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**Economic Transformation in
Azerbaijan:
Achievements, Weaknesses and
Challenges**

Brussels, April 21, 2008

THE GREATEST ACHIEVEMENT: ECONOMIC SOVEREIGNTY

Nation chooses economical system independently

True for Azerbaijan. IFIs (WB, IMF and others) mostly provide advisory assistance – no terms linked to loan contracts

Nation manages to self-finance

True for Azerbaijan. International reserves reached \$ 7.4 bln. and exceed the external debt (\$ 2.4 bln) for more than three times.
Exports/External debt ratio is 2.2

Economic potential of a country belongs to the Nation

International reserves of Georgia \$ 0.9 bln; Exports/External debt ratio is 0.69

True for Azerbaijan. Including natural resources.

In Armenia power industry almost completely belongs to Russia
International reserves of Georgia \$ 0.9 bln; Exports/External debt ratio is 0.69

bln; Exports/External debt ratio is 0.63

THE GREATEST ACHIEVEMENT: ECONOMIC SOVEREIGNTY

Failure to establish countrywide economic sovereignty

True for Azerbaijan and Georgia

Gap between economic and political developments

In Azerbaijan economic growth leaves behind
the process of political democratization

THE ACHIEVEMENT – NOT SMALLER: FREE MARKET ECONOMY

*Composition of property forms appropriate
for market economy*

True for Azerbaijan (1995); in industry – 72,4%; in goods transportation – 58,9%

Property rights are not secured de facto

Free prices and free competition

True for Azerbaijan
BUT...

Monopoly activities and prices still remain

Freedom of International economic activities

Again true for Azerbaijan
BUT...

Non-tariff barriers to foreign trade are excessive

Land reform is successfully completed

THE LATEST ECONOMIC PROGRESS

Azerbaijan is World's Number 1 in economic growth

GDP Real Growth rate:

Azerbaijan is one of World Leaders in Inward and Outward FDI Performance Index

~~GDP was doubled in 2006-2007~~

According to *World Investment Report* by UNCTAD:

ITIs' forecast: ✓ 2006 - № 1 in Inward, and № 5 in Outward FDI PI

Azerbaijan is one of World Leaders in State Budget increase

✓ 2007 – \$ 7 878 mln 2006 – 11,9%

Government Expenditures: ✓ 2007 – 11,3%

In 2007:

✓ with 10 times increase in 2003-2007 main contributors

✓ one of leaders in CEE for per capita investments

✓ ADP local base in 2007 exceeded foreign investments for the first time

✓ public investments in 2008 reached 12,1%

✓ local companies active 2009 invested abroad (SOCAR's investments in Georgia exceeded \$ 400 mln; another \$ 100 mln project was announced recently)

4.9%)

SOME GENERAL AND ECONOMIC COMPARISONS

Indicators	Azerbaijan	Georgia	Armenia
Territory (<i>thou. km²</i>) ¹	86.6	69.7	29.8
Total Population (<i>thou.</i>)			
2006 ²	8 474.4	4 436.5	3 007.2
2020 ³	9 400.0	4 100.0	3 000.0
2050 ⁴	11 600.0	3 000.0	3 400.0
Average Annual Change in Population size (%) ³			
1990-2004	+ 1.1	- 1.4	- 1.1
2004-2020	+ 0.8	- 0.7	- 0.2
Estimated weight in total population of the S.C. in 2050	64.4%	16.7%	18.9%

SOME GENERAL AND ECONOMIC COMPARISONS

Indicators	Azerbaijan	Georgia	Armenia
GDP on PPP (<i>bln int doll</i>) ⁵			
<i>2006</i>	51.681	17.763	14.679
<i>2009 (est)</i>	93.209	25.294	21.162
<i>2012 (est)</i>	103.298	32.999	26.715
GDP per cap. (<i>PPP, int dol</i>) ⁵			
<i>2006</i>	6 092	4 036	4 326
<i>2009 (est)</i>	10 728	5 872	5 829
<i>2012 (est)</i>	11 609	7 836	7 196
GDP Annual Growth (%) ²			
<i>2005</i>	26.4	9.3	14.0
<i>2006</i>	34.5	9.4	13.4
<i>2007</i>	25.4	12.4	13.8

