

Azerbaijan's Participation Opportunities in the Global Services Market

written by Rovshan Aghayev

The service sector is usually ignored during the public debate on how to reduce Azerbaijan's excessive reliance on resource revenues. When it comes to increasing the export potential even in discussions taking place in the research community, we tend to think of the development of material production, especially the processing industries and the agrarian sector. If we look at World Trade Organization (WTO) statistics on the global service market, it becomes obvious that the export of services had almost remained beyond the attention (other than travel and tourism). But, actually, travel and tourism account for 25-26% of global trade in services, while transport 25%, telecoms, computer and info 10% and business services 11%. According to World Trade Statistical Review 2017, world exports of commercial services totaled US\$ 4.8 trillion, making up one-third of world merchandise exports (US\$ 16 trillion) in 2016. Ten countries (USA, China, South Korea, Switzerland, Germany, Canada, Japan, India, Singapore, etc.) totaled 10 per cent of exports of commercial services. These economies constitute the lion's share of exports of intellectual property-related services,[\[1\]](#) encompassing research and development (R&D) services, legal services, accounting, management consulting, public relations services, advertising, market research, public opinion polling services, architectural, engineering, and other technical services, waste treatment and depollution, mining services, trade-related services, and telecommunications, computer and information services. In addition, the share of financial services (pension and investment funds, services provided by banks and insurers) in world exports of commercial services have significantly increased in recent years.

It is also of note, some economies' profit from exports of commercial services surpasses or is nearly equal to that from merchandise exports. For example, according to International Monetary Fund's (IMF) latest data report, Georgia's profit from exports of commercial services (US\$ 3.976 billion) surpassed that from merchandise exports (US\$ 3.843 billion) in 2017. Or sales of services to non-residents account for 35-45 per cent of Israel and Estonia's total export-related profits. Exports of services in developed economies have a substantial share in their total export profits. Some 31 per cent of total export profits come from exports of commercial services in Sweden, while 33 per cent in France, 34 per cent in the United States, 35 per cent in Denmark, and 45 per cent in the United Kingdom. Russia's service exports potential is very low – 14 per cent. Its exports of commercial services in 2017, by comparison, were 13.7 times less than the USA's, 5 times than Armenia, 4 times than China and two times than Switzerland. [\[ii\]](#)

This indicator for Azerbaijan was around 25 per cent in 2017.

It is worth noting that more than 70% of employment is provided through the services sector in developed economies. Therefore, the expansion of services exports plays a key role in developing and securing a stable economy through this sector in the country.

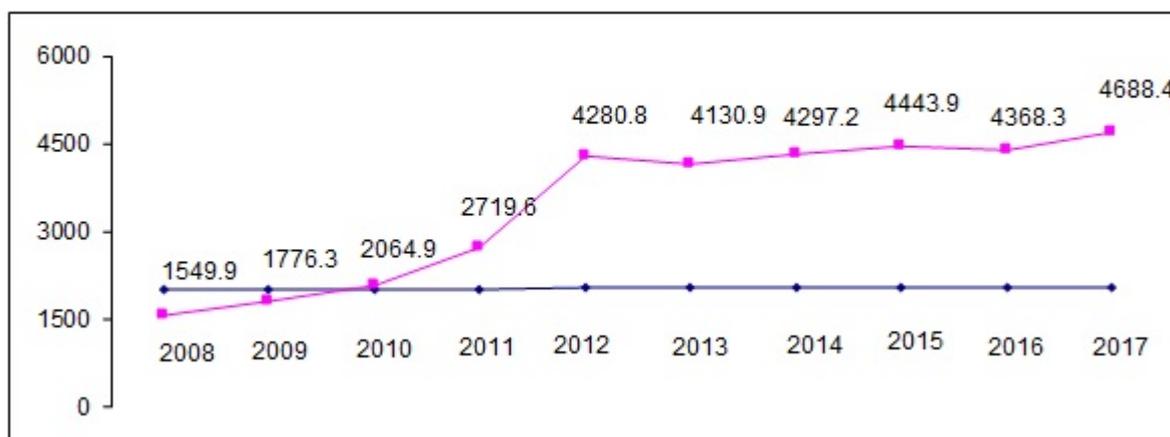
What about the current status of the export opportunities in Azerbaijan's service sector? In general, what to expect from the country's increasing participation level in the global services market? The statistics of the current status of Azerbaijan's commercial service imports and exports has been conducted based on the Balance of Payments Review Report for 2017.

