

REPUBLIC OF AZERBAIJAN

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ABSTRACT

of the dissertation for the degree of Doctor of Philosophy

**ASSESSMENT OF DIVERSIFICATION OF THE
ECONOMY AND ITS FINANCIAL EFFICIENCY**

Speciality: 5301.01 - Internal fiscal policy and public finance

Field of science: 53 – Economic sciences

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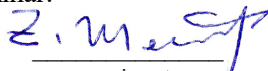
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GENERAL CHARACTERISTICS OF THE DISSERTATION WORK

The relevance of the topic: Diversification is a factor impacting the economy's further resurrection, dynamic development, growing resilience, strength, and sustainability, according to the world's economic development history. Especially when the country's economy is in crisis, diversification is one of the routes out of this situation.

Simultaneously, diversification prevents one-sided economic development, promotes interdependent industry development, and eventually, increases efficiency. The number of developing industries and sectors in the economy grows as diversification is implemented successfully. The importance of these sectors in the economy is growing, and the economy's structure is shifting, resulting in a more reliable management and production system. Diversification is one of the most effective ways of economic development or support for economic development, and it is utilized as the most widespread instrument in world practice, when these traits and parameters are considered.

Economic diversification has allowed for the qualitative developments that have occurred in the Azerbaijani economy in recent years. The widespread use of this approach in our country, as well as its dependence on scientific foundations and considerable global experience, has made it the main strategic underpinning of our country's economic policy.

Diversification strategy envisions and implements a diverse range of domestically produced products and services that are both supplied to the public on the domestic market and exported to foreign markets, resulting in rapid economic growth. Given this, it is reasonable to conclude that economic diversification, as well as all linked development characteristics, is one of the world's and Azerbaijan's most pressing issues today. Increased financial efficiency is one of the most essential responsibilities and indicators of this strategy, namely diversification policy.

The more efficient economic diversification is, the more diverse the economy will be and the more dynamically it will grow.

The recent events on the global oil market have prompted Azerbaijan to make significant changes in its economic policies. President Ilham Aliyev declared the end of the oil age in Azerbaijan in 2014. As a result, diversification of the economy in order to lessen reliance on oil has been proclaimed a priority in our country's economic policy. President of the Republic of Azerbaijan Mr. Ilham Aliyev signed a decree in December 2016 authorizing "the approval of strategic roadmaps for the national economy and main sectors of the economy." This decree established short, medium, and long-term goals and priorities for the country's economic development. The major goal is to achieve high and efficient economic diversification while reducing reliance on oil. As a result, a significant priority should be given to increase the non-oil sector's contribution to government revenue generation.

Based on the above-mentioned arguments, it can be concluded that strengthening the economy's financial efficiency and diversification is a serious challenge for both the country's economy and researchers and scientists.

Level of investigation into the problem. The theoretical and methodological aspects of the necessary components of economic diversification, their necessity, organization and management, regulation of the process and its impact on the economy have been investigated in the research works of both foreign and Azerbaijani scholars.

Representatives of the Azerbaijan School of Economics including Z. Samadzadeh, A. Musayev, D. Baghirov, A. Shakaraliyev, A. Alakbarov, Z. Mammadov, G. Manafov, I. Karimli, A. Babayev, K. Shahbazov, A. Alirzayev, Y. Kalbiyev, F. Mustafayev, U. Aliyev, E. Sadiqov and others studied various parameters of different sectors and branches of the country's economy in their respective works and researches.

Representatives of the American and European Schools in Economics M. P. Todaro, C. S. Stephen, K. Qlezakos, O. Kadot, J. Karrere, M. R. Agoshin, F. M. Shearer, F. Hachman, Q. Khuefenq, R. Alvarez, O. J. Bravo, G. E. Mclaughlin, A. Ridvan, A. Jeffrey, B. H. Hammouda, and S. N. Karingic created works that cover a

wide range of topics related to economic diversification, such as its content and importance, organizational principles, export advantages, their impact on economic dynamics, issues related to export stability and variability, the emergence of a diversification environment and the problems associated with its proper organization, and investment problems in a diversification environment.

In addition, a number of Russian scientists studied on numerous problems of diversification. These scholars include Shatalov M.A., Nikolay S.A., Gitman M.B., Michka S.Y., Kuslan A.A., Aleksandr M.B., Vodenko K.B., Kollegov A.K., Baskov I.S., Shvakov E.E., Qurova I.P., Kovalenko M.Q., Chayka B., Nikita O.A., Uskova T.V., Bayko I.V., Darovskikh E.V. and others.

Apart from the theoretical, methodological, and practical importance of the above-mentioned works by Azerbaijani and international specialists, it is worth emphasizing that the issues of economic diversification and the effectiveness of its financial effects in our country have yet to be explored. As a result, the study's purpose was to assess economic diversification's financial efficiency.

Goals and objectives of the research: The purpose of the study is to assess the financial efficiency of diversification, which is used as a strategic direction in the economic development of the Republic of Azerbaijan, to further improve diversification and to identify areas for increasing its level. In order to achieve the set goals, the following objectives are envisaged in the research work:

- Identify the content and essence of diversification as a factor in assuring economic dynamics, as well as its role and financial efficiency in the country's economic development on important factors;

- Research the theoretical foundations of economic diversification, make observations based on analysis, and provide recommendations;

- The financial effectiveness of economic diversification is examined using the examples of countries with various diversification methods from around the world;

- Analyze the current financial efficiency of the measures done in our country in the direction of economic diversification;

- Evaluate the current situation of financial outcomes of the country's economic diversification in many sectors and areas;
- Assessment of the economy's level of diversification and its effectiveness as a financial efficiency indicator;
- Investigate the feasibility of implementing diversification methods from countries with extensive experience and best practices in Azerbaijan;
- Identification of financial resources for diversification of the economy;
- Identification of directions to improve the financial efficiency of the country's economic diversification in modern conditions.

