



Center for Analysis of Economic  
Reforms and Communication

# AZERBAIJAN ECONOMIC REFORMS REVIEW

**FISCAL REFORMS**  
SPECIAL EDITION



It is our core priority to strengthen our sovereignty, to further continue initiation of reforms and provide better living conditions to our people.

**ILHAM ALIYEV**  
President of the Republic of Azerbaijan

## CONTENT

01	Legal framework of the reforms aimed at strengthening fiscal sustainability _____	3
02	Economic ground of reforms aimed at strengthening fiscal sustainability _____	4
03	Reforms towards strengthening fiscal sustainability _____	5
04	“Amendments to the Law of the Republic of Azerbaijan “on Budget system” _____	6
05	Shift to Countercyclical policy _____	7
06	Expected positive impacts of the introduction of budget regulation _____	8

07	Mid-term Expenditure Framework (MTEF) _____	9
08	Development and approval of MTEF _____	10
09	Goals of developing a Strategy on Management of Government Debt _____	11
10	Actions planned under the Strategy _____	12
11	Fiscal sustainability as the result of reforms _____	13
12	Conclusion _____	14

**LEGAL FRAMEWORK OF THE REFORMS AIMED AT  
STRENGTHENING FISCAL SUSTAINABILITY**

“Strategic Road Map on National Economic Perspectives of the Republic of Azerbaijan” approved by the Decree of the Republic of Azerbaijan on December 6, 2016

Decree 1180 of the President of the Republic of Azerbaijan, dated 27 December, 2016, “On Introduction of the Law of the Republic of Azerbaijan “on Public Budget of the Republic of Azerbaijan for 2017”

## ECONOMIC GROUND OF REFORMS AIMED AT STRENGTHENING FISCAL SUSTAINABILITY



Ensure that improved tools are introduced to manage risks to economic growth associated with the reliance on oil export



Deepened needs for stabilization of revenues and facilitation of their forecast



The importance of stabilized Manat to attract more investment



Deepened needs for increasing and prioritizing cost effectiveness



Decreasing impacts of "Crowding out" to achieve development of private sector



Deepened needs for regulation of indebtedness

## REFORMS TOWARDS STRENGTHENING FISCAL SUSTAINABILITY

Both institutional and practical measures are prerequisite for sustainable economic growth, which could be achieved with fiscal sustainability and financial policies. Strengthening the basic legal framework, developing modern institutional framework for income and expenditure policies, evaluation of and strengthening the regulation of fiscal risks will lead to improved financial management at government level.

Adequate regulation of budget incomes and expenditures, proper management of government debt are priority issues to achieve positive results in this regard.

Important reform measures have been taken to achieve optimized management of public funds :

been taken to achieve optimized



Amendments were made to the Law "On Budget System"

Rule for developing Mid-Term Expenditure Framework has been approved

A Mid and Long- Term Strategy for the Management of Government Debt in the Republic of Azerbaijan has been developed



The new Clause on Budget Rule Clause 11-1 has been added to the Rule

### According to the Budget Rule :

The projected upper limit of the consolidated budget expenditures for the next year and the subsequent three years cannot exceed the upper limit of the consolidated budget of the current year. When estimating the upper limit of the consolidated budget expenditures, government debt and the debts of state-owned enterprises shall be taken into consideration before setting mid-term growth and restriction targets of the government and state-owned enterprises with respect to indebtedness. Rule for calculating the upper limit of the consolidated budget expenditures as specified by budget rule will be developed by the Ministry of Finance within two months to submit the President of the Republic of Azerbaijan.

Ratio of the non-oil base deficit of the consolidated budget for the net budget year to non-oil gross domestic product is targeted to be less than the relevant indicator of the current year. Otherwise, the projected upper limit of the consolidated budget expenditures is decreased accordingly.

Mid-term targets of the ratio of non-oil base deficit of the consolidated budget to the non-oil gross domestic product shall be established by the Ministry of Finance.

