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THE ROLE OF THE OIL TRANSFERS IN THE FISCAL POLICY THE CASE OF AZERBAIJAN

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ABSTRACT

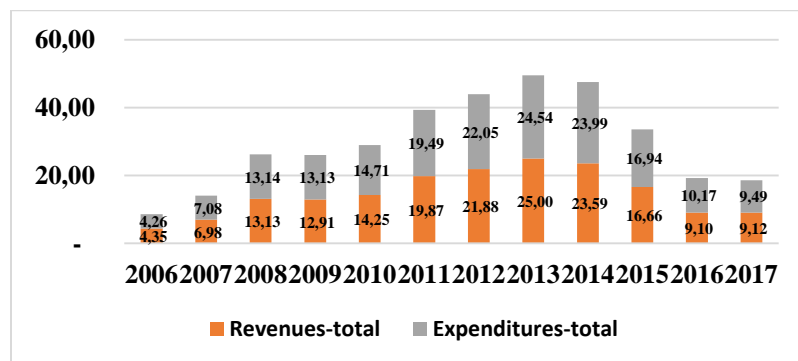
The Azerbaijan economy has been more sensitive to the fluctuations in the world market. Unlike from the other developing countries, the main source of this relationship has been oil-gas products. That is why, the falling oil prices in the world oil market has affected the macroeconomic situation in Azerbaijan. In this context, the main goal of the paper is to investigate the fiscal policy in Azerbaijan for the last decade. The author applies the correlation and data analysis of the state budget of Azerbaijan with investigating the relationship between the transfers from the State Oil Fund (SOFAZ) and some groups of the expenditures.

Keywords: Fiscal policy, expenditure, revenue, oil transfer, state budget
JEL Codes: E62, H50, H51, H52, H53, H60, H61

1. THE STATE BUDGET AND OIL TRANSFERS

The fiscal policy has the key power to foster the economic development in the world. That is why, the allocation of the financial resources in state budgets and to diversify them to the governments’ needs as expenditures are the main part of this policy. However, the source and percent of the revenue varies in the world countries. The Azerbaijan economy has been affected from the oil gas revenue. Ultimately, the transfers from the SOFAZ has been the key donor for the state budget of Azerbaijan in the last decade. Logically, increasing resource revenue enhanced the level of the public spending. Unfortunately, the economy was “infected” with the oil revenue in the booming years of the oil-gas sector. The main reason of the “infection”, is the inefficient spending of the government revenues. Furthermore, the correlation coefficient r between oil transfers and the groups of the public expenditures have been more than 0.7 (except for the expenditure on agriculture).

Graph 1: Revenues and Expenditures of the State Budget, in billions USD



Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

The revenue and expenditure of the state budget oscillated in the last decade. So, in five years from 2007 to 2012 the size of the budget increased more than three times. However, in the next five years the state budget has lessened by more than 50% (Graph 1). The main reasons to take into consideration on this trend are the role of oil transfers, the falling oil prices, and the depreciation of the national currency. Not only size of the state budget, but also the distribution of the public spending has been unstable. The percent of the public expenditure on education and social protection, security has been around 10% of the total government spending. On the contrary, the shares of the government expenditure on health care and agriculture have changed between 2% and 5% of the total expenditure. With attention to the expenditure on construction, we can see the crucial trend in the last decade. Particularly during the booming years of the oil-gas sector, the government spent more than one third of the gross expenditure (Table 1).

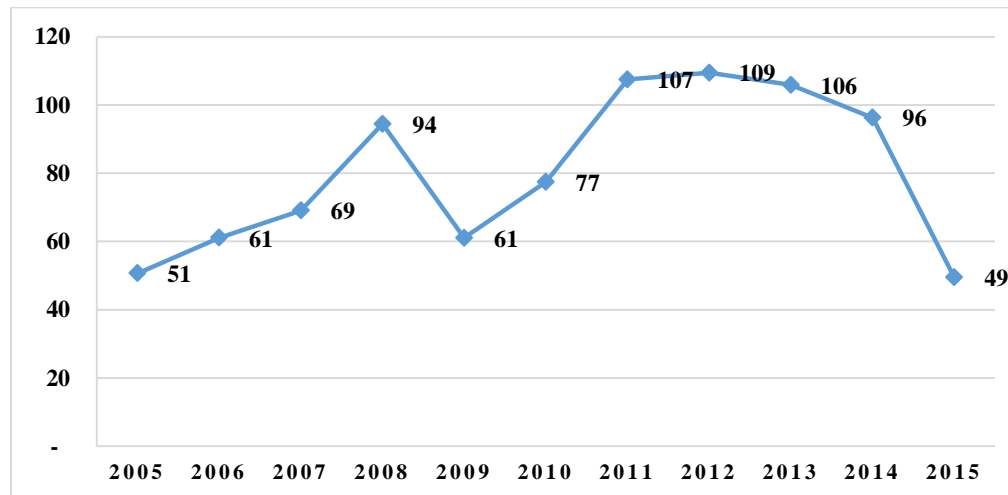
Table 1: The Classification of the Expenditures of the State Budget, % of the total expenditure

Definition	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Education	13%	12%	9%	11%	10%	8%	8%	8%	8%	9%	11%	11%
Health care	4%	4%	3%	4%	4%	3%	3%	3%	4%	4%	5%	5%
Social protection and security	9%	10%	8%	10%	10%	10%	10%	9%	11%	10%	12%	13%
Construction	23%	32%	26%	45%	30%	22%	33%	36%	33%	39%	22%	11%
Agriculture	3%	4%	2%	4%	3%	3%	3%	2%	3%	3%	4%	5%

Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

First thing to remember is the crude oil prices in the world market. The last decade has become the historical period for the oil exporting countries. That is why, the level of the prices has been doubled and then fallen by more than 100% (Graph 2). Without a doubt this situation had impact on the resource dependent economies, including Azerbaijan.

