2022 State Budget in Azerbaijan: Expectation and Perspectives

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Abstract

The macroeconomic forecast prepared by the Ministry of Economy of the Republic of Azerbaijan emphasized the main priorities for the budget policy for the upcoming five years. The forecast was prepared following the order "Azerbaijan 2030: National Priorities for Socio-Economic Development" and its main notations. An analysis of the forecast depicts the main features of the report, assessing the current environment and eligibility of the major points outlined. The forecast highlighted the primary targets for the medium and long terms, accentuating the importance of moving towards a more diversified and sustainable economy.

Keywords: Azerbaijan, fiscal policy, budget, diversification
Introduction

After a tough period for the Azerbaijani economy, flexible management of the quarantine regime, provision of fiscal support packages, and slight expansion of demand in world markets allow the revival of the economy. Restructure and infrastructure building tasks in the liberated territories remain a priority objective for the government, which means that for its successful implementation, financial security has to be ensured. At the same time, on the background of increasing initiatives for the transition to a green economy, decarbonization, and expanded utilization of alternative energy, the declining demand for oil in the global energy market represents one of the main challenges facing fiscal policy in the medium term.

The goals and objectives of the budget policy for short and medium terms have been determined in accordance with the order "Azerbaijan 2030: National Priorities for Socio-Economic Development" and existing global economic challenges. The main goal in the short-term period includes a contribution to ensuring economic growth, maintaining economic balance, inflation, unemployment, and balance of payments through fiscal instruments. For the medium term, the main objective includes ensuring budget balance, macroeconomic and fiscal sustainability by preserving the budget deficit and public debt at an administrable level.

The world’s leading financial institutions, along with agencies specializing in the forecasting of oil prices, predicted an approximate price of Brent oil around $65 for the current year with no significant change over the next year (Table 1).

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1 [https://en.president.az/articles/50474](https://en.president.az/articles/50474)
Table 1. The projected average annual price of 1 barrel of Brent oil, in US dollars

<table>
<thead>
<tr>
<th>Institutions/Agencies</th>
<th>2021</th>
<th>2022*</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Monetary Fund (July, 2021)</td>
<td>64.8</td>
<td>63.2</td>
</tr>
<tr>
<td>World Bank (June, 21)</td>
<td>62</td>
<td>62</td>
</tr>
<tr>
<td>Asian Development Bank (July, 2021)</td>
<td>67</td>
<td>64</td>
</tr>
<tr>
<td>U.S. Energy Information Administration (September, 2021)</td>
<td>68.6</td>
<td>66</td>
</tr>
<tr>
<td>Fitch Ratings (June, 2021)</td>
<td>63</td>
<td>55</td>
</tr>
</tbody>
</table>

*Sources: IMF, World Bank, ADB, EIA, Fitch Ratings*

As it becomes clear, key policy priorities include designing and implementing reforms to diversify the economy and improve its resilience to unexpected shocks. Along with it, reforms to facilitate private sector development, including improved business environment and better access to finance have to be implemented, respectively.

The main macroeconomic targets for 2022-2025

According to the macroeconomic forecast prepared by the Ministry of Economy of the Republic of Azerbaijan for the next 4 years (the average annual price of a barrel of oil is $55), there is an assumption that the real GDP growth in the country will compose 4.6%, along with non-oil GDP growth indicated at 5.2%. In a meantime, it is expected that the share of non-oil revenues in the state budget will increase steadily due to the transformation of the main driving force of economic growth from the oil sector to the non-oil sector.
As it may be observed from Graph 1, a steady increase in the non-oil sector growth is expected in the upcoming years. Moreover, following the forecast, inflation, projected at 4.9% by the end of 2021 and 3.6% in 2022, is expected to decline to 3.2% in 2025 (Graph 2). Strengthening the coordination of fiscal and monetary policies to maintain macroeconomic stability will support the exchange rate of the national currency to remain stable this year. In this regard, the exchange rate of the manat against the US dollar in 2022 was set at 1.7.

