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**FINANCIAL STABILITY IN AZERBAIJAN**

**Abstract**

Key indicators for assessing the fiscal sustainability of Azerbaijan's financial system using econometric methods:

1. Budget balance indicators

- Budget deficit / GDP – the difference between revenues and expenditures.
- Primary budget balance – the fiscal outcome after excluding interest payments.
- Structural budget balance – calculated by excluding cyclical factors and one-off revenues.

2. Public debt indicators

- Total public debt / GDP
- External and domestic debt / GDP
- Interest payments / budget revenues

3. Budget revenues and expenditures

- Tax revenue to GDP ratio
- Oil and non-oil revenues / GDP
- Expenditure structure (investment, social spending)

4. Impact of oil revenues

- Transfers from the State Oil Fund / budget revenues
- Volatility of oil revenues
- Non-oil budget deficit – one of the key indicators of Azerbaijan's fiscal sustainability

Approach

5. Macroeconomic indicators

- GDP growth rate
- Inflation
- Exchange rate stability
- Export–import indicators (especially in the oil sector)

Findings

Econometric models

- ARDL model
- VAR model
- Debt sustainability tests

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## Introduction

There are several major challenges in ensuring fiscal sustainability in Azerbaijan. These challenges have both structural and institutional characteristics and affect the country's macroeconomic stability, the effectiveness of budgetary policy, and long-term economic development. The main issues in this area are summarized below [5]:

1. High dependence of budget revenues on oil
  - A significant share of the state budget is still formed from revenues generated by the oil and gas sector.
  - Volatility in global oil prices puts fiscal stability at risk.
  - The tax base in the non-oil sector is not sufficiently broad.
2. Weak development of non-oil revenue sources
  - The taxation base in the non-oil sector remains limited.
  - The shadow economy and informal employment are widespread, reducing budget revenues.
  - Tax evasion and weak tax discipline constrain fiscal income.
3. Low efficiency and transparency of expenditures
  - Inefficiencies, wasteful spending, and sometimes corruption are observed in the use of budget funds.
  - Systems for evaluating and monitoring project-based expenditures are underdeveloped.
  - Mechanisms for transparency and public accountability are weak.
4. Growing social commitments
  - Government social expenditures (pensions, social benefits, etc.) increase every year, strengthening fiscal pressures.
  - Financing these social commitments may pose a risk to long-term fiscal stability, especially in the context of demographic factors and unemployment.
5. Public debt management
  - Although the level of public debt remains manageable, declining oil revenues and rising expenditures may increase borrowing needs.

- Risks related to servicing external debt grow, particularly in the context of exchange rate fluctuations.
6. Weak implementation of fiscal rules
    - The absence of stable and transparent fiscal rules (or inconsistent implementation of existing rules) undermines fiscal sustainability.
    - The institutional foundations for medium- and long-term fiscal frameworks and forecasting are weak.
  7. Interregional fiscal inequality
    - There are disparities in the balance of revenues and expenditures across regions.
    - Low levels of fiscal autonomy in local areas increase the burden on the centralized budget [1].

## Purpose

One of the main priorities for ensuring fiscal sustainability in Azerbaijan is the development of the non-oil sector, strengthening fiscal discipline, increasing the efficiency of public expenditures, and ensuring transparency. At the same time, medium- and long-term fiscal planning systems should be established, and fiscal risk management must be strengthened [4].

Below are realistic and practical solutions to the key challenges in Azerbaijan, including high dependence on oil revenues, underdeveloped non-oil revenues, inefficient expenditures, increasing social obligations, public debt management, weak implementation of fiscal rules, and interregional fiscal inequality [6]:

1. Reducing Dependence on Oil. Solutions:
  - Promoting the development of the non-oil sector – increasing support for non-oil areas of agriculture, tourism, information technologies, logistics, and industry.
  - Limiting the use of oil revenues – imposing restrictions on transfers from the State Oil Fund to the budget and accumulating more revenues in strategic and stabilization funds.
  - Reducing the sensitivity of public spending to oil prices – budget planning

should be based on baseline scenarios independent of oil price volatility.

2. Increasing Non-Oil Revenues. Solutions:

- Improving tax administration – implementation of electronic tax systems and combating the shadow economy.
- Developing small and medium-sized enterprises (SMEs) – tax incentives, technical and legal support mechanisms.
- Incentives for the innovation and technology sector – tax support for new products and services.
- Providing incentives and simplified tax regimes to legalize unregistered business activities.

