

Social Protection and Social Inclusion in Azerbaijan

European Commission

Directorate-General for Employment, Social Affairs and Inclusion

Manuscript completed in 2011



European Commission

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Special thanks are given to Robia Charles, Malte Viefhues, Catherine Scott, Turkhan Sadigov, Rahima Guliyeva and others who have helped in the creation of this document.

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Abbreviations

ADB	Asian Development Bank
ADECRI	French Agency for Development and Coordination of International Relations
AIMS	Assessment Instrument for Mental Health Systems Report
ASLC	Azerbaijan Survey of Living Conditions
AzDHS	Azerbaijan Demographic and Health Survey
BTC	Baku-Tbilisi-Ceyhan
CIS	Commonwealth of Independent States
CLED	Center for Local Economic Development
CLED	Center for Local Economic Development
CPI	Consumer Price Index
CRRC	Caucasus Research Resource Center
DRC	Danish Refugee Council
EBRD	European Bank for Reconstruction and Development
ECE	Early Childhood Education
ERC	Economic Research Center
Europe HFA-DB	European Health for All Database
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GER	Gross Enrollment Ratio
GoA	Government of Azerbaijan
HBS	Household Budget Survey
HH	Households
HIV/AIDS	Human immunodeficiency virus/Acquired Immune Deficiency Syndrome
HSRP	Household Survey on Remittances and Poverty
IDMC	Internal Displacement Monitoring Center
IDMC	Internal Displacement Monitoring Center
IDP	Internally Displaced People

IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IMF	International Monetary Fund
ISCED	International Standard Classification on Education
LSMS	Living Standards Measurement Study
MCB	Minimum Consumer Basket
MCL	Minimum Cost of Living
MED	Ministry of Economic Development of Azerbaijan Republic
MICS	Multiple Indicator Cluster Survey
NDC	Notional Defined Contribution
NGO	Non-Governmental Organization
OECD	Organisation for Economic Co-operation and Development
OECD	Organisation for Economic Co-operation and Development
OHS	Occupational Health and Safety
OOP	Out of pocket
PAYGO	Pay as you go
PISA	Programme for International Student Assessment
PPP	Per capita GDP
PSA	Production Sharing Agreement
PTU	Professional Technical Education (Профессиональное Техническое Училище)
RHS	Reproductive Health Survey
SLI	State Labor Inspectorate
SOCAR	State Oil Company of Azerbaijan Republic
SPIEC	State Program on Implementation Employment Strategy
SPPRED	State Program on Poverty Reduction and Economic Development
SPPRSD	State Program on Poverty Reduction and Sustainable Development
SPSEDR	State Program on Social and Economic Development of Regions
SSAC	State Student Admission Committee
SSC	State Statistical Committee
SSPFA	State Social Protection Fund of Azerbaijan
TSA	Targeted Social Assistance
UN	United Nations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USSR	Union of Soviet Socialist Republics
VAT	Value Added Tax
VET	Vocational Education and Training
WB	World Bank
WHO	World Health Organization

Executive Summary

This report provides an overview of the economic system, labor market and education system in the country. It also examines the modernization of the social protection system in Azerbaijan, outlines demographic trends, and discusses issues surrounding poverty as well as the pension and healthcare system.

Macroeconomic Overview

Azerbaijani economy has been growing for the last fifteen years. From 1997 to 2009, Azerbaijan's Gross Domestic Product (GDP) grew by 14% per year on average. However, much of the growth was generated by industrial output—mostly in the oil and gas industry that grew by 18.8% on average between 2003 and 2009.

The oil boom that peaked in the first decade of this century affected also the structure of Azerbaijani economy. The share of agriculture in GDP slumped from 15.9% in 2000 to 6.4% in 2009. The share of manufacturing (including industries and production of oil refineries) dropped from 5.3% to 4.1% in 2009. Meanwhile, the share of crude oil and natural gas extraction as well as services related to oil and gas extraction jumped from 27.6% in 2000 to 44.8% in 2009. The growth in the oil GDP out-paced the non-oil GDP, while the share of other sectors was marginalized.

In the context of the global financial crisis of 2008-2009, the growth rate of the economy was slowed. This happened mostly because of the decline in the foreign direct investments (FDI) and the depression in the property market and construction. The Azerbaijani government took serious steps to mitigate the impact of the financial crisis. Since the beginning of the crisis, the government has invested around €3.72 billion into the local economy, mostly to infrastructure projects (60%) and to social projects (20%).

Windfall of oil revenue helped to substantially raise the state budget over a relatively short period. From 2003 to 2009, the total state budget expenditures have gone up by more than 10 times from €887.76 million to € 9.9 billion. The increased public expenditures in that period was not directed toward human development (e.g., health care, education, science), but rather to infrastructure projects, defense and general government services. Despite the absolute increase, the share of social expenses in state budget has been decreasing for the past few years. For example, in 2003 the expenses for social security represented 18.2% of overall expenses while in 2009 they were at 9.7% level. Educational expenses decreased from 23.7% of overall expenditures to 11.6% in 2009; health expenses dropped from 5% to 4.3%. In absolute terms, corresponding to rising oil prices and budget expansion, social expenses have increased. However, in relative terms, their share decreased overall in the inflated budget.

Since 2009 the government began to divert funds from infrastructure projects into health care, education and social protection. However, the public expenditures in the social sector are still not adequate.

The bulk of taxes and budget income comes from the Absheron region as well as Baku. All offshore and onshore oil and gas production, oil refinery and transportation are accredited to Absheron and Baku. Since most of the taxes come from the economic activities related to oil and gas production, these sites pay the bulk of the taxes. In contrast, other regions of the country marginally contribute to the formation of the state budget and remain totally dependent on transfers from the state budget.

The Labor Markets

The economically active portion of the population significantly increased in absolute terms. While in 2000 there were 3,748,200 economically active people, in 2009 their number reached 4,331,800, increasing by more than 14%. However, the labor force participation rate only marginally increased. In 2003, the participation rate was 70.3% (75.5% for men and 65.5% for women), while it rose only to 71.3% in 2008. Furthermore, a review of gender statistics reveals that the share of female participation remained nearly constant and the rate was 10% lower than male's over the last decade. Meanwhile, the employment to population ratio slightly increased for the 6-7 year period due to increased employment among males. It is important to note that most of the jobs that created in recent years were in male-dominated sectors. Thus, in most cases only males could obtain new employment while sectors commonly dominated by women did not experience job growth.

The labor participation rate for the 15-24 age group did not change for a 5 year period and remained at 46%. Only the cohort aged 55-64 changed considerably from 36% to 43%, mostly as a result of the increase in the pension age.

The labor force participation rate also varies across urban and rural areas. The unemployment and inactivity rate is usually higher in urban areas. In rural areas, in contrast, due to subsistence agriculture labor force participation is very high. Involvement of rural people in subsistence farming is the major reason for the high labor force participation rate across the country.

The overall employment rate went down from 78.6% in 2003 to 71.1% in 2009. The employment rate for people in the age group 15-19 is one of the lowest at 16% rate. The figures for the age cohort of 20-24 are also low. Only 45.1% of this cohort is employed. Most of the people who are able to find employment are those aged 30-34 for whom the employment rate is around 90%.

Comparing the distribution of people involved in various types of economic activity, the percentage share did not change too much. In 2003, the share of people involved in agriculture was around 40%, and then in 2009 it slightly decreased to 38.5%. Other small changes occurred in the share of manufacturing that increased from 4.5% to 4.9%.

Construction increased from 4.8% to 5.5%, retail and wholesale trade from 16.5% to 16.3%, and the share of real estate jobs expanded from 2.6% to 3.4%. The share of other sectors grew marginally or stayed the same. While employment in transport and communication grew from 4.8% to 5.2%, the share of employment in delivery of health and social service remained almost the same at 4.5%.

The situation with Azerbaijan's labor market is similar to many other countries of post-Soviet region. Sectors that employ the most people are not those that generate the most value added per person. This may be observed in contrast with employment, wages and productivity among sectors. The mining industry employs only 1.1% of all employed people while generating most of Azerbaijan's GDP. Meanwhile, 38.3% of employed people in agriculture generate only 7.1% of GDP. The highest salaries are also observed in the mining industry and 12 times more than in agriculture and almost 8 times more than in education. Only a small number of workers have access to high-productive, high-wage job in oil industry. The rest of the labor force is located in low-productive and low-wage sectors.

The share of self-employed people within Azerbaijan's employment statistics is significant. In 2000, this group consisted of 17.4% of all people employed in economy (645,000 self-employed people total). In 2009, the statistics showed 706,500 self-employed people while their share remained the same. This increase in number is mostly attributed to the governmental policy that introduces simplified taxation and a "one-shop" system for business registration.

At the same time, the issue of unregistered or undeclared employment remains problematic. According to the Azerbaijani statistics agency, around 2.1 million people are employed in the private sector. Out of that number, the statistics reveal occupations for only 800,000 while the rest of 1.3 million goes under category of private or natural person. In fact, most of these people are primarily self-employed in subsistence agriculture. However, they are unregistered and do not pay taxes. Such a situation with unregistered self-employed people in agriculture is detrimental for Azerbaijan's pension system as well as for the people themselves.

There are huge disparities in salaries across different sectors of the economy. Thus, while the employees of the mining sector were earning €895 in 2009, people employed in agriculture only earned €118 on average.

Large regional wage disparities also exist mainly because there are many high paying jobs available in Baku and its vicinities which are absent elsewhere, particularly in rural areas. The largest monthly wage per capita was observed in Baku city in 2009 (with settlements)—that was €380. The lowest wage in 2009 was observed in the Sheki-Zaqatala economic region at €151. The wages in most of the regions of Azerbaijan are half of those in Baku with the highest wages after Baku observed in Guba-Khachmaz (€182).

There is also a gap between wages earned by males and females. Men receive higher wages than women in most jobs.

Meanwhile, the labor market situation is further complicated by the presence of a large number of IDPs. Despite all efforts, most of the IDPs are still struggling to get a stable and sustainable income. In rural areas, IDPs are employed in agricultural enterprises or involved in subsistence agriculture. However, the absence of investments or loans does not allow IDPs to produce enough products for sale. Thus, most of their agricultural production is used for subsistence. Many IDPs in rural areas still depend on governmental assistance or remittances from relatives abroad. There is no information about the incomes and wages of IDPs since there are no statistics for this population. Most IDPs are scattered across the country and this fact complicated any measurement of poverty among the group.

Education

Public expenditures on education have fallen consistently since the collapse of the Soviet Union. Compared with other countries in transition, Azerbaijan's spending on education is very low. According to our calculations it was about 2.4% and 3.3% of the GDP in 2008 and 2009, respectively. Insufficient public expenditures on education translate into inadequate level of salaries of teachers. Low salaries in its turn lead to corruption and a public tutoring phenomenon when a teacher teaches his students the same materials that he/she supposed to teach in the class for additional payment. Correspondingly, the quality of public education eventually deteriorates.

There could be several explanations for the low quality of education. Most of the investments and expenses in the education sphere are directed toward material goods, such as the construction of new schools and equipment. However, this equipment does not enhance the quality of education. Anecdotal examples are abundant and describe situations in which new computers were purchased for schools and high speed internet connected, but the pupils are not allowed to use these resources. Low salaries for teachers and faculties make them disinterested in the quality of education.

Low public expenditures on education also creates problems with the access to education service. As public spending on education declines, families must supplement educational expenses—a burden that is greatest for low income and poor families. According to a World Bank report, the richest 20% of the population consistently accounts for nearly 40% of private spending while the poorest 20% spends only approximately 10% of the total private spending on education.

Demographic trends

According to the preliminary estimates of census data in early 2010, the population of Azerbaijan was about 9 million persons. Fifty four percent live in urban areas and 45.9% in rural areas. The age structure of the country's population is characterized by the following figures: 22.6% under 15 years of age and 6.8% over 65 years old. In 2009,

152,139 new babies were born in the country or 417 new citizens per day. The birth rate remains stable for the last couple of years at 17.2 babies per 1,000 persons. Although it is much less than in 1990-1991 (26 babies per 1,000 persons), it is still higher than in 2001 when there were 13.8 babies born per 1,000 persons. The total fertility rate averaged 2.1 for the period of 2000-2010.

Due to the relatively high fertility rates, Azerbaijan's working age population (15-64) has grown rapidly. The total dependency ratio will also grow, but not with accelerated speed as in other countries of Europe. For the 40 year period it will only grow by 10 points mostly due to old age dependency ratio growth that will increase by three times. The slow decrease of child dependency ratio and comparatively high fertility rate will partially neutralize the old age dependency ratio growth. In comparison with Georgia and Armenia, Azerbaijan's dependency ratio will be lowest in the region.

Migration and remittances

Migration from Azerbaijan intensified following the disintegration of the Soviet Union. Russia was the first destination for most migrants. Only primarily Russian speaking-minorities emigrated during the early stages of independence. However, mostly ethnic Azerbaijanis from rural areas began to immigrate to Russia for work beginning in 1993.

As the number of migrants increased, so did the remittances. According to a World Bank report, the remittances coming to Azerbaijan from all countries increased from \$6 million in 1998 and peaked in 2008 when over \$1.5 billion (€1.06 billion) were sent to the country. Fifty seven percent of these remittances came from Russia. Approximately 9% of the Azerbaijani population receives remittances. Sixty one percent of the incomes from these recipients are below \$100 per month. A majority of remittance recipients in Azerbaijan are not employed (61%) and around 60% of the remittances are sent to rural areas.

It should be noted that there is no consolidated data on labor remittances to Azerbaijan. Various agencies and organizations report different figures. The main discrepancy is the result of different methodologies used to calculate remittances.

Territorial Disparities

There are large disparities in economic development between the capital city and the other regions of the country. Out of €36.3 billion of goods produced in Azerbaijan in 2009, €28.3 billion or almost 78% were produced in Baku. The rest of Azerbaijan produced only €7.3 billion worth of products (22%). The Aran economic region—the second largest economic region by production—produced only €2.3 billion or 6.5% of all goods produced in the country.

The same situation is observed in the per capita production of goods by different regions. The average per capita good production in the country was €4,124. It was €13,800 specifically in Baku. Per capita production was €1,180 in the other regions of Azerbaijan.

Per capita good production significantly varies across the regions. Thus, the per capita production of goods is € 844 in Lankaran and €1,265 in Ganja-Gazakh (State Statistical Committee, 2009). This uneven distribution of goods production also results from the composition of the country's GDP. Most of the regions that produce a marginal share of products are agricultural regions. Agriculture composes only 6.7% of country's GDP. In contrast, industries such as oil and gas produce 50% of the GDP, mostly originating in Baku.

Social Protection System

The current social protection system in Azerbaijan is mainly divided into two programs: social insurance and social assistance. Social insurance benefits (e.g., old age, unemployment, illness) are financed through social insurance contributions made by the employed population. These types of benefits protect households and individuals from falling into poverty when the above mentioned events (e.g., old age, temporary disability, unemployment) occur. Social transfers such as child benefits, funeral grants, in kind benefits, targeted social assistance and disability benefits are non-contributory in nature and financed from the state budget. The main goal of such social assistance programs is to redistribute resources to ensure that the poor maintain a minimum consumption level.

Administratively, the functions of the social protection system in Azerbaijan are divided between two entities: the Ministry of Labor and Social Protection of Population and the SSPF. Currently, the SSPF oversees and provides social protection types of benefits: old age pensions, family allowances, health care, temporary disability (illness), maternity leave, unemployment benefits and others. In 2006 the SSPF was granted additional functions including the collection and administration of social payments made by state entities and enterprises. These are mandatory state social insurance contributions. The Ministry oversees and provides for disability pensions, targeted social assistance, social allowances, occupational injuries, and funeral benefits among others. Overall, the Ministry is responsible for designing and implementing poverty alleviation strategies.

The report identifies 4 key challenges in the social protection system of the country. First of all, abundance of undeclared/informal jobs causes at least two major problems. It excludes many from enjoying the benefits of the social protection and it reduces worker's contribution to the system. A large share of the workforce does not pay taxes for a variety of reasons and is not covered by social insurance. Most of them are involved in subsistence farming and produce agriculture goods mainly for family consumption. Thus, there is not much income to declare which may be taxed. Moreover, employers prefer not to declare their employees (unpaid family workers) and do not pay social security taxes since taxes add an additional cost to labor.

Second, most social benefits continue to be distributed based on categorical consideration rather than means-testing. Child benefits, disability pensions and benefits to refugees are good examples of this. The same disability pension could be given to persons with different incomes. An individual who has refugee status, but whose income is high

enough could get exemption from education as well as health payments. However, a non-refugee family may struggle to cover education payments for their children.

Third, the government thinly distributes resources to a larger share of the population, providing minimal benefits to as many as possible, thus overall failing to significantly change the status of poor people.

Fourth, inclusion of vulnerable groups like disabled people and children in institutional care is another major challenge. Despite the existence of the State Program on Inclusive Education, issues of access to education are still a problem. According to UNICEF statistics, the number of children with disabilities involved in so called “home education” and “specialized education” is relatively high. Such education prevents children from socializing and active participation in community life. These children often have difficulties integrating into society after reaching adulthood. In general, people living with disabilities in Azerbaijan have limited access to the health care and education. In addition to that most of the public spaces or public transportation is not equipped for the physical access of people with disabilities. The cash and in kind benefits received are not enough to help them to integrate into society and the benefits to not provide proper support for this vulnerable group.

Poverty and Social Exclusion

The official poverty incidence in the country fell steadily for the last 10 years. One of the main reasons for this downward trend was high paced economic growth. The economic growth of the last decade was also accompanied by growth in real wages; the main source of poverty reduction among the working poor. The annual growth rate of the average monthly real wages has been well over 14% since 2003 on average. The government of Azerbaijan has also gradually increased the minimum wage since 2001. The minimum monthly wage rate went up from less than 23% of the minimum subsistence level in 2001 to over 95% in 2008. Moreover, the government of Azerbaijan gradually increased the minimum pension and brought it closer to the minimum subsistence level over the last several years. The minimum pension went up from 42% of the minimum subsistence level in 2001 to 95% in 2008. This government policy played a significant role in reducing official poverty by pulling many households with pensioners out of “the officially poor” status and by mitigating the intensity of the poverty.

Unfortunately, the official poverty rates by various vulnerable groups (IDPs, refugees, ethnic minorities, elderly people, children, disabled people) are not publicly available. This makes it difficult to assess poverty in the mentioned segments of the society in Azerbaijan.

Some non-monetary indicators of poverty show that it is still a serious problem in the country, despite a significant decline in official poverty rates. A substantial portion of the population has limited or no access to basic utility services such as water (including hot water), gas supply and telephone services. Azerbaijan’s child and infant mortality rates are one of the highest among Eastern European and CIS countries. Healthy life

expectancy at birth is below the regional average and also the average for the lower middle income countries to which Azerbaijan belongs. Furthermore, the coverage and quality of education services has been considerably low in the country for the last decade. Although primary and secondary education enjoys quite high enrollment rates, the quality of these education levels is questioned.. In comparison to the other post-socialist countries and to the lower middle income countries, Azerbaijan experiences very low enrollment rates in tertiary and pre-primary education.

There are certain segments of the population that are more susceptible to poverty and exclusion. The analysis in this report shows that persons 65 years old and over, especially those who live alone or single parent households with 1 or more dependent children are the most vulnerable groups. These households are more at risk of being excluded or materially deprived if the education of the household head is low and if they live outside of the capital (especially in rural area). The number of children also positively correlated with vulnerability to poverty. Households with 3 or more children are more likely to be poor relative to households with fewer children. IDPs and refugees are another group exposed to poverty and social exclusion.

It is evident that cases of severe material deprivation still exist despite strong economic growth and reduction in the poverty rate during recent years. This is particularly true in rural areas and among the IDP and refugee population—the majority of them still live in inadequate conditions.

Another major deficiency of the Azerbaijani government's approach to the poverty reduction and social exclusion alleviation is the lack of well-defined and precise benchmarks against which the success of governmental measures in implementing programs and reforms could be compared to in the future.

Among other important aspects of the social exclusion is the lack of social infrastructure to accommodate the needs of the disabled population. For instance, the lack of educational infrastructure and facilities that are adapted to the needs of disabled people drives them toward home schooling which is a contributing factor to their social exclusion. The same is true of transportation, recreation and other points of access to public space. The lack of infrastructure for disabled people confines them to domestic space and prevents them from active participation in public life.

Pensions

The pension system dependency ratio (proportion of beneficiaries to contributors) in Azerbaijan at around 31% in 2008 was already much higher than the old-age dependency ratio (population 60+ as proportion of population 15-59) at around 13% in the same year. A constant increase in life expectancy and growing share of population aged 65 and more would create additional pressure for the pension system in the next two decades.

In 2001 the Azerbaijani government launched a pension reform that was intended to complete the formation of the social insurance and pension systems. The main objectives

of the reform were aimed at the substitution of present wage-based pension system (PAYGO) with a new one based on individual social insurance contributions. The task was to link the social insurance benefits with the level of participation in the social insurance systems and the amount of paid contributions.

However, the current level of pensions is still barely enough to sustain a pensioner. By January 1, 2010 the average monthly old-age pension totaled €91 while the minimum pension totaled €76. The average monthly old-age pension is 34% of the average monthly salary while the minimum pension/average salary ratio totals 26%.

It is important to create a sustainable pension system that will ease the burden on public expenditure once the oil boom is over and the oil money is gone. The biggest challenge comes from the low collections of contributions and social insurance revenues. In spite of the fact that the total non-state budget revenues of the SSPFA gone up, they are still not enough to make the system sustainable. The transfers from the state budget are also increasing. Since 2003 the number of transfers increased by almost 3.5 times. Despite the fact that the share of these transfers in the total revenues of the SSPFA is still lower than in 2003, it is still sizable by being around 30%.

The government should continue its policy of extending the coverage of pension system to the informal sector. Greater share of employees' contribution in the total social tax payments and subsidised pension entitlements for those who contribute could be options to consider. Moreover, the coverage of social security could be gradually extended to agriculture and the self-employed.

The government should also take serious steps towards the launch of private pension scheme within the next five to six years. Introduction of mandatory funded pension would entail transition costs (when future expenditure would be pre-financed in parallel to the current expenditure), but revenues from oil could possibly cover the gap.

The government could also look at the privileged pensions which are currently based on non-insurance principles. Public officials, employees of some ministries, the police, the military and other categories who are entitled for earlier retirement and higher pensions constitute quite a large share of the population.

Health and Long Term Care

The overall quality of health care services has deteriorated after the collapse of the Soviet Union, mainly due to the lack of funding, the poor infrastructure of health facilities and the inefficient training of physicians.

The comparison of Azerbaijan's public health care expenditures with those of other countries reveals a substantial lag: with regard to its GDP, Azerbaijani health care expenditures take up the lowest share among all post-Soviet and post-Communist countries. Specifically, according to the TransMONEE 2010 database, the general government expenditures on health for Azerbaijan were 0.9% of GDP in 2008. This was

followed by Turkmenistan at 1.0%, Tajikistan (1.5%) and Armenia (1.7%). The respective figures for some other post-Soviet economies were the following: Georgia 1.8%, Kazakhstan 2.4%, Uzbekistan 2.5%, Kyrgyzstan 3.2% and the Russian Federation 3.4%. In the other post-Soviet and post-Communist countries the figures were generally higher. The public expenditures on health as percent of GDP in 2008 were 3.8% for Ukraine, 4.9% for Belarus, 5.6% for Slovenia, 5.8% for the Czech Republic, and 6.6% (the highest among the post-communist countries) for Croatia.

The tight control over health care providers in the current centralized system allows them limited freedom and few opportunities to develop and raise the quality of their services. For instance, rural health care providers have no independence over financial issues and staffing decisions. It is not uncommon if they do not even know the financial resources at their disposal. In urban environments, the suburban hospitals and health care institutions under the direct supervision of the Ministry of Health have more autonomy in hiring staff. However, they, too, are under strict systematic control of their spending that limits their financial independence. In recent years, this already strict control over these institutions has become even tighter. These dependencies limit the ability of health care providers to be proactive and positively change the quality of health care services in Azerbaijan.

In addition to their limited autonomy, health care institutions experience a lack of qualified staff and extremely low wages in the health care sector. The average salary for health care personnel was €72 in 2007, or less than half of the average Azerbaijani salary in all sectors combined. As a result, out of pocket payments, only formal in private clinics and in a number of public hospitals, but informal in all other public hospitals, are the main source of income for many public health workers. At the same time, while these payments are usually not accounted for, they do not contribute to the overall improvement of public health facilities.

All these problems negatively affect the end users—who turn out to be patients with limited access to unsatisfactory treatment. In addition, the lack of a mandatory system of health insurance means that people themselves have to bear the high costs of the system. As a result, effective health care becomes a good that the majority of the Azerbaijani population simply cannot afford.

The unprecedented psychological stress caused by the socio-economic hardships of the post-Soviet transition, coupled with a cultural environment of strict taboos, calls for a more proactive engagement in terms of facing up to the population's psychological problems. Furthermore, taboos on sexuality prevent public debate and an effective fight against HIV/AIDS and related problems. Moreover, Azerbaijani culture is particularly open to male alcohol consumption and smoking, restricts the mobility of women and provides a high-cholesterol traditional diet.

Chapter 1: Economic, Demographic, Labor Market and Education Trends

1.1 Economic Development after the Collapse of the Soviet Union

Azerbaijan had a broad and diversified economic base until the collapse of the Soviet Union in 1991. Nevertheless, a significant part of its industry was dependent on imports from other Soviet republics and the bulk of its exports were specifically produced for consumers inside the USSR. The disintegration of the Soviet Union and the beginning of the Karabakh conflict severed Azerbaijan's economic ties with the other republics. The country's industrial sector and other sectors of the economy subsequently collapsed, leading to layoffs, massive unemployment and a level of poverty. The presence of hundreds of thousands of refugees and internally displaced people (IDP) further aggravated the economic situation. The exchange rate of the country had weakened because of triple digit inflation from 1992-1994 that led to massive exchange rate depreciation of the Azerbaijani manat (AZN). The Gross Domestic Product (GDP) also significantly dropped. In 1995, Azerbaijan's real GDP only totaled 37% of the 1989 level, while the average CIS level comprised 58%. On average, Azerbaijan's real GDP decreased by 15% per annum from 1992 to 1996 (World Bank, 2009a).

Since 1995, Azerbaijan has made substantial progress towards stabilizing its economy. With greater political stability, the government has launched a program to stabilize the economy and has introduced structural reforms. One of the components of the reforms was a privatization process that occurred in two stages. The first stage included privatization of all small firms and enterprises. This was almost complete by 2000-2001. The government distributed privatization vouchers among the general public and launched voucher auctions in which people were allowed to exchange their vouchers for stocks in plants and factories. Most of the state-owned companies were transformed into open joint stock companies. The shares of state enterprises were sold or distributed through voucher or cash auctions as well as tenders. These and other reforms allowed the Azerbaijani GDP to increase by 1.3% in 1996 while inflation sharply declined from 1,788% in 1994 to 50% in 1995, and to 20% in 1996 (The State Statistical Committee of the Republic of Azerbaijan, 2009a).

The country was more concerned with stabilizing the economy in the early stages of its independence. The government launched a wide-ranging reform program in the late 1990s and later on, directed its resources to achieving sustainable growth and development. With the increasing flow of oil revenues, state authorities began to strengthen governance in financial markets, reform the tax code, fight corruption and ensure transparent budget execution and accounting.

Two factors significantly contributed to sustained growth in the country. First, a Production Sharing Agreement (PSA) was signed with foreign oil companies in 1994 to developing oil and gas deposits in the Caspian Sea. Second, oil companies promised to

construct the Baku-Tbilisi-Ceyhan (BTC) pipeline and the South Caucasus Gas pipeline to transport oil and gas to Turkey through Georgia. Both contracts became the cornerstones of Azerbaijan's forthcoming development as they generated a significant amount of foreign direct investment (FDI) into the country. Thanks to the oil development, FDI into the country increased from €825 million (\$927 million) in 2001 to €4.655 billion (\$6.847 billion) in 2008 (The State Statistical Committee of Azerbaijan Republic of Azerbaijan, 2008).

The State Oil Fund of Azerbaijan was created in December 1999 “to ensure intergenerational equality of benefit with regard to the country's oil wealth, whilst improving the economic well-being of the population today and safeguarding economic security for future generations” (State Oil Fund of Azerbaijan Republic, 2009). The fund's activities include preservation of macroeconomic stability, safeguarding fiscal-tax discipline, decreasing dependence on oil revenues and stimulating development of the non-oil sector. Its assets reached €14.9 billion (\$21.7 billion) by October 2010 (State Oil Fund of Azerbaijan Republic, 2010).

Azerbaijan's rapid economic development and significant improvement across several indicators allowed the country to be placed on the list of countries with high human development. For example, Azerbaijan's ranking in the Human Development Index (HDI) has significantly improved. In 2010 it reached the highest score at 0.713 and the country was ranked 67th among 169 countries. Thus, for the first time in its history Azerbaijan has left the ranks of countries with “medium human development” and joined the “high human development” cohort. Since 1995, Azerbaijan's life expectancy (one of the indicators of HDI) has increased by 5 years, the expected years of schooling increased by 3 years, and Gross National Income per capita jumped by 338% (HDI, 2010).

1.2 Main Macroeconomic Trends

Azerbaijan has been able to attract foreign direct investments and export its natural resources due to exploration of new oil fields and PSA agreements with foreign oil companies. For the thirteen year period from 1997 to 2009, Azerbaijan's GDP grew by 14% per year on average (The State Statistical Committee of the Republic of Azerbaijan, 2009a). However, much of the growth was generated by industrial output—mostly in the oil and gas industry that grew by 18.8% on average between 2003 and 2009 (EBRD, 2009; World Bank, 2009a).

As a result of the oil boom and inflows of oil revenues, the GDP per capita (PPP) also grew to €3,411 (\$4,874) in 2009.¹ High oil revenues allowed Azerbaijan's GDP per capita to reach 54.3% of the 10 EU countries' average put together (Latvia, Lithuania, Estonia, Czech Republic, Poland, Hungary, Slovenia, Slovakia, Romania and Bulgaria).²

¹ It was actually slightly less in 2009 than in 2008 €3,922 (\$5,603). Following the sharp decline in the oil prices in 2009, the nominal GDP of Azerbaijan significantly decreased, while the real GDP increased by 9.3%.

² Comparing the same index with the CIS average, the GDP per capita in Azerbaijan rose from 42.3% from 1997-2000 to 155% in 2009.

Windfall of oil revenue spurred the Azerbaijani government's initiative to spend a large amount of revenue on infrastructure projects such as roads, bridges and city beautification. The total government expenditure increased by a cumulative 160% in nominal terms from 2005 to 2007 (The State Statistical Committee of the Republic of Azerbaijan, 2009a).

The government pays specific attention to developing regions outside of the capital as well. In 2004, the government adopted the State Program on Regional Socioeconomic Development for 2004-2008 immediately following the election of President Ilham Aliyev. The main objectives of that program were to develop local entrepreneurship, increase employment and improve the living standards of the population.

In April 2009, the government adopted a new State Program on Regional Socioeconomic Development for 2009-2013. The second program was merely a continuation of the first one with more attention to the development of non-oil sectors, stimulation of export-oriented goods, improvement of public services and decline of poverty. Within the framework of that plan, the State Investment Fund was established and accumulated more than €1.77 billion (2 billion AZN) by the end of 2008. According to the governmental figures, about €5.3 billion (6 billion AZN) of investments were spent to implement this program, including €1.77 billion (2 billion AZN) which was spent in 2008. By the government's estimates, about 26,641 companies were opened within the last five years and 839,800 new jobs have been created with 602,088 being permanent jobs.

Significant changes were observed in the structure of GDP. Over the last decade, increased income from oil and related sectors has altered the structure of GDP. The share of agriculture in GDP slumped from 15.9% in 2000 to 6.4% in 2009. The share of manufacturing (including industries and production of oil refineries) dropped from 5.3% to 4.1% in 2009. Meanwhile, the share of crude oil and natural gas extraction as well as services related to oil and gas extraction jumped from 27.6% in 2000 to 44.8% in 2009. The growth in the oil GDP out-paced the non-oil GDP, while the share of other sectors was marginalized.³

The second half of 2008 began with a global and financial crisis that hit many countries in the region. Despite the statements of governmental officials, Azerbaijan has felt the impact of the crisis that was observed in a significant drop in FDI from 2008-2009. Many sectors of the economy have declined, but mostly in agriculture, manufacturing and construction. These declines have been compensated by increasingly large inflows in the sectors of production and in the distribution of electricity, gas and water. FDI in manufacturing, assembly and services is extremely weak and most FDI in the country goes to infrastructure and extractive industries. According to EBRD data, the net FDI dropped from €1.6 billion (\$2.3 billion) to negative €607.6 million (\$870 million) in 2009 (EBRD, 2009b). The government, which uses a different method of counting FDI,

³ Meanwhile, the transport and communication sector shrank from 12% to 8.6%. Social service delivery, education, social protection, welfare and health dropped from 16.4% to 11.7% of GDP. Gas, electric and water supply sectors also decreased their shares in GDP from 3.1% to 1.1%, while trade and non-taxes sector rose to 8% and 7.6%, respectively.

claimed that this index dropped by 21% and reached €4.2 billion (The State Statistical Committee of the Republic of Azerbaijan, 2009b).

The impact of the crisis on Azerbaijan was also felt due to lower oil revenues. Nevertheless, the country still managed to end 2008 with a double-digit growth rate and held 9.3% growth in 2009. The Azerbaijani government took serious steps to mitigate the impact of the financial crisis. In order to revive the property market and construction industry that received the hardest hit, the government allocated €134.6 million (152 million AZN) to revive these sectors. By the end of 2009, over 3,000 mortgage loans had been given to people for buying apartments (Azerbaijan Mortgage Fund, 2009). Despite these measures, the property market nevertheless lost 20% of its value in 2009 alone and over 30% over the period of crisis. Meanwhile, the government has increased state run investments in an attempt to compensate for the loss of FDI due to the crisis. Since the crisis hit the country, the government has invested around €3.72 billion (4.2 billion AZN) into the local economy, mostly to infrastructure projects (60%) and to social projects (20%) (State Statistical Committee of Azerbaijan Republic, 2009b).

1.3 Budget, Fiscal Policy and Governance

For the last seven years, the expenditures of the state budget nominally increased by more than 10 times from €887.76 million (1.1 billion AZN) in 2003 to € 9.9 billion (11.2 billion AZN) in 2009. Due to the high oil revenues, the budget heavily relied on income from the oil sector. The share of direct oil revenues in state budget incomes reached 65.4% in 2009, while the non-oil trade balance has deteriorated and dropped to 3.2% in total exports (The State Statistical Committee of the Republic of Azerbaijan, 2009b). Meanwhile, State Oil Fund transfers to the budget reached a record 40.4% of all budget incomes. Due to the financial crisis, the Azerbaijani government took some steps that were reflected in the new budget for 2010. However, the new budget demonstrated the extreme dependence of the country on oil revenues.⁴

It is worthwhile to mention that the bulk of taxes also come from the oil sector. It was expected in 2010, out of €4.32 billion (4.887 billion AZN) of tax revenues, €2.74 billion (3.1 billion AZN) will be paid by the oil sector. In total, around 80% of all revenues to the state budget in 2010 came from the oil sector (National Budget Group, 2009; The State Statistical Committee of Azerbaijan Republic of Azerbaijan, 2009a; Zermeno, 2008). In comparing the 2010 budget with the previous year, a significant drop is evident in the allocation of funds for construction, as well as a modest increase in social protection, education and health care. The government has declared the development of agriculture to be one of its priority fields due to the impacts of the global food crisis. This is reflected in the 2009 and 2010 budgets. Agricultural expenses increased by 65% in 2009. This funding supported measures including the increase of subsidies to agricultural

⁴ Budget expenses comprised €9.90 billion (11.2 billion AZN), while revenues was at €8.93 billion (10.1 billion AZN). €4.33 billion (4.9 billion AZN) out of €9.90 billion (11.2 billion AZN) of revenue was taken from the Oil Fund, while €4.32 billion (4.887 billion AZN) was generated by taxes. The rest of the funds at €186.56 million (211 million AZN) came from other sources.

producers and implementation of the State Program on Reliable Food Provision for Population that was adopted in August 2008 (National Budget Group, 2009).

The budget for the last five years indicates that increased public expenditures are not directed toward human development (e.g., health care, education, science), but rather to infrastructure projects, defense and general government services. Despite the absolute increase, the share of social expenses in state budget has been decreasing for the past few years. For example, in 2003 the expenses for social security represented 18.2% of overall expenses while in 2009 they were at 9.7% level. Educational expenses decreased from 23.7% of overall expenditures to 11.6% in 2009; health expenses dropped from 5% to 4.3%. In absolute terms, corresponding to rising oil prices and budget expansion, social expenses have increased. However, in relative terms, their share decreased overall in the inflated budget.⁵

The budgets of 2009 and 2010 indicated that the government began to decrease expenditure on infrastructure projects and to divert funds into health care, education and social protection as a result of the financial crisis. However, the increase in educational and health expenditure, above all, represents the salary growth of the employees of these sectors, as well as operational expenses. Nevertheless, the average monthly nominal wages of people working in education and health services remain low compared to those paid in other economic sectors. In 2009, the average salary of people employed in education was about €230 (259 AZN), less than the average salary in the country, €259 (298 AZN). Providers of health and social services earn even two times less than the national average (€139.8 or 152 AZN). Only people working in agriculture received lower wages than health workers and people working in education sphere. In the health care system, around 95.5% of people received salaries between 50 to 150 AZN (€43.5-€130.5). Of this total, 68.4% of all people involved in healthcare received salaries between 50 to 75 AZN (€43.5-€65.2), below or at the same level as the minimum wage (Education subchapter on teacher's salaries).

1.3.1 Taxation

The tax system of Azerbaijan has remained mostly unchanged for the past 5 years. In addition to some changes introduced with simplified taxes in 2006-2007, non-oil tax collection has mainly consisted of the VAT, simplified tax, income taxes, social security contributions, excise taxes and custom duties. In 2005, the corporate income tax was lowered from 24% to 22% and in 2004 the combined social security contributions by employer and employee were reduced from 28% to 25%. Despite the predicted regular increase of tax payments from the non-oil sector, their share in the total budget income remained unchanged (Zermeño, 2008).

Tax collection and its composition in budget revenues shows a sharp decrease of profit taxes. Table 1.3 indicates that the share of the profit tax in all budgetary revenues was 41% in 2007 and it declined to 12% in 2009. That can be explained by financial crisis

⁵ Until 2009, the share of these expenditures in percent of GDP has also dropped (Table 1.2.1). However, in 2009 the share of these expenditures slightly increased due to a decrease of GDP in nominal values.

that led to lower profits of companies and forced many of them to shut down. Meanwhile, a significant jump was observed in non-tax revenues that grew from 19.5% in 2007 to 56.7% in 2009. It was the first time that non-tax revenues constituted majority of revenues in the budget. The bulk of that non-tax revenues are transfers from the State Oil Fund. This reiterates the previous arguments that the state budget is becoming more dependent on oil revenues. By taking into consideration that a significant share of profit taxes is also coming from oil-related industries, it becomes obvious that the slightest price change on oil products is going to significantly affect budget performance.

