

Fidan Namazova

HELIOS

July 17, 2023

UKRAINIAN WAR AND ITS IMPACT ON SOCIA-ECONOMIC SITUATION IN AZERBAIJAN

Introduction

The Russian invasion of Ukraine created chaos, uncertainty as well as need for stability for many countries. The war has divided the world into two parts: Ukraine-supporters and pro-Russian camp. However, coming closer to the region, especially, the ones bordering with Russia, the situation here is more complicated. There are several countries in post-Soviet space that hardly support the Russian war in Ukraine, but meanwhile are cautious to not openly criticize Kremlin actions fearing the repercussions. Azerbaijan, along with Kazakhstan, Uzbekistan, and Kyrgyzstan, was one of the countries greatly affected by the war. The Russian invasion of Ukraine changed the security perspective for Azerbaijan, creating a new perception of threat coming from the North (Valiyev, A., & Yagubova, I., 2022). While Azerbaijan's active foreign policy has not changed much in response to the Ukrainian conflict, Russia's full-scale invasion created new challenges to stability in the region. Baku was cozying Moscow trying to not irritate the Kremlin and slowly de-occupying territories that were under control of the Russian peacekeepers (Valiyev, A., 2021). The Russian invasion of Ukraine has created a huge domain of uncertainty that increases the need for stability. The main ramifications of the situation in Ukraine on the foreign policy of Azerbaijan is reduced space for manoeuvring, and increased costs/risks of manoeuvring steps. The war has seriously affected and will continue to affect the calculations of the decision-makers in Baku (Kakachia et al., 2022).

Azerbaijan faces not only political challenges due to the war, but also there are major socio-economic effects of Ukrainian war to the country. From the economic perspectives, the war affected on the flows of crude oil, energy prices, hydrocarbons exports and products' prices. Moreover, from social perspective, number of migrants/refugees and ethnic Azerbaijanians (more than 1 million living in Russia now) coming to the country increased after the war. Even if, the country was not a top destination for Ukrainians, but according to statistics, in March 2022 the

number of arrivals drastically increased from a month average of 1,600 to 5,300. Over the next seven months, in average 2000 Ukrainians arrived every month, although just 3925 have officially registered as refugees (Chaikhana.media, 2022). Besides Ukrainians, there is also a flow of Russians in the country. State Tourism Agency announced that in February 2022, 23,600 Russian citizens came to Azerbaijan. In May 2022, 28,300 arrived and by July 2022, the number had nearly tripled to 60,000 Russian citizens arrived in Azerbaijan. Furthermore, after V. Putin's announcement of the general mobilization of 300,000 man back in September 2022, Azerbaijan became the third most popular destination for Russian citizens. Also, with the aim of avoiding a huge flow of migrants to the country, even if officially pandemic regime is announced to be the main reason, the borders are still closed and airplanes are the only possible route of travel, which creates a threat to local population as well. Considering all these socio-economic problems created due to the war in the region, Azerbaijan should clarify the reasons standing behind and finds solutions to overcome unexpected problems lasting from 2022.

Background

The war in Ukraine has affected Azerbaijan's flows of crude oil (Valiyev, A., Alili, A., & Namazova, F., 2022). Due to the safety of oil tankers in the Black Sea, Azerbaijan has halted the operation of the Baku-Supsa pipeline since March 15 (AzerNews, 2022). Instead, the country has redirected the Supsa oil to the Baku-Tbilisi-Ceyhan (BTC) pipeline. The rerouting comes at a cost. While the Baku-Supsa transit fee costs only \$0.42 per barrel of oil, the longer BTC route also traverses Türkiye which alone receives around \$1.50-\$2 per barrel (Eurasianet, 2022). BP, the technical operator of the Baku-Supsa pipeline and a major player in Azerbaijan's energy industry, called the shutdown of the pipeline "temporary", but did not report when it is expected to resume its operation. The Baku-Supsa oil pipeline, also known as the Western Route Export Pipeline (WREP), had been transporting Azeri Light, Azerbaijan's major and top-quality crude, since 1999. With the annual capacity of around 7.2 million tons a year, the pipeline delivered 4.2 million tons of crude in 2021 (Trend, 2022). The 60 million tons/year capacity BTC pipeline, currently operating at around half of its maximum capacity, well accommodates the rerouted Supsa volumes.

