

INTERNATIONAL MONETARY FUND

AZERBAIJAN REPUBLIC

**Enhanced Structural Adjustment Facility and Extended Fund Facility
Policy Framework Paper, 1997-2000**

Prepared by the Azerbaijan Authorities in Collaboration with
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I. INTRODUCTION AND BACKGROUND

1. Since early 1995, Azerbaijan has been implementing an ambitious economic reform program supported by financial resources from the International Monetary Fund (IMF), the World Bank, and other bilateral and multilateral creditors. As a result, macroeconomic conditions have stabilized, as evidenced by a drastic reduction of inflation and the resumption of growth. Moreover, rapid progress has lately been made in developing market-based mechanisms in key areas of the economy. Following this initial success, the Azeri economy is now facing the dual challenge of continuing the transition to a market economy while at the same time dealing with increasing capital inflows related, in particular, to the development of its oil resources. In addressing these challenges, the Azeri government will be guided by the medium-term strategy laid out in the Policy Framework Paper for the period 1996-99. A revised program for the period from October 1, 1997 to September 30, 2000 has been designed in close cooperation with the staffs of the IMF and the World Bank. In support of this program, the government intends to request financial assistance under a second annual arrangement under the Fund's Enhanced Structural Adjustment Facility (ESAF) combined with the use of resources under the Extended Fund Facility (EFF), as well as a Structural Adjustment Credit (SAC) from the International Development Association (IDA).

2. During the first year under the program supported by an ESAF/EFF arrangement Azerbaijan began to reap the benefits from the reforms launched in 1995. **Macroeconomic performance** was in line with the program's targets: inflation dropped to an estimated 4 percent in 1997 and output re-bounded by an estimated 5 percent. The manat appreciated by 7 percent in nominal terms against the U.S. dollar in the period from October 1996 to September 1997 as the overall balance of payments recorded a surplus. These outcomes reflected tight monetary and budgetary policies, as well as a pick up of foreign direct investment in the oil sector.

3. **Structural reforms**, which had been lagging behind in 1995-96, have accelerated during the last twelve months. Small scale privatization has been virtually completed. In the

fiscal area, the tax system was modernized, tax collection procedures were improved, a treasury single account was introduced, and the free use of gas and electricity by large parts of the population was abolished. In the financial sector, the government and the ANB initiated a thorough restructuring of the banking sector, while the operations of the ANB were reformed, and its supervision capacities were strengthened. Moreover, progress has been made in adapting Azerbaijan's legal framework to the requirements of a market economy, including through the introduction of laws on bankruptcy and foreign trade.

4. While pursuing successful macroeconomic stabilization and structural reforms, Azerbaijan has also made significant progress toward **developing its oil wealth**. Eight new oil exploration contracts were concluded in 1996 and 1997, bringing total expected foreign investment commitments to some US\$15 billion over the next 10 years. Oil exports are projected to reach 7.5 million tons per annum by year 2000.

II. MEDIUM-TERM POLICIES AND MACROECONOMIC OBJECTIVES

5. Azerbaijan's medium-term economic policy strategy aims at speeding up the transition to a market economy and to develop the country's oil resources without adverse impact on the rest of the economy. While the production of oil will increase sharply only after year 2000, the net foreign exchange inflow from export earnings from "early" oil (i.e., oil from the Chirag field), oil signature bonuses, and foreign direct investments would already be substantial during the program period. Growing income from oil is expected to relax the constraints on economic growth in Azerbaijan, but the government recognizes that such inflows could also become sources for unbalanced economic development—the so-called “Dutch Disease”—characterized by a strong appreciation of the real exchange rate and crowding out of the non-oil economy.

6. To address these risks, the government has chosen a **two-tier strategy**: First, both macroeconomic and structural policies will be used to dampen the pressures of domestic demand on the non-oil sector and encourage domestic savings. Lowering trade barriers by phasing out remaining regulations on exports and reducing import tariffs will help slow the appreciation of the real exchange rate. The higher imports will partially offset the BOP inflows related to the oil sector. In the same vein, the government will further liberalize capital account transactions, thus ensuring free transfer of savings abroad.

7. Secondly, supply side policies will aim to remove the obstacle to growth in the non-oil sector (agriculture, food processing and manufacturing), which were inherited from the planning era. These measures include, inter alia, the liberalization of export regulations (e.g., elimination of licencing requirements for so-called strategic export goods), the freeing of producer prices, a simplification of the tax code, privatization, and land reform. A restructuring of the banking sector will improve financial intermediation and facilitate the channeling of profits and savings from the oil sector to investment in the non-oil sector.

8. **Fiscal policies** will aim to reduce the deficit of the general government (excluding oil funds-signature bonuses and others) to less than 1 percent of GDP during the next three years. No net central bank financing of the budget will be permitted during the program period except for short-term liquidity management purposes. Fiscal deficits will be financed by treasury bill sales, utilization of part of the oil funds, disbursements of program and project loans from the World Bank and other international creditors, and by proceeds from privatization. The government will also adhere to its external debt repayment schedule and will be cautious in its nonconcessional foreign borrowing.

9. **Monetary policy** will aim to maintain low levels of inflation. With abating inflation expectations and an improved confidence in banks, the demand for money is likely to increase, and the velocity of manat broad money will continue to decline. Nominal as well as real interest rates are likely to decline as well with lower inflation and the strengthening of the financial system.

10. In the framework of a **flexible exchange rate policy**, cautious financial policies will also underpin the goal of building a strong international reserve position. Likely upward pressures on the exchange rate as a result of continued capital inflows will not be resisted as long as consistent with maintaining competitiveness. In the event that the tendency toward nominal appreciation would be stronger than warranted, the decision to pursue sterilized or unsterilized intervention or to let the exchange rate appreciate further would be based on an assessment of the competitiveness situation, as well as developments in money demand, inflation, and interest rates. A smooth operation of the foreign exchange market will be facilitated by the development of the ANB's indirect monetary policy instruments.

11. According to the projected **macroeconomic framework**, real GDP will grow by 7-9 percent per annum in 1998-2000, mainly led by the development and export of oil, and supported by a 3-4 percent increase per annum in agriculture and manufacturing, as well as an improvement in Azerbaijan's investment ratio from an estimated 27 percent of GDP in 1997 to 45 percent of GDP in 2000. While most investment will be in the oil and oil-related sectors, the non-oil sector and public investment will also play a role in increasing the economy's investment ratio. Investment will be largely financed by capital inflows, primarily in the form of foreign direct investment in the development of oil fields and services. The current account deficit is projected to increase to about 35 percent of GDP in 2000 before declining in subsequent years due to the rapid growth in oil exports. National savings will need to rise from less than 5 percent of GDP in 1997 to almost 10 percent of GDP in 2000 to provide an additional domestic source of financing for the programmed rise in investment, and to contain the growth in domestic demand. Most of this saving is expected to arise in the government sector, as oil-related revenues are transferred to government, tax revenue collection is strengthened, and the growth of current expenditures is contained. Household saving is projected to increase slowly with recovering real incomes, positive real interest rates, the introduction of individual retirement accounts, and gradually improving confidence in the banking system.

