

GROWTH PATTERNS AND DIVERSIFICATION ISSUES OF THE NON-OIL EXPORT SECTOR IN AZERBAIJAN

Bahrüz Babayev

Azerbaijan State University of Economics (UNEC)

Email: bahrüz.babayev@unec.edu.az; Tel: (+994 55) 981 06 15

Received October 15; accepted 10 December 2020; published online 28 December 2020

ABSTRACT:

This article discusses and analyzes recent trends and tendencies about growth patterns and diversification issues of the non-oil export sector in Azerbaijan. Despite the fact that Azerbaijan has enjoyed from the energy projects since its establishment as an independent state in 1991, there is a need for the development of non-oil export sectors to achieve the sustainable development of national economy. Therefore, economic diversification has become a vital issue for Azerbaijan. The government of Azerbaijan has adopted strategic roadmaps since 2016 that have prioritized the development of agriculture, small and medium-sized businesses, as well as the establishment regional transport corridors to diversify export revenues of Azerbaijan and foster lasting growth. However, this article mentions that the reforms must be continued consistently as Azerbaijan's national economy has a still strong reliance on the energy resources, namely crude oil.

Keywords: Economic Diversification, Non-oil sector, Tourism, Logistics, Business development

JEL classification: F11, F14, F41, F43.

INTRODUCTION

Azerbaijan is a small country in the Caucasus with a population of ten million people. Azerbaijan has an importance in the world energy market. The proven and potential resources of the Azerbaijani sector of the Caspian Sea have played an important role in terms of diversification, strengthening and stabilizing the world's energy supply. It has land borders with Russia, Iran, Turkey, Georgia and Armenia, and a sea border with the Caspian Sea. Azerbaijan is located on the transport links between Europe and Asia and at the junction of the ancient Silk Road. Azerbaijan has been known as a crude oil country since Soviet times. The country's main natural resources are crude oil and natural gas. In addition, the country has gold deposits, great tourism and transit potentials. Oil and fuel products produced in Azerbaijan played an important role in providing the Soviet army with fuel during

the World War II. Azerbaijan gained independence in 1991 after the collapse of the Soviet Union in 1989. In the first years of independence, the economy faced great challenges. The people's movement for independence, the Nagorno-Karabakh war with Armenia, and the transition from a centralized to a free market economy has put the country's economy in a difficult position. Despite all this, a ceasefire agreement was signed with Armenia in 1994 stopping military operations, and the country began to build its economy.

During the Soviet governance system, Azerbaijan's economic activity was about extraction and production of raw materials. Since 1994, the country's "oil strategy" has started playing an important role in strengthening and building the economy of the Republic of Azerbaijan. The Republic of Azerbaijan, which signed oil contracts with the world's leading companies in 1994, has attracted large investments in the country's economy. Foreign direct investment in the oil and gas sector played an important role in terms of giving impetus to the country's economic recovery. The long-term national strategy of Azerbaijan was "to attract investment in the oil and gas sector of many countries to strengthen national security" (Ipek, 234). Between 2001 and 2009, Azerbaijan began to develop its oil and gas sector, and GDP began to grow by 16% per year (Nasirov, 4). Strong oil and gas production, high international oil prices, foreign investments put in Azerbaijan and sharply rising government spending averaged 27% economic growth per year between 2003 and 2009 (Nasirov, 4). The full operation of the Baku-Tbilisi-Ceyhan oil pipeline in 2006 and construction of the South Caucasus Gas pipeline led to the peak of oil export revenues to Azerbaijan between 2006 and 2012 and led to rapid growth of the national economy.

Despite all this, the sharp fall in world oil prices between 2014 and 2015 and the fluctuations in world oil prices indicated that the economy's dependence on oil is dangerous for the national economy. The head of state, leading economists and politicians understanding the need to diversify the country's national economy and ensuring the development and sustainability of the non-oil sector decided to begin to make important decisions in this direction. At present, the development of the non-oil sector is very important for the President of the Republic of Azerbaijan, Azerbaijani economists and Azerbaijani politicians, and this is often highlighted in their speeches. In 2019, the President of the Republic of Azerbaijan, Mr. Ilham Aliyev, said at a conference on the results of the implementation of the State Program on Socio-Economic Development of the Regions of the Republic of Azerbaijan in 2014-2018: *"Of course, the main sector of our economy is the oil and gas sector. This is so today; it has been before and will continue to be so. We are*

simply trying to develop the non-oil sector rapidly, and we are achieving this” (President.az, 2019).