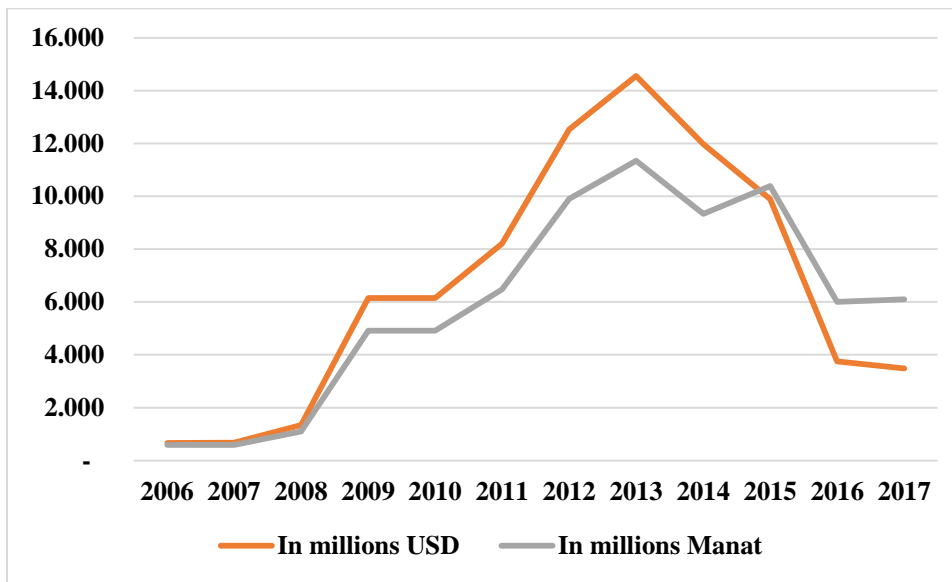
Graph 2: The World average crude oil price, per barrel, USD



Source: OPEC, http://www.opec.org/opec_web/en/data_graphs/40.htm

Moreover, it is enough to take into consideration the trend of the oil transfer from SOFAZ to the state budget. There is logical relations between the world oil prices and the amount of the transfers. In the years of the higher prices, the government has "infected" the state budget with the resource revenue, and enhanced the level of the dependence from the oil sector (Graph 3). Fortunately, there is reasonable amount of assets (USD 35 822.1 million, as of October 1, 2016) has left in the reserve fund (SOFAZ, 2016).

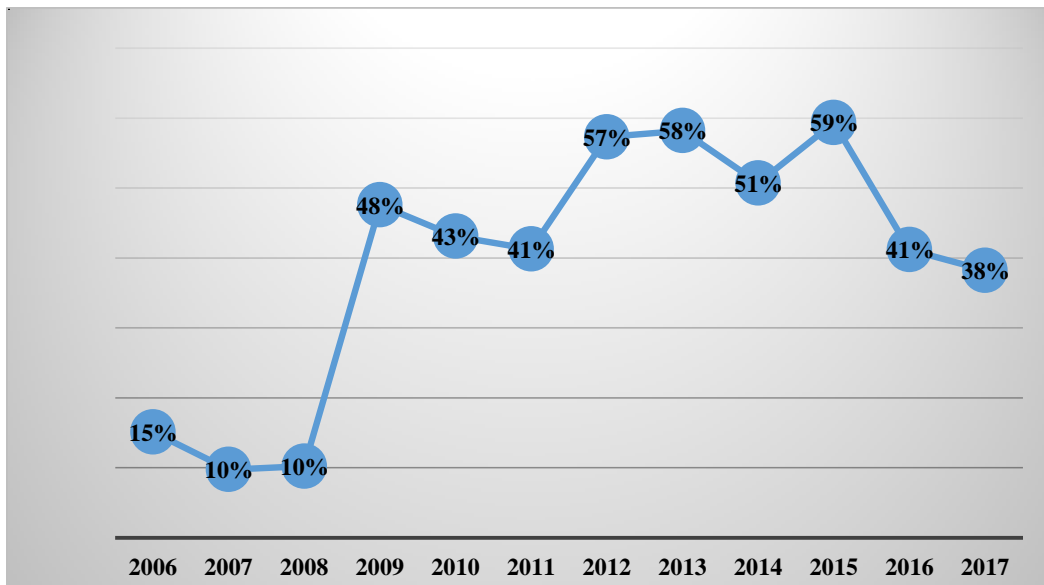
Graph 3: The Transfers from SOFAZ



Source: The Ministry of Finance of the Republic of Azerbaijan

By all means, the main questions have been how much oil rent to spend as a transfer and save in the fund. From 2008 to 2009 the amount of the transfers rocketed to 6 billion USD (48% of the total revenue). Unfortunately, the dependence of the state budget from the oil increased in the next years with the double amount. Furthermore, more than 50% of the total revenue was organized by oil transfers between 2012 and 2015. (Graph 3 and 4).

Graph 4: The Transfers from SOFAZ, Percent of the Total Revenue



Source: The Ministry of Finance of the Republic of Azerbaijan

However this figure has declined in 2016, 2017 to the same level in the beginning of the decade (less than 4 billion of USD). Logically, the share of the oil transfers has decreased in the total revenue. The government tries to explain these changes as an attempt to diversify and minimize the dependence from the oil rents. Without a doubt, the main reason is the falling oil prices in the world oil market. The structure of the study is organized as below. The methodology explains the author’s approach to the research. Then, the study continues with indicating the main features of the group of the public expenditure in Azerbaijan.

Apart from that, the author try to investigate the recent researches in the fiscal policy of Azerbaijan. The next sections are devoted to the results of the analysis and to discuss them. Finally, the paper concludes with the summary of the analysis and comments on the fiscal policy in Azerbaijan.

