

Could the economy of Azerbaijan fall into the middle-income trap?

Gubad Ibadoghlu, senior policy analyst of the Economic Research Center

Emin Bayramli, Rutgers, the State University of New Jersey

The government of Azerbaijan predicts a 1.7 percent decrease in the country's oil and gas sector and a 4.6 percent increase in the non-oil and gas sector in 2024, which means a 2.4 percent increase in GDP in the base scenario. This is lower than both global and regional economic growth forecasts. So, the International Monetary Fund (IMF) predicts that the global economy will grow by 2.9 percent in 2024. Director of the IMF's Middle East and Central Asia Department, Jihad Azour, said¹ in the briefing held during the spring meetings that the economic growth in the Caucasus and Central Asia is estimated to be 3.9 percent in 2024 and 4.8 percent in 2025. It should be recalled that the government of Azerbaijan predicted economic growth of 2.7 percent for the current year in the 2023 budget project, but at the end of the year, the economic growth was 1.1 percent². According to World Bank forecasts on June 2024, the lowest GDP growth rates in the CIS region for the next 3 years are in Russia (2.9%, 1.4%, 1.1%) and Azerbaijan (2.3%, 2.3%, 2.4%). As can be seen, there are World Bank predictions³ that in 2024 and next 3 years, Azerbaijan will lag far behind not only the regional but also the global economic growth rate.

Azerbaijan will lag behind the global economic growth rate and the average of the region in the current year are already coming true. Although a positive result is expected in the national economy this year due to state expenditures, unfortunately, the economic

¹<https://www.imf.org/en/Publications/REO/MECA/Issues/2024/04/18/regional-economic-outlook-middle-east-central-asia-april-2024>

² <https://www.stat.gov.az/news/macroeconomy.php?lang=az&page=5>

³ <https://openknowledge.worldbank.org/bitstreams/5c59e4f8-ab2d-4bec-9da4-fa3edcd78d9a/download>

growth is expected to be even slower for the next years. The World Bank's long-term growth simulations show⁴ that, faced with these challenges and without any policy response to them, Azerbaijan's economic growth may average only 0.5 percent in 2024-2050, and GDP per capita may only increase by 11 percent over the next 30 years.

According to S&P⁵, real GDP per capita growth in Azerbaijan in 2024 is estimated to be 0.5 percent. Analysts also forecast real investment growth of 3 percent in the current year and nominal GDP at the end of the year at \$76.08 billion.

The economic results of the first 4 months of 2024 show that the difficulties deepened from last year will continue for Azerbaijan. Thus, in the first 4 months of 2024, the foreign trade balance amounted to 2.7 billion dollars, which decreased by 4.6 billion dollars or 2.7 times compared to the same period of the previous year⁶.

The national economy is developing this year, as in previous years, due to the increase of state investments aimed at reconstruction and restoration works, especially in the territories liberated from occupation. And public investments require increasing and stable incomes. This is also on the list of main difficulties in the current period. So, the current year's changes in the conjuncture of the world raw materials market, the decrease in oil production, and the decrease in gas export prices caused a decrease in the income from the sale of the country's main export products. So, in January-April 2024, the volume of exports of goods entering the oil and gas sector amounted to 7 billion 248.6 million dollars, which is 4 billion 149.1 million dollars or 36.4 percent less compared to the same period last year. Furthermore, in the same period, the volume of exports in the non-oil

4

<https://documents1.worldbank.org/curated/en/099100009222236784/pdf/P17532606988e2056084e603c9c48ddc618.pdf>

⁵ <https://en.trend.az/business/3886871.html>

⁶ https://customs.gov.az/uploads/foreign/2024/2024_4.pdf?v=1715840938

sector decreased by 267.2 million dollars or 22.5 percent compared to January-April last year⁷.

