Azerbaijan:
Public Investment: Still Driving Growth

THE WORLD BANK

Azerbaijan Economic Report No.5
Spring 2014

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Washington, D.C.

Government Fiscal Year:	January 1–December 31
Currency Equivalents:	Exchange rate effective as of February 25, 2014
	Currency Unit = Azerbaijani Manat (AZN)
	USD 1.00 = 0.78 AZN
Weights and Measures:	Metric System

Abbreviations

AZN	Azerbaijani Manat
AzSTAT	The State Statistical Committee of the Republic of Azerbaijan
BP	British Petroleum
CBAR	Central Bank of Azerbaijan Republic
ECA	Europe and Central Asia
GDP	Gross Domestic Product
SOCAR	State Oil Company of Azerbaijan Republic
SOFAZ	State Oil Fund of the Republic of Azerbaijan
TAP	Trans-Adriatic Pipeline
TSA	Targeted Social Assistance
VAT	Value Added Tax
YAP	New Azerbaijan Party
OSCE	Organization for Security and Cooperation in Europe
USA	United States of America
EU	European Union
CIS	Commonwealth of Independent States
ACG	Azeri-Chirag-Guneshli oil field
SSPF	State Social Protection Fund
PSA	Profit Sharing Agreement
ICT	Information and Communication Technologies
GCR	Global Competitiveness Report
SSPF	State Social Protection Fund

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Acknowledgment

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Overview

The presidential elections were held in October 2013 and incumbent President Ilham Aliyev was elected for the third term. He won by a substantial margin, securing 85 percent of the votes. This election outcome was largely in line with expectations.

Economic growth continued to be powered by spending of previously accumulated oil-related proceeds, although the stabilization of oil production also helped. The non-oil sector grew by 10 percent in 2013, essentially aided by public investment. In addition, efforts aimed at stabilizing oil production bore fruit and resulted in an increase of 0.9 percent in oil output. However this stabilization is likely to be short lived and in the absence of a new production sharing agreement (PSA), oil production is expected to decline over the medium-term. Gas production will provide some reprieve but to what extent will be evident only after 2019 when Azerbaijan starts exporting gas to Europe. In the meantime, with modest progress on improving human capital and the business environment and limitations to the public investment driven growth model, economic expansion will see a significant moderation to around 4.5–5 percent per year.

The fiscal surplus narrowed to 1.8 percent of GDP in 2013 because of lower oil revenues and sustained expenditures, and the non-oil fiscal deficit continues to be high. While oil production did not change much from 2012, lower oil prices—which averaged $108 a barrel in 2013 compared with $112 a barrel in 2012—resulted in lower oil-related revenues. Despite the decline in revenues, total expenditures were maintained at the level of the previous year. As a percent of non-oil GDP, the non-oil fiscal deficit narrowed marginally to 48 percent in 2013 from 49 percent a year ago, driven by higher non-oil revenue collections. Fiscal dependence on oil—similar to the dependence of exports and GDP on oil—continues although the government is taking steps to enhance non-oil tax collections. The 2014 budget signals fiscal consolidation, essentially through lower public investments, a step in the right direction.

With the announcement of 2014 as the 'Year of Industry', the authorities intend to prioritize adoption of the competition code, establishment of special economic zones and techno parks, winemaking, and other agricultural products. An action plan for 2014, focusing on the above mentioned areas, is in the making and will be finalized soon. Such policies, targeting specific sectors, however have a low success rate and should be guarded against. A modest increase in public expenditures on health and education in 2014 adds to the concerns that the government's efforts at diversification might not be focused on strengthening its asset base.

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A. Recent Political Developments

The presidential elections were held on October 9, 2013 and incumbent President Aliyev was elected for his third term. He scored a landslide victory with 85 percent of the votes while the opposition party garnered a mere 10 percent. However, the election process was disputed both within and outside the country. The Organization for Security and Co-operation in Europe (OSCE) mission for monitoring the elections concluded that in most of the regions there were substantial violations of election rules. This statement was supported by the European Union (EU) and the United States (US) though observers from the Commonwealth of Independent States (CIS) countries declared the elections to be fair. Protest meetings were organized in Baku by opposition parties both before and after the elections. Contrary to past experience, the government allowed these gatherings to congregate peacefully although participation was not very high.

President Aliyev retained most of his team although a few changes in key positions were made. The Minister of Agriculture was appointed as the deputy prime minister and Haydar Asadov was appointed to this position. In addition, the Defense Minister (Safar Abiyev) and the Minister of Labor and Social Protection of Population (Fuzuli Alakbarov) were not included in the new government. Zakir Hasanov is the new Defense Minister of Azerbaijan while Salim Muslumov is the new Minister of Labor and Social Protection of Population. Two new deputy prime ministers were appointed although their area of responsibilities is still unclear.

The President declared 2014 as the 'Year of Industry' and enhanced the mandate of the Ministry of Economic Development to include industries and to prepare an industrial development program for 2014. The ministry was renamed as the Ministry of Economy and Industry and is required to produce an action plan for this year in the first quarter of 2014. In addition, the Cabinet of Ministers is required to draft a state program for the development of industries during 2015–2020 by April 2014. Some of the areas which will be prioritized include adoption of the competition code, establishment of special economic zones and techno parks, winemaking, and other agricultural products. However, the overall emphasis seems to be on sector specific policies—something that the government needs to guard against as such policies have a low success rate.

Peace talks between Armenia and Azerbaijan on the disputed territory of Nagorno-Karabakh resumed but no solution seems likely over the medium-term. The two presidents met in Geneva in November, 2013 after a two year hiatus. This meeting was followed by meetings between the two ministers of Foreign affairs. Despite these developments, a resolution of the problem looks unlikely in the medium-term.