Object of the study. The study focused on the financial issues and procedures of the Republic of Azerbaijan's economy, as well as its diversification.

The subject of this study to examine the current state of economic diversification in our country, as well as to assess financial efficiency, socio-economic trends, patterns, methods, rules, and a set of tools to determine the factors that influence its role and the economic relationships that have developed in this regard.

The research's theoretical and methodological foundations include Azerbaijani and foreign scientists' research on theoretical and practical issues of organization, management, and regulation of economic diversification, programs and laws adopted by the National Parliament, decrees and orders of the President of the Republic of Azerbaijan, decisions of the Cabinet of Ministers, normative acts, authorized methodology and material produced the State Statistical Committee of the Republic of Azerbaijan and the report indicators of the Central Bank of Azerbaijan.

The research process employed systematic-complex, positive-pragmatic, statistical, grouping, generalization, comparative analysis, comparison, synthesis, balancing, and other research approaches.

The database of the research contains data from the Republic of Azerbaijan's State Statistical Committee, the Central Bank of Azerbaijan, the Organization for Economic Cooperation and Development, as well as annual report indicators, legislation and regulations governing the process of economic diversification,

monographic researches, scientific-theoretical and scientific-practical conference materials, observational materials and online resources.

The main provisions of the dissertation. The following main provisions are included in the defence, which contain new or innovative elements:

- A set of key indicators that reflect the current state of economic diversification in the country's economy, its economic essence and significance, and its role in economic development;
- Examining sophisticated world economic diversification experience and identifying potential for applying its most essential criteria to Azerbaijan's economy;
- Identification of the major factors and goals of changes in the direction of diversification in order to secure long-term economic growth patterns, as well as an assessment of the current situation;
- Evaluation of the financial efficiency of Azerbaijan's economic diversification based on the most crucial parameters;
- Ways to improve the financial efficiency of economic diversification in line with economic development's strategic aims.

The scientific novelty of the research is as follows:

- Based on the methodologies and viewpoints of experts from many countries, the study investigates the importance of economic diversification and its role in economic development, and substantiates its necessity.
- Theoretical foundations of economic diversification in ensuring stable, dynamic, and sustainable development of the country's economy were studied, the principles of its organization were defined, methodological foundations based on a conceptual approach were analysed, world experience was studied, and recommendations for improvement were proposed.
- The current condition of reforms and diversification processes implemented in the direction of diversification of the country's economy was extensively evaluated as a result of rigorous analysis, and recommendations were made to improve it.
- When assessing the amount of diversity by sectors and branches of the economy, calculations were performed to determine the level of concentration in certain sectors, and suggestions were

made to improve it.

- The level of diversification and its financial efficiency have been assessed using data from various sectors and parts of the economy, and the important avenues for increasing efficiency have been found.

Theoretical and practical significance of the research:The theoretical and conceptual provisions, proposals, and recommendations systematized as a result of the dissertation research can be widely applied in the development of programs and forecasts that can be used in the further development, regulation, and improvement of our country's economic diversification.

The research materials can also be used as visual aids in the classroom for students pursuing bachelors and master's degrees.

Approbation and application of the dissertation's scientific findings:Between 2015 and 2018, the dissertation's findings and main theoretical provisions were presented and discussed at international and national conferences, symposiums, and seminars.

The conclusions and recommendations derived from the dissertation's content were adopted for use in the Chamber of Commerce and Industry of the Republic of Azerbaijan for the expansion of overseas economic connections. (Reference №7100-3/92 dated 16.11.2018)

Research, materials published. The research resulted in the publication of 21 scientific articles and theses on the dissertation, totalling 16.5 printed pages.

The scope and structure of the research. The dissertation includes of an introduction (11830 symbols), 3 chapters (I chapter–81252 symbols, II chapter – symbols, III chapter – symbols), a conclusion (13115 symbols), and a list of references, as well as 15 tables and 14 diagrams, totalling 153 pages written in 1.5 intervals on a computer (275794 symbols). There are 137 sources in the bibliography.

Contents of the dissertation

Introduction

Chapter I Theoretical and methodological foundations of economic diversification

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MAIN SCIENTIFIC PROVISIONS FOR DEFENSE

1. Key indicators that reflect the current state of economic diversification in the country's economy, its economic essence, significance, as well as its role in economic development: The observed strong volatility in commodities markets has raised the necessity of diversification throughout the prevalent period of economic diversification measures. Countries whose economies rely on earnings from the export of a small number of products have experienced economic crises as a result of commodities market volatility at various periods. During this time, the rate of globalization has accelerated, and the global economy's interconnection has grown. This has paved the way for the country's rapid economic development, as well as expanded the ability of processes in various countries to affect those in other countries. As a result, the formation of a volatile environment was unavoidable in tandem with the rapid rise of the global economy.

Economic diversification has been chosen as a crucial development paradigm for emerging and less developed countries, with international organizations promoting it. These organizations' different reports are also useful in expanding the economic literature and theoretical basis for economic diversification. The research undertaken in the field of economic diversification has been evaluated, and three primary aspects impacting the establishment of economic diversification and its methodology have been identified, according to the World Bank's report. **Macroeconomic variables, economic reforms, and structural factors** are among these topics.

The globalization of economies and financial markets is also directly tied to the growing importance of economic diversification and the fact that resource-dependent countries have become a vital aspect of development initiatives. It means that, in a free market system, the rapid expansion of global economic links permits hazards to swiftly spread and damage neighbouring countries. This is particularly problematic for countries with a lack of economic diversification and operations, particularly in many economic sectors. In this regard such economies are vulnerable to external influences and have few options for mitigating the negative consequences of

international economic processes.

