

İngilab Ahmadov
Doctor of economy
Baku, Azerbaijan

Favorable conjuncture on the global market and conservative debt policy. Azerbaijan case study

Azerbaijan: country profile. Republic of Azerbaijan is situated in the South Caucasus.
Official languages: Azerbaijani.

Independence from the Soviet Union confirmed in the 18 October 1991.

Total Area: 86,600 km².

Population (July 1, 2007): 8,580,000.

Currency: Manat (AZN).

GDP per capita: 7023 USD (PPP)

Azerbaijan is an economy that has completed its post-Soviet transition into a major oil based economy (with the completion of the Baku-Tbilisi-Ceyhan Pipeline), from one where the state played the major role. Azeri GDP grew an astonishing 41.7% in the first quarter of 2007, very likely the highest of any nation worldwide. Of course, such rates cannot be sustained, but interesting enough, despite reaching 26.4% in 2005 (second highest GDP growth in the world) and 2006 over 36.6% (world highest), GDP has been accelerating every year.

Stages in borrowing

At present the state's foreign debt process is managed by the Law "Public Debt", adopted in 2007 and recently entered the force. The Law reflects instances competent for debts and responsibilities of the Ministry of Finances and National Bank as well as limitations of debts during a year. Determination of limitations prevents from possible risks in this field, namely the desire of state to be engaged in debts with a higher rate. Since regaining its independence Azerbaijan has passed several stages in borrowing:

1. Borrowing directed to provision of financial stability (1994-1999).
2. Borrowing related to structural changes and institutional reforms (2000-2004).
3. Borrowing related to infrastructural, economic development and other commercial projects (since 2005).

Due to several reasons since regaining its independence Azerbaijan has been experiencing a stable, permanent and conservative policy in the field of debts.

1. Not taking into account civil confrontation of 1991-1993 in the country, war with Armenia and domestic anarchy, the fact, that from mid 1993 the same political authority has been in power up to present time has decreased volatility and risk to minimum. In the first years of independence political authority did not go into

debts. This means that the basis for cooperation with international financial institutions and creditors was laid by current authority.

2. From the very beginning Azeri authority sensitively addressed to foreign, refused from risky debts as much as it was possible and after the restoration of financial stability attracted foreign credit only in exceptional cases. Such policy actions enabled Azerbaijan always to occupy successful place in this field. It is not accidentally that by the ratio of foreign debt to GDP Azerbaijan occupies one of the best places among CIS countries.

3. Due to oil revenues entering the country's economy from 2005 and increasing with every past year the need for foreign debts has considerably decreased.

4. Having seen that Azerbaijan's financial stability is strong enough (oil factor) creditors have shown great enthusiasm in financing various projects.

Azerbaijan's specific environment. Debt policy

Due to a range of its stipulating factors at present Azerbaijan continues its conservative and cautious policy towards foreign borrowing:

1. There is strong enough and stable political authority in Azerbaijan. In near future current authority intends to continue this political course and retain its permanence. From this point in short- and mid term authority addresses to debts, in particular to foreign debts as to its exceptional business. It does not intend to leave this issue as a legacy to any other political group or party.

2. Azerbaijan's modern oil history has completely determined its political course for short- and mid-term perspective and this course is directed to determination of management ways of large revenues that will enter the country (according to the most pessimistic forecasts if the oil price in world market remains the same as it is at the current level, then in near 20 years the country will get about 200 bln.\$). For comparison: at present overall amount of revenues of the state budget does not exceed 7 bln. \$). In such case there is no place for high rate foreign debts.

3. During disadvantageous political situation there is a risk of state's entering debts because oil economy itself is a risky field. Experience of the most oil countries (Nigeria, Angola, etc.) shows the possibility of this scenario which will be the worst one.

