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Policy Brief

Implications of the EU's Russian oil ban for Azerbaijan

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EU imposes ban on Russian oil

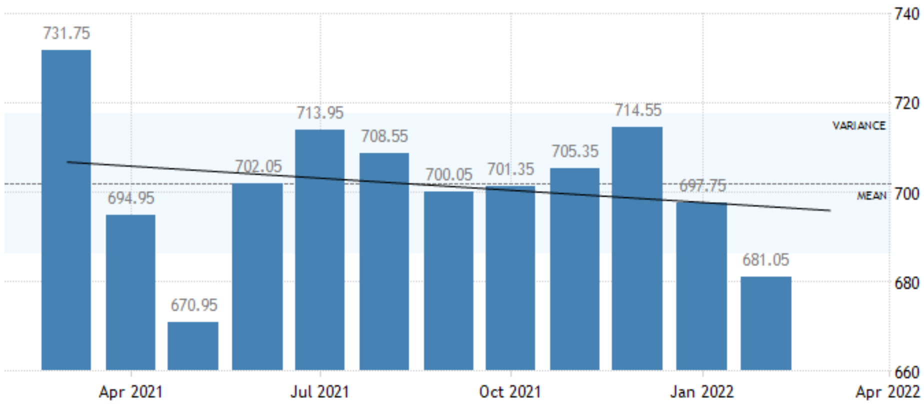
In a way towards increasing limitations in various spheres on Russia to ward off Kremlin's ability to finance the war by imposing further sanctions, on June 3, 2022 the Council of the European Union adopted 6th package of economic sanctions with a particular focus on restrictive measures for oil imports from Russia by the end of 2022. The latest sanctions are supposed to officially come into force that mainly targeted Russia's energy sector, banking system and major broadcasters. New sanctions envisage partial ban on oil imports from Russia and removes Sberbank, a majority state-owned banking and financial services company, from the international SWIFT payment platform. According to EU, it can take up to 6 and 8 months to phase out from Russian crude oil and refined oil products respectively. The EU wide ban will certainly affect the oil that is being imported by the sea as EU leaders agreed to ban seaborne oil transport partially exempting pipeline oil. Oil delivered from Russia by pipeline is temporarily exempted from the ban for land-locked countries, such as Hungary, Slovakia and the Czech Republic, to replace Russian imports with oil and products from other sources. For example, MOL Hungarian Oil and Gas Company (MOL) could potentially be highly affected by the ban as it operates refineries in Hungary and Slovakia. Currently about 70% of MOL's oil supplies are bought from Russia via pipeline, although those will be temporarily be exempted from the ban. Capital investments may be required to diversify oil import infrastructure and overhaul refineries so that they could process lighter sorts of crude oil, although additional investments may be partially or fully covered by the Hungarian government or the EU. Due to their specific circumstances in turn, Bulgaria and Croatia have some exemptions to oil ban as well. A ban o n three Russian state-owned television channels is also enshrined in the package. Moreover, the export of some advanced technology items to Russia is prohibited that could be used in the process of manufacture of chemical weapons.

The afore-mentioned is part of sanctions approved at a summit in Brussels. Currently, Russia' s share in EU oil and gas supply accounts for 27% and 40% respectively that goes back to Russia around €400bn a year in return. Following the sanctions with oil ban, the EU shifts the supply sources and reorients their directions to other oil and gas producing countries such as UAE, Saudi Arabia, Kuwait, Iran and Azerbaijan. This ban, in certain case, hurts Moscow that comes with regional and global consequences as well. The repercussions of the recent embargo can not be bypassed by EU itself as shrinking oil supply will result in higher energy prices driving the food prices and inflation further up and causing serious economic harm. Especially in poorer countries, which have less robust and resilient absorptive capacity from global shocks, are highly likely to suffer more. The new shift in the EU will certainly have a significant effect on global oil trade flows as approximately 30% of the EU's supply needs substitution from other sources, and Russia would seek new contractors for displaced volumes. In this vein, India and China have been increasing Russian energy purchases lessening the pressure on global oil market. However, redirection of Russian is not immediately feasible and subject to a number of impediments such as infrastructural limitations, buyers' self-restrictions and logistical complications.

Implications of sanctions including Russian oil ban for Azerbaijan

Russia remains a strategically and economically important partner for Azerbaijan with its significant weight in the import. Bilateral trade turnover of two countries account for more than 3 billion USD. Sanctions envisage negative spillover effects of the sanctions on Azerbaijan that appear to be in the form of import-export and supply chain disruptions, additional inflationary pressures, shortage of remittance inflows and to a certain degree food scarcity.

Figure 1: Azerbaijan Crude Oil production



Source: www.tradingeconomics.com

On the other hand, along with possible repercussions, new opportunities are predestined. As supply chain routes from Asia to Europe passing through the territory of Russia are disrupted and blocked, the international transport lines within the territory of Azerbaijan is highly likely to gain momentum for the delivery of goods and services between the continents that provides a favorable background to boost the competitive potential of Zangazur Corridor, Baku-Tbilisi-Qars railway, Euro-Asia railway alliance increasing the geopolitical importance of Azerbaijan.

The study by Vugar Bayramov and Gulnara Abbas, which highlighted the huge percentage of 90% of mineral exports between 2009 and 2014, then reported on the correlation for Azerbaijan between dependence on hydrocarbons and economic diversification through a process of liberalization (Bayramov, Abbas; 2017). From the beginning of the 2000s till the 2015-16 oil crisis, as a result of a massive resource windfall to Azerbaijan, the tradeable and productive non-oil sectors such as agricultural and manufacturing sectors were out of attention which hindered their growth (Bayramov and Orujova, 2017).

In terms of the energy market, EU plans to reorient the direction of its energy supply where Azerbaijan could act as a significantly potential energy supplier, and EU's subsequent bans on Russian energy exacerbate the oil market tightness further push the global prices up in the short-term. These newly emerging tendencies create a lucrative economic environment for Azerbaijan to generate increasing revenues in foreign currency reserves from the resource windfalls in the short-term. However, dramatic increase in energy prices do not provide direct advantages for Azerbaijan. Increasing production costs abroad due to the upsurge in energy prices and disrupted supply chains ramp up the pressure on import inflation in Azerbaijan in the upcoming period. The explicit response arises in the form of resource-curse and volatility with a probable sharp decline that might bring a new oil schock. Oil exporters mostly pin their hopes on ensuring long-term stability of energy prices to put the economy on a continuous path of sustainable growth. Oil price fluctuations have a significant impact on the oil exporting country's real GDP, CPI inflation rate, interest rate, and exchange rate that stipulates the need of stability. Oil-dependent economies such as Azerbaijan would certainly benefit from price stability stabilizing national income, government spending plans and allowing the states to plan the future through the formation of wealth funds. The stability would remove the speculations from the market, and international oil companies can arrange more secure investments, infrastructure development and energy production projects. Indeed, an energy country needs stable, sustainable prices that can provide the basis for effective planning.

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