



Entrepreneurship Development Foundation (EDF)
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STATE POLICY ON REDUCING THE NEGATIVE IMPACT OF THE MANAT DEVALUATION ON THE BUSINESS SECTOR

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1. INTRODUCTION

In contrast to the 2008-2009 global financial recession, the depreciation of oil on world markets at the end of 2014 had an adverse impact on the Azerbaijani economy. The price of Brent reduced in half in the latter half of 2014 – from \$115 to 56 per barrel. The oil price plummeted further to \$29 in subsequent months. Against the backdrop of reducing oil revenues, oil-rich countries entered a period of an economic downturn. First, they spent their exchange reserves to protect the national currency and macroeconomic stability. Then, in order to protect the exchange reserves, they had to devalue national currencies. In an effort to protect the national currency from the global crisis, the Government of Azerbaijan has to drastically reduce the value of the national currency in half. In 2015, the exchange rate of the national currency depreciated by 50%, falling from \$1.28 to 0.65 for 1 manat. The soft depreciation of the manat subsequently continued. At present, the official exchange rate of the manat is \$0.53. Devaluation dealt the first blow to the banking sector. About a third of banks and 8.3% of non-bank credit organizations operating in the country were shut down and left the market. The bank sector was quickly dollarized. All this has had a negative impact on entrepreneurship. The reduction in population incomes led to a weakened purchasing capacity. As a result of the manat devaluation, prices increased, while the demand for goods and services dramatically decreased. This also affected the turnover of businesses. The results of a survey carried out among small and medium-sized businesses as part of this study show that the average monthly turnover of more than 80% businesses reduced and 72.6% resorted to staff cuts. The dollarization has led to the fact that the proportion of foreign currency loans has increased from 31.2 to 53.8% in the 2012-2016 period. The dollarization of deposits reached 75.6% at the end of 2016. The depreciation of the national currency and the pervasive dollarization of the economy have resulted in a number of problems for

businesses. This is also confirmed by the surveys and interviews conducted, as well as the analysis of statistical data. As a result of the reduced demand for goods and services, the turnover of businesses has dramatically shrunk. Eventually, the incomes of businesses have dropped and losses increased. More cases of business closures were observed in comparison with earlier periods. In particular, the number of industrial enterprises reduced by 29.1% and construction companies by 5.5% in 2015. This has led to extensive staff cuts. According to the State Statistical Committee, the number of hired workers reduced by 1.13% in 2015.

Businesses have also had their access to loans restricted. The allocation of loans in both national and foreign currency has reduced. The expectation of devaluation compelled banks to reduce the allocation of loans in the national currency. Devaluation has also made the repayment of loans taken in foreign currency more difficult. As a result, some companies were taken over by banks. Some were left without loans, others had to put their property on sale.

As a direct impact of devaluation, 13 banks were closed. Some banks were faced with liquidity problems and had to limit the capacity of businesses to dispose of their money in banks. The exchange rate instability of foreign currencies and the frequent shortages of dollars on the market adversely affected importers.

The government took a number of steps to support businesses in the wake of devaluation. This includes a suspension of illegal inspections, simplification of licensing and import procedures, the introduction of tax amnesties and breaks, and measures to boost exports.

2. BUSINESS IMPACT OF DEPRECIATION (DEVALUATION) OF THE NATIONAL CURRENCY

The fact that the national currency, which had remained stable for a long time, lost much of its value over a short period of time put the business sector at risk. Things were compounded by the poor

development of small and medium-sized businesses, the dependence of the business sector on the oil money and its expansion at the expense of oil revenues. As a result, economic activity weakened, jobs were closed, turnover reduced, wages dropped and losses increased.

The impact of devaluation on the business sector can be systematized as follows:

- **Drastic reduction of business turnover resulting from poor demand for goods and services.**

The depreciation of the national currency in relation to foreign currencies led to a price hike. Considering the fact that a large portion of non-food items, 20% of food products are fully and 80% partly dependent on imports, price went up. In addition, population incomes were not commensurate with the price increase. In other words, the reduction in real incomes led to a drop in the purchasing capacity of the population and weakened the demand for goods and services.

The survey conducted among small and medium-sized entrepreneurs as part of this study shows that four fifths of them noted a turnover reduction. According to 40% of those polled, their average monthly turnover has reduced 40-60%. In fact, 20% of those polled said their losses exceeded 60%. 13.3% of those polled said their turnover had reduced by up to 20% and 26.7% said the reduction was around 20-40%.

The official reports of the State Statistical Committee show that devaluation has had a negative impact on the output of a number of small businesses. Although growth rate in certain fields was quite high before 2014, it slowed down in some areas in 2015, while some even registered a decline. The reduction mainly occurred in important economic sectors. While production in agriculture, forest management and fishing sectors increased by 98% in 2014, it dropped

by 78% in 2015. In 2015, the year of devaluation, the reduction in industry constituted 51.7%, in IT and communications 66.5%, in construction 58.9% and in real estate transactions 46.9% (**Chart 1**).

- **More businesses are closed.**

Against the backdrop of growing consumer prices and the reducing purchasing capacity of the population, the turnover reduction caused some of them to close. The surveys carried out and official reports show that more businesses were closed in 2015-2016 than before.

The survey carried out as part of this study shows that 7.7% of those polled closed their businesses in the aftermath of devaluation.

According to official reports of the State Statistical Committee, this has had a negative impact on the growth rate of the number of small businesses (**Chart 2**)

- **Weakened personnel potential due to staff cuts in businesses**

The sharp decline in the incomes of businesses starting from 2015 compelled them to take a number of drastic steps. One of such steps was personnel reduction. Significant staff cuts in some businesses and wage (and/or benefit) cuts (and complete removal of the latter) in others increased unemployment on the one hand and accelerated the outflow of qualified professionals. In a Cabinet of Ministers meeting dedicated to the results of the first half of 2016, the President of Azerbaijan said a total of 26,000 jobs were closed in the country in the first six months of the year.

