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The Economic Consequences of Russia-Ukraine War for Azerbaijan

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Dynamics of Economic Relations

Russia

The past three decades of independence demonstrate that Russia remains a strategically economic and political partner, and multidirectional relations between two parties historically were of crucial importance. In the year 2021, total trade turnover between Russia and Azerbaijan accounted for 2.295 bln USD with a 12% upsurge¹ recovering to pre-pandemic levels. Russia ranked as the 3rd largest trade partner of Azerbaijan in 2021 following Italy and Turkey and the share of trade with Russia alone made up 8.83% of the total in this period. Figure 1 illustrates the total trade turnover of Azerbaijan with Russia in the past 5 years. The chart dynamics show that trade turnover towards the end of the previous decade had an increasing tendency, however, in 2020 the figure experienced contraction by 11.6% amounting to \$2.671 bln triggered by Covid-19. In 2021, the value of the goods and services exported to Russia was at 920 million USD (up by 29.8% compared to 2020), and Russia in imports to Azerbaijan occupied the head of the list exceeding 2.074 bln USD dollar (up by 5.7%)(Customs, 2021). Notwithstanding the small share in total trade turnover, Russia plays a significant role in the operations of the non-oil sector as well as in the exports of the non-oil sector of the economy predominating other countries with a value of 877760 million USD. In the import structure from Russia to Azerbaijan, wheat, forest materials, fertilizers, steel, food products, medicines, chemical products prevailed, while fruits, vegetables and other food products, electricity, petroleum coke, tea, tobacco, and etc, mainly formed the export structure from Azerbaijan to Russia².

¹ <https://customs.gov.az/az/faydali/gomruk-statistikasi/xarici-ticaretin-veziyyeti-haqqinda>

² <https://www.stat.gov.az/source/trade/>

Figure 1 *Trade Turnover of Azerbaijan with Russia (bln USD)*



Source: Statistical Committee of Azerbaijan, 2022

Ukraine

As an important alliance, relations between Ukraine and Azerbaijan have successfully developed over three decades in various areas and bilateral engagement in the economic sphere remained at a high level. During this period Ukraine was in the list of top trading countries ranked as 7th and total trade turnover in the previous year between Ukraine and Azerbaijan amounted to 922 473.48 million USD with 17% up compared to 2020 due to economic rebound. The dynamics of the total trade turnover of Azerbaijan with Ukraine in the last five years is shown in figure 2. Although the volume of the trade experienced stability with small fluctuations later backed up by pandemic recession in 2020, approximately 20 percent upswing is achieved in 2021 following the revival of international trade. In the analyzed period, Ukraine has a special place in bilateral trade statistics with the amount of exports from Azerbaijan to Ukraine hitting 452 449.32 million USD. In imports to Azerbaijan, Ukraine is among the top five countries with the value of goods and services at 470 024.16 (4% in total) million USD in 2021, while being a significant consumer of the non-oil exports of Azerbaijan. Within the structure of goods and services imported to Azerbaijan from Ukraine, tobacco, beef, cigarettes, poultry products, medicines, food products, agri-food products and so on. top imported products. On the export side

from Azerbaijan to Ukraine, food products, oil products prevail. In addition, it should be noted both countries have immense potential to embark on a mutually beneficial collaboration in the field of agriculture further strengthening the food security of Azerbaijan.

Figure 2: *Trade turnover of Azerbaijan with Ukraine(million USD)*



Source: Statistical Committee of Azerbaijan, 2022

Impact of the Russia-Ukraine War on Global Economy and Azerbaijani

In a global and increasingly globalized economic system, the worldwide economic implications of the Russia-Ukraine conflict stretch in three different directions: financial sanctions, commodity prices and supply-chain disruptions³, and prevail in a harsh time adding to inflationary pressures from supply chain disruptions and economic upswing after Covid-19. Ensued from a tough package of sanctions imposed by western governments, the access of the Russian Central Bank to its international reserves to support financial liquidity and exchange rate system is severely restricted that is accompanied by the exclusion of numerous banks from the SWIFT system disrupting the ability to carry out international financial transactions, that is to say, pay for imports, receive payments for export

³ <https://www.eiu.com/n/global-economic-implications-of-the-russia-ukraine-war/>

and etc⁴. The value of the ruble has been in a free-fall indicating a deeper economic recession for the Russian economy. As the war rages on, the most serious effect of the conflict is expected to appear in the form of surging energy and commodity prices including wheat and grains owing to three factors: concerns around supplies, destruction of physical infrastructure and sanctions. With the threat on Russian hydrocarbon exports and supply chains, oil prices will remain over 100\$⁵ and gas prices will rise. The USA's ban on energy import from Russia further drives the prices up⁶. Russia is also a producer of several metals (aluminum, titanium, nickel) and agricultural commodities that experience price jumps affecting industrial sectors at the global level such as automotive industry and food security respectively. Furthermore, the absence of financial channels through which companies can trade will pose obstacles to supply chains coupled with the destruction of transportation infrastructure. The disruptions to intercontinental land-based trade routes, cancellation of air ties, and sea freights will certainly compound trade operations including grain shipment generating food crunch. Countries with close economic links to these parties such as Azerbaijan will certainly be affected by spillover effects over the region.

