Azerbaijan Debates Dutch Disease

Author: Nurlana Gulieva

The oil-rich country discusses the economic impact of its sudden new wealth.
With the opening of the massive Baku-Tbilisi-Ceyhan pipeline this month promising to bring fabulous wealth to Azerbaijan, some are warning that the influx of revenue could also cause huge problems if not handled properly.

A grand ceremony was held in the Turkish Mediterranean port of Ceyhan on July 13 to mark the opening of the 1,760-kilometre, four billion US dollar BTC pipeline, giving Azerbaijani oil a new outlet to world markets.

The Azerbaijani International Operation Company, AIOC, which manages the pipeline, predicts that this year alone, revenues from the oil from the Azeri-Chirag-Guneshli fields will hit 2.8 billion dollars, based oil prices of 60 dollars a barrel.

Experts from BP-Azerbaijan estimate that the country's revenues will grow to twice the value of its gross domestic product if oil prices remain high for the next 10-12 years. They say the next 20 years will see Azerbaijan receive 140 billion dollars in revenues from the export of its energy resources.

Oil and petroleum products already account for 84 per cent of Azerbaijan's exports, and local experts say the figure is unlikely to diminish in the future. Herein, say economists, lie potential problems as well as benefits for Azerbaijan.

The oil dollars are already affecting the lives of ordinary citizens. According to statistics for the first six months of this year, incomes have increased by 19.6 per cent from a year ago, with the average salary worth 135 manats (about 150 dollars), an increase of more than a fifth in one year.

But prices have been rising, too. Arif Veliev, head of the state statistics department, said the overall inflation rate was no more than six per cent in the last year, but some foods have doubled in price this summer. Even fruit and vegetables, abundant in southern Azerbaijan, cost 30 per cent more than they did last year.

“One reason for inflation is the large amount of money in circulation,” the chairman of Azerbaijan's state securities committee, Gunduz Mamedov, told journalists this week. “As oil revenues grow, there will be more ‘excess’ money, which is why the government is already working out how to spend its additional money.”

The minister of economic development, Heidar Babayev, said the first symptoms of “Dutch disease” – in which an economy is distorted by over-reliance on one sector – were now evident in Azerbaijan, though he says the disease itself has been avoided so far. The term refers to the decline of the manufacturing sector in the Netherlands in the Sixties after natural gas was discovered.

Gubad Ibadoglu, director of the Economic Research Centre in Baku, says all four effects of Dutch disease can be observed in the Azerbaijani economy.

Firstly, he said, there is rising inflation and a strong national currency. In the first five months of this year, the manat appreciated by four per cent compared with the same period last year. “As a result, the country’s competitiveness on world markets has been decreasing,” he said.

Ibadoglu also cited other symptoms, pointing out that the energy sector is attracting all the best professionals from other sectors, and is the only area where there is investment in new technologies.

Government spokesman Oktai Akhverdiev disagrees. “There are five or six major branches of the Azerbaijani economy,” he said, citing engineering, the metals and food industries and agriculture. “Dutch disease appears in countries where only one sector is developed.”

Akhverdiev said the government has a long-term strategy for using oil revenues until 2025 and also set up an Oil Fund to hold and spend its revenues. By the end of the year the fund will be split into three divisions, or portfolios, each with different profiles.

The first will concentrate on spending. Currently, the fund allocates money to improve the housing conditions of refugees and internally displaced persons. It is also spending money on the BTC project and transferring some funds into the government budget.

The second portfolio focuses on stabilisation, and includes sums that will be used to fill a budget deficit should world oil prices fall short of the targets set by Azerbaijan. It can also be used to cope with the consequences of emergencies and natural disasters. Experts say the second portfolio should account for no less than three per cent of GDP.

The third is a special investment portfolio. The funds here will come from the difference between the oil prices projected in Azerbaijan’s government budget and the actual ones on the world market. This year’s budget estimated a price of 40 dollars a barrel, while the actual price has exceeded 75 dollars.

The government has rejected the idea of simply distributing the fund’s revenues among the population, as that would stimulate a short-term spending surge and high inflation.

“There are around two billion dollars accumulated in the fund,” said Finance Minister Samir Sharifov, who used to head the fund. “Dividing the sum by eight million people, we get roughly around 250 dollars per head. Let’s imagine that we gave it out to people. How would they use it? They’d immediately go shopping and spend it. That would lead to a shortage of goods, prices would soar, and inflation would become uncontrollable. So it’s better to invest the sum in the economy. That will be more beneficial.”

Another independent economist, Ingilab Ahmedov, says it is too early to say what the impact of the influx of money will be. He said Azerbaijan is “learning as it goes along – like any developing country” how to spend its new revenues.

“It’s important that the oil money should not be allowed to spoil the competitiveness of business, where there are certain rules of the game, tax rates, and so on,” he said. “That is frightening, and that is why I suggest that this money should be spent in small doses and targeted on certain investment programmes.”

Nurlana Gulieva is an economic journalist and IWPR contributor in Baku.

Location: Azerbaijan
Focus: Caucasus
