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Strategic Roadmap for development of logistics and trade in the Republic of Azerbaijan



The Strategic Roadmap does not only sets short, medium and long term policy directions for economic development, but also defines a series of strategic priorities and actions to achieve those objectives and targets covering development prospect, and a detailed action plan specifying main and other responsible persons, period of execution and indicator.

“Strategic Roadmap for development of logistics and trade in the Republic of Azerbaijan” (further called - Strategic Roadmap) is developed as a part of an initiative to build a competitive, diversified, inclusive and sustainable economy. The Strategic Roadmap sets short, medium and long term policy directions for economic development in logistics and trade of Azerbaijan for the periods by 2020, by 2025 and post 2025.

Strategic priorities defined in the Strategic Roadmap underscore the importance of investments by public-private partnerships and has preliminary impact estimation attached to them. At the same time, the activities of the relevant bodies assigned as responsible bodies in those priorities need to be coordinated and continued within defined time frame.

GLOBAL TRENDS

There are three major trends that shape the current global patterns of trade, and these trends need to be followed closely to capture additional value.

- First, macroeconomic factors contribute to growing trade across borders. In last two decades, open markets and trade facilitated growth has been a dominant model for economic growth. These trends have been markedly expedited by the global agreements to ease trade, through reforms facilitated by World Trade Organization (WTO). As a result, trade has grown faster than the GDP growth globally.

- Second, sector and firm level factors also promote geographical distribution of production. Companies, in general, have been motivated to expand operations internationally due to two factors. On one hand, they are expanding into new geographies to tap into new growth opportunities, especially in emerging and developing markets. On the other hand, companies expand production operations to take advantage of low cost production opportunities. These trends are strengthened by the development of global value chains and rising vertical specialization.

- Third, macro and micro level factors are supported by development of certain driving mechanisms. Without doubt, advances in information and communication technologies can be considered as the primary factors. Growth of trade financing and development of new financing tools has made the rapid expansion possible.

Both in maritime, overland and railroad transportation, countries around the world aim to capture value through establishing hubs, to capture the aforementioned benefits to the economy. Logistics centers based on best practices around the world signal three critical key success factors to create value from logistics hubs:

- First, given that balanced development brings more benefit in a selected supply chain, creating value requires equal development of infrastructure and services.

- Second, logistics hub investments require clear strategy and careful upfront planning. Incorrect capacity and revenue plans can lead to delays in construction and problems in startup and ramp-up. Given that building a hub above critical volume requires massive investments with respective risks, it is important to conduct prior risk assessment. As a result, careful planning and feasibility studies become critical.

- Third, typically, there is no natural owner from private sector to drive total supply chain optimization in building a logistics hubs. Fragmented planning and optimization at company level can lead to inefficiencies while at the development phase of logistics hubs. In addition, there is often lack of strong domestic third-party logistics companies that understand how to optimize logistics for entire supply chains, or that have market power to do it. Presence of key supply chain components such as customs and foreign direct investment framework under government control also contributes to the establishment and development of logistics system.

ANALYSIS OF CURRENT SITUATION

Azerbaijan's geographical position allows increasing the trade capacities regularly. Continued development of the logistics assets of the country will give a boost to increase its role in regional and international trade. Azerbaijan's favorable geographical position on both the East-West Corridor and the North-South Corridor offer significant potential to capture both transit trade and import and export volumes. Several major infrastructure projects in connection with new port and railroad connectivity projects are already underway. In consideration of these assets and advantages, a number of initiatives will be taken for the purpose of increasing trade volume through establishment of intermodal and multimodal (by various types of transport) logistics infrastructure in the territory of Azerbaijan and creating more value from transit trade and increasing the level of participation of the private sector in logistics.

Current status of Azerbaijan's trade-transportation assets

International transportation through the territory of Azerbaijan is mainly done by railroad. In these freights, the transport volume is dominated by imports and exports, with a relatively low transshipment—the shipment of goods to an intermediate destination before shipping to their final destination—ratio. The transshipment ratio for those goods traveling by rail in Azerbaijan was 23 percent in 2015, compared with 71 percent for railways in Georgia.

