

Pandemic 2020: Key Outcomes for Azerbaijan's Economy

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The year 2020 has already entered history as a year of a global pandemic, almost half of which was spent under a strict quarantine regime. No crisis has hit the world economy so hard since the depression of the 1930s, not only because it was an unexpected event that caught economies off guard, but also because the crisis came from outside the economy – from the health care system. Under quarantine requirements, normal, healthy, operational businesses with no financial problems were forced to stop, suspend production (services), and lay off employees. Over the past year, governments have been able to adapt to crises from both the manufacturing sector (low demand or excess supply) and the financial sector (liquidity or debt problems, bubbles, the emergence of large-scale risky assets as a result of speculative transactions over a long period of time, etc.). What are the most important challenges and weaknesses for the economy?

The main social problems

Undoubtedly, the most serious consequence of the economic downturn was the large-scale increase in unemployment. For many years, official propaganda has claimed that unemployment is not a problem in Azerbaijan at all, and some years official statistics have shown an unemployment rate not exceeding [4-5%](#), but in a deep crisis it became immediately clear that it was impossible to hide the problem. [The Action Plan](#), approved by the Cabinet of Ministers on April 4, 2020, provided for the allocation of assistance to people who had lost their jobs. According to the Ministry of Labor and Social Protection of the Population, 600,000 low-income people were identified as unemployed and informally employed after losing their jobs under the special quarantine regime, and a total of [228](#)

[million AZN](#) was allocated for lump-sum payments to them for April-May. However, according to [the data](#) on the labor market published by the State Statistics Committee (SSC) last year, in 2010-2019, the number of unemployed officially registered with state employment agencies was 81,300, the number of people receiving unemployment benefits was 6,900, and the number of people considered unemployed based on the methodology of the International Labor Organization did not exceed 258,000. In this context, the government's use of a phrase such as: "600,000 low-income people have been identified who are working informally after losing their jobs," is an official acknowledgment that the pandemic has created a very serious unemployment problem in Azerbaijan. In addition, the data published in the monthly socio-economic [bulletins](#) prepared by the SSC shows that compared to the beginning of 2020, the number of people identified as unemployed by the SSC increased by 114,000, or 45.2%, from 252,000 to 366,000.

However, it should be noted that the current official mechanisms in Azerbaijan are unable to detect the real level of unemployment. One of the main reasons is that, in Azerbaijan, the number of employees with a formal contract and who pay unemployment insurance is a very small part of the total economically active population. For example, according to [the statistics](#) of the International Labor Organization, currently 85-90% of the workforce in developed countries (Germany, USA, Norway, etc.) is covered, as employees, by unemployment insurance and can register as unemployed when faced with a potential risk. According to the same statistics, the corresponding figure is about 32% in Azerbaijan. Another important reason is that there are a large number of people working legally in Azerbaijan whose legal status does not allow them to be covered by unemployment insurance or to be recognized as unemployed. Articles 220.5 and 220.10 of the [Tax Code](#) define a large group of employees as able-bodied persons engaged in entrepreneurial activities. [The Law on Unemployment](#)

Insurance does not include this group of unemployed people in the scope of unemployment insurance because they do not work based on an employment contract. Although these people are engaged in individual activities as freelancers, the social risk they constantly face is real. This group of workers includes drivers who provide individual passenger and cargo transportation services; people who provide music services; individual household services (shoemakers and cobblers; individual photo and audio-visual services; repair of watches, televisions, refrigerators and other household appliances); domestic help in private homes and apartments; nannies; personal drivers; housecleaning; gardeners; cooks; security guards; food service waitstaff serving customers; painters in workshops; and hairdressers. During the pandemic, people working in almost all of these occupations had to cease operations in accordance with the requirements of the strict quarantine regime. However, the current legislation did not recognize them as unemployed.

For the two reasons mentioned above, it was impossible to determine the real scale of unemployment during the pandemic. However, the fact that the number of unemployed increased by more than 45% in just 10 months demonstrates how critical the situation is and reflects the real growth dynamics of unemployment.

Along with unemployment, it is crucial to understand how the pandemic affects the scale of poverty. It is extremely important to accurately determine the real scale and causes of poverty, especially in order for responsible and professional management to formulate risk-sensitive social policies. Within 3-4 months after the declaration of the pandemic, poverty could have been measured rapidly through surveys of all the regions of Azerbaijan and social policy could have been adjusted based on the results. It should be noted that the SSC states that the nominal income per capita decreased by 2% in 11 months, and inflation was 2.8%. This means that the nominal income of the population actually decreased by about 5%. This

is not a small reduction and is a factor that directly affects the growth of poverty. (Unfortunately, data on the level of poverty in the regions and cities of Azerbaijan is not open to the public at all, and the indicator for the country overall is not disclosed in a timely manner.)

