https://doi.org/10.58225/tim.2025-3-399-402

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Məqalə redaksiyaya daxil olub 05.10.2025
The article was received by editorial board on 05.10.2025
Статья принята к печати 05.10.2025

FISCAL SUSTAINABILITY IN AZERBAIJAN

Abstract

There are various approaches in economic theory regarding the outcomes of government intervention in the economy through fiscal instruments. Research shows that the impact of fiscal policy varies depending on the level of development, economic structure, and institutional quality of a country. Studies on Azerbaijan indicate a positive short-term relationship between government spending and non-oil GDP, while long-term effects remain ambiguous. The theoretical foundation of the relationship between fiscal policy and economic growth is based on Wagner's Law and the Keynesian hypothesis. According to Wagner's Law, economic growth leads to an increase in budget revenues and expenditures. The Keynesian approach, however, states that government spending stimulates economic growth by increasing aggregate demand. Hasanov's (1998–2012) research using the ARDLBT method found a statistically significant positive long-term relationship between government spending and non-oil GDP in Azerbaijan. In the short term, both government expenditures and private investments are positively related to non-oil GDP, but in the long term, only government spending maintains this relationship, while private investments show no significant effect.

Keywords: *fiscal sustainability, budget, tax, duty, financial system, development dynamics.*

INTRODUCTION

Research on the distribution of real private investments and their impact, particularly on the non-oil sector, shows that the main mechanism of the "Dutch disease" in Azerbaijan is primarily linked to the "government spending effect." Although studies conducted during 2000–2007 revealed a negative long-term cointegration between non-oil GDP and oil prices, the growth trend of the non-oil sector remained positive. Infrastructure and social projects financed by the state budget increased employment and wages in non-tradable sectors, leading to real exchange rate appreciation and a weakening of non-oil exports.Subsequent studies also indicate that while government spending on infrastructure and social projects positively influences the non-oil economy in the long run, this effect is stronger in non-tradable sectors. Analyses based on FMOLS and ARDLBT models covering the years 1995–2014 confirmed the positive relationship between oil prices, oil production, and the non-oil economy. However, in the long-term perspective, oil prices were found to play a more significant role than oil production. This, although government expenditures are a decisive factor in the development of the non-oil economy, the dominance of non-tradable sectors within the expenditure structure increases the risk of weakening the tradable sectors.

(Aliyev, K.və Nadirov, O. How Fiscal Policy Affects Non-Oil Economic Performance in Azerbaijan? Academic Journal of Economic Studies, Vol. 2, No.3, September 2016: 11–29)

THEORETICAL APPROACHES

Transparency and accountability are among the fundamental principles of public financial management. They strengthen both the financial system and citizens' trust in the government.

• Transparency – refers to the open presentation of budget plans, expenditures, and financial operations. It enables citizens to monitor the government's financial activities and participate in the process.

• Accountability – involves the regular reporting on the use of public financial resources and the execution of the budget. This increases the efficiency of policies and enhances public oversight.

• Citizen participation – as a result of openness, society plays a more active role in budget discussions and can demand changes aligned with its needs.

In summary, transparency and accountability reinforce fiscal sustainability and enhance public trust.

(Hasanov, F., Yusifov, S., Mikayilov, C., Aliyev, K., və Talishinskaya, S. The role of social and physical infrastructure spending in tradable and non tradable growth. Forthcoming Contemporary Economics. Doi: 10.5709 / ce. 1897-9254.300, 2018)

Reducing Corruption and Ensuring Transparency – Open reporting and monitoring reduce corruption risks, increase public trust in the government, and support economic stability. A transparent financial system is more attractive to both domestic and foreign investors.

Investment Management – Plays a crucial role in maintaining financial stability:

• Prioritization – focuses on strategic sectors such as infrastructure, education, and healthcare.

• Effective management – ensures efficient use of resources through risk analysis and financial management.

• Public–Private Partnership (PPP) – expands financing opportunities for infrastructure and other projects.

• Budget planning – ensures balanced management of public investments.

• Sustainability – economic diversification, support for education, and innovation create long-term stability.

• Monitoring – evaluation of project outcomes improves future decision-making.

Economic Diversification – broadens income sources, increases resilience to economic shocks, reduces unemployment, and supports social development. Diversification also stimulates innovation and attracts new investments.

Financial Incubators and Investments – support the development of new businesses, create jobs, encourage innovation, and strengthen financial stability through effective risk management.

Risk Management – the assessment of assets, analysis of economic and financial risks, and implementation of appropriate measures ensure the stability of the financial system.

(Seyfullayev, I. Trade openness and economic growth: Evidence from Azerbaijan. Problems and Perspectives in Management, 20(1), 564-572. http://dx.doi.org/10.21511/ppm.20(1).2022.45, 2022)

ANALYSIS

Key Aspects of Risk Management and Its Impact on Financial Sustainability

Types of Risks:

• Economic risks – inflation, deflation, unemployment.
• Financial risk – debt burden, liquidity, currency fluctuations.
• Political risk – political instability, legislative changes.
• Security risk – corruption and illegal activities.

