.37 for adult equivalent food expenditure in 1995. Although these are not high by international standards, the World Bank survey found evidence that a small group of very rich households had emerged. In addition the results show that IDPs were strongly represented in the bottom decile, and that there was greater inequality in Baku, as Baku households were over-represented in the bottom two deciles as well as in the top decile.

¹⁹ See Branko Milanovic, 1999.

72. **Regional inequality.** As shown in Table 10, the Nakichevan autonomous republic was the region with the highest incidence of poverty in 1995, followed by the Central and Apsheron regions (including Baku). When regional prices are used, poverty rates in the Nakichevan region increase even further. However, some of these results are somewhat driven by the regional concentrations of IDPs. When IDPs are excluded, the relative poverty of the Near Northwest and the Central North becomes more apparent.

Table 10. Azerbaijan: Poverty Rates by Region

	<u>Using National Prices</u>		<u>Using Regional Prices</u>		<u>Excluding IDPs and Using Regional Prices</u>	
	Very Poor	Poor	Very Poor	Poor	Very Poor	Poor
Southwest	11.8	49.5	10.5	50.0	6.8	43.2
Far Northwest	10.8	49.7	12.4	52.2	11.1	47.6
Center North	11.8	59.0	11.8	61.8	11.8	61.8
Nakichevan	31.0	84.5	59.5	90.5	59.5	90.5
Far South	14.1	57.0	15.5	60.6	15.5	60.6
Near Northwest	20.5	64.4	22.0	65.2	22.0	65.2
Central	35.2	70.7	31.0	67.1	20.8	59.4
Apsheron	22.6	64.2	25.8	66.8	23.4	63.6

Source: 1997 Azerbaijan Poverty Assessment, p. 4 Vol. 1 and p. 16 Vol. 2.

73. **Employment** opportunities have declined and unemployment has increased. Official unemployment rates classify as unemployed only those who receive benefits, (about 1 percent of the labor force). However, when one classifies as unemployed those who do not have employment but are looking for work, then the unemployment rate increased from 10 percent in 1994 to 14 percent in 1999.²⁰

74. **Education.** Although overall enrollment rates remain high (Table 11), high informal charges are making these services increasingly prohibitive for the poor. The World Bank survey found that absence rates were significantly higher among the poor, accounted for by high costs and children's health. The survey found that private expenditures represented over one-third of total education expenditure in 1995. Private expenditures include payments for private tutoring, purchase of books, and informal payments for good exam marks or admission to good schools. According to the 1999 UNDP Human Development Report on Azerbaijan, poverty has induced many families to withdraw their children from school on a temporary or permanent basis, evidenced by a growing drop out rate.

²⁰ Official unemployment spells for benefit recipients are recorded as having lengthened, with over 70 percent of spells being over 6 months long.

Table 11. Azerbaijan: Social Indicators

	1990	1995	1996	1997	1998
Population, total	7,218,500	7,726,200	7,799,800	7,876,700	7,949,000
Population growth (annual percentage)	...	1.08	0.95	0.99	0.92
Population, female (percent of total)	51.18	50.78	50.70	50.70	50.92
Urban population (percent of total)	54.3	55.70	56.02	56.34	56/66
Health					
Hospital beds (per 1,000 people)	9.9	9.9	8.7	8.6	8.5
Average length of stay (days)		18.0	18.0	17.5	17.1
Life expectancy at birth, female (years)	74.8	72.9	73.8	74.6	75.0
Life expectancy at birth, male (years)	67.0	65.2	66.3	67.4	67.9
Life expectancy at birth, total (years)	70.8	69.0	70.0	70.9	71.4
Mortality rates by age					
Under age 1 (per 1,000 live births)					
Boys	25.0	26.0	22.0	21.0	18.0
Girls	21.0	22.0	20.0	18.0	15.0
Ages 1-4 (per 1,000 people)					
Boys	5.0	4.0	4.0	4.0	6.0
Girls	4.0	4.0	3.0	3.0	5.0
Maternal mortality rate (per 100,000 live births)	9.0	37.0	44.0	31.0	41.0
Urban	11.0	49.0	56.0	52.0	56.0
Rural	8.0	29.0	35.0	23.0	30.0
Physicians (per 1,000 people)	3.8	3.8	3.4	3.4	3.4
Nurses (per 1,000 people)	...	...	7.9	7.6	7.3
Number of Hospitals	...	768	763	759	746
Number of patients seen in hospitals (per 1,000 people)	...	768	763	759	746
Education					
Expenditure per student, primary (percent of GNP per capita)	40.6	19.6	21.8	22.1	21.7
Pupil-teacher ratio, primary	...	21.0	...	...	18.8
School enrollment, primary (percent gross)	113.7	103.5	106.4	...	96.3
School enrollment, primary, female (percent gross)	113.3	107.5	104.8	...	96.2
School enrollment, primary, male (percent gross)	114.2	99.7	107.9	...	96.5

Source: State Statistics Committee, Ministry of Health, Ministry of Education; and the World Bank.

75. **Health.** While some measures of health sector outcomes such as the infant mortality rate have improved,²¹ maternal mortality increased from 9 per thousand live births in 1990 to 37 per thousand live births in 1995 and 41 per thousand live births in 1998. This rise in maternal mortality is greatest in urban areas where levels reached 56 deaths per thousand live

²¹ Official infant mortality rates are lower bounds, as the official definition of live births excludes many infants who die in the first seven days of life, which results in an infant mortality rate that is 25-30 percent lower than if the WHO definition were used. In addition, deaths following home delivery are not likely to be reported (UNDP, 1999).

births in 1998, possibly accounted for by higher hospital costs in urban areas. In addition, the 1996 survey by USAID, the World Health Organization (WHO) and UNICEF found that nearly one-quarter of the country's children were malnourished and more than two-fifths of them were suffering from anemia (UNDP, 1999). This survey also found that only about 30 percent of children between 12 and 23 months had received all the recommended immunizations. According to the 1995 World Bank survey, about half of the respondents who were ill in the month previous to the survey did not seek treatment, particularly in rural areas where illness was 70 percent higher than in Baku. More striking is the finding that private health expenditures were four times the expenditures in the government budget, pointing to high informal costs of health care. Anecdotal evidence suggests that the poor rarely seek treatment due to high costs.

76. **Basic utilities.** Existing infrastructure in Azerbaijan is extensive, with electricity being available to nearly all households, and water pipelines and central gas available to over half the population. However, energy shortages are common and both electricity and gas are highly rationed. In particular, in regions outside of Baku gas is hardly available and electricity blackouts are scheduled for peak consumption hours.

C. Social Spending

77. **Total budgetary expenditures** fluctuated between 20 and 22 percent of GDP in the period between 1995 and 1998, but increased to 25 percent of GDP in 1999. However, spending in the education and health sectors has lagged behind; public spending on education fluctuated around 4 percent between 1995 and 1998, increasing to under 5 percent in 1999, while public spending on health fell from 2 percent of GDP in 1995 to 1 percent of GDP in 1999. Average educational spending is in line with the world average of about 3.8 percent of GDP, but spending on health is below the international average of 2.3 percent of GDP (Gupta et al, 1999).

78. **Education.** Spending in the education sector has been biased toward spending on wages and salaries for the past several years, but this bias has become increasingly accentuated as salaries increased from 66 percent of overall education spending in 1997 to 81 percent in 1999 (Table 26). Goods and services, on the other hand, made up only 16 percent of education spending in 1999, while only 0.84 percent was dedicated to capital and building repair. The increasing wage bill can be explained partly by increases in salaries, but mostly by increases in the number of positions in the education sector. The number of positions in the education sector was 65 percent of total general government employment in 1999, most of which are in local budget institutions (Table 12). When comparing the number of education sector workers across countries, one notes that Azerbaijan has a ratio of 39 positions per 1,000 inhabitants in the education sector, compared to 22 per thousand in Kazakhstan, and the Kyrgyz Republic, and 20.3 per thousand in OECD member countries (Table 13).

Table 12. Azerbaijan: Number of Public Workers in the General Government by Functional Classification, 1999

	Number of Workers			Salaries Paid (000 Manats)	Average Wage (000 Manats)
		Percent of total Workers	Percent of Population		
Republican Budget	86,074	17.8	1.1	16,260,304	158.7
General Government Expenditures	7,045	1.5	0.1	1,954,245	277.4
Education	41,267	8.5	0.5	10,697,516	259.2
Health	20,512	4.2	0.3	2,403,174	117.2
Social Security and Protection	342	0.1	0.0	27,862	81.5
Culture, Media, Physical Training, Religion	1,674	0.3	0.0	262,549	156.9
Agriculture, Forestry and Fishing	15,236	3.2	0.2	914,959	60.1
Local Budget Institutions	397,489	82.2	5.2	86,435,518	142.4
General Government Expenditures	165	0.0	0.0	64,576	391.4
Education	273,403	56.5	3.6	73,757,524	269.8
Health	95,229	19.7	1.2	9,750,971	102.4
Social Security and Protection	486	0.1	0.0	92,915	191.2
Culture, Media, Fiscal Training, Religious	24,839	5.1	0.3	2,447,470	98.5
Housing Management Expenditures	689	0.1	0.0	67,120	97.4
Agriculture, Forestry and Fishing	2,678	0.6	0.0	254,943	95.2
Overall Total	483,562	100.0	6.3	102,695,822	212.4

Source: Public Sector Employment Survey, First Quarter, 1999

79. **Management of the education system** is highly fragmented; there are at least seven central government bodies that have responsibility over education policy and are responsible for administering certain educational institutions (Table 27). This continues to hamper the formulation and implementation of educational policy, and leads to duplication of activities. An educational reform program was approved in 1999 which provides a comprehensive treatment of the education sector, acting both as a strategic document and as an outline for an implementation plan. The main features of the government's reform plan include: (i) curriculum reform and teacher training; (ii) provision of educational materials including textbooks; and (iii) educational management and finance. The World Bank, UNICEF, and the United Nations High Commission for Refugees (UNHCR) have pilot programs in the field.

80. **Health** sector expenditures are also biased toward spending on wages and salaries, but to a lesser extent than in the education sector. In 1999, 53 percent of all spending in health went to pay for wages and salaries, 13 percent for public utilities, and only about 10 percent was spent on medicines and binding materials (Table 28). Partly a result of the continuing practice of allocating health funding on the basis of inputs (such as the number of hospital beds) rather than according to the size and risk factors of the population served, over

60 percent of all spending in health continues takes place in hospitals (Table 29). The number of hospitals and hospital beds has fallen slightly, while the average length of stay shortened only slightly from 18 days in 1992 to 17.1 days in 1998 (Table 11). These indicators continue to point to a public health system characterized by an oversupply of hospital beds and health workers, long stays at hospitals, and little emphasis on preventive and basic health. Hospitals are the focus of the system, with the bulk of resources going to acute care facilities staffed by specialized doctors. The trend will continue with the construction of a new cardiology hospital in Baku in 2000.

Table 13. Comparative Government Employment

	Total	Education	Health	Defense	Police	Labor & Soc. Security	Other
	(per thousand inhabitants)						
Azerbaijan (1999)	60.8	39.6	14.6				6.7
Kazakhstan (1996)	66.7	22.1	37.6	4.0			3.0
The Kyrgyz Republic (1994)	49.1	22.1	16.6	1.3	1.3	1.2	6.6
Lithuania (1995)	88.0	37.0	21.0				
Macedonia (1997)	43.2	11.3	14.4				
Moldova (1997)	92.4	43.1	23.8	3.1		1.5	20.9
Russian Federation	95.0			9.0			
Ukraine	93.0	44.0	29.0	9.0			
China	53.0	16.0	4.0				
OECD member countries 1/	57.7	20.3	14.1	6.5	3.4	1.0	12.4
Developing countries 1/	36.1	9.0	3.7	6.3	3.1	0.5	13.5
Latin America 2/	34.0	8.0	3.0	4.0			
Middle East and North Africa 2/	46.0	12.0	4.0	7.0			

Source: IMF estimates based on information provided by country authorities.