12. Provided that the monetary effects of the balance of payments inflows can be kept in line with moderate growth in broad money, taking into account remonetization of the economy, annual inflation should be contained to around 5 percent during 1998-2000. As nominal wages catch up with other nontraded goods prices, and productivity increases, real wages could rise by more than 10 percent per year during 1998-2000, while employment is projected to start growing toward the end of the program period with the expansion of the labor intensive service sector.

III. MACROECONOMIC POLICY IMPLEMENTATION

A. Fiscal Management

13. Azerbaijan's transition to a market economy requires a significant reorientation of the role of the public sector: while the government will withdraw from direct involvement in production and trade, its regulatory and policy-making functions in a market environment will be strengthened. At the same time, the government will improve the provision of essential public services and the targeting of social benefits. To this end, civil service reform and a comprehensive restructuring of the public sector will receive close attention over the medium term.

14. **Fiscal revenues** are projected to increase from 18 percent of GDP in 1997 to 22.4 percent of GDP by the year 2000. Measures to improve the government's revenue raising capacity during the next three years will focus on broadening the tax base and raising tax collection rates. Measures affecting indirect taxes will include: harmonizing excise taxes on domestic goods and imports; switching to the destination principal for the value-added tax for trade within the CIS once an agreement with other CIS countries has been reached; and achieving a uniform low rate for customs duties. With respect to direct taxes, measures in 1999-2000 will concentrate on further reforming the enterprise profit tax by modifying depreciation and deduction rules, and phasing in the full deductibility of loan-loss provisioning of banks. The income taxation of interest and dividends will also be reviewed and rationalized. In order to raise employees' awareness of the cost of their retirement, and reduce the existing distortion between wages paid by enterprises and received by workers, the burden of paying the payroll tax will be shifted in part from employers to employees in 1999 by lowering the employers' rate from 35 to 33 percent and raising the employees' rate from 1 to 3 percent. Furthermore, it is envisaged that, as a first step towards creating a self-financing pension system, the employees' 3 percent contribution, and an equivalent 3 percentage points from the employer's contribution be allocated to individual retirement accounts at the pension fund (see below). Finally, the land tax and property tax will be further developed as a source of revenue for localities.

15. Growing **receipts from the petroleum sector** will accrue to government over the 1998-2000 period. In the near future, revenues will mainly derive from royalties and excises on existing oil production and domestic consumption. Revenue from new oil fields is

determined by production sharing agreements, which also include the disbursement of oil signature bonuses. During 1998, the government will continue the practice of accumulating oil signature bonuses on a special account at the ANB from where they will be in part disbursed to the budget as needed to finance the fiscal deficit. By late 1998, the government will seek to establish more formal and permanent arrangements for managing all financial flows accruing to the government as a result of the development and exploitation of new oil fields. This will also necessitate a thorough review of financial relations between the government and the state oil company (SOCAR). An effective management of oil revenues will need to balance macroeconomic stabilization, developmental, and optimal portfolio management objectives. Key decisions in this regard will relate to the amount of resources to earmark for financing public investment, building international reserves at the ANB, reducing public debt, or investing abroad.

16. The necessity to improve tax collection rates, requires a substantial strengthening of **tax administration**. Reform measures in this area include: (i) developing a common taxpayer identification code for the State Tax Inspectorate, Social Protection Fund, Customs Committee, banks, enterprises, and individuals; (ii) providing tax collection officers with more tools and techniques to enforce collection; (iii) increasing the number of tax inspectors and auditors assigned to the large taxpayer unit; and (iv) implementing measures to improve the collection of excises, in particular from alcohol and tobacco at the factory gate and customs. The simplification of the tax code to eliminate contradictions and ambiguities should also facilitate administration of the tax system. And the VAT refunding mechanism will also be improved.

17. **Public expenditures** (including foreign-financed capital expenditures and net lending) are programmed to increase from 20.8 percent of GDP in 1997 to 23.3 percent of GDP in the year 2000. A key policy objective will be to restructure **government employment and pay**. The overall strategy will be to discuss redundant government workers while increasing pay for those qualified and productive. Progress in this area has been hindered by the inadequacy of information regarding the size, composition, and pay structure of the civil service. To overcome this problem, a survey of public sector employment and pay will be concluded by March 1998. At the same time an effective severance pay scheme needs to be developed so that once the survey has been conducted, further reductions in employment can be pursued. While this may raise expenditures in the short term because of the need to provide severance pay, over the longer term, these employment reductions should compensate for needed wage increases to bring public sector wages in line with private sector wages.

18. Given the recent elimination of exemptions for the payment of electricity and gas, and the intention to increase cost recovery for other communal services, a well-targeted **social safety-net** is important to ensure that the poorest of the population are not excessively hurt by these policies. The aim in the short term will be to broaden the use of means and categorical testing and improve the targeting of compensation programs, as well as expand them to cover

the urban poor. The goal for 1999 is to consolidate the numerous programs into one easily administered means-tested program and to raise the real level of benefits for the truly needy.

19. The **pension system** will need to be made more effective and financially sound over the longer term by continuing to raise the age of eligibility, further increasing contributions from workers, and developing a two-tiered pension system. The two tiers will consist of a basic social pension that will be financed on a pay-as-you-go basis, and a mandatory-funded pension scheme consisting of individual retirement accounts (IRAs). As a first step, IRAs will be set up, a task for which the government is seeking World Bank technical assistance. The individual retirement accounts will also have important secondary benefits such as strengthening the collection of social security contributions, increasing national savings, and promoting of financial intermediation.

20. Government **capital expenditures** have been quite low in recent years, yet private sector growth depends on the expansion of transportation, communication, and power infrastructure. Starting in 1998, all capital expenditures and net lending will be integrated into the budget in the framework of a public investment program focused on infrastructure. Such capital outlays are expected to steadily increase from their level of 1997 during the next few years, to reach more than 3 percent of GDP by year 2000. At the same time, the government will refrain from providing guarantees on the external borrowing to finance capital investment of purely commercial enterprises.

21. The operation of a State Treasury, which is to start at the beginning of 1998, is expected to significantly improve **budget management**, in particular, by making it possible to reduce the incidence of payments arrears, and, over time, strengthening expenditure control, monitoring, and analysis. The treasury should also be instrumental in improving debt management. The government intends to create a position of Head of the Treasury at the deputy minister level, separate from the other deputy minister positions, with exclusive responsibility for the running of the treasury.

22. During the program period, the government and the Azerbaijan National Bank (ANB) will aim at improving the transparency of their financial relations, including the payment of interest on mutual claims and liabilities and a formula for the transfer of central bank profits to the budget. The securitization of part of the government's debt to the ANB during 1998, and other measures in connection with the resolution of the bad loans portfolio of banks, will also be significant steps in that direction.

