

WAYS OF ENSURING FISCAL SUSTAINABILITY IN AZERBAIJAN

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SUMMARY

Enhancing fiscal sustainability in Azerbaijan, or to put it more exactly, reducing the dependence of budget revenues on the oil sector has been one of the main challenges facing the country for many years. The sharp decline in the oil price observed since 2014 has made this problem even more relevant. The adopted Strategic Road Map and the changes made to the Law "On the Budget System" contain provisions on ensuring fiscal sustainability and set the upper limit of expendable oil revenues. However, it should be taken into account that fiscal dependence on the oil sector occurs through both direct and indirect channels. Therefore, there is a need for a comprehensive and systematic approach to the problem. This policy paper analyzes the status of fiscal sustainability using descriptive methods and examines policy options that can be used to ensure sustainability.

Earlier empirical studies and the author's own assessments stated that the increase in fiscal sustainability can be achieved by simultaneous and coordinated implementation of four policy options: (1) determine the upper limit of SOFAZ and direct oil sector taxes in the budget revenue; (2) determine oil-price sensitive non-oil sector areas and take further measures to reduce taxpayers' dependence on the oil factor; (3) expand the non-oil sector's tax base, minimize tax evasion and increase tax rates; (4) take additional steps to increase efficiency against the backdrop of reducing budget expenditure.

The paper analyzes and assesses all policy options. In the end, recommendations are provided on the basis of findings.

1. INTRODUCTION

From the standpoint of economic stability and elasticity against shocks, fiscal sustainability is crucial for any economy. The fact that "fiscal sustainability" is described as the first strategic objective in the "Strategic Road Map on National Economy Prospects of the Republic of Azerbaijan" approved by a decree of the President of the Republic of Azerbaijan from 6 December 2016 shows how important this problem is.

It would be helpful to briefly review the path of the country's economy to understand the level and features of fiscal sustainability in Azerbaijan. When analyzing the performance of the Azerbaijani economy since the country regained independence in 1991, researchers divide it in three stages: economic crisis (1991-1994), reconstruction (1995-2005) and the oil boom (after 2005) (Aliyev, 2014; Aliyev and Suleymanov, 2015). However, the sharp decline in the oil price which started on world markets in late 2014 brought the political and scientific concept of a "post-oil" era to the foreground for the Azerbaijani economy (Aliyev and Gasimov, 2018).

Although the adopted Strategic Road Map uses a different division methodology, it seems more appropriate for a clearer description of the issue to use the concept of an "oil boom" instead of a "sharp growth period" and a "post-oil" era instead of a "low oil price period". After the commissioning of the Baku-Tbilisi-Ceyhan oil pipeline in 2005, an economic breakthrough based on the extractive industry began and the dependence of budget-tax policies on the oil sector gradually increased. This, in turn, made fiscal sustainability a national priority in the context of the oil sector's elasticity. In early 2015, this issue became even more relevant and was reflected in the Strategic Road Map.

This policy document provides answers to the following research questions:

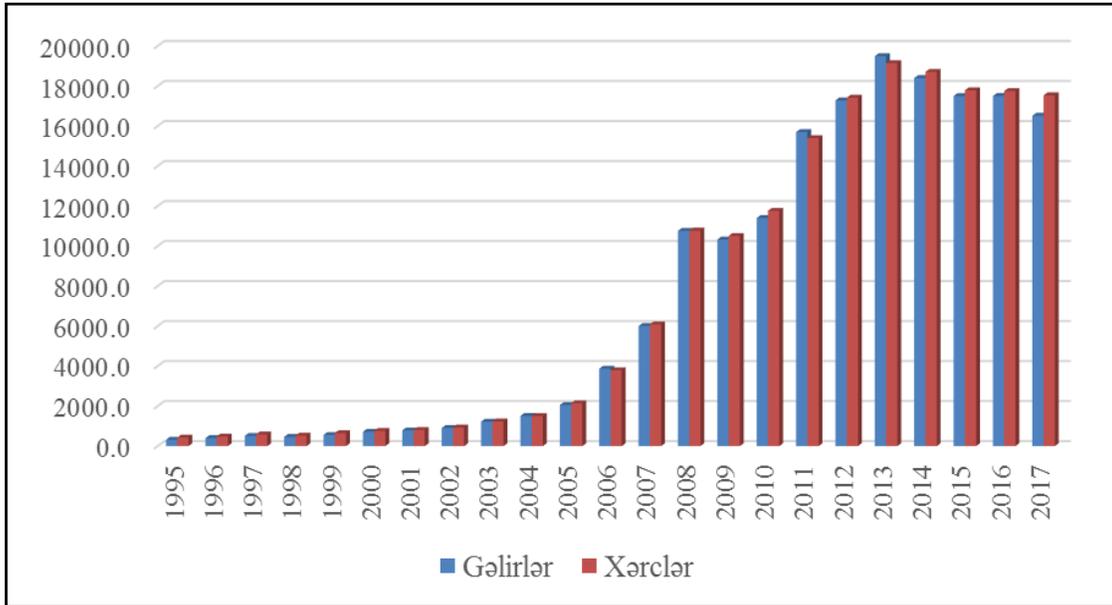
- What is the level of fiscal sustainability in Azerbaijan, what are the main threats and what is the action mechanism like?
- What alternative strategies are there to strengthen fiscal sustainability? What can be the best alternative solution in the current situation?