The difficulty of anticipating economic occurrences is one of the aspects that raises the relevance of economic diversification. As the global economy expands and the sensitivity of relationships between sectors rises, it becomes more difficult, if not impossible, to predict how each unfavourable occurrence would influence other sectors. Economic entities in a market economy serve their own interests more, which leads to a self-protective and passive attitude toward a negative economic event, which contributes to the negative event's quick spread and more effective shape. Due to the low level of globalization in the international economy in the past, it was simpler to predict the impact of potential events, and hence the economy's significant dependency on any sector was not as harmful. Because it was easy to predict the events that could affect this sector, and it was possible to take the necessary measures to reduce its negative effects in advance. It is currently impossible to do so, and unforeseen negative outcomes are unavoidable. As it is difficult to take precautionary measures in this instance, the most effective strategy to protect against the consequences of foreign economic processes is to diversify the economy. As diversified economies are more resistant to external unfavourable economic processes, it is easier to manage the negative consequences of any unexpected incident. The Asian Financial Crisis of 1998 is an example. No one expected that fast-growing countries of South and Southeast Asia to face a crisis after the 1960s. Influential agencies such as the World Bank and the International Monetary Fund, on the other hand, praised these countries' economic governance and predicted continued prosperity. This, however, did not occur, and many Asian countries experienced a prolonged period of economic deterioration as a result of the crisis. The lack of control in these nations' financial systems as a result of the market economy system's demands, which allowed any of these countries' crises to spread easily and fast to other countries, made this crisis unpredictable and dangerous. Despite these countries' high levels of economic diversification, the crisis has weakened the global economy and the powerful in general, causing resource-rich countries' export operations to suffer and their

economies to become crippled. As a result, resource-rich countries' key macroeconomic aims should be to promote economic diversification and maintain the economy's resilience to external economic shocks.

2. Study of sophisticated world economic diversification experience and identification of potential for applying its most essential features to Azerbaijan's economy;

The highest level of economic diversification is found in industrialized countries, according to an analysis of the level of economic diversification in different countries around the world. The structure of economic revenues and the labour market in these countries is diverse, incorporating numerous industries. However, it should be noted that the economies of the majority of these countries are not resource-dependent, and the high level of economic diversification that has developed in their economies is not the consequence of steps taken to eliminate resource reliance. They have always worked for the economy's overall development in order to effectively build the economy and offer employment for the population involved in various economic activities in those countries. The economic management tradition in resource-rich countries, on the other hand, was rather different. As a result, economic policy in these countries is primarily focused on the development of the economy through these resources, as well as the establishment of critical economic infrastructure through resource earnings. Many of these countries are undeveloped and lack the infrastructure to sustain their economies' overall development at first, and development is mostly sector-dependent, as their economies acquire substantial amounts of foreign exchange reserves once resources are discovered. These countries, who are adopting a policy of speedier diversification in order to break free from the "oil curse," will secure long-term development. If, on the other hand, fresh resources are already being discovered in industrialized countries, then the reliance on already diversified economic systems prevents harmful levels of dependence. Countries like Norway and Canada, for example, have a high level of economic diversification while having abundant natural resources. The Netherlands, on the other hand, experienced the

“Dutch syndrome,” which entered economic theory as a result of the economic processes that occurred in this country for a period of time following the discovery of gas reserves, but quickly recovered from this negative economic process. Given the disparities between the nations and the state of the Azerbaijani economy, it is more crucial for the study to focus on resource-intensive countries that are first reliant on resources before attempting to diversify their economies. Since the experience of such nations has been more relevant in terms of economic structure, it is possible to use these experiences to examine the diversification of the Azerbaijani economy and to define future courses in this regard.

The Development Concept “Azerbaijan 2020: Vision for the Future,” adopted in 2012, was the first comprehensive document encompassing diversification in Azerbaijan and reflecting the steps that need to be done in this regard. This concept is organized into eight primary sections that describe the strategic vision and priorities through 2020. Although these sectors are not directly tied to the economy’s diversification policy, they do entail the creation of an environment that will allow the economy to diversify while also contributing to the economy’s overall development.

A thorough examination of the strategic goals outlined in the national economy’s roadmap, as well as their utility in terms of economic diversification, is critical for study. The first strategic goal identified is to strengthen *fiscal sustainability* and adopt *a sustainable monetary policy*. The implementation of a “golden rule” to regulate the transfer of oil earnings to the state budget is the first objective mentioned in this goal. The application of the golden rule and the implementation of appropriate measures in this regard are critical since the major goal in the approval of roadmaps and the implementation of the transition to diversification strategy is to decrease dependency on oil earnings. The importance of applying the golden rule to the map is supported by the reduction of risks posed by external shocks, the establishment of reserves for future generations, and increased fiscal management efficacy¹.

¹*Strategic Roadmap for the National Economic Prospects of the Republic of Azerbaijan* (approved by the Decree of the President of the Republic of Azerbaijan dated December 6, 2016) p.60.

Industry is one of the areas in the Azerbaijani economy that generates the most value. As a result, one of the most essential challenges is the diversification of this area's structure. The importance of the oil component in Azerbaijan's economy is reflected in the industrial structure. As a result, the mining industry has the largest portion of the industry, accounting for more than 80% in the last nine years. In 2015, it dropped from 87.2 percent in 2012 to 80.2 percent (Table 1). After that, it grew to 92.3 percent in 2019. During the time period under consideration, the manufacturing industry's share rose. The manufacturing industry's proportion of the economy climbed from 8.6% in 2012 to 15.2% in 2015. It has fallen in recent years, and it will be 13.2 percent in 2020. With changes in the mining industry, the percentage of the power, gas, and steam industries has also altered. To put it another way, while its proportion grew until 2014, it has been decreasing in recent years. Thus, the electricity, gas, and steam industry's proportion of GDP reached 4.5 percent in 2014, the highest in the prior nine years, up from 4% in 2012. Unlike the manufacturing industry, this industry's downturn started in 2015 and slowed to 2.2 percent in 2018. (Table 1).

