



**Support to Economic Initiatives Public Union**

**REVIEW**  
**on 2016 state budget (forecast) of Azerbaijan**  
**Republic**



**BAKU – 2015**

The review has been developed in order to enlarge public participation in state fiscal policy and budget discussions, to improve the contribution of the civil society to the development and implementation of budget policy and to explain 2016 state budget to larger community.

The Review is planned to be published in media, as well as to be sent to the relevant government bodies.

**The review has been developed by the experts of Support to Economic Initiatives Public Union**

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## ABOUT US

The Baku-based Non-governmental Organization - **Support to Economic Initiatives Public Union** (SEI) came into existence in order to promote expansion of advanced and innovative socioeconomic initiatives. On September 29, 2006, SEI was registered with the Ministry of Justice. SEI's slogan is "From guided society to self-governed society". The idea behind this slogan also denotes the key mission SEI is committed to accomplishing.

Major features and attributes of self-governed society are the grounding of human freedom, human and civil rights provisions; establishment of an electoral system for authorities at all levels of politics; strong local self-governance; decentralization as a principle and practice of managing society's business; provision of transparency, accountability, efficiency and public participation regarding the activities of government bodies (including use of public funds); promotion of social dialog; availability of competitive market economy; practicing freedom of initiative; building a healthy and well educated society, etc.

SEI adopts as its mandate the following purposes and objectives:

- ❑ To support implementation of socioeconomic reforms and civil society development;
- ❑ To contribute to economic liberalization and private sector development;
- ❑ To initiate socioeconomic researches and awareness ;
- ❑ To promote modern economic education and development;
- ❑ To conduct monitoring of government-led investment projects and socio-economic programs;
- ❑ To aid in the development of the institutional framework for local self-government and the solution of local government problems, etc.

The Center has become a member of the Council of Extractive Industries Transparency Initiative (EITI), National Budget Group (NBG) and Municipality Alliance of NGOs in Azerbaijan.

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## Introduction

Azerbaijan has stepped into a quite complicated stage from the point of economic growth perspectives: the decreasing tendency of oil prices in world markets that has been going on since mid-2014 and up to now has caused the sharp reduction of oil revenues that had been the main source for economic growth and economic activity of the country for the past 10 years. The rapid decrease of oil revenues has caused real threats for the macroeconomic and financial stability of the country: at the beginning of the current year (February 21<sup>st</sup> ) the national currency of the country was devalued<sup>1</sup> by 25,7%<sup>2</sup> which caused high tension in financial and banking spheres as well as currency markets of the country. The strategic currency reserves of the country have been rapidly reducing.

Due to the fact that more than half of the budget revenues of the country has been formed directly by the oil sector and oil revenues since 2006, the reduction of these revenues had their immediate negative impact on the state budget implementation – in regard to the state budget for the current (2015) year: for the end of the year the budget revenues are expected as 12,1% (or AZN 2358.0 million) and budget expenses as 16,0% (or AZN 3370.0 million) less than the figures approved by Law.

The sharp decrease of oil revenues, i.e. the budget revenues causes problems with fulfilment of social and economic obligations undertaken by the government having limited the financial opportunities of the country. This situation urges the government to enlarge the tax base, optimize the budget expenses, increase the efficiency of state funds utilization, carry out more effective and result-oriented budget policy in order to increase non-oil revenues. 2016 state budget of Azerbaijan has been developed and approved in this complicated economic period when uncertainty of economic processes is increasing, crisis trends are becoming stronger and hard budget constraints are present.

The state budget is considered the mirror of the economic policy of the government. Hence, the analysis of the approved state budget for 2016 allows to evaluate the economic policy the government has determined and is planning to implement for next year.

The experts of Support to Economic Initiatives Public Union have prepared this review having carried out necessary study and research on 2016 approved state budget. The review determines the main trends observed in budget revenues and expenses for the coming year, as well as evaluates the impact of the budget policy to be implemented on economic processes.

