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# **Potential Impacts of Sanctions against Russia on the Non-oil Exports of Azerbaijan**

**Eldayag Mustafayev**

**CESD Press**

**Center for Economic and Social Development (CESD)**

**Jafar Jabbarli 44,**

**Baku, Az 1065,**

**Azerbaijan**

**Phone; (99412) 597-06-91**

**Email; [info@cesd.az](mailto:info@cesd.az)**

**URL; [www.cesd.az](http://www.cesd.az)**

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**Abstract:**

By using statistical descriptive analysis, this article analyzes how the isolation of Russia from the international trade and finance system, as a result of the Western sanctions, will affect the Russian trade turnover and what type of future challenges and opportunities it may provide for the non-oil export base of Azerbaijan. In terms of the opportunities, Azerbaijan can further focus on its main non-oil export goods such as agricultural and chemical industrial products to capture an additional share in the semi-abandoned Russian market, along with considering possible competition pressure coming from the other non-western Russian trade partners. Re-exporting opportunities currently are limited in scale and have a risk of facing international sanctions and criticism. In terms of challenges, the upcoming recession in the Russian economy and the removal of Russia from the SWIFT system, combined with the capital immobility measures imposed by the Russian government, may negatively affect the non-oil exports of Azerbaijan. The attraction of investment to the non-oil sector and the non-oil REER of Azerbaijan do not seem to successfully explain the Russian-Azerbaijan trade volume dynamics, expected to be driven by the third factor.

**Abbreviation:**

APEC – Asia-Pacific Economic Cooperation

EU – European Union

CBAR – The Central Bank of the Republic of Azerbaijan

CIS – Commonwealth of Independent States

SSCRA – The State Statistical Committee of the Republic of Azerbaijan

SWIFT – Society for Worldwide Interbank Financial Telecommunications

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## **1. Introduction**

Russia is the fourth biggest exporter of crude oil and oil products and the second largest exporter of wheat and wheat products, globally (Statista Database: BP Statistical Review of World Energy 2021; Statista Database: US Department of Agriculture and USDA Foreign Agricultural Service). In 2021, its total trade turnover reached about 800 billion US dollars, where the total value of imported and exported goods was equal to about 304 and 494 billion US dollars, respectively (FRED Database: Exports and Imports: Value Goods for the Russian Federation). Among its trade partners, Russia had the biggest trade turnover volume with EU countries in total, reaching about 282 billion US dollars, comprising nearly 36% of its total trade turnover in 2021 (Statista Database: External trade revenue in Russia from 2010 to 2021; FRED Database: Exports and Imports: Value Goods for the Russian Federation).

However, since the beginning of the Russian-Ukrainian war, the Western sanctions on Russia has been immensely intensified so far, by cutting trade relationship with Russia, removing Russia from the SWIFT system and leaving the Russian market. This will surely adversely affect the Russian trade turnover and may create new opportunities for the other non-western economies, including Azerbaijan, to intensify their trade relationships with Russia. Russia is the first biggest import (from Russia to Azerbaijan) and the third largest export partner (from Azerbaijan to Russia) of Azerbaijan and is the biggest market for Azerbaijan's non-oil exports between 2010-2020 (The Statistics of SSCRA: The foreign trade of Azerbaijan: Foreign trade by countries).

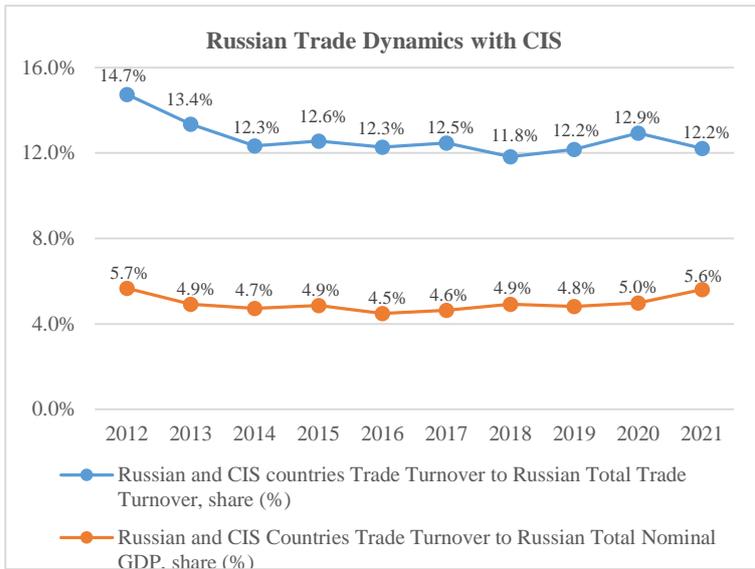
The volume of trade turnover of merchandise goods between Russia and Azerbaijan reached 3.35 billion US dollars, where the imports from Russia and the exports to Russia accounted for 2.32 and 1.03 billion US dollars, respectively, in 2021 (Statista Database: Value of merchandise imports from the Commonwealth of Independent States (CIS) in Russia in 2021; Value of merchandise exports to the Commonwealth of Independent States (CIS) from Russia in 2021). By considering

the strategic importance of Russia for the non-oil sector of Azerbaijan, this article analyzes the current trade relationship between Russia and Azerbaijan and clarifies what the current international situation may promise for the upcoming development of Azerbaijan's non-oil export potential.

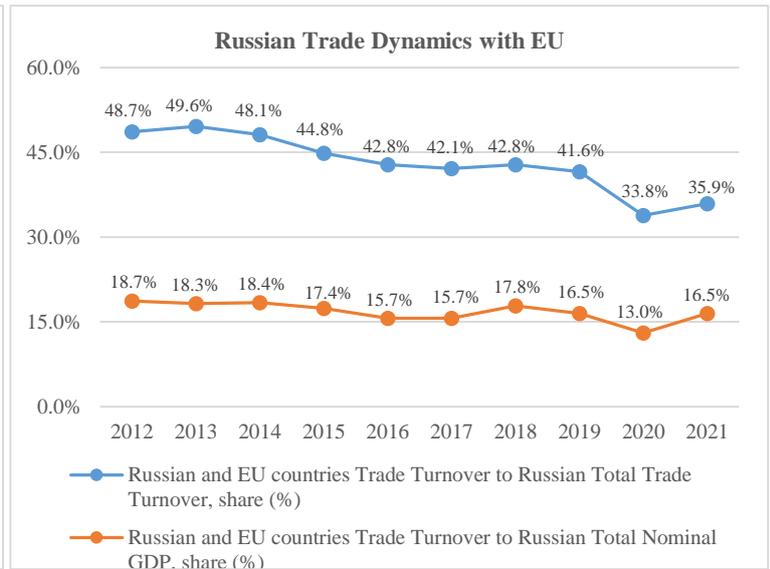
## **2. Searching for Alternative Markets**

Considering the West cutting its trade relationships with Russia, it is highly likely that Russia will search for new markets and deepen its trade relationships with the current friendly non-western trade partners. As an example, since the sanctions were imposed by the West, the Rosselkhoznadzor (The Federal Service for Veterinary and Phytosanitary Surveillance, the institution under the Ministry of Agriculture of the Russian Federation) has removed restrictions on the imported livestock products to Russia from 19 Belarusian enterprises and is considering expanding the list of suppliers from Georgia and Azerbaijan (Федеральная служба по ветеринарному и фитосанитарному надзору, 2022). However, are the alternative new markets and current trade partners capable of replacing the missing trade volume of the Western market?

