

**THE MINISTRY OF EDUCATION OF THE
REPUBLIC AZERBAIJAN**

**Critique of Dutch Disease in transition
economies: Study on Oil Boom risks and
responding to policy reforms in Azerbaijan**

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INTRODUCTION

The availability of natural resources in a country is seen as an important source of prosperity for the country. After years of independence, Azerbaijan has drawn attention to the rich natural resources and world companies. Having rich oil and natural gas reserves, Azerbaijan is able to reach the world market as the resultant oil and natural gas. Azerbaijan has shown a generous economic growth root from oil boom in the course of the most recent quite a while. Proportion of oil division in general GDP has expanded from 30% to an over 60% amid the 2001-2007. Immense oil incomes, driven by high oil incomes and development the oil generation, have been the real wellspring of the enormous surge in government consumptions. The main part of these consumptions has been arranged to the non-tradable division of the economy in the types of framework and social tasks, which are extremely valuable for financial advancement of a nation.

Notwithstanding, the given boom in the oil division in parallel with the previously mentioned respectable framework and social improvement aims additionally has been joined by some negative patterns in the economy. As indicated by official measurements the offer of non-oil trade total export has diminished (expanded) from 52.5% in 2004 to 4.7% (95.3%) in 2008. The volume of non-oil trade has diminished by 26.5% amid 2004-2008. From opposite side, it gives the idea that mining has significantly higher offer in GDP in Azerbaijan than in other Oil Exporting Countries (OEC) of Commonwealth Independent States (CIS). For example, the offer of assembling (mining) in GDP was 5% (66%) in Azerbaijan, while 14% (18%) in Kazakhstan and 37% (8%) in Turkmenistan and 19% (7%) in Russia individually in 2006 (Egert, 2009). Additionally, Azerbaijan has the most noticeably bad

circumstance as far as spending of oil incomes, offer of oil incomes in government incomes and non-oil shortage in correlation with other OEC of CIS, for example, Kazakhstan and Russia (See Appendix). Oil incomes are motor for development in the non-tradable segment and the non-oil tradable part is vanishing step by step in the economy. The other basic issue is an energy about the genuine viable swapping scale which has acknowledged around 100% amid 2004-2008 . The fundamental result of the energy about genuine compelling conversion scale was undermining intensity of non-oil tradable parts.

A few original examinations, for example, Sachs and Warner (1997), Auty (2001), Gylfason (2001), Gylfason and Zoega (2002) demonstrate that the vast majority of asset rich nations have a tendency to develop slower than nations without normal assets and these economies experience the ill effects of various macroeconomic difficulties which are firmly identified with blasting part. This wonder wound up known as the "asset revile" and in such manner asset plenitude is by all accounts a revile instead of a gift for such kinds of economies. There are four principle clarifications of the asset revile, however the conventional approach in clarifying the asset revile was the Dutch Disease idea (Sturm et al., 2009). As indicated by Corden (1984) and Nearly Dutch Disease is the energy about a nation's genuine conversion standard caused by the sharp ascent in sends out and the propensity of a blasting asset division to draw capital and work far from a nation's assembling and agrarian parts, which can prompt a decrease in fares of rural and made merchandise and expand the cost of non-tradable products.

Since Azerbaijan is asset plenteous and there are some negative patterns identified with blasting part it is critical to break down the economy from Dutch Disease point of view. Along these lines, the target of this

examination is to research whether there are any side effects of Dutch Disease in the economy.

The rapidly growing Azerbaijani economy and significant income from oil and the exponential growth of the country have brought about the "Dutch Disease" risk, which is a comparison of foreign countries based on a single sector. Despite significant steps taken by the government against the Dutch disease, the "Dutch Disease" in the Azerbaijani economy was seen according to foreign economists and researchers

Chapter 1. Reasoning Dutch Disease in emerging economies

1.1. The Definition and Theoretical Framework of Dutch Disease

The exposure of natural resources or extreme money flow, as well as the export explosion in any sector, leads to the "Dutch Disease" risk. Dutch disease is a phenomenon that affects all macroeconomic variables in the long run, even if positive results occur in the first place.

1.1.1. Definition of Dutch Disease

Natural resources are seen as a potential source of prosperity because they are not evenly distributed on the earth. So it is seen as a very important target to find a new natural resource especially for underdeveloped countries. Relevant news, especially in terms of examples of metals and energy products, is that small reserves are seen as a key to enrichment in these countries, often with great enthusiasm. Having a rich reservoir in terms of natural resources in such countries is considered as a way of getting rid of the vicious cycle of poverty. Indeed, there are examples of countries that have abundant natural resources in the 1800s, and in the 1990s some oil-rich countries are rapidly enriched when compared to natural resource poor countries.

It is not easy to imagine that having wealthy natural resources can automatically provide economic development, albeit with relevant examples to influence the economy positively. Even the opposite results have been observed. Many studies on the economic performance of the rich countries in terms of natural resources have pointed out remarkable findings in this respect and it is stated that being rich in terms of natural resources may have negative effects. The "Dutch Disease" is used in economics to explain these negative effects in the economy. (Honey, 2011: 90)

The Dutch disease concept was first used in 1977 in The Economist magazine. This concept explains the fact that two sub-sectors expanding and narrowing within the goods-producing sector that are subject to commercialization exist in the economy as a whole. In the case of the Dutch disease, it is assumed that there are commercial and non-commercial goods groups and that it is not possible for both groups of goods to exist among themselves. As commodities are used in imports and exports, they are imported and sold in the international market. Therefore, international markets determine the price of commodities. Non-commercial goods are determined in national markets. When classified in another respect, the three sectors are at the forefront. These; sectors (agriculture, industry) subject to commercialization and sectors that are not subject to commercialization (health, education) "are sectors based on natural resources (mining, natural gas, oil, etc.). Sectors based on natural resources and sectors that are subject to commercialization are priced in the international market while sectors not subject to commercialization are priced in the national market. (Brahmbhatt et al. 2010: 3)

1.1.2. Theoretical framework

Natural resource rich countries show a lower economic growth than countries with natural resource problems. According to Manzano and Rigobon (2008), there is an inverse relation between natural resource wealth and wealth growth. There is a debate about whether underground resources are a disadvantage. The four most important discussions in these discussions are shown below.

1. Natural resource prices are always exposed to a volatile trend in the international market.
2. It is a splitting effect. The high profitability in the natural resource sector results in the other sectors of the natural resource sector falling out.

This outbreak is particularly acute in the agricultural and manufacturing sectors.

3. The determination of the prices of the natural resources sector in the international market is the result of fluctuations in the prices of these sectors, which can cause significant problems in the economy of the country.

4. The natural resource richness is to prevent the development of institutions by holding the income that countries obtain from natural sources from the government or a certain elite. (Arezki and Min, 2012: 3)

There are different views on Dutch Disease. According to Sachs and Warner (2001), the availability of natural resources in one country and the high share of the natural resources sector in exports lead to the Netherlands Disease. They also argue that resource-rich countries tend to be high-priced economies and that these countries are ignoring the growth driven by exports. According to Lederman and Maloney (2002), the export economy of natural resources can not always be adversely affected and can even lead to positive results. According to Tanja Broz and Dubravcic (2011), the amount of overpricing coming from the export of natural resources will increase the real wages in the country and cause the industrialization, and the economic growth will be negatively affected in these conditions. According to Matsen and Tovrik (2005), more conservation of resources reduces the risk of Dutch disease. They also argue that the revenues derived from the sale of resources from underground should not be regarded as income.

The classic economic model of the Dutch Disease was prepared by W. Max Corden and J. Piter Neary in 1982. This model is still regarded as the main model. According to the model, three conditions are searched for the Dutch Patient's life.

1. Increase in the share of the booming sector in exports

2. Overvaluation of the national currency
3. Other sectors lose competitiveness due to explosion of the passing sector

According to the model, three sectors are in the forefront in the Dutch diseases.

1. Natural resource or exploding sector
2. Existing export sector
3. Unexecuted products sector

In the case of the Dutch disease, the explosion-free sector and the non-exported sector are in a positive direction, contraction of the remaining export products sector due to resource and spending effects.

Possible economic changes in countries affected by the Dutch disease are: (Corden, 1984: 361)

1. Assessment of the overpayment of the national currency as a result of increased exports of the natural resource exploitation sector (oil).
2. Loss of competitiveness of the manufacturing sector resulting in the appreciation of the national currency and a decline in exports
3. The shrinking of the manufacturing sector leads to a decline in employment in this sector, the penetration of labor and capital as other sectors become attractive.
4. The economy becomes dependent on only one sector
5. Imbalance between demand and supply in the country. Importing of economy into imports
6. The possibility of fluctuations in world oil prices causing economic shocks

1.2. Macroeconomic Effects of Dutch Disease

When the Dutch disease is mentioned, the three sectors are at the forefront. These are the sectors (oil sector), sectors that are subject to trade (manufacturing sector) and sectors that are not subject to commercialization (health, education, service). While the prices of two of these three sectors (commodity sectors which are subject to petroleum and commercialization) are determined in the international market, the prices of the sectors that are not subject to commercialization are determined in the national market. The Netherlands's disease has two macroeconomic effects that are of primary importance. These are resource allocation and spending.

1.2.1. Resource Allocation Effect

When natural resources are found in a country, the boom in the natural resources sector in that country increases the marginal product of the factors employed in this sector. An increase in oil prices increases the demand for labor and capital in the oil sector. Naturally, wages are rising. The fact that there is a demand, directs labor and capital from the manufacturing and service sector to the oil sector. As a result, production and employment in the oil sector will increase. As the prices for the manufacturing sector are determined in the international market, they will not change the downward demand in production. In the service sector, this will lead to lower overheads in production. As a result, prices in the service sector will increase. The real exchange rate will be evaluated together with all these. (Magud and Sosa, 2010: 8)

1.2.2. Spending Effect

Another macroeconomic effect of the Dutch disease is the spending effect. The spending effect is due to the higher oil prices producing higher wages and earnings in the oil sector, thus increasing the total

demand in the economy. In the event that some of these claims go to domestic services, the prices of services rise while the prices of the other two sectors are determined in the international market. The increase in demand for the service sector leads to an increase in the supply of services. This, in turn, increases the wages in the service sector. Such a situation would encourage the manufacturing and oil sector workers to move to the service sector.

