The CESD Assessment on the 2017 State Budget Project

By CESD Research Team

Center for Economic and Social Development (CESD)
Shirin Mirzeyev 76 "a"/33,
Baku, Az1002,
AZERBAIJAN

Phone/Fax: (99412) 4975684
Email; info@cesd.az
URL; www.cesd.az

CESD PRESS

Baku, November 23rd, 2016
Content

Introduction ................................................................................................................. Error! Bookmark not defined.


2. Macroeconomic Overview of the Economy of Azerbaijan ......................................... 4

3. Forecasts for 2017 and next three years .................................................................... 5

4. Summary of 2017 Budget Forecasts ........................................................................... 6
   4.1. SOFAZ budget ........................................................................................................ 6
   4.2. State Budget Revenues ............................................................................................ 7
       4.2.1. Non-oil revenues of the State Budget .............................................................. 9
       4.2.2. Tax Revenues .................................................................................................. 9
       4.2.3. Budget Revenues via State Customs Committee ............................................. 11
       4.2.4. Budget Transfers of State Oil Fund ................................................................. 11
   4.3. 2015 State Budget Expenditure ............................................................................... 12
       4.3.1. Social expenditure of the State Budget ............................................................ 14
       4.3.2. Social, defense and social assistance expenditure of 2017 ............................... 15
       4.3.3. Education expenditure .................................................................................... 16
       4.3.4. Healthcare expenditure of 2017 State Budget .............................................. 17
       4.3.5. State Debt Expenditure for 2017 .................................................................. 18
       4.3.6. State capital investment .................................................................................. 19
       4.3.7. Local revenues and expenditure of the State Budget ..................................... 19
       4.3.8. Expenditure directions not included in main sections of the State Budget ........ 20

Conclusion ....................................................................................................................... Error! Bookmark not defined.
Introduction

According to the legislation on the Budget system, the legislative project on the state budget of the Republic of Azerbaijan for 2017 and the state and consolidated budget projects of 2017 were publicized on 29th of September, 2016.

It has been three years that the legislative projects on the consolidated and state budgets of the Republic of Azerbaijan are being prepared amidst the absence of positive economic trends for the country. Specifically, during the preparation of 2017 state budget, external and internal economic impacts were considered at greater extent. As in previous years, the Center for Economic and Social Development has prepared a comparative analysis of the budget project publicized by the government.

It is to be mentioned that, during the preparation of the analysis, the conversion of indicators into the foreign (US dollars) currency is carried out according to annual average currency indicators published by the Central Bank of the Republic of Azerbaijan, whereas the conversion of 2016 indicators into US dollars is conducted in accordance with the average exchange rate of first 8 months (1 US Dollars = 1.56 manat) and 2017 indicators in accordance with the official exchange rate dated 29th September 2016 (1 US dollars = 1.6252 manat).

The comparison of the budget project with previous years plays a prominent role in the forecasting of socio-economic trends for next year and the determination of state fiscal policy and the short-term and strategic position of the government in separate directions.


Amidst the sharp volatility observed especially in oil markets, the declining impact of Chinese and Japanese economies on the global economic expansion, the ongoing recession of Russian economy, adverse impacts of political uncertainties observed in Turkey and Near East countries on the pace of economic growth and important events such as Brexit causing the grounded concerns regarding the fate of the European Union, the world economy has performed below the expectations within the first three quarters of 2016. Hence, resource-exporting countries have encountered more adverse economic pressure (weakening economic growth, fiscal instability, depreciation of national currencies, shrinking consumption etc.) in comparison with others.

It is to be noted that, it was agreed to set quotas on oil production for the first time after 8 years on 28th of September in Algiers meeting of OPEC countries, which produces 40% of the world supply. Although the surge of oil prices is not observed in world markets due to the uncertainty regarding the formalization of the obtained agreement in November, 7-10 dollar price increase per barrel is forecasted in 2017 in case of the formalization of the agreement (Goldman Sachs\(^1\)).

---

\(^1\) Oilprice.com, “Goldman Sachs: OPEC Freeze Could Add $10 To Oil Prices”, 29.09.2016
http://oilprice.com/Energy/Oil-Prices/Goldman-Sachs-OPEC-Freeze-Could-Add-10-To-Oil-Prices.html
2. Macroeconomic Overview of the Economy of Azerbaijan