Graphs 1, 2, 3 and 4 demonstrate Russian trade turnover volume with the CIS, EU and APEC members, which equals, on average, 12.7%, 43.0% and 29.4% of the Russian total trade turnover, respectively, between 2012-2021. The imposed sanctions are expected to decrease the Russian trade turnover with the EU countries to the lowest historical minimum for upcoming quarters. Russian trade turnover with the CIS members is stable, on average, around 12.7% and the trade turnover with the APEC members is gradually increasing on an annual basis. Though it creates a favorable opportunity for the alternative and current trade partners of Russia to expand their export volume to the Russian market, it will take a time to fill the gap, caused by the Western sanctions, within the Russian trade turnover.



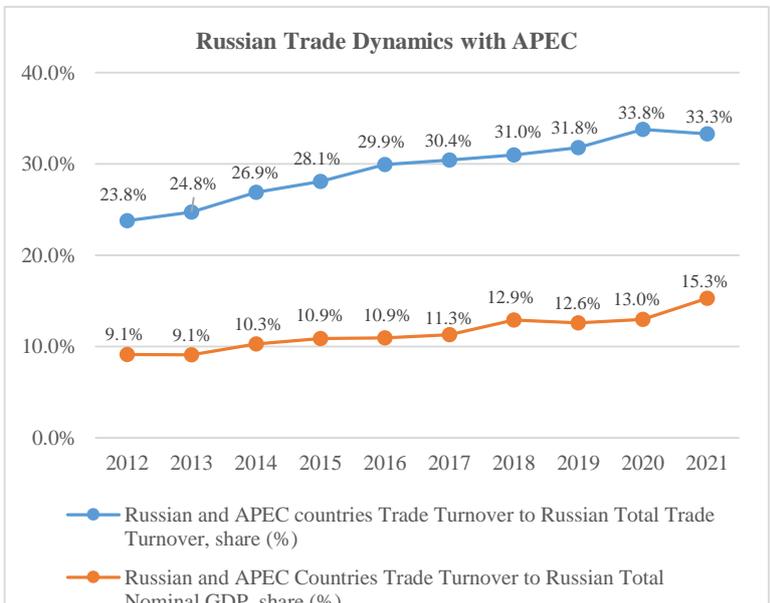
**Figure 1.**



**Figure 2.**



**Figure 3.**



**Figure 4.**

Source: Statista Database: External trade revenue in Russia from 2010 to 2021; FRED Database: Exports and Imports: Value Goods for the Russian Federation; Statista Database: Russia: Gross domestic product (GDP) in current prices from 1996 to 2026

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). Since the 2015-16 oil crisis, to benefit from the increased international competitiveness caused by the depreciation of the exchange rate, decrease reliance on the resource revenues, diversify the economy, and avoid future possible similar economic recessions, the

government have begun to implement structural reforms (Bayramov and Abbas, 2017). Specifically, paying attention to the non-oil sector and putting the best effort to enlarge its export potential is gradually yielding a positive outcome. As a primary non-oil export destination of Azerbaijan, Russia has a significant share in the total non-oil trade turnover and nominal non-oil GDP of Azerbaijan being equal to, on average, 21.4% and 10.2%, respectively, and has an upward trend from the 2015-16 oil crisis (figure 5).

From the point of Russia, though it has a very small share, the trade turnover between Russia and Azerbaijan has an increasing trend relative to Russian total trade turnover and Russian nominal GDP, being on average 0.42% and 0.16%, respectively, since 2016 (figure 6). By comparing the trade turnover of merchandise goods between Russia and Azerbaijan with the trade turnover of merchandise goods between Russia and the other CIS members, Azerbaijan is in fifth place, significantly lacking behind Belarus, Kazakhstan, Ukraine and Uzbekistan in 2021 (figure 7). Overall, the expected sharp decline in the Russian trade turnover with the West provides Azerbaijan with new opportunities to capture the semi-abandoned Russian market and boost its non-oil export potential further for upcoming quarters.

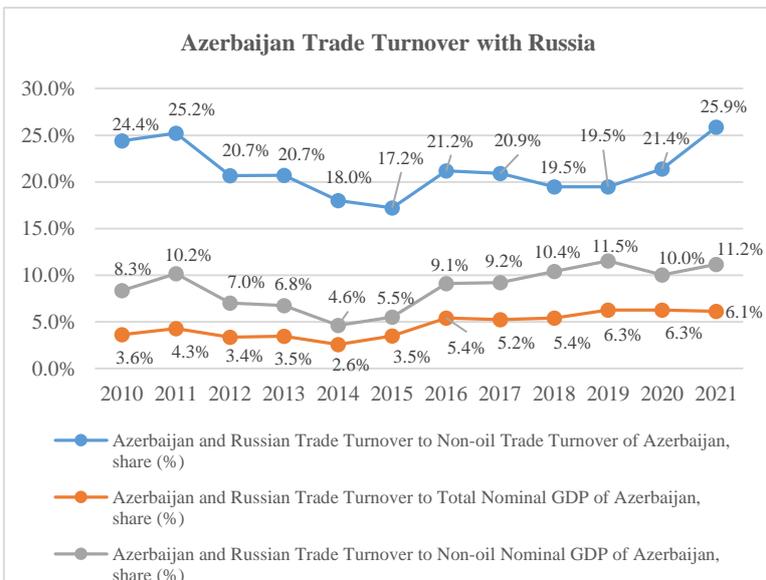


Figure 5.



Figure 6.

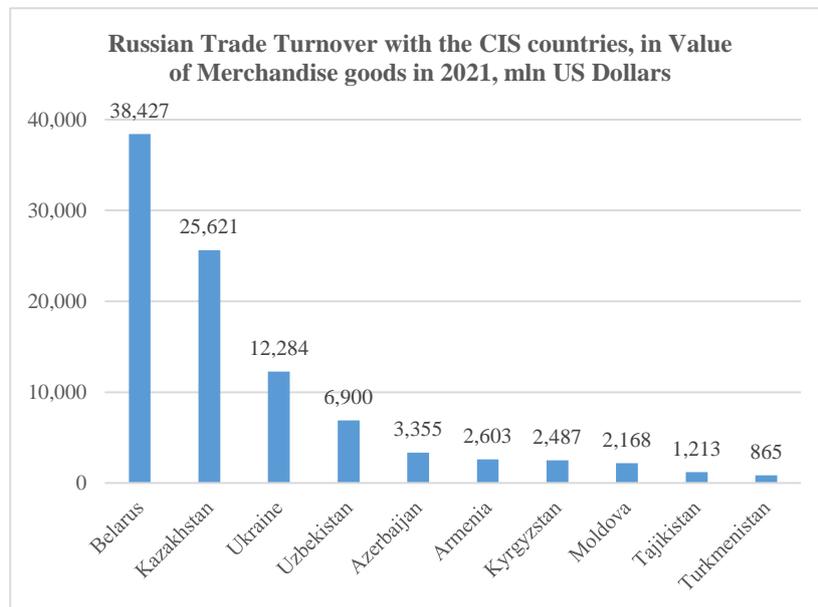


Figure 7.

Source: FRED Database: Exports and Imports: Value Goods for the Russian Federation; Statista Database: Russia: Gross domestic product (GDP) in current prices from 1996 to 2026; The Statistics of SSCRA: The foreign trade of Azerbaijan: Foreign trade by countries; The Statistics of CBAR: Macroeconomic Indicators: Total GDP and Non-oil GDP; Statista Database: Value of merchandise imports from the Commonwealth of Independent States (CIS) in Russia in 2021; Value of merchandise exports to the Commonwealth of Independent States (CIS) from Russia in 2021

### 3. The Composition of Traded Goods

It is also necessary to look at the composition of the traded goods between Russia and Azerbaijan to analyze whether Azerbaijan can maximize its non-oil export potential further by capturing an additional share in the recently emptied Russian market and if so, on which sector Azerbaijan should mainly focus on. Table 1 shows that, expectedly, energy exports comprise more than half of the total

Russian export value, followed by metals, machinery, chemical products, agricultural raw material and foodstuff, and manufactured items of the mentioned commodities between 2019-2021. Machinery and relevant items comprise about half of the total Russian import value, followed by chemical products, agricultural raw materials and foodstuff, metals, textiles, and the manufactured items of the mentioned imported commodities between 2019 and 2021 (table 2).