1.2.3. Impact of Low Economic Growth

When examined over the past three decades, countries rich in natural resources have shown a lower performance than countries suffering from natural resource shortages. If the natural resource sector has a great advantage in the exports of any country, then this country is more affected. There are many studies on the natural resource richness in the country that these sources affect the economy in the negative direction. In 2002, the World Bank examined the economic situation of countries with rich natural resources for 90 years. In countries with a share of the natural resource sector in total exports varying between 6 and 15 percent, the Gross Domestic Product (GDP) declined by 0.7 percent on a 10-year time horizon. In this case, the GDP per capita declined by 1.1 percent annually in countries with rates ranging between 15 and 50 percent. On the other hand, in countries with a 50 percent share of GDP, the annual average GDP declined by 2.3 percent. (World Bank, 2002: 7)

1.2.4. The Impact of Poverty

If a country is based on exports and high-ranking natural resource sector, this is the result of high poverty. As a result of the conclusions of these studies, it is seen that the governments of these states are generally not successful in the education and health sector. One of the other reasons is

that the boom in the natural resource sector can be offset by a certain amount of income in the living country. The revenues from the boom in the natural resource sector are more than enough to effectively manage by the state. One other reason is that the rapid increase and fall trends in prices in the natural resource sector adversely affect the country's economy and at the same time weaken the institutions in the country.

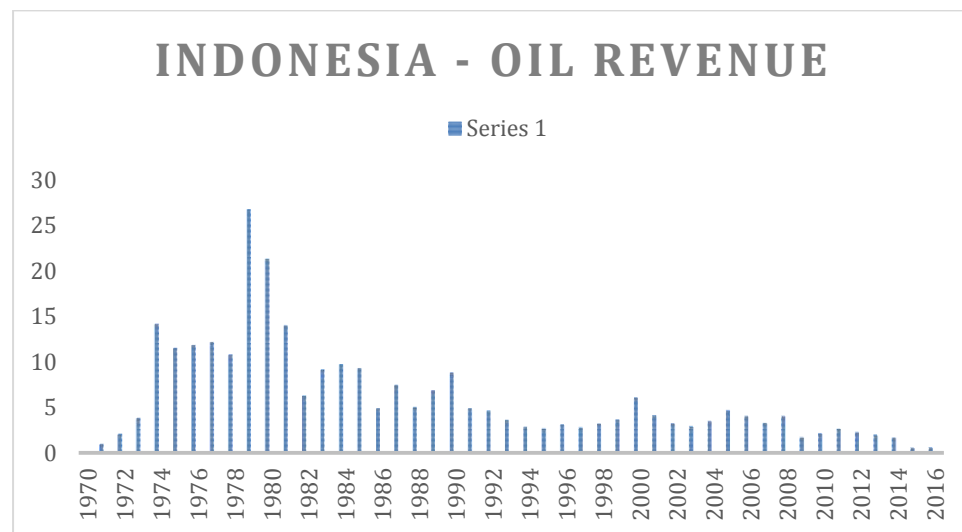
1.3 Examples of Selected Countries Covered by Dutch Disease

1.3.1. Netherlands and Indonesia

In 1959, this phenomenon occurred in the Netherlands due to the presence of natural gas in the North Sea, and this situation took place under the name "Dutch Disease" in the economic literature. With the availability of natural gas, the Dutch Florin was overvalued. After such a situation, the competitiveness of the sectors other than the natural gas sector has decreased and the industrial sector has decreased. The shift in the resource allocation to the natural resource sector of the post-production factors has dragged the country into disarray. (Coral and Migration 2014: 254)

The indication of the Dutch Disease in Indonesia was seen in 1972. Petroleum prices increased significantly in 1973, with the resultant increase in oil revenues. A fragmented situation has caused production factors to shift from other sectors to the oil sector. As a result of this, there has been a contraction in the industrial sector exporting non-commercial products, and 244,000 jobs have been lost in the top eleven industrial areas. (Gurbanli, 2010: 67)

Figure 1.1. Indonesia's Oil Revenue Share in GDP (%)



Source: http://www.theglobaleconomy.com/Indonesia/Oil_revenue/

Figure 1.1. it is seen that in 1973 the share of Indonesia's oil revenues in GDP was 7%. The oil revenues that started to increase since this year reached the highest level in 1979 with a 31% indicator.

1.3.2. Botswana

The results obtained when examining the Netherlands's disease approach to Botswana make this country a special location. Botswana gained independence in 1966. Researches on diamond mines before and after the years of independence have brought the country into the position of diamond maker. In 1980 's, Botswana produced the world' s best quality apples with 4 diamond mines.

The mining sector has made significant contributions to GDP in the 1970s. As a continuation of this, since the 1980s, the mining industry has formed a third with one third of GDP. At the same time, Botswana was producing considerable amounts of copper and nickel.

After winning Botswana independence, instead of driving its own currency to the market, South Africa was bound to Rand, and in 1976 the currency policy was left to South Africa until Pula, its currency, was

formed. With the creation of the national currency in 1976, Pula began to gain value. The assessment of national currency has emerged as the first indication of Dutch disease for Botswana. At the same time, the boom in earnings has led to an increase in the wage level of the sector. Such a situation, though not significant for Botswana, has affected resource allocation.

In terms of spending impact, Botswana has shown a successful policy. When diamond prices have fallen, budget reserves have decreased, but public spending has been carried out steadily. In order to minimize the risk of Dutch disease, external reserves should be large enough to correct spending that causes current income to decline in the case of commodity prices deterioration or resource depletion. Because Botswana's external reserves are considerably larger, they could have come from above, using sink time reserves in diamond prices. In 1995, foreign reserves had the capacity to meet one and a half year exports. In addition, the reserves of foreign reserves had the lowest demand for money, so that upside pressure on foreign exchange could be mitigated slightly.

If the natural resource boom did not accumulate external reserves during the period in question, it would be expected to reduce imports or borrow from the public sector when diamond prices were low. (Poteete and Gramajo, 2005: 18)

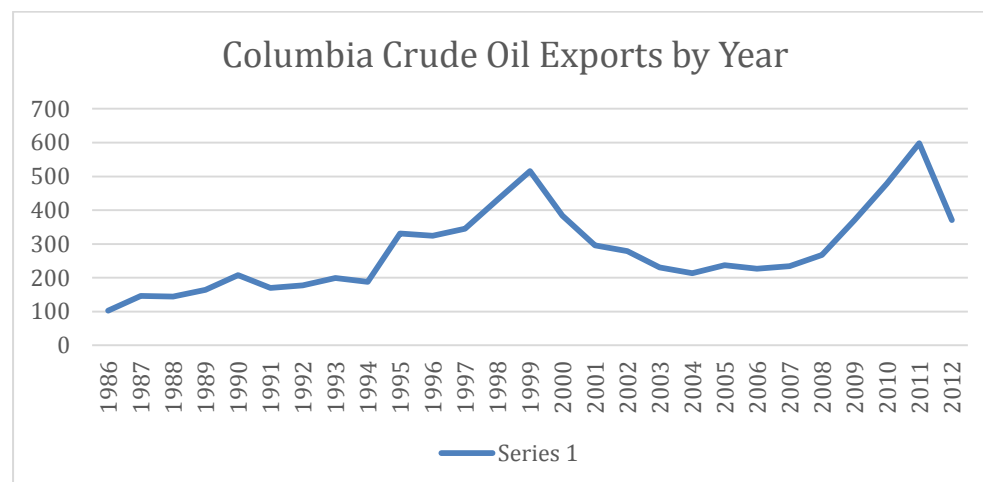
1.3.3. Colombia

Colombia, which has one of the largest economies of South America; Brazil, Mexico, Argentina and Venezuela. Colombia has experienced a rapid growth in the first decade of the twenty-first century and has taken its place among the emerging economies. This increase in economic growth in the country was due to improved macroeconomic stability, increased fiscal incentives for investments and public investment programs. Nevertheless, the most important of the recent global

commodity explosion is the sudden rise in oil, coal and gold prices, the main export products of Colombia. As a result of this explosion, Colombia's oil exports increased 3.5 times between 1991 and 2011, while coal exports increased 4.5 times. Gold exports increased 6 times between 2002 and 2012. The positive economic performance that has emerged has clearly led to the improvement of general living conditions, the widening of the share of the middle class in the total population and the reduction of poverty. Along with these developments, in the long run, questions have been raised about sustainability of this growth. In these developments, the share of industrial and agricultural production in GDP has begun to decline and the country has become vulnerable to external shocks. (ITKIB, 2013: 6)

. Despite the average annual growth of 4.8 per cent since the beginning of the year 2000, this has been frequently discussed by Colombian economists over the last few years. The reason for these disputes is the commodity explosion of the main driving force behind the growth at this level. Between 1991 and 2011, annual oil exports increased from 61 million to 215 million, coal exports to 18 million 83 million metric tons. At the same time gold production was 20,823 kilograms in 2002, while in 2012 this figure reached 66,178 kilograms. (Goda and Torres, 2013: 5)

Figure 1.2. Colombia's Daily Crude Oil Exports (thousand barrels)



Source:<http://www.indexmundi.com/energy/?country=co&product=oil&graph=exports>

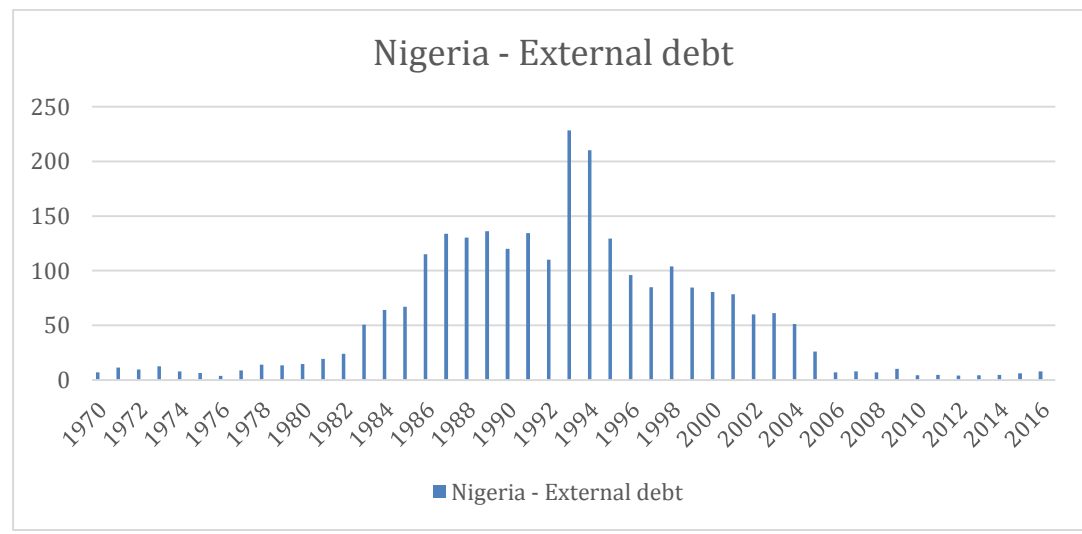
Figure 1.2. it is seen that Colombia's daily oil exports in 1991 were 170 thousand barrels. Increasing oil exports from 1994 onwards have reached 384 thousand in 2000. Between 1995 and 2010 Colombia's average daily oil exports were around 388 thousand barrels. In 2011, Colombia's daily maximum oil exports amounted to 598 thousand barrels.

