

The World Bank in Azerbaijan Country Snapshot



An overview of the World Bank's work in Azerbaijan

April 2017

AZERBAIJAN	2016
Population, million	9.6
GDP, current US\$ billion	37.5
GDP per capita, current US\$	3889
Life Expectancy at birth, years (2015)	70.6

At a Glance

- 2016 marked a year of economic recession for Azerbaijan, the first in two decades. Annual inflation rose to 15.6% annually, driven mainly by devaluation of the manat and rising domestic food prices. Investment and consumption fell sharply due to a deep cut in public investment, banking sector distress, and a drop in real income.
- The Government has accelerated structural reforms, including the simplification of customs clearance and licensing procedures. It also approved a Strategic Roadmap for the development of key sectors of the economy.
- The immediate challenge is to minimize the impact of fiscal consolidation on growth and to safeguard spending for the poor. Although recent efforts to step up social spending may be beneficial, high inflation and constrained private sector growth could have a negative impact on the poor.
- The World Bank is working with the Government of Azerbaijan and its development partners to support the country on a path toward sustainable, inclusive, and diversified development.

Country Context

Azerbaijan is in the process of redefining its government structure following a Constitutional amendment in September 2016 making it a fully presidential republic and instituting new vice president positions. These changes come at a time when Azerbaijan's economy is facing critical challenges due to the fall in oil prices, high inflation, and the crisis in the financial sector.

The Government is trying to address these challenges by accelerating reforms to improve the environment for private sector development. In December 2016, it launched a Strategic Roadmap for the development of the national economy and 11 key sectors. These strategy documents set medium- and long-term goals for reforms and sustained development. Fiscal consolidation will likely remain a policy priority through the medium term, however, which may delay implementation of some of the investment programs.

Azerbaijan is trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East–West and North–South transport corridors. Construction of the Baku–Tbilisi–Kars railway line, which will connect the Caspian region with Turkey, is expected to be completed in July 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan's Shah Deniz gas field to Turkey and Europe.

The Government has embarked on reforms that will accelerate banking sector resolution and improve the business environment—critical ingredients for restoring public and investor confidence.

The World Bank and Azerbaijan

The Country Partnership Framework 2015–20 (CPF) for Azerbaijan was endorsed by the Board of Directors on July 21, 2015. It is a joint strategy of the World Bank Group (WBG) aiming to support Azerbaijan on its path toward sustainable, inclusive, and private sector-led growth.

The CPF is underpinned by the Systematic Country Diagnostic (SCD) for Azerbaijan, the WBG's comprehensive analysis of the country's economic conditions, challenges, and constraints in the short and longer term. The Bank program in Azerbaijan is helping to address a selected set of those constraints. It is also well aligned with Azerbaijan's own development priorities and the Bank's global twin goals of reducing poverty and boosting shared prosperity.

The program has two main focus areas: public sector management and service delivery and economic competitiveness. The Bank is also supporting the country to strengthen public resource management, facilitate public service delivery, improve the quality of environmental assets, improve selected infrastructure networks, increase the country's financial inclusion, reduce the regulatory burden on the private sector, and bolster economic activities in rural areas.

Key Engagement

Azerbaijan's agriculture sector faces weaknesses in the legal and regulatory systems and infrastructure provision and must also contend with the low availability of credit. Increasing domestic demand for agricultural products would provide significant opportunities for the private sector, including by shifting production from subsistence crops to high-value products with a competitive advantage.

Growth in agricultural exports and value-added processing and import substitution through investments in agriculture would contribute to stimulating the rural economy. Access to market opportunities, however, requires the significant modernization of the sector, which needs to produce higher value-added and safe products in order to

WORLD BANK PORTFOLIO

No. of Projects: 10
Lending: \$2,526.2 Million
IBRD: \$2,349.4 Million
IDA: \$176.8 Million

meet demanding markets. The current lack of improved seed varieties and more productive livestock breeds, combined with outdated processing technologies, limits product quality and, in turn, restricts the ability of agri-food processors to access potentially lucrative markets.

Cooperation between producers and agri-food processors is not sufficiently developed or systematically implemented, and this further restricts the development of efficient agri-food production value chains.

To address these challenges, the Bank's engagement in the agriculture sector, most prominently within the Agricultural Competitiveness Improvement Project, helps facilitate the access of agricultural producers to markets by strengthening sanitary and phytosanitary services, enhancing selected value chains, and providing financial services to agribusiness enterprises.

Activities of the animal disease control program are well under way, including training on vaccination, brucellosis sero-monitoring, and the procurement of serosurvey equipment and modern vaccines. The brucellosis vaccination program covered the entire sheep and goat population in the country.