The available results of theoretical and empirical studies on Azerbaijan's economy were widely used in preparing this policy paper. The document consists of four main parts. Part 1, called "**Statement of the Problem**", reviews the level of fiscal sustainability, analyzes the main threat factors in Azerbaijan from a variety of perspectives and examines action mechanisms. Part 2, "**Alternative Options**", explains the proposed policy alternatives to strengthen fiscal sustainability and, along with their applicability, analyzes potential adverse impacts on economic activity. The next part, "**Assessment of Alternatives**", assesses proposed policy alternatives on the basis of existing theoretical and empirical experience. The "**Conclusions and Recommendations**" section summarizes research findings and provides suggestions and recommendations to relevant authorities.

2. STATEMENT OF THE PROBLEM

As mentioned above, after 2005, in parallel to the oil boom, a tough expansionary fiscal policy was initiated in Azerbaijan and budget spending dramatically increased (see Figure 1).

Figure 1: Azerbaijan's total budget revenue and expenditure (million AZN)

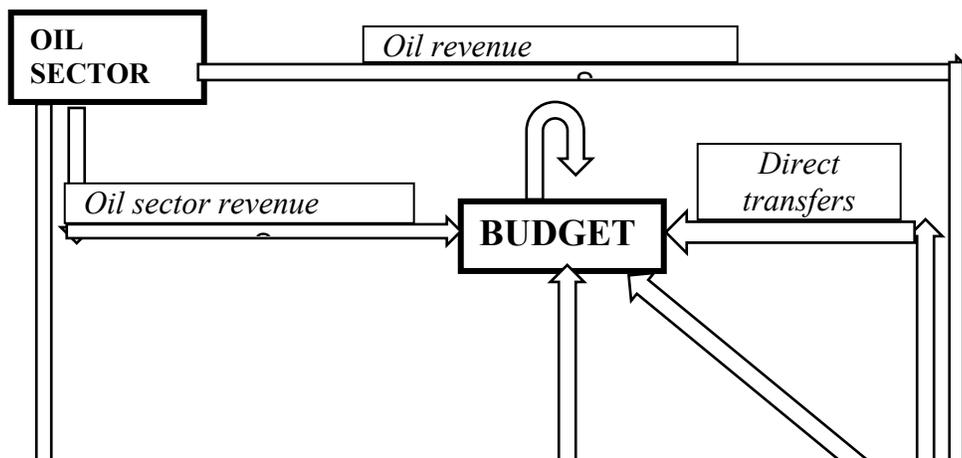


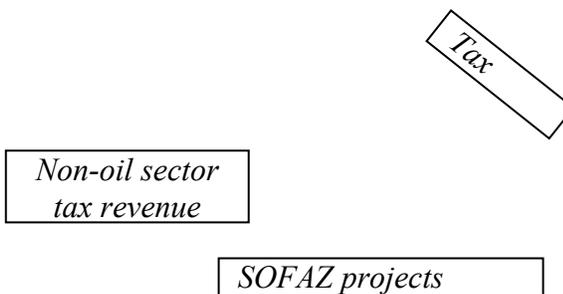
Source: State Statistical Committee of the Republic of Azerbaijan (SSCRA)

Since the sharp increase in expenditure was financed by growing oil revenue, especially direct transfers from the State Oil Fund of the Republic of Azerbaijan (SOFAZ) into the state budget, fiscal dependence on the extractive industry began to increase. If we look at the dynamics of Azerbaijan's state budget revenue and expenditure in 2005-2017, we can observe leaps and halts associated with the price of oil on world markets and the level of oil production in the country, which also be understood as poor fiscal sustainability. The mechanism describing the role of oil in the formation of budget revenues explicitly shows fiscal vulnerability. Such a mechanism was developed by Musayev and Aliyev (2017) (see Figure 2).

