



Tariff and regulatory barriers for the Freedom to Trade in Azerbaijan

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Introduction

Free trade as a concept also requires policy reforms toward the reduction of tariffs and for quantitative restrictions for efficacious trade liberalisation. Nations are getting to be convinced to have trade liberalisation as a result of a series of rounds of trade policy reforms addressed primarily toward the reduction of tariffs and of quantitative restrictions. Given the interrelation and interdependence between trade and economic growth, high dependence on crude oil also can lead to the discretions in economic growth of country. The Trade and Development Report, 2012 of UNSTAD suggests that the commodity price volatility is one of the reasons why commodity-dependent economies have lower long-term average growth rates than economies with diversified production structures.¹ Unfortunately, among the countries oil-gas, minerals and mining products make up the dominant share of their exports, there has been a trend toward the increased use of protective trade measures of a discretionary character. This tendency has accelerated in recent years.

Foreign trade of Azerbaijan

According to the official statistics of Azerbaijan for 2014, the volume of foreign trade turnover was \$31 billion, with imports at \$9.2 billion and exports at \$21.8 billion. During 2014, Azerbaijan cooperated with 150 countries and the foreign trade balance was positive, at \$12.6 billion.²

Table 1 demonstrates the level of the commodity dependence of Azerbaijan exports. In fact the non-oil sector, including the private sector and individuals, accounted for only 6.7% of

¹ http://unctad.org/en/PublicationsLibrary/tdr2012_en.pdf

² <http://economy.gov.az/index.php/en/international/foreign-trade/2012-ft/98-international-relations/foreign-trade/2012/496-xt2012>

total export volume in 2012. This demonstrates that the *private sector* has not yet established itself as a key player in the economic sphere.

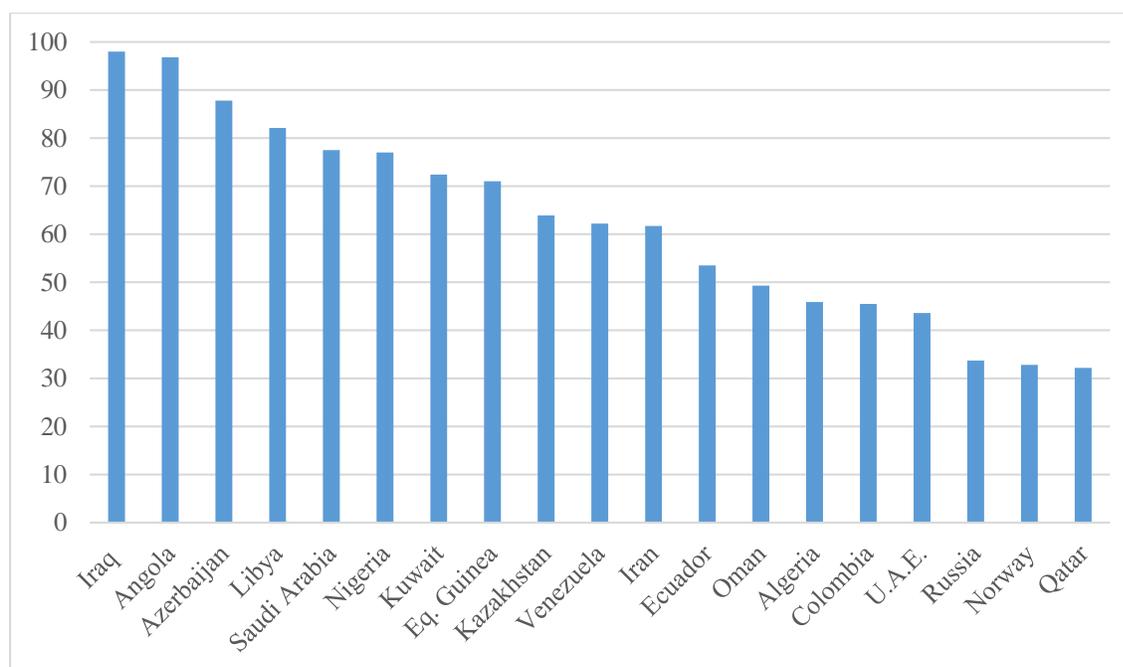
Table 1: Export basket of Azerbaijan

Leading products exported based on average 2012-2013 values (3-digit level)	Value (f.o.b., thousands of USD)	As percentage of country total
All commodity groups	32,075,181	100
Crude petroleum, bituminous oil	2,814,822	87.8
Heavy petroleum, bituminous oil	1,319,484	4.1
Natural gas, liquefied or not	458,886	1.4
Fruit, nut excl. oils, fresh, dried	238,509	0.7
Sugars, molasses and honey	233,749	0.7
Fixed veg fats, oils, "soft"	119,710	0.4
Aluminum	110,297	0.3
Processed animal, veg fats, oils	99,024	0.3
Vegetables, vegetable products, nes	83,753	0.3
Ethylene polymers in primary form	79,594	0.2
Remainder	1,183,951	3.8