2. METHODOLOGY

The study characterizes the public expenditure in Azerbaijan with applying the correlation analysis between the selected expenditures and the transfers from SOFAZ to the state budget in order to investigate the potential relationship and the efficiency. At the end of the analysis, we can understand that, in which level these variables have been correlated with each other. Apart from that, we will able to investigate which group public expenditures have been related to the oil transfers with implementing comparisons.

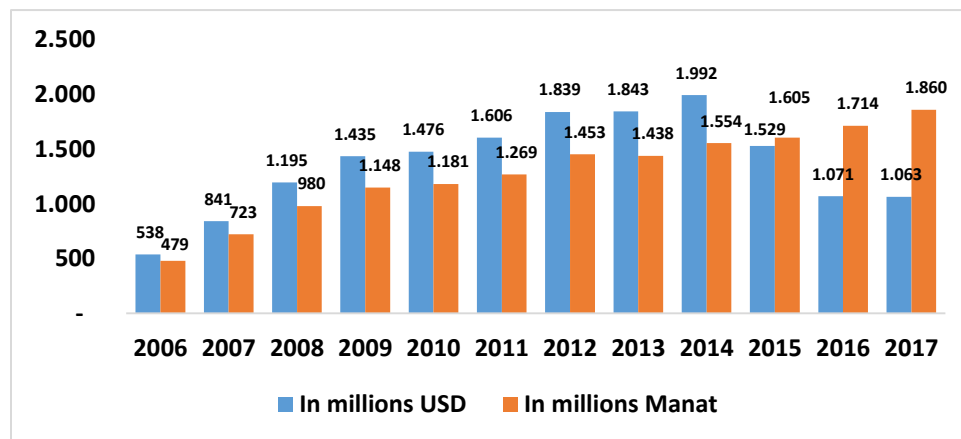
3. DATA

The main source of the data is exported from the State Statistical Committee of the Republic of Azerbaijan, the Ministry of Finance of the Republic of Azerbaijan. The author has taken the data for the period of 2006-2017 for the correlation analysis in order to investigate the relationship between the variables. The variables are the followings:

- Oil transfers from SOFAZ to the state budget
- Expenditure on Education
- Expenditure on Health Care
- Expenditure on Social Protection and Security
- Expenditure on Administration: the Legislation and Executive government authorities
- Expenditure on Construction
- Expenditure on Agriculture

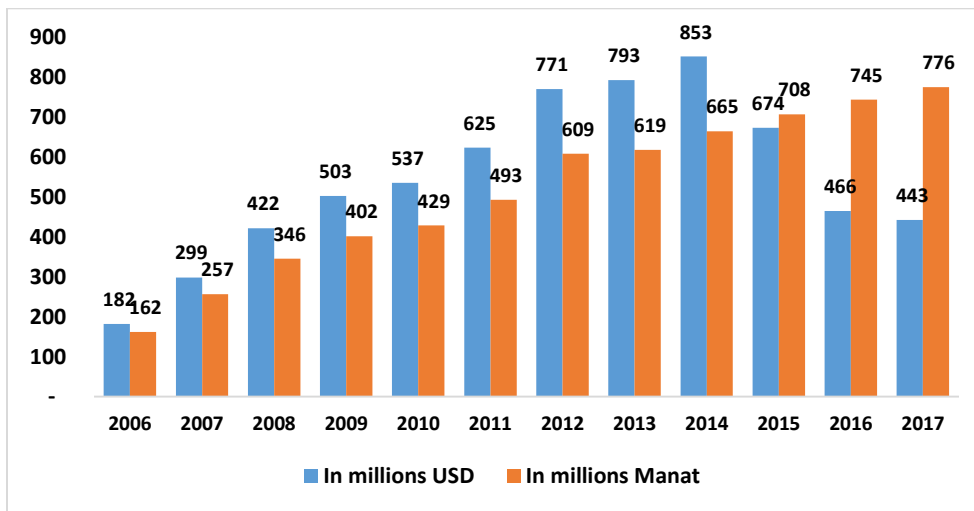
On the other hand, in each table, the source of the data have been mentioned with only names. The relevant data can be accessed from the web links in the websites. The main limitation for the data is the misallocation in one source. So, in the official portal of the State Statistical Committee of the Republic of Azerbaijan, the information about state budget is available only with general numbers. That is why, the author should take investigate to find the missing information from the other official authorities. In this context, the author has collected some parts of the data from the State Statistical Committee of the Republic of Azerbaijan and some of them from the Ministry of Finance of the Republic of Azerbaijan. Interestingly, the government has accepted the new budget for 2017 with the less numbers in comparisons with the previous years. The main reasons for this situation have been the declining oil rents and the devaluation of the national currency.

Graph 5: The Government Expenditure on Education



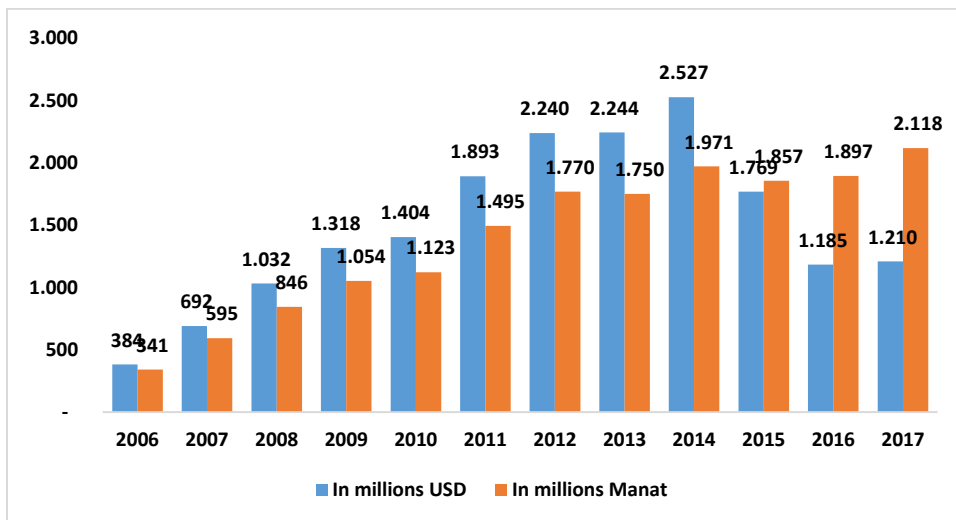
Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

The government expenditure on education shows upward trend by 2014 in the national and foreign currencies. As matter of fact, the amount of the educational spending grew 4 times between 2006 and 2014, reaching 2 billion USD. In contrast, due to the devaluation of the national currency the amount of the educational spending has been projected half of the previous years' numbers (Graph 5).