The bulk of taxes and budget income comes from the Absheron region as well as Baku. All offshore and onshore oil and gas production, oil refinery and transportation are accredited to Absheron and Baku. Since most of the taxes come from the economic activities related to oil and gas production, these sites pay the bulk of the taxes. In contrast, other regions of the country marginally contribute to the formation of the state budget and remain totally dependent on transfers from the state budget. Also, regions do not have the right to keep their incomes (except fees for leasing municipality lands) and do not have fiscal independence. The distorted nature of tax collections prevents the regions to seek fiscal decentralization since these areas will not be able to cover their major expenses if they are left alone. Such a situation also prevents local governments from making autonomous decisions to spending their budget. Since their budget is formed on government transfers, the government has control over regions' spending too. At this stage the government will hardly be able to do anything to change the situation since the oil sector dominates the economy. However, diversification of the economy and growth of regional potential may eventually change the situation. The government will then need to give certain fiscal independence to the regions.

1.3.2 Governance and Business Environment

Azerbaijan has shown significant improvement in governance indicators during the past few years. The introduction of “a one-stop shop” system has decreased and eased the time, cost, and a number of procedural hurdles that must be expended or passed to start a business. The registration of new businesses rose by 40% in the first 6 months of 2008 following the introduction of this system. Azerbaijan also eliminated the minimum loan cutoff of €780.29 (\$1,100), more than doubling the number of borrowers covered by the credit registry. Meanwhile, significant changes were adopted to introduce e-governance in Azerbaijan. For example, the Ministry of Taxes introduced an online tax system allowing businesses to report and pay electronically (World Bank, 2009a; World Bank, 2009 b). As the Global Competitiveness Report for 2009-2010 describes the situation:

Measurable improvements across many aspects characterized by strong and improving macroeconomic stability, high national savings, a large budget surplus, and low and shrinking government debt, although high inflation does raise some concerns. Within the goods markets it has become much easier and less expensive to start a business: the number of procedures required more than halved from 13 to 6, and the time required has been reduced from 30 to 16 days. (Global Competitiveness Report, 2009-2010)

However, corruption remains one of the country's endemic problems. For the last decade, Azerbaijan has occupied the 143rd place out of 180 on Transparency International's Corruption Perception Index (Transparency International, 2009). Corruption is prevalent in almost every sphere of social life and is considered to be one of the country's challenges in its transition to a market-based economy. Azerbaijan did not show much improvement for the last 6-7 years. Its position remained unchanged in almost all indexes, such as large scale privatization, small scale privatization enterprise restructuring, price liberalization, competition policy and others (EBRD Transition Report, 2009).

1.4. The Labor Market Situation

1.4.1 Labor Market Development

The precipitous decline of the economy has had a disastrous effect on employment since the collapse of the Soviet Union. Many positions became redundant and massive layoffs took place due to de-industrialization. The situation has been exacerbated by an increasing workforce. The government's major policy focused on increasing employment in the oil and attendant industries and the removal of bureaucratic and legislative barriers to entrepreneurial activity. In the state sector, it was intended that the civil service would be reformed and reduced in size and that the privatization of state properties would "free up" capital for productivity improvements.

The economic progress over the following years demonstrated that the Azerbaijani government could stimulate the economy and partially implement the intended policies. However, most of the foreign investments were concentrated in the oil sector and created limited job opportunities. Meanwhile, an analysis of the country's labor market was constrained by an absence of surveys of the labor force. Starting only in 2003, the government of Azerbaijan began to irregularly conduct such surveys, together with ILO. In most cases, analysis is limited to the official data that sometimes contradicts international figures. Some data is available also from the ILO database.

According to state statistics, the economically active portion of the population significantly increased in absolute terms. While in 2000 there were 3,748,200 economically active people, in 2009 their number reached 4,331,800, increasing by more than 14%. However, the labor force participation rate only marginally increased. In 2003, the participation rate was 70.3% (75.5% for men and 65.5% for women), while it rose only to 71.3% in 2008 (State Statistical Committee of the Republic of Azerbaijan, 2009c). Furthermore, a review of gender statistics reveals that the share of female participation remained nearly constant and the rate was 10% lower than male's over the last decade (State Statistical Committee of the Republic of Azerbaijan, 2009c). A similar pattern is apparent in an analysis of age group dynamics. The labor participation rate for the 15-24 age group did not change for a 5 year period and remained at 46%. Only the cohort aged 55-64 changed considerably from 36% to 43%, mostly as a result of the increase in the pension age (State Statistical Committee of the Republic of Azerbaijan,

2009c). Meanwhile, the employment to population ratio slightly increased for the 6-7 year period due to increased employment among males. It is important to note that most of the jobs that created in recent years were in male-dominated sectors. Thus, in most cases only males could obtain new employment while sectors commonly dominated by women did not experience job growth.

The overall employment rate for the last 6 years went down from 78.6% to 71.1% in 2009. Unfortunately, it was impossible to calculate the employment rate by gender since the State Statistical Committee does not reveal figures for women or men in working age. The employment rate for people in the age group 15-19 is one of the lowest at 16% rate. This is understandable for Azerbaijan since most young people graduate from secondary or vocational schools at the age of 18 or 19. However, the figures for the age cohort of 20-24 are also low. Only 45.1% of this cohort is employed. At this stage in life many young people are still university students in the process of finishing their Bachelor's degrees. Another reason for such a low employment rate is the disparity between university education and skills desired by workplaces. Most of the people who are able to find employment are those aged 30-34 for whom the employment rate is around 90%.

The labor force participation rate also varies across urban and rural areas. The unemployment and inactivity rate is usually higher in urban areas. In rural areas, in contrast, due to subsistence agriculture labor force participation is very high. Involvement of rural people in subsistence farming is the major reason for the labor force participation rate across the country.

Productive job opportunities remain limited although Azerbaijan's employment has benefited from the oil boom. Between 2003 and 2009, economic growth facilitated the creation of 839,890 new jobs. About 72% of this total (602,088 jobs) were considered to be permanent by the State Statistical Committee. That goes in line with frequent statements by the Azerbaijani president on the creation of "600,000 jobs". However, looking at the number of people employed in economy from 2003 to 2009, we can see that their number grew by only 324,000 people suggesting that may be more jobs should have been considered as non-permanent. According to statistics, out of 324,000 new jobs the big share (56,000 jobs or 17%) goes to jobs created in agriculture sector. 43,200 new jobs were created in wholesale trade (13.3%); 42,200 new jobs in real estate (13%). Only 29,000 jobs were created in manufacturing (9%) (State Statistical Committee of the Republic of Azerbaijan, 2009c).

It should be noted that although the Statistical Committee claimed the creation of new jobs in agriculture, these jobs already existed. About 56,000 new jobs are in fact registered as already existing jobs in rural areas, taking into consideration the high rural to urban migration, low number of farm registration in country, and the fact that 31% of all new created jobs in the country (out of 839,890 jobs) are falling into category of "natural person".⁶ People working in rural areas were already involved in agriculture, but

⁶ Subsistence agriculture and non-agriculture household or market-oriented farming is often distinguished in the literature. In Azerbaijan's case, it is nearly impossible to make such distinction. Almost all rural people in Azerbaijan have small plots of land at their disposal, thanks to land reform. Meanwhile, almost

have not been registered or included into statistical data. Thus, such claims of job creation are exaggerated. Meanwhile, many jobs created in construction and wholesale trade were temporary and dependent on some infrastructure projects. Other new jobs were distributed in education, defense, public administration and other areas of economic activities. In 2009, the pace of job creation has slowed down reaching only 73,613 jobs (122,924 in 2008).

Comparing the distribution of people involved in various types of economic activity, the percentage share did not change too much. In 2003, the share of people involved in agriculture was around 40%, and then in 2009 it slightly decreased to 38.5%. Other small changes occurred in the share of manufacturing that increased from 4.5% to 4.9%. Construction increased from 4.8% to 5.5%, retail and wholesale trade from 16.5% to 16.3%, and the share of real estate jobs expanded from 2.6% to 3.4%. The share of other sectors grew marginally or stayed the same. While employment in transport and communication grew from 4.8% to 5.2%, the share of employment in delivery of health and social service remained almost the same at 4.5%.

Not much change occurred in the distribution of employees in enterprises, institutions, organizations and other economically active individuals. Thus, the share of people working in the state sector decreased from 31.5% to 28.2%, while the non-state sector grew from 68.5% to 71.8%. The share of jobs in companies with foreign investment and joint enterprises remained marginal and rose from 1.1% to 1.5%. The share of women employed in the economy also decreased from 2003 to 2009 from 45.2% to 42.8%. The biggest drop occurred in manufacturing (from 33.5% of all jobs occupied by both categories to 27.7%) and real estate (from 42.9% to 36.6%). Women kept majority positions in traditional areas of occupation such as education (67.2%), health and social services (76.6%) and other community activities (54.7%).

The situation with Azerbaijan's labor market is similar to many other countries of post-Soviet region. Sectors that employ the most people are not those that generate the most value added per person. This may be observed in contrast with employment, wages and productivity among sectors (Table 1.3.2). The mining industry employs only 1.1% of all employed people while generating most of Azerbaijan's GDP. Meanwhile, 38.3% of employed people in agriculture generate only 7.1% of GDP. The highest salaries are also observed in the mining industry and 12 times more than in agriculture and almost 8 times more than in education. In general, 44,000 workers have access to high-productive, high-wage job in oil industry (World Bank, 2009a; The State Statistical Committee of Azerbaijan Republic of Azerbaijan, 2009a). The rest of the labor force is located in low-productive and low-wage sectors. Unfortunately, there was not much information available on temporary, seasonal, occasional or part-time jobs.

no off-farm employment exists in rural areas of the country. Thus, as in many other countries of the former Soviet Union, the differences between subsistence agriculture, subsidiary farming and non-agricultural households with garden plots have become so small that it is often impossible to determine to which category a household belongs. Meanwhile, the State Statistics Committee does not distinguish subsistence farming as a separate category and relates it to people who are involved in agriculture. To answer this question, we would have to look at the income distribution of rural people and the share of agriculture in their household income. Unfortunately, no available data exist.

One of the disturbing facts about the labor market is that many people are not officially registered and do not pay social contributions. Thus, for example only 34% of all employed people in 2009 were on the payroll. The lowest number of people on the payroll was observed in agriculture (2.8%).

Meanwhile, the labor market situation is further complicated by the presence of a large number of IDPs. Despite all efforts, most of the IDPs are still struggling to get a stable and sustainable income. In rural areas, IDPs are employed in agricultural enterprises or involved in subsistence agriculture. However, the absence of investments or loans does not allow IDPs to produce enough products for sale. Thus, all agricultural production is for subsistence. Many IDPs in rural areas still depend on governmental assistance or remittances from relatives abroad.

In contrast, IDPs in urban areas are able to easily find decent jobs that pay for their expenses and allow them to save some funds. However, most of them are involved in informal work where they do not have official status. This includes many sales persons, construction workers, cleaners and others. Typically, IDPs have a wide range of skills and education levels. They will often engage in various activities to generate income even if jobs do not reflect their qualifications. These include informal day laborer jobs such as trading, construction, cleaning, repair work, gardening or agricultural activities. Some IDPs are engaged in semi-permanent jobs with local state administrations. IDP settlement facilities generate most of the employment for IDPs. While income is higher for IDPs working in local administration or in IDP settlements (between €80-100 per month), day labor yields low and erratic incomes (about €60 per month). Transportation to and from work also makes a significant impacts upon IDP resources and is a noteworthy obstacle in the ability of IDPs to search for and sustain employment in nearby towns and cities (UNHCR, 2010).

1.4.2 Self-employment and Undeclared Work

Statistics regarding self-employed people in Azerbaijan is ambiguous. The state statistics committee has no clear definition of self-employment. However, the Azerbaijani State Statistics Committee classifies self-employment under the category of “non-state property form”. The Social Protection Fund considers an individual who operates a business or profession, or who works as consultant as self-employed. The share of self-employed people within Azerbaijan’s employment statistics is significant. In 2000, this group consisted of 17.4% of all people employed in economy (645,000 self-employed people total). In 2009, the statistics showed 706,500 self-employed people while their share remained the same. This increase in number is mostly attributed to the governmental policy that introduces simplified taxation and a “one-shop” system for business registration.

At the same time, the issue of unregistered or undeclared employment remains problematic. According to the Azerbaijani statistics agency, around 2.1 million people are employed in the private sector. Out of that number, the statistics reveal occupations for

only 800,000 while the rest of 1.3 million goes under category of private or natural person. In fact, most of these people are primarily self-employed in subsistence agriculture. However, they are unregistered and do not pay taxes. Such a situation with unregistered self-employed people in agriculture is detrimental for Azerbaijan's pension system as well as for the people themselves. Many of them are not covered by the insurance portion of the pension; they will be left with no means for survival after liquidation of basic part of the pension (for a detailed analysis see chapter 4). Thus, the chairman of the State Social Protection Fund of Azerbaijan (SSPFA) recently claimed that around half a million employed people are not involved in the social insurance system.

Although this phenomenon is widespread, little attempt has been made to define and study it. Some authors (Schneider, 2009) categorize such economic activity as constituting an informal economy and claim that its size comprises almost 70% of the GDP in Azerbaijan (from 2006 to 2007). Other international institutions treat such economic activity as undeclared employment or employment without contracts. In fact, using the terminology of "informal economy" or "shadow economy" politicizes the topic and renders such employment difficult to measure. Even though the government does not specifically define the informal economy, independent analysts often include corruption, bribery and tax evasion as a part of a shadow economy.

Any number becomes speculative since it is very difficult to measure. According to the 2009 World Bank report, the share of workers employed without a contract increased from 45.3% to 59.5% between 2003 and 2006 (World Bank 2009a). A strong disparity exists between informal workers in rural or urban areas. In 2006, 59.5% of all people were working without labor contracts; of these, 70.7% were rural workers (69.4% in 2003). The Ministry of Labor and Social Protection estimates that of the total 223,000 individuals employed in construction only one fourth had written labor contracts with their employers (World Bank 2009a). By not providing employees with contracts, employers save money on various types of taxes and are not held responsible for the work injuries of their employees, maternity leave or any other social benefits.

Even in the cases of employees with labor contracts, companies, organizations and even government entities under-report wages because they prefer to show low formal salaries and pay employees cash. This allows them to avoid a payment of 22% of social security taxes or income taxes. Such tax evasion and high percentage of employment without contracts is possible because the government does not rigorously monitor the incomes of a large share of the population. For the government, it is difficult to track self-employed people as well as subsistence farmers. All of their activities, especially in rural regions, are not reported to tax agencies. In most cases they are not registered with special agencies and pay "informal" fees to local tax inspectors.

Although official data is limited on the size and structure of the informal economy, some evidence suggests that women represent a significant share in this sector. Most of these people are market vendors, shuttle traders and home workers (e.g., homemakers, day care personnel). The 2003 Labor Force Survey found that 17% of women who reported

themselves as employed also defined themselves as engaging in a private entrepreneurial activity without formal legal recognition (ADB, 2005).

Many unemployed people were able to work for construction companies and were hired as workers following the construction boom. They were usually hired for a short period of time and paid daily, usually without a contract or social benefits. There are also a noteworthy number of people (40,000) involved in the real estate business. These individuals, usually called *makler*, buy and sell apartments which became a lucrative business from 2003 to 2008. Also, the failure of the day-care system and absence of decent kindergartens allowed many people, especially in their mid-50s, to gain positions as children's nurses. They are usually paid around €175-€350 and this type of job has allowed many retired women or women in their early 50s to earn a living. Another category of self-employed people is shop-keepers, traders and businessmen. They usually evade taxation by operating in many cases without legal status. Many shopkeepers convert their small houses into small shops.

1.4.3 Inactivity

The inactivity rate for people who are of working age (men 15-63 years old and women 15-60 years old), but who are not employed, nor available for or willing to work, has remained stable for the last 5 to 7 years at 28-31%.⁷ The inactivity rate for women was usually higher, even reaching a record 36% in 2006. For many years, the highest inactivity rate that has been observed for both genders is in the lowest and highest age groups--dominated by students and the elderly.

Fluctuations in labor force participation or inactivity rates are very often connected with some mega-projects in the country. Thus, the construction of a pipeline or an oil rig could create temporary employment for thousands of people and decrease the inactivity rate. However, at the same time, the end of the work project could lay off thousands of people. As usual, the highest inactivity rate is observed among the 15 to 24-aged cohort (around 35% across from 2000 to 2008). There is a large gap between male and female inactivity in that age cohort. Male inactivity in this cohort is 28-29% and for females it is around 39-40%. A similar trend is observed in the 25-35 age cohorts in which the inactivity rate is around 30% (24% for males and 34% for females on average over the last decade). Only in the 35-54 age cohort does the inactivity rate decrease significantly to 10-12%. However, the gender gap is still observed at about 10% (5-7% for males and 15-17% for females) (Economic and Social Data Service, 2009).

The high rate of inactivity among women in their early twenties coincides with the average age of marriage in Azerbaijan (23.7 years) and with the beginning of their child-bearing and caring years (ADB, 2005). Meanwhile, it is also likely that employers are reluctant to take such young women, fearing the additional cost of maternity leave and

⁷ The state statistical committee has a different methodology of calculating the inactivity rate. The figure for the economically active population is calculated as the sum of employed and unemployed people. For this study, the figure for the active population is the number of able-bodied persons in the population who are of working age.

associated payments. As in many other CIS countries, labor inactivity is much more common among women. In 2007, 49.7% of women in the working age were inactive, compared to 15.7% of men (World Bank, 2009a). In 2007, 330,000 women stayed at home to look after their children and homes.

However, such female deference to domestic duties also disguises a labor market that is dominated by men and offers restricted options for women. Meanwhile, women are developing specialized skills (e.g., as teachers and doctors) which qualify them for work in sectors with few vacancies due to the nature of labor division in Azerbaijan and shortages in the education system. Also, there is evidence that women are more vulnerable in the labor market as they face a higher risk of unemployment. Additionally, females tend to dominate those sectors where wages are below the national average (Republic of Azerbaijan State Program on Poverty Reduction and Economic Development, 2003-2005). Comparing inactivity rates among women across education and over time, it appears that the inactivity rate among university students as well as secondary students aged fifteen and above, who may legally enter the labor force, rose from 21% in 2004 to 24% in 2007. At the same time, in 2004 44.2% of all inactive women were involved in housework and in 2007 their share significantly dropped to 32.3%. Discrimination against women in hiring and promotion is widely reported. Statistical data suggests that there is significant vertical gender segregation in the country's economy. Education and health care are the major sectors that employ women; approximately 56% of all employed women are involved in these sectors.

Inactivity is also regionally distributed; a significant majority of inactive people are located in urban areas. For example, 1,099,365 people (62.7% of the inactive population) were inactive in urban areas while the rest were rural residents in 2007.⁸ Of this total, 420,000 people or 23.9% are university or secondary students aged fifteen and above; 774,500 are old-age pensioners (44.1%); 140,700 are disability pensioners (8%); 379,200 or 21.6% of total inactive people are home makers or taking care of children and other family members. Finally, 37,000 or 2.4% of this group are people who receive income from capital investments.

1.4.4 Wage Policy

Minimum wage and salary is adjusted annually. The minimum wage in Azerbaijan was €76 (85 AZN) by September 2010. However, the minimum wage in 2010 was only 28.5% of the average monthly wage in 2010 (€264 or 298 AZN).

Average nominal monthly wage have increased by more than seven times from €39.23 (44.3 AZN) to €264 (298 AZN) since 2000. From 2000 to 2010, the average real wage increased at an annual rate of 18.6%. However, inflation in the country also was level due to the flow of oil money into the country. The Consumer Price Index rose by 10% in 2004 compared to the previous year. It grew by 11% in 2005, 8% in 2006, 16% in 2007 and by 28% in 2008 (State Statistical Committee of the Republic of Azerbaijan, 2009e).

⁸ 2007 was the last year when the Labor Force Survey was conducted and the data is publicly available.

Only in 2009 was a 1.2% drop in prices observed in the country due to the impact of global financial crisis.

There are huge disparities in salaries across different sectors of the economy. Thus, while the employees of the mining sector were earning €895.32 (994.6 AZN) in 2009, people employed in agriculture only earned €118 (134.5 AZN) on average. The latter figure is only 13% of salaries earned in the mining sector.

Large regional wage disparities also exist mainly because there are many high paying jobs available in Baku and its vicinities which are absent elsewhere, particularly in rural areas. The largest monthly wage per capita was observed in Baku city in 2009 (with settlements)—that was €380 (429.8 AZN). The lowest wage in 2009 was observed in the Sheki-Zaqatala economic region at €151 (171.7 AZN). The wages in most of the regions of Azerbaijan are half of those in Baku with the highest wages after Baku observed in Guba-Khachmaz (€182 or 204.1 AZN). (State Statistical Committee of Republic of Azerbaijan, 2009d).

There is also a gap between wages earned by males and females. Men receive higher wages than women in most jobs. Furthermore, the highest wage difference between genders exists in those industries where the proportion of women is marginal or low. For example, women involved in the field of construction received 52.6% of what men made in the same sector in 2009. However, the proportion of women in the construction industry is no larger than 10%. In contrast, women hold 61% of the positions in education and their salary is around 63.6% of males earn. Women's lower salaries, on average, are also related to their traditional involvement in activities such as education, social and health services, and community services which pay lower salaries. For instance, average salaries in the health and education sector were around €142 (154.5 AZN) and €239.2 (260 AZN) in 2009, respectively. Males received approximately €195 (210.6 AZN) within the health and social service sectors, while females received only €128.2 (136.9 AZN) or 65%. The gender gap is the same in higher education at 63% (€207 or 221 AZN) received by women and €326 (347.5 AZN) received by men (The State Statistical Committee of Republic of Azerbaijan, 2009d).

There is no information about the incomes and wages of IDPs since there are no statistics for this population. Most IDPs are scattered across the country and this fact complicated any measurement of poverty among the group. In 2003, a government study showed that 30% of IDPs were officially employed (GoA, 2005). This percentage includes administrative officials, teachers, school staff and medical personnel. IDPs are usually involved in small businesses in rural areas. As the Internal Displacement Monitoring Center reported back in 2008, "the majority of IDPs who returned to their homes live below [the] official poverty level and struggle to earn [a] decent income in agriculture" (IDMC, 2008).

Azerbaijan has higher wages than some CIS countries, while salaries are twice as low as those in Russia and much lower than those in Kazakhstan (The State Statistical Committee of Azerbaijan Republic of Azerbaijan, 2009d). The situation is almost the

same as when comparing GDP per capita with all these countries. Azerbaijan's PPP-based GDP per capita is higher than in any of the CIS countries except Kazakhstan, Russia and Belorussia. However, it is interesting to observe that the gap between Azerbaijan and these countries is steadily decreasing. In 2001, Azerbaijan's GDP per capita was almost three times less than Russia's and twice less than Kazakhstan's GDP. However, in 2008 the Azerbaijani GDP per capita was only twice less than Russia's and around 90% of Kazakhstan's GDP.

1.4.5 Unemployment

Official unemployment remained comparatively low as a consequence of new job creation in construction, wholesale trade, transport and manufacturing. According to the State Statistics Committee, the register-based unemployment rate in 2003 was at 8.1% and was constantly decreasing. This figure reached 6.9% in 2004, 6.2% in 2005 and 5.3% in 2006. In 2007, the unemployment rate rose to 7.0% due to the end of oil-related projects, but dropped again to 6.4% in 2008. By official estimates, the government succeeded in lowering unemployment to a historical minimum of 6% in 2009. However, the government and ILO have different figures for the number of unemployed people due to their different methodologies for counting. The government counts unemployed people as those who have been registered as unemployed by service officers or agencies. The ILO counts unemployed people based on a survey of economic activity. In 2009, only 41,000 people were registered as unemployed by government agencies, while the ILO reported the amount at 260,000 (Chapter 2 on unemployment benefits).

Moreover, only 2,109 people (0.8%) of all unemployed people were receiving unemployment benefits in 2008-2009 (Sections 2.3.1 for more on unemployment benefits). Registered unemployment is far less than both ILO-based calculations and SSC unemployment data. This is mostly due to limited access to unemployment benefits and active labor market programs (Kuddo, 2009). Nevertheless, one of the major contributing factors for low the unemployment rate is due to the amount of people employed in agriculture (including subsistence agriculture). For example, according to the Law on Employment, individuals who own agricultural land are considered to be employed and are also not eligible to be classified as unemployed. Thus, farmers cannot be registered as unemployed and cannot claim unemployment benefits since they cannot participate in social insurance programs.⁹

⁹ In 2008, 137,168 people were unemployed in urban areas and 124,243 people were unemployed in rural areas. Out of all unemployed people in 2008, only 12.8% had higher education (20.4% in urban areas and 4.3% in rural areas); 17% had a secondary specialized education (16.8% urban and 17.2% rural); 3.3% had a vocational education (4.8% urban and 1.7% rural); 58.2% had secondary education (52.3% urban and 64.7% rural); and 8.7% had primary education (8.7% and 5.7%). The relationship between education and unemployment will be discussed in detail in the education section. With respect to age groups, in 2008 the highest number of unemployed people among males occurred in the 15-19 age groups (14.9% of all unemployed males); 20-24 cohort (25.1%) and 55-59 group (13.9%). The distribution of unemployed by age cohorts is the same for women. The highest unemployment is observed in the 20-24 age group (23.8% of all unemployed women); 40-44 age group (18.1%); 25-29 age cohort (14.4%) and 30-34 age group (14.1%) (State Statistical Committee, 2009).

Data on labor force participation also shows considerable disparities by region. There is almost no unemployment in the Nakhchivan economic zone, mostly due to the absence of reliable data. Unemployment is also well below average in Absheron, Aran, and Sheki-Zaqatala districts. It is average in Baku city (6.8%). In contrast, the unemployment rate is very high in Guba-Khachmaz districts (13.5%) (World Bank, 2009). Due to the fact that IDPs have difficulties finding jobs and lack skills, it is not surprising the rate of unemployment is high among this group. In 2008, the Internal Displacement Monitoring Center reported that the rate of unemployment is higher among displaced women than displaced men (IDMC, 2008). As the 2007 DRC livelihood study reported, “Unemployment is more widespread among IDPs than the local population and that economic self-reliance activities targeting IDP settlements are needed to combat regional poverty. The assessment showed that 81% of local residents and 74% of IDPs who are not currently involved in private business are interested in establishing a business of their own, preferably in agriculture and trade”(DRC, 2007).

Another reason for such regional disparity is the variation in access to employment opportunities. The low level of unemployment in Absheron results from its proximity to Baku which is a major supplier of jobs. The Aran and Sheki-Zaqatala regions are mostly agricultural regions in which the population is largely involved in subsistence farming or is otherwise self-employed.

Despite governmental interventions to decrease unemployment, the low intensity of inflows and outflows from the pool of registered unemployed persons remains a major challenge. Azerbaijan has a stagnant pool of registered unemployed people in which monthly inflows and outflows account for less than 4% of the total number of unemployed people every month. Basically, this suggests that once the job seeker registers, they remain on the unemployment roster for a long period of time. For example, only 2% of the registered unemployed were placed in a job in 2008. This indicates a lack of demand for labor, but primarily a passiveness among both the public employment service (PES) and job seekers themselves in finding job opportunities (Kuddo, 2009). The composition of the unemployed has not changed much throughout the years. From 2000 to 2008, the ratio of youth in the overall unemployed population was between 35-40%. These figures have recently decreased in the last several years. However, they are still high around 32%. Likewise, the youth unemployment rate is higher than the adult one. In 2007, the youth unemployment rate comprised around 14% (18% for male youth and 11% for female).

1.4.6 Labor Market Policy

In 2006 the government of Azerbaijan launched the Program on Reduction of Poverty (2006-2015) to address poverty reduction, diversification of the economy, as well as regional, social and economic development. Three strategies for job creation were identified: developing active labour market programmes such as public works and wage subsidies, exploiting revenues from the oil sector to finance public infrastructure projects with employment-intensive technologies, and creating a conducive environment for the development of small and medium enterprises. In the previous year, the president of

Azerbaijan signed the Employment Strategy of the Republic of Azerbaijan for 2006-2015 which was operationalized through the National Action Plan (NAP). The strategy identified several priority areas such as reforming labor market institutions and policies, strengthening the National Employment Service and modernizing the vocational education and training system. The priority areas also included an introduction to life-long learning, improvement of social protection for job seekers and unemployed citizens, and the promotion of employment among youth, women, people living with disabilities, IDPs, refugees and other groups experiencing difficulties in joining the labor market. The government has also developed the Decent Work Country Program 2006-2009 in cooperation with the ILO. The main purpose of this program was to improve employment policies, create jobs, strengthen social dialogue and advance the implementation of international labor standards.

Within the framework of this program, the Ministry of Labor and Social Protection has opened regional professional education centers in Baku (2007), Geychay (2008) and Nakhchivan (2009). These centers strive to teach professional skills to unemployed people. Following such programs in 2009, 1,398 graduates of the Baku school found employment. In Geychay, 580 graduates found jobs as well as 216 graduates from the Nakhchivan school. These regional schools provide vocational education on 15 specialties (mostly on blue-collar work). Concurrently, the government established computer and linguistic rooms in the General Employment Department where youth are trained in the English language and information and communication technologies. Other courses train participants for employment as secretaries, computer accountants, carpet weaving, sellers, cashiers and auto repair mechanics. More than 50% of graduating students have found employment after completing these courses. However, the number of people who were trained and found jobs through the state program is very low compared to the overall number of people entering the labour market every year. Due to the imperfect education system in Azerbaijan, students spend 4 to 6 years studying subjects that will not be used in their lives. A short-term program is not enough for such people to acquire enough knowledge and skills to compete in the market. The jobs they would be qualified for might only provide a very low salary that would not meet their needs.

To increase local employment, certain policies have been implemented to protect the internal labour market from low-paid workers from other countries. Starting from February 12, 2009, the government introduced a fee off 1,000 AZN (€869.6) for foreigners who want to legally work in Azerbaijan.

The situation in the labor market is also complicated by the large number of IDPs as mentioned earlier. Azerbaijani laws are giving some support to IDPs and refugees so that they gain access to the labor market or obtain employment. Furthermore, the government has established the Social Development Fund for IDPs (SFDI) which is designed to help IDPs rehabilitate small-scale infrastructure (i.e. renovating water pipes, electricity lines, roads, etc.). However, the general situation with unemployment affects IDPs. Salaries in significant sectors of the economy were equal to or scarcely above the minimum wage. This impacted on the ability of IDPs to find employment and to generate enough income

to significantly raise their standard of living. Thus, the majority of IDPs, especially youth and women, have limited employment opportunities and income possibilities.

A UNHCR study from 2007 found that:

IDP men and women between the ages of 18 and 40 pointed to insufficient opportunities for youth employment as well as a need for further vocational training programmes to pave the way to securing jobs. Adolescents aged 14 to 17 and children aged 10 to 13 linked the unemployment of their parents and resulting household poverty as an obstacle for their continuing education. Women, single mothers and youth in particular felt their lack of employment and self-reliance contributed to their marginalization and isolation from economic and social life. IDPs in rural settlements and the urban poor are hardest hit by limited opportunities for employment. Many view high unemployment as one of their main hardships in comparison to the local population. The scarcity of economic opportunities forces many IDP men to move to urban centers or even to Russia and other countries in search of employment. This leads to the separation of families as women and children remain in Azerbaijan to maintain social ties and assistance. (AGDM, 2007)

Youth employment is also considered to be one of the government's priorities. The National Assembly of Youth Organizations (NAYORA) unites more than 20 youth NGOs and civil society organizations. It formed the Youth Employment Coalition of Azerbaijan (YECA). The coalition is working with the government, including the Ministries of Labour, Education and Youth, workers' and employers' organizations and other stakeholders. The coalition provides youth with inputs into the country's NAP. They collected proposals on a national employment strategy from young people in all regions of the country. In November 2004, NAYORA initiated a youth conference entitled "Challenges and Opportunities Facing Young People in Azerbaijan". The main goal of the conference was to identify priorities and define strategies for improving the lives of young people (UN, 2007). The funding for this type of organisation comes from the government Council of State Support to Non-Governmental Organizations under the President of the Republic of Azerbaijan. Since its establishment in 2007, the council gave grants totaling €2 million. However, most of the grants were allocated among certain NGOs for organizing conferences, workshops and seminars. No visible project addressing youth unemployment was conducted.

Analyses of public expenditures for the last three years show increasing allocations for employment programs such as the Active Labor Market Programs (ALMP).¹⁰ For example, Azerbaijan spent €5.6 million (6.4 million AZN) in labor market programs in 2008. In 2009 this funding increased to €8.78 million (10.1 million AZN) and these programs are projected to receive €9.2 million (10.6 million AZN) in 2010. However, despite the growth of budget expenditures for employment programs, at least 40% of these financial resources are allocated to cover administrative and maintenance expenses.

¹⁰ It is worth mentioning that the government does not define ALMP spending as such. The following calculations are solely the author's estimation based on budget expenditures of the Ministry of Social Protection and Social Protection Fund.

Only €944,000 in 2008, €1.19 million in 2009 and €1.25 million in 2010 (about 10-15% of allocations for labor employment programs) were allotted for the organization of job fairs, trainings and services to assist unemployed people or job seekers. Meanwhile, the remainder of the budget allocations (40-45%) were directed to an unemployment benefit program (Section 2.3.2). Overall, no more than .01-.02% of Azerbaijani GDP was spent on employment programs in the country during these years. Expenses on the ALMP were even less. In comparison, these figures were at the .6%-1% level in Central European countries (e.g., Hungary, Slovakia and Poland) (Kuddo, 2009).

The number of people who are trained and retrained by employment services is also very low. Only 3,393 people were directed to professional training by PES in 2008 including 2,524 young people (under 29 years old). This is less than 10% of the officially registered unemployed people and around 1% of all unemployed people (State Statistics Committee, 2009). Meanwhile, another reason for ineffective work of PES could be understaffing or low qualification of employees. Around 577 people were working for PES in Azerbaijan by the end of 2008—that is several times less than in several Central and Eastern European countries. Of this total, only 430 people were in contact with job seekers and employers.

A common strategy for PES in assisting job seekers is to hold or direct them to job-fairs. The National Employment Program stated that around 56,564 persons found relevant work at job fairs organized from 1997 to 2007, including 850 disabled persons. In 2008, 29,400 individuals participated in job fairs that were open for the general public as well. This low number again demonstrates that many of the registered unemployed are not actively seeking jobs. A survey among participants of Job Fairs in 2006 was carried out by the Scientific Research and Training Center on Labor and Social Issues. Results show that there were certain mismatches between the requirements of employers and skills of job seekers. Kuddo (2009) writes that:

The registered unemployed made up only 6% of the 4,460 participants, whereas 81% were unregistered unemployed, 10% employed (either formally or informally) and the remainder involved in education. Other findings are that 45% of the participants of job fairs had no prior work experience, while 22% had worked less than 10 years. Finally, more than half the participants were long-term unemployed (more than one year unemployed) and 43% of the participants were unemployed for more than two years.

Public works projects are not implemented in Azerbaijan in contrast to other countries of the region. Public work projects together with on-the-job training could be an effective mechanism increased employment within the population. Meanwhile, despite the fact that the national strategy envisions a self-employment/small business scheme, such a support program in Azerbaijan has not been launched yet. Disadvantaged or vulnerable groups are primary targets for the employment strategy. However, not many people from these groups were able to benefit even though Azerbaijan has an employment quota system for disabled workers. The main reason for this is the absence of an enforcement mechanism as well as the flawed assumption that people living with disabilities are less productive

than others. However, there is not much support for youth who are seeking jobs and no program has been developed to specifically target this population.

1.5 The Education System

1.5.1 General Information

Until independence, the education system in Azerbaijan primarily followed the same structure as the Soviet educational system. However, the system has undergone several reforms in the past 19 years. This makes an analysis of educational data across a wide range of ages challenging (Demographic and Health Survey, 2006). According to the Azerbaijani Constitution, every citizen of the country has a right to receive an education. Children can begin primary education at 6 or 7 years old. The state provides free secondary education. As defined in the new Law on Education adopted in 2009, the Azerbaijani education system consists of the following levels:

Pre-school (typically for children between 3 and 6 years old). Pre-Primary education (ISCED- 0)

General education:

- Primary education (4 years: grades 1-4) (ISCED-1)
- General lower secondary education (5 years: grades 5-9) (middle-ISCED 2A)
- Full secondary education (2 years: grades 10-11) (upper-ISCED 3A)

Vocational education:

Professional or Technical Institutions (former PTU-for manual and basic skills: 3 years-ISCED 4B)

Secondary specialized education (former Tekhnikum: 2 to 4 years-4A)

Higher Education (University Education)

- Bachelor (5A)
- Master (5A)
- Doctoral (6)¹¹

General education consists of three levels: primary school (grades 1-4 for students aged 6-9), middle school or general secondary education (grades 5-9 for students aged 10-14), and upper school (grades 10-11). The first two levels (9 years) together constitute what is

¹¹ Pre-primary education includes mostly kindergartens and pre-school institutions. Primary education includes the first four years of studies. Lower secondary education (2A) includes the next 5 years of studies from the classes 4 to 9. Upper secondary education includes classes from 10 to 11. Upper secondary vocational education is professional or specialized education that is available for students after graduation from 9th grade of school. Upper secondary vocational education can last from 1 to 3 years. Post-secondary non-tertiary education (4B) includes higher education institutions leading to non-tertiary and no vocational degree. Examples of such institutions are the Academy of Ministry of National Security, College of Ministry of Emergencies, military schools, Police Academy, and Academy of the State Border Service of Azerbaijan. There are approximately up to 60 special education institutions in the country. The Ministry of Education and International Organizations are usually giving contradicting figures on the number of students in 4b or 3b categories due to different calculating methodologies. 5a tertiary education includes a general bachelor and master degree. 6 tertiary educations include people studying toward scientific degrees such as Ph.D.s or doctors.

referred to as basic secondary education. The three levels together constitute a complete secondary education.

Students who have completed a minimum of nine grades may enroll for specialized secondary education. There are two tracks within specialized secondary education. The first track consists of professional or technical institutions known as PTU. These train students in a variety of manual or basic skills occupations. Students in this track finish 9th grade and then study for three years at professional or technical institutions. Upon graduation these students receive a degree of primary professional (vocational) education equivalent to a complete secondary education. The second track is called “tekhnikum” or secondary specialized education. It prepares specialists with mid-level qualifications such as nurses, midwives, musicians, technicians and others. This track can be completed in two years by students who have completed the 11th grade or can be completed in four years by students who completed the 9th grade. Upon graduation students receive a secondary special education degree. This is a level that is somewhat higher than complete secondary education, but lower than high education.

Starting from the mid-1990s Azerbaijan switched to three level systems in higher education. The first level is a bachelor’s degree that requires studying four years at university. Then, students have an option to study for a master degree for another two years. Interested students may apply for admission to institutions granting doctoral degrees. After finishing doctoral studies and successfully defending a dissertation, an individual receives a Ph.D. that is equal to the Kandidat degree of the old system. Ph.D.s need to defend another dissertation to receive the title of Doctor of Science. Despite switching to the new Western system, remnants of the old system remain. In Western institutions granting Ph.D.s, there is no additional title such as Doctor of Science. The reforms were exemplified only in changing the name of *kandidat* to Ph.D., but the system remained the same due to fierce opposition of the old system of doctors and *kandidats*.

1.5.2. Public Expenditures on Education and Wages

Public expenditures on education have fallen consistently since the collapse of the Soviet Union. Compared with other countries in transition, Azerbaijan’s spending on education is very low. According to our calculations it was about 2.4% and 3.3% of the GDP in 2008 and 2009, respectively.¹²

As public spending on education declines, families must supplement educational expenses—a burden that is greatest for low income and poor families. According to a World Bank report, the richest 20% of the population consistently accounts for nearly 40% of private spending while the poorest 20% spends only approximately 10% of the total private spending on education (World Bank, 2009a).