The war has also negatively impacted the price of the Azerbaijan's crude delivered to the Russian Black Sea port of Novorossiysk. Besides Azeri Light, the high-quality sweet and light type of crude sold at a premium to the Brent global benchmark price, Azerbaijan also exports a

small portion of its crude under Urals brand. (Figure 1) However, as the Black Sea route currently incurs a war risk premium, the Russia-associated Urals crude blend at the port of Novorossiysk has been traded at steepest discounts (Valiyev, A., Alili, A., & Namazova, F., 2022). Thus, Ural's average price for the first week of August was around \$64 per barrel, while Azeri Light averaged at around \$100 per barrel for the same period (Trend.az, 2022). Azerbaijan is able to export all of its Novorossiysk oil via other outlets but keeps the Black Sea route alive due to diversification considerations. In 2021, the country exported 27.1 million tons of oil, (AzerNews, 2022) with only 1.7 million tons of oil transported through the Baku-Novorossiysk pipeline (AzerNews, 2022).

Figure 1. Weekly review of Azerbaijan's oil market for August 1-5, 2022

Weekly review of Azerbaijan's oil market for August 1-5, 2022

Oil grade/date	August 1, 2022	August 2, 2022	August 3, 2022	August 4, 2022	August 5, 2022	Average price
Azeri LT CIF	\$105.97	\$104.57	\$102.19	\$96.61	\$98.45	\$101.56
Azeri Light FOB Ceyhan	\$103.81	\$102.40	\$100.29	\$94.83	\$96.70	\$99.61
Urals (EX NOVO)	\$65.78	\$65.83	\$63.71	\$59.92	\$63.39	\$63.73
Brent Dated	\$107.07	\$106.56	\$103.15	\$97.77	\$101.41	\$103.20

Source: Trend.az

Despite the above-mentioned negative implications of the war in Ukraine for crude supplies through the mentioned pipelines, Azerbaijan's energy industry, as the economy overall, certainly stands to benefit from the recent geopolitical developments. With hydrocarbons accounting for around 90% of all exports and 60% of the government budget, (iea, 2021) high energy prices, reinforced by the intensified fighting, have provided a windfall to Azerbaijan's fiscal and external balances. Azerbaijan's economy is projected to grow by 2.7 percent in 2022, up from 2.3 percent predicted earlier. In July, given the high energy-price market environment, the 2022 budget was revised with the oil price now assumed at \$85 per barrel, versus \$50 per barrel set previously (Trend.az, 2022). At the end of July 2022, a barrel of Azeri light costed well over \$110. According to the updated forecasts of the approved state budget of Azerbaijan for 2022, revenues are set at 29 billion 197 million 800 thousand AZN, expenses - 32 billion 303 million 800 thousand

AZN. Therefore, comparing to the previous budget forecast, revenues should increase by 2 billion 381.8 million AZN or 8.9%, and expenditures by 2 billion 424.8 million AZN or 8.1% (Turan, 2022).

High natural gas prices in Europe have also brought significant economic dividends to Azerbaijan as it has recently started to supply gas to EU via the Southern Gas Corridor (SGC). SGC is a 3,500-kilometer chain of three interconnected pipelines traversing seven countries to deliver natural gas from Azerbaijan's Shah Deniz field in the Caspian Sea to European markets for the first time in history. After seven years in making, SGC became operational on 31 December 2020. The corridor's route from Azerbaijan to EU markets consists of three pipeline projects: the South Caucasus Pipeline (SCP) and its expansion (SCPX), the Trans-Anatolian Natural Gas Pipeline (TANAP), and the Trans Adriatic Pipeline (TAP). Via the Trans Adriatic Pipeline (TAP), the corridor's European leg, Azerbaijan can currently supply 10 billion cubic meters (bcm) to Europe annually, providing 8 bcm to Italy, and 1 bcm each to Greece and Bulgaria.

Brussels's ambition to wean itself off Russian energy imports, as stated in the EU's new energy strategy REPowerEU, is also good news for Baku. As Europe seeks to diversify away from Russia, the strategic role of Azerbaijan and the Southern Gas Corridor only increases. The Memorandum of Understanding (MoU) on Strategic Partnership in the field of Energy, signed between Azerbaijan and EU on 18 July 2022 is another example for this. To be noted that a key message of the new Memorandum is the intention to double Azerbaijan's gas exports via the Southern Gas Corridor to the EU by 2027.