“Macroeconomic processes observed in the world has exerted an impact on the economy of Azerbaijan, and in comparison with previous years, substantially different macroeconomic situation is dominant in our country in the recent period. The surge of total supply in world energy markets and the poor accordance of the demand with this surge conditions the persistently low oil prices which is the main revenue and foreign currency source for the country’s economy. This, in turn, has caused the decline in the foreign currency inflows and the current account deficit in the economy. The exchange rate of national currency has been subject to the pressure during the ongoing year after two consecutive devaluations in 2015. Alongside with the indicators listed, the shrinkage of credit capacity of the banks and the reduction of GDP during the previous period amidst the dollarization and accelerating inflation characterize the complex macroeconomic situation encountered by our country.” 2

As seen, the government officially admits the complexity of current economic situation. It is worth mentioning that, in first 8 months of 2016, GDP has been estimated as 24, 36 billion US dollars. In comparison with the corresponding period of the previous year, the economy has shrunk by 3,1%. The main reason of economic decline was 32,3% shrinkage of GDP generated by construction sector in comparison with previous year.

**Figure 1. Dynamics of GDP and GDP per capita annually, million US dollars**

GDP per capita has declined to 2534 US dollars. The average nominal monthly salary has constituted 304 US dollars and inflation was equal to 10,8% in January-July months of the ongoing year. 78,2% of the population income was spent on final consumption goods.

The foreign trade circulation of the Republic of Azerbaijan has constituted 12,1 billion US dollars in January-July months of 2016, 7.4 billion US dollars of which were attributed to total

---

exports, while total imports constituted 4.8 billion dollars. In comparison with corresponding period of 2015, import and export volume have decreased by 10.5% and 38.7% respectively.

The State budget revenues and expenditure have equaled to 6.5 billion US dollars (10.1 billion manats) and 6.8 US dollars (10.6 billion manats), respectively during January-July period of the ongoing year. The budget deficit was equal to 0.32 billion US dollars (0.5 billion manats) which amounted to 1.1% of GDP.

The state budget revenues in January-August months of the current year have been estimated as 6.5 billion US dollars (10.1 billion manats), whereas the budget expenditure have was to 6.8 US dollars (10.6 billion manats). The budget deficit of 0.32 billion US dollars (0.5 billion manat) has constituted 1.1% of GDP.

In first eight months of 2016, the credit portfolio of bank and non-bank credit organizations has shrunk by 17.2% in comparison with the previous year. The volume of non-performing loans has amounted to 9.3% of total loans.

Strategic currency reserves of the Republic of Azerbaijan have declined by 14.3 billion US dollars or 26.3% in comparison with the first half of 2014 year. At present, strategic currency reserves are at 40.1 billion US dollars (01 September 2016) level. 35.9 billion US dollars or 90% of total currency reserves are concentrated in SOFAZ.

According to the information for April 1st of the current year, the foreign debt of the Republic of Azerbaijan was equal to 7.5 billion US dollars constituting 21% of GDP.

To weaken the resource-dependence of the country, the government has taken specific measures towards the diversification of non-oil sector of the economy. Some institutional changes are already carried out and legislative projects are approved, the roadmap is prepared and the development of the plan of strategic measures on specific economic sectors is entrusted to “MC Kinsey”.

3. Forecast for 2017 and next three years

According to the “Law on the Budget System “of the RA, The Ministry of Economy of the Republic of Azerbaijan prepares the forecast of economic and social development for 2017 and next three years. According to the forecast, country GDP will grow by 1% in 2017 [see: table 1].

<table>
<thead>
<tr>
<th>GDP</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>-real growth, in percent</td>
<td>1.0</td>
<td>1.5</td>
<td>2.8</td>
<td>2.4</td>
</tr>
<tr>
<td>-real growth in non-oil sectors</td>
<td>2.5</td>
<td>2.6</td>
<td>1.7</td>
<td>2.8</td>
</tr>
</tbody>
</table>

As seen from the Table, the share of non-oil sector of Azerbaijani economy is forecasted to increase in subsequent three years.

---


Figure 1. The share of oil sector and non-government sector in GDP, in percentage


It is to be noted that, after slumping to its minimal level of 43.9% in 2007, the share of non-oil sector in the economy has exhibited a noteworthy growth starting from the second half of 2014 due to the declining oil production. As a result, the share of this sector has increased to 69.3% in 2015.

4. Consolidated budget forecast for 2017

The consolidated budget of the Republic Azerbaijan is constituted of the state budget, the budget of the Autonomous Republic of Nakhichevan, State Oil Fund and the budget of State Social Protection Fund under the Ministry of Labor and Social Protection of the Population of RA. It must be noted that, Azerbaijani Government has envisaged three development scenarios while preparing the budget project: pessimist – 35 dollars per barrel, base – 40 dollars per barrel and optimist – 45 dollars per barrel. Oil prices have a direct effect on the revenues of the state budget and SOFAZ budget components of the consolidated budget.

