

## **AZERBAIJAN\***

This paper gives an account of the recent economic developments which occurred in the Republic of Azerbaijan with a particular emphasis on the progress achieved since 1993 when the current government came into power and launched a programme of economic reforms.

Azerbaijan is located on the southeastern part of the Caucasian Mountains. The territory covers 86,600 square kilometres. The population is 8.1 million. Half the population is urban. 2 million people live in the capital of the country, Baky, which is the largest harbour of the Caspian Sea.

### **The legacy of the past**

After the collapse of the Soviet Union, Azerbaijan's economy experienced serious macroeconomic disturbances. Real GDP declined by more than 70 per cent during 1992-1995, a high inflation rate brought to naught all the real income, and international reserves were depleted. All of these developments derived from the following 4 factors:

1. Because of the Armenian aggression, 20 per cent of the country's territory was occupied and more than 1 million people became homeless. It has to be noted that the overwhelming majority of these people took refuge in camps denuded of the necessary living conditions. Being homeless made them entirely dependent on assistance rendered by the Government and international organisations. However, the international organisations suspended relief actions and, subsequently, their living conditions deteriorated. To address the problems connected with the social needs of refugees, the Government allotted US70,000 from the Oil Fund.

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2. Disruption of the traditional financial and trade network between the Soviet Union and the Baltic States.
3. The trade climate was also affected as consumers in the Soviet Union moved towards a market-oriented system.
4. Fiscal deficit led the Central Bank to make large-scale emissions which in turn engendered macroeconomic unsteadiness.

All of the above-mentioned factors have led to a crisis-ridden economy.

Income per capita in Azerbaijan amounts to US\$500. However, unlike the other newly-independent states with a similar per capita income, Azerbaijan inherited more advanced transport and irrigation infrastructure as well as educational basis. Azerbaijan also inherited no sovereign debt from the Soviet Union following the signature of the so-called zero option with Russia in 1997.

The early years of independence were accompanied by the above-mentioned difficulties. Output declined by over 80 per cent due to the inevitable dislocations caused by separation from Soviet-era markets and supplies, to poor economic policy and to an outbreak of fighting in Nagorno-Karabakh.

### **The programme of economic reform**

The coming to power of President Heydar Aliyev in 1993 enabled to reach an agreement on a cease-fire regime in Nagorni-Karabakh. The Government launched a programme of economic reform. Fiscal control was restored and the budget deficit has been under 3 per cent of GDP since 1996. Unlike the situation in the CIS countries, price stability as well as convertibility of national currency were restored and maintained.

This was a favourable development for foreign oil companies in the light of possible investment agreements. Indeed, a modern era of offshore oil development was started in 1994 by signing the First Production Sharing Agreement (PSA) (the so-called “Contract of the Century”) with the worldwide leading oil companies for the Azeri-Chirag-Guneshli (ASS) field. Since then, Azerbaijan has signed 21 PSA

contracts for exploration and development, of which 15 are offshore. Azerbaijan International Operating Company (AIOC) started its earliest export in 1997 and presently exports 100 000 barrels of oil per day. The production share of the AIOC in GDP constitutes 16 per cent.

Having ensured sustained financial stability and economic growth, the economic reforms were successful steps forward. The foreign trade regime and domestic prices were liberalised. Designed to transform state-owned small- and medium-sized enterprises into joint stock companies, the first privatisation programme was completed. The banking system was restructured and subsequently, banking control was strengthened. The tax system is modernised and tax administration is consolidated. To improve expenditure management, an effective treasury system was created. However, the pace of private sector development and reforms aimed to ensure good governance of the public sector have been slower compared to previous years and much remains to be done towards the completion of transformation.

The share of industry with respect to GNP is more than half of the latter, and 70 per cent of the industrial enterprises located on the Apheron peninsula are oil processing, chemistry, electro-technical, machine building, metallurgy ones. Taking into consideration the upward trend of investment inflows oriented to exploration of new oil fields, these sectors are considered extremely important.

