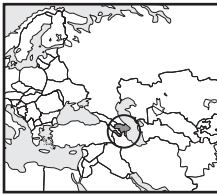


## AZERBAIJAN

# Oil wealth could meet social needs



Sixteen years after regaining its independence and moving to a market economy, Azerbaijan has yet to establish an adequate new system of social security. Large numbers of refugees and internally displaced persons create an even greater demand for social protection, while an ageing population is putting pressure on the pension system. The recent massive influx of oil revenues means the country can afford to meet social needs more effectively, but the share of state expenditure allocated to social spending remains highly insufficient.

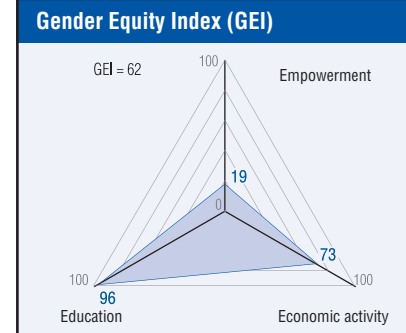
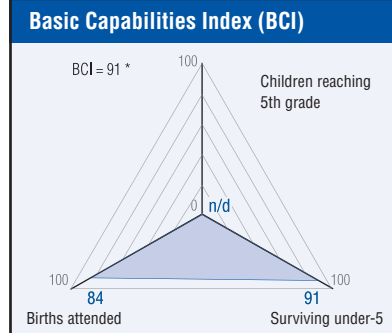
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Formerly a Soviet republic with a comprehensive state-financed social security system, Azerbaijan regained its independence 16 years ago and moved to a market economy, yet has been unable to establish an adequate new system of social protection. People who once had access to all essential goods and services (albeit mainly of low quality) must now confront the severe rules imposed by the market. The weakened role played by the state and the absence of a developed administrative infrastructure meant that in the post-Soviet era, the majority of the country's people were largely left to solve their socioeconomic problems on their own. It is only during the last few years that the state has taken significant steps towards ensuring the population's social security needs, but until now these have failed to provide a full solution.

Soon after regaining its independence, in the early 1990s, Azerbaijan was the target of Armenian military aggression which led to the capture of 20% of the country's territory. As a result, roughly one million Azeri citizens became refugees and internally displaced persons, forced to settle in new areas and cities. Today Azerbaijan has one of the world's highest per capita proportions of refugees and internally displaced persons, and it is expected that in 2007, social security expenditures targeted specifically to this sector of the population will amount to AZN 150 million (USD 164.3 million), more than 2% of total state budget expenditures.

Another challenge that has faced Azerbaijan in recent years as a result of a range of different factors – demographic composition, population/territory imbalance due to the military aggression, etc. – is the surplus labour force and consequent high unemployment rate. At present, one out of every three economically active Azeri citizens is working in the Russian Federation or other Commonwealth of Independent States countries, where they are welcomed as 'cheap labour'. Expatriate workers send home an estimated USD 1 billion a year, and these remittances are believed to comprise up to one quarter of the income of the average Azeri family.

Paradoxically, Azerbaijan has also begun to attract immigration as a result of the recent oil boom. The sudden influx of huge oil revenues has sparked fears of 'Dutch disease', particularly with regard to



such effects of this 'disease' as rampant inflation. The establishment of a State Oil Fund to redistribute oil wealth through the national economy is aimed at counteracting such negative impacts. Nevertheless, the sting of rising inflation rates is already being felt by the most vulnerable members of society: those with low incomes and without social security.

### Social protection expenditure: rising amounts, declining share

Between 2003 and 2007, budget expenditures on social security and social assistance programmes increased almost threefold, reaching AZN 612.8 million (USD 671.2 million) in 2007. From 2003 to 2006, the average annual increase in social security expenditure was 15% and represented the lowest rate of increase among all budget items. However, in 2007, social security expenditure increased by a whopping 79.5% over the previous year. Despite this impressive growth in the amount of money allocated, however, the share of budgetary expenditure represented by social spending tells a somewhat different story.

