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Azerbaijani Oil Fund: Fiscal Consolidation, Volatility and Oil Wealth

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Azerbaijani Oil Fund: Fiscal Consolidation, Volatility and Oil Wealth

The execution of the State Oil Fund of Azerbaijan's (SOFAZ) 2016 budget has been approved. According to a Presidential decree, SOFAZ's revenue was 9.410 billion manat (\$5.881 billion USD) and expenditure was 9.022 billion manat (\$5.638 billion USD). Initially, SOFAZ's revenue for 2016 was forecasted as 4.6 billion manat, while expenditure was expected to be 10.7 billion manat. The latest figures show that SOFAZ's actual income for 2016 was over 2 times higher than forecasted. Meanwhile, SOFAZ's actual expenditure for 2016 was 15.4% less than forecasted.

The reason behind SOFAZ's increased revenue was that in 2016, oil prices were higher than expected. Due to the stabilization of the price of oil in the second half of 2016, SOFAZ was able to increase its income. At the same time, SOFAZ had also undergone a fiscal consolidation process, whereby certain expenditure items were cut.

It serves to remember that the assets of the State Oil Fund of Azerbaijan (SOFAZ) decreased by 9.5% during 2015; as of 1 January 2016, they reached \$33.57 billion, as compared to the \$37.1 billion of the previous year (as of 1 January 2015). At that time, SOFAZ's press release stated that budget revenues for 2015 amounted to 7.7 billion manat and expenditures 9.187 billion manat.

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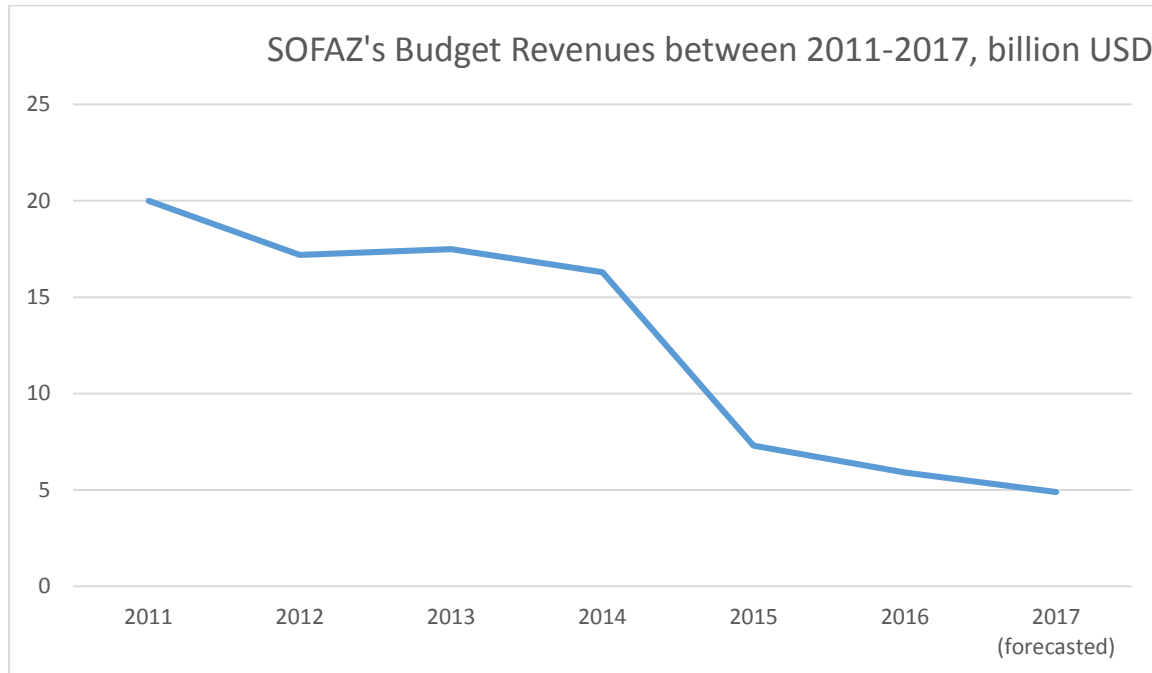
SOFAZ's Budget Figures for 2011-2017