The biggest reduction occurred in construction and industry sectors in 2015. While the number of industrial enterprises increased by 19.6% in 2013 and by 24.1% in 2014, it reduced by 29.1% in 2015. Whereas the number of small industrial enterprises was 5,173 in 2013 and 6,418 in 2014, it fell to 4,551 in 2015. In construction companies, while there was an increase by 10.1 and 20.6% respec-

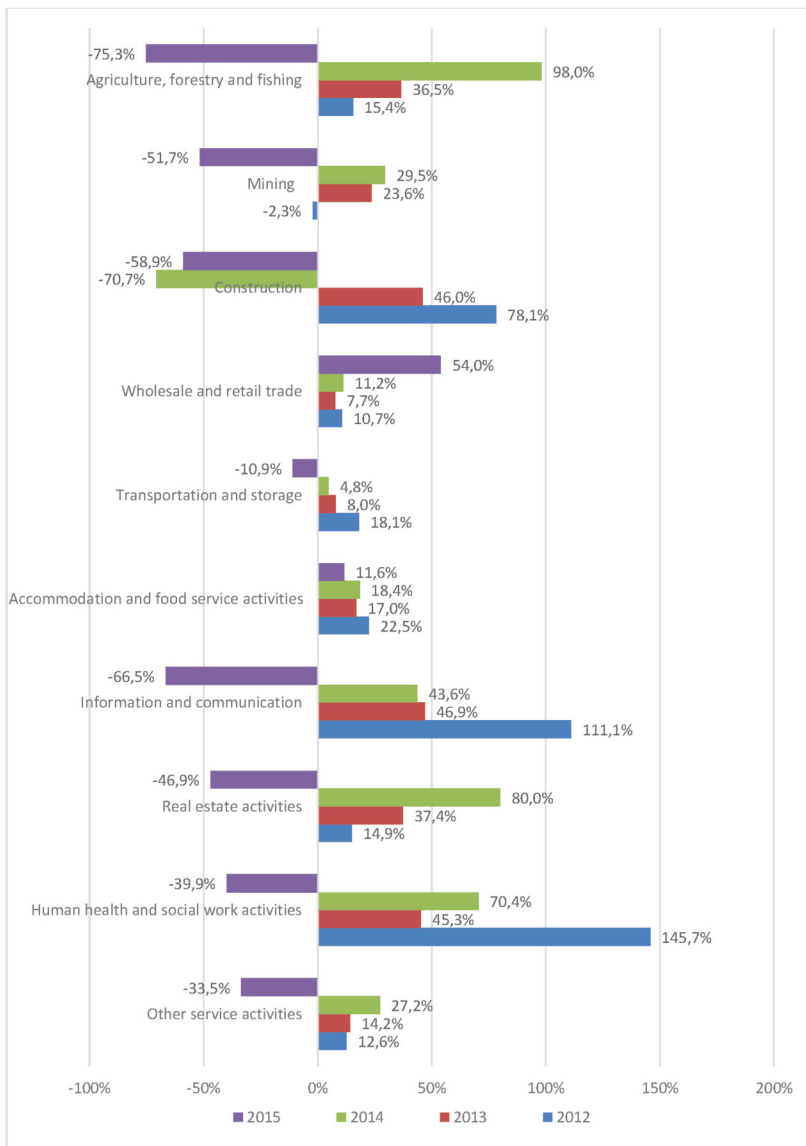


Chart 1. Production growth rate of small businesses

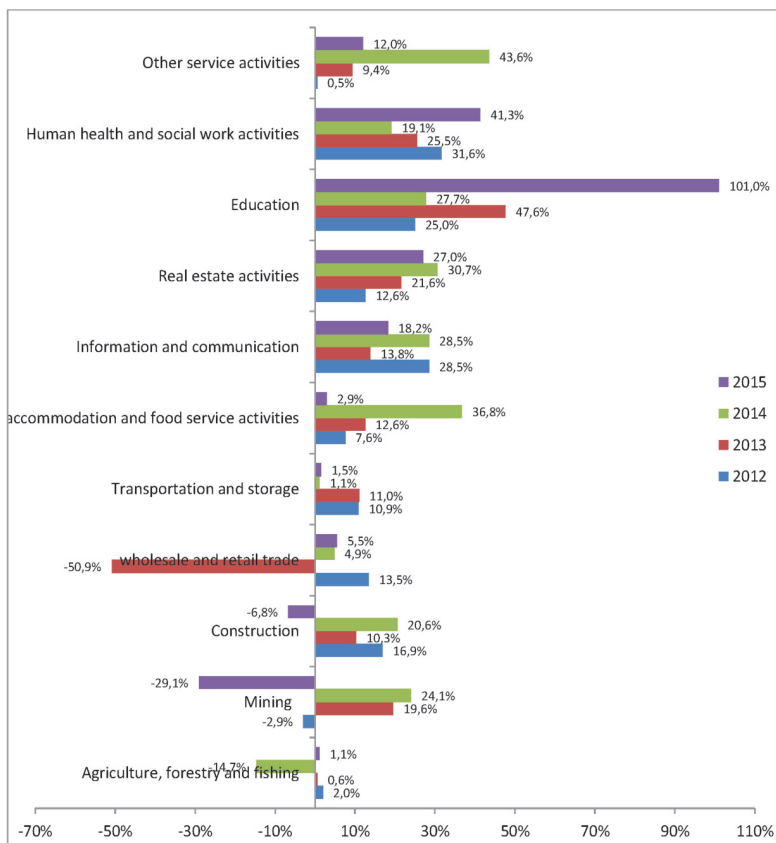


Chart 2. Growth rate of the number of small businesses

tively, a reduction of 5.5% was registered in 2015. The number of small construction companies has dropped from 2,335 in 2014 to 2,177. Although the number of businesses has increased in catering (2.9%), real estate (27%), information technology and communication (18.2%) sectors, the growth rate has slowed down. These sectors registered growth even in the period of devaluation. In comparison with 2014, the number of wholesale and retail businesses

in 2015 has increased from 91,690 to 96,731, catering businesses from 12,863 to 13,242, and businesses dealing with real estate transactions from 1,478 to 1,877 (Chart 2).

