

Azerbaijan did not accede to the **Mine Ban Treaty**, the **Convention on Conventional Weapons** or the **Convention on Cluster Munitions**. Baku officially says it fulfils all its obligations under the Ottawa Convention, but cannot accede to the Conventions before the Nagorno-Karabakh conflict is settled. Currently two national plans are being implemented as part of the national mine action programme. The first (mid-term) element, which aims to clear all suspected hazardous areas by the end of 2013, has little chance of materialising, considering the recent pace of mine clearance. The second (long-term) element relates to the improvement of operational and management capacity. Azerbaijan increased co-financing from 10% to 90%, being one of only a few mine-affected countries to tackle this issue largely through the state budget.

Russia's lease of the **Gabala radar** station expired in December 2012, and was not renewed due to irreconcilable lease expectations. The transfer of the station to Azerbaijan was completed in June.

In March, Azerbaijan tabled a proposal to decrease the size of the **local OSCE Office** in Baku. In July, the OSCE Permanent Council approved the decision to downgrade the local Office in Baku to a project coordinator from 1 January 2014. The new project coordinator is to continue carrying out projects in all three dimensions of the OSCE.

The CoE's local office remained without a permanent Head in 2013.

3. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy¹

Following measured recovery over the last year when the economy grew by 2.2%, real GDP growth continued in 2013 and reached 5.8% year-on-year. While oil production increased by 0.2% due to efforts boosting production in big oil fields, the non-oil sector increased by over 10.0%. Growth in the non-oil sector was driven mainly by increased government spending and transfers of oil and gas export revenues, as well as high domestic demand supporting the expansion of the service sector and the already booming construction sector.

Inflationary pressures re-emerged in 2013, with a rebound in food and fuel prices, expansionary fiscal policy and a fast-growing non-oil economy. The average annual inflation nevertheless increased only moderately to 2.4% year-on-year in 2013 from 1% in 2012. The central bank reduced the key refinancing rate to 4.75% in February 2013, taking advantage of the low inflationary environment to encourage economic activity. The conduct of its activities remains constrained by the weak monetary policy transmission channel caused by the tightly managed exchange rate and the absence of well-developed money and bond-markets.

Azerbaijan continues to rely on hydrocarbon sales to finance state expenditure, as transfers from the State Oil Fund of Azerbaijan (SOFAZ) accounted for 58.43% of total

¹ Figures are from the national statistical office, the central bank, the IMF or Commission Staff estimates, as indicated in the Statistical Annex. When other data sources are used these are then indicated.

revenue in 2013, leading to a budget surplus of 0.47% of GDP (Ministry of Finance, SOFAZ). However, the growing reliance on oil exports raises concerns about the long-term sustainability of public finances since the state budget shows a deficit of 19.1% of GDP when SOFAZ transfers are excluded (Ministry of Finance, SOFAZ).

The current account surplus was projected to decline from 21.7% of GDP in the 2012 to 15.9% of GDP at the end of 2013, due both to weaker oil proceeds and growing imports responding to high domestic demand. The external position remained strong, supported by the sound reserve standing and low level of public debt that significantly mitigated the risks of the volatility of oil prices. However, the non-oil current account deficit of 17.4% of GDP remained large, due to government-related non-oil imports and gas-related Foreign Direct Investment.

In November, the government raised retail prices for various fuel products by between 25% and 33%. This was allegedly due to upfront investment needs and capacity problems in the refinery sector. At the same time, tariffs for various telecommunication services were reduced. Despite the consequences for ordinary households, no major protests against the price hikes were observed.

Baku hosted a number of international events such as the Davos World Economic Forum, and the first South Caucasus Forum. In June Azerbaijan organised a donor's conference in support of Palestine which did not lead to significant new commitments.

Social situation, employment and poverty reduction

Despite Azerbaijan classified by OECD/DAC as an upper middle income country and the progress made in reducing poverty levels through growth and social assistance programmes, significant inequalities remain. Officially the **unemployment rate** dropped to around 5% in the first half of 2013 but the methodology used to assess the real unemployment is debateable, with large categories of the population being *de facto* jobless. The real unemployment rate is likely to be much higher. At the same date, the unemployment benefit was AZN 260 per month (compared to AZN 224 on 1 January).

Average **monthly wages** grew in 2013 to AZN 423, or by over 6% compared to the same period of 2012. Discrepancies between different economic sectors remained high, with high average salaries in the oil sector (AZN 1566 per month) and disproportionately smaller wages in the non-oil sectors (AZN 387 in the non-oil sector, AZN 337 in the state sector and AZN 539 in the non-state sector). Substantial income disparities between Baku and the regions persisted in 2013.

Authorities continued implementing the 2009-2013 State Programme on socio-economic development of the regions of Azerbaijan, and the 2008-2015 State Programme of poverty reduction and economic development. The National Entrepreneurship Support Fund, under the Ministry for Economic Development, continued to provide concessional loans throughout the year, thus contributing to the creation of new jobs. Across 2013, subsidised lending from the Fund made up AZN 275 million. However, the distribution process for funds was not transparent, with many bureaucratic obstacles facing the beneficiaries.

A number of laws tackled the area of **social services** and **social protection**. A January presidential order approved support from the President's Reserve Fund to the Ministry of Labour and Social Security, aiming to provide social services to children with disabilities and to young people at risk. In February, the law on veterans was updated to provide social services to war veterans. The rules on granting preferential mortgage loans were also amended, thus increasing the maximum sum for social mortgages from AZN 35 000 to AZN 50 000 and reducing administrative requirements for accessing social mortgages. Parliament also made amendments to the law on labour **pensions** to simplify registration of documents for old-age pensions for citizens residing abroad. According to official statistics, Azerbaijan has 1.27 million pensioners and the average pension reached AZN 170 in October, while the average retirement pension was AZN 187.

Azerbaijani Ministry of Labour and Social Protection with support of the World Bank has developed over 200 occupational standards and continued to work on establishing a workforce resources development agency.

On 5 June, the National Action Group on the development project '**Azerbaijan 2020: vision into the future**' was launched, with the Minister of Economic Development leading on implementation. The action group was tasked with developing draft strategies and state programmes to implement the project but so far little involvement from independent experts and civil society has taken place.

Azerbaijan continued cooperation with international partners in the field of **rural development** and special reserve funds were allocated to the executive power to speed up socio-economic development. Agreements were signed with various donors to renovate and improve roads and water supply and sewerage systems in cities. The Cabinet of Ministers ordered the transfer of management of internal water supply and sewerage systems in apartment buildings from ministries and local authorities to the state company Azersu. This was generally considered a positive step in coordinated management. As a result of new, less permissive migration rules in place in Russia (one of the main destinations for Azerbaijani labour migration) overall remittances decreased, with a negative impact on the social situation of families living mostly in rural Azerbaijan.

4. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

The EU was Azerbaijan's main trading partner in 2012.² In 2012 **bilateral trade** flows decreased, compared to 2011, amounting to EUR 17.3 billion. EU exports to Azerbaijan consisted mainly of machinery and transport equipment. EU imports from Azerbaijan consisted mainly of mineral fuels.

There was no significant progress in Azerbaijan's **WTO accession**, which is a pre-condition for Deep and Comprehensive Free Trade Area (DCFTA) negotiations. No meetings of the WTO working party on the accession were convened in 2013. Nevertheless, technical work advanced in 2013 and working party activity resumed in February 2014.

² Data for 2013 was not available at the time of writing.