**Table 1.**

<b>Total Export Value Distribution in Russia in 2019-2021, by commodity, share (%)</b>			
<b>Export Structure</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Mineral products (including fuel and energy)	63,9%	51,2%	56,1%
Metals and articles thereof	8,9%	10,4%	10,4%
Machinery, equipment and transport means	6,6%	7,4%	6,6%
Chemical products, rubber	7,7%	7,1%	7,7%
Foodstuffs and agricultural raw materials	4,0%	8,8%	7,3%
Wood, pulp-and-paper products	3,1%	3,7%	3,5%
Precious stones and metals and articles thereof	3,6%	9,0%	6,4%
Textiles, textile articles and footwear	0,1%	0,4%	0,4%
Leather raw materials, fur and articles thereof	0,0%	0,0%	0,0%
Other goods	2,0%	1,9%	1,6%

**Table 2.**

<b>Total Import Value Distribution in Russia in 2019-2021, by commodity, share (%)</b>			
<b>Import Structure</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Machinery, equipment and transport means	45,8%	47,3%	49,2%
Chemical products, rubber	19,4%	18,2%	18,3%
Foodstuffs and agricultural raw materials	12,1%	12,7%	11,6%
Metals and articles thereof	7,2%	6,8%	6,9%
Textiles, textile articles and footwear	6,1%	6,3%	5,8%
Mineral products	2,1%	1,9%	1,9%
Wood, pulp-and-paper products	1,5%	1,5%	1,4%
Leather raw materials, fur and articles thereof	0,9%	0,8%	0,4%
Precious stones, precious metals, and articles thereof	0,5%	0,4%	0,4%
Other goods	4,3%	4,2%	4,1%

Source: Statista Database: Export value distribution in Russia from 2020 to 2021, by commodity; Statista Database: Value of exports from Russia from 2019 to 2020, by commodity group; Statista Database: Import value distribution in Russia in 2021, by commodity; Statista Database: Value of imports to Russia from 2019 to 2020, by commodity group

**Table 3.**

<b>Russian Import to Azerbaijan, Commodity Structure, the share of import value (%)</b>	<b>2019</b>	<b>2020</b>
Wheat	25,1%	26,2%
Timber and forest materials	10,0%	8,9%
Mineral fertilizers	8,4%	7,1%

**Table 4.**

<b>Azerbaijan Export to Russia, Commodity Structure, the share of export value (%)</b>	<b>2019</b>	<b>2020</b>
Fresh fruit	46,6%	46,9%
Fresh vegetables	35,1%	36,5%
Potato	4,2%	5,3%

Rolled steel	6,2%	5,0%
Chocolate and chocolate products	4,2%	4,2%
Raw sugar and sugar	2,2%	4,2%
Vegetable oils	4,1%	4,1%
TV receivers	3,6%	4,0%
Glued plywood	2,4%	2,5%
Medicines	1,3%	2,5%
Other Goods	32,3%	31,4%

Electricity	1,5%	2,0%
Coke oil	3,8%	1,6%
Ethylene polymers, original form	0,5%	1,4%
Fruit and vegetable juices	1,1%	1,4%
Bentonite clay	1,4%	1,4%
Cotton yarn	1,5%	0,9%
Canned fruits and vegetables	0,7%	0,8%
Other Goods	3,5%	1,9%

**Table 5.**

**Table 6.**

<b>Russian Import to Azerbaijan, Broad Category the share of import value (%)</b>	<b>2019</b>	<b>2020</b>
Raw Agricultural Products	31,6%	34,2%
Manufactured Agricultural Products (Foodstuffs)	15,9%	15,9%
Chemical and Manufactured Industrial Products	14,3%	14,5%
Timber and Manufactured Wood-related Products	15,5%	13,5%
Electronic Consumer Goods	6,1%	6,7%
Metal Types and Manufactured Metal related Stuff	7,9%	6,5%
Construction Commodities	3,3%	3,1%
Transportation and Its Parts	1,9%	2,0%
Energy and Fuel Products	2,0%	1,9%
Farm Animals, Beef, Poultry, Fish	1,5%	1,7%

<b>Azerbaijan's Export to Russia, Broad Category, the share of export value (%)</b>	<b>2019</b>	<b>2020</b>
Raw Agricultural Products	87,4%	89,5%
Energy and Fuel Products	6,2%	4,1%
Manufactured Agricultural Products (Foodstuffs)	2,8%	2,7%
Chemical and Manufactured Industrial Products	2,2%	2,4%
Other Goods	1,4%	1,4%

Note: The statistics for the year 2021 has not been published by SSCRA yet.

Source: The Statistics of SSCRA: The foreign trade of Azerbaijan: Structure of foreign trade by products

Focusing on the trade composition between Russia and Azerbaijan, about 90% of Azerbaijan's non-oil exports going to the Russian market consist of different types of raw and manufactured agricultural products and foodstuff, and the rest 10% consist of energy and fuel products combined with chemical manufactured and industrial products during 2019 and 2020. Whereas, about a half of the Russian import to Azerbaijan includes raw and manufactured agricultural products, followed by chemical industrial and manufactured products, timber and manufactured wood-related goods, electronic consumer goods, and metal and items thereof during 2019 and 2020 (table 3, 4, 5 and 6).

Chemical products, agricultural raw materials and foodstuff, and the manufactured related items (that are the main non-oil export categories from Azerbaijan to Russia), on an aggregate level, comprise approximately 30% of the total Russian import value (table 2), which equals to the market share worth of about 75 billion US dollars for 2019 and 2020 (Statista Database: Value of imports to Russia from 2019 to 2020, by commodity group). To expand its market share in the Russian market, the non-oil export sector of Azerbaijan may focus more on the mentioned export sectors. However, it should also be mentioned that not all Russian imports from the Western market consisted of the mentioned exported goods and the Western sanctions on Russia may or may not immensely empty the Russian market in these segments. Simultaneously, the non-oil export sector of Azerbaijan may face harsh competition pressure coming from the other CIS countries, the APEC members and the other friendly non-western Russian trade partners in capturing an additional share in the Russian market. All in all, the current international environment creates a favorable opportunity for Azerbaijan which has a small volume but a big potential to expand its non-oil export scale by further focusing on chemical products, agricultural raw materials and foodstuff, and the manufactured related item export segments.

#### **4. Are There Any Re-exporting Opportunities?**

Mentioning that the sanctions will hinder the imports from and exports to Russia, the companies that are engaged in import-export business may use this opportunity to export the goods of the third countries to Russia and vice-versa. In terms of re-exporting Russian goods to the third countries, because sanctions are imposed by the EU and the USA, the re-export destination of the Russian goods is the western markets. To approximate what type of goods are potential candidates for re-exporting purposes, the goods that Azerbaijan imports from Russia and the identical category of goods that Azerbaijan exports to the world are depicted in table 7, 8 and 9:

Table 7.

