Azerbaijan’s Rapidly Aging Automotive Fleet

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The “golden decade” of oil wealth in Azerbaijan (2005-2015) was also marked by the rapid growth of the country’s automotive fleet (i.e. the total number of cars in the country). Between 1990 and 2000, the number of passenger vehicles increased by 27% (72,000) to 332,000. In 2005-2015, however, it increased by 2.4 times (650,000) bringing the total number of passenger vehicles to 1.130 million. While in 1990-2000, the number of passenger vehicles in the country increased by 7,000 per year on average, the same indicator for 2005-2015 was 65,000. After 2014, there was an abrupt slowdown in the growth of the automotive fleet. For comparison, in 2015-2018 the number of passenger vehicles grew by 70,000—an increase of 17,500 per year on average. In 2010-2014, however, the automotive fleet grew on average by 70,000 annually—or nearly 300,000 units in four years. This article will address the possible causes of the slowdown after 2014.

The End of the Cheap Dollar Era

One of the negative economic effects of oil and gas money was the strengthening of the national currency, the manat (AZN), as a result of which imports of every sort, including automotive imports, became affordable for everyone. While the cheap dollar destroyed local production, it made it possible to import consumer goods produced abroad at an affordable price. Consumers could pay less than 8,000 AZN for an imported car worth 10,000 USD. In 2015, the situation changed drastically when the manat lost nearly half its value—for the same car, consumers now had to pay almost twice as much in manats. The end of the cheap dollar era meant an end to cheap automotive imports as well. While in 2014, the cheapest new car cost about 15,000-16,000 AZN, today at car dealerships the price of an equivalent car is not less than 24,000-25,000 AZN.

The Worsening Social Situation

However hard the population's income statistics try to show that the devaluation of the manat, the high inflation caused by it, and the economic recession have had no serious impact on the social conditions of the population, an analysis of the national accounts statistics reveals a different picture. According to those statistics, every year until 2015, households enjoyed a surplus on average of 1.2-1.5 billion USD after consumption and those funds were put towards accumulation (in the form of finances or property). In 2015, the situation changed abruptly. According to national accounts statistics, the population's current incomes did not cover their consumption, so households had to use their savings from previous years to meet their basic needs.

As a result, in 2015-2016, not only did households have no surplus from their current incomes, but over those two years they were actually forced to spend 2 billion USD of their savings from previous years just to cover current consumption (the corresponding statistics for 2017 and 2018 have not been released yet). Whether in the form of personal property, real estate, or financial instruments, accumulation obviously occurs in times when people have the opportunity to save. In short, declining household wealth cannot be ignored as a factor in the abrupt end of the rapid growth of the automotive fleet.

Restrictions on Auto Loans

One of the restrictions on the banking sector, which was devastated by the currency devaluation, has reduced banks' ability to provide consumer loans (debt-to-income ratio, loan-to-value ratio, etc.), particularly auto loans. It is enough to point out that, at the end of 2014, the amount of loans received by households was 7.8 billion AZN, while at the end of 2016 it was 5.8 billion, and at the end of 2017 it had fallen to 4.6 billion AZN. At present, the total amount of loans received by households is 5 billion AZN.

In September 2017, media reported that out of every 100 new cars purchased in Azerbaijan before the crisis, at least 70 were bought on credit. By the time of that report, however, only 1 out of every 5-6 banks in the country continued to issue car loans. A sharp reduction in lending on the one hand, and severe restrictions on consumer loans on the other, should be considered one more cause of the drastic reduction in the growth of the automotive fleet.

Rising Taxes

Since 2014, the government of Azerbaijan has been steadily raising taxes on automotive imports, mainly by raising excise duties. This is clearly illustrated by two different examples from the Tax Code:

- Until 2014, the excise duty on the import of an automobile with up to a 2000cc engine was 0.15 AZN per cubic centimeter. The amount increased to 0.20 AZN in 2014, and then to 0.30 AZN starting this year (2019). That is a 2-fold increase in 5 years;
- Until 2014, the excise duty on an automobile with a 3000cc engine was 300 AZN plus 1 manat per cubic centimeter between 2001-3000. In 2014, these amounts increased to 400 AZN and 1.5 AZN respectively, and from 2019 to 600 AZN and 5 AZN. If you had to pay 1,300 AZN in excise duties to import a car with up to a 3000cc engine in 2013, it would now require around 5,600 manat. The cost has increased by about 4.5 times.