¹² The sudden growth of the education share of the GDP is explained by the significant drop of the Azerbaijani GDP in nominal values. Nevertheless, education expenses increase by €314 million compared with 2008.

A significant share of the education budget is directed towards renovation, technical support and the construction of new schools. Thus, for example in 2007 and 2008, €91.3 million (113.7 million AZN) and €195.8 million (221.1 million AZN) were respectively invested for these purposes. In 2009, investment for these purposes significantly dropped comprising only €55.4 million (63.7 million AZN) due to the financial crisis (Ministry of Education of Azerbaijan, 2009). Also, insufficient funds are directed for curriculum development or for increasing the qualification of teachers and faculties.

The salaries of teachers and faculty members are another problem in the education sphere. Close reviewing of the distribution of salaries within the education sphere reveals a disturbing situation: 84.5% of people receive a salary between 50 to 150 AZN (€43.5 - 130.5). Of this total, 42.3% of people involved in the education sphere, including teachers and faculty members, received salaries less or on the same level as the nominal minimum wage. Only 5.3% of these people received salaries between 400 to 900 AZN (€347.8-782.7). No teacher, faculty member or person involved in the education sphere received a salary exceeding 900 AZN (€782.7) (The State Statistical Committee of Republic of Azerbaijan, 2009d).

Such low salaries lead to corruption and a public tutoring phenomenon when a teacher teaches his pupils the same materials that he supposed to teach in the class for additional payment. Correspondingly, the quality of public education eventually deteriorates. Many highly qualified teachers exit the public education system and are hired by private schools. The number of private schools increased from 12 to 17 since 2005, while their total enrollment rose from 2,000 to 7,000 pupils. Already nearly 1,000 teachers are employed in such schools and their numbers increase every year. Another related, widespread occurrence is the unofficial withdrawal of secondary students from schools to study at home with private tutors who prepare them for entrance exams to universities.

1.5.3. Access to Education

Despite the fact that Azerbaijan has inherited a relatively good education system from the Soviet period, the share of students at each level of education has changed due to the recent economic depression and years of transition. Pre-primary enrollment remains low and decreases every year. Sixteen percent of children aged 1-5 attended preschools in 2009 (The State Statistical Committee of the Republic of Azerbaijan, 2009e). There is a large difference in the amount of children with preschool education in rural and urban areas. In urban areas 24.4% attend preschool (dropping from 32% in 2004) and in rural areas only 8.4% of children attend (decreasing from 10.3% in 2004).

There are several reasons for this contrast. First, preschool infrastructure in rural areas has deteriorated since the collapse of the Soviet Union and in most cases ceased to exist. Second, thousands of women lost their jobs under massive unemployment since the collapse of kolkhozes and sovkhoses. Subsequently these women taught their children at home, rather than sending them to preschools. Another factor that plays a role is the cost of preschool institutions. The one that is run by the government is in bad shape and condition. Meanwhile, private preschool institutions and even some state-run ones charge

fees ranging from €150 to €600. Gross enrollment ratio (GER) at the pre-primary level decreases through the years while the GER for primary and secondary education is constantly increasing. The GER for higher institutions remains low at 15.7%.

School participation is measured by net attendance (enrollment) ratio (NAR).¹³ A 2006 Demographic and Health Survey found out that primary school enrollment was around 73%. This could indicate that some share of children could fall outside of the official school age or that some pupils repeated certain grades. However, the 27% remaining is too high for both of these reasons. There are few other factors. First, a significant number of children of primary age might not attend school. Second, children who were supposed to go to primary school may have migrated abroad with their parents.

Meanwhile, the Gross Attendance Ratio (GAR) which measures participation at each level of schooling among those of any age from 6 to 24 is 108 for primary school education. This indicates that approximately 35% of students are either under age or over age (Demographic and Health Survey, 2006). The NAR for the complete secondary school level (81) is higher than in primary school. The GAR for the same level is 99 and lower than that for the primary school. This suggests that there has been a decrease in over age or under age participation at the complete secondary school level. Indeed, a comparison of the NAR and GAR indicates that approximately 18% of students are either under age or over age (Demographic and Health Survey, 2006).

Meanwhile, there has been a large drop in enrolment for the non-compulsory level of education. Thus, if the number of students admitted to bachelor's programs was constantly increasing in 2005 (having reached 28,747 students), then in 2006 the number of admitted undergraduates dropped by almost 5,000 (State Statistical Committee). Although in the following years there was an increase in the number of undergraduates, still it was not high as in 2005. For example, 108,271 people graduated from high schools in 2009. Out of this number only 66,619 people or 61% applied for admittance exams. Overall, 107,347 people applied for admittance exams in 2009 (over 40,000 people were graduates from the previous year). Only 28,009 people were admitted to the universities in 2009.

For further insight into this dynamic, it is beneficial to study the number of students in high schools. In 2003 the number of high school students was 1,689,866 people and in 2009 this number dropped to 1,367,900. Statistics also show a decrease in the number of students in professional and technical schools. Although statistics are not available for the entire period since 1990, one can guess that there are several reasons for such a significant drop in admissions for the bachelor level.

Migration is one of the important factors contributing to this issue. Approximately, 750,000 to 1 million Azerbaijanis have migrated to Russia and other neighboring countries which affects youth demography as well. Potential students apply to

¹³ Net primary enrolment ratio is the ratio of the number of children of official school age (as defined by the national education system) who are enrolled in primary school to the total number of children of official school age.

universities in their resident countries rather than in Azerbaijan. A second and not less important factor could be the introduction of the single graduation exam in Azerbaijani schools. Thus, for example in 2008 approximately 4,190 pupils were unable to graduate from high schools and apply for admission to universities. In 2010 the situation continued to worsen. The number of students finishing high school in 2010 was 92,002. Of this total 88,815 students (96.54%) took the school-leaving examination and 74,832 students passed the test.

The same situation may be observed at the Master's level. In 2004 the number of admitted master students was 5,455, and by 2006 this number dropped by half to only 2,757. In 2009, out of 5,168 places offered by universities, only 3,830 were filled with students. Overall, 15,719 people were applying to study at the master level. At the same time, the great majority of the graduates at the bachelor's degree level do not apply for a master degree. In 2009, out of 27,763 graduates with a Bachelor's degree, only 9,962 people (35.8%) applied to study at the Master level. The low level of Master's students is most likely related to little understanding of Master programs and the lack of curriculum development in many master's programs.

In most of the programs, universities squeezed a 5-year curriculum (from old system) into a 4-year program. There is no new program developed for the Master's level and students repeat the Bachelor's program over again. At the same time students do not perceive a master's degree as beneficial for their careers. Thus, it is considered to be an additional 2 years before entering the labor market. Meanwhile, mandatory military service plays a negative role as well. After finishing a bachelor's degree, most males must complete one year of military service and are not allowed to pursue a Master's degree. After finishing their military service, most of the former students prefer not to return to university, but rather to pursue a career.

As the Demographic and Health Survey states, "The median number of years of schooling is 9.6 years for men and 9.4 years for women" (DHS, 2006). The proportion of the population with no education is low (5% or less), with the highest percentages among those aged 6-9 (i.e. children who have not yet begun school) and among those 65 years and older. Individuals residing in urban areas have significantly higher levels of university education than those in rural areas. Wealth status has a strong positive relationship with education; 38% of men in the highest wealth quintile have at least some university education, compared with 3% of men in the lowest quintile (DHS, 2007). The decrease in graduates from secondary schools is also alarming. In 2009, 108,271 people graduated from schools. This figure was less than 14,837 5 years ago (12%) (The State Statistical Committee of Azerbaijan Republic of Azerbaijan, 2009e).

1.5.4. The Quality of Education

One of the assessments tools for secondary and university students' performance is the amount of points received during admission exams to higher education. The testing system launched in 1992 is administered by the State Student Admission Committee (SSAC). The test system, in which students receive a maximum of 700 points, enables

applicants to become admitted to one of the higher educational institutions based on their test score. Statistics revealed by the SSAC showed that the year 2009 was the worst in the history of admission tests. In 2009 39.2% of applicants scored between 0-99 points; 23.6% between 100-199; 16.5% between 200-299; 16.6% between 300-500; and 4.1% between 501-700 (SSAC, 2009). Over 60% of the applicants received less than 200 points which is considered the minimum passing score for some universities.

This situation with applicants is mirrored in high schools. In 2006, the Azerbaijan National Assessment Study conducted a survey among 4th year and 9th grade pupils at secondary schools. Performance was measured in language and mathematics. The survey was conducted within the framework of the PISA study. Test scores indicated that Azerbaijan ranks reasonably well in mathematics (ranked 35th among 57 countries—the highest is 1) in comparison with other countries that share a similar level of economic development.

However, the country distinctly lags in reading and science. In fact, Azerbaijan is unique in having the highest gap between math and reading scores in PISA. This largest recorded difference (123 points) is followed by that in China and Russia (only at 20 points) (OECD, 2006). Such a gap may be related to several factors. First, the math exams require memorization skills that are usual practice in Azerbaijani schools. However, PISA reading questions require higher-level thinking and analyses that is not taught at local schools. Second, most schools or tutors prepare students for entrance exams to universities rather than giving them general knowledge or teaching them independent thinking. PISA 2009 findings ranked Azerbaijan 64th out of 65 surveyed countries and territories (Kyrgyzstan was ranked the lowest). As previously mentioned, Azerbaijani pupils did comparatively well on the math section (although it was below the OECD average), but scored very low on the reading section and on science (OECD, 2009).

There is also an important mismatch between the skills that graduates of universities cultivate and the needs of the developing economy. Table 1.3.7 shows the percentage of unemployed people by education level. The high unemployment rate among people with only secondary general education is not surprising and the comparatively high unemployment rate among people with higher education is unusual. This supports the notion that there is a surplus of graduates in Azerbaijan in areas such as health, education and humanities, as well as a shortage of graduates with the qualifications of financial managers and agriculture experts. For instance, half of the graduates of higher education institutions specialized in education—a sector that provides only 8.6% of employment and rather low salaries. Meanwhile, this share of people does not have any vocational skills and may become unemployed. They represent 70% of the unemployed population, whereas only a maximum of 60% of all jobs require general secondary education. Thus, at the November 2007 Baku job fair, no suitable candidates could be found for 50% of the 7,000 jobs being offered (World Bank, 2009a).

There could be several explanations for the low quality of education. Most of the investments and expenses in the education sphere are directed toward material goods, such as the construction of new schools and equipment. However, this equipment does

not enhance the quality of education. Anecdotal examples are abundant and describe situations in which new computers were purchased for schools and high speed internet connected, but the pupils are not allowed to use these resources. Low salaries for teachers and faculties make them disinterested in the quality of education.

A common and widespread practice in Azerbaijan is for the parents of pupils to provide additional payments to hire the same teacher to teach their children material they should include in regular classroom instruction. Thus, pupils whose parents cannot afford to pay additional fees to the teacher will be deprived from average quality education. Deterioration of the education system at university level also affects schools. The graduates of universities that prepare teachers use outdated resources and materials. In addition, after graduation from universities, future teachers who are trained in Baku prefer to stay in Baku and teach there rather than go to the regions. Widespread corruption leads to a situation in which these future teachers need to pay “fees” in order to be assigned to Baku schools. Thus, the teachers are assigned to schools based on their ability to pay the “fee”, but not for their qualifications. Many qualified graduates remain unemployed or switch to other jobs.

Problems with the low quality of education and mismatches in the labor market have caused various ministries to establish their own universities for educating future employees. Thus, the Ministry of Emergencies, Tourism, Border Service, National Security, and Customs have opened their own academies and universities. The skills received at these institutions allow graduates easily get jobs in the respective ministries. However, highly narrowed specialization of the graduates does not allow students to change their profile or place of work and decreases workforce mobility.

1.6. Demographic Trends

According to the preliminary estimates of census data in early 2010, the population of Azerbaijan was about 8,997,400 persons. Fifty four percent live in urban areas and 45.9% in rural areas (State Statistical Committee of Azerbaijan Republic, 2009). The demographic structure of the country’s population is characterized by the following figures: 49% males and 51% females; 22.6% under 15 years of age and 6.8% over 65 years old. In 2009, 152,139 new babies were born in the country or 417 new citizens per day. The birth rate remains stable for the last couple of years at 17.2 babies per 1,000 persons. Although it is much less than in 1990-1991 (26 babies per 1,000 persons), it is still higher than in 2001 when there were 13.8 babies born per 1,000 persons.

The death rate in Azerbaijan for many years has been relatively low and stable. However, the military conflict with Armenia resulting in numerous victims, led to an increased death rate in 1992-1994 (from 6.1 in 1990 to 7.3 per 1000 people). The main causes of death are circulation and respiratory organ diseases, tumors or cancer. The life expectancy in 2009 was 73.5 years on average: 70.9 for men and 76.1 for women.

Recently, there has been a decrease in infant mortality. As the Minister of Health reported during a meeting on February 15th, 2010, the child mortality rate in Azerbaijan in 2009

totaled 14.4 per 1,000 people. As the ministry reports, this resulted in more funding was directed towards addressing mother's health. In 2003 €47.6 million (59 million AZN) were allocated for these purposes, increasing to €436.6 million (502 million AZN) in 2009. The mortality rate of mothers decreased from 26.1 people per 100,000 to 24.3 (The State Statistical Committee of Republic of Azerbaijan, 2009-f).

Due to the relatively high fertility rates (2.1 in average for 2000-2010) in the past and quite recently, Azerbaijan's working age population (15-64) has grown rapidly. It is worth mentioning that the fertility rate in rural and urban areas of Azerbaijan was significantly different. For example, in 2000 the fertility rate in urban areas was at 1.6 while in rural areas it was 2.2. The massive influx of rural residents to urban areas (especially to Baku) in search of jobs and opportunities increased the fertility rate of urban areas up to 2.0 by 2008. Despite the fact that the population growth rate in Azerbaijan has slowed down for the last decade, the fertility rate in country actually was increasing for the last 7-8 years. In 2002 the historical low fertility rate at the 1.8 level was observed in Azerbaijan. Ever since that the rate was steadily increasing reaching 2.3 in 2008.

The labor force will get older as a result (UN Population forecast, 2008). The number of people in the population of working age (15-64) will increase; in 2005 working age people represented 67.5% of the total population and by 2010 they will increase to 70.6%. Consequently, due to the slow drop in birth rates, the share of people under 14 years old has dropped from 25.5% in 2005 to 22.6% in 2010. The share of older people remained almost the same and changed marginally from 7% to 6%.

According to the U.N. population scenario for Azerbaijan, the population of Azerbaijan will reach 9.5 million people in 2015 while the working-age population will number 6.5 million. This growth will increase pressure on government to create more jobs.

Meanwhile, as in many Western European countries, the 15-24 year old population will shrink from 1.74 million in 2006 to 1.54 million in 2015 and to 1.19 million in 2020. The population sex ratio will constantly increase. In 2010, there were 95.8 males for every 100 females. This number will reach 97.6 by the year of 2050. The median age of the population will follow the pattern of European countries and grow to 40.6 due to an increase in life expectancy that will reach 76.7 years in 2050. There will also be a drop in the fertility rate.

The same high fertility rate will not allow the working age population to shrink dramatically as in many other places. For the period from 2010-2050, the share of the 15-64 age cohort will drop from 69.5% to only 64.7%. By 2050, Azerbaijan's birth rate will be almost twice more than its neighbors altogether due to the drop in the fertility rate and number of births per year in Georgia and Armenia (World Population Prospects).

It is difficult to count the real number of ethnic minorities in Azerbaijan. Even during the Soviet Union period many ethnic groups were grouped under the general title "Azerbaijani", thus diminishing their actual number. This was the case with the populous

Talysh minority. The situation has slightly changed after the collapse of the Soviet Union as ethnic minorities are allowed to be called by their own name. Thus, from 1989 to 1999 the number of Talysh increased by almost 4 times reaching 77,000.

Meanwhile, the number of other minorities has significantly decreased. The number of Armenians dropped from 390,000 to 120,000 in 1999 due to the Karabakh conflict, including around 20,000 families outside of the Karabakh area (The State Statistical Committee of the Republic of Azerbaijan, 2009h). At the same time, the number of Jews in the country also dropped from 31,000 to 9,000 due to immigration to Israel. The situation with minority demographics remains complicated because of the absence of statistics.

The public education system offers education in three languages – Azerbaijani, Russian and Georgian (only 340 pupils study in Georgian schools). Public schools offer elective language classes in minority languages in places where ethnic minorities constitute a significant majority.¹⁴ By early 2010, there were over 6,000 pupils studying in the Russian language program (5% of all pupils). Classes in minority language are offered for the first 4 or 5 years of primary school. Parents often do not see reasons for continuing classes in minority languages since higher education is offered in Azerbaijani or Russian.

The additional absence of textbooks in minority languages (except Georgian) hinders further study in minority languages. Pupils of Georgian schools can study in their native language while other ethnic minorities cannot. It is worth mentioning that during the Soviet Union the public education system used a quota system for certain minorities (i.e. allowing children of ethnic minorities to enter universities on preferential conditions). However, this practice was abandoned in 1990s and there are no quotas for hiring or education. A problem arises when employers demand knowledge of Azerbaijani which some ethnic minorities do not possess since most of their education is solely in Russian language. However, this problem is faced by ethnic Azerbaijanis as well as ethnic minorities.

As in many Eastern and Central European countries, Azerbaijan also has a Roma community. State agencies do not take statistics of the Roma population and they often refer to themselves as either Azerbaijani or Kurdish. They are scattered across the country and live in few villages. There is no exact data on their numbers although some researchers estimate their number to be about 2,000 people (Ali, 2008). There are not many reports or studies that focus on the population. A small study from 2006 surveyed ten Roma families and it was found that their official monthly income is around €27-125 (Ali, 2006). Most of their children lack education and tend to marry early. Many Roma

¹⁴ For example, the Gusar region is traditionally populated by the Lezgin minority and the Lezgin language is offered in 88 schools where a total number of 18,000 students have the opportunity to learn their mother tongue as a separate subject. The Udi language is currently taught in three schools in the village of Nidzh. Meanwhile between 20 and 25 schools (out of a total of 88 schools) in the Lankaran district offer Talysh language classes (Gerber, 2007).

children are involved in begging and are often arrested and deported outside of Baku or other big cities. No state program has been developed to integrate them into society.

1.6.1 Emigration and Labor Remittances

Migration from Azerbaijan intensified following the disintegration of the Soviet Union. Russia was the first destination for most migrants. Only primarily Russian speaking-minorities emigrated during the early stages of independence. However, mostly ethnic Azerbaijanis from rural areas began to immigrate to Russia for work beginning in 1993. By 2002, official Russian statistics documented 621,500 ethnic Azerbaijanis living in 55 administrative entities in the Russian Federation, making them the thirteenth-largest ethnic minority in the country. Russian law enforcement bodies and the Azerbaijani embassy in Moscow believe that the actual number of ethnic Azerbaijanis in Russia is much higher; some modest estimates place the number between 1.3 million to 1.8 million. These estimates also include seasonal workers or Azerbaijanis who live in Russia on a temporary basis (Valiyev, 2009).

There is no definitive data on labor remittances to Azerbaijan. Various agencies and organizations report different figures. The main discrepancy is the result of different methodologies used to calculate remittances. The government's methodology heavily relies on the payment balance while the State Statistics Committee uses the Household Budget Survey as a main source. At the same time, other policy-making agencies report absolutely different figures. For example, according to Ruslan Grinberg, director of the Institute of Economics at the Russian Academy of Science, private remittances sent from Russia to Azerbaijan are somewhere between \$1.8 billion (€1.3 billion) and \$2.4 billion (€1.7 billion) every year. However, the Russian Central Bank put this figure much below (Markedonov, 2008). In 2008, only \$887 million (€629.2 million) were transferred from Russia to Azerbaijan (Central Bank of Russia, 2009).

According to a World Bank report, the remittances coming to Azerbaijan from all countries increased from \$6 million in 1998 and peaked in 2008 when over \$1.5 billion (€1.06 billion) were sent to the country (World Bank, 2009c).¹⁵ Fifty seven percent of these remittances came from Russia. Approximately 9% of the Azerbaijani population receives remittances. Sixty one percent of the income from these recipients falls between \$0 and \$100 per month. A majority of remittance recipients in Azerbaijan are female (52%) and are not employed (61%). A majority of these remittances (around 60%) are sent to rural areas (EBRD, 2009). A study implemented by the Asian Development Bank found that in 2006 77% of remittances sent to Azerbaijan were used for basic household expenses. Less than half of this is used for business investment. The greatest parts of the 77% are used by households to compensate for low incomes. Meanwhile, the families receiving remittances became dependent on such income. It should be noted that share of remittances in total income of receiving households was very high and is about 46% (ADB, 2007).

¹⁵ The International Fund for Agricultural Development IFAD estimated the remittances to Azerbaijan in 2006 at \$1.8 billion that is 9.3% of GDP.

Azerbaijani statistics present a different picture. According to the Household Budget Survey in 2008, only 2.6% of all household incomes came from remittances. However, the same survey found an interesting pattern. Twenty four percent of incomes of single adults with children relied on money received abroad that is higher than their income from employment, pensions or other transfers. This documents the known fact that heads of families (usually males) work abroad and send money to their families. These remittances have become increasingly important for rural Azerbaijani families, and they outweigh the level of aid-related flows. The pattern shows that the impact of the financial crisis and decrease of remittances will certainly affect this group of people and could increase the level of poverty in the country.

1.6.2 Territorial Income Disparities and Regional Good Production

There are significant differences the incomes that households receive depending on their location. According to HBS 2008 data, the average household size in Azerbaijan is 4.49 people (4.35 for urban areas and 4.63 for rural). Compared with 2007, household incomes in 2008 rose by 23.6% and were €96.4 (108.9 AZN) per person. Incomes in urban areas rose by 21.7% and totaled €100.1 (113 AZN), while the same amount rose by 25.9% to €91.8 (103.7 AZN) in rural areas.

There is a significant difference in the structure of income in urban and rural communities. Forty four percent of all of the income in urban households comes from waged employment, while this amount is around 19.7% in rural areas. This is largely due to the fact that much of the rural population is involved with subsistence agriculture. Logically, the share of income from agriculture is much higher in rural areas and comprises 30.6% of total income, compared to urban areas at the 3.2% level.

The share of income from self-employment is also higher in urban areas (27.1%) than in rural (20%) areas. In most cases, the cities and urban areas of Azerbaijan are the major consumers of products supplied by self-employed people. The share of current transfers (pensions, benefits and social contributions and social transfers in kind) in the overall structure of income of households is higher in rural areas (17.8%) than in urban (11.4%) areas. This most likely occurs because the average urban household income is higher than in rural areas although pensions and social benefits are the same across rural and urban areas.

Territorial income disparity is not surprising when considering the disposition of the overall economy; a large discrepancy exists in the production of goods by region.¹⁶ For example, out of €36.3 billion (39.5 billion AZN) of goods produced in Azerbaijan in 2009, €28.3 billion (30.8 billion AZN) or almost 78% were produced in Baku. The rest of Azerbaijan produced only €7.3 billion worth of products (22%). The Aran economic region—the second largest economic region by production—produced only €2.3 billion or 6.5% of all goods produced in the country.

¹⁶ There is no data on regional GDP production. The production of goods by region serves as a proxy for GDP production.

The same situation is observed in the per capita production of goods by different regions. The average per capita good production in the country was €4,124. It was €13,800 specifically in Baku. Per capita production was €1,180 in the other regions of Azerbaijan. Per capita good production significantly varies across the regions. For example, the per capita production of goods is €844 in Lankaran and €1,265 in Ganja-Gazakh (State Statistical Committee, 2009). This uneven distribution of goods production also results from the composition of the country's GDP. Most of the regions that produce a marginal share of products are agricultural regions. Agriculture composes only 6.7% of country's GDP. In contrast, industries such as oil and gas produce 50% of the GDP, mostly originating in Baku.

Appendix:

Table 1.1: Azerbaijan's Economy After Independence

* Latvia, Lithuania, Estonia, Hungary, Czech Republic, Poland, Slovenia, Slovakia, Romania and Bulgaria.

	1992-1996 (annual average)	1997-2000 (annual average)	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP growth (%)	-15.2	8.6	9.9	10.6	11.2	10.2	26.4	34.5	25.0	10.8	9.3
Oil GDP growth	-10.6	23.1	4.0	3.6	0.6	3.6	65.8	68.7	37.1	n/a	16
Non-Oil GDP growth	-18.4	3.5	7.8	10.5	15.3	13.3	7.9	7.5	10.3	15.7	3.2
GDP per capita (PPP), % of CIS countries average	42.0	44.0	44.2	45.0	45.7	46.1	54.0	64.7	73.0	137	155
GDP per capita (PPP), % of EU 8+2 Countries * ^	30.3	23.6	25.3	25.8	27.0	27.8	33.2	40.3	46.4	51.5	54.3
Inflation (average)	827.7	-1.0	1.5	2.7	2.2	6.7	9.5	8.4	16.7	20.8	1.5
Government spending, % of GDP	22.4	22.5	18.7	27.7	28.5	25.9	22.5	26.3	26.4	22.3	33.5
Total investment, % of GDP	8.5	22.9	22.0	34.8	52.9	57.7	46.1	33.3	25.5	23.8	21.2
GDP, USD and Euro in millions **	2,071	4,724	6,392	5,986	5,748	6,337	11,120	15,736	16,233	33,677	29,665
Non-oil GDP, USD and Euro in millions **	1,662	3,062	4,047	4,128	4,019	4,352	6,217	7,312	8,679	18,996	13,474
Share of Non-oil GDP	80.2	64	63	68.9	70	68	60	46.4	53	39	45.9

** Data is in US dollars until 2001. The data is in Euros from 2001 to 2009.

^ World Bank Data

Sources:

The Statistical Committee of the Republic of Azerbaijan, Azerbaijan in Figures, Gross Domestic Product,

http://www.azstat.org/publications/azfigures/2010/en/010.shtml#t10_1

Central Bank of Azerbaijan, Key Macroeconomic Indicators, <http://www.cbar.az/pages/statistics/key-macroeconomic-indicators/>

World Bank - Azerbaijan Country Economic Memorandum. A New Silk Road: Export-Led Diversification. http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2010/01/07/000333037_20100107230943/Rendered/PDF/443650ESW0AZ0P1IC0Disclosed01161101.pdf.

Table 1.2.1 Azerbaijan: Functional Classification of State Budget Expenditure, 2003-10

	2003	2004	2005	2006	2007	2008	2009	2010
<i>In millions of Euros (AZN)</i>								
General government services	79.09 (98)	99.52 (133)	153.87 (168)	351.32 (403)	376.71 (469)	655.24 (739.9)	849.55 (976,9)	931.92 (1,054)
Defense	109.76 (136)	132.81 (181)	242.31 (288)	486.94 (641)	550.63 (811)	903.1 (1019.8)	1047.92 (1,205)	1065.43 (1,205)
Public order and justice	97.65 (121)	118.87 (162)	173.32 (206)	211.94 (279)	292.63 (431)	435.8 (492.1)	591.53 (680.2)	625.11 (707)
Education	188.85 (234)	230.48 (308)	341.64 (373)	417.57 (479)	580.72 (723)	862.29 (973.7)	1,176.62 (1,353)	1,128.21 (1,276)
Health	44.39 (55)	59.12 (79)	105.33 (115)	141.23 (162)	206.43 (257)	292.60 (330.4)	443.17 (509.6)	427.06 (483)
Social security	172.71 (214)	178.10 (238)	279.35 (305)	297.27 (341)	477.91 (595)	657.72 (742.7)	986.17 (1,134)	1,053.93 (1,192)
Housing and community affairs	23.40 (29)	22.45 (30)	36.64 (40)	53.18 (61)	73.90 (92)	99.36 (112.2)	183.32 (210.8)	177.90 (201.2)
Recreation and culture	25.83 (32)	29.93 (40)	46.71 (51)	58.41 (67)	76.31 (95)	113.97 (128,7)	150.97 (173.6)	158.36 179.1
Agriculture and environment	43.58 (54)	47.14 (63)	87.93 (96)	115.07 (132)	199.20 (248)	236.72 (267.3)	355.60 (408.9)	355.44 (402)
Public works, transport and communication	63.76 (79)	124.97 (167)	238.14 (260)	842.12 (966)	1,606.43 (2,000)	2,597.41 (2,933)	4,173.41 (4,799)	3,206.90 (3,627)
Other economic services and expenditures	100.08 (124)	123.47 (165)	156.62 (171)	168.25 (193)	205.62 (256)	146.56 (165.5)	135.66 (156)	160.48 (181.5)
Total expenditure (including investment)	948.29 (1,175)	1,172.59 (1,567)	1,898.70 (2,073)	3,246.45 (3,724)	4,800.00 (5,976)	7,535.42 (8,509)	10,087.83 (11,600)	9,902.74 (11,200)
<i>In % of GDP</i>								
General government services	1.4	1.6	1.3	2.2	1.7	1.9	2.8	n/a
Defense	1.9	2.1	2.3	3.4	3.0	2.6	3.4	n/a
Public order and justice	1.7	1.9	1.6	1.5	1.6	1.2	1.9	n/a
Education	3.3	3.6	3.0	2.6	2.7	2.5	3.9	n/a
Health	0.8	0.9	0.9	0.9	1.0	0.8	1.4	n/a
Social security	3.0	2.8	2.4	1.8	2.2	1.9	3.2	n/a
Housing & community	0.4	0.4	0.3	0.3	0.3	0.2	0.6	n/a

affairs								
Recreation and culture	0.4	0.5	0.4	0.4	0.4	0.3	0.5	n/a
Agriculture	0.8	0.7	0.8	0.7	0.9	0.7	1.1	n/a
Public works, transport and communications	1.1	2.0	2.1	5.2	7.4	7.7	13.8	n/a
Other economic services and expenditures	1.7	1.9	1.4	1.0	1.0	0.4	0.4	n/a
Total expenditure (including investment)	16.4	18.4	16.6	19.9	22.0	22.3	33.5	n/a

Sources:

The Statistical Committee of the Republic of Azerbaijan, Azerbaijan in Figures, Gross Domestic Product
http://www.azstat.org/publications/azfigures/2010/en/010.shtml#t10_1

Ministry of Finance– State Budget of the Republic of Azerbaijan, <http://www.maliyye.gov.az/>

The data for 2010 will be available by beginning of March of 2011.

Table 1.2.2 Share of Taxes in Overall Budget Revenues (%)

	2005	2006	2007	2008	2009
VAT	29.1	19.0	19.6	17.7	19.4
Excise (i.e. excise tax)	6.8	4.8	6.6	4.5	4.6
Profit	17.3	35.1	40.9	26.5	12.8
Royalty	2.6	2.5	2.0	1.3	1.1
Individual	15.4	10.5	9.8	5.8	5.6
Asset	1.9	1.4	1.2	1.0	0.6
Land taxes	0.7	0.4	0.4	0.2	0.2
Non-tax revenues including transfers from the oil fund	26.2	26.3	19.5	43	56.7

Sources: Ministry of Finance – State Budget of the Republic of Azerbaijan, <http://www.maliyye.gov.az/>.

Table: 1.3.1 Azerbaijan: Labor Market Indicators, 2003-2008

		Labor force participation rate	Inactivity rate	Unemployment rates*	Employment-to population ratio	Employment rates
2003	Total	70.3	29.7	8.1	57.6	78.60%
	Male	75.5	24.6		61.7	
	Female	65.5	34.5		54.0	
2004	Total	70.4	29.6	6.9	59.0	78.29%
	Male	75.5	24.6		63.3	
	Female	65.7	34.3		55.2	
2005	Total	70.2	29.8	6.2	58.6	77.90%

	Male	75.1	24.9		62.8	
	Female	65.6	24.4		54.8	
2006	Total	69.4	30.6	5.3	58.9	75.14%
	Male	74.2	35.8		63.1	
	Female	65.0	36		55.1	
2007	Total	71.1	28.9	7.0	60.4	72.46%
	Male	76.2	33.8		64.9	
	Female	66.4	33.6		56.4	
2008	Total	71.3	28.7	6.4	59.9	72.74%
	Male	76.5	23.5		64.5	
	Female	66.5	33.5		55.8	
2009						71.14%

Sources: The State Statistics Committee of Azerbaijan Republic, Labour Statistics - http://www.azstat.org/publications/azfigures/2010/en/005.shtml#t5_1.

Table: 1.3.2 Employment Rates by Age Groups (2008)

Age groups	Total Population	Employed population	Employment rate (%)
15-19	942,600	151,144	16
20-24	886,000	400,442	45.1
25-29	736,600	530,018	71.9
30-34	630,300	569,512	90.3
35-39	651,900	542,322	83.1
40-44	682,100	601,663	88.2
45-49	679,400	568,627	83.6
50-54	464,400	368,452	79.3
55-59	309,400	186,580	60.3
60-64	149,600	91,771	65.3
65+	613,000	45,486	7.4

Source: State Statistical Committee of Republic of Azerbaijan, The Sample Statistical Survey of the Economic Activity of Population, - http://www.azstat.org/statinfo/labour/en/008_1.shtml.

Table 1.3.3 Employment, Wages and Productivity among Selected Sectors in 2009

Sector	Total employment, in thousands	Total employment %	Value added/employee (Euros)*	Average monthly wage (Euros)
Agriculture, forestry, hunting and fishing	1,568.7	38.5	651	108.8
Non-oil manufacturing	198.6	4.9	4,473	226
Mining	41.2	1.0	245,529	848.3
Electricity, gas and water supply	39.5	1.0	1882	248
Construction	224.3	5.5	7539	382.4

Wholesale and retail trade	661.5	16.3	1539	181.9
Rendering of services by hotels and restaurants	24.2	0.6	6,066	247.7
Transport, storage and communication	210.2	5.2	6,930	323
Financial activity	19.7	0.5	9,036	705.5
Real estate, renting and business activity	139.7	3.4	1,453	441.3
Public administration, defense, social security	277	6.8	-	297.5
Education	345.8	8.5	862	220.1
Rendering of health and social services	184.5	4.5	938	129.7
Other community services	135.9	3.3	1,254	186
Extra-territorial organizations activity	0.6	0.0	0.0	0.0

* Data for Value Added is for 2008.

Source: The State Statistics Committee of Azerbaijan Republic, Labor Statistics-

http://www.azstat.org/publications/azfigures/2010/en/005.shtml#t5_1 ;Gross Domestic Product-

http://www.azstat.org/publications/azfigures/2010/en/010.shtml#t10_1

Table 1.3.4 Average Monthly Nominal Wages and Salaries by CIS Countries (Euro)

	2001	2002	2003	2004	2005	2006	2007	2008
Azerbaijan	62.4	62.3	62.2	73.9	109.7	125.1	168.5	236.8
Belarus	97	100.7	95.4	117.7	180.7	203.4	216.4	286.3
Kazakhstan	128	127.5	122.1	152.6	215.2	242.6	291.0	358.3
Kyrgyzstan	33.6	34.4	34.6	38.4	53.5	61.0	71.6	105.1
Armenia	49.3	45.7	47.4	59.6	95.5	112.2	151.7	212.1
Georgia	-	49.6	46.2	59.3	94.7	-	-	-
Moldova	47.3	49	50.4	65.6	87.9	96.9	114.0	172.6
Russia	124	133.5	141.5	171.5	254.1	293.3	354.4	494.1
Tajikistan	11	11.3	11.8	15.2	22.5	26.4	35.5	47.8
Ukraine	64.8	67.7	68.4	81.2	132.1	154.6	179.2	243.1

Source: State Statistical Committee of Republic of Azerbaijan, Wages, Salaries, Expenditures Spent for Labor Force. Average monthly nominal wages and salaries by CIS countries - http://www.azstat.org/statinfo/labour/en/004_1.shtml

**Table 1.3.5 Gross Domestic Product per Capita, in 1998-2008 by
CIS Countries and Georgia (current prices, Euro) PPP**

	2001	2002	2003	2004	2005	2006	2007	2008
Azerbaijan	795.8	738.1	701.9	765.4	1327.0	1853.7	2573.9	3922.3
Belarus	1358.4	1401.5	1409.9	1716.7	2594.4	2846.0	3122.5	4334.0
Armenia	738.2	710.3	690.5	812.3	1279.6	1486.6	1911.7	2579.2
Kazakhstan	1670.0	1591.8	1633.8	2098.3	3167.9	3968.6	4537.0	5959.2
Kyrgyzstan	346.6	310.4	302.6	318.8	403.9	411.5	489.4	674.6
Moldova	456.7	441.6	433.1	526.8	698.2	713.0	824.2	1185.9
Uzbekistan	522.0	367.9	307.4	339.5	438.7	482.3	556.2	715.5
Russia	2352.7	2282.6	2358.1	3004.0	4488.3	5210.1	6105.0	8279.2
Tajikistan	191.7	182.0	187.0	225.8	283.5	303.6	349.0	495.2
Ukraine	878.6	846.2	831.5	1001.9	1542.2	1733.9	2064.0	2738.3
Georgia	780.6	710.3	690.0	826.1	1194.3	1321.1	1553.1	2036.2

Source: The State Statistical Committee of Republic of Azerbaijan. System of National Accounts and Balance of Payments, http://www.azstat.org/statinfo/system_nat_accounts/en/011.shtml

Table 1.3.6 Distribution of Unemployed Population by Sex and Age Groups 2008 (overall unemployed including registered) (percentage to total and sex)

Age groups	Women	Men	Sex distribution	
			Women	Men
15-19	5.2	14.9	18.7	81.3
20-24	23.8	25.1	38.7	61.3
25-29	14.4	9.1	51.4	48.6
30-34	14.1	9	50.9	49.1
35-39	5.4	4.6	43.5	56.5
40-44	18.1	8.1	59.8	40.2
45-49	12.1	6.9	54.0	46.0
50-54	6.5	7.1	37.9	62.1
55-59	0.4	13.9	1.8	98.2
60-64	-	1.3	-	100
Total, in per cent	100	100		
000 person	104.5	156.9		

Sources: State Statistical Committee of Republic of Azerbaijan, The Sample Statistical Survey of the Economic Activity of Population, - http://www.azstat.org/statinfo/labour/en/008_1.shtml

Table 1.3.7 Structure of Unemployed Population by Education Level, 2006

Age	Total	Including				
		Higher	Secondary, Incomplete higher	Vocational	Secondary General	Below secondary general
25-34	100	18.3	9.2	4.2	64.1	4.2
35-44	100	19.0	12.3	6.1	60.0	2.6
45-54	100	24.0	15.2	6.8	50.7	3.3

Sources: State Statistical Committee of Republic of Azerbaijan, The Sample Statistical Survey of the Economic Activity of Population, - http://www.azstat.org/statinfo/labour/en/008_1.shtml.

Table 1.3.8 Job Fair Participation and Placement in Azerbaijan

	2004	2005	2006	2007
Number of persons who participated in job and vacancy fairs	32,141	38,093	39,991	43,966
Number of persons who placed in jobs	6,185	7,212	7,842	9,056
Percentage of participants who placed in jobs	19.2	18.9	19.6	20.6

Source: Kuddo, 2009

Table 1.4 Azerbaijan ISCED Mapping 2008

Name of the education program	Minimum age / entrance requirements	Main diplomas, qualifications or certificates awarded at end of program	Theoretical entrance age	Theoretical duration (in years)	Is the program part of Compulsory Education?
Pre-primary education	3	N.A	3	3	No
Primary education	6	N.A	5	4	Yes
Lower secondary education 2A	10	Certificate	10	5	Yes
Upper secondary education 3A	15	Atestat (high school diploma)	15	2	No

Upper Secondary Vocational Education	15	Certificate	15	3	No
Bachelor program	General Secondary diploma	Bachelor	17	4	No
Master program	Bachelor degree	Master degree	21	2	No
Postgraduate	Master degree	Candidate of Science	23	3	No
Doctor of Science	Candidate of science	Doctor of Science	26	5	No

Source: State Statistical Committee of Republic of Azerbaijan; Education, Science and Culture
<http://www.azstat.org/statinfo/education/en/index.shtml>
 Consultant estimates.

