

Social Protection and Social Inclusion in Azerbaijan

Executive Summary

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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 €95 in 2009, people employed in agriculture only earned €18 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 €80. The lowest wage in 2009 was observed in the Sheki-Zaqatala economic region at €51. 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 (€82).

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 €1 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.