One of the areas of concern in social policy this year has been health. The health care system was caught unprepared for an unexpected crisis – in the sense that it was not yet possible to transition to an insurance system that provides quality and affordable health care for everyone. As a result, a significant proportion of people infected with the COVID-19 virus were completely excluded from the state health care system. People in difficult situations used the very expensive testing services of private laboratories, bought all the medicines necessary for treatment, and used the services of doctors they found through private channels at their own expense. The consequences of the inability of a large part of the population to get tested and treated on time have become clearer since early November: the number of deaths from the virus suddenly increased by 7-8 times compared to the previous 3-4 months. In December, the daily mortality rate (40-45 on average) remained stable. However, there has been a significant increase (almost double) in state health expenditures. According to the latest statistics released by the SSC in its monthly socio-economic [bulletins](#), health expenditures in the first 10 months of 2020 amounted to 1.395 billion AZN, compared to 739 million AZN in the same period last year.

Macroeconomic conditions

[In the first 11 months of 2020](#), the GDP decreased by 4.3% overall, including a 2.9% decrease in the share of the non-oil sector, and a 6.5% decrease in the share of the oil sector. The growth rate in the agricultural sector, which provides income and employment for almost a third of the population, fell to its lowest level in recent years. For example, in 2019

the crop segment grew by more than 11%, while in the first 11 months of this year that figure fell to 1%. Meanwhile, freight turnover decreased by 20%, passenger turnover by 40%, and capital investment in non-oil sectors by 11%.

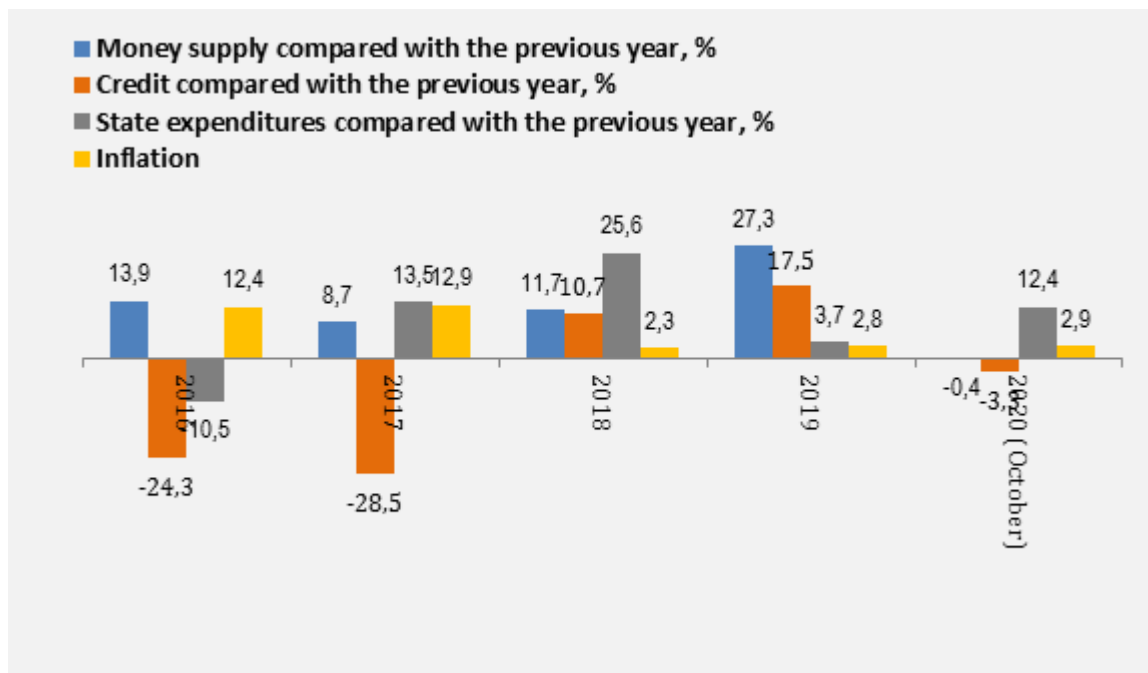
There was no decrease in foreign exchange reserves, which serve as a guarantee of macroeconomic stability. (However, the latest data is for the end of September, and the results of the last quarter of the year will have a decisive impact on this figure.) According to the latest [report](#) released by the Oil Fund, its assets decreased by only 0.08% (86.6 million USD) compared to the beginning of the year. In fact, thanks to the increase of about 233 million USD in the reserves at the disposal of the Central Bank, it was possible to increase the country's [total strategic foreign exchange reserves](#) by about 150 million USD. Although the favorable price situation in the world stock and gold markets prevented a depletion of the Fund's assets, the government's increased spending on anti-crisis measures, as well as the sharp decline in world crude oil prices, led to a large budget deficit. According to the outcomes of the third quarter of 2020, the budget deficit of the Oil Fund amounted to 2.453 billion AZN (about 1.5 billion USD). The deficit was mainly the result of declining revenues. According to the [Fund's report](#) on the first 9 months of 2019, revenues for the same period this year amounted to 8.122 billion USD, less than half of the 2019 figure. The increase in expenditures was 1.366 billion AZN (17.7%).