Figure 2 shows that the dependence of budget revenues on the oil sector is not limited to direct transfers from SOFAZ. Under such circumstances, direct tax payments from the oil sector, indirect proceeds from the non-oil sector and tax revenue generated by the state budget must also be taken into account. On the other hand, it should also be remembered that some state projects were financed by SOFAZ.

Figure 2: Role of oil in budget revenue





Source: Musayev and Aliyev (2017), p.1025.

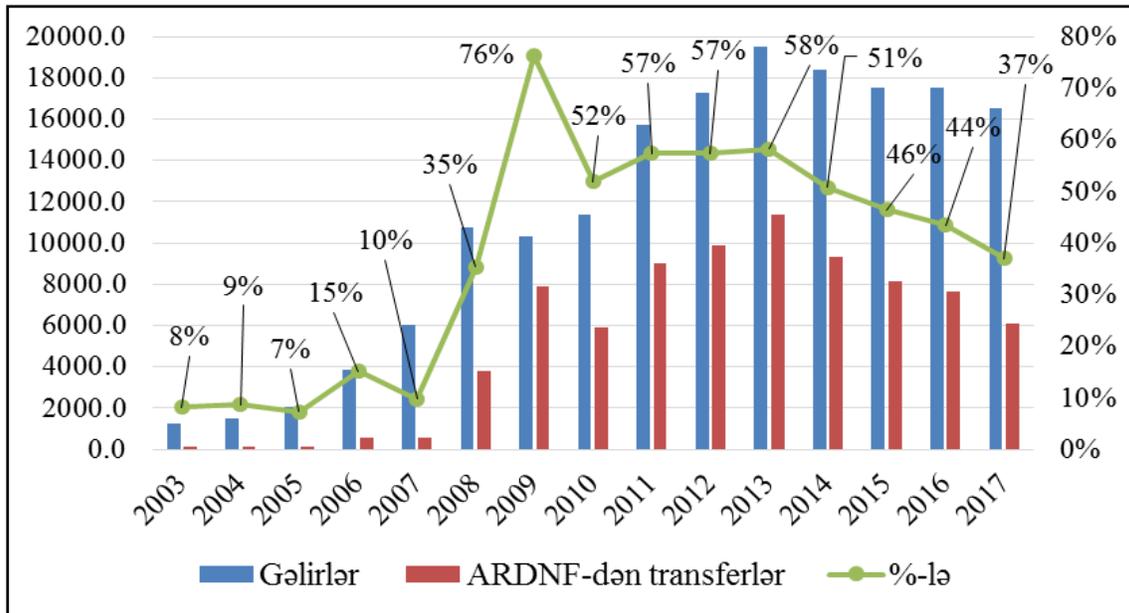
It is practically impossible to calculate the tax base indirectly created by the oil sector in the non-oil sector. Also, there is no accurate information on the amount of tax revenue generated by budget expenditures incurred on the account of oil revenue. It is possible that the volume of tax payments from SOFAZ will not significantly affect fiscal sustainability. According to the statistical data on SOFAZ's official web site, as of 1 July 2018, the Fund spent about AZN 8.8 billion on the implementation of state-funded projects.

Of course, the biggest impact on fiscal sustainability occurs as a result of direct transfers from SOFAZ and direct tax revenue from the oil sector. In general, SOFAZ directly transferred AZN 82.23 billion to the state budget as of 1 July 2018. According to the Ministry of Taxes of the Republic of Azerbaijan, the oil and gas sector accounted for AZN 27 billion (or about 46 percent) of the aggregate tax payments of AZN 58.7 billion in 2000-2017. Based on these indicators, we can calculate the minimum threshold of budget dependency on the oil sector. According to the SSCRA, the aggregate revenues of the Azerbaijan state budget in 2000-2017 was AZN 172 billion. If we add the total amount of direct SOFAZ transfers (AZN 82.23 billion) to direct oil and gas sector taxes (up to AZN 27 billion by 2015) and divide this by total budget revenues, we will have 0.635. If we include SOFAZ's additional expenditure of AZN 8.8 billion which is not reflected in budget revenues $((82.23 + 27 + 8.8) / ((172 + 8.8) = 0.652)$, this ratio will be 0.652. In other words, at least 63-65 percent of budget revenues in Azerbaijan were formed directly from the oil and gas sector in 2000-2017. This confirms the high level of fiscal sensitivity to changes in the oil sector.