Should the expenditures of consolidated budget is over than the upper limit of the consolidated budget as the result of suspension in the introduction of budget rule, the Ministry of Finance shall submit its proposals to reach consolidated budget expenditures to estimated mid-term upper limit as specified by budget rule.

## SHIFT TO COUNTERCYCLICAL POLICY

The fact that nominal economic growth has exceeded the potential economic growth following the rise in oil prices, to put differently, a growth that came about due to the overabundance of revenues against expected amount and demand where no increase has been recorded in the production will be resulted with the increase in prices. It means, such economic growth which is accompanied by inflation will be just a nominal growth, which will have negative impact on real economic growth. Under such circumstances, the following policy options could be chosen:

### **Pro-cyclical financial policy**

Public expenditures spent for growth of production might be the characteristics of the policy that has been pursued traditionally. This policy shall be carried out in accordance with the current phase of the economic development and the cyclicity of development is not taken into account, which causes the risk of economic regress in the aftermath of the fall in oil prices. In addition, the private sector is exposed to pressure effect.

Due to these effects, the pro-cyclical policy does not meet the current conjecture of Azerbaijani economy to increase the share of private sector in the development of non-oil sector and involvement of investments, and to create enabling conditions necessary for decreasing reliance on oil revenues.

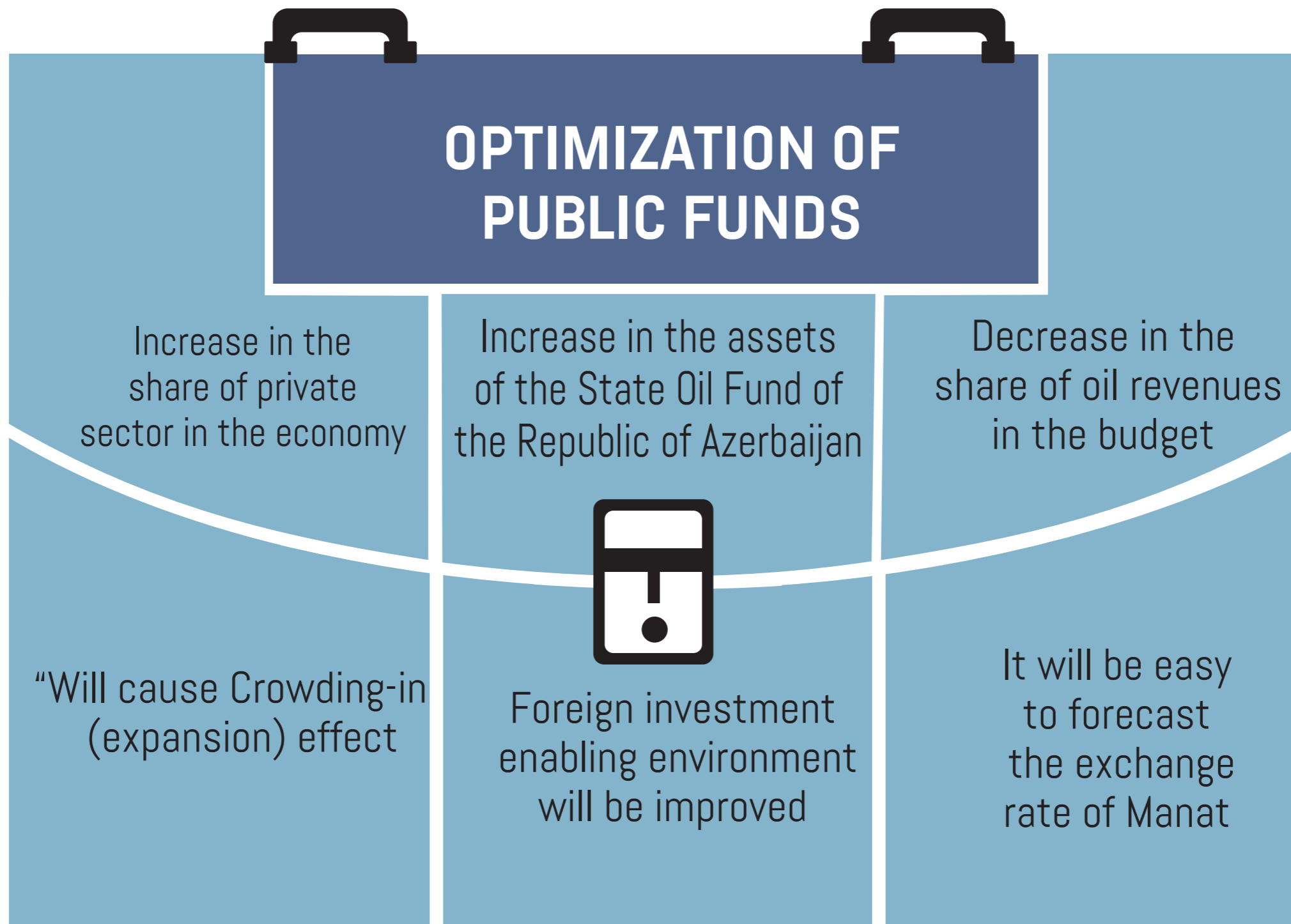
### **Countercyclical financial policy**