B. Monetary Management and Financial Market Reform

23. The development of **financial markets** is still at an early stage in Azerbaijan. Acknowledging that the lack of indirect monetary policy instruments is impeding effective liquidity management, the ANB will seek to broaden and increase the competition on the foreign exchange, Treasury bill, and credit auction markets. Access to these markets will be

expanded, including by allowing full participation of foreign banks and, in the case of the Treasury bill market, of nonbank institutions. To this end, Treasury bills will be increasingly used for budget financing purposes; part of the outstanding government debt to the ANB will be gradually securitized; and the secondary market for Treasury bills will be made fully functional. Moreover, the ANB plans to start open market operations of Treasury bills in the secondary market in 1998. During the program period, the ANB will also stand ready to organize auctions of its own bills or certificates of deposit if necessary to counteract the impact of capital inflows on the growth of base money. Moreover, the ANB will take steps with Fund technical assistance to improve the payments system. Most of the measures to improve the capacity of monetary policy will be completed during the second program year.

24. The ANB's **bank supervision** faces a difficult challenge with many banks operating with losses in a rapidly changing financial and economic environment. The organizational structure of supervision within the ANB is now being reformed and the implementation of prudential regulations is made uniform across banks with technical assistance from the IMF. Full loan-loss provisioning against nonperforming loans will be introduced during the program period. The ANB will monitor closely that prudential regulations are being met by all banks and that those which do not comply face a specified course of actions and penalties, including the revocation of the bank's license. Both the government and the ANB will continue to refrain from participating in any form of deposit insurance scheme.

25. The government will continue its policy of strengthening the **banking system** to channel domestic and foreign savings to investment and improve the range and the quality of financial services. Azerbaijan's financial system is still dominated by the four large, state-owned banks, while at the same time it is highly fragmented with many small private banks. A comprehensive restructuring plan for the state-owned banks—which was launched in September 1996—aims at establishing the conditions for the emergence of a competitive and stable private banking system by addressing the precarious financial situation of the state-owned banks. All four banks were put under a special supervision and management program monitored by the ANB. An action plan for each bank has been developed for 1997-1998, in which period they will have to prove their viability. The action plans have been formalized into agreements between each bank and the ANB building on a program worked out with the IMF and the World Bank as part of the first year ESAF/EFF program and the World Bank's Structural Adjustment Credit (SAC) operation. Measures under the program include steps to strengthen operations, cut costs, and improve loan recovery, including through recourse to bankruptcy procedures. At the end of the restructuring period, the banks will either be privatized or liquidated. Meanwhile, their banking activities have been narrowed considerably to prevent a further deterioration of their solvency. New loans will be based on applying strictest criteria for controlling risk, including proper collateralization. The ANB will also continue to gradually increase the minimum capital requirements for existing banks to US\$5 million (EU level) by 2001 in order to strengthen the capital base of the banking system.

IV. STRUCTURAL POLICIES

26. Achieving the objectives of the outlined macroeconomic medium-term program requires strong progress in structural reforms. The agenda needs to be ambitious and its implementation requires extensive and well-targeted technical assistance of the World Bank and other international institutions. The highest priority will be placed on public sector management reform, bank restructuring and privatization, and a transparent and equitable process of land and enterprise privatization. Some of the key structural reforms are sector specific—e.g., agriculture and energy—while others are broad in their scope and have long-term implications for economic growth—e.g., fostering the accumulation of human capital.

A. Privatization

27. The scope of the government's privatization program, which was approved by parliament in the fall of 1995, is broad and over 70 percent (by asset value and employment) of state enterprises is to be transferred to private hands within the program period. In the implementation of the program, initial priority has been given to small-scale privatization, which is almost complete. Emphasis has now shifted to voucher privatization of medium-size and large enterprises. The legal, regulatory, administrative and physical infrastructure for mass privatization, as well as for the establishment of a share trading market, is being set up, and corporatization of medium- and large-size enterprises is underway. Privatization vouchers have been distributed to 95 percent of the population. By early November 1997, 328 enterprises had been corporatized; and 10 voucher auctions and 9 cash auctions had been held, resulting in privatization of 258 enterprises, including 19 cotton ginneries. Through 1998, the voucher auctions are expected to continue at a rate of at least one a month, with some 40 enterprises placed for privatization at each auction. The authorities aim at increasing the size, quality, and market attractiveness of enterprises to be privatized in the coming year.

28. In order to allow wide public participation, the government will provide the State Property Committee (SPC) with all the necessary means to improve the auction centers and process, and the public information campaign with a view to helping voucher holders understand the options available for voucher use. The network of bid collection centers will be extended and fully developed in the regions. Also, the number of voucher auction centers will be increased in order to provide an opportunity for all the population to come to an auction center and exchange vouchers for shares.

29. The Privatization Program foresees that a number of large enterprises will be privatized through open and transparent commercial tenders. This form of privatization will allow meeting three targets: to receive privatization proceeds for the state treasury, to satisfy investment requirements of the enterprise, and to resolve the corporate governance issue by passing the controlling block of shares to a strategic investor (foreign or national). The SPC has identified some 50 large enterprises for case by case privatization beginning in 1998.

30. To allow for share trading and capital market development, steps are being taken to consolidate the functions of share registry and depository functions in one centralized National Registry and Depository Agency, recently established by Presidential decree. Those functions will be developed gradually, taking into consideration the needs of a future stock exchange. Licensing of investment funds and broker dealer activities will be carried out by a Securities and Exchange Commission to be established with the passage of a Securities Law in 1998.

B. Agriculture

31. The government's overall land policy aims at providing security of land tenure to individuals in the near term and at the creation of land markets. The passage of the Land Reform Law in early 1997 has provided the legal basis, momentum and clarity for land privatization. It provides for individual land ownership, which would grant the freedom to use, sell, exchange, mortgage, rent and inherit land. On the basis of this new land law, formal land titles have been issued to farms in a number of rayons, including with the assistance of the Farm Privatization Project from the World Bank. Moreover, state and collective farms in several rayons have been dismantled, and their lands allocated to former workers. The government plans to accelerate this process in the coming years with a target of completing land privatization and the issuance of formal land titles by the year 2000.

32. The government's overall agricultural policy aims at the creation of a market-oriented agricultural sector. In this regard, complete liberalization in output prices of perishable products (e.g., fruit, vegetables, and livestock) has taken place, which has led to their production taking place almost exclusively in the private sector. Grain and cotton prices are being aligned to world prices through the privatization of the monopsonic bread complex and the elimination of the monopoly position of Agroincom enterprise in the export of cotton. Also, an accelerated program is being undertaken to restructure and privatize state-owned agro-enterprises, especially those involved in the marketing of agricultural inputs. This program is expected to result in the elimination of major state-owned agricultural concerns (umbrella organizations of state-owned agricultural enterprises) during 1998.

33. On the institutional front, the Ministry of Agriculture is in the process of being restructured. In the future, it will be expected to undertake the following functions: (i) formulation of policies aimed at accelerating land reform and farm restructuring; (ii) provision of critical services for land reform and farm restructuring; (iii) maintenance of grain reserves and food security; and (iv) agricultural research coordination. The State Irrigation Committee, responsible for the development of water resources in the country, is also being reorganized, based on hydrological boundaries.

C. Energy

34. The government has been following a two-pronged strategy to develop the energy sector: attract foreign investment for oil development, and improve the efficiency of energy

supply and usage within the country. In addition to the already signed nine major agreements for development of resources in the Caspian Sea, and others in the making, the government also intends to attract foreign investment to the power generation and gas processing sectors.

