

Better research, better policy, better reform

CESD | CENTER FOR ECONOMIC
& SOCIAL DEVELOPMENT

Global Think-Tank

EU-Azerbaijan Economic Relations: New Perspectives and Targets

CESD Research Group

CESD PRESS

Center for Economic and Social Development (CESD)

Caspian Plaza, 3rd Block, 14th floor

J.Jabbarli str. 44,

Baku, Azerbaijan

Phone: (99412) 5943665

Fax: (99412) 5943665

Email: info@cesd.az

URL: www.cesd.az

Baku, 2022

Executive Summary

The study is an example of the series on issues analyzing the EU-Azerbaijan economic relations which can be considered a step forward to empower economic approach in the policy-making process aiming to provide an alternative view in addressing current challenges and developments in Azerbaijan. The European Union's relations with Azerbaijan have been formulated based on the EU-Azerbaijan Partnership and Cooperation Agreement which entered into force since 1999. In February 2017, the EU and Azerbaijan began negotiations on a new framework agreement designed to enhance the political dialogue, trade and mutually beneficial cooperation covering a wide range of economic aspects. One of the most important strategies of EU in the energy policy is to ensure energy security through diversification of energy routes. Azerbaijan is a strategically important energy partner for the EU and plays a significant role in bringing Caspian energy resources to the EU market. In 2018, the EU and Azerbaijan endorsed joint Partnership Priorities, along the four Eastern Partnership priorities that accompany the political dialogue and economic cooperation.

The publication comprises the analysis of the EU-Azerbaijan economic relations in terms of Energy and Transportation sectors as main drivers of collaboration. It also highlights the importance of the bilateral engagement in other non-oil sectors of the economy. The findings of the study suggest that the EU is Azerbaijan's first trading partner and biggest export and import market. Trade turnover between the EU and Azerbaijan in the year 2021 made up 13.2 billion euro, which in turn showed Azerbaijan as the largest trade partner in the region accounting for the 76 percent share of the EU's trade turnover with the South Caucasus. According to statistical committee¹ of Azerbaijan, in 2021, the trade turnover between Azerbaijan and the EU exceeded \$15 billion. In 2021, Azerbaijani exports to the EU countries amounted to \$6.8 billion. In 2011 Azerbaijan and the EU signed a joint declaration on the *Southern Gas Corridor*. Initially, it is planned to bring 10 billion cubic meters Azerbaijani gas through SCP and TANAP to Turkey in 2018 and through the TAP to Italy and Greece in 2020. The Southern Gas Corridor is a strategic initiative to bring gas from the Caspian Sea to the European markets, particularly, following the strategic memorandum in energy field with the EU, which will increase the volume of the supplied gas.

The union aims to support Azerbaijan's economic diversification through the negotiation of the new agreement with Azerbaijan and the accession process to the WTO. EU assistance includes policy dialogue and Azerbaijan's economic modernization supporting youth education, entrepreneurship and regional development. In addition to aforementioned economic aspects, this study also provides some policy recommendations which will be useful in crafting right policies and in widening our economic relations with the EU.

The bilateral relations between Azerbaijan and the European Union (EU) are built on the principles of equal partnership and mutual benefit, common interests, and bilateral engagement in economic sphere between the Union and Azerbaijan has historically been of crucial importance underpinned by strategic documents. The launch of the legalization of

¹ <https://www.stat.gov.az/>

multidimensional relations between Azerbaijan and the EU has been marked with the *EU-Azerbaijan Partnership and Cooperation Agreement* which aimed at enhancing economic relations including trade and investment flows. Since 2009, Azerbaijan has been cooperating with the EU as part of the *Eastern Partnership (EaP) programme* in bilateral and multilateral formats. In a way towards strengthening our relations, on the 11th of July 2018, a ceremony was organized in Brussels with the participation of Ilham Aliyev, to mark the completion of negotiations on Partnership priorities in which economic development and market opportunities are enshrined as well².