For a clearer picture, the dynamics of change in fiscal dependence on oil sector is presented in Figures 3-4.

Direct transfers from SOFAZ, one of the main sources of state budget revenue, accounted for less than 15 percent by 2008. However, when direct fiscal expansion began in 2008, the volume of direct transfers into the state budget increased 6.5 times and their share in total revenues 3.5 times. In 2009, the highest level of direct transfers was recorded (76 percent). In the following years, this indicator slightly reduced to 51-58 percent, while after 2015, which is referred to as the start of a post-oil era, direct transfers from SOFAZ accounted for less than half total budget revenues.

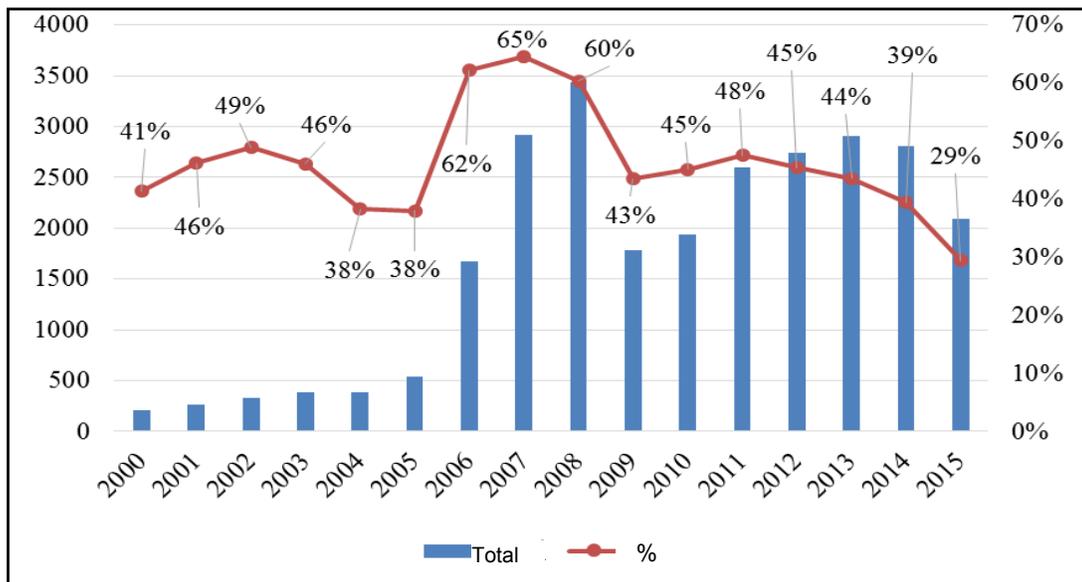
Figure 3: Direct SOFAZ transfers (million AZN) and their budget share (%)



Source: Prepared by author using SSCRA and SOFAZ data

Another key indicator of fiscal dependence on the oil sector is the share of this sector in tax revenue (see Figure 3). As is evident, 40-50 percent of tax payments were contributed by the oil and gas sector even before the oil boom.

Figure 4: Oil and gas sector tax revenues (million AZN) and their share (%)



Source: Prepared by author using Ministry of Taxes data

After 2005, this indicator shot up to 60-65 percent. After dropping to 43 percent in 2009, it gradually rose to 48 percent but then hit a downward trend again. The lowest level in the analyzed period was 29 percent in 2015.

The fact that fluctuations in tax revenue from the oil and gas sector went hand in hand with oil price fluctuations on world markets should be seen as very important for Azerbaijan in terms of fiscal sustainability. In general, as observed in the recent past, the oil factor is of great importance for fiscal sustainability in Azerbaijan and is almost the key factor in that. Empirical studies confirm that the impact of the oil factor on fiscal sustainability also depends on the non-oil sector revenue and other payments into the state budget (see Musayev and Aliyev, 2017; Aliyev, 2017; Aliyev, Ismayilov and Gasimov, 2018). Results of the empirical studies will be widely analyzed when evaluating policy alternatives.