1.3.4. Nigeria

Nigeria "poverty, the most important reason is the diversification of the economy. In the 1970s, the Nigerian economy was dominated by the agricultural sector. While the share of petroleum exports in 1988 was 1%, it reached 97% in 1984 and has not fallen below 90% since then. In 2008, the oil and gas sector accounted for 97.5% of export revenues, 81% of government revenues and 17% of GDP. In the first half of the 1980s, a major oil explosion occurred in Nigeria. In such a case, the increase in oil revenues adversely affects the agriculture sector, and the agricultural sector has passed through the oil sector in large quantities. The oil exploding has led to over-government borrowing and poverty in the country becoming more prominent. The drop in oil revenues in 1986 led to a significant reduction in oil revenues in Nigeria and a substantial increase in external debt. (Ucha, 2010: 52)

Figure 1.3. it is seen that Nigeria 's external borrowing increased considerably from 1983 to 1998. In 1993, Nigeria's external borrowing was about 2-3 times the national income.

Figure 1.3. Nigeria's External Debt (External Debt / National Income)



Source: http://www.theglobaleconomy.com/Nigeria/External_debt/
<http://data.worldbank.org/topic/external-debt?locations=NG>

Despite the fact that Gross National Income has an outstanding debt on foreign debt, Nigeria has demonstrated a successful debt payment management with the foreign trade surplus provided by its petroleum revenues. In 1995, the foreign debt stock rose to \$ 34 billion, while oil revenues and policies enabled the external debt stock to drop to \$ 9 billion in 2006. The foreign debt stake that started to increase since 2006 was \$ 29 billion in 2015.

Chapter 2. Negative aspects of oil boom in Azerbaijan

2.1 . Rebuilding national economy in Azerbaijan

The fall of Union of Soviet Socialist Republics (USSR) went up against Azerbaijan with numerous inconveniences. Issues in all fields, particularly in financial and political lives showed itself. Azerbaijan passed far from 1991 to 2014, as it were from retreat to stable monetary development. There are different divisions for the time of history which covers the time from 1991 to these days. In this proposal, this period is separated into three sections: Recession period (1991-1994), recuperation period (1995-2005), blast and droop period (from 2005 to show time).

2.1.1 Recession period: 1991-1994

In 1991 world's political guide changed once more. Association of Soviet Socialist Republics (USSR) fallen and 15 nations recaptured their autonomy. Azerbaijan additionally was among these nations.

In 1991, on the eighteenth of October Supreme Soviet of Azerbaijan embraced the "Sacred Act on the State Independence of Azerbaijan Republic". This was the official statement of autonomy of Azerbaijan. Ayaz Mutellibov turned into the principal leader of the nation. On 29th of December, 95.27% of residents partook in the choice and 99.58% of them voted in favor of the power of Azerbaijan Republic (Zulfugarli, 2009, p 5).

The primary years of autonomy passed exceptionally sensational for Azerbaijan. In the wake of proclaiming freedom nation looked with genuine financial and political issues. The fundamental driver of issues was a difference in framework. In the Soviet Union, economy and legislative issues were brought together. State guaranteed the economy

with every single vital component and there was just a single political gathering. Be that as it may, after the fall of Soviets previous association nations entered the market economy and multi-party fair political framework.

As a matter of first importance, the fall of Soviet Union affected Azerbaijan by financial channels. As a piece of unified financial framework Azerbaijan likewise generally delivered crude materials and horticultural items amid Soviet years (Kalyuzhnova, p 3, 2002). It required imports from other association individuals and furthermore traded to just other Soviet nations. In any case, separate of USSR stopped the monetary relations between association nations. Other than it, there was not adequate foundation for financial improvement.

The political circumstance was additionally unsteady. In spite of the fact that the Soviet Union fallen, "Socialist gathering" was still intense and beneficiary of USSR, new free Russia kept the main leader of Azerbaijan Ayaz Mutellibov under strain. He was not free and it made dangers to the youthful nation. Because of this circumstance in 1992 Abulfaz Elchibey came to control. He altered the course of the nation from Russia to Turkish states and pulled back the Russian troops from Azerbaijan (Yunusov, 2011, p 62). The adjustments in legislative issues joined by political and social fiascoes. Russia utilized Karabakh card as a squeezing technique to Elchibey. With the help of Russia, Armenia started military activities in Karabakh and a portion of the urban communities in this area were involved. (Aydın, p 13, 2000). Thus, in excess of one million evacuees traveled to various parts of the nation.

This deepened the political circumstance and furthermore influenced the economy contrarily. Notwithstanding these issues, Elchibey did some valuable changes as far as economy. The Central Bank of Azerbaijan Republic (CBAR) was established and national money – manat (AZN)

was presented. Also, State Committee on Property Issues, the Committee on Foreign Investment, Anti-Monopoly Committee and other essential state ventures were built up amid his short administration period. (Yunusov, 2011, p 64). In any case, every one of these changes were insufficient him to remain on control. The expanding number of unsatisfied individuals, inverse gatherings and weight of Russia made the president to leave. After him Haydar Aliyev came to control in July 1993. He was previous KGB (Komitet gosudarstvennoy bezopasnosti, Committee for State Security) general and had ruled the nation between 1969 – 1982.

The primary assignment for another president was to balance out the circumstance in the nation. Economy was crumpled, all parts of the nation were in mayhem, terrible news originated from front. For taking the nation out from this circumstance Aliyev required a break in the war. The solidness in nation additionally implied as span of his power (Hoffman, 1999, pp 10-11). All things considered the main confirmation for him was western group. That is the reason, he marked truce with Armenia in May 1994 and swing to financial issues.

As it said before amid three years economy intensified. In 1994 GDP was 30% lower than 1990. The expansion rate was at its record level – 1764% (Aras, Suleymanov, Huseynov, 2013, p 2,). The other macroeconomic pointers demonstrate the circumstance all the more plainly. For instance, outside exchange volume, industry, farming diminished separately half, 62%, and 45% between 1991 – 1994 (Soyak, Nesirova, 2003, p 4). For beating troubles Haydar Aliyev altered the course of the nation from Russia toward the west yet additionally endeavored to keep great relations with official Moscow. He comprehended cap the best way to protect the nation is assets, particularly oil and flammable gas. We can

state that from this period regular assets assumed a dynamic part in the recently autonomous Azerbaijan's life. For instance, in 1994 every day creation was 195.000 barrels. In 1995 and in 1996 this number diminished 20.000 barrels for each day (Lenczowski, 1997, p 113). The first and primary advance towards a financial organization with the west in oil division was Baku – Tbilisi – Ceyhan oil pipeline which is likewise called as "Contract of the century" marked with 33 organization from 15 nations (Bayulgen, 2003, p. 209). The majority of the member states were created nations and biggest organizations in this part, for example, Amoco, British Petroleum (BP), Pennzoil, Exxon and so on. Russian organizations were avoided from this agreement. Be that as it may, after some political moves and weights, it got 10% offer. Iran was likewise one of the members in any case, because of USA's (United States of America) dissents it was taken out. As per USA Department of State, International Energy Agency (IEA), BP and national sources oil stores of this pipeline were assessed separately as 0.5, 0.5-1.5, 1 and 2 billion tons. 13 billion dollars was put resources into this venture. The agreement gave the chance to the legislature to get 80% of incomes in the wake of subtracting costs (CESD look into gathering, 2012, p 4). As a matter of fact, this was the start of FDI streams to the nation.

After this Haydar Aliyev marked another agreement with remote organizations which let Azerbaijan send out its assets from "Shah Deniz" terminal (Atmaca, pp 1-9, 2002). The regular investigation of this period demonstrates that nation was in profound subsidence. The crucial explanations behind this retreat were recapturing freedom, the crumple of the previous financial framework and furthermore political disasters. Because of this circumstance, the primary financial pointers diminished between 1991-1993, abnormal state of swelling and negative monetary

development was trademark for the nation. A few changes and endeavors were not ready to safeguard the nation. War with Armenia and political insurgency hindered the improvement of Azerbaijan. The happened to Aliyev to power and marking of "Agreement of the century" can be acknowledged as the finish of subsidence period in Azerbaijan.

2.2.2 Recovery period: 1995-2005

After the principal time frame, the fundamental objective of state control was to recuperate the economy. For this reason president needed to roll out a few revisions and improvements in a political framework. Right off the bat, on 12nd of November in 1995 new constitution was presented. As indicated by new laws framework, Azerbaijan turned into a presidential nation and Aliyev got incredible power. Authoritative and official organizations were separately parliament and legal (Abbasov, 2011, p 110). Parliament called Milli Majlis (MM) and it comprised of 125 delegates. The primary official courts were Constitutional Court, Supreme Court, and High Economic Court. New constitution and specialist of Aliyev gave him the chance to control all branches of state organizations. As oil was a pivotal factor for the two nations and Aliyev's power president controlled the State Oil Company of Azerbaijan Republic (SOCAR). That is the reason he designated his cousin Natig Aliyev as leader of SOCAR. Haydar Aliyev's child, future leader of nation Ilham Aliyev moved toward becoming bad habit president. The changes in oil area proceeded by the foundation of State Oil Fund of Azerbaijan (SOFAZ) on 29th of December in 1999. Authoritatively the making reason for this reserve was expressed as: "To guarantee intergenerational uniformity of advantage with respect to the nation's oil riches, while enhancing the financial prosperity of the populace today and defending monetary security for who and what is to come". One of the

fundamental errands of this store was to safeguard the nation from unwanted effects of outside swapping scale increment (Eldaroglu, 2001, p 169). A few powers in the nation attempted to hamper these changes. Endeavors to upset and death to the president were averted. Subsequent to clearing nation and government from military restriction, Azerbaijan entered the solidness time frame. Presently, the fundamental undertaking was to build up the economy. For doing this, the nation required an organization with the global group. Subsequently, in 1995 Azerbaijan concurred with European Union's (EU) bolster on conquering troubles of changing to majority rule government. A few months after the fact "Association and Cooperation Agreement" was marked with EU. The inclination of joining to universal associations proceeded with additionally thereafter. From the 2000s the possibility of Azerbaijan's enrollment to Northern Atlantic Treaty Organization (NATO) was talked about. Likewise in 2001, Azerbaijan turned into an individual from Council of Europe (CE) (Yunusov, 2011, pp 68-69).