B. Recent Economic Developments

Economic Growth and Domestic Demand

GDP growth picked up in 2013 aided by renewed increase in oil production and continued strong performance of the non-oil economy. Economic output expanded by 5.8 percent in 2013. The stabilization in oil production was the key differentiating factor between the economic performance of 2012 and 2013 (Table 1). In addition, saved oil receipts continued to finance public investments thereby boosting the construction sector which grew by 23 percent in 2013. Other non-tradables like hotels and restaurants, and communication services were also significant contributors to growth and expanded by 16 percent and 10.7 percent, respectively. A third consecutive year of good harvests resulted in agricultural growth of 4.9 percent in 2013. The manufacturing sector which is primarily driven by petroleum and food products maintained its 2012 performance and grew by 5.8 percent.

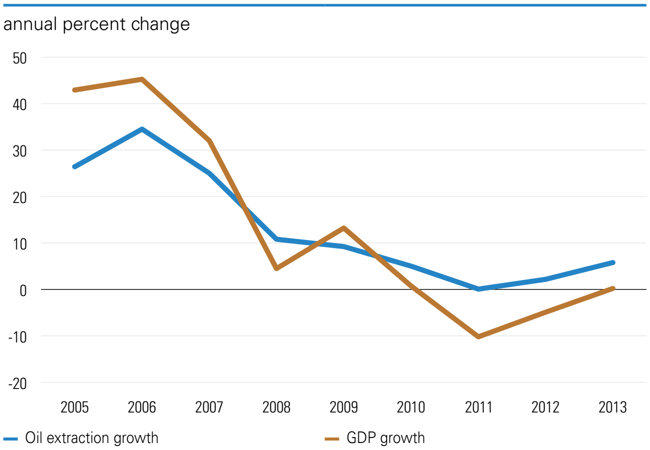
With technological upgrades and extraction process optimization, oil production finally rebounded after 2 consecutive years of decline. Oil production grew by 0.9 percent in 2013 while gas

Table 1. Gross domestic product, 2011–2013

	2011	2012	2013
Gross Domestic Product	0.1	2.2	5.8
Hydrocarbon GDP	-9	-5	0.9
Non-hydrocarbon GDP	9.4	9.7	9.9
Industry			
Mining and quarrying	-10	-5	0.7
Manufacturing	7.4	5.3	5.8
Electricity, gas, steam and air conditioning supply	11.1	11.6	3.2
Water collection, treatment and supply	12	1.3	11.6
Agriculture	5.8	5.8	4.9
Construction	20	18	23
Services			
Trade	10.2	9.6	9.9
Hotels and Restaurants	22.6	18.8	16
Transportation	-0.8	5	6.3
Communication	11.8	15.9	10.7
Social and other services	5.7	5.4	4.9
Net taxes on Products and imports	8.2	7	8.5

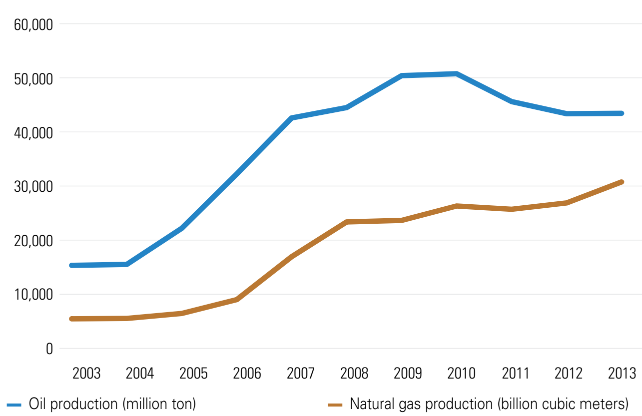
Source: AzSTAT.

Figure 1. GDP growth picked up in 2013



Source: AzSTAT.

Figure 2. Gas production grew while oil stabilized

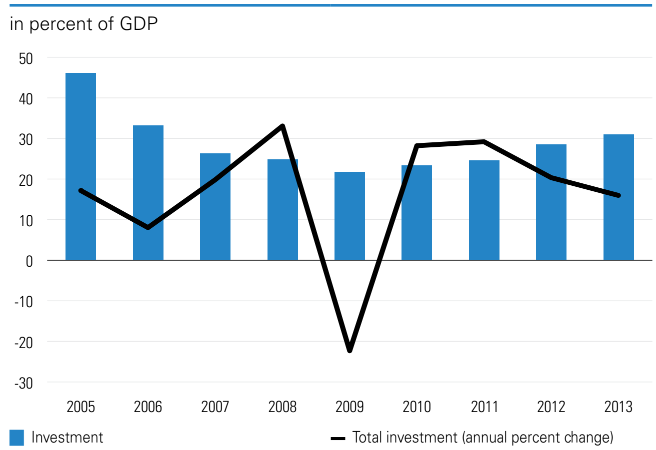


Source: SOCAR.

production grew by 14.4 percent (Figure 1 and 2). Stabilization of oil production came as a result of measures undertaken by British Petroleum (BP) after a series of negotiations with the State Oil Company of Azerbaijan Republic (SOCAR). These negotiations led to technological upgrades and optimization of the extraction process resulting in output increase. In addition, in January 2014, production started at the West Chirag oil platform which will provide a small boost to the sagging oil production. However, with the current PSA, oil production will follow a downward trajectory over the medium- to long-term.

Fixed investments averaged more than 20 percent of GDP a year during the past 5 years. The Commission on Growth and Development (2008) found that overall investment rates of 25 percent of GDP or above are needed to ensure sustained growth. Since Azerbaijan has a low stock of capital, it is important to create the business environment that attracts even higher private investment. At the same time, the oversight for selecting, monitoring, executing and evaluating public investment projects needs to be strengthened to avoid waste and pilferage (Figure 3). Investments in Azerbaijan are dominated by the public sector and this could raise fiscal sustainability issues down the road. Majority of public investments have been on building the road network. In the past 5 years the government's share in total investments has remained over 50 percent. In 2013, public investments accounted for 14.3 percent of GDP compared with 11.6 percent by the private sector.

