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**Changes to the Oil Fund's Budget: the
impact of increased revenues on
government spending**

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Introduction

Last week, on October 4th, the budget of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) for 2017 was changed.¹ It should be noted that earlier on June 30th, state budget revenues increased by 511 million manat, and expenditures by 1 billion 41 million manat, as amended by the law "On the State Budget of the Republic of Azerbaijan for 2017".² Changes in the budget of the Oil Fund did not cause wide public debate. We suppose that the changes in the document reflect important symptoms for the analysis and forecasting of the government's current fiscal policy.

SOFAZ main directions in the amended budget

First of all, it should be noted that when preparing a budget forecast for SOFAZ for 2017, the price of a barrel of oil was projected at \$40 USD, taking into account the current conjuncture in the world energy markets.³ However, the average price for Brent crude in January-September 2017 was \$ 51.3 per barrel,⁴ which is approximately 28% higher than the government's forecast. In this way, the current conjuncture in the energy markets led to a significant increase in Azerbaijan's revenues, including SOFAZ's. In other words, one of the reasons for changing the budget of the Fund is that oil prices are higher than predicted.

Nevertheless, the Fund's revenues increased by 29%, or 2 billion 443 million manat, to 10 billion 814 million manat. The 2 billion 275 million manat growth was due to revenues from the sale of oil and gas.

Expenses of the Fund increased by 5.2%, or 759 million manat, to 15 billion 243 million manat. The purpose of this increase was to finance the participation of Azerbaijan in the STAR refinery complex, which is being built in Turkey. In addition, 15 million manat were directed to solve the problems of internally displaced persons, through increased spending to remedy social and housing problems.

Dynamics of oil revenues and expenditures

Issues such as tempo, direction and effectiveness of oil revenues have always been in the focus of the Azerbaijani public. It should be noted that in 1999, SOFAZ was established for

¹ Prezident.az, 04.10.2017

<http://www.president.az/articles/25422>

² AZERBAIJAN STATE NEWS AGENCY, 30.06.2017

https://azertag.az/store/files/news/QANUN_2017-

[CI%20IL_%20DOVLAT_%20BUDCASI_%20HAQQINDA.pdf](https://azertag.az/store/files/news/QANUN_2017-CI%20IL_%20DOVLAT_%20BUDCASI_%20HAQQINDA.pdf)

³ Ministry of Finance of the Republic of Azerbaijan, "Presentation of draft state and consolidated budgets of 2017", page 15

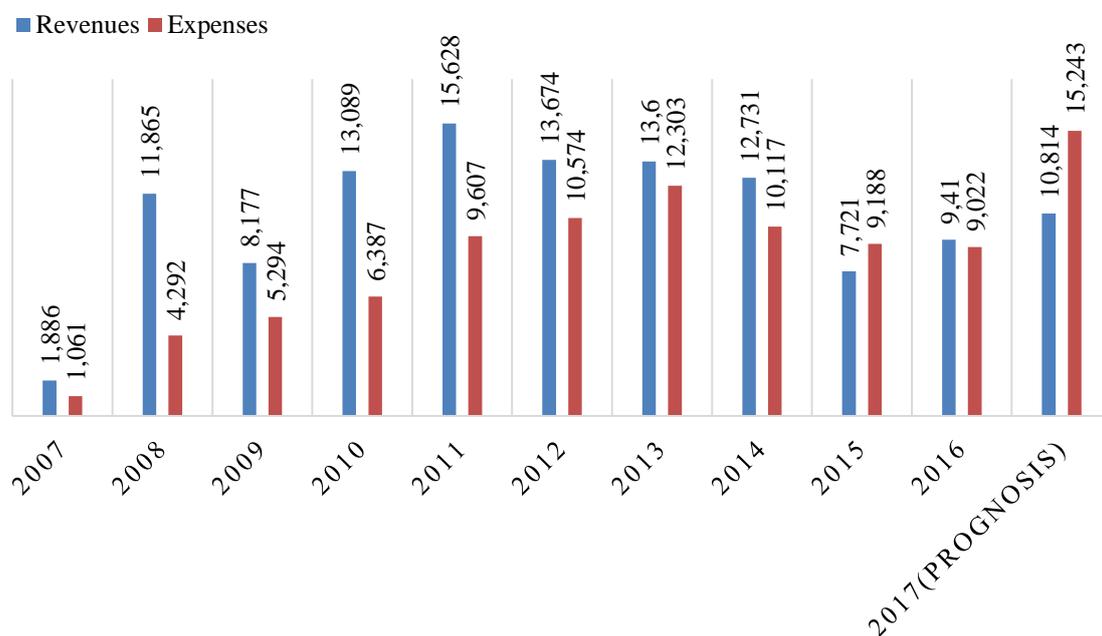
<http://www.maliyye.gov.az/sites/default/files/Budce-16-11-2016.pdf>