Minister of Labor and Social Protection of the Population Salim Muslimov has told the media that 2,700 people had applied to local employment agencies in the wake of the changes taking place in the banking and financial sector¹. According to the Chamber for Control over Financial Markets, the overall number of bank personnel was 17,000 at the end of 2016. The number of those who applied for jobs to employment agencies constituted 16% of the banking sector's workforce.

Staff cuts have occurred in all sectors of the economy. According to the State Statistical Committee, whereas the number of hired workers increased by 2.6% in 2012-2014, it dropped by 0.35% in 2014-2016. The reduction was mainly observed in 2015 (1.13%). Growth was registered again in 2016 (0.8%). Despite this, it dropped to the level of 2013 (**Chart 3**).

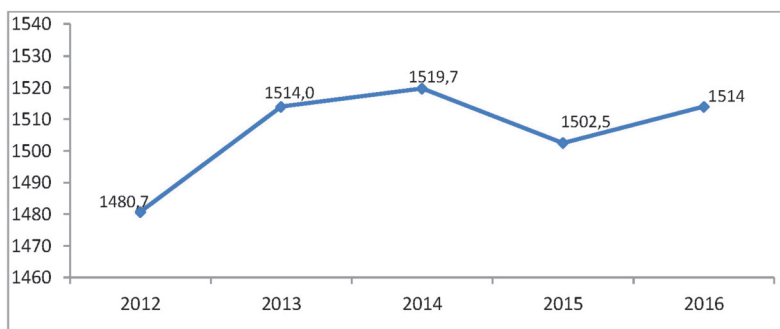


Chart 3. Dynamics of the number of hired workers by activity types

¹http://www.apa.az/maliyye_xeberleri/nazir-2700-bank-iscisi-mesgulluq-merkezlerine-muraciet-edib.html

The number of hired workers has reduced in some economic sectors and increased in others. The reduction was observed in the processing (8.3%), construction (11.9%), financial and insurance (2.6%), and IT and communications (0.8%) in 2015, the year in which devaluation occurred. Hired workers in the processing sector accounted for 4.8% in 2012, 4.7% in 2013 and 0.7% in 2014. The biggest decline in 2015 was registered in the construction sector. However, this decline started in 2013. Whereas a growth of 21.2% was observed in 2012, a decline of 2.4% and 0.6% was registered in 2013 and 2014 respectively (**Chart 4**).

According to the results of a survey carried out among businesses, those polled see staff cuts as a second adverse impact of devaluation on businesses. 55.8% of those polled pointed out to the existence of this problem. In general, the survey illustrates that 72.6% of businesses had to resort to staff cuts in one form or another. 15.7% of those polled said they had to cut 20% of staff and about as many said they had to cut up to 40% of jobs. A fourth of the businesses cut 60% and 15.7% cut more than 60% of their jobs.

- **Access of businesses to loans was limited**

The statistical analysis of lending in 2012-2016 shows that the worsening of bank assets resulting from devaluation made them restrict their lending policies. The growth observed in the area of lending in the mid-2000s has not only slowed down in the last two years, it has even reduced in some areas.

The lending of areas predominantly populated by small and medium-sized businesses (trade and services, agriculture and processing, transportation and communication, construction and real estate) has gradually weakened. Whereas lending registered growth prior to devaluation, it has started to decline after it (Chart 5).