The following documents have been studied upon preparation of the Review, along with the necessary studies and researches carried out on the basis of the information they contain:

- Law of Azerbaijan Republic on 2016 State Budget (October 20, 2015)

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<sup>1</sup> The very day we finalized this review and were ready to reveal it to public – December 21, 2015 the country experienced the second devaluation. Thus, we had to delay the reveal for a couple of days.

<sup>2</sup> February 21 devaluation caused the national currency decrease by 25,7% against USD whereas the USD gained 34,6% value against AZN.

- Decree of the President of Azerbaijan Republic on the approval of the Law of Azerbaijan Republic on 2016 State Budget (December 7, 2015)
- Set of documents to be submitted to the Parliament alongside with the draft Law on 2016 State Budget
- Review of the Chamber of Accounts of Azerbaijan Republic on the Draft Law of Azerbaijan Republic on 2016 State Budget, etc.

The very day we were going to finalize this review and reveal it to the public – December 21, 2015 the Central Bank declared the second devaluation (this time AZN was devalued for 32,3% with USD exchange rate increasing for 44,6%) and the shift to floating exchange rate policy. Thus, Azerbaijani manat was devalued twice during 2015 and lost its value for almost twice against USD. The studies and research we have carried out on 2016 budget forecast show that yet this is not the final devaluation the national currency has experienced: the economic crisis and devaluation of AZN in the country will continue.

The review has been developed in order to enlarge public participation in state fiscal policy and budget discussions, to improve the contribution of the civil society to the development and implementation of budget policy and to explain 2016 state budget to larger community.

The Review is planned to be published in media, as well as to be sent to the relevant government bodies.

## I. Concise statistical view of 2016 state budget

### a) Budget revenues:

The Law of Azerbaijan Republic on 2016 state budget states budget revenues as AZN 14566.0 million. This is 3834.6 million or 20,8% less than the actual state budget revenues in 2014 and 4872.0 million AZN or 25,1% less than the forecast budget revenues for 2015 approved by Law (it should be mentioned that this is 2514.0 million or 14,7% less than the revenues to be accumulated to the state budget by the end of 2015).

The ratio of state budget revenues to annual GDP is forecast as 2,5% in 2016. The ratio of non-oil revenues of the state budget to annual GDP is expected to be 11,7% and the ratio of non-oil budget revenues to non-oil GDP through the year is expected to be 16,3% next year.

According to the forecasts, 6000.0 million AZN (41,2% of budget revenues) of 2016 budget revenues will be formed by State Oil Fund transfers, 3336.0 million (22,9%) by value added tax (VAT), 1806.6 million (12,4%) by profit tax by entities, 957.0 million (6,6%) by income tax by individuals and 637.0 million (4,4%) by excise tax.

In 2016 the amount of transfers to the state budget from the State Oil Fund is expected to be 4338.0 million AZN less, that of profit tax by entities 389.4 million AZN less, that of difference between the contractual (sales) prices of products produced inside the country with regulated prices and the internal wholesale prices (export expenses exclusive) 77.0 million AZN less and that of VAT 10.0 million AZN less compared to forecasts on 2015 budget. The revenues generated from simplified tax are expected to be 25.0 million AZN more, from road tax 19.4 million more, from loans issued to foreign governments 11.5 million AZN more, from property tax of legal entities 11.2 million AZN more and from other revenues 6.7 million AZN more compared to 2015.

According to the forecasts approved by Law, 94,7% (or AZN 13799.6 million) of state budget revenues of next year will be formed by centralized revenues and the remaining 5,3% (AZN 766.3 million) by local revenues.

45,3% of 2016 state budget revenues will come from the Ministry of Taxes, 10,9% from State Customs Committee and 41,2% from State Oil Fund, with remaining 2,6% to be generated by other sources.

Out of total 6602.0 million AZN to be accumulated to the state budget by tax bodies in 2016, 1790.0 million AZN (27,1%) fall to the share of the oil sector and 4812.0 million AZN (72,9%) to the share of non-oil sector.