Azerbaijan's ports, however, are dominated by the transit of goods. Most commodity flows consist of dry bulk such as coal, refined oil products and coke, mineral products, and agricultural products, and liquid bulk such as crude petroleum. However, in both railways and ports, container traffic is relatively limited.

Based on the existing strengths and opportunities, Azerbaijan aims to become a logistic and trade hub of regional importance through logistics centers efficiently operating with strong relations with the other countries in the period post-2025. As a part of this prospect, logistic and trade

centers will be established in Azerbaijan with good relations with the international markets. The most advanced digital operating models will be applied in order to ensure the efficiency of the operations in these centers and private sector participation in this sector will be further incentivized and direct foreign investments will be promoted with the purpose of accelerating the transition process.

SWOT analysis of logistics and trade sector

Strengths

- implement a number of important infrastructure projects in the country such as construction of new port complexes and establishment of railway relations with the neighboring counties;
- Existence of various concession mechanisms in line with the legislation.

Weaknesses

- small potential for qualified personnel in logistics;
- low labor productivity;
- financial shortage, obsolete equipment;
- inadequate level of marketing, sale and distribution services;
- establishment of modern business model in the enterprises;
- lack of innovative activities;
- Low potential load bearing capacity of the ships sailing in the Caspian Basin, abundance of the windy days in the Caspian Sea and small depth of the sea.

Opportunities

- Opportunities to create added value in transit freights on account of establishing a free economic zone in the territory of new Baku International Sea Trade Port located in Alat settlement, Garadagh district, Baku city and logistics hub in the territory of Haydar Aliyev International Airport;
- Government support to development of logistics and trade sector;
- Opportunities to attract foreign investors

to support the proposed projects;

- suitable geographic position of the country and potential to turn into logistics and trade hub of regional importance;
- increased trade volume and competition in the region and world;
- proximity to large regional markets;
- Commissioning of the North -South transport corridors joining Iran with Russia and Iran with Europe by removing the economic sanctions from Iran and establishment of opportunities to transport goods from Iran, India and Pakistan to Europe through this corridor over Azerbaijan.

Threats

- stagnation in financial markets;
- likelihood of weakening investment activity as a result of sharp decline in oil prices;
- the issue of exchange rate stability which is one of the main factors for foreign investors;
- delays in construction - completion of infrastructure projects;
- Strong competition in the corridor by means of the routes such as the Trans-Siberian -Kazakhstan, and Sea freights which are an alternative to East - West corridor joining Europe with Middle Asia and China, as well as the combination of the railways of Iran and Turkmenistan.

STRATEGIC VISION

Strategic Vision for 2020

Azerbaijan's strategic vision for the period by 2020 in logistics and trade sector is to achieve creation of added value over the regional transit freights in addition to attracting these freights.

Interpretation of the strategic vision

Pursuant to the identified strategic targets, it is proposed to implement seven strategic priorities covering the following issues by leveraging its key strengths and fully capturing the relevant opportunities:

- Strengthen respective efforts to make the transit corridors crossing the country's territory

competitive with a view to turn Azerbaijan into a regional logistics and trade hub in the long-term;

- Put into operation the free trade zone including the territory of new Baku International Sea Trade Port located in Alat settlement, Garadagh district, Baku city and launch feasibility analyses for increased number of free trade zones;
- Increase volume of trade and capture higher added value from transit trade towards diversifying Azerbaijani economy.

It is expected that investment in amount of a total of AZN 3160 million will be required using public and private sources in order to realize the actions proposed within the Strategic Roadmap which will be provided on account of public - private financing sources following conduct of respective feasibility studies.

LONG-TERM Vision for the period by 2025

Azerbaijan's long-term vision for the period by 2025 is to significantly improve the logistics and trade infrastructure, driven by regulatory incentives to become more attractive in this sector in the region and to turn into an important hub.