Association with multinational associations opened an awesome open door for expanding collaboration with global financial associations, for example, International Money Fund (IMF), World Bank (WB), Asian Development Bank (ADB) and European Bank for Reconstruction and Development (EBRD). These associations, particularly IMF and WB were primary monetary help for recouping the economy.

The historical backdrop of association with IMF backpedals to 18 September 1992. In this day Azerbaijan was the individual from IMF with 117 million exceptional illustration rights (SDR). Be that as it may, political unsteadiness, war condition, and different troubles blocked the expansive scale cooperation. The nation could get the main credit from

IMF just in 1995. IMF masters arranged dependability program and 46 million dollars was spent on this venture. A few months after the fact Azerbaijan government was given by 132 million dollars to supporting financial change program. It was planned to diminish the expansion rate and help for remaking the money related part. In December 1997 two separate 64 million credits were displayed to Azerbaijan. In January 1999 112 million dollars credit was guaranteed for supporting monetary and money related projects and furthermore repay the negative impact of oil value diminishes on trades. The last credit for this period was given in 2001. It was 100 million dollars credit and intended to diminish destitution and advancement of non-oil areas (Soyak, Nasirova, 2003, pp 5-6). Because of IMF material help economy restored. There were additionally negative impacts of IMF helps. This showed itself for the most part in the business division. In 2000 industry division declined 70% contrasted with 1990. (Hooper, 1999, pp 51-52). Besides, oil industry expanded from 16.4 to 37% in the vicinity of 1995 and first quarter of 2001. Amid this period non-oil industry diminished from 13% to 6%. World Bank additionally assumed a dynamic part in recouping of the economy in Azerbaijan. The nation went into this association in 1992, yet as on account of IMF, it got the emergency treatment in 1995 after adjustment. Amid the organization, World Bank burned through 726 million dollars for 31 extends in Azerbaijan (World Bank, 2013). One of the fundamental changes of this period was propelling of privatization program. Prior strides towards privatization were taken by the foundation of State Committee on Privatization (SCP) in 1992. The main law on privatization embraced in 1993. Lamentably, political shakiness, the state of war and different components determents this procedure till the start of 1996. In this date "little scale privatization" began. After one year vouchers conveyed among residents and in May privatization of medium-

scale business started (Yunusova, 2012, p 26). This program restored the economy. As indicated by measurements till 1999 around 22200 little scale business was privatized and furthermore almost 1100 business entity was made. Outside subjects additionally participated in privatization. They purchased shares in excess of 50 organizations. At the end of the day, 15% of stocks were privatized by non-Azerbaijani subjects (Bayramov, 2001, p 166). Despite the fact that to a few challenges privatization process expanded the offer of private part in nation's GDP.

	1994	1995	1996	1997	1998	1999
Share of private sector in GDP,						

The privatization secured additionally farming part. It began in 1996. For dealing with this procedure in excess of 50 laws and directions were received by the legislature. Amid the period under five years almost 2000 ranch was privatized, likewise around 36100 new homesteads were established (State Statistics Committee, 2001, p 87). Thus, 874 families comprising of 3.5 million individuals get private grounds. After this execution state-possessed 56%, districts' offer was 23.5%, the remain lands swung to the private bequest (Ibadoglu, 2014, p 3).

The impacts of privatization are far fetched. There are certain and negative impacts of this program for Azerbaijan. As a matter of first importance, this procedure put away new financial framework like other entrepreneur nations. In addition, privatization strengthened the new economy and built up the combination to global markets. Another constructive outcome was that after a long stretch nationals get the

chance to partake in financial life all the more effectively. Be that as it may, likewise some negative impacts of privatization in the monetary and political existence of the nation was watched. There was an extensive number of ventures which lost its ability 45ort his stopped movement after privatization. All these negative elements affected the benefits from privatization. The genuine incomes from the program were very not as much as guess. Thus, Azerbaijan increased 2120 dollars from privatization of each little venture and 18300 dollars from one medium and substantial size undertaking. Absolutely nations spending plan profited 100 million dollars from privatization amid the principal time frame (Ibadoglu, 2006, pp 80-81).

The nonappearance of involvement in this kind of issues brought about low administration amid this procedure. The state couldn't participate as proprietor and privatization was not ready to diminish the restraining infrastructures, even expanded the quantity of monopolistic firms and organizations. Likewise, state authorities specifically and in a roundabout way took an interest and illicitly mediated the procedure. Regardless of all these negative cases privatization was propelled and it's beneficial outcomes were more than negative. Every one of these changes improved the economy. The principle macroeconomic markers for this period endorsements this. Amid 1991-1995 monetary development was negative. Just in 1996 GDP development was 1.3%. In 1998 10% and in 2000 14% expansion in GDP was watched. One of the principle issues of the economy was expansion. This issue additionally was understood in 1995. Swelling forcefully declined from 1.788% of every 1994 to half in 1995 and to 20% out of 1996 (SSCAR). The primary monetary markers 45ort his period is given in table 1.2.

	Growth rate of GDP, %	GDP per capita, \$US	Consumer Price Index, %	Deficit of the state budget, GDP, %	Revenues of the state budget, GDP, %	Expenditures of the state budget, GDP, %	Deficit of the payment balance, in \$US	Deficit of the foreign trade balance, in \$US
			%					
1993	-23,1	177,6	1129,1	7.1	35,0	NA	NA	174,8
1994	-21,9	NA	1663,5	11.5	31,7	NA	NA	-141,1
1995	-11,8	321,6	411,8	5.2	14,9	20.1	400,7	-373,1
1996	1,3	421,0	19,9	2,9	14,7	17,6	931,2	-693,9
1997	5,8	507,5	3.7	4	16,2	18,6	915,8	-566,9
1998	10,0	537,0	-0,8	1,8	13,5	16,3	1365	1.046,1
1999	7,4	508,3	-8,5	2,4	14,6	19,8	599,7	-104,8

Source: MFAR, SSCAR

Alternate pointers at table 1.2 demonstrate that legislature could defeat the primary issues and dangers for the economy. This numbers can be acknowledged as first stage's consequences of the recuperation time frame.

The second stage started in 2003. In 2003 political circumstance changed once more. The passing of Haydar Aliyev made new and genuine inquiries for the fate of the nation. After some period of his demise president decisions wrapped up by the triumph of Ilham Aliyev on fifteenth of October in 2003. It was the main case in post Soviets that father is supplanted by his child. As it expressed before up to this point Ilham Aliyev was VP of SOCAR. But this, he was the agent of MM, head of National Olympic Committee and was the executive of the nation for a brief span. The resistance dissented the outcomes following day after races and wellbeing powers wrecked the mobilizes, substantial quantities of protestors were captured. In this period, child Aliyev's administration

is specified as weight on the resistance and other freethought individuals. A portion of the restriction parties was ousted from their workplaces, likewise, a few universal radios studios needed to stop the telecom. In 2005 boss editorial manager of "Screen" political magazine Elmar Huseynov was executed. Killings are as yet not decided and imprisoned. Other than it, same year two priests were captured. One of them was head of "Service of Economic Development". In the wake of strengthening his place as president, Ilham Aliyev swung to the economy. The economy remains as the principal need of a new president. In one of his first talks as president, he declared around 600.000 new openings for work amid initial five years time span. Also, he marked "State Program on Social-Economic Development of the Regions of the Azerbaijan Republic for 2004-2008" in 2004. The principal reason for this program was to annul the monetary distinction amongst areas and substantial urban communities, likewise to build up the economy in various parts of the nation.

The common assets caused the FDI streams to the nation, particularly in this period. As indicated by insights in 1995 FDI streams into Azerbaijan was just 375.1 million dollars, after one year this number expanded to 620.5. Next two years it wound up 1307.3 and 1472.0 million dollars. The expansion in FDI proceeded until the finish of this period. In 2000 it was 967.8 million AZN, following five years in 2005 it was 8 billion AZN. FDI expanded roughly 22 times from 1995 to 2005.

For outlining this period we can reason that economy created as it arranged, dependability was accomplished, likewise, normal assets turned into the principal source of the recuperation time frame. The income inflows and expanding number of FDI built up the economy.

Characteristic asset incomes additionally let Ilham Aliyev set up and quality his dictator administration.

2.2.3 Boom and droop period: (2005 - present)

This period is normal for the blast in the oil area and abnormal state of income inflows. Since in 2006 the primary oil was sent out by Baku-Tbilisi-Ceyhan . But this with 5.7 billion barrels holds world's third biggest oil stage Azeri-Chirag-Guneshli after one year by Baku-Erzurum-Tbilisi pipeline, and Azerbaijan's first, world's ninth field with 1.2 trillion m³ stock Shah-Deniz terminal expanded the chance of sending out characteristic assets.

In 2003 oil creation was 15.3 million tons. Amid next two years, it was 22.2, 32.3 and 41.7 million tons in 2007. 2009 was a critical year regarding oil generation. In this year generation was in its record level – 56 million tons and after two years diminished to 46 million tons (Aras, Suleymanov, Huseynov, 2013, pp 80 - 81). In 2009 nation was in nineteenth place because of it's demonstrated raw petroleum saves. As far as creation, it was positioned in 22nd place. It took one of the best places in petroleum gas stores and creation. Azerbaijan was in 24th and third places individually.

Gas generation likewise expanded amid this period. In the wake of sending out gaseous petrol by Shah-Deniz, petroleum gas creation expanded 4 billion m³ and came to 15 billion out of 2008. As per visualization, this number will be 30 billion m³ in 2015

The increment in characteristic asset creation affected the economy emphatically. In 2006 Azerbaijan was first because of its GDP expanding level. Additionally, financial development in 2011 was 80% higher contrasted and 2003. Destitution rate additionally declined. Despite the fact that it was roughly half in 2003, in 2011 it was just 7%.