Categories, thousand US \$	2019		2020	
	Import from Russia to Azerbaijan	Total Non-oil Export of Azerbaijan to the World (excluding Russia)	Import from Russia to Azerbaijan	Total Non-oil Export of Azerbaijan to the World (excluding Russia)
<b>Non-Durable, Total Value</b>	<b>35,6</b>	<b>90,5</b>	<b>29,2</b>	<b>83,9</b>
Fresh fruit	0,8	83,5	0,2	75,1
Fresh vegetables	1,2	5,3	5,5	5,8
Potato	33,7	1,8	23,5	3,0

<b>Somewhat Durable, Total Value</b>	<b>75,4</b>	<b>27,8</b>	<b>79,6</b>	<b>34,8</b>
Vegetable oils	46,1	7,4	46,2	12,2
Tobacco	1,2	8,2	2,8	8,7
Tea	4,5	6,7	5,4	7,8
Margarine, other food additives	19,8	3,6	20,6	4,2
Natural grape wines and grape juice	0,0	1,5	0,0	1,2
Products made of flour and pasta	3,8	0,4	4,7	0,7

<b>Durable, Total Value</b>	<b>31,3</b>	<b>142,9</b>	<b>29,7</b>	<b>129,9</b>
Ethylene polymers, in the original form	0,6	66,5	0,0	69,4
Electricity, mln. kVt.s.	3,9	67,7	3,3	48,1
Lubricants	16,1	6,0	15,1	10,0
Gypsum	0,1	2,5	0,0	2,3
Sanitary and hygienic products from paper and cardboard	10,7	0,1	11,3	0,1

Source: The Statistics of SSCRA: The foreign trade of Azerbaijan: Structure of foreign trade by products

Table 8.

Table 9.

Source: The Statistics of SSCRA: The foreign trade of Azerbaijan: Structure of foreign trade by products

Countries	The Durability of Goods, 2019, mln US Dollars		
	Non-Durable	Somewhat Durable	Durable
<b>Non-Western</b>	<b>12,1</b>	<b>24,0</b>	<b>133,9</b>
Georgia	5,2	11,8	66,1
Turkey	1,5	0,0	29,3
China	0,0	0,4	28,8
Uzbekistan	0,0	0,0	5,5
Belarus	1,6	7,3	3,4
Iran	0,8	0,0	0,9
UAE	0,3	0,0	0,0
Iraq	0,1	1,6	0,0
Kuwait	0,1	0,0	0,0
Moldova	0,1	0,0	0,0
Kazakhstan	2,5	0,2	0,0
The Kyrgyz Republic	0,0	0,1	0,0
Tajikistan	0,0	2,3	0,0
Turkmenistan	0,0	0,3	0,0

<b>USA+EU+Ukrain</b>	<b>69,0</b>	<b>2,3</b>	<b>6,7</b>
Italy	33,2	0,0	0,0
Germany	20,9	0,0	0,0
Ukrain	14,6	2,0	6,7
Poland	0,2	0,0	0,0
Bulgaria	0,1	0,0	0,0
Netherlands	0,0	0,1	0,0
Greece	0,0	0,2	0,0

<b>Other Countries</b>	<b>9,5</b>	<b>1,4</b>	<b>2,3</b>
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Countries	The Durability of Goods, 2020, mln US Dollars		
	Non-Durable	Somewhat Durable	Durable
<b>Non-Western</b>	<b>7,2</b>	<b>30,8</b>	<b>123,4</b>
Georgia	2,5	13,1	37,8
Turkey	0,0	1,2	36,8
China	0,0	0,3	36,7
Iran	0,0	0,0	8,7
Belarus	1,1	8,1	2,0
Iraq	0,0	3,1	1,3
UAE	0,5	0,0	0,0
Indonesia	0,0	0,3	0,0
Kazakhstan	2,9	0,0	0,0
The Kyrgyz Republic	0,0	0,1	0,0
Saudi Arabia	0,0	0,4	0,0
Tajikistan	0,0	2,7	0,0
Turkmenistan	0,3	1,3	0,0

<b>USA+EU+Ukrain</b>	<b>67,0</b>	<b>2,1</b>	<b>3,9</b>
Italy	28,9	0,0	0,0
Germany	15,2	0,0	0,0
Ukrain	13,4	2,0	3,4
Czech Republic	9,2	0,0	0,0
Poland	0,3	0,0	0,0
The USA	0,0	0,1	0,0
Lativa	0,0	0,0	0,5

<b>Other Countries</b>	<b>9,7</b>	<b>2,0</b>	<b>2,6</b>
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Non-durable goods can be immediately excluded from the list of goods that can be re-exported. These goods include raw agricultural commodities and products that have very short durability to be re-exported to the third parties and mostly have one export destination. On the other hand, somewhat durable and durable goods have the potential to be re-exported. Somewhat durable goods include mainly manufactured agricultural goods and raw agricultural commodities that are not expected to rot, decay or be spoiled within a short period. An average of 2019-2020, Azerbaijan imported about 77.5 million US dollars equivalent of somewhat durable goods from Russia and exported 31.3 million US dollars equivalent of the identical goods to the world (table 7). Finally, durable goods encompass non-edible industrial and manufactured products and electricity. Azerbaijan imported about 30.5 million

US dollars equivalent of durable goods from Russia and exported 136.4 million US dollars equivalent of the same goods to international markets (table 7).

The fact that Azerbaijan imports somewhat durable goods (table 7) more than it exports them may imply that there is a high demand for these goods in Azerbaijan and it may be favorable to sell these goods in the internal market rather than re-exporting them. As a matter of fact, food products comprised about 43.4% of total consumption expenditure in 2020 (The Statistics of SSCRA: Consumption expenditures by living place in 2020). On the other hand, durable goods are imported at a significantly smaller scale compared with the export volume of these goods (table 7). This may suggest that such industrial and manufactural products and electricity are already well satisfied on the account of domestic production and they have more export value benefit. In such a case, the current geopolitical condition may provide the opportunity for Azerbaijan's import-export companies to import mentioned Russian durable industrial and manufactured products (except electricity, produced and provided by state-owned enterprises in Azerbaijan) in order to re-export them. As is highlighted, the main re-export destination of the Russian goods is the western market. Unfortunately, the volume of somewhat durable and durable goods that Azerbaijan imports from Russia and exports to the western markets, currently, is significantly small, by being 7.5 million US dollars, an average of 2019-2020 (table 8 and 9).

Simultaneously, it is also necessary to analyze re-exporting opportunities from the western countries to Russia. Given the complexity and radius of the sanctions, the possible legal consequences of engaging in re-exporting the western-produced goods to the Russian market should also be considered. While the West tries to pressure Russia economically, especially by squeezing its trade potential, re-exporting the western-produced goods to Russia may not be welcomed and may lead to the deterioration of the friendly foreign relations of Azerbaijan, specifically with the EU members. As an example, the EU members are expected to have a check-balance mechanism that will audit and ensure that the EU made products are not re-

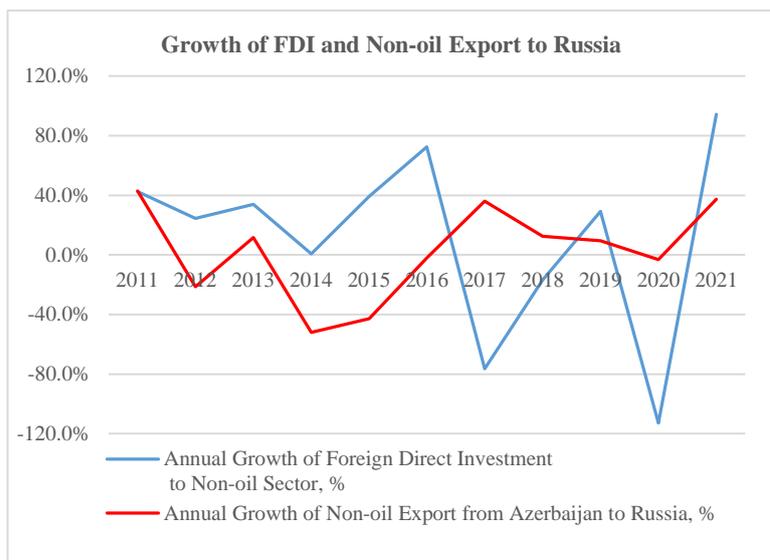
exported to Russia via a third party. Otherwise, it may raise a liability against the third party business partner based on the contractual clauses established between the EU member and the third party country, giving the EU member authority to implement and enforce sanctions if necessary (Frequently asked questions on export-related restrictions pursuant to Articles 2, 2a and 2b of Council Regulation No 833/2014 concerning restrictive measures in view of Russia's actions destabilizing the situation in Ukraine, 2022). Hence, though there may be opportunities to re-export Russian goods to the western countries, the volume of somewhat durable and durable goods, currently, is very small. Whereas, re-exporting the western goods to Russia may increase the risk of facing international sanctions and criticism.