Graph 6: The Government Expenditure on Health Care

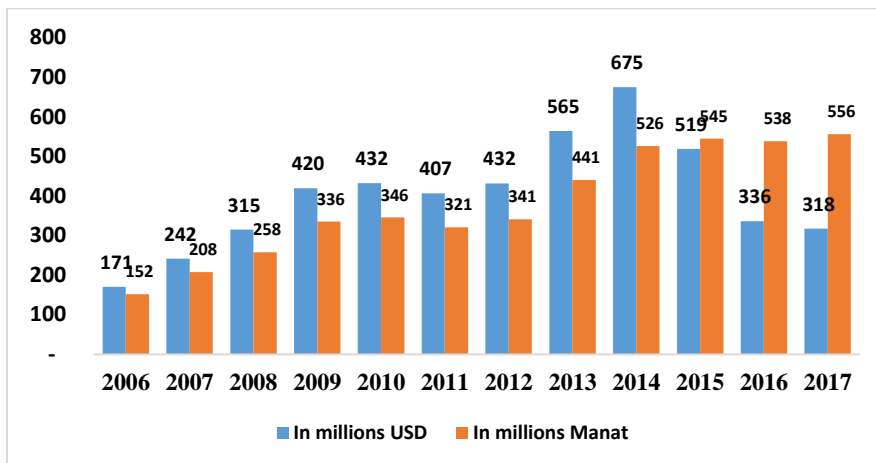
Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

The government expenditure on health care shows also upward trend by 2014 in the national and foreign currencies. As the result of the increasing size of the revenue, the amount of the health care spending grew more than 2 times between 2007 and 2014. On the contrary, due to the devaluation of the national currency the amount of the spending has been projected half of the previous years' numbers (Graph 6).

Graph 7: The Government Expenditure on Social Protection and Security

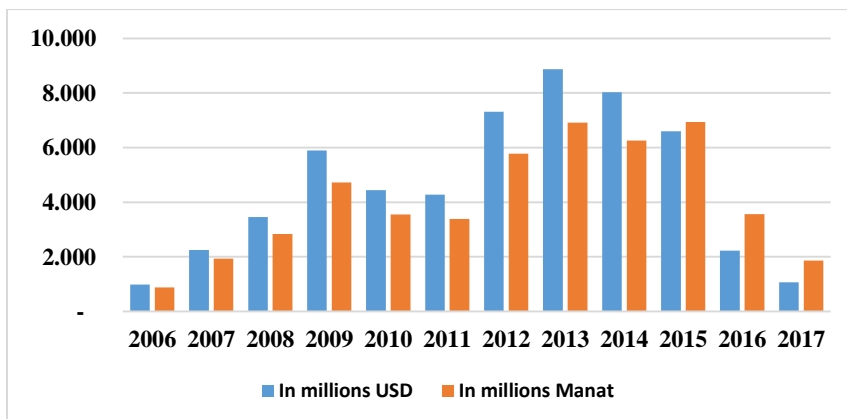
Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

Another government expenditure, social protection and security spending shows also upward trend by 2014 in the both currencies. As the result of the increasing size of the revenue, the amount of the social spending grew more than 4 times between 2007 and 2014. Moreover, due to the devaluation of the national currency the amount of the spending has been projected half of the 2014 numbers (Graph 7).

Graph 8: The Government Administrative Expenditure of the Legislation and Executive Government Authorities

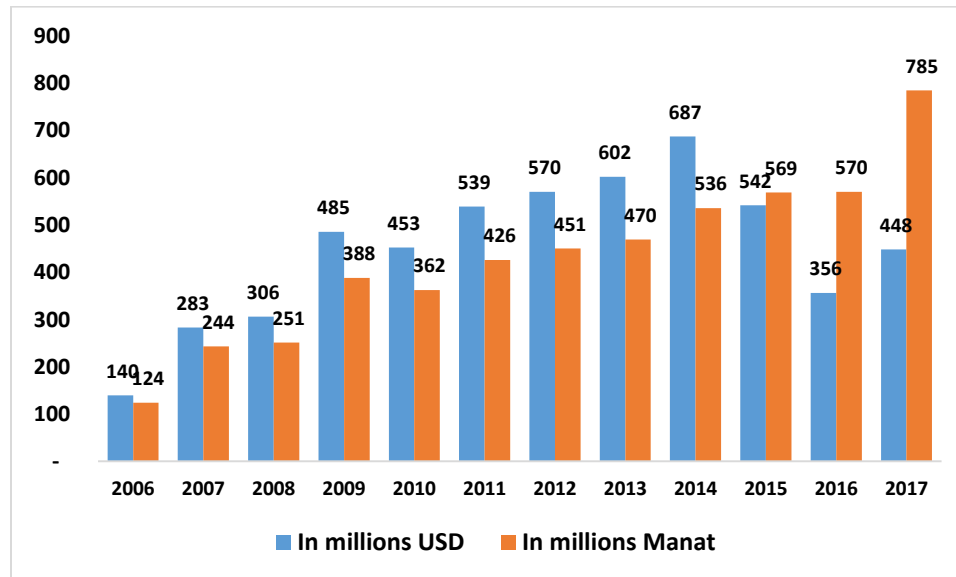
Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

The government administrative expenditure of the Legislation, and Executive government authorities fluctuated and peaked in 2013-2014 with the more than half billion of USD. Interestingly, the main reason of this development was not only the qualitative increase of the living standards of the civil servants, but also establishing new inefficient government bodies. Moreover, due to the devaluation of the national currency the amount of the spending has been projected half of the 2014 numbers (Graph 8).