1/ Based on available data for 17 OECD countries and 38 developing countries reported in Government Employment and Pay: Some International Comparisons, by Peter Heller and Alan Tait, Occasional Paper 24 (Washington: International Monetary Fund, March 1984). The data refer to a year around 1980.

2/ Based on Schiavo-Campo Salvatore, Guilio De Tommaso, Amitabha Mukerjee, "An International Statistical Survey of Government and Wages," World Bank Policy Research Working Paper, No.7806 (Washington: World Bank, August 1997). Data refer to the 1990s.

81. **Formal and informal user charges** prevent the poor from accessing basic care. Paid medical services provided in specialized institutions were introduced in 1994, permitting repairs of medical institutions, purchases of medical equipment, and increases in wages of certain medical workers. The strategy focuses on increasing cost recovery for almost all services, with fee exemptions for vulnerable social groups, including invalids, teachers, health workers and refugees. Although the strategy is to focus on primary care, 75 percent of the population is classified as vulnerable and exempt from fees, thus making it fiscally impossible to provide the intended services under current budgetary allocations. As a result, nearly all the services are paid for by the population either informally or formally. There are several NGOs

and donors working to improve health. However, little progress has been made by the government toward a comprehensive reform effort.²²

82. **Social safety nets** include a monthly basic child allowance for poor families; small unemployment and disability benefits, and a series of small allowances for portions of the population considered poor.²³ These include allowances for non-working pensioners, IDPs, children of servicemen, and those citizens disabled, orphaned or widowed in wars; maternity and child-birth allowances; and funeral and health allowances. With the exception of the basic child allowance, benefits are independent of income or means, which may lead to problems in adequately targeting the poor.

83. **Pensions.** The pension scheme has been facing financial difficulties in recent years due to low collection yields, mixing of social insurance with social protection functions, lack of a central registry with information on contributions, and evasion. Pensions paid out by the system are low, as their value has been eroded by high inflation. However, even these low benefits are generous relative to the level of contributions, while retirement ages remain below international norms despite recent increases.²⁴ The government has controlled expenditures on pensions through discretionary indexation rules and ceilings on the reference wage. In addition, the system presents many inequities, including: favorable retirement conditions for some professional groups, lower retirement age and special exemptions for women, and different contribution rates for different economic sectors. The government has drafted a reform concept paper and is working with the World Bank on a reform strategy which includes: (i) clarifying the social insurance and social assistance schemes, (ii) clarifying the financing roles of social security contributions versus budget financing, (iii) reducing early retirement privileges, (iv) eliminating gender inequalities in retirement ages, and (v) increasing the length of service necessary to receive a full pension.

²² Some of the main sources of international assistance include UNICEF, Medecins Sans Frontiers, and the Red Cross in basic health services including immunization. United Nations Population Fund and UNHCR have programs in reproductive health and family planning (UNDP, 1999).

²³ The regular allowance per child is a monthly transfer of about US\$ 2 for families with income of less than about US\$4 per month. Unemployment benefits consist of two months salary with possibly a third month if the person continues to be unemployed within the first two months.

²⁴ The retirement age has been increasing every year by half a year, from 54 to 57 for women and from 59 to 62 for men. At the beginning of 2000, retirement ages stood at 56½ for women and 61½ for men.

84. **Subsidies.** There are large untargeted implicit subsidies to the population from the state gas and electricity companies. The electricity and gas companies have extremely low collection rates from industrial and residential consumers. These subsidies are being paid for by arrears to suppliers and to the government budget, deferred maintenance, and consumption of oil wealth as these companies receive gas and fuel which they do not pay for. Recent World Bank and IMF missions estimated that the arrears to the state oil company, SOCAR, from the electricity and gas companies represented about 6 percent of GDP in 1999. Government foregone revenue in the form of accumulation of tax arrears from SOCAR, Azerenergy, and Azerigas amounted to 7 percent of GDP in 1999, of which 6½ percent was an accumulation of arrears from SOCAR. The amount spent on this implicit subsidy is roughly equivalent to total spending on the health and education sectors, and 1.8 times the spending on social safety nets in 1999. Concomitantly, there are substantial external credits for the electricity and gas sectors which will eventually have to be serviced by the budget. Due to this countrywide non-payments problem, large areas of the country outside the Apsheron Peninsula receive little or no gas and there are continuous electricity shortages throughout the country. People outside of Baku have to resort to more expensive fuels, thus effectively cross-subsidizing populations that are better off.

D. Conclusions

85. Despite strong economic growth, poverty and inequality in Azerbaijan are a major concern. There has been an increase in the unemployment rate, while health and education indicators point to worrying trends with regard to malnourishment, maternal mortality rates, drop-out rates, and widespread use of unofficial user charges. Simultaneously, public spending on health is low, but more importantly the intrasectoral distribution is skewed toward wages and salaries and away from basic health and education. Existing social safety nets are not effective in keeping the unemployed population out of poverty. Finally, the large implicit and untargeted subsidies in the energy sector point to the need for a comprehensive reform program, which is transparent and conducive toward poverty alleviation. The government will soon initiate work on a poverty reduction strategy in consultation with civil society, NGOs and other development partners with the aim of formulating a reform strategy that addresses these issues.

IV. MACROECONOMIC POLICY AND MANAGEMENT OF OIL WEALTH

A. Introduction

86. The importance of the oil sector in Azerbaijan has grown substantially since the collapse of the planned economy at the beginning of the 1990s. Following the signature of a major production sharing agreement (PSA) between the government and foreign investors in 1994, there has been significant foreign interest in exploration and development of new oil fields. By mid-2000, a total of 20 PSAs had been signed. Oil production under the 1994 PSA began in late 1997 and accounted for a 50 percent rise in overall oil extraction over the following two years. Foreign direct investments (FDI) in oil sector have been large, in some

years amounting to more than 20 percent of GDP (Table 14). Direct transfers to the government associated with new fields—in the form of front loaded bonus payments—have increased steadily during this period to nearly 4 percent of GDP in 1999. As previous investment now starts to pay off and the government begins to receive a share of profits, annual average transfers to the government are expected to average about 5 percent of GDP in 2000-2002.

Table 14. Azerbaijan: Selected Oil Sector Indicators

	1996	1997	1998	1999	2000-2002 proj.
Total crude oil production					
(In millions of tons)	9.1	9.1	11.4	13.8	14.9
(In millions of US\$)	1,353	1,276	1,091	1,828	2,342
Export of crude and oil products					
(In millions of US\$)	402	448	434	801	1,259
(In percent of total export of G&S)	43	39	43	63	69
Foreign direct investments in oil sector					
(In millions of US\$)	487	845	832	350	788
(In percent of GDP)	15	21	20	9	17
Oil sector imports					
(In millions of US\$)	592	833	642	514	970
Government bonus and profit oil receipts					
(In millions of US\$)	37	64	75	155	220
(In percent of GDP)	1.2	1.6	1.8	3.9	5.0

Source: Azerbaijan authorities; and Fund staff estimates.

87. The importance of appropriate macroeconomic policies is likely to increase over the coming years as the inflow of foreign exchange from foreign investments and direct income transfers to the government increase further. With the changing market conditions, monetary and fiscal policies will have to adjust to avoid excessive real exchange rate appreciation. In the following, the required policy mix during such an oil boom will be discussed and, in particular, the role of an oil fund as a tool to accomplish both short and long-term fiscal goals will be addressed.

B. Macroeconomic Adjustment During An Oil Boom

88. The macroeconomic policy response to the oil boom in Azerbaijan can usefully be illustrated in a simple model of a small country with two sectors (a traded and a non-traded)

under the assumption of flexible wages and prices. The main conclusions regarding the appropriate policy response are discussed below while more details of the model are explained in the Appendix.

89. The immediate effect of an oil boom is a discrete increase of demand for non-traded goods because of an increase in disposable income and foreign financed investments. In contrast to many other oil-dominated economies, where exploration has largely been completed, the oil boom in Azerbaijan will continue to be dominated by significant exploration and new development, which require very large investments. In these circumstances, over the short- and medium-term, the objective of fiscal and monetary policies should be to cushion the spending effects and to prevent excessive overshooting of the real exchange rate that could hurt other sectors of the economy. However, over time a resource transfer from the non-oil traded sector to the non-traded sector is unavoidable and should not be prevented. The objective of macroeconomic policy, therefore, should be to facilitate a smooth transition of resources between these sectors.²⁵

90. The government's direct tool to influence the impact of the boom is its fiscal policy. By saving a share of its proceeds from the boom in foreign assets, some spending can be directed away from the non-traded sector, thus reducing the required relative price adjustment to maintain equilibrium. The feasibility of higher public saving will depend on how sensitive fiscal revenue is to the boom. In Azerbaijan, as the government receives a share of the profit generated, there is a direct link between government revenue and oil revenue. Since saving originating from oil income is based on a exhaustible resource, fiscal policy also has an important role to make sure that future generations will benefit from these activities. Since oil revenues in Azerbaijan will be substantial, an appropriate way to save this money would be in the form of an oil fund.

91. For a given spending effect of the boom, the role of monetary policy and the expected change in the real exchange rate can be determined. The increased demand for non-traded goods and the rise in income, which increases money demand, will lead to a real appreciation of the exchange rate. In the case of a flexible exchange rate, the real appreciation will occur mainly as a combination of higher prices of non-traded goods and lower domestic prices of traded goods associated with a nominal exchange rate appreciation. This change in relative prices ensures that the necessary resources are moved from the non-oil traded sector to the non-traded sector to eliminate excess demand. In other words, the real appreciation of the exchange rate is a natural (and unavoidable) market reaction that is necessary to satisfy the new demand structure. Moreover, Dutch disease effects will only be apparent (as a *disease*) if the real appreciation overshoots the equilibrium. Most likely, overshooting could arise due to

²⁵ This issue is discussed by Rosenberg C. and Saavalainen T. (1997) "How to Deal with Azerbaijan's Oil Boom? Policy Strategies in a Resource-Rich Transition Economy", IMF WP/98/6.

price-wage rigidities (which mainly occur in certain special cases where the price level falls during the boom). If the real exchange rate is overshooting, easing monetary policy can help prevent the problem.

92. In the case of a fixed exchange rate, the required real exchange rate appreciation is transmitted via higher domestic prices of non-traded goods only. Therefore, during a resource boom, fixed exchange rate regimes are generally more inflationary than flexible regimes. Over time, monetary policy will have to accommodate the boom by being sufficiently expansionary to prevent excess inflow of foreign exchange.

93. Despite annual inflows amounting to 20–30 percent of GDP, fiscal and monetary policies in Azerbaijan have prevented major real exchange rate fluctuations since 1995. By end-1999, the real effective exchange rate was at about the same level as end-1994, and fluctuations have been less than 10 percent around the average level (Figure 3). Monetary policies were adjusted in late 1997—when strong inflows were not fully sterilized—and again following the Russian crisis—when policies were eased and the nominal exchange rate allowed to depreciate—to prevent excessive real exchange rate appreciation.

94. Regarding fiscal policy, the government's overall deficit has been relatively low in recent years (Figure 4). In the second half of the 1990s, oil bonus payments were deposited in a special government account of the central bank, which held the money in external accounts as part of its foreign exchange reserves. Much of the money was eventually used to finance budget deficits, allowing Azerbaijan to avoid substantial accumulation of domestic or external debt. Nonetheless, at the end of 1999 around US\$150 million remained in this account. Thus, the account already fulfilled some of the functions of an oil fund.