## **5. The Parallel between the Investment in the Non-oil Sector and the Non-oil Export to Russia**

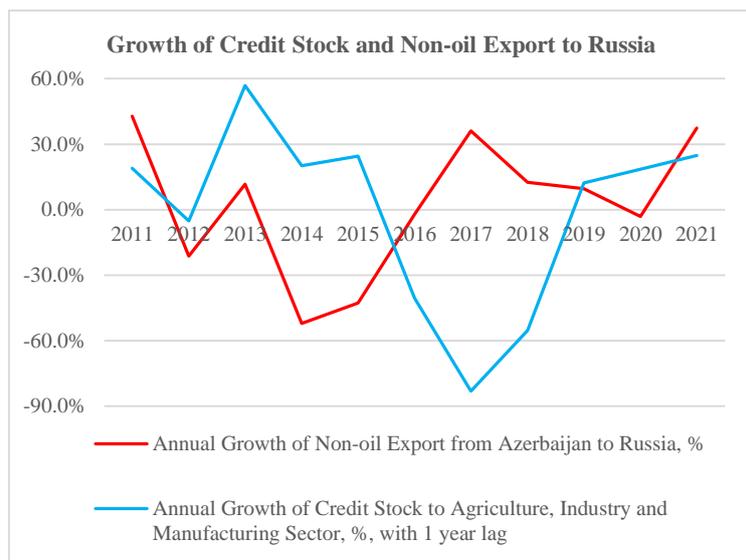
It is expected that the higher the amount of factors of production, the higher the output. As one of the factors of production – investment in the non-oil sector in Azerbaijan is divided into two parts: foreign direct investment (FDI) and banking credit, which are treated as an internationally attracted investment and domestic investment, respectively (table 10).

**Table 10.**

Year	Foreign Direct Investment to Non-oil Sector in Azerbaijan, mln US \$	Credit Stock to Agriculture, Forestry and Fisheries Sector and Industry and Manufacturing Sector in Azerbaijan, mln US \$	Non-oil Export from Azerbaijan to Russia, mln US \$
2010	199,8	1 398,7	773,6
2011	305,4	1 328,8	1 187,4
2012	390,5	2 345,9	959,8
2013	548,4	2 867,6	1 077,8
2014	552,7	3 664,5	640,3
2015	818,2	2 444,7	417,8
2016	1 688,8	1 065,0	409,3
2017	785,8	612,7	587,0
2018	664,3	692,2	665,0
2019	889,8	833,0	731,8
2020	287,7	1 067,6	709,4
2021	738,3	919,7	1 031,7



**Figure 8.**



**Figure 9.**

Source: The Statistics of SSCRA: The foreign trade of Azerbaijan: Structure of foreign trade by products; The Statistics of CBAR: External sector statistics: Macroeconomic Parameters of the Balance of Payment of the Republic of Azerbaijan (Multiple: 2010...2021); The Statistics of CBAR: Monetary Indicators: Sectoral Breakdown of Loans; Statista Database: Value of merchandise imports from the Commonwealth of Independent States (CIS) in Russia in 2021

As is seen in figure 8, there is a visually somewhat positive correlation between the annual growth rate of FDI to the non-oil sector and the annual growth rate of the non-oil export to Russia from 2011 to 2016, violated from 2017 till now. One year lag of the growth rate of the credit stock to the agricultural sector and industry and manufacturing sectors and the growth rate of the non-oil exports to Russia have a visually somewhat positive relationship till 2016, and a negative relationship since 2016 (figure 9). The reason for choosing one year lag is based on the presumption of domestic investment which requires a period of time for being fully established and yielding exporting capacity if possible. The credit given to the agricultural sector and industry and manufacturing sectors is specifically highlighted as these sectors have non-oil exporting capacity (table 6).

The possible explanations for such an aberrant relationship between the banking credit growth rate and the growth rate of the non-oil exports; the growth rate of FDI to the non-oil sector and the growth rate of the non-oil exports can be linked to the 2015-16 oil crisis, devaluation of the currency, structural shift in the

trend of the economic growth, etc. Hence, having more amount of FDI and banking credit to the non-oil sector may not be the only determinants of the non-oil export potential of Azerbaijan. Besides focusing only on the attracted investment to the non-oil sector, it is also necessary to encompass several other factors such as technological integration, institutional efficiency, government policies, the productivity level of the non-oil sector, favorable opportunities in the Russian market, etc.

## 6. The Role of Real Effective Exchange Rate

While analyzing the trade relationship between Russia and Azerbaijan, exchange rate dynamics should also be considered. Since February 2022, the Russian ruble has immensely depreciated with respect to the US Dollar. However, thanks to government intervention and policies, the Russian ruble is stabilizing around the pre-war level (figure 11). Such a positive behavior of the Russian Ruble is not the outcome of a liberal forex market and is expected not to be sustainable (Maki, 2022). Mentioning that Azerbaijan manat is pegged to the US dollar at 1.7 USD/AZN since 2017 (The Statistics of CBAR: Monetary Indicators: Official average exchange rates of manat), the possible upcoming depreciation of the Russian ruble will appreciate Azerbaijan manat vis-a-vis the Russian ruble and is expected to affect trade relations between Russia and Azerbaijan.

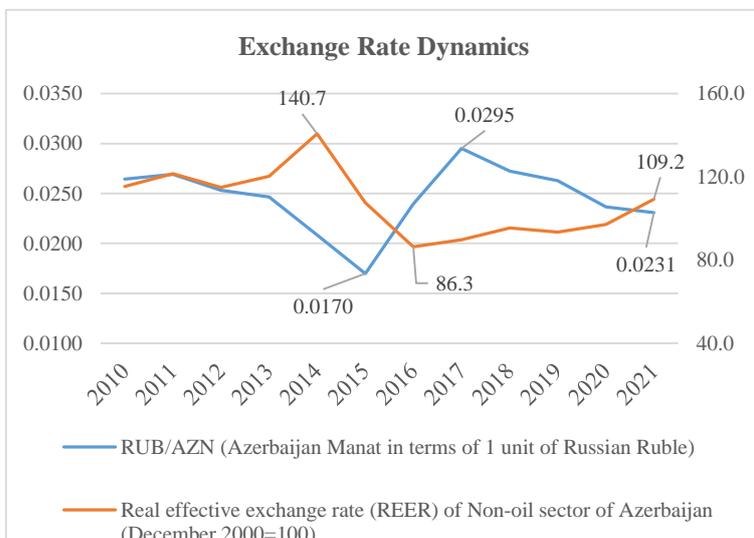


Figure 10.