Table 1. The structure of value-added created in industries (in percentage)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Mining industry	87,2	86,2	83,7	80,2	82,5	85,3	87,0	92,3	82,5
Manufacturing industry	8,6	9,3	11,4	15,2	13,9	11,8	10,4	12,1	13,2
Electricity, gas and steam industry	4	4,2	4,5	4,1	3,1	2,5	2,2	2,4	3,5
Water supply, waste treatment	0,2	0,3	0,4	0,5	0,5	0,5	0,4	0,5	1,1

Source: Prepared by the author on the basis of data of the State Statistical Committee of the Republic of Azerbaijan

In the economic literature, the main direction in determining the level of economic diversification is the **diversification of exports**. As a result, it is critical to look at Azerbaijan's exports in terms of commodity structure. Because of the drop-in oil prices, the amount of exports in the oil and gas sector changed dramatically between 2012 and 2017. Thus, compared to 2012, the volume of mineral product exports in US dollars plummeted by 2.8 times, falling below the \$ 8 billion mark (Table 2).

Table 2. Commodity structure of the export (million USD)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Mineral	22281	22256	20194	11203	7987	12404	17924	17852	12028
Other	1627	1720	1635	1526	1156	1408	1565	1783	1712
Total	23908	23975	21829	12729	9143	13812	19489	19635	13740

Source: Prepared by the author on the basis of data of the State Statistical Committee of the Republic of Azerbaijan

This decrease was due to a threefold decrease in oil prices on world markets. During these years, there has been a decrease in the volume of mineral products exported each year. Subsequently, as a result of rising oil prices, exports of mineral products increased to \$ 17.8 billion in 2019 and decreased to \$ 12 billion in 2020 associated with the pandemic.

It is vital to examine the share of mineral goods and other commodity products in exports in order to more correctly estimate the amount of diversification of exports. The overall picture shows that the share of mineral goods in exports has fallen during the last nine years, while the share of other items has climbed. As a result, the share of mineral goods in exports fell from 93.2 percent in 2012 to 89.8 percent in 2017, before increasing to a degree but not reaching the 2012 level. (See Table 3) Falling oil prices and efforts to diversify the economy are to blame for the emergence of this downturn. It is possible to conclude that the diversification policy is justified. Vegetable goods have the highest percentage of other commodity groups in exports.

Table 3. Commodity structure of export (Percentage)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Mineral products	93,2	92,8	92,5	88	91,4	89,8	92	90,9	87,5
Herbal products	1,3	1,3	1,5	2,6	2,9	3,8	3	3,2	4,5
Low-precious metals and products	0,9	0,8	0,6	1	1,7	1,8	1,3	1,2	1,5
Ready-made food, beverages, tobacco	1,3	1,4	1,4	2,2	0,9	0,8	0,5	0,5	0,7
Plastics, rubber, rubber	0,5	0,5	0,7	0,9	0,7	0,7	0,6	0,9	1,2
Pearls, precious stones and metals	0,3	0,3	0,4	0,7	0,6	1	0,8	0,9	1,5
Animal or vegetable oils	0,9	1	0,9	1,2	0,1	0,1	0,1	0,1	0,2
Chemical industry products	0,7	0,2	0,3	0,6	0,4	0,6	0,4	0,5	0,6
Vehicles, flying machines	0,2	0,4	0	0	0,5	0,1	0	0,1	0
Textile materials and products	0,2	0,2	0,2	0,3	0,3	0,6	0,7	0,9	1,3
Leather, leather, fur and articles	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1

Source: Prepared by the author on the basis of data of the State Statistical Committee of the Republic of Azerbaijan

Another essential factor to consider when it comes to *export diversification is the extent of country diversification*. Export diversification has political benefits, as we have seen. Let's look at the extent of diversification each country in this regard. Italy, which had the biggest percentage of exports in the previous eight years, saw its share drop to 25% in 2016 from 25% in 2013.

Italy's export share climbed by 1.9 times in 2017, reaching a high of 31.9 percent in the prior eight years. Although it declined in subsequent years, it was still higher than 30% in 2020. Oil exports account for Italy's large portion. The high share of oil products in exports to Italy is due to the considerable share of mineral products in exports. Israel, like Italy, is a buyer of Azerbaijani oil, which accounts for a major portion of the country's exports. Since 2015, Turkey's gas exports have increased, making it the country's second largest exporter. Turkey's share of exports dropped from 12 percent in 2015 and 2016 to 9.9 percent in 2017.

The split of the labour market by kind of economic activity is an essential direction for defining the level of diversification of the economy. In terms of labour productivity, labour intensity, and value generation, it also reveals how effective economic activities are. Unlike GDP and exports, the oil sector does not have a large labour market share. Agriculture accounts for the majority of the total. Thus, the agricultural industry had the biggest share of the labour market in 2012 (37.7%), and the lowest share in 2019 (36 percent).

In order to assess the state of the Azerbaijani economy in recent years, it is necessary to examine *economic investments in terms of sectors, types, and economic areas*. As a result, let's look at the structure of fixed-asset investments from several angles. In general, following 2014, the volume of fixed asset investments declined, but surged again in 2017 and returned to the prior level. Despite a drop over the next three years, it was still above 17 billion manat. The decline was 1.8 billion manats between 2014 and 2016. (Table 4).

Table 4. Fixed capital investments (Billion manat)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total	15,41	17,85	17,62	15,96	15,77	17,43	17,24	17,18	17,03
Foreign	3,26	4,67	4,90	6,90	9,28	8,67	5,22	5,19	5,12
Internal	12,15	13,18	12,72	9,06	6,49	8,77	12,02	11,99	11,91
Oil sector	3,85	5,09	5,96	7,14	8,65	8,48	6,32	5,21	5,22
Non-oil sector	11,55	12,76	11,66	8,82	7,12	8,95	10,91	11,98	11,81