The advancement of oil and gas segment prompts increment in FDI. Marking contract with various nations and universal organizations affected the FDI increment decidedly. The aggregate number of speculations from 1995 to 2010 was 54.2 billion dollars. These speculations comprised of 23% credits, 69% circuitous venture, 1.3% portfolio venture, 6% as another kind of speculations

This propensity proceeded until 2009. In 2009 level of FDI to nation diminished 3.8 billion dollars since quite a while. In 2010 FDI came to 5890 billion dollars.

The expanding number of oil and gas generation additionally caused fares and offer of oil incomes in a financial plan to increment. In 2005 unrefined petroleum creation was over half of aggregate generation. In 2008 it achieved it's greatest level with 92.50%. In 2010 it was 86.50 % (SSCAR ,2011). The offer of oil incomes in spending plan expanded year-by-year. On the off chance that in 2002 the bit of oil incomes in the financial backing was 36.5 %, in 2003 this number was 31%. After one year it expanded to 40.9%. This inclination proceeded in the vicinity of 2005 and 2010. In 2005 the offer of oil in the monetary allowance was 51.4%. In 2010 this number wound up 65.4%. Numbers demonstrate the significance of oil incomes in state spending plan as well. On the off chance that in 2003 incomes from oil was 887.76 million euros, amid seven years it expanded to 9.2 billion (SSCAR, 2010). The bearings of spending spending's likewise changed in 2010. As of recently the primary piece of the financial backing was spent on development and so forth extends, however in 2010 offer of wellbeing and training divisions expanded. Likewise, incomes to rural area ascended amid 2009 and 2010 years spending plan. Be that as it may, even for this situation offer of training, government managed savings and wellbeing part diminished in genuine terms separately 12.1%, 8.5%, and 0.7% contrasted and 2003.

Increment in pay rates of individuals working in these parts additionally watched. Be that as it may, these pay rates are as yet one of the most minimal. For instance, the normal compensation in the instruction framework was around 230

euro, while the normal number of wages is 259 euros. It must be said that the most astounding pay rates were seen in the oil part. As indicated by measurements, the specialists in this segment are just 1.1% of all workers individuals. Be that as it may, they make the biggest piece of aggregate GDP. Pay rates in oil area were 12 times higher than horticulture, 8 times higher than training division in 2009. These realities can be acknowledged as one of the principle wellsprings of suspects about Dutch infection. Another indication of Dutch disease in the nation economy is conversion standard appreciation. In 2005 president marked request about of the costs". As per this 5000 manats considered equivalent to 1 new manats. This choice affected the nation's fares contrarily. Since it turned out to be more important and it made the fares less focused in worldwide markets.

2.2. Investment policy and “natural resource curse”

Natural resource curse hypothesis contemplates negative impacts of natural resources plenitude on various divisions of nations, for example, economy, legislative issues and social life. As indicated by hypothesis, nations with asset wealth grow not as much as the asset deficiency ones. This issue likewise influences the political existence of nations by diminishing institutional quality, expanding defilement and reinforcing expert. Diminishing number of school enrolments and doctor's facilities,

low wages in instruction and wellbeing divisions are indications of resource curse issue in social life.

As a previous Soviet resource various researchers hypothetically and experimentally explore abundant nation Azerbaijan's oil and gas areas. The fundamental bearings of studies are the impact of oil on the financial and political divisions of the nation. Be that as it may, there is a need as far as learns about the impact of national resource richness on the social existence of the nation.

3.1 Economic side of resource curse in Azerbaijan

First time resource abundance issues for Azerbaijan studied by Rosenberg in 1998. They contend that the oil boom can prompt Dutch disease and natural resource curse in Azerbaijan economy. Rosenberg express that because of oil boom local products and resources costs made vacillations for Azerbaijan economy in the short run, yet real exchange change did not harm the aggressiveness of non-oil division in the brief timeframe. As indicated by creators after the autonomy GDP development rate was right off the bat positive amid 1996 and 1997, likewise there was a decrease in industry and assembling segments. Rosenberg and Saavalainen demonstrate that long haul impacts of oil sends out came about with Dutch sickness for Azerbaijan. In spite of the fact that there isn't much data about presence of Dutch infection in nation economy, creators express that after the capital inflow from assets and remote direct speculation to oil area genuine conversion scale acknowledged and it can be noted as one of the primary side effects of Dutch disease problem. illness issue. The second indication of Dutch infection in Azerbaijan economy is the decrease in assembling and agribusiness parts. They demonstrate the wasteful assignment of asset income as a third factor.

Rosenberg and Saavalainen offer a few recommendations for beating monetary issues connected with resource curse and Dutch disease. They contend that nation must spare some piece of oil incomes at out of the nation. The other solution for getting away from Dutch disease is to create establishments controlling oil incomes and venture issues. Additionally, financial and money related approaches must be led to conquer the negative impacts of income inflows.

Laurila and Singh examine the connection between financial development and wealth of assets, for example, petroleum gas and oil, likewise think about the indications of Dutch Disease in Azerbaijan economy in the vicinity of 1990 and 1998 (1999). Creators express that amid initial five years of freedom, notwithstanding numerous issues, for example, a tremendous decrease in GDP, high expansion rate and so forth, Azerbaijan accomplished stable monetary improvement. By the marking of agreements with remote organizations on the misuse of natural curse in 1995 Azerbaijan entered to another time of advancement which began to profit by the oil and natural gas incomes. Singh contend that because of substantial income inflow, the nation looked with dangers, for example, Dutch disease. Researchers show that amid the primary years of production exchange rate did not acknowledge, inverse happened. Be that as it may, it can be the effect of different causes as opposed to Dutch disease. Yet, creators express that it is normal energy about real exchange rate in future.

In the year 2008 Clemens explores the resource curse issue and remote direct issues in Azerbaijan. In the first place, the examination outlines the Azerbaijan economy, at that point researches the impacts of resource curse and FDI flow to the nation. The creator expresses that amid the

most recent years Azerbaijan stored high rate of development. This development draws in numerous financial specialists and a large number of dollars to the nation. Unmistakably the vast majority of these speculations go to resource abundant field and it creates Dutch sickness inconvenience. Researcher shows that administration can keep this danger by guiding ventures to non-oil area. Clemens contends that amid years ago level of direct speculations diminished and it isn't terrible for the economy. He displays this as a reason for expanding another sort of speculations. The creator expresses that if Azerbaijan government makes a few changes in majority rules system, human rights fields and battle against defilement it can be a standout amongst the most created nations of previous the Soviet Union.

Bayramov and Conway considered Dutch sickness issue by inquiring about 238 exchanged and non-exchanged firms in Azerbaijan (2010). The speculation is that, example firms looked with Dutch disease since 2006. Results dismiss this speculation and demonstrate that there is no distinction between the experience of tradable and non-tradable firms. Researchers set the second theory as import-contending tradable firms in the example are acting also with non-tradable organizations. Barring the length of task time, Bayramov does not discover any indistinguishable quality between two sorts of ventures.

The paper shows that nation does not experience the ill effects of total de-industrialization but rather from relative de-industrialization. Research demonstrates that "resource movement effect" isn't critical for the example time frame, yet there is "spending impact" in the non-tradable part. The creator likewise expresses that average real wage expanded from the earliest starting point of 2004. Other than it, comes about

demonstrate that there is a positive connection between genuine oil costs and valuation for real exchange rate.

3.2 Political side of resource curse in Azerbaijan

In the following period researchers comprehended that it isn't conceivable to clarify the resource curse just with financial reasons. As indicated by a few researchers political reasons additionally make the nations confront resource curse problem. After this, inquire about papers exploring political side of resource abundance. This propensity is same for Azerbaijan as well. As a post – Soviet nation, which all fields of nation was halfway-arranged legislative issues assume a dynamic part in monetary existence of the nation. This is additionally valid for natural resource . It isn't astonishing that common assets are additionally under the control of political expert. Nonetheless, there is set number of research papers empirically examining the effect of oil wealth on governmental issues for Azerbaijan. A large portion of the papers considers the issue hypothetically.

Luong and Weinthal researched the oil and gas methodology of Azerbaijan with Central Asian post-Soviet Countries (2001). Researchers express that after the fall of Soviet Union, as different nations, Azerbaijan likewise reproduced its economy and required expansive measure of venture. Numerous monetary and political issues, likewise, the war with Armenia made the policymakers to begin utilizing the natural resource as a hotspot for improvement. Since it was best way to enter the world market and draw in FDI streams to nation. That is the reason, political first class attempted to keep control over resource. Researchers display this reality as one of the principle reasons of introductory political framework and oil - gas procedure.

The paper by Raiser and Esanov presents the monetary and political perspective of resource rich nations of previous Soviet Union, for example, Turkmenistan, Kazakhstan and Azerbaijan following 10 years of freedom (2001). Creators contend that resource abundance isn't favoring, however curse for these nations amid 10 years as a result of political framework. Paper clarifies the connection between resource wealth and political changes. As indicated by creators in the initial segment of change period Azerbaijan pulled in substantial number of FDI and it constrained the nation to make a few changes. In any case, it was insufficient and in the second time of process inverse happened. Raiser, Buiter and Esanov express that policymakers are not intriguing for making changes and there is negative connection between asset incomes and changes. Researchers propose to simplify enlistment process for representatives, make accessible condition for local and remote exchange viable tax collection framework and increment institutional quality. Creators demonstrate that Azerbaijan is better than Turkmenistan and more regrettable than Kazakhstan as far as monetary and political changes.

Paper displayed by Kalyuzhnova examines the beating strategies for resource curse and the part of oil funds in this procedure (2006). As test she takes two nations: Kazakhstan and Azerbaijan. Kalyuzhnova indicates oil funds can be one of the primary components of administration through three channels. To start with, government must decide the points of such supports, second, policymakers must form such frameworks which can make association among these points. Third, government must give straightforward administration of oil incomes in these assets. Likewise, these assets must give straight forward administration of oil funds is one of principle ventures of changes. Creator contends that assets in test

nations are recently settled and that is the reason it is difficult to judge their exercises. Simply after long haul the part of this kind of funds can be clear in Azerbaijan and Kazakhstan.

3.3 Social side of resource curse in Azerbaijan

Asset revile impact the social life as well. It is the less researched piece of asset revile hypothesis. This reality is likewise valid for Azerbaijan. Additionally the vast majority of the current research papers consider the issue hypothetically. Along these lines, there is few research papers exploring the effect of oil on social segment of Azerbaijan independently. Also, the majority of the current papers explore the asset plenitude issue by clarifying its negative effects on wellbeing division. It can be reasoned that as of not long ago effect of oil on training arrangement of Azerbaijan isn't examined yet.