It should be mentioned that the per-barrel price of crude oil was considered as USD 50.0 and average annual exchange rate of AZN against USD as 1.05 AZN upon development of forecasts for 2016 state budget revenues.

## **b) Budget expenses:**

The Law of Azerbaijan Republic on 2016 state budget determines the amount of state budget expenses as AZN 16264.0 million. This is AZN 2445.0 million or 13, 1% less than the actual state budget expenses for 2014. The forecast amount of the budget expenses for 2016 is expected to be AZN 4836.0 million (or 22,9%) less than forecast figures for 2015 and AZN 1466.0 million (8,3%) less compared to the expected implementation level of budget expenses for the end of the current year.

The ratio of 2016 state budget expenses to annual GDP is expected to be 28, 2%. This indicator was determined as 33, 5% for 2015 in accordance with relevant forecasts. The ratio of actual budget expenses to annual GDP in 2014 was 34, 4%.

The allocations from 2016 state budget are determined as AZN 2416.9 million to general state services, as AZN 1837.8 million to defense expenses, as AZN 1138.9 million to juridical and law-enforcement expenses, as AZN 1713.5 million to education, as AZN 744.9 million to health sector, AZN 1896.6 million to social protection and social provision expenses, AZN 652.7 million to culture, art, sports and information sectors, AZN 416.7 million to housing and utilities, AZN 596.6 million to agriculture, forestry and fishery, AZN 3578.9 million to industry, construction and minerals, AZN 114.8 million to transportation and communications, AZN 254.0 million to economic activity and AZN 896.2 million to other services not included into main sections.

The following are the sections with more share (special weight) in 2016 state budget expenses: industry, construction and minerals – 22,0%, general state services – 14,9%, social protection and social provision – 11,7%, defense – 11,3% and education – 10,5%. Alongside with this, the juridical, law-enforcement and prosecution expenses will have 7,0% share, other expenses not included into the main expenses 5,5%, health expenses 4,6%, culture, art, sports and information expenses 4,0%, agriculture, forestry and fishery expenses 3,7% share, housing and utilities 2,6%, economic activity expenses 1,6%, transportation and communication expenses 0,7% share of the budget expenses of next year.

Compared to the previous years the expenses that will be most reduced in 2016 state budget are investment projects, special defense projects and measures: the funds allocated to investment projects have been reduced by AZN 3395.5 million (up to 69,4% of total reductions) in 2016 state budget compared to 2015 budget forecast and the allocations to special defense projects and measures have been reduced by AZN 1270.5 million.

Compared to 2015 budget forecasts, only 3 sections of 2016 budget expenses have undergone certain increase: culture, art, information and sports expenses are expected to be increased by 87,4% (or AZN 304.4 million), general state expenses by 18,1% (or AZN 369.9 million) and defense expenses by 3,3% (or AZN 59.3 million).

AZN 10188.3 million (62,6% of budget expenses) of 2016 state budget expenses will be allocated for current expenses, AZN 4826.0 million (29,7%) to capital expenses and the remaining 1249.7 million (7,7%) to the expenses related to the state debt.

### **c) State debt and budget deficit:**

The Law of Azerbaijan Republic on 2016 state budget of Azerbaijan Republic considers AZN 301.1 million for the payment of state domestic debts (4,1 times more than it was in 2015 forecast budget) and AZN 948.7 million for the payment of state foreign debts (35% more than it was in 2015 forecast budget).

The Law has approved the upper limit of domestic borrowing to be AZN 2500.0 million and the upper limit of foreign borrowing to be AZN 1500.0 million.

The upper limit of state budget deficit in 2016 has determined as AZN 1698.0 million which is 2,9% of the forecast annual GDP for 2016. The approved amount of the state budget deficit for 2016 is equal to 11,7% of the forecast revenues of the state budget.

### **d) Consolidated budget:**

The consolidated budget revenues for 2016 are forecast as AZN 16.7 billion which is about AZN 4 billion (19,3%) less than the forecasts for 2015. The forecast consolidated budget revenues for 2016 comprise about 28,9% of the expected annual GDP.