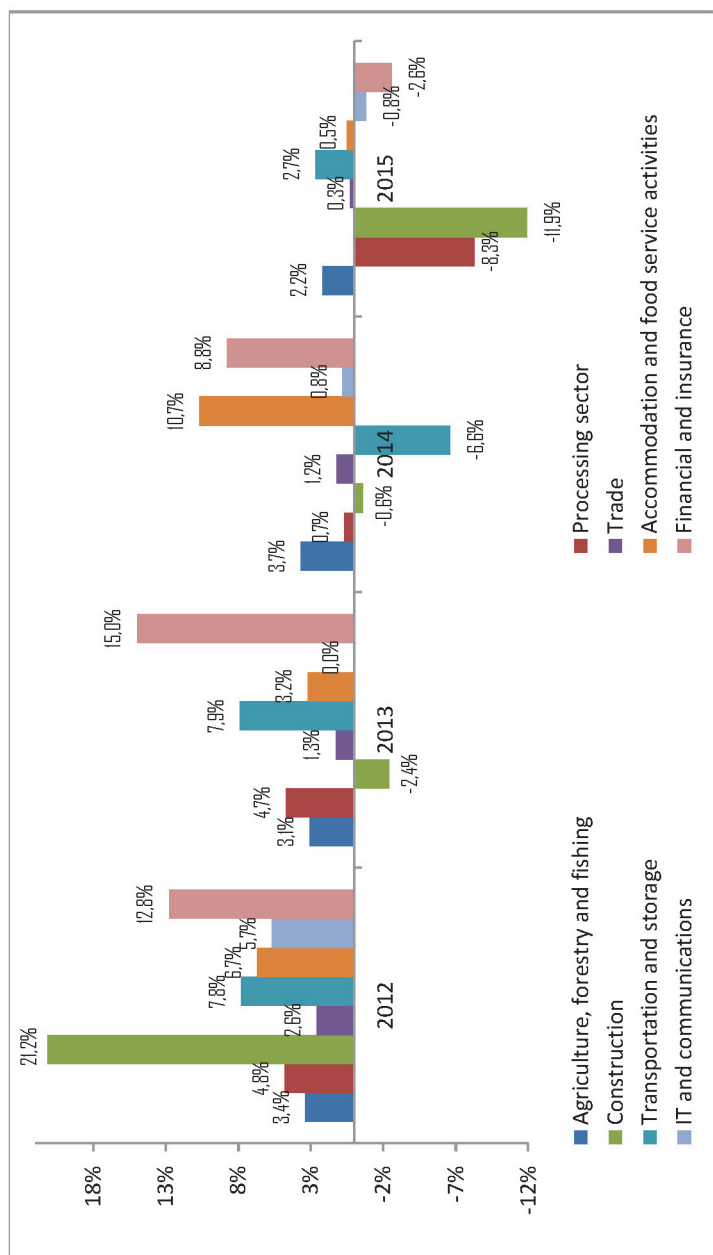


Chart 4. Dynamics of the number of hired workers by some types of economic activity

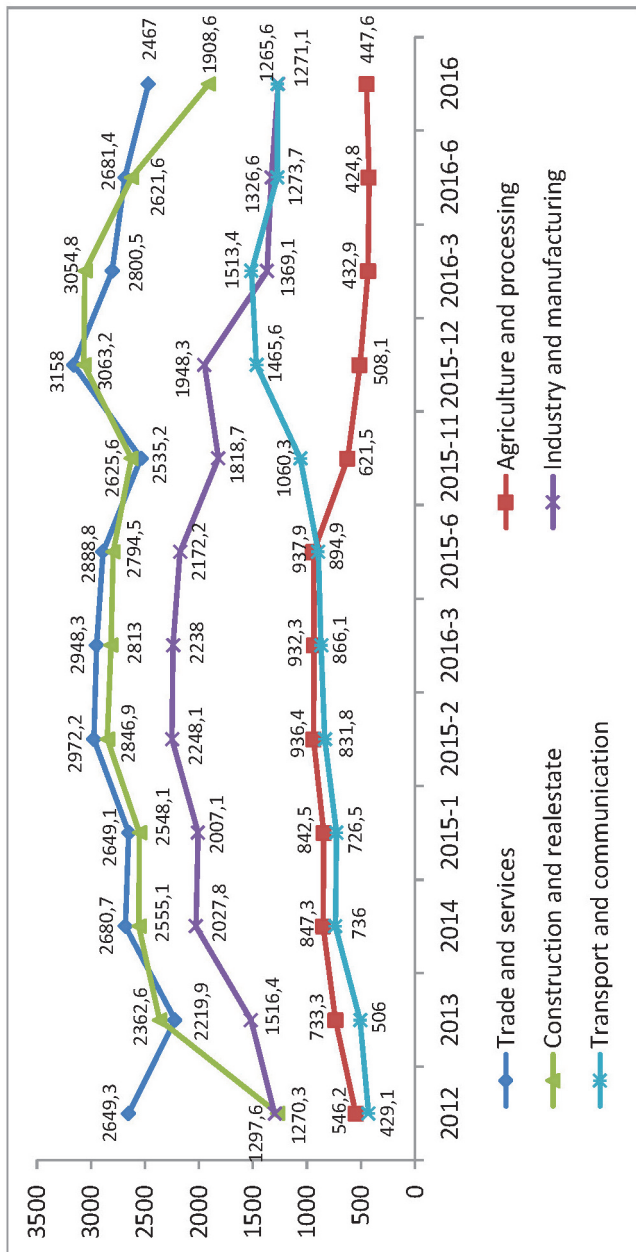


Chart 5. Dynamics of lending by economic sectors (2012-2016)

Source: Central Bank

The lending of the trade and services sector in the time period from 2012 to the first devaluation (February 2015) increased by 13%, of agriculture and processing by 54.3%, of construction and real estate by 100.6%, of industry and production by 54.5%, and transportation and communication by 69.3%. After the devaluation, reduction was observed in all sectors except for transportation and communication. In particular, the lending of trade and services dropped by 16.5%, agriculture and processing by 57%, construction and real estate by 36.1%, and industry and production by 46.1%. The growth of 46.1% registered in the transportation and communication sector occurred because the value of dollar loans as calculated in manats doubled. However, real lending of this sector has also reduced.

While the dollarization of loans initially led to an increase of foreign currency loans, the deterioration of bank assets in the aftermath of devaluation compelled credit organizations to limit their foreign currency loans.

- **As the burden of payment grew heavier, it became more difficult to repay the loans.**

The devaluation not only reduced the turnover of businesses, it also increased their burden of debt. Due to a poor development of the capital market in Azerbaijan, businesses attract their resources mainly from banks. The depreciation of the manat to the dollar forced those who had borrowed dollar loans, including entrepreneurs, to pay twice as much. The reduced turnover of goods and services resulting from the poorer purchasing capacity of the population on the one hand, and the increased burden of debt on the other undermined the payment discipline among businesses. This, in turn, led to an increase in the volume of problem loans.

According to official information of the Central Bank, the volume of overdue loans in the country has increased from 6.1% in 2012 to 9.0% at the end of 2016. The share of overdue manat loans has not

increased significantly. In the last four years, the proportion of such loans has risen from 6.8 to 7.9%. On the one hand, the devaluation led to an increase of foreign currency loans and, on the other, brought about a reduction of their repayment interest. Whereas in 2012 problem loans accounted for 4.5%, in 2016 this figure rose to 10.2%.

The analysis of survey results shows that 36.5% of those polled said they could not repay their loans. This, they said, is the third biggest impact of devaluation on their businesses. 21.2% of those polled said they needed the government's help in repayment of their loans.