In the case of customs duties for imported cars, according to the Cabinet of Ministers' decision #500 from November 17, 2017, called "On the approval of the goods nomenclature of foreign economic activity, import customs duty rates and export customs duty rates," customs duties apply to passenger vehicles according to engine capacity, the type of fuel they use, and their purpose. According to the decision, the import duties will be 0.40-1.20 USD per cubic centimeter of engine capacity depending on the type of fuel it uses, reaching 15% of the import value for certain passenger vehicles. For example, the excise duty for a passenger vehicle with the code 870322 and a 1500cc engine is 450 AZN, and the import duty is 1,785 AZN (0.70 USD per cubic centimeter).

Keep in mind that VAT is calculated after adding excise duties to the import value. For example, in 2013, when importing a car with an invoice value of 10,000 AZN, VAT was calculated based on that value plus excise and import duties, or an import value of 13,000 AZN, but today for a car of the same invoice value and engine capacity, VAT would be calculated based on an import value of at least 17,000 AZN. In other words, the 4.5-fold increase in excise duties on a typical motor vehicle with an engine capacity of up to 3000cc has the effect of increasing the VAT by nearly 30%. For example, there is a difference of over 700 AZN between the amount of VAT paid in 2013 for the import of a car with a 3000cc engine and an invoice value of 10,000 AZN, compared to the VAT paid for a car with the same engine capacity and invoice value today.

If that same vehicle's invoice value is 10,000 AZN, based on the above calculations of import and excise duties, the VAT charged to the importer will be about 2,300 AZN. For a passenger vehicle with a 1500cc engine and an invoice value of 10,000 AZN, customs taxes and duties would come to about 4,800 AZN (approximately 50% of the vehicle's value). If customs officials reject the invoice value and use a minimum price control, there is a risk that the tax burden on the imported automobile could rise by 55-60%.

Azerbaijan's Place in the World Rankings for Cars Per Capita

There may be some who disagree with the 4 arguments above related to the abrupt slowdown in the expansion of Azerbaijan's automotive fleet, and who propose entirely different arguments. For example, one opposing argument might be that in 10 years the country's passenger vehicle fleet expended enough, the market was saturated, and the demand was met.

We do not have any surveys or research to give accurate figures on how many people actually need a car, but have not been able to meet this need for the last four years for the reasons listed above. But throughout the world, there is a widely used benchmark to measure this—specifically the number of cars per 1,000 people. Currently, the number of cars per 1,000 people in Azerbaijan is about 140. However, in some countries this indicator is very high. For example, this figure in Europe is 587: over 700 in Italy and above 600 in Spain and Germany. In Romania, which has the smallest index, this figure is 324, about 2.5 times higher than Azerbaijan. Among the neighboring countries, in Russia this figure is 310.

Inside Azerbaijan, however, the difference between regions is quite large. In particular, the number of cars per capita in Baku is 3-4 times higher than in other regions. From this point of view, the argument that the rapid slowdown of the expansion of the automotive fleet resulted from meeting demand and saturating the market is weak.

Undesirable Results

But the problem is not just whether or not the fleet grows. A more serious problem is the rapid aging of the Azerbaijani automotive fleet. Unable to renew itself due to high prices, taxes, and credit restrictions, the relative weight of old cars in the automotive fleet is growing. For example, if in 2014, 17% of all passenger vehicles were 5 years old or less, in 2018 that figure dropped to 6%. Instead, the share of cars 10 years old and over increased from 62% to 77%. In absolute figures, in 2014 the number of cars 5 years old or less was about 187,000, and in 2018 it fell to 72,000.

Unfortunately, the design of Azerbaijani statistics is unprofessional and uninformative. Therefore, it is not possible to calculate the average age of cars. If it were, it would be easy to make international comparisons. For example, according to a study by Galt & Taggart, the average age of cars in Georgia is 20.3 years, in Lithuania—15.5, in Russia—13.1, in Poland—17.3, and in Ukraine—19.6. At the same time, about 5% of all cars in Georgia are 5 years old or less.

The situation is a source of serious concern for the Azerbaijan Automobile Dealers Association. At their meeting 2 months ago, it was proposed to toughen restrictions on the import of old cars, to restrict based on their year, to provide incentives and discounts for new cars, and to facilitate their import. As a side note, in Azerbaijan the government is also extremely passive in terms of importing environmentally friendly cars and takes a position inadequate to meet the demands of our time. Hybrid cars are subject to all the same import taxes and duties as cars with internal combustion engines. Although electric cars are exempt from excise duties and VAT, they are subject to a 15% import duty. Under the current conditions, a legal basis must be created for tax- and duty-free imports of both hybrid cars and electric vehicles. At the same time, the government should set targets to increase the share of electric cars in the fleet over the next 10-20 years.