Thus, both graphical analysis of the existing statistical indicators and the results of empirical assessments show that fiscal sustainability in Azerbaijan demonstrates a serious sensitivity in relation to the oil factor. In this context, it is quite understandable that the adoption of the “golden rule” governing transfers of oil revenues into the state budget is regarded as a top priority for “strengthening fiscal sustainability” in the Strategic Road Map. In order to ensure fiscal stability, it is necessary to prepare and implement strategies that would minimize sensitivity in relation to the oil factor.

3. POLICY ALTERNATIVES

The previous section analyzed the current state and dynamics of fiscal stability in Azerbaijan against the backdrop of the oil factor. Recommendations for the use of various economic and political instruments to ensure fiscal sustainability, which is seen as one of the top priorities for the country, were voiced by experts. This policy paper analyzes four policy alternatives for achieving fiscal sustainability:

- a. Determination of the upper limit of SOFAZ and direct oil sector taxes in budget revenue;*
- b. Determination of oil-price sensitive non-oil sector areas and additional measures to reduce taxpayers' sensitivity in relation to the oil factor;*
- c. Expansion of the non-oil sector tax base, minimization of tax evasion and increase of tax rates;*
- d. Additional measures to enhance effectiveness against the backdrop of reducing budget expenditure.*

The first three of the proposed options view fiscal sustainability in the context of income stability, while the last alternative views it through the prism of budget spending efficiency. The first alternative proposes to exercise control over oil sector transfers into the state budget and envisages the establishment of an upper limit on direct transfers from SOFAZ and other payments into the budget. This should lead to the identification of specific fiscal rules. Increasing non-oil sector tax revenues through the use of extensive and intensive methods is presented as a second alternative. The third policy alternative

recommends that additional measures be taken to safeguard the stability of non-oil sector tax revenue and minimize sensitivity in relation to changes in the oil sector (price and production fluctuations). The last alternative proposes, in parallel with the reduction of budget expenditures, to minimize adverse impacts on the non-oil sector and, consequently, increase fiscal sustainability.

4. ASSESSMENT OF ALTERNATIVES

The importance of fiscal sustainability for the country's economy and the complex nature of the problem require a more careful approach. Therefore, every alternative approach proposed should be thoroughly analyzed and added to the "possible alternatives" basket after it has been supported by empirical research results. In general, it would be more useful to introduce multi-vectoral alternatives to enhance fiscal sustainability.

A. Determination of the upper limit of SOFAZ and direct oil sector taxes in budget revenue;

As mentioned earlier, direct transfers from SOFAZ and tax revenue from the oil sector are the biggest contributors to the state budget. However, it is important to set a limit for such transfers as this is an easy-income area which is exposed to a high level of instability depending on the world oil price. It is also important to save oil revenues for future generations. The fact that reduction of the dependence on oil is high on the agenda of the Strategic Road Map confirms the importance of this policy alternative.

However, although it seems reasonable to determine a limit to oil revenue transfers into the state budget, there is still a need for a detailed analysis. The key question is what an upper limit means. This issue can be approached both from the perspective of fiscal rules adopted in the interests of long-term sustainability and from a quantitative standpoint.

From the perspective of fiscal rules, it is possible to say that the legal framework is already in place. The fiscal rules defined in the "Strategic Road Map on National Economy Prospects of the Republic of Azerbaijan", approved by a presidential decree from 6 December 2016, and the amendments introduced to the "Law on the Budget System" on 29 June 2018 constitute the legal framework. As a result of the amendments to the law, a mechanism has been put in place to establish an expendable amount of oil revenues. According to this mechanism, the amount of expendable oil revenues is the difference between 30 percent of net financial assets as of the beginning of the financial year and the amount of expected oil revenues for the same financial year. Then this figure is added to the smaller of the two indicators¹. The amount of net financial assets is calculated by subtracting the difference between the internal and external public debt from the aggregated amount of the balance of the State Oil Fund, the balance of the single treasury account, funds allocated for management from the single treasury account, the liabilities of foreign states under the agreements signed on behalf of the

¹ Amendments to the "Law on the Budget System". <http://www.e-qanun.az/framework/39838> , 01.12.2018

Republic of Azerbaijan and current year liabilities of state companies for servicing their state budget obligations.

The concept of "oil revenues" represents a sum of revenues of the State Oil Fund of the Republic of Azerbaijan and income from oil and gas operations (excluding the income tax of natural persons).

As is evident, the fiscal rules described in this policy alternative were already followed in the preparation of the draft state budget for 2019. Exceptions to the rules are also reflected in the law.

