

LONG-TERM STRATEGY ON THE MANAGEMENT OF OIL AND GAS REVENUES

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INTRODUCTION

Reforms conducted in the Republic of Azerbaijan in recent years have ensured macroeconomic and financial stability, deeper restructuring of the economy, and created propitious conditions for the development of SMEs in the country. Broad-based and consistent activities undertaken have provided a strong impetus to the socio-economic development of the country as well as improvement of the people's wellbeing.

As a result of the implementation of the National Oil Strategy since 1994 the Republic of Azerbaijan embarked on a qualitatively new phase in the development of its oil and gas deposits: large investments have been attracted to the country's economy, success has been achieved in ensuring the transportation of hydrocarbon reserves of the Caspian to the world market via Azerbaijan, and since 1999 the country has been continuously receiving foreign currency from the export of profit oil in the framework of the Contract of the Century.

Bearing in mind, from one side, a sharp increase in oil and gas revenues from 2008 due to large-scale exploitation of hydrocarbon deposits of Azerbaijan and, from the other side, the possibility of a complete exhaustion of the current oil and gas wealth in a relatively short period of time, the need for the preservation of macroeconomic stability alongside the inflow of foreign exchange, and the setting aside of part of the revenues for future generations, as well as ensuring their use for improving the well being of the current generation, stimulating development of the non-oil sector, and ensuring the balanced development of the economy, the issue of the adoption of a long-term strategy on management of oil and gas revenues was brought to the agenda.

A long-term strategy on management of oil and gas revenues, which covers the period 2005-2025, establishes the principles for the use of oil and gas revenues and medium term expenditures policy for this period. This strategy ensures the management of the revenues acquired from sale of natural gas and oil in conformity with the sources described below, accrued in the State Oil Fund of the Azerbaijan Republic, and in the state budget.

1. LONG-TERM PROJECTIONS ON OIL AND GAS REVENUES

The size of the oil and gas revenues of the Republic of Azerbaijan in the long term shall be assessed based on the price forecast for the proven oil reserves of the country.

The volume of oil and gas reserves shall be determined based on the assessment of the oil and gas resources expected from Azeri-Chirag-Guneshli field, Shah Deniz field, and the other fields envisaged in the Production Sharing Agreements, as well as the fields operated by SOCAR and the joint ventures founded by SOCAR.

In the event that new fields are discovered, the projections on the volume of oil and gas deposits of Azerbaijan shall be updated.

Oil and gas prices shall be forecast on the basis of a pessimistic assumption (on a price lower than the one in the baseline assumption) (baseline assumption: the oil and gas price forecast for the respective period).

The sources of oil and gas revenues are as follows:

- a) Azerbaijan's share of profit oil under production sharing agreements and the other sources of income of the State Oil Fund of Azerbaijan Republic as envisaged by the law;
- b) profit tax paid by investors to the state budget under production sharing agreements;
- c) tax payments by the State Oil Company of the Azerbaijan Republic relating to oil and gas production and its other liabilities to the state budget;
- d) tax payments made to the state budget by joint ventures established by the State Oil Company.

2. PRINCIPLES FOR LONG-TERM USE OF OIL AND GAS REVENUES

The principles for long-term use of oil and gas revenues are as follows:

- when forecasting the amount of long-term expenditures from oil and gas revenues, the 'constant real expenditures' principle shall be used as a basis and annual limits shall be set for these expenditures that are to be made within the period covered by the strategy;

- when incomes from oil and gas revenues peak, at least 25 percent of them shall be saved;
- the regulations adopted for spending oil and gas revenues shall remain unchanged during the effective period of the long-term strategy on management of oil and gas revenues and the expenditure limits projected on the basis of the constant real expenditures principle shall be observed;
- the volume of medium-term expenditures shall be determined based on the non-oil deficit (the difference between revenues and expenditures of the consolidated budget of the country, excluding the oil sector) and taking account of the long-term expenditure limit. Sharp year to year fluctuations in expenditures are undesirable and the non-oil deficit may not be abruptly changed;
- investment expenditures shall be made in the framework of the medium-term State Investment Program that is drafted annually;

Meeting the current high demand of Azerbaijan for investment will result in larger expenditures during the initial period and create conditions for the development of the non-oil sector and the gradual reduction in the dependence on oil and gas revenues.

The development of non-oil sector based on the use of long-term oil and gas revenues will help in reducing the country's need for external borrowing.

3. MEDIUM TERM POLICY ON THE MANAGEMENT AND EXPENDITURE OF OIL AND GAS REVENUES

Macroeconomic stability shall be ensured and priority expenditures from oil revenues shall be coordinated based on the medium term policy.

The size of the medium term real expenditures may be higher or lower than the established long-term expenditure limit. Although this will accelerate development of the non-oil sector and lead to increased investments in different periods, annual real expenditures shall be made taking account of the established non-oil deficit limit.

The annual size of real expenditures and the non-oil deficit shall be established consistent with the long-term expenditure limit. When the size of the non-oil deficit is adjusted, concrete justification for such adjustments shall be provided.

4. MAJOR OBJECTIVES FOR THE USE OF OIL AND GAS REVENUES

The strategy on use of oil and gas revenues includes the following objectives, while aiming at retaining macroeconomic stability:

- developing the non-oil sector, regions, SMEs;
- large-scale development of infrastructure;
- fulfillment of poverty reduction measures and the solution of other social problems;
- stimulating the improvement of the intellectual, material, and technical base of the economy;
- development of “human capital” (training (including in foreign countries) highly qualified specialists and improving the professional capacity of employees);
- consolidating the defense capabilities of the country;
- executing projects relating to reconstruction activities in liberated territories and the return of internally displaced persons to their native lands.