In 1995, the Government of Azerbaijan began to implement a far-reaching economic reform programme. The decline in production started to slow down, although year-on-year, output still fell by a further 11 per cent. In 1996, the production decline was reversed and output increased by 1.3 per cent compared with the same period of the previous year. Economic recovery is mostly attributable to exploration of new oil fields of the Caspian Sea and, related with it, Foreign Direct Investment inflows.

Azerbaijan made a late start in the southern region of the former Soviet Union in attracting FDI, especially as compared to Kazakhstan, the region's first mover. Nevertheless, all in all, Azerbaijan is the second largest Central Asian recipient of total FDI inflows since 1992. However, in the context of total inflows with respect to per capita and GDP, Azerbaijan takes the lead over the countries of the region.

| Country      | Inflows of Foreign Direct Investment (FDI) \$US million |      |      |      |      |      |      |               | FDI per Capita \$US | FDI/GDP % |
|--------------|---|------|------|------|------|------|------|---------------|---------------------|-----------|
|              | Average 1989-93   | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | Total 1994-99 |                     |           |
| Azerbaijan   |   | 22   | 330  | 627  | 1115 | 1023 | 691  | 3808          | 82                  | 15.5      |
| Of which:    |   |      |      |      |      |      |      |               |                     |           |
| Oil          |   | 22   | 140  | 417  | 780  | 944  | 527  | 2830          | 61                  | 11.5      |
| Non-oil      |   |      | 190  | 210  | 335  | 79   | 164  | 978           | 21                  | 44.0      |
| Southern FSU |   |      |      |      |      |      |      |               |                     |           |
| Armenia      | 7   | 8    | 25   | 18   | 52   | 232  | 130  | 465           | 21                  | 4.1       |
| Georgia      |   | 8    | 5    | 45   | 11   | 265  | 96   | 530           | 16                  | 1.6       |
| Kazakhstan   | 686   | 660  | 964  | 1137 | 1321 | 1152 | 1587 | 6821          | 67                  | 5.1       |
| Kyrgyzstan   | 10  | 38   | 96   | 47   | 83   | 109  | 35   | 408           | 15                  | 3.6       |
| Tajikistan   |   | 10   | 15   | 16   | 4    | 30   | 29   | 104           | 3                   | 1.8       |
| Turkmenistan |   | 100  | 100  | 108  | 108  | 130  | 80   | 626           | 24                  | 6.4       |
| Uzbekistan   | 43  | 50   | 120  | 55   | 285  | 200  | 113  | 823           | 6                   | 1.0       |
| Others       |   |      |      |      |      |      |      |               |                     |           |
| Turkey       | 665   | 608  | 885  | 722  | 805  | 940  | 783  | 4743          | 12                  | 0.4       |
| Russia       | 956   | 640  | 2016 | 2479 | 6638 | 2761 | 2861 | 17395         | 20                  | 1.0       |
| Moldova      | 16  | 28   | 67   | 24   | 76   | 81   | 34   | 309           | 12                  | 3.2       |
| Ukraine      | 200   | 159  | 267  | 521  | 624  | 743  | 496  | 2810          | 9                   | 1.1       |

The growth of GDP from 1.3 per cent to 5.8 per cent for the period 1996-1997 could also serve as an exemplification of economic recovery. The very same period witnessed an increase in investment inflows into the country's economy. Export of the new oil products has got under way since 1997. Economic growth was much speeded up in 1997. Economic recovery was also diffused to industry and agriculture. Financial stability and strong real growth characterised both 1997 and 1998: the average growth of real GDP was 8 per cent a year. In 2000, real GDP growth was 11.1 per cent, largely driven by a continued expansion in oil production.

Along with being the largest country of the Caucasus, Azerbaijan is confidently striding towards integration into market economy.

All the reforms conducted by the Government will improve the socio-economic situation and raise living standards. Amendments made in the legislation create a more auspicious condition for foreign investors than ever before. It is not inconceivable that, after a while, Azerbaijan will be a country with a highly-developed economy and strong democratic and market institutions.