C. The Oil Fund in Azerbaijan

95. On December 29, 1999, President Aliyev issued a decree announcing the intention to establish the State Oil Fund of Azerbaijan. It instructed the government to prepare detailed proposals regarding the operation, objectives, and management of the fund, and indicated that future receipts of oil bonus payments, profit oil, rental payments from foreign oil companies, and revenues generated from the oil fund's operation would be deposited in the fund. Pending establishment of the fund, such receipts would be saved in a designated government account at the Azerbaijan National Bank.

96. The government is actively working on the detailed proposals for the operation of the fund. Experience elsewhere clearly demonstrates that simply setting up a fund is no guarantee that the resources will not be misused. Clear objectives and rules, and transparent procedures,

are still necessary. Experience and practice in other resource rich countries that have established such funds would suggest that its broad objectives could be the following:²⁶

- to establish a simple and transparent mechanism for managing the flow of oil revenue;
- to provide a buffer for the government to insulate budget operations from large swings in oil prices and uncertainties regarding future oil production;
- to save part of the oil revenue for future generations;
- to prevent wasteful use of public resources that could arise, due to lack of public expenditure management capacity, from attempts to spend large amounts quickly; and
- to limit the adverse impact on the non-oil economy from activities in the oil sector by investing a substantial part of the oil revenues in foreign financial assets, so limiting real exchange rate appreciation, as discussed above.

97. Having clearly defined the income sources of the fund, there would need to be clear guidelines or rules regarding the use of the resources. Consistent with the above objectives, there is a strong case for (i) saving the revenues in the form of foreign financial assets, and (ii) transferring to the general government budget any resources that are to be spent. The latter is important to ensure that expenditures from the fund are subject to the same, transparent approval procedures as other budgetary expenditures, and that spending decisions are closely integrated with the annual budgetary process to ensure coherent fiscal policy.

98. The fund could be managed by a Board, which would oversee the investment of the assets. The Board might, however, wish to engage the Azerbaijan National Bank or external experts to conduct the day to day management of the portfolio. Initially, there is a strong case for limiting investments to deposits in major currencies and AAA securities, in line with the policy for the investment of the international reserves. The activities of the fund should be subject to regular audits which should be published.

D. Determination of Current Public Expenditures of Oil Revenues

99. It will be important for the government to establish clear guidelines or rules that would determine how much should be transferred from the oil fund to the budget each year and, within total spending from the fund, how much should be consumed and how much invested in fixed capital, such as infrastructure.

100. Determining a sustainable level of consumption (financed from oil revenue) would provide a good basis for determining the transfer from the oil fund to the budget to finance

²⁶ See also SM/98/139 for a discussion of practices in other resource-rich countries.

current expenditures. This would allow public consumption to remain unchanged indefinitely, even after the oil resources are exhausted, and future generations would therefore benefit equally from the oil wealth. The sustainable level of transfers to be used for current consumption (in real terms) equals the real return from oil wealth, since this implies that the initial stock of oil wealth would be maintained in real terms. To maintain the stock of real oil wealth per capita, the real return less population growth should be used in the calculation instead. The stock of oil wealth should include both oil reserves and financial assets accumulated in the oil fund.

101. The use of oil revenue since 1995 is summarized in Table 15. Because of the fungibility of money, the calculation in the table should only be viewed as a very rough measure of consumption financed from oil revenue. As budgeted government capital expenditures have been very low, it has been (conservatively) assumed that all tax revenues from SOCAR and the use of oil bonuses have financed current expenditures. According to this, current expenditures financed from oil revenues averaged 7 percent of GDP during 1995-99.

Table 15. Use of Oil Revenue for Public Sector Consumption

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999
Total revenue from oil sector	239	213	331	232	331
SOCAR tax payments	117	176	267	157	176
Bonus payments	122	37	64	75	155
Use of oil revenue	209	259	324	194	228
SOCAR tax payments	117	176	267	157	176
Use of oil bonus payments	92	83	57	37	52
Use of oil revenue (percent of GDP)	8.7	8.2	8.4	4.7	5.7

Sources: Ministry of Finance; and Fund staff estimates.

102. A calculation of sustainable government consumption levels requires assumptions on: (a) future oil production levels over a very long time horizon; (b) the real discount rate; (c) the annual population growth rate; (d) oil prices; and (e) government revenues from the oil sector, including bonus payments, profit oil, and SOCAR tax payments. There are huge uncertainties in many of these areas, especially future oil production, oil prices, and the level of SOCAR tax payments. Future production reflects uncertainties regarding exploration, transport routes, and identification of markets for gas. SOCAR tax payments have been well below their potential level in the past, reflecting the problem of non-payment in the domestic

energy sector (see Chapter III, paragraph 84).²⁷ An assumption is therefore needed regarding the extent to which collection rates in the energy sector might improve over time. Ministry of finance's estimates,²⁸ based on conservative assumptions (including that there would be no improvement in energy sector collection rates) imply that annual consumption in line with recent levels is broadly consistent with the sustainable rate of consumption. This suggests that there is little room for any significant increase in consumption of oil revenues through the budget from the current windfall.

103. Having established an appropriate level of consumption from oil wealth, the decision regarding how much to save in foreign financial assets and how much to invest in fixed capital depends on both macroeconomic considerations and on the quality of governance. Macroeconomic factors will determine the extent to which it is necessary to accumulate foreign assets, to avoid excessive real appreciation and overheating. Having taken account of these factors, in principle remaining resources could be used to finance government capital expenditures, provided these investments carried a real rate of return equal to or higher than the real discount rate. There is little doubt that there is a huge need for public infrastructure social investments to help alleviate poverty. However, the calculations of rates of return of investment projects can be extremely difficult and politically influenced. Furthermore, given the limited progress that has been made so far in strengthening governance in Azerbaijan, there is a serious risk that an attempt to invest large amounts quickly would lead to waste through poor choice of projects and corruption. An important first step would therefore be to strengthen the capacity within government to conduct investment appraisal and evaluation. Until implementation capacity is improved, annual limits on total public sector investments, including those financed from the oil fund, would be prudent.

E. Concluding Remarks

104. The above discussion suggests the following conclusions:

- The role of fiscal and monetary policies in response to an oil boom should be to facilitate a smooth transfer of resources from the non-oil traded sector to the non-traded sector, while seeking to prevent excessive real exchange rate appreciation.
- This requires a willingness to adjust monetary policy in the face of strong inflows, and argues for a flexible rather than fixed exchange rate regime.

²⁷ The true consumption of energy resources in the past has been much higher than shown in Table 15, reflecting the indirect and poorly targeted subsidies to energy consumers who do not pay their bills.

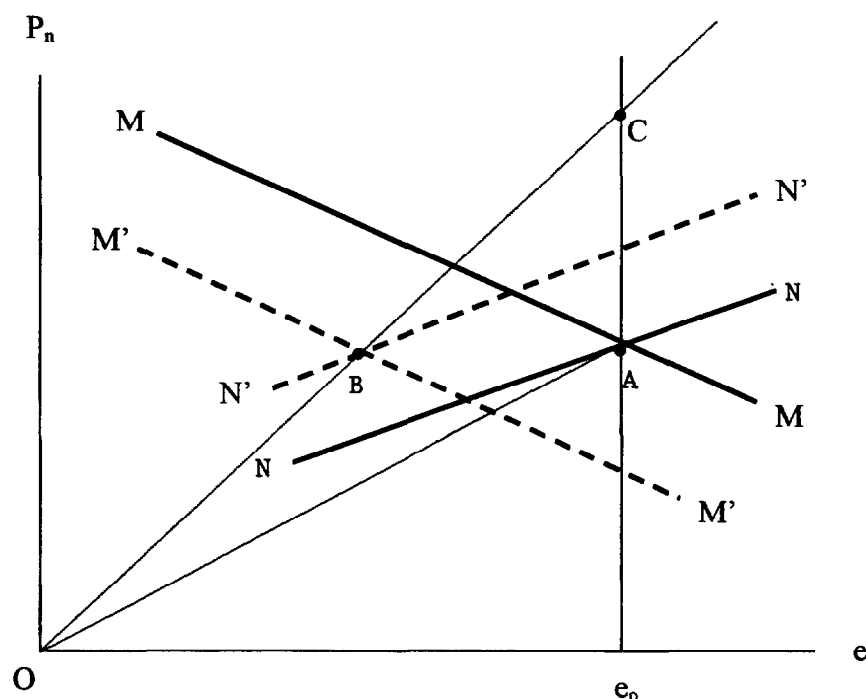
²⁸ Prepared with the assistance of UK DFID-financed advisors.

- Fiscal policy will be an important tool, directed at saving some of the proceeds of the boom, to limit the need for sharp adjustment and to pass on the benefits of the boom to future generations.
- The proposed oil fund should provide a valuable mechanism for achieving these objectives. It should be transparently managed with clear guidelines on the use of resources, and be closely linked with the budgetary process.
- There is little scope for increasing consumption of oil resources, if the value of oil wealth is to be maintained for future generations.
- Decisions on how much to save in the form of foreign assets and how much to invest in infrastructure or social capital should reflect both macroeconomic and governance considerations. Pending improvements in implementation capacity and governance, annual limits on public investments would be prudent.

Appendix: Macroeconomic Policy Response During An Oil Boom

The policy response to an oil boom is illustrated in Figure 10 below. The model represents a small country with two goods, a traded (t) and a non-traded (n), and flexible wages and prices.²⁹

Figure 10. Effects of An Oil Boom Under Flexible and Fixed Exchange Rates



The **NN line** represents equilibrium in production of non-traded goods:

$$x_n(p_n/e) = d_n(e/p_n, y, m), \quad (\text{all derivatives are positive})$$

where

x_n : output of non-traded goods

d_n : demand of non-traded goods

²⁹ For more details, see the first chapter of J. Peter Neary and Sweder Van Wijnbergen: "Natural Resources and the Macroeconomy", 1986, The MIT Press, Cambridge, Massachusetts.

- p_n : domestic price of non-traded goods in terms of world market price of traded goods (normalized to one)
 e : domestic price of traded goods in terms of world market price of traded goods (i.e. e is the nominal exchange rate defined as local currency in terms of foreign).
 y : real income
 m : real money supply M/P where $P=P(p_n, e)$
 e/p_n : real exchange rate

For a given increase in p_n , the required increase in e (depreciation) to maintain equilibrium must be proportionally higher since the real money balance (m) is lower.

The **MM line** represents equilibrium on the money market:

$$m = m(y), m' > 0$$

where $m \equiv M/P(p_n, e)$. Higher price level of non-traded goods requires lower domestic price level of traded goods to maintain equilibrium.

Depending on the exchange rate regime, the effects of a boom can be summarized as follows:

- **Flexible exchange rate.** Starting in equilibrium A, the boom raises real income and demand for non-traded goods. This shifts the NN line to $N'N'$. The size of excess demand for non-traded goods can be influenced by **fiscal policy**; for example, by saving some of the income in an oil fund, the shift in the NN line will be smaller. The rise in real income also raises demand for money, which shifts the MM line down to $M'M'$. The new equilibrium after the boom is characterized by a more appreciated real and nominal exchange rate. In this case, a **real appreciation of the exchange rate** is a natural reaction of the boom. Resources have to move towards the non-traded goods sector to satisfy the rise in demand. Depending on the specific formulation of the functions above, the price on non-traded goods could be both higher or lower compared to the initial point (increase in demand from boom and lower real money balances work in opposite directions). If **nominal prices are sticky downwards**, overshooting of the real appreciation rate is possible which causes so-called **Dutch disease** problems for other trading sectors. However, more expansionary monetary policy can ensure that changes in nominal prices stay positive, and thereby prevent Dutch disease effects. In the chart, a more expansionary monetary policy will move the $M'M'$ line upwards.
- **Fixed exchange rate.** The higher demand from the boom will raise the price of non-traded goods along the vertical line AC (to where it intersects $N'N'$). However, with constant nominal money supply, the higher price and real income level create excess demand for real money or a balance of payments surplus, which can only be eliminated if money supply increases. This process will stop when the price of non-traded goods

reach point C, where the real exchange rate is equal to the flexible exchange rate case (as measured by the slope of the OC ray).