McKee and Figueras think about changes in wellbeing segment of Central Asian nations and Azerbaijan (1998). Creators utilize figures from World Health Organization (WHO) and Health Systems in Transition (HIT) profiles distributed by WHO. There are likewise a few increments from different sources, for example, World Bank advancement markers. Researchers express that outcomes are comparable for test nations. It is demonstrated that war with Armenia put off changes, particularly in wellbeing area in Azerbaijan and this factor impacts the circumstance contrarily in wellbeing framework. Nonappearance of any national wellbeing program in Azerbaijan is likewise one of the negative cases for nation.

Paper by Falkingham examines the effect of progress period on living standarts in Turkemistan, Azerbaijan and Kazakhstan (1998). Creator expresses that subsequent to recapturing freedom these nations looked

with genuine financial issues. Be that as it may, later each of the three nation restored and caught financial development. Falkingham considers whether this development made neediness and imbalance and if there are these sort of issues how reasonable they are. Examination demonstrate that however there are issues with imbalance and neediness in test nations, amid most recent five year positive financial advancement is watched. Inside this timeframe disparity psychologists and neediness rates are beter off. Creator proposes to expand straightforwardness and proficiency of item showcases. Interest in schools and wellbeing administrations are another solutions for Azerbaijan.

Habibov and Fan examines destitution and social insurance issues in Azerbaijan (2007). Creators express that social assurance programms positively affect diminishing in destitution level. However, there is stil high destitution level in Azerbaijan on account of significant impediments in this program. The most critical deficiency is that program does not cover all poor populace. The second issue is terrible administration and defilement. Due to these antagonistic cases destitute individuals get little parts of advantages. As per researchers the other critical reason is that social installments are not ready to expel the neediness. Habibov and Fan recommend to quality the present social assurance program. As per creators just a single program can not diminish the neediness. Researchers propose taking care of this issue by growing new social measures held by government.

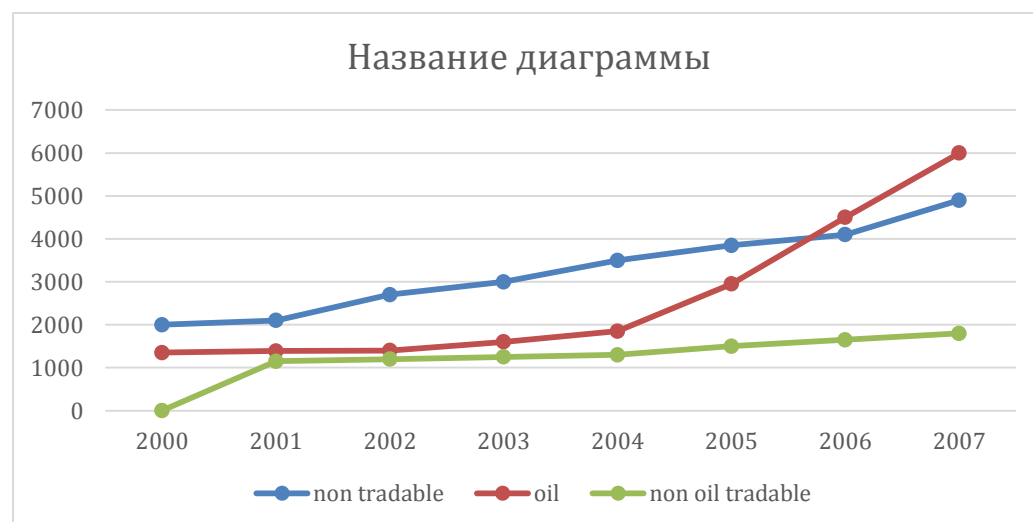
Rzayeva states that subsequent to recovering freedom government diminished the uses on this segment and it affected the future as well. From 1990 to 2002 future diminished six years and it is the most noticeably awful outcome on the planet after Sub-Saharan nations. Other

than it, as indicated by insights in 2005 Azerbaijan was second nation which spend less cash to wellbeing area after non-rich Tajikistan among previous Soviet states. Rzaeva states this is the reason for oil-subordinate economy and defilement. This division additionally affected by struggle with Armenia on Nagorny-Karabakh. She contends that after the crumple of Soviet Union nation entered the worldwide market and new oil serious framework contrarily influenced the wellbeing part by lessening wages and part of this segment. Rzaeva reasons that after 2005 government spendings on wellbeing area expanded, yet debasement and other institutional issues stil keeps the improvement of segment.

2.3. Local changable effects of resource movement

A crumbling of a tradable division that isn't resource abundat and an improvement of a non-tradable area are significant indications of the Dutch Disease. Generation esteems and development rates of oil, non-tradable and non-oil tradable segments in genuine terms for the period 2000-2007 are delineated underneath in Figure 1.

Figure 2.1: Real GDP by sectors



Source: SSCAR data

It is obvious from the left chart in Figure 2.1, the entire time frame can be isolated into two sections: More steady period till 2005 which there are no sensational changes in the creation of the segments and more unstable period after 2005 portrayed by sharp upward pattern in oil segment and developing hole between preparations of the non-tradable and the non-oil tradable divisions. As appeared from the correct chart of Figure 1, the oil division has displayed enormous and unpredictable development since 2005. There has been an upward pattern in the non-tradable GDP development rate and a descending pattern in the non-oil tradable GDP development rate amid 2005-2007. By contrasting 2007 and 2005, one can watch that the non-tradable GDP development has ascended from 6.3 percent to 12.3 percent, while the non-oil tradable GDP development has declined from 10.1 percent to 5.8 percent.

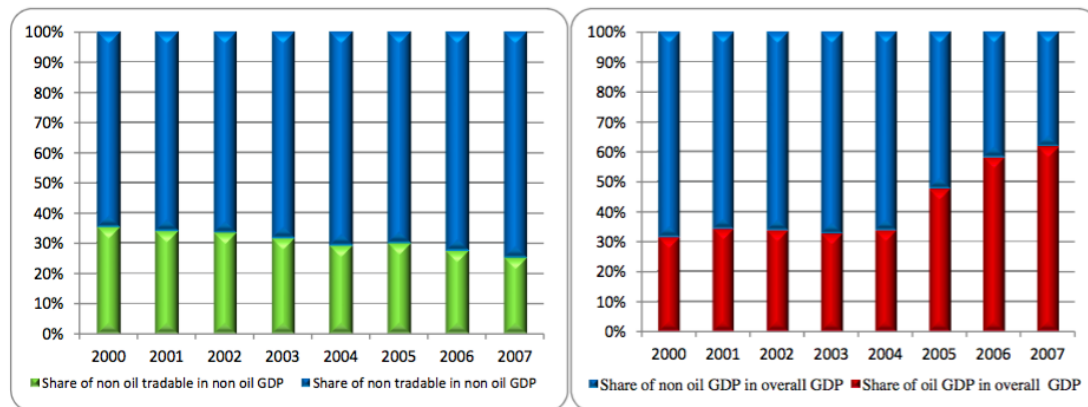
In spite of the fact that the development rate of non-oil tradable yield has declined, there have not been negative development rates.

Thus there has not been "supreme de-industrialization" but rather watched "relative de-industrialization" in the non-oil tradable division since 2004. It is worth to take note of that such sort of conclusion is steady with consequences of Kalcheva (2007) for the Russian economy.

As Egert (2009) states the principal sign of a conceivable Dutch Disease is an adjustment in an arrangement of ostensible GDP. In 1997 he calls attention to: "in the Dutch Disease writing, the expansion in the GDP offer of the blasting division isn't in question; rather, the urgent inquiry is whether the financial offer of the non-blasting tradable part is falling". Information plotted in Figure 2 demonstrates that amid 2000-2004 the offer of oil division in GDP has been roughly 30%, yet since 2004 it has forcefully expanded and has been over 60% out of 2007. In the meantime

the offer of the non-oil tradable segment in non-oil GDP has declined efficiently finished the period, yet this decrease has been more critical since 2004.

Figure 2.2: Shares of sectors



Source: SSCAR data

The execution from Figure 2.2 might be reliable with the disintegration in non-oil tradable and improvement in non-tradable sectors.

It ought not be reasoned that disintegration of the non-oil tradable and improvement in the non-tradable areas is the side effect of Dutch Disease unless test for elective factors that conceivably could cause the watched design. As specified over this proof might be identified with progress impact. The fact of the matter is that dissimilar to other asset bottomless economies in Europe and Africa, the Azerbaijan economy has confronted critical basic changes amid the post-Soviet progress period like Russia and different CIS nations. As indicated by Oomes (2007) numerous organizations, which had gotten critical state bolster amid Soviet circumstances, demonstrated useless and vanished when they were opened up to the world rivalry. In such manner, a progress impact can be considered as an elective clarification for watched relative de-industrialization of the non-oil tradable part in Azerbaijani economy.

Keeping in mind the end goal to test Dutch Disease impact together with a change impact, effects of the oil cost and time incline on the non-oil tradable yield have been evaluated. As appeared in Table 1, there has been monetarily important and measurably noteworthy relationship.