Year	Revenue, billion manat	Expenditure, billion manat	Revenue, billion USD	Expenditure, billion USD	Deficit/Surplus, billion USD
2017 (forecasted)	8.4	14.5	4.9	8.5	-3.6
2016	9.4	9.0	5.9	5.6	0.3
2015	7.7	9.2	7.3	8.8	- 1.1
2014	12.7	10.2	16.3	13.1	3.2
2013	13.6	12.3	17.5	15.8	1.7
2012	13.4	10.6	17.2	13.6	3.6
2011	15.6	9.6	20.0	12.3	7.8

Source: State Oil Fund of Azerbaijan Republic, 2017

The table above shows that in spite of the fact that SOFAZ had deficits in its budget in 2015, the fund had a surplus in 2016, due to higher oil prices compared to those forecasted. Meanwhile, fiscal consolidation also helped SOFAZ to save money in 2016. SOFAZ's 2017 budget is forecasted as having a -\$3.6 billion USD deficit; however, CESD's studies show that SOFAZ will further cut certain budget expenditure items in 2017, in order to reduce the total amount of expenditure and produce a smaller deficit. Of course, the price of crude oil in the second half of 2017, will be key for both SOFAZ's income and expenditure.

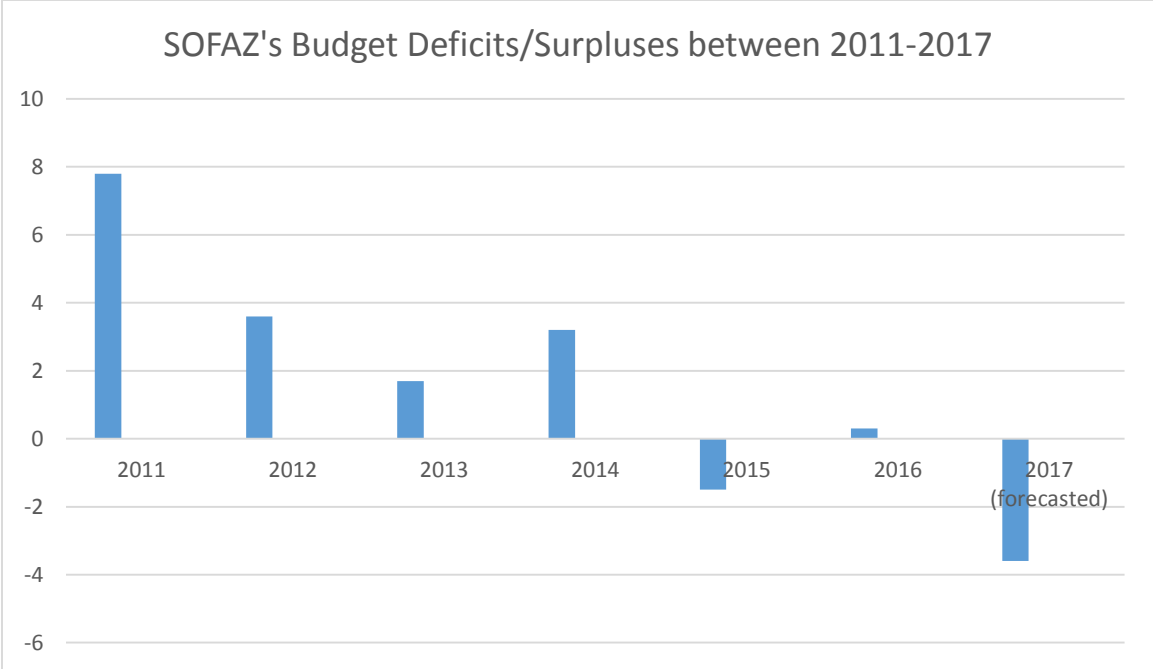
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Source: State Oil Fund of Azerbaijan Republic, 2017

The above graph also confirms that SOFAZ has entered the post-oil boom period. SOFAZ's 2016 revenue was over 3 times smaller than that of 2011. In fact, the volume of oil for export has decreased over this period; however, income decline was more rapid than that of oil output. According to the State Oil Company of Azerbaijan Republic, in 2011, oil output was 45.6 million tons, and it declined to 41.0 million tons in 2016. This observation shows that although oil output declined by only 8.0% over the last 5 years, SOFAZ's budget decreased more than 3.0 times.