Overall dynamics of services imports and exports: major trends [\[iii\]](#)

If we look at the last ten-year period (2008-2017),

Azerbaijan's commercial services exports rose three times from US\$ 1.595 billion to US\$ 4.688 billion. Interestingly, its merchandise exports had been halved over the same period: decreasing up to US\$ 15.1 billion in 2017 from US\$ 30.6 billion in 2008.

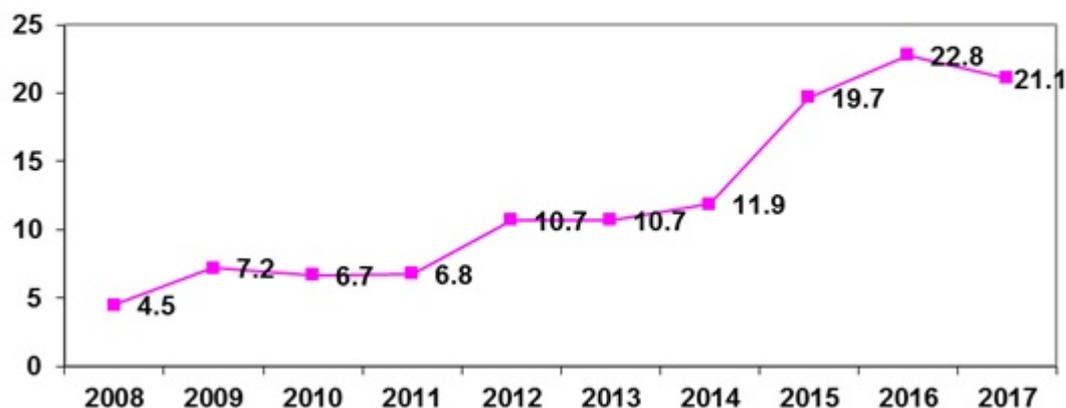
Exports of commercial services, 2008-2017 (US\$ million)



As can be seen from statistics above, the volume of services exports sharply rose in 2008 and 2012, reaching growth of 2.5 times within the next five years, but with sharp decreases within another five years (2013-2017). The volume of services exports only rose by 2% in 2013-2016, up to 7.3% in 2017.

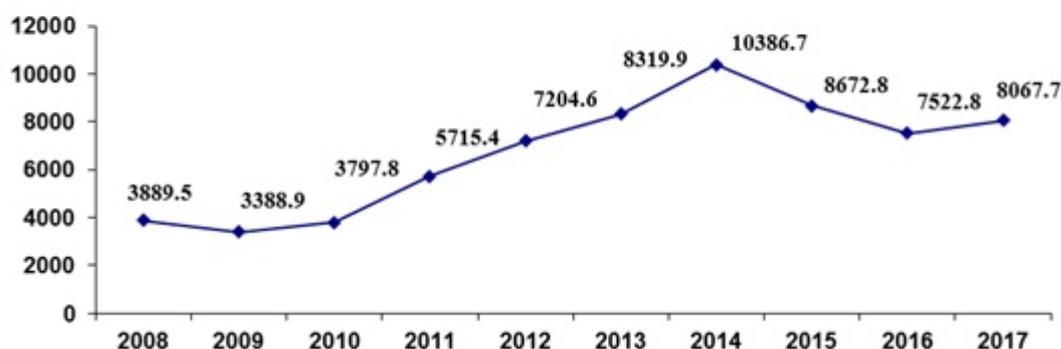
Alongside with the expansion of exports, the share of proceeds on exports of commercial services in total revenues generated abroad as part of the current account balance significantly also increased during the reporting period.

Share of proceeds on exports of commercial services in total revenues generated abroad as part of the current account balance, (Percentage, %)



As can be seen above, the share of proceeds on exports of commercial services in total revenues generated abroad as part of the current account balance has significantly increased from 4.5% to 21.1% over the past ten years. One of the reasons for this growth has been a two-time loss in merchandise exports after the oil price and oil output fall. At the same time, services exports also tripled amid declining merchandise exports. In 2017, the volume of currencies generated from services exports accounted for 30% of merchandise exports gains. Azerbaijan's demand for global services doubled, totaling US\$ 8.1 billion in 2017 from US\$ 3.9 billion in 2008 during the reporting period.