The consolidated budget expenses for 2016 are expected to be AZN 19.9 billion (AZN 6.0 billion or 23,2% less than 2015 forecasts) which is 34,5% of the annual GDP.

The 2016 consolidated budget deficit of the country has been determined as AZN 9.9 billion (AZN 5.5 billion less than the corresponding indicator of 2015), excluding the revenues of the State Oil Fund.

## II. Main tendencies observed on budget revenues policy

The fiscal policy for 2016 declared by the government includes the increase of the special weight of non-oil revenues in budget revenues, gradual reduction of transfers by the State Oil Fund to the state budget, improvement of simplified taxation system, limitation or annulation of tax incentives, payment of dividends to the state budget by entities that have state share in their authorized capital or stocks, increase of tax collection percentage, increase of state budget payments from the privatization of the state property, increase of budget revenues from the leasing of state-owned lands, etc.

The structural and trend analysis of forecast revenues of 2016 state budget have revealed the following:

- 1) *The role of direct payments from the oil sector in the formation of state budget revenues has considerably reduced in both absolute and relative terms:* whereas the special weight of direct payments from the oil sector in budget revenues was 74,4% in 2011, 73,4% in 2012 and 2013 and 66,1% in 2014, the indicator has been determined as 65,3% for 2015 and 53,5% for the next coming year. The amount of direct payments from the oil sector to the state budget was AZN 11.68 billion in 2011, AZN 12.64 billion in 2012, AZN 14.27 billion in 2013, AZN 12.16 billion in 2014 and is expected to be AZN 7.79 billion in 2016. Such a reduction of both the absolute amount and share of direct payments from the oil sector in the budget revenues is due to the significant reduction of oil revenues of the country related to the sharp decline of oil prices in the world markets and the decrease of oil production of the country from year to year (it should be mentioned that 40,7 million ton of oil is expected to be produced in the country in 2016 which is 10,1 million ton less than the production volume in 2010);
- 2) *The amount of transfers to the state budget from the State Oil Fund is significantly reduced:* whereas the amount of funds transferred from the Fund to the state budget was AZN 9.9 billion in 2012, AZN 11.35 billion in 2013 and AZN 9.34 billion in 2014, the amount is expected to be AZN 6.0 billion in 2016. The share of Oil Fund transfers in the formation of state budget revenues was 57,3% in 2012, 58,2% in 2013 and 50,7% in 2014, with 41,2% to be expected for the next year. However, the purpose of this reduction of transfers is not the increase of the Fund saving; rather it is related to the sharp decrease of the Fund's revenues themselves. Hence, the annual revenues of the Oil Fund were USD 19.8 billion in 2011, USD 17.3 billion in 2013 and USD 16.2 billion in 2014 and forecast to be USD 6.4 billion in 2016 (considering 1 barrel = USD 50). This means that the revenues of the oil fund are forecast to be reduced by 2,5 times compared to 2014. Though the amount of transfers to the state budget has been reduced, around AZN 8.2 billion are expected to be spent from the Oil Fund in 2016 which is AZN 1488.4 million (or 22,2%) more than the revenues forecast (AZN 6711.6 million) of the Fund for the next year. Thus, it has now already been planned to reduce the assets of the Oil Fund for the next year by USD 1.4 billion (based on 1 USD = 1.05 AZN exchange rate). The lower the price of oil the world markets goes below USD 50, the more the resources of the Fund will "melt away". In case the

government decides on a sharper devaluation<sup>3</sup> during the coming year in order to protect the resources of the Oil Fund, the economic crisis can become deeper leading to higher inflation in the country;