This policy takes into account the cyclicity of economy, and that suggests to ensure more efficient use of oil revenues and to make necessary transfer to public budget should the economic growth experiences any fall.

Contrary to pro-cyclical policy, this policy causes improvement of the environment necessary to involve more investments via decreasing public expenditures and to develop the private sector. This, in turn, ensures the economic stability thanks to the development of non-oil sector and decreases in reliance on oil revenues following the increase in budget revenues thanks to increased share of private sector.

At the same time, public investment expenditures become more efficient thanks to the countercyclical policy.





## MID- TERM EXPENDITURE FRAMEWORK (MTEF)

It is a document that shapes the framework of the public budget in view of the estimated budget incomes and revenues, orders of budget organizations with respect to current and capital expenditures, and expenditures prioritized in accordance with the key targets of the government.

### WHY MID- TERM EXPENDITURES FRAMEWORK IS CREATED ?

Make fiscal administration more efficient

Improve existing budget planning process

Increase accountability of organizations

Draw attention to national expenditure priorities

Further increase of the financial transparency

## MTEF DEVELOPMENT AND APPROVAL PROCESS

Ministry of Economy submits current and projected indicators on economic and social development to the Ministry of Finance. Budget organizations submit strategic plan of the organization

Ministry of Finance prepares the initial draft of the mid-term resource package (estimated incomes and revenues of the consolidated budget and public budget)

Orders of public organizations on current and capital expenditures, as well as new policy initiatives which require additional financing are submitted to the Ministry of Finance.

The Ministry of Finance undertakes the re-evaluation of the mid-term resource package and ensures accuracy of indicators on economic growth, inflation, oil revenues allowed for spending, amount of transfers to public budget from the State Oil Fund, upper limit of the consolidated budget, non-oil base deficit of the consolidated budget and other target indicators in order to develop MTEF document.

MTEF is submitted the Financial Stability Council and the Cabinet of Ministers.