Imports of commercial services, 2008-2017 (US\$ million)

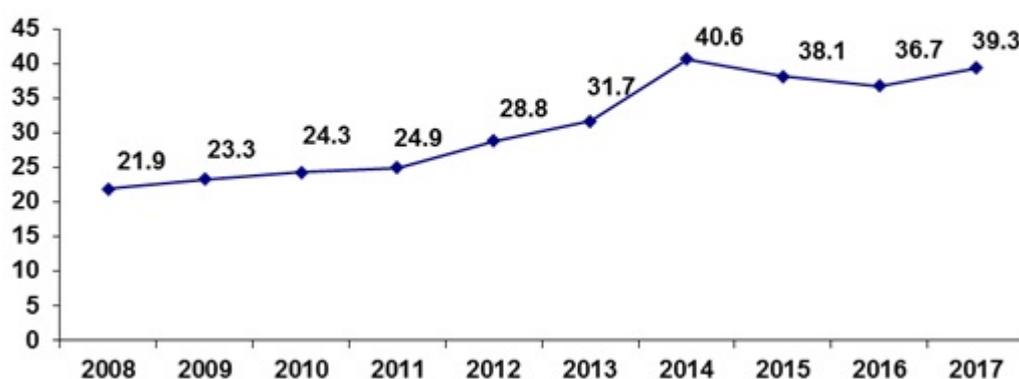


As can be seen from statistics above, the peak of services imports was recorded in 2014, totaling US\$ 10.4 billion. The next three years saw a decline in the size of service imports,

being US\$ 2.3 billion, or 22.3%, down from 2014 to US\$ 8.1 billion in 2017.

Spending on imports of commercial services in total repatriated foreign currency, as part of the current account balance is significant.

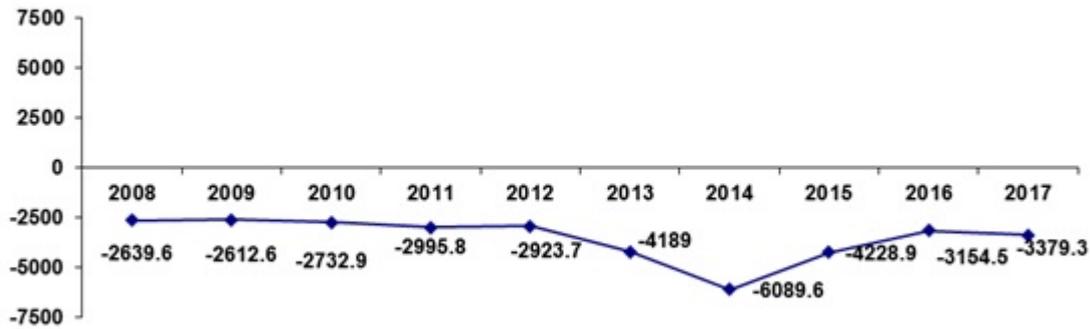
Spending on imports of commercial services in total repatriated foreign currency as part of the current account balance, (Percentage, %)



In 2008, the share of spending on services imports in total foreign currency paid to non-residents, as part of the current account balance was 21.9 per cent, touching 40 per cent in 2013 and beyond. Apparently, services imports are one of the major sources for currency outflows from Azerbaijan.

Azerbaijan is a net services importing economy. Since, there has been chronic shortage of the services balance. The value of Azerbaijan's commercial services exports has never surpassed that of commercial services imports over the past ten years. Indeed, although the year 2014 saw the peak of the negative services balance, there was a significant decrease over subsequent years.

Azerbaijan's total services balance, (US\$ million)



As can be seen from the chart, the volume of negative services balance varied between US\$ 2.6 billion and US\$ 2.9 billion from 2008 to 2012, surging by US\$ 4.2 billion in 2013 and US\$ 6.1 billion in 2015. The volume of negative services balance for the last two years was down US\$ 3.1 billion in 2017 from US\$ 3.4 billion in 2016. The reason for the decline in the negative balance over the past three years stems from a 25% decrease in services imports. Since, the volume of imports reduced up to US\$ 2.3 billion, while that of exports to US\$ 400 million between 2014 and 2017. Namely, the declining pace of services imports exceeded the growth pace of services exports by 3-3.5 times.