- 3) ***The significant increase in the special weight of payments from non-oil sector in the formation of the state budget revenues, is mainly due to the decrease of total budget revenues and absolute amount of the oil revenues of the budget:*** 46,5% of total state budget revenues in 2016 is forecast to be comprised by the revenues from non-oil sectors which is 12,6% more compared to 2014. The absolute amount (AZN 6776.0 million) of non-oil revenues of 2016 budget however is only AZN 532.1 million (or 8,5%) more than 2014 non-oil revenues of the budget (AZN 6243.9 million). The 8,5% increase of budget payments from non-oil sector compared to 2014 against 12,6% increase of the special weight of these budget revenues is primarily explained by AZN 3834.0 million or 20,8% decrease of the forecast for 2016 budget revenues compared to the actual revenues in 2014;
- 4) ***Excluding the transfers by the State Oil Fund, 2016 state budget revenues will not cover the annual current expenses of the budget:*** Excluding the transfers by the Oil Fund, the state budget revenues for the next year are forecast to be AZN 8566.0 million which is 84,1% of the current expenses (AZN 10188.3 million) for the next year. Considering the service fees related to the state debt alongside with the current expenses of the state budget (total of AZN 11438.0 million) the revenues of the state budget are forecast to be AZN 2872.0 million less (or 25,1%) than these expenses, excluding the transfers by the Oil Fund. This means that the significant portion of the funds transferred to the budget from the Oil Fund shall be spent on the current expenses of the budget and to the service fees related to the state debt;
- 5) ***The impact of the decrease of country's oil revenues on the formation of non-oil revenues of state budget has not been sufficiently considered in 2016 budget forecast:*** the reduction of oil revenues leads to the sharp decrease of both government orders (those through budget expenses) and orders by the oil company which directly effects the revenues of organizations dealing with such orders and the payments they make to the state budget accordingly. For instance, the significant reduction of profits of oil companies in 2016 shall certainly lead to the reduction of their orders. This means that the incomes and budget payment of the organizations dealing with the orders of oil companies can severely decrease. Nevertheless, the payments from the profit tax by PSA subcontractor companies to the state budget have been forecast (AZN 175.0 million) to be 38.3 million AZN (or 28,0%) more than the corresponding figure of 2014. Another example: the funds to be allocated to state capital investments (AZN 3554.8 million) in 2016 state budget are stated AZN 2704.7 million less than the actual spending (AZN 6259.5 million) from 2014 state budget in this directions. Considering the fact that orders on state capital investments are mostly placed by resident companies, this much sharp reduction of state orders should have led to the decrease of payments on profit tax as well as payments on VAT by resident companies. However, neither the explanation on the draft state budget submitted to the

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<sup>3</sup> Mərkəzi Bank növbəti ili gözləmədən manatın ikinci devalvasiyasına getdi

Parliament by the government, nor other documents include any calculations or comments on such impacts upon budget revenue forecasting;

- 6) *The forecasts on profit tax payments to the state budget by resident companies can again be considered exaggerated, just like the previous years:* The annual implementation level on this source was 59,2% in 2013 and 74,8% in 2014. The profit tax payments to the state budget by resident companies are considered to be AZN 669.7 million which is AZN 97.7 million or 17,1% more than the actual payments in 2014. Such an increase in profit tax payments by resident companies against the expected decrease of the economic activity of the country and revenues of resident companies requires serious justification;
- 7) *The payments from the income tax by individuals might be less than the forecasts:* the forecasts on income tax payments to 2016 state budget by individuals are stated as AZN 957.0 million which is AZN 23.3 million or 2,4% less than the actual figures for 2014. The decrease is related to the income tax from employments, as well as income from employments at budget organizations which is primarily explained by the changes made to the Tax Code on income tax. However, the possible impacts of the expected redundancies on the amount of budget payments due to the decrease of state orders as well as economic activity have been ignored;
- 8) *83,1% of state budget incomes is formed through 4 sources:* 41,2% of the budget incomes fall to the share of the State Oil Fund, 22,9% to the share of VAT, 12,4% to the share of the profit tax from legal entities and 6,6% to the share of income tax from individuals;
- 9) *Local revenues being a budget component are forecast to be decreased, however the government is not stating the reasons for this decrease:* local revenues that are part of state budget are forecast as AZN 766.3 million for 2016 which is AZN 68.2 million or 8,2% less than corresponding 2015 figures. As is known, the Law of Azerbaijan Republic on 2014 State Budget of Azerbaijan Republic states that the taxes collected from the tax payers that function within the territory of cities and regions and undergo centralized tax registration have been included into the total local revenues of cities and regions since 2014. Besides, the main source for the formation of the revenue potential of the regions is non-oil sector and the non-oil GDP of the country is forecast to increase next year. Given the current situation, the government should have provided additional explanation on the reasons for the forecast on decreased local revenues of the state budget. Therefore it is recommended to provide detailed classification of local revenues of regions (or regional territories) and payment types in documents related to the draft budget;
- 10) *It is recommended to submit more detailed forecasts on budget revenues in draft budget envelope:* upon such sharp decrease of oil revenues of the country, it is important to clarify the role of the private and public sector, especially the role of large state companies in the formation of budget revenues of the country. At present the budget envelope submitted alongside with draft state budget has no such detailed information.

