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APPROACH TO THE AZERBAIJAN ECONOMIC STRUCTURE: NON-OIL SECTOR

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ABSTRACT

The division of Azerbaijan economy to the oil and non-oil sectors has been crucial economic approach due to the boom in the energy sector during the last decades. However, this division cannot eliminate the gap between the sectors. The oil sector has dominant position in Azerbaijan economy. This paper investigates and characterises the potential economic sectors of the non-oil division in Azerbaijan which can promote the economic growth using the main indicators and their shares in the gross output. Likewise, this research assesses the efficiency of the Azerbaijan government in order to foster the percentage of non-oil sector particularly in the agricultural activities and the development of the regions. The results of the paper asserts that the falling oil prices and oil production have amplified the share of the non-oil sector in the economy. The current economic situation reveals the outcomes of the activities by the Azerbaijan government in the non-oil sector.

KEYWORDS: *non-oil GDP, agriculture, industry, trade, tourism*

JEL CLASSIFICATION: *E00, Q10, L70, F10, Z30*

1. INTRODUCTION

Azerbaijan economy has been dependent on the oil-gas industry and non-oil sector concept is getting more substantial interest after the challenges in the world oil market. This paper is an attempt to address the issue of less share of the non-oil sector in the Azerbaijan economy. On the basis of data currently available, the traditional sectors of the economy have lost their importance and gave the main role to the oil-gas sector due to foreign direct investments. In other words, the non-oil sector of the economy has been out of the priorities of the government. Even though the manufactory sector as the main part of the industry has enlarged dramatically, the main outputs of the manufactory industry is directly related to the oil-gas industry. Apart from that the major export products have been produced for the oil-gas sector.

The objective of this study is to investigate the performance of the government in the non-oil sector within the last decade.

The main research has focused on evaluation of the traditional sectors.

The structure of the paper is organised as follows. The literature review identifies and differentiates the varied researches about Azerbaijan and mono-product economies.

The main research question and methodology substantiate the main problems in the non-oil sector and explain the author's approach to the issue.

The research continues with indicating the current situation of the Azerbaijan economy. The next section is devoted to explain the non-oil concept and emphasize the importance of the selected sectors. In this section, the author points out and characterizes the main economic indicators of the selected sectors. Finally, the paper concludes with the summary of the analysis of the non-oil sector and recommendation to develop the traditional sectors in order to diversify the Azerbaijan economy.

2. NON-OIL SECTOR IN AZERBAIJAN AND WORLD COUNTRIES

The macroeconomic structure of the world economies forms a unity with their main activities. Furthermore, if the share of an economy's one sector produces more than half part of the gross output, it may cause challenges to the whole economy in order to diversify the situation. From this context, the current research focuses on the non-oil sector in Azerbaijan with using the main indicators and their shares in the gross output. This part of the paper investigates and associates the related literature from Azerbaijan and resource-dependent countries.

Previous research about the situation of trade balance of non-oil sector in Azerbaijan has been informative analysis to identify export potentials of the whole economy (Nuri, Suleymanov and Zeynalov, 2010). In the study, they consider the application of the modern technologies, efficient usage of the natural and labour resource in the industry, enhancing of the competitiveness of the non-oil products as the main tasks to raise the share of the non-oil sector in the export. A recent study by Bashirli and Sabiroghlu (2012) assesses the Azerbaijan economy using the input-output framework and suggests that the government should establish long-term strategy to advance the non-oil economy in the regions. Hasanov (2013) traces the Dutch Disease threats in the Azerbaijan economy and claims that policymakers should promote the non-oil tradable sector for the sustainable development. According to Dargahov and Karimov (2014), Azerbaijan has huge possibilities to attract investments to the tourism industry, unequal distribution of the financial resources between small and medium entrepreneurship is the main challenge for the sector. Garayev (2016) highlights the importance of the state support to the agrarian sector of the national economy of Azerbaijan.

Joachim and Sola (2016) recommends that Nigerian government has to ensure the efficient public expenditure management to the non-oil sector, to guarantee fair and competitive market environment, to make it easy for a producer to access the modern technologies in agriculture. Alodadi and Benhin (2015) discusses the main factors of the economic growth of Saudi Arabia. In this analysis, they have separated those factors to the oil and non-oil sections and emphasized the importance of the tourism, private investment and non-oil export. It has been characterised that the political situation and the wars had negative impact on the agriculture and industry of Iraq during last decades and the oil-gas sector holds the main part of the economy (Ahmed, Mohammed, and Rostam, 2015).

In this research, the author selects the non-oil sectors and analyses them separately. The main idea of the study is to indicate the performance of the Azerbaijan government in the non-oil sector. A number of studies have found that Azerbaijan economy needs to diversify the export. Moreover, this study indicates the importance of the local production in order to supply the local demand before the export.