3. Increasing the Efficiency of Budget Expenditures. Solutions:

- Result-based budgeting – expenditure mechanisms based on the implementation and outcomes of state programs.
- Strengthening public oversight and auditing – expanding the powers of the Chamber of Accounts and independent audit mechanisms.
- Full implementation of electronic procurement systems – platforms necessary for transparency and competition.
- Conducting efficiency analyses of public investment projects – economic and social impacts must be evaluated prior to implementation.

4. Managing the Growth of Social Obligations. Solutions:

- Targeted social assistance and pension systems – expanding need-based assistance mechanisms.
- Labor market reforms – reducing informal employment to increase contributions to social funds.
- Actuarial assessment of pension and social assistance systems – mechanisms aimed at long-term sustainability.

5. Sustainable Public Debt Management. Solutions:

- Implementation and oversight of medium- and long-term debt strategies.
- Promoting borrowing through domestic markets – using domestic debt

instruments to reduce foreign currency risks.

- Directing new borrowings towards investment-oriented and revenue-generating areas.
- Applying strict criteria for borrowing – limits based on indicators such as the debt-to-GDP ratio and debt service capacity.

6. Strengthening Fiscal Rules. Solutions:

- Legally anchoring fiscal rules and making their amendment more difficult – creating a stable framework to safeguard fiscal discipline.
- Applying accountability mechanisms in cases of rule violations.
- Ensuring that transparent budget data is publicly accessible – increasing public oversight and accountability.

7. Reducing Interregional Fiscal Inequality. Solutions:

- Developing the fiscal potential of regions – expanding the local tax base and providing technical support to increase tax collection.
- Targeted state programs for regions – improving infrastructure, education, healthcare, and the investment climate.
- Fair and transparent application of fiscal transfer mechanisms – distributing financial support based on needs and outcomes.
- Strengthening local self-governance – granting greater authority in forming local budgets.

Final Recommendations:

- Fiscal policy should be designed to ensure long-term and sustainable economic growth.
- Strengthening the non-oil sector is a key condition for economic and social stability.
- Digitalization, transparency, and public oversight are essential for successful fiscal reforms [2].

### **Approach**

Ensuring fiscal sustainability within the financial system of the Republic of Azerbaijan is one of the key priorities of the country's public financial policy. Fiscal sustainability

refers to the ability of the state to maintain budgetary stability over the long term, manage its debt burden effectively, support macro-economic stability, and create conditions for sustainable economic growth. The main directions in this regard are outlined below [7]:

1. Enhancing the efficiency of fiscal and tax policy

- Expanding the tax base and reducing the shadow economy.
- Digitalizing tax administration (e.g., e-invoices, online cash register systems).
- Optimizing tax exemptions and eliminating inefficient tax privileges.
- Prioritizing public expenditures and reducing inefficient spending.

2. Public debt management

- Maintaining the ratio of external debt to GDP at an acceptable level.
- Aligning debt obligations with long-term financing capacities.
- Increasing reliance on the domestic financial market for borrowing.

3. Reducing dependence on oil revenues

- Aligning the use of the State Oil Fund's resources with sustainability principles.
- Implementing fiscal rules (e.g., expenditure limits based on the baseline oil price).
- Diversifying budget revenues through the development of the non-oil sector.

4. Implementation of fiscal rules

- Strengthening the "fiscal rule" to protect budget expenditures from sharp oil price fluctuations.
- Preparing medium- and long-term fiscal forecasts and securing parliamentary approval.
- Enhancing transparency and accountability mechanisms.

5. Balancing social and investment expenditures

- Aligning social commitments in the budget with financial capacity.
- Prioritizing expenditures directed at infrastructure and human capital.
- Improving the social protection system through targeted and sustainable mechanisms.

6. Strengthening stability in the financial sector

- Ensuring the stability of the banking sector and reducing non-performing loans.
- Developing the securities market to expand public borrowing opportunities.
- Improving financial monitoring and fiscal risk management systems.

7. Digital and institutional reforms

- Strengthening electronic monitoring of public expenditures and open budget initiatives.
- Systematic accounting of fiscal risks (state guarantees, state-owned enterprises' debt, demographic burden).
- Expanding the powers of the Chamber of Accounts and other oversight bodies.

