



Why the Poor are Most Vulnerable to Trade Barriers in Azerbaijan

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Introduction

In Caucasus Barometer 2013, when respondents were asked that “what do you think is the most important issue facing Azerbaijan at the moment?”, they subsequently put in order unsolved territorial conflicts (38%), unemployment (25%), poverty (8%), corruption (7%), low wages (7%), low pensions (5%), rising prices or inflation (2%), low quality of education 2 (%). However, when they have been asked to identify the second most important issue facing the country, respondents put unemployment to first place (20%) and poverty to the second place (15%)¹. This indicates that relative poverty and unemployment still occupy the domestic public discourse widely in Azerbaijan. World Bank’s study indicates that “while the drop in poverty has been greatest in Baku, it has been almost equal in other urban and rural areas. There is estimation that every percentage decline in economic growth rates is pushing an additional percentage of people into poverty also driven by high food and fuel prices.

Trade-poverty Nexus

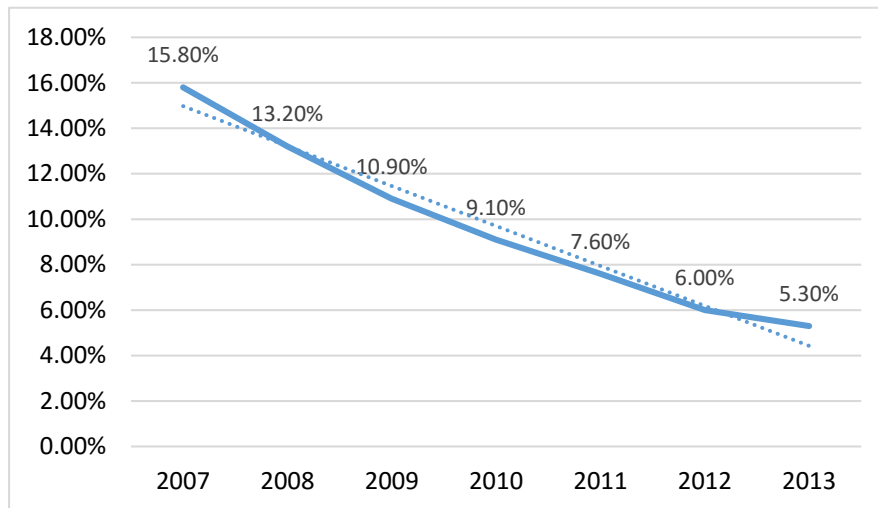
Existing literature on trade-poverty nexus have evaluated the impact of trade openness linking trade growth to economic development outcome.² Ad Valorem Equivalent (AVE) tariffs and non-tariff barriers are major components of barriers to trade. It is estimated that non-tariff barriers harmed the poor even to a greater extent than tariffs. Thus, openness to trade is an important contributor to growth and that growth associated with trade liberalization is as pro-poor as it is to growth.³

¹ <http://caucasusbarometer.org/en/cb2013az/IMPISS2/> (2014)

² <http://www.oecd.org/site/tadicite/50288623.pdf> (2014)

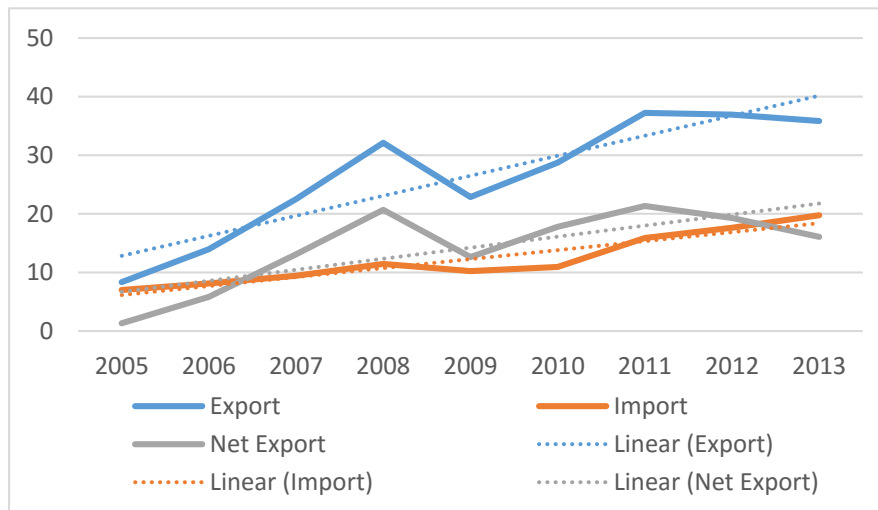
³ Paolo Giordano, Kun Li “An Updated Assessment of the Trade and Poverty Nexus in Latin America”, Inter-American Development Bank, OECD Policy Priorities 2012 (p.355)