3. CURRENT SITUATION AND STRUCTURE OF THE AZERBAIJAN ECONOMY

Azerbaijan has known as the one of main oil-gas producer in the region. Furthermore, the Azerbaijan economy experiences it's the most difficult time in the last decade. The main factor is the recent drops in the world oil prices and it has negative impact on the oil-dependent economies. Therefore, the situation has induced the Azerbaijan government to reconsider its fiscal and monetary policies.

Ahmadov (2016) mentions the low oil prices, the presence of a large informal economic sector, and the using only conventional tools as the main reasons for the painful economic situation. In another major study, Mammadov (2016) indicates that, the devaluation of national currency can

promote the exports, attract foreign direct investment, and recommends that Azerbaijan government should create a safer financial sector.

Aslanli (2016) considers the current economic crisis in the Azerbaijan economy can foster the fiscal and public administration reforms.

The available Figures exhibits the current situation of the Azerbaijan economy. In fact, from 2005 to 2007 GDP growth rate was over 25% (Figure 1).

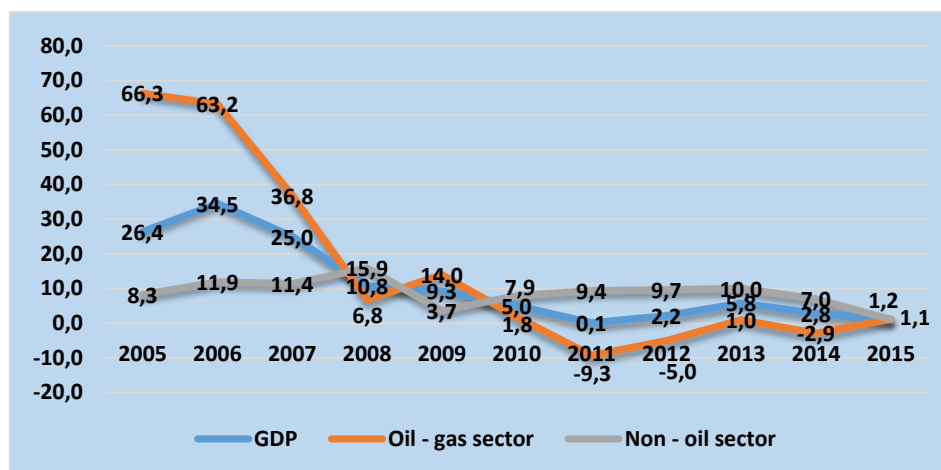


Figure 1. Growth rate of GDP, as percentage of the previous year

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Moreover, the oil-gas sector increased dramatically more than 63 percent throughout the first two years of the decade. Likewise, the growth percentage of the gross output of the economy was about 10% from 2008 to 2009.

This trend continued to descending direction, in other words, the rate was more than 5% for 2010, 2013 and more than 1% in 2012, 2014.

However, Azerbaijan economy performed the lowest performance in 2011 with 0.1%. The non-oil sector changed about 10% from 2005 to 2014 (except 3.7% in 2009). The development of the oil-gas sector was not stable; after 2007 the rate went up and drop to the lowest point in 2011. All in all, throughout the decade, the economic growth level of the Azerbaijan economy indicates that the oil-gas sector had impact on the growth output.

The main goal is to point out the size of the main part of the gross output of Azerbaijan economy (Figure 2 and Figure 3).

The production level doubled in 2007 and reached to the record level (50 million ton) in 2009. On the other hand, after 2010 the production level had been shrinking. The average crude oil price was between 49\$ and 109\$. Undoubtedly, in different years this price volatility has affected the revenue from oil export and GDP.

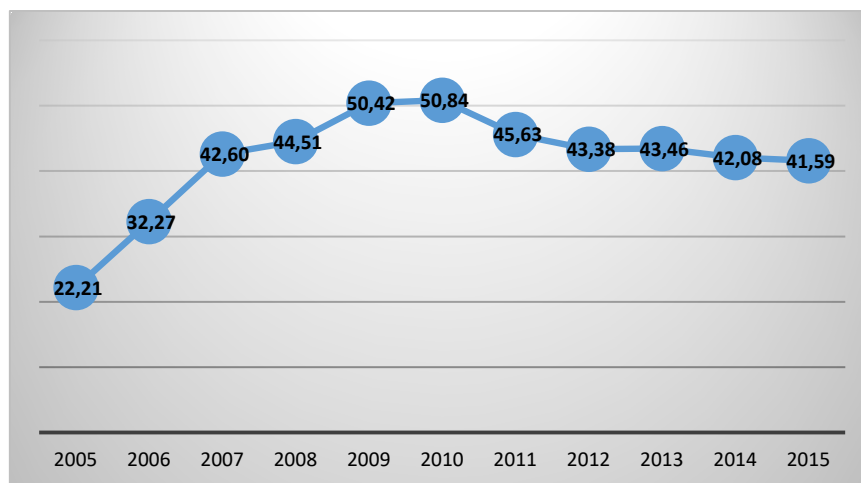


Figure 2. Crude oil production, million ton

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

The State Oil Company of Azerbaijan Republic (SOCAR) (2016)

