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EU-Azerbaijani Economic Relations: New Perspectives and Opportunities

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Economic relations between the European Union (EU) and Azerbaijan are currently mainly driven by cooperation in the energy and transport sectors but there is considerable potential for growth both in these and many other areas. In the light of recent events, notably the Russia-Ukraine war and its global consequences, bilateral relations with Azerbaijan will be pivotal for strengthening the EU's energy security and independence, increasing its geopolitical sway in the Caucasus region and beyond, and fostering social and economic development in its eastern neighbourhood. While cooperation in the vital energy and connectivity spheres should be developed further, the EU also needs to foster and strengthen bilateral relations in areas such as tourism, entrepreneurship and civil society. This would offer the EU crucial opportunities to further its economic, strategic and political goals in the region and beyond.

EU-Azerbaijani Economic Relations

Bilateral relations between Azerbaijan and the European Union (EU) are built on principles of equal partnership, mutual benefit and common interest, as well as historically crucial bilateral engagement in the economic sphere underpinned by strategic agreements. The EU is Azerbaijan's main trading partner. Trade turnover exceeded \$15 billion in 2021 and accounted for 44% of the country's foreign trade. The EU continues to be Azerbaijan's biggest export (51%) and second-biggest import (16 %) market, as well as the largest investor in the country with nearly €7 billion in direct investments. Azerbaijan is also the EU's largest trading partner in the region, accounting for 76% of the EU's trade with the South Caucasus. EU imports from Azerbaijan are largely mineral fuels, lubricants and related materials, while exports to Azerbaijan are dominated by machinery and transport equipment.

Azerbaijan gained its independence in 1991, following the break-up of the Soviet Union, and quickly became a strategically important ally for the EU. A politically, economically and strategically important agreement was signed on joint EU-Azerbaijani oil production in the Caspian Sea in 1994. EU relations with Azerbaijan are based on the European Union-Azerbaijan Partnership and Cooperation Agreement of 1999, which aims to enhance economic relations. Azerbaijan has been part of the Eastern Partnership since 2009. In 2017, the EU and Azerbaijan began negotiations on a new comprehensive framework agreement

designed to increase political dialogue, trade and mutually beneficial cooperation in a wide range of economic areas. The EU and Azerbaijan agreed on joint Partnership Priorities to guide and enhance relations in 2018.

Energy

Economic relations between Azerbaijan and the European Union are largely based on the energy and transport sectors. A crucial EU strategy is to ensure energy security through the diversification of energy routes, partly to reduce its dependence on Russia. With its rich energy resources and geostrategic location, Azerbaijan is therefore a strategically important energy partner for the EU and plays a significant role in bringing Caspian energy resources to the EU market.

Azerbaijan and the EU signed a joint declaration on the Southern Gas Corridor (SGC) in 2011. This strategic initiative brings Azerbaijani gas through Turkey to southern European markets such as Italy and Greece. Azerbaijan currently meets 5% of Europe's energy needs through the SGC. There are further plans to export Azerbaijani gas from the Shah Deniz field through the SGC to Austria, Switzerland, Germany and beyond. The SGC is therefore vital to establishing and integrating the European infrastructure for energy transportation.

Recent developments, notably the geopolitical upheaval and energy turmoil in Europe, have only strengthened these trends. The war in Ukraine and its consequences for geopolitics, EU-Russian relations and European energy security have heightened the EU's need to deal concurrently with multidimensional energy problems linked to the security, diversification and sustainability of supply.

In this regard, the EU has supported various energy projects in its efforts to diversify the sources of its natural gas imports. In July 2022, the EU and Azerbaijan agreed to boost their energy cooperation in a *Memorandum on Strategic Partnership in the field of Energy*. This will help mitigate European gas shortages by increasing supplies from Azerbaijan. The agreement is a timely opportunity for the EU to consolidate its energy security through a new gas supplier. It also earns Azerbaijan a larger share of the European market, allowing it to eventually double its supply of gas to the EU. An initial 4 billion cubic metres (bcm) of gas extra annually will increase to an extra 20 bcm annually by 2027.

The EU perceives a number of economic, political and strategic advantages in collaborating with Azerbaijan linked to its geographic location as a producer, and its existing engagement and cooperation through the European Neighbourhood Policy and the Eastern Partnership. Azerbaijan welcomes the fact that political and economic cooperation with the EU will enable it to reach global markets and be recognized as a regional power. Energy cooperation more generally fits well with its own diversification strategy. Energy also plays a key role at the core of Azerbaijan's national sovereignty and is of key importance to global competition. For these reasons, Azerbaijan could become a reliable strategic partner in pursuing the economic, geopolitical and security interests of the EU.