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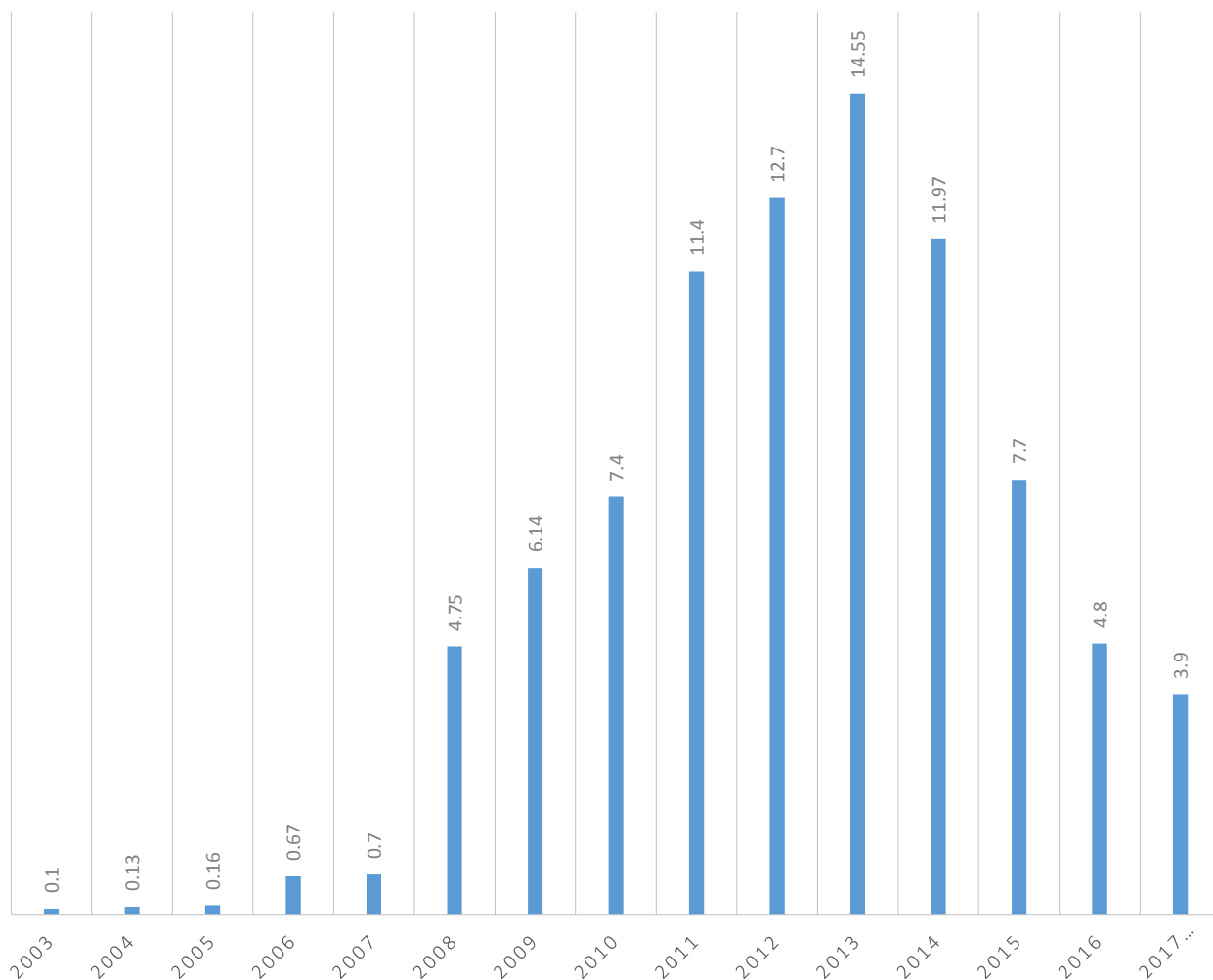


Source: State Oil Fund of Azerbaijan Republic, 2017

This graph clearly shows the changes between the fund’s revenues and expenditures over the last 5 years. A deficit in SOFAZ’s budget occurred immediately after the price of oil started to decline in world markets. SOFAZ was able to strike a balance between its expenditure and revenue in 2016, thanks to higher oil prices and fiscal consolidation. However, the Azerbaijani fund again expects a deficit for 2017, due to a high amount of spending.