Nevertheless, the determination of the limit to SOFAZ transfers as part of the fiscal rules does not yet translate into rational utilization of resources. This, in turn, calls the effectiveness of the rules into question. In the long run, in order to maintain economic stability, reduce economic dependence on natural resources and build a knowledge-based economic system, it is necessary to apply additional rules on effective utilization of SOFAZ funds.

On the other hand, when determining the upper limit to the use of oil revenues it might be useful to take into account the state of the national economy at different stages. It is advisable to use a smaller portion of the oil revenues at times of viable economic activity and when internal and external risks are relatively low. It would also be useful to prepare a mechanism for the funds saved from previous years to be used during oil price and production fluctuations and in order to increase economic activity in times of crisis. Another alternative for using the savings is to announce open bidding or grant competitions to raise the level of knowledge and finance long-term and fundamental research projects.

Modern experience and scientific research show that the introduction of expansionary budget policies, particularly in countries where expenditure is largely financed by resource revenues, can significantly reduce the effectiveness of budget spending. Therefore, in order to ensure fiscal sustainability in Azerbaijan, it is necessary to introduce broader policies to set a limit for the use of oil revenues.

B. Determination of oil-price sensitive non-oil sector areas and additional measures to reduce taxpayers' sensitivity in relation to the oil factor;

As noted earlier, the oil factor also has indirect influence on fiscal stability. In this context, it is important to ensure the elasticity of non-oil tax revenues of the state budget to changes in the oil price and production. The empirical studies carried out have revealed significant results. A research carried out by Musayev and Aliyev for Azerbaijan (2017) points to a 0.42-0.56-percent increase in non-transfer budget revenues (aggregate budget revenues after deduction of direct SOFAZ transfers) in the event of a 1-percent oil price increase and a 0.52-0.53-percent increase in the event of an increase in daily oil production by 1 percent. Although these coefficients may seem rather weak in terms of elasticity, they are undoubtedly strong if units of measure and variation factors are taken into account. However, the research does not evaluate how such dependency would change by sources of income.

In this context, the empirical assessments by Aliyev and others (2018) provide more information on fiscal dependence on the oil factor. The empirical research assesses how the oil price and production volumes will affect the amount of non-oil revenues in Azerbaijan and state budget's proceeds from different tax types. The findings show a

parabolic dependence between non-oil tax revenues and the world oil price. Parabolas for cumulative tax revenues, income tax and profit tax are pointed downwards (rising and dropping effect) and the oil price at the threshold level of the parabola is \$69, \$79 and \$67 respectively. The research finds that, unlike other types of taxes, the parabolas showing the impact of the oil price on Value Added Tax (VAT) are pointed upward (U-shaped) and the oil price at the point of transition is \$79.

In other words, the price of oil also has a significant and indirect impact on the behavior of non-oil sector taxpayers. Increase of the price of oil up to \$69 stimulates the "produce and sell" trend among non-oil sector producers. If the price exceeds \$69, the tendency to "import and sell" increases, while at \$79 it leads to a reduction in income tax for individuals (Aliyev and others, 2018). In the same study, Aliyev and others (2018) establish that VAT revenues increase by 0.93-0.97 percent against a 1-percent increase in oil production, while the impact on other taxes is not significant.

As is evident, by affecting the volume of non-oil sector taxes, the oil factor increases fiscal sensitivity. Therefore, in order to strengthen fiscal sustainability it is important to identify non-oil sector areas that demonstrate sensitivity to the oil factor, in particular to oil price fluctuations in world markets. This requires additional scientific research.

After a thorough analysis of the problem, it is advisable to carry out activities to reduce taxpayer sensitivity.

C. Expansion of the non-oil sector tax base, minimization of tax evasion and increase of tax rates;

One of the main policy alternatives aimed at strengthening fiscal sustainability is to increase non-oil sector payments against the backdrop of steps towards increasing non-oil tax revenues, expanding the tax base and/or increasing tax rates. Of course, it is also necessary to include the penalties and framework to minimize tax evasion.

It is necessary to view the changes to the Tax Code of the Republic of Azerbaijan to be introduced in January 2019 against the background of this policy alternative. Although the proposed changes are, on the one hand, intended to reduce the tax burden, on the other, they will result in increasing non-oil sector tax burden by expanding the tax base and dramatically reducing the coverage of simplified tax. More specifically, starting from 1 January 2019 and for a period of seven years, those working in the non-oil sector and earning less than AZN 8,000 will be exempt from income tax and a 14-percent discount will be applied to those earning more. Since coverage of the proposed amendments is quite broad and their overall impact on non-oil tax burden is still being discussed, it is not important to thoroughly analyze them in this policy paper.