The consolidated budget revenues are forecasted as 12.2 billion US dollars (19.7 billion manats), exceeding the current year revenues by 39.3% and the expenditure as 12.9 billion US dollars (21 billion manats), being 14.7% less in comparison with the current year. Hence, it is clear that, the government has taken prudent measures under existing conditions in order to minimize the consolidated budget deficit. Such that, the consolidated budget deficit is projected as 0.7 billion US dollars (1.25 billion manats) for the next year.

4.1. SOFAZ budget

In case of average oil price of 40 US dollars per barrel, the Fund revenues and expenditure are projected as 5.15 billion US dollars (8.4 million manats) and 4.38 US dollars (6.95 billion manats).
manats), respectively. Thus, SOFAZ will succeed to achieve the revenues of 770 million US dollars.

Figure 2: SOFAZ revenues, by years

![Figure 2: SOFAZ revenues, by years](image)

Source: SOFAZ, 2016

Figure 2 demonstrates the sharp decline of the oil fund revenues starting from 2011. The observed decline has damaged the fiscal sustainability of the country and weakened the general economic dynamics.

The transfers to the state budget constitute 87.8% or 3.75 billion US dollars (6.1 billion manats) of fund expenditures. The volume of fund transfers to the budget is projected as 23% less in comparison with 2016 budget forecast and 4 times less in comparison with 2013 year (ceiling level).

4.2. State Budget Indicators

The revenues of 2017 state budget is projected as 9.842 billion US dollars (15.96 billion manats), which is 5.2% lower in comparison with the current year. It is to be noted that, after the long-term steady growth, the state budget revenues have begun to decline starting from 2014 due to the plunging oil prices. The ongoing trend is expected to be observed in the next year as well.

Figure 3: Dynamics of state budget revenues, by years

![Figure 3: Dynamics of state budget revenues, by years](image)
As seen, the state budget revenues have reached 10.8 billion US dollars in 2016, shrinking by 57% in comparison with 2013. The main reason for decreasing budget revenues is the declining revenues from the oil sector. Such that, the share oil revenues in budget inflows has reached its peak of 73.8% in 2011; however, the share was sharply declining starting from 2014.

**Diagram 2: Share of oil sector in state budget revenues, in percent, by years**


So, after the large oil windfalls, 50% of budget revenues will be generated by non-oil sector in 2017. However, the main factor of the increasing share of non-oil sector is the decline of oil receipts due to compelling reasons. As a result, oil revenues of the state budget are projected as 4.845 billion US dollars (7.85 billion manats) according to the base forecast. It is to be noted that, 77.7% of oil sector receipts will be generated by SOFAZ transfers, whereas 22.3% will be accounted for tax payments of oil sector. In general, tax collections from oil sector are projected to increase by 9% in comparison with previous year.

**Diagram 3: Breakdown of State Budget Revenues, in percent**

It is projected that, 59% of state budget revenues will be generated by tax and tariff collections in 2017.

4.2.1. Non-oil revenues of State Budget

Non-oil revenues of the state budget are projected as 5 billion US dollars or 8.1 billion manats, which exceeds the similar indicator of the current year in US dollar terms, but is 29.5% lower in comparison with 2015. It must be mentioned that, the growth of non-oil revenues amidst the economic recession is achieved through the attempts of the government to formalize the economy and to strengthen of measures against the corruption in State Customs Committee. The growth of non-oil sector in manat terms is till observed, although weaker. Such that, the receipts from this sector will increase by 0.5 billion in manat terms or 6.6% in comparison with previous year.

Diagram 4: Non-oil revenues of State Budget, by years


As seen, although non-oil sector revenues have grown in manat terms, it has started to decline in US dollar terms due to the devaluation of national currency. Hence, non-oil revenues have deteriorated by 37.3% in US dollar terms in comparison with 2014. The maximum level in this regard was observed in 2014 (7.98 billion US dollars).

4.2.2. Tax revenues

Tax revenues will reach 4.45 billion US dollars or 7.21 billion manats constituting 45.2% of the state budget in 2017. 75.7% of total tax receipts are projected to be generated by non-oil sector.
Diagram 5: Tax revenues of State Budget, by years


It must be mentioned that, the reason for the sharp reduction in revenues collected via the Ministry of Taxes is the devaluation of the currency. However in reality, the corresponding indicator was at the constant level in average in last four years. Alongside, tax revenues from oil sector have been declining, while tax collections from non-oil sector were sought to rise.

Figure 4: Tax revenues from oil- and non-oil sector, billion US dollars


As seen, tax revenues amounted to 3.52 billion US dollars on average during 2011-2014 years. Considering the projections from 2016 and 2017 years, the sharp reduction in oil prices implies 6.4 billion US dollars’ loss in terms of direct tax revenues for state budget in last 3 years. Hence, the adverse effects of resource dependence strictly necessitate the diversification of economy.