Azerbaijan's economy appears to be experiencing mixed fortunes according to the latest data from the State Statistics Committee. The Committee reports a GDP growth of 4.2 per cent in the first five months of the 2024 year, reaching 48,026 million manats. Although this figure may indicate an improvement in the economic situation, a deeper study of the figures indicates the opposite. A comparison with the previous year paints a different picture: The GDP for the same period in 2023 amounted to 49 580.8 million manats. This discrepancy indicates a decrease in GDP by 3 per cent, and not the declared growth. This isn't the first instance of discrepancies in Azerbaijan's GDP reports. In the first four months of 2024, the State Statistics Committee announced a 4.3% growth. However, an audit contradicted these claims, revealing an actual decrease of 4.5%.

To achieve these development goals, Azerbaijan must strengthen growth and continue sustainable development. In the "Socio-Economic Development Strategy for 2022-2026", the government of Azerbaijan aims for an annual GDP growth rate of 3-4 percent for the medium term⁸. In the Strategy, five main goals have been set to ensure a 5 percent increase in GDP in the non-oil and gas sector. At the same time, although the Strategy mentions the socio-economic development model of the country in the next decade and it is envisaged to implement this model in two stages, still, the basic conditions for the implementation of the socio-economic development model by 2030 in the first stage (2022–2026) have not been implemented. A new economic model, a modern economic approach to achieve the goals up to 2026 has not been established, since there has been no qualitative change in the economic policy in the last 2 years, new sources of economic

⁷ https://customs.gov.az/uploads/foreign/2023/2023_4.pdf?v=1684330538

⁸ <https://e-qanun.az/framework/50013>

growth have not been created, even the role of old sources in the current growth is decreasing a little.

All this gives reason to think that the economy of Azerbaijan is moving towards the middle-income trap. The concept of the middle-income trap⁹, first used by Indermit Gill and Homi Kharas, describes a common phenomenon observed in regions such as Latin America and the Middle East. The story of economic growth is one of many narratives. Over the past 80 years, many low-income countries around the world have developed rapidly, relatively few countries have reached high-income status, and many countries are stuck in the "middle-income trap" because income growth is volatile. Latin America, the Middle East, and Asia are characterized by a reversal in the absence of new sources of economic growth after rapid growth from low to middle income in some countries of the region. One of the countries that fell into this trap was Malaysia. The slowdown in economic growth in the late 2000s confronted this country with the nature and risks of the middle-income trap.

The middle-income trap describes a situation in which a middle-income country is unable to transition to a high-income economy due to rising costs and declining competitiveness. For this reason, very few countries manage the transition from low to middle income successfully.

According to the World Bank, countries are divided into 4 groups regarding the income level¹⁰. Countries with per capita incomes of less than \$ 1,135 for fiscal year 2023/2024 belong to low-income group (1); countries with per capita income between \$ 1,136 and \$ 4,465 – lower-middle income group (2); countries with per capita income between \$ 4,466

⁹ <https://documents1.worldbank.org/curated/en/965511468194956837/pdf/104230-BRI-Policy-1.pdf>

¹⁰ <https://blogs.worldbank.org/en/opendata/new-world-bank-group-country-classifications-income-level-fy24>

and \$ 13,845 – upper-middle income group (3); countries with per capita income of more than \$ 13,846 - high-income group (4).

Of the 58 countries of Europe and Central Asia, where Azerbaijan is geographically located, 4 are low-income countries, 16 are middle-income countries, and 38 are high-income countries. Azerbaijan is currently one of the 16 middle-income countries located in this region. Although Azerbaijan has been included in the group of countries with an upper-middle income level for many years, the results of 2023 and the forecasts for the following years have raised serious doubts about whether the country will stay in this group and move forward. The results of the four or five months of the current year increase these doubts even more.

According to the statements of the State Statistics Committee, the gross domestic product (GDP) per capita in Azerbaijan was \$ 7,126.2 in 2023¹¹ compared to \$ 7,818.9 in 2022¹², so this indicator decreased by \$ 692.7 per capita in 1 year. At the same time, the indicator¹³ of 2023 still characterizes a low level compared to the corresponding indicators of 2012, 2013, and 2014.