Management Stages:

• Identification and assessment of risks.
• Management strategies (diversification, insurance, reserves).
• Continuous monitoring.

Impacts:

• Financial stability and debt management.
• Increased public trust.
• Improvement of the investment climate.
• Opportunity for long-term planning.

Key Indicators for Econometric Analysis of Fiscal Sustainability

Budget deficit / GDP – should be stable or decreasing.

Public debt / GDP – if increasing, sustainability is at risk.
Interest payments / revenues – reflects the debt burden.
Primary budget balance (PBB) – should be positive.
r – g gap – if the real interest rate exceeds economic growth, debt will rise.
Net borrowing requirement / GDP.
Additional variables: inflation, imports–exports, government expenditures and revenues, financial stability indicators, external debt.
Models used: ADF/KPSS tests, Johansen cointegration, VAR/VECM, ARDL, Fiscal Reaction Function.
Main Fiscal Indicators
• Budget indicators: revenues, expenditures, budget balance.
• Debt indicators: public debt, debt/GDP ratio, debt service costs.
• Fiscal sustainability: primary balance, structural balance, fiscal rules.
• Tax indicators: tax burden, indirect/direct taxes.
• Expenditure efficiency: socio-economic impacts, financing of public services.
Thus, effective risk management strengthens fiscal sustainability, enhances economic stability, and builds public trust.
International Experience in Ensuring Financial Stability
The provision of financial stability in different countries is based on their respective economic policies and strategies. The main principles include:
Balanced budget – matching revenues and expenditures, reducing budget deficits (Scandinavian countries).
Public debt management – limiting debt and enforcing legal fiscal rules (Germany's "debt brake").
Financial stability – independence of the Central Bank and inflation control (U.S. Federal Reserve System).
Tax reform and administration – broadening the tax base, ensuring fair and efficient tax collection (South Korea, China).
Investment environment – attracting domestic and foreign investment (Mexico).
Fiscal rules – setting limits on public spending and debt levels (European Union, Chile).
Social investment – supporting social programs to strengthen economic stability (Scandinavian countries).
Transparency and accountability – open budget processes and increased public confidence (Canada, New Zealand).
Risk management and reserves – establishing stabilization funds against potential crises (Sweden).
International cooperation – collaboration with the IMF and World Bank.
International experience shows that financial stability is reinforced through balanced budgets, prudent debt management, tax and investment reforms, transparency, and effective risk management. Each country must choose a strategy suited to its socio-economic conditions.

CONCLUSION

The conducted analysis shows that oil revenues play both a positive and risky role in Azerbaijan's economic development. The "Dutch disease" experience demonstrates that while budget expenditures financed by oil revenues stimulate activity, particularly in non-tradable sectors, they may also lead to real exchange rate appreciation and a decline in exports over the long term. Therefore, the primary goal of fiscal policy should be to ensure the efficient and balanced management of oil revenues. Transparency and accountability principles strengthen the financial system's resilience, reduce corruption risks, and enhance citizens' trust in the government. An open budget management system and public oversight create a reliable economic environment for both domestic and foreign investors.

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http://dx.doi.org/10.21511/ppm.20(1).2022.45.

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Azərbaycanda maliyyə davamlılığı

Xülasə

İqtisadiyyatda dövlətin fiskal alətlərlə müdaxiləsinin nəticələri barədə elmdə müxtəlif yanaşmalar mövcuddur. Tədqiqatlar göstərir ki, fiskal siyasətin təsiri ölkələrin inkişaf səviyyəsi, iqtisadiyyatın strukturu və institutların keyfiyyətindən asılı olaraq fərqli formalarda əks olunur. Azərbaycan üzrə araşdırmalar qısamüddətli dövrdə dövlət xərcləri ilə qeyri-neft ÜDM arasında müsbət əlaqə göstərir, lakin uzunmüddətli təsirlər birmənalı deyil. Fiskal siyasət və iqtisadi artım münasibətlərinin nəzəri əsasını Vaqner qanunu və Keyns fərziyyəsi təşkil edir. Vaqner qanununa görə, iqtisadi artım büdcə gəlirləri və xərclərinin artmasına səbəb olur. Keyns yanaşması isə dövlət xərclərinin məcmu tələbi artıraraq iqtisadi artımı stimullaşdırdığını bildirir. Azərbaycan üzrə Həsənov (1998–2012) ADLBT üsulu ilə apardığı araşdırmada uzunmüddətli dövrdə dövlət xərcləri ilə qeyri-neft ÜDM arasında statistik əhəmiyyətli müsbət əlaqə tapmışdır. Qısamüddətli dövrdə həm dövlət xərcləri, həm də özəl investisiyalar qeyri-neft ÜDM ilə müsbət əlaqəyə malikdir. Lakin uzunmüddətdə yalnız dövlət xərcləri bu əlaqəni qoruyur, özəl investisiyalar isə əhəmiyyətli təsir göstərmir.

Açar sözlər: *fiskal dayanıqlılıq, büdcə, vergi, rüsum, maliyyə sistemi, inkişaf dinamikası.*