Graph 9: The Government Expenditure on Construction

Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

At the same time, the government has spent the crucial part of the revenue to the construction sector. So, the percent of the expenditure on construction changed between 22% and 45% (almost half, 2009, Table 1) from 2006 to 2016. On other hand this number peaked by 9 billion USD in 2013. Finally, after the falling oil prices, the government understood that, there is need to cut this expenditure. That is why, the expenditure on construction in the projected state budget for 2017 will be 9 times less than 2009, equal to 11% of the total revenue (Graph 9).

Graph 10. The Government Expenditure on Agriculture

Source: The state Statistical Committee of the Republic of Azerbaijan, The Ministry of Finance of the Republic of Azerbaijan

The government expenditure on agriculture shows upward trend by 2014 in the national and foreign currencies. As the result, the amount of the agricultural spending grew more than 2 times between 2007 and 2014. In case of the devaluation of the national currency, the amount of the agricultural spending has been projected for 2017 more than current year (Graph 10). The main goal of the government to foster the non-oil sector to invest in the agricultural sector.

3. FISCAL POLICY IN AZERBAIJAN

The efficient management of the public expenditure and revenue is the key feature of the fiscal policy. First aspect in the fiscal policy in Azerbaijan has been the contribution of the oil rents to the state budget. The Oil Fund of the Republic Azerbaijan (SOFAZ) is the key player in the economic policy of Azerbaijan. First thing to remember, the Azerbaijan economy has experienced varied booms and downturn due to the resource dependent economy in the last decade. The key feature of the public expenditure management to take into consideration the lack of the sustainability of the public revenue, the abnormal increase of the spending in the years of the booming oil-gas sectors. That is why, this dependence from the one source: oil-gas export can create more challenges for the Azerbaijan economy (Aslanli, 2015). On the other hand, the Azerbaijan government could manage to prevent the negative effects of the world economic crisis in 2008-2009. Unfortunately, the main reason for this achievement was not the sustainable economic development. The oil rents played crucial role to stabilize the situation (Guliyev, 2013). Consequently, a 1% rise in the oil prices has increased a 1.66% growth in the capital spending of the state budget. Thus, this relationship between oil-gas sector and the fiscal policy shows the importance of the dependence from the one factor (Gurbanov, Nugent, and Mikayilov, 2015). As a result of the falling oil prices since 2014, the government has started to consider to cut the public spending in some directions. However, this process can motivate to concentrate on the development of the non-oil sector. In the contrast, the government should compensate the decreasing share of the oil rents in the revenue of the state budget. So, any increase in the tax collection can be solution to remedy the situation. On the other side, it may has the negative impact on the non-oil sector (Aliyev and Nadirov, 2016). The size of the state budget for the next year proves that, the government's expectation about the oil prices is not optimist and they admit that, the situation will be more difficult than previous years (CESD, 2016).

4. RESULTS

Table 2 and Graph 11 identify the correlation between oil transfers and administrative expenditure of the legislation, executive government authorities. As the result of the analysis, there is a strong positive linear relationship between these variables.

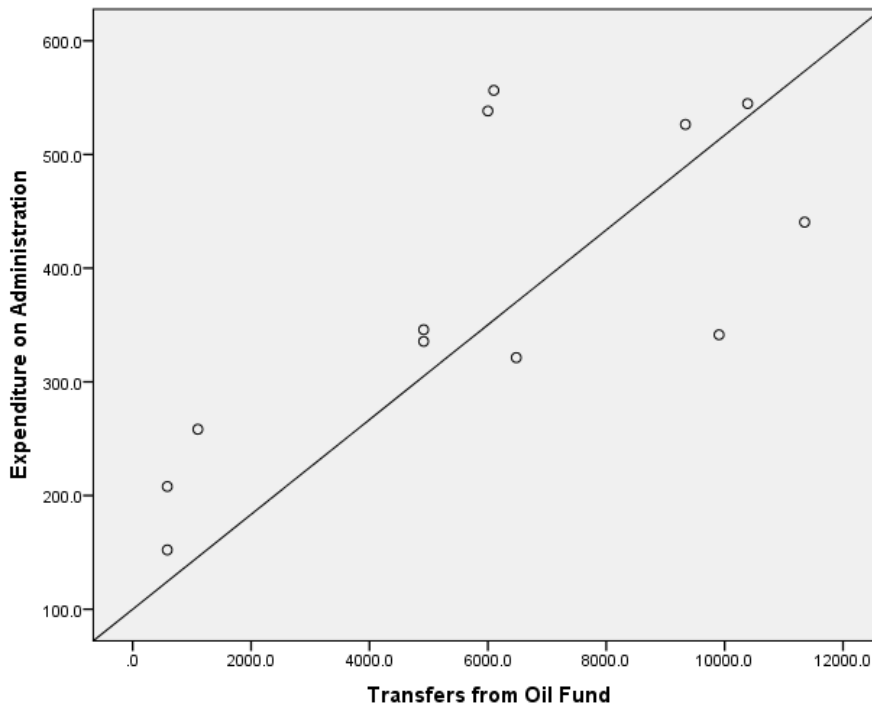
Table 2: The Correlation between Oil Transfers and Administrative Expenditure of the Legislation and Executive Government Authorities

		Transfers from Oil Fund	Expenditure on Administration
Transfers from Oil Fund	Pearson Correlation	1	.725**
	Sig. (2-tailed)		.008
	N	12	12
Expenditure on Administration	Pearson Correlation	.725**	1
	Sig. (2-tailed)	.008	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 11: The Correlation between Oil Transfers and Administrative Expenditure of the Legislation and Executive Government Authorities



Source: According to the Statistics author’s own analysis

The Azerbaijan government projects to spend 11% of the total public spending for the construction purposes in 2017 (Table 1). However, this indicator is 100% less than the current year. In fact, the main reason is the declining oil rents in the economy. In this context, there is strong positive linear relationship between the oil transfers and the expenditure on construction (Table 3 and Graph 12).