Figure 3. Total investments have been high



Source: AzSTAT.

Inflation

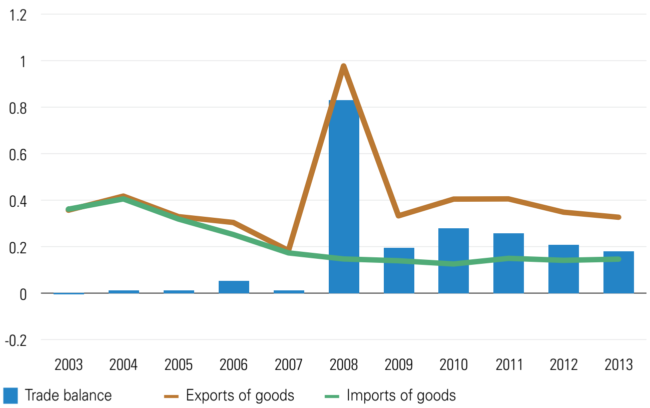
Increases in administered fuel prices and higher prices for food raised the average inflation rate to 2.4 percent in 2013, marginally higher than 2012. An increase in the administered price of gasoline in December 2013 raised the end-of-period inflation to 3.5 percent. Price of fuels, on average, increased by 30 percent and this was long overdue since the last price increase had happened in 2007. Price of gasoline with octane number of 92 and 95 increased by 33 percent and 27 percent respectively while the price of diesel increased by 33 percent. Despite these increases in price levels, inflation continued to be below the Central Bank's targeted band of 5–6 percent and as a result, the policy rate was reduced. A further increase in energy tariffs is expected in 2014 and this would have a significant implication on inflation for this year.

External Accounts

An increase in imported machinery by the oil sector reduced the trade surplus to 18 percent of GDP in 2013 compared with 20.7 percent in 2012. Oil exports were at the same level as 2012 while gas exports increased by 8.4 percent in 2013. Non-oil exports continued to be marginal and grew by 6 percent in 2013, led by fats and oil, sugar and tea. Total imports however grew by 11 percent in 2013, thereby, worsening the trade balance (Figure 4). Growth in imports was led by machineries, which grew by 7.5 percent, and was used as inputs in the oil sector. In addition, cereal imports also expanded by 16 percent. The non-oil trade deficit stayed at 21 percent in 2013, almost the same as in 2012 (Figure 5).

Figure 4. The trade balance reduced further

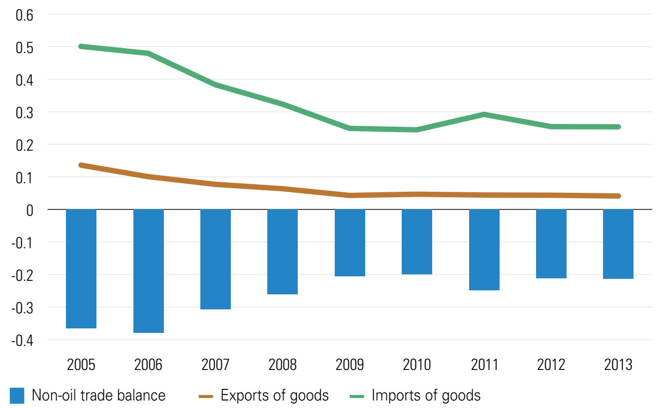
in percent of GDP



Source: AzStat and Customs Committee.

Figure 5. The non-oil trade deficit did not change much

in percent of non-oil GDP



Source: AzStat and Customs Committee.

In terms of export destinations, Azerbaijan's exports are well diversified, thereby, reducing vulnerabilities arising from economic difficulties in specific regions. Total exports are more evenly spread out across the world while non-oil exports are largely concentrated in the ECA region and Middle-East and North Africa. The top three destinations for total exports were Italy, France, and the US while for non-oil exports they were Russia, Iraq and Turkey. Over the past few years, Azerbaijan significantly diversified its export destinations for total exports. However, non-oil exports became more concentrated in the CIS countries, possibly resonating quality concerns.

The current account surplus narrowed to 15 percent of GDP in the third quarter of 2013 from 19 percent in Q3 2012, driven by the surge in oil sector service imports and the reduced trade balance. The deficit in services trade widened from 3.4 percent of GDP in Q3 2012 to 4 percent of GDP in Q3 2013. Import of services increased by 11 percent during the period, mostly driven by the oil sector. Service exports are dominated by traditional services which include travel and transport, although, Azerbaijan does not have a revealed comparative advantage in either traditional or modern services. There was also a deficit on the net income from abroad, essentially because of profit repatriation by foreign oil companies.

Oil and gas related FDI inflows narrowed the deficit on the capital account by 5 percent in the third quarter of 2013 compared with Q3 2012. The ongoing investments to halt the decline in oil production along with new investments in the Shah Deniz gas field increased FDI inflows. Capital outflows were led by trade credits which accounted for 56 percent of the total, along with deposits and loans resulting in a deficit of $6.5 billion in the capital account.

The current account surplus together with the reduced deficit in the capital account led to a balance of payments surplus of $3.3 billion in the first three quarters of 2013. By the end of the year, Azerbaijan's official reserves were at $14.1 billion, an increase of 17 percent from last year, and covering 11 months of imports. In addition, the assets of the Oil Fund were at $35.8 billion accounting for 50 percent of GDP, providing further cushion on the external front.