Overall, the growth of tax collections is projected from personal income tax (by 60 million manats of 5.6%), profit tax (153 million manats or 8%), whereas the revenues from tax sanctions are expected to decline (by 39 million manats or 11.8%).
4.2.3. Budget revenues via State Customs Committee

In 2017, the budget revenues received via State Customs Committee are projected to grow by 21.5% in terms of local currency in comparison with 2016. The main factor of growth is that, the source of revenues is in foreign currency terms. This factor as such was crucial in the growth of customs tariffs in subsequent period. At the same time, the application electronic customs declarations and the rise of import tariffs for the products also produced within the country have favorably affected the volume of revenues. Hence, the budget revenue is projected as 1.35 billion US dollars or 2.2 billion manats. Overall, the dynamics of budget revenues via State Customs Committee has been observed as below.

**Figure 6: Dynamics of budget revenues via State Customs Committee, in billion US dollars**

![Diagram showing the dynamics of budget revenues via State Customs Committee.]

**Source: Ministry of Finance of the Republic of Azerbaijan**

As seen from the diagram, customs revenues have steadily declined in foreign currency terms starting from 2014. It is noteworthy that, the slump in oil prices has resulted in the reduction of investment expenditure by the government and the decline in aggregate demand within the country, which has led to 6.2% reduction in comparison with previous year despite the import formalization.

The main source of increase in customs collection is 26.1% or 0.2 billion US dollars (0.34 billion manats) increase in the volume of value added tax (VAT) which constitutes 74% of main revenues sources. The growth will be achieved through the adopted measures towards the import formalization. Moreover, 17% in terms of national currency or 0.04 billion US dollars (0.066 billion manats) increase is projected in the volume of customs tariff revenues. The changes carried out in tariff policy (the application of higher tariffs for the products groups also produced within the country) will constitute the main source of the growth.

4.2.4. Budget Transfers of State Oil Fund

As noted above, the support of SOFAZ to the state budget is observed to decline. The plunging oil prices has led to a large reduction in Fund revenues which resulted in the adoption of measures of expenditure control and the protection of Fund reserves which is considered as the buffer for the country economy. Hence, the volume of transfers from the Fund is regularly reduced which is observed in the revenues of state budget.
So, transfers from the Fund to state budget in 2017 will be 30% in US dollar terms and 25% in manat terms in comparison with the current year and 3.9 and 2.4 times less in US dollar and manat terms respectively, in comparison with 2013, which was the year of maximum transfers made. As seen from the figure, the decline in the volume of Fund transfers is moderate in manat terms and sharp in dollar terms. Overall, the Oil Fund will transfer 72.9% of its total revenues to the state budget in 2017. The share of transfers in state budget revenues is projected as 38.2%.

4.3. 2017 state budget expenditure

First, it must be mentioned that the project of 2017 state budget reflects the shift of the government to the strict regime of thrift. Such that, the growth in allocated resources is only observed for four out of 14 expenditure components of state budget. Overall, the state budget expenditure has declined by 13.8% or 1.64 billion in dollar terms and 10.2% in manat terms. The reduction is mainly carried out in functional expenditure components of the state budget such as social protection and social assistance, defense, and industry and construction.
As illustrated in Figure, the maximum level of state budget expenditure was observed in 2013 in both manat and US dollar terms, and the expenditure projected for 2017 is 13.2% or 2.4 times lower in dollar terms. It is noteworthy that, GDP generated by the rapid growth of budget expenditure during 2006-2013 years has begun to shrink amidst the reduction in expenditure, and such tendency is also projected for 2017 and 2018 by the experts of the Center for Economic and Social Development (CESD).

Table 2: State budget expenditure on functional components in 2017, in comparison with 2016 (in percent)