Source: UNCTAD Handbook of Statistics 2014

Azerbaijan has very high commodity and country concentration in foreign trade, especially in export operations. Table 1 also illustrates that the crude oil and natural gas heavily dominate Azerbaijan's exports, making up 89.2% of total exports in 2012-2013. The lack of export diversification is one of the main challenges for Azerbaijan's economy. In a survey conducted for 'Aid for Trade at a Glance 2009 - Maintaining Momentum' (OECD/WTO, 2009), "the country identified three major binding constraints: trade policy analysis, negotiation and implementation; network infrastructure; and export diversification".

Given the comparison in the Chart 1 shows that Azerbaijan one of most commodity depend countries in the world regarding the exports structure. Export diversification refers to policies designed to change the shares of commodities in the existing export mix, to introduce new products in the export portfolio, or to break into new geographical markets. Entering new markets requires both the capacity to produce new products, and the application of innovative solutions.

Chart 1. Crude oil exports as a share of total exports in 2012-2013, in percentage

Source: UNCTAD Handbook of Statistics, 2014

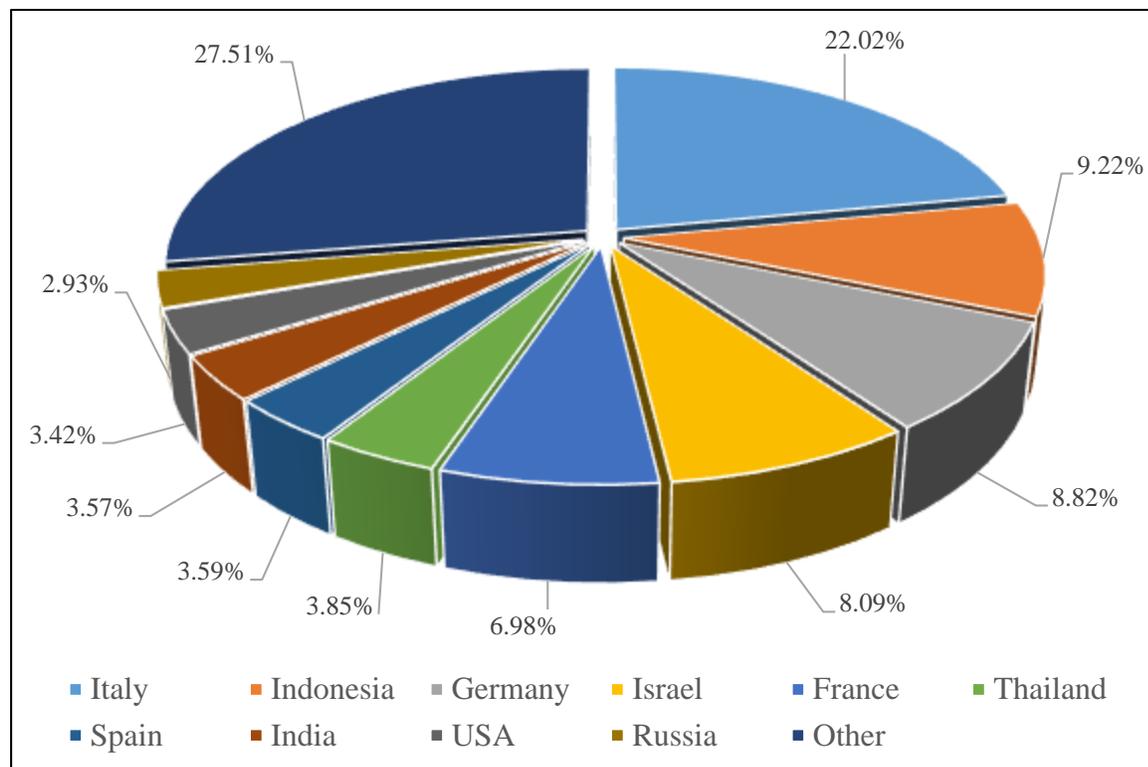
Also, higher oil prices have boosted the current account surplus, although the non-oil trade balance continues to deteriorate. In addition, Azerbaijan's foreign trade was affected by the exchange rate regime created by the Central Bank. From the start of 2011 the Central Bank has kept the national currency (AZN) pegged to the US dollar. It is assumed that this presented a shift from a managed float against a basket of the US dollar and the Euro, reflecting the rising importance of the oil sector – whose main outputs are prices in dollars - and the authorities' goal of ensuring the stability of the financial sector and attaining single digit inflation rate³. There are estimations about Azerbaijan's currency depreciation and trade surplus (the well-known "J-curve phenomenon; the weighted average of the production indexes of country's four major trading partners account for 70% of Azerbaijan's total trade turnover. Empirical results suggest that for 3 of 10 cases there is strong evidence that trade balance in each of those three industries improves in the long run in response to a currency devaluation⁴. It is important to highlight that from February 2015 the Central Bank changed pigging from the US dollar to the US dollar & Euro. It happened after the decreasing of oil prices in the world market 2014. Because of the decreasing of