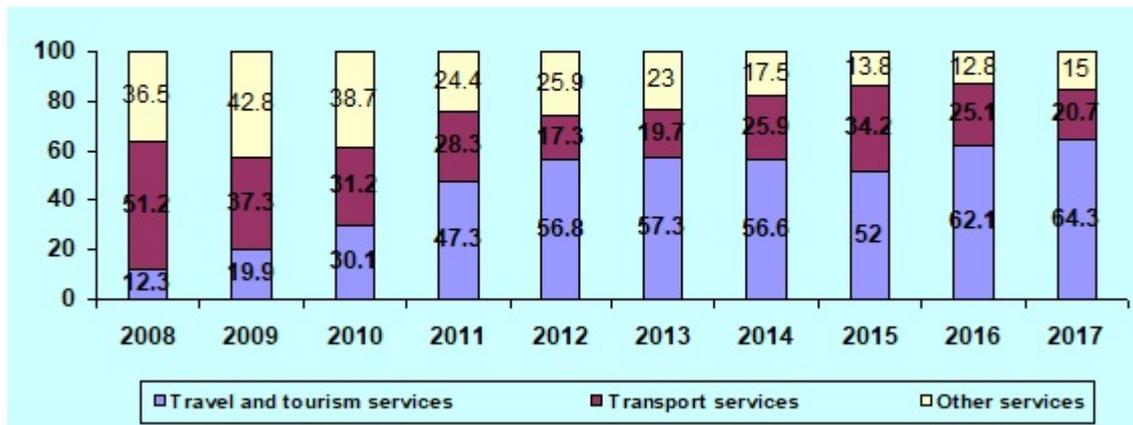
Export diversification level by commercial services by category

Depending on the capacity of the economy, national economies can offer a range of services to the international services market, including but not limited to, travel and tourism, communications, transport, construction, finance, government, business services, etc. These lines in turn included a range of services. For example business services include research and development (R&D) services, legal services, accounting, management consulting, public relations services, advertising, market research, public opinion polling services, architectural, engineering, and other technical services, waste treatment and depollution, mining services, trade-related services, and telecommunications, computer and information services, financial services (pension and

investment funds, services provided by banks and insurers, factoring, etc.).

What statistics say: which services are dominant in services exports?

Azerbaijan's total exports of commercial services by category, (Share, %)



As can be seen from the chart, the diversification level of services by category is very low, with travel and tourism services accounting for 64.3 per cent and transport services 20.7 per cent of services exports. Thus, the share of the two branches in overall services exports is 85 per cent.

Tourism and transport services exports amounted to US\$ 3 billion and US\$ 971.3 million, respectively, during the year.

The share of travel and tourism in Azerbaijan's commercial services exports grew to 64.3 per cent in 2017 from 12.3 per cent in 2008, while the share of dropped to 20.7 per cent from 51.2 per cent over the reporting period, with the share of communications, construction and finance sectors totaling US\$ 259 million (6%).

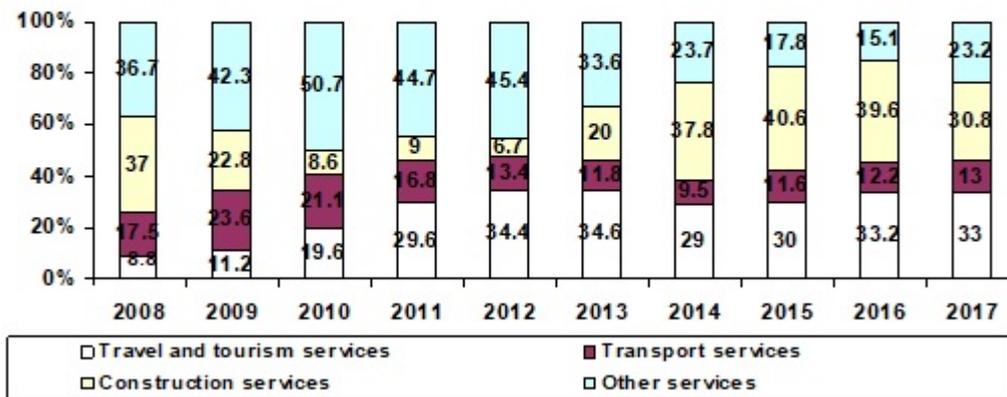
Notably, some 80 per cent of tourism services exports is provided through these countries –Georgia, Russia, Turkey and Iran. It shows that the geography of Azerbaijan's service exports is poorly diversified, more than 50% of service exports falling to the share of the four neighboring

economies.

Structure of commercial services imports

Unlike services exports, the level of concentration of services imports is not so high.