Reducing economic growth in Azerbaijan in 2023 from 4.6 percent in the previous year to 1.1 percent and forecasts that the decline will continue in the current and future years make avoiding the middle-income trap one of the challenges facing the country's government. The fact that the growth in the national economy lagged behind the global (2.7 percent), South Caucasus (3.8 percent), and Central Asia (5.5 percent) economic

¹¹ <https://www.stat.gov.az/news/macroeconomy.php?lang=az&page=5>

¹² <https://www.stat.gov.az/news/macroeconomy.php?lang=az&page=17&arxiv=1>

¹³ [https://www.ceicdata.com/en/indicator/azerbaijan/gdp-per-capita#:~:text=Capita%20in%202023%3F-Azerbaijan%20Gross%20Domestic%20Product%20\(GDP\)%20per%20Capita%20reached%207%2C126.200%20USD,7%2C806.400%20USD%20in%20Dec%202022.](https://www.ceicdata.com/en/indicator/azerbaijan/gdp-per-capita#:~:text=Capita%20in%202023%3F-Azerbaijan%20Gross%20Domestic%20Product%20(GDP)%20per%20Capita%20reached%207%2C126.200%20USD,7%2C806.400%20USD%20in%20Dec%202022.)

growth average last year and forecasts that the same trend will continue in the coming years puts this challenge among the most critical tasks for the near term.

The World Bank's report¹⁴ on the economies of Europe and Central Asia entitled "Unleashing the power of the private sector" states that the World Bank predicts economic growth in Azerbaijan at 2.3 percent in 2024 and 2.4 percent in 2025 and 2026. Compared to the forecast published in January of this year, the GDP growth rate in 2024-2025 decreased by 0.1 percentage points in the April announcement.

When the economic growth in Azerbaijan slows down, the continuous population increase decreases the country's per capita GDP indicator. The GDP indicator per capita in Azerbaijan averaged 3,156.6 US dollars from 1990 to 2024, and the maximum level of this indicator was recorded in 2014 (7,990.8 US dollars). Although GDP per capita has passed the peak level of the indicator ten years ago, the economy of Azerbaijan still cannot restore the national income lost due to the devaluation of the national currency in 2015. So, the per capita GDP indicator for 2023 was 7,126.2 US dollars, and for 2022, it was 7,806.4 US dollars. As can be seen, in 2023, compared to the previous year, the per capita national income has decreased, even below the level of 2012. The continuation of this trend may put Azerbaijan in a middle-income trap. Therefore, the competitiveness of the non-oil sector should be increased by ensuring the rules of free market economy and the rule of law, eliminating the dominant position of monopolists.

The slowdown of economic growth and the sharp decrease in the growth rate of per capita national income in Azerbaijan is due to the weak renewal of the structure of the economy in the last 30 years since the signing of the agreement on the exploitation of the previous Azeri-Chirag-Guneshli field, which has the leading role in the oil sector. The

¹⁴ <https://www.worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update>

reduction of the value-added produced in the oil and gas sector of the economy as a result of the decrease in the production of commodity oil, the main export product of the country, from 51 million tons in 2010 to 30.2 million tons in 2023 and the failure to recover the declining value in this sector over the past 15 years through the export of new products have now become the main factor inhibiting economic growth¹⁵. Moreover, the slowdown of the growth rate in the non-oil and gas sector reduces the growth size.

According to the State Statistics Committee¹⁶, in 2023, 67.4 percent of the industrial product, which is 40.5 percent of the value-added created in the economy of Azerbaijan, was produced in the mining sector. In 2023, in the mining sector, commodity oil production decreased by 7.6 percent, while commodity gas production increased by 4.2 percent. The share of the oil and gas sector in the GDP produced in 2023 was 36.8 percent, and the specific weight of goods included in the oil and gas sector in exports was 90.12 percent. Furthermore, compared to the previous year, the growth rate of investments in the oil and gas sector exceeded the growth rate of investments directed to the non-oil and gas sector. As can be seen, the oil and gas sector still attracts the majority of skilled labor and capital resources, which is an indication of the weak transition from the traditional energy sector to others. The attraction of private investment, which is essential for this transition, is delayed due to the lack of formation of an independent judicial institution and the presence of corruption and monopolies.