Economic relations between Azerbaijan and the European Union are largely embedded in energy and transportation sector. The latter is the former's first and main trading partner, the biggest export and import market, and is the biggest investor for the country (with nearly €7 billion of direct investment). The EU accounts for around 36.7% of Azerbaijan's total trade and continues to be Azerbaijan's biggest export and second-biggest import market, with a 51% share of Azerbaijan's exports and a 16% share of Azerbaijan's imports. Analyzing the composition of mutual import-export structure between these trade partners reveals that EU imports from Azerbaijan largely consist of energy, fossil-fuels, mineral fuels, lubricants and related materials. Other imports from Azerbaijan include mainly food and live animals, chemicals and related products, and certain manufactured goods, while exports to Azerbaijan from the EU are dominated by machinery and transport equipment. Other EU exports to Azerbaijan include mainly chemicals and related products, manufactured goods and articles, and food and live animals. The following figures descriptively highlight the relations in economic terms with the up to date figures.

Figure 1: Trade in goods between the EU and Azerbaijan billions in euro

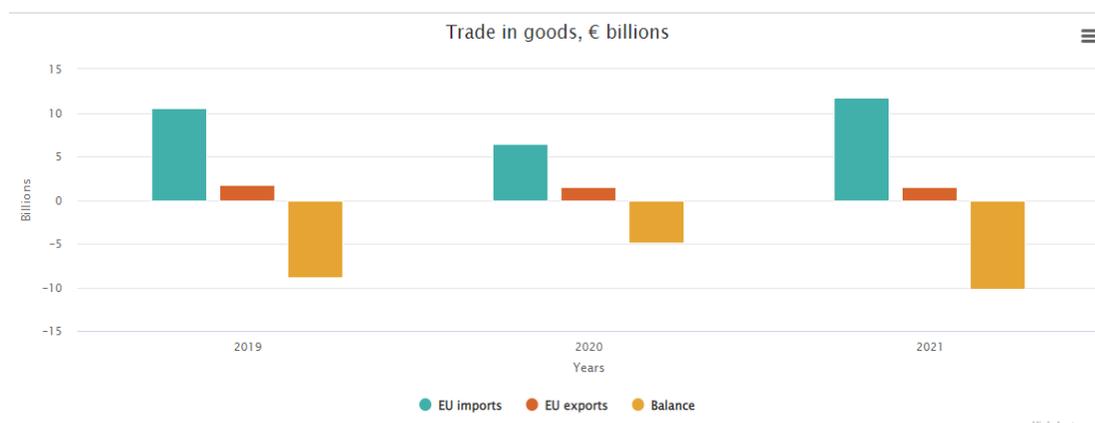


Figure 2: Trade in services between the EU and Azerbaijan billions in euro

² <https://www.mfa.gov.az/en/category/regional-organisations/relations-between-azerbaijan-and-european-union>

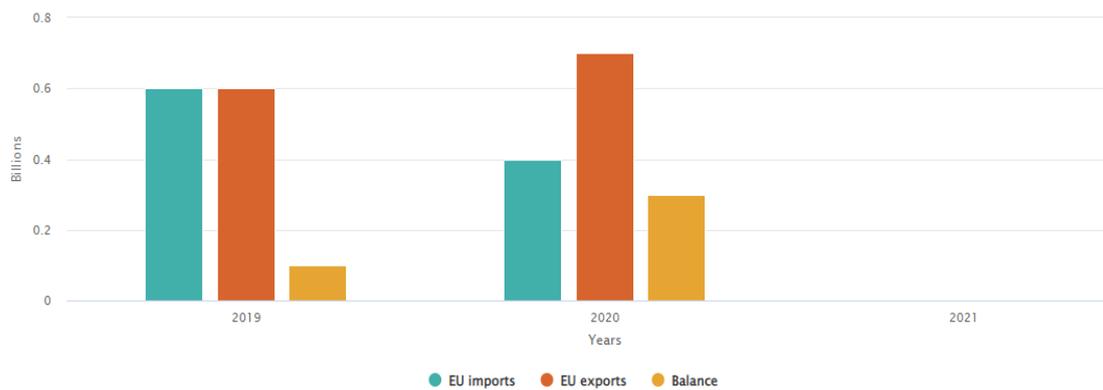
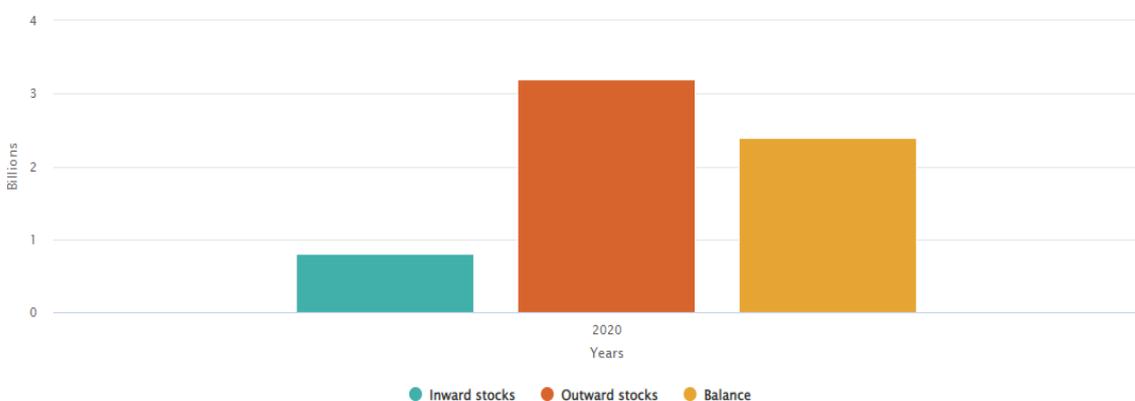