Table 1.4.1 Number of Students and Pupils in Schools based on ISCED

Categories	2004	2005	2006	2007	2008
Pre-primary education	95,187	93,613	94,055	93,838	88,888
Gross enrolment rate. Pre-primary	29.4	29.0	29.7	29.8	26.4
Primary education	606,176	567,129	537,152	511,639	495,151
Gross enrolment rate. Primary		110.5	113.7	115.8	116.2
Lower secondary education 2A	812,338	810,167	797,092	769,553	741,335
Upper secondary education 3A	267,124	253,201	247,175	252,065	248,690
Gross Enrollment Rate. Secondary		86.8	87.6	88.8	105.6
Gross enrolment ratio. Primary & Secondary combined. Total	93.0	93.7	94.9	96.2	108.6
Upper Secondary Vocational Education	2,773	3,060	3,431	3,478	29,911*
Post-secondary non-tertiary education 4B	71,160	72,676	73,786	77,713	46,163*
Enrolment in 5A tertiary	121,535	127,248	129,948	133,379	140,132
Enrolment in 6 tertiary	1,235	1,386	1,559	1,785	1,764
Gross enrolment ratio. ISCED 5 and 6. Total	14.9	15.1	15.1	15.2	15.7

* Sudden increase in number of Upper Secondary Vocational Education Students as well as sudden drop in enrollment of Post-Secondary non-tertiary education 4B is attributed to the changes in methodology of counting.

Source: State Statistical Committee of Republic of Azerbaijan; Education, Science and Culture
<http://www.azstat.org/statinfo/education/en/index.shtml>
 Consultant estimates, OECD 2006.

Table 1.5.1 Selected Demographic Indices (per 1,000 people)

Year	Births rate	Deaths rate	Natural increase	Migration (net)	Marriages	Divorces	Fertility rate
1990	25.9	6.1	19.8	-53.6	10.4	2.0	2.8
1991	26.6	6.3	20.3	-40.1	10.4	1.5	2.9
1992	25.0	7.1	17.9	-14.2	9.5	1.3	2.7
1993	23.7	7.2	16.5	-12.2	8.1	0.9	2.7
1994	21.4	7.3	14.1	-11.0	6.3	0.8	2.5
1995	18.9	6.7	12.2	-9.8	5.7	0.8	2.3

1996	16.9	6.3	10.6	-7.4	5.1	0.7	2.1
1997	17.1	6.1	11.0	-8.2	6.1	0.8	2.1
1998	15.9	5.9	10.0	-5.1	5.2	0.7	2.0
1999	14.9	5.9	9.0	-4.3	4.8	0.6	2.0
2000	14.8	5.9	8.9	-5.5	5.0	0.7	2.0
2001	13.8	5.7	8.1	-4.7	5.2	0.7	1.8
2002	13.8	5.8	8.0	-3.1	5.2	0.7	1.8
2003	14.0	6.0	8.0	-1.3	6.9	0.8	1.9
2004	16.1	6.1	10.0	-0.4	7.6	0.8	2.1
2005	17.2	6.3	10.9	-0.9	8.7	1.1	2.3
2006	17.8	6.2	11.6	-0.4	9.5	0.9	2.3
2007	18.0	6.3	11.7	-1.1	9.7	1.0	2.3
2008	17.8	6.2	11.6	-1.9	9.3	0.9	2.3
2009	17.2	5.9	11.3	0.9	8.8	0.9	2.3

Source: State Statistical Committee of Republic of Azerbaijan; Demographic Indicators,
<http://www.azstat.org/statinfo/demographic/en/index.shtml>.

Table 1.5.2 U.N. Population Projections for Azerbaijan (Medium Variant Scenario)

	2010	2015	2020	2025	2030	2035	2040	2045	2050
Number of residents (000) *	8 934	9 426	9 838	10 128	10 323	10 466	10 571	10 614	10 579
Median age (years)	28.4	29.9	32.0	34.2	36.4	38.0	38.8	39.4	40.6
Population sex ratio (males per 100 females)	95.8	96.5	97.0	97.2	97.3	97.3	97.3	97.4	97.6
Total fertility (children per woman)	2.1	2.12	2.03	1.96	1.89	1.85	1.85	1.85	1.85
Life expectancy at birth by sex (years)	71	71.4	72.3	73.2	74.0	74.8	75.4	76.1	76.7
<i>Old Age Dependency Ratio</i>	9	9	11	15	19	22	23	25	28
<i>Child Dependency Ratio</i>	34	34	35	33	30	27	26	27	27
Total Dependency	44	44	46	48	49	49	49	51	54

Ration												
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* By 2010 Azerbaijan's population has reached 9 million residents.

Source: World Population Prospects, The 2008 Revision Population Database; United Nations Population Division
<http://esa.un.org/unpp/>

Table 1.6 Migrant Remittances Flow – millions of Euros

Remittances by Origin	1998*	1999*	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
From all countries	6	54	61.3	117.4	174.3	135.8	167.3	583.0	617.5	873.8	1102.0	758.4
Of which from Russia										443.3	629.0	461.6
Per capita (Euro)	0.76	6.7	7.6	14.4	21.1	16.3	19.8	69.0	72.6	101.8	126.2	85.9
Share of all remittances to GDP (%)			1.1	1.8	2.9	2.4	2.7	5.5	3.5	3.8	3	2.5

* The date for 1998 and 1999 is in USD.

Sources: World Bank report. "Migration and Development Brief 11". 2009.

[http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-](http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1110315015165/MigrationAndDevelopmentBrief11.pdf)

[1110315015165/MigrationAndDevelopmentBrief11.pdf](http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1110315015165/MigrationAndDevelopmentBrief11.pdf). & Russian Central Bank Data, <http://www.cbr.ru/eng>.

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Chapter 2: The Social Protection System

2.1 Historical Development

The social protection system of Azerbaijan has changed little during the 1990s and early 2000s. It has continued to follow the Soviet approach which included components of social protection such as social insurance, social assistance and free services. During the communist period, many social assistance programs such as kindergartens and sanatorium vouchers were attached to state industries and enterprises. The families of people working in these places were eligible for free medical treatment, houses and discounted cars. The closure of many enterprises, industrial transformation, economic restructuring and the changing character of employment left employees without social protection and deprived them of usual benefits. In addition, the collapse of the industrial factories in the country forced many people to take jobs in different services or become self-employed. This phenomenon eventually led to the disappearance of trade unions. The emerging service sector where most unemployed people found jobs did not offer any social benefits.

As mentioned in chapter 1, most employment is either unregistered, informal or does not generate taxes. For example, only 1.385 million out of 4.07 million people employed were on the payroll in 2009, (The State Statistical Committee, 2009a). Out of the total number of people employed, 1.573 million people were involved in agriculture. Of those working in agriculture, only 44,000 people or just 2.8% were registered employees. In other sectors of economy, the number of registered people goes as low as 36.5% in construction or 40% in wholesale and retail trade (The State Statistical Committee, 2009b). Tax evasion and avoidance by those working in the informal sector led to a low level of tax collection. This provided the major source of funding for non-contributory social assistance programs. However, it is hard to estimate how much unregistered people earn monthly and how much they pay in taxes. On average, the nominal monthly salary of those working in the agriculture sector does not exceed €120—that is 40% of the average nominal wage. We can expect the tiny minority of unregistered people would earn enough to pay taxes and significantly increase collection.

At the same time, the changing nature of poverty and the new criteria for defining poor families has not allowed the social protection system properly define vulnerable categories of people. Poverty was homogeneous before the Soviet transition. The overwhelming majority of the poor were families with a large number of dependents, pensioners and single mothers (Braithwaite, 1995; Manning and Tikhonova, 2004). This allowed the government to provide social protection through easily definable categories (e.g., number of children, age and marital status). In addition, verification of the income of those who might need social protection was not difficult due to the nature of a centrally planned economy in which the government provided all employment. However, since independence poverty has become more heterogeneous throughout the country and demographic characteristics have become weak determinants of poverty (GoA, 2004). The situation is also exacerbated by the presence of IDPs who are scattered across the

country (Subchapter 1.4.6). The nature of poverty as well as the significant size of the unregistered economy makes identification of the neediest difficult.

The Azerbaijani government has been able to address poverty issues and develop reform social policies because of the influx of oil income and resulting budget surplus. Actual reforms in the system began in 2003 even though the legislative base for the social protection system was developed and adopted long before. In 1997 Azerbaijan adopted a Law on Social Insurance (defining the state's responsibilities for mandatory state social insurance) and a Law on Individual Accounting as part of the state social insurance in 2001. In 2005, Azerbaijan adopted a new Law on Labor Pensions and since 2006 has been applying the system of individual registration of contributors.

Administratively, the functions of the social protection system in Azerbaijan are divided between two entities: the Ministry of Labor and Social Protection of Population and the SSPFA. In August 2003, the arena of pension benefits was passed to the SSPFA under the Pension Reform Concept. In 2006 the SSPFA was granted additional functions including the collection and administration of social payments made by state entities and enterprises. These are mandatory state social insurance contributions.

Currently, the SSPFA oversees and provides social protection types of benefits: old age pensions, family allowances, health care, temporary disability (illness), maternity leave, unemployment benefits and others. The Ministry oversees and provides for disability pensions, targeted social assistance, social allowances, occupational injuries, and funeral benefits among others. Overall, the Ministry is responsible for designing and implementing poverty alleviation strategies. Though the SSPFA is not a ministry, it has a ministry-like structure and has ministerial functions. The SSPFA has the following (administrative) structure: a central office, an office for the Nakhchivan Autonomous Republic, 3 departments and 75 city (district) branches. About 2,616 civil servants are employed with the fund. 2,384 of them occupy administrative positions and 232 are support personnel (SSPFA, 2009a). The head of the SSPFA is appointed by the president of Azerbaijan. The budget of SSPFA is determined separately from the budget of other ministries and prepared by the government. It is approved by parliament and signed into the law by the president.

2.1.1 Social Assistance and Social Protection Schemes

The current social protection system in Azerbaijan is mainly divided into two programs: social insurance and social assistance. Social insurance benefits (e.g., old age, unemployment, illness) are financed through social insurance contributions made by the employed population. These types of benefits protect households and individuals from falling into poverty when the above mentioned events (e.g., old age, temporary disability, unemployment) occur. Social transfers such as child benefits, funeral grants, in kind benefits, targeted social assistance and disability benefits are non-contributory in nature and financed from the state budget. The main goal of such social assistance programs is to redistribute resources to ensure that the poor maintain a minimum consumption level. With the launching of such reforms, Azerbaijan made huge progress in registering and

enforcing the payments of social insurance. 1.807 million people were insured under the system by the end of 2009. Individual accounts were opened for 1.606 million people and certificates were printed for 1.598 million insured people (SSPFA, 2009a).

2.2 Financing of Social Protection and Social Transfers

The Ministry of Labor and Social Protection of the Population provides general oversight, while local branches of the ministry are responsible for administering social benefits and providing benefits to unemployed parents. The SSPFA collects and manages contributions and finances benefits. The table below identifies the sources of financing, contribution and social assistance programs covered by these contributions. All contributions are collected through the SSPFA.

Table 1. Sources of Financing

Source of Financing	Description	Contribution per month	Financing
Government		Transfers	Family allowances; general non-contributory minimum, birth grant, funeral grant, deficit of SSPFA
Employers, non-agricultural	Public, semi-public institutions (municipalities, trade unions) and private companies. Non-agricultural	22% payroll. No minimum and maximum earnings for contribution calculation purposes	Old age, temporary disability, survivors, health care, maternity and sickness cash benefits, unemployment
Employers (Agricultural)	Farmers, some rural partnerships	2-12% of minimum wage for each person	Old age, temporary disability, survivors, health care, maternity and sickness cash benefits
Employees	All formally employed people	3% of gross earnings. No minimum or maximum earnings for contribution calculation purposes.	Old age, temporary disability, survivors, health care, maternity and sickness cash benefits, unemployment
Self Employed Persons	People involved in entrepreneurial activity	1st category: trade and construction activities: 50% of minimum wage; 2nd category: other fields: 20% of minimum wage	Old age, temporary disability, survivors, health care, maternity and sickness cash and unemployment benefits

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Employment injuries and occupational diseases are financed entirely by individual employers (duty of compensation) and by the state budget in limited and specified circumstances. The social insurance scheme does not cover these risks. The cost of benefits for refugees from Armenia and IDPs is covered under the state budget. These benefits include free education in state institutions, free housing and free medical services. Disabled individuals from Group I (severely disabled) and Group II (less severe disabilities) who contracted diseases or were injured at working in a kolkhoz or sovkhoz receive benefits from the state budget (SSPFA, 2009a).

Financing for illness or maternity leave is provided for in two ways. First, in kind benefits are given. State budget mandatory insurance payments are taken from the budget and the Social Protection Fund (taking into account medical services price index) on behalf of the following groups: non-working pensioners, temporarily unemployed persons, disabled persons, children, students, and public employees paid from the state budget. Second, the state can provide cash benefits and intervene to cover deficit. However, cash benefits are funded by contributions alone according to legislation.

2.2.1 Patterns of Revenue Collection and Expenditures

Most sectors are not taxed and workers do not pay social contributions. Only a few taxes apply to the agricultural sector, not exceeding 12% of the minimum wage. For example, only 294,342 farmers and people employed in agriculture paid social security tax to the SSPFA in 2008. Very few contributors take into consideration the fact that approximately 1.5 million people work in agriculture.

By the rough estimates, about 1.3 million people do not pay taxes for a variety of reasons. First, most of them are involved in subsistence farming and produce agriculture goods mainly for family consumption. Only a marginal share of their production is sold at a market. Thus, there is not much income to declare which may be taxed. Second, employers prefer not to declare their employees (unpaid family workers) and do not pay social security taxes since taxes add an additional cost to labor. Most of the farmers who pay taxes are those that have formally registered farms or work with governmental acquisition agencies. Overall, there were only 2,500 private owners of farms in 2009.

This situation creates problems since such a large share of people (1.3 million) is outside of the social security system. These factors foster undeclared employment in the agricultural sector. In addition to losses of fiscal revenues, there is a dangerous situation when almost one-sixth of the country's population is not covered by social insurance. All of these people will be left without social and health protection once they retire.

One of the alarming trends observed in the revenue side of SSPFA budget is a heavy reliance on budget transfers. In 2008 budget transfers comprised 27% of all SSPFA revenues and transfers will reach 31% in 2010. This figure is high compared to other revenues even though it is much less than those observed in 2003-2004 (almost 50%).

Looking at the share of budget transfers to overall GDP, it is clear that the figures are comparatively low and did not exceed more than 2.1% of the GDP. The growth in budget transfers seems to compensate for losses that the government is expecting from mandatory social security contributions.

The government expects to receive less payroll taxes than it did in 2009 due to the financial crisis. In 2010, the receipts of payroll taxes will decrease by €50 million (57 million AZN) or by 5%. A large drop by €30.4 million (35 million AZN) is expected from non-state and private organizations. There are several contributing factors. First, many non-state organizations ceased to exist due to the financial crisis. Second, many organizations will tend to evade paying burdensome social security contributions due to the shortage of financial resources. A positive aspect of revenue collection is that the growing share of contributions comes from non-budget organizations. The SSPFA collected €370 million from January to September 2008. This figure was €403 million from January to September in 2009 and €436 million from January to September in 2010.

The government introduced a simplified tax system in 2007 for individuals involved in entrepreneurial activities (for more details on the tax system see subchapter 1.3.1). People who register with tax agencies receive a tax identification number (TIN) and are obliged to pay 4 % of income tax on his or her income (if the income does not exceed €88,000 a year). People who are registered outside of Baku only 2% of income tax on their income. Meanwhile, people are obliged to pay 22% of their salary every month to the SSPFA as a social security contribution. In most cases, TIN holders report their salary at the level of minimum wage determined by Azerbaijani government (75 AZN or €73) and pay 22% of the €73 every month. The goal of this policy is to legalize informal entrepreneurial activities and to increase budget revenues. The system proved to be beneficial for both sides since otherwise private employers tend to evade 22% of social security contributions. With this system, employers sign a contract with each employee and are easily able to pay social security contributions.

This system also contributes to an increase in the amount of people with social insurance who are registered by the SSPFA. There were 1.7 million people with social insurance by July 1. Of that total, 402,477 (23.6%) people are under 30 years old and 142,263 (8.3%) people above 60 years old. In Azerbaijan, individual records are organized in order to provide people with pensions and other social protections (Ismayilov, 2010). At the same time, the SSPFA has been able to increase its collection of insurance fees and revenues. Thus, in 2009 the fund's revenues totaled €1.4 billion (1.6 billion AZN) which is €178.3 million (205 million AZN) more than it was in 2008. Social insurance fees increased by 8.3% from €69 million (79.4 million AZN) in 2008 to €902 million (1.04 billion AZN) in 2009. Of this total, 56 % was provided by the private sector (SSPFA, 2009).

In 2009 €3.2 billion (3.7 billion AZN) (32.6% of the state budget or 10.8% of the GDP) were allocated for social and other programs. These allocations are intended to increase such expenses up to 11.2% of GDP in 2010. The share of spending for social programs is constantly increasing. For example in 2007 and 2008, these expenses were around 27% and 21% of budget expenditures, respectively (or 6.2% and 5.7% of GDP, respectively)

(State Statistics Committee of Republic of Azerbaijan, 2009c). Such sharp fluctuations in the share of the budget and GDP are connected with the sudden increase of oil incomes and growth of GDP, as well as a drop in oil prices and consequent decrease in nominal GDP. Social expenditures in nominal values were increasing throughout these years. On the expenditure side, the majority of expenses fund elderly pensions. Ninety three percent of expenses in 2009 funded pensions.

After reviewing allocations to social assistance programs, it is apparent that the government does not reward revenue expenditures consistently. In 2005, the government allocated €6.4 million (7 million AZN) to child birth allowances and then suddenly decreased the allocation to €871,764 (1 million AZN) one year later. It was later increased to €1.77 million (2 million AZN) in 2010. The number of people receiving such aid also significantly dropped from 112,500 people in 2005 to 18,000 in 2006 and 26,800 people in 2008. It is believed that the main reason for such drop is the re-allocation of these funds to other programs that are income-tested benefits. In this case the government is able to target families who are in need of additional allowances.

The same situation is observed in the allocation of child allowances for the care of children under 3 years old. In 2006, 21,400 people received child allowances. The amount of assistance per month in 2006 was €22 (25 AZN) for a year and in 2010 this figure rose to €34 (34.49 AZN). This amount is extremely low and does not make a substantial difference for many people. Resources are spread thin over a large section of the population, rather than providing meaningful support to a poor subset of the population. For example, the per capita monthly allowance granted to families with children is €6 (6.16 AZN).

A similar trend is observed in the allocation for maternity leave. In 2008, €8.15 million (9.2 million AZN) was allocated for maternity leave. In 2009, the government spent €8.5 million (9.8 million AZN) and intends to increase spending to €16 million (18 million AZN). The government is willing to protect this vulnerable group of people by increasing the allocation for maternity leave. There are many instances of discrimination in the workplace in Azerbaijan when employers prefer not to let pregnant women take maternity leave and dismiss them from their position. The government hopes to diminish such cases by increasing financing for maternity leave.

In the 2010 budget, the SSPFA allocated €17 million (19 million AZN) or 1.1% of all expenses to expenses related to administrative costs (e.g., delivering pensions, social assistance and bank transfers).

2.3 Types of Benefits and Services

2.3.1 Contributory Benefits

Unemployment Benefits.

In order to qualify for unemployment benefits, a person must have at least 26 weeks of covered registered employment and have paid contributions in the 12 months before

unemployment. The insured must be between age of 15 and the normal pension age, registered with state employment services, and be actively seeking and willing to work. The benefit is suspended for 3 months for refusing two acceptable job offers or for failing to register each month at the employment service without a valid reason. The benefit ceases if citizens filed false or fraudulent claims or refuse to attend vocational training. The benefit is equal to 70% of the average gross monthly earnings during the 12 months before unemployment. The benefit must not exceed the national average monthly wage (€221.4 or 250.40 AZN) and it is paid for a maximum of 26 weeks in any 12-month period.

There are approximately 40,000 registered unemployed people in the country while the overall official unemployment number is around 250,000 according to the ILO's methodology (The State Statistical Committee of the Republic of Azerbaijan 2009c). The coverage rate of unemployed people is very low. Since 2003, unemployment benefits have not exceeded 2 to 3% of all registered unemployed people. This is less than 1% of the calculations based on ILO's methodology. One reason for such low coverage is that many unemployed people have difficulty justifying their unemployment status. A second reason is their involvement in the informal economy. The average size of unemployment benefits totaled €165. In most cases agricultural workers are not eligible to receive unemployment status because most of them are either self-employed or unregistered and do not pay contributions.

Sickness Benefits.

An employee must have at least 8 years of employment in order to be eligible for sickness benefits. In this case, an employee receives 100% of the last month of earnings. The benefit is paid from the first day of incapacity until recovery or certified as permanently incapable of work.

Maternity benefits.

A person must be in covered employment with at least 6 months of contributions in order to qualify for this type of benefit. For insured women in the nonagricultural sector, maternity leave is provided for 70 days before and 56 days after the expected date of childbirth (70 days after for multiple births or for childbirth with complications). For insured women in the agricultural sector, leave is provided for 70 days before and 70 days after the expected date of childbirth (86 days for childbirth with complications, or 110 days for multiple births). Employers pay maternity benefits for the first 56 to 70 days after which benefits are paid by the social protection fund. The benefit is equal to 100% of the gross average monthly earning and is paid for 126 days total (70 days before and 56 days after the expected date of childbirth). The state budget allocated €22.3 million (25.2 million AZN) for maternity leave in 2010.

Child Care Benefits (contributory).

Child care benefits are paid to employees who leave work to raise a child younger than 18 months old. €15 (20 AZN) is paid until the child is 3 years old. The state budget allocated €4 million (4.5 million AZN) for raising children until they are 3 years old in 2010.

Survivor Benefits.

Survivor benefits are paid to survivors who are retired spouses, disabled spouses, nonworking spouses, or spouses caring for a child younger than age 8 or children younger than age 18 (or age 23 if the dependent is a full-time student and there is no age limit if a disability began before age 18). This pension is equal to 100% of the average monthly earnings of the deceased. If there is more than one survivor, then the pension is split equally among them. Benefits are annually adjusted according to changes in the consumer price index for the previous year. Survivor pensions are allocated to citizens living abroad under bilateral agreements.

Funeral Benefits.

Funeral benefits are €90.4 (100 AZN) for the death of a single employee or a labor pensioner. The amount is very low taking into consideration the high cost of funeral expenses that vary from €1,000 to €3,000 (SSPFA, 2009a).

In-Kind Benefits (contributory)

The Privileges Program encompasses multiple benefits such as vouchers for sanatoria and recreational centers, free medical check-ups or surgery at hospitals belonging to industry; free kindergartens and others. For example, sanatorium vouchers (putyevka) are for employees of various ministries and their children. Over €11 million (12 million AZN) were allocated for these purposes in the state budget of 2010.

2.3.2 Non-Contributory Benefits**Birth Grant.**

The government pays a birth grant that is provided to each family as a lump-sum payment at the birth of a child. The amount of the payments is constantly increasing. The amount was increased to €44.2 (50 AZN) in August 2008 by presidential decree and it was €65.2 (75 AZN) in December 2009. In 2009, €1.2 million (1.39 million AZN) was spent on birth grants; this consisted of grants for the birth of 27,800 children although around 160,000 babies total were born during that period. The government allocated €1.8 million (2 million AZN) that was paid to about 27,000 families in 2010. The grant's increase will be of little impact to low-income families. By some estimates, the informal cost of giving birth to a child in a state-run hospital can reach €354 (400 AZN) on average.

Childcare Benefits (non-contributory).

One of the means-tested benefits is childcare benefits. This benefit is paid to residents of Azerbaijan who are younger than 16 years old and up to age 18 if the individual is a student without a student allowance. The procedure to determine eligibility for children's benefits consists of two tests: categorical and income. Categorical tests determine how many children are in an applicant's family. In order to determine the income of the applicant, income tests are conducted by the mother's employer or the father's employer

if the mother is not employed. The investigative agency does not require the mother or father to be legally unemployed.

In order to qualify for this benefit, the per capita monthly family income must be less than €48.6 (55 AZN). Another type of childcare benefits allows low-income families with a child younger than age 1 to receive €16.3 (20 AZN) a month. If the child has a parent who is in active military service, then they are eligible to receive €35 (40 AZN) a month. A child who has lost the family head is paid €35 (40 AZN) per month (SSPFA, 2009a). In addition, the full orphan special benefit at €8.8 (10 AZN) is paid to a child monthly with no parents. Other monthly allowances include a payment of €44 (50 AZN) for children less than 18 years with health limitations. Custodians (guardians) of children who have lost their parents care also receive €22 (25 AZN) per month.

In-kind Benefits (non-contributory).

The Privileges Program is intended for specific categories of households which are deemed to be poor without an attempt to evaluate their actual poverty status. Privileges include multiple benefits such as exemptions for educational and health care as well as discounts for food, rent and utilities. The rationale behind this benefit is to make these services affordable for poor households. Thus, these benefits are considered to be an effective way to mitigate poverty and inequality during transition. IDPs are also one of the target groups. According to the law, all IDPs are exempt from all charges and fees if they study at state universities or institutions. The same rule applies to children of people who died for the independence of Azerbaijan, National Heroes and others. In 2008-2009, the government initiated social or subsidized mortgages. Families of shehids (martyrs) could thus qualify for a 35,000 AZN (€30,995) mortgage for 25 years under a four % annual rate. At the same time, most refugees live in houses provided by the Azerbaijani government. Until recently they did not pay utilities. The government liquidated some of the benefits to IDPs relating to utilities. In 2010, the Azerbaijani parliament initiated discussions on adopting a law on subsidized or rent controlled housing. However, the issue was only discussed and no regulations were passed.

Targeted Social Assistance.

Azerbaijan introduced Targeted Social Assistance (TSA) on July 1, 2006. It is a means tested program run by the Ministry of Labor and Social Protection of Population. It is completely financed by the state budget and meant to help certain groups to avoid falling into poverty. The level of social assistance given in Azerbaijan is defined by the level of need. This was set at €42.56 (60 AZN) per capita in 2008 and €57.4 (65 AZN) for 2010. The number of people receiving such aid has increased every year. In 2007, only 48,705 families (218,673 people) or 2.5% of the population received this aid and by the end of 2009, 163,409 families (749,965 people) or 8.4% of the population were eligible to receive it (The State Statistical Committee of the Republic of Azerbaijan, 2009b). The average amount of assistance for one family in the country is €86.81 (98.19 AZN) and it is €19.06 (22 AZN) for one person.

Table 2. Contributory and Non-contributory Benefits (Means Tested and Not Means Tested)

Type of Benefits	Means Tested		Not means tested	
	<i>Contributory</i>	<i>Non-contributory</i>	<i>Contributory</i>	<i>Non-contributory</i>
Unemployment			26 weeks of covered registered employment. Payment of contribution in the 12 months before unemployment	
Birth Grant				€65.2 is paid for birth of child
Funeral allowance			€90.4 for the funeral expenses of an employee or a labor pensioner.	
Targeted Social Assistance		To qualify per capita monthly income should be below €57.4		
Survivor benefits			100% of the average monthly earnings of the deceased.	
In-Kind benefits			Vouchers and <i>putyevkas</i>	Exemption from tuition fees
Child Care Benefits		Paid to the residents of Azerbaijan who are younger than 16. In order to qualify per capita monthly family income must be less than €48.6 (55 AZN).	The child care benefit is also paid to employees who leave work to raise a child younger than 18 months	

2.4 Social Protection and Support for Most Disadvantaged

There were approximately 432,000 people living with disabilities in Azerbaijan by the end of 2009. Out of that number, 23.9% were pensioners, 7.2% (22,400 persons) were Group I, 83.7% (260,300) were Group II, and 9.1% (30,000) were constituted Group II. Each category of people living with disabilities receives different pensions ranging from €53 (60 AZN) to €170 (200 AZN). In addition, military personnel who became disabled following participation in the containment of the Chernobyl catastrophe receive an annual benefit of €132.6 (150 AZN) for medical treatment (SSPFA, 2009).

The government adopted the State Program of Financing Measures Related to the Social Protection of Disabled Persons in 2010. The purpose of this program is to creation of a united database of people living with disabilities. The database will include personal and family information about this group, background and need, as well as a record of past and future social and rehabilitation measures implemented for each individual's treatment. This database will improve programming to provide social protection for disabled persons, thus allowing delivery to be more timely and an improvement in living conditions (Ismayilova, 2010). This system will also improve the detection of people who falsely report disabilities. People who receive disability benefits must have their disabilities verified by the Medical Social Expertise Commission. They are then assigned to one of three categories with higher benefits going to those with the most serious disabilities. Lack of oversight and transparency has led to some serious violations in the current system.

Disabled children are the most vulnerable group in Azerbaijan. According to different sources there are 49,000 children with disabilities in the country. In the last several years the government has been constructing new medical centers for disabled children including the Thalassemia centre. The government also has announced to construction of a Down Syndrome Center in Baku in 2010. Currently there are 111 children below 16 years old registered with Down Syndrome in Baku alone. Overall, there are only two boarding schools for mentally retarded children. The number of places at these institutions has remained stable over the last decade at 605. The number of children studying there fluctuates, but has not exceeded 380. Nevertheless, the social exclusion of such children is very high. In Azerbaijan the approach towards children with disabilities has been heavily influenced by the Soviet science of “defectology”.

Defectology is usually associated with the education of children with disabilities in special schools who are separated from other children. These schools do not encourage social integration, particularly when they take the form of large-scale residential institutions (UNICEF, 2009). Despite the existence of the State Program on Inclusive Education, issues of access to education are still a problem. According to UNICEF statistics, the number of children with disabilities involved in so called “home education” and “specialized education” is relatively high. According to a study conducted by UNICEF, “48.5% of interviewed parents of children with disabilities (reported that) children receive education at home, 15.8% of children are involved in inclusive classes in mainstream schools, around 5% in boarding schools, and general schools 24.1%” (UNICEF, 2009). In fact, such education prevents children from socialization that active

participation in community. These children often have difficulties integrating into society after reaching adulthood. In general, people living with disabilities in Azerbaijan have limited access to the health care system, education and public space. The cash and in kind benefits received are not enough to help them to integrate into society and the benefits do not provide proper support for this vulnerable group.

The government and society's attitude towards the problems of this group comprises the main barrier to better assisting disabled individuals in many post-socialist countries. Assistance to such groups is widely perceived as charity rather than relating to human rights issues. In addition, the government pays little attention to the creation of proper infrastructure for people with disabilities. It does not ensure their physical access to public services. Most of the public spaces or public transportation is not equipped for the needs of people living with disabilities.

However, the main problem is a non-transparent system of determining disability. According to statistical data, there were 432,000 people living with disabilities in Azerbaijan by the end of 2009. This is the highest number of disabled people per thousand persons in the Commonwealth of Independent States. Such figures make the public suspicious of the method used to determine disability. In Azerbaijan, the Medical Social Expert Commission determines the disability status of the people based on a medical examination. A person could be eligible for disability pension following an affirmative conclusion from the commission. Additionally, the number of people who are willing to be determined as disabled is increasing. Public officials say that around 50 applications are filed to such commissions on average, while the average load should be 20 applications per day because complicated cases demand much time. Meanwhile, allegations about the non-transparent system of disability determination have forced the Ministry of Social Protection to make structural alterations to the commissions.

There are only seven nursing and care houses for elderly and disabled persons in the entire country. These figures have remained stable for almost a decade. No new houses have been built for this group of people since independence. There are only 1,012 available places in these houses and the number of residents increases every year. By 2009, the number of residents in these institutions grew to 779 people (State Statistical Committee of the Republic of Azerbaijan, 2009b).

The low number of such houses and residents for the whole population of nine million is understandable. Such types of institutions are not popular among Azerbaijanis who prefer to take care for their parents at home rather than send them to institutions. Despite this, there is a large share of elderly people who are not being taken care of by their relatives and who are left without support other than pensions and social assistance. The elderly are often afraid of nursing institutions, prefer to not be institutionalized and many live in miserable conditions at home.

Children who live in care houses (usually called *Internat*) are another vulnerable group. Unfortunately, it is very difficult to estimate the number of institutionalized children. In Azerbaijan, child care houses are inhabited by orphans as well as children from poor

families. For example, these institutions in regions such as Gusar, Ganja, Gazakh and others provide free education and food for children and parents from surrounding rural areas. None of these children can be considered institutionalized since they stay in the care of their families. In March 2006, Azerbaijani President Ilham Aliyev approved the state program to move children from children's homes into families (de-institutionalization) and other alternative care situations. Some work has been done within this program from 2006-2015. About 45 institutions are planned to transform within the subsequent 3-5 years.

In addition, domestic violence against women still remains taboo in the society. Not much has been done to protect or assist women who become victims of violence or trafficking. International organizations have warned the government about the negative consequences of trafficking since it has become more frequent and better understood. The Ministry of Internal Affairs has thus opened free shelters for victims of trafficking. These shelters are government funded. However, since the shelters are government sponsored entities, many victims of trafficking prefer to not report to these institutions fearing repercussions or prostitution charges. Another type of institution established by a local NGO is called "Temiz Dunya" (Pure World) Assistance for Women Public Union. It is located in Baku city and there are ten beds available. Service is provided on a voluntary basis. The situation is the same for elderly women who prefer to not report domestic violence and to resolve their problems within the family.

2.5 Influence of International Organizations

Several international organizations are working with the Azerbaijani government to improve social protection and social inclusion. Despite bureaucratic obstacles, in most cases the government and ministries are in favor of such cooperation. They prefer to work with large international organizations for seeking expertise such as UNDP, ILO, World Bank and EBRD. At the same time and in contrast with many other countries in transition, the government often ignores small NGOs for program implementation or service delivery. In 2005, the Azerbaijani government and UNDP implemented a joint project called Capacity Building for the SSPFA. The project aimed to assist the SSPFA in modernizing its operations, enhancing managerial and data processing capacity, as well as in introducing a new pension system based on individual accounts. The project also helped the fund establish a new pension system based on individual accounts throughout the territory of Azerbaijan. The Management Information System, designed under the auspices of the project, was set up at the local branches of SSPFA.

In May 2008, the World Bank allocated €18.94 million (\$26.7 million) credits for a five year Social Protection Development Project that aims to improve delivery of labor market and social protection interventions through strengthened institutions and the better targeting of social safety net programs. The primary target group for the project includes job seekers, young labor market participants, youth, poor households, pensioners, and people living with disabilities who need disability certification. The project will also provide assistance to reform the pension system. The project aims to make improvements

in four key areas: labor market reform, capacity building and social safety net development, pension system development and project management (World Bank, 2008).

The European Union also actively participates in reforming the social protection system in Azerbaijan. One project is currently underway and another is going to be launched this year. The project intends to enhance effectiveness and efficiency of social protection policy through the improvement of analytical and forecasting capacities at the Ministry of Social Protection of Azerbaijan. The project is coordinated by the French Agency for Development and Coordination of International Relations (ADECRI). The second project stipulates support to the State Labor Inspectorate (SLI) in Occupational Health and Safety (OHS).

2.6 Key Challenges and Recommendations

Azerbaijan's social protection system is very important in the fight against poverty. Without social transfers, poverty may have grown as much as by 60% exacerbating the situation in the country. Poverty would increase by more than 11 percentage points, from 10.8% to 21.0%, if no social transfer program gets implemented (including TSA) (World Bank, 2009b). The poverty gap would more than double from 2.4% to 7.2% and the severity of poverty would more than quadruple from 0.7% to 3.8% (World Bank, 2009b).

However, there are a few major challenges to the social protection system in Azerbaijan. First, there is no clear separation between social insurance and social assistance programs due to the non-homogenous nature of poverty, especially in cases related to old-age. Second, most social benefits continue to be distributed based on categorical consideration rather than means-testing. Child benefits, disability pensions and benefits to refugees are good examples of this. The same disability pension could be given to persons with different incomes. An individual who has refugee status, but whose income is high enough could get exemption from education as well as health payments. However, a non-refugee family may struggle to cover education payments for their children.

In the case of child benefits, the major shortcoming of such programs is the requirement that an officially recorded salary provide the basis for identifying eligibility. Non-poor families could also receive this aid from the government since informal or unregistered employment is very common in Azerbaijan. Meanwhile, families whose income is slightly higher than €48.6 (55 AZN) are completely cut off from benefits. As a result, non-contributory social transfers reach 30.5% of the population with coverage for the poor at 47.2% compared to 24.7% for the non-poor (World Bank, 2009).

Third, major problems in the system of social protection and inclusion stem from the absence of clear objectives for the programs. Despite the fact that the government announced poverty reduction programs in 2000, its social protection programs were not tailored for the purposes of poverty reduction. In fact, the government thinly distributes resources to a larger share of the population, providing minimal benefits to as many as possible, thus overall failing to significantly change the status of poor people. Targeted social assistance is the classical example of such a policy.

According to the World Bank monitoring survey of 2008, half of all recipients come from the poorest 10% of the population indicating an excellent degree of targeting (World Bank, 2009a). As the Azerbaijan Living Conditions Report indicates:

TSA contributes to poverty reduction, but because of the small size of the program (0.36% of GDP in 2008—only 7.5% of total spending on social transfers covering only 12.4% of the poor), the impact is much smaller. However, the TSA performs better than pensions in poverty reduction relative to its budget. For each point of GDP spent on TSA, poverty incidence declines by 2.8 points compared to 2.0 points for pensions. (World Bank, 2009b)

There are several disadvantages and shortcomings of the TSA program. First, the current legislation and mechanism of TSA allocations do not allow effective redistribution of the aid and provides an open opportunity for abuse by public officials. Thus, the NGO Coalition on Monitoring of State Programs reveals that “corruption has deepened in this area and public officials, in return for determining the citizens eligible for TSA, asks beneficiaries to give half of the aid to the local public official” (Turan, 2010).

Second, it is difficult to explain the program’s almost triple growth by the number of recipients, while the government reports on a constantly decreasing level of poverty. Thus, the program should limit the number of recipients if poverty decreases.

Third, in defining social assistance, the program does not take into consideration the urban/rural dichotomy or the cost of the consumer basket which is not equivalent across regions. Thus, the impact of TSA in urban areas could be marginal compared to rural areas. Fourth, the average amount of aid is so marginal that it may not improve a recipient’s condition or affect their financial status.

Fifth, there are no clear criteria determining which strata of the population the program should target. Thus, large families with many children and dependents (pensioner-parents) may not be eligible for aid. Finally, eligibility determination poses a concern. A minimum threshold of €57.4 is needed in order to be eligible for aid. This could somewhat improve conditions for extremely poor people by marginally increasing their income and alleviating extreme poverty. In contrast, people whose income falls slightly above the threshold (e.g., all pensioners and working people who get a minimum salary) are not eligible for the program and are completely cut off from such assistance.