35. Within the petroleum sector, Azerbaijan's large oil refining capacity needs to be rationalized. Such rationalization will, however, require significant environmental remediation effort. The government will actively attract joint ventures with private investors to improve the efficiency of the refineries, while reducing overall capacity to take account of local and regional demands and market competition. Regarding natural gas production, a major priority is to retain self-sufficiency. Within the next decade the production of gas can be increased to meet all domestic requirements. To that end, the government will maintain producer prices at levels which give appropriate incentives to gas development. In order to improve the efficiency of gas use, the government will extend gas metering to cover all customers within the next three years.

36. For the efficient allocation of resources, the government is committed to ensuring that Azerbaijan's energy prices be based on economic costs. To that end, a formula is being applied, according to which domestic crude oil prices are adjusted to reflect price developments in the world market within a band of +/- 10 percent. On average, gas and electricity prices now cover operating costs, with, however, substantial cross-subsidization of households by industrial users. The government intends to eliminate these cross-subsidies by the end of 1998.

37. The development of the energy sector requires an appropriate legal and institutional framework. The basis for foreign investment in the crude oil sector, and the financial relationship between this sector and government need to be clearly defined; there also needs to be independent regulation of the natural monopoly aspects of gas and electricity supply.

38. Energy sector institutions will need to continue to evolve toward a market-oriented system. As a first step, all noncore activities of energy enterprise such as construction and farming will be spun-off and privatized. The energy enterprises SOCAR, Azerenerji, and Azerigaz will be restructured to reflect the separability of their business activities (such as oil production and refining, electricity generation and transmission).

D. Legal Framework

39. In the first years of transition, many key laws were passed that provide the general framework for the operation of the market economy. Legislation is still needed to further define property rights and commercial rules. Specifically, to complete the legal framework, the government is planning to adopt: (i) a new Civil Code harmonizing laws on private property rights; (ii) a Secured Transactions Law to improve the enforcement of commercial contracts; (iii) a Securities Law to regulate the trading of shares; (iv) implementation guidelines for the newly adopted Bankruptcy Law to provide enforcement measures; (v) a new Competition Law; and (vi) a new Land Code based on market principles and a national

system of automated registration of land plots which would ensure quick and safe issuance of documents proving ownership and encumbrance. Most of this legislative agenda is expected to be approved or sent to parliament before the end of 1998. In addition, to ensure that the public has adequate information about laws, the Government plans to establish an automated system for recording and disseminating laws, regulations, and all normative documents and ministerial instructions through an expanded Official Gazette, according to the Law on Normative Documents.

E. Public Sector Management

40. An important component of the government's reform program is the design and implementation of a comprehensive program to overhaul the public sector based on the appropriate role of the state in a market economy. The guiding principle will be the elimination of the state's commercial and industrial activities, while focusing on regulatory and policy-making functions. This program will aim at establishing a modern, efficient and professional civil service, capable of managing public resources, together with a competent and neutral judiciary and legal system that can enforce property rights and contracts. The government recognizes that the reforms in this area cannot be achieved overnight and will require sustained political commitment and will. The program will cover the following key components.

41. **Administrative Restructuring.** The government has begun the process of adapting the functions, structure and size of the machinery of the state to a market economy. The immediate priority is to restructure and regroup the ministry- and supra-ministry level entities on functional lines, so that the decision-making process is more transparent, efficient and accountable. This process is expected to reduce the number of ministries, state committees and other central organs from the existing 45-odd to a fewer and more cohesive configuration. The ministry-level entities will formulate policy, perform regulatory functions, and oversee policy implementation. This first phase of the restructuring will review the existing functions being performed by the central bodies of executive power with a view to doing away with duplication of functions and eliminating or transferring to the private sector all functions which are identified as unnecessary or obsolete.

42. **Civil Service Reform.** The development of a civil service which would enhance administrative capacity, and contribute to efficient decision making is of high priority on the government's reform agenda. The government intends to establish, through a new law on the civil service, an independent regulatory body for the civil service; centralize civil service management; and clearly define the reciprocal rights and obligations of civil servants and the government (including on conflict of interest, and disclosure of income and assets) to assure integrity. Furthermore, as already indicated, the government will undertake in early 1998 a survey of public sector employment and pay, with a view to include in the 1999 Budget further measures to reduce redundant staff. Improving institutional arrangements for personnel management, and developing a payroll-personnel management linkage for effective

control over numbers and the wage bill will assist the budgetary sector to move to a workforce with the skills and of the size required for a market-oriented economy.

43. **Fiscal Management.** The government believes that in parallel with the establishment of a treasury, the current practices in the areas of public procurement and budget planning need to be improved. A presidential decree has already been issued on mandatory competitive bidding procedures for the procurement practice of state-owned agencies, and a State Procurement Regulatory Agency has been established. Before the end of 1997, the government will announce the institutional arrangements for administration of public procurement, and issue detailed regulations and procedures; various workshops will be held in early 1998 with a view to making the system fully operative by end-March. In order to improve budget planning and execution, the government will undertake a comprehensive review of the budget process.

44. **Reform Judicial System.** A Law on Courts and Judges was recently adopted, which establishes a new institutional structure for the judiciary. Among many other aspects of the new law, it increases access to the economic court system by establishing local economic courts, eliminates the Supreme Court's function as a first instance court, and regulates the appointment of judges and their remuneration. Although it was adopted in June, a series of actions needs to be taken by the Government to implement the new law. In particular, critical elements of the legal framework for the judiciary are expected to be adopted in 1998, including the Civil Code and the Civil Procedural Code. Complementary reforms are anticipated in 1998 that will ensure the proper functioning of the judiciary, including reform of the Procuracy to limit its role in protecting the public interest in criminal cases involving private enterprise.

45. **Policy Coordination.** The government's economic policy implementation capacity has remained weak and needs to be strengthened considerably. To this end, the work of the Cabinet of Ministers (COM) in the area of economic policies will be reorganized. The restructured COM is intended: (a) to be responsible for high-level economic policy coordination, policy advice and information management for decision-making under the chairmanship of the Prime Minister; (b) not to duplicate the Ministries' policy formulation and regulatory functions. This will enable the COM to fulfill its constitutional role as the supreme executive body of the President of the Azerbaijan Republic. However, to preserve the independence of the central bank, monetary and exchange rate policies will be implemented by the decisions of the ANB as mandated by the Central Bank Law.

F. Human Resource Development

Health

46. The government is committed to substantial reforms in the health sector, in response to deteriorating quality, excess capacities, and access problems. A government commission

will be established by end-December 1997 to develop a comprehensive reform plan. A number of measures are expected to be introduced to support improved efficiency, quality, and access in the sector. With regard to financing: first, territorial budgetary allocation mechanisms will be shifted away from input-based allocations (e.g., based on number of beds), to capitated transfers based on the number and structure of local populations. This will be initiated in the 1999 budget (with at least of half total transfers to local health budgets made on a capitated basis), and increased in subsequent years. Second, in order to ensure that the allocation of funds within districts is made more efficient, and to create incentives for providers to improve services, payment mechanisms will be reformed during the program period, based on pilot experience under the proposed World Bank-financed Health Reform Project.