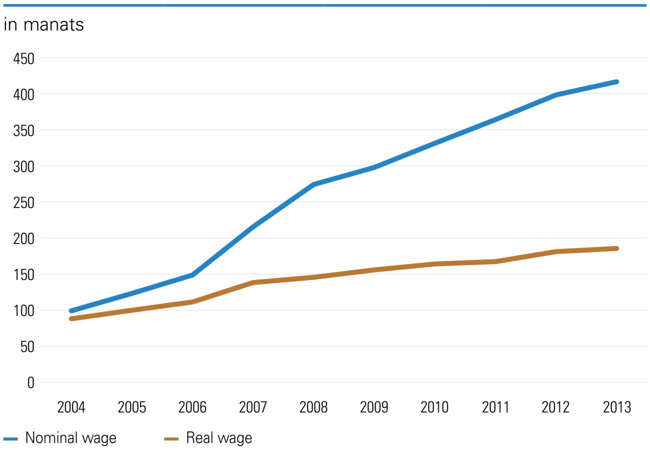
Azerbaijan did not initial the Association Agreement with the EU in Vilnius in November 2013 but it has no plans to join the Russian Customs Union since Armenia is now a member of the latter. In November 2013, the EU and Azerbaijan however did sign an agreement on visa facilitation which will ease travel for citizens between Azerbaijan and the Schengen area and is expected to come into effect during 2014. Discussions are also underway to sign an agreement on Strategic Modernization Partnership which complements the Association Agreement and supports modernization and reforms in Azerbaijan, including those in the areas of good governance, human rights and democracy. On WTO accession, there was no significant progress in 2013. With Armenia joining the Russian Customs Union in 2013, Azerbaijan has made it clear that it has no intentions to follow a similar path.

Employment and Labor Markets

In line with output expansion, new jobs were created in the non-tradable sectors which led to a decline in the unemployment rate to 4.9 percent in 2013 from 5.2 percent in 2012. The number of jobs increased by 1.7 percent in 2013 and the main contributors were the construction sector, hotels and restaurants and retail trade. Although there was a rebound in oil production as well, it had no perceivable impact on employment because of the capital intensive nature of the industry. In Azerbaijan, the oil sector accounts for less than 1 percent of total employment.

Informal employment, however, continues to be a problem. The share of people working with formal labor contracts is about 33 percent and this has not changed much over the last few years. This problem is more acute in regions outside Baku. In Baku, formal employment accounts for 60 percent of the total while in the regions, this figure ranges between 10 and 30 percent.

Figure 6. The real wage growth is plateauing



Source: AzStat and Customs Committee.

Figure 7. Nominal wages increased marginally

Source: AzStat and Customs Committee.

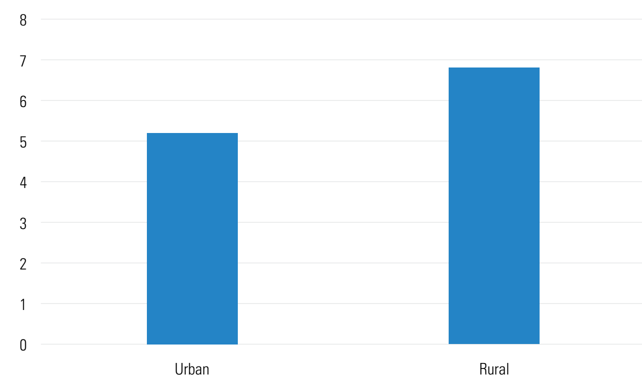
The marginal decline in unemployment and pick-up in economic growth in 2013 did not have a significant impact on wages. Nominal wages grew by 5 percent in 2013, much lower than the 9 percent growth in 2012. Real wage growth was lower at 2.5 percent (Figures 6 and 7). The wage difference between the mining sector and other sectors as well as between Baku and other regions persisted.

Poverty

The government's social assistance programs helped to reduce the poverty rate further to 5.3 percent in 2013 from 6 percent a year ago. Social assistance plays a major role in income redistribution and forms a significant share of household incomes. All social transfers combined finance over a third of total household consumption. The most important transfer is pensions, which accounts for half of overall transfers, followed by the Targeted Social Assistance (TSA) program (one third), and disability benefits (11 percent of all transfers). The remaining four social transfers (benefits to civil servants, child and family benefits, unemployment benefits, and other benefits) are much less important. The disparity in poverty rates between urban and rural areas is not substantial. At the national poverty line of AZN 115 for 2012, urban and rural poverty was at 5.2 percent and 6.8 percent, respectively. There are however significant variations among regions. While Baku has the lowest poverty rate of 1.3 percent, Guba-Khachmaz has the highest at 11 percent (Figures 8 and 9). The government's expenditure on pensions and social benefits accounted for around 8 percent of consolidated expenditures, both in 2012 and 2013.

Figure 8. Rural poverty is slightly higher than urban poverty

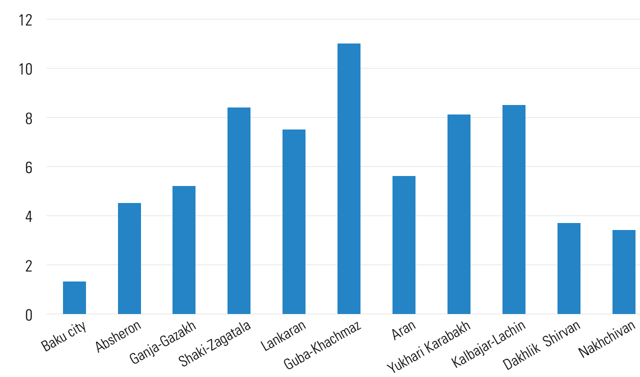
2012, in percent



Source: AzStat.

Figure 9. Significant variation in poverty exists across regions

in percent of total population



Source: AzStat.

C. Economic and Structural Policies

Fiscal Policy

With lower oil revenues and sustained expenditures, the fiscal balance reduced to 1.8 percent of GDP in 2013 from 4.2 percent a year ago. Lower oil prices in 2013 contributed to reduced oil revenues even though oil production stabilized during the year. Higher non-oil revenue collections however helped to narrow the non-oil primary deficit to 48 percent of non-oil GDP in 2013 from 49 percent a year earlier. The 2013 fiscal performance was however better than what was originally budgeted. Against a budgeted consolidated deficit of 6.6 percent of GDP for 2013, the country recorded a surplus of 1.8 percent. This was because of higher than budgeted revenue performance (102 percent execution rate for revenues) and lower expenditures because of limitations on the absorptive capacity of the economy (Table 2).