- **Businesses have limited opportunity to dispose of their assets in banks (current accounts and deposits).**

The fact that the licenses of 13 commercial banks were revoked after the devaluation caused problems to the businesses that had accounts in them. The future of current accounts and deposits was called into question. Since current accounts and deposits of legal entities are not protected by the state, the future of the money on these accounts was placed into dependence on the financial status of closing banks. According to media publications, a number of national companies (e.g. "Azercell Telecom" LLC) are unable to withdraw their money from the accounts of closed banks. Since most of the information related to the banking sector is not disclosed, it is impossible to find out what companies have sustained losses and how much.

The problem is not only about closing banks. Some of the existing banks are experiencing a similar situation. Companies are unable to use their money. For example, the director of a company we talked to said that although there were rubles in the company's account, he can't transfer them to a Russian partner. The payment is five months overdue, but the bank delays the transfer for different reasons. There are many examples like that.

- **Imports have become more difficult because of foreign currency instability and shortage of dollars**

Against the backdrop of pressure on the national currency, the instability on the currency market compelled the Central Bank to switch to the floating exchange rate on 21 December 2015. This decision signified the provision of the economy with currency by means of the auction tool. Then, on 29 December 2015, according to the Procedure for the organization of currency exchange stations and execution of exchange operations introduced by the Central Bank, the currency exchange stations operating outside banks were abolished. The Central Bank and the Oil Fund started conducting auctions twice a week, selling a limited amount of dollars. Whereas about 200 million dollars were put on sale in the early period of auctions, the figure was subsequently reduced to 50 million. The growing demand for dollars resulted in the demand exceeding the supply in currency auctions. The abolition of currency exchange stations, for its part, led to the emergence of an unofficial currency exchange market ("black market"). The fact that demand was not met in currency auctions and banks sold dollars only in limited volumes further expanded the turnover of the unofficial market. The 4% margin introduced by the Central Bank to the official exchange rate encouraged those selling dollars to turn to the unofficial market to make a quick profit. As a result of this, three exchange rates emerged on the currency market (the official exchange rate of the Central Bank, the exchange rate determined by banks, and the exchange rate of the unofficial market). Whereas the exchange rate of banks was within the 4% margin of the official rate, the one of the unofficial market was 10-15% higher. Banks faced difficulty supplying importer companies with the adequate amount of dollars. For this reason, companies had to turn to the unofficial market. The dollars purchased at a higher price led to the increase of the value of imported products and the eventual price hike.

By the decision of the Central Bank dated 12 January 2017, the +4% margin applied to the exchange rate of foreign currencies during cash and non-cash operations was removed. After this decision, the exchange rates of the black market and banks became equal. However, this decision failed to completely eliminate the black market.

The interviews we have conducted with small and medium-sized business owners show that the price of imported goods and services is formed on the basis of the exchange rate on the currency market. The expectation of devaluation (possible depreciation of the manat in the next 1-2 months) also affects the price of imported goods and services.

If we analyze the foreign trade turnover in the 2012-2016 period, we can see that devaluation reduces imports. Imports started declining after peaking in 2013. Over this period, the value of imports have dropped by 14% from \$10.7 billion to 9.2 billion. The reduction was observed in both public and private sectors. The volume of goods imported to the country through official channels in 2013-2016 dropped by 62.5% from \$3.3 billion to 1.2 billion. In the private sector, it has reduced by 2.2% compared to 2013. Private individuals have increased imports from \$467.1 million to 489.1 million in 2013-2016 (**Chart 6**).

The minor reduction of imports amid depreciation of the manat more than in half can be attributed to greater transparency at customs checkpoints. The improved registration of imports and minimized imports of unregistered goods as part of the measures to enhance transparency in the tax and customs systems in 2015 have prevented a drastic reduction of official import indicators. In reality, in comparison with earlier periods, there is a significant reduction of imports. Our discussions with importer companies confirmed this theory. The reduction of imports is particularly noticeable with expensive goods.

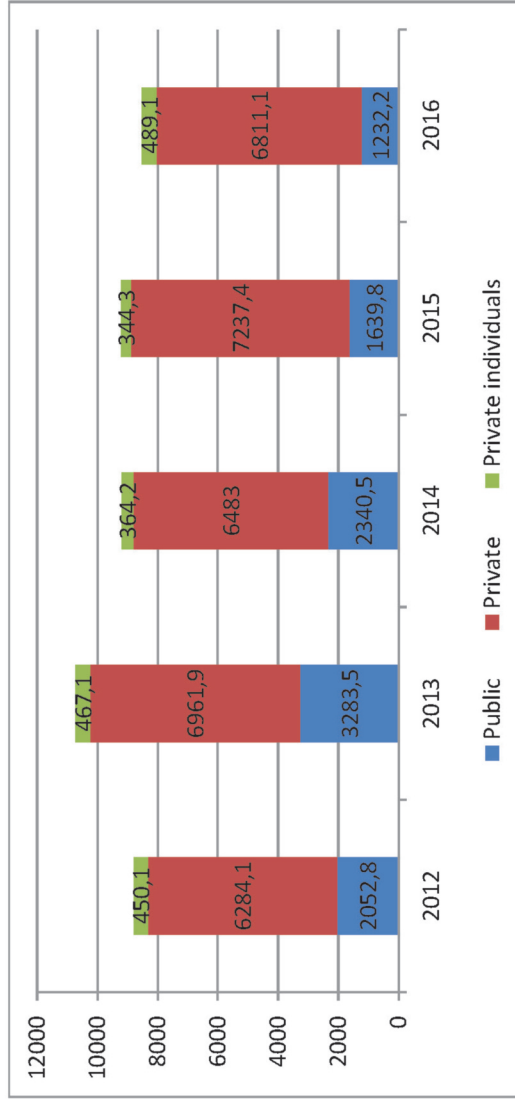


Chart 6. Dynamics of imports, million USD (2012-2016)

Source: State Customs Committee

3. KEY DIRECTIONS OF STATE SUPPORT FOR REDUCING THE IMPACT OF DEVALUATION ON THE BUSINESS SECTOR

The need for developing the non-oil sector amid the reduction of oil revenues and the decline of state budget earnings from the oil sector compelled the government to focus on the problems of the business sector. The difficulties experienced in the early period of the crisis, in early 2015, with the execution of state budget revenues resulted in increased pressure on the business sector from tax bodies. This pressure consisted in prepayment of tax and widespread penalties. The businesses already affected by devaluation and experiencing a significant decline in the turnover of goods and services saw a way out in leaving the market, while some foreign companies even started leaving the country. Not only did this aggravate problems with budget revenues, it also caused unemployment problems. All these prompted the government to revisit its approach to the business sector, revise the customs, tax and control system, and take a number of steps to mitigate the impact of devaluation.