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Transfers from the SOFAZ to state budget (billion USD)



Source: The State Oil Fund of the Republic of Azerbaijan, 2017

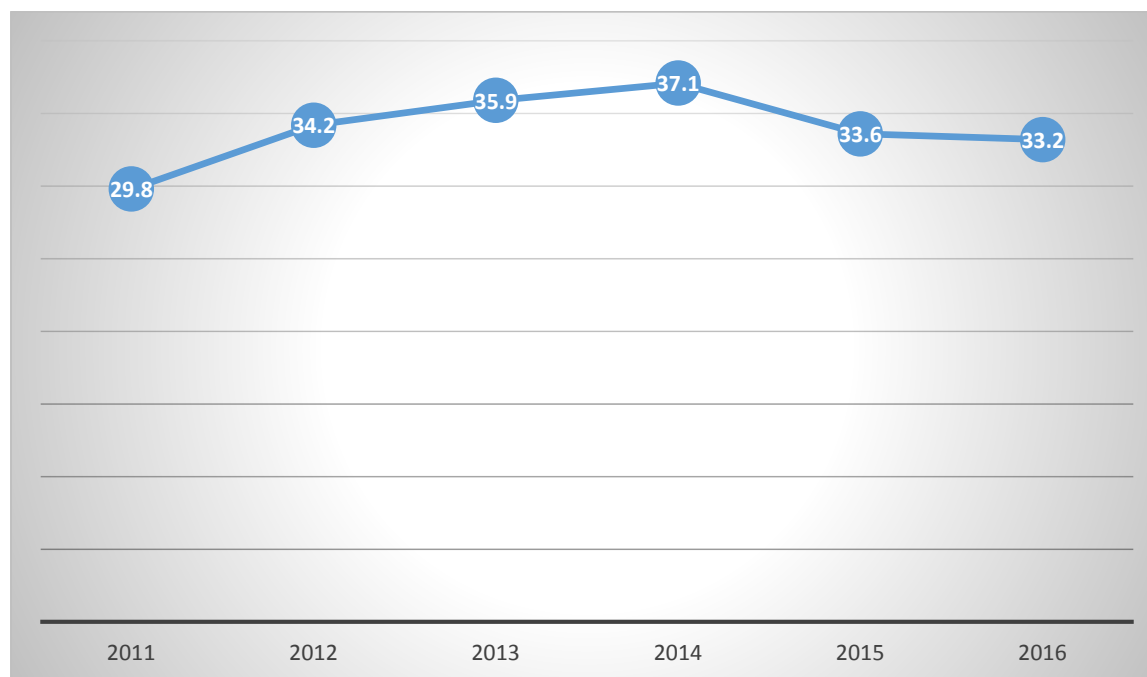
As presented in the diagram above, starting from 2006, the amount of transfers from the fund to the state budget rose rapidly and reached its maximum in 2013. To put it another way, during the period 2005-2013, the volume of transfers from the fund to the state budget increased 91 times. In 2014, the government reduced the amount of transfers for the purpose of fiscal consolidation.

Based on the information available in April 2017, the assets of SOFAZ have increased by 0.18% compared to the beginning of 2017 (\$33.147 billion USD) and stood at \$33.072 billion USD.

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According to SOFAZ’s own estimates, “the increase was mainly due to a sizeable positive effect of changes in exchange rates of investment portfolio currencies (mainly Euro, Russian ruble and Pound sterling), as well as the impact of asset appreciation (specifically, equity and gold portfolios)”¹.

Diagram 7. Assets of the Oil Fund, billion USD



Source: The State Oil Fund of the Republic of Azerbaijan, 2017

During the period 2005-2015, the assets of the Oil Fund decreased for the first time only in 2015. It should be noted that, the CESD recommended reducing transfers to the state budget as early as 2011. According to the CESD, the rapid depletion of oil funds should have been avoided in order to meet demand in the period of lower oil production in 2010-2025. Moreover, the CESD also underlined that fuel price determination is out of the control of the Azerbaijani government and therefore, any fall in oil prices would have a negative impact on the fiscal policy of the country¹.