Comments on the long term vision

With the view to turn the country into a logistic and trade hub of regional importance by 2025, works will be performed to incentivize regionally-operating companies to establish their base in Azerbaijan, conducive environment for investments will be ensured and optimized initiatives and proposals will be made in this area. This way, by ensuring strong growth in its logistics sector Azerbaijan will transform towards becoming a logistics and trade center for regionally-operating companies.

First, it will strengthen road and rail connections of Baku International Sea Trade Port to enable seamless integration to the Baku Heydar Aliyev International Airport and domestic trade network of the country. To improve its connectivity between the regions, road connection will be the initial priority, while rail connections will be established once a certain level of volume is reached to ensure economic feasibility.

As a priority within this logistics and trade hub,

Azerbaijan aims to excel in processing of original and intermediary food, pharmaceuticals, commodity plastics and fertilizers by 2025.

By 2025, logistics and trade sector in Azerbaijan would be driven mostly by private sector investments. In this direction, Azerbaijan will continue its efforts in increasing private sector participation, prioritizing its state-owned enterprises.

Aspirational vision post 2025

Azerbaijan in long-term aspires to become a regional logistics hub through its efficiently operating logistics centers with strong connectivity to other countries.

Comments on aspirational vision

As part of its post-2025 vision, Azerbaijan would have a strong logistics hub located in the territory of Baku Heydar Aliyev International Airport and free trade zone included in Baku International Sea Trade Port complex in Alat settlement (further called new Port of Baku complex). In addition to main transportation companies, this hub would accommodate operational centers and factories of complementary logistics sectors, such as packaging, storage and processing. These companies will receive tax incentives and be exempted from customs duties, which will give rise to an output-oriented mindset and increase in competitiveness.

Azerbaijan targets to expand the variety of successful businesses within this hub, specifically towards labor intensive commodities (e.g. textile) and innovative high-technology products (e.g. pharmaceuticals and machinery).

Azerbaijan will continue to expand its logistics network into other regions as part of its post-2025 vision. In this direction, it aspires to complete construction of its second wave logistics and trade centers along the borders by this period, and focus on incentivizing logistics and trading enterprises to move into these regions.

Azerbaijan, in general, envisions increase of private sector participation in the logistics sector as one

of the major objectives. Keeping the infrastructure under state property and privatizing their operations, Azerbaijan aims to increase efficiency and added value of its railways into its economy and to trigger improvements across other logistics chain operations.

In order to achieve its objectives in logistics and trade sector, Azerbaijan will greatly install and utilize advanced technological infrastructure in managing its logistical operations. It will collect and integrate data from various sources on specifics of commodities and transportation routes, and feed its central database. Through an intelligent system built upon this database, Azerbaijan will quantify, analyze, and better manage different operations of freight effectively and cost-efficiently.

TARGET INDICATORS

Despite transportation of transit freight of 150 million tons through The East-West Corridor in 2015, Azerbaijan's share is small in this. While Central Asia and Black Sea region trade along the corridor stood at 9.9 million tons in 2015, it is expected to grow to 13.8 million in 2020. The East-West Corridor saw 40 million tons of Central Asia and Europe trade in 2015 with expected growth to 56 million tons in 2020. In addition, annual trade turnover between Russia and Iran along the North - South corridor (mainly over the Caspian Sea) was 4 million tons, and 2,3 million tons between Iran and Black Sea countries. There is great potential to increase transit freights and it is forecasted that the volume of transit freights to be attracted to Azerbaijan by 2020 will increase.

As a result of maximum use of the potential of the mentioned corridors, and reconstruction or optimization of the logistics infrastructure and other works:

- Real GDP will grow by a total AZN 605 million including AZN 400 million direct and AZN 205 million indirect,
- in total 18900 new jobs including 10900 in this area will be opened.