SOME GENERAL AND ECONOMIC COMPARISONS

Indicators	Azerbaijan	Georgia	Armenia
State Budget for 2008 (<i>bln USD</i>) ⁶	<i>Oil price est. \$ 50 for bbl</i>		
- revenues	8.698	3.330	2.529
- spending	10.022	2.997	2.780
- deficit/surplus	- 1.324 *	+ 0.333	- 0.251
Gross Capital Formation (% of GDP, 2006) ²	37.7	28.7	30.4
FDI Stock (<i>mln USD</i>) ⁷			
Inward			
2000	3 735	725	583
2006	13 275	3 367	1 705
Outward			
2000	5	-	1
2006	4 391	-	13

SOME GENERAL AND ECONOMIC COMPARISONS

Indicators	Azerbaijan	Georgia	Armenia
Military Expenditure (% of GDP) ²			
2004	1.74	1.37	2.60
2005	2.01	3.14	2.71
Foreign Trade (<i>mln USD, 2006</i>) ⁸			
- exports	19 530 (R.71)	1 240 (R.143)	1 157 (R.147)
- imports	6 376 (102)	5 200 (R.107)	3 281 (R.124)
Current Account Balance (<i>mln USD, 2007</i>) ⁸			
	+ 7 535 Rank 33	- 1 582 Rank 124	- 440 Rank 96
Current Account Balance (% of GDP) ⁹			
2007	+ 28.8	- 19.7	- 6.5
2008 (<i>est</i>)	+ 39.5	- 16.6	- 6.8
2009 (<i>est</i>)	+ 39.2	- 13.2	- 5.0

COMPETITIVENESS OF THE ECONOMY

WORLD ECONOMIC FORUM

(founded in 1971, based in Geneva, SWITZERLAND)

★ BUSINESS COMPETITIVENESS INDEX

compares microeconomic factors in 131 countries as expressed in the

★ ECONOMIC GROWTH COMPETITIVENESS INDEX

current competitiveness of companies

is not included in the latest Report

★ GLOBAL COMPETITIVENESS INDEX

✓ sophistication of company operations and strategy

since 2005; replaced Economic Growth Competitiveness Index in the latest Report (2007-2008)

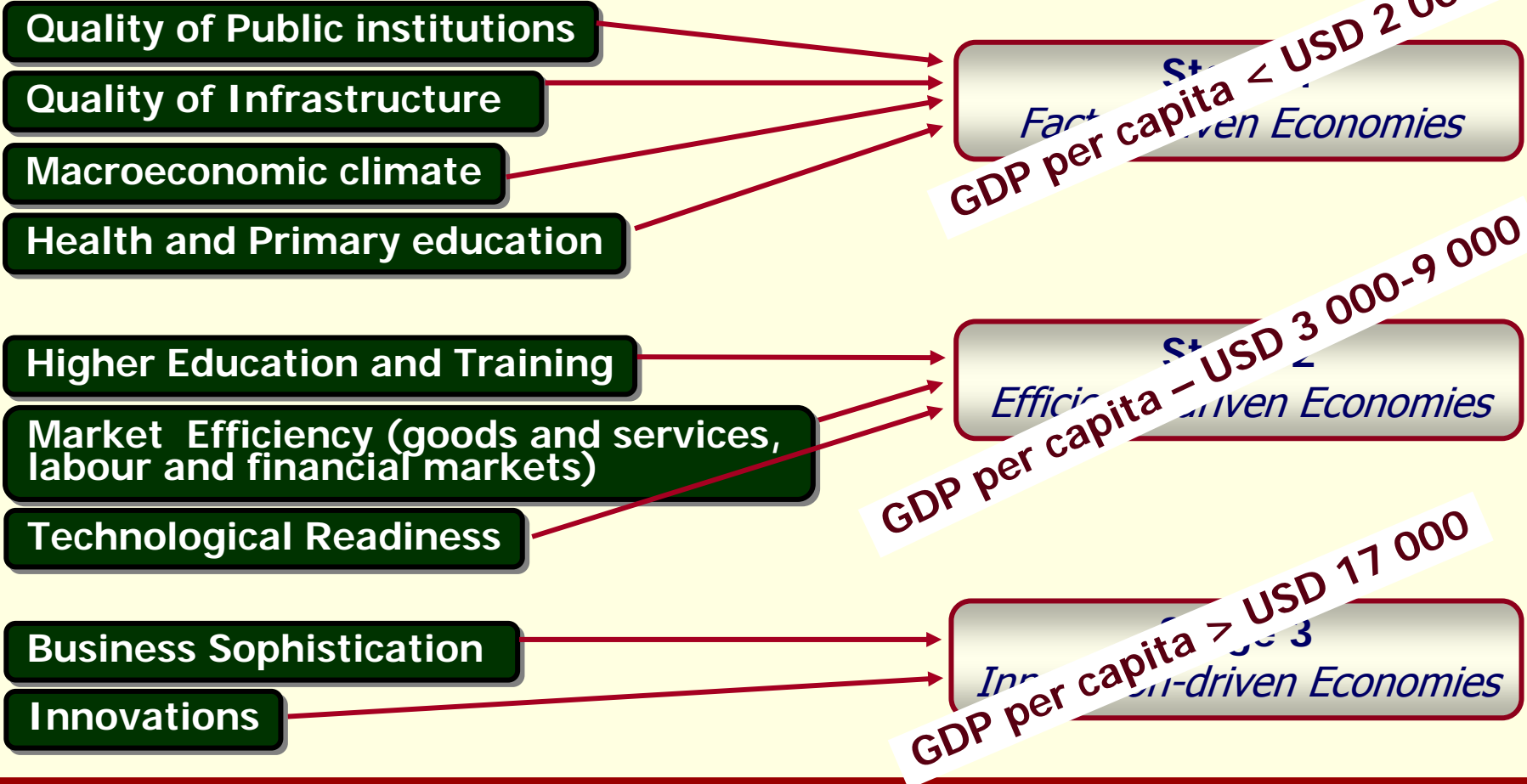
✓ quality of the national business environment