The main conclusions from the chart are:

- **Real exchange rate appreciation** is inevitable during a boom and is required to maintain market equilibrium.
- Appropriate **monetary policy** can help prevent Dutch disease problems.
- **Fiscal policy** geared to save part of the income from the boom can effectively limit the “size” of the boom.
- **Fixed exchange rate regimes are more inflationary** than flexible exchange rate regimes during a boom since, in the case of a fixed rate, the real exchange rate appreciation only takes place via higher domestic prices.

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Table 16. Azerbaijan: Gross Domestic Product by Sector of Origin, 1993-99

	1993	1994	1995	1996	1997	1998	1999
(In billions of manats)							
Gross domestic product	157.1	1,873.4	10,669.0	13,663.2	15,791.4	16,177.0	16,488.5
Industry	39.1	382.2	2,913.0	3,533.0	3,999.1	4,068.0	3,871.4
Agriculture	42.2	603.9	2,680.0	3,376.2	3,156.0	3,188.6	3,575.7
Construction	11.4	136.6	397.0	1,271.9	1,812.4	2,303.7	1,551.2
Transportation	10.4	207.1	1,748.0	1,224.8	1,313.1	1,663.9	1,888.5
Other	54.0	543.6	2,931.0	4,257.3	5,510.8	4,952.8	5,601.7
(In percent of GDP)							
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Industry	24.9	20.4	27.3	25.9	25.3	25.1	23.5
Agriculture	26.9	32.2	25.1	24.7	20.0	19.7	21.7
Construction	7.3	7.3	3.7	9.3	11.5	14.2	9.4
Transportation	6.6	11.1	16.4	9.0	8.3	10.3	11.5
Other	34.4	29.0	27.5	31.2	34.9	30.6	34.0
(Real percentage changes)							
Gross domestic product	-23.1	-19.7	-11.8	1.3	5.8	10.0	7.4
Industry	-19.7	-24.7	-21.4	-6.7	0.3	2.7	3.6
Agriculture	-15.4	-13.0	-6.8	3.0	-6.9	3.9	7.1
Construction	...	-36.0	9.0	11.0	66.1	52.1	0.8
Transportation	...	-12.4	-35.5	-22.0	-6.9	12.2	7.3
Other	...	-19.6	-5.3	1.8	17.3	4.4	13.8
Oil sector	-13.8	-6.7	-6.0	-1.6	-3.6	23.1	20.0
Non-oil sectors	...	-22.0	-14.3	1.8	7.8	7.5	4.7

Sources: Azerbaijan State Committee on Statistics; and Fund staff estimates.

Table 17. Azerbaijan: Gross Domestic Product by Final Use, 1993-99

	1993	1994	1995	1996	1997	1998	1999
(In billions of manats)							
Gross domestic product	157.1	1,873.4	10,669.0	13,663.2	15,791.4	16,177.0	16,488.5
Final consumption	152.0	1,872.6	10,364.0	13,190.6	14,456.4	15,383.6	14,770.7
Households	104.7	1,432.1	8,999.0	11,763.8	12,524.2	13,410.0	12,750.9
Government	47.3	440.5	1,365.0	1,426.8	1,932.2	1,973.6	2,019.8
Gross fixed capital formation	32.9	492.0	1,669.0	4,024.0	5,121.4	6,268.1	4,341.9
Net exports	-29.1	-286.1	-2,232.0	-3,551.4	-3,786.4	-5,474.6	-2,624.1
Exports of goods and nonfactor services	90.2	1,196.7	3,466.0	4,033.0	4,579.5	3,907.7	5,285.4
Imports of goods and nonfactor services	-119.3	-1,482.8	-5,698.0	-7,584.4	-8,365.9	-9,382.3	-7,909.5
(In percent of GDP)							
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Final consumption	96.8	100.0	97.1	96.5	91.5	95.1	89.6
Households	66.6	76.4	84.3	86.1	79.3	82.9	77.3
Government	30.1	23.5	12.8	10.4	12.2	12.2	12.3
Gross fixed capital formation	20.9	26.3	15.6	29.5	32.4	38.7	26.3
Net exports	-18.5	-15.3	-20.9	-26.0	-24.0	-33.8	-15.9
Exports of goods and nonfactor services	57.4	63.9	32.5	29.5	29.0	24.2	32.1
Imports of goods and nonfactor services	-75.9	-79.2	-53.4	-55.5	-53.0	-58.0	-48.0

Sources: Azerbaijan State Committee on Statistics; and Fund staff estimates.

Table 18. Azerbaijan: Crude Oil and Gas Production, 1981-99

	Offshore crude oil of which AIOC		Onshore crude oil	Total crude oil	Total gas
	(In millions of tons)				(In billions of m3)
1981	9.4	...	4.7	14.1	
1982	8.2	...	4.7	12.9	
1983	8.4	...	4.3	12.7	
1984	8.4	...	4.1	12.5	
1985	9.2	...	3.9	13.1	
1986	9.4	...	3.9	13.3	
1987	10.1	...	3.7	13.8	
1988	10.3	...	3.4	13.7	
1989	10.1	...	3.0	13.2	
1990	9.9	...	2.6	12.5	
1991	9.5	...	2.2	11.7	8.6
1992	9.2	...	2.0	11.1	7.9
1993	8.3	...	2.0	10.3	6.8
1994	7.8	...	1.8	9.6	6.4
1995	7.5	...	1.6	9.2	6.6
1996	7.5	...	1.6	9.1	6.3
1997	7.5	0.1	1.6	9.1	6.0
1998	9.8	2.4	1.6	11.4	5.6
1999	12.3	4.8	1.5	13.8	6.0

Sources: Azerbaijan State Committee on Statistics, and State Oil Company of the Azerbaijan Republic.

Table 19. Azerbaijan: Production Indicators, 1994-99

	1994	1995	1996	1997	1998	1999
(Index of real output; 1992 = 100)						
Total industry	60.5	47.5	44.3	44.4	45.6	47.2
Energy	82.8	76.1	74.4	73.2	78.3	82.4
Electricity	83.5	78.4	75.6	70.6	74.8	75.9
Oil and gas	80.4	75.6	74.4	74.5	80.1	85.7
Metallurgy	16.2	8.6	2.1	9.7	4.4	7.1
Machine building	46.1	25.0	20.5	20.4	14.2	6.3
Chemical and petro-chemical	43.8	37.2	46.5	33.4	29.6	32.2
Construction materials	45.9	17.0	16.3	15.6	12.1	9.5
Light industry	61.2	54.0	32.1	26.8	15.6	9.3
Textiles	58.1	53.4	31.8	27.4	15.3	10.0
Agroprocessing	47.0	25.8	16.8	15.7	15.3	15.9
Agriculture	73.6	68.6	70.7	65.8	68.4	73.2
Grains	77.7	68.9	76.2	84.3	70.8	82.1
Cotton	84.4	81.5	81.6	37.1	33.5	28.8
(Real percentage changes)						
Total industry	-24.7	-21.4	-6.7	0.3	2.7	3.6
Energy	-7.0	-8.0	-2.3	-1.6	7.0	5.2
Electricity	-11.5	-6.1	-3.6	-6.6	5.9	1.5
Oil and gas	-6.7	-6.0	-1.6	0.1	7.5	7.0
Metallurgy	-73.6	-46.9	-75.6	361.9	-54.6	61.4
Machine building	-46.1	-45.8	-18.0	-0.5	-30.4	-55.6
Chemical and petro-chemical	-39.4	-15.1	25.0	-28.2	-11.4	8.8
Construction materials	-30.2	-63.0	-4.1	-4.3	-22.4	-21.5
Light industry	-28.3	-11.8	-40.6	-16.5	-41.8	-40.4
Textiles	-34.0	-8.1	-40.4	-13.8	-44.2	-34.6
Agroprocessing	-35.4	-45.1	-34.9	-6.5	-2.5	3.9
Agriculture	-13.0	-6.8	3.0	-6.9	3.9	7.1
Grains	-9.5	-11.3	10.5	10.7	-16.0	16.0
Cotton	-0.3	-3.4	0.1	-54.6	-9.6	-14.0

Source: Azerbaijan State Committee on Statistics.

Table 20. Azerbaijan: Average Monthly Wages by Sector, 1992-99

	1992	1993	1994	1995	1996	1997	1998	1999 1/
(Annual average, in manats)								
National economy	270	2,185	15,325	62,467	89,370	141,643	168,419	184,368
Industry	388	3,109	21,009	95,557	146,175	231,304	277,050	365,575
Agriculture	147	1,120	8,311	33,549	37,774	49,575	43,957	65,122
Transportation	285	2,623	18,636	98,241	150,452	226,771	291,028	249,870
Communication	295	2,270	19,599	83,802	119,363	206,799	263,576	249,870
Construction	368	3,278	22,366	98,873	167,185	299,859	441,595	428,473
Trade	163	1,164	7,648	37,519	50,602	67,422	75,789	117,943
Hotel industry	163	1,640	11,206	49,206	75,135	113,598	120,925	343,351
Health and social services	241	1,294	9,983	26,304	46,884	67,847	70,062	52,409
Education	257	2,013	14,038	46,412	63,047	119,830	132,209	124,545
Culture	203	1,502	10,481	33,443	41,186	68,555	76,016	...
Banking and insurance	676	6,431	33,317	169,064	169,324	238,811	332,796	590,961
Government administration	345	3,478	19,134	57,515	69,281	109,430	165,051	148,474
(Annual percentage changes)								
National economy	750.0	708.3	601.5	307.6	43.1	58.5	18.9	9.5
Industry	870.8	700.7	575.7	354.8	53.0	58.2	19.8	32.0
Agriculture	463.2	662.2	641.8	303.7	12.6	31.2	-11.3	48.1
Transportation	727.2	819.2	610.4	427.2	53.1	50.7	28.3	-14.1
Communication	851.0	670.1	763.3	327.6	42.4	73.3	27.5	-5.2
Construction	718.5	791.9	582.4	342.1	69.1	79.4	47.3	-3.0
Trade	610.9	614.9	557.1	390.6	34.9	33.2	12.4	55.6
Hotel industry	561.4	908.1	583.3	339.1	52.7	51.2	6.4	183.9
Health and social services	959.9	437.8	671.5	163.5	78.2	44.7	3.3	-25.2
Education	904.3	682.8	597.5	230.6	35.8	90.1	10.3	-5.8
Culture	591.1	641.7	597.8	219.1	23.2	66.5	10.9	...
Banking and insurance	1000.5	851.8	418.1	407.4	0.2	41.0	39.4	77.6
Government administration	823.0	907.6	450.1	200.6	20.5	58.0	50.8	-10.0
Memorandum item:								
Average annual wage (U.S. dollars)	...	...	10.7	14.1	20.8	35.6	43.5	44.7
Agriculture/Banking and insurance (ratio)	0.22	0.17	0.25	0.20	0.22	0.21	0.13	0.11

Sources: Azerbaijan State Committee on Statistics; and Fund staff estimates.

1/ In 1999, Goskomstat introduced a new economic classification. As a result, sectoral changes between 1998 and 1999 should be treated with caution.