Despite the severe conditions of the pandemic, the government was able to maintain stability in the state budget. According to the outcomes of the first 11 months of 2020, state revenues amounted to 22.241 billion AZN, an increase of 1.109 billion AZN (5.2%) compared to the same period last year. However, this increase did not come from business or citizen taxes, but from transfers from the Oil Fund. Budget statistics for the first 9 months show that the amount of transfers from the Fund to the state budget compared to 2019 grew by 1.316 billion AZN (18%). This increase made it possible to compensate for the

reduction in tax revenues and maintain a budget surplus (78.2 million AZN). For example, if we compare the outcomes of the first 10 months based on [SSC data](#), the revenues from basic taxes (VAT, profit, excises, road, land taxes, simplified tax, etc.) decreased by 166 million AZN, in addition to a decrease of 376 million AZN [in customs revenues](#). But one important point must be taken into account: assessing the state of the Azerbaijani economy on the basis of fiscal indicators during periods of short-term crisis can lead us to erroneous analytical conclusions, because the current political and economic governance and the major role played by monopoly companies make it possible, in times of crisis, to attract resources to the budget mainly through unwritten rules, rather than written ones. In this sense, in the short-term assessment of the macroeconomic situation in Azerbaijan, it is more useful to follow monetary variables and foreign economic relations than fiscal indicators.

The economy has seen a sharp decline in the money supply from the Central Bank throughout the year. Although the monetary base in AZN decreased by more than 10% (about 1.2 billion AZN) in the first period (April-May) of the strict quarantine regime compared to the end of 2019, it began to return to its previous level [in the second half of 2020](#). However, at the end of October, the monetary base in AZN amounted to 12.104 billion AZN, which is 0.4% less than at the end of last year. To make things clearer, keep in mind that the monetary base grew dynamically in 2015 following the slowdown in the Azerbaijani economy, influenced by the sharp depreciation of the national currency and a sharp drop in crude oil prices on world markets. This growth was accelerated on the one hand by double-digit inflation in the economy as a result of devaluation, and on the other hand by a significant increase in loans and state expenditures.

Factors affecting the money supply in the economy over time



This graphic shows that the end of high lending in 2017-2019, and a 3.3% decrease in loans as a result of declining economic activity during the year, also limited the money supply from the Central Bank in the economy. In 2019, against the backdrop of a sharp slowdown in fiscal expansion compared to previous years, the growth of the monetary base at a very high rate (27.3%) coincided with a period of 17.5% growth in lending. This fact confirms that credit issuance is a more decisive factor in increasing the demand for money in the economy than fiscal expansion.

Another source that reflects the macroeconomic conditions of the pandemic year, as well as the economic losses, is the balance of payments. The balance of payments during a reporting period (quarter, half year, year) is a system for the statistical accounting of the economic relations between residents and non-residents based on commodities, services and financial instruments. The final balance of the current account reflects whether residents have either gained or lost against foreign entities in the current economic situation. When the balance is negative during a reporting period, that means the national economy has suffered losses, and when the balance is positive, the national economy profited more from its relations with residents. The balance of payments as a

whole allows us to assess how attractive the economy is to capital. According to the Central Bank's latest [statistics](#), for the first time since 2016, in the first 9 months of 2020 Azerbaijan had a deficit in the current account balance (208.3 million USD). Meanwhile, that deficit did not go unnoticed in the financial account, where there was a deficit of 2.106 billion USD. Overall, in the payment account's 9-month totals, there was a negative balance of 1.804 billion USD (a decrease in Azerbaijan's total reserve assets).

Despite the negative balance of payments, the government was able to maintain the exchange rate of the manat against the dollar throughout the year (1 USD = 1.7 AZN). However, the Central Bank's [data](#) shows that the manat has nominally appreciated against the currencies of a number of important foreign economic partners. The highest appreciation of the real exchange rate of Azerbaijan's national currency since the devaluation of 2015 occurred in the last 10 months. In 2020, the real exchange rate of the manat in the non-oil sector rose by 6.6%. The real appreciation of the national currency is a negative process and reduces the competitiveness of the local economy. The manat gained 31.5% against the Turkish lira, 22.2% against the Belarusian ruble, 19.5% against the Russian ruble, 18.9% against the Ukrainian hryvnia, and 15.1% against the Georgian lari.

As in every other country, 2020 is coming to an end under difficult economic conditions for Azerbaijan. The recovery of the global economy next year will primarily depend on how soon the pandemic ends. There are other serious challenges for the Azerbaijani economy: it is extremely important not only to find resources, but also to use them efficiently and transparently for the reconstruction of the newly liberated territories. It is clear that the economy cannot move to a qualitative stage of development without the necessary institutional and structural reforms. Will there be the will to make these reforms in 2021? We will find out very soon ...