

MAIN DIRECTIONS OF THE NON-OIL EXPORT SECTOR IN AZERBAIJAN

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ABSTRACT

Development of the non-oil export sector and economic diversification has become a critical issue for the government of Azerbaijan. This necessity is connected with fluctuating oil prices in the world energy markets and precipitous changes in international economics. President Mr Ilham Aliyev attended an interactive session on Strategic Outlook: Eurasia held as part of the Davos World Economic Forum in 2018 and stressed that “as a source of major income we should look at technology, innovation, industry, entrepreneurship, and agriculture”. Although these sectors have been prioritized and large-scale reforms are conducted in Azerbaijan, this paper detects that Azerbaijan is at the onset of economic diversification and its economy is still fueled by oil and gas revenues. The future progress will depend on how deeply and holistically the reforms will be realized.

Keywords: Economic diversification, non-oil sector, Azerbaijan, policies, growth.

JEL classification: F00, F01, F55, 038.

INTRODUCTION

Before started to discuss the development of Azerbaijan’s non-oil export sector, we will have to determine the main directions of non-oil export sector. Azerbaijan has identified several key areas. President Ilham Aliyev participated at the interactive session on “Strategic Outlook: Eurasia” held as a part of the Davos World Economic Forum in 2018 and mentioned that “diversification of the economy is our main objective, and I think that we achieved success in that direction. When we experienced a dramatic drop in oil prices I said in Azerbaijan that for us a post-oil period has already started, and we should forget about oil, forget about gas. Of course, we must implement completely the projects, which we are now implementing. But as a source of major income we should look at technology, innovation, industry, entrepreneurship, and agriculture” (President.az, 2018). It shows that Azerbaijan is committed to develop the mentioned sectors.

Moreover, the above-mentioned sectors have been made a part of the strategic roadmaps for the development of the national economy. Besides, a very special focus has been given to the development of other non-oil sectors, including tourism, regional transportation routes, information technologies, innovations, and logistics centres at the state level. While entrepreneurship, agriculture and the non-oil industry may enjoy huge export potential, innovation and technological advancements can enhance international competitiveness and productivity in these areas. Therefore, the development of the non-oil export sector is regarded to be closely correlated with the development of technology, innovation and information technologies.

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Regarded as one of the earliest engagements of the local population in Azerbaijan since ancient times, an agricultural sector today employs 37% of the population working in the country's economy. When looking at Azerbaijan's foreign trade indicators, exports of agricultural products are second after the exports of oil products. Productive soils, natural water resources and a diversity of climate zones offer tremendous opportunities for a developed agricultural sector in Azerbaijan. The state has made serious investments in agriculture in recent years and large-scale reforms are underway. Experts predict that the agricultural sector will experience a rapid rise in the years ahead.

It must be mentioned that Strategic roadmap on Agricultural Development (2016: 41) outlines the state's agricultural development goals. The state's objective by 2025 is to strengthen the competitiveness of agricultural production and manufacturing industry (2016: 45). In addition, the strategic map illustrates that the introduction of innovations and agricultural automation is required to create modern farms to enhance productivity (2016: 45). Furthermore, farmers' access to financial resources will be strengthened, the country's agro-industrial complex will be transformed, significant investments will be made in irrigation systems, and rural electrification will be consolidated by 2025 (2016: 45-47). Experts and policy-makers mention that agriculture is an important field that can decrease Azerbaijan's dependence on oil and gas exports.

Industrial development is a second part of the non-oil export sector. The national industry of Azerbaijan includes industrial sector, mining industry, manufacturing industry, electricity, gas, steam production, distribution and supply and water supply, waste treatment. The industrial sector also includes light industry which is textiles, clothing, carpet weaving, leather products and footwear production (Ministry of Industry of Azerbaijan, 2016: 2). The main features characterizing the

light industry are that low capital and manual labour is required to drive production. Although Azerbaijan has heavily invested in the establishment of industrial facilities and parks, the majority of established industrial enterprises remain inefficient. Azerbaijan has chosen “import substitution” to support industrialization. However, this strategy extensively used by the least developed countries of Latin America and Africa between 1930s and 1980s have failed to produce outcomes.