Despite the criticism, TSA was able to improve the situation via poverty reduction and to reach vulnerable segments of the population. TSA has eliminated and replaced three types of benefits to families with children that proved to be deficient. Additionally, it is expected that TSA will further replace a few other categorical benefits. However, the government should only do that if TSA reaches a good target performance. At the same time, the government should take steps to distribute social transfers (except TSA) more pro-poor. This specifically relates to unemployment benefits, some child benefits and in-kind benefits.

As mentioned in a few reports (World Bank, 2009b), Azerbaijan has to develop a new mechanism for targeting vulnerable segments of the population. It also has to deliver benefits that could decrease the poverty level in the country more effectively. This could include reconsidering some benefits to certain categories of people and rely more on income-tested benefits rather than universal ones. At the same time, the government should address the causes of poverty rather than its consequences.¹⁷

Another recommendation would be to link certain benefits given to the poor to certain requirements for recipients. Such a scheme is used in many developing countries and achieves tremendous results. For example, the government can give social allowance and assistance to the poorest if they meet certain conditions, such as their children attending school, vaccinating their children, or attending vocational school themselves to master new skills. However, in Azerbaijan such opportunities could be limited due to administrative costs as well as the sustainability of such programs. In addition, the liquidation of certain benefits is politically not a priority especially before the presidential and parliamentary elections.

Nevertheless, it should be mentioned that the government experiences a problem in the delivery of social services, not in financing. Most social services are delivered by the local representative office or ministry. In some Central and Eastern European countries, the governments have decentralized social service delivery and have involved the NGO sector or local governments. This could be useful for Azerbaijan and the government could contract out some services, such as disability care and elderly care to NGOs or to local municipalities depending on quality. The government could also give block grants to local governments that could then distribute aid or direct finances based on the needs of the region. For example, rural local governments would concentrate their financial resources more on social care, while urban municipalities would spend more finances on improving situation with unemployment. This would ease the pressure on the government, decentralize social services and make social service delivery more effective.

Appendix

Table 2.1 Azerbaijan: Social Protection Fund, 2003-2010, in millions of Euros (AZN)

	2003	2004	2005	2006	2007	2008	2009	2010
Total revenues	305.07 (378)	312.79 (418)	460.71 (503)	516.08 (592)	867.47 (1,080)	1123.5 (1,268.6)	1544.0 (1,775.5)	1528.0 (1,757.2)

¹⁷ The government rarely intervenes and writes off debts for certain categories of the population. In December of 2009, the government took a radical decision to forgive €284.37 million (327 million AZN) of the population's debts that were accumulated for gas consumption. The government substantiated this decision to remove or reduce the debt of the poorest section of the population. Although the decision was publicly welcomed, it did not solve the fundamental issue with the low income level of the majority of the population. This actually facilitated the current situation in which most of the population does not pay for gas, hoping that the government will write off the debts again.

Total payroll tax	179.97 (223)	208.78 (279)	289.43 (316)	368.76 (423)	642.57 (800)	812.2 (917.1)	111.4 (1,278)	1061.8 (1,221)
Payments from non-budgetary agencies	123.48 (153)	143.67 (192)	184.10 (201)	241.48 (277)	408.03 (508)	453.9 (512.6)	639.4 (735.3)	605.3 (696)
Transfer from state budget	124.29 (154)	102.52 (137)	170.36 (186)	145.58 (167)	224.10 (279)	310.0 (350)	429.6 (494)	464.1 (533.7)
Other	0.81 (1)	1.50 (2)	0.92 (1)	1.74 (2)	1.61 (2)	1.33 (1.5)	2.17 (2.5)	2.17 (2.5)
Total expenditures	299.42 (371)	302.31 (404)	453.38 (495)	493.42 (566)	807.23 (1,005)	1123.5 (1,268.6)	1544.0 (1,775.5)	1528.0 (1,757.2)
Pensions	168.67 (209)	178.10 (238)	217.07 (237)	447.21 (513)	744.58 (927)	1044.8 (1,179.8)	1443.6 (1,660)	1420.9 (1,633.9)
Child allowances	0.81 (1)	1.50 (2)	6.41 (7)	0.87 (1)	1.61 (2)	0.8 (0.9)	1.13 (1.3)	1.74 (2)
Maternity leave	1.61 (2)	2.24 (3)	4.58 (5)	5.23 (6)	8.03 (10)	8.15 (9.2)	13.80 (15.87)	16.26 (18.7)
Sanatorium vouchers	3.23 (4)	2.99 (4)	4.58 (5)	5.23 (6)	6.43 (8)	6.55 (7.4)	8.52 (9.8)	8.87 (10.2)
Sick leave	7.26 (9)	8.98 (12)	5.50 (6)	5.23 (6)	7.23 (9)	8.5 (9.6)	13.04 (15)	16.7 (19.2)
Funeral allowances	1.61 (2)	1.50 (2)	2.75 (3)	3.49 (4)	5.62 (7)	7.0 (7.9)	7.91 (9.1)	8.61 (9.9)
In % of GDP								
Total revenues	5.3	4.9	4.0	3.2	4.0	3.1	5.1	4.6
Total payroll tax	3.1	3.3	2.5	2.3	3.0	2.2	3.6	3.2
Payments from non-budgetary agencies	2.1	2.3	1.6	1.5	1.9	1.2	2.1	1.8
Transfer from State Budget	2.1	1.6	1.5	0.9	1.0	0.8	2.1	1.4
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditures	5.2	4.7	4.0	3.0	3.7	3.1	5.1	4.6
Pensions	2.9	2.8	1.9	2.7	3.4	2.9	4.8	4.3
Child allowances	0.0	0.0	0.1	0.0	0.0	0.0	0	0
Maternity leave	0.0	0.0	0.0	0.0	0.0	0	0	0

Sanatorium vouchers	0.1	0.1	0.0	0.0	0.0	0	0	0
Sick leave	0.1	0.1	0.0	0.0	0.0	0	0	0
Funeral allowances	0.0	0.0	0.0	0.0	0.0	0	0	0

Source ** State Social Protection Fund. *Statistics*,

<http://www.sspf.gov.az/view.php?lang=en&menu=103&id=606>

The Euro-Manat exchange rate of 2009 was used to convert the numbers for 2010.

Table 2.2 Families Receiving Targeted Social Assistance

	2007	2008	2009
Number of families receiving targeted public social aid	48,705	78,092	163,409
Number of family members receiving targeted public social aid	218,673	364,059	749,965
Respectively:			
Women	83,529	168,007	387,609
Children	92,291	165,064	357,620
Amount of monthly targeted public social aid per person, (AZN)	€6.71 (8.36)	€15.39 (17.38)	€19.13 (22.0)

Source: The State Statistical Committee of Azerbaijan Republic, Health and Social Security,

<http://www.azstat.org/statinfo/healthcare/en/006.shtml>.

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Chapter 3: Poverty and Social Exclusion: Dimensions, Characteristics, Trends and State Programs

3.1 Researching Poverty and Social Exclusion in Historical Perspective

Although the first household budget survey in the country during the Soviet era was conducted in the early 1950s, the number of studies and surveys on poverty in Azerbaijan was limited during that period. Moreover, most of these studies were not made public for political reasons. The imposition of communist ideology implied that poverty would not exist with the presence of stable and omnipresent jobs, an adequate pension system, free education and health, and subsidized consumption. Nevertheless, “subsistence levels” were officially introduced and “designed to capture [the] ‘under-provision’ of households (a proxy word for ‘poverty’) as compared to [a] desired consumption pattern” (Ewa Ruminska-Zimny, 1997).

Historically, Azerbaijan had a high poverty rate in comparison to most other socialist countries and republics. In 1990, just before the breakup of the Soviet Union, around 35% of the population in the country lived below the subsistence level (SSC, 2004). As a result, Azerbaijan entered its period of independence with a substantial social burden that was exacerbated further by the armed conflict with neighboring Armenia.

One of the early efforts to measure poverty in post-Soviet Azerbaijan was the Azerbaijan Survey of Living Conditions (ASLC) that had a representative sample size of 2,016 households and was conducted in late 1995. The results of that survey showed that over 60% of the households lived below the “food-only poverty line”. This food-only poverty line was based upon the cost of a minimum maintenance food basket developed by the Ministry of Labor and Social Protection. The surveyed households were classified as “poor” if their actual expenditures for food (adjusted for the household size) were below the cost of that food basket. The major limitation of this poverty line was that it was “not taking into account the effects of non-food consumption on total welfare” (World Bank, 1997).

In 2001, the SSC introduced a new methodology in conducting its Household Budget Survey (HBS). This revised methodology was developed with technical assistance from experts at the World Bank and other international organization. It is more in line with international standards. Since the beginning, the new HBS—a quarterly survey—became one of the major sources of data for estimating monetary poverty indicators in the country.

A new absolute poverty line was developed that was based on the cost of a minimum consumption basket (including non-food consumption) with the advent of new HBS methodology. The consumption of non-food products and services constituted 30% of the total costs of the basket. Currently, the cost of the minimum consumption basket is separately estimated for three different population groups: the working age population, pensioners and children. The average cost of the basket is then calculated using the weight of these population categories in the overall population. Along with the absolute

poverty line, a relative poverty line set at 70% of the median consumption was defined as an estimate of the extreme poverty line in 2002 (IMF, 2004).¹⁸

Using the improved HBS 2001 dataset and revised poverty thresholds, research showed that the poverty incidence in urban areas outside of Baku was higher than that in rural areas, as well as inside Baku (World Bank, 2003). This finding is also confirmed by the results of the recent HBS and of the Household Survey on Remittances and Poverty (HSRP) (CLED, 2008) which was conducted in 2007 for the Asian Development Bank (ADB). The latter survey also shows that the effect of remittances on the poverty level in the country is significant. According to estimates based on the survey data, remittances reduce poverty incidence by 4.5% when the poverty line is taken as 4USD per day per capita. Remittances are also seen to decrease the extreme poverty (2 USD per day per capita) incidence by 2.5%.

There are also some studies and surveys on the effectiveness of the social protection system in reducing poverty in the country. A good example is the study, “Social Protection and Poverty in Azerbaijan, a Low-income Country in Transition: Implications of a Household Survey” by N. Habibov and L. Fan. By using HBS 2004 data and by estimating the impact of then-existing social assistance programs on poverty, inequality and the coverage error of these programs, the authors of that study came to the conclusion that although these social assistance programs play an important role in poverty alleviation, they still were inadequate in its eradication for several reasons. “First, a significant proportion of the poor population was not covered by the social protection system. Second, the poor typically received a smaller share of total benefits than the non-poor. Finally, most social transfers were too small to lift households out of poverty” (N. Habibov, L.Fan, 2007).

Since independence, numerous regional and local data collection initiatives, studies and surveys have been launched and conducted to describe the non-monetary dimensions of poverty in Azerbaijan. These include the UNICEF-driven TransMONEE project, the Multiple Indicator Cluster Survey (MICS), Reproductive Health Survey (RHS) and Demographic and Health Survey (DHS). An interesting study on non-monetary poverty in Azerbaijan was done by E. Afandi and N. Habibov who used the 2006 CRRC Data Initiative Survey (later renamed the Caucasus Barometer) to examine subjective well-being in South Caucasus countries. According to the study, around 49% of the population in Azerbaijan rated the economic condition of their households as “very poor” and “poor”. The authors also found that having a university education and participating in political discussions were positively associated with subjective wellbeing (E. Afandi, N.Habibov, 2009).

To conclude, almost all studies on poverty and social exclusion after independence touch upon IDP and refugee issues. In spite of the significant efforts to better the situation for IDPs and refugees, they are still identified as two of the most vulnerable groups in the country. A report by the Internal Displacement Monitoring Center (IDMC) in July 2008

¹⁸ Initially, the extreme poverty line was set at 60% of the median and the extreme poverty rates for 2001 were estimated with this threshold.

indicates that IDPs have poorer living conditions than the rest of the population in general. They have fewer employment opportunities and continue to be dependent on government assistance (IDMC, 2008).

3.2 Poverty and Exclusion in Azerbaijan

3.2.1 Official Poverty Incidence and Regional Disparities

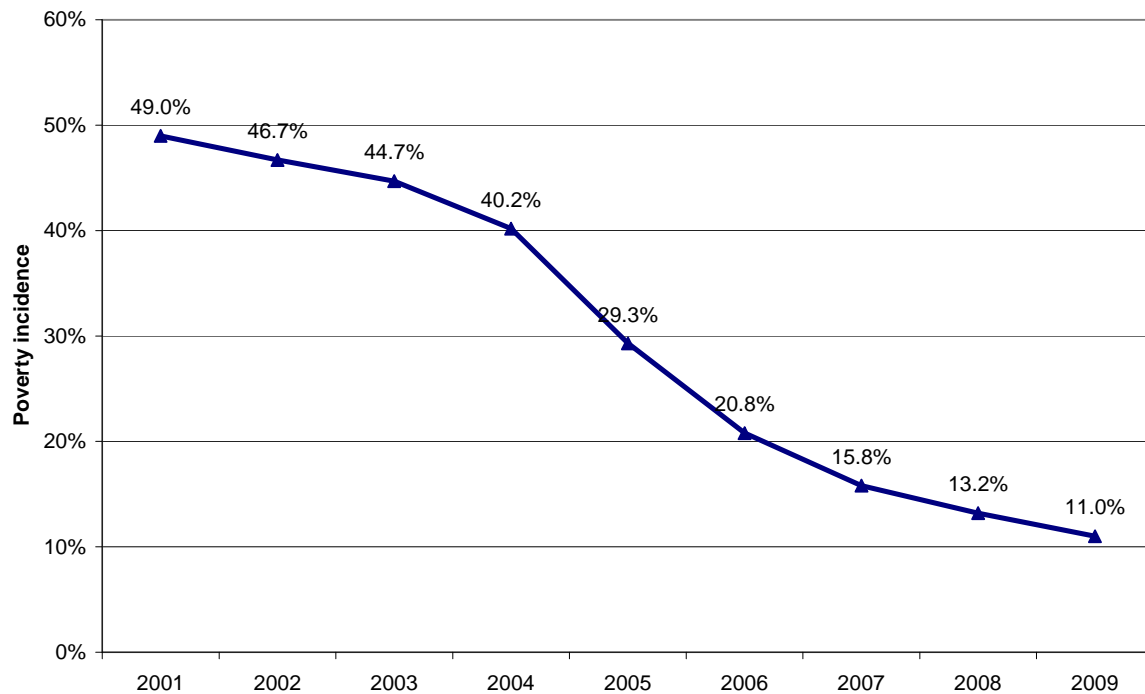
The average minimum subsistence level (MSL) for 2010 was set at €71.72 (87 manats) per capita per month by the Law on “The Minimum Subsistence Level in Azerbaijan for 2010” signed by the president Ilham Aliyev on November 26, 2009.¹⁹ That number was €61.99 (70 manats) for 2008 and the official poverty rate given by the Ministry of Economic Development in 2008 was €69.61 (78.6 manats) per capita per month. The poverty rate for that year was estimated to be 13.2%, well over 36 percentage points less than that in 2001.²⁰ The official (absolute) poverty rate fell by 2 percentage points in 2009 and became 11%.²¹

¹⁹ According to the “The Law on the Minimum Subsistence Level” (MSL), No.768-IIQ, signed by the President of the Azerbaijan Republic on October 5, 2004, the MSL is defined as “the total of a monthly cost of the consumption basket that is needed to maintain a person at a minimum level and obligatory payments”. It is separately estimated for three different population groups: the working age population, pensioners and children. The average is calculated using the weight of these population categories in the overall population. MSL is used as an official poverty line. Therefore, the official poverty rates measure absolute poverty.

²⁰ Source: Presidential Decree on “State Program for Social and Economic Development of the Regions in 2009-2013” signed on April 14, 2009. Source: “Azerbaijan Republic Poverty Assessment,” Report No. 24890-AZ, WB, June 2003.

²¹ Source: First year progress report on the implementation of the “State Program for Social and Economic Development of the Regions in 2009-2013,” the Ministry of Economic Development, 2010.

Chart 3.1: Official Absolute Poverty Rates in Azerbaijan, 2001-2009



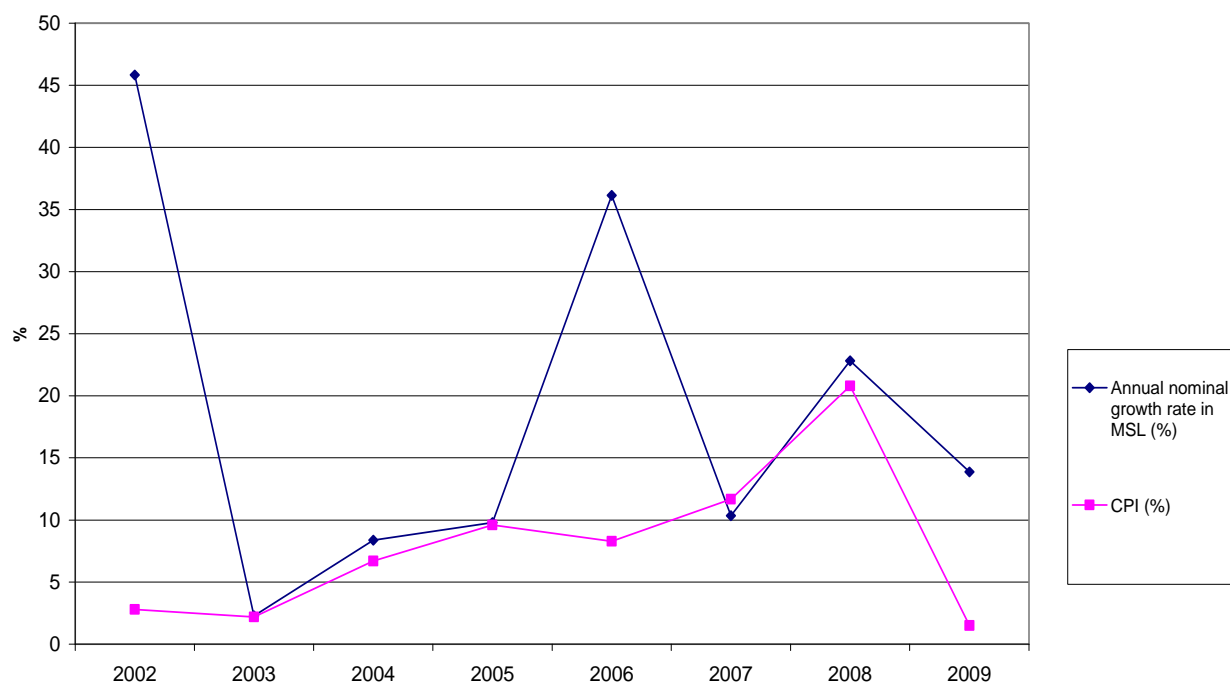
Sources: First year progress report on the implementation of the "State Program for Social and Economic Development of the Regions in 2009-2013", the Ministry of Economic Development, 2010; Statistical Yearbook of Azerbaijan 2008, SSC

As one can see from the chart below, in general, the official poverty incidence in the country fell steadily for the last 10 years. This happened in spite of the fact that the annual growth rate of the poverty threshold was higher than the official inflation rates (CPI) since 2001.²² One of the main reasons for this downward trend is high paced economic growth. Calculations based on the Central Bank of the Azerbaijan Republic shows that the annual real GDP growth rate averaged 16% over 2001-2009. The real GDP growth rates were extraordinarily high in 2005, 2006 and 2007 (26.4%, 34.5% and 25%, respectively).²³ These were the peak years of the oil and construction boom when the decline in the official poverty rates was the steepest.

²² An exception was in 2007 when the annual nominal growth rate in MSL (10.3%) was slightly lower than the CPI (11.7%) (Chart 3.2).

²³ Retrieved from <http://cbar.az/assets/85/1.1.pdf>.

Chart 3.2: Annual Nominal Growth Rate in the Minimum Subsistence Level and Inflation



Sources: The growth rates are calculated based on the information retrieved from the Statistical Yearbook of Azerbaijan 2009, SSC, and The Law on the Minimum Subsistence Level in Azerbaijan for 2009.

The economic growth of the last decade was also accompanied by growth in real wages; the main source of poverty reduction among the working poor. The annual growth rate of the average monthly real wages has been well over 14% since 2003 on average. The government of Azerbaijan has also gradually increased the minimum wage since 2001. The minimum monthly wage rate went up from less than 23% of the minimum subsistence level in 2001 to over 95% in 2008.²⁴ Narrowing the gap between the minimum wage and the official poverty line has probably contributed to a substantial decrease in official poverty incidence in the country during the last decade.

During the earlier years of the current decade, the average pension was substantially below the official poverty line. Moreover, the minimum pension was only 42% of the minimum subsistence level in 2001, which was clearly not enough to sustain the pensioners. The government of Azerbaijan gradually increased the minimum pension and brought it closer to the minimum subsistence level over the last several years. The minimum pension reached 95% of the minimum subsistence level in 2008. This government policy played a significant role in reducing official poverty by pulling many households with pensioners out of “the officially poor” status and by mitigating the intensity of the poverty (“Statistical Yearbook of Azerbaijan 2009”, SSC).

²⁴ Estimates are based on data retrieved from http://www.azstat.org/statinfo/labour/en/004_1.shtml, in the “Wages and Salaries, Expenditures Spent for Labour Force” subsection of the “Labour” section on the SSC website.

The official poverty incidence is much higher in rural areas than in urban areas.²⁵ The corresponding rates were 10.9% and 15.8% in 2008 (HBS 2008 report). The Living Standards Measurement Study (LSMS) 2008 data suggests that poverty incidence in rural areas are even higher than that in non-Baku urban areas, which was not the case about nine years ago (World Bank, 2010).

Official poverty rates are not available for the eleven economic regions in Azerbaijan. However, the estimates based on LSMS 2008 data show that absolute poverty rates are the highest in Daghligh Shirvan, Sheki-Zaqatala, Aran, Guba-Khachmaz and Lankaran-Astara economic regions (World Bank, 2010). It should be noted that Daghligh Shirvan and Aran regions are ethnically homogeneous and mostly populated by Azerbaijani Turks, whereas Sheki-Zagatala and Guba-Khachmaz regions host large communities of different ethnicities such as Lezgins, Avars, Tats and Georgians. There is also a large Talysh community in Lankaran-Astara region. Unfortunately, the regional poverty rates are too aggregated for examining poverty and social exclusion among different ethnic minorities. It is impossible to tell if the ethnic minorities are more vulnerable to poverty than the Azerbaijani Turks living in the same region. A study on the social inclusion of socially vulnerable communities in Azerbaijan could be very useful in shaping the government's policies toward minorities. community

Updated official poverty rates for one of the most vulnerable groups in the country (IDPs and refugees) are not publicly available. The most recent absolute poverty rates for IDPs are provided in the "Azerbaijan Living Condition Assessment Report" by the World Bank. However, these rates are not directly comparable with official poverty rates. Nevertheless, this report shows that the poverty incidence is quite high among IDPs living in the non-Baku urban areas (World Bank, 2010).

3.2.2. Income and Consumption Inequality

The Gini index was based on the consumption expenditure data from the LSMS in 2008 and was equal to 0.31. This is 0.15 points less than the index estimate for 2001. Consumption inequality was higher in cities than in towns and rural areas. The Gini index for cities, towns and rural areas was equal to 0.328, 0.287 and 0.271, respectively (World Bank, 2010). According to the results of the 2007 HSRP conducted earlier than LSMS 2008, the income-based Gini index was 0.32 for 2006, while the income inequality ratio was 4.9—this is the ratio of the total income of the top income quintile to the total income of the lowest income quintile. It should be noted that annual income per adult equivalent household member was used when calculating this ratio (CLEd, 2008).²⁶ HBS data yields much lower estimates of income and consumption inequality measures. In the

²⁵ Urban-rural status of any settlement in the country is determined in an administrative manner, usually by the Milli Medjlis (the Parliament of Azerbaijan). As a general rule, any settlement with more than half of its working population being active in non-agricultural sector and with basic urban infrastructure is considered to be an urban area.

²⁶ The number of adult equivalent household members was calculated by adding the number of household members who are above 16 years old and 0.67 times the number of children below 16 years old.

first year of the survey, the Gini index was estimated to be 0.365, while the inequality ratio was well over 6 (World Bank, 2003). However, estimates of the Gini coefficient based on HBS data seemed to be less reliable and were unusually low by being around 16-18% in all consecutive years.²⁷

3.3 Non-monetary Dimensions of Poverty

Some non-monetary indicators of poverty show that it is still a serious problem in the country, despite a significant decline in official poverty rates. A substantial portion of the population has limited or no access to basic utility services such as water (including hot water), gas supply and telephone services (HBS 2008 report). Azerbaijan's child and infant mortality rates are one of the highest among Eastern European and CIS countries. Healthy life expectancy at birth is below the regional average and also the average for the lower middle income countries to which Azerbaijan belongs (World Health Statistics 2010. Part II, Global Health Indicators, WHO). Moreover, the coverage and quality of education services has been considerably low in the country for the last decade. Although primary and secondary education enjoys quite high enrollment rates, the quality of these education levels is undermined by corruption. In comparison to the other post-socialist countries and to the lower middle income countries, Azerbaijan experiences very low enrollment rates in tertiary and pre-primary education.

There are certain segments of the population that are more susceptible to poverty and exclusion. The analysis in this section shows that persons 65 years old and over, especially those who live alone or single parent households with 1 or more dependent children are the most vulnerable groups. These households are more at risk of being excluded or materially deprived if the education of the household head is low and if they live outside of the capital (especially in rural area). The number of children also positively correlated with vulnerability to poverty. Households with 3 or more children are more likely to be poor relative to households with fewer children. IDPs and refugees are another group exposed to poverty and social exclusion.

A. Living Conditions and Material Deprivation

Analysis of HBS data over the last several years indicates that there is some improvement in the living conditions of the households in Azerbaijan. Table 3.1 shows that average living area per household member has been increasing since 2001. This is more so in case of rural households than the urban ones. The coverage of the basic utility services illustrated in Table 3.1 has a general tendency of going up. This growth seems to be faster in rural than in urban areas. Nevertheless, rural households still have much more limited access to these services than their urban counterparts.

²⁷ L. Ersado provides a detailed explanation of why the HBS yields unreliable estimates of the inequality measures in "Azerbaijan's Household Survey Data: Explaining Why Inequality is So Low", World Bank Policy Research Working Paper 4009.

Table 3.1: Living area and access to some basic utility services by urban-rural areas, 2001-2009									
	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>Living area per household member (square meters)</i>									
urban	10.3	10.9	11.8	11.7	11.7	11.4	11.4	11.5	11.4
rural	11.9	12.2	13.4	13.0	13.5	13.8	14.0	14.2	14.0
<i>Central heating</i>									
urban	12.1	29.9	29.3	28.0	26.7	28.5	27.4	24.3	22.6
rural	0.0	0.8	2.7	2.2	2.9	2.7	0.9	0.2	1.4
<i>Telephone (landline)</i>									
urban	53.7	66.0	73.2	76.3	82.8	82.7	84.4	86.4	86.7
rural	18.2	17.8	23.2	25.0	30.7	31.2	33.6	38.2	42.7
<i>Mobile telephone</i>									
urban	12	22	30.8	39.8	55.3	68.8	76.2	85.1	88.1
rural	4	10.3	15.4	23.5	37.9	49.4	64.3	77.9	82.6
<i>Internet</i>									
urban	1	0.1	0.3	1	1.2	2.4	3.2	3.3	3.8
rural	--	0	0	0	0	0.2	0.2	0.3	0.2
<i>Bathroom, shower</i>									
urban	75.4	79.8	84.8	89.7	91.6	87.3	87.4	86	87.9
rural	16.7	27.7	35.4	32.1	41.7	42.8	42.3	42.0	39.8
<i>Gas supply</i>									
urban	72.6	91.9	92.9	93.5	92.1	87.3	87.1	87.9	90.7
rural	6.8	7.3	9.7	10.6	13.9	20.6	27.6	35.5	42.0
<i>Hot water</i>									
urban	22.3	61.0	73.4	79.4	79.6	74.2	71.9	75.4	81.4
rural	2.0	9.8	14.2	16.9	23.6	27.6	25.7	26.6	22.6
<i>Water pipeline</i>									
urban	82.7	87.0	91.7	96.0	97.4	95.2	95.6	95.5	96.1
rural	17.1	29.8	39.2	43.3	47.6	45.8	43.7	46.8	46.6
Source: "Main Results of Household Budget Survey in Azerbaijan" reports for years 2001-2009, SSC									

Box 1: IDPs in Azerbaijan

The Nagorno-Karabakh conflict between Armenia and Azerbaijan has resulted in an influx of around a million refugees to Azerbaijan. Around 200,000 of them were deported from Armenia: 45,000 from Nagorno-Karabakh proper and more than 600,000 from the seven regions adjacent to the contested territory. However, the number of IDPs differ according to the source and range from 590,000 (IDMC, 2009) to around 750,000.

Currently, the majority of IDPs have an urban profile. More than 40% of them are settled in Baku and Sumgait, while large populations also inhabit Barda, Mingechevir, Ganja, Agjabadi (IDMC, 2008: 2)—all big urban centers. The rest of IDPs live primarily in the countryside, mainly in chaotically developed refugee camps made of makeshift tents or carriage/containers. Schools, hospitals and other public buildings are similarly constructed.

IDPs in urban settings live in clusters and have no central heating, sewage or other basic amenities. They primarily live in former dormitories, half-built buildings, abandoned plants and factories and other facilities. However, since 2010 the government has resettled around 100,000 IDPs to newly built houses (Wechlin, 2010). Remaining IDPs still struggle in squalid communal conditions.

To ease the acute social situation of IDPs, the government has provided them with a range of benefits, including free usage of communal services (electricity, gas and water), free medical treatment and free higher education in any type of university among other benefits. However, these benefits do not drastically affect the social welfare of IDPs.

IDPs garner low social standing in Azerbaijan for several reasons. First, social capital and the exchange of favors is a primary guarantor of welfare in Azerbaijan. Thus, being a member of an uprooted segment of the population such as an IDP is in an unfavorable position to gain stable sources of income. They lack such social networks. This may be one of the reasons why the majority of IDPs of working age have undeclared employment.

Second, the strategic calculations of the Azerbaijani government oppose full reintegration of IDPs into their host communities throughout the country in the hope that IDPs can be resettled into the regions from which they come, now occupied by Armenia. For example, a great number of the newly constructed buildings and settlements for IDPs are located in the immediate vicinity of the ceasefire line (EU, UNCHR, 2009: 8) between Azerbaijani and Armenian troops. This is supposed to signal the imminent return to the lands across the current frontline for IDPs.

The demographic profile of IDPs also puts certain strains on their welfare. Around 40% of IDPs are children and 10% elderly people (EU, UNCHR, 2009: 9). With high birth rates and low life expectancy, the pressure on able-bodied IDPs will increase in the foreseeable future. Transfers of remittances from relatives and government support are the main sources of living for IDPs (IDMC, 2009). Refugees in rural areas can engage in agriculture as an important source of food supply.

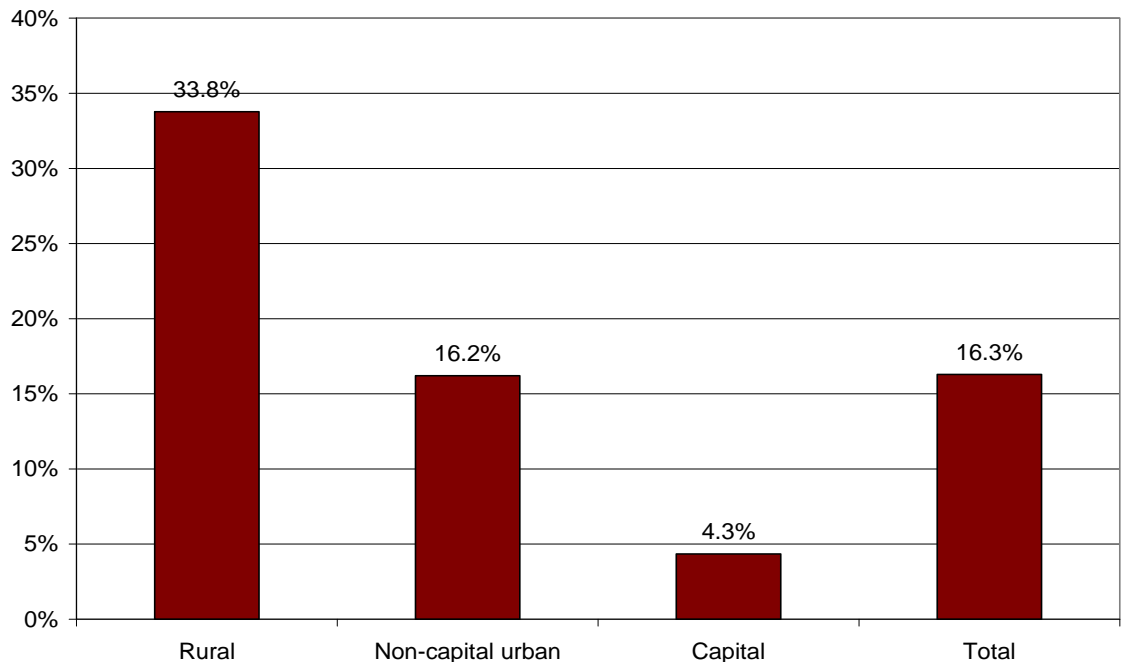
There are currently no state programs to provide IDPs with vocational trainings, business credits or skills necessary to empower themselves. This is especially true in the case of rural IDPs, whose remote settlements leave virtually no chances for job opportunities or engagement into more productive agricultural work.

As a result, the grim situation of IDPs affects their health, outlook, life expectancy, education level, cultural habits and human development in general.

The problem is not only the non-availability of utilities, but also the quality of the basic utility services mentioned above. Households that have access to utilities such as electricity, water supply and gas are also vulnerable to shortages. LSMS 2008 data indicates that this is especially the case for the poorest households. About half of the poorest 20% of the population have access to the water supply less than 6 hours per day, whereas less than 40% of the richest 20% of the population experiences the same service limitation. A similar pattern is observed in the availability of heating services as well (World Bank, 2010).

There are also disparities in the ownership of durable goods including color TVs, washing machines, refrigerators, cars, cell phones or landline telephones. According to our estimates based on CRRC's 2007 Data Initiative, about 34% of rural households lack at least three of the above-mentioned durable goods, whereas the corresponding percentages in non-capital urban areas and in the capital are 16.2% and 4.3%, respectively.²⁸

Chart 3.3: Percentage of Households Lacking at Least Three of the Following Durable Items: 1) washing machine, 2) color TV, 3) telephone (mobile and landline, 4) car, 5) refrigerator—by urban-rural areas



Source: Authors' estimates based on CRRC DI 2007 survey

²⁸ Preliminary unweighted version of CRRC DI 2007 dataset was used in the calculations.

Moreover, certain types of households seem to be more exposed to material deprivation.²⁹ These are mostly single people 65 years old and over, single parents with one or more dependent children³⁰ and two-adult households where at least one member is 65 years old and over. The risk of being materially deprived is the highest among individuals aged 65 and over years old who are living alone. About 60% of these people are faced with material deprivation. The runners-up are households of single parents with one or more dependent children. More than 32% of these households are materially deprived.³¹ For the two-adult households where at least one person aged 65 years and over this percentage was 24.6%.

The households of two or more adults with dependent children are less likely to be materially deprived than the three types of households mentioned in the previous paragraph. However, the risk of material deprivation generally increases by the number of dependent children in the family (Chart 3.4). Moreover, these households constituted the majority (about 60%) of an estimated 335,000 materially deprived households in 2007.³²

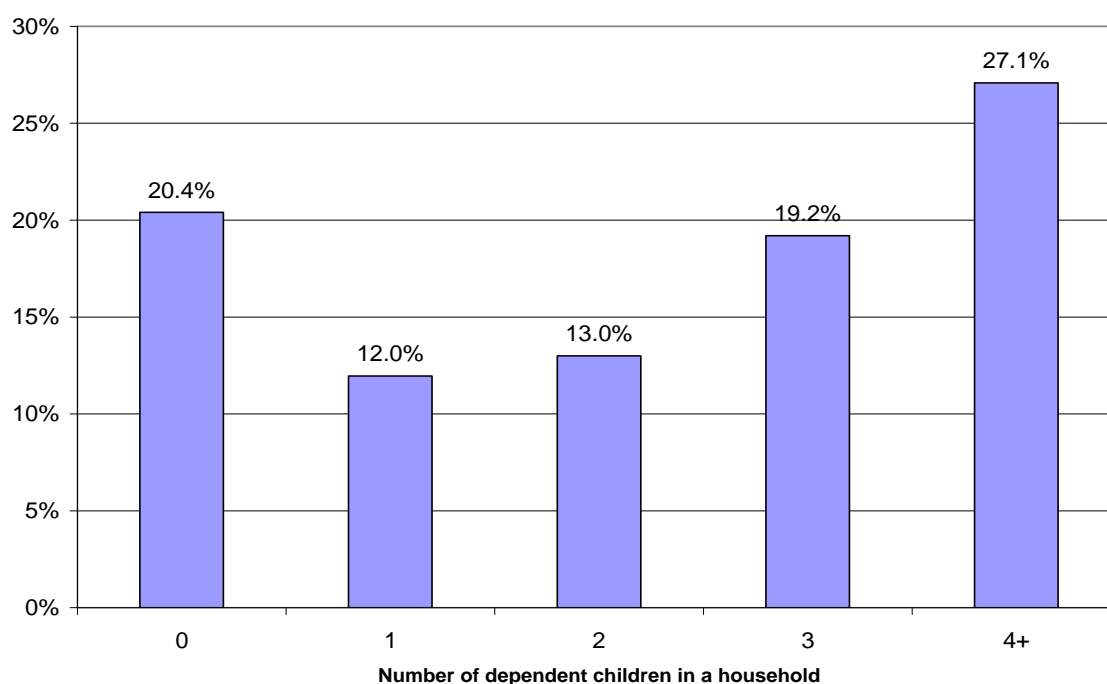
²⁹ The definition of “material deprivation” used is the lack of at least 3 items among the following 5 durable goods: 1) a washing machine; 2) a color TV; 3) a telephone (mobile and landline); 4) a personal car; 5) a refrigerator.

³⁰ Dependent children are all individuals who are 0-17 years old, as well as individuals 18-24 years old who are inactive and living with at least one parent.

³¹ The majority in this category (over 80%) are widowed, divorced, or separated parents. A small fraction of these households are married adults whose spouse does not live with them. This group mostly consists of families where one of the spouses is in migration. If this group is excluded from the “single parent with one or more dependent” category, then the material deprivation rate will go up to 38% for the single parent households.

³² For the calculation of the number of materially deprived households see Table A3.3 in Appendix A3.1.