Table 1: Co-integration Analysis of Transition Effect

Dependent variable	NON OIL TRADABLE	
Explanatory variable	OIL PRICE	TREND
coefficients	- 0.888727	0.074750
t-statistics	[3.78867]	[-6.68447]
ECM coefficient	-0.706775	
t-statistics	[-3.04751]	
Jarque-Bera normality test	4.108108 (0.3916)	
Heteroskedasticity test	19.49503 (0.3620)	
AIC	-1.643910	
SC	-1.125281	
Log likelihood	34.83670	

The oil cost negatively affected the non-oil tradable division yield, at the end of the day, one percent expansion in the oil cost has prompted 0.889 percent diminish in the non-oil tradable part yield. The versatility of the non-oil tradable part's yield with respect to time slant has been 0.075. It implies that keeping different elements consistent, the non-oil tradable part's

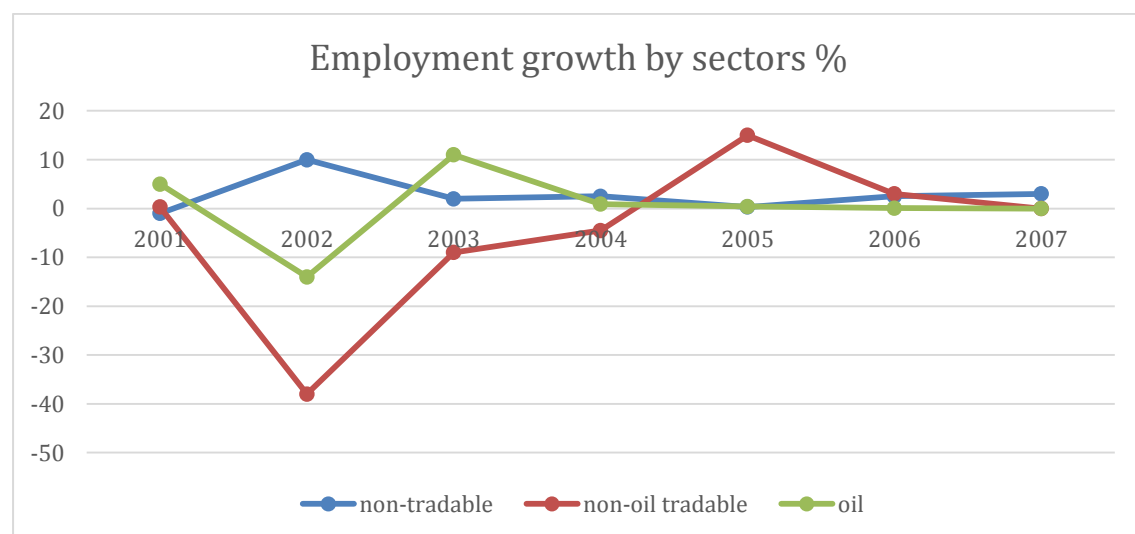
yield has expanded by 7.5 percent in each quarter. As appeared from estimation yields, progress impact which is reflected by time drift had not a negative effect on the non-oil tradable division yield. At the end of the day, it implies that relative de-industrialization of the non-oil tradable division yield can't be clarified by an elective clarification, for example, change impact. Be that as it may, as per estimation comes about, oil value filling in as an intermediary of oil part had a factually noteworthy negative effect on the non-oil tradable area.

Along these lines, in the wake of controlling the change impact, it can be presumed that Dutch Disease hypothesis has been more grounded than the elective clarification so as to clarify relative de-industrialization saw in the non-oil tradable part and advancement in the non-tradable division.

2.3.2 Labor force movement and Government expenditures

As the hypothesis shows that labor and capital are fundamental components of production, the adjustment in the production is right off the bat sourced from changes in these variables. It is critical to survey the progressions of work labor force in the areas of intrigue. The dynamic of work in each of the three segments over the period 2001-2007 was outlined in Figure 2.3:

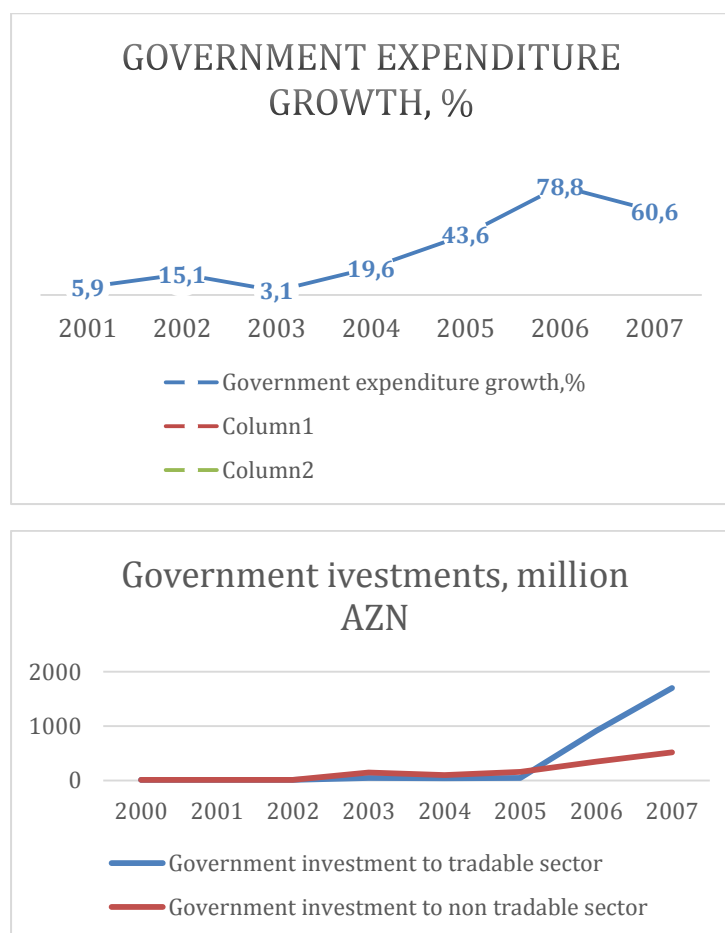
Figure 2.3: Growth of employment by sectors



As appeared from left chart in Figure 2.3, growth of employment in all segments and particularly in the oil and the non-oil tradable areas have been exceptionally unpredictable till 2004. Employment growth in the non-oil tradable and oil divisions has had descending pattern while non-tradable segment has shown upward pattern since 2005. Precisely saying, work development in the non-tradable segment has expanded from 1.4 percent in 2005 to 3.5 percent in 2007 while business developments in the

oil and the non-oil tradable areas have diminished from 2.8 percent and 15.5 percent to - 0.2 percent and - 1.0 percent separately. Along these lines, one can presume that recourse movement impact of Dutch Disease has not been noteworthy on Azerbaijan economy since employment growth in the oil area has not expanded, in actuality, it has taken after descending pattern over the period 2005-2007. Note that such sort of conclusion is reliable with finding of Oomes and Kalcheva (2007) for Russian economy. Truth be told, as demonstrated in the correct diagram of Figure 2.3, oil division in Azerbaijan isn't a work serious and there are not noteworthy work versatility between oil segment and different segments.

Figure 2.4: Government expenditures and government investments to non-oil tradable and non-tradable sectors

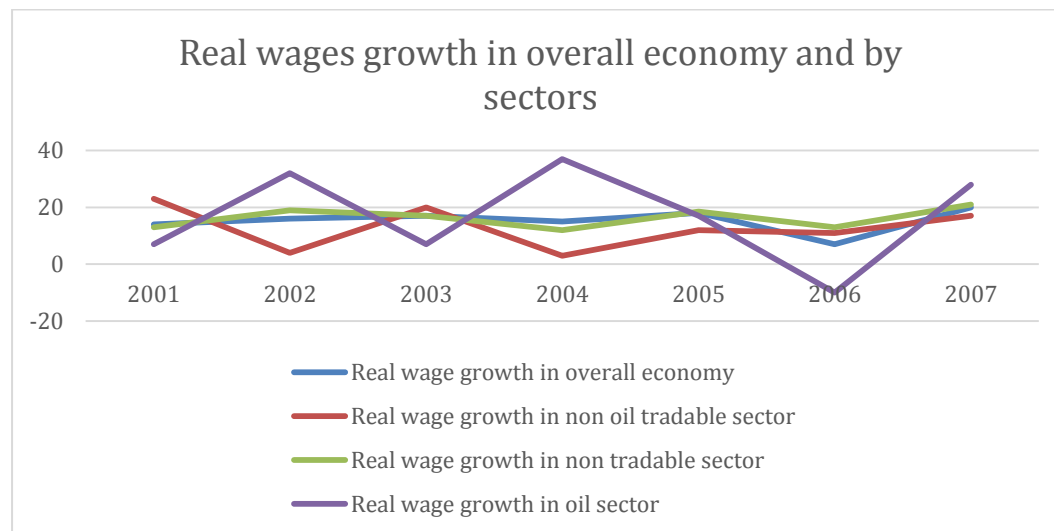


Subsequently, one can expect that "spending effect" is more critical than the "resource movement effect" in the Azerbaijani economy since 2005 in view of the supreme and relative increment of work in the non-tradable area and a reduction of work in oil and non-oil tradable parts. It is worth to take note of that our outcome is like discoveries of Westin (2004), and Kalcheva (2007) for the Russian economy. From another side as Gelb and Associates (1988) close infrastructural predisposition of government spending did not prompt salary producing action and in this manner thus, if there should be an occurrence of decreases in oil earnings, monetary incomes may endure and the economies may confront subsidence.

2.3.3 An increase in wage growth in overall economy

As it was determined, one of the testable speculations for testing an indication of the Dutch Disease is wage development in general economy. Figure 2.5 demonstrate average real wage and its development rate in general economy and furthermore by divisions.

Figure 2.5: Real wages growth in overall economy and by sectors



The correct diagram in Figure 2.5 exhibits that average real wage in the general economy has expanded after some time and even there has been an upward break in the incline since 2004. As appeared from the left diagram in Figure 2.5, real wage development in the oil area had high

and unpredictable elements all the more most likely identified with nature of oil costs especially since 2004. From the opposite side, real wage growth has been generally low in the non-oil tradable division, while it has been very high in the non-tradable area, presumably as the consequence of "spending effect". Since real wages growth rate both in the non-tradable segment and in general economy portray nearly similar directions it can be inferred that the wage increment in the non-tradable segment has been a benchmark for wage growth in the entire economy. This supposition sounds consistent, right off the bat in light of the fact that, as it was finished up over, the oil segment is capital serious than work and along these lines it doesn't give the work a chance to constrain move from different divisions to oil area; furthermore, the spending impact has been more essential in Azerbaijan, which has prompted high total request in the non-tradable part.

It is essential to test whether the quick real wage development since 2004 can be clarified by the components other than the Dutch Disease. One conceivable elective clarification is the supposed de-shadowization of wages, implying that beforehand unrecorded wages have slowly begun to show up in the official insights, inferring an expansion in announced growth of real wage yet not in real wage development. Lamentably, absence of the significant data identified with de-shadowization of wages, does not enable us to test this presumption.

Chapter 3. Analysis of the Azerbaijan Economy in terms of Dutch disease and assisting economic reforms

In this chapter, how the macroeconomic effects of the Dutch disease emerged in the Azerbaijani economy has been examined. In addition, economic models were estimated between exports, GDP and oil prices.

3.1. Macroeconomic Effects of Dutch Disease in the Azerbaijani Economy

When we look at the Azerbaijani economy from the point of "Dutch disease", it is seen that the effect of resource allocation from macroeconomic effects is very little. This result can be achieved by examining the employment situation in the Azerbaijani economy.