Innovative and technological agricultural and food producers are benefiting from the credit line program through select participating banks. The project is also providing technical assistance for establishing an animal identification system, phytosanitary and seed lab upgrading, and pest risk analysis.

Recent Economic Developments

The Azerbaijani economy contracted by 3.8% in 2016, driven by a fall of 5.4% in non-oil sector output. Oil GDP showed no growth in 2016.

Driven by a 40% fall in oil exports, Azerbaijan's external accounts deteriorated from a near balanced position in 2015 to a deficit of 4.8% of GDP by September 2016. Annual inflation rose to 15.6% in 2016, driven mainly by the pass-through from the manat depreciation and a rise in domestic food prices.

To curb the price pressures, the Central Bank tightened monetary policy significantly, raising the policy rate by 12 percentage points from February to September 2016, and expanded deposit auction operations to absorb manat liquidity. However, inflationary pressures remain strong, reflecting a large increase in the prices of electricity and natural gas in January 2017.

The consolidated fiscal balance recorded a surplus of 0.3% of GDP in 2016 compared with a deficit of 6.2% in 2015, as lower oil revenues and increases in wages, pensions, and targeted social assistance were offset by cuts in public investment and significantly lower-than-planned spending by the Oil Fund. This fiscal outturn was supported by increased customs revenue (as a result of customs reform) and the manat depreciation, which raised prices of manat-based imports.

Public confidence in the financial system remains weak. Total bank deposits fell by 23% in 2016, while credit to the private sector contracted by 24%. The Government also accelerated structural reforms, including the simplification of customs clearance and licensing to support private sector growth. In December 2016, the Government launched a "Strategic Roadmap for the National Economy and Main Economic Sectors" that outlined the medium- and long-term goals for the development of the economy and 11 key sectors.

Economic Outlook

Azerbaijan's economy is likely to experience another year of negative growth in 2017 despite the anticipated recovery of oil prices, as oil production is not expected to increase and the non-oil sector continues to be affected by the Government's spending cuts and the banking sector distress. However, output is projected to expand from 2018 onward, supported by the acceleration of oil GDP as the Shah Deniz gas field begins production.

Non-oil sector growth will remain weak, as the Government is set to keep a tight stance on both fiscal and monetary policies to safeguard macroeconomic stability, and the banking sector slowly regains strength to support the private sector. Inflation will abate due to limited liquidity on the market and will hover at about 5% a year. Meanwhile, there will be a notable improvement in the consolidated fiscal position over 2017–19 as a result of envisioned spending consolidation.

Current conditions do not appear conducive to significant poverty reduction. Although recent efforts to step up social spending should help alleviate poverty, constrained private sector growth could have a negative impact on the poor.

Risks to growth and poverty reduction remain high. The immediate challenge for the Government is to minimize the impact of the planned fiscal consolidation on growth and safeguard spending to protect the poor.

Another challenge going forward is to restore public and investor confidence, which requires bold reforms that accelerate banking sector resolution and improve the business environment—and the Government's transparency and effectiveness in communicating these policies.

Project Spotlight

In 2008, the Government of Azerbaijan invited the World Bank to help implement an ambitious response to the development challenges facing the Absheron Peninsula that surrounds the capital city of Baku. Poorly managed solid waste was a highly visible environmental issue.

The smoke from the Balakhani landfill, the main dump site for greater Baku, could be seen from far away. Outside the central city, informal dump sites were numerous, especially in the new settlements with inadequate service coverage and quality. The rapid population growth across the peninsula exacerbated the solid waste problems.

The Integrated Solid Waste Management Project was designed to assist in improving solid waste disposal management, increasing waste collection coverage, and enhancing waste data information and financial management capacity in the Greater Baku area. The project is a highly successful operation in Azerbaijan with several notable achievements:

- Waste disposal in the Greater Baku area has been significantly improved through the reorganization of waste collection, transportation, and disposal. The core landfill that serves the Greater Baku area has been transformed from an open uncontrolled dump site into a modern sanitary landfill with leakage collection and treatment and methane gas collection.
- The entire waste collection system in Greater Baku, particularly in underserved districts, has been improved.
- The Greater Baku Solid Waste Management Strategy and the Sector Policy Note have been prepared.
- The project helped to clean more than 50 large illegal dump sites located on Absheron peninsula, contributing to land regeneration in the Greater Baku area.
- The project helped to establish the new solid waste management agency for Greater Baku (Tamiz Shahar) and to build up its capacity through broad technical assistance.

Current and future engagements are expected to improve the environmental conditions in the regions and outline the elements needed for a sustainable and efficient solid waste management system in Azerbaijan.



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