To minimize the impact of devaluation on businesses, the government took the following steps:

- **Reduce interferences in business activities and number of inspections**

One of the crucial steps towards protecting the interests of business people has been the decision to stop inspections of companies. According to the Law “On suspension of inspections in the business sector” adopted on 20 October 2015, inspections of businesses were suspended for two years starting 1 November 2015. According to the said law, only tax inspections and those related to cases posing a threat to public health, national security and economic interests can be conducted in the said period of time with the approval of a relevant body of executive authority. At the same time, it says that

this does not apply to the inspections conducted by the Prosecutor-General's Office in relation to cases of corruption.

- **Simplify licensing and permitting procedures.**

The government has introduced changes to the licensing legislation, improving the licensing (permitting) procedure for entrepreneurial activity and reducing the number of licensable activities. Following the adoption on 15 March 2016 of the Law “On licenses and permits”, the number of licenses and permits was reduced, licenses for 22 activity types were removed, the number of state licensing authorities was reduced from 23 to four, the period for the consideration of applications was shortened from 15 to 10 days, and the provision of licenses by “ASAN xidmət” was ensured. In addition, the number of permits has been reduced to 80 and the period for the consideration of applications has been reduced to seven days. The legislation also provides for the provision of electronic licenses and the application of a “one window” system to the provision of licenses. It also encourages state bodies to provide entrepreneurs with methodological guidance on licensing for five days.

- **Simplification of customs procedures in the customs system**

Presidential Resolution No 1853 “On additional measures for the continuation of reforms in the customs system” dated 4 March 2016 was signed. The objectives of the resolution are to increase the capacity of customs border checkpoints, further improve the “one window” principle in the examination of goods and services in the interests of people's comfort, simplify import and export operations in trade and economic relations, carry out customs work in all directions in accordance with international standards, speed up the turnover of goods across customs borders, etc.

- **Application of a number of tax breaks for business people**

According to the changes introduced to the Tax Code on 19 January

2016, a number of tax breaks are to be introduced for legal entities and individual entrepreneurs who have received investment promotion documents. For example, individual entrepreneurs who have received investment promotion documents get a 50% income tax exemption for a period of seven years and legal entities get a 50% profit tax exemption for a period of seven years from the date on which such documents are received. In addition, the importation of equipment, process equipment and facilities on the part of legal entities and individual entrepreneurs who have received investment promotion documents is subject, on the basis of approval by a relevant body of executive authority, to a seven-year exemption from the property tax from the date of receipt of the investment promotion document, while the production and sale of wheat flour and bread has a one-year property tax exemption starting from 1 January 2016. Also, the legal entities and individual entrepreneurs who have received investment promotion documents have a seven-year land tax exemption from the date of receipt of the investment promotion document.

A number of tax breaks have been applied in respect of legal entities and individual entrepreneurs in the industrial and technology parks being set up in the country in recent years. According to the Tax Code, the income derived by residents of industrial and technology parks set up by the decision of the Ministry of Economy is exempt from income tax for seven years. Also, the equipment, process equipment and facilities imported to the industrial and technology parks by legal entities and individual entrepreneurs operating without establishing a legal entity are subject to a seven-year exemption from a duty from the date of registration as residents of such parks.

- **Increased import duties to protect domestic production**

The depreciation of the national currency led to an increase in the prices of imported goods. However, the price hike has also affected

domestic production. After the sharp devaluation, local producers, including such major producers of groceries as “Azersun Holding”² and “Veysəloğlu” Group of Companies³, increased their prices. The reason for that was the high share of foreign raw materials in domestic production. As a result, the depreciation of the manat could not boost the competitiveness of local production against imports. Customs duties on imported goods were increased to encourage domestic production.

According to Decision No 367 of the Cabinet of Ministers dated 23 September 2016, changes were made to the Decision “On customs duties for import-export operations in the Republic of Azerbaijan”, duties for the importation of certain categories of goods were extended by two years. The changes affected a number of goods, including eggs, vegetables (cucumbers, grapes), fruit (hazelnuts, apples, pears, etc.), juices, nonalcoholic drinks, some construction materials (ceramic, bricks). According to the decision, the import duty for 1 kg of poultry meat was set at \$1, for 1,000 eggs at \$100, for 1 kg of onions at \$0.2, for 1 kg of cucumbers at \$0.2, for 1 kg of walnuts and hazelnuts at \$1.5, for 1 kg of grapes at \$0.4. Prior to that, a standard customs duty of 15% of the customs values of these goods was applied.

- **Support of measures to enhance the export potential of businesses**

Among key directions in non-oil sector development the government has increased attention to export promotion policies. A number of steps have been taken in this direction since late 2015. Following a presidential decree dated 18 January 2016, a regulatory act on encourage non-oil exports was adopted. The decree envisages

²<http://azpolitika.info/?p=180794>

³<https://xeberman.com/main/1809-veyslolu-mhsullarn-bahaladrd.html>

the following measures to encourage the exports of non-oil exports, enhance production and exports of competitive non-oil goods, and expand access to traditional and new markets:

- *Mechanism of repayment support for exported agricultural and processing products;*
- *Mechanism of organization of export missions in foreign countries, exploration and marketing activities of foreign markets, promotion of the “Made in Azerbaijan” brand in foreign markets, acquisition of certificates and patents for local companies exporting goods to foreign countries, state payment for export-related research and development programs and projects.*

3 million manats were allocated to the Ministry of Economy from the President’s Contingency Fund in 2016 to finance the support of export missions in foreign countries.