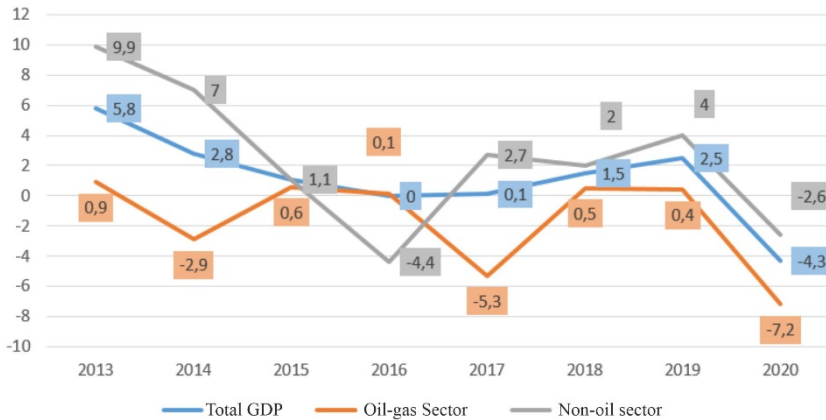
Source: Prepared by the author on the basis of data of the State Statistical Committee of the Republic of Azerbaijan

Although there has been no substantial change in the volume of fixed asset investments, there have been considerable changes in the structure of these investments in terms of domestic and international investment. Thus, between 2012 and 2017, the annual volume of foreign investment climbed by 5.4 billion manat. It fell by 3.55 billion manat from 2017 and 2020.

3. Evaluation of the financial efficiency of Azerbaijan's economic diversification based on the most crucial parameters;

Our analysis, while providing an overview of the positive results obtained in the direction of diversification, does not allow us to assess the financial efficiency, utility of various diversification models, or the impact of various economic sectors on diversification. There is a need to analyse the level of diversification and its financial efficiency in this regard.

When we look at the change in the growth rate of GDP in the oil and non-oil sectors, which is one of the most important economic indicators, we can see that the changes in the non-oil sector's growth rate are consistent with total GDP changes. It means that, in the non-oil sector, both the average GDP growth rate and the value-added growth rate are trending in the same direction (Figure 1).



Graph 1. Growth rate of the GDP (in percent)

Source: Prepared by the author on the basis of data of the State Statistical Committee of the Republic of Azerbaijan

As can be seen in Figure 1, both the average GDP growth rate and the non-oil sector GDP growth rate decreased from 2013 to 2016, but both measures increased from 2017 to 2019. This trend does not apply to the oil industry. As a result, the sector's growth rate declined in 2014, and then increased in 2015, decreased again in 2017, and then increased until 2020. The growth rate fell substantially in 2017 and 2020, to -5.3 percent and -7.2 percent, respectively. As a result, we can deduce that oil prices have an impact on GDP in the non-oil sector as an average GDP indicator. If the impact of dropping oil prices on the non-oil industry was minor, the non-oil sector would have to maintain its growth rate in the worst-case scenario during the period of falling oil prices (2014-2016). As a result, the high non-oil sector's proportion of GDP does not completely reflect the financial efficiency of diversification.

The non-oil industry has a high level of diversification, according to an analysis of its makeup. We can observe from the dynamics of several non-oil industries that the service sector's part of GDP has climbed in recent years, while the construction sector's share of GDP has decreased. Along with the service industry, trade, vehicle repair, and tourist accommodation also grew. Agriculture's share of GDP did not change significantly. Only in 2020, due to the pandemic's impact, these sectors experienced some declines. These shifts in the

non-oil sector's percentage of GDP make it impossible to evaluate how the sector's diversification has changed during the years studied. In this regard, we can use the **Herfindahl-Hirschman Index** to determine the concentration within the sector.

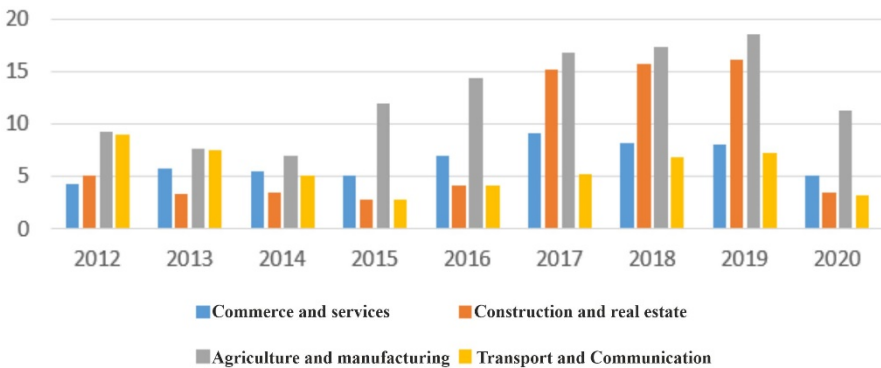
Table 5. The structure of GDP in the non-oil sector (in percent)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Non-oil and gas industry	9,5	8,8	8,6	9,0	7,9	7,7	8,8	7,9	8,7
Agriculture, forestry	10,7	10,2	9,5	9,8	9,4	9,8	10,0	10,3	11,1
Construction	19,0	22,7	22,3	19,1	16,8	16,6	14,8	13,5	12,4
Transport and warehousing	11,1	9,2	8,0	8,5	11,4	11,9	11,8	11,2	11,5
Trade, repair of vehicles	13,8	13,7	14,1	15,7	17,3	18,2	18,4	17,8	18,5
Accommodation of tourists	3,5	3,5	3,9	4,3	4,0	4,0	4,4	4,4	1,9
Social and other services	28,5	28,3	30,4	30,4	30,4	28,7	30,8	29,1	27,9
Herfindahl-Hirschman index	0,172	0,179	0,187	0,181	0,181	0,174	0,184	0,166	0,161

Source: Prepared by the author on the basis of the Central Bank of the Republic of Azerbaijan

We can observe from the index data that the Herfindahl - Hirschman index ranged about 0.16-0.18 within this sector, indicating a low level of concentration (Table 5). At the same time, it is worth noting that the index rose from 2012 to 2018, and then fell in the last two years. The overall concentration, however, has not altered considerably due to the limited number of these alterations.