The development of small and medium-sized businesses (SME) and their export potential remains a third essential section of non-oil export sector. SMEs around the world are at the core of the economy and have a vital role in the job creation. Support for entrepreneurship in Azerbaijan has been supported by the Strategic Roadmap which includes several activities for SMEs including the establishment of a centralized SME agency, the establishment of clusters, the development of business incubators as well as start-ups (2016: 5). Moreover, the development of innovations and technologies in Azerbaijan has been reflected in the key strategic maps of the country’s economy to increase productivity and competitiveness in various sectors of the economy. The government believes that innovation-driven development should cover all sectors (Babayev, 2019: 140; Babayev and Hajiyev, 2019: 312).

FINDINGS AND DISCUSSION

Azerbaijan enjoys an enormous potential for the development of agrarian, industrial and manufacturing sectors. Moreover, one of the great advantages of Azerbaijan is its geographical vicinity to the CIS countries and Russia, which are in great demand for agricultural products. Every region in Azerbaijan differs almost exclusively by specific agricultural products. Cultivation of a diverse range of agricultural products provides great opportunities for entrepreneurs who manufacture these products. Azerbaijan pays great attention to the establishment and development of agricultural manufacturing facilities. Exports of agricultural products are not sufficient. However, they provide a significant portion of the country's employment. After the reconstruction of the Ministry of Agriculture, this sector experience a serious revival and great attention is paid by the state. However, the export indicators are still low due to the small size of the country, low productivity, and failure of farmers to meet the qualitative and quantitative demands of foreign buyers. The involvement of SMEs in agrarian sector can contribute to this sector. With all this in mind, Azerbaijan’s non-oil export sector has several objectives to boost its agricultural output. The first is to increase agricultural productivity through the use of innovations and minimize costs and procedures for companies to enter the world market. It also includes tax privileges, subsidies, low-interest loans, and elimination of restriction of imports.

The Decree of the President of the Republic of Azerbaijan on the approval of the “State Program for Industry Development in the Republic of Azerbaijan for 2015-2020” was approved in 2014, and the same year was declared the “Year of Industry” in Azerbaijan. The main objectives of the state program are to increase the non-oil export potential, the use of innovations in industrial enterprises, the use of advanced technologies, the promotion and application of investments in the non-oil industry, the modernization of industry and the use of infrastructure (2014). The main components of the state program are strengthening the industry’s competitiveness, supporting the activity of industrial enterprises, establishment of industrial zones and clusters, reinforcing human resources and scientific support and advancement of legislation. The most addressed term used in the strategic roadmap for the development of heavy industry and mechanical engineering in the Republic of Azerbaijan is the broad use of the term “support for import substitution”.

It must be mentioned that two basic strategies for industrialization are used when considering the structure of world trade. One of them is import substitution activities. The import substitution strategy means that the goods imported to the country are replaced with products of the domestic industry. Export promotion refers to the establishment of production for international trade and the strengthening of foreign trade (Yilmazkuday, 2003: 1). Export promotion refers to the fact that industries can compete with foreign competitors. The application of export promotion policies has been very successful in the new industrialized Asian tigers, Hong Kong, South Korea, Taiwan and Singapore. Since 2010, Turkey has used two industrialization strategies in the industrialization of the national economy. Turkey is actively encouraging the export of industrial goods, along with a policy of meeting the demand for industrial goods at the expense of the local industry. Considering this the application the Turkish industrialization strategy in Azerbaijan may produce successful outcomes. It is important to prepare Azerbaijan’s export products for international competition.

The Azerbaijani industry is a sector that has historic traditions, both in light and heavy industries. Mechanical engineering, carpet weaving, silk and metallurgy have historically developed in Azerbaijan. The problems associated with industrial development include low labour productivity, lack of funding, low marketing and sales, low innovation activity, poor quality of products and lack of strong business models. Furthermore, industrialization can also be defined as the main focus for the non-oil sector in Azerbaijan. The development of the light industry in terms of developing the export potential of the industry seems to be very promising for Azerbaijan, where there are quite a rich tradition and raw materials. Azerbaijan can support traditional light industries by establishing manufacturing facilities and

preparing these manufacturing centres for international competition which does not require much investment and resource.

When it comes to the role of the state, the state has to simplify the regulations for entrepreneurs entering the foreign market and improving all the conditions in the country to ensure competition and doing business. Regarding the heavy industry, it is necessary to conduct a cost-effectiveness audit of existing businesses and evaluate international sale opportunities. Government have to stop to support for industrial enterprises with no prospects in the long run which leads to an inefficient economy. Majority of these businesses will stop or operate inefficiently in the post-oil era. Supporting these businesses is a huge risk and leads to the emergence of a national economy-dependent pseudo-industry. It is important to monitor which enterprises work efficiently and which do not. State's permanent support to these companies is a big obstacle.