Azerbaijan's total imports of services by category, (Share, %)



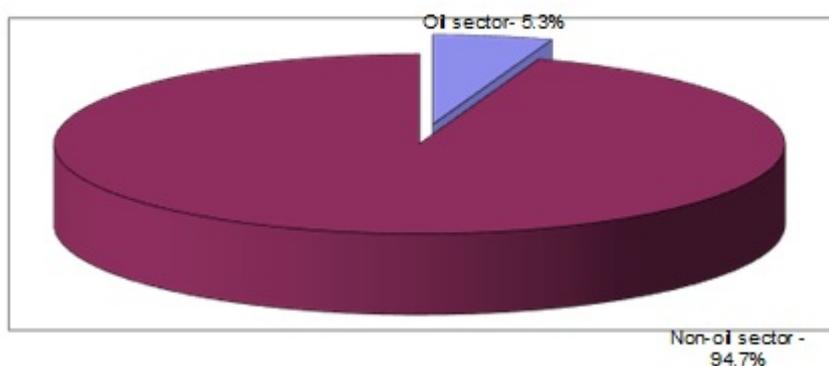
In 2017, travel and tourism had the highest share (33%) in commercial services imports, whereas construction and transport services accounted for 30.8% and 13%, respectively. Tourism, construction and transport services (rendered to non-residents) amounted to an estimated US\$ 2.7 billion and US\$ 1.1 billion during the year. Their share in aggregate overseas payments accounted for nearly 77%.

As can be seen from the figures, the share of travel and tourism in Azerbaijan's commercial services imports was 8.8% in 2008, significantly rising up to 33% over the next 10 years.

Share of oil and nonoil sectors in the global services market

Despite oil sector has accounted the dominant share of Azerbaijan's merchandize exports (more than 90%) for many years, the role of nonoil sector in exporting commercial services has been critical. Oil sector had not contributed to service exports until 2015.

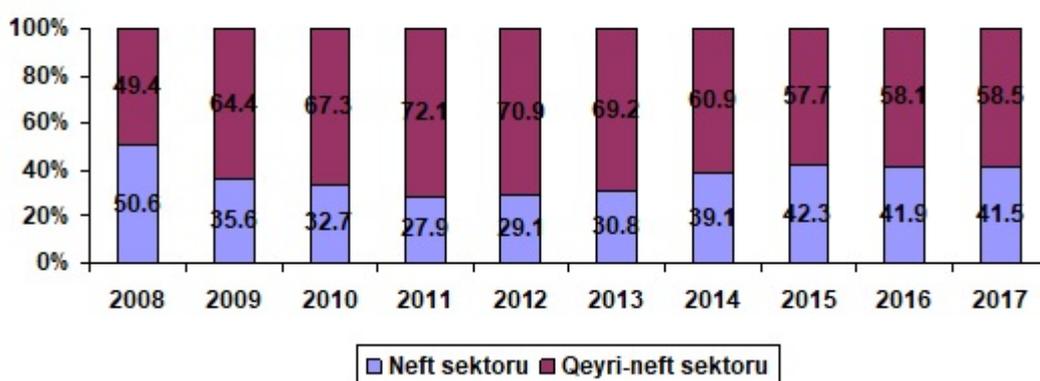
Share in exports of services of oil and non-oil sectors, 2017 (Percentage, %)



In 2015 and 2017, oil sector provided a total of US\$ 1.3 billion in services exports. And 94.7% and 5.3% of overall services exports, respectively, were provided by nonoil and oil sectors in 2017 alone. Services exports in the oil sector are provided only through oil and oil products transportation services. For example, the entire US\$ 250 million in service exports in 2017 came from transport services.

Unlike exports, oil sector has a substantial share in services imports, showing growth from 2011.

Neft və qeyri-neft sektorunun xidmət idxalında payı, % (2008-2017-ci illər)



As can be seen from the statistics above, the share of oil sector in imports of commercial services significantly fell from over 50 per cent in 2008 to 27.9 per cent in 2011. There had been a surge in the demand for services in oil sector from 2012, growing by 41.5 per cent in 2017. Commercial services imports in value through the oil sector stood at USD 3.4

billion in 2017. The lion share in oil sector's imports of commercial services belongs to construction and business services. In 2017, for example, out of US\$ 3.351 billion in services imports within this sector, US\$ 905 million and US\$ 2.446 billion, accordingly, came from business and construction services. Thus, 90 per cent of the deficits in the balance of services has been attributed to oil sector. In 2017, oil sector exported services worth US\$ 250 million, while imported services at US\$ 3.4 billion, resulting in the deficits in the balance of services to the extent of US\$ 3.1 billion. Moreover, the deficits in the country's aggregate balance of services did not exceed US\$ 3.3 billion. This alarming fact illustrates that oil sector channels USD 3-4 billion to meet global services through foreign-exchange earnings generated from merchandise exports.