According to the information released by the Ministry of Energy¹⁷, in 2023, 48.3 billion cubic meters of natural gas were produced in the republic. 12.9 billion cubic meters of gas were produced by the Azeri-Chirag-Guneshli field, 26.2 billion cubic meters by the Shah

¹⁵ Ibadoghlu, Gubad, What Has Azerbaijan Gained from ACG? (September 27, 2021). Available at SSRN: <https://ssrn.com/abstract=3931367> or <http://dx.doi.org/10.2139/ssrn.3931367>

¹⁶ <https://www.stat.gov.az/news/macroeconomy.php?lang=az&page=5>

¹⁷ https://minenergy.gov.az/az/xeberler-arxivi/00146_7892

Deniz field, 0.8 billion cubic meters by the Absheron field, and 8.4 billion cubic meters by SOCAR. The increase was 3.2 percent, or 1.5 billion cubic meters, compared to 2022. Gas sales abroad amounted to 23.8 billion cubic meters last year, 5.3 percent more than in 2022. 11.8 billion cubic meters of exported gas were sent to Europe, 9.5 billion cubic meters to Turkey, and 2.5 billion to Georgia¹⁸.

From the commissioning until January 1, 2024, our industry has demonstrated its robust production capabilities, with a total of 216.3 billion cubic meters of gas produced from the Azeri-Chirag-Guneshli field and an impressive 209 billion cubic meters from the Shah Deniz field.

During 2023, our industry showcased its resilience and diversity, with 30.2 million tons of oil (including condensate) produced in the country. This production was distributed across various fields, with 17.8 million tons falling to the Azeri-Chirag-Guneshli field, 4.3 million tons (including condensate) to the Shah Deniz field, and 0.3 million tons (including condensate) to the Absheron field. SOCAR's oil production (including condensate) amounted to 7.8 million tons, further diversifying our sources. During this period, 25.2 million tons of oil (including condensate) were transported for export, with 22.1 million tons falling to the consortium, and 3.1 million tons to SOCAR¹⁹.

From the commissioning until January 1, 2024, 629.2 million tons of oil (including condensate) were produced from the Azeri-Chirag-Gunashli and Shah Deniz fields. 584.7

¹⁸ Ibadoghlu, Gubad and Bayramov, Ibad (2023) An Assessment of the Potential of EU-Azerbaijan Energy Cooperation and its Impact on EU Gas Dependence on Russia. FOREIGN POLICY REVIEW, 16 (1). pp. 91-108. ISSN 1588-7855 (print); 2064-9428 (online)

¹⁹ Ibadoghlu, Gubad, Retrospective Assessment of Corruption Risks and Perspective Assessment of Future Activities of SOCAR (July 21, 2022). Available at SSRN: <https://ssrn.com/abstract=4168843> or <http://dx.doi.org/10.2139/ssrn.4168843>

million tons of oil were extracted from the Azeri-Chirag-Guneshli field, and about 44.5 million tons of condensate from the Shah Deniz field.

You can see the country's oil production in Figure 1.