Thus, as study shows, the dependence of forecast revenues of 2016 state budget on the oil revenues of the country is significant. The processes happening in the world oil market

and most of the forecasts regarding the oil price show that the oil price is going to be below USD 30-35 next year. Under the current circumstances, serious measures should be taken for improving the business environment of the country, eliminating officials' entrepreneurship and monopoly, stimulating competitiveness and initiatives in order to collect sufficient funds to the budget to ensure the timely and necessary implementation of the current liabilities of the state budget for next year. Any obstacle to exports and imports, especially monopoly and illegal prohibitions shall be eliminated without any delay.

### III. The main trends observed on budget expenses policy

The following are the main targets related to expenses stated in the documents on main directions of 2016-2019 budget policy of the government: (1) optimize state budget expenses and increase the efficiency of current and capital expenses; (2) prioritize the formation of social and production infrastructure by improving the structure of state capital investments; (3) strengthen the legislative framework to ensure the improvement of the structure of state budget expenses and the increase of transparency; (4) intensify control over financial activity of organizations that get loans under government guarantee; (5) adjust state programs with midterm budget expenditures.

The comparative analysis of forecasts for 2016 state budget expenses with the previous years allows the assessment of the following trends:

- 1) **For the first time since 2005 the state budget expenses are forecast to decrease.** Though the decrease on total expenses makes 23%, the size of reduction on separate expense items differs. With small exceptions, most of the main expense items of the state budget have been decreased. Compared to expense forecasts for 2015 the greatest decrease refers to the functional division called “other services not included into the main divisions”. This division includes expenses related to reserve funds, purposeful budget funds, elimination of the impacts of emergencies, financing of special defense projects and organization of international and local events. In total the expenses in this division have been decreased by AZN 1801.7 million or thrice, including AZN 340 million (46,8%) on reserve funds, AZN 160 million (35,5%) on purposeful budget funds, AZN 1275.0 million (100%) on special defense projects and AZN 34 million (56,7%) on organization of international and local events. The second large item reduced is budget investments. Hence, compared to the budget forecasts of 2015 the construction expenses have been forecast AZN 3374.7 million or 48,7% less. The decrease on other budget items compared to 2015 budget forecasts is following: AZN 91.3 million (26,4%) on expenses related to economic activity, AZN 13.5 million (10,5%) on transportation and communication expenses, AZN 88.4 million (7,2%) on the maintenance of law-enforcement bodies, AZN 144.0 million (7,1%) on social defense and provision expenses, AZN 27.1 million (6,1%) on housing and utilities expenses, AZN 32.8 million (4,2%) health expenses and AZN 14.1 million (2,5%) on maintenance of legislative and executive bodies.
- 2) **The government has not reduced certain expenses it has declared priority.** Thus expenses on agriculture have been kept almost at the last year’s level. And defense expenses are planned to be increased by AZN 59.3 million or 3,3%.
- 3) **Expenses on the development of science and education have been reduced.** Though declared priority directions in government policy, the science-related expenses have been reduced by AZN 10.3 million (72%) and higher education expenses by AZN 42.4 million (14,%) in next year’s budget. Total AZN 244.0 million will be allocated to higher education sector in 2016 including per capita expenses

for education financed by the state; whereas this figure was AZN 291.8 million last year.