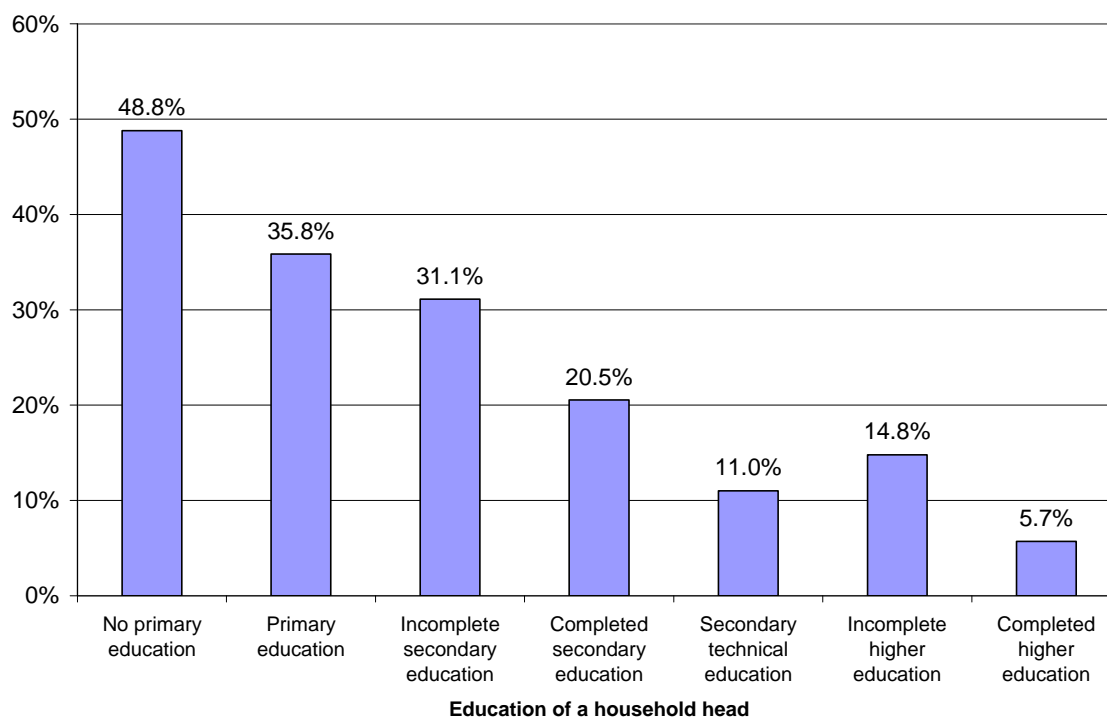
Chart 3.4: Percentage of Households Lacking at Least Three of the Following Durable Items: 1) washing machine, 2) color TV, 3) telephone (mobile and landline, 4) car, 5) refrigerator— by number of dependent children



Source: Authors' estimates based on CRRC DI 2007 survey

Material deprivation also seems to be strongly related with the level of education of the household head. The higher the level of education of the household head, the lower the risk of that household being materially deprived (Chart 3.5). Households headed by a person with complete higher education are almost 9 times less likely to be materially deprived than the ones headed by a person with no primary education. The risk of material deprivation is above the national average (16.3%) if a household head has complete secondary or lower education level. More than half of the materially deprived households are headed by a person with complete secondary education.

Chart 3.5: Percentage of Households Lacking at Least Three of the Following Durable Items: 1) washing machine, 2) colour TV, 3) telephone (mobile and landline, 4) car, 5) refrigerator— by education of household head



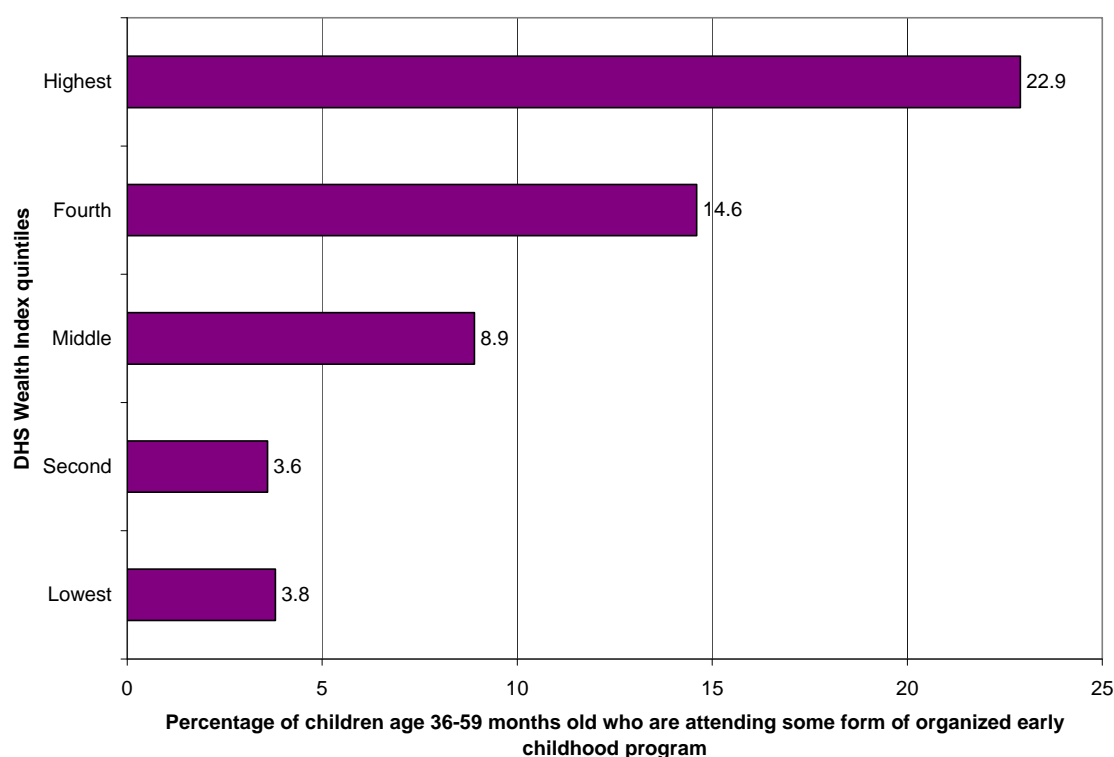
Source: Authors' estimates based on CRRC DI 2007 survey

B. Education

People at the lower end of the income and wealth distribution in Azerbaijan have problems accessing basic services including education and health. Net enrollment and net attendance rates are in general lower for the poorest 20% of the population than those for the richest 20% almost at all education levels. This pattern is especially noticeable for the early childhood education (ECE) attendance rates and for the net enrollment rates in higher education. Chart 3.6 shows that the net attendance rates in early childhood education are extremely low for children from the bottom two wealth quintiles. They are 6 times less likely to attend ECE than their peers from the highest wealth quintile.³³

³³ The DHS Wealth Index was used to measure/rank the households/individuals by their wealth. This index “is constructed by assigning a weight or factor score to each household asset through principal components analysis. These scores are summed by household, and individuals are ranked according to the total score of the household in which they reside.” The sample is then divided into 5 equal groups – quintiles, and there is approximately 20% of the population in each quintile (AzDHS, 2006). Household assets used in constructing the wealth index are usually assets such as radio, television, telephone, refrigerator, electricity, water supply, sanitation facilities, vehicles and agricultural land. For more details about the DHS Wealth Index see, “DHS Comparative Reports No.6: DHS Wealth Index” by Shea Oscar Rutstein and Kiersten Johnson, 2004.

Chart 3.6: Early Childhood Education on Attendance by Wealth Quintiles in Azerbaijan

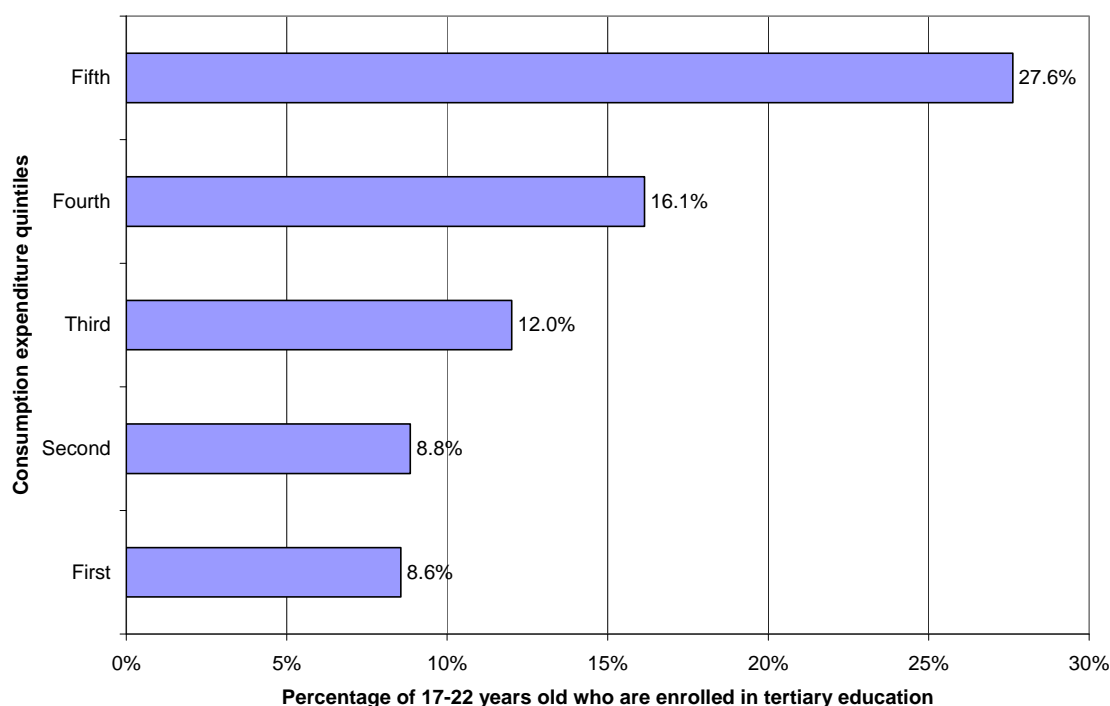


DHS data also suggests that geographic location and mothers' education are strongly related to children's attendance rates in ECE. Children living in rural areas are less likely to attend ECE than their peers living in urban areas. The attendance rate in rural areas was 2.0% in rural areas as opposed to 17.3% in urban areas. Moreover, the rates are above the national average, 9.9%, in Baku, Absheron, Sheki-Zaqatala and Ganja-Gazakh economic regions, and well below 5% in all other regions. The urban-rural and regional disparities at large could be explained by the availability of the service.

Children of mothers with a higher level of education are in general more likely to attend some form of organized early childhood program. Only 4% of children whose mothers have basic or lower education attend ECE, whereas the percentage is more than 4 times higher if the mother has specialized secondary or university education (AzDHS 2006).

Poor people also have relatively limited access to tertiary education. Chart 3.7 shows that the net enrollment rates in tertiary education for the bottom two consumption quintiles is much lower than that for the top quintile. It is worth mentioning that tertiary education is not compulsory in the country and most students do not pursue it after completing compulsory education due to lack of funding. According to the LSMS 2008, 52% of respondents indicated this as the main reason for not continuing education.

Chart 3.7: Net Enrolment Rates in Tertiary Education by Consumption Expenditure Quintiles (consumption expenditures are equivalent on the basis of the modified OECD scale)



SOURCE: 2009 HBS Data, SSC

It should also be mentioned that females are slightly underrepresented in higher education. According to the TransMONEE 2010 database, female students made up about 45% of the total number of students enrolled in tertiary education in the 2008-2009 academic year. This number is way below than those for the other South Caucasus countries (54%, in Armenia and 55% in Georgia, TransMONEE, 2010).

There is also an urban-rural disparity in access to university level education. The percent of high school graduates who were admitted to a university program was slightly less than 20% in 2009. This percentage was higher than 20% for only the following large cities and districts: Baku, Sumgait, Nakhchivan, Ganja, Shirvan, Mingechevir and Absheron district. The exceptions were refugee schools in occupied Gubadli and Zengilan districts, but most of those schools are located in Sumgait and Baku. In all other districts of the country, the share of high school graduates admitted to university level education was well below 20%, and was as low as 4% in rural districts like Agebedi and Agsu (SSAC, 2009). This disparity can be explained by two major factors: 1) the affordability of university education for people from rural areas (relatively less high school graduates from the rural areas apply to universities) and 2) the quality of secondary school education is, in general, lower in rural areas than in urban areas (relatively fewer applicants from rural areas have good test results and are admitted).

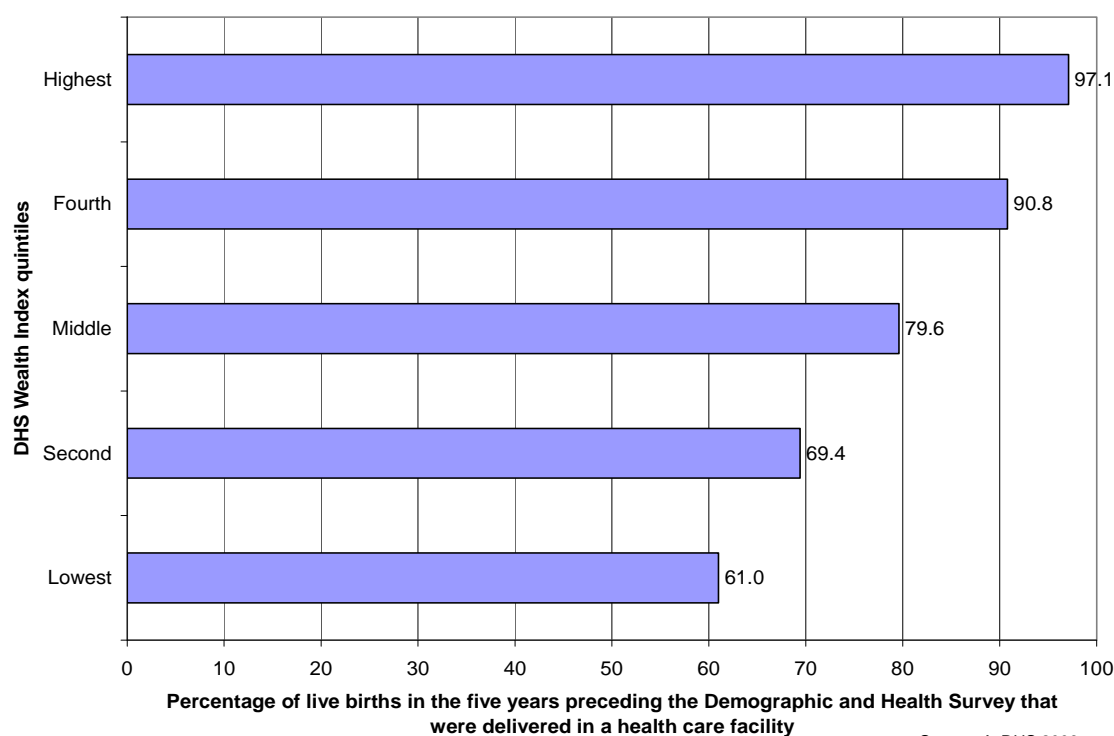
C. Health and Malnutrition

One of the major problems in accessing health care services seems to be shortage of money for treatment. According to CRRC's 2008 Data Initiative Azerbaijan, not having money to pay for treatment was the most frequently reported reason for not getting medical treatment or consultation when needed.³⁴ About 7.7% of respondents stated that they had an illness, accident or chronic health problem over the 12 months preceding the survey, but did not visit a health facility or consulted with a medical professional. Fifty-two percent of these respondents (or 4% of all respondents) said that the most important reason for not getting medical help was lack of money to pay for services. Surprisingly, in the capital, out of those who needed medical help but did not get it, 55.9% mentioned the lack of money as the main reason for not seeking medical help, whereas this percent in non-capital urban areas and in rural areas was 45.5% and 52.7%, respectively. A possible explanation to this could be higher informal payments in Baku than in other regions of the country. In general, out-of-pocket health expenditures constitute about 73% of total health expenditures in Azerbaijan in spite of the fact that most of the medical services are officially free of charge (World Bank, 2010).

Informal payments in the health care system of the country seem to hurt mostly the underprivileged. For example, the percentage of live birth deliveries in a health facility is much lower in the bottom wealth quintiles (61%) than in the highest wealth quintile (97.1%) (Chart 3.8). Similar pattern is observed in the percentage of pregnant women receiving prenatal care and post-natal check-ups (AzDHS 2006). Thus, limited access to the health care services makes mothers and their babies from the lower economic strata of the society more exposed to health hazards.

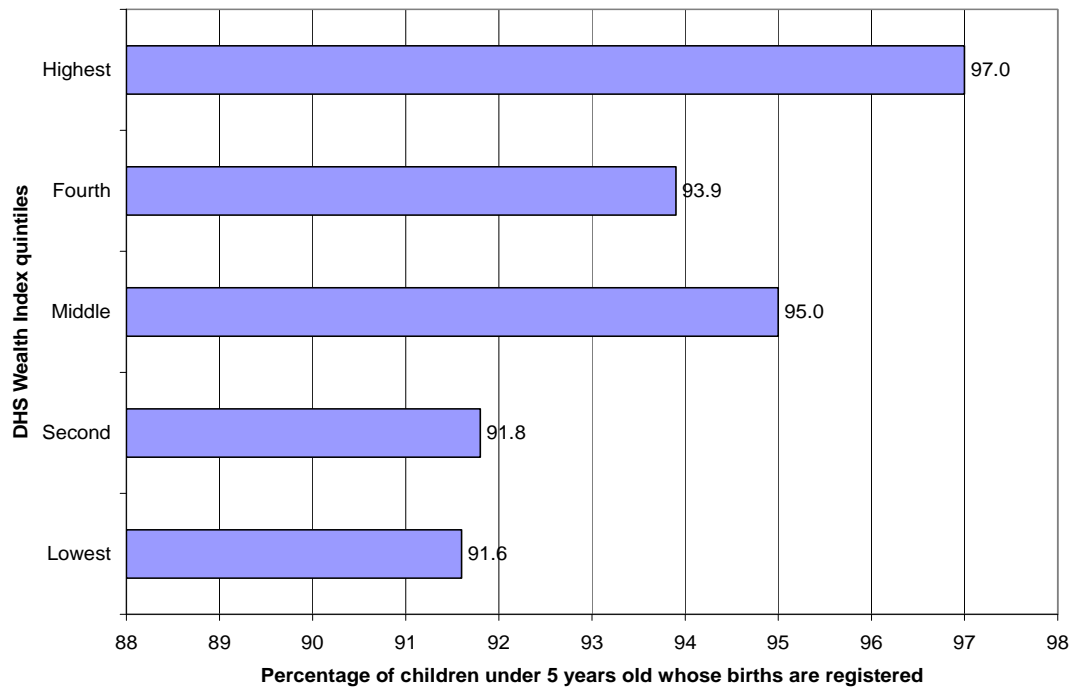
³⁴ Preliminary unweighted version of CRRC DI 2008 dataset was used in the calculations.

Chart 3.8: Percentage of Live Births Delivered in a Health Facility by Wealth Quintiles



Moreover, the 2006 AzDHS shows that the rate of birth registrations is also lower among the less wealthy people. One of the major reasons for not registering newborns is reported to be the cost of registration (Chart 3.9). This means that the relatively poor families are more likely to be excluded from receiving child benefits. Moreover, children who are not registered cannot attend any formal early childhood development programs. However, since primary school is mandatory, most of the non-registered children eventually become registered before they reach the age of six.

Chart 3.9: Birth Registration by Wealth Quintiles



Source: AzDHS 2006

Malnutrition is another health-related problem that affects mostly low income groups in Azerbaijan. Children under five years old from the lowest and second wealth quintiles have a higher risk of being stunted, malnourished and underweight than their peers from the highest quintile. Moderate and severe stunting, malnourishment and underweight rates in the lowest quintile are 33.2%, 10% and 15.4 %, respectively; while these numbers are 15.2%, 3.8% and 2.2% for children from the top wealth quintile. Table 3.2 suggests that there is strong relationship between economic status of a family and malnutrition problems in that family.

Table 3.2: Malnourishment of children under 5 by wealth quintiles

DHS Wealth Index Quintiles	Percentage of malnourished children*		
	Stunted	Wasted	Underweight
Lowest	33.2	10.0	15.4
Second	30.5	8.0	8.7
Middle	25.7	5.3	6.0
Fourth	14.9	5.5	2.8
Highest	15.2	3.8	2.2
Total	25.1	6.8	7.7

* Percentage of children below 2 standard deviation units from the median of the international reference population based on the new WHO Child Growth Standards adopted in April 2006. Source: AzDHS 2006

3.4 Government Programs to Eradicate Poverty and Address Social Inclusion

Several governmental programs were implemented that led to economic growth and macroeconomic stability, including the State Program on Poverty Reduction and Economic Development (2003-2005) (SPPRED), the State Program on Social and Economic Development of Regions (SPSEDR) for 2004-2008 and 2009-2013, and the State Program on Poverty Reduction and Sustainable Development (SPPRSD) in Azerbaijan for 2008-2015. All of these programs are consistent with Millennium Development Goals. The State Program on Poverty Reduction and Economic Development strategy paper is a national document that was made possible due to input and efforts of national governments in collaboration and coordination with the international agencies (IMF, 2004). The Ministry of Economic Development of Azerbaijan Republic (MED) has coordinated the work of SPPRED to combine six key strategic directions and the following four policy priorities within the policy matrix: 1) economic development and employment growth; 2) social policy and human development; 3) regional policy and infrastructure development; 4) institutional reform and capacity building. The SPPRED strategy was implemented from 2003 to 2005.

In February 2004, a new State Program on Social and Economic Development of Regions for 2004-2008 was approved by the President of Azerbaijan. The program was designed within the framework of SPPRED and in fact was a continuation of SPPRED for the subsequent years. The State Program on Social and Economic Development of Regions was accomplished in all the regions of Azerbaijan with the coordination of the Ministry of Economic Development of the Azerbaijani Republic. The program put an emphasis on improving socio-economic life, infrastructure development, investment attraction and increase of employment in the regions through the development of local entrepreneurship and utilization of internal resources.

In September 2008, President of Azerbaijan Ilham Aliyev approved the State Program on Poverty Reduction and Sustainable Development in Azerbaijan for 2008-2015 (SPPRSD, 2008). This program builds on the core of SPPRED and sets out the policy priorities for further implementation strategies on poverty reduction and sustainable development “by fostering macroeconomic stability and growth in non-oil based sectors” (IFAD, 2007). The priorities for this program are to develop rural areas and to invest in rural development.

Among the field-specific measures, other notable examples of such legislation include the State Program on Implementation Employment Strategy (SPIES) for 2007-2010 and the State Program on Development of Vocational Education in the Republic of Azerbaijan for 2007-2012. Other programs are also noteworthy in the area of education and social protection of children. These include the State Program on De-institutionalization and Alternative Care Services (2006-2015) and the Development Program on Access of Children in Need of Special Care (limited health) and Education in the Republic of Azerbaijan for 2005-2009.

3.5 Key Challenges and Recommendations

SPPRED implementation achieved a number of accomplishments that are outlined in the progress report (2003). These accomplishments included the introduction of a new Household Budget Survey on the basis of a new methodology, the establishment of a monitoring unit which supported the work of SPPRED secretariat, the development of the Medium Term Expenditure Framework, and active work in the sphere of targeted social assistance. Audit institutions were also established and a governance and management framework for the oil fund was established (IMF, 2004).

The impact of SPPRSD can be measured by the changes in various inclusion and protection indicators. In 2007, average salaries of public sector employees increased on average by 42%. Simultaneously, official statistics put the number of people living below the poverty level below 16%, compared to 39.7% in 2003. In the area of social inclusion and social protection, a number of measures have been introduced. In accordance with the law on targeted state social assistance, a mechanism of targeted social assistance has been in place since July 2006. This covers groups within the population who are most vulnerable to poverty and exclusion. The result was around 250,000 people benefiting from state support.

The positive changes are also noticeable in the analysis of other socio-economic indicators, for instance, the inequality dynamics among the population. Specifically, as it was already mentioned, the period from 2001 to 2008 saw a decrease of the Gini coefficient from 36.5% (2001) to 31% (World Bank, 2010). On the other hand, the structure of household consumption also hints on the positive changes in the life of the population. The share of foodstuff in the structure of household expenditures has decreased from 75% in 2001 to 56% in 2008 (World Bank, 2010). While there is usually a direct correlation between the amount spent by the household on foodstuff and the welfare of the respective household, the figures point to a positive dynamics in the welfare of the Azerbaijani households.

The State Committee of the Republic of Azerbaijan on Family, Woman and Child Issues was established in February 2006. This was a milestone in the implementation of state programs and generally as a state body coordinating the immediate work with children and maternity issues. According to the Second Report on the implementation of the Revised European Social Charter, submitted by the Government of Azerbaijan (2008) “seminars were held and awareness raising works carried out in Baku city and different districts of the country with the participation of state structures, NGOs and broad public and relevant materials prepared” with the aim of public promotion of the De-institutionalization Program of child care.

While the scope of such governmental interventions in Azerbaijan is multifaceted and addresses many issues well, it still has some shortcomings. First, the government predominantly sees the main mechanism of poverty alleviation through the top-down approach, specifically arguing that poverty alleviation and integration of the disadvantaged population strata depend totally on the effectiveness of the state apparatus to address these problems (SPPRSD, 2008). However, clearly, sustainable solutions to

poverty and social exclusions equally depend on the provision of equal access to quality employment of vulnerable communities including IDPs. In addition, the government should not hamper creative and entrepreneurial initiatives within the population.

Another major deficiency of the Azerbaijani government's approach to the poverty reduction and social exclusion alleviation is the lack of well-defined and precise benchmarks against which the success of governmental measures in implementing programs and reforms could be compared to in the future.

The SPPRED (2003-2005) impact has generally been moderate, according to the IMF (2004). Specifically, despite achievements in attracting participation in the program, as well as the fiscal decentralization, SPPRED failed in a number of respects, such as "in providing specific measures to improve the effectiveness of public policies", regardless of important factors (like class size in education and reasons for the consistent low state budget spending in health sector amounting to 1% of GDP) affecting the achievement of its goals. The implementation of the (SPPRS) has witnessed substantial regional disparities which led the Economic Research Center (ERC) as a recommendation to propose the development of "tailored programs for individual regions" (2010).

The effectiveness of governmental intervention also can be measured by reference to the current situation and recent changes in the sphere of social protection. Generally, the outcomes fall short of expectations. The 2008 Ministry of Education report outlines specific measures taken by the government to improve education provisions in the country. These include the fact that, "a total of 21 preschool institutions have been reconstructed... over 1,000 new schools have been constructed, 785 schools underwent a capital repair, 71 schools have been rehabilitated", and a project that trains parents has been developed.

However, according to the 2010 ERC report, despite increasing spending on education, "children's access to education in Azerbaijan is still limited and its quality is sometimes questionable. The latter parameter does not appear to be improving proportionately to the increase in spending." The report also found that around 93% of families do not send their children to preschools because of the long distances they need to travel to the school or because there are no preschools in the local area. According to the ERC report, secondary school effectiveness showed negative developments for the period of the implementation of state programs. That is, the performance of secondary school students on centralized university admission exams fell drastically and "23% of students failed to obtain high school diplomas based on the results of the general graduation test" (ERC, 2010).

The government's spending on healthcare has increased six-fold for the previous six years. However, it is still 35% less than the internationally recommended level. Despite the recorded 90% satisfaction rate with the provided health services, 55% of the population "who did not buy the necessary medication simply could not afford it" (ERC, 2010). In the field of social protection and security, established social benefits for children do not meet the minimal needs of children.

Conclusion

It is evident that cases of substantial poverty still exist despite strong economic growth and reduction in the poverty rate during recent years. This is particularly true in rural areas and among the IDP and refugee population—the majority of them still live in inadequate conditions.

Social policies are not always sufficient in meeting the needs of these groups even though the government is inclined to support socially disadvantaged groups. Poverty and inequality reduction effectiveness of social assistance programs are inadequate. Social assistance benefits tend to be minimalist and stigmatizing and not necessarily based on need. For example, people with different health problems and medical diagnosis can be included into the same disability category and thus eligible for the same package of benefits even though their needs might drastically differ. Benefits can be modest and the poor might only receive a small proportion of them.

Among other important aspects of the social exclusion is the lack of social infrastructure to accommodate the needs of the disabled population. For instance, the lack of educational infrastructure and facilities that are adapted to the needs of disabled people drives them toward home schooling which is a contributing factor to their social exclusion. The same is true of transportation, recreation and other points of access to public space. The lack of infrastructure for disabled people confines them to domestic space and prevents them from active participation in public life.

In general, the positive changes undertaken by governmental interventions and programs can to a great extent be attributed to quantitative increases in salaries, pensions, GDP and other important indicators, rather than a qualitative leap in attitudes. This makes the current positive trend potentially unsustainable in the future when oil revenues will diminish. Specifically, the WB report (2010) argues that the “substantial increase in wages and expansion of an advantageous state transfer program were the main reasons leading to the increase in consumption and decrease in poverty.”

In conclusion, the additional measures (programs) should be introduced and implemented to minimize social exclusion and poverty in Azerbaijan:

- Increase state investments (spending) in the area of health and education.
- Provide equal access to quality employment to all strata of population including IDPs and people with disabilities.
- Improve and create an accessible infrastructure people with disabilities.
- Social benefits and assistance should reflect the real needs of target populations.
- Develop rural areas so that the standard of living is similar to urban areas.

Appendix:

Table A3.1: Official Absolute Poverty Line and Poverty Level in Azerbaijan

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Official Poverty Line/MSL	€	€	€	€	€	€	€	€	€
	28.4	34.5	28.9	29.0	39.0	50.6	51.4	69.6	77.8
(Manat)	24.0	35.0	35.8	38.8	42.6	58.0	64.0	78.6	89.5
Official Poverty Level (%)	49	46.7	44.7	40.2	29.3	20.8	15.8	13.2	10.9
Annual nominal growth rate in MSL (%)	na	45.8	2.3	8.4	9.8	36.2	10.3	22.8	13.9
CPI (%)	1.5	2.8	2.2	6.7	9.6	8.3	11.67	20.8	1.5

Source: "Statistical Yearbook of Azerbaijan", SSC, 2010

Table A3.2: Living conditions and access to some basic utility services by economic regions, 2001-2009, (percentage of households)

	2006	2007	2008	2009
Living area per household member (square meters)				
Nakhchivan	12.5	13	13.2	13.2
Absheron	8.0	8.2	8.8	8.9
Ganja-Gazakh	13.2	13.2	13.6	13.4
Sheki-Zagatala	13.8	14	14.4	14.0
Lankaran	15.8	15.9	16.4	15.8
Guba-Khachmaz	13.6	13.7	14.3	12.9
Aran	13.2	13.3	12.9	12.8
Yukhary Garabagh*	12.2	12.5	13.4	13.8
Daghligh Shirvan	13.0	13.1	13.2	14.6
Kalbajar-Lachin*	6.1	7.0	7.1	6.7
Baku city	11.1	11	11.1	11.0
Central heating				
Nakhchivan	7.7	8	7.4	7.3
Absheron	46.5	46.6	30.6	28.0
Ganja-Gazakh	0.4	0	0	0.1

Sheki-Zagatala	0.9	0.9	0	0.1
Lankaran	0.9	0.2	0	0.0
Guba-Khachmaz	3.5	2.3	2.7	3.4
Aran	9.5	8.9	8.6	5.5
Yukhary Garabagh*	0	0	0	0.0
Daghligh Shirvan	0.6	1.6	0.7	0.4
Kalbajar-Lachin*	19.7	11.1	0	21.5
Baku city	45.2	41.2	38.2	37.3
Telephone (landline)				
Nakhchivan	54.9	58.8	67.9	71.4
Absheron	77.8	82.4	82.9	80.9
Ganja-Gazakh	48.7	49.9	56.9	64.0
Sheki-Zagatala	59.7	67.1	71.8	68.5
Lankaran	56.2	57.3	61.3	64.5
Guba-Khachmaz	27.1	24.7	30.9	39.5
Aran	44.9	49.2	51.8	53.6
Yukhary Garabagh*	14.5	13	8.7	9.1
Daghligh Shirvan	74.7	73.3	82.1	76.2
Kalbajar-Lachin*	10.3	23.4	15.2	34.8
Baku city	93.4	93.6	95.3	95.9
Mobile phone				
Nakhchivan	59.2	69.7	78.1	78.6
Absheron	64.3	73.6	87.5	91.9
Ganja-Gazakh	41.1	60.9	77.2	80.5
Sheki-Zagatala	49.0	62.6	77.8	87.3
Lankaran	60.4	74.9	90.0	93.5
Guba-Khachmaz	46.1	66.7	80.1	76.8
Aran	59.0	67.9	76.5	80.3
Yukhary Garabagh*	49.9	56.9	71.3	82.7
Daghligh Shirvan	41.6	57.4	77.1	82.5
Kalbajar-Lachin*	47.1	64.5	72.8	85.6
Baku city	81.6	84.9	90.4	92.1
Access to Internet (modem)				
Nakhchivan	0.8	1.0	1.1	1.3
Absheron	0.4	0.3	0.5	1.7
Ganja-Gazakh	0.3	1.1	0.5	0.6
Sheki-Zagatala	0.8	0.7	0.5	0.4
Lankaran	0.3	0.4	0.5	0.6
Guba-Khachmaz	0.0	0.1	0.2	0.6

Aran	0.3	0.2	0.3	0.5
Yukhary Garabagh*	0.2	0.0	0.0	0.0
Daghligh Shirvan	0.8	1.0	1.0	0.7
Kalbajar-Lachin*	0.0	0.3	0.0	0.0
Baku city	4.4	5.8	6.5	6.9
Sewage				
Nakhchivan	96.5	97.6	96.7	99.0
Absheron	99.5	99.7	99.6	99.7
Ganja-Gazakh	90.5	93.5	98.6	98.5
Sheki-Zagatala	71.7	72.1	74.8	80.1
Lankaran	90.4	90.8	90	90.4
Guba-Khachmaz	96.4	98.4	100	100.0
Aran	86.8	88.7	91.1	90.0
Yukhary Garabagh*	65.3	62.7	63.1	72.6
Daghligh Shirvan	91.9	92.5	77.7	80.9
Kalbajar-Lachin*	85.4	80	83.3	83.6
Baku city	100	100	100	100.0
Bathroom, shower				
Nakhchivan	68.1	71.3	78.8	80.0
Absheron	91.5	89.9	96.3	96.0
Ganja-Gazakh	67.6	68.2	69.6	65.2
Sheki-Zagatala	46	48.1	45.8	47.9
Lankaran	53.8	54.9	54	55.8
Guba-Khachmaz	55	55	48.8	33.9
Aran	51.4	51.6	44.1	45.9
Yukhary Garabagh*	25.5	25	22.7	43.6
Daghligh Shirvan	61.6	67.6	69.2	69.3
Kalbajar-Lachin*	63.9	26.7	36.7	23.0
Baku city	96.8	97.5	97.8	97.8
Gas supply				
Nakhchivan	9.4	25.7	64.3	93.1
Absheron	100	100	100	100.0
Ganja-Gazakh	56.3	57.6	69.4	71.9
Sheki-Zagatala	27.7	34.5	37.5	51.8
Lankaran	24.3	35.2	35.3	37.1
Guba-Khachmaz	46.4	55.1	58.3	69.3
Aran	38.9	42.8	43.9	49.4
Yukhary Garabagh*	14.6	11.5	12	13.9
Daghligh Shirvan	78	80.2	80.6	81.8

Kalbajar-Lachin*	58.2	36.7	40.4	46.2
Baku city	99	99.6	99.6	99.4
Hot water				
Nakhchivan	68.4	71	55.7	56.3
Absheron	85.5	86.8	96.2	95.9
Ganja-Gazakh	47	47.9	60.6	56.7
Sheki-Zagatala	16	14.7	15.5	27.9
Lankaran	46.8	49.1	48.3	50.2
Guba-Khachmaz	50.4	50.4	53	42.7
Aran	34.1	31.6	30	32.0
Yukhary Garabagh*	23.3	22.8	20.5	34.7
Daghligh Shirvan	16.4	14.2	15.2	17.1
Kalbajar-Lachin*	37.3	3.3	17.6	2.0
Baku city	86.6	82.4	84.9	88.0
Water pipeline				
Nakhchivan	56.4	61.9	59.3	60.8
Absheron	99.6	99.7	99.6	99.7
Ganja-Gazakh	71.6	70.6	75	69.3
Sheki-Zagatala	58.2	52.2	57.3	61.4
Lankaran	48.2	50.7	51.5	55.1
Guba-Khachmaz	81.9	81.3	80.9	86.5
Aran	59.8	56.2	59.8	53.2
Yukhary Garabagh*	40.2	40.5	34.3	57.7
Daghligh Shirvan	54.5	56.4	56.2	58.8
Kalbajar-Lachin*	85.4	80	82.9	83.2
Baku city	99.2	99.4	99.8	99.8

SOURCE: "Main Results of Household Budget Survey in Azerbaijan" reports for years 2006-2009, SSC

* These data are either for IDPs from these regions or for people living in the territories of Yukhary Garabagh that are not occupied by Armenian military forces.

Table A3.3: Estimating the number of materially deprived households in Azerbaijan

Total number of households in the country (thousands)	2,054.4	=Total Population divided by average household size
Total population of the country (thousands)	8,779.8	

Household types	Average household size ¹	Share in total number of households ¹	Percentage of materially deprived households ¹	Estimated number of materially deprived households (thousands) ²	Estimated number of materially deprived population (thousands) ³
	a)	b)	c)	d)	e)
Single person, 65 years and over	1.00	1.6%	58.8%	19.1	19.1
Single parent, 1 or more dependent children	2.91	3.4%	32.4%	23.0	66.7
Two adults, at least one person 65 years and over	2.00	3.2%	24.6%	16.3	32.5
Single person, under 65 years old	1.00	2.8%	23.0%	13.4	13.4
Two adults, both under 65 years	2.00	5.8%	22.6%	26.8	53.6
Two adults, three or more dependent children	5.26	9.5%	22.0%	43.0	226.5
Other households with no dependent children	3.81	14.2%	13.5%	39.2	149.2
Three or more adults with dependent children	5.82	34.3%	13.4%	94.7	550.8
Two adults, two dependent children	4.00	15.9%	12.9%	42.1	168.3
Two adults, one dependent children	3.00	9.3%	9.0%	17.2	51.6
Total	4.27	100.0%	16.3%	335	1,331.8

1 - Estimated based on CRRC DI 2007 survey data

2 - Column d) = Total number of households times the percent in Column b) and times the percent in Column c)

3 - Column e) = Column a) times Column d)

NOTE: Materially deprived households are defined as households lacking at least three of the following durable goods:

1) washing machine; 2) color TV; 3) telephone (mobile and landline); 4) personal car; 5) refrigerator.

Sources: Author's estimates based on CRRC DI 2007 survey data and "Statistical Yearbook of Azerbaijan, 2010", p 41, SSC.

Identifying actual household head in the 2007 CRRC Data Initiative

In many households, the titular household head may not actually be the breadwinners of the family and may not be the main decision-maker in the household. This is especially the case when the titular household head is not in the working age and is not economically active.³⁵ Therefore, we applied following rules to identify household heads in the 2007 CRRC Data Initiative.

Rules:

1. If titular household head is male, over 60 years old and does not work, then select the eldest (but younger than 60) male household member who works. This is the household head.

³⁵ The working age was 15-60 years old for males and 15-56 years old for females by the time the CRRC 2007 DI survey was conducted.

2. If titular household head is male, over 60 and does not work, but there is no other male household member who works, then select the eldest (but younger than 56) female household member who works. This is the household head.
3. If titular household head is male over 60 and does not work, and there is no other household member who works, then keep the titular household head as a household head.
4. If titular household head is male over 60 and does not work, and if the working adult household members are only the ones who are not in working age, then select the eldest male household member who works and make him household head.
5. If titular household head is male over 60 and does not work, and if the working adult household members are only the ones who are female and not in working age, then select the eldest female household member who works and make her household head.
6. If titular household head is male over 60 who works, and if there is another male household member who works, then select the eldest (but younger than 60) male household member who works and make him household head.
7. If titular household head is male over 60 who works, and if there is no other male household member who is younger than 60 and who works, then keep the titular household head as a household head.
8. If titular household head is female over 56 and do not work, then select the eldest (but younger than 60) male household member who works and make him household head.
9. If titular household head is female over 56 and does not work, but there is no other male household member who works, then select the eldest (but younger than 56) female household member who works and make her household head.
10. If titular household head is female over 56 and does not work, and there is no other adult household member who works, then keep the titular household head as a household head.
11. If titular household head is female over 56 who works, and if there is another male household member who works, then select the eldest (but younger than 60) male household member who works and make him household head.
12. If titular household head is female over 56 who works, and if there is no other male household member who is younger than 60 and who works, then select the eldest (but younger than 56) female household member who works and make her household head.
13. If titular household head is female over 56 who works, and if there is no other adult household member who works, then keep the titular household head as the household head.