DIVERSIFICATION ISSUES OF THE NON-OIL EXPORT SECTOR IN AZERBAIJAN

The “Decree of the President of the Republic of Azerbaijan on the Approval of Strategic Roadmaps for the National Economy and Key Sectors of the Economy” in 2016 defines a strategic road map for the development of key sectors of the national economy and development perspective for each sector. The document states that "sustainable and competitive development of the non-oil sector in the Republic of Azerbaijan is a priority of the state's economic policy" (2016). According to the document, the main sectors of the non-oil sector include oil and gas industry, agricultural production and manufacturing, production of consumer goods at the level of small and medium enterprises, heavy industry and engineering, tourism industry, logistics and trade development, telecommunications and information technology as well as the development of regional transport corridors.

At present, the country's strategic documents show that the development of the non-oil sector is one of the most important priorities for the country's economy. Furthermore, an analysis of the structure of the economy shows that the Azerbaijani economy consists of two main sectors. The first is the oil sector and the second is the non-oil sector. Although the non-oil sector covers many sectors, the Azerbaijani government's economic diversification policy identifies tourism, agricultural development, telecommunications and information technology development, and the development of international transport corridors as important areas for the Azerbaijani government. At the same time, starting from 2018, the development of small and medium-sized businesses, increasing their export and competitive potential is one of the important goals for Azerbaijan.

Therefore, the establishment of a diverse range of agencies under various ministries to support startups, small, and medium-sized businesses has been approved. The establishment of incubation centers for business development and the promotion of entrepreneurial skills remain one of the most important areas for the Azerbaijani government. Despite all the work done, increasing the export potential of Azerbaijan's non-oil sector remains a problem. The country's main revenues including GDP are being formed with the contributions of oil revenues. Although there are no accurate statistical on what percentage of the country's national income comes from oil, figures from various international organizations and portals suggest that the figure varies between 90 and 95%. Export.gov shows that in 2019, 44% of Azerbaijan's GDP will be provided by

the country's oil sector, 90% of the country's exports will be oil products, and only 5% of the population will work in the oil sector. All these figures prove that the export potential of the non-oil sector is low and does not bring significant revenues to the country. The country's economy has not been diversified well so far, and serious work is needed to be implemented in this direction.

According to the Trading Economics, Azerbaijan's exports are dominated by oil and natural gas, which account for 95 percent of total export earnings. Other Azerbaijani exports include sugar, fruit, metals and polymers. Although the country is seeking to diversify its economy, it remains one of the key priorities for the government. Export diversification means “diversification of exports means increasing the range of products in a country exports” (Dennis and Shepherd, 2007). In addition, in some literatures, export diversification is seen as a transition from the export of raw materials to the export of manufactured products. The problems of diversification of the non-oil export sector have been identified by many economists. The sector needs to be analyzed in more depth. Economic reforms implemented in Azerbaijan aim to strengthen the country's non-oil sector, diversify the economy and integrate the Azerbaijani economy into the world economy. Rovlan Karimov argues that today the Azerbaijani economy is characterized by two interrelated problems. The first of these is the country's dependence on oil revenues. The second is that Azerbaijan's refining industry is so weak that all of this continues to make the economy dependent on oil.

The results of the research of the Baku Research Institute, the main problems of non-oil exports of Azerbaijan were identified, which included the followings: “Problem 1: Absence of variety of supplies, Problem 2: Limited volume of supplies, Problem 3: Geographical Limit, Problem 4: Technological Constraints, Problem 5: Exporter Limitations and Problem 6: Private Sector Potential”. The web portal claims that “in this regard, diversification of Azerbaijan's exports and increase of non-resource based foreign exchange earnings are extremely important. The short-term depreciation of the Azerbaijani manat more than twice in 2015 showed that long-term sustainable development and macroeconomic stability will not be possible unless the exchange rate of the national currency is freed from dependence on natural resource revenues” (BRI, no date).