- 4) **Though the establishment of social infrastructure is one of the main directions in budget investment priorities of the government for the coming period, the most significant reductions in the budget investment plan of the next year have been applied to the social fields.** Thus, the investment expenses on social infrastructure projects of 2016 have been determined as AZN 145.4 million which is AZN 2546.5 million (or 18 times) less than the figure for the previous year. Besides, investment expenses on health and education sectors are AZN 95.7 million (AZN 383.4 million in 2015) and on sports sector AZN 36 million (AZN 1952.2 million in 2015). The sectors with least reduction of investment expenses are transportation, utilities and power engineering. Hence, the expenses on these three sectors are considered to be AZN 3171.7 million for 2016 which is AZN 1470.0 million or 31,6% less than the previous year.
- 5) **No funds are considered for the indexation of salaries, pensions and benefits paid through the budget.** Though most consumer goods in the country became more expensive following the decision of the Central Bank on the 34,8% devaluation of the national currency in February 2015, the amount of the fund for the increase of salaries, pensions and benefits in next year's budget is scanty. The expenses on the payment of salaries in 2016 state budget is AZN 3523.6 million which is only AZN 71.2 million or 2% more than the previous year. No increase of salaries is considered for health, culture, art and sports divisions. Salary expenses in health sector are forecast with AZN 70.6 million increase which is 6,5% more than the previous year. AZN 1827.1 million shall be allocated for the payment of pensions and social benefits from 2016 budget which is AZN 17.8 million or 1% less than the previous year. However, the budget documents submitted to the Parliament by the government state the expected inflation rate as 4,4% for 2015 and the forecast inflation rate for 2016 as 3,3%. Taking into account the fact that the most recent decision on salary increase in budget sector was made in 2013, it becomes clear that the government has no plan to protect the incomes of people getting salaries, pensions and benefits from the state budget from the actual inflations of 2014 and 2015 and expected inflation of 2016.
- 6) **Though the stimulation of economic development was declared among government priorities, expenses related to this direction have been reduced.** Thus, the expenses on the functional division of economic activities have been reduced by AZN 91.3 million or 26,4% and are forecast to be AZN 254 million. This reduction is directly related to the halt of the allocations for soft loans to the National Fund on Assistance to Entrepreneurship by the Ministry of Economic Development each year. In 2015 AZN 96.3 million was considered for these state budget allocations. At the same time the budget support to Agroleasing JSC has been reduced by AZN 8.0 million or 20% reaching AZN 32.0 million. Allocations to the Mortgage Fund, however, have been forecast in the same amount as last year –

AZ 50.0 million. The State Agency on Agriculture Loans too will get the same amount from 2016 state budget as from 2015 – AZN 5.0 million.

- 7) **The amount of closed and undetailed expenses stated as “other expenses” item in budget documents has been reduced.** The amount of expenses classified as “other” in 2016 budget has been reduced by AZN 606.2 million or 28,5%.
- 8) **The state budget support to local governments is too small.** 2016 state budget considers total of AZN 5.2 million for the municipalities or AZN 3.0 thousand on average per municipality. Taking into account the fact that local governments have weak financial potential and numerous social and economic problems to be resolved, the importance of significant increase of financial flows from central government budget to local (municipality) budgets becomes clear.
- 9) **Though the government has declared the importance of efficient and effective spending of state budget funds at the time when oil revenues decrease, the financing of events that have become regular will continue in 2016 as well.** Thus, AZN 314.0 million is planned to be allocated for the international sports competition in the budget of the next year. The budget documents do not include any justifications on reasons why the organization of these events is necessary and why these expenses have turned to a state budget burden.
- 10) *The gender analysis and expertise of 2016 budget have not been submitted to the Parliament.* Paragraph 5 of Law on “the Provision of Gender (males and females) Equity” signed in October 2006 states that all legislative acts (including the law on state budget) shall undergo gender expertise. Besides, Paragraph 346 of the Activity Platform accepted at the 4<sup>th</sup> International Women’s Conference of the UN held in Beijing in 1995 states that governments shall conduct systematic monitoring on how women benefit from budget expenses as well as draw up the budget in a way that allows equal access to state expenses. The budget envelope on 2016 draft state budget submitted to the Parliament does not include any gender analysis or expertise of the budget.