**Figure 1: Poverty Headcount Ratio at National Poverty Line
(% of Population) in Azerbaijan**



Source: World Bank's meta-data

Figure 2: Trade Growth in Azerbaijan 2005-2013, in Billion US Dollars



Source: World Bank's meta-data

Growth in trade in Azerbaijan over the past five years has significantly reduced poverty headcount ratio at national poverty line established by World Bank. In 2007 the poverty headcount rate in Azerbaijan was 15.80%, which means 15.8 out of 100 people live below \$1.25 a day at the international prices of the same year. The poverty headcount rate has reduced by almost 10% over the past five years. Until 2013, only 5.30 people 100 people are still living below poverty line. Despite that other economic policies might have played a role in reducing poverty rate, growth in trade have played a critical role in lifting the poor out of poverty. Different studies have also found

a strong correlation between growth in trade and poverty reduction through changes in institutions, domestic prices and border prices, household behaviors and labor markets. (Figure 1,2)

Cost of Trade Barriers in Azerbaijan

Azerbaijan's average tariff rate is 4.5 percent. Although the country is working to improve its customs procedures, inefficiencies with its regulatory system still significantly undermine trade and investment. Trade financing is operated through banks which hold about 95 percent of total financial-sector assets (but Azerbaijan's financial penetration rate remains one of the lowest in the region and capital markets are dominated by government securities). Non-tariff barriers have significantly increased time and cost of trade. Situations vary from year to year, generally speaking, more trade barriers also affect people's well-being through employment, inflation and spill-over effects.

According to the Doing Business report for Azerbaijan (2014-2015), exporting a standard container of goods on average⁴:

- a) requires 9 documents*
- b) takes 27.0 days*
- c) costs \$3460*

Importing the same container of goods to the country on average:

- a) requires 11 documents*
- b) takes 25.0 days*
- c) costs \$3450*

Azerbaijan stands at 166 out of 189 economies on its performance in ease of trading across borders. The rankings for comparator economies and the regional average ranking provide other useful information for assessing how easy it is for a business in Azerbaijan to export and import goods. World Bank collected information on the required documents, time and associated cost to

⁴ <http://www.doingbusiness.org/data/exploreeconomies/azerbaijan> (2014-2015)

complete export and import from local freight forwarders, shipping lines, customs brokers, port officials and banks. Compare to its neighbouring countries, the associated cost for trading standard shipment of goods are relatively high in Azerbaijan.

Table 1: Cost to Trade in Azerbaijan

Type of barriers	Exports		Imports	
	Time (days)	Cost (US\$)	Time (days)	Cost (US\$)
Customs clearance and inspections	3	425	3	425
Documents preparation	15	635	14	625
Inland transportation and handling	7	2,100	6	2,100
Ports and terminal handling	2	300	2	300
Totals	27	3,460	25	3,450

Source: World Bank Doing Business Report 2015

Changes in Income and Industry Structure

Both income structure and industry structure are changing due to “earning-side impacts over consumption impacts”. According to the “Caucasus Barometer 2013” survey, many households obtain income from several sources and it is indicated that 25% of household (HH) incomes are from sales of agricultural products.⁵ Household income is classified as income from employment, self-employment, agriculture, rent, property, current transfers (received pensions benefits, social contributions, social transfers in kind), other households’ money and that received from abroad. This official classification doesn’t include or aggregate income from small, usually unofficial trade which plays crucial role for households living in Baku and especially, in the border regions which are mostly affected by various border controls during import of goods from neighbour countries.