¹ CESD, “The State Oil Fund may run out of funds by 2015”, 26.11.2011 <http://cesd.az/new/?p=1391&lang=az>

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CESD experts have also recommended that SOFAZ should have revised its investment strategy policy in order to increase indirect revenues. The fund is still highly dependent on direct income from oil export; however, it should work on increasing its income from better managing its revenues.

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Appendix 1. SOFAZ's 2016 budget

№	Indicators	Thousand manats
Revenues: (total)		9,410,180.0
Including:		
1.	Proceeds from sales of the Republic of Azerbaijan's share of hydrocarbons (deducts the costs of hydrocarbons transportation, banking expenses, customs clearances, independent surveyor, marketing and insurance costs, and also exclusive of the revenues from the SOCAR's share in the projects of which it is an investor, shareholder or partner)	8,320,045.7
2.	Acreage fees paid by foreign investors for use of the contract areas for the development of hydrocarbon resources	3,267.0
3.	Revenues from transportation of oil and gas through the territory of the Republic of Azerbaijan	17,953.6
4.	Bonuses paid by investors to SOCAR or authorized state body for signing or execution of oil and gas contracts	82.1
5.	Revenues from SOFAZ's asset management	1,068,831.6
Expenditures: (total)		9,022,059.0
including:		
1.	Financing the improvement of social condition of refugees and IDPs	89,994.9
2.	Transfer to 2016 State Budget of the Republic of Azerbaijan	7,615,000.0
3.	Financing the reconstruction of the Samur-Absheron irrigation system	69,998.1
4.	Financing Baku-Tbilisi-Kars railway project	66,174.5

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5.	Financing the "State Programme on the Education of Azerbaijani Youth abroad in the years 2007-2015"	31,606.7
6.	Financing the share of the Republic of Azerbaijan in STAR oil refinery in Turkey	331,776.0
7.	Financing the share of the Republic of Azerbaijan in Southern Gas Corridor projects	797,427.6
8.	Administrative expenses of the State Oil Fund of the Republic of Azerbaijan	20,081.2

Appendix 2. SOFAZ's 2017 budget

The incomes of the budget of the State Oil Fund of the Republic of Azerbaijan for the year 2017 are established out of the following revenues:

Income sources	Amount (in thousand manats)
Proceeds from sales of the Republic of Azerbaijan's share of hydrocarbons (deducts the costs of hydrocarbons transportation, banking expenses, customs clearances, independent surveyor, marketing and insurance costs and also exclusive of the revenues from the SOCAR's share in the projects of which it is an investor, shareholder or partner)	7 550 705.3
Acreage fees paid by foreign investors for use of the contract areas for the development of hydrocarbon resources	3 465.0

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Revenues from transportation of oil and gas through the territory of the Republic of Azerbaijan	16 830.0
Revenues from SOFAZ's asset management	799 094.6
Bonuses paid by the investors due to the signature or implementation of oil and gas contracts	495.0
Total	8 370 589.9

Budget expenditures of the State Oil Fund of the Republic of Azerbaijan for the year 2017 are assigned to the following purposes:

Directions of expenditures	Amount (in thousand manats)
Financing the improvement of social condition of refugees and IDPs	90 000.0
Upper bound of the transfer to 2017 State Budget of the Republic of Azerbaijan	6 100 000.0
Upper bound of the transfer to the Central Bank of the Republic of Azerbaijan for ensuring macroeconomic stability	7 500 000.0
Financing the reconstruction of the Samur-Absheron irrigation system	70 000.0
Financing "Baku-Tbilisi-Kars railway" project	165 825.0
Financing the "State Programme on the Education of Azerbaijani Youth abroad in the years 2007-2015"	29 304.0

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Financing the share of the Republic of Azerbaijan in Southern Gas Corridor projects	496 155.0
Administrative expenses of the State Oil Fund of the Republic of Azerbaijan	32 572.0
Total	14 483 856.0

ⁱ http://www.oilfund.az/en_US/hesabat-arxivi/rublukh/2017_1/2017_1_1/#sthash.1lhfiNXf.dpuf