Regarding SMEs, the analysis shows that most businesses in Azerbaijan are engaged in the production of goods that are largely aimed at meeting the needs of consumers across the country. Local consumers buy their goods with lower quality indicators. As a result, these companies are not interested in the production of competitive goods and lose income from foreign trade. This, in turn, reduces the interest of producing better quality products through the use of technology and innovation to produce competitive products. Big holding companies produce products to meet the needs of such a major local market and have little interest in foreign markets. This trend is seriously hampering the development of local businesses. There is a lack of management skills, a business philosophy that is relevant to foreign market growth of local businesses. The biggest challenges in the development of entrepreneurship include weak linkages between the private sector, low management skills, low access to financial resources, and lack of competition (2016: 11).

In addition to this, President Ilham Aliyev underlined the importance of good governance in Azerbaijan and introduced a series of structural reforms. He said in Davos: "The future is not about oil and gas; they will be exhausted one day. The future will consist of state support for innovation, technology, good governance, transparency and entrepreneurship" (President.az, 2018). A new reform has been launched to improve the competitive environment and good governance in Azerbaijan since 2019. SME Development Agency of Azerbaijan (KOBIA) was established in 2019. Furthermore, Mr President has entrusted the Ministry of Economy of the Republic of Azerbaijan with the task of creating a favourable environment for entrepreneurship development.

In addition, Azerbaijan started to support startup incubation centres to operate. The biggest obstacle to entrepreneurship development in Azerbaijan is to consolidate the

competitive environment. The most important factor that contributes to the success of local companies in international competition is the competition existing in the national economy and the state's role as a facilitator (Robert, 1991: 535-548). This could include improving legislation, enhancing the competitive environment, maximum simplification of the regulations for doing business and financial openness.

The prerequisite for improving the export potential in the non-oil sector including in the manufacturing, industrial, and the agricultural, is to invest in improved business conditions, financial openness and infrastructure, which serves to build confidence of local and foreign investors to return the investment. The main incentive for investors to do this is to reduce the cost of doing business and share this information with entrepreneurs in a simple way. There are so-called "transaction costs" for business people entering the market, which include the needless and information costs that prevent entrepreneurs from entering the market. If the government takes care these costs through simplification of business climate regulations for businesses, the number of companies that want to invest will be tripled. It is important to create a portal that will encourage foreign businesses to invest in the Azerbaijan's economy, agriculture and industry, as well as enable businesses to register online, open a bank account and easily explain business rules in Azerbaijan. The state must eliminate its role in the private sector that interferes with its development.

At last, funding support should be provided to startups and small businesses through the Entrepreneurship Support Fund and other agencies. The involvement of consolidated banks in this sector could improve the industrial landscape. The overall analysis of the strategic roadmaps allows us to conclude that the Government of Azerbaijan understands the economic problems of the non-oil sector and regions in the economy, implements sustainable programs to address them, creates new flexible state structures and invests heavily in all sectors of the economy. However, most strategic documents connected with economic development are characterized with activity drivenness rather than result-orientedness. The main government agencies that are responsible for the implementation of the reforms and the implementation of the maps should be built on more efficient and flexible mechanisms and should be accountable for the results. The result based audits must be conducted. The presence of an effective public management is one of the factors that positively impact business operations. The new institutional economy stresses the role of the state in the economy as a regulator. This policy has been the core of the World Bank, World Trade Organization and International Monetary Fund policies for many years in developing countries.

CONCLUSIONS

As a conclusion, it should be noted that the government in Azerbaijan understands the importance of diversification of the national export sector. Therefore, Mr President Aliyev and strategic roadmaps of Azerbaijan have identified several areas for the development of the economy. These areas include agriculture, industry, technological development and applications of innovations, as well as the development of small and medium-sized entrepreneurship. Azerbaijan has also started economic and structural reforms, and form organizations to support the development of the above-mentioned sectors. However, it should be noted that Azerbaijan is still at the earliest stage of reforms. There is much needed to be done in the years ahead for economic diversification. A new reform should be evaluated in terms of its impact on export indicators.

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