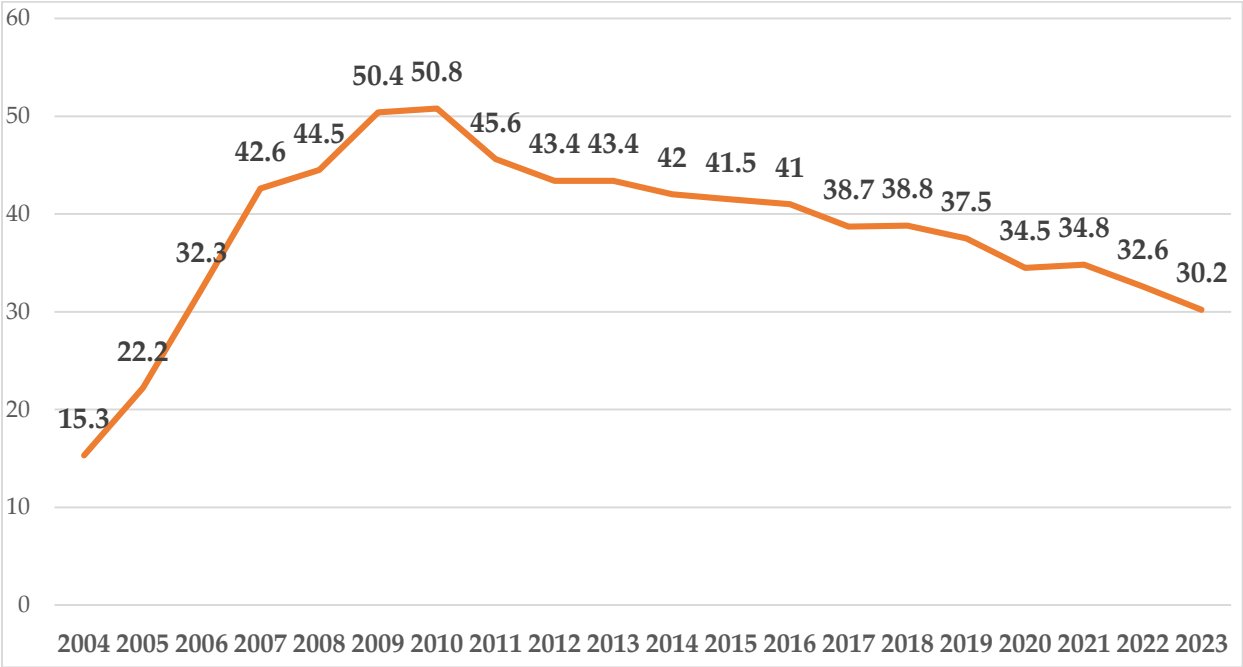


Figure 1. Oil production in Azerbaijan in 2004-2024, in million tons

Note: 2004-2023 indicators are actual, and 2024 indicator is forecast.

As can be seen from the diagram, a sharp decrease in oil production in Azerbaijan in 20 years was 5.2 million tons in 2011 or 10.3 percent compared to the previous year, 2.4 million tons in 2017 or 5.8 percent compared to last year, 2.9 million tons in 2020 or 7.9 percent compared with the year earlier, and 2.5 million tons in 2023 or 7.5 percent compared to the previous year. Since there was no sharp decrease in SOCAR's production during this period, the decrease observed in the country was determined by the reduction of the ACG field. This can be seen from the 20-year production dynamics

in the Azeri-Chirag-Gunashli (ACG) field, which is the leading oil field of Azerbaijan, presented in Figure 2.