In addition to fixed asset investments, the value-added ability of credit investments in various sectors of the economy is critical in determining the financial success of diversification. Because of the significant role that loans play in the distribution of financial resources across the economy, they can be used as a measure of financial efficiency. The efficiency of loans can also be used to determine the banking system's efficiency. Let's use the cost-benefit ratio to determine the relationship between credit investments and value created, just as we did in the prior example. The results are shown in Figure 2.



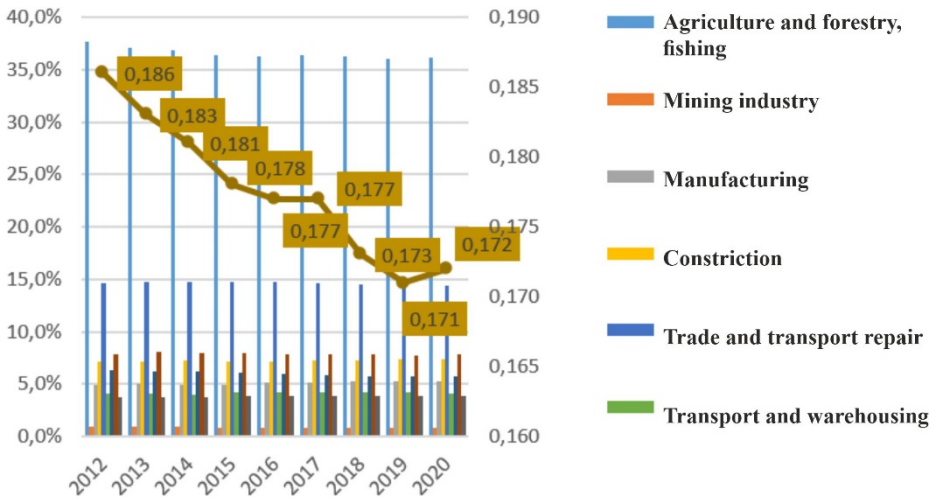
Graph 2. Cost-benefit relationship on loan-based investments and value-added in the economy

Note: The graph was prepared by the author on the basis of data from the Central Bank of the Republic of Azerbaijan and the State Statistical Committee of the Republic of Azerbaijan

The construction and real estate sector, as seen in the graph, had the biggest increase in the profit-loss ratio from 2012 to 2020. As a result, from 2012 to 2019, this ratio climbed by more than thrice, reaching 16.2 in 2019. With the exception of 2013, 2015, and 2020, this area's profit-loss ratio has risen. The commerce and services sector saw the second-largest growth in the value-added ability of loans. Between 2012 and 2017, the number of people working in this field more than doubled.

The efficacy of economic diversification is also influenced by labour market variety. The value created in various locations can be compared to the labour force operating in different areas to estimate labour productivity. When we look at the labour market in Azerbaijan, we can see that the oil industry has a lower share than other sectors and directions. The mining industry, which includes the oil sector, has a labour market share of less than one percent (Figure 3).

Despite the fact that the oil sector accounts for a considerable portion of both exports and GDP, its low labour market share shows that labour productivity is high in this sector. However, when you look at other sectors, the picture changes dramatically.



Graph 3. Distribution of the employed population by types of economic activity

Source: Prepared by the author on the basis of data of the State Statistics Committee of the Republic of Azerbaijan

Agriculture, which has the largest proportion of the labour market, has altered around 5-6 percent in the formation of GDP throughout the time under review. This demonstrates that agricultural worker productivity is low. A comparison of the labour market and the value added provided by the oil and agricultural sectors reveals that the work force’s role in the establishment of Azerbaijan’s economic development is limited.

4. Sources of increasing the financial efficiency of economic diversification in the direction of strategic goals of economic development.

It is critical to have sustainable sources of finance in the first place in order to diversify the economy and boost its financial efficiency. Diversification policy is a thorough, long-term process that necessitates significant investment as well as the long-term viability of these resources. We can only talk about boosting the financial efficiency of diversification in this scenario. Otherwise, in the absence or at a low level of necessary and sustainable financial resources, the financial efficiency of diversification will be minimal.

The state budget is Azerbaijan’s principal source of economic

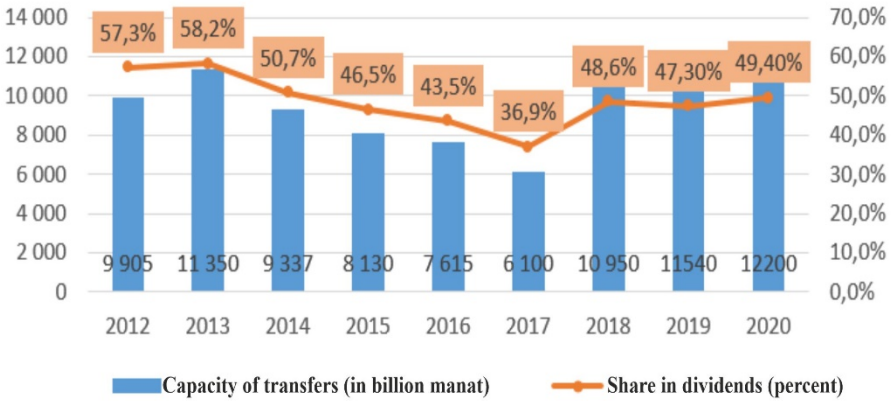
diversification. As Azerbaijan's diversification program is still in its early stages, it is critical to give state support for its funding in order to improve financial efficiency. Budget funds have been used to implement the Strategic Road Map, which aims to diversify the economy, finance various organizations and government agencies established to carry out diversification policy, and support the development of various sectors of the economy, including small and medium enterprises. The construction of budget revenues and expenditures, as well as the state's power to finance the economy, leads to the formation of the necessary financial sources to boost diversification's financial efficiency.