4. Depending on state policy oil revenues can be used by economy as a starting chance and as a result economy can gain its valid and effective competitiveness. The opposite variant is also possible: in order to retain economic balance like number of oil

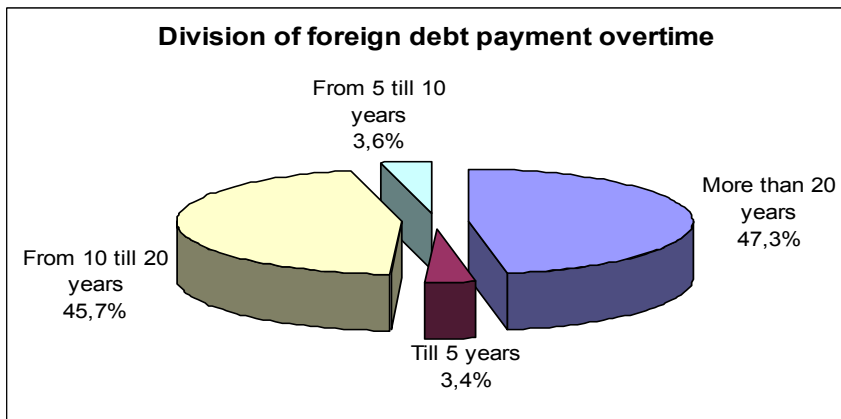
countries which committed traditional mistakes, state can enter forced debts.. In such case this debt can become a controversial debt for future generations.

Structure of foreign debt

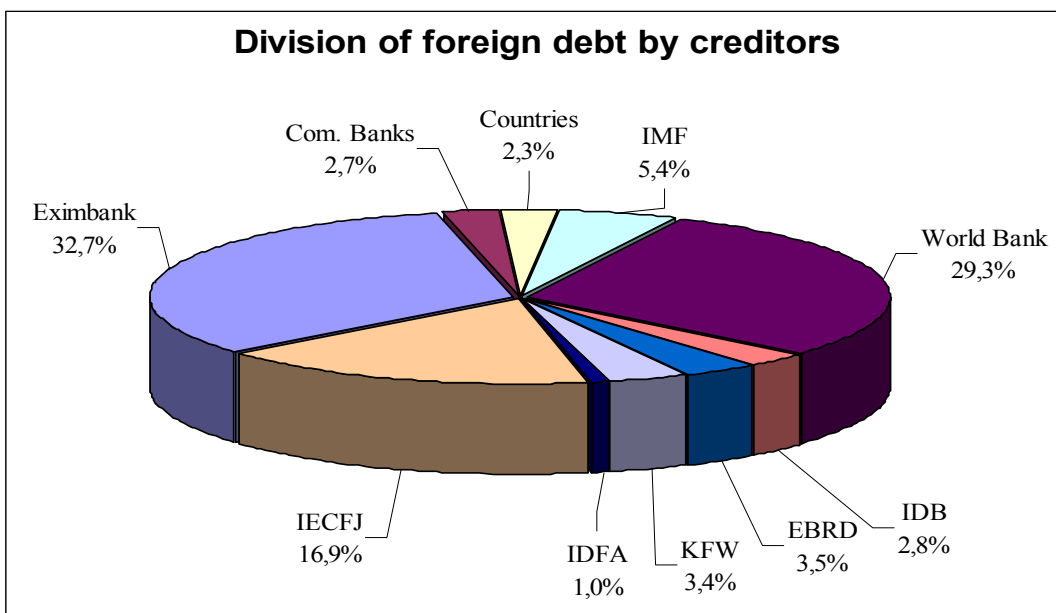
At present (July 1, 2007) Azerbaijan has debt of 2 bln. 089 mln.\$. In comparison with GDP this amount comprises 7,7 % and is accepted as one of the best indicators in CIS. By the amount of foreign debt per capita Azerbaijan with 242,9 \$ occupies relatively favorable place in the world.

Below is the structure of foreign debt:

1. division of foreign debt by payment terms

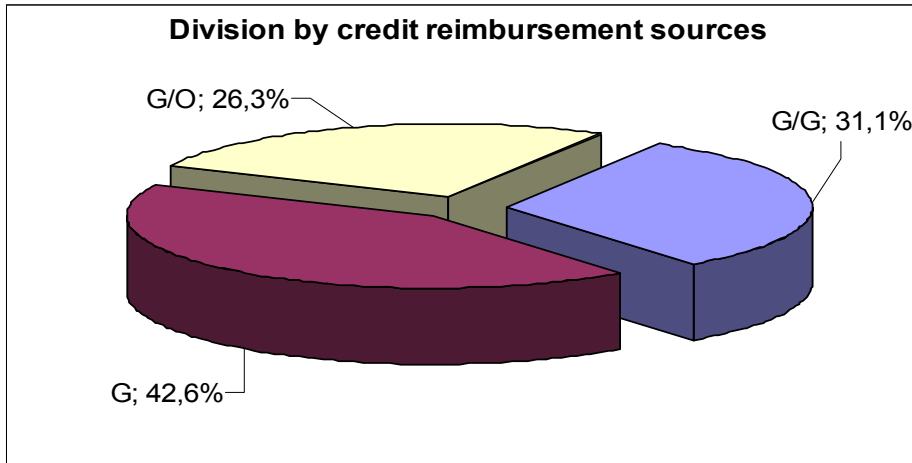


2. division of foreign debt by creditors



IMF - International Monetary Fond
 IDB - Islam Development Bank
 EBRD - European Bank of Reconstruction and Development
 KFW - Germany Bank
 IDFA - International Development Fond of Agriculture
 IECFJ - International Economic Cooperation Fond of Japan