<table>
<thead>
<tr>
<th>Total Expenditure</th>
<th>2017 vs 2016 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. General state services</td>
<td>-2.2</td>
</tr>
<tr>
<td>2. Defense</td>
<td>-27.5</td>
</tr>
<tr>
<td>3. Judiciary, law enforcement agencies and public prosecution office</td>
<td>2.1</td>
</tr>
<tr>
<td>4. Education</td>
<td>1.6</td>
</tr>
<tr>
<td>5. Healthcare</td>
<td>-6.6</td>
</tr>
<tr>
<td>6. Social protection and social assistance</td>
<td>-21.5</td>
</tr>
<tr>
<td>7. Culture, arts, information, sports, and activities not included in other sections</td>
<td>-30.5</td>
</tr>
<tr>
<td>8. Housing maintenance and utilities</td>
<td>-32.1</td>
</tr>
<tr>
<td>9. Fuel and Energy expenditure</td>
<td>-22.4</td>
</tr>
<tr>
<td>10. Agriculture, forestry, fishery, hunting and environmental protection</td>
<td>20.2</td>
</tr>
<tr>
<td>11. Industry and construction expenditure</td>
<td>-37.8</td>
</tr>
<tr>
<td>11.1. State capital expenditure</td>
<td>-38</td>
</tr>
<tr>
<td>12. Transportation and communication</td>
<td>-21.7</td>
</tr>
<tr>
<td>13. Other expenditure related to economic activities</td>
<td>-18.5</td>
</tr>
<tr>
<td>14. Services not included in main sections</td>
<td>67.2</td>
</tr>
</tbody>
</table>

Moreover, CESD experts conclude that, as in 2015-2016, the Ministry of Finance will carry out a general cut in government spending for the unprotected part of the state budget and the expenditure will be lower than projected *(protected expenditure of the state budget: salaries, salary bonuses, pensions, social benefits and obligations, state (foreign and local) debt service, the purchase of food products and medication)*.

It is to be mentioned that, in 2017, 6.6% of state budget, that is, 0.678 billion dollars or 1.1 billion manats are allocated to subsidies.

The share of current expenditure is reduced by 1.9 percentage points in the structure of total expenditure of state budget, whereas, the share of state debt service expenditure has increased by 1 percentage points. On the other hand, the share of capital expenditure has shrunk by 2.9 percentage points. Hence, the breakdown of total expenditure is projected as follows.

### Diagram 7: Breakdown of total expenditure of 2017 state budget

**Source: Ministry of Finance of the Republic of Azerbaijan, 2016**

Overall, it is projected that the state budget spending as a share of GDP will shrink by 4.4 percentage points in comparison with previous years constituting 26.6% of GDP. 67.3% of total expenditure or 6.87 billion US dollars (11.17 billion manats) are attributed to current expenditure, which is 7.7% less in manat terms in comparison with the previous year. Hence, as observed in past years, non-oil revenues will be unable to cover the current expenditure in 2017 as well.

#### 4.3.1. Social expenditure of State budget

Social-oriented expenditure (labour compensation, pensions and benefits, total expenditure on the purchase of medicaments, bandaging supplies and materials, as well as food products) has been increased by 6.6 percentage points in comparison with past year and projected as 6.8 billion manats or 4.2 billion US dollars. The reduction of 95 million US dollars in total expenditure of state budget and the growth of the resource allocated to this section are the main factors of growth dynamics in the share of total expenditure. It is to be noted that, the social expenditure constitutes 41.1% of total expenditure.
3.86 billion US dollars (6.26 billion manats) or 92% of social expenditure are constituted by labour compensation, as well as pensions and social benefits. Those costs will constitute 37.7% of total budget expenditure. The share of labour compensation expenditure in total expenditure of state budget is 25.1% (4.17 billion manats or 2.56 billion US dollars).

4.3.2. Social, defense and social assistance expenditure of 2017

Social protection and social assistance costs in 2017 is projected as 1.2 billion US dollars or 2.12 billion manats. It is to be noted that, the corresponding indicators are expected to be 1.73 billion US dollars or 2.7 billion manats in the ongoing year. As a result, it is projected to spend 0.43 billion US dollars or 25% less in 2017 in comparison with 2016. Overall, social protection and social assistance expenditure will constitute 12.8% of total expenditure (Note: social protection and social assistance costs include pensions and benefits, targeted social assistance, and the social spending on the issue of internally displaced people).

Figure 7: Social protection and social assistance expenditure

As observed, the social protection and social assistance expenditure have sought to decline starting from 2014, that is, the period of slumping oil prices. In general, the projection for 2016 is 50.7% lower than that in 2014 in dollar terms. Although the main factor of the decline is the sharp depreciation of currency, high inflation has also become one of the factors leading to the depreciation of the expenditure in real terms.

60.1% of the social protection expenditure, that is, 0.78 billion US dollars or 1.27 billion manats are projected to be allocated to State Social Protection Fund, 28.2% or 0.37 billion US dollars (0.6 billion manats) to the Ministry of Labor and Social Protection of the Population, and 11.4% or 0.15 billion US dollars (0.24 billion manats) to the State Committee on Deals of Refugees and IDPs. It must be noted that, the main reason for the shrinking social expenditure in 2017 is the cut of subsidies “for the subsection of “Social protection, pensions and other social assistance expenditure”, which constitutes approximately 0.66 billion manats or 0.4 billion US dollars.