³"Azerbaijan: switching the drivers of growth", World Bank, Azerbaijan regular economic report, no. 1, 2012

⁴<http://ideas.repec.org/p/prs/mprapa/39370.html>

US dollar flows from exports, the Central Bank could not control the exchange rate of AZN. Afterward AZN devaluated 34% on February 21, 2015.

Chart 2. Regional breakdown Azerbaijan's exports basket (2014)



Source: State Customs Committee of the Azerbaijani Republic

Chart 2 describes that most of partners country in the exports located in Europe. In general the European Union is one of Azerbaijan's main trade partners. State Customs Committee of Azerbaijan reports that the trade turnover with the EU exceeded the share of total trade by 35% in 2014. The trio of Azerbaijan's key trading partners however, changed radically in 2014, and the current trio is Italy, Germany, and Indonesia. The top three of trade partners was Italy, Indonesia, and Russia for 2013.

Legislation and institutions

Different legislative acts influence the regulation of trade, including laws and regulations on natural monopolies, protection of consumer rights, state support for small business, state

registration of legal entities, unfair competition, antimonopoly policy and consumer rights protection, certification of the country of origin, and special economic zones⁵. Strong technical support from the European Union and the United Nations Development Program (UNDP), along with the accession process to the WTO, played a strong role in the adoption of the new Customs Code in 2011. Under the decree on the approval of the Customs Code, the government was tasked with updating 59 acts to meet the requirements of the new Code. The necessary amendments to the regulatory framework have been made. One of the most important bills to be passed is the Bill on Customs Tariff, which under consideration in parliamentary committees.

Beside these, Azerbaijan has signed bilateral free trade agreements with the Russian Federation (1992), Moldova (1995), Ukraine (1995), Turkmenistan (1996), Uzbekistan (1996), Georgia (1996) and Kazakhstan (1997). Also, a free trade agreement was signed between Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and the Kyrgyz Republic in Moscow on 15 April 1994. The EU started negotiations with Moldova, Armenia and Georgia for a Deep and Comprehensive Free Trade Area as part of Association Agreements in early 2012⁶. With Azerbaijan, the EU is negotiating a non-preferential trade and investment agreement, as Azerbaijan is not yet a member of the WTO. Azerbaijan's State Commission for European Integration, which consists of representatives of relevant structures, regularly discusses the current and future state of trade and economic relations between the EU and Azerbaijan. Additionally, Azerbaijan has signed regional and bilateral trade agreements with member countries of the Economic Cooperation Organization.

The State Customs Committee is a leading player in institutional regulation of foreign trade in Azerbaijan. After the restoration of the in January 1992, the State Customs Committee was established. But domestic trade has suffered from the lack of a special regulative framework, which has led to some uncertainties. The legislative body adopted Customs Code back in 1997, following which the government continued to update the regulatory framework for foreign trade relations. Another relevant state body, the Ministry of Commerce of the Republic of Azerbaijan, was established by special decree on 24 June 1997. The Ministry of Commerce regulates relations with

⁵<http://economy.gov.az/index.php/en/legislation/laws>

⁶[http://europa.eu/rapid/press-release MEMO-13-282_en.htm](http://europa.eu/rapid/press-release_MEMO-13-282_en.htm)

international trade organizations and implements harmonized state policy in the field of domestic and foreign trade⁷. In 2001, the Ministry of State Property, Ministry of Economy, Ministry of Commerce, State Antimonopoly Policy and Support of Entrepreneurship Committee and the Foreign Investments Agency were dissolved and replaced by the Ministry of Economic Development (current Ministry of Economy and Industry) was established on their basis. The Ministry of Economy and Industry designs and implements state policy on domestic trade, foreign economic and trade contacts, on partnerships with international economic and trading institutions. It also works to ensure the efficient function of the commodity circulation system within the country⁸.