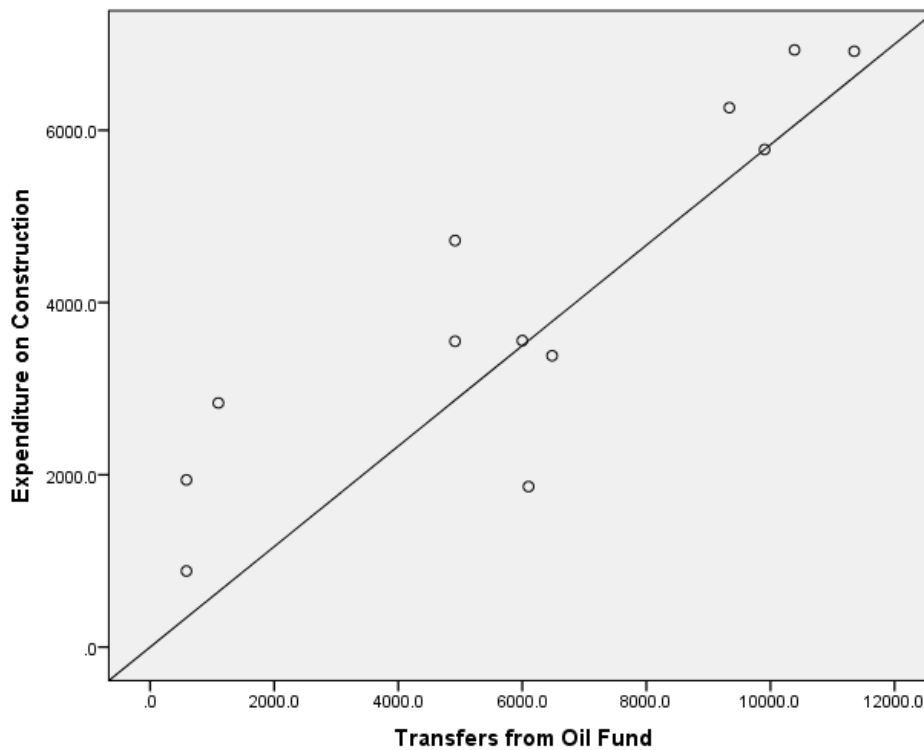
Table 3: The Correlation between Oil Transfers and the Expenditure on Construction

		Transfers from Oil Fund	Expenditure on Construction
Transfers from Oil Fund	Pearson Correlation	1	.881**
	Sig. (2-tailed)		.000
	N	12	12
Expenditure on Construction	Pearson Correlation	.881**	1
	Sig. (2-tailed)	.000	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 12: The Correlation between Oil Transfers and the Expenditure on Construction



Source: According to the Statistics author’s own analysis

The Azerbaijan government projects to spend 5% of the total public spending for the agricultural purposes in 2017 (Table 1). In contrast, this indicator is 214 million USD more than the current year. That is why, there is moderate positive linear relationship between the oil transfers and the expenditure on agriculture (Table 4 and Graph 13).

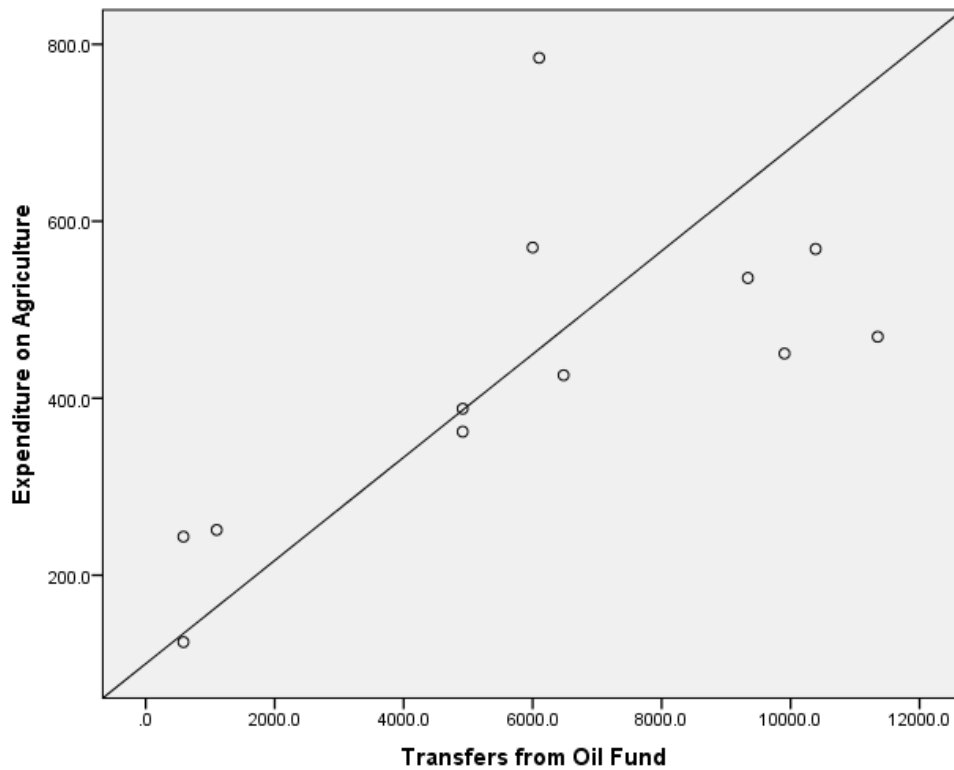
Table 4: The Correlation between Oil Transfers and the Expenditure on Agriculture