Figure 3: Foreign Direct Investment billions in euro



Sources: European Commission, 2022

As seen from the graphs, trade turnover between the EU and Azerbaijan in the previous year constituted 13.2 billion euro, while statistical committee of Azerbaijan shows the figure of the trade turnover between Azerbaijan and the EU to be more than \$15 billion. In 2021, Azerbaijani exports to the EU countries amounted to \$6.8 billion. Last year, through the TAP gas pipeline 8.2 billion cubic meters of natural gas were brought to Europe, and from January through June 2022 - 5.4 billion cubic meters, while 70 % of the Azerbaijani oil reached the EU countries. Among the key areas of mutual cooperation, tourism industry is found to be an important area of focus for cooperation between the EU and Azerbaijan. Sustainable tourism is set to be a key economic driver in Azerbaijan, particularly following the plunging oil prices in a way towards the diversification of national economy-one of the sectors that promote investment and development, which can act as a bridge between people in Europe and Azerbaijan, and in people to people contacts. In the first half of 2022 According to the statistics provided by Azerbaijan's State Statistics Committee³, in the first quarter of 2022, the departure countries of the 10 percent of the tourists arrived in Azerbaijan were Europeans. The development of entrepreneurship in Azerbaijan is one of the sectors where the EU intends to support the government by announcing grants, invests in a number of projects and promotes economic growth in rural areas. On the other hand, education is mentioned to be one of the key partnership and cooperation areas between the parties. Beyond energy and transportation

³ <https://stat.gov.az/source/tourism/>

and state level cooperation, the role and cooperation at the level of civil society organizations should not be overlooked which can play an undeniably significant role in the implementation of the reforms and for the process of fostering EU-Azerbaijan integration beyond energy. One particular area for potential cooperation between the EU and Azerbaijan is support for the regions of Azerbaijan that have suffered from the Nagorno-Karabakh war, as a result of which almost one million people have become refugees(Lavrina & Politics, 2018).