The following targets have been identified in order to achieve this:

- Increase the share of transit trade in the region, reaching to below shares:
 - o 40% of Central Asia Black Sea route
 - o 25% of Central Asia and Europe route
 - o 3% of China and Europe route
 - o 40% of Russia and Iran route
 - o 25% of Iran and Black Sea route.
- Put into operation a Free Trade Zone including logistics and port services;
- Establish 5 or 6 logistics centers around Azerbaijan (4 to be completed before 2020. Direct impact of logistics and trade center should be equal to 20 percent of the total impact from regional logistics and trade hub
- Increase operating net margins of airlines by 5%.

STRATEGIC OBJECTIVES

- As one of the priority areas for development of non - oil sector, logistics as an important factor for interconnection of other sectors of economy plays the role of a driving force in the progress of these sectors.
- The transit freights will be attracted to the transport corridors crossing the country, logistics and trade centers will be created in the regions efficiently using country's strategic geographic position and the country's attractiveness will be increased assessing the opportunities for new business, employment and added values at the same time for the purpose of becoming an important logistics and trade hub in the region.
- In order to ensure Azerbaijan's competitiveness in East - West and North - South transport corridors, time and costs spent for import - export operations and transit freights should be optimized border crossing procedures should be simplified and other important steps should be taken in this area, road infrastructure along the international corridors should be expanded, reconstruction and construction works should be completed and brought in line with international standards.

STRATEGIC TARGETS

Strategic Roadmap for development of logistics and trade in the Republic of Azerbaijan identified 4 strategic objectives and relevant priorities for each

objective. These could be classified as following.

Strategic objective 1

- Creating favorable environment to Increase trade volume through Azerbaijan
- Strengthening the leading role of Azerbaijan as a regional logistics and trade hub
- Completing New Port of Baku complex situated in Alat settlement, Baku - Tbilisi - Kars railway and Astara - Astara railway projects
- Improving logistics performance

Strategic objective 2

- Capture higher value from transit trade
- Establishing Baku as a regional commercial zone
- Establishing a trade-focused processing hub
- Establishing logistics centers in Baku and throughout the country

Strategic objective 3

- Implementing key enablers to realize logistics and trade objectives
- Increasing private-sector involvement in the logistics sector
- Developing a program for improving the participation level of private sector in logistics

FINANCING MECHANISMS

AZN 3 billion 160 million is required to achieve the specified strategic targets. Performance of the actions provided in the Strategic Roadmap will be financed on account of the below sources:

- State budget;
- Off-budget funds;
- Funds of National Fund for Support to Entrepreneurs
- Local budgets;
- Funds of the local departments, institutions and organizations irrespective of their type of ownership;
- Foreign direct investment;
- Credits from the country's banking system;
- Credits, technical and financial assistance of international organizations and foreign countries;
- Other sources not prohibited by law.

The budgets will be developed within the frame of

result-based budget drafting process to ensure funds are most efficiently spent for the specified strategic priorities.

IMPLEMENTATION, MONITORING AND EVALUATION PRINCIPLES

Monitoring and evaluation of the Strategic Roadmap

There will be conducted monitoring and evaluation of the Strategic Roadmap in order to ensure successful execution through required instruments, processes etc. When conducting monitoring and evaluation, attention will be paid to proper execution of the actions and to expected outcomes and indicators for relevant priorities, compliance with schedule of execution will be inspected. Monitoring and evaluation will be conducted based on the rules prepared according to international methodologies.

Annual working programs of the working groups will be approved by the main responsible entity agreed with the coordination authority. Quarterly meetings of the working groups will be held by the main responsible entity with the participation of the representatives from coordination authority.

Report on the works performed quarterly will be submitted to the coordination authority at least 10 days prior to the quarterly meeting of the working group. In consideration of the comprehensive analysis and assessment of the mentioned report as well as the discussions made in the last meeting of the working group, the coordination authority will submit the results of the quarterly monitoring and the recommendations for the follow-up period to the main responsible entity within 10 (ten) days from date of the meeting. Coordination authority and the main responsible entity will take actions in order to include the results of monitoring and recommendations in the daily activities of the working group.





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