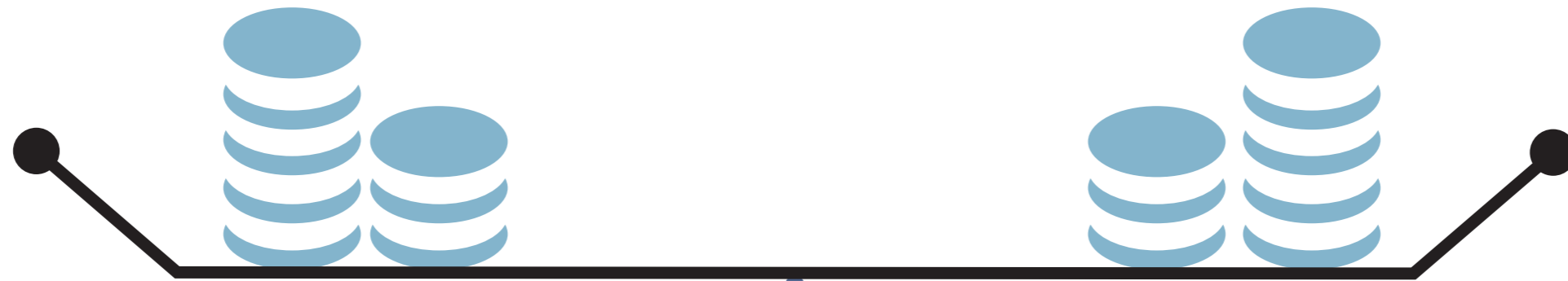
Upon the initial selection of the national expenditure priorities, the paper is further submitted to the President of the Republic of Azerbaijan.

The MTEF paper, mid-term resource package, budget policy and the national expenditure priorities are approved by the President until June 15.



Note: The orders on new policy initiatives shall be consistent with strategic road maps and sectoral strategic plans, and the total annual amount of the allocations should not be more than 10% of the allocations for the next budget year.

**GOALS OF DEVELOPING A STRATEGY  
ON MANAGEMENT OF GOVERNMENT DEBT**



The increase of efficiency in government borrowings

Development of financial markets

**TO FURTHER  
STRENGTHEN THE  
FINANCIAL  
SUSTAINABILITY OF  
THE COUNTRY**

Financial needs of the government are ensured on the basis of the least risk –cost principles

Improvement of infrastructure and control mechanisms for government borrowings

## ACTIONS PLANNED UNDER STRATEGY

✓  
**Ensure that the ratio of service costs for government debt (money spent for return of debts) to public budget expenditures is less than 15 percent**

The above indicator is expected to be less than 15 percent during 2018-2025 years.

✓  
**Involve debts for financing the projects and limit government guarantee**

The projects to be financed will be determined based on the list of priority projects available in the Strategy.

✓  
**Decrease the amount of new debts with respect to recovered obligations on government debt in order to ensure that the share of total government debt in GDP is not more than 30 % and decrease this amount by 20 % until 2025**

It is expected to be less than 21,7 per cent in 2021, 15 per cent in 2025.

✓  
**Undertake quarterly assessment of the risk of increase in interest rates and involve new debts with suitable interest rates based on the above assessment**

Where the governments borrow new money thanks to the improvement of the prestige of the country at international level, take loans with favourable conditions, and ensure that the existing debts are refinanced based on more favourable conditions.

✓  
**Ensure that the duration of government securities in domestic market is gradually extended, second market is formed and foreign indebtedness is gradually decreased by giving preference to increase of internal indebtedness**

Domestic securities market will be further developed by joint efforts of the Central Bank of the Republic of Azerbaijan and Financial Markets Supervision Authority of the Republic of Azerbaijan.

## FISCAL SUSTAINABILITY ACHIEVED BY REFORMS

Systematic regulation of both incomes and expenditures which form the public budget **will strengthen the fiscal sector in complex.**

The reforms will ensure the efficient regulation of budget revenues and expenditures while also contributing the increase in incomes, stability and facilitating projection (Figure 1) All these efforts will further **increase the fiscal sustainability.**

