AZERBAIJAN IN THE EURASIAN ECONOMIC UNION

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RUSSIA

BELARUS

KAZAKHSTAN

ARMENIA

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Azerbaijan in the EAEU: The devil is in the details

Despite the economic difficulties associated with the Covid-19 pandemic, the Eurasian Economic Union (EAEU) continued to expand its international trade connections in 2020 and some countries even consider future membership in the organization as a possible way out of the current socio-economic impasse. The EAEU already has free trade agreements with Serbia, Singapore, and Vietnam and negotiations on updating the existing temporary FTA with Iran to a permanent one has long been underway. According to Deputy Foreign Minister of Russia Alexander Pankin, a draft FTA with Egypt and Israel is almost ready for further discussion and joint research groups are currently working on the feasibility of signing FTAs with Indonesia and Mongolia.1

Moreover, Uzbekistan (an observer state) and Tajikistan may soon join the union as the easier access to a market of about 170 million people would to some extent relieve the pressure on local economies. As Uzbekistan’s President Shavkat Mirziyoyev mentioned, the trade with the union accounts for 70% of the country’s total trade and free movement of goods and services would increase the export of locally-produced high-quality products to the member state markets.2 Tajikistan’s Minister of Economic Development and Trade Zavqi Zavqizoda noted that Bishkek has been studying the positive and negative results of other countries’ membership in the EAEU and the final decision will be made only after a comprehensive analysis.3 Similarly, Azerbaijan’s ambassador to Russia Polad Bulbuloglu said that Baku shares the EAEU countries’ interest to be in the common economic space but its possible membership in the organization may take some time. Back in 2014, when Russia’s then Minister of Economic Development Alexei Ulyukayev invited Azerbaijan to join the soon-to-be-launched Eurasian Economic Union, his Azerbaijani counterpart declared that integrating into the EAEU or the EU is not in Azerbaijan’s plans “since these projects do not only have economic components but also political implications as well”.5 Afterwards, Azerbaijani leadership gradually shifted the emphasis to the occupation of its territories by Armenia as the major obstacle on the road to accession.

Baku’s procrastination with regard to membership in Russia-led integration projects will take a new form after the country’s victory in the Second Karabakh War and the signing of a peace agreement with Armenia in November 2020. The new geopolitical configuration in the wider Caspian basin with Turkey emerging as an assertive player in regional affairs and Russia consolidating its grip over Armenia and to a lesser extent over Azerbaijan presents both challenges and opportunities for Baku to promote regional cooperation and reap the benefits of new
transportation projects which are expected to bolster its position as a trade hub between the neighboring major powers. On the one hand, the opening of trade corridors with Armenia may further tie Azerbaijan to the EAEU market as Iran, Russia, Kazakhstan, and Armenia will use Azerbaijani territory too to have access to the common economic area. According to Azerbaijan State Customs Committee statistics, Russia is Azerbaijan’s leading import partner (16.8%) and accounts for more than 87% of Baku’s total trade turnover with the EAEU. Although Azerbaijani leadership declined the Russian proposal to join the Commonwealth of Independent States Free Trade Area in 2012 (the only CIS country to do so), it has free trade agreements with the other EAEU members (Kazakhstan, Kyrgyzstan, Belarus) except Armenia.

On the other hand, the EU keeps its status as the major trade partner of Azerbaijan. The trade with the union accounted for 38.8% of Azerbaijan’s total trade turnover in 2019 while Russia’s share stood at 9.1%. In the same period, 53.5% of Azerbaijani exports went to the EU countries and 17.8% of imports came from there. Bilateral trade is expected to get a boost in 2021 as Azerbaijan started direct transport of commercial gas from its Shah Deniz field in the Caspian Sea through the Trans-Adriatic Pipeline (TAP) to the European market. TAP connects with 878-km-long Trans-Anatolian Natural Gas Pipeline (TANAP) - the other leg of the Southern Gas Corridor project - in the Turkish-Greek border in Kipoi, passes through Greece and Albania before coming ashore in Southern Italy. The pipeline started to work with a 10 bcm/year capacity and it can be increased up to 20 bcm/year in the future. Azerbaijan’s government also continues negotiations with the EU on signing a new partnership agreement in 2021 that may give a new impetus to the economic cooperation between the two sides.

Deepening military-economic cooperation with Turkey will be another crucial factor to watch in Azerbaijan’s economic alignment policies in the coming months. Preferential trade agreement between Ankara and Baku was signed in February and came into force from March 2021. According to Turkey’s Trade Minister Ruhsar Pekcan, Turkey is interested in upgrading the current framework into a free trade agreement in the near future. Turkey is Azerbaijan’s second-largest trade partner and Russia’s main rival in imports to the Azerbaijani market.

