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**Working Paper**

## Conceptualizing Public Finance Research in the Context of the Azerbaijani Economy Via Expert Interviews

Discussion Paper, No. 1

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# Conceptualizing Public Finance Research in the Context of the Azerbaijani Economy via Expert Interviews

Discussion Paper No. 1

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This preliminary manuscript has yet to undergo the conclusive formal review and should be acknowledged as such. The primary objective of this document is to assemble and refine the materials, concepts and discussions intended for inclusion in the forthcoming academic journal publication, currently in progress. It is imperative to note that the author bears no obligations or responsibilities to produce a final paper solely based on the content presented in this working paper.

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## Abstract

Public finance is a vital area of study that helps governments make informed decisions about how to raise and allocate funds to finance their activities, ultimately contributing to the well-being of society. Oil-rich developing and emerging economies present a distinct set of public finance realities. While they may enjoy substantial revenue streams from oil exports, this dependence creates unique challenges. This fact should have stimulated academic research to thoroughly analyze public finance, but it seems that there is not enough work in Azerbaijan that accurately captures the current challenges and proposes sound policy solutions in public finance sphere. Most of the studies are practice-oriented and written by international organizations (i.e., policy briefs, expert opinions) rather than local experts who could communicate them to a wider societal audience. This discussion paper draws some conclusions from the expert interviews on the problems and challenges in the field of public finance, the quality of research conducted in this field and future directions in the field of public finance in the case study of Azerbaijan. Briefly, the experts pointed out that the current state of research in the field of public finance is inadequate and highlighted some key problems such as inefficiency, transparency and dependence on the extractive industry in public finance. This discussion paper also provides some possible future research directions in the field of public finance in relation to Azerbaijan. This paper is not a conclusive study, but a conceptualization of the mentioned direction in the literature. The findings should be in the interest of policy makers and researchers working intensively on public finance issues in Azerbaijan.

**Keywords:** Azerbaijani economy, expert consultation, fiscal policy, macroeconomic stability, public finance, public policy

**JEL Classification Codes:** H11, O10, P10

## 1. Introduction

Public finance refers to the study of how governments raise and allocate funds to finance their activities, including the provision of public goods and services. It is a branch of economics that examines the role of government in the economy and the ways in which governments finance their activities. Studies in public finance are crucial for society as they provide insights into how governments allocate resources, manage public revenues and expenditures, and influence economic stability and growth (Musgrave, 1959; Stiglitz, 2000). Understanding public finance helps policymakers design effective fiscal policies that promote equitable distribution of wealth, efficient public service delivery, and sustainable economic development, thereby enhancing overall societal welfare (Rosen & Gayer, 2014).

In more detail, public finance involves the analysis of government revenue, expenditure, and debt, as well as the impact of government policies on the economy (Musgrave, 1959; Stiglitz, 2000). It also considers the distribution of the tax burden and the allocation of public resources among different sectors of society (Rosen & Gayer,

2014). Key areas of focus in public finance include taxation, government spending, public debt, fiscal policy, and the role of government in redistributing income and wealth to promote social welfare (Hyman, 2010). By studying these areas, public finance helps to understand how governmental financial activities influence macroeconomic stability, resource allocation efficiency, and the equitable distribution of wealth, which are essential for achieving sustainable economic development and social justice (Buchanan & Tullock, 1962; Atkinson & Stiglitz, 2015). There are some key aspects that need to be considered in public finance:

1. **Government Revenue:** This includes the various sources of income for governments, such as taxes, fees and grants. Public finance experts analyze the different types of taxes, including income taxes, sales taxes and property taxes, as well as the impact of tax policies on economic behavior.
2. **Government Expenditure:** This includes the various ways in which governments spend their money, such as on public goods and services, transfer payments and debt repayment. Public finance experts examine the efficiency and effectiveness of government spending, as well as the impact of different spending priorities on the economy.
3. **Public Goods and Services:** Public finance experts study the provision of public goods and services, such as education, healthcare, infrastructure and national defense. They analyze the role of government in providing these goods and services, as well as the impact of government policies on their availability and quality.
4. **Fiscal Policy:** Public finance experts examine the use of fiscal policy, which involves the use of government spending and taxation to influence the overall level of economic activity. They analyze the impact of fiscal policy on the economy, including its effects on employment, inflation and economic growth.
5. **Public Debt:** Public finance experts study the management of government debt, including the issuance of bonds and other securities to finance government activities. They analyze the impact of government debt on the economy, including its effects on interest rates, inflation and economic growth.