⁴ Statista.com, 09.10.2017

<https://www.statista.com/statistics/262860/uk-brent-crude-oil-price-changes-since-1976/>

the purpose of providing the effective and purposeful usage of resources.⁵ On 1 July 2017, the volume of the general assets of the Fund equaled \$34 billion and 791 million.⁶

Figure1. The dynamics of the revenues and expenses of the Oil Fund



Source: SOFAZ, 2017

While making an empirical assessment, it becomes obvious that over the last years, the expenditures of SOFAZ increased more rapidly, as compared to its revenues [please refer to Figure 1]. In 2013, 90% of the Fund's revenues were directed to spending. Although the spending was decreased to some extent during the period 2014-2016, it was impossible to adjust to the speedy fall in revenues and, in 2015, for the first time in the history of the Fund, expenditures were 19% higher than revenues. In the same year, a significant decrease, about \$3 billion and 500 million in the Fund assets, was noticed.

The Fund's budget prognosis for 2017 allows us to say that the assets of the institution will again sharply decrease, around \$2.6 billion, dropping to 30.5 billion. As a result, the 3-year chronic decrease of the Fund's assets will continue. It should also be mentioned that the expenses of the Fund for 2017 increased 69%, in comparison with 2016.

Note 1: Decisions regarding SOFAZ's expenditures, how much is spent on what, are included in the responsibilities of the national government.

As seen in 2015-2016, the government tried to pursue a uniform financial policy, but in 2017, there was a significant shift in its approach. This observation is reflected both in the reduction

⁵ The State Oil Fund of the Republic of Azerbaijan
http://www.oilfund.az/az_AZ/about_found/meqsed-ve-felsefe.asp

⁶ The State Oil Fund of the Republic of Azerbaijan, 09.10.2017
http://www.oilfund.az/az_AZ/hesabatlar-ve-statistika/son-reqemler.asp

of the state budget and in the expenditures of the Oil Found. Apparently, this approach will be revived in 2018. A few days ago, a Member of Parliament, Mr. Vahid Ahmedov, told the media about some indicators of the state budget in 2018. According to him, state budget expenditures in 2018 will amount to 20 billion manat.⁷ It should be noted that the corresponding figure for 2017 was projected at about 18 billion manat. In other words, in 2018, it is expected that the state budget will increase by about 11%.

Therefore, it can be concluded that, after short-term fluctuations, the government is trying to restore its previous policy and ensure that the growth of the economy encompasses more government spending. Obviously, the rise in oil prices in world markets is also an auxiliary factor for the implementation of this policy. However, one of the key factors that deepened the crisis in 2015, was the fact that the consumption economy was stalled by a sharp reduction in government spending in a short period of time. Therefore, for the next period, past experiences should be considered when enacting the important task of implementing a more sound fiscal policy.

Results:

1. The crisis of 2015 didn't lead to strategic changes in the state's fiscal policy.
2. Increased income leads to increased costs.
3. The possibility of renewing the dependence of the economy on oil is strengthened.
4. Specific criteria have not been defined to ensure financial sustainability.

⁷ Fins.az, "The revenues of the state budget in 2018 have been revealed: the price of oil is about \$45", 28.09.2017
<https://fins.az/budce/929064/2018-ci-ilin-dovlet-budcesinin-gelirleri-melum-oldu-neftin-qiymeti-45-dollardan-goturulur.html>

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