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Chapter 4: The Pension System: History, Coverage, Sustainability and Reform Challenges

4.1. Introduction and Historical Perspectives

Azerbaijan's public pension system is a pay-as-you-go (PAYGO) system, providing old age, disability and survivor's benefits to about 1,308.4 thousand people or 14.5% of the population (at the end of 2009).³⁶ According to Azerbaijani laws, if a person can qualify for two or three pensions simultaneously, he or she can choose only one type of pension (SSPFA, 2009a). The Azerbaijani pension system virtually copied the former Soviet system in many respects. Thus, as in Soviet times social insurance payments are paid by employers and employees at 25% of the employee's salary. Out of that, 22% is paid by employers and 3% by employees themselves. As in Soviet times, contributions made by employers and employees are used for payments of pensions for the majority of the population. However, after the collapse of the Soviet Union and the privatization of many state enterprises, employers are becoming concerned with high payments for social security since it decreases their profits.

Since independence, the Azerbaijani branch of the USSR Pension Fund was transformed into the Pension Fund of the Republic of Azerbaijan. At that time, social insurance allocations were defined as constituting 40% of the gross payroll. Of this 85% was directed to the Pension Fund, and 15% to the Social Insurance Fund. However, despite the high payment rates average pension benefits were of symbolic amounts (USD10-15 per month), and procedures for claiming them were very bureaucratic, payment delays could reach three to four months. In order to improve administration in financing the provision of pensions and social insurance, the SSPFA was established on the basis of the Pension Fund of Azerbaijan Republic and the Social Insurance Fund of the Republic of Azerbaijan (SSPFA, 2009a).

4.2 Existing Pension System

Currently there are three types of pensions in Azerbaijan: old age labor, disability and survivor.

Old-Age Pension

This type of pension is granted for a life term on the basis of a claim of a person from the date of the legal accrual. Until 2009 the retirement age for men and women was 60 and 57 years, respectively. In October of 2009, the parliament adopted a new amendment stipulating an increase in the age eligibility for pensions up to 63 and 60 years, respectively. However, this amendment will be adopted gradually, over a 6 year period by increasing the age eligibility for pensions by 6 months every year until 2016. There

³⁶ Of these recipients, 516.1 thousand were males (39.4% of all pensioners) and 792.3 thousand were females (60.6%). Of all pensioners 133,880 still worked at various positions. By the end of 2009, there were 858.7 thousand people receiving elderly labor pensions, 311,8 thousand people receiving disability pensions and 137,9 receiving survivor pensions.

(Retrieved from: <http://www.azstat.org/statinfo/healthcare/en/006.shtml>)

are certain groups of people who can retire earlier than this age. The special group of people involved in underground work and generally harmful and difficult working conditions has special terms for receipt of the old-age labor pension. Special provision is also envisioned for prosecution office employees as well as military servicemen. These categories of people can retire earlier too. In November 2009, the president of Azerbaijan amended a law on labor pensions stipulating that women who raised five or more children in an eight year period and who have five years work experience can become a pensioner earlier. According to this law the age for becoming a pensioner is reduced by one year for each additional child given birth to by a woman. The same law is applied for a father who raised the children in case the mother of the children died pre-maturely.

This law amended the calculation of pensions too. Old-age labor pension consists of two parts: a basic part and an insurance part. The amount of the basic part of old-age labor pension is established by the president of the Azerbaijan Republic. Currently the amount of basic payment is €76 (85 AZN) per month making it second out of all CIS countries in nominal amount after Kazakhstan (without taking into consideration PPP adjustment).

The insurance part of the old-age labor pension is calculated by adding €150 (170 AZN) for each year of work experience prior to January 1, 2006 plus indexing the insurance part of the pensions for 2006-2009. Then, the whole sum is divided into 144 months (average life expectancy after retirement). The received amount will comprise the insurance part of the labor pension per month (SSPFA, 2009). The system of new pension calculations was launched on January 1, 2006.

Example of old-age labor pension calculation

The average Azerbaijani citizen becomes a pensioner in 2010 with 40 years of working experience. Since this system of pension calculations began in 2006, in this case 36 years will be calculated based on the old system and four years based on the new one. Thus, 36 years are multiplied by €150 (170 AZN), the amount defined by government as the average annual payment of a contributor to the system. Then, the whole amount of €5,411 (6,120 AZN) is indexed for inflation during the period from 2007-2009 (8.3%, 16.7% and 20.8% respectively). Overall, the sum after multiplication and indexation will total €8,341 (9,434 AZN). Afterwards, the whole amount is divided into 144 (the number of months for 12 years) and the monthly award comes to €57 (65 AZN). This amount together with the basic part of the pension at € 76 (85 AZN) will aggregate to €133 (150 AZN) per month – the new pension amount for a retired person.

Disability labor pension

The disability labor pension is granted to any insured individual who became disabled before the age of 19. The minimum requirement is at least one year of covered employment. For those who become disabled after the age of 19 the minimum requirement is one year plus four months for every subsequent year over the age of 19. The disability labor pension consists of three parts: a basic part, an insurance part and a funded part. Currently the amount of disability labor pension is calculated by adding together the three basic parts of the pension, though the funded part has yet to be implemented.

The base pension of the disability labor pension is paid as follows: persons with a Group I disability (a person with a total disability, incapable of any work, and requiring constant attendance) receive 120% of the base pension of the old-age labor pension (Group I visually impaired persons receive 200%); persons with a Group II disability (a disabled person, incapable of any work, but not requiring constant attendance) receive 100%; and persons with a Group III disability (a person incapable of usual work) receive 55% (SSPFA, 2009a).

The insurance part of the disability labor pension is calculated based on insurance payments of the beneficiaries to the social protection system during their years of employment. The last part of the disability pensions (i.e. the funded part) has not been launched yet. In all calculations of disability labor pensions, this part is usually calculated as “0”. This is supposed to be a voluntary system where the person could consistently contribute a certain amount of money to private funds. However, this pillar has not been launched yet due to the fact that no private pension fund operates in the country

Survivor Labor Pension

The survivor’s labor pension is granted if the deceased had a social insurance record and is given to the family members of military servicemen. Children who have lost both parents, each child of a deceased unmarried mother, as well as the single child of a deceased breadwinner are entitled to the survivor’s labor pension as 100% of the basic part of the old-age labor pension (€76) (SSPFA, 2009a). There are a few other categories of people receiving survivor labor pension including the spouse and children of deceased National Heroes of Azerbaijan—citizens who died during the country's struggle for independence and others. A full 100% of the base pension of the deceased's old-age labor pension is paid for each orphan, the children of an unwed mother, or the deceased's only child.

4.3 Pension Reform and the Drivers of Change

In 2001 the Azerbaijani government launched a pension reform that was intended to complete the formation of the social insurance and pension systems. The main objectives of the reform were aimed at the substitution of present wage-based pension system (PAYGO) with a new one based on individual social insurance contributions. The task was to link the social insurance benefits with the level of participation in the social insurance systems and the amount of paid contributions. A three-pillar system was taken as a basis for pension reforms. The first pillar kept PAYGO system intact, providing current pensioners a minimum level of income. This was adjusted by presidential decree and in 2010 it was €76 (85 AZN). The main reason for having such pillar is to ensure that the people who do not have any employment history would get a minimum income. This pillar is solely financed by employers and employees contributions (22% and 3% respectively).

The second pillar introduces the National Defined Contribution (NDC) scheme. In this pillar the future pensioners accrue their benefits based on average wages and years of

service. Despite the fact that the government has introduced a second pillar since January of 2006, the calculations for pensions based on that pillar have not started yet and are supposed to be launched in 2010-2011. The second pillar or insurance part depends on the amount of contributions paid by a person. The contribution rate for this pillar is paid by employers (22%) and by employees (3%). However, in this case the contribution amount will depend on the wage or salary received by a person. Higher salaries will yield higher contributions. This pillar was specifically designed to assure a closer link between contributions and benefits.

The government uses the NDC scheme as a transition model for a fully funded system. In line with these aims, in December of 2009, the Azerbaijani President signed the State Program on State Pension-Insurance System Development for 2009-2015. The program stipulates the collection of insurance payments, the legalization of employees' salaries, and increase in the number of those registered in the individual account system as well as gradually decreasing the dependence of the system on the state budget. In its turn, the reforms will eventually abolish the base part of labor pensions that is the major transfer from the state budget.

However, in order to achieve total independence and sustainability, the last pillar, intended to encourage additional savings and capital development, should be launched. The last pillar allows insured people to accumulate funds on their own personal capital. In this pillar the future pensioners are encouraged to contribute a certain portion of their wages to the accounts of some private pension funds. Contributions paid into private pension funds are invested and should provide annuity payments at retirement. In Azerbaijan the launching of the third pillar was connected with the establishment of private pension funds. However, since the beginning of pension reforms in Azerbaijan, the government did not show an interest in launching this pillar.

There are several reasons for such a delay. First, the weakness of the Azerbaijani financial market does not allow the pension funds to freely operate in the market. The absence of a stock exchange and trading on shares preclude the entrance of pension funds into the market. Banking and financial institutions are not interested in such types of operations and prefer to abstain from such involvement.

Second, there is no legislative base for pension funds. Since 2007 the parliament has not adopted the Law on Non-Governmental Pension Funds that the government promised to do in 2005-2006. Third, successful examples of pension reforms that involved pension funds in CIS countries are nonexistent. These countries and especially Russia (in contrast to the Baltic or Central European countries) do not serve as examples for reforms and currently provide no additional incentive to launch private funds. The only example that Azerbaijan could have copied was the Kazakhstan model that turned out to be problematic taking into consideration the recent financial crisis and problems faced by pension funds there. Thus, the government is not urgently pursuing the introduction of the last pillar.

Fourth and probably most importantly is the financial power the private funds can gain. Today in Azerbaijan no single financial entity, except the Central Bank, has enough resources to manipulate the financial market. Most of the banks own small shares of the market since the public generally distrusts the banks. Thus, they do not have the capacity to monopolize it. In contrast, private pension funds could easily accumulate billions of manats in their accounts. Furthermore, the collapse of any private fund could instigate social unrest in the country and undermine stability.

Despite the fact that the government did not explicitly state that it wants to have only a two-pillar system, the documents and statements of public officials indicate this to be the case. Most of the documents indicate links between social contributions and pension payments. At the same time, public officials clearly stated that the basic part of the pension would be eventually abolished, leaving only two pillars. Thus, there was a confusion of aims. The government does not clearly indicate whether the second pillar—the National Defined Contribution System—would become a defined contribution system and whether it is going to be mandatory or voluntary in future. No documents yet reveal the future direction of pension reforms.

It is interesting to mention that with the implementation of a new system, no strata of the population would lose in the beginning. The basic part of the pension is already given to all pensioners. Introduction of the second pillar will add some funds to the pensions of elderly people. Even if the pensioner does not have employment records or did not pay any social contribution, he or she still could receive current benefits, the basic part of the pension. During the first few years of the two-pillar system implementation, the government will take the additional burden for paying the insurance part of the pension system. However, later on the basic part of the labor pension will be abolished in Azerbaijan. Salim Muslimov, head of SSPFA has mentioned that after the certain period when the pension system will be fully operative, the basic part of the pension will gradually lose its significance and lead to the abolishment of basic part (Ismayilova, 2009).

The abolishment of the basic part of the pension and movement toward a fully-funded system would definitely create winners and losers. With no basic part of the pension that cohort of people who retired before 2006 would be able to receive a fraction of their current benefit. In contrast, the people who retired after 2006 and paid social contribution would get the maximum from the system. In addition, introduction of private funds would allow these people to invest a certain amount of their income into these funds and receive full benefits. The new system could also create income classes of pensioners in the future. Today, people with higher income would make greater contributions to the system and receive higher pensions when they retire.

In contrast, people with lower salaries make fewer contributions to the system. Consequently, people with higher income will benefit more than the poorer strata of the population. Another negative side of the new system is that each person will not be awarded for their recent labor activity. Meanwhile, the people working abroad will be provided with pensions only if Azerbaijan has a relevant agreement with that country and

people who rejected Azerbaijani citizenship will be deprived of pensions. Thus, it is logical to assume that the government is trying to solve the problem by delaying the abolishment of the basic part for at least the next six or seven years and switching to a new system. If the abolishment of the basic part happens sometime between 2016 and 2018, the new system would be in place for at least 10 years. That would enable the minimization of the number of people whose pensions mostly depend on the basic part of the pension.

Some administrative reforms have been implemented in the country for the last couple of years. In 2003, the functions of the Ministry of Labor and Social Protection on granting, financing and control of pensions and supplemental benefits were passed to the SSPFA. The SSPFA carried out administration in the area of individual accounting and mandatory state social insurance (Ibrahimov, 2005). Specific attention was paid to the automation of the pension system in order to make it free from fraud.

Likewise, pension fund revenues and payments for beneficiaries significantly increased. In 2007-2008 the government initiated the One Window Policy in order to correct the deficiency and let the employees pay taxes (Chapter 1). This new policy allowed many companies to decrease tax evasion and hire people as individual contractors. The policy enhanced social insurance contributions. Thus, in 2009 the government was able to pay €40 million (44.7 million AZN) of social assistance as social insurance payments, thus almost meeting government forecasts. Overall, in 2009 the share of pension payments in GDP reached 5.13%, the highest since independence. Meanwhile, the share of the insurance part of pensions in overall pension expenditure was 20.8% in 2008, 28.7% in 2009 and is expected to increase up to 30.3% in 2010 (The State Statistical Committee of Azerbaijan Republic, 2009a).

Few actors play significant roles in driving the pension reforms in the country. The government of Azerbaijan is the major initiator of the reforms. Since 2003 and with the windfall of oil revenues, the government understands the importance of creating a sustainable pension system that will ease the burden of the government once the oil money is gone. Thus, the government does not spare money for reformation of the system. International organizations such as the UNDP and World Bank are helping the government in its reforms. As Salim Muslimov, the head of SSPFA stated “Azerbaijan’s pension reform successes were made possible by three key factors: high levels of government commitment, appropriate and timely technical and financial assistance from the international community (UNDP and World Bank), and appropriate use of e-governance tools” (Muslimov, 2009). In 2004 the World Bank and the U.S. government allocated USD13 million (€10 million) to the Pension and Social Assistance Project in Azerbaijan with the aim to improve the effectiveness and transparency of the social protection and pension systems. At the same time, the US Trade and Development Agency is working closely with SSPFA on setting up and maintaining an individual pension account system. In 2008 the Agency allocated a grant to SSPFA for technical assistance.

4.4 Adequacy of Pensions, Sustainability of System

By January 1, 2010 the average monthly old-age pension totaled €91 (104 AZN) while the minimum pension totaled €76 (85 AZN). The average monthly old-age pension is 34% of the average monthly salary while the minimum pension/average salary ratio totals 26%.

The inequality gap among pensioners is not so large. The majority of pensioners (except those who are in privileged groups such as former law enforcement officers, artists and others) receive basically the same pension amount. Despite a warning from international financial institutions, in comparative perspective the average replacement rate, that is, pensions as a proportion of salaries, comprises 34%, putting Azerbaijan in fourth place among former Soviet Union republics after Estonia, Lithuania and Kazakhstan. As the government promises, it plans to reach a 40% rate within several years.

The basic part of the old-age labor pension increases at least once a year to a level not less than the annual level of consumer prices index established by the appropriate executive authority. The insurance part of a labor pension and notional pension capital accumulated in the insurance part of a personal account are indexed at least once a year to the level of the consumer prices index established by the appropriate executive authority. In the event of a subsequent rise in the labor wages of those individuals, the service supplements to the labor pension are recalculated accordingly. Increases and indexation of the labor pensions are carried out by the order of the appropriate executive authority from the finance resources provided under paragraph six of the Law for the Payment of Labor Pensions.

According to a decree by the president of Azerbaijan in 2009, the pensions of 60% of pensioners or 765,000 people were indexed and increased by 20.8%. This indexation adjusts pensions after retirement by some mix of inflation and wage growth. Formally this system seems very generous. Theoretically it leads to higher benefit increases than inflation adjustment alone, because wage tends to increase more quickly than prices. However, in Azerbaijan such indexation does not resolve the inadequacy of pensions because the government indexes the pension based on official inflation that is very often much below the actual inflation.

As the pension system dependency rises, expenditures rise relative to revenues. This puts additional pressure on the fiscal system. In 2006 the percentage of those dependent on the system was 30.5% and it increased to 31.3% in 2008. It is expected that such trends will continue with the introduction of the second pillar and while keeping the basic pension still in place. Only within the next 10 to 12 years is it expected that the system dependency ratio will go down. Therefore, without additional transfers from the state budget, the whole pension system could be in deep crisis in several years. Nevertheless, the demographic situation in the country is not problematic as it is in other countries in Europe. The demographic dependency ratio (that is the number of dependents versus the number of the population age 15-64) in the country continues to go down and from 1999

it dropped from 15.2% to 12.7%. The age dependency ratio has remained constant at 10% for the last six years. It is not expected that these figures will grow dramatically.

There are a few challenges for the government today. The biggest challenge comes from the low collections of contributions and social insurance revenues. Table 4.4 presents a clear picture of the government's expenses and revenues related to pensions. In spite of the fact that the total non-state budget revenues of the SSPFA gone up, they are still not enough to make the system sustainable. The transfers from the state budget are also increasing. Since 2003 the number of transfers increased by almost 3.5 times. Despite the fact that the share of these transfers in the total revenues of the SSPFA is still lower than in 2003, it is still sizable by being around 30%. (The State Statistical Committee of Azerbaijan Republic, 2009a).

At the same time, fluctuations in the oil market as well as lower receipts of the state budget, will lead to a situation in which the government will most likely not be able to continue financing its obligations. Moreover, the bulk of the social contributions are paid by government agencies or giant state enterprises such as SOCAR. With the resulting shortfalls, the government has focused its revenues on maintaining a reasonable minimum pension that prevents old-age poverty and has been less concerned with the consumption-smoothing objective of pension systems.

The financial crisis had and will have a limited impact on the pension system. Since most of the pensions are paid from the transfers from the state budget, pensioners continued to receive their pensions without delays. But further fluctuations of oil prices will affect the state budget, therefore indirectly affecting the pension system as well. As the IMF cautioned Azerbaijan, the oil sector will no longer be the main source of growth and there is an urgent need to accelerate economic diversification. The IMF has urged the government to encourage the private sector "through trade facilitation, tax and customs modernization, and reducing monopolies" (IMF Statement, 2010).

Another problem for the system is the fact that the ratio between social insurance payments and social insurance contributions still does not indicate sustainable development. For example in January-September of 2010, €714 million of social insurance fees were collected in Azerbaijan while the social payments (pensions) totaled €1,128 million. Thus, the pension system had a deficit at €414 million that was covered by the state budget. Meanwhile, the number of insured people with personal accounts in the personal account system of the SSPFA reached 1.8 million people by the end of 2009 while the number of pensioners in the country was 1.3 million. Thus, calculations reveal that there are 1.37 insured people per pensioner which is not enough to sustainably ensure development of the pension system. Thus, SSPFA continues to receive €600 million in transfers from the budget (State Oil Fund) every year for the payments of pensions.

The problem is exacerbated by the fact that many people are not registered and are not willing to register with the system. The head of SSPFA even stated recently that around half a million people would be living without a pension in the nearest future since they do not contribute to the system. But even these high figures raise some doubts. There are

approximately 4.3 million economically active people in the country and only 1.8 million have social insurance. It means that around 2.5 million are still not registered with the system. Thus, around 2.5 million people will be left without pensions once the basic pensions are abolished.

If we look at the distribution of people registered with the social security system, we can see that out of 1.8 million registered people only 305,000 are people working on the land (in agriculture), 220,000 are individually registered and 1.2 million are people who are working for a legal entity. The lion's share of registered people is those who are employed in government or other companies that pay taxes. So, we can say that out of the 1.5 million people involved in agriculture, only 20% are registered and pay taxes. Most of them do not see any benefit in contributing to the system or in hoping to get basic pensions in the future. SSPFA in its turn are registering mostly those who are working in urban areas since it is difficult and costly to register people in rural areas. This problem is also connected with the fact that the government is behind on the schedules of introducing an automated system of pension calculations. It was supposed to have been set up by the end of 2010, but it seems that the country will be able to make use of this only by the end of 2011.

In order to increase the number of people registered with the system, SSPFA was asking the government to give them rights to check the salaries in the private and public sectors involved in trade, health care and transport that are major employment generating sectors. However, it is hard to believe that the SSPFA would be able to bring the salaries in these sectors from the second economy into the legal economy taking into consideration the fact that the high contribution rate creates a disincentive to declare earnings. There are a few positive factors too. Social insurance fees continue to increase. Compared with 2003 the fees grew by more than 5.5 times. The share of non-government organizations in total revenues from payments on social obligatory insurance reached 56%. Meanwhile, the number of insured people with personal accounts registered by SSPFA also grew. If in 2008 their number were 1.5 million people, then by the end of 2009 that number had reached 1.8 million. Moreover, the SSPFA was able to increase the weight of the insurance part of the pension in pension expenses, which reached 28.7% in 2009 and it is expected to grow to 30.3% in 2010.

The high statutory contribution rate at 22% creates a large gap between the cost of labor and employees' take home pay and, together with a tenuous link between contributions and benefits, encourages evasion and the growth of informal activities. As a result, effective contribution rates are often only a fraction of the standard contributory rates (Branco, 1998). Despite the government's data which indicate high employment and low unemployment rates, the significant share of economically active people is involved in the informal sector and does not contribute to the social security system. Employees in government, government organizations and some private companies contribute to the social security system. All agriculture workers, family workers and subsistence farmers, with few exceptions, do not pay taxes. In most cases employers prefer to not report hiring people.

Meanwhile, despite the fact that the current pension system in the country is built on insurance principles, there is a large group of people who is paid and will be paid based on non-insurance principles. These people, such as public officials, police, employees of some ministries, the military and other categories which are entitled for earlier retirement and higher pensions will constitute a large share of the population. Their pensions will be financed through the compulsory state social insurance charges that deteriorate the insurance principles. The case is exacerbated by the fact that high pensions and early retirement is stipulated by the law, and any changes would require amendments to the law.

About 61% of all pensioners are women, as a result of their lower pension age and higher life expectancy. The analyses of the last couple of years show that the share of women is remaining stable around 60-63%. The share of female pensioners will hardly change within the next decade. But the numbers of people who receive disability pensions are constantly increasing. Annually, one third of people who become pensioners fall in the disability category. This occurrence raises some legitimate suspicions that people tend to fake their disability in order to qualify for a higher pension. For example, in comparison with other states of the CIS, the share of people receiving disability pensions relative to the total number of pensioners was 23.3% in 2008. This proportion was the highest in the CIS, with the exception of Armenia (26.3%). It was twice that of Russia, Belarus, Kazakhstan or Ukraine. In 2008 Kazakhstan had 251,000 disabled pensioners while Azerbaijan (which has half the population) had approximately 291,000 disabled pensioners.

A small proportion of pensioners is still employed. Around 125,000 or 9.8% of all pensioners were employed in 2009. Looking at the trends we can see that the employment rate among pensioners is increasing. In 2005 for example it was at 7.2%. Several factors encourage rising employment. First, more people decide to stay in the labor market rather than exit since employment offers more income. The people who prefer to stay in the labor market earn more income not only from legal sources but from the informal economy, as well. If earnings from informal income were factored into the calculation of the replacement rate, then the actual pension would be a lot less than 34% of actual income.

It is interesting to observe that the pension system does not discriminate at all against employed pensioners. On average the employed pensioners even get higher pensions than the unemployed. Thus, in 2009 the average pension for an employed pensioner was €87.83 (101 AZN) while for the unemployed it totaled €82.88 (95.3 AZN). Another difference in pensions is observed among the pensioners who receive disability benefits. Thus, the pension for a working disabled pensioner is €70.27 (80.8 AZN) while for an unemployed one it was €83.31 (95.8 AZN). The biggest discrepancy may be observed among pensioners who receive benefits after the loss of the head of the family. In 2009 the average employed pensioners who lost the head of the family were receiving €143.49 (165 AZN) while unemployed ones were receiving half as much—€66.35 (76.3 AZN). It is difficult to explain such a policy, taking into consideration that in 2007 on average the pensions for employed pensioners were less or slightly more than today.

4.5. Public Awareness and Acceptance

In post-transition Azerbaijan, public sector employers, large enterprises and organizations continue to pay contributions. However, some large public enterprises often accumulate debts in social security funds that are written off by the government. Since the pension system traditionally was a very politically sensitive area, the government preferred to not reform it, but maintain stability even at excessive expense. The smaller and newer private enterprises often realized that it is too expensive to participate in the system since contribution rates were high. They preferred to avoid or evade taxation believing that benefits provided today may not be available for workers when they retire.

Meanwhile, the taxes and regulations were so cumbersome that it was easier to not formalize labor contracts. Enforcement of the labor policy is not so strict and large numbers of people who are working prefer not to contribute. Meanwhile, the collapse of the Soviet system made the archives in which employment records were kept unusable. The identification of employment periods and income levels for workers who used to live in other Soviet republics became a real challenge. A lack of reforms and the late timing of the introduction of market economy relations and a new social insurance system have aggravated the situation. People treated the social insurance fees as another kind of tax, and in many instances this still occurs-when private businesses try to avoid paying social insurance fees or hide real incomes and wage rates of employees.

Most citizens are unaware of the pension reforms ongoing in the government. Familiar with the former system, they may not understand the newer, complex pension calculations. For example, in a poll conducted by the SSPFA on achievements of the pension system reforms, nearly 27.5% of respondents described ATM cards for receiving pensions³⁷ as the major achievement of pension system reforms. About 23.5% said the major achievement was a rise in pensions, 17.3% said it was a shift to an individual accounting system and 12.9% said it was the elimination of bureaucratic obstacles. About 18.8% found it difficult to respond. The poll indicated that roughly 80% of respondents are interested in reforms in the pension system (SSPFA, 2009a). It is interesting that a majority believe that the plastic cards are a much more important achievement than the new accounting system. Judging reforms from a technical perspective, the public may have missed the real essence of the reforms.

Meanwhile, not many debates are going on in society related to pension reforms. Only a few involved and interested organizations are raising this issue and then only rarely. The majority of the population still does not understand either the concept of the pension reforms or the new method of new pension calculations. The majority of the public is more interested in the raise of the basic pension. At the same time even public agencies and ministries do not express their opinions on the pension reforms and what it implies for their ministries' work.

³⁷ Before the reforms the pensioners were getting their pensions from the cashiers at the local SSPFA offices.

4.6. Key Challenges and Recommendations

Most of the indexes of the pension system sustainability are currently favorable to Azerbaijan. The average replacement rate is defined as the ratio of the average pension benefit to the average wage not exceeding 38% (by the end of 2009 pensioners were receiving €87.30. On average that was approximately 34% of average salary level in the country). At the same time, the demographic dependency ratio, which is defined as the ratio of people 60 years and older to people aged between 15 and 59 years old, was constantly decreasing reaching 12.7 - 12.8% in 2008-2009, the lowest figures since independence. These figures hint that the pension system is not going to be affected by demographic pressure within the near future. The system will be able (with proper tax collection) to collect enough funding to sustain the pensions of old-age people. Meanwhile, recent trends suggest that the burden created by the system will be lightened since less people will retire because of the increase in the retirement age and the willingness of those eligible to retire later. For example, it was expected that around 14,000 people would become pensioners in July-September 2010, but in fact only 8,800 people would retired.

However, despite the low demographic dependency ratio, the sustainability of the system could be under question within the next few decades. With the decrease of the birth rate since independence, the share of the population in the 0-14 age cohort is steadily decreasing, reaching 25% of the total population in 2008. With the constant increase of the population in the age group 65 and over and life expectancies of males and females in the country, within one or two decades the pension system will face serious problems. The demographic statistics also indicate that within the next decade people who were born in the years 1948-1958 will retire. These years are considered “baby boom” years in Azerbaijan. Large numbers of retired elderly people would put additional pressure on the social security system that already covers a large deficit using funds from a state budget buoyed by high oil prices. However, it is expected that income from oil will gradually decrease as well as the receipts to the state budget. Thus, the government could have a serious problem as regards covering the payment of pensions.

There are several steps that the government may take in order to mitigate future social and financial problems. First, the government should continue its policy of “bringing back” unregistered businesses and employees from the informal to the formal sector. The “One Window Policy” is a good example of the government’s successful move towards legalization of the informal sector. However, this policy covers the minority of businesses and organizations. It would be advisable for the government to reduce social taxes that are at 25% of wages to a sustainable minimum. In addition, altering the share of social tax payment toward a greater contribution from employees will lessen the employer’s incentive to evade taxation. Such an approach would also reduce informal payments and reduce the operation costs for businesses. Meanwhile, the government should continue its work on increasing the number of people with personal accounts. This would allow registering most working people and thereby obliging them to pay contributions.

Second, the government should begin considering social security for those who are working in areas that usually do not pay contributions especially agriculture and self-employed people. Over a million people are involved in farming, subsistence agriculture and self-employment and are marginally covered by the social security system. Today, they do not usually pay contributions to the system and in future will not be covered by social security. They are able to receive only the basic portion of the pension. In case of eliminating the basic pensions, these people will not get anything and will be vulnerable. The government should develop a new mechanism of taxing these categories of people.

Last but not least, the government should take serious steps towards preparing the launch of private pension funds within the next five to six years. It is stipulated in the State Program that a legislative basis should be prepared based on the experience of other countries. Nevertheless, the government should start working with financial institutions within the country to prepare them for the launch of pension funds. The Central Bank should also come out with a mechanism of regulation of such funds. The government should understand that without these funds it will not be able to fully switch to a funded pension system. Private funds would lighten the burden on the government and the state budget and allow future pensioners more choice in their investments.

Appendix:

Table 4.1 Selected Indicators

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Age dependency ratio (% of working-age population)	61	60	58	57	55	53	52	50	49	47	
Age dependency ratio, old (% of working-age population)	9	9	9	9	10	10	10	10	10	10	10
Age dependency ratio, young (% of working-age population)	52	51	49	47	45	43	42	40	38	37	36
Demographic dependency ratio (%)		15.2	15.3	15.4	15.2	14.9	14.2	13.6	13.1	12.8	12.7
System dependency Ratio (%)									30.5	31.1	31.3
Life expectancy at birth, female (years)	70	70	70	71	71	71	72	72	72	72	73
Life expectancy at birth, male (years)	63	63	64	65	65	66	66	67	67	68	68
Life expectancy at birth, total (years)	66	67	67	68	68	68	69	69	70	70	70
Population ages 0-14 (% of total)	33	32	31	30	29	28	27	27	26	25	25
Population ages 15-64 (% of total)	62	63	63	64	64	65	66	67	67	68	69
Population ages 65 and above (% of total)	5	5	6	6	6	6	7	7	7	7	7
Survival to age 65, female (% of cohort)	76	76	76	76	76	77	77	77	78	78	79
Survival to age 65, male (% of cohort)	60	61	62	63	64	65	66	67	68	68	69
Average monthly pension (Euro)		11.82	16.07	18.06	15.70	23.84	22.01	30.29	38.74	61.11	85.12
Average monthly salary (Euro)		44.36	53.39	63.67	62.61	62.14	71.91	97.60	120.7	181	237
Average replacement rate (%)		26.6	30	28.1	25	38.3	31	31	32	34	35
Employment rate of pensioners (%)				8.1	7.7	7.2	7.2	7.3	7.4	9.1	9.5

Sources: World Development Indicators. Azerbaijan State Statistical Committee., *Health and Social Security*, <http://www.azstat.org/statinfo/healthcare/en/006.shtml>.

Table 4.2 Number of Pensioners (Based on information of Social Security Fund, at the beginning of year, person)

	2007	2008	2009	2010
Total number of pensioners	1,226,772	1,248,683	1,275,138	1,299,200
	of which:			
Old - age pension	807,066	821,026	835,844	859,228

Disability pension	280,682	291,092	301,661	301,661
Survival pension	139,024	136,565	137,633	138,311

Source: Azerbaijan State Statistical Committee, *Health and Social Security*,
<http://www.azstat.org/statinfo/healthcare/en/006.shtml>.

Table 4.3 Number of Pensioners by Sex (Based on information of Social Security Fund, at the beginning of year)

	2008			2009			2010		
	Total	of which:		Total	of which:		Total	of which:	
		men	women		men	women		men	women
Number of pensioners	1,248,683	473,136	775,547	1,275,138	496,788	778,350	1,308,432	516,142	792,290
of which:									
Old - age pension	821,026	280,581	540,445	835,844	288,547	547,297	858,659	299,063	559,596
Disability pension	291,092	153,707	137,385	301,661	168,095	133,566	311,849	174,182	137,667
Loss of head of family	136,565	38,848	97,717	137,633	40,146	97,487	137,924	42,897	95,027

Source: Azerbaijan State Statistical Committee, *Health and Social Security*,
<http://www.azstat.org/statinfo/healthcare/en/006.shtml>

**Table 4.4 Azerbaijan: State Social Protection Fund, 2003-10, million Euros
(million AZN)**

	2003	2004	2005	2006	2007	2008	2009	2010
Total revenues	305.07 (378)	312.79 (418)	460.71 (503)	516.08 (592)	867.47 (1,080)	1,122.92 (1,268)	1,543.61 (1,775)	1528.0 (1,757.2)
Total payroll tax:	179.97 (223)	208.78 (279)	289.43 (316)	368.76 (423)	642.57 (800)	812.08 (917)	1,111.40 (1,278)	1061.8 (1,221)
<i>Of which:</i> Payment by non-budgetary agencies	123.48 (153)	143.67 (192)	184.10 (201)	241.48 (277)	408.03 (508)	453.42 (512)	639.19 (735)	605.3 (696)
Transfer from state budget	124.29 (154)	102.52 (137)	170.36 (186)	145.58 (167)	224.10 (279)	309.95 (350)	430.47 (495)	464.1 (533.7)
Total expenditures	299.42 (371)	302.31 (404)	453.38 (495)	493.42 (566)	807.23 (1,005)	1,122.92 (1,268)	1,543.61 (1,775)	1,528.0 (1,757.2)
Old age pensioners	156.57 (194)	163.88 (219)	197.84 (216)	410.60 (471)	653.01 (813)	1,044.10 (1,179)	1,443.60 (1,660)	1,420.9 (1,633.9)
Including:								
Base part of pension						769.57 (869)	1,052.27 (1,210)	989.65 (1,138)
Insurance part of pension						274.53 (310)	391.34 (450)	430.47 (495)
In% of GDP								
Total revenues	5.3	4.9	4.0	3.2	4.0	3.3	5.1	

Total payroll tax	3.1	3.3	2.5	2.3	3.0	2.4	3.6	
Payment by non-budgetary agencies	2.1	2.3	1.6	1.5	1.9	1.3	2.1	
Transfer from State Budget	2.1	1.6	1.5	0.9	1.0	0.9	1.4	
Total expenditures	5.2	4.7	4.0	3.0	3.7			
Pensions	2.9	2.8	1.9	2.7	3.4	3.1	4.8	
Including:								
Base part of pension						2.2	3.5	
Insurance part of pension						0.9	1.3	

Source: State Social Protection Fund of Azerbaijan Republic. *Statistics, Annual Budgets*.

<http://www.sspf.gov.az/view.php?lang=az&menu=0>

* The division of pension into base and insurance part started in 2006.

** The Euro-Manat exchange rate of 2009 was used to convert the numbers for 2010.

Sources: Social Protection Fund.

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Chapter 5: Health and Long-term Care Systems: Access, Viability and Reform Challenges

5.1 Structure of Health and Long-Term Care Systems in Azerbaijan

Historical background

Before the country's independence in 1991, the Azerbaijani healthcare system was part of the centrally organized Semashko system, which was intended to provide universal and free access to health care. It was administered from Moscow. However, even after 1991 and operating in a new, market-based economic environment, health care in Azerbaijan retains its fundamentally Soviet features. The serious economic challenges of the transition put unprecedented pressure on its current forms of operation.

As a result, in order to sustain operations and provide salaries for doctors, hospitals began to charge their patients informal payments for services. These informal payments were not reported, as they were illegitimate, therefore they did not lead to a transition in the public medical infrastructure. In fact, they only profited doctors and encouraged corruption: those in charge of medical administration and issuing licenses demanded bribes from practicing doctors, who in turn received informal payments from their patients. Essentially, while medical personnel adapted to market realities, shared public utilities and institutions lagged behind.

Also, over the last decades, since independence, private medical companies have been introduced and developed. However, in the absence of widespread and affordable medical insurance options, high prices still cut off a substantial portion of the population from timely and effective medical care.

5.1.1 Health Outcomes (EU and NAT Indicators)

Azerbaijan traditionally has had high life expectancy and birth rates, persisting from the Soviet years well into the period of independence. The life expectancy at birth for the Azerbaijani population was 73.8 years in 2007 (76.3 for women and 71.3 for men), showing consistent increases since 2000 (WHO, 2009). In the same year, the mortality rate for men and women was 11.0 and 8.0, respectively, per 1,000 individuals. Infant deaths showed a substantial decrease: in 2007, 9.8 infant deaths occurred per 1,000 live births, less than half of the 22.9 deaths per 1,000 live births recorded in 1990. The maternal mortality rate, however, rose from 9.3 deaths per 100,000 live births to 24.3 in 2009, reflecting a further exacerbation of the problems indicated by past high maternal mortality rates.

The official data on a range of health indicators contradicts the data from international sources. For example, according to the World Bank, life expectancy at birth in Azerbaijan is 65 years, while official statistics (SSC, 2008) report 72 years. The discrepancy in data also occurs with regard to mortality rates and other country indicators. One explanation

might be different definitions of terms between the EU and WHO, and the old Soviet-inspired Azerbaijani calculation. Thus, the Azerbaijani Department of Health Services (Az-DHS) 2006 survey which was carried out according to international standards, calculated the infant mortality rate to be 43 per 1,000 live births, while the government estimates for the same period reported a figure as low as 12 per 1,000 live births. WHO (2008) argues that “as with infant mortality rates, maternal mortality rates in Azerbaijan use a more narrow definition than that advocated by WHO, as it covers the death of pregnant women only beyond 13 weeks gestation or up to 14 days after delivery/termination.”

In Azerbaijan, the mortality rate of those under 65 years old is almost three times lower than the population's overall mortality rate for both genders. According to WHO Europe Health for All Database (HFA-DB) (2009), the mortality rate for women under 65 was 2.3 per 1,000 in 2007, almost 3.5 times as low as the mortality rate for the overall female population in Azerbaijan in the same year. The same was true for men, with a death rate at 4.4 per 1,000 under 65, thus 2.5 times lower than the figures for the whole male population (11.0 persons per 1,000).

Unlike those of other former Soviet and eastern European states, the Azerbaijani mortality indicators are not stable. This is especially true for the infant and maternal mortality rates, which after a brief period of decline began to rise again during the second half of the decade. However, while infant and maternal mortality rates in the country are, at times, twice as high as those of the other countries of the former Communist bloc, a high number of births and a relatively high life expectancy guarantees a consistent population growth of around 1% a year – an impressive figure when compared with other European countries.