#### **IV. Main trends on state debt and state budget deficit**

- 1) The budget burden on the payment of state debt has significantly increased.** Hence, AZN 1249.7 million will be allocated from the budget to cover the state debt service expenses in 2016 which is AZN 473.5 million or 61,05% more than the previous year. State debt service fees make up 8,6% of 2016 state budget revenues and 7.7% of budget expenses. This implies that the amount of these debts is rapidly reaching the upper limit (10%) of ratio of the amount of these expenses to budget revenues and expenses allowed in the international practice. For comparison purposes, the share of state debt service fees in total budget expenses for 2015 was 3,7%. Further devaluation of AZN shall lead to the increase of state foreign debt service fees.
- 2) The budget deficit is kept at the level of the previous year.** The deficit of 2016 state budget is forecast to be AZN 1.7 billion which is 2,9% of the forecasted GDP for the year.

## V. Conclusion and Recommendations

Based on the analysis and evaluation of 2016 state budget forecasts we come into a conclusion that the state budget of the next year will be devaluation and inflation budget. The second devaluation of the national currency in 2015 too will not be able to eliminate the problems expected (above mentioned) in the implementation of the forecast 2016 state budget. Though this and further devaluation of AZN will increase the oil revenues entering the country expressed in the national currency, the crisis of the country's economy will continue to deepen and the social life of population and the condition of business and bank sector will worsen. As mentioned above, the budget does not consider any additional funds for the indexation of the incomes and pensions of the population upon devaluation of the national currency and the inflation; also the investment opportunities of the government to improve the economic activity of the country are extremely limited.

Upon current situation when the oil revenues of the country are decreasing and the non-oil development has been declared a priority, we recommend the following for improving the forecast of the state budget and the management of state finances:

- 1) To start applying limits to the budget transfers from SOFAZ and follow the long-term utilization (at least 25% of the revenues to be collected) principle of oil and gas revenues;
- 2) To reveal the tax projections of the State Oil Company of Azerbaijan Republic (SOCAR) and other large state companies on payment types;
- 3) To reveal budget income forecasts from private and public sectors on payment types;
- 4) To reveal the tax forecasts of the regions and cities of the country on payment types;
- 5) To include detailed information on all projects financed through state capital investments into the budget envelope;
- 6) To include detailed information on state debts paid through the state budget, as well as the subjects where the debts are paid to, main and interest amounts on each debt item, assignment of the debt, start and end dates of the debt agreement, etc;
- 7) To establish legislative base that will ensure the coordination of strategic and budget planning, to shift all government agencies to functioning in accordance with 5-year strategic development plans split by years and to ensure the adjustment of all budget orders to the social-economic development programs of the government;
- 8) To ensure shift to result-oriented budget planning mechanism, to develop interim and final indicators, as well as efficiency and quality indicators for evaluating budget programs and to include them into the budget envelope;

- 9) To prevent the speedy growth of state foreign debt and to apply strict limitations on foreign loans acquired by state companies through state guarantee;
- 10) To develop efficiency and effectiveness reports based on real outcomes related to financing of priority directions, especially development of entrepreneurship, housing and utilities sector and infrastructure projects and submit them to the Parliament (and also to the public);
- 11) To consider the local incomes of cities and regions as a stimulating factor for determining the amount of the funds allocated from centralized expenses in order to regulate local incomes and expenses in budget policy;
- 12) To include gender analysis and expertise of the budget into the budget envelope submitted to the Parliament. It is necessary to accept special legislative documents on the application of gender approach in budgeting for this purpose;
- 13) To establish legal mechanisms that will ensure the acceptance of the draft budget on the basis of discussions with professional civil society institutes and public entities that represent the interests of separate social groups.