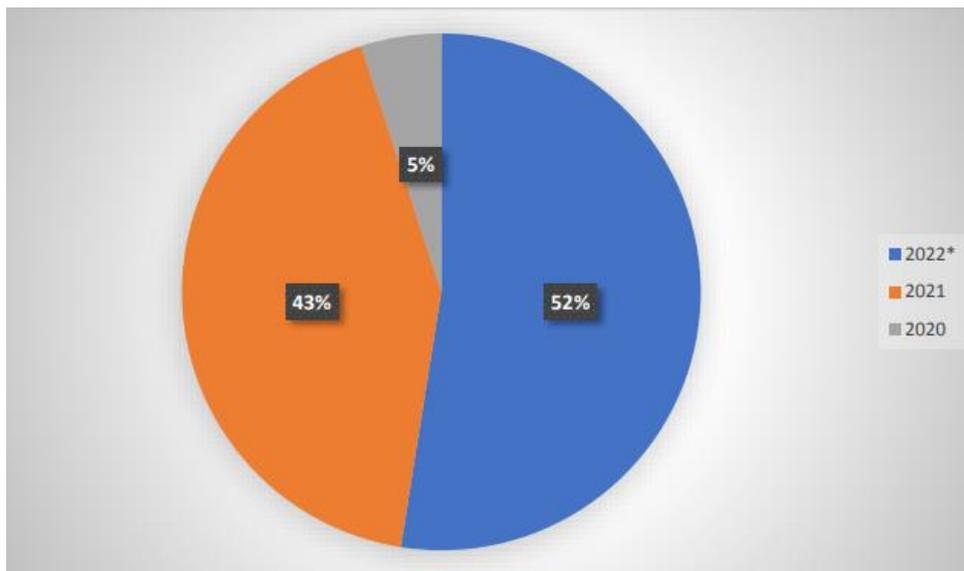
Energy and Transportation

Azerbaijan and the European Union share common interests on a number of policies and are presently working jointly to upgrade their combined interests. Following the dissolution of Soviet Union, Azerbaijan gained its independence in 1991 becoming an strategically important ally for the Union. On September 20, 1994, one of the most political, economic, and strategic necessary contracts – "An agreement on the joint development and production sharing of the Azeri, Chirag and Gunashli fields in Azerbaijani sector of the Caspian Sea" was signed under the leadership of the ex-President Heydar Aliyev(Ciarreta & Nasirov, 2012). Azerbaijan was in the constant interest of the EU due to its rich energy resources and geostrategic location. Because the EU was in sought of alternative energy sources to reduce its oil and gas dependence from Russia. With the failure of Nabucco project due to artificial obstacles imposed by Russia and unfeasible full gas supply to the European Union, in 2011 Azerbaijan and the EU signed a joint declaration on the *Southern Gas Corridor*. Initially, it is planned to bring 10 billion cubic meters Azerbaijani gas through SCP and TANAP to Turkey in 2018 and through the TAP to Italy and Greece in 2020. With this project their pragmatic partnership to deliver Azerbaijani gas to EU market without Russian intervention. Currently, Azerbaijan meets 5% of Europe's energy needs through the Southern Gas Corridor by bringing Caspian gas to the EU energy market(Hasanov et al., 2020). It is worth to note that Italy will not be the final country to receive the gas of Azerbaijan, and it is further planned to be exported gas resources from the Shah Deniz field to Austria, Switzerland, Germany and other countries. From this point of view, TANAP and TAP projects as well as Greece-Bulgaria, Bulgaria-Romania and Romania-Hungary gas networks supported by the European Union, are significant in terms of establishing the infrastructure of transportation of energy, carrying energy resources, and the integration of the European energy transport system(Azimov, 2021). Following the current trends, Russia-Ukraine war which resulted in the application of subsequent sanctions against the Europe's largest gas supplier, the EU is in seek of alternative energy sources and resources to diversify its energy supply and reduce its dependence on Russian energy. Although Gazprom is likely to be the main supplier of the European gas at least in the short-term, Azerbaijan increases its natural gas production and is export to Europe. Owing to rich renewable energy potential and favorable investment opportunities, Saudi Arabia Company Aqua Power(ACWA POWER, 2020) and UAE's company Masdar(June, 2020) initiated investment projects in Azerbaijan which will save huge amount of gas stocks.

Figure 3: Southern Gas Corridor



Figure 4: Forecasted Gas Exports of Azerbaijan to Europe.



Sources: CESD Azerbaijan, 2022

Taking into account the recent geopolitical developments and energy turmoil currently happening in Europe, the union is in seek of other energy sources. In a way towards the diversification of energy suppliers, European Union and Azerbaijan agreed to boost their energy cooperation through a *Memorandum on Strategic Partnership in the field of Energy* which will enable Europe to meet its gas shortages by increasing gas supplies from Azerbaijan. The agreement provides a timely opportunity for the EU to consolidate a new gas market for its energy security and earns Azerbaijan a larger share in European market. It will allow Azerbaijan to double its supply of gas towards the European Union covering extra 4 billion cubic meters of gas but will increase to 20 billion cubic meters by the year 2027.

There are prospects of contract revival beyond 2027 because energy demands in Europe are unlikely to go down which serves best for the socio-economic development of both partners. More gas from Azerbaijan inflow to the European Union will change the energy map of Europe and larger Caucuses. It is line with European standards as well to diversify its energy supply under European Union Energy Security. With this memorandum in scenario, both parties express interests also in promoting cooperation in the areas of renewable energy and connectivity. The Azerbaijani territories liberated from the Armenian occupation in 2020 have substantially boosted the Azerbaijan's renewable energy potential⁴⁵.