The main goal of this policy paper is to carry out a scientific or, as far as possible, empirical evaluation-based analysis of policy alternatives that can be used to increase fiscal sustainability. An empirical assessment carried out by Nadirov et al. (2017) indicates that the tax factor does not have a significant impact on employees' labor activity in Azerbaijan. Results of the said research show that this does not affect socioeconomic characteristics of employees either. The survey reveals that the majority of respondents answered the question "How would your business motivation change if the income tax rate were increased by 5 percent?" by saying "it would not change". This suggests that employees in Azerbaijan are not vulnerable to income tax. In this context, it is possible to say that the proposed income tax amendments to the tax code regarding

work without an employment agreement or replacement of service agreements with employment agreements are unlikely to produce tangible results.

On the contrary, the administrative burden is low because income tax payments are deducted from direct income. Given people's non-vulnerability to tax rates, it would be more effective to increase income tax and keep or even alleviate the tax burden on entrepreneurs. It is difficult to predict how restrictions on simplified tax will affect the rate of employment.

In general, the tax breaks applied to the private sector in Azerbaijan over the past two decades have not produced the desired result. Analyses show that entrepreneurs see other institutional and legal matters they are facing as an obstacle for their activities. The "enterprise surveys" carried out as part of a 2013 empirical analysis of factors affecting tax evasion in Azerbaijan, conducted by Aliyev (2018a) with support from the World Bank, revealed that the increase in tax rates does not have a significant impact on the tax evasion trend. The survey also shows that labor market regulations have no significant impact on tax evasion either. The results of empirical assessments show that the key determinants of tax evasion are other institutional factors, in particular close contacts (communication) with senior tax officials and confidence in the judiciary.

Obviously, the proposed amendments to the Tax Code will seriously reduce state budget's tax revenues. To find out how revenues from other taxes will change requires more in-depth empirical analysis. However, since increasing fiscal sustainability is the top priority, there is a need for the policy to expand the non-oil tax base and increase tax revenues. For these reasons, it is unlikely that changes in income tax will result in a favorable outcome.

Analyses show that the steps to be taken within this policy alternative should focus more on institutional reforms. In particular, further liberalization of the economy and emergence of a competitive environment will lead to the expansion of the tax base, while solution of institutional issues will minimize tax evasion. This, in turn, will result in increased fiscal sustainability.

D. Additional measures to enhance effectiveness against the backdrop of reducing budget expenditure.

The previous three policy alternatives view fiscal sustainability through the prism of revenues. However, perhaps the most important is to look at ways of ensuring fiscal sustainability while increasing budget spending efficiency. Budget spending in relation to the non-oil sector of the Azerbaijani economy is fairly quite large and, according to the Keynesian theory, it is possible to expect a significant positive impact on the economy in the long term. On the other hand, by creating the demand effect in the economy, budget spending will form an additional tax base and contribute to fiscal sustainability through the revenue window.

Various empirical surveys have been conducted to assess the impact of budget spending on non-oil sector production in Azerbaijan. It has been established that there is a significant positive effect in the long term (Aliyev and others, 2016; Dehning et al., 2016; Aliyev and Nadirov, 2016; Aliyev and Mikayilov, 2016; Hasanov et al., 2018; Mukhtarov et al., 2018, Jabrayilova and Aliyeva, 2018). However, Devarjan et al. (1996) have empirically substantiated the importance of the "productivity paradox" effect on budget

spending efficiency, maintaining that excessive resource utilization will reduce efficiency and even make "productive" costs "unproductive".

Dehning and others (2016) and Aliyev (2018b) have attempted to measure the impact of the "productivity paradox" in Azerbaijan's budget policy. Using dummy variables in their empirical assessment, Dehning et al. (2016) concluded that the long-term impact of oil boom (2005-2015) spending on the non-oil sector reduced for investment by 11.6 percent, for education by 9.7 percent, for healthcare by 11.3 percent, for other social areas by 11.3 percent, for administrative costs by 6.4 percent, and for other areas by 10.6 percent.

Aliyev (2018b) takes a different perspective and argues that the effectiveness of aggregate budget expenditures has declined substantially since the oil boom started in 2008, especially after the sharp increase in direct SOFAZ transfers. Evaluation was performed separately for the 2000Q1-2009Q3 and 2009Q3-2018Q1 time periods after the spending efficiency break point was determined at 2009Q3. The results of the study indicate that in the second period (2009Q3-2018Q1), as compared to the first (2000Q1-2009Q3), the long-term effectiveness of budget spending dropped four to six times. There was no significant impact on non-oil GDP. This can be viewed as scientific confirmation of the productivity paradox in Azerbaijan.