Revenues from the State Oil Fund of the Republic of Azerbaijan (SOFAZ), in addition to customs and tax revenues, play an essential part in the formation of budget revenues. As a result, the Oil Fund plays an important role in the establishment of financial sources that finance the economy and improve diversification's financial efficiency. It should be highlighted, however, that the role of transfers from the oil fund in the budget considerably increases the economy's reliance on oil, allowing variations in oil prices to have a greater impact on the economy. As a result, the "Golden Rule," a new method for reducing the percentage of oil funds and consequently oil income in the economy, is being implemented. The "Strategic Road Map" also has this regulation. The adoption of this rule places a cap on the amount of oil revenue that can be transferred to the economy. When revenue exceeds this threshold, funds are transferred to a newly established fund and earmarked to foreign investment.

The proportion of transfers from the Oil Fund in budget revenues changed in tandem with the fund's volume. It means that from 2013 and 2017, the share of transfers in budget income fell, then grew in succeeding years (Figure 4). The ratio of transfers declined from 58.2 percent to 36.9 percent between 2013 and 2017. It increased to 49.4 percent in 2020 as a result of future years of growth.

Because SOFAZ indirectly contributes to economic diversification and financial efficiency through the budget, it is critical to examine its structure as the primary source of funding. The resources of the oil fund operate as a buffer in giving financial support to the economy during the crisis, as well as in implementing other government

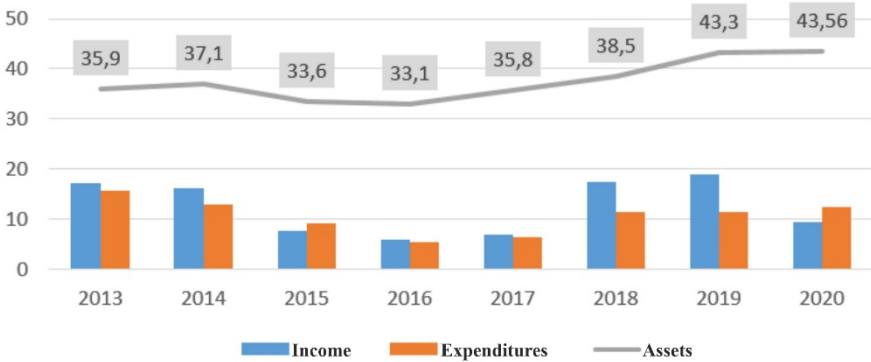
projects and maintaining financial security.



Graph 4. Transfers from the State Oil Fund to the budget

Source: Ministry of Finance of the Republic of Azerbaijan

Until 2014, SOFAZ’s assets rose in general. This has been achievable since the Oil Fund’s income have consistently exceeded its expenditures over time. However, in 2014-2016, the fund’s revenues and expenditures both decreased due to lower oil revenues. The fund’s assets tend to shrink when revenue declines outweigh the decline in assets. It climbed once again in the period 2017-2020 (10.46 billion US dollars). Between 2014 and 2016, there was a \$ 4 billion drop (Figure 5).



Graph 5. Income, expenditures and assets of SOFAZ

Source: Annual reports of SOFAZ

Only between 2015 and 2020 did expenditures exceed receipts, by \$ 1.53 billion and \$ 3 billion, respectively. Despite this, the fund's assets have consistently surpassed \$ 30 billion over time.

The *Central Bank's reserves*, along with the assets of the State Oil Fund, contribute to the establishment of the country's strategic foreign exchange reserves. As a result, the size of strategic foreign exchange reserves has increased. The Central Bank's foreign exchange reserves fell considerably in 2015 during the time under review. The Central Bank's foreign exchange reserves fell by \$8.8 billion in 2015, resulting in two devaluations. This has contributed significantly to the reduction of strategic foreign exchange reserves. According to SOFAZ, the Republic of Azerbaijan's strategic foreign currency reserves grew rapidly until 2014, reaching \$ 50.9 billion in 2014. It had dropped \$13.8 billion by 2016. This drop has allowed the economy to recover from the crisis and meet the need for foreign money. It began to rise in 2017 and is expected to reach \$ 51.25 billion by 2020.

Banks, with government funding, *are one of the most important sources of funding for economic diversification*. Entrepreneurship plays a crucial role in the implementation and expansion of diversification policies. As a result, banks are directly involved in enhancing the financial effectiveness of diversification programs through financing entrepreneurship. In this regard, loan-based investments in the economy should be seen as one of the primary sources of financing diversification.

5. The main directions of increasing the level of financial efficiency of economic diversification

The fundamental problem confronting Azerbaijan's current economic policy is to diversify the economy and develop the non-oil industry. The major goal of this work is to safeguard the economy from external shocks and to increase the options for mitigating the negative effects of oil price volatility.

The following are some of the steps we recommend in this direction to raise the economy's level of diversification and financial efficiency.

1) Becoming a member of the World Trade Organization (WTO). The World Trade Organization (WTO), as one of the world's

major institutions for economic development, works to improve the efficiency of trade connections between countries and strengthen economic ties.

2) Gaining access to new markets. As previously stated, Azerbaijani indigenous products now have limited potential to compete in developed markets like as Europe and America. Of fact, producing items that fully satisfy world standards and can compete in developed markets is challenging in a short period of economic development. In the long run, reforms in this direction will make it easier for Azerbaijani products to access established markets. But first, other markets must be considered, as well as new markets where Azerbaijani products can compete.

3) Re-export. Re-exporting is one of the most successful techniques to boost the economy's income. This procedure enables any government to strengthen economic ties and expand the number of partners with which it has both buyer and seller relationships.

4) Improving access to finance. Economic entities' financial accessibility is critical in the implementation of economic diversification policies. Entrepreneurs are the key driving force behind economic diversification policies. The availability of financial resources has increased the incentives for entrepreneurs to expand their activity and operate in any economic field. The limited availability to capital for start-ups, along with the high level of risk, can sometimes stifle the diversification process. As a result, one of the most essential challenges is to supply entrepreneurs with low-cost financial resources so that diversification policies can be implemented more effectively in the economy.