		Transfers from Oil Fund	Expenditure on Agriculture
Transfers from Oil Fund	Pearson Correlation	1	.667*
	Sig. (2-tailed)		.018
	N	12	12
Expenditure on Agriculture	Pearson Correlation	.667*	1
	Sig. (2-tailed)	.018	
	N	12	12

*. Correlation is significant at the 0.05 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 13: The Correlation between Oil Transfers and the Expenditure on Agriculture



Source: According to the Statistics author’s own analysis

The Azerbaijan government projects to spend 11% of the total public spending for the education purposes in 2017 (Table 1). On the other hand, this indicator is 929 million USD less than 2014 due to falling oil rents. That is why, there is strong positive linear relationship between the oil transfers and the expenditure on education (Table 5 and Graph 14).

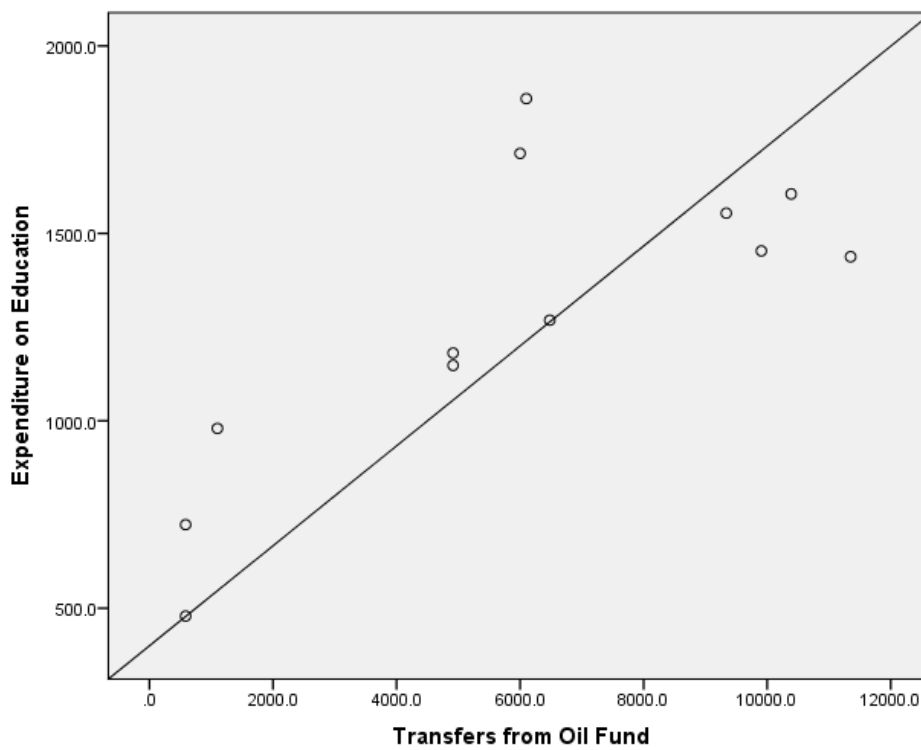
Table 5: The Correlation between Oil Transfers and the Expenditure on Education

		Transfers from Oil Fund	Expenditure on Education
Transfers from Oil Fund	Pearson Correlation	1	.761**
	Sig. (2-tailed)		.004
	N	12	12
Expenditure on Education	Pearson Correlation	.761**	1
	Sig. (2-tailed)	.004	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 14: The Correlation between Oil Transfers and the Expenditure on Education



Source: According to the Statistics author’s own analysis

The Azerbaijan government projects to spend 11% of the total public spending for the health care in 2017 (Table 1). Nevertheless, this indicator is 43% or 350 million USD less than 2013 due to falling oil rents and the devaluation of the national currency. That is why, there is strong positive linear relationship between the oil transfers and the expenditure on health care (Table 6 and Graph 15).

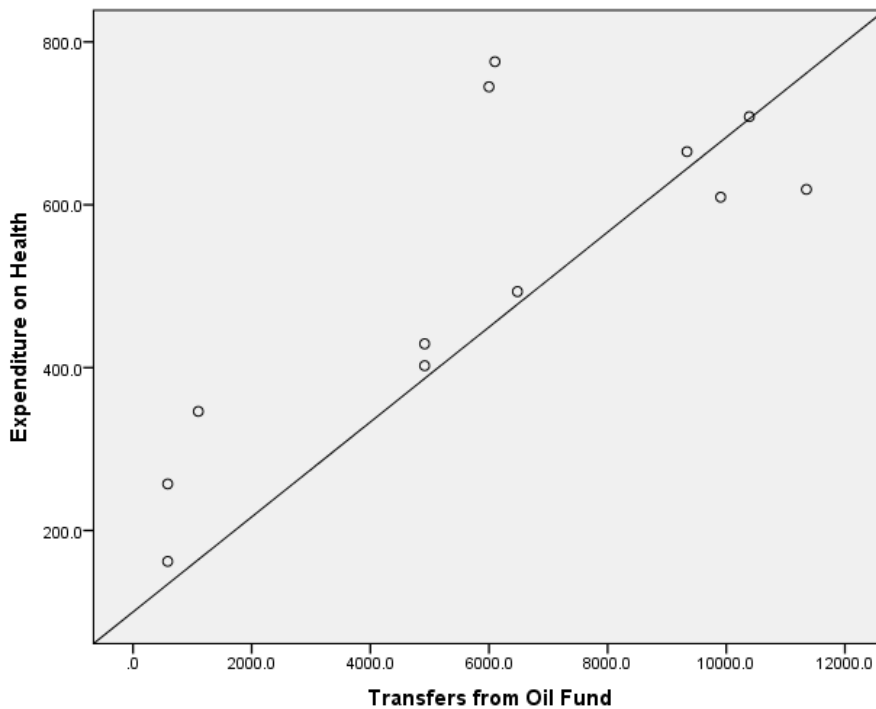
Table 6. The Correlation between Oil Transfers and the Expenditure on Health Care