There are also prospects of a contract renewal beyond 2027 as energy demand in Europe is unlikely to decline, which suits the socio-economic development aims of both partners. More gas exported to the EU from Azerbaijan will change the energy map of Europe and the larger Caucasus. This is in line with EU goal of diversifying its energy supply to enhance its energy security. In the memorandum, both parties also express an interest in promoting cooperation in the areas of renewable energy and connectivity, where recent developments in the region have demonstrated an increase in Azerbaijan's potential.^{1,2}

1 https://azertag.az/en/xeber/EU_Azerbaijan_Strategic_Partnership_on_Energy-2227949

2 <https://jamestown.org/program/azerbaijan-and-european-union-ink-deal-on-strategic-partnership-in-energy/>

Transportation

Azerbaijan and the EU share common interests in a number of policy areas and are currently working jointly to upgrade their cooperation efforts. In addition to the energy sector, Azerbaijan's role as a key transportation hub is of particular importance to the EU. The EU and Azerbaijan are also jointly showing a strong willingness to deepen cooperation in the connectivity sector. The key role of the Trans-Caspian International Transportation Route (TITR), or Middle Corridor, and the significance of the opportunities it presents have increased substantially against a backdrop of the disruption to transport routes connecting Asia and Europe through Russia.

Furthermore, the importance of EU-Azerbaijani relations from a regional economic development perspective is not being ignored as the upgrading of communications and connectivity infrastructure receives special attention in the negotiations. Establishing lines of communication is also crucial to providing fertile ground for additional economic and geopolitical benefits from EU-Azerbaijani relations. It also acts as a stimulus for new investment in the region.

In accordance with its Economic and Investment Plan, the EU intends to expand mutual economic relations by establishing an economic advisory platform that will enhance and strengthen the scope for regional relations with other actors in the near future, which is a crucial factor in the economic development, and in increasing the geopolitical relevance, of the region. Market access for Azerbaijan's products in Europe is expected to increase. Azerbaijan's trade fleet is the biggest in the Caspian region, and its operational seaport, modern infrastructure, shipbuilding yard and rail network will provide connectivity and allow trade with Europe and other adjacent regions.

Other Cooperation Areas: Tourism, Entrepreneurship and Civil Society

Beyond energy and trade, there are also good prospects for EU-Azerbaijani cooperation in other economic areas. The EU is seeking to support Azerbaijan's economic diversification through the negotiation of a new agreement with Azerbaijan and its accession to the World Trade Organization (WTO). EU assistance comprises policy dialogue and support for Azerbaijan's economic modernization by strengthening youth education, entrepreneurship and regional development.

Of the areas for mutual cooperation, the tourism industry is a key focus area for cooperation. Sustainable tourism is set to be a crucial economic driver in Azerbaijan, particularly following plunging oil prices, as a way to diversify the national economy. It is also a sector that promotes investment and development, and can act as a bridge between people in Europe and Azerbaijan and in people-to-people contacts. In the first quarter of 2022, 10 per cent of the tourists arriving in Azerbaijan were Europeans.

The development of entrepreneurship in Azerbaijan is one sector where the EU intends to support the government by awarding grants, investing in a number of projects and promoting economic growth in rural areas. Education is another sphere mentioned as a key partnership and cooperation area. Beyond energy, transportation and state level cooperation, civil society organizations should not be overlooked. They play an undeniably significant role in the implementation of reforms and in the process of fostering EU-Azerbaijani integration beyond energy.

Policy Recommendations

- The EU should continue to develop its energy cooperation with Azerbaijan to enable it to increase its geopolitical influence in the region, reduce its energy dependence on Russia, diversify its energy sources, and ensure energy sustainability and security.
- In order to promote economic development in the Caucasus, and improve its geopolitical, economic and normative reach in the regions beyond, the EU should step up its cooperation with Azerbaijan in the areas of transportation and connectivity.
- For mutual benefit, the scope of EU-Azerbaijani cooperation should be widened to non-oil sectors such as tourism, education, renewable energy and civil society.
- The export potential of Azerbaijan's small and medium-sized enterprises should be further enhanced and their access to the European market accelerated, for example by implementation of capacity building programmes.
- EU support for and cooperation with Azerbaijan on WTO accession negotiations should be accelerated.
- Due to its enormous potential for renewable energy and non-oil sector economic development, cooperation between the EU and Azerbaijan on development of the Karabakh region should be strengthened, for example by improving employment terms and conditions, living standards and the education system.



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