Alcohol consumption in Azerbaijan is disproportionally high in comparison to countries with a similar socio-economic situation and cultural background. According to WHO calculations, the per capita consumption among adults (≥ 15 years) amounted to 4.5 liters of pure alcohol in 2003. The same indicator for neighboring countries was reported as the following: in Turkey, 1.4 liters of pure alcohol were consumed in 2003 per capita among adults, and in Georgia, Armenia and Uzbekistan 1.5 liters (WHO, 2008).

On the other hand, in terms of vaccination, Azerbaijan is doing well. For example, according to WHO Europe HFA-DB (2009), 96% of all Azerbaijani children were vaccinated against measles in 2006. However, various estimates show that a consistent vaccination pattern, i.e. vaccination of more than 90% of children, is only assured for infants ranging from 18 to 29 months. Older children are often passed over during periodic vaccination.

5.1.2 Organization and Structure

Health care provision in Azerbaijan is divided between the Ministry of Health and local authorities. In theory, the Ministry of Health is responsible for the effective operation of the entire health care system. However, the current system limits its direct management

powers over local and rural hospitals, which are operated by district and municipal authorities, respectively. The Ministry of Health owns the central institutions and some further facilities such as republican hospitals and research institutes. The district administrations and cities own local hospitals, district polyclinics and specialist dispensaries. In addition, some ministries directly provide select health services for their employees. The majority of health care facilities are state owned, but some facilities have been privatized (Ibrahimov, Ibrahimova, Kehler, & Richardson, 2010). Recently, the non-governmental organizations initiated provision of some health care services. Among these organizations are professional associations (for pulmonologists, psychiatrists, etc.), League of Diabetics, and the Heydar Aliyev Fund. The latter is noteworthy as the Fund has implemented a number of health related initiatives, including rehabilitation of health facilities, hospitals, screening and treatment of thalassaemia.

5.1.3 Public Health Services, Primary and Secondary Health Care, Long-term Care

Public health services can be divided into free and charged-based ones. Although formally free, in the majority of cases patients are required to pay informal fees. According to the Law on Protection of Population Health (1997), “children, students, invalids and pensioners have the right to be examined free of charge.” Additionally, there is a list of around 100 drugs that public health facilities are obliged to provide free of charge. Moreover, free immunization and vaccination are provided in state and municipal medical facilities. Public institutions also provide free medication to certain patients, e.g. those affected by HIV/AIDS, tuberculosis or diabetes (Ibrahimov et al., 2010).

Primary health care services are provided through the central district hospitals and polyclinics in urban districts; and aid posts and ambulatory clinics in rural districts. Dental services are provided both in public facilities and private clinics. However, individuals face obstacles in receiving primary care including the lack of service availability in remote areas, low quality, etc. The main challenge to obtaining primary health care is the failure of doctors to systemically refer patients. With this “gatekeeper function” missing, patients might bypass primary care practitioners and institutions and turn directly to secondary and tertiary health care providers. This, in turn, undermines the ability of primary health care to function effectively. Moreover, among other acute problems, is the shortage of medical personnel in rural areas, where there is no inflow of specialists or replacement of retiring older personnel (Ibrahimov et al., 2010).

According to Ibrahimov et al. (2010), during the Soviet period there were “3.9 physicians per 1,000 population, which was in line with the Soviet average of 4.0 physicians (physical persons) per 1,000 but significantly higher than the average across the WHO European Region of 3.3 physicians per 1,000”. However, Azerbaijan saw a substantial decrease in this number during the independence period. Until the early 2000s, the ratio stabilized at around 3.6 physicians per 1,000, still remaining above the average European figure of 3.4. The same dynamics are visible regarding the number of nurses. In 1990, there were 9.7 nurses per 1,000 citizens – which were close to the CIS average of 9.4, but higher than the average WHO figures for Europe. However, during the subsequent

period, Azerbaijan experienced a substantial decrease, and in the early 2000s the number of nurses stabilized at around 7.3 nurses per 1,000 citizens, this time close to the European average of 7.3.

Secondary health care includes both specialized ambulatory services and hospitals providing basic care. Tertiary care provides more complex, specialized health services. There are approximately 735 hospitals in the country. In addition to the standard health facilities, there is a network of sanatoria, established to provide rehabilitation and post-discharge care. The major challenge of the secondary and tertiary health care is underinvestment, and a resulting constant deterioration of buildings and equipment. Since the middle of the decade, with favorable macroeconomic changes, the government started to invest in infrastructure and facilities. Among the other challenges of the health care system is centralization: secondary health care spots are located in the centers of regions, while all tertiary hospitals are in the capital, preventing timely and cost-effective care of patients in the provinces.

Long-term care is defined as the care of the elderly and disabled people that does not involve direct health care interventions. It is administered by the Ministry of Education, the Ministry of Health, and the Ministry of Labor and Social Protection. There are six different forms of institutions: sanatoria, baby-houses, *internats* (residential schools for orphans and abandoned children), boarding schools for children with special needs, orphanages and kindergartens. In addition, care for adults with mental illnesses is provided by specialized institutions (WHO, 2004).

5.2 Access and Quality of Health and Long-term Care Services

According to the World Bank Survey in 2002 “one in three households in Azerbaijan declared that they could not make use of health services when needed, because they were too expensive. Many people, particularly the poor, tend to postpone seeking treatment, and often do not have the means to pay for preventive care, either.”

Certain vulnerable population groups (IDPs, pensioners, veterans of wars and disabled individuals) are entitled to special medical benefits, including being reimbursed for a certain percentage of drug expenditure. Moreover, as was already mentioned, according to the Law on Protection of Population Health (1997), “Children, students, invalids and pensioners have the right to be examined free of charge.” However, all of the household surveys show that out-of-pocket (OOP) payments are the primary means of access to medical care for the absolute majority of population. The lack of financial resources results in the use of a system of formal and informal (“under the table”) OOP payments for all health care services. Formal payments are charges for services or pharmaceuticals not covered by the state and payments for services in private clinics. OOP payments account for about 60% of the overall health expenditure in Azerbaijan (Ibrahimov et al., 2010). As a result of the over-reliance on OOP coupled with substantial poverty, the current system leads to unequal access to health care services for various groups within the population.

In addition to the centralization of secondary and especially tertiary health care providers in Baku, as mentioned in the previous subchapter, there is also a regional disparity of access to health care services. According to the Ministry of Health, differences in access and the quality of health services in rural and urban areas can be explained by vacant positions for physicians and a lack of qualified medical personnel in rural districts (Ibrahimov et al., 2010).

With the majority population ethnic Azerbaijani (over 90%), Azerbaijan has a number of smaller ethnic minorities groups such as Lezgins (2%), Russians (1.8%) and others (Armenians, Talyshs, Tatars, Turks, Jews, Avars, etc.). Though people from some migrant or ethnic minority backgrounds may have more difficulty in receiving, or receive worse, health care provision (for example, discrimination can create barriers to accessing health care services) data substantiating this are not available and such discrimination has not been discussed in reports. According to the Law on Protection of Population Health (1997), non-residents also have access to health care services, such as treatment of common diseases, emergency care, implementation of sanitary-hygienic and anti-epidemic activities, and family health interventions.

IDPs still suffer from psychological stress connected to their displacement. This is especially noted among elderly displaced people whose health problems seemed more severe due to additional factors of being displaced, lower family income, and lack of health facilities, personnel in their place of residence. Although IDPs are legally exempt from payment for health services, they still have to pay informal fees like all other residents (IDMC, 2008).

There is no information available about waiting times, but the figures about patient admission may be a reliable source of assessing the access to health care. During the independence period the patient admission rate in Azerbaijan, already low by European standards, declined further. While in 1995 there were 6.8 in-patient care admissions per 100 individuals, in 2006 the number dropped to 5.9 admissions (Ibrahimov et al., 2010).

The overall quality of health care services has deteriorated after the collapse of the Soviet Union, mainly due to the lack of funding, the poor infrastructure of health facilities and the inefficient training of physicians. Several surveys (USAID, 2003; WHO, 2008) point out the poor quality of existing reproductive health care services. The Ministry of Health confines its activities to the development of regulations and procedures that aim at guaranteeing the overall quality and volume of health services provisions. The Ministry also oversees the regulation of pharmaceuticals and medical equipment used in the country. However, it does not administer periodic or one-time certification of health facilities, let alone medical practitioners. In fact, no centralized authority regulates the proficiency level of practicing doctors. On the other hand, safety and infection control is administered by the sanitary-epidemiological bodies.

The Cabinet of Ministers signed an order on mandatory certification of medical personnel on June 12th, 2010. Henceforth, medical personnel have to pass a centralized certification exam every five years. The mainstream medical education requires six years of

undergraduate education and a one year internship. The Azerbaijan Medical University is the only provider of medical education in Azerbaijan.

The deterioration of health in Azerbaijan is illustrated by various independent sources, for example the Azerbaijan Demographic and Health Survey. It reveals a number of discrepancies between official accounts of the health situation in the country and reports of independent international agencies (AzDHS, 2006). For example, while the government argues that the life expectancy in Azerbaijan is stable, or even following a slightly positive trend - life expectancy is reported to have risen by one year between 1990 and 2002 - World Bank estimates show that life expectancy in the country actually decreased by six years in this period. Further analyzing the health status of the Azerbaijani population, the report points to the “premature death of adults [as] the major cause of low life expectancy in Azerbaijan” (World Bank, 2005). Non-communicable diseases such as cancer, problems with the respiratory and digestive systems or diseases of the circulatory system are among the major causes of death for adults in Azerbaijan, and they thus seriously affect the overall health situation of its population.

Social work and the provision of social services, including mental health services, are poorly developed in Azerbaijan. The mental health sector especially experiences serious problems. According to the WHO Assessment Instrument for Mental Health Systems Report (AIMS2007) there is no systematic approach or long-term strategy in Azerbaijan to deal with mental problems, especially when it comes to emergencies and *force majeure* situations that substantial portions of the population may face. Recent years have shown a great increase in suicides (more than 360 cases per year), and official investigations show that the majority of cases involved mentally ill people. The psychological stress caused by socio-economic hardships occurring in a post-war transitional country, coupled with a cultural environment of strict taboos, calls for more active work targeting the psychological problems of the population.

However, Azerbaijan’s health care system appears to be absolutely unprepared to deal with the growing need for psychologists and psychiatrists. The former are almost non-existent, and the majority of graduates from the local psychology departments are not fit to deal professionally with the current problems of social work. According to the State Statistical Committee, in 2008 there were 445 psychiatrists in Azerbaijan (SSC, 2008). They are, however, pooled in secondary care institutions, where only individuals that are recognized as psychologically ill have access. The psychological problems of the ordinary population are socially taboo, and their treatment is not welcomed by professionals, either. As a result, individuals in need of a primary medical care regarding psychological treatment are effectively cut off from any support.

5.3 Healthcare Financing and Expenditure

On average, about 25% of public funding for health care is allocated by the Ministry of Health, while the remaining 75% is managed at the district level through the funding of local branches of the executive power (WHO, 2004). However, the health care system is

considered to be funded both publicly and privately due to informal payments (OOP payments) and private (voluntary) insurance.

Individual (voluntary) medical insurance is provided for about 1% of the working population, mainly benefiting the employees of oil companies and inter-governmental organizations. There is no centralized state insurance policy, but there are some spheres in which the government provides insurance for workers (e.g., the oil business). The insured person is a client of a private company. Depending on the insurance contract, the company covers only a range of selected health-related problems; dental services are, for instance, usually excluded from coverage. For covered expenses, either the individual pays and is later reimbursed, or the insurance company covers the costs directly. In either case, the insurer has the ability to bargain for the services' costs, depending on its relative strength and weight on the local medical market.

Providing mandatory insurance for the whole population is urgent, but has not yet been fully realized in Azerbaijan. In January 2008, the Government of Azerbaijan has introduced mandatory health insurance and established the State Agency for Mandatory Medical Insurance. However, this agency is not yet operational.

The country's drastic economic downturn during the post-Soviet period seriously affected health care expenditures in Azerbaijan. Up to the year 2000, public spending on health care did not exceed €6.47 (USD6) per capita. However, the situation is changing dramatically since the beginning of the 2000s, when the country started to receive the first oil revenues. As a result, in 2008, the per capita expenditure on health care even exceeded the predicted figure of €35.47 (USD50) per capita (Ibrahimov et al., 2010). Yet the share of the GDP spent on health care has not changed drastically. In 2006, WHO reported that Azerbaijan had spent 4.1% of its GDP on healthcare. Other sources (UNICEF, World Bank) cite numbers as low as 1%. At the same time, the share of the state's budget allocated to health care decreased from 5.4% in 2000 to below a projected 3% in 2008 (Ibrahimov et al., 2010). Such figures exemplify the relatively low priority of health care in the government's current policy agenda.

The exact share of Azerbaijani public and personal spending on health care is difficult to estimate. The main difficulty is the interception and evaluation of out-of-pocket payments, which constitute the majority of the population's health care spending. Moreover, drug stores tend to underreport the value and volume of their sales. Currently, the organizational relationship between purchasers and providers in the Azerbaijani health system is "integrated", with many "providers [...] actually owned by the payers" (Ibrahimov et al., 2010). The government tries to reform the system, separating purchasers from the service provision sector.

The comparison of Azerbaijan's public health care expenditures with those of other countries reveals a substantial lag: with regard to its GDP, Azerbaijani health care expenditures take up the lowest share among all post-Soviet and post-Communist countries. Specifically, according to the TransMONEE 2010 database, the general government expenditures on health for Azerbaijan were 0.9% of GDP in 2008. This was

followed by Turkmenistan at 1.0%, Tajikistan (1.5%) and Armenia (1.7%). The respective figures for some other post-Soviet economies were the following: Georgia 1.8%, Kazakhstan 2.4%, Uzbekistan 2.5%, Kyrgyzstan 3.2% and the Russian Federation 3.4%. In the other post-Soviet and post-Communist countries the figures were generally higher. The public expenditures on health as percent of GDP in 2008 were 3.8% for Ukraine, 4.9% for Belarus, 5.6% for Slovenia, 5.8% for the Czech Republic, and 6.6% (the highest among the post-communist countries) for Croatia (TransMONEE, 2010).

As the UNICEF report *Budget Investments in Health and Education of Azerbaijani Children* argues, “not only is Azerbaijan spending much less of its GDP on health than most of the countries in the world, but also it spends very little relative to its economic capacity and what could be accepted as a ‘norm’” (UNICEF, 2008). Moreover, according to calculations by the World Bank, this will remain the case for approximately five decades, based on a number of assumptions about the intensity of the use of health services among elderly cohorts, the availability and use of health goods and services, and their respective costs. These projections do not take into consideration possible future changes of political priorities. However, for a range of reasons, by tying health-related expenditures to a country’s economic situation, demographic tendencies, and other important factors, these projections seem to cohere with real development dynamics.

The projected dynamics of health care spending as a share of GDP by the World Bank shows that for the upcoming four decades, until 2050, Azerbaijan will still be among the lowest health care spenders in the region. The share of health care spending for Azerbaijan constitutes: 0.97% (for 2020), 0.99% (for 2030), 1.00% (for 2040) and 0.96 (for 2050). As a result, the World Bank projects a slight increase (0.06%) in comparison with the indicators from 2005.

As Azerbaijan’s regional neighbors mostly maintain their current health care spending relative to GDP (the biggest positive increase is expected in Uzbekistan: +1.36%, while the greatest decrease might take place in Bosnia and Herzegovina (–1.34%), Azerbaijan will still occupy one of the bottom places, spending more than Armenia (0.51% in 2050, a decrease of 0.77% in comparison to 2005), Georgia (0.67% in 2050, or a decrease of 0.24% in comparison to 2005), and slightly less than Tajikistan (1.56% in 2050). These projections are based on aging projections and extrapolate previous dynamics of GDP per capita expenditures on health and other related indices into the future health care policy of the governments under consideration (Mukesh Chawla et. al, 2007).

More autonomy for medical institutions might alleviate their financial strains. The tight control over health care providers in the current centralized system allows them limited freedom and few opportunities to develop and raise the quality of their services. For instance, rural health care providers have no independence over financial issues and staffing decisions. It is not uncommon if they do not even know the financial resources at their disposal. In urban environments, the suburban hospitals and health care institutions under the direct supervision of the Ministry of Health have more autonomy in hiring staff. However, they, too, are under strict systematic control of their spending that limits their financial independence. In recent years, this already strict control over these

institutions has become even tighter. These dependencies limit the ability of health care providers to be proactive and positively change the quality of health care services in Azerbaijan.

In addition to their limited autonomy, health care institutions experience a lack of qualified staff and extremely low wages in the health care sector. The average salary for health care personnel was 89.9 AZN (€72.2) in 2007, or only less than half of the average Azerbaijani salary in all sectors combined (Ibrahimov et al., 2010). The minimum subsistence level, which is calculated on the basis of a minimum basket of products, is officially set to be at 79 AZN (€63.45), while independent calculations report 110 AZN (€88.35). When compared with these figures, the difficult financial situation of public health care workers becomes obvious. As a result, OOP payments, only formal in private clinics and in a number of public hospitals, but informal in all other public hospitals, are the main source of income for many public health workers. In the private sector, physicians keep a certain share of the fees their patients pay, leading them to examine and treat even patients without serious problems that merely came for diagnostics.

There are today three different Azerbaijani state agencies that oversee pharmaceuticals, instead of the single agency that was in charge in the period from 1996 to 2005. The Department of Licensing and Medical Equipment of the Ministry of Health oversees the registration and licensing of pharmaceuticals. The procurement of pharmaceuticals is orchestrated by the Innovation and Supply Center, and ensuring their quality is the main function of the Analytical Expertise Centre for Medicines.

Despite the strict control over the pharmaceutical sphere, there is no control over the prices of pharmaceutical products (Ibrahimov et al., 2010). Azerbaijani pharmacies are free to charge any price for the items they sell. Distribution and promotion of the drugs is also totally in the hands of private companies and distributors. There is virtually no local production of pharmaceuticals: less than 1% of the local demand is met by locally produced drugs. World Bank estimates put the turnover of the local pharmaceuticals market at USD120 to USD150 million (€88 to €110 million) in 2004 (WB, 2005). By the end of 2008, there were 876 retailers and 107 drug importers in Azerbaijan.

5.4 Policy Development, Reforms and Program Monitoring

5.4.1 Key Interventions

The Ministry of Health has started reforms of the Azerbaijani health sector, and is now actively involved in the reorganization of the provision of health care. Its interventions include, but are not limited to:

- a) The State Program on Poverty Reduction and Economic Development, Health Care Policy, 2003-2005
- b) Health Sector Reform Project, 2001, 2006-2012
- c) Reproductive Health and Family Planning Project, 2004

- d) Tuberculosis DOTS Program
- e) Response to the HIV/AIDS Program
- f) The State Program on Immuno-prophylaxis of Communicable Diseases, 2006-2010
- g) National Malaria Control Program, 1998
- h) National Mental Health Policy, 2008
- i) The State Health Programs, 2007–2009
- j) The National Concept on Health Financing Reform, 2008

5.4.2 Implementation: Capital and District Levels

The Health Sector Reform Project was started in 2001 with the primary development objective of exploring ways to strengthen and reform district health care services. The major drivers of reform are international agencies and donors. In some cases, the government takes steps to successfully meet its international obligations (e.g., the tuberculosis monitoring in penitentiary institutions). The second Health Sector Reform Project is being conducted from 2006 to 2012, and focuses on improvement of health system financing, access to and quality of health care services in selected pilot districts (Ibrahimov et al., 2010).

A milestone in the development of nation-wide reforms of the health care sector was the creation of the Public Health and Reforms Center (PHRC) with its Department of Health Communication and Public Relations (DHCPR), as part of the Ministry of Health. Prior to the center's launch, there was virtually no implementation of nation-wide reform programs or orchestrated communication on health. The DHCPR has the authority to regulate health campaigns and is currently cooperating with international agencies like USAID to develop a national strategy of health communication. In addition, PHRC has been introducing a number of evidence-based medical guidelines (Ibrahimov et al., 2010).

Despite the introduction of the DHCPR, the government still allocates very few resources to public health communication programs. The majority of these programs are proposed and sponsored by international agencies. Among the successful health communication programs is the enrichment of nutritional salt with iodine, as a prophylactic measure to prevent goiters, especially among the mountainous population of Azerbaijan. Another program, introduced in 2004, is the supply of vitamin A to two-month, 18-month and 6 year-old children.

Another example of the program, the PHC revitalization project in the Quba district, was supported and implemented by UNICEF and tried to introduce a new model of primary care to the country. In 1997, it was extended to four other districts (Masalli, Lankaran, Calilabad and Neftcala). Its goal was to identify ways to reform primary health care services at the district level, and it comprised the following components: staff training,

improving management and organizing a national dialogue on policy changes, monitoring and evaluation processes (WHO, 2004).

The government of Azerbaijan contributes substantially to combat the spread of HIV/AIDS in the country. Considerable work has been done to establish an effective system of diagnosis, early detection and treatment of the disease, covered by an extensive legislative basis. As the UNESCO report (2005) argues, “the New National Strategic Plan for 2002-2006 approved by the Cabinet of Ministers is oriented as a multi-sectional approach to the response to HIV and AIDS, and provides for the cooperation of different ministries, departments, non-governmental and international organizations, making them all partners in the joint activities.”

The National Mental Health Policy (2008) is focused on the development and improvement of mental health resources and services, and the integration of mental health services into primary health care.

The National Concept on Health Financing Reform (2008) puts a special emphasis on introducing the state guaranteed basic benefit package and mandatory health insurance, which is also viewed as an additional source of funds for health care. This basic benefit package will be fully introduced by the end of 2012 (Ibrahimov et al., 2010).

5.5 Key Challenges and Recommendations

The biggest challenge to these reforms is the increasing centralization of the health care system, while this sphere is neglected politically. The lack of funding is one of the major barriers to the implementation of new reforms, and it is not projected to be addressed in the near and medium-term future (Section 5.3). With public hospitals and clinics in a very difficult situation, the tendency to over-centralize leaves the local staff with little independence and flexibility to introduce improvements. Addressing the negative impact from under-funding health institutions, the UNICEF report (2008) describes children and women as the primary victims. The report argues that low investment in health care “can decrease access to health services and increase morbidity, especially among the most vulnerable groups in society and may, in the longer-term, result in higher child and maternal mortality even though childhood mortality rates can have many immediate and underlying causes varying from healthcare to nutrition, from water and sanitation to mothers’ education.”

The implementation of effective reforms requires cross-sectional initiatives and involvement from various sides. Currently, there is no systemic vision within the government about the future of health care in Azerbaijan. All current initiatives only touch isolated aspects of the health care system, while the system itself is a relic from Soviet times, hardly meeting the demands of the market-based economy under which it operates. This, in addition to the inflexible financial and staffing policies, encourages rampant corruption and informal payments, as doctors try to gain as much as possible financially by treating and at times even operating on basically healthy patients.

Among other challenges to the development of the Azerbaijani health care system is the change in cultural attitudes to health-related issues of society. For instance, the persistence of strict cultural taboos to discuss sexual issues prevents a public debate about the causes and prevention of sexually transmitted diseases, including HIV/AIDS. Moreover, the population tends to ignore the possibility of private health insurance, and this is true even for those who could afford it. One of the priorities should be the introduction and implementation of a national health insurance program, as currently less than 1% of the population is insured.

In Azerbaijan, vaccination is mandatory only for children, and adults undergo vaccination only where it is needed for administrative reasons (e.g., as a requirement when traveling to other countries, or when their job requires vaccination). This problem is aggravated by the general reluctance to pay routine and periodic prophylactic visits to doctors, which is a symptom of a cultural disregard for the importance of a sustained good personal health. The majority of the population only seeks help on a case-by-case basis, or at later stages of serious health problems that require treatment in secondary or tertiary health care institutions.

Despite this unfavorable cultural environment, the government has managed to improve some health-related issues substantially. For example, it created a functional infrastructure to deal with the detection and treatment of HIV/AIDS. It also has a very proactive policy to popularize sport among young Azerbaijanis: Olympic Sport Complexes have been built in almost every major regional center throughout the country, with free entrance for children and young people.

Among the major practical problems that should be tackled is the reduction of maternal and child death rates. The shortage of medical personnel, especially in rural areas, is a problem that will be aggravated if current migration patterns persist. The second problem of utmost urgency is the separation of psychology and psychiatry in the country. Currently, both are exercised in psychiatric institutions, while there is virtually no place where individuals with mere psychological problems can receive effective assistance.

Conclusion

The current situation of Azerbaijan's health-care system is characterized by governmental inefficiency in a social and economic environment less favorable for health care than that of the Soviet period. Unfortunately, the Azerbaijani government has so far not been able to render the system more transparent and, therefore, more efficient. At the same time, the amount of health expenditures as a share of the Azerbaijani GDP is still relatively low when the financial potential of the country is taken into account.

Informal payments (OOP payments), coupled with a lack of adequate funding, leads the doctors to charge arbitrary fees for their services. At the same time, while these payments are not accounted for, they do not contribute to the overall improvement of public health facilities. As a result, public hospitals and equipment are in a state of decay, while individual doctors are able to have decent (informal) incomes.

All these problems negatively affect the end users—who turn out to be patients with limited access to unsatisfactory treatment. In addition, the lack of a mandatory system of health insurance means that people themselves have to bear the high costs of the system. As a result, effective health care becomes a good that the majority of the Azerbaijani population simply cannot afford.

The unprecedented psychological stress caused by the socio-economic hardships of the post-Soviet transition, coupled with a cultural environment of strict taboos, calls for a more proactive engagement in terms of facing up to the population's psychological problems. Furthermore, taboos on sexuality prevent public debate and an effective fight against HIV/AIDS and related problems. Moreover, Azerbaijani culture is particularly open to male alcohol consumption and smoking, restricts the mobility of women and provides a high-cholesterol traditional diet.

In this challenging environment, the government could have been more active in attempting to improve the health situation of its population. The problems, however, are not easily solved. Each section of Azerbaijani health care suffers from systemic issues. The main challenge for the primary health care sector, for example, is the lack of systematic referral of patients. With no gatekeeper patients, might bypass primary care and turn directly to secondary and tertiary health institutions. The major challenge of the secondary and tertiary care sectors, on the other hand, is severe underinvestment that results in the accelerating decay of buildings and equipment.

To conclude, health care provision in Azerbaijan needs a systemic transformation in order to be able to address major problems that arise from the country's specific economic, social and cultural background. Thus, the government should elaborate a systemic vision of health care, and develop policies for its effective transformation.

Appendix

Table 5.1 Available Laeken Indicators

Indicator	Value	Source	Year
Self reported unmet need for medical care			
Care utilization			
Self reported unmet need for dental care			
The proportion of the population covered by health insurance			
Life expectancy (men)	62	WHO, http://www.who.int/countries/aze/en/	2006
(women)	66		
Life expectancy by socio-economic status			

Healthy life years (expectancy at birth) Men	56	WHO, http://www.who.int/countries/aze/en/	2003
Same, Women	59		
Healthy life years by socio-economic status			
Self-perceived limitations in daily activities			
Self-perceived general health (percent of people reporting poor health, 16+)	3.8	HBS	2007
Mortality rate (per 1000 population)	6.3	SSC , Statistical Year Book	2007
Infant mortality rate (per 1000 live births)	74.4	USAID http://www.usaid.gov/locations/europe_eurasia/health/docs/reproductive_maternal_and_child_health_chapter13.pdf	2001
Infant mortality	12.5	WHO, http://www.euro.who.int/document/E84991.pdf	2001
Infant mortality by socio-economic status (Rich)	35	UNICEF, http://siteresources.worldbank.org/INTAZERBAIJAN/Resources/HealthSectorNoteVol2_Chapt01.pdf	2000
(Poor)	102		
Vaccination coverage in children (percent) (DPT)	97	WHO, http://data.unaids.org/publications/Fact-Sheets01/azerbaijan_en.pdf	2002
(MMR)	99	WHO	2001
Cervical cancer screening			
Cervical cancer mortality rates (women per 100 000 population)	1.9	American Cancer Society, http://www.cureresearch.com/c/cervical_cancer/deaths.htm	2000
Colorectal cancer mortality rate (per 100 000 population)	6.4 men 4.8 women	American Cancer Society, http://www.wrongdiagnosis.com/c/colorectal/stats.htm	2000
Satisfaction with health care services			
Influenza vaccination for adults over 65+			
Breast cancer screening			
Breast cancer survival rate			
Perinatal mortality	58	WHO, http://www.who.int/making_pregnancy_saf	2000

		er/events/2008/mdg5/countries/final_cp_az erbaijan_18_09_08.pdf	
Total health expenditure per capita (USD)	25	WHO, http://www.euro.who.int/document/E84991.pdf	2001
	218	WHO, http://www.who.int/countries/aze/en/	2006
Total health care expenditure as a % of GDP	0.8	WHO, http://www.euro.who.int/document/E84991.pdf	2002
	3.4	WHO, http://www.who.int/countries/aze/en/	2006
Total long-term care expenditure as a % of GDP			
Projections of public expenditure on health care as a % of GDP (to 2050)	0,97	World Bank, http://siteresources.worldbank.org/ECAEXT/Resources/publications/454763-1181939083693/chaw_177-216_ch05.pdf	
Projections of public expenditure on long-term care as % of GDP			
Hospital inpatient discharges			
Hospital day-cases			
Obesity (%) Men	15.4	WHO, https://apps.who.int/infobase/report.aspx?rid=114&iso=AZE&ind=BMI	2006
Same, Women	24.9		
Sales of generics			
Acute care bed occupancy rates (%)	27.8	WHO	2007
Hospital average length of stay (days)	13.8	WHO	2007
Regular smokers (%)	0.9	WHO, http://apps.who.int/whosis/database/core/core_select_process.cfm?countries=aze&indicators=	2005
Percent of smokers, 16+	18.2	HBS,	2007
Alcohol consumption (liters)	4.5	WHO, http://apps.who.int/whosis/database/core/core_select_process.cfm?countries=aze&indicators=AlcoholConsumption&indicators=TobaccoUseAdultMale&indicators=TobaccoUseAdultFemale	2003
Total number of practicing physicians per 10 000 inhabitants	36	WHO, http://apps.who.int/whosis/database/core/core_select_process.cfm?country=aze&indi	2006

		cators=healthpersonnel	
Total number of practicing nurses and midwives per 10 000 inhabitants	84	WHO, http://apps.who.int/whosis/database/core/core_select_process.cfm?country=aze&indicators=healthpersonnel	2006
Public and private expenditure as a% of total health expenditure	24.8 government 75.2 private	WHO, http://apps.who.int/whosis/database/core/core_select_process.cfm?country=aze&indicators=nha	2005
Total expenditure on main types of activities or functions of care			

Table 5.2 Main Indicators of Public Health (per 10,000 of population)

Indicators	1996	2000	2001	2003	2004	2005	2006	2007	2008	2009
Physicians of all specialties, persons	38.4	36.1	36.5	36.5	36.4	36.6	36.8	36.6	38.1	38.6
Paramedical personnel, persons	88.1	76.7	75.4	73.1	73.1	72.6	73.1	73.2	73.1	73.8
Number of hospitals*	768	739	735	738	734	732	729	726	748**	756
Hospital beds	98.1	89.9	87.8	85.0	83.6	83.1	82.9	81.3	80.0	79.9
Number of ambulance-polyclinic service organizations*	1779	1611	1614	1603	1591	1594	1595	1589	1682**	1712
Number of female consultation units, children polyclinics and ambulances (independent and included in other organizations)*	943	879	913	917	916	922	923	914	904	906

*for total population

** including non-state medical institutions

Source: SSC, 2008, SSC 2009

Table 5.3 Life Expectancy at Birth (years)

Years	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total pop.	69.1	70.2	71.2	71.6	71.6	71.8	71.9	72.2	72.3	72.4	72.4	72.4	72.4
Male	65.2	66.3	67.4	67.9	68.1	68.6	68.6	69.4	69.5	69.6	69.6	69.6	69.7
Female	72.9	73.8	74.6	75.0	75.1	75.1	75.2	75.0	75.1	75.2	75.1	75.1	75.1

Source: SSC, 2008

Table 5.4 Mortality by Main Groups of Causes (per 100,000 of population)

Main causes	1995	2000	2002	2003	2004	2005	2006	2007
Total deaths by main causes	671,9	589,0	577,8	603,9	605,5	628,2	624,6	634,1
Diseases of the circulatory system	340,6	330,5	329,2	344,6	348,0	355,3	355,2	358,8
Neoplasms	62,9	64,1	72,8	77,0	74,6	77,2	77,9	78,6
Diseases of the respiratory system	86,3	53,1	39,7	38,6	39,2	37,1	34,2	44,0
Accidents, poisoning and injuries	46,5	26,4	23,2	25,8	27,5	32,6	32,1	35,5

Source: SSC, 2008

Table 5.6 Vaccination of Children under Age 1 in 2007 (% of registered children)

Vaccination	Share of children inoculated
Tuberculosis	97.8
Diphtheria, Whooping cough	94.8
Poliomyelitis	97.0
Measles, Mumps, Rubella, epidemic Parotiditis	95.1
Hepatitis B	97.2

Table 5.7 Infant and Maternal Mortality, from 1995–2008

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Infant mortality rate (per 1000 live births) both Sexes	23.2	19.9	19.6	16.6	16.5	16.4	16.6	16.7	15.5	14.4	12.7	11.9	12.1	11.4
Infant mortality rate (per 1000 live births) female	22.2	19.7	18.3	15.0	15.7	15.5	15.8	16.1	14.7	13.3	11.6	11.1	11.5	11.2
Infant mortality rate (per 1000 live births) male	26.2	21.8	20.7	18.0	17.3	17.2	17.3	17.3	16.1	15.4	13.6	12.6	12.6	11.6
All causes of infant mortality (under 1 year) per 10 000 live births	233.4					163.7		167.4	154.5	144.5	126.9	119.0	120.9	
Diseases of respiratory system	115.3					82.0		85.2	75.1	71.7	65.9	54.1	49.1	
Certain conditions originating in perinatal period	36.9					32.9		25.2	26.8	25.2	21.3	21.8	21.7	
Infectious and parasitic diseases	36.9					18.9		19.8	16.6	13.7	11.2	9.4	9.7	
Congenital anomalies	11.6					7.9		13.1	13.5	13.2	11.3	17.4	21.2	
Accidents poisoning and injuries	3.8					2.5		1.5	1.6	2.0	2.2	2.3	2.1	
Maternal mortality ratio (per 100,000 live births)	37.0	44.1	31.0	41.1	43.4	37.6	25.4	19.9	18.5	25.8	28.9	34.2	35.5	26.3

Source: SSC, 2008, 2009

Table 5.8 Health Expenditure (per capita)

	1995	2000	2001	2002	2003	2004	2005	2006	2007
Total expenditure on health per capita, PPP\$ per capita, WHO estimates		104	112	127	129	139	197	254	320
Total health expenditure as % of gross domestic product (GDP), WHO estimates		4.8	4.6	4.7	4.2	4.0	4.4	4.1	4.0
General government expenditure on health care	29.7	40.9		44.8	55.3	73.5	115.3	162.0	257.2
Public sector health expenditure as% of total health expenditure, WHO estimates		18.1	19	17.1	20.5	21.9	21.7	26.1	29.3
Private households' out-of-pocket payment on health as% of total health expenditure		64.1	63.6	66.7	64.1	62.8	67.7	63.9	61.5
Government health spending as% of total government spending		5.4	5.2	4.8	4.5	4.9	5.5	4.3	4.2

Source: SSC, WHO

Table 5.9 Selected Indicators of Health care Utilization and Expenditure

Countries	2005			2006		
	Population per doctor	Population per hospital bed	Total health exp. as % of GDP	Population per doctor	Population per hospital bed	Total health exp. as % of GDP
Azerbaijan	273*	123*	4.4	262.7**	125**	4.1
Russia	205	90		202	91	
Belarus	214	90	6.00	210	89	5.90
Kazakhstan	274	129		268	129	
Lithuania	249	123		251	125	
Ukraine				207	105	

*2006, **2007

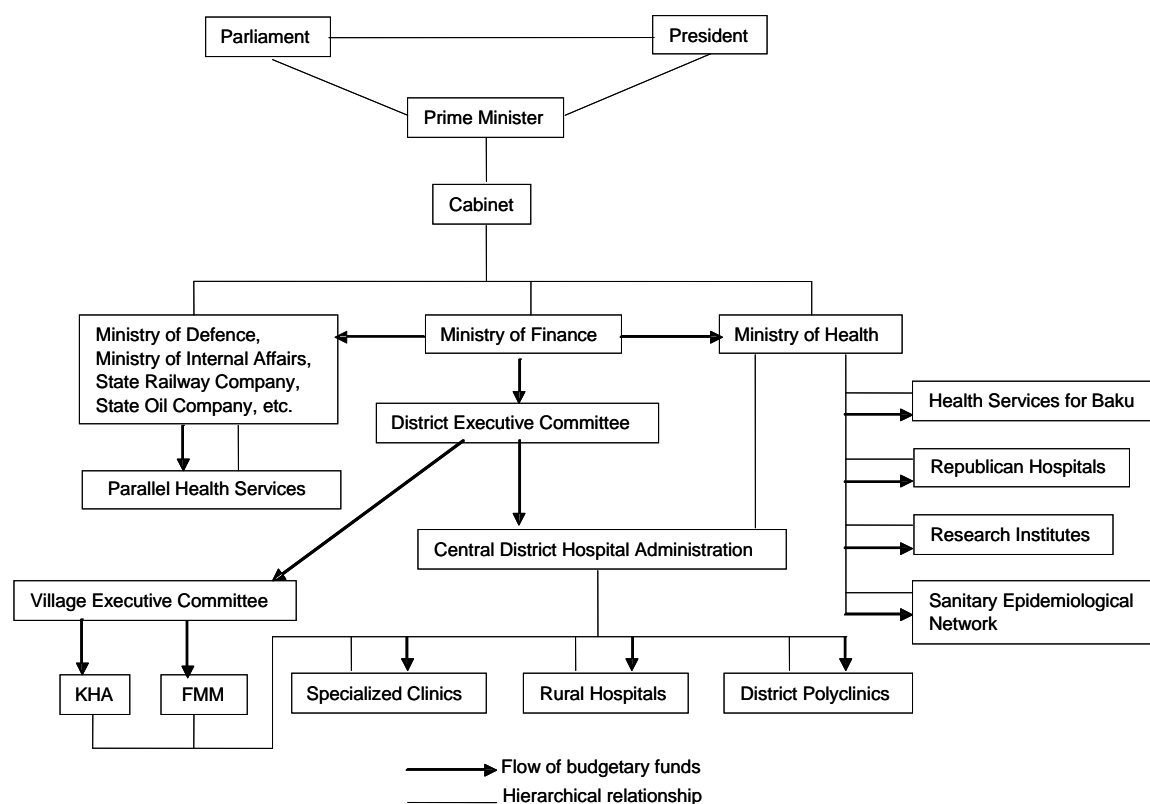
Source: SSC, 2008, WHO

Table 5.10 Nursing Homes for Disabled and Aged Persons

	1996	2001	2003	2004	2005	2006	2007	2008
Number nursing and care houses for aged people and disabled persons adults	7	7	7	7	7	7	7	7
Number residents	605	677	731	774	767	797	776	787
Number nursing and care houses for children recognized as disabled	2	2	2	2	2	2	2	2
Number residents	271	300	359	366	381	298	300	306

Source: SSC 2008

Figure 5.1 Organizational Structure of Healthcare System in Azerbaijan



Notes: FMM: *Feldsher-midwife point*; KHA: *Village doctor outpatient clinic*.

Source: Ibrahimov et al., 2010; WHO, 2009

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