Developing and emerging economies face unique challenges in public finance compared to their developed counterparts. Limited tax bases, often reliant on resource extraction or a small number of industries, constrain government revenue (Masood, 2022). Additionally, a large informal sector and weak tax administration further reduce income streams (Dahlström et al., 2017). On the expenditure side, these economies often grapple with high poverty rates and a significant need for investments in infrastructure, education, and healthcare. Balancing these competing needs necessitates difficult choices and innovative solutions in public finance management (Tanzi, 2008).

Oil-rich developing and emerging economies present a distinct set of public finance realities. While they may enjoy substantial revenue streams from oil exports, this

dependence creates unique challenges. The boom-and-bust cycles of oil prices can lead to volatile government income, making long-term planning difficult (Isham et al., 2005). Additionally, the "resource curse" phenomenon can occur, where dependence on a single resource hinders economic diversification and fosters corruption (Ross, 2012). Managing these oil revenues effectively requires strong institutions and forward-looking strategies to invest in other sectors and build sovereign wealth funds for future generations (Sachs & Warner, 1997).

The public finance landscape of post-Soviet countries presents a complex picture, marked by a unique set of challenges following the transition from centrally planned economies. One key issue is the struggle to establish efficient and sustainable tax systems (Dabrowski, 2016). These economies grapple with legacies of shadow economies and a lack of experience with diversified tax structures. Additionally, the social safety nets inherited from the Soviet era often require significant reform to meet contemporary needs while remaining fiscally responsible (Bartlett et al., 2006). Furthermore, many post-Soviet countries face high levels of corruption, which can significantly hinder public finance management and divert resources away from critical social programs and infrastructure development (Hellman et al., 2003). Addressing these challenges necessitates ongoing efforts to improve tax administration, reform social safety nets and combat corruption to ensure a more stable and equitable public finance system.

Azerbaijan's economy presents a unique case study, characterized by both resource wealth and a need for diversification. Oil and gas exports have been the backbone of the economy, generating significant revenue (International Monetary Fund, 2022). However, this dependence creates vulnerability to oil price fluctuations, hindering long-term planning and economic diversification (World Bank, 2018). Public finance challenges further strain the system. A large informal sector and weaknesses in tax administration limit government revenue collection (Asian Development Bank, 2016). Additionally, the need to balance social spending with investments in infrastructure and other vital sectors creates difficult choices for policymakers. Diversifying the economy beyond oil and gas, coupled with improvements in tax collection and public finance management, will be crucial for ensuring long-term sustainable growth in Azerbaijan.

Given Azerbaijan's unique economic situation, characterized by oil dependence and a need for diversification (International Monetary Fund, 2022), public finance research holds immense importance and relevance. The boom-and-bust cycles of oil prices necessitate exploring strategies to manage this volatile revenue stream, as highlighted by studies on resource-rich economies (Isham et al., 2005). Research on economic diversification, exemplified by the World Bank's (2018) work on Azerbaijan, can inform policy decisions to develop non-oil sectors and mitigate dependence on a single resource. Furthermore, public finance research focused on the informal sector, like that conducted by the Asian Development Bank (2016), can provide valuable insights for improving tax collection and bolstering government revenue. In conclusion, public finance research offers crucial tools for Azerbaijan to navigate its economic realities—ensuring sustainable growth through responsible management of oil revenue, diversification efforts and improved public finance practices.