However, Azerbaijani economy is expected to be adversely impacted by the war between Russia and Ukraine through potential loss of market for Azerbaijan's non-energy exports, access to vital imports, inflation, and the loss of assets (Ramazanov and Bogdan, 2022). Being one of the main destinations for Azerbaijani non-oil exports with 32 % share of total non-oil/gas exports, any disruption in Russian market impacts Azerbaijani economy (SSC, 2021). There are potential risks to food security, especially among the poor and vulnerable communities, considering Azerbaijan's reliance on wheat imports from Russia and Ukraine. In addition, surging food prices globally will add burden on domestic inflation rates. Beyond this, despite the growth of the economy (GDP) by 6.8% (for the first three months) of 2022, the country still struggles with global economic downturn. The war and constant growth of prices is haunting the country. The growth of oil and gas prices has increased the income of Azerbaijani budget allowing it to fulfill the plan. There is

confidence that the Azerbaijani economy is growing and is free from serious macroeconomic risks. The rating agencies have different opinion. There is a simple explanation for this: the country's economy is oil-oriented, and oil prices have been exceeding \$100 per barrel for weeks. To a large extent, this growth was due to an unprecedented increase in the price of oil (10.1%) and growth in gas exports to Europe (65%).

Also, most Azerbaijani immigrants working in Russia and Ukraine are either single or married yet left their family in their home country. According to recent World Bank data, Azerbaijan received more than 62% of its total remittance inflows from Russia in 2021 (Ratha and Kim, 2022). In 2020 remittances were the equivalent of 3.3% of total GDP of Azerbaijan. According to the Central Bank of Azerbaijan data for 2021, about 60% of remittances came from migrants living in Russia which amounted to \$680 million. Even though remittances constitute a marginal share of Azerbaijani GDP, they still represent a significant part of the disposable income of Azerbaijani rural families. With the currently created situation, there is a risk of the loss of these inflows and increase of poverty rate in the country.

Additionally, it should be noticed that the income of the budget is not distributed evenly and hardly affects the citizens. Consequences of price growth and supply chain disruptions are felt especially in the poorest and vulnerable segments of Azerbaijan. Along with these, the pressure on the ruble, banking restrictions on foreigners and — in the long run — the collapse of the labor market in Russia have an economic and social impact on Azerbaijan. Perhaps, the war impacts everyone nevertheless, the poorest and vulnerable people are the ones who suffer the most. The depth of the social and economic impacts of the war on Azerbaijan of course depends on how long the war lasts, and the scale of the devastation and disruption that it causes.

Moreover, increasing prices of imported products is worrisome for the large segment of population. In other words, increased oil prices cannot offset the growth of prices felt by larger sectors of population. Some Azerbaijani exporters even suspended their activities, as they did not know how to build their pricing policy against the backdrop of noticeable fluctuations in the ruble exchange rate. As the World Bank report states, wheat prices have risen in price by 30%, fertilizer by 35-40%. As a result, it affected the agriculture sector significantly since the supply chain has been affected too.

Furthermore, increasing prices of imported products is worrisome for the large segment of population. In other words, increased oil prices cannot offset the growth of prices felt by larger sectors of population. Food prices are forecasted to continue growing, as disruptions to global commodity markets linger. Worse 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.

Policy Recommendations and Conclusion

Taken into consideration the current situation, Azerbaijan does not have many options to change situation on oil/gas markets toward stabilizing the prices. Nevertheless, Baku has abilities to mitigate the impact of war on Azerbaijan especially, in price control and poverty reduction. The following policy recommendations are necessary for stabilizing the socio-economic conditions in the country.

1. Expand Targeted Social Assistance to the vulnerable group of people that suffered from the socio-economic situation created after the war. The government could compensate the poor strata of population the losses incurred from remittances decrease. TSA could be increased to help this category of people to improve their condition.
2. Encourage trans-border movement and trade, especially in the borders with Russia and Iran. For this, the government of Azerbaijan should open the border and ease movement of people in the border regions for increasing their income-generating abilities.
3. Decrease the fee of money transfers from Russia to Azerbaijan. Today, many companies such as Zolotaya Korona, Western Union and others charge high fees for transfer of money. Government of Azerbaijan could encourage local banks to decrease the fees for money transfers for helping to increase remittances from Russia and Ukraine to Azerbaijan. \
4. Support local agricultural firms with subsidies for faster replacement of imports with local products.
5. Control prices and inflation. The government of Azerbaijan should establish committee/commission for monitoring inflation and price increases and have strategy for price control.