Results of statistical analysis

The share of commercial services in Azerbaijan's export revenues remains far too low, hitting around 25 per cent in 2017. This percentage ranges from 40 per cent to 60 per cent for selected countries across the world. The amount of Azerbaijan's services exports in value (US\$ 4.6 billion) is significantly small, while that of Georgia's services exports, whose economy is three times smaller than Azerbaijan's, is almost equal to the latter's, reaching a total of US\$ 4 billion. The value of Estonia's services exports, is 50 per cent up from Azerbaijan's to US\$ 6.9 billion.

Commercial services exports have been poorly diversified. In 2017, one sector (tourism) accounted for almost two thirds of total exports, whereas two sectors (tourism and transport services) accounted for 85%. The share of finance, communications and business services is scarce. Underdeveloped education, health and ICT sectors have hampered the country to become merely a player in regional exports of commercial services.

It is a positive outcome that the volume of Azerbaijan's services exports has tripled over the past ten years, but the bulk of the growth was recorded in 2008-2012, with an average annual growth of 2 per cent recorded in the last four years.

Exports of commercial services not only have expanded, but also there has been a surge in the demand for global services in the national economy over the past ten years. The volume of Azerbaijan's service imports almost doubled, from US\$ 3.8 billion to US\$ 8.1 billion between 2008 and 2017.

The value of Azerbaijani commercial services exports never surpassed that of commercial services imports during the last period and consequently, this economy become a net importer of services. The country has seen the deficits in the balance of services over the past ten years, varying between US\$ 2.6 billion and US\$ 6.1 billion.

Three service lines are predominant, with transport, construction and tourism sectors representing over 75 per cent of Azerbaijan's services imports.

Unlike merchandise exports, the key role in exports of commercial services belongs to non-oil sector. Since oil accounts for more than 90 per cent of Azerbaijan's merchandise exports, while non-oil sector makes up more than 90 per cent of services exports. The share of both sectors in services imports does not differ sharply (42% oil sector, 58% non-oil sector, accordingly).

What is the potential of limiting the outflow of money from the country through this channel due to an increase in exports of commercial services and significant reduction in the service balance of Azerbaijan? Underdeveloped education (including science), health and business sectors are the bottlenecks for the country to export these services in the near-term. Moreover, its expanding tourism sector could boost exports of services. But first of all, this sector should be able to compete with Turkey's and Georgia's two largest

Turkic-speaking countries, thanks to improving the quality of tourism infrastructure and creating favorable prices. Nevertheless, this sector should first be able to compete with at least two tourist destinations in the region – Turkey and Georgia, improving the quality of tourism infrastructure and offering favorable prices.

One more important field the government looks at is the transport sector. Especially, with the establishment of the port of Alyat, it is hoped that Azerbaijan will become a transport hub for transit flows from China and Europe, but Azerbaijan has to compete with Kazakhstan, Iran and Russia in this sector. Because of its shorter distance from Azerbaijan, the Kazakhstan-China route is a competitive advantage. According to experts, however, transporting goods from Europe to China and back– crossing through Georgia, as well as both the Black and Caspian Seas is at a disadvantage to the Russian route, as flows crossing Russia and Belarus go to Europe through the overland route. Although the overland route is longer than the sea route, it faces no risks, such as extreme weather conditions affecting ships in winter period, etc.

In any case, it will be possible to observe how Azerbaijan will become a more favorable transport hub at the crossroads of the China-Europe transit flows, compared to other international trading routes, in five years into the future. Even under the most optimistic scenarios for growth, Azerbaijan can compete for about 20 mln tons of overland transit by 2035, which gives ground to conclude that the revenue from such a volume of this route will not be able to absorb a large deficit on the country's balance of services.

[i] World Trade Statistical Review 2017. World Trade Organization
https://www.wto.org/english/res_e/statis_e/wts2017_e/wts2017_e.pdf

[ii] All data on exports and imports by country taken from IMF

Balance of Payments Statistics. Access this link to see the report: <http://data.imf.org/regular.aspx?key=61468205>

[iii] All data on exports and imports for Azerbaijan taken from Central Bank of Azerbaijan's Balance of Payments Statistics. Access this link to see the report: <https://www.cbar.az/lpages/statistics/external-sector-statistics/>