Unfortunately, despite the clear need for robust public finance research in Azerbaijan, there seems to be a scarcity of in-depth academic studies specifically focused on the country's unique challenges. While broader research on resource-rich economies and economic diversification offers valuable insights, a deeper understanding of Azerbaijan's specific context—the size and composition of its informal sector, the effectiveness of current tax collection methods and the optimal allocation of oil revenue—is crucial for formulating targeted policy solutions. This lack of focused research hinders the development of a comprehensive and evidence-based approach to public finance management in Azerbaijan, potentially limiting its ability to navigate the complexities of its economic landscape.

As the title of this discussion paper suggests, this paper is a brief conceptualization of the current state of academic studies in the field of public finance in the Azerbaijani economy. Economic experts were contacted to get their opinion on the three questions related to the main objective of this discussion paper and finally 12 of them participated. In the future, the number of experts will be increased in order to obtain a larger sample suitable for publication in a journal or presentation at a conference or symposium.

Although this is a discussion paper, the author considers the results to be a small contribution to the current literature. The findings and results can be interpreted by readers, scholars and policy makers to shed light on certain issues and areas of public finance in Azerbaijan. Therefore, the next section briefly presents the data and methodology of this study. The third section presents the results in the three subsections. The final section concludes with the author's suggestions and additional interpretations.

## **2. Data and methodology**

If we take into account that this work is a discussion paper primarily intended to stimulate and discover the ongoing debate and possible or potential research directions, interviewing professional economists on three interrelated issues related to the current situation of public finance in the Azerbaijani economy was considered the most appropriate research method. First, the experts were asked about the current challenges, problems or issues related to the present situation of public finance in the Azerbaijani economy. Secondly, they were asked about the quality of academic research that has been or is being conducted in the field of public finance in Azerbaijan. Thirdly, they were asked about their expectations regarding future academic publications or research in the field of public finance in Azerbaijan. Or simply put, what kind of topics will gain importance over the time.

It should be noted that this discussion paper is far from being an exploratory or empirical research paper. The main purpose of this paper was to begin one after careful consideration of the professional opinions of economists involved either directly or indirectly in public finance research. The main method of data collection included short email interviews and the exchange of voice messages via some social networks such as WhatsApp. The answers were then collected and systematically grouped under the structured questions for further interpretation. The experts' insights can be a very valuable

source of knowledge to determine the most demanded and expected directions of future research.

For ethical reasons, the first and last names of the experts were anonymized. The interviews were conducted in the Azerbaijani language. In order to convey the results briefly and quickly, the author summarizes the most important points in this discussion paper integratively in English, without translating or quoting them qualitatively. However, it should be mentioned that for future research purposes, the created dataset will be translated, coded and analyzed using a software (i.e., Quirkos).

Overall, the results and findings of this discussion paper are based on the responses of 12 experts, most of whom have an economic background and extensive experience in public finance or related fields, using the Azerbaijani economy as an example. Most of them have a PhD in economics and actively participate in academic discussions on various problems and issues of Azerbaijan. The response rate was 66.6%. The next section therefore contains brief summaries of the expert opinions and consultations.

### **3. Results**

#### *3.1. What are the current and priority problems/topics/challenges related to public finance in Azerbaijan?*

One of the major common concerns of the experts is the fact that the relevant reforms to change the undesirable economic realities related to public finances in the Azerbaijani economy have been implemented without much success since the late 1990s, which puts the government in a position of exercising insufficient institutional control over public finances. The situation is particularly worrisome when we think about the coming post-oil era, as the events of 2014 and 2015 clearly show that without national diversification strategies, public finances will suffer greatly. Transparency, accountability, efficiency and various other issues are among the biggest concerns of the economists interviewed in this short expert interview.

One of the most common responses in the interviews referred to the economic reality of the Azerbaijani economy, namely its dependence on oil and how this dependence poses challenges to public finances. Indeed, non-oil tax revenues in Azerbaijan contribute very little to the government's tax revenues. The government itself has created several loopholes in the collection of oil taxes since 1991. However, the dramatic drop in oil prices in 2015 has clearly shown that dependence on other revenues must be reduced, as a deep crisis and social tensions can arise in a very short time if nothing is done.