Table 21. Azerbaijan: Labor Market Indicators, 1994-99

	1994	1995	1996	1997	1998	1999 1/
(In thousands of persons)						
Population	7,644	7,726	7,800	7,877	7,949	8,016
Working age population	4,688	4,714	4,661	4,762	4,838	4,878
Outside labor force	635	622	468	530	590	578
Labor force	4,053	4,092	4,193	4,232	4,248	4,300
Total employment	3,631	3,613	3,687	3,694	3,702	3,702
Industry	374	352	283	242	251	255
Government	653	648	659	651	650	650
Agriculture	1,144	1,113	1,172	1,071	1,139	1,267
Other	1,461	1,500	1,572	1,730	1,661	1,530
Unemployment	421	479	506	538	546	598
Unemployment rate (in percent)	10	12	12	13	13	14
Registered unemployed	24	28	32	38	42	45
Benefit recipients	4	3	3	3	3	3
Pensioners	1,283	1,227	1,245	1,206	1,177	1,202
(Percentage changes)						
Population	1.2	1.1	1.0	1.0	0.9	0.8
Working age population	1.7	0.6	-1.1	2.2	1.6	0.8
Labor force	-1.4	1.0	2.5	0.9	0.4	1.2
Total employment	-2.2	-0.5	2.0	0.2	0.2	0.0

Sources: Azerbaijan State Committee on Statistics; and Fund staff estimates.

1/ In 1999, Goskomstat introduced a new economic classification. As a result, sectoral changes between 1998 and 1999 should be treated with caution.

Table 22. Azerbaijan: Consumer Price Index, 1997-2000

	Index 1994=100	Percentage changes				
		In the month	Quarterly		Annual	
			In the quarter	Over the previous quarter	In the last twelve months	Over the previous twelve months
1997 January	638.9	1.7			6.1	16.7
February	643.0	0.6			3.6	14.1
March	643.6	0.1	2.5	3.5	4.3	12.0
April	656.7	2.0			5.9	10.5
May	643.3	-2.1			4.8	9.4
June	635.4	-1.2	-1.3	0.5	6.3	8.6
July	621.2	-2.2			4.0	7.7
August	616.1	-0.8			1.1	6.3
September	621.7	0.9	-2.2	-3.9	1.2	5.3
October	630.2	1.4			2.7	4.6
November	631.7	0.2			2.1	4.0
December	630.4	-0.2	1.4	1.8	0.4	3.5
1998 January	634.8	0.7			-0.6	3.0
February	637.9	0.5			-0.8	2.6
March	645.5	1.2	2.4	1.4	0.3	2.2
April	647.8	0.4			-1.4	1.6
May	640.2	-1.2			-0.5	1.2
June	634.1	-1.0	-1.8	0.2	-0.2	0.7
July	627.1	-1.1			0.9	0.4
August	629.7	0.4			2.2	0.5
September	631.8	0.3	-0.4	-1.7	1.6	0.5
October	622.9	-1.4			-1.2	0.2
November	619.3	-0.6			-2.0	-0.1
December	582.6	-5.9	-7.8	-3.4	-7.6	-0.8
1999 January	579.7	-0.5			-8.7	-1.4
February	577.6	-0.4			-9.4	-2.2
March	577.6	0.0	-0.8	-4.9	-10.5	-3.1
April	578.7	0.2			-10.7	-3.9
May	577.7	-0.2			-9.8	-4.7
June	573.0	-0.8	-0.8	-0.3	-9.6	-5.5
July	568.3	-0.8			-9.4	-6.3
August	568.6	0.0			-9.7	-7.3
September	574.7	1.1	0.3	-1.0	-9.0	-8.1
October	576.3	0.3			-7.5	-8.7
November	577.5	0.2			-6.8	-9.1
December	579.8	0.4	0.9	1.3	-0.5	-8.5
2000 January	584.1	0.7			0.7	-7.8
February	590.1	1.0			2.2	-6.9
March	590.4	0.1	1.8	1.8	2.2	-5.9
April	590.5	0.0			2.0	-4.8
May	587.7	-0.5			1.7	-3.8

Source: Azerbaijan State Committee on Statistics.

Table 23. Azerbaijan: Breakdown of Consumer Price Index, 1997–2000

	Total		Food items		Non-food items		Non-food goods		Services	
	Percentage change	Index Dec 94=100	Percentage change	Index Dec 94=100	Percentage change	Index Dec 94=100	Percentage change	Index Dec 94=100	Percentage change	Index Dec 94=100
1997 January	1.7	200.4	2.3	195.4	0.0	222.8	-0.1	184.2	0.0	344.2
February	0.6	201.6	0.8	196.9	0.0	222.8	0.0	184.2	0.0	344.2
March	0.1	201.8	0.1	197.1	0.1	223.0	0.0	184.2	0.3	345.2
April	2.0	205.8	2.3	201.7	1.2	225.7	-0.3	183.7	4.8	361.8
May	-2.1	201.5	-2.9	195.8	1.2	228.4	1.8	187.0	0.0	361.8
June	-1.2	199.1	-1.8	192.3	0.9	230.4	-0.6	185.9	4.1	376.6
July	-2.2	194.7	-2.7	187.1	-0.5	229.3	-0.7	184.6	0.0	376.6
August	-0.8	193.1	-1.1	185.0	0.0	229.3	0.0	184.6	0.0	376.6
September	0.9	194.9	1.2	187.2	0.0	229.3	0.0	184.6	0.0	376.6
October	1.4	197.6	1.3	189.7	1.5	232.7	0.0	184.6	4.7	394.3
November	0.3	198.0	0.3	190.3	0.0	232.7	0.0	184.6	0.0	394.3
December	-0.2	197.6	-0.2	189.9	0.0	232.7	0.0	184.6	0.0	394.3
1998 January	0.7	199.2	0.9	191.2	0.0	232.9	-0.1	184.9	0.0	394.2
February	0.5	200.2	0.6	192.4	-0.1	232.7	-0.2	184.6	0.0	394.2
March	1.2	202.6	1.5	195.3	-0.1	232.4	-0.2	184.3	0.0	394.2
April	0.4	203.3	0.5	196.2	0.0	232.3	-0.1	184.1	0.1	394.5
May	-1.2	200.9	-1.4	193.4	-0.1	232.1	-0.1	183.8	0.0	394.4
June	-1.0	199.0	-1.2	191.1	-0.1	231.9	-0.1	183.6	0.0	394.4
July	-1.1	196.8	-1.4	188.5	0.0	231.8	-0.1	183.5	0.0	394.3
August	0.4	197.6	0.5	189.5	0.0	231.8	0.0	183.4	0.0	394.3
September	0.3	198.3	0.4	190.3	0.0	231.7	0.0	183.4	0.0	394.3
October	-1.4	195.5	-1.6	187.3	-0.7	230.1	-0.8	181.9	-0.6	392.1
November	-0.6	194.4	-0.7	186.0	-0.1	229.8	-0.2	181.5	0.0	392.0
December	-5.9	182.8	-7.3	172.5	-0.7	228.2	-1.1	179.5	0.0	392.0
1999 January	-0.5	181.9	-0.6	171.5	-0.1	228.1	-0.1	179.3	0.0	392.0
February	-0.4	181.3	-0.4	170.7	-0.3	227.5	-0.4	178.6	0.0	391.9
March	0.0	181.3	-0.5	169.8	0.9	229.6	-0.1	178.4	2.4	401.2
April	0.2	181.6	0.3	170.4	-0.1	229.3	-0.2	178.1	0.0	401.2
May	-0.2	181.3	-0.3	169.9	0.0	229.3	0.0	178.1	0.0	401.2
June	-0.8	179.8	-1.3	167.7	0.0	229.4	0.0	178.1	0.0	401.2
July	-0.8	178.3	-1.3	165.5	0.0	229.4	0.0	178.2	0.0	401.2
August	0.0	178.4	0.1	165.6	0.0	229.4	0.0	178.2	0.0	401.2
September	1.1	180.3	1.7	168.5	0.0	229.3	0.0	178.1	0.0	401.1
October	0.3	180.8	-0.4	167.9	1.4	232.5	0.7	179.4	2.2	410.0
November	0.2	181.2	0.0	167.9	0.6	233.9	0.0	179.4	1.5	416.0
December	0.4	181.9	0.7	169.0	0.0	233.8	0.0	179.4	0.0	416.0
2000 January	0.7	183.3	0.4	169.7	1.2	236.6	2.0	182.9	0.2	416.7
February	1.0	185.2	1.7	172.7	-0.2	236.3	0.1	183.0	-0.5	414.6
March	0.1	185.3	1.1	174.7	-1.8	232.0	-0.5	182.1	-3.6	399.7
April	0.0	185.3	0.2	175.0	-0.3	231.4	-0.2	181.7	-0.4	397.9
May	-0.5	184.4	-0.7	173.8	-0.1	231.1	-0.1	181.4	-0.1	397.6

Source: Azerbaijan State Committee on Statistics.

Table 24. Azerbaijan, Consolidated Operations of the General Government, 1995-99

	1995		1996		1997		1998		1999	
	Billions of Manat	Percent of GDP	Billions of Manat	Percent of GDP	Billions of Manat	Percent of GDP	Billions of Manat	Percent of GDP	Billions of Manat	Percent of GDP
Total revenues	1,873	17.6	2,401	17.6	3,023	19.1	2,755	17.0	3,206	19.4
Individual income tax	117	1.1	213	1.6	331	2.1	408	2.5	448	2.7
Enterprise profits tax	409	3.8	586	4.3	444	2.8	327	2.0	368	2.2
Social security contributions	250	2.3	310	2.3	388	2.5	405	2.5	422	2.6
Value-added tax	176	1.7	468	3.4	654	4.1	719	4.4	791	4.8
Excise taxes	88	0.8	206	1.5	222	1.4	95	0.6	114	0.7
Land tax	4	0.0	5	0.0	22	0.1	25	0.2	42	0.3
Property tax	0	0.0	1	0.0	28	0.2	23	0.1	49	0.3
Royalties	0	0.0	42	0.3	342	2.2	171	1.1	180	1.1
Customs revenue	69	0.6	112	0.8	234	1.5	293	1.8	318	1.9
Other revenues	760	7.1	459	3.4	359	2.3	289	1.8	475	2.9
Of which:										
Employment Fund revenue	6	0.1	7	0.1	14	0.1	15	0.1	20	0.1
Road Fund revenue	0	0.0	30	0.2	46	0.3	47	0.3	100	0.6
Disabled Persons' Fund revenue	0	0.0	0	0.0	0	0.0	17	0.1	16	0.1
State duties	12	0.0	38	0.0	33	0.2	51	0.3	73	0.4
Azerbaijan National Bank profits	0	0.0	0	0.0	0	0.0	5	0.0	51	0.3
Grants	0	0.0	0	0.0	0	0.0	13	0.1	61	0.4
Strategic Export tax	188	1.8	124	0.9	68	0.4	0	0.0	0	0.0
Foreign exchange revenue	317	3.0	0	0.0	0	0.0	0	0.0	0	0.0
All other revenue	236	2.3	261	2.2	199	1.3	142	0.9	154	0.9
Total expenditure (incl. foreign financed projects)	2,396	22.5	2,780	20.3	3,280	20.8	3,430	21.2	4,105	24.9
Total expenditure (excl. foreign financed projects)	1,991	18.7	2,697	19.7	3,188	20.2	3,300	20.4	3,653	22.2
Wages and salaries	390	3.7	483	3.5	701	4.4	813	5.0	959	5.8
Purchases of goods and services	732	6.9	944	6.9	1,161	7.4	943	5.8	1,036	6.3
Interest payments	11	0.1	44	0.3	19	0.1	17	0.1	24	0.1
Transfers to households	539	5.1	872	6.4	984	6.2	1,096	6.8	1,335	8.1
Of which: Pensions	195	1.8	366	2.7	421	2.7	528	3.3	695	4.2
Subsidies	233	2.2	285	2.1	106	0.7	20	0.1	19	0.1
Other current expenditures	8	0.1	0	0.0	17	0.1	12	0.1	27	0.2
Capital investment	79	0.7	68	0.5	201	1.3	185	1.1	261	1.6
Other	0	0.0	1	0.0	0	0.0	214	1.3	-8	0.0
Balance excluding foreign financed project spending	-119	-1.1	-296	-2.2	-165	-1.0	-545	-3.4	-447	-2.7
Foreign Financed Project Spending	404	3.8	83	0.6	92	0.6	130	0.8	452	2.7
Government project spending	0	0.0	0	0.0	0	0.0	0	0.0	45	0.3
Net lending	404	3.8	83	0.6	92	0.6	130	0.8	406	2.5
On lending	404	3.8	83	0.6	92	0.6	138	0.9	416	2.5
Repayments	0	0.0	0	0.0	0	0.0	7	0.0	9	0.1
Overall balance	-523	-4.9	-379	-2.8	-257	-1.6	-675	-4.2	-895	-5.4
Available financing	523	4.9	379	2.8	257	1.6	675	4.2	895	5.4
Domestic	30	0.3	-32	-0.2	-61	-0.4	233	1.4	-331	-2.0
External	493	4.6	411	3.0	318	2.0	443	2.7	1,226	7.4
Memorandum items:										
Nominal GDP	10,669		13,663		15,791		16,177		16,489	

Sources: Ministry of Finance, State Tax Inspectorate, Azerbaijan National Bank; and Fund staff projections.