Also, according to a presidential decree on the promotion of non-oil exports adopted on 1 March 2016, the businesses engaged in non-oil exports have started to be paid for export promotion depending on the value and type of their non-oil exports. The base export promotion amount constitutes 3% of the customs value of exported goods as stated in the customs declaration. This decision will remain in force until 31 December 2020.

4. RISKS CAUSED BY THE IMPACT OF DEVALUATION ON THE BUSINESS SECTOR

The impact of devaluation on the business sector creates several risks. The risks are as follows:

Risk 1. Limited borrowing opportunities in national currency due to dollarization of the economy

Although the dollarization observed in the financial market since late 2014 has slightly subsided, it has yet to stabilize. The dollariza-

tion of deposits, including those of the population, and the instability of the national currency compelled banks and non-bank credit organizations to limit their lending in national currency and give preference to dollars.

The share of foreign currency loans in 2012-2016 has increased from 31.2 to 53.8%. In comparison with loans, the dollarization of deposits has been even higher. The share of foreign currency deposits as of the end of 2016 has increased to 75.6%. The dollarization of deposits of financial organization reached 88.3% in this period of time.

The dollarization of the financial sector also affected the securities market and made it more difficult to attract national currency resources to this market. Although it is cheaper to attract resources from capital markets in comparison with loan interest, this sector is underdeveloped in Azerbaijan. Only a handful of companies have access to this market. Interest in national currency bonds in the capital market is at a low level. Although foreign bonds are cheaper than loans, there is little interest. This is why companies have to borrow foreign currency.

Risk 2. National currency instability creates strong inflation pressure

The exchange rate stability of the manat is possible in the circumstances of sustainable microeconomic stability and economic development. The rapid dollarization of the country's financial sector has not only increased pressure on the national currency but also jeopardized macroeconomic stability. The depreciation of the national currency has exposed the import-dependent national economy to the high risk of inflation. In the last five years, the level of inflation has risen from being a single-digit (1.1% in 2012) to double-digit (12.4% in 2016). The instability of the national currency has affected consumer prices as well. Most of the non-food items

and the overwhelming majority of food products are imported (fully or partly). The depreciation of the national currency makes the goods bought for foreign currency more expensive. Food prices in 2016 rose by 14.7% and non-food items by 16.7% in 2016. According to the Central Bank, the manat has lost its value to the dollar by 13% over this period. The depreciation of the manat in the “black market” referred to by importer companies made up 20% during the year.

Risk 3. Reduction in the turnover of goods and services hampers business development and weakens personnel capacity.

The appreciation of goods and services due to the devaluation of the national currency and the reduction of the purchasing capacity of the population due to the decrease of incomes significantly undermined demand for goods and services. The fact that repayment of foreign currency loans has become more difficult forced some businesses to close, others to suffer major losses and others still to limit their resources. This led to a reduction of the business turnover and pervasive staff cuts. The reduction in the actual incomes of the population to 2.74% in 2016 affected the purchasing capacity.

The survey conducted among small and medium-sized businesses as part of this study has revealed that four out of five people polled said the turnover had increased and three out of four said they had to cut their staff. Official statistics also point to the turnover reduction and widespread staff cuts. In 2015, the year of severe devaluation, production in agriculture, forest management and fishing sectors reduced by 78%, in industry by 51.7%, in information and communications by 66.5%, in construction by 58.9%, and in real estate transactions by 46.9%.

The number of hired workers reduced by 1.13% in 2015. The reduction in the number of hired workers in 2015 was registered in

the processing sector (8.3%), construction (11.9%), financial and insurance (2.6%), and information and communications (0.8%). Unemployment was also palpable in small businesses. According to the State Statistical Committee, the average number of people working in this sector reduced by 24% in 2015.

The head count reduction has weakened the personnel capacity of such companies. Although some companies have preferred cutting wages to staff cuts, this has compelled qualified professionals to seek better paid jobs.

Risk 4. Limitation of business access to inexpensive credit resources

The high interest rates on loans are one of the factors limiting the access of businesses, especially small and medium-sized, to credit resources. Although high interest rates on loans do not cause major implications at a time of significant oil revenues, they do affect businesses in the circumstances of poor economic activity and national currency instability. Despite the low level of inflation for many years, the yearly interest rate on credit resources has always been high. Whereas the average rate of inflation varied between 1 and 8% in 2009-2015, it rose to 12.4% in 2016. There has been a significant change in the interest rate on loans in this period. It has dropped from 15.9 to 12.8% for the manat and from 17.19 to 9.16% for the dollar. However, businesses do not have access to cheap resources, as banks don't provide loans in the national currency.

The interest rate on 1-3-year foreign currency loans varies between 15 and 25%. The prospects of the dollar further appreciating suggest that such loans are of high risk to businesses. In relation to the manat, the value of the dollar doubled in 2015, rose by 13.4% in 2016 and by 8.2% in January 2017. The instability of the manat has deterred businesses from borrowing dollar loans. In the meantime, banks prefer to lend foreign currency loans.