Consolidated budget expenditures in 2013 did not change much from last year because the increase in capital expenditures was offset by the decline in recurrent spending. Capital expenditures, which accounted for 40 percent of the total, increase further in 2013 and were essentially on infrastructure projects, primarily roads and water and sanitation. This increase was offset by a decline in current expenditures, mainly purchases of goods and services and other non-classified current expenditures. Social spending which comprises education, health and social protection was maintained in 2013 at last year's level of 7 percent of GDP.

Table 2. Consolidated budget expenditures

percent of GDP

	2012	2013	2014
Consolidated Budget Expenditures	37.2	37.9	38.6
State Budget Expenditures	32.3	33.1	31.7
Capital Expenditures	14.7	15.1	13.3
Current Expenditures	17.2	16.8	17.2
Expenditures on Debt	0.4	1.3	1.2
Expenditures on External Debt	0.3	1.0	1.1
Expenditures on Domestic Debt	0.0	0.2	0.1
Nakhchivan AR Budget Expenditures*	0.1	0.2	0.1
SOFAZ Expenditures**	1.3	1.6	3.0
SSPF Expenditures***	1.6	1.7	2.0
Expenditures on externally financed projects	1.9	1.4	1.8
Consolidated Budget Balance	4.2	1.8	-4
State Budget Balance	-0.3	0.7	-2.6
Non-oil balance as percent of Non-oil GDP	-49	-48	-46

Source: Ministry of Finance and staff calculations.

Notes: * excluding transfers from oil fund; ** excluding transfers to the budget; *** excluding transfers and social contribution of government employees

The decline in average oil prices in 2013 lowered the overall revenue collections compared with the previous year. Oil prices averaged $108/barrel in 2013 compared with $111.7/barrel in 2012 contributing to the decline in oil revenues even though production did not change much between the two years. It also led to the decline in the share of oil revenues in consolidated budget revenues to 72 percent compared with 75 percent in 2012. With robust non-oil growth, non-oil revenues increased in 2013 to 11.1 percent of GDP from 10.5 percent a year ago.

Driven by increased transfers to the state budget and higher extra-budgetary spending, the Oil Fund saved only 10 percent of its revenues in 2013 compared with 23 percent in 2012. The revenues of the Oil Fund did not change appreciably between 2012 and 2013 (Figure 10). However, the government made increasing demands on the Fund to finance its budget. Such transfers have traditionally financed over 50 percent of consolidated budget expenditures. At the same time, extra budgetary expenditures financed improvements in the living conditions for refugees and internally displaced persons, infrastructure projects like the reconstruction of the Samur-Absheron irrigation system and the Baku-Tbilisi-Kars railway and the state program on education. These expenditures amounted to 1.6 percent of GDP in 2013, up from 1.1 percent in 2012. Although the assets of the Oil Fund accounted for a respectable 50 percent of 2013 GDP, the absence of a fiscal rule gives ample discretion to the policy makers to spend these resources and could result in a rapid depletion of the Fund if state finances are under strain.

The 2014 budget signals fiscal consolidation. For the first time in the last 5 years, public investments are projected to decline. Although this could weaken non-oil growth, it is a welcome measure towards maintaining overall macro stability and avoiding a depletion of the Oil Fund. With a decline in budgeted expenditures, transfers from the Oil Fund are also projected to go down. However, a decline in revenues is also projected, thereby, raising the fiscal deficit to 4 percent of GDP in 2014. In addition, the government has agreed to undertake the Public Expenditure and Financial Accountability (PEFA) assessment in 2014 with its development partners. This is a welcome measure as the last PEFA was done in 2008 and the report was not made public.

The priorities for the 2014 budget, in particular, are mainly centered on investments to aid diversification and on social expenditures. Investment spending is budgeted to decline to AZN 8,401 million in 2014 compared to AZN 8,696 in 2013 though they will continue to form a significant part of total expenditures. Social spending is expected to increase by 11 percent to AZN 4,451 million in 2014 but it remains the same as a share of GDP, at 7 percent. In addition, there is also an effort to raise the share of non-oil revenues by 4.5 percent in 2014 compared with the previous year. Fiscal policy in the medium term will continue to focus on infrastructure and social assistance expenditures and on raising non-oil revenues. However, the benefits from the government's efforts at improving tax administration and moving to a simpler tax regime could be nullified by the foregone revenues arising from the variety of tax holidays granted to Special Economic Zones.

Table 3. Consolidated budget revenues

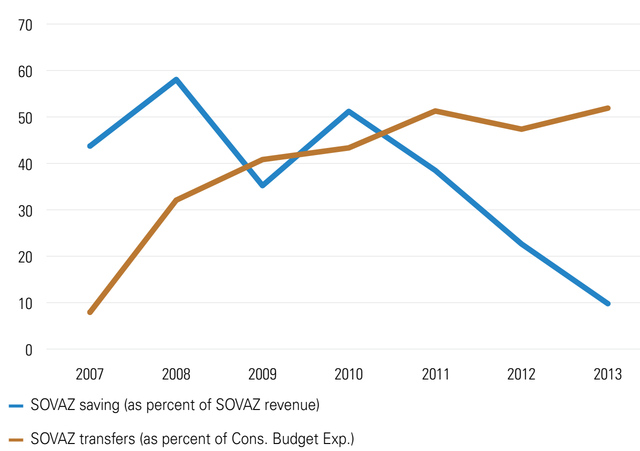
percent of GDP

	2012	2013	2014
Consolidated Budget Revenues	41.4	39.7	34.7
State Budget revenue*	13.8	14.3	14.3
Revenues from the Ministry of Taxes	11.2	11.5	11.2
Oil Sector	5.1	5.0	4.4
Non-Oil Sector	6.1	6.5	6.8
Revenues from Customs Committee	2.2	2.4	2.4
Other	0.4	0.3	0.7
Nakhchivan AR Budget Revenues**	0.1	0.2	0.1
SOFAZ Revenues	25.8	23.6	18.3
SSPF Revenues***	1.6	1.7	2.0
Memorandum items			
Oil revenues	30.9	28.7	22.8
Non-oil revenues	10.5	11.1	11.9
Tax revenues	12.8	13.8	13.0
Non-tax revenues	1.0	1.4	1.3
Transfers from SOFAZ	18.3	21.0	14.7

Source: Ministry of Finance.