Table 25. Azerbaijan: Social Protection Fund, 1995-99

	1995	1996	1997	1998	1999
(In billions of manat)					
Total revenues	533	787	842	947	1,139
Total payroll tax	317	387	563	607	670
Of which: paid by nonbudgetary agencies	250	310	388	202	173
Transfer from State Budget	174	299	279	340	462
EU Grant	29	78	0	0	0
Others	13	23	0	0	7
Total expenditures	533	795	844	947	1,139
Pensions	195	366	422	528	695
Old age pensioners	159	290	348	473	638
Working pensioners	36	76	74	55	57
Child allowances	55	39	17	9	8
Maternity leave	7	9	6	9	9
Sanatorium vouchers	11	17	15	15	15
Sick leave	11	18	19	21	19
Funeral allowances	0	2	1	6	10
Compensation for elimination of communal services	...	...	25	50	38
Other compensations and allowances	241	308	321	290	319
Children under 16	138	169	167	163	169
Pensioners	99	131	141	117	136
War veterans	4	8	13	10	14
Others	13	36	18	19	26
Balance	0	-8	-2	0	0
(In percent of GDP)					
Total revenues	5.0	5.8	5.3	5.9	6.9
Total payroll tax	3.0	2.8	3.6	3.7	4.1
Of which: paid by nonbudgetary agencies	2.3	2.3	2.5	1.3	1.0
Transfer from State Budget	1.6	2.2	1.8	2.1	2.8
EU Grant	0.3	0.6	0.0	0.0	0.0
Others	0.1	0.2	0.0	0.0	0.0
Total expenditures	5.0	5.8	5.3	5.9	6.9
Pensions	1.8	2.7	2.7	3.3	4.2
Old age pensioners	1.5	2.1	2.2	2.9	3.9
Working pensioners	0.3	0.6	0.5	0.3	0.3
Child allowances	0.5	0.3	0.1	0.1	0.1
Maternity leave	0.1	0.1	0.0	0.1	0.1
Sanatorium vouchers	0.1	0.1	0.1	0.1	0.1
Sick leave	0.1	0.1	0.1	0.1	0.1
Funeral allowances	0.0	0.0	0.0	0.0	0.1
Compensation for elimination of communal services	...	...	0.2	0.3	0.2
Other compensations and allowances	2.3	2.3	2.0	1.8	1.9
Children under 16	1.3	1.2	1.1	1.0	1.0
Pensioners	0.9	1.0	0.9	0.7	0.8
War veterans	0.0	0.1	0.1	0.1	0.1
Others	0.1	0.3	0.1	0.1	0.2
Balance	0.0	-0.1	0.0	0.0	0.0
Memorandum item:					
Nominal GDP (billions of manat)	10,669	13,663	15,791	16,177	16,489
Number of pensioners (thousands)	1,227	1,245	1,206	1,177	1,202

Sources: Social Protection Fund; and Fund staff estimates.

Table 26. Azerbaijan: Educational Expenditures by Economic Classification, 1997-99

	1997			1998			1999		
	In billions of Manat	Percentage of Education Spending	Percentage Of Total Spending	In billions of Manat	Percentage of Education Spending	Percentage of Total Spending	In billions of Manat	Percentage of Education Spending	Percentage of Total Spending
TOTAL	560.26	100	17.57	581.39	100	17.62	795.06	100	21.76
Wages	371.98	66.40	11.67	436.17	75.02	13.22	645.02	81.13	17.66
Salaries and wages	368.85	65.84	11.57	436.16	75.02	13.22	481.87	60.61	13.19
Employers contributions	3.14	0.56	0.10	0.01	0.00	0.00	163.14	20.52	4.47
Purchase of Other Goods and Services	144.92	25.87	4.55	117.42	20.20	3.56	128.58	16.17	3.52
Stationary	11.42	2.04	0.36	10.42	1.79	0.32	12.24	1.54	0.33
Linen and bedding	1.65	0.29	0.05	1.80	0.31	0.05	2.74	0.34	0.08
Food products	14.14	2.52	0.44	14.53	2.50	0.44	38.48	4.84	1.05
Business trips	1.60	0.29	0.05	2.44	0.42	0.07	2.42	0.30	0.07
Transportation expenses	2.01	0.36	0.06	2.13	0.37	0.06	2.24	0.28	0.06
Communication expenses	2.18	0.39	0.07	1.93	0.33	0.06	2.01	0.25	0.05
Public utilities	32.48	5.80	1.02	23.23	3.99	0.70	41.50	5.22	1.14
Science and research institutes	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sightseeing improvement	5.56	0.99	0.17	9.93	1.71	0.30	6.98	0.88	0.19
Plants and equipment	9.24	1.65	0.29	0.00	0.00	0.00	0.00	0.00	0.00
Current repairs to buildings	1.95	0.35	0.06	1.70	0.29	0.05	1.51	0.19	0.04
Other current expenditures	62.68	11.19	1.97	49.31	8.48	1.49	18.46	2.32	0.51
Transfers to population	16.35	2.92	0.51	13.81	2.38	0.42	14.79	1.86	0.40
Stipends	16.35	2.92	0.51	13.81	2.38	0.42	14.79	1.86	0.40
Purchase of Capital							0.02	0.00	0.00
Capital repair	27.00	4.82	0.85	13.98	2.41	0.42	6.66	0.84	0.18
Capital repair to social, cultural and household objects	26.95	4.81	0.85	11.81	2.03	0.36	6.54	0.82	0.18
Capital repair to administrative and management objects	0.02	0.00	0.00	0.09	0.02	0.00	0.02	0.00	0.00
Other capital repair	0.03	0.00	0.00	2.08	0.36	0.06	0.11	0.01	0.00

Source: Ministry of Finance.

Table 27. Azerbaijan: Educational Expenditures by Agency, 1997-99

	1997		1998		1999	
	Billion Manat	Percentage of Total	Billion Manat	Percentage of Total	Billion Manat	Percentage of Total
Overall Total	560.26	100	581.39	100	795.06	100
Railway	5.28	0.94	6.97	1.20	8.90	1.12
Pre-school enterprises	0.92	0.16	0.31	0.05	0.14	0.02
Kindergartens, elementary and secondary schools	3.82	0.68	4.17	0.72	3.61	0.45
Evening and vocational secondary schools	0.06	0.01	0.00	0.00	0.04	0.00
Technical and professional schools and lyceums	0.11	0.02	0.10	0.02	0.21	0.03
Secondary educational professional schools	0.16	0.03	0.17	0.03	0.21	0.03
Enterprises on children and out of school affairs	0.12	0.02	0.03	0.00	0.00	0.00
Other	0.09	0.02	2.19	0.38	4.69	0.59
Health Ministry	6.92	1.24	7.44	1.28	9.17	1.15
Secondary educational - professional enterprises	2.11	0.38	2.33	0.40	3.03	0.38
High education enterprises	4.15	0.74	4.39	0.76	5.15	0.65
Professional skills improvement institutes	0.67	0.12	0.71	0.12	0.98	0.12
Ministry of Culture	17.66	3.15	21.06	3.62	30.28	3.81
Secondary educational - professional enterprises	0.56	0.10	0.63	0.11	0.78	0.10
Skills improvement institutes	0.07	0.01	0.06	0.01	0.08	0.01
Enterprises on children and out-of-school activities	17.02	3.04	20.37	3.50	29.24	3.68
Ministry of Education	523.57	93.45	538.91	92.69	739.82	93.05
Pre-school enterprises	68.25	12.18	53.75	9.24	64.89	8.16
Kindergartens, elementary and secondary schools	334.77	59.75	368.14	63.32	517.30	65.06
Evening and vocational and secondary schools	1.88	0.34	2.59	0.44	4.13	0.52
Boarding schools	22.77	4.06	23.06	3.97	30.98	3.90
Special schools	0.40	0.07	0.91	0.16	5.05	0.64
Technical and professional schools and lyceums	15.49	2.77	14.78	2.54	21.98	2.76
Secondary professional education enterprises	8.57	1.53	9.84	1.69	11.80	1.48
High education enterprises	31.27	5.58	30.43	5.23	37.69	4.74
Professional skills improvement	1.06	0.19	1.16	0.20	1.53	0.19
Enterprises on children and out of school activities	17.20	3.07	21.77	3.75	24.17	3.04
Methodical works, education and advertisement	10.82	1.93	5.43	0.93	10.92	1.37
Other	11.07	1.98	7.06	1.21	9.37	1.18
Ministry of Agriculture	3.91	0.70	3.76	0.65	3.07	0.39
Secondary Professional education institutions	1.95	0.35	1.71	0.29	1.58	0.20
High education enterprises	1.90	0.34	2.00	0.34	1.45	0.18
Sports and Youth Ministry	1.95	0.35	2.25	0.39	2.94	0.37
Secondary Professional education institutions	0.11	0.02	0.58	0.10	0.12	0.02
High education enterprises	0.66	0.12	0.67	0.12	0.89	0.11
Other educational enterprises on staff training	1.19	0.21	0.99	0.17	1.92	0.24
Other organizations, ministries and central offices	0.97	0.17	1.00	0.17	0.90	0.11
High education enterprises	0.37	0.07	0.87	0.15	0.67	0.08
Professional skills improvement institutes	0.14	0.02	0.14	0.02	0.23	0.03
Methodical works, education and advertisement	0.46	0.08	0.00	0.00	0.00	0.00

Source: Ministry of Finance.