As can be seen in Table 1, the share of total budget expenditure allocated to social security and social assistance actually decreased from 16.8% in 2003 to 9.0% in 2006. Although this figure rose once again in 2007, to 9.7%, this is still a significantly lower share of budget expenditure than in 2003.

Social security and social assistance expenditure as a proportion of GDP also declined annually between 2003 and 2006, until rising in 2007 to come close to the 2003 figure, as illustrated in Table 1 and Figure 1.

\* One of the BCI components was imputed based on data from countries of a similar level.

During the last four years, 32% of the increase in social security expenditure, or AZN 127 million (USD 139.1 million), corresponded to an increase in pension expenditure, while 17.5% or AZN 70 million (USD 76.7 million) represented increased allocations to social security measures for refugees and internally displaced persons. The remainder was related to increased spending on various social assistance programmes and benefits targeting people with low incomes.

In 2003 the combined state expenditure on the four sectors considered to comprise 'social spending' in Azerbaijan – namely education, social security and social assistance, health care, and culture and the arts – totalled 43% of all budgetary expenditures. In the 2007 budget, however, the share of spending accounted for by these four sectors has fallen to 27.7%. In the meantime, the budget share allocated to investment expenditure has risen from 7.9% to 31%. In other words, more funds are being allocated to investments in 2007 than to the four major sectors that constitute social spending.

### Pension reforms aimed at financial sustainability

Pensions are financed from the budget of the State Social Protection Fund (SSPF). The revenues entering the SSPF budget in 2006 totalled AZN 590 million (USD 646.2 million) while expenditures totalled AZN 562 million (USD 615.5 million). The SSPF revenue sources are compulsory social insurance contributions paid by employees and employers and state budget transfers. These transfers decreased 10.2% in 2006 in comparison with 2005, but were subsequently increased 67% in the 2007 state budget. The SSPF main expenditures are so-called labour pensions for retired workers.

Pensions are currently regulated by the Law on Labour Pensions that was adopted on 7 February 2006. Workers are required to pay a mandatory social insurance contribution, which entitles them to old age pensions, disability pensions, or survivors pensions, paid to their families in the event of their death. For those who have never worked, the state provides 'social' old age, survivors and disability pensions.

Like many countries in the world, Azerbaijan is faced with an ageing population and thus an increasing proportion of pensioners. To confront this challenge, the Pension Reform Conception was approved on 17 July 2001 by presidential decree. The stated goal of pension reform is to develop a new pension system that is fair, financially sustainable and transparent, and in which the social services provided correspond to the level of participation of individuals in the social insurance system. The means of fulfilling this objective was the introduction of individual social insurance accounts.

The ultimate goal is to establish a multi-pillar pension system with three components. The first pillar is a pay-as-you-go (PAYG) system, based on intergenerational solidarity. In other words, the pension benefits paid out to retired workers are financed from the contributions of those who are currently working and their employers. The second pillar would be a defined contribution scheme, based on individual accounts, as opposed to the defined benefit scheme traditionally implemented in Azerbaijan, while the third pillar would involve voluntary private pension funds. Because the implementation of a multi-pillar system is a totally new undertaking for the country, it has sought the support of the United Nations Development Programme and other international organizations.