GROWTH PATTERNS OF THE NON-OIL EXPORT SECTOR

The State of Azerbaijan has been implementing a number of programs to develop the economy during the recent years. The diversification of the economy and business development, the creation of a competitive environment and the diversification of the non-oil sector play an important role in all these programs. These programs have been included into the “Azerbaijan 2020:

The development of logistics and trade is highlighted as one of the key areas in the Strategic Roadmap for the Development of Logistics and Trade in the Republic of Azerbaijan. Yusifov, Kulu and Mammadov argue that activities should be continued to reduce dependence on the non-oil sector and turn Azerbaijan into a logistics hub of the region. Azerbaijan's strategic position in the region between the east and west gives it a very favorable and good position in terms of cargo delivery through the territory of Azerbaijan. Therefore, many shopping centers are being built in the country. Furthermore, it is necessary to work seriously for the country's openness to investment, which will bring the country a lot of job opportunities and value-creating activities (2019, 37).

The strategic map emphasizes the importance of strengthening Azerbaijan's regional logistics route, the further development of the new Baku port complex in Alat settlement, the Baku-Tbilisi-Kars Railway and the Astara Railway, and the transformation of Baku into an important logistics center. Today, Azerbaijan is implementing successful projects in the field of logistics. These projects are very important for the opening of the economy and the connection of Azerbaijan's economy with the world economy. Azerbaijan's development potential in the field of logistics is huge. Therefore, it should be kept as one of the main priority sectors of the country, and Azerbaijan should be considered as one of the areas that play a very important role in the development of the non-oil sector and its integration into the world economy. Cooperation with the Chinese project "One Belt, One Road" can turn Azerbaijan into a logistics center. The project, initiated by China, aims to restore the historic Silk Road in the future, under which the Chinese government plans to allocate \$40 billion for infrastructure projects. In this regard, the active cooperation under this project will increase Azerbaijan's transit revenues in the future, will play a significant role in diversifying its economy and will become a hub between east and west.

One of the important areas for the strategic development of the national economy is the development of tourism. Azerbaijan is one of the countries with great tourism potential. Its geographical proximity to Europe and the Middle East makes the country an interesting destination for tourists from both the CIS and the Arab world. The establishment of the ASAN visa service, the opening of the country to the international economy and visa reforms is one of the factors that have a positive impact on the flow of tourists to the country. In addition, the establishment of the Azerbaijan State Tourism Agency to promote tourism is one of the important steps taken in this direction.

The strategic roadmap also includes the production of the education system and information technology, which remains one of the most important factors in the economy. Production of information technologies and production of high technologies are important for Azerbaijan. Although high-tech parks have been established and given importance with the support of the state, the country has not yet received any income in this area, and this issue remains in question. Despite all this, a number of problems remain in increasing the export potential of the non-oil export sector. Although the reforms launched in 2019 have been very successful in increasing the export potential of the non-oil sector, a diverse range of problems have been remaining in this area.

Initially, the biggest problem is the implementation of strategic roadmaps and the creation of new institutions. The creation of new institutions increases government spending, and their impact on development in the country is not studied. This must be seriously analyzed and the results presented. The International Trade Center report shows that, despite all efforts, trade competitiveness is characterized by low productivity, limited access to financial resources, a protracted regulatory business environment, and underdeveloped physical institutional management infrastructure.

While the reform at the end of 2019 looks very promising, it is not yet possible to see how deep and consistent these institutional reforms will be. If the reforms are consistent and all obstacles to business development are removed, competition can lead to sustainable economic development in the years ahead. While Azerbaijan's negotiations with the WTO continue, the issue of Azerbaijan's membership is still delayed. WTO membership can allow Azerbaijan to quickly integrate into the world economy, trade with other countries in accordance with WTO rules, obtain additional support for economic reforms as well as attracting foreign investment to the country.

CONCLUSION

This paper discussed growth patterns and diversification issues of the non-oil export sector in Azerbaijan. Despite the fact that no accurate statistical data exist on what percentage of the country's national income comes from oil, figures from various international organizations and portals suggest that the figure varies around 90 percent. Therefore, Azerbaijan has been implementing a number of programs and strategies to develop the economy during the recent years.

Azerbaijan's economic diversification policy identifies tourism, agricultural development, telecommunications and information technology development as important areas for the Azerbaijani government. Development of small and medium-sized businesses, increasing their export and competitive potential has been one of

the important objectives for Azerbaijan starting from 2018. Furthermore, the establishment of incubation centers for business development and the promotion of entrepreneurial skills remain important areas of focus for the government.

At last, it is argued that activities should be continued to reduce Azerbaijan's dependence on the oil sector and turn Azerbaijan into a logistics hub of the region. In general, Azerbaijan's development potential in logistics is huge. Cooperation with the Chinese project "One Belt, One Road" can turn Azerbaijan into a logistics center and geographical hub between East and West.