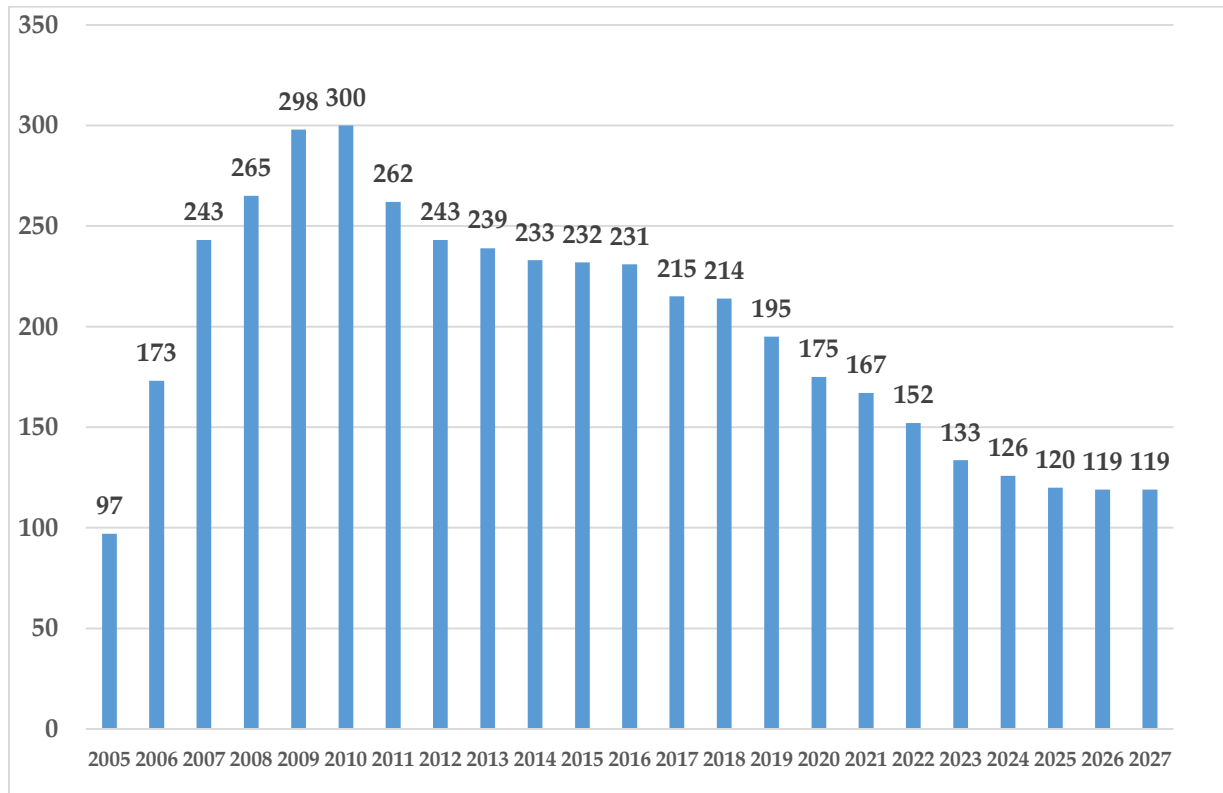


Figure 2. Oil production in the Azeri-Chirag-Guneshli field in 2005-2027, in million barrels

Note: 2005-2023 indicators are actual, and 2024-2027 are forecasts.

As can be seen from the diagram, the highest production of the ACG field during the 20-year reporting period was 300 million barrels in 2010; at the same time, sharp decreases in the oil production of the ACG were recorded in 2011 - 38 million barrels, in 2017 - 16 million barrels, in 2020 - 20 million barrels, and in 2023 - 19 million barrels. In 2023, the ACG oil production indicator was 44.5 percent of the peak production in 2010; compared to 2014, the production decreased to 100 million barrels and 43 percent. A sharp decrease in the production of the ACG field has been observed since 2018; according to forecasts,

this trend will continue until 2025, and between 2025 and 2027, production is expected to stabilize at the level of 119 million tons per year. The reason for this is the construction of the Azeri Central East (ACE) platform with an investment capacity of 6 billion dollars to stabilize ACG production. The project includes a new offshore platform and other facilities with a production capacity of up to 100,000 barrels per day. It is predicted that up to 300 million barrels of oil will be produced during the project's operation period. The first oil production from ACE was expected in early 2024. Although the forecast indicators reflecting the situation after 2027 have yet to be disclosed, the negative trend creates grounds for continuing the decline in the following years. This trend characterizes a positive change in the dynamics of oil production in the ACG field, i.e., no return, and this natural decline leads to a decrease in the main export revenues of the country, which necessitates changes in the fiscal, monetary, and credit, and exchange rate policies at the current stage.

Therefore, debates should be started in this direction, and the policies that can help Azerbaijan avoid the middle-income trap should be discussed. This requires fundamental changes and severe economic reforms based on new models.