Notes: * excluding transfers from oil fund; ** excluding transfers from budget; *** excluding transfers and social contribution of government employees

Figure 10. SOFAZ' saving rate is declining rapidly

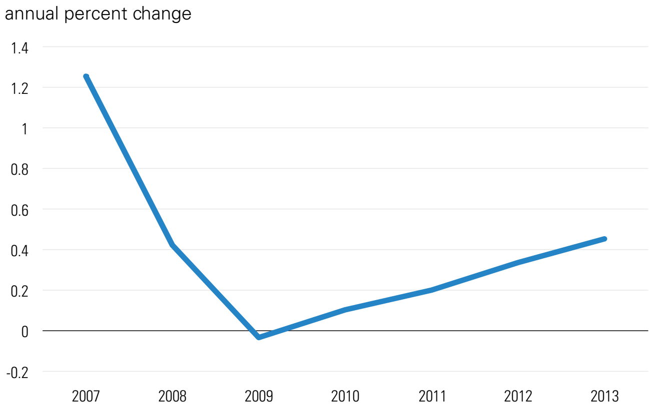


Source: SOFAZ.

Monetary and Exchange Rate Policies

With inflation below target, the central bank reduced the policy rate by 25 basis points to 4.75 percent in January 2013. Average interest rates on commercial bank loans in local currency dropped from 15.2 percent in 2012 to 14.1 percent. However, interest rates continue to be high reflecting weaknesses and rigidities in the financial system.

Figure 11. Consumer loans increased significantly in 2013

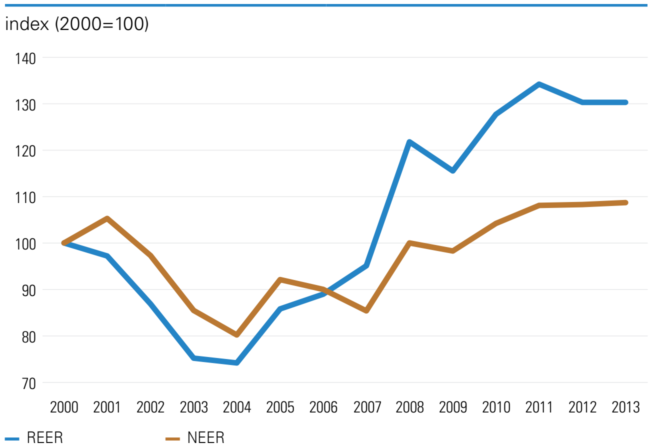


Source: CBA.

Boosted by the decline in interest rates, credit growth increased to 26 percent in 2013 from 24.3 percent a year earlier. This was primarily led by consumer lending which increased by 45 percent (Figure 11). The portfolio of consumer loans nearly doubled between 2011 and 2013 prompting the central bank to introduce more stringent guidelines to avail consumer loans. Growth in lending to the private business sector was slightly lower at 36 percent in 2013 and, as in the past, was concentrated in the areas of construction, trade and services. There was no direct lending by the central bank to the real sector in 2013.

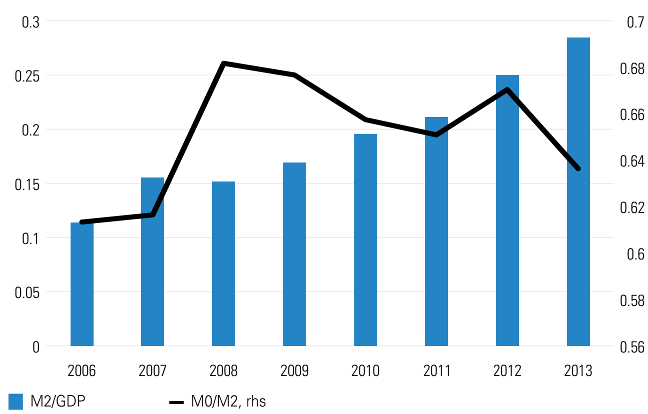
With a stable nominal exchange rate and inflation lower than among its key trading partners, the real exchange rate depreciated by 0.9 percent in 2013. The CBA intervened in the foreign exchange market much more than in 2012 to maintain the fixed exchange rate (Figure 12). Interventions in 2013 totaled $2.4 billion compared with $1.5 billion in 2012. There are no plans to move to a more flexible exchange rate system over the medium-term. The impact of the tapering of quantitative easing in the United States will be limited on Azerbaijan because of its low reliance on external savings and capital inflows.

Figure 12. The real exchange rate stabilized



Source: CBA.

Figure 13. Monetization remains low



Source: CBA.

Financial depth remains limited even with the ratio of broad money to GDP doubling in the last five years to 28 percent. It is still low compared to emerging economies and a substantial part of the broad money is in the form of cash balances (Figure 13). The government is making concerted efforts to reduce the amount of cash transactions and some of the measures in this direction include expansion of electronic payment systems, promoting e-filing for tax returns, and equipping retailers with electronic payment devices.

In the financial sector, the main cause of concern is the decision to recapitalize the International Bank of Azerbaijan without restructuring it. IBA holds 33.4 percent of the total assets of the banking system and there is a need to restructure its operations and governance in line with internationally accepted practices. In the absence of this restructuring, it could pose a systemic risk to the banking system and a fiscal risk to the government. The four-year recapitalization plan was adopted in the meeting of the supervisory board of the Bank in October 2013 and it envisages raising AZN 500 million.