Official statistics have indicated a rise in per capita income of average households in Azerbaijan. Per capita income of households per month increased from 29.1 AZN in 2001 to 214.7

⁵ Caucasus Barometer is the annual household survey about social economic issues and political attitudes conducted by CRRC for three South Caucasus countries including Azerbaijan (fieldwork dates for 2013 survey: 5 November 2013 – 14 December 2013) <http://caucasusbarometer.org/en> (2014)

AZN in 2013.⁶ In 2014, total income reached 33.6 billion AZN, increased by 4.7% from 2013. Average monthly income per capita amounted to 3573.3 AZN or 324.8 AZN. Growth of per capita income was 3.4%, exceeding the rise of consumer prices by 1.9 percentage points. In 2014, 69.5% of income was spent on consumer goods, 9.1% on payment of taxes, social insurance and voluntary membership fees, 2.6% for the payment of interest on loans, and 18.8% - on the charges which indicate still a robust consumers' market⁷.

Trade has also generated a remarkable growth in jobs. Employed labour force in trade sector (number of employed population by statistical Classification of Economic Activities) increased by 52 thousands from 612 thousands in 2000 to 664 thousands in 2013.⁸ This figure is equivalent to 15% of the economically active population. This portion jobs is directly affected by fluctuations in of trade regulations. According to "Caucasus Barometer 2013" survey for Azerbaijan, only 7% of employed respondents indicated wholesale and retail trade as primary employment sector while most people remain in trade related to education, construction, agriculture and other industries.

Table 2: Primary Employment Sector in Trade by %

<i>Year</i>	Agriculture, hunting and forestry	Wholesale and retail trade, repairing	Education	Construction	Other
2008	14	7	12	7	56
2009	5	6	21	13	53
2010	12	8	15	12	52
2011	13	8	14	14	51
2012	18	7	16	11	47
2013	13	7	18	10	51

Source: State Statistics Committee of Azerbaijan

Scholars widely agree that industrialization leads to economic growth and alleviation of poverty. As more people move from the agricultural sector and into the industrial sector, they receive regular wage-jobs, become more educated, and become free from poverty. Currently, the Azerbaijani economy mainly relies on agriculture. Trade, however, has caused a growth in industry and an upward movement of individuals who were previously poor into regular-wage industrial jobs. As seen in the table below, employment in agriculture has decreased by 1.6 percent, while

⁶ http://www.stat.gov.az/source/budget_households/indexen.php (2015)

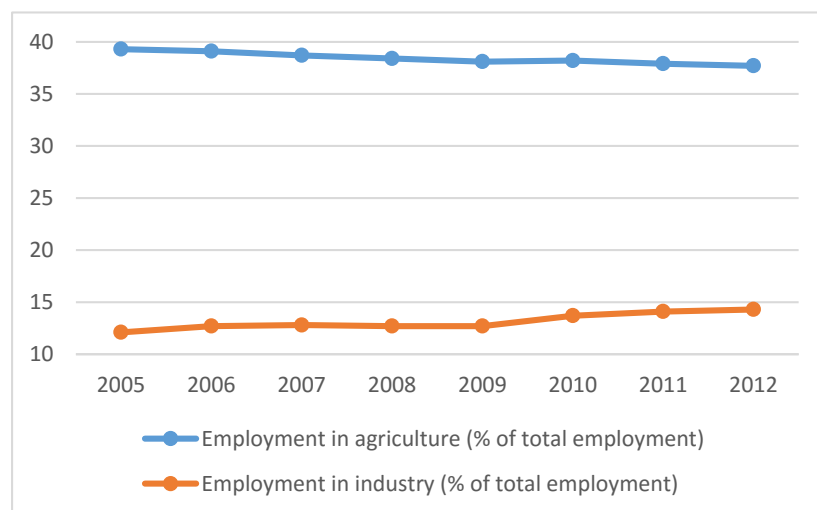
AZN – manat is a local currency of Azerbaijan.