The Turkish companies’ active involvement in the reconstruction of Nagorno-Karabakh after the devastating war in the region and Baku’s increasing preference for Turkish weapons to modernize its armed forces in line with the Turkish army may further entrench Turkey’s military and economic presence in Azerbaijan.
Adding China’s gradually more active involvement in the industrialization of South Caucasus economies makes the picture more complex. Since 2018, Chinese companies invested heavily in Azerbaijan’s non-oil sector, among others, a $1.5 billion industrial park at Alyat port, a $1.17 billion integrated steel mill complex in Ganja, and a $300 million tyre plant in Sumgait. After Russia and Turkey, China is Azerbaijan’s third-largest (10.5%) import partner. Interestingly, Azerbaijan’s closer economic relations with the EU, Turkey, and China may come at the expense of Russia’s position in the country and negatively affect the Aliyev government’s calculations about the pros and cons of joining Russia-led regional integration projects in general, and the EAEU in particular.

Disadvantages of the EAEU membership

When Russia, Kazakhstan, and Belarus came together to launch the Eurasian Economic Union in 2015 (Armenia and Kyrgyzstan joined later the same year), it was only one of the many attempts they had made in the last two decades to establish a customs union. Previously, the Customs Union (1995-1999) and the Eurasian Economic Community (2000-2014) could not achieve the full implementation of common external tariffs with the non-member countries mainly due to the unwillingness of authoritarian leaders to cede a part of their control over
domestic economy to the supranational institutions. Azerbaijani leadership has had similar concerns during negotiations on the country’s possible accession into the World Trade Organization (WTO), the EU Association Agreement (DCFTA), or the EAEU as the eventual economic liberalization would disturb the rather fragile balance of interests in the national economy, subject to a large degree of monopolization. The opening of the domestic market to external competition would challenge domestic monopolies and risk further foreign (Russian) presence at the expense of the local vested interests.

Besides, the general trends in Azerbaijan’s trade with the EAEU and non-EAEU countries indicate that entering into the customs union with Russia, Kazakhstan, Belarus, Armenia, and Kyrgyzstan would negatively affect Baku’s economic ties with its major trade partners (the EU and Turkey) due to higher external tariffs. Azerbaijan would trade less with the rest of the world and more with Russia and the other EAEU members, resulting in less imported technology from the more technologically advanced trade partners such as the EU and China. The EAEU accession would increase the price of equipment and materials which Azerbaijan currently imports with zero tariffs (12% of imports), negatively affecting the competitiveness of local producers. Oil and natural gas comprise more than 80% and 10% of Azerbaijan’s exports to the global economy, respectively, and the driving economies within the EAEU (Russia and Kazakhstan) have been Azerbaijan’s rivals in the market rather than lucrative export destinations in this regard.
Azerbaijan’s exports to the global economy, respectively, and the driving economies within the EAEU (Russia and Kazakhstan) have been Azerbaijan’s rivals in the market rather than lucrative export destinations in this regard. Among the EAEU states, only Russia attracts a significant part of Azerbaijan’s non-oil exports. According to the Center for Analysis of Economic Reforms and Communication report, Russia was Azerbaijan’s major non-oil export partner in 2018 followed by Turkey, Switzerland, Georgia, and Ukraine.¹⁵

The EAEU share in Azerbaijan’s total trade turnover is 10.5% and Azerbaijan has a trade deficit with all the member countries except Armenia. As the other EAEU countries, Azerbaijan recorded a comparably higher deficit in exchanges with Russia amounting to $1.6 billion in 2019. According to some estimates, while the membership in the organization would increase Azerbaijan’s exports (fruits, vegetables, wine) to the EAEU, it would add another $216 million to the trade deficit with Russia as the local products would find it difficult to compete with the Russian exports in the domestic market.¹⁶ This was what happened to Kazakhstan when it joined the Customs Union in 2010. Although Kazakhstan’s exports to Russia increased about 2%, Russian exports grew by 10% and the share of the EU imports to the country declined from 29% to 20%. Similarly, Armenia incurred a trade deficit with Russia equal to about 1% of its GDP after the accession to the customs union in 2015.¹⁷ To this, one may add the lower trade exchanges between the member states, excluding Russia. Accordingly, the volume of the trade between Russia and Belarus in 2020 made up more than half (52%) of the total trade among the EAEU member states for the first time since the creation of the union in 2015.¹⁸ Or in 2017, Armenia’s trade turnover with Kyrgyzstan was so insignificant that appropriate data was not introduced in the country’s official foreign trade statistics.¹⁹

Baku’s accession into the EAEU would also make it vulnerable to slowdowns in the Russian economy emanating from the Western economic sanctions, falling oil prices, or lately, the COVID-19 pandemic. That said, the depreciation of the Russian rouble after the Ukraine crisis in 2014 led to the flooding of cheaper Russian goods into the member state markets in 2015 that rendered the domestic products uncompetitive vis-à-vis the depreciated Russian goods and inflicted certain economic costs on the other EAEU countries.²⁰

Azerbaijan’s agricultural sector that accounts for about 6% of GDP and employs more than 35% of the labor force would face pressure in the case of decreasing tariff rates with the major EAEU
Although remittances from the diaspora have been lower (as part of GDP) in comparison with the other post-Soviet countries, it remains a critical source of income for people living in different parts of Azerbaijan.