47. In the area of service provision, the government will define and approve—in collaboration with the World Bank—the basic package of health services that will be provided free of charge in public health facilities, and the essential medicines that will be needed to implement the basic service package. Development of the package and medicines list will need to take into account the health profile as well as the budget constraint. Reforms in the provision of health care at the district level will also be encouraged by increasing autonomy for local authorities in the operation of their health systems, including giving the local authorities the powers to hire and fire staff, reduce bed and facility capacity, and determine the appropriate mix of non-core services. In this context, the government will develop the regulatory framework and introduce legislation regarding the privatization of state-owned facilities, and the private sector provision of health services.

Education

48. Azerbaijan began the transition with an education system characterized by impressive adult literacy, high enrollment rates and an extensive network of educational institutions. However, the economic crisis considerably weakened the education system. While primary and secondary enrollment rates have not declined substantially, there are emerging regional differentials in enrollments and extended absence. To a large extent this reflects increased direct school-associated costs (such as clothing and books), perceptions by users of declining quality, pressure on the school system from an Internally Displaced Population (IDP), and the need for children in poor households to generate income. In higher education, major problems are over-specialization in course design, the collapse in the real value of student stipends, and the growing expectation of side payments in order to be accepted to and pass university courses.

49. Current fiscal constraints require that budgetary funds be used more efficiently to reverse the decline of the education system. To this end, a government commission will be established by end-December 1997 to develop a plan for a comprehensive reform of the education sector. In light of fiscal constraints and efficiency dimensions, the current teacher/student ratios will be reduced by increasing the class size and/or increasing the weekly teaching load. The government will also allow more local and institutional flexibility

in reallocation of resources between expenditure line items. During 1997, teacher wages were raised significantly to reduce previous disincentives.

50. The transparency in the resource allocation mechanism will be increased by moving away from budgeting based on class complexes (notional class sizes rather than actual student enrollment) and toward capitation financing of general education on a per student basis. The level of specialization in vocational, technical, and higher education will be reduced and curriculum design will be made to reflect emerging demand patterns in the labor market. The system of student stipends in higher education will be overhauled to increase the level of stipend for poor students and reduce or eliminate it for those from better-off households. Targeting will be done on the basis of existing programs, to minimize administrative costs. Also, the Ministry of Education will take a stronger oversight role in ensuring that enrollment levels, and quality are maintained at a minimum standard in all regions. The government will also undertake a study of the scope and the type of private education spending, to assess the implications for private sector provision of certain educational services, and the future role of community financing.

G. Reconstruction of War-Damaged Areas

51. With improved prospects for a permanent settlement of the Nagorno-Karabagh conflict, the government has started preparations to resettle internally displaced persons (IDPs) initially in the currently liberated areas. This has begun in the Fizuli area and will expand into other liberated areas in 1998. However, the reconstruction effort is likely to be a lengthy process, as the damage in occupied territories is extensive. The government has taken a number of steps to prepare for the reconstruction program, including: (i) setting up in July 1996 a state Commission for reconstruction chaired by a deputy prime minister with full authority and reporting to the President; (ii) setting up the Azerbaijan Rehabilitation and Reconstruction Agency (ARRA) under the State Commission for reconstruction to coordinate and implement the reconstruction program; and (iii) establishing an International Advisory Group on reconstruction with representation of bilateral and multilateral institutions as well as NGOs, and endorsing the principle of partnership among donors, NGOs and the government in the implementation of the reconstruction and relief activities. This strengthening of capacity will also involve executive committees at the rayon level, and other key players at the local level. The presence of land mines is a serious concern and needs to be addressed in coordination with reconstruction and relief activities. At the earliest possible time, overall evaluation of the damages in the occupied territories will be conducted through detailed inspections by multisectoral teams. Social assessments have been started among IDPs in order to determine their needs and priorities.

H. Environment

52. Azerbaijan inherited from the Former Soviet Union severe environmental degradation in a number of areas (particularly on the Apsheron Peninsula) and one of the least efficient systems of environmental management. While the environment has improved as a result of

the collapse of heavily polluting industries, nevertheless, the lack of funds, the economic transition, the rising Caspian Sea level, and the conflict with Armenia have contributed to the emergence of new problems, or worsening of some of the existing ones.

53. The country's main environmental problems include: (i) severe pollution damage caused by industries, oil exploration and production, and energy generation; (ii) a threat of irreversible loss of the sturgeon stock triggered by loss of reproduction capacity, pollution and overfishing; (iii) damage to the Caspian coastal zone caused by flooding from the sea level rise and pollution; (iv) deteriorating water quality, especially of drinking water, both in rural and urban areas, causing an increase of water-borne diseases; (v) loss of fertile agricultural land from erosion, salinization, pollution with heavy metals and chemicals, and deteriorating irrigation systems; (vi) loss of forestry cover in war-affected areas, areas with high density of refugees and IDPs, and areas with limited access to other sources of fuel; and (vii) the threat to protected areas leading to possible loss of biodiversity.

54. In collaboration with the World Bank, the government has established environmental priorities in a National Environmental Action Plan (NEAP) and requested further World Bank assistance to address the most critical problems identified in the NEAP. The government intends to take actions to increase the effectiveness of the environmental management system and to finance critical interventions which will prevent the irreversible loss of valuable assets, avoid significant health risks, and facilitate private investments. World Bank assistance will facilitate legislative and institutional improvements, including a legal framework for dealing with past environmental liabilities during privatization, capacity building in environmental assessment, and strengthening the enforcement capability of the national and local environmental authorities. The Bank will support urgent interventions to mitigate the negative impact of the Caspian Sea rise in the most severely affected areas, and actions to prevent further decrease of the sturgeon stock and to eliminate the risk of mercury contamination in the area of Sumgait.

V. EXTERNAL FINANCING REQUIREMENTS AND DEBT MANAGEMENT

55. Azerbaijan's long-term **balance of payments prospects** are promising. Abundant petroleum resources will, when fully exploited, put the external accounts on a sustainable basis. Balance of payments developments are largely governed by the activities of the oil sector: while oil exports will strengthen the current account over the longer term, large current account deficits averaging more than 30 percent of GDP are expected in the near term (1998-2000). Over this period, a surge in imports of goods and nonfactor services related to oil sector development financed with large foreign direct investment will more than offset the increase in oil and non-oil exports. The current account deficit excluding these imports is projected to remain at around 10 percent of GDP during 1998-2000, but decline rapidly thereafter to turn into a surplus by 2003.

56. Based on this balance of payments outlook, total external **financing requirements** for the period 1998-2000 are about to US\$5.9 billion, after allowing for a level of foreign reserves equivalent to 17 weeks of imports. Roughly US\$4.1 billion of the financing needs are expected to be met by oil sector foreign direct investment (including oil bonuses), US\$1.1 billion by other private capital inflows, and US\$0.7 billion by disbursements from bilateral and multilateral institutions. The latter would include, in addition to disbursements of project loans, net disbursements from the IMF under the ESAF and EFF arrangement and from the World Bank under the SAC of about US\$0.1 billion. It is envisaged that by the year 2000 Azerbaijan would be in a position where no exceptional financing would be needed.