As long as the conflict worsens and sanctions are imposed on the important trade ally, the economic consequences for Azerbaijan are undeniable breeding grounds for scarcity and supply disruptions and creating an additional negative basis for inflation and economic activities. Even if Russia holds a minor share in total export, thus, in *total foreign currency influx*⁷ (less than 5%), one-third of the *currency inflows in the non-oil sector* excluding tourism is generated by the exports to Russia. This fact indicates this economic turmoil in the neighboring country can shrink export revenues of the non-oil sector, which provides 97% of the country's employment. As the value of the ruble substantially plummets having a deteriorating impact on the purchasing power of the Russian population, a reduction in Russia's imports is expected. That being the case, contraction in the exports and demand for products from Azerbaijan to Russia stands ahead. In 2021 Azerbaijan received more than half of the remittances from Russia which provides a significant financial lifeline to the country. The recession comes with two-sided implications for remittance inflows from Russia that are expected to be disrupted due to crisis and exclusion from the SWIFT system. A weakening

⁴ <https://www.imf.org/en/News/Articles/2022/03/05/pr2261-imf-staff-statement-on-the-economic-impact-of-war-in-ukraine>

⁵ <https://economictimes.indiatimes.com/markets/commodities/crude-oil-prices-break-100-on-russian-military-operation-in-ukraine/articleshow/89789149.cms?from=mdr>

⁶ <https://www.aljazeera.com/news/2022/3/9/us-bans-russian-oil-what-does-this-mean-for-oil-prices>

⁷ <https://www.stat.gov.az/source/trade/>

economic activity can diminish the employment rate of migrants and their ability to send remittances. Secondly, upheaval in the value of the ruble against the dollar reduces the nominal US dollar value sent in remittances⁸. It should be noted that the existing situation stipulates the need for monetary authority in Azerbaijan to monitor the pass-through of the deepening shortage of, and increasing demand for, dollars in Russia and introduce an adoptive strategy to regulate the outflow of the dollar from Azerbaijan.

Russia, as well as Ukraine, are massive growers in agriculture and food globally including fertilizers, grain, wheat and cross-border trade of agricultural commodities between Azerbaijan and them is one of the key components in bilateral trade relations. More bad than ever before, combined with disrupted supply channels, suspended productions, and sanctions on Russia, food scarcity followed by higher prices in food or associated ingredients amid already higher price pressures may result from the war.

Figure 3: **Crude Oil Price since July 2021**



Source: www.tradingeconomics.com, date:11.03.2022

On the other hand, the strong economic recovery with increasing demand for oil prices has been accompanied by the Ukraine-Russia war that trigger supply fears. In addition, the US ban on the import of Russian crude oil further exacerbated market tightness. All these taken into account accelerated the pace of crude oil price increase (figure 3) including Azeri Light⁹ and resulted in a fresh

⁸ <https://blogs.worldbank.org/peoplemove/russia-ukraine-conflict-implications-remittance-flows-ukraine-and-central-asia>

⁹ <https://oilprice.com/oil-price-charts/>

record providing a background for more foreign currency reserves for Azerbaijan in the short term as national export is largely dominated by hydrocarbons. The west is in seek of alternative energy sources and the US plans to ease sanctions imposed on Venezuela to overcome the disruption of Russian oil and receive more supply. OPEC chose to increase oil production by 400,000 barrels per day in April¹⁰. Additional supplies are expected to come to market that can exert downward pressure on oil prices. Although for the time being high prices prevail, with high geopolitical tensions, there is uncertainty over the date when they will stabilize¹¹. These increasing resource windfalls and uncertain situations should be carefully monitored by the respective government and monetary authorities without laying the basis for long-term dependency in the continuity of economic diversification strategies.

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¹⁰ <https://abcnews.go.com/US/wireStory/opec-allies-weigh-oil-output-amid-high-prices-83199968#:~:text=The%20OPEC%2B%20coalition%20of%20oil,barrels%20per%20day%20in%20April.>

¹¹ <https://www.gisreportsonline.com/r/oil-prices-2022/>

<https://www.aljazeera.com/news/2022/3/9/us-bans-russian-oil-what-does-this-mean-for-oil-prices>

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