Being a non-WTO country, Azerbaijan has a larger room for maneuver to adjust tariff lines to protect the agricultural sector by improving the import taxes and decreasing the trade barriers on tertiary and secondary sectors such as manufacturing and services to keep the overall balance. In this context, Azerbaijan’s membership in the EAEU would mean adjusting its tariff rates with Russian tariffs in line with the latter’s WTO commitments and lead to more liberal tariff rates for agricultural products. Baku’s non-WTO status would make it easier to realize in comparison with the other EAEU countries all of which have WTO membership. For example, as the customs union (Russian) tariff lines were higher than the Kazakh tariffs had been prior to its joining the organization, the sides agreed to grant Kazakhstan a large number of exemptions (3500 tariff lines) that would be gradually phased out till 2024. Similar transitional exemptions were offered to Armenia (800 tariff lines till 2022) and Kyrgyzstan (200 tariff lines 2020). In their turn, all three countries promised to refrain from re-exporting goods that benefited from specified lower tariffs to the rest of the EAEU market during this time.

Joining the EAEU would also have uncertain implications for the Aliyev government’s domestic standing and Azerbaijan’s place in the contemporary international relations system. Although Azerbaijani leadership does not face serious internal constraints over the choice of which international organizations to join, it still has to take into account the Azerbaijani population’s attitude toward Russia, especially, in the context of the Nagorno-Karabakh conflict. While Turkey is viewed as a brotherly nation that greatly contributed to Azerbaijan’s victory in the Second Karabakh War, Russia is seen as a menace on the country’s road to recover its de facto sovereignty over all of Nagorno-Karabakh. At the same time, the Soviet army’s bloody massacre of Azerbaijani people in Baku on 20 January 1990 is still linked to Russia as the colonial oppressor, and hence conceding a part of sovereignty to Russia-led integration projects would be a sensitive issue in domestic politics. Geopolitically, Azerbaijan’s membership in the EAEU would mean punching below its geopolitical weight as it would weaken its pivotal position between the economies. The simple average tariff rate was 4.75% in 2019 but agricultural products faced higher bound tariffs (15% or more) in comparison with non-agricultural imports and raw materials to protect the local producers. The state subsidizes the agricultural sector to a significant degree by direct budgetary support to producers with annual payments per hectare, tax exemptions (except the land tax), and financial assistance for the investors to purchase machinery, fuel, engine oil, and fertilizers.
More importantly, the provisions such as the barrier-free access to transport infrastructure and common rules for the trade in oil and natural gas (e.g. elimination of tariff barriers and export duties) would be something the Azerbaijani government would hardly accept as it would, among others, increase Russia’s influence over Azerbaijan’s energy policy.

Advantages of the EAEU membership

When different states come together to create a common economic space, each member state aims to benefit from access to others’ markets. The strategic rationale behind the integration within the EAEU has been no different in this regard even if some countries’ membership in the union was to a large extent politically (Kazakhstan) or geopolitically (Armenia) motivated. Azerbaijan’s accession into the EAEU would similarly make it easier for export-oriented businesses to find customers abroad and change the circumstances in favor of some stakeholders who own businesses out of the country. The non-oil sector would benefit the way Kazakhstan’s respective economic players did as the common economic area was established in 2015 and the lower trade barriers led to remarkable growth in the export of non-commodities to the other member countries. In the context of the Azerbaijani government’s recent attempts to diversify the economy away from the dependence on oil and gas exports, this aspect of the EAEU membership may look attractive at least in the long term.

At the same time, Azerbaijani citizens would be eligible to live, study and work in the country of choice within the EAEU. In the framework of the free movement of goods and services (Article 1
of the Treaty on the EAEU), the part of the Azerbaijani population not involved in the commercial sector would benefit from the lower prices and increasing quality products thanks to the measures to be taken in the fields of sanitary, phytosanitary, and intellectual property rights. Moreover, joining the EAEU would offer better living conditions for the Azerbaijani labor migrants in Russia whose number is believed to be more than 1 million. Although remittances from the diaspora have been lower (as part of GDP) in comparison with the other post-Soviet countries, it remains a critical source of income for people living in different parts of Azerbaijan. The remittances sent to the country amounted to $1.2 billion in 2019, 2.6% of GDP. Due to the COVID-19 pandemic, remittances from Russia decreased by $80 million in the first 9 months of 2020, a 17% decrease year-on-year. In the early phases of the coronavirus pandemic, hundreds of Azerbaijani labour migrants lost their jobs due to the quarantine measures taken by the Russian government and faced serious difficulties on their return to the country as the border was closed for similar reasons.