Another expert pointed out that there are no mechanisms to ensure the efficiency and effectiveness of budget spendings when it comes to the main problems of public finance in Azerbaijan. In other words, the institutional mechanisms and the necessary checks and balances are not sufficient to ensure sustainable public finance in Azerbaijan. The activities of external audit bodies in relation to public finances are not effective, in particular performance auditing needs to be expanded. Accountability and transparency issues are also of great importance as they are the most important issues and challenges in the field of public finance, especially when it comes to public investments.



Although public control over the state budget itself is a different issue, experts consider this to be one of the main aspects of the current challenges to public finances. Some experts even point out that this is the reason why efficient and productive spending is not taking place. This hinders the achievement of equity and efficiency in the management of public finances in Azerbaijan. In this context, some experts recommended using the practice and experience of other countries to have accessible data and information on public finances and to achieve a sustainable fiscal reality in the context of oil-based industrial development.

### *3.2. The current state of the research in public finances*

Interestingly, the absolute majority of the experts surveyed stated that there are not enough scientific and empirical analyzes of public finances in the case of the Azerbaijani economy. The reasons for this are manifold: there is too much emphasis on econometric work and not on qualitative analysis of the state budget and its components; there is no access to data on public finances, which hinders objective evaluation and assessment by independent civil society institutions, the number of which have also declined sharply; the national financial authorities do not conduct systematic and methodological research in this area, etc. They noted that international organizations in particular tend to carry out practical work rather than scientific studies. Policy papers are not produced in the desired number and do not reflect the true realities in the field of public finance. Therefore, universities and some governmental institutions should have an interest in solving this problem and changing the current situation.

### *3.3. The future of the public finance research*

The experts pointed out some important issues for the near future that could become more topical in the literature on Azerbaijan's public finances. These include, for example, issues such as optimization of state spending, qualitative assessment of social spending, ways to increase the efficiency of the state budget, ways to increase the efficiency of the work of the Accounts Chamber, the transition to the results-based state budget, fiscal sustainability and fiscal decentralization, issues of accountability and transparency in public finances, preparation for the post-oil era, the role of payments of the State Customs Committee, gender aspects of the state budget, links to green finance and green economy, assessment of corruption cases, inflation channels that may arise from public investment, social wealth, the role of the state budget in economic growth and development, relationships between budgets, mechanisms related to the transfer of public finances to local finance or budgets, digitalization in public finance, and finally, opportunities for the non-oil industry to contribute to the state budget.

Interestingly, some aspects of the Azerbaijani economy are well researched. In particular, these include bilateral trade relations (see works by Orudzhev and Huseynova, 2019; Orudzhev and Huseynova, 2020; Orudzhev and Alizade, 2021), exchange rate dynamics (see works by Orudzhev and Mamedova, 2024; Orudzhev and İ sazadeh, 2018), the impact of oil and non-oil industries on economic growth (see work by Mukhtarov et

al., 2019; Seyfullayev, 2020) and transition issues (see work by Gunes and Hajiyeva, 2020). However, empirical and evidence-based studies on public finance are rather scarce and unsystematic. For this reason, the third question was put to the experts in order to conceptualize possible future research themes in this area.

#### **4. Concluding Remarks and Suggestions**

The aim of this discussion paper was to integrate the responses received from various economic experts on the case of Azerbaijan. The motivation for such a discussion paper was the uncertainty and lack of a sufficient number of publications in academia to discuss the possible and important issues in the field of public finance publications in Azerbaijan. The current discussion paper achieved its main objective by collecting the opinions of 12 experts to integrate their ideas into a broader set of perceptions and plans about public finance using the Azerbaijani economy as an example. It should be noted that the present material is not an empirical or conclusive academic work. Readers and users of this material must recognize this fact and benefit from it in this way.