Tariffs and non-tariff barriers

In some cases, it is more expensive for countries to trade manufactured goods with their next-door neighbours than to trade with distant countries. Research by the World Bank has revealed that the two most important factors determining “thickness of borders” (in terms of trade costs) are maritime transport connectivity and logistics performance. Thus, poorer countries tend to have higher levels of trade costs than richer countries, in both manufactured and agricultural goods⁹. This is a technical approach to cost of trade, but we also have to take into account the potential of free trade to diminish trade cost in the long run.

Trade regimes, customs and trade finance are key aspects of free trade. Specializing in goods and services where countries have relatively lower opportunity costs can encourage more benefits in terms of mutual trade turnover. Free trade enables countries to specialize in those goods for which they have a comparative advantage. The existing literature defines free trade as “the

⁷http://www.e-qanun.az/files/framework/data/1/f_1779.htm

⁸<http://economy.gov.az/index.php/en/ministry/history>

⁹<http://blogs.worldbank.org/trade/why-is-trade-more-costly-for-poor-countries-a-new-database-gives-us-some-answers>

importation and exportation of goods without any barriers in the form of tariffs, quotas, or other restrictions”¹⁰.

Trade freedom is also considered as a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The trade freedom assessment is based on two inputs: (i) Trade-weighted average tariff rate; (ii) Non-tariff barriers (NTBs). Different imports entering a country can face different tariffs. The weighted average tariff uses weights for each tariff based on the share of imports for each good. NTBs are used extensively across many goods and services and/or act to effectively impede a significant amount of international trade. Methodology of Index of Economic Freedom includes these categories of NTBs:

- *“Quantity restrictions - import quotas, export limitations, voluntary export restraints, import-export embargoes and bans, countertrade etc.*
- *Price restrictions - antidumping duties, countervailing duties, border tax adjustments, variable levies/tariff rate quotas.*
- *Regulatory restrictions – licensing, domestic content and mixing requirements, sanitary and*
- *Phyto-sanitary standards (SPSs), safety and industrial standards regulations, packaging, labelling, and trademark regulations, advertising and media regulations;*
- *Investment restrictions - exchange and other financial controls;*
- *Customs restrictions - advance deposit requirements, customs valuation procedures, customs classification procedures, customs clearance procedures.*
- *Direct government intervention—subsidies and other aid, government industrial policy and regional development measures, government-financed research and other technology policies; national taxes and social insurance, competition policies, immigration policies, government procurement policies, state trading, government monopolies, and exclusive franchises”. In Azerbaijan, the trade-weighted average tariff rate is 3.9 per cent, and non-tariff barriers such as arbitrary customs administration raise the cost of trade¹¹.*

¹⁰ Economic Development, Michael Todaro and Stephen Smith, 11th edition, (page 570), 2012

¹¹2013 Index of Economic Freedom, (page 483-484), The Heritage Foundation

Table 2: Regional comparison (Black Sea and Caspian Countries) on trade freedom

Country	Trade freedom score (out of 100)	Trade freedom rank (out of 177)	Trade-weighted average tariff rate
Georgia	88.6	7 th	0.7%
Ukraine	85.8	46 th	2.1%
Armenia	84.5	48 th	2.3%
Turkey	84.6	53 st	2.7%
Kazakhstan	79	76 th	3%
Azerbaijan	76	95 th	4.5%
Russia	75	104 rd	5%

Source: 2015 Index of Economic Freedom, Heritage Foundation

Table 2 indicates the regional comparison on trade freedom, revealing that Azerbaijan has the highest trade-weighted average tariff rate and lowest trade freedom score in the region. In order to achieve a free and integrated trade system in the Black Sea region, countries should commit to the gradual removal of customs duties, taxes and levies which have equivalent effect and quantitative restrictions in mutual trade; elimination of other barriers to a free transfer of goods and services; creation and development of an effective system of mutual settlements and payments on trade and other transactions; coordination of trade policy with respect to other countries; coordination of economic policy to that extent to which this is necessary to achieve the regional objectives in the area of industry, agriculture, transport, finance, investment, social sphere, development of fair competition; promotion of cooperation of different branches, intra-branch and scientific technical cooperation; harmonization and unification of legislation¹². All these conditions are applicable to Azerbaijan, which needs to make its national policies consistent.