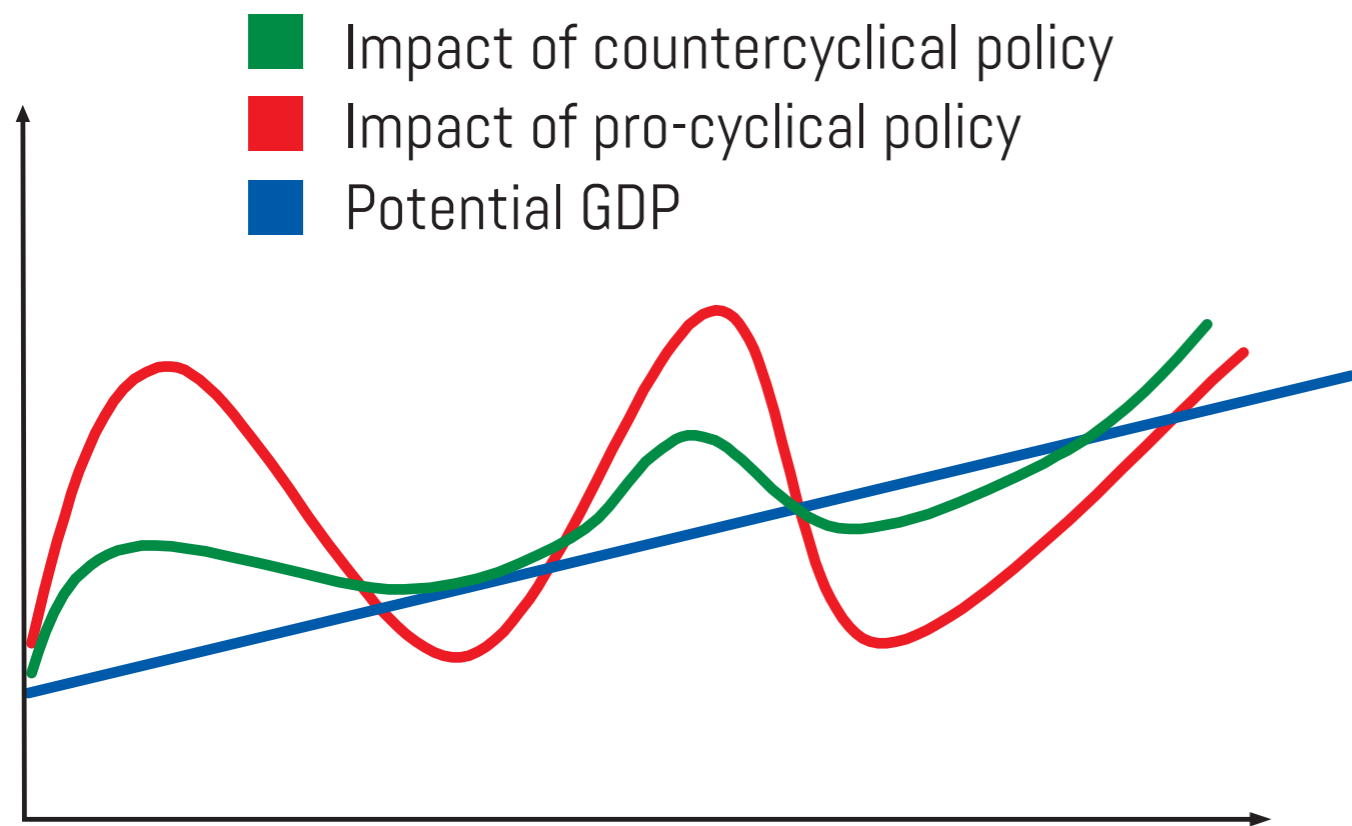


Figure 1. GDP impact of reforms

Besides, strategic resources of Azerbaijan exceed government debts 4 times (Figure 2). It is not by chance that **international credit rating agencies ("Standard and Poor's" , "Fitch" "Moody's") consider Azerbaijan as a country with strong fiscal position.** The reforms will further strengthen this particular area.