As you can see, the prospects for reducing budgetary spending to increase fiscal sustainability are also quite sizable. However, it is absolutely necessary to increase the efficiency of spending in order to minimize adverse impacts on the non-oil sector.

5. CONCLUSIONS AND RECOMMENDATIONS

This policy paper analyzes ways of increasing fiscal sustainability in Azerbaijan and evaluates various alternative approaches. The dependence of fiscal sustainability on the oil sector and sensitivity in relation to the world oil price require both diversification of budget revenue sources and effectiveness of spending.

It would be wrong to approach fiscal sustainability from one perspective. Although the volume of oil revenue and its share in gross revenues are the key contributors to sustainability, the other two components – increase in the volume of non-oil revenues and budget spending efficiency – should also have a place in policy priorities.

This paper highlights the importance of a more comprehensive approach to increasing fiscal sustainability. The establishment of fiscal rules and the development of a mechanism to set the upper limit for expendable oil revenues are not enough to ensure long-term fiscal sustainability. Therefore, the issue needs to be addressed thoroughly. In other words, in addition to fiscal rules, economic nuances should also be taken into account. Fiscal rules should be designed to strengthen sustainability against economic shocks. In other words, they should be counter-cyclical. The current fiscal rules do not have this feature.

In order to ensure fiscal sustainability, it is necessary to determine oil-sector dependent non-oil areas. Tax revenue from these areas should also be considered as a risk factor in

this context because in cyclical situations related to oil shocks, there may be significant changes in the amount of tax payments from them. There is a need for further analysis in this direction.

Reduction of budget dependency on oil against the backdrop of expanding the non-oil sector's tax base, increasing the tax rates and strengthening the fight against tax evasion may be considered as an extremely powerful policy alternative in times of economic stability. Observations show that these provisions are not treated seriously when reform-oriented steps are taken.

Increasing the efficiency of budget spending is the starting point of fiscal sustainability. No fiscal rules or alternative policies can succeed in the absence of spending efficiency. First of all, when looking at the classification of budget spending to address the productivity paradox, the level of efficiency should be assessed and the participation of civil society should be ensured in the monitoring of fundamental state projects.

It is possible to conclude at the end of this analysis that the above-mentioned policy options should not be seen as alternatives but should actually complement each other. Fiscal sustainability in Azerbaijan can only be achieved if all policy alternatives are implemented in a concerted manner.

In institutional terms, the following specific steps are proposed for the agencies contributing to fiscal sustainability:

- **The Ministry of Finance of the Republic of Azerbaijan** and relevant organizations subordinated to it, when preparing a budget proposal for each year, should provide scientific justification on the necessity and expected economic effect of expenditures for each expense category based on the results of the empirical analysis. To make the process more transparent, empirical analysis of the effectiveness of budget expenditure should be entrusted to an independent body or experts provided that relevant database is provided.
- **The Ministry of Taxes of the Republic of Azerbaijan** and relevant organizations subordinated to it, when preparing a forecast of tax revenues for next year, should provide an empirical assessment of the impact of possible oil and non-oil economic shocks (sharp fluctuations of the oil price and production volume, sharp fluctuations in the rate of the national currency, etc.) on the volume of revenue for each tax type. This forecast should be based on the results of analysis. Non-oil sector areas vulnerable to economic shocks should be identified and policy alternatives prepared. A roadmap for increasing tax revenues from the non-oil sector in the medium and long term, expanding the tax base and minimizing tax evasion should be prepared. Independent institutions and experts should be involved in such empirical analysis.
- **The Chamber of Accounts of the Republic of Azerbaijan**, when expressing opinion on the draft state budget for next year, should require relevant bodies to provide a statement based on the results of the empirical analysis of the predicted amount of budget revenues and the effectiveness of proposed expenditure, and provide an alternative assessment in this opinion.
- **The Milli Majlis (National Assembly)**, which discusses the draft law "On the state budget of the Republic of Azerbaijan" for each year, should require relevant bodies to provide a statement on the current status of fiscal sustainability and scientific justification of this issue.

- The scientific justification and empirical analysis conducted to ensure transparency should be shared with the public, and **decision-makers** should be open to criticism and proposals.

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