Table 28. Azerbaijan: Health Expenditures by Economic Classification, 1997-99

	1997			1998			1999		
	In billions of Manat	Percentage of Health Spending	Percentage of Total Spending	In billions of Manat	Percentage of Health Spending	Percentage of Total Spending	In billions of Manat	Percentage of Health Spending	Percentage of Total Spending
TOTAL	189.373	100	5.9	154.866	100	4.7	186.162	100	5.1
Wages	72.502	38.3	2.3	70.703	45.7	2.1	98.528	52.9	2.7
Salaries and wages	71.881	38.0	2.3	70.679	45.6	2.1	73.217	39.3	2.0
Employers contributions	0.621	0.3	0.0	0.025	0.0	0.0	25.311	13.6	0.7
Purchase of Other Goods and Services	103.931	54.9	3.3	74.008	47.8	2.2	81.913	44.0	2.2
Stationary and office equipment	6.625	3.5	0.2	5.077	3.3	0.2	5.197	2.8	0.1
Medicines and binding materials	19.697	10.4	0.6	15.144	9.8	0.5	18.129	9.7	0.5
Linen and bedding	3.971	2.1	0.1	2.624	1.7	0.1	2.421	1.3	0.1
Food products	12.548	6.6	0.4	11.301	7.3	0.3	12.757	6.9	0.3
Business trips	0.461	0.2	0.0	0.538	0.3	0.0	0.539	0.3	0.0
Transportation expenses	8.516	4.5	0.3	8.346	5.4	0.3	8.906	4.8	0.2
Communication expenses	1.544	0.8	0.0	1.513	1.0	0.0	1.258	0.7	0.0
Public utilities	35.253	18.6	1.1	18.940	12.2	0.6	24.473	13.1	0.7
Purchase and repair of plants and equipment	10.881	5.7	0.3	7.578	4.9	0.2	5.218	2.8	0.1
Current repairs to buildings	0.473	0.2	0.0	0.535	0.3	0.0	0.595	0.3	0.0
Other current expenditures	3.962	2.1	0.1	2.412	1.6	0.1	2.420	1.3	0.1
Capital repair	12.941	6.8	0.4	10.155	6.6	0.3	5.721	3.1	0.2
Capital repair to social, cultural and household objects	12.115	6.4	0.4	9.755	6.3	0.3	5.721	3.1	0.2
Other capital repair	0.826	0.4	0.0	0.400	0.3	0.0	0.000	0.0	0.0

Source: Ministry of Finance.

Table 29. Azerbaijan: Health Expenditures by Agency, 1997-99

	1997		1998		1999	
	Billions of Manat	Percentage of Total	Billions of Manat	Percentage of Total	Billions of Manat	Percentage of Total
Overall Total	189.373	100	154.866	100	186.161	100
Railway	2.504	1.32	2.679	1.73	2.751	1.48
Hospitals	1.713	0.90	1.691	1.09	1.767	0.95
Polyclinics	0.296	0.16	0.276	0.18	0.358	0.19
Gynecology centers	0.039	0.02	0.000	0.00	0.000	0.00
Sanitary - epidemiological centers	0.396	0.21	0.653	0.42	0.577	0.31
Antiepidemic measures	0.000	0.00	0.020	0.01	0.000	0.00
Children's home	0.002	0.00	0.000	0.00	0.000	0.00
Other health offices	0.057	0.03	0.039	0.02	0.048	0.03
Health Ministry	186.870	98.68	152.187	98.27	183.410	98.52
Hospitals	112.076	59.18	90.278	58.29	111.667	59.98
Polyclinics	31.544	16.66	23.522	15.19	29.368	15.78
Gynecological centers	2.366	1.25	2.256	1.46	3.044	1.64
First aid centers	10.409	5.50	10.095	6.52	12.662	6.80
Blood transfusion centers	0.247	0.13	0.398	0.26	0.277	0.15
Sanatoriums for patients with tuberculosis	1.954	1.03	1.961	1.27	1.884	1.01
Sanatoriums for children and teenagers (w/out tuberculosis)	1.347	0.71	1.000	0.65	1.129	0.61
Sanitary and epidemiological centers	5.083	2.68	4.337	2.80	5.957	3.20
Disinfection centers	0.694	0.37	0.692	0.45	0.840	0.45
Antiepidemic measures	0.255	0.13	0.083	0.05	0.029	0.02
Health centers	0.267	0.14	0.112	0.07	0.092	0.05
Children's home	0.573	0.30	0.714	0.46	0.981	0.53
Other offices and measures on health	17.152	9.06	15.240	9.84	12.948	6.96
Maintenance expenditures on centralized accounting	1.747	0.92	1.499	0.97	2.527	1.36
Maintenance expenditures on centralized services	0.000	0.00	0.000	0.00	0.005	0.00
Capital construction on health ministry institutions	1.155	0.61	0.000	0.00	0.000	0.00

Source: Ministry of Finance.

Table 30. Azerbaijan: Balance Sheet of the Azerbaijan National Bank and Monetary Survey, 1995-99
(In billions of manats, end of period)

	1995	1996	1997	1998	1999
Balance Sheet of the Azerbaijan National Bank					
Net foreign assets	244.6	264.9	858.2	565.4	1,238.1
Net international reserves (convertible)	81.1	187.1	779.1	488.5	1,175.4
Gross international reserves (convertible)	529.0	876.5	1,817.5	1,745.4	2,958.7
Foreign liabilities (convertible)	-447.9	-689.5	-1,038.3	-1,256.9	-1,783.3
Other	163.5	77.8	79.1	76.9	62.7
Net domestic assets	666.5	806.2	571.6	579.7	89.8
Domestic credit	784.5	853.0	781.5	735.9	397.2
Credit to general government (net; incl counterpart funds)	-114.2	82.3	-5.7	64.3	-280.6
Claims on banks	890.3	761.8	778.8	672.0	677.6
Other items (net)	-118.0	-46.9	-209.9	-156.3	-307.4
Reserve money	906.4	1,066.8	1,422.3	1,140.2	1,324.7
Manat reserve money	742.2	991.3	1,339.3	1,057.0	1,256.6
Required reserves in foreign currencies	164.3	75.5	83.0	83.2	68.1
Other deposits	4.7	4.2	7.6	4.8	3.2
Monetary Survey					
Net foreign assets	676.3	593.9	1,233.3	694.8	1,584.0
Net international reserves of the ANB (convertible)	81.1	187.1	779.1	488.5	1,175.4
Net foreign assets of commercial banks (convertible)	591.3	396.1	450.0	214.9	408.6
Other	3.8	10.7	4.2	-8.6	-0.1
Net domestic assets	623.3	951.2	830.3	1,018.0	508.5
Domestic credit	1,336.1	1,780.1	1,977.6	2,202.5	1,987.4
Credit to general government (net, incl. counterpart funds)	-199.9	-108.0	-53.5	12.1	-295.9
Claims on enterprises and individuals	1,536.0	1,888.1	2,031.1	2,190.4	2,283.3
Other items (net)	-712.7	-828.8	-1,147.3	-1,184.5	-1,478.9
Broad money	1,299.6	1,545.1	2,063.7	1,712.9	2,092.5
Manat broad money	957.6	1,204.2	1,556.3	1,218.5	1,404.3
Currency outside banks	602.4	865.4	1,170.5	926.0	1,135.8
Manat deposits	355.2	338.7	385.8	292.5	268.5
Foreign currency deposits	342.0	340.9	507.4	494.4	688.2
Memorandum Items:					
Money multiplier (level)	1.4	1.4	1.5	1.5	1.6
Manat velocity (ratio)	17.7	13.3	12.0	12.0	9.0
Manat reserve money (annual percentage change)	129.7	33.6	35.1	-21.1	18.9
Manat broad money (annual percentage change)	122.2	25.8	29.2	-21.7	15.2
Reserve Money (annual percentage change)	...	17.7	33.3	-19.8	16.2
Broad money (annual percentage change)	24.0	18.9	33.6	-17.0	22.2

Sources: Azerbaijan National Bank; and Fund staff estimates.

Table 31. Azerbaijan: Credit and Deposit Interest Rates, 1997-2000
(In percent per annum)

Average Interbank Credit Rates, Baku											Average bank deposit rates for customers (3 month)		ANB refinance rate (6 month)	Credit auction interest rate (6 month)	Treasury bill rate 3/	
7 days manats		30 days manats		90 days manats		180 days manats		90 days US dollars		manats	US dollars	1 month			3 month	
IBOR 1/	WA 2/	IBOR	WA	IBOR	WA	IBOR	WA	IBOR	WA							
1997	Jan	25.0	20.5	33.4	28.1	36.0	28.2	36.0	32.2	27.5	25.0	13.0	9.0	20.0	20.0	...
	Feb	25.0	20.3	24.8	20.9	25.3	19.8	26.5	20.4	19.3	15.8	12.4	9.0	16.0	16.0	17.0
	Mar	28.0	28.0	26.7	26.7	26.3	21.4	25.8	19.9	21.6	16.8	10.7	9.0	15.0	15.0	...
	Apr	28.0	22.0	27.0	22.8	24.8	18.6	23.6	19.1	24.0	15.3	11.0	9.0	15.0	15.0	...
	May	17.7	14.7	21.0	16.3	21.4	16.9	21.5	17.5	16.1	12.5	11.8	9.5	15.0	15.0	13.9
	Jun	19.6	16.0	21.4	17.8	22.3	17.5	23.0	18.0	16.8	14.2	12.0	9.5	12.0	12.0	...
	Jul	22.6	17.6	21.3	17.0	20.9	16.2	20.1	16.0	16.6	13.4	10.8	9.5	12.0	12.0	...
	Aug	21.0	15.6	21.8	16.4	22.0	17.0	23.4	17.3	17.3	14.1	11.8	11.4	12.0	12.0	...
	Sep	15.5	12.8	18.2	14.2	21.4	14.9	21.1	17.4	16.0	12.5	11.1	10.4	12.0	12.0	12.0
	Oct	18.7	14.7	20.8	15.4	22.0	16.6	20.4	17.1	16.7	13.1	12.5	10.5	12.0	12.0	11.9
	Nov	24.0	17.7	24.5	17.4	27.0	18.7	23.6	18.9	17.8	15.1	10.5	9.7	12.0	12.0	11.9
	Dec	22.0	16.2	27.0	20.8	22.9	17.9	22.9	19.2	22.1	19.0	11.5	10.3	12.0	12.0	...
1998	Jan	18.3	12.5	22.2	15.8	22.2	17.4	20.9	17.7	18.5	14.9	9.5	9.0	12.0	12.5	...
	Feb	18.5	12.8	21.4	16.4	22.3	16.5	21.0	16.8	20.0	16.1	10.0	9.3	12.0	13.0	...
	Mar	18.5	14.8	22.2	16.5	24.5	18.1	22.6	18.3	19.5	15.8	10.7	9.8	12.0	13.0	...
	Apr	18.5	12.8	23.8	15.8	24.8	17.6	23.2	18.8	19.1	15.6	10.6	9.8	12.0	14.0	13.9
	May	18.5	12.8	23.8	15.8	24.8	17.6	23.2	18.8	19.1	15.6	10.6	9.8	12.0	14.0	...
	Jun	24.3	17.0	22.8	15.0	24.5	17.3	23.7	18.9	21.7	15.9	9.9	9.2	12.0	14.0	...
	Jul	17.0	11.0	25.3	16.2	25.8	18.9	25.9	20.6	24.3	17.7	10.2	9.5	14.0	14.0	...
	Aug	17.0	11.0	25.2	17.1	25.7	19.0	25.8	20.5	24.4	18.5	10.1	9.9	14.0	14.0	...
	Sep	...	...	26.5	19.4	25.8	19.0	25.8	20.4	24.9	18.0	11.7	10.5	14.0	14.0	14.8
	Oct	...	...	25.3	18.6	25.1	19.5	24.3	19.4	24.4	18.8	11.4	10.2	14.0	14.0	15.0
	Nov	...	...	25.3	19.3	24.3	18.7	21.9	18.9	25.3	18.5	11.9	10.6	14.0	14.0	14.7
	Dec	15.0	15.0	23.8	17.8	23.2	17.6	21.5	17.6	25.0	18.4	11.9	10.6	14.0	14.0	...
1999	Jan.	15.0	15.0	25.3	17.9	25.2	19.2	23.4	19.3	26.4	19.6	12.8	11.2	14.0	14.0	...
	Feb	15.0	15.0	25.3	17.9	25.2	18.7	22.6	18.7	25.7	19.3	12.6	11.1	14.0	14.0	...
	Mar.	15.0	15.0	25.3	16.9	25.2	19.1	22.6	18.6	25.1	19.1	12.5	11.0	14.0	14.0	...
	Apr.	15.0	15.0	22.8	16.1	25.2	19.1	22.3	18.3	25.1	19.7	11.7	10.5	14.0	14.0	...
	May	15.0	14.5	25.3	17.9	23.6	18.0	21.0	17.4	23.9	18.6	11.8	10.6	14.0	14.0	...
	Jun	15.0	15.0	21.3	14.2	21.8	17.5	20.8	17.4	22.8	17.9	12.1	10.8	14.0	14.0	...
	Jul	15.0	15.0	21.3	15.6	21.6	16.7	21.4	17.0	23.9	18.0	12.1	10.1	14.0	14.0	...
	Aug	15.0	15.5	22.3	15.5	22.0	17.4	21.3	17.0	23.7	18.6	12.0	10.0	14.0	14.0	...
	Sep	21.0	16.7	22.0	15.3	22.1	17.7	22.1	17.6	25.2	19.1	12.3	10.2	14.0	14.0	...
	Oct	21.0	16.7	22.0	15.3	22.1	17.7	22.1	17.6	25.2	19.1	12.3	10.2	14.0	14.0	...
	Nov	17.0	17.0	17.0	10.4	20.2	15.6	19.6	15.5	24.5	18.2	12.3	10.2	10.0	10.0	...
	Dec	17.0	17.0	17.0	9.1	20.5	14.6	20.0	15.0	24.3	17.8	11.8	9.9	10.0	10.0	17.1
2000	Jan.	17.0	17.0	20.5	13.9	21.0	15.7	21.0	15.8	23.2	17.5	12.1	10.1	10.0	10.0	...
	Feb.	17.0	17.0	23.7	15.4	21.3	16.0	21.2	16.5	24.0	17.8	13.5	10.8	10.0	10.0	...
	Mar.	17.0	18.5	20.5	15.2	21.3	16.4	19.9	15.9	22.5	17.5	13.6	10.8	10.0	10.0	...
	Apr.	17.0	12.5	20.5	13.8	21.5	15.9	19.9	15.6	22.8	17.1	13.6	10.8	10.0	10.0	...