5) Development of financial and interbank markets. The high level of development of financial markets is one of the key reasons that industrialized countries' economic systems are more efficient. Economic entities can create more income and become more competitive by having efficient financial markets. Attracting cash through financial markets opens doors for new businesses and improves their access to capital.

6) Use of resources in the liberated territories. The liberation of occupied lands by Azerbaijan's national army, which had been under occupation for over thirty years, as well as the preservation of

Azerbaijan's territorial integrity, opened up new economic opportunities in 2020, after the "Forty-Four Day War". In the 1990s, the occupation of up to 20% of Azerbaijan's territory resulted in the loss of vast amounts of natural resources. Prior to the occupation, the reserves in these areas supplied 24% of Azerbaijan's total grain production, 41% of its alcohol production, 18% of meat production, 46% of potato production, and 34% of milk production. Approximately 7,000 businesses in those locations offered these production capabilities, and nearly all of them were forced to close as a result of the occupation. The fact that these lands had a significant economic impact prior to the occupation and were thereafter lost as a result of the occupation had a significant impact on the Azerbaijani economy at the time. Thus, between 1989 and 1994, the entire volume of GDP fell by 60%, GDP in agriculture fell by 43%, and GDP in industry fell by 60%. Despite the fact that the Azerbaijani economy grew swiftly in the years after the crisis and emerged from it, access to the resources located in these territories was not available until our territories were liberated. As a result, the liberation of our formerly occupied territories has opened up new economic prospects by restoring access to these resources. The magnitude of the lost economic potential during the occupation demonstrates how significant and vital the fresh opportunities in our liberated lands are.

RESULT

Taking all of this into account, the paper examines the processes taking place in the global economic relations system, as well as the threats these processes represent to countries' economy, and the relevance of economic diversification is substantiated in this regard.

1. The economic diversification model is one of the most effective methods for nations that rely on the export of a small number of items to shield their economy from commodity and financial market volatility, according to the study. Because economic diversification allows governments to diversify their sources of income and increase the number of currency channels. Diversification improves financial efficiency, as evidenced by this. The variety of financial resources entering the market provides for the long-term sustainability of financial security, which creates the essential atmosphere for economic

entities to operate effectively.

2. Several studies in the subject of economic diversification, as well as various theories put forward, were evaluated throughout the dissertation study, and their value in the implementation of diversification policy was assessed. Diversification is a multidimensional term that covers diversification in numerous areas of the economy and generates circumstances for the expansion of financial channels, according to an analysis of the present theoretical framework about economic diversification.
3. Research has shown that, due to the diversity of economic systems among countries, there is no universally successful strategy to economic diversification, and diversification policies do not always produce the desired results and greater financial efficiency. As a result, it is vital to research global economic diversification policy experience.
4. The study examines the economic diversification policies made in Azerbaijan in recent years and assesses their influence on the financial efficiency of diversification. To this end, the “Azerbaijan 2020: Vision for the Future” Development Concept, “Strategic Road Maps” aimed at comprehensive economic development and the measures required for its implementation in various sectors and the economy as a whole have been analysed, and the importance of the goals and priorities set out in these documents has been assessed.
5. In order to assess the financial effectiveness of economic diversification in current conditions, the research looked at a variety of economic indicators and orientations. The increase in economic diversification has been found to be reflected in the Gross Domestic Product. The non-oil sectors percentage of GDP has risen dramatically in recent years, enhancing financial security. Simultaneously, it was found that the mining industry’s share in the oil sector has reduced in recent years, and a satisfactory level of GDP diversification in the non-oil sector has been achieved. This has improved financial efficiency by allowing non-oil sector exports to expand and diversify.
6. The study discovered that, after assessing economic diversification and financial efficiency, the steps taken to diversify the economy and increase its financial efficiency, as well as the reforms implemented, yielded positive results, but the results varied depending on the areas

and indicators of the economy.

7. Demonstrating the value of other nations' expertise, it has been demonstrated that incorporating world experience into Azerbaijan's diversification policy and its future implementation can improve the financial efficiency of diversification.
8. To speed up the diversification process, it has been identified areas for diversification as well as ways to improve its financial efficiency. WTO membership, access to new markets, re-exports, enhanced access to financing, the growth of financial and interbank markets, and resource usage in the liberated territories are among these topics.

The main content of the dissertation work is reflected in the following published works:

1. "Maliyyə təhlükəsizliyi və onun müasir vəziyyəti" Azərbaycan Respublikası Vergilər Nazirliyinin "Azərbaycanın davamlı inkişafında vergi siyasətinin rolu" adlı Elmi praktiki konfransı. Şamaxı şəhəri, 5 iyun 2015-ci il, səh 151-152
2. "Azərbaycan Respublikasının regionlarında sənayenin inkişafı" Azərbaycan Respublikası Təhsil Nazirliyinin Bakı Biznes Universiteti. Ümummilli lider H.Əliyevin anadan olmasının 93-cü ildönümünə həsr olunmuş "Dünya iqtisadiyyatı və Azərbaycanda turizmin inkişaf istiqamətləri mövzusunda beynəlxalq-elmi-praktiki konfrans, Bakı-2016, səh 322-326
3. Azərbaycan Respublikasının bank sistemində tətbiq edilmiş antiböhran mexanizmləri. Odlar Yurdu Universitetinin Elmi və Pedaqoji xəbərləri, 2016, №44, səh 89-94
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5. Новые приоритеты стратегической деятельности банковского сектора в Азербайджане. XII Международная научно-практическая конференция по теме «Государственное регулирование экономики и повышение эффективности деятельности субъектов хозяйствование Сборник научных статей, 13-14 апреля 2017 года, г.Минск, с 153-155
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- AMEA-nın xəbərləri, İqtisadiyyat seriyası, 2018-1, №5, səh 59-64
7. Значение диверсификации экономики и ее роль в экономическом развитии. Международный научно-практический журнал «Экономика Держава», №5, 2018, г.Киев, с 78-82
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