57. Azerbaijan's **external debt** is anticipated to remain modest during 1998-2000. Medium- and long-term public and publicly guaranteed debt at end-1997 is estimated at about US\$550 million or 14 percent of GDP and the debt service ratio amounts to some 9 percent of exports of goods and services. In 1997, an agreement was reached with Russia to cancel all mutual outstanding debt obligations (approximately US\$57 million) and a loan from the EU of US\$58 million was repaid in its entirety in September 1997. Despite its low indebtedness, Azerbaijan intends to limit the amount of new debt that it contracts or guarantees on nonconcessional terms for the program period and beyond. Medium-term projections suggest that external debt would increase to 17 percent of GDP in 1999 before falling to 7 percent of GDP by 2005, entailing a reduction in the debt service ratio to about 2 percent of exports by the end of the period. Further progress in the implementation of the reform agenda would allow Azerbaijan to reduce its perceived risk considerably, foster foreign direct (other than oil) and portfolio investment, and thus achieve its ambitious growth targets without recourse to foreign borrowing.

VI. TECHNICAL ASSISTANCE AND STATISTICAL ISSUES

58. The reforms described above will continue to require an extensive and well-coordinated program of **technical assistance** (Appendix I, Table 1). In the fiscal area, the authorities are planning to request further assistance in improving tax policy and administration as well as customs administration, concluding the treasury project, and improving expenditure control. The IMF will also support the ANB in its efforts to modernize central bank operations, strengthen banking supervision, restructure the state-owned banks, and improve the payments system. The World Bank will continue to provide technical assistance in the financial (including bank restructuring), energy, agricultural, and health sectors, as well as in restructuring government (including civil service reform), pension reform, privatization, environmental policies, and reconstruction of war damaged areas. EU-TACIS is already providing support for restructuring enterprises. The government also intends to submit its Technical Assistance Program to the Consultative Group to seek grant financing for further technical assistance needs.

59. The government recognizes the urgent need to improve the coverage and quality of **economic statistics** in Azerbaijan. With technical assistance from the IMF, the World Bank,

the Organization for Economic Cooperation and Development, the United Nations Development Program and other bilateral and multilateral donors and creditors, the government is implementing a medium-term program for improving economic statistics. The aim of this program is to make the statistical system adequate for policy design, implementation, and monitoring. Short-term objectives are to improve data on the operations and financial flows of the oil company SOCAR as they impact on the balance of payments and the budget; to move to international standards for the reporting of data on commercial banks' accounts; and to strengthen trade statistics by making the State Customs Committee responsible for the valuation of imports and exports.

VII. ASSESSMENT OF MACROECONOMIC RISKS

60. The excellent prospects for the Azeri economy into the medium term as described above are based on two fundamental assumptions: first, that oil development, production, and export volumes and prices are proceeding as it is now reasonable to expect. Delays or setbacks in the exploitation of oil fields, or adverse developments in the international environment affecting oil exports and revenues could significantly affect the macroeconomic outcome. The Azeri authorities are prepared to adjust policies in such cases, for instance by scaling down expenditure or borrowing plans over the near term. Second, that the pressures for relaxation of the fiscal policy stance, which are likely to materialize as the oil revenues begin to flow, are successfully resisted. Third, that the implementation of structural market reforms proceeds at the fast pace intended, so that the financial resources associated with the oil boom can be put to the most efficient uses and balanced growth achieved. The Azeri authorities are determined to address successfully both of these challenges.

Table 1. Azerbaijan: Summary and Timetable for Macroeconomic and Structural Adjustment Policies, 1998-2000

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
1. Fiscal policy				
1.1 Revenue policy	Improve the revenue raising capacity and efficiency of the tax system	Rationalize depreciation rules for profit tax	1999 Budget	
		Rationalize the income taxation of dividends and interest	1999 Budget	
		Make interest and other legitimate expenses fully deductible for the purpose of calculating the base for the profit tax	1999 Budget	
		Allow fully profit tax deduction for loan provisioning of banks ¹	1999 Budget	
		Move to destination principle of VAT and excises for CIS trade	1998-1999	As consistent with intra CIS agreements
		Review VAT law to ensure that all business-related expenses are creditable	1999	IMF technical assistance by FAD
		Calculate VAT liabilities on an accrual basis	1999 Budget	
		Base land and property taxes on market values	End-December 1998	Timetable for new cadastre may be longer
		Reduce employers' payroll tax rate from 35 to 33 percent, and increase employees' contributions from 1 percent to 3 percent	1999 Budget	

¹Defined as the difference between end of year reserves and begin of year reserves adjusted for bad debts written off and actual recoveries during the year.

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Allocate 3 percentage points of employers' payroll tax rate (33 percent) to employees' individual pension accounts	1999 Budget	World Bank technical assistance to set individual accounts
		Allocate the 3 percent employees' social insurance contribution rate to individual pension accounts	1999 Budget	
		Update Tax Code in order to consolidate various laws, decrees, and regulations to eliminate contradictions and ambiguities and to standardize administrative provisions	End-December 1998	IMF technical assistance by LEG
	Improve tax administration	Develop a common taxpayer identification for STI, SCC, and banks (pass necessary legislation)	End-June 1997	In progress
		Amend law on Tax Services to provide collection officers with authority to use a variety of tools and techniques to enforce collection	End-December 1997	
		Implement measures to improve excise tax collection on tobacco and alcohol (payment at factory gate or customs)	Early-December 1997	
		Double tax inspectors in LTU through reallocation of staff, and assign 40 percent of staff to auditing	End-November 1997	
		Improve VAT refunding mechanism by Ministry of Finance	Continuous	
		Grant legal authority to the State Customs Administration to perform independent assessment of valuation	End-December 1997	
1.2 Expenditure Policy	Reorient expenditure priorities	Eliminate or transfer non-essential tasks to the private sector (e.g., from State Committees)	1998/99	World Bank technical assistance

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Implement government employment/pay policy consistent with objective to reduce number of employees while increasing wage incentives for the more productive employees	1998 and 1999 Budgets	
		Introduce an effective severance pay scheme	End-June 1998	
		Grant targeted subsidies to families hardest hit by increases in the price for communal services and electricity	1997-1998	
		Consolidate various social benefits into a single categorical/means-tested poverty benefit	1999 Budget	
		Raise the statutory retirement age for men and women by 6 months each year	1997-2000	Ongoing
		Reform the pension system by introducing a two-tier pension structure comprising of: (i) a basic social pension financed by the government on a pay-as-you go basis; and (ii) a mandatory funded pension scheme financed through individual contributions based on their labor income	End-December 1998	
		Introduce individual retirement accounts	End-December 1998	World Bank technical assistance
		Shift initial responsibility for sick leave benefits from the SPF to employers	End-June 1997	Pending
		Review eligibility requirements for unemployment compensation	End-March 1997	Pending
	Improve infrastructure	Develop a 3-year public investment program	End-June 1997	Draft prepared; World Bank technical assistance
		Set annual consolidated budget investment targets for general government	1998-2000	