4.3.3. Education Expenditure

In the next year, education expenditure will constitute 11,2% of total expenditure, which is 1.3 percentage points higher in comparison with the ongoing year. The main cause of the increase in the share is the reduction of total expenditure. Hence, the education expenditure in 2017 will amount to 1,14 billion US dollars or 1,86 billion manats. The main expenditure growth is observed in the general education expenditure. Such that, budget expenditure on this section is projected as 4,3% or 41 million manats (25,2 million US dollars) higher than in the ongoing year. The share of separate education levels in total education expenditure is illustrated in the following diagram.

Diagram 9: Main directions of education expenditure, in percent


52.8% or total education expenditure or 0.6 billion US dollars (0.98 billion manats) overall are allocated to general education. Higher education expenditure continues to decline. At present, higher education institutions shift to self-financing scheme; hence, only 0.2% of total education expenditure or 23 million US dollars (37.5 million manats) will be allocated to higher education.
The education expenditure of the budget during past years has steadily increased in manat terms, and the share of education expenditure in state budget has increased by 1.2 percentage points reaching 11.2% in 2017 in comparison 2010. However, the depreciation of national currency and two-digit inflation has caused the depreciation of allocated resource in real terms. Hence, education expenditure does not have a supportive impact observed in previous years.

4.3.4. Healthcare expenditure of 2017 state budget

Healthcare expenditure for 2017 is projected as 0.2 percentage points higher in comparison with the ongoing year reaching 4.7 percent as a share of total expenditure; however, the allocations have declined both in national currency terms (6.6% less) and US dollar terms (11.2%) [see: diagram 11]. Such that, it is planned to allocate 0.477 billion US dollars or 0.776 billion manats to the healthcare sector in 2017.


As seen, healthcare expenditure of the state budget has shrunk twofold in US dollar terms in comparison with 2014.
Out of the budget resources to be spent on healthcare during the year, 47.1% is assigned for hospitals, 15% for polyclinics, 37.1% for research, and development, etc. services in healthcare. It is to be noted that, the government envisages to commence the implementation of country-wide mandatory insurance in 2017. However, CESD experts reckon that, the national healthcare system is not ready for the implementation of compulsory insurance system both in technical terms and in terms of formation of financing mechanisms. In other words, the capability of the improvement and diversification of the financing mechanisms of healthcare system is assessed as limited. As in past years, the large share of healthcare expenditure in 2017 is attributed to individual payments (direct spending by citizens).

4.3.5. Government debt management expenditure for 2017

The government debt service expenditure will constitute 1.1 billion US dollars or 1.77 billion manats, which is similar with the amount planned for 2016. However, the government debt service expenditure is increasing in comparison with ongoing year. CESD experts forecast the increase in expenditure in later years. Such that, government foreign debt has increased in last two years [see: diagram 12]. As a result, the share of foreign debt in GDP has risen to 20% for the beginning of 2016. The main reason for the rapid increase of the debt is that the GDP has shrunk in foreign currency terms (due to devaluations) and the debt is in foreign currency.

Diagram 12: Government debt service expenditure, in billion US dollars

![Diagram 12: Government debt service expenditure, in billion US dollars](source: Ministry of Finance of the Republic of Azerbaijan, 2016)

At present, the volume of foreign government debt is 7.6 billion US dollars. 4 billion dollars of the total debt are due 10-year period. It must be mentioned that, some large enterprises which have applied for foreign financing with the government guarantee scheme are not able to perform the debt liabilities, which exerts additional expenditure burden for the budget.

Overall, CESD experts reckon that, due to various reasons:

- Financing of large-scale enterprises (e.g. Southern Gas Corridor);
- Projection of low oil prices for next 2 years etc.

the volume of foreign debt will rapidly increase in subsequent years.

It is to be mentioned that, including the foreign debt service, 3.06 billion US dollars or approximately 30% of state budget expenditure are projected to perform in foreign currency, which is considered as one of the reasons putting and upward pressure on currency risks during budget
execution. To regulate such kind of risks, additional expenditure of 51.7 manats US dollars (84 million manats) are considered in the budget project.

The maximum of local borrowing in state budget is projected as 615.3 million US dollars (1000 million manats), whereas the maximum for foreign borrowing are considered as 307.7 million US dollars (500 million manats); the maximum level of government guarantees during the years are planned as 6.15 billion US dollars (10000 million manats).