REFERENCES

- Baku Research Institute. No date. Main problems of non-oil export sector of Azerbaijan available at <https://bakuresearchinstitute.org/az/analysis-of-main-problems-facing-azerbajians-non-oil-exports/>, accessed on December 23, 2020.
- Center for Analysis of Economic Reforms and Communication. 2019. Special Issue., available at <http://iqtisadiislahat.org/store//media/2019/Dekabr/other/Idareetme%20islahatlari.pdf>, accessed on December 23, 2020.
- Dennis, A. and Shepherd, B., 2007. *Trade costs, barriers to entry, and export diversification in developing countries*. The World Bank
- Ipek, P., 2009. Azerbaijan's foreign policy and challenges for energy security. *The Middle East Journal*, 63(2), pp.227-239.
- LK Almas, NU Hajiyev (2014). Azerbaijan's Current and Potential Comparative Advantage: An Exploratory Study. *Journal of Agricultural Science* 6 (11), 74-87
- Muradov, A., Hasanli, Y. and Hajiyev, N. (2019). *The Assesment of Impact of Competitiveness to Economic Development*. Economic and Social Development: Book of Proceedings. Varazdin Development and Entrepreneurship Agency (VADEA). pp.1170-1177
- Muradov, A., Hajiyev, N. (2014). *Competitive Environment Is The Main Factor For Integration Into The World Economy*. *Journal of Economic Sciences: Theory & Practice* 71 (2). pp.5-20
- Nazim Uzbey oglu Hajiyev (2013), *Assessment Stages of Cyclical Development of Monopoly And Competition in Terms of The Reconstruction of Azerbaijan Economy*. The journal of "Economic sciences: theory and practice", Vol. 70, Issue 1. pp. 97-117.
- Nasirov, S. and Ciarreta, A., (2011), October. Analysis of Azerbaijan Oil and Gas Sector. In *Changing Roles of Industry, Government and Research*, 30th

USAEE/IAEE North American Conference, Oct 9-12, 2011. International Association for Energy Economics.

Yusifov, E.M., Kulu, T.K. and oghlu Mammadov, H.P., (2019). Logistics Sector In Azerbaijan Economy: Structural Improvements And Orientations Strategic Development. *EUREKA: Social and Humanities*, (2), pp.29-38

Prezident.az (2019) “Conference dedicated to the results of the implementation of the State Program on Socio-Economic Development of the Regions of the Republic of Azerbaijan in 2014-2018”, available at <https://president.az/articles/31679>. accessed on December 23, 2020.

Ramil Huseyn (.2016). “Agriculture is a strategic sector of Azerbaijan’s economy”, available at http://www.iqtisadiislahat.org/columns/kend_teserrufati_azerbaycan_iqtisadiyyatinin_strateji_sektoru_kimi-14, accessed on December 23, 2020.

Strategic Road Map for the National Economic Prospects of the Republic of Azerbaijan. 2016. Available at https://mida.gov.az/documents/%C4%B0qtisadiyyat_Yol_%20xeritesi.pdf., accessed on December 23, 2020.

Strategic roadmap for the development of the tourism industry in the Republic of Azerbaijan.2016. available at https://mida.gov.az/documents/Turizm_s%C9%99nayesinin_inki%C5%9Faf%C4%B1na_dair_strateji_yol_xeritesi.pdf., accessed on December 23, 2020.

Strategic roadmap for the production of consumer goods at the level of small and medium enterprises in the Republic of Azerbaijan. 2016., available at https://mida.gov.az/documents/Ki%C3%A7ik_v%C9%99orta_sahibkarl%C4%B1q_s%C9%99viyy%C9%99sind%C9%99istehlak_mallar%C4%B1n%C4%B1n_istehsal%C4%B1na_dair.pdf, accessed on December 23, 2020

Strategic Roadmap for the production and manufacturing agricultural products in the Republic of Azerbaijan. 2016. Available at https://mida.gov.az/documents/strateji_yol_xeritesi_kend_teserrufati_mehsullarinin_istehsalina_ve_emalina_dair.pdf., accessed on December 23, 2020.

Trading Economics .no date, Azerbaijan Exports, available at <https://tradingeconomics.com/azerbaijan/exports>, accessed on December 23, 2020.