Source: Ministry of Economy of the Republic of Azerbaijan, 2021
Developments in the efficiency of public spending, generalized subsidies, public employment, and taxation could maintain fiscal consolidation.

**Budget policy**

Despite a significant decline in oil revenues over the last years, the foreign exchange reserves accumulated in the State Oil Fund so far ensured the resilience of the macrophysical framework to internal and external influence in the short and medium term. However, protection of foreign exchange reserves in the long run as well as strengthening macroeconomic and fiscal stability remains crucial.

Firstly, it goes without a doubt that the uncertainty of the duration of the pandemic was one of the main challenges for the state budget in 2021 (CESD Press, 2020). In this regard, mitigation of the impact of the pandemic on the economy, provision of social protection to the population, and support businesses reflect the priorities in the formation of the budget in the upcoming years.
Expenditure priorities for 2022-2025 cover the global economic environment and trends, including 2 main primary areas: restructuration of the liberated territories and support of the priority sectors. Expenditures of the state budget in 2022 are projected at 28974.0 million manat (35.6% of GDP), which is 1.5% more than the approved figure for 2021. Economic activity (18.64%), defense and national security (15.5%), general public services (14.7%), education (12.9%), social protection and social security (12.4%) have the largest share in the structure of the state budget expenditures in 2022 by functional classification.

It is worth mentioning that in recent years, especially in the post-devaluation period, a fairly dynamic increase in budget expenditures has not been accompanied by a proportional growth in the non-oil sector. Thus, in 2019 the average annual non-oil GDP growth was composed by 2.9%.

**Graph 3. Indicators of budget policy in 2017-2020**

![Graph 3. Indicators of budget policy in 2017-2020](source: State Statistical Committee, Ministry of Finances, 2021)
Graph 3 indicates the main compositions of the budget policy over the period of 3 years. It is hard not to notice that the State Oil Fund remains the main actor in income sources and the formation of revenues.

Although the necessity for diversification of the economy was systematically stressed out and studied by several scholars, it goes without a doubt that the oil sector still dominates in income. Bayramov and Orujova have demonstrated the vulnerability of the Azerbaijani economy after the oil shock occurred in 2014-2015. The study urged a more detailed analysis of the economic constituencies and paths for further economic prosperity.

Therefore, one of the main and principled approaches for further policies is to create a favorable environment for the gradual replacement of oil revenues with non-oil revenues. Support investment in areas that can create added value in order to ensure economic recovery in the medium term and later ensure competitiveness and sustainable development. The state will continue to expand industrial support measures to modernize and improve the structure of the industry, increase the export potential of the non-oil industry, and achieve the goals of expanding science-based and innovative production.
It is presumed that from 2022, along with the reduction of transfers from the State Oil Fund to the state budget through the introduction of improved budget rules, the projected growth rate of non-oil revenues of the state budget will lead to an increase in the share of non-oil revenues in budget revenues (Graph 4).

Furthermore, reducing the level of the shadow economy, full legalization of revenues, ensuring transparency, and strengthening control as a result of the growing influence of e-government in most sectors of the economy allow forecasting an increase in tax and customs revenues in the coming years.

**The main goals, directions, and objectives of the budget policy for 2022-2025**

The goals, directions, and main objectives of the budget policy for the short and medium terms have been identified in accordance with the existing macro-fiscal
challenges, as well as on the basis of the document "Azerbaijan 2030: National Priorities for Socio-Economic Development".

The main goal of fiscal policy in the short term is to maintain macroeconomic balance by contributing to economic growth, inflation, unemployment and ensure a balance of payments stability through fiscal instruments. In the medium term, the main goal of fiscal policy is to ensure budget balance, macroeconomic and fiscal stability by maintaining foreign exchange reserves at a stable and manageable level of public borrowing.

In the approved budget for 2021, following the continuation of state support to the sectors affected by the pandemic, the reconstruction and rehabilitation of the liberated territories, along with additional costs related to special defense measures, the ratio of the non-oil base deficit to non-oil GDP was predicted at 30.1%. However, on the basis of the current trend, this figure is expected to settle at 28.4%.