Ensuring fiscal sustainability in the Republic of Azerbaijan is mainly linked to efficient tax–budget policy, effective management of public debt, reduction of dependence on oil revenues, strengthening fiscal rules, and the implementation of transparency mechanisms. These measures not only help maintain long-term financial stability but also support economic growth [3].

**Results**

Ensuring Azerbaijan's fiscal sustainability is of critical importance for the country's long-term economic stability and development. The analysis demonstrates that the main challenges affecting fiscal stability — the budget's dependence on oil revenues, limited non-oil revenue generation, inefficiencies in public expenditures, increasing social obligations, emerging risks in public debt management, inconsistent application of fiscal rules, and regional disparities — are structural and institutional in nature.

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## **AZƏRBAYCANDA MALİYYƏ SABİTLİYİ**

### **Xülasə**

Tədqiqatın məqsədi

Azərbaycanın maliyyə sisteminin fiskal dayanıqlığının ekonometriya üsulu ilə qiymətləndirilməsi üçün əsas göstəricilər:

1. Bütçə balansı göstəriciləri

- Bütçə kəsiri / ÜDM – gəlir və xərclər fərqi.
- İlk bütçə saldosu – faiz ödənişləri çıxıldıqdan sonra yaranan bütçə nəticəsi.
- Struktur bütçə saldosu – dövrü amillər və birdəfəlik gəlirlər nəzərə alınmadan hesablanır.

2. Dövlət borcu göstəriciləri

- Ümumi dövlət borcu / ÜDM
- Xarici və daxili borc / ÜDM
- Faiz ödənişləri / bütçə gəlirləri

3. Bütçə gəlirləri və xərcləri

- Vergi yığımlarının ÜDM-ə nisbəti
- Neft və qeyri-neft gəlirləri / ÜDM
- Xərclərin strukturu (investisiya, sosial)

4. Neft gəlirlərinin təsiri

- Neft fondu transfertləri / bütçə gəlirləri
- Neft gəlirlərinin dəyişkənliyi
- Qeyri-neft bütçə kəsiri – Azərbaycanın fiskal dayanıqlığı üçün əsas göstəricilərdən biri

Tədqiqatın metodu

5. Makroiqtisadi göstəricilər

- ÜDM artım tempi
- İnflyasiya
- Məzənnə sabitliyi
- İxrac-idخال göstəriciləri (xüsusilə neft sektoru)

Tədqiqatın nəticələri

Ekonometriya modelləri

- ARDL modeli
- VAR modeli
- Borc davamlılığı testləri

**Açar sözlər:** ÜDM (Ümumi Daxili Məhsul), bütçə kəsiri, dövlət borcu, İnflyasiya, fiskal davamlılıq.

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**Резюме**

#### Цель исследования

Для оценки фискальной устойчивости финансовой системы Азербайджана с использованием эконометрических методов применяются следующие основные показатели:

#### 1. Показатели бюджетного баланса

- Дефицит бюджета / ВВП – разница между доходами и расходами.
- Первичное бюджетное сальдо – результат бюджета за вычетом процентных выплат.
- Структурное бюджетное сальдо – рассчитывается без учета циклических факторов и разовых доходов.

#### 2. Показатели государственного долга

- Общий государственный долг / ВВП
- Внешний и внутренний долг / ВВП
- Процентные выплаты / бюджетные доходы

#### 3. Доходы и расходы бюджета

- Налоговые поступления к ВВП
- Нефтяные и ненефтяные доходы / ВВП
- Структура расходов (инвестиционные, социальные)

#### 4. Влияние нефтяных доходов

- Трансферты из Нефтяного фонда / бюджетные доходы
- Волатильность нефтяных доходов
- Ненефтяной бюджетный дефицит – один из ключевых показателей фискальной устойчивости Азербайджана

#### Метод исследования

#### 5. Макроэкономические показатели

- Темп роста ВВП
- Инфляция
- Стабильность обменного курса
- Показатели экспорта и импорта (особенно нефтяного сектора)

#### Результаты исследования

#### Эконометрические модели

- Модель ARDL
- Модель VAR
- Тесты устойчивости государственного долга

**Ключевые слова:** ВВП (Валовой внутренний продукт), дефицит бюджета, государственный долг, инфляция, фискальная устойчивость.

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