### Social insurance contributions finance wide range of services

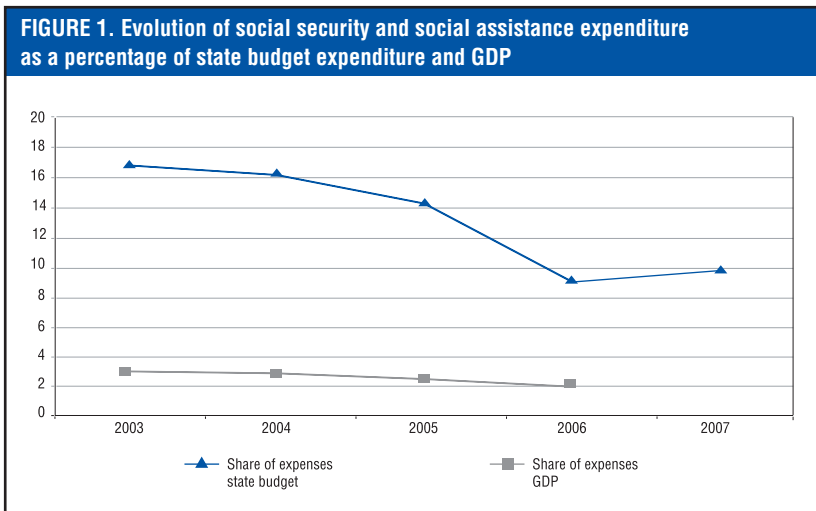
The social insurance contributions paid by employees and employers also help finance sickness and maternity benefits, temporary disability benefits, funeral grants, unemployment benefits and child care benefits, while government funding subsidizes these and other social protection measures.

The Ministry of Labour and Social Protection provides general oversight of social security services. Local branches of the Ministry are responsible for administering social benefits, while the SSPF collects and manages contributions and finances benefits.

The responsibilities of the SSPF include financing the following social security and social assistance benefits and programmes, among others:

- Social assistance for temporary work disability
- Social assistance during pregnancy and childbirth
- Social assistance for childcare for preschool children
- Full or partial payment of hospital expenses for insured individuals
- Implementation of employment activities

	2003	2004	2005	2006	2007
Amount of social security and social assistance expenditure (AZN million)	213.1	236.6	302.9	341.5	612.8
Increase in amount of expenditure compared to previous year (%)	12.1	10.8	28.3	11.9	79.5
Share of total budget expenditures (%)	16.8	16.1	14.2	9.0	9.7
Share of GDP (%)	3.0	2.8	2.4	1.9	2.8



- Implementation of social security measures for disabled persons
- Social assistance for funeral expenses
- Financing of social pensions with transfers from the state budget
- Social assistance for people with low incomes.

While there is no unemployment insurance system per se in Azerbaijan, monthly compensation benefits are available to some unemployed people. The number of unemployed people in the country on 1 October 2006, according to official statistics, was 54,700, which leads to an official unemployment rate of 1.4%. Of the total number of unemployed, 51.3% were women. Of the total number of people officially registered as unemployed, 5.2% (2,864) were receiving social assistance under the provision of the 2001 Law on Employment of the Population. The average monthly amount of social assistance paid for unemployment was AZN 53.5 (USD 58.6), which is equivalent to 36.3% of the average monthly salary of the working population in September 2006.

### Targeted assistance for vulnerable sectors

For the last two years the government has been implementing a system of targeted state social assistance to strengthen the social security of families with low incomes. This targeted assistance is financed from the state budget. It is provided to families whose total combined income is lower than the minimum living wage determined for the number of persons in the household, for reasons beyond their control, for instance, because of disabled family members, the

death of a family member, a family member considered lost or dead by the courts, imprisoned family members, or the absence of information on the location of a family member.

According to data from the first quarter of 2007, there were 45,527 families or 207,148 people receiving targeted social assistance, and 4,740 of them were families of refugees and internally displaced persons. At present, the average targeted assistance benefit payment is AZN 58.4 (USD 64) per family and AZN 12.80 (USD 14) per family member.

Despite the efforts made in recent years to bolster the social security system, including initiatives like the pension system reform, the need for institutional and financial reforms has not weakened. The country's vastly increasing financial opportunities as a result of the influx of oil revenues means it can afford to meet social needs in a more comprehensive manner. However, the state budget continues to lack an adequately social orientation. ■

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