Otherwise, the banking system showed an improvement in 2013 as measured by prudential indicators. The ratio of non-performing loans to the total reduced to 5.1 percent in 2013 from 6.1 percent a year back. The return on assets strengthened to 1.5 percent by the end of 2013 compared with 0.9 in 2012. The banks are adequately capitalized with a capital adequacy ratio of over 18 percent in 2013. The CBA extended for one year the deadline for banks to meet the new capital requirement of AZN 50 million.

Structural Reforms

Azerbaijan's ranking in the 2014 Doing Business report did not change compared with the previous year, neither did its performance on the sub-indicators where it performs poorly. It was ranked 70th out of 189 countries in the 2014 Doing Business Report (Table 4). This was somewhat similar to last year's ranking since the number of countries increased in this year's exercise. Azerbaijan ranks 10th and 13th, respectively, in 'starting a business' and 'registering property'. However, the country is one of the worst performers in 'dealing with construction permits', 'getting electricity' and 'trading across borders'.

In June 2013, the government adopted the new customs tariff law which regulates imported goods. It was developed in accordance with the country's new customs code (adopted in 2012) with the objective of protecting the economy from international competition. The law also has provisions on maintaining data privacy, rights and obligations of traders, rights and duties of customs officials, exemption from customs duties and tariff preferences.

Table 4. Doing business ranking

Topic Rankings	DB 2013 Rank	DB 2014 Rank	Change in Rank
Doing Business Rank	67	70	-3
Starting a Business	18	10	8
Dealing with Construction Permits	177	180	-3
Getting Electricity	175	181	-6
Registering Property	9	13	-4
Getting Credit	53	55	-2
Protecting Investors	25	22	3
Paying Taxes	76	77	-1
Trading Across Borders	169	168	1
Enforcing Contracts	25	28	-3
Resolving Insolvency	95	86	9

Source: Doing Business Report 2013 and 2014.

The government made significant investments on ICT to enable customs operations but they have not helped in automating customs clearance. The Azerbaijan customs administration is well positioned with regard to operational capacity and resources. It makes use of state-of-the art information and communication technologies (ICT) and has developed other supporting infrastructure to support border control activities. The locally developed automated clearance system is fully operational. Past the customs gateway, all information is in digital form, with no hard copy documents used to process or control transactions. To support and manage all of this, a comprehensive modernization strategy (the United Automated Management System, 'UAMS') is in place and is led by a capable and technically knowledgeable person. However, the upgraded technical infrastructure has not led to the creation of a more facilitative trading environment. Most improvements in operational capacity are directed to improving control and border security, more generally. The government uses its customs machinery to ensure national security, above all other considerations. Support to domestic industries (protection from import competition) and community protection (product standards and conformity) are also high on the priority list. Despite all investments on ICT in an effort to automate customs clearance, there is still an intensive, manual pre-approval process that takes place between the trader and the approval agency.

Azerbaijan was ranked 39th (out of 148 countries) in the 2013–14 Global Competitiveness Report, an improvement from last year's rank of 46. This improvement primarily stemmed from a better macroeconomic environment in which the country advanced from the 18th position in 2012 to 8th in 2013. The ranking on institutions also improved from 63rd to 59th. Within institutions, the biggest improvement was in the category of irregular payments and bribes which advanced from the 110th position in 2012 to 87th in 2013. The ASAN service centers could possibly account for this improvement. However, unfair competition and monopolization of the economy continues to remain an issue in Azerbaijan. Azerbaijan ranked 128 (out of 148 countries) in the pillar on 'Intensity of local completion' and 127th in the 'Effectiveness of anti-monopoly policy' according to GCR 2013–14. The Competition Code was drafted in 2004, and is expected to be approved in 2014. The code was prepared with the aim of boosting competition, improving market access and transparency and preventing practices which inhibit competition. However, even though the initial draft has been assessed as satisfactory by the international community, the latest draft, as assessed by international community, is not a significant improvement over the existing legislation. For the most part, it is just a consolidation of the existing laws and does not promote competition any better than the existing rules.

A new inspections law was enacted in July 2013 which consolidates inspections by different public entities into a single system. All government agencies are required to register their inspections under the unified system. In addition, a registry of business inspections was created under the Ministry of Justice. Authorities plan to amend the law to exclude the supervision of the banking and insurance sectors from the overall scope of the inspections law.

D. Outlook

Near-Term Outlook

Economic growth in 2014 will be supported by stabilization in oil production and continued growth in the non-oil sector, albeit at a slightly lower pace. With the on-streaming of the West Chirag oil platform, oil production is likely to be maintained at 2013 levels. This, coupled with the signs of a nascent recovery in Europe, Azerbaijan's main export market for oil, bodes well for the country. Non-oil growth will be a bit lower because of reduced public investment expenditures. As a result, the economy is expected to grow at 5.1 percent in 2014. While a fiscal deficit of 4.2 percent of GDP is expected during the year, the budget makes important strides towards fiscal consolidation.

Medium-Term Outlook

Growth over the next 3 years is expected to moderate to an average of 4.6 percent a year, with lower public investments and declining oil production. This moderation will be driven by the expected decline in oil production, efforts at fiscal consolidation, limited progress on diversification of assets and large scale gas production still being a few years away. Under the current PSA, the country will face a declining trajectory for oil production. Gas production could provide a boost but that will start only from 2019 onwards when Azerbaijan will start exporting gas to Europe. As with all commodities, hydrocarbon prices will also have an important bearing on the country's fortunes.