4.3.6. Government capital expenditure

The capital expenditure of the state budget is projected to sharply decline in 2017. The main cause of the decline is the preparation of the budget by considering the economic realities (low sale prices of oil, rapid reduction of revenues, high level of corruption risk of infrastructure expenditure, thrift regime for Oil fund resources, keeping the budget deficit at manageable level etc.). Such that, the volume of capital expenditure in 2017 will constitute 1.15 billion US dollars (1.87 billion manats), which is 0.8 billion US dollars lower in comparison with the ongoing year.

**Diagram 13: 2017 Capital expenditure**

![Diagram showing capital expenditure in billion US dollars and manats from 2011 to 2017 (projected)]

*Source: Ministry of Finance of the Republic of Azerbaijan, 2016*

As seen, country investments directly hinge on the oil revenues. Starting from 2014, the volume of such expenditure has sharply shrunk. Hence, the volume of projected investment expenditure in 2017 has declined by approximately 7.7 times in dollar terms and 3.7 times in manat terms. Given that, the GDP growth was mainly achieved through the state budget spending, it is to be noted that, the decline in capital expenditure has adversely affected the economic growth and the similar situation is projected for the next year as well. Alongside, the decline in the volume of capital expenditure can favorable affect the effective utilization of public resources as well.

30.1% or approximately 0.35 billion US dollars (0.56 billion manats) of projected capital expenditure will be allocated to the increase of the share capital for the financing of SOCAR’s participation share of in Southern Gas Corridor, and 69.9% to the fulfillment of liabilities of Azerbaijan in investment projects executed with foreign loans according the government guarantee scheme. Moreover, the execution of the projects is considered for the construction of social housing and the provision of accommodation for citizens under favorable conditions, which envisages the allocation of 61.5 million US dollars or 100 million manats in this regard.

4.3.7. Local revenues and expenditure of State Budget
It must be mentioned that, amidst the slumping oil prices, the decline in government revenues has necessitated the reconsideration of the state policy in several fields, including the implementation of the strategy for the shift to self-financing. It is expected that only 6 regions or towns throughout the country will be able to meet the local expenditure with local revenues. This indicator is projected to reach 33 in 2017. However, the basis of the increase in number of self-financed regions is not due to the increase in local revenues or other initiatives, but the changes taken place in the breakdown of the state budget. Such that, while forecasting 2017 state budget, education (excluding pre-school education financing), culture, arts, information, sports etc. spending are excluded from local expenditure, which constitutes 60% of local expenditure in general. Thus, the reduction of local expenditure and the rise in the number of self-financed take place. In order words, the noteworthy improvement in this case has emerged by the alteration of expenditure sections.

Overall, in 2017, the local expenditure of state budget is projected as 53.3% or 0.5 billion US dollars (0.82 billion manats) less in comparison with the ongoing year. The inclusion of education spending in centralized expenditure. Thus, the volume of subsidies from state budget allocated for the financing of local spending has reduced to 10.6% by shrinking 42.7 percentage points.

**Diagram 14: Breakdown of local expenditure, in percent**

![Diagram](image)

*Source: Ministry of Finance of the Republic of Azerbaijan, 2016*

As seen from the diagram, the share of education spending in local expenditure was reduced from 60% to 23.65%, while the expenditure of pre-school education facilities financing was included in local expenditure during project preparation. Other education spending is included in the centralized expenditure. Incidentally, it is to be mentioned that, 41.5% or 3.89 billion US dollars (6.33 billion manats) of the centralized expenditure are attributed to Baku city.

**4.3.8. Other expenditure sections of State Budget not included in main sections**

61.1 million US dollars is planned to be allocated from the state budget towards the improvement of accommodation of the population which is twofold higher than that in the ongoing year. Those resources are to be utilized via “Azerbaijan Mortgage Fund” OJSC and the State Agency for Housing Construction - MIDA. It is to be noted that, MIDA is established amidst the institutional reforms carried out in 2016 and the main obligation of this institution is to conduct the policy of higher-quality housing for the accommodation needs of the country population.
The reduction of budget revenues has resulted in the decline in resources allocated for reserve funds. It is projected to allocate 123 million US dollars (200 million manats) to the Reserve Fund under the President of Azerbaijan. It is to be mentioned that, this indicator was even raised to 467 US dollars (366 million manats) in previous years [see: diagram 15].

**Diagram 15: State budget resources allocated to Reserve Fund, by years**

![Diagram 15: State budget resources allocated to Reserve Fund, by years](image)

**Source: Ministry of Finance of the Republic of Azerbaijan, 2016**

Hence, the volume of resources allocated for the Reserve Fund under the President has declined by 32.7% in comparison with the ongoing year or 23.8 times in comparison with 2014. The similar situation is observed in the scope of resource allocated for the state budget reserves. Such that, in comparison with years of high oil prices, for instance, 2012, while 1.07 billion US dollars (0.83 billion manats) were allocated for this purpose, it is projected to allocate 61.5 million US dollars (100 million manats) in 2017 which is 17 times lower.