⁷ <http://www.news.az/articles/economy/94335> (2014)

⁸ <http://www.stat.gov.az/source/labour/indexen.php> (2014)

employment in industry has grown by 2.1 percent from 2005-2012, when we began examining the trade data above. The growth of trade presented at the beginning of this study has caused a shift in employment to the industrial sector, and a secure way for some individuals out of long-term poverty. (See Chart 3)

Chart 3: Employment by Sector, Azerbaijan

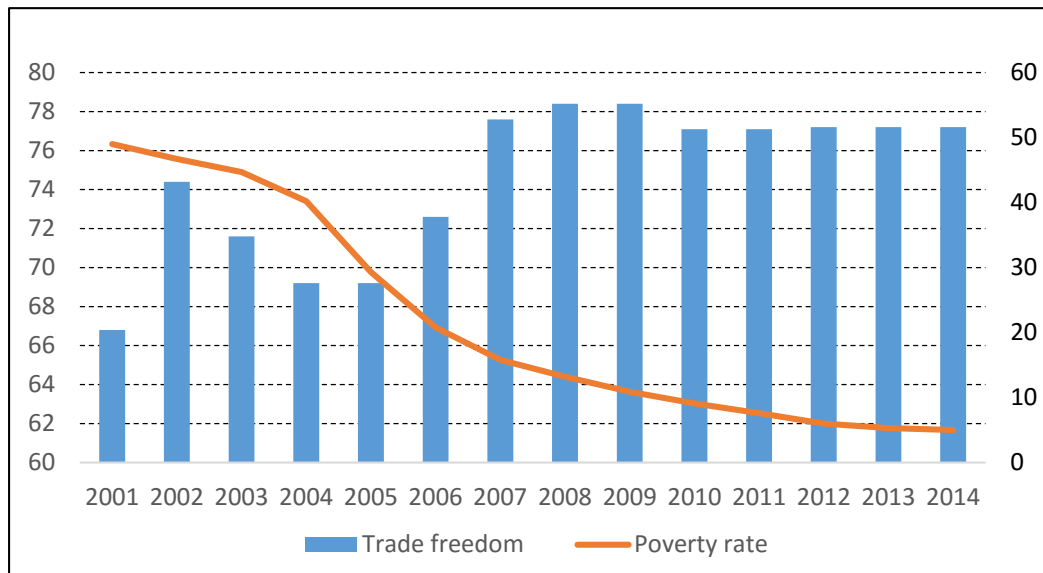


Source: World Bank's Meta-data

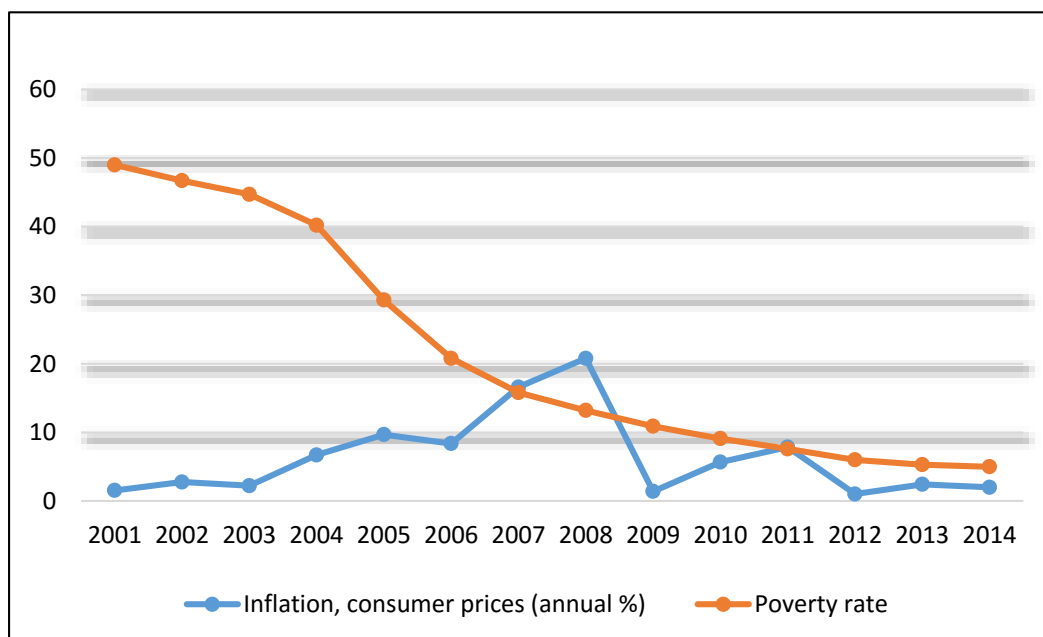
Trade Freedom, Inflation and Poverty Reduction