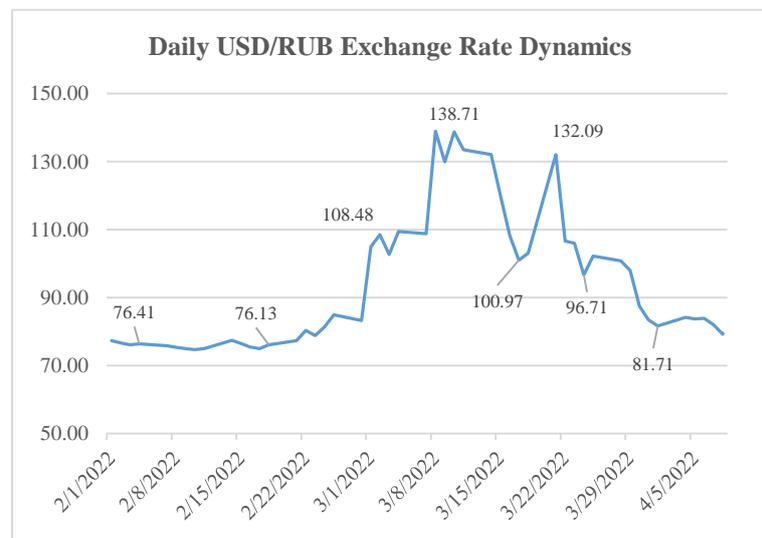
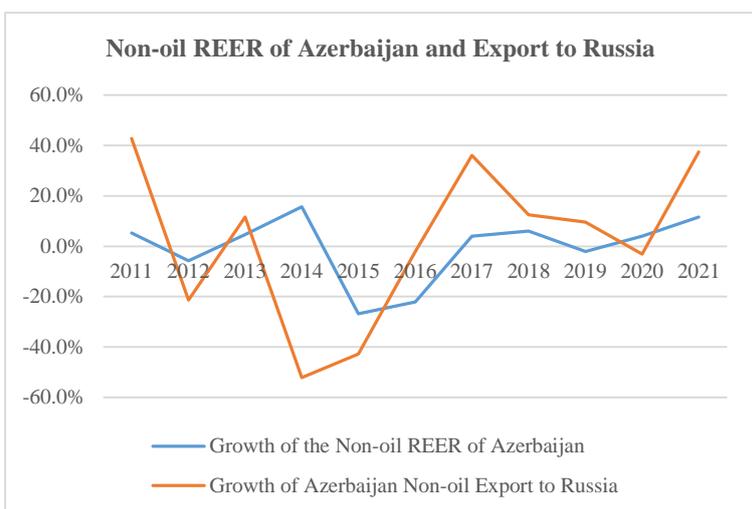


Figure 11.

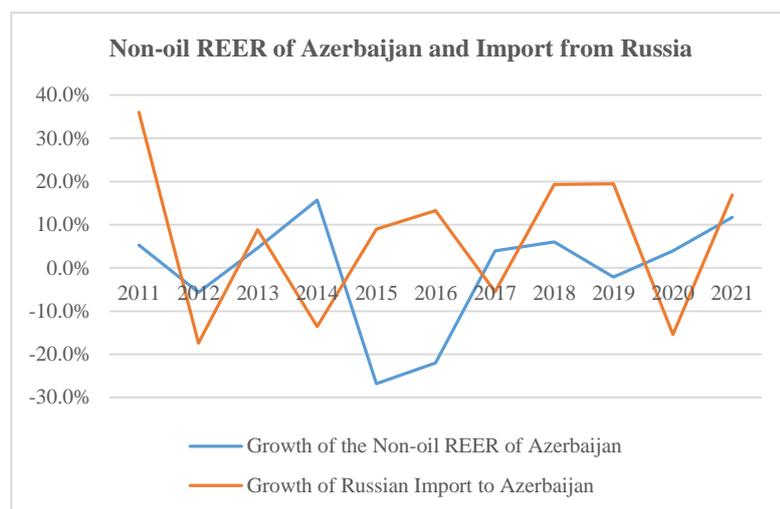
Source: The Statistics of CBAR: Monetary Indicators: Official average exchange rates of manat; The Statistics of CBAR: Macroeconomic Indicators: Nominal and Real Effective Exchange Rates of manat to foreign currencies, %; Yahoo Finance: USD/RUB (RUB=X)

From the point of Azerbaijan, the possible appreciation of Azerbaijan's nominal exchange rate, and therefore, the appreciation of the real exchange rate (RER) with respect to the Russian ruble is expected to decrease the international competitiveness of Azerbaijan's non-oil export goods among the other non-western trade partners in capturing additional share in the Russian market. Interestingly, against the mentioned theory, graphs 12 and 13 exhibit the opposite trend. From 2011 to 2020, an increase in the growth rate of the non-oil real effective exchange rate (REER) of Azerbaijan (which means the loss of international competitiveness as exports become expensive and imports become cheaper) is positively associated with the increase in the growth rate of non-oil export of Azerbaijan to Russia, whereas it is negatively associated with the growth rate of Russian import to Azerbaijan.

Such an anomaly can be explained by analyzing how sensitive is the composition of the imported and exported goods to price change. As is mentioned above, about 90% of Azerbaijan's export to Russia and about 50% of Russian imports to Azerbaijan consist of agricultural raw and manufactured products and foodstuff that are expected to be relatively price inelastic goods, and therefore, are insensitive to the appreciation of non-oil REER in Azerbaijan. Hence, it is difficult to derive a conclusion about how the appreciation of Azerbaijan RER vis-a-vis Russia will affect the non-oil export of Azerbaijan. Whereas, from the point of Russian imports to Azerbaijan, considering a massive reconstruction process in the Karabakh region and rising commodity prices across the globe, the depreciation of the Russian ruble may facilitate the relatively cheaper imported timber and construction commodities from Russia to Azerbaijan if the imported goods are denominated in Russian ruble.



**Figure 12.**



**Figure 13.**

Source: The Statistics of CBAR: Macroeconomic Indicators: Nominal and Real Effective Exchange Rates of manat to foreign currencies, %; The Statistics of SSCRA: The foreign trade of Azerbaijan: Foreign trade by countries; Statista Database: Value of merchandise imports from the Commonwealth of Independent States (CIS) in Russia in 2021

Furthermore, it is also necessary to analyze the degree of export price competitiveness of Azerbaijan with the other CIS countries, by considering REER. Mentioning that the lower the REER, the higher the international competitiveness, Azerbaijan is on fifth place in terms of REER among the CIS members since 2015 (table 11). The reason for the relatively higher REER of Azerbaijan is partially sourced from Azerbaijan having a fixed exchange rate regime. This does not let the REER of Azerbaijan gradually adjust to the effect of rising inflation and, therefore, endangers the international competitiveness of the non-oil exports of Azerbaijan in the medium run. Mentioning that the non-oil REER dynamics does not seem to effectively explain the trade relationship between Azerbaijan and Russia, compared to the other CIS members, whether having the relatively expensive REER will hinder the growth potential of the non-oil exports of Azerbaijan is up to a question.