Risk 5. Restricted access of businesses to money resources due to limitation of monetary stock

In the time of crisis, governments usually try to increase economic activity, including the provision of the economy with money in order to increase demand. When the expectation of devaluation emerged in Azerbaijan, the Central Bank started to pursue a policy of restraining the monetary stock in order to reduce the demand for dollars as part of its measures to contain inflation. Whereas the provision of the economy with money in 2012-2014 varied in the 26-30% range, it reduced to 16-17% in 2015-2016. This led to a shortage of both dollars and manats in the country. This level in the economies similar to that of Azerbaijan, such as Russia and Kazakhstan, was 42-45 and 20% respectively in 2015-2016. US, European, English and Japanese Central Banks pursued the policy of increasing the monetary stock during the global financial recession. Russia and Kazakhstan took similar steps. Azerbaijan, however, took a step in the opposite direction and opted for the policy of restricting the monetary stock. As is evident from the Central Bank's monetary and credit policy statement for 2017, the key objectives are to contain inflation and ensure the stability of the manat, which is why the stringent money policies will be continued. Therefore, the monetary stock is not expected to increase significantly.

Risk 6. Limitation of imports and reduction in the assortment of goods due to the inability of production to meet demand

The appreciation of imported goods against the backdrop of depreciation of the manat and the reduced purchasing capacity of the population led to the weakening of demand for imported goods. Under such circumstances, importer companies, in order to prevent a reduction in the turnover of goods, are giving preference to the goods that are in more demand and less expensive. This has led to a reduc-

tion in the assortment of goods and the quality of imports.

The simplification of imports through customs systems has led to the further appreciation of expensive goods that had been imported to the country unofficially due to the application of customs duties to them. Since the sales of such goods dropped, importers started replacing them with cheaper equivalents.

In contrast to food items, the domestic production of non-food items is at a very low level. The level dependence of non-food items on imports is high. This is why the country's provision with non-food items depends on the choice of importers. As the purchasing capacity of the population falls, so do the assortment and quality of imports. As a result, the market will give preference to the goods of lower quality and limited assortment.

5. CONCLUSIONS AND RECOMMENDATIONS

Government interventions in the economy in the times of crises increase both in developed and developing countries. Under such circumstances, the main objective of governments is to support the real sector of the economy. A crisis first affects the financial sector and then spreads across the real sector. This is why governments first focus on the financial sector, adjust their monetary policies and attempt to maintain economic activity by means of a fiscal policy.

Regardless of their form, nature and duration, all crises require the implementation of emergency measures. The source of the global recession of 2008-2009 was the financial sector and the crisis currency experienced by Azerbaijan stems from depreciation on global stock exchanges. The depreciation of oil has created major difficulties for economies dependent on hydrocarbon revenues. Studies show that there is a link between the depth of a crisis and economic diversification. Countries with a diversified economy (Norway, Canada, partly Russia) are more resistant the impacts of oil depre-

ciation. Economies relying heavily on oil revenues (Venezuela, Azerbaijan, Turkmenistan) are experiencing difficult times. The impact of crisis on the financial sector of oil-exporter economies occurs by means of the national currency devaluation. Devaluation first hits the financial sector and then the real sector. The closure of banks, the tightening lending terms and the difficulties experienced with repayment of loans eventually limit the access to financial resources for businesses.

Anti-crisis “Strategic roadmaps for the national economy and key sectors of the economy” have been adopted in Azerbaijan. One of these is the “Strategic roadmap for the production of consumer goods at the level of small and medium-sized enterprises”. The roadmap sets out objectives such as economic diversification, enhanced competitiveness, increased employment, satisfaction of the demand for consumer goods with local resources, and the development of small and medium-sized businesses.

In addition, in order to mitigate the impact of devaluation on the business sector in Azerbaijan, it would be appropriate to pursue the following directions:

Implementation of a counter-dollarization policy:

The government should develop a Counter-dollarization Strategy in cooperation with the Central Bank and implement the following activities within the framework of this document:

- Development of the capital market, liberalization of the bank sector and enhanced competition
- Development of the alternative financial tools market, including the indexation of state bonds according to inflation
- More stringent requirements for foreign currency deposits (increasing the mandatory prescribed level from 1 to 3%, taxation of incomes made on deposits)

- Provision of incentives for national currency deposits (increasing the insurance threshold from 15 to 18%)
- Development of an indexation mechanism to enable insurance of manat deposits from sharp exchange rate fluctuations
- Exploration of the opportunities for the conversion of foreign currency consumer loans to national currency and provision of recommendations to banks
- Provision of national currency focus credits from the Central Bank to banks
- Establishment of a Problem Loans Fund within the Central Bank (the Fund will ensure conversion of dollar loans to manats at the expense of deposits placed with banks for a long time and on low interest)

Enhanced access of small and medium-sized businesses to financial resources:

- Develop and implement a State Program to support small and medium-sized businesses covering 2017-2021
- Introduce the concept of a micro-enterprise to the legislation on small and medium-sized businesses
- Enable the National Fund on Entrepreneurial Support to focus only on the provision of credits to micro-, small and medium-sized businesses
- Establish specialized banks set up with the participation of the government (Agricultural Development Bank, Export Bank, Investment Bank, etc.)
- Establish a fund for the insurance of loans provided to small and medium-sized businesses and develop a relevant legal framework for that
- Simplify the procedure for pledging immovable property
- Develop venture funds that have become widespread in re-

cent years and improve the legal framework to encourage investment in innovation. To do that, adopt a law “On venture funds” and amend the law “On investment funds”

- Implement a government program on micro-financing to support small businesses, introduce a system of benefits to expand franchising, factoring and leasing services, and ensure development of regulatory documents

Application of tax breaks for businesses:

- In order to speed up the shift to cash-free payments, apply tax breaks to cash-free operations. The reduction of simplified tax rate from 6 to 4% may encourage businesses to give preference to cash-free payments
- Ensure a transition of micro-businesses to a stable tax system
- Engage small and medium-sized businesses in state purchases
- In order to reduce the tax burden of businesses, ensure a transition of the social insurance allocations rate from 22+3% to 15+10%

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2 OF THE MANAT DEVALUATION
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Samir Aliyev

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