The World Bank's Doing Business 2015 special report on Azerbaijan tried to answer the simple question: "What does it take to export or import in Azerbaijan"? According to the Table 3, exporting a standard container of goods requires 9 documents, takes 27 days and costs \$3460. Importing the same container of goods requires 11 documents, takes 25 days and costs \$3450. Globally, Azerbaijan is ranked 166th of 185 economies on the ease of trading across borders. The rankings for comparator economies and the regional average ranking provide other useful

¹²<http://wits.worldbank.org/GPTAD/PDF/archive/CIS.pdf>

information for assessing how easy it is for a business in Azerbaijan to export and import goods (Table 4).

Table 3: The ease of trading across borders in Azerbaijan over time

Trading Across Borders ¹			
DB 2015 RANK	166	DB 2014 RANK**	165
CHANGE IN RANK		+1	
DB 2015 DTF** (% POINTS)	42.37	DB 2014 DTF** (% POINTS)	41.16
CHANGE IN DTF** (% POINTS)		+1.21	
Indicator	Azerbaijan	Europe & Central Asia	OECD
Documents to export (number)	9	7	4
Time to export (days)	27.0	23.6	10.5
Cost to export (US\$ per container)	3,460.0	2,154.5	1,080.3
Cost to export (deflated US\$ per container)	3,460.0	2,154.5	1,080.3
Documents to import (number)	11	8	4
Time to import (days)	25.0	25.9	9.6
Cost to import (US\$ per container)	3,450.0	2,435.9	1,100.4
Cost to import (deflated US\$ per container)	3,450.0	2,435.9	1,100.4

Source: World Bank Doing Business Index, 2015

The OECD's paper adds to the literature by identifying and quantifying the severity of binding constraints to trade expansion by assessing the role of complementary policies in the impact of trade reforms on economic growth, using two case studies (Azerbaijan and Uganda) to illustrate the issue. According to that report: "for commodity exporters like Azerbaijan, general governance framework is a priority. In addition to policies related to better governance, lack of export diversification, the tariff regime and access to credit are constraints to foreign trade performance"¹³.

¹³<http://www.oecd.org/trade/aft/47428944.pdf>

Conclusion

Azerbaijan as an oil-rich and commodity dependent country faces unavoidable challenge in terms of free trade and fair regulation of foreign trade. Azerbaijan's foreign trade has several key features which deserve special attention: (i) huge dependence on crude oil and other raw materials, in other words, high commodity concentration and lack of diversification of exports; (ii) high regional concentration of exports (mostly EU countries – Italy, France, also Israel) and import (Russia and Turkey) operations; (iii) monopolistic attitudes to export and import operations, promoted by non-tariff barriers of relevant regulatory agencies; (iv) unfavourable exchange rate regime which make local products more expensive in foreign markets. Azerbaijan is not yet a member of the WTO and therefore cannot sign a DCFTA with the EU. Non-tariff barriers and regulatory shortcomings in export-import operations are serious challenges for the country.

Table 4: Doing Business 2015: ease of trading across borders in the region

	Azerbaijan	Georgia	Armenia	Ukraine
Rank	166	33	110	154
Documents to export (number)	9	4	5	8
Time to export (days)	27	9	16	29
Cost to export (US\$ per container)	3460	1355	1885	1880
Documents to import (number)	11	4	8	9
Time to import (days)	25	10	18	28
Cost to import (US\$ per container)	3450	1595	2175	2455

Source: *Doing Business 2013*

As it shown in the Table 4, Georgia is a leader with regard to ease of cross-border trading, i.e. ease of fulfilling documentation requirements and procedures at customs and other regulatory agencies, as well as ease of trade logistics when exporting or importing one standard container. According to the Doing Business 2015 report, Georgia is ranked 33th among 185 economies for ease of trading across borders. Cross-border trading with Azerbaijan and Ukraine is much more difficult. Doing Business 2015 reports that Ukraine stands in 154th place among 185 economies, while Azerbaijan is 166th. Both countries have longer, more costly procedures with more documentation required.