Considering current position of Azerbaijan, it enjoys benefits and maneuvering possibilities in the political arena. With the wise and careful tactics, the country can focus on the development and fight with socio-economic consequences of the war. By focusing on the provision of social assistance, encouragement of the trade as well as support to agricultural sector, Azerbaijan could overcome the existing socio-economic disruptions and proceed with further development in this direction.

Reference List:

Azerbaijan Amid the Ukrainian Crisis: Perceptions, Implications and Expectations – 2022

Valiyev, A., Alili, A., & Namazova, F. (2022). Azerbaijan Amid the Ukrainian Crisis: Perceptions, Implications and Expectations. *Caucasus Analytical Digest*, 130, 16–21. <https://doi.org/DOI: 10.3929/ethz-b-000579582>

AzerNews. (2021, September 12). Retrieved from Azerbaijan, Kazakhstan eye boosting trade cooperation: <https://www.azernews.az/business/183134.html>

AzerNews. (2022, January 5). Retrieved from SOCAR boosts oil transportation via Novorossiysk: https://www.azernews.az/oil_and_gas/187685.html#:~:text=The%20State%20Oil%20Company%20of,through%20the%20Baku%2DNovorossiysk%20pipeline.

AzerNews. (2022, July 25). Retrieved from Azerbaijan exports 12.9m tons of oil in 1H2022: https://www.azernews.az/oil_and_gas/197188.html

AzerNews. (2022, June 7). Retrieved from bp halts pumping oil via Baku-Supsa pipeline: https://www.azernews.az/oil_and_gas/195023.html#:~:text=bp%20has%20halted%20pumping%20oil,%2DSupsa%20pipeline%20%22temporary%22.

Eurasianet. (2022, June 6). Retrieved from Ukraine war forces closure of Azerbaijani oil export pipeline: <https://eurasianet.org/ukraine-war-forces-closure-of-azerbaijani-oil-export-pipeline>

Finding sanctuary from war in Azerbaijan. (2022, October 22). Chaikhana.

<https://chaikhana.media/en/stories/1388/finding-sanctuary-from-war-in-azerbaijan>

Kornely Kakachia, Anar Valiyev, Hanna Shelest, Bidzina Lebanidze, Maksym Khylyko, Ahmad

Alili, Salome Kandelaki, “Black Sea Security after the Russian invasion of Ukraine: Views from Ukraine, Georgia, and Azerbaijan,” Policy Paper No. 31, Georgian Institute of Politics, September 2022.

Ramazanov and Bogdan. (2022, March). *AZERBAIJAN MONTHLY ECONOMIC UPDATE – MARCH 2022*. Retrieved from worldbank.org:

<https://thedocs.worldbank.org/en/doc/e8e43c0df11998f62e273514cbc9a8bf-0080012022/original/AZE-Monthly-Economic-Update-March-2022.pdf>

Ratha and Kim. (2022, March 4). *World Bank Blogs*. Retrieved from Russia-Ukraine Conflict:

Implications for Remittance flows to Ukraine and Central Asia:

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

SSC. (2021). *State Statistical Committee of the Republic of Azerbaijan*. Retrieved from State Statistical Committee of the Republic of Azerbaijan:

<https://www.stat.gov.az/source/labour/?lang=en>

SSC. (2021, November 16). Retrieved from The foreign trade of Azerbaijan:

<https://www.stat.gov.az/source/trade/?lang=en>

SSC. (2022, June 17). Retrieved from Macro-economic indicators and social development of the country (January-May, 2022):

<https://www.stat.gov.az/news/macroeconomy.php?page=1&lang=en>

Turan. (2022, June 22). Retrieved from Thanks to high oil prices, state budget revenues will increase by 8.9%:

https://www.turan.az/ext/news/2022/6/free/finance_news/en/6318.htm/001

Valiyev, A. (2021, August 23). Karabakh After the 44-Day War: Russian Peacekeepers and Patterns - PONARS Eurasia. <https://www.ponarseurasia.org/>.

<https://www.ponarseurasia.org/karabakh-after-the-44-day-war-russian-peacekeepers-and-patterns/>

Valiyev, A., & Yagubova, I. (2022, August 30). *Azerbaijan's Strategic Patience in a Changing*

World. www.cacianalyst.org. <https://www.cacianalyst.org/publications/feature-articles/item/13730-azerbaijan%E2%80%99s-strategic-patience-in-a-changing-world.html>

World Bank, 2021.

<https://www.worldbank.org/en/news/press-release/2021/11/17/remittance-flows-register-robust-7-3-percent-growth-in-2021>