**Table 11.**

Country Name	2015	2016	2017	2018	2019	2020	2021
Uzbekistan	-	-	-	60,6	64,5	64,6	63,3
Kazakhstan	100,0	74,5	78,2	77,8	74,0	74,9	74,4
Belarus	100,0	93,6	86,1	91,8	90,0	83,7	86,1
Tajikistan	100,0	90,0	80,3	83,3	84,5	84,4	90,5
Azerbaijan	100,0	80,2	83,5	88,6	86,8	90,3	101,5
Armenia	100,0	99,4	97,2	97,4	100,0	97,9	106,6
Kyrgyz Republic	100,0	103,5	103,0	107,7	106,6	103,2	111,0
Ukraine	100,0	99,5	104,6	111,4	128,3	127,5	142,8

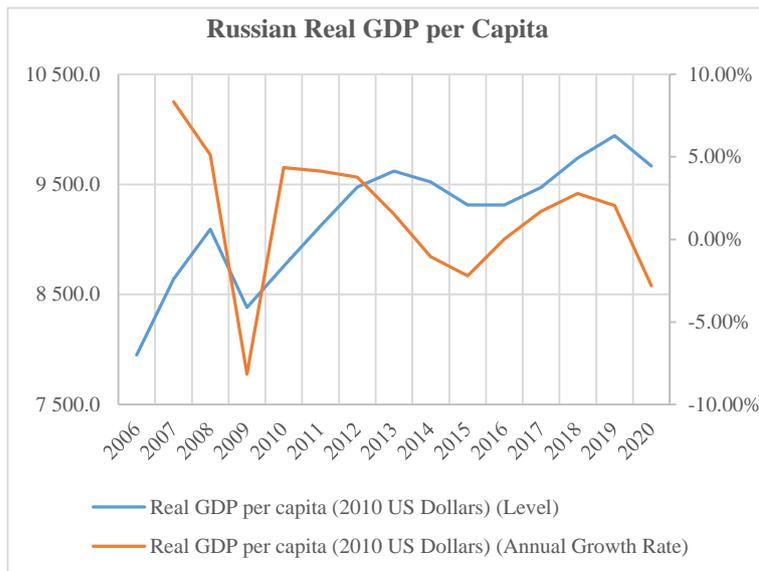
Moldova	100,0	102,4	113,1	123,4	126,0	132,7	145,9
Turkmenistan	-	-	-	-	-	-	-

Note: REER has been calculated relative to the year 2015=100; the table shows non-oil REER for Kazakhstan and Azerbaijan; full data for Turkmenistan and partially for Uzbekistan is missing

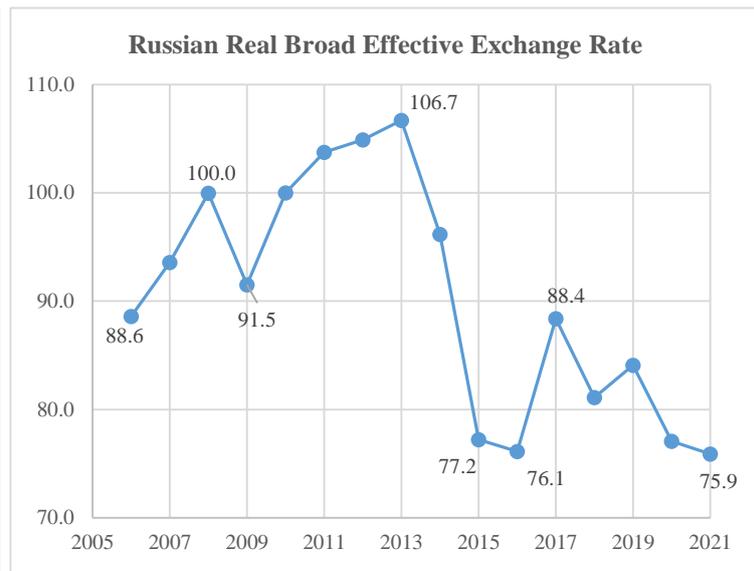
Source: Author's calculations; The World Bank Dataset, Real effective exchange rate index (2010 = 100); The National Bank of Belarus, Kazakhstan, Kyrgyz Republic, Ukraine, Tajikistan: Real effective exchange rate (REER); The Central Bank of the Republic of Azerbaijan: Nominal and Real Effective Exchange Rates of manat to foreign currencies; International Monetary Fund Executive Board concludes 2021 Article IV consultation with the Republic of Uzbekistan

## **7. The Decrease in Russian Aggregate Demand and Purchasing Power Capability**

The international sanctions, withdrawal of foreign companies from Russia, sharp depreciation of the Russian ruble, and the Western refusal to trade with Russia, combined with other negative macroeconomic damages, will surely trigger a new recession in the Russian economy by decreasing its real output and, as a result, its aggregate demand and purchasing capability for upcoming quarters. Figure 16 demonstrates that there exists a strong co-movement between the annual growth rate of Russian real GDP and the annual growth rate of the total value of Russian imports and export between 2011 and 2021. As is shown in table 1, the Russian economy is highly concentrated on energy resources and a negative global oil shock immediately hits the Russian economy through its main export channel. The examples can be drawn from the 2015-16 oil crisis and 2020 pandemics when the global oil price experienced a sharp decline (FRED Database: Global Price of Brent Crude). Though the current oil price is above 100 US dollars/barrel (Yahoo Finance: Brent Crude Oil Last Day Financ (BZ=F)), the Western refusal to purchase Russian energy resources (Natter et al. 2022) will surely hit the Russian economy through its main export channel and trigger the upcoming recession.



**Figure 14.**



**Figure 15.**

Source: FRED Database: Real Broad Effective Exchange Rate for Russia; FRED Database: Constant GDP per capita for the Russian Federation

Moreover, the inevitable economic slowdown will also worsen the purchasing capability of Russian citizens. The optimal way to understand how it may affect future purchasing capability is to analyze the 2008 global recession, the 2015-16 oil crisis and the 2020 global pandemics that severely damaged the Russian economy. Special attention has been put upon the Russian real GDP per capita and Russian REER dynamics, which can be suitable proxy indicators to show the purchasing power of the Russian citizens, for the last 15 years (figures 14 and 15). According to figure 14, Russian real GDP per capita plummeted during the 2008 global recession and smoothed down during the 2015-16 crisis and the 2020 global pandemics. Similarly, Russian REER decreased during the 2008 crisis and the 2020 global pandemics, whereas it immensely declined during the 2015-16 oil crisis (partially because of the sharp decrease in the global energy prices) (figure 15). A decrease in Russian real GDP per capita will limit the income of an average Russian citizen to demand goods and services (imported or domestic) in large amounts. Simultaneously, the decline in Russian REER will make Russian

exported goods internationally competitive and imported goods more expensive.

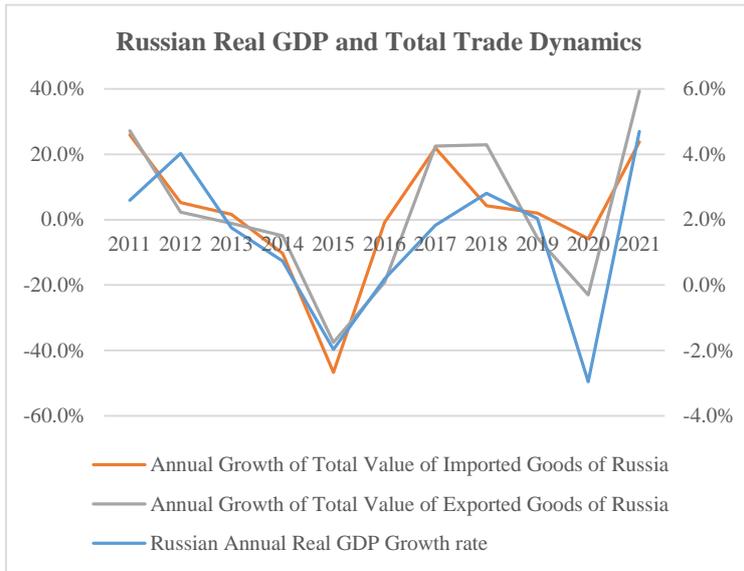


Figure 16.