The non-oil economy will continue to be the main engine of growth over the medium-term. However, it might continue to be driven by the public sector which could run into fiscal sustainability issues. With the announcement of 2014 as the 'Year of Industry', there is a possibility that the government may end up pursuing sector-specific policies which could be detrimental to the long-term growth prospects of the country. A modest increase in public expenditures on health and education in 2014 adds to the concerns that the government's efforts at diversification might not be headed in the right direction. In 2015, the country will host the first European Games and in preparation, significant construction will be undertaken. Hence, publicly driven construction may continue to be a major source of growth in the medium-term.

Appendix

Appendix 1. Economic and Social Indicators – Azerbaijan 2005–2016

Selected Indicators	2008	2009	2010	2011	2012	2013	2014	2015
Income and Economic Growth	*(in percent unless indicated otherwise)*							
GDP growth (percent change)	10.8	9.3	5.0	0.1	2.2	5.8	5.2	4.1
GDP per capita (in US dollars)	5,603	5,018	5,922	7,156	7,491	7,842	8,597	9,265
Private Consumption growth	17.4	6.4	-15.0	17.4	2.0	7.1	10.2	10.3
Gross Domestic Investment (percent of GDP)	19.8	18.4	18.5	21.2	23.7	26.8	25.3	24.5
Public	12.5	12.3	10.9	11.3	14.7	15.1	13.9	13.8
Private	7.3	6.0	7.6	9.9	9.0	11.6	11.5	10.7
Gross national savings (% of GDP)	53.5	41.4	46.6	47.6	43.4	42.4	38.6	32.7
Money and Prices								
Consumer price inflation (percent change, year-end)	20.8	1.5	5.7	7.8	1.1	3.50	..	..
Consumer price inflation (percent change, annual average)	15.5	0.7	7.8	5.5	-0.3	2.40	3.50	2.50
Nominal Exchange Rate (manat per dollar, end-year)	0.801	0.803	0.798	0.787	0.785	0.785	0.785	0.785
Real Exchange Rate Index (1998=100)	103.1	117.6	118.8	121.9	123.1	130.3	127.8	126.1
Fiscal	*(in percent of GDP unless indicated otherwise)*							
Revenues	48.4	40.4	45.8	45.4	41.4	39.7	34.2	33.9
Expenditures	29.5	33.8	32.1	34.3	37.2	37.9	38.2	37.6
Current	17.0	21.4	21.2	23.0	22.5	22.8	24.3	23.8
Capital	12.5	12.3	10.9	11.3	14.7	15.1	13.9	13.8
Fiscal Balance before grants (% of GDP)	18.9	6.6	13.7	11.1	4.2	1.8	-4.0	-3.7
Fiscal Balance after grants (% of GDP)	18.9	6.6	13.7	11.1	4.2	1.8	-4.0	-3.7
Primary Fiscal Balance (% of GDP)	19.2	7.0	13.9	11.8	4.4	2.1	-3.7	-3.4
Primary Non-Oil Fiscal Balance (% of GDP)	-19.1	-21.3	-21.5	-23.8	-24.6	-26.2	-26.2	-25.3
External debt, total (current US$ million)	9,368	8,960	11,012	9,945	11,927	13,229	14,781	16,144
External public debt								
Total Public Debt	6.9	11.8	11.1	10.2	11.3	11.7	11.9	11.9
External Accounts	*(In millions of US dollars unless indicated otherwise)*							
Export growth (percent change, constant prices)	7.8	8.1	24.2	-0.6	-8.3	1.1	0.97	-0.85
Import real growth (percent change, constant prices)	14.3	-5.3	1.3	35.6	0.0	13.9	9.4	7.6
Merchandise exports	30,586	21,097	26,476	34,495	30,927	32,380	32,358	30,754
Merchandise imports	7,575	6,514	6,746	10,166	10,267	11,422	12,738	13,680
Services, net	-2,343	-1,613	-1,733	-2,996	-3,461	-3,901	-4,436	-5,096
Workers' remittances, net	1,017	659	498	634	..			
Current account balance (BoP, current US$ millions)	16,454	10,173	15,040	17,146	12,702	12,137	10,257	7,180
as percent of GDP	33.7	23.0	28.4	26.5	21.7	16.5	12.6	8.1
Foreign Direct Investment, net (current US$ millions)	-545	146	329	913	1,245	1,390	1,509	1,586

Population, Employment and Poverty								
Population (millions)	8.8	8.9	9.0	9.1	9.2	9.3	9.4	9.5
Population Growth (percent change)	1.31	1.33	1.13	1.26	1.36	0.8	0.8	0.8
Unemployment Rate (percent of labor force)	5.9	5.7	5.6	5.4	5.2	4.50		
Poverty headcount ratio (percent of population)								
national poverty line	13.2	10.9	9.1	7.6	6.0	5.3		
At US$ 1.25 a day PPP								
At US $2 a day PPP								
Gini coefficient (income)	30.7	..	..	29	..			
Life Expectancy (years)	73.4	73.5	73.6	73.8	..			
Other								
GDP (current LCU, billions)	40.1	35.6	42.5	51.2	54.0	57.7	63.8	69.2
GDP (current US$, billions)	48.9	44.3	52.9	64.8	68.7	73.5	81.2	88.2
Doing Business Rank 1	97	38	55	69	67	70		
HDI (Human Development Index) ranking 2	98	86	67	91	..			
CPIA (overall rating)	3.8	3.8	3.7	3.7	3.7			
Economic Management	4.5	4.5	4.3	4.3	4.3			
Structural Policies	3.8	3.8	3.5	3.7	3.5			
Social Inclusion and Equity Policies	3.8	3.8	3.8	3.8	3.7			
Public Sector Management and Institutions	3.2	3.2	3.1	3.1	3.0			

1/ This indicator is ranked out of 175 countries in 2007, 178 in 2008, 181 in 2009 and 183 in 2010 and 2011, 2012–2013 189

2/ The HDI ranking in 2008 is in relation to 177 countries; in 2009, to 181; in 2010, to 169 countries; and, in 2011, to 187 countries, in 2012 to 185

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