enables:

- ✓ to describe the economic environment for business activities in a more detailed way
- ✓ to broaden the range of countries and regions assessed

GLOBAL COMPETITIVENESS INDEX METHODOLOGY

NINE PILLARS



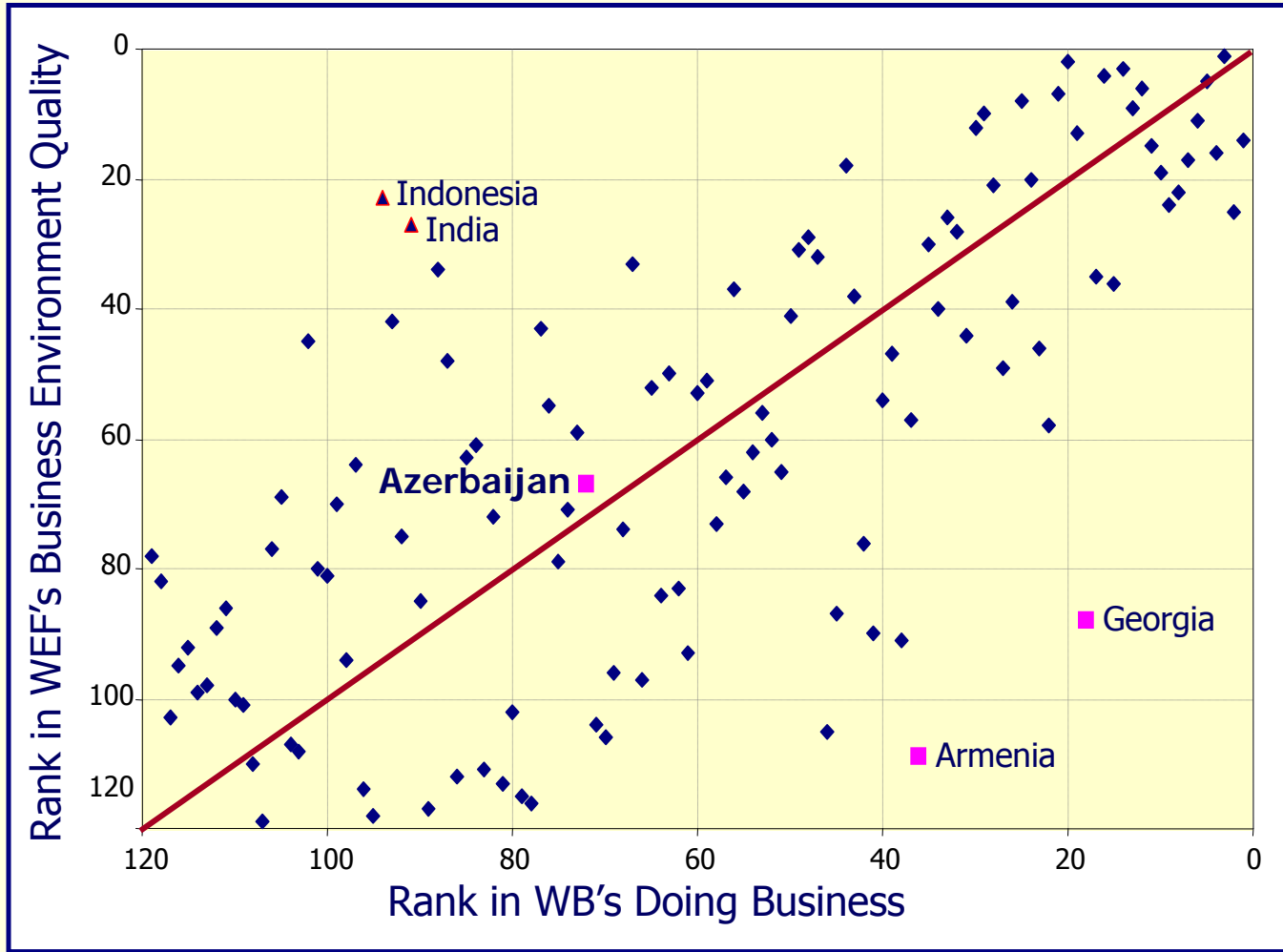
GLOBAL COMPETITIVENESS INDEX METHODOLOGY