Graph 5. The share of the non-oil base deficit of the consolidated budget in non-oil GDP, in %
The ratio of non-oil base deficit to non-oil GDP in the consolidated budget is aimed to be reduced to 20% in the medium term (until 2025) and to 10% in the long term (until 2030) (Graph 5). In order to achieve the goals, an operational target can be set for the annual reduction of that indicator. Thereby, if the actual annual reduction is less than the target (annual forecast), the medium-term goal will be achieved in the coming years with the application of the correction mechanism.

In the period of declining oil revenues, it is planned to provide the necessary budget expenditures, as well as to make more active use of borrowing until a strong and sustainable potential for non-oil revenue growth is formed. From Graph 6, it becomes clear that the share of public debt service expenditures in state budget expenditures is projected to fall to 5.9% in 2025.

**Graph 6. Structure of state budget expenditures for the medium term**

*Source: Ministry of Economy of the Republic of Azerbaijan, 2021*
The new macrophysical framework, which will be formed on the basis of an improved budget rule and a renewed borrowing strategy, will reduce its share in GDP by ensuring that the budget deficit is kept at an appropriate level in the medium term. Thus, the ratio of budget deficit to GDP is estimated to fall to 3.2% in 2022 and 1.5% in 2025. The upper limit of the state budget deficit in 2022 will be 2567.0 million manat, and for the next three years - 2061.0 mln. manat, 1795.0 mln. manat and 1513.0 mln. manat respectively. As in previous years, the budget deficit will be financed from privatization, borrowing (foreign and domestic), and the balance of the single treasury account. In the medium term, the main source of funding for the budget deficit will be revenues from external and domestic borrowing. Accordingly, the share of external and domestic borrowing in financing the budget deficit is projected to increase from 27.3% to 52.9% between 2022-2025.

**Graph 7. Sources of financing the budget deficit (%, left scale) and the ratio of GDP (%, right scale)**

Source: Ministry of Economy of the Republic of Azerbaijan, 2021
The balance of the single treasury account is projected to decrease. In a meantime, the consolidated budget deficit, projected at 5,178.2 million manat in 2022, is expected to decrease to 2,283.5 million manat in 2025. The reasons for this are the reduction of transfers to the state budget in the coming years, the expenditures of the State Oil Fund, as well as the state budget deficit.

**Conclusion**

Submitted by the Ministry of Economy of the Republic of Azerbaijan, the macroeconomic forecast outlines national expenditure priorities, main goals, objectives, and directions of budget policy. The forecast depicts that the main direction of future budget policies will be aimed at the provision of supporting measures for economic recovery, maintaining the level of transfers to ensure public spending.

Additionally, a special emphasis will remain on the restoration of the liberated territories and healthcare system. In the post-pandemic period, the protection of human health, the provision of social protection of the population, especially the vulnerable, the adaptation of the health system to the requirements of existing realities remains of particular importance.

Despite the fact that the share of the non-oil sector in GDP increases steadily, the share of the non-oil sector in budget revenues remains comparatively lower. Therefore, it is essential to expand measures to increase the share of the non-oil sector in the budget revenues in the future.

Taking into account the current environment, it becomes clear that the Azerbaijani economy is passing through a transitional period, which requires a detailed approach in order to ensure the sustainable development of the economy.
Thereby, measures aimed at diversification of the economy have to be expanded in order to ensure macroeconomic stability in the country. In this regard, the structure of export in foreign trade has to be diversified as well. The promotion of the export of non-oil products has to be expanded.

Fiscal policy has to strengthen financial and debt discipline. Key areas of an extended fiscal policy direction have to cover a balance between budget revenues and expenditures, strengthening of a country's economic competitiveness, and stimulation of non-oil exports.

It is an undeniable fact that the sustainability of budget revenues relates to one of the crucial components as well. In this respect, reducing the dependency on the transfers from the State Oil Fund reflects one of the main priorities for the medium term.

Transparency of budget compositions and related operations plays a major role in the formation of a sustainable economy.

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