	2005	2010	2011	2012	2013
Total employment	4062,3	4329,1	4375,2	4445,3	4521,4
Agriculture	1573,6	1655,0	1657,4	1673,8	1678,9
Mining	42,3	41,5	41,2	41,8	42,1
Industrial	198,4	208,9	210,3	215,6	224,5
Construction	211,9	287,5	308,9	321,8	325,6
Public	256,6	279,1	281,0	281,7	282,3
Commerce	634,8	626,7	635,4	646,8	664,5
Transport and storage	174,6	179,1	181,8	182,7	183,2

Source: <http://www.stat.gov.az/source/labour/>

Table 3.1 shows that while the agriculture sector constituted 39% of total employment in 2005, 38% in 2010 and 2015 this indicator was 36%. The share of the mining sector in total employment was 1.05% in 2005 and it was around 0.83% in 2015. The industrial sector had 4.88% of employment in 2005, 4.82% in 2010 and 4.91% in 2015. Construction, public sector, commerce, transport and storage accounted for 5%, 6.3%, 15.6% and 4.3% of total employment respectively in 2005, while in 2015 these indicators were 7.2%, 6.14% , 14.8% and 4.2% respectively.

Despite the increase in the added value of the natural resource boom in the affected sector, there has been no significant change in the employment levels in other sectors. This situation is shown in detail in table 3.1.

Firstly, total employment was 4062.3 thousand persons in 2005, while in 2015 this figure increased by 609.3 thousand persons and reached 4671.6 thousand persons. While 198,4 thousand people were working in the industrial sector in 2005, this figure reached 229 thousand in 2015. When Table 3 is examined, there is also an increase in employment in agriculture sector. The natural resource boom for the theory of "Dutch disease" is predicted to be the labor movement towards the booming sector, which is the result of productivity and productivity growth in other sectors. It is seen that this situation does not appear when the employment data in the Azerbaijani economy is examined. This is mainly due to the fact that the mining sector in Azerbaijan is more capital intensive. In short, such a situation reveals that there is no direct industrialization as a result of the Azerbaijani resource allocation effect.

The spending effect has emerged in the Azerbaijani economy as an increase in public expenditures. When the figures in Figure 3.2 are examined, it appears that transfers from the oil fund to budget

expenditures have significantly increased since 2007. Transfers from the oil fund, which generated 10% of budget spending in 2007, have risen to 60% in 2013. The oil fund can not fully fulfill this situation if it is necessary to block the relationship between the oil revenues and the fiscal policy in the Azerbaijani economy.

When examined in Table 3.2 it is clear that oil revenues are an important source for the Azerbaijani economy.

The fact that the Azerbaijani economy is so dependent on the oil sector reveals the fact that fluctuations in world oil prices will deeply affect the economy of Azerbaijan.

Table 3.2. Transfers from the Oil Fund to the State Budget

Years	Budget Expenditures (Million manats)	Transfers from the (Million manats)
2005	2140	150
2006	3790	585
2007	6060	585
2008	10680	3800
2009	10557	4915
2010	11766	5915
2011	15394	9000
2012	17105	9905
2013	19143	11350

2014	18700	9337
2015	17786	8130

Source: SOFAZ, 2015: 31, CBAR, 2016: 6
http://www.oilfund.az/uploads/Annual_Report_2015_AZ.pdf

3.2. The policies that should be applied for the prevention of Dutch disease in Azerbaijan and resource curse

The "Dutch Disease" is a time of natural resource exploitation, which can be expressed as the economy grows rapidly over time and then the economy is affected in the negative direction. In Azerbaijan this situation is due to the fact that there is a high amount of hydro carbonaceous raw material in exports. High amounts of hydrocarbons exported to the country were abundant in foreign currency, and as a result, the country's money was overvalued. Then, the overexploited Azerbaijani economy in oil prices became difficult, Azerbaijan Central Bank (AMB) decided to go into floating exchange rate and it had to go to devaluation on 21.02.2015 and 21.12.2015. To get rid of similar negative consequences of the Dutch disease, the country can implement the following policies:

Fiscal Policy:

So as to avoid world value variances destabilizing the economy, nations can seek after a countercyclical financial approach. That implies, running spending plan surpluses when costs are high, and shortfalls when they are low. Running spending plan surpluses has the extra favorable position that it enables private area reserve funds to back private part venture instead of government shortages. It likewise decreases the gathered load of open segment obligation, which diminishes future intrigue

installments. Since spending plan surpluses draw in the consideration of spending divisions, campaign gatherings and assessment cutters, one method for protecting them is to exchange them to an extraordinary reserve, which is one of the reasons for oil funds.

Oil Fund

Numerous vitality rich nations round the world have made extraordinary assets into which an extensive piece of their lease installments is paid. Such a strategy has three objectives. In the first place, to balance out the economy by diminishing (or disposing of) the impacts of destabilizing monetary strategy coming about because of ware value instability. Also, to shield household makers from the impacts of upward weight on the swapping scale and consequently alleviate the Dutch malady. Thirdly, to aggregate resources for supplant the hydrocarbons that have been spent. The gathering objective is comparable to deterioration in organization funds. Similarly that organizations put aside cash to balance the diminishment in the estimation of their capital, so nations can set aside cash to balance the lessening in the estimation of their mineral assets. This guarantees their net resources are not decreased by vitality extraction but rather that they simply change their frame, from hydrocarbons in the ground to different resources. This empowers them to reinvest the oil cash in new salary creating resources. It likewise serves the objective of between generational value since it keeps the present age getting a charge out of the considerable number of advantages from limited assets however guarantees that future ages additionally advantage.

To the extent adjustment is concerned, the objective is to see that macroeconomic arrangement isn't destabilizing. For nations intensely reliant on unpredictable item costs, there is a threat that a rise in their cost will prompt an expansion in government consumptions and a downswing

to a reduction. Along these lines, monetary approach increases the impacts of the product unpredictability. By setting aside part of the godsend pay from high costs in an exceptional reserve, to be spent when vitality costs tumble to a lower level, monetary approach can be settling instead of destabilizing. This is totally sensible on a fundamental level. The trouble emerges in comprehending what is the long-run normal level of costs, above which income ought to be paid in to the adjustment finance, and beneath which the reserve ought to be spent.

To the extent amassing is concerned, a major issue is in which kind of advantages for contribute the reserve. It is traditional to put resources into outside budgetary resources, in order to diminish weight on the conversion standard and maintain a strategic distance from entrepreneurial hazard. In any case, the objectives of aggregation and between generational value might be served by an extensive variety of speculations from residential foundation to show-stoppers bought for local exhibition halls and direct responsibility for firms.

At the point when the cash in the oil/adjustment subsidize is put resources into outside resources, this decreases upward weight on the conversion standard and thus lessens the force of the Dutch malady.

In Azerbaijan the State Oil Fund of Azerbaijan was made by a presidential declaration of December 1999. However, these seem to have an alternate character from the assets in the other nation being utilized for the most part to back household venture as opposed to collect remote money related resources.

The production of exceptional oil reserves, for adjustment, hostile to Dutch infection, or amassing purposes, for example, has been done in the majority of the nations concerned, is a sensible approach in light of

universal experience and on the guidance of the IFIs. It is normally alluring that the assets be responsible and frequently evaluated and not transform into a slush subsidize for the head of detail.

Exchange rate policy

So as to stay away from, or at any rate to direct, the Dutch sickness, nations with vast current record surpluses coming about because of the fare of hydrocarbons need to keep the flood of remote cash prompting (over the top) money appreciation. There are an assortment of approaches to accomplish this. They incorporate capital fare (by means of an official oil store or private division outside venture), the development of residential utilization (prompting the import of shopper merchandise), the development of household speculation (prompting the import of venture products), and conversion scale mediation. The vitality rich CIS nations have utilized every one of these strategies. A striking aftereffect of the last said has been a fast development of remote trade holds. Russia, which in 1998 was not able meet its worldwide commitments and defaulted, by 1 January 2006 had gathered remote trade stores of US\$ 182 billion. Generous buys of dollars by national banks have the upsides of monetising the household economy and decreasing upward weight on the swapping scale.

The gathering of outside trade holds is valuable to shield the nation worried from conceivable future falls in vitality costs or sudden exit of remote capital. In any case, on the off chance that they ascend high that may recommend that the nation needs to animate residential utilization or local speculation. As a long run approach, it has neither rhyme nor reason for poor nations to loan cash to rich nations at low financing costs.

Diversification economy;

The dependence of Azerbaijani exports on the oil and natural gas sector should be reduced and exported goods should be diversified. At the same

time, the natural exploding sector should be made more resistant to shocks from international price fluctuations. If these measures are not implemented, natural resource reserves will be exhausted, or if the negative revenues of negative shocks decrease, there will be serious welfare loss in the country.

--Gains from hydrocarbon exports to R&D or infrastructure works. In such a case the manufacturing sector will become stronger in the economy. At the same time the manufacturing sector will be able to combat exchange rate and real wages.

In order to better evaluate the Azerbaijani economy in terms of "Dutch disease", the level of relation between oil revenues, exports and GDP is examined by econometric analysis.

3.3. Econometric Application

CONCLUSION

The enclave situation arises when the explosive sector does not use production factors that are active in other sectors of the economy. Looking at the Azerbaijani economy in terms of the Dutch disease, the boom of the income boom shows the enclave of the emerging oil sector. The fact that the petroleum industry is capital intensive has set the ground for the oil and natural gas sectors' share in employment to be very low. Despite the increase in production in the petroleum sector, employment did not lead to a decrease in employment in other sectors. In other words, there is no question of any labor mobility in the oil sector from other sectors. It is seen that the effect of the distribution of resources, which is

the effect of the Dutch disease, does not lead directly to industrialization in the Azerbaijani economy.

It is seen that the spending effect, another effect of the Dutch disease, is more dominant for the Azerbaijani economy. The main reason for this is that priority is given to the infrastructure works for development in the country. Therefore, the source of the explosion will arise after the completion of infrastructure investments in the country to which extent the changes in the sectors other than the living sectors depend on the Dutch Disability. From a different perspective, controlling the spending effect of the Dutch disease is highly dependent on how the oil revenues are managed.

As a matter of fact, the results of the researches and findings have not been clear that the Azerbaijani economy has been clearly captured by the Dutch Disease but it has been found that the risk of getting the Dutch Disease is high.

On the other hand, an analysis has been made about how the oil sector plays a role of locomotive for the Azerbaijani economy and how fluctuations in world oil prices will affect the economy. As a result of the analysis, a strong relationship between oil revenues and economic growth and exports has emerged.

As a result of the analysis, an increase of 1% in oil prices caused 1.79% increase in exports of Azerbaijan and at the same time an increase of 1% in oil prices led to a growth of 1.51% in Azerbaijan.

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