	Basic Requirements	Efficiency Enhancers	Innovation & Sophistication factors
Stage 1. Factor-driven Competitiveness	50%	40%	10%
Stage 2. Efficiency-driven Competitiveness	40%	50%	10%
Stage 3. Innovation-driven Competitiveness	30%	40%	30%

GLOBAL COMPETITIVENESS INDEX 2007-2008 RESULTS

Rank	Country	GCI Score	Basic Requirements		Efficiency Enhancers		Innovation factors	
			Rank	Sub-index	Rank	Sub-index	Rank	Sub-index
1	United States	5.67	23	5.41	1	5.77	4	5.68
27	Estonia	4.74	29	5.25	27	4.66	35	4.07
53	Turkey	4.25	63	4.44	51	4.16	48	3.90
58	Russia	4.19	68	4.36	48	4.19	77	3.50
<i>66</i>	<i>Azerbaijan</i>	<i>4.07</i>	<i>65</i>	<i>4.41</i>	<i>84</i>	<i>3.65</i>	<i>68</i>	<i>3.60</i>
73	Ukraine	3.98	90	4.06	66	3.93	75	3.52
90	Georgia	3.83	87	4.07	90	3.55	119	2.90
93	Armenia	3.76	91	4.05	101	3.36	103	3.06
97	Moldova	3.64	96	3.87	102	3.36	122	2.87
131	Chad	2.78	130	2.88	130	2.64	128	2.62

BUSINESS ENVIRONMENT: WEF RANKING vs. WB RANKING



In countries above the median line the development level of factor conditions (physical infrastructure) is higher than the relative level of liberalization of the business environment. In countries below the median line, on the contrary, factor conditions lag behind the liberalization of regulatory rules

CHALLENGES TO BOOST AZERBAIJAN'S COMPETITIVENESS

IN GENERAL:

- *to raise the quality of national competitiveness, which means a renunciation of competitive advantages based on cheap labour and natural resources, and a transition to a higher stage driven by investment and efficiency*

AT THE ENTERPRISE LEVEL:

- *to upgrade production processes based on advanced technologies, marketing research and strategic long-term planning*

AT THE NATIONAL LEVEL:

- *to upgrade the physical and "soft" infrastructure*
- *to enhance the quality and effectiveness of Government's economic policies*