In the case of Azerbaijan, poverty reduction is also associated with a low inflation rate, however, this is only macro-perspective to the problem. In reality, according to studies done by international organizations “price controls are in effect for most energy products, and monopolies, limits on imports, and agricultural subsidies also cause distortions in domestic prices”⁹. Especially, during mid 2000’s, it was often circulated that continuing existence of monopolies has demolished business environment and created very high barriers for the competitive pricing.

⁹ <http://www.heritage.org/index/country/azerbaijan> (2014)

Chart 4: Trade freedom versus Poverty

Source: World Bank's Meta-data

Chart 5: Poverty versus Inflation

Source: World Bank's Meta-data

Trade freedom contributed significantly to the elimination of absolute poverty, while relative poverty continued to exist even during the economic boom. Poverty reduction was accompanied by removal of some trade barriers in Azerbaijan. During last 12 years (2003-2015) poverty has fallen due to several factors which contributed to poverty reduction: (Chart 4, 5)

- (1) higher minimum wage,
- (2) higher average wages in the economy,
- (3) significant transfers to households based on the government's social programs,
- (4) remittances from abroad, especially from Russia¹⁰.

Conclusion and Recommendations

Some policy reforms have carried out, particularly in the areas of (i) “reducing the clearance and border crossing time for goods by streamlining and regrouping agencies behind a single customs service window; and (ii) to made trading across borders easier by streamlining internal customs procedures”.

Azerbaijan applied for WTO membership in 1997, however, has not concluded the negotiation. Azerbaijan has established trade relations with EU through the *Partnership and Cooperation Agreement* which was issued since 1999. The country is also a partner of the EU in the framework of the European Neighborhood Policy. Despite that Azerbaijan is not yet a WTO member, the negotiation process in general has pushed forward reforms in the areas of customs valuation, rules of origin, sanitary rules and technical barriers to trade policy, public procurement, and subsidies.

In order to further liberalizing trade in Azerbaijan and continue to leverage trade growth as a way to reduce poverty, we recommend government to consider the policy changes:

- To mitigate cross-border trade rules and control mechanisms in order to promote social-economic wellbeing in border districts and nationwide.
- To improve tools to facilitate trade including single windows for all operations, risk-based inspections and electronic data interchange systems, while these changes can improve the trading environment and boost firms' international competitiveness.

¹⁰ <http://documents.worldbank.org/curated/en/2009/12/11620676/azerbaijan-country-economic-memorandum-new-silk-road-export-led-diversification> (2014)

- To implement new reforms in customs and trade facilitation in both land-border and sea ports crossings, and gradually move towards a more open, modern, computerized and risk-based, clearing process, which lead to lower inspections.
- To continue to push forward the accession to WTO, Azerbaijan can expect to start negotiations on a deep and comprehensive free-trade agreement with the EU, which will make possible further reforms such as
 - a) *further reduction of import duties and elimination of quotas and licenses*
 - b) *approximation of trade rules (such as rules of origin, trade remedies) to the WTO and EU norms and practices,*
 - c) *changes in general economic policies (in the spheres of technical regulation, sanitary control, public procurement, subsidies, intellectual property rights protection).*