		Transfers from Oil Fund	Expenditure on Health
Transfers from Oil Fund	Pearson Correlation	1	.792**
	Sig. (2-tailed)		.002
	N	12	12
Expenditure on Health	Pearson Correlation	.792**	1
	Sig. (2-tailed)	.002	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 15. The Correlation between Oil Transfers and the Expenditure on Health Care



Source: According to the Statistics author’s own analysis

The Azerbaijan government projects to spend 13% of the total public spending for the social protection, security purposes in 2017 (Table 1). At the same time, this indicator is 52% or 1.3 billion USD less than 2014 due to falling

oil rents and the devaluation of the national currency. That is why, there is strong positive linear relationship between the oil transfers and the expenditure on social protection, security (Table 7 and Graph 16).

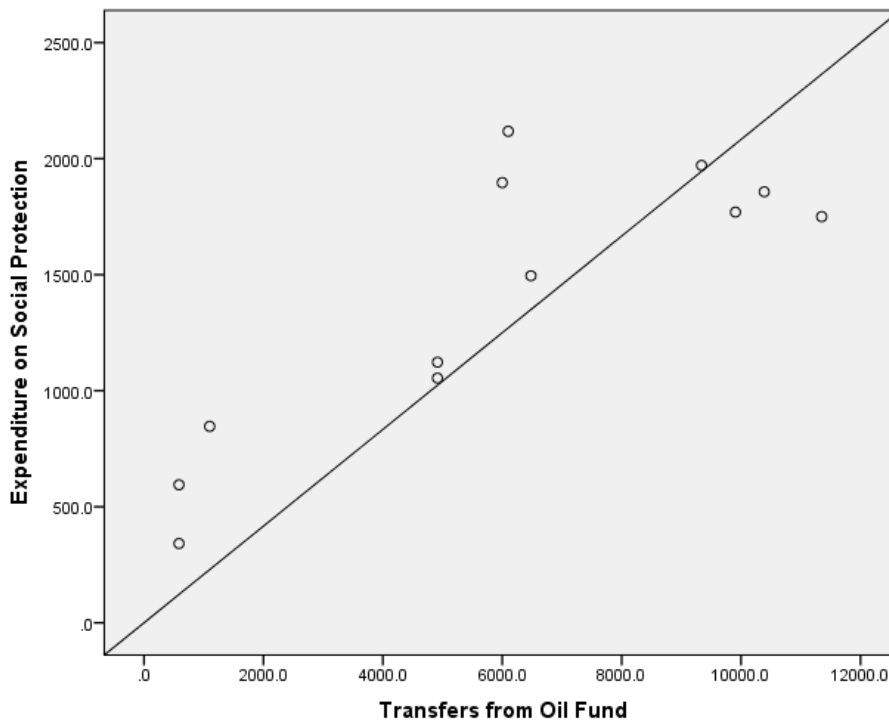
Table 7: The Correlation between Oil Transfers and the Expenditure on Social Protection and Security

		Transfers from Oil Fund	Expenditure on Social Protection
Transfers from Oil Fund	Pearson Correlation	1	.842**
	Sig. (2-tailed)		.001
	N	12	12
Expenditure on Social Protection	Pearson Correlation	.842**	1
	Sig. (2-tailed)	.001	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Source: According to the Statistics author’s own analysis

Graph 16: The Correlation between Oil Transfers and the Expenditure on Social Protection and Security



Source: According to the Statistics author’s own analysis

5. DISCUSSIONS

The most striking result to emerge from the data is that there has been positive linear relationship between the oil transfers from SOFAZ and the selected government expenditures. The most remarkable correlation is with the public spending on construction. That is why, within the booming years of the oil sector, the government has increased the share and amount of the expenditure to the construction projects. On the other hand, the least correlation coefficient in the selected variables is in the relationship between the oil transfers and the expenditure on agriculture. The main reason is the new approach by the government to the agricultural development in order to diversify the economy and to minimize the resource dependence. By all means, when there have been more resource revenues the government has spent more or vice versa. In fact, the Azerbaijan

economy experiences the most difficult time in the last decade. Apart from the selected public expenditures, there are crucial cuts for other directions too. Surprisingly, the government still considers that, this dramatic changes in the fiscal policy, particularly, the decreasing oil transfers from SOFAZ is the important step to minimize this dependence. However, the government projects to collect more taxes in the comparison with previous years. As the result of these decisions, tax burden may affect the taxpayers negatively.

6. CONCLUSION

This paper has investigated the relationship between the oil transfers and the selected government expenditures. The results has shown that, there have been strong linear correlation between the oil transfers from SOFAZ and all of the selected expenditures. So, the coefficients of the correlations analysis of the variables have changed between 0.67 (expenditure on agriculture) and 0.88 (expenditure on construction). In general, the state budget of Azerbaijan has been "infected" with the resource revenue. The revenue and expenditure of the state budget oscillated in the last decade. So, in five years from 2007 to 2012 the size of the budget increased more than three times. Not only size of the state budget, but also the distribution of the public spending has been unstable. Without a doubt the falling world oil prices had impact on the resource dependent economies, including Azerbaijan. By all means, the main questions has been how much oil rent to spend as a transfer and save in the fund.

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