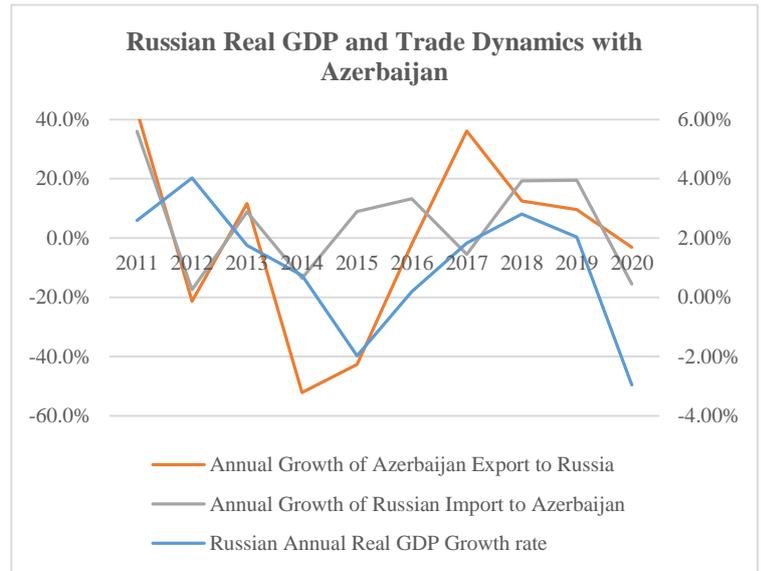


Figure 17.

Source: FRED Database: Gross Domestic Product by Expenditure in Constant Prices: Total Gross Domestic Product for the Russian Federation; The Statistics of SSCRA: The foreign trade of Azerbaijan: Foreign trade by countries; FRED Database: Exports and Imports: Value Goods for the Russian Federation

Coming to the case of Azerbaijan, unlike the annual growth of Russian imports to Azerbaijan, the annual growth of the non-oil export of Azerbaijan to Russia seems to more strongly co-move with the annual growth of the Russian real GDP (figure 17). According to the analyst from Goldman Sachs, the forecasted Russian GDP growth rate is expected to fall as low as 7% (Partington, 2022). As a result of the expected upcoming economic slowdown sourced from the sanctions, a decrease in average income and aggregate demand, combined with the expensive imported goods, will negatively affect the purchasing capability of an average Russian citizen. These three negative effects are expected to decrease the Russian demand for imported goods, including the non-oil goods of Azerbaijan, and may hinder the growth potential of the non-oil export base of Azerbaijan.

## 8. The Removal of Russia from the SWIFT System and Capital Immobility Measures

Financial intermediaries play an irreplaceable role across the globe to facilitate trade relationships. Banks and other financial institutions provide financial

services such as a letter of guarantee and letter of credit for import and export-oriented companies. The more efficient and advanced are such financial services, the quicker and less risky are trading transactions. As a part of the sanctions, Russian financial institutions are also gradually removed from the SWIFT system, expected to severely damage the Russian economy from several sides (Perez, 2022). To highlight the degree of the reliance of the Russian economy on the SWIFT system, Russia is the second largest user of the SWIFT system in terms of the number of users. According to the Russian National Swift Association, approximately 300 banks and more than 50% of the credit institutions in Russia are connected to the SWIFT system (Gollom, 2022). Moreover, to show the severity of the case, according to the estimations of the Ministry of Finance of the Russian Federation in 2014, the removal of Russia from the SWIFT system may cost about a 5% decrease in the Russian economy (Perez, 2022). The removal of Russia from the SWIFT system will hit all sectors of the economy that are highly interconnected with the international trade and finance because it will paralyze financial transactions with foreign counterparties, meeting financial obligations, receiving export payments and supporting the importers with the short-term trade credit (Rebucci, 2022). As it will increase the risk and the cost of exporting to and importing from Russia, foreign counterparties are likely to search for alternative markets and suppliers (Bergin, 2022).

The main question is how Russian financial operations may proceed after the removal from the SWIFT system. As an alternative, since 2014, Russia has developed its own the System for Transfer of Financial Messages (SPFS) that currently encompasses 404 financial institutions, including 23 banks from seven countries, covers about 13 million messages per year and accounts for about one-fifth of the Russian domestic transactions in 2021. To compare the weight of the SPFS system with the SWIFT system, the SWIFT system accounts for 56% of the global transactions, equals 77 trillion US dollars, covers about 11000 banks and financial organizations in over 200 countries and annually proceeds more than 10

billion messages globally. Albeit the SPFS is not as technically advanced as the SWIFT system, it may play as an alternative system to proceed with foreign transactions to a limited extent. International coverage of the SPFS encompasses only Russia, Armenia, Belarus, Germany, Kazakhstan, Kyrgyzstan, and Switzerland (Perez, 2022), whereas Russian trade geography is massively broader than these mentioned countries.

The negative effects of the removal of Russia from the SWIFT system on the trade relationship between Azerbaijan and Russia are also inevitable. Recently, the treaty called, “Declaration on Allied Interaction between the Republic of Azerbaijan and the Russian Federation”, signed between the Russian Federation and the Republic of Azerbaijan includes item 27 that mentions the cooperation between the financial institutions of Azerbaijan and Russia (Azertag, 2022). Though it may seem like an alternative for Russia and Azerbaijan to commence their trading relationship by circumventing the SWIFT system, with a great probability, it is going to take time to properly establish and adapt to the alternative system. Moreover, in terms of capital immobility measures, the Russian government has recently imposed a limit on foreign currency purchases by its citizens from banks and stopped foreign exchange operations for the next six months (Whalen, 2022). The removal of Russia from the SWIFT system and the capital immobility measures imposed by the Russian government is highly likely to delay the export-import transaction turnover and reduce the amount of traded goods and services between Russia and Azerbaijan, mitigating the growth of the non-oil export of Azerbaijan.

## **9. Conclusion**

In terms of future perspectives and opportunities for the non-oil export base of Azerbaijan, because of the Western sanctions on Russia, an expected sharp decline in the trade turnover between Russia and the West may create a favorable opportunity for Azerbaijan to capture an additional share in the semi-abandoned Russian market by focusing on chemical products, agricultural raw materials and foodstuff, and the manufactured related item segments. While trying to use this

opportunity, Azerbaijan must be ready to face competitive pressure coming from the other CIS members, APEC countries and other non-western friendly trade partners of Russia, by also considering its export price competitiveness in terms of REER. However, the possibility of re-exporting Russian goods to the western markets currently has a limited scale and re-exporting the western-produced goods to Russia has a risk of facing international sanctions and criticism.

In terms of challenges, an upcoming economic recession in Russia, the decrease in the Russian aggregate demand, deterioration of the Russian purchasing capability (that will decrease the demand for the imported goods), the removal of Russia from the SWIFT system and the capital immobility measures imposed by the Russian government are the biggest challenges for Azerbaijan's non-oil exports to Russia for upcoming several quarters. Also, expanding the volume of non-oil exports to Russia by just attracting FDI and local investment to the non-oil sector may not be sufficient. It may require considering other factors such as technological integration, institutional efficiency, government policies, favorable opportunities in the Russian market, etc. Finally, the link between the non-oil REER of Azerbaijan and Azerbaijan-Russian trade volume seems to be counter-intuitive and does not overlap with the economic intuition. It can be inferred that the third factors that overshadow the role of the non-oil REER have a strong role in determining the trade volume.

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## **Bio of the Author**

### **Eldayag Mustafayev**

Eldayag Mustafayev works at Kapital Bank (the third biggest commercial bank in Azerbaijan) as a Market Risk Specialist. He is engaged in assessing the market risks that may affect the balance sheet position of the bank and implementing stress-testing analysis. He holds a Bachelor's and Master's Degree in Science of Economics and is specialized in macroeconomic and econometric analysis. Mr. Mustafayev has experience in writing academic research and conducting business-oriented market research. The scope of his research covers the topics such as international trade, oil market, exchange rate and financial economics mainly in Azerbaijan. As a co-author, he published the academic paper, called “Predicting the changes in the WTI crude oil price dynamics using machine learning models” in

Resource Policy Journal; as a main author, he published the research, called “Potential Impacts of Sanctions against Russia on the Non-oil Exports of Azerbaijan” at the Center for Economic and Social Development.