PROBLEMS TO SOLVE IN THE NEAREST FUTURE

MAJOR IMPEDIMENT FOR ECONOMIC DEVELOPMENT AND PROSPERITY – REGIONAL POLITICAL CONTRADICTIONS

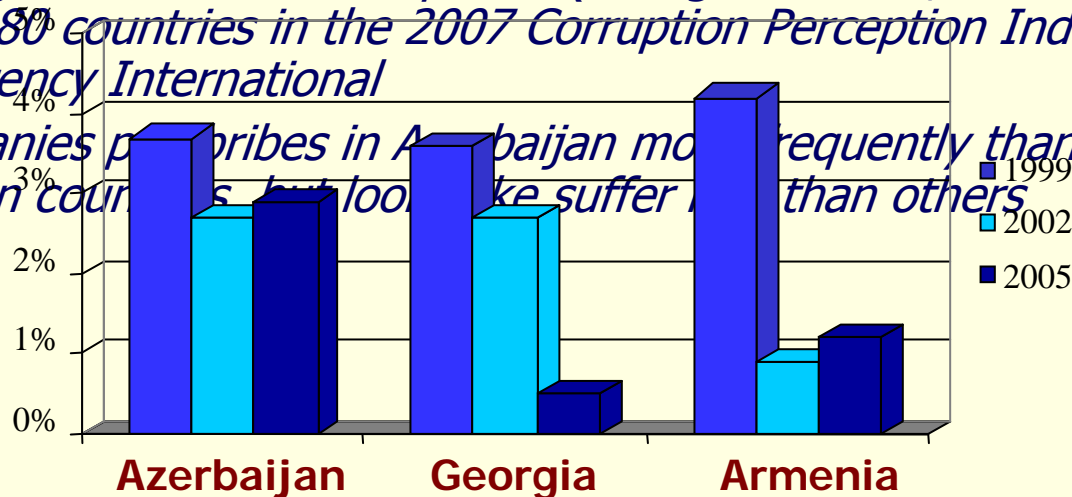
- ★ **Armenia and Azerbaijan are in a state of war**
 - Armenia currently occupies 20% of Azerbaijan's territory, most of which is outside NK
- ★ **Georgia's territorial integrity also is under strain**
 - Abkhazla and South Ossetia continue to claim their independence, displaced persons in the country, 50% of whom are living below the poverty line
- ★ **Armenia has turned into a monoethnic aggressor-state**
 - The Azeris forcefully deported from Armenia at the end of the 1980s were the last large non-Armenian ethnic group
- ★ **The only encouraging matter is that Azerbaijan and Georgia are strategic political and economic allies**
 - The nature of Georgia's territorial problems differs fundamentally from Azerbaijan's. Armenia is not included in the large regional projects being implemented in the Caucasus
 - Ossetians, the Abkhazs have already achieved their national self-identity and have their statehood
 - Foreign dependence level (primarily on Russia) is much higher than in Azerbaijan's and Georgia's
 - Both states are founders and active members of GUAM, and jointly participate in the large economic projects (BTC, BTA, TRACECA)

PROBLEMS TO SOLVE IN THE NEAREST FUTURE

MAJOR IMPEDIMENT FOR ECONOMIC DEVELOPMENT AND
PROSPERITY – REGIONAL POLITICAL CONTRADICTIONS

INFORMAL ECONOMY AND CORRUPTION

- ✓ ... are the major impediments to economic development
- ✓ **Bribes Paid by Companies (% of annual sales)**
Azerbaijan shares 150-161 places (Georgia – 79-83, Armenia – 99-104)
among 180 countries in the 2007 Corruption Perception Index Ranking by
Transparency International
- ✓ Companies pay bribes in Azerbaijan more frequently than in the other
Caucasian countries, but look like suffer less than others



PROBLEMS TO SOLVE IN THE NEAREST FUTURE

MAJOR IMPEDIMENT FOR ECONOMIC DEVELOPMENT AND PROSPERITY – REGIONAL POLITICAL CONTRADICTIONS

INFORMAL ECONOMY AND CORRUPTION

SHORTCOMINGS OF SECTORAL COMPOSITION OF THE ECONOMY

- ✓ *The oil sector prevails, accounting for more than two-thirds of industrial production and more than half of Budget revenues*
- ✓ *Azerbaijan is Number 10 in the world in Dependency on exports of fuels with 5-year (2000-2004) average 86.6 % of total exports. (Georgia is 16th in dependency on non fuel minerals exports, with 24,9% average share of various metals in total exports)*
- ✓ *Dramatic increase in gas supply through the Baku-Tbilisi-Erzurum gas pipeline will even worsen the sectoral composition*
- ✓ *Government makes efforts to develop non-oil sectors*

PROBLEMS TO SOLVE IN THE NEAREST FUTURE

MAJOR IMPEDIMENT FOR ECONOMIC DEVELOPMENT AND PROSPERITY – REGIONAL POLITICAL CONTRADICTIONS

INFORMAL ECONOMY AND CORRUPTION

SHORTCOMINGS OF SECTORAL COMPOSITION OF THE ECONOMY

TERRITORIAL DISTRIBUTION OF THE ECONOMY

- ✓ *Due to oil and gas reserves allocation 93% of Budget revenues are collected in Baku, and just only 7% – in the rest of the country*
- ✓ *To mitigate this discrepancy by stimulating the opening of new jobs in the provinces (and correspondingly – in the non-oil sector) Government implemented "The Regional Development Programme 2003-2008"*
- ✓ *The second part of that Programme for 2008-2013 is now under consideration*



THANK YOU VERY MUCH!