**Conclusion**

The declining trend of revenues and expenditures of state budget amidst the slumping oil prices starting from 2014 will continue in 2017 as well (budget revenues and expenditure are projected to be 5.2% and 10.2% lower in manat terms, and 10% and 16.2% lower in US dollar terms respectively). Alongside, the consideration of base, optimist and pessimist scenarios considering the oil prices during state budget preparation is an indicator of a more prudent approach which can be considered as a favorable event.

The base price of oil is taken as 1 barrel = 40 US dollars, which accords to the forecasts of most international financial institutions and agencies. Hence, the risks during the execution of 2017 state budget revenues and expenditure are lower in comparison with past years, especially 2015.

The transfers from State Oil Fund to budget have declined. This situation can be evaluated as the attempt to weaken the dependence of state budget revenues on oil sector and the to protect strategic currency reserves in the period of declining oil revenues.

Overall, noteworthy increase in budget revenues in 2017 is expected in personal income tax revenues (60 million manats or 5.6%), profit tax (153 million manats of 8%), value added tax applied for imported products (339 million manats or 26%), and customs tariff revenues (66 million manats or 17%).
The sharp reduction of revenues is projected from the collections of tax sanctions (39 million manats or 11.8%) and budget transfers from SOFAZ (1515 million manats or 19.9%).

Only 4 out of 14 functional expenditure sections of the state budget (The judiciary, law enforcement and prosecution; education; agriculture, forestry, economy, fishing, hunting and environmental protection; directions are not related to the main sections) are projected to grow. The expenditure on other directions is reduced. It must be mentioned that, during the preparation of state budget, labor compensation cost has been increased in 2017 budget, which implies that the salaries may rise.

The largest cut occurred in investment expenditure is forecasted due to the decline in revenues. The capital expenditure of budget is projected 40.7% lower in comparison with expectations of the ongoing year and 7.7 times less than the real budget execution of 2013. Surely, the reduction in investment expenditure is evaluated as a favorable condition for the effective spending of public revenues and the lowering of risks of corruption in this sphere. However, the economic expansion and increasing employment achieved via the increase in state budget spending substantially is substantially weakened due to the implied thrift regime, which adversely affects the population well-being.

The main reason for the reduction in social protection and social assistance costs in 2017 is the cut in allocations to “Social protection, pensions and other social assistance expenditure” subsections. This, in turn, implies 0.66 billion manats or 0.4 billion US dollars.

52.8% of total education expenditure or 0.6 billion US dollars (0.98 billion manats) are allocated to the general education. Higher education expenditure continues to shrink. At present, higher education institutions shift to self-financing scheme; hence, only 0.2% or 23 million US dollars (37.5 million manats) of 2017 state budget expenditure are allocated to higher education.

The reduction in the number of regions dependent on the central budget (2016-6 self-financing regions, 2017-33 self-financing regions) has taken place as a result of changes occurred in functional expenditure direction of the budget. Hence, this growth is not in real terms and the adoption of real measures is necessary towards the weakening of dependence of the regions on central budget.

The volume of resources allocated for the Reserve Fund under the President has shrunk by 32.7% in comparison with the past year and is 3.8 times less in comparison with 2014. The similar situation is observed in the volume of resources allocated from the budget to state budget reserves. Such that, in comparison with years of high oil prices, for instance, while 1.07 billion US dollars (0.83 billion manats) were allocated in 2012 for this purpose, this indicator has dropped by 17 times or 61.5 million US dollars (100 million manats)

For the first time, the volume of total expenditure is also announced in foreign currency terms during the state budget execution (3.061 billion US dollars), which facilitates the assessment of risks to emerge for state budget due to the changes in exchange rates. 51.7 million US dollars in budget project are allocated for compensation for exchange rate risks.
References

- Azərbaycan Respublikasının Maliyyə Nazirliyi
  http://www.maliyye.gov.az/
- Azərbaycan Respublikasının İqtisadiyat Nazirliyi
- Azərbaycan Respublikasının Mərkəzi Bankı
  http://www.cbar.az/
- Azərbaycan Respublikasının Dövlət Statistika Komitəsi
  http://www.cbar.az/
- Azərbaycan Respublikası Dövlət Neft Fondu
  http://www.oilfund.az/
- Oilprice.com, “Goldman Sachs: OPEC Freeze Could Add $10 To Oil Prices”,
  29.09.2016
  http://oilprice.com/Energy/Oil-Prices/Goldman-Sachs-OPEC-Freeze-Could-Add-10-To-Oil-Prices.html