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
1.3 Fiscal management and budget planning	Improve Ministry of Finance's control over public finances and expenditures	Integrate all government spending agencies' accounts in the Treasury Single Account	End-November 1997	IMF technical assistance by FAD
		Make fully operative mandatory competitive bidding procedures for government procurement and the Procurement Regulatory Agency	End-March 1998	World Bank technical assistance
		Prepare proposals about institutional arrangements to receive future oil revenues, and to decide on their best use	End-September 1998	IMF/World Bank technical assistance
		Clarify financial relations between government and ANB regarding payments and receipts of interest on mutual claims, and allocation of central bank profits	End-December 1998	
2. Monetary policy	Improve monetary management	Allow off-auction interbank trading in foreign exchange for all banks	September 1997	Implemented
		Remove remaining restrictions on direct interbank trading in foreign exchange	End-June 1998	
		Allow foreign banks to participate directly in the foreign exchange (BICEX), Treasury Bill, and interbank money markets. Also allow non-residents as well as all residents to participate in the Treasury Bill market	Early-December 1997	
		Allow foreign banks to participate in the ANB credit auctions market	End-June 1998	
		Securitize part of outstanding government debt at ANB with a view to developing the stock of Treasury bills	From beginning 1998	
		Be prepared to start open market operations in Treasury bills	End-July 1998	

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Encourage full-fledged collateralized interbank money market		
		Establish framework for auctions of central bank deposits or ANB certificates to address any capital inflows problem	End- March 1998	Fund technical assistance by MAE
		Phase out credit auctions in favor of open market operations	End-December 1998	
	Improve banking supervision	Increase frequency and quality of on- and off-site inspections by hiring more staff and improving their skills through training and use of foreign experts	End-December 1997	In progress
		Enforce timetable for fully achieving requirements for loan-loss provisions over 3 years		
		Up to 40 percent	End-1997	
		Up to 75 percent	End-1998	
		Up to 100 percent	End-1999	
		Introduce a new chart of accounts and financial reporting standards in line with international accounting standards for commercial banks	End-March 1998	In progress
		Raise the minimum capital requirement for existing banks to the manat equivalent of: US\$1,000,000	End-December 1997	
		Announce phased increase to minimum of US\$5 million by 2001		
	Improve soundness of existing banking system	Implement the restructuring program of the four state-owned banks	1997-1998	In progress
		Resolve problem of bad loans portfolio upon successful completion of initial phase of restructuring program, and privatize the banks	1998-1999	

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
3. Enterprise reform	Medium- and large-scale privatization	Privatize 400 (cumulative) medium-size/large enterprises through voucher auctions or commercial tender	End-December 1997	In progress
		Establish privatization targets for 1998, including 50 large enterprises	End-December 1997	Part of World Bank SAC supervision
		Formulate and begin implementing program of privatization by liquidation		
		Establish a National Share Registry and Depository Agency	October 1998	To be made operational
		Establish a Securities' Commission	End-June 1998	
		Issue regulations complementing Accounting Law for enterprises to introduce international standards	End-September 1998	UNDP technical assistance
4. Agriculture	Develop private sector agriculture		1998-2000	Good progress with World Bank technical assistance
		Complete the distribution of land titles to private farmers	End-June 1998	In progress
		Reorganize irrigation management	End-December 1997	In progress
		Phase out most agricultural concerns	End-June 1998	
5. Energy	Rationalize use of energy	Raise gas and electricity prices to full operating cost recovery levels on average	October 1997	Implemented
		Phase out cross-subsidization in energy prices (electricity, and gas)	End-December 1998	
		Extend gas metering to cover all customers	End-September 1999	In progress
		Develop a strategy for the rationalization of Azerbaijan oil refineries	1998-1999	World Bank technical assistance
		Provide data to IMF on the operations of SOCAR	End-December 1997	

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Reform communal services and phase out subsidies	1999	
		Spin off noncore activities of energy enterprises (SOCAR, Azerenerji and Azerigaz); and internally restructure them to reflect separability of their business activities	1998-1999	World Bank technical assistance
		Establish a proper regulatory environment for natural monopolies	1999-2000	
		Introduce a Petroleum Law to provide a sustainable basis for foreign investment in oil sector	End-December 1998	
6. Education		Establish government commission to develop a comprehensive reform plan for the education sector, focusing on downsizing, improving efficiency, and partial privatization.	End-December 1997	
		Raise the student/teacher ratio by increasing the class size or increasing the weekly teaching load from the current low level of 12 hours	1998-1999	
		Allocate budgetary funds on the basis of number of students	1999 Budget	
7. Health care		Establish government commission to develop a comprehensive reform plan for the health sector, focusing on downsizing, improving efficiency, and partial privatization	End-December 1997	
		Develop regulatory framework for privatization and entry of the private sector in health care	1998-1999	
		Eliminate 15 percent of hospital beds	1998	some progress

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Allocate health budget among institutions according to population rather than according to the number of beds	1998	Some progress
		Reform provider payment mechanisms by paying providers on a capitation basis	1998	Some progress
		Reorganize health care system to provide universal access to a basic package of medical services	1998-1999	
8. Legal framework	Establish framework appropriate for market economy	Submit a Secured Transaction Law to parliament	Early-December 1997	
		Issue a decree clarifying the debt-service obligations of enterprises during and after privatization.	Early-December 1997	
		Issue implementing regulations for the Bankruptcy Law to provide enforcement measures	End-December 1998	World Bank technical assistance
		Introduce a new Securities Law	End-March 1998	
		Adopt a new Land Code, including provisions for privatized land of enterprises	End-March 1998	
		Introduce a new draft law on the State Police and Procurators	End-June 1998	
		Introduce new Corporate Law, Civil Code, and Competition Law	1998-1999	
9. Trade and exchange regime	Further liberalize the trade system	Unify import tariff rates at 15 percent and eliminate all exemptions	1997 Budget	Modified in May 1997 to include a reduced rate of 5 percent for capital goods and raw materials
		Reduce progressively the general tariff rate of 15 percent by at least 5 percentage points	1999-2001	

Policy Area	Targets	Objectives and Measures	Strategies and Implementation	Technical Assistance/status
		Further liberalize remaining ex ante registration in the case of exports on credit, consignment, and through barter	End-December 1997	
		Introduce new Foreign Trade Charter to meet requirements of WTO accession	End-December 1998	
10. Government restructuring	Align structure of government with the needs of the emerging market economy	Reduce number of Ministries and Agencies. Eliminate the state's commercial and industrial activities, while strengthening regulatory and policy-making functions	From end-March 1997	Ongoing
11. Reconstruction of war-damaged areas	Start rehabilitation of war damaged areas	Initiate information campaign on mine-awareness	End-March 1997	
		Undertake social assessments of internally displaced persons	End-March 1997	Ongoing
12. Environment	Halt and reverse degradation of environment due to industrial pollution, overfishing, and deforestation	Formulate and implement a National Environmental Action Plan	1998, 1999	World Bank assistance
13. Statistics	Improve the statistical base for economic policy	Develop a new statistical program to make the statistical system adequate for policy design, implementation and monitoring	End-June 1997	In progress