3. division of credits by reimbursement sources

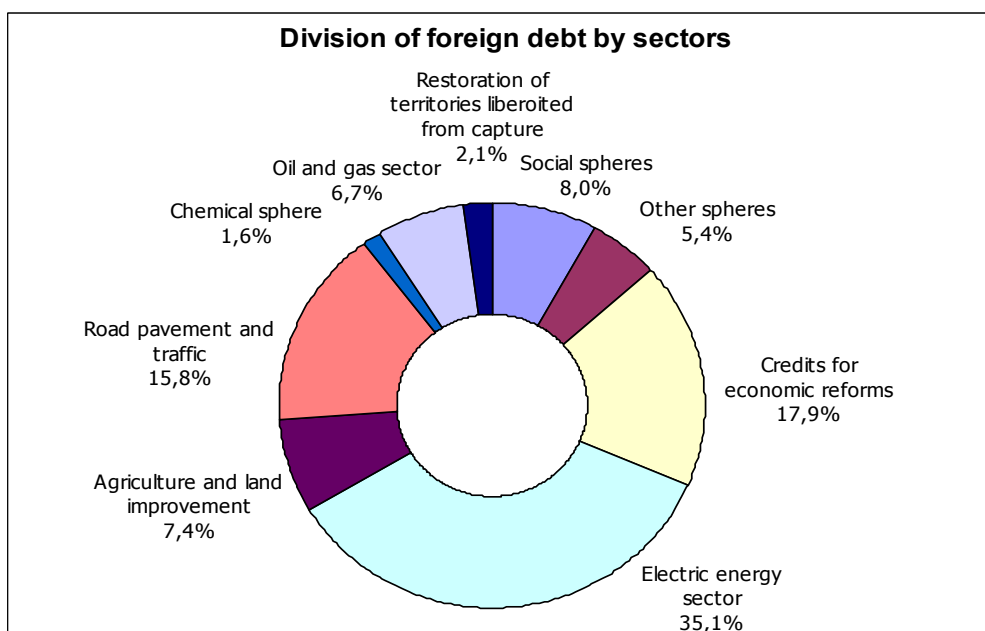


G/O - credit given to Government, passed to implementer and reimbursed by implementer

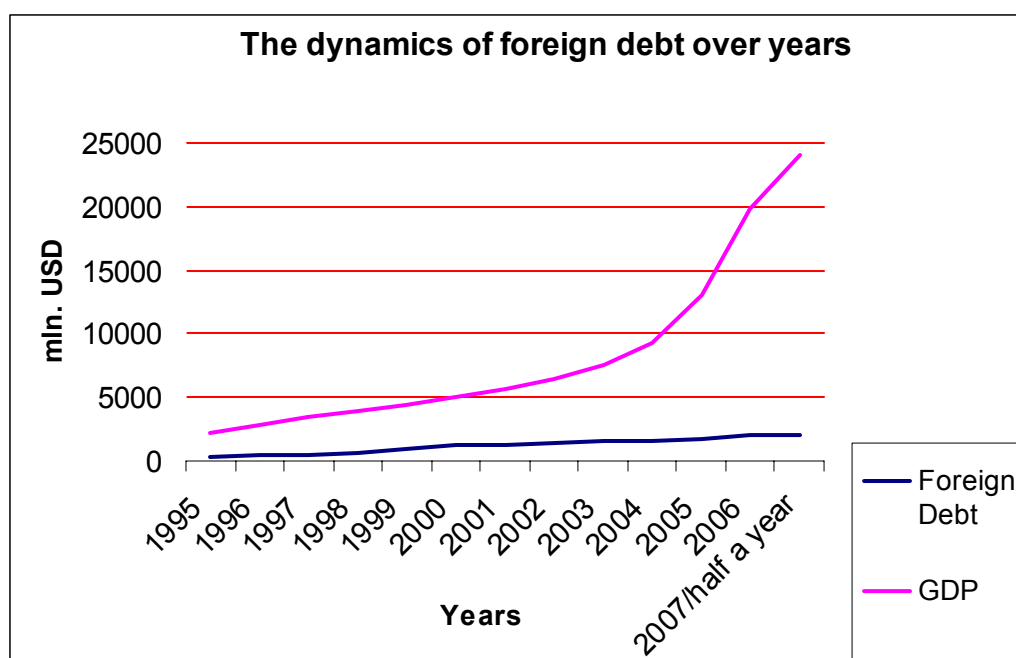
G/G - credit presented by Government guarantees, but reimbursed by implementer