In addition to energy sector, Azerbaijan's role as a key transportation route is of exceptional importance, in particular following the restoration of the territorial integrity of Azerbaijan which provides a direct and shorter intercontinental route through Zangazur Corridor. The European Union and Azerbaijan jointly show strong willingness to deepen cooperation in the connectivity sector. Against the backdrop of disruptions in transportation routes connecting Asia and Europe through the territory of Russia, the key role of the Trans-Caspian International Transportation Route (TITR), or Middle Corridor, is increasing significantly. The significance of the opportunities that stem from the new deal have substantially grown specially since the start of the Russia-Ukraine war. On the other hand, the importance of the relations for regional economic perspectives should not be unseen as the reestablishment of communications and connectivity infrastructure take special attention in the negotiations. Establishment of the communication lines is of crucial significance in providing a fertile ground for the rapid launching of Zangazur Corridor project that offers additional economic and geopolitical benefits for Eu-Azerbaijan relations. In addition, it is a stimulus for new investment in the liberated cities. In accordance with the Economic and Investment Planning Project, the EU intends to widen mutual economic relations with both sides by means of the economic advisory platform that will further enable in the near future to enhance and strengthen the scope of regional relations to other actors which is a crucial factor in lifting up the economic development as well as geopolitical relevance of the region. The market access of Azerbaijan's products in Europe are expected to increase in the coming period. Azerbaijan's the biggest trade fleet in the Caspian region, operational sea port, modern infrastructure, shipbuilding yard, and railroad network will enable connectivity and trade with Europe and other adjacent regions.

In concluding remarks, The recent policy and existing circumstances such as increasing demand for energy, Russia-Ukraine war stipulated the need for the EU to deal with multi-dimensional energy problems of union such as security, diversification, and sustainability of supply. Mitigating energy security risks in the import of natural gas received particular attention following the disputes between Russia and Ukraine. In this regard, the EU has supported various energy projects to diversify sources of natural gas imports into the region. EU. The continent prefers to hold collaboration with Azerbaijan due to geographical location as a producer bolstered by the European Neighbourhood Policy and by the Eastern Partnership Program. On the other hand, Azerbaijan expresses willingness in political and economic cooperation with the EU to reach the global market and to be recognized as a regional power.

⁴ https://azertag.az/en/xeber/EU_Azerbaijan_Strategic_Partnership_on_Energy-2227949

⁵ <https://jamestown.org/program/azerbaijan-and-european-union-ink-deal-on-strategic-partnership-in-energy/>

The SGC in general fit well into its diversification strategy. Energy plays a key role at the core of national sovereignty and is of key significance for global competition. It seems that in the case study of EU-Azerbaijan energy relations, Azerbaijan is a reliable and strategic partner due to economic, geopolitical and security interest of the EU.

Based on the above analysis of the development areas in energy and transport sector, other areas with possible cooperation opportunities exist. The paper proposes the following policy recommendations to be taken into account.

- The scope of the mutual cooperation should be widened to non-oil sectors such as tourism, education, renewable energy, agriculture.
- Export potential of the SMEs should be further improved and their access to the European market should be accelerated. Capacity building programs can be implemented.
- The phase of the negotiations in a way towards the accession to the WTO need to be accelerated.
- Due to the enormous renewable energy and non-oil sector development potential in liberated territories of Azerbaijan, a shift in foreign investment policy to this area can be developed. This can be a particular area of cooperation between the EU and Azerbaijan for the development of Karabakh region to increase the level of employment, living conditions and education system in those regions.

References

- Aliyev, G., Valiyev, A., & Rustamova, S. (2011). Social protection and social inclusion in Azerbaijan: Executive summary. European Commission & Caucasus Research Resource Center—Azerbaijan. www.crrccenters.org/20541/Social-Protection-and-Social-Inclusion-in-Azerbaijan
- Bayramov, V., Breban, D., & Mukhtarov, E. (2019, September). Economic effects estimation for the Eurasian economic union: Application of regional linear regression. *Communist and Post-Communist Studies*, 52(3), 209–225. <https://doi.org/10.1016/j.postcomstud.2019.07.001>.
- K Hallberg, A Market-Oriented Strategy for Small and Medium-Scale Enterprises. Geneva: International Finance Corporation, the World Bank, Posted: 2000
- Bayramov, V. Ending Dependency: How is oil revenues effectively used in Azerbaijan, Baku, 2009.
- Abdygaliyeva G. et al. (2007). “Economic Diversification in The Republic of Kazakhstan Through Small and Medium Enterprise Development: Introducing New Models of Funding for SME’s”. Center for Marketing and Analytical Research Report.
- Bayramov, V. A Comparative Study on Development of Small and Medium Enterprises (SMEs) in Azerbaijan, Baku, 2017.
- Dabrowski M. (2016). “Currency crises in post-Soviet economies— a never ending story?”. *Russian Journal of Economics* 2: 302-326.
- Bayramov, V. at al, K. (2011). Public Administration in EU Eastern Partner Countries: Comparative Report 2011. Estonian Center of Eastern Partnership, (11).
- Gurbanov, S. (2015). Migration and brain drain: Survey for the Azerbaijan economy. *Journal of Qafqaz University—Economics and Administration*, 2(1), 1–11. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604362.
- CESD, AZERBAIJANI GAS EXPORT TO EUROPE: WHAT ADVANTAGES ARE THERE?, (2022). <https://cesd.az/y/panel/uploads/32475285090-CESDBriefAzerbaijaniGasExport.pdf>