Source: Baku Interbank Currency Exchange

1/ IBOR. Interbank offer rate

2/ WA: Represents weighted average of all bids and offers.

3/ Weighted average rate for all auctions in respective month.

Table 32. Azerbaijan: Exchange Rates, 1997–2000
(Manat per US dollar)

		Period average	End of period
1997	QI	4,076	4,035
	QII	4,009	3,980
	QIII	3,952	3,930
	QIV	3,905	3,888
1998	QI	3,884	3,868
	QII	3,861	3,861
	QIII	3,862	3,857
	QIV	3,868	3,890
1999	QI	3,910	3,929
	QII	3,958	3,975
	QIII	4,259	4,320
	QIV	4,376	4,378
2000	QI	4,393	4,413

Source: Azerbaijan authorities; and Fund staff calculations.

Table 33. Azerbaijan: Balance of Payments, 1995-99
(In millions of U.S. dollars, unless otherwise indicated)

	1994	1995	1996	1997	1998	1999
Current account	-123	-319	-821	-915	-1,363	-600
Trade Balance	-163	-275	-549	-566	-1,046	-408
Exports, of which:	682	680	789	808	678	1,025
Oil	207	257	402	448	434	801
Cotton	...	105	57	105	49	20
Imports, f.o.b.	-845	-955	-1,338	-1,375	-1,724	-1,433
of which: oil sector	0	-30	-213	-256	-356	-325
Services	-33	-140	-277	-384	-369	-228
Receipts	137	172	149	342	332	256
Payments	-170	-312	-426	-726	-701	-484
of which: oil sector	0	-68	-166	-321	-286	-189
Income	-2	-14	-62	-9	-17	-45
Compensation of employees	0	-6	-16	-19	-24	-46
of which: oil consortia	0	-9	-13	-19	-20	-29
interest payments on public external debt	-3	-7	-17	-7	-17	-22
investment income (net)	1	-1	-29	-39	24	23
of which: profit repatriation of oil consortia	0	-7	-34	-55	0	0
Current transfers	75	111	67	46	69	81
Official	71	81	86	55	24	56
Private	4	29	-20	-10	45	25
Capital and financial account	54	318	739	1,009	1,266	828
Official medium- and long-term	54	87	-19	11	60	204
Disbursements	54	116	50	88	90	225
Project loans	54	14	19	53	90	183
Program loans	0	102	31	35	0	42
Amortization	0	-29	-70	-77	-30	-21
Direct and portfolio investment	22	282	661	1,093	1,024	510
Oil companies	0	252	487	845	832	350
Oil bonus (net) 1/	0	122	37	64	75	155
Other, net	0	130	450	781	757	195
Other	22	30	174	248	192	160
Banking system (net)	-22	-42	15	-5	61	-44
Trade credit and other short term capital	0	-9	82	-90	121	158
Errors & omissions	-12	0	21	49	38	-97
Overall balance	-81	0	-62	144	-59	131
Financing	79	0	52	-143	59	-131
Net foreign assets of the Central Bank(- increase)	-2	-16	-24	-143	59	-131
Central bank gross reserves	-2	-117	-95	-253	18	-227
IMF	0	101	71	110	41	96
Change in arrears 2/	81	-76	25	0	0	0
Rescheduling	0	92	51	0	0	0
Memorandum items:						
Gross reserves of the ANB						
In millions of dollars	2	119	214	467	449	676
In weeks of next year's imports 3/	0	4	5	10	12	17
Current account in percent of GDP						
including oil sector development	-9.3	-13.2	-25.5	-23.1	-32.6	-15.0
excluding oil sector development 4/	-9.3	-9.2	-13.9	-8.5	-17.2	-2.2
External debt in percent of GDP	...	...	...	...	15.9	24.2
External debt service in terms of export of GNFS	...	...	...	...	3.7	4.3

Sources: Azerbaijan authorities; and Fund staff estimates.

1/ Contract signing bonuses paid to the Government by foreign oil companies.

2/ Debt service obligations to Russia. An agreement to cancel all outstanding mutual claims with Russia was reached in 1997.

3/ Imports of goods and non factor services, excluding oil sector operations.

4/ Excludes imports of goods and nonfactor services related to oil sector development.

Table 34. Registered Foreign Trade, 1995-99 1/
(In millions of US dollars)

	1995	1996	1997	1998	1999
Exports	637	631	781	606	929
Food	39	29	55	47	60
Cotton	117	59	123	49	22
Oil and oil products	282	395	452	418	731
Metals	18	6	15	13	25
Chemicals and petrochemicals 2/	18	20	13	11	23
Machinery and equipment	46	48	41	41	48
Other	117	74	82	27	20
Imports 3/	668	961	794	1077	1036
Food	277	383	181	175	185
Natural gas	--	--	--	--	--
Metals	42	87	109	127	112
Chemicals and petrochemicals 2/	58	60	50	79	58
Machinery and equipment	123	226	219	458	470
Other	168	205	235	238	211

Source: Azerbaijan State Committee on Statistics.

1/ Figures are based on customs data and might be different from Table 33 which is based on central bank data.

2/ Including pharmaceutical products.

3/ Do not include data on shuttle trade.

Table 35. Direction of Registered Foreign Trade, 1994-99 1/

	1994	1995	1996	1997	1998	1999
(In millions of US dollars)						
Exports	637	621	623	779	607	929
C.I.S.	274	280	287	377	233	211
Georgia	17	45	92	133	77	72
Kazakhstan	17	21	15	9	11	4
Russia	140	100	111	181	106	83
Ukraine	59	34	22	32	12	24
Other countries	41	80	47	22	27	28
Non-CIS	363	341	336	402	374	718
Iran	242	186	226	190	44	23
Turkey	16	26	39	41	136	69
United Kingdom	62	49	13	1	40	11
Other countries	43	80	58	170	154	615
Imports	778	668	961	794	1077	1035
C.I.S.	486	228	340	351	405	325
Georgia	8	19	28	37	25	9
Kazakhstan	52	18	19	30	44	25
Russia	118	88	158	152	194	226
Turkmenistan	196	51	15	25	26	13
Ukraine	86	34	94	86	93	38
Other countries	26	18	26	21	23	14
Non-CIS	292	440	621	443	672	710
Iran	67	80	66	49	43	47
Turkey	76	141	216	180	220	143
United Arab Emirates	9	69	109	42	46	12
United Kingdom	7	9	15	14	69	67
Other countries	133	141	215	158	294	441
(In percent of the total)						
Exports	100.0	100.0	100.0	100.0	100.0	100.0
C.I.S.	43.0	45.1	46.1	48.4	38.4	22.7
Georgia	2.7	7.2	14.8	17.1	12.7	7.8
Kazakhstan	2.7	3.4	2.4	1.2	1.8	0.4
Russia	22.0	16.1	17.8	23.2	17.5	8.9
Ukraine	9.3	5.5	3.5	4.1	2.0	2.6
Other countries	6.4	12.9	7.5	2.8	4.4	3.0
Non-CIS	57.0	54.9	53.9	51.6	61.6	77.3
Iran	38.0	30.0	36.3	24.4	7.2	2.5
Turkey	2.5	4.2	6.3	5.3	22.4	7.4
United Kingdom	9.7	7.9	2.1	0.1	6.6	1.2
Other countries	6.8	12.9	9.3	21.8	25.4	66.2
Imports	100.0	100.0	100.0	100.0	100.0	100.0
C.I.S.	62.5	34.1	35.4	44.2	37.6	31.4
Georgia	1.0	2.8	2.9	4.7	2.3	0.9
Kazakhstan	6.7	2.7	2.0	3.8	4.1	2.4
Russia	15.2	13.2	16.4	19.1	18.0	21.8
Turkmenistan	25.2	7.6	1.6	3.1	2.4	1.3
Ukraine	11.1	5.1	9.8	10.8	8.6	3.7
Other countries	3.3	2.7	2.7	2.6	2.1	1.4
Non-CIS	37.5	65.9	64.6	55.8	62.4	68.6
Iran	8.6	12.0	6.9	6.2	4.0	4.5
Turkey	9.8	21.1	22.5	22.7	20.4	13.8
United Arab Emirates	1.2	10.3	11.3	5.3	4.3	1.2
Other countries	17.1	21.1	22.4	19.9	27.3	42.6

Source: Azerbaijan State Committee on Statistics.

1/ Figures are based on customs data and might be different from Table 31 which is based on central bank data.

Table 36. Azerbaijan: Energy Balance, 1992-99

	1992	1993	1994	1995	1996	1997	1998	1999
Oil and oil products	(In millions of barrels)							
Production	80.9	75.2	69.8	66.9	66.4	66.2	83.4	100.8
Net volume of trade	11.2	5.7	6.2	2.4	16.8	19.1	29.9	46.7
Exports	22.4	14.2	12.4	2.9	17.4	21.5	32.0	48.8
of which: crude oil	0.0	0.0	0.0	0.0	0.0	2.1	15.7	31.2
Imports	-11.2	-8.5	-6.2	-0.5	-0.6	-2.4	-2.1	-2.1
Domestic consumption	67.7	70.8	64.4	62.4	50.8	48.4	53.6	55.5
Variation in stocks	2.0	-1.3	-0.8	2.1	-1.2	-1.3	-0.1	-1.4
Natural gas	(In billions of cubic meters)							
Production (excluding losses) 1/	7.9	6.8	6.4	6.6	6.3	6.0	5.6	6.0
Net volume of trade	-3.5	-1.8	-2.5	-0.6	0.0	0.0	0.0	0.0
Exports	1.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Imports	-4.6	-2.5	-2.5	-0.6	0.0	0.0	0.0	0.0
Domestic consumption	11.3	9.2	8.5	8.8	6.3	6.0	5.6	6.0
Variation in stocks	0.1	-0.6	0.4	-1.6	0.0	0.0	0.0	0.0

Source: Azerbaijan State Committee on Statistics.

1/ Production excludes vented gas.