G - credit given to Government and paid at the expense of public budget

4. division of foreign debt by sectors



5. dynamics of foreign debt by years



Risk factors in borrowing

Despite of the fact that total amount of Azerbaijan's foreign debt is relatively little, legislative base regulating debts is perfect and its structure is relatively advantageous yet there is a range of risks in foreign debts:

1. In short- and mid-term perspective the country's successful financial and overall economic policy depends mainly on oil. In its turn oil depends on world market conjuncture and is unsteady and of a high risk.
2. The main part of attracted foreign credit is under the management of state natural monopolies. From the perspective of effective management and accountability not subjected to reforms, the majority of these enterprises SOCAR (State Oil Company), Azerigaz (State gas company), Azerenergy (State energy company), etc. have lots of problems with effective management.
3. In the future problems in investments and business can create another problem in reimbursement of number of credits on time.
4. Problems in management as well as high corruption rate can cause additional problem in effective management of foreign debt.
5. Lack of transparency and accountability in government activity.

Bad debts

Despite of the fact that in its relatively short history Azerbaijan did not have global problems with foreign debts during this period it had a range controversial debts of local character part of which still remains unsolved.

As a result 3.4 mln.\$ debt dispute with Turkish company “Saka Korkmaz” in 2004 aircrafts of “Azal” State Concern and “Caspar” (State Shipping Company) were arrested as well as various penalties were applied.

Direct damage to “Azal” comprised 578 000\$ and to “Caspar”-3.4. mln. \$. Afterwards the situation was discussed on intergovernmental commissions’ level with the participation of companies’ representatives. Azerbaijani government reimbursed the whole debt. Along with this case the government faced with Turkish Eksimbank over 74 mln \$ debt dispute and with Turkmenistan over 60 mln. as well.

Foreign legal entities also had debt disputes with Azerbaijani government. For instance, Ukraine’s State Company “Ukrresursi” insisted on reimbursement of 20 % of diesel engine (5.3 mln.\$) which it had bought from SOCAR in 1999-2000 in the form of product. This debt problem was also solved within the framework of intergovernmental economic commission. Debt disputes with CIS members and neighboring countries were settled through bilateral negotiations. However a number of debt disputes (France, Cyprus, etc.) resulted in suing some of which have not found their solution yet.

Perspectives of borrowing.

Positive scenario

Government conducts serious changes in institutional and management field; economy gradually increases its competitiveness. Not like unsuccessful experience in number of countries, oil revenues are managed more effectively and gradually the dependence of economy on oil decreases and its competitiveness increases. There will be no grave problem in foreign debt management and in the future credits are attracted to commercial projects. Specific weight of credits by government guarantee decreases. The credit rating of Azerbaijan is measured not only by large amount of its currency reserve but also by the increase of its competitiveness.

Negative scenario

Government slows down implementation of reforms. Relying on its oil revenues it carries out budgetary and social expenditures at the expense of oil. After the oil boom and in order to retain the level of public expenditures carried out at a high limit the state, along with expending finances from State Oil Fond (SOFAR) also enters the debts. Thus the amount of foreign debt abruptly increases and that in the future complicates management and timely reimbursement of debt by state.

Realist scenario

Government partially paves way for reforms. Weak entrepreneurship environment is organized and as an alternative to oil mainly service sector (Dutch disease) is established which plays a definite role in budget formation. Government gets little profit from management of large oil revenues abroad and at the expense of that equalizes non-profitable economic situation. Even despite of the fact that there are no serious problems in borrowing, creditors refuse from financing different subjects of the country, instead, meeting mainly state's own needs. Government loses unique chance created by oil revenues but nevertheless it does not become a controversially debt country.