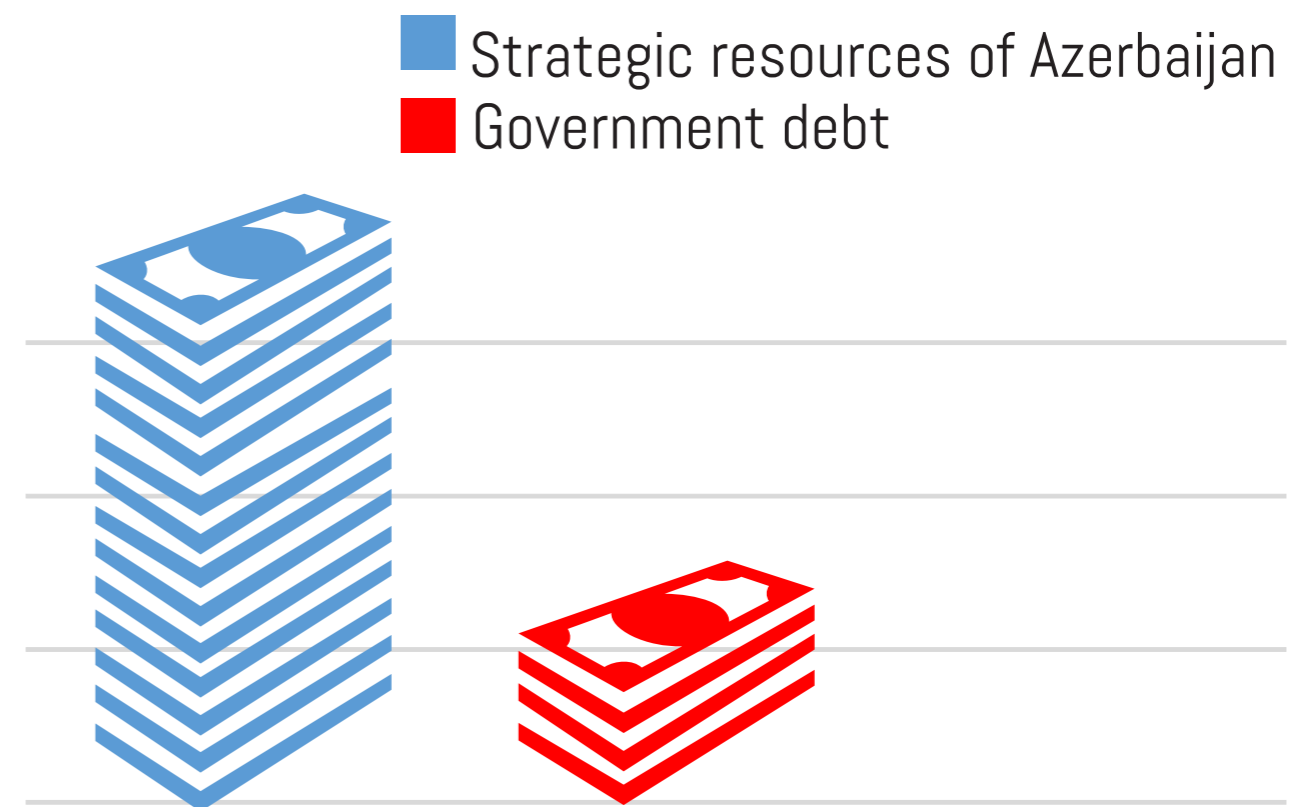


Figure 2. Comparison of the strategic resources of Azerbaijan and government debt

## CONCLUSION

All these reforms will strengthen the fiscal discipline in the country, increase efficiency of public regulation while also having positive impact on overall macroeconomic stability.

Preference for countercyclical financial policy – it will level the risks by further strengthening the existing state of the economy, decrease the risks and will have mitigating impact on any future crisis.

Costs necessary to develop technological progress and human capital will be forwarded to the needs which play a triggering role for future growth.

Efficient expenditure policy will ensure rational use of resources, benefits from investments and self-recovery of the capital.

In these reforms, the government will act as a party, which offers an enabling environment, which will help private sector to become a driving force of the country economy. All these efforts will lead to improvement in business enabling environment, development of non-oil sector and stabilization of overall macro-economic situation.