Azerbaijan’s EAEU membership would also provide it certain opportunities to strengthen economic relations with China and make better use of its geostrategic location in the heart of the Middle Corridor, known as the Trans-Caspian International Transport Route, starting from China, running through Kazakhstan, Azerbaijan, Georgia, Turkey, and the EU. Baku has been a dialogue partner of the Shanghai Cooperation Organization (SCO) since 2016. In the official declaration ceremony in Beijing, Azerbaijan’s then Foreign Minister Elmar Mammadyarov said that “Azerbaijan would like to go further within the organization.” When it comes to the EAEU, Azerbaijan would benefit from easier access to the Chinese market thanks to the would-be

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![Remittances as part of GDP (percent)](image-url)

(Source: the World Bank)
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regulatory approximation within the EAEU and with the other Central Asian countries (Uzbekistan and Tajikistan) which consider joining the union in the near future. In this context, it is important to note that the EAEU and China started talks to take the first steps towards coupling the EAEU and the Chinese Belt and Road Initiative in 2015. Consequently, the two sides signed a non-preferential trade agreement in 2018 which is expected to “make possible to improve conditions for access of goods to the Chinese market through norms for simplification of trade procedures, increasing the transparency level and improving the level of interaction across all spheres of trade cooperation”.\textsuperscript{30} A Joint Commission has been launched to deepen the cooperation on regulatory harmonization of customs, transit, and digitalization of trade.\textsuperscript{31} Similar arguments could be put forward in the case of Iran’s recent attempts to have a much closer economic partnership with the EAEU and its implications for the Azerbaijani membership in the organization. Iran and the EAEU are planning to sign a free trade agreement in the coming months. In this context, Azerbaijan’s presence in the EAEU would further bolster its position within the North-South Transport Corridor (NSTC) that aims to connect India (South Asia) to Iran and Russia (Northern Europe) via rail, road, and sea routes. Offering an alternative to Georgian railways and ports in the Black Sea, the NSTC provides Azerbaijan direct access to the Persian Gulf and comparative advantage over Armenia’s own regional railway initiative.\textsuperscript{32} Azerbaijan’s restoration of its control over the territories along its border with Iran as a result of the victory in the Second Karabakh War was a significant development in this regard and the opening of new transportation projects engaging the Nakhchivan exclave of Azerbaijan will make deeper partnership proposals more attractive for all sides.

Last but not the least, joining the EAEU would strengthen Azerbaijan’s hand in Nagorno-Karabakh negotiations and at the same time, have a stabilizing effect on the consolidation of the domestic government. In this context, the year 2025 will be a critical juncture as the status of the Russian peacekeepers in Nagorno-Karabakh will expire and the succession issue may emerge during the presidential elections. What kind of concessions the Azerbaijani government would require from Russia in the case of Nagorno-Karabakh remains to be seen. When it comes to presidential succession, Russia has certain leverage in its geopolitical toolbox to influence the direction of events and the Kremlin actually used it to different extents in the past. It has been no secret that Russia was always determined to represent itself as a party interested in the internal political stability in Azerbaijan and has many times covertly signaled its capacities for manipulating it. Currently, the Azerbaijani and Russian leaders view each other as valuable partners on the promotion of peace and stability in the region and a
necessary, though not always favourable, element in preserving the benign regional balance.

In lieu of conclusions

Azerbaijani government stepped up its efforts to broaden its international linkages in recent years and the victory in the Karabakh War will make it more confident in this process. Turkey's growing military and economic support to Baku will afford the latter much larger room for maneuver in the so-called shared neighborhood and help it to engage Russia in a dialogical manner. In this context, Azerbaijan's EAEU membership issue may soon return to the agenda of bilateral relations and the Azerbaijani government will have to go a long way to keep Russia on its side without joining the union. Unlike Uzbekistan and Tajikistan, Azerbaijan has not yet formed a governmental working group to weigh the pros and cons of accession into the EAEU. As the next step, the Aliyev government may consider the creation of such a group and an observer status in the organization. Currently, Moldova, Cuba, and Uzbekistan have observer status in the EAEU which lets them participate in high-level meetings (when invited) and obtain those documents adopted by the Union that do not contain any confidential information.  

Similarly, Azerbaijan's observer status would not lead to any meaningful change in its relations with the EAEU but it might add a positive tone to mutual relations with the neighbor to the north.
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