When we talk about the Azerbaijani economy, we mainly focus on the fact that the country is rich in oil and natural gas and has mainly used these resources for economic growth and development since 2005. While there is nothing wrong with the country utilizing its natural resources for economic development or growth, it is important to point out that dependence on export revenues from commodities usually creates structural problems, problems in diversifying the industrial structure and internal fiscal and monetary challenges. Similarly, resource-rich governments have proven vulnerable to external shocks and are susceptible to a variety of problems and issues such as corruption, accountability, transparency and other institutional risks due to weak public financial management capacities. While until the recent past various civil societies and public oversight have helped to keep an eye on the state budget and its main components, recent years have led to greater uncertainties and an unpredictable future when it comes to public finances in Azerbaijan. For this reason, this issue should always be at the center of attention of academics, independent experts and other stakeholders in order to ensure sustainable and long-term economic prosperity in a small and open economy like Azerbaijan.

Experts express concern that reforms to improve public finances in Azerbaijan have failed since the late 1990s, resulting in poor institutional control. The economy's heavy reliance on oil is problematic, especially as shown by the 2014–2015 oil price drop, which highlighted the need for diversification to avoid financial crises. The inefficiency and lack of effectiveness in budget spending mechanisms, particularly in performance auditing, are major issues. Transparency and accountability are critical challenges, affecting public investments and overall fiscal management. Experts suggest learning from other countries to enhance data accessibility and achieve sustainable public finances.

Most experts agree that there is a lack of scientific and empirical analyses of Azerbaijan's public finances. The primary reasons include an overemphasis on econometric work over qualitative analysis, limited access to public finance data and a decline in independent civil society institutions. Additionally, national financial authorities fail to conduct systematic research, and international organizations focus more on practical

work than scientific studies. There is a need for universities and some government institutions to address this issue by producing more policy papers that accurately reflect the realities of public finances.

Experts highlighted key issues for future research on Azerbaijan's public finance, including optimizing state spending, assessing social spending and improving budget efficiency. They also emphasized enhancing the Accounts Chamber's work, transitioning to results-based budgeting, ensuring fiscal sustainability and decentralization, and increasing accountability and transparency. Other important topics are preparing for the post-oil era, the role of State Customs Committee payments, gender aspects, green finance, corruption assessment, inflation from public investment, digitalization and the non-oil industry's budget contributions.

As an economist who is trying to conceptualize the public finance in Azerbaijan, my own professional position on the main policy suggestions for Azerbaijan to address the highlighted issues in public finances would be to focus on diversification of revenue sources by reducing dependency on oil revenues and promoting the development of non-oil sectors such as agriculture, tourism and manufacturing. Enhancing transparency and accountability is crucial, requiring improved access to public finance data, strengthening institutions like the Accounts Chamber, and implementing anti-corruption measures. Optimizing state spending involves regular reviews, qualitative assessments of social spending and transitioning to a results-based budgeting system. Fiscal sustainability and decentralization can be achieved through a long-term fiscal strategy and empowering local governments with greater financial autonomy. Preparing for the post-oil era necessitates a comprehensive national diversification strategy and investment in education, research, and innovation. Leveraging green finance and digitalization will promote sustainable growth and improve efficiency in public finance management. Addressing social and gender issues in budget policies is essential for inclusive growth, supported by social safety nets and programs for vulnerable populations. Strengthening international collaboration will help adopt best practices in public finance management and enhance the skills of public finance officials. By addressing these areas, Azerbaijan can create a more diversified, transparent, and sustainable economic environment, better prepared for future challenges and less dependent on oil revenues.

Above all, the number of studies on public finance in Azerbaijan should be increased and their quality improved, as this issue is one of the most important economic and social directions of national prosperity. It is surprising that despite numerous universities, institutions, think tanks, research centers, government agencies, experts and other interested parties, the number of professional academic works is insufficient to clearly conceptualize the current state and future of Azerbaijan's public finance. Most of the works are from older periods, and since public finance is extremely dynamic, systematic and gradual academic research should be conducted in an empirical manner. After the recovery from the Covid-19 pandemic (Barigzadeh, 2023) and an increase in commodity revenues in 2022—due to the war between Russia and Ukraine leading to higher commodity prices—public finance research will most likely become more attractive for academics.

This discussion paper was intended to make the public attention to the urgent need for academic and scientific research in the field of public finance in Azerbaijan. This discussion paper should also clarify the nature and direction of future research projects of the author himself.

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