Table 2. Azerbaijan: Selected Economic and Financial Indicators, 1995-2000

	1995	1996	1997	1998	1999
			Estimate	Program	Projection
(Annual percentage change, unless otherwise indicated)					
Output, incomes and prices					
Real GDP	-11.0	1.3	5.1	7.0	8.5
Real GDP per capita	-11.6	0.7	4.5	6.4	7.9
Real per capita consumption	-9.3	1.1	0.7	0.4	3.9
Consumer price index (period average)	411.7	19.8	4.0	5.5	5.5
External sector (in terms of US dollars)					
Exports of goods and non-factor services at current prices	852	938	1,111	1,504	1,795
Imports of goods and non-factor services at current prices	1,267	1,764	1,984	2,630	3,227
Export volume	-4.0	15.0	13.3	22.4	23.0
Import volume	-16.0	29.5	16.4	29.9	20.3
Real effective exchange rate (Index 1995=100)	100.0	125.9	141.2	147.4	151.1
Money and credit					
Manat broad money	175.2	55.7	19.4	16.6	...
Manat reserve money	190.6	62.7	25.0	15.0	...
Velocity of manat broad money	53.8	-23.8	-6.2	-3.8	...
(In percent of GDP, unless otherwise indicated)					
Public finances 1/					
Revenue	15.2	16.2	18.0	19.3	21.4
Direct taxes	5.4	6.6	5.9	6.1	8.0
Indirect taxes	4.3	6.4	7.4	7.8	8.7
Social Security contributions	2.1	2.1	2.5	2.7	3.1
Oil Royalties	0.0	0.3	1.8	2.1	2.2
Other	2.7	0.1	0.1	0.1	0.1
Expenditure	19.5	18.8	20.8	22.3	22.5
Government consumption	9.1	9.6	11.8	11.8	11.5
Transfers and subsidies	6.3	7.9	5.8	7.0	7.4
Other current expenditure	4.1	1.3	3.2	3.5	3.6
Capital expenditure	0.6	0.5	1.6	1.7	2.1
Net lending	3.3	0.6	0.3	1.1	0.7
Overall deficit (-) (on a accrual basis)	-4.3	-2.6	-2.8	-3.0	-1.1
incl. oil funds and privatization proceeds 2/	5.3	-0.9	-0.9	0.8	0.2
Savings and Investment					
Savings	2.8	0.0	5.6	6.1	7.2
General government sector	8.2	-1.5	0.8	2.4	2.3
Private sector	-0.1	1.6	3.4	9.0	5.8
Gross investment	14.3	23.6	27.2	33.7	39.3
General government sector	0.6	0.5	1.6	1.7	2.1
Private sector	13.7	23.1	25.6	32.0	37.2
External current account balance	-11.5	-23.6	-21.6	-27.6	-32.1
External Debt and Debt Service					
Public sector external debt, end of year	15.1	15.4	14.0	16.2	17.3
Public sector external debt service	2.4	2.6	2.5	1.7	1.4
Of which: interest due	0.3	0.5	0.5	0.5	0.8
Gross official reserves, end of year					
(In millions of US dollars)	119	214	422	565	631
(In weeks) 3/	5.0	8.0	15.0	16.0	16.0
Exchange rate (manat/US dollar)	4,416	4,301	3,996	3,835	3,759
Nominal GDP (In millions of US dollars)	2,777	3,443	4,112	4,799	5,652

Sources: Azerbaijan authorities; and IMF staff estimates.

1/ Revenue and expenditure figures in 1994 and 1995 are not fully comparable to later years due to the inclusion of the Foreign Exchange Fund which was dissolved in March 1995.

2/ Signature bonuses from oil consortiums and privatization receipts are treated as below the line item in the program.

3/ Imports of goods and services, excluding operations of oil consortia.

Table 3. Azerbaijan: Income and Social Indicators, 1995-2000

		1995	1996	1997	1998	1999
Unit of Measure		Program				
Population						
Population (mid-year)	thousand	7,487	7,535	7,575	7,620	7,666
Population growth rate (annual average)	percentage change	0.8	0.6	0.5	0.6	0.6
Urban population	percent of total	54	...	...	...	...
Poverty						
Headcount index 1/	percent of population	68	...	...	...	...
Income						
GDP per capita	US-Dollars	371	457	543	630	737
Official wage (monthly average)	US-Dollars	13	20	31	37	46
Real labor compensation index	1994=100	90.8	90.4	94.9	95.8	99.2
Employment (annual average)	thousand	2,837	2,886	2,941	2,960	2,983
Social Indicators						
Life expectancy at birth	years	71	...	...	...	...
Infant mortality rate	per thousand	26	...	...	...	...
Illiteracy (population age 15+)	percent of total	3	...	...	...	...
Gross primary school enrollment (population in school age)						
Male	percent of total	91	...	...	...	...
Female	percent of total	87	...	...	...	...

Sources: Azerbaijan authorities; and World Bank and IMF Staff estimates.

1/ Percent of population below the "food only" poverty line; see World Bank, Azerbaijan Poverty Assessment, June 1996 (15601 AZ).

Table 4. Azerbaijan-External Financing Requirements and Sources, 1995-2000

	1995	1996	1997	1998	1999	2000	1998-2000 Total
(In millions of US dollars)							
Requirements	621	1,037	1,231	1,551	1,940	2,492	5,984
Financing of the non- interest current account deficit, excluding official transfers	392	880	921	1,328	1,798	2,267	5,393
Scheduled interest	7	17	21	24	44	56	124
Scheduled amortization	29	70	81	56	16	38	110
IMF repayments 1/	0	0	0	0	16	46	62
Reduction in external payments arrears (+)	76	25	0	0	0	0	0
Change in ANB gross official reserves	117	95	208	143	66	86	295
Resources	327	884	1,088	1,435	1,862	2,493	5,790
Official project grants	81	86	50	31	25	20	76
Official project loans	14	19	62	156	179	128	463
Private direct investment (net) 2/	282	661	929	1,189	1,588	2,275	5,051
Other private capital (net) 3/	(51)	118	48	60	70	70	200
Financing gap	295	153	143	116	78	0	194
Exceptional financing disbursed	295	153	0	0	0	0	0
Use of IMF resources	101	71	0	0	0	0	0
World Bank program assistance	30	31	0	0	0	0	0
Other bilateral and multilateral assistance	72	0	0	0	0	0	0
Debt rescheduling or cancellation	92	51	0	0	0	0	0
Exceptional financing committed	0	0	143	96	38	0	134
Use of IMF resources	0	0	108	61	38	0	99
World Bank program assistance	0	0	35	35	0	0	35
Other bilateral and multilateral assistance	0	0	0	0	0	0	0
Debt rescheduling or cancellation	0	0	0	0	0	0	0
Residual financing gap	0	0	0	20	40	0	60
Memorandum items	(In percent of GDP)						
Financing requirements	22.4	30.1	29.9	32.2	34.1	38.2	31.6
Official financing	3.4	3.1	6.2	5.9	4.3	2.3	4.8
Private financing	8.3	22.6	23.7	25.9	29.1	35.9	25.3
Residual financing gap	0.0	0.0	0.0	0.4	0.7	0.0	0.3

1/ Including repurchases.

2/ Including oil signature bonuses.

3/ Including errors and omissions.