CESD Research Group. (2018). Foreign debt of Azerbaijan in 2018: Realities and perspectives. http://cesd.az/new/wp-content/uploads/2018/02/Azerbaijan_Foreign_Debt_2018.pdf.

EXPERT GROUP, CESD, A Preliminary Assessment of the Impact of the COVID-19 Pandemic on Azerbaijani Economy (August 19, 2020). Available at SSRN: <https://ssrn.com/abstract=3676919> or <http://dx.doi.org/10.2139/ssrn.3676919>

Vugar Bayramov, Gulnara Abbas, Oil shock in the Caspian Basin: Diversification policy and subsidized economies, Resources Policy, Volume 54, 2017, Pages 149-156, ISSN 0301-4207, <https://doi.org/10.1016/j.resourpol.2017.10.006>

Vugar Bayramov, Tim McNaught, Elchin Rashidov, Managing Resource Revenues in Oil-Rich CAREC Countries: The Case of Azerbaijan, 2011, https://cesd.az/new/wp-content/uploads/2011/05/CESD_Paper_Oil_Revenues_Management_Azerbaijan.pdf

Research Group, CESD, Social Consequences of the Oil Price Shock in the Resource Rich Post-Soviet Countries (May 11, 2020). Available at SSRN: <https://ssrn.com/abstract=3598521> or <http://dx.doi.org/10.2139/ssrn.3598521>

https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/armenia_en

https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/georgia_en

https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/azerbaijan_en

<https://euneighbourseast.eu/news/publications/eu-azerbaijan-relations-factsheet/>

<https://mfa.gov.az/en/category/regional-organisations/relations-between-azerbaijan-and-european-union>

<https://www.economy.gov.az/en/page/beynelxalq-elaeler/avropa-ittifaqi-eu-ve-azerbaycan>

https://azertag.az/en/xeber/Eurasia_Review_EU_Azerbaijan_relations_are_developing_in_context_of_new_geopolitical_realities-1957690

<https://www.azernews.az/nation/196924.html>

[https://azertag.az/en/xeber/EU Azerbaijan Strategic Partnership on Energy-2227949](https://azertag.az/en/xeber/EU_Azerbaijan_Strategic_Partnership_on_Energy-2227949)

<https://www.eureporter.co/world/azerbaijan-world/2021/12/07/examining-the-eu-azerbaijan-relations-prior-to-the-eastern-partnership-summit/>

[https://www.researchgate.net/publication/347906923 EUROPEAN ENERGY POLICY AND THE EU- AZERBAIJAN ENERGY COOPERATION](https://www.researchgate.net/publication/347906923_EUROPEAN_ENERGY_POLICY_AND_THE_EU-AZERBAIJAN_ENERGY_COOPERATION)

<https://www.euronews.com/my-europe/2022/07/18/von-der-leyen-heads-to-azerbaijan-to-secure-new-gas-import-deal>

<https://president.az/en/articles/view/56689>

<https://en.trend.az/azerbaijan/politics/3640372.html>

<https://www.eupoliticalreport.eu/eu-and-azerbaijan-enhance-bilateral-relations-including-energy-cooperation/>

<https://news.az/news/details-of-eu-azerbaijan-mou-on-strategic-partnership-in-energy-field-disclosed>

<https://eurasianet.org/azerbaijan-and-eu-agree-to-strategic-energy-partnership>

<https://aircenter.az/en/single/azerbaijan-increases-natural-gas-exports-after-completion-of-southern-gas-corridor--oped-718>