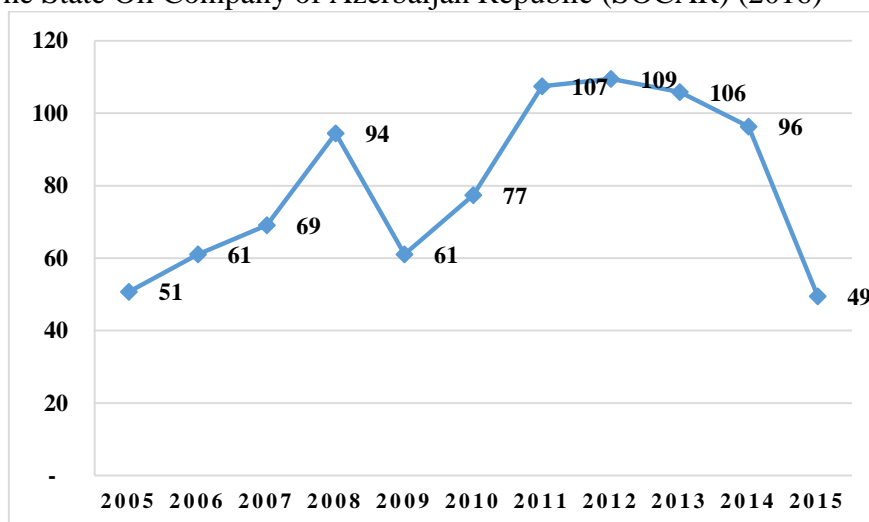


Figure 3. World average crude oil price, per barrel, USD

Source: OPEC (2016)

This division makes evident that the oil sector has been dominant part of GDP. The percentage of the oil sector fluctuated between 41% and 56% (from 2005 to 2013). In parallel, another part of GDP changed between 37% and 52% during the same period.

Notably, the share of the non-oil sector has reached to 63%, on the contrary the percentage of the oil sector has decreased to 28%.

At a glance, it can be seen that, the government has achieved to diversify the economy with amplifying the position of the non-oil sector. In contrast, the falling oil prices and oil production has made the oil products cheaper in GDP as a whole, subsequently the share of non-oil sector has gone up (Figure 4).

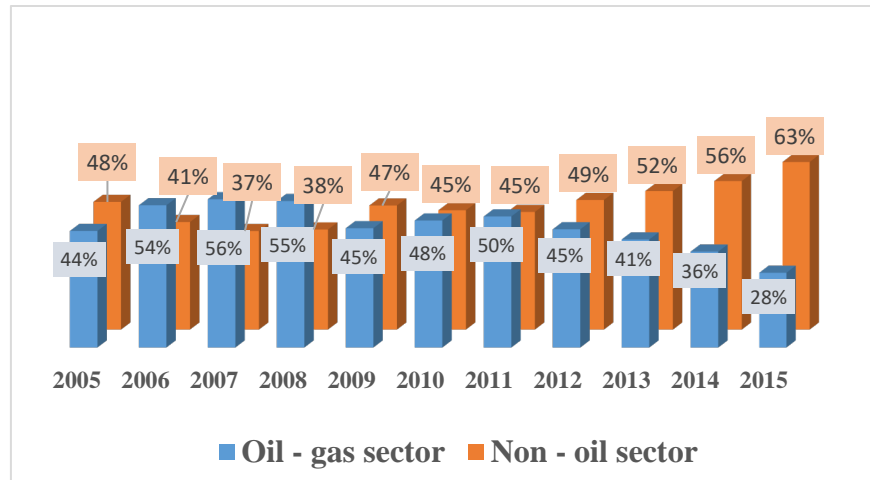


Figure 4. Share of the Non-Oil and Oil sectors in GDP, as percentage
Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

In total, the private sector holds about 80% of the gross output of the economy. In the industry the private sector produces more than 85% of the industrial products and services. The private sector holds the main part in construction too. Thus, this percentage changed between 72% and 90% during the last decade. Besides that, in the agriculture and trade activities the private sector almost produces all of the output. In the transport, the state sector was the leader in 2005 and 2006 with the more than 50% share. However, subsequently, this situation changed favour of the private sector with about 80%. Apart from these, the private sector operates with approximately 80% share in the communication (Table 1).

Table 1. Share of the private sector in GDP, current prices of the previous years, as %

Description	05	06	07	08	09	10	11	12	13	14	15
GDP - total	77.8	81.0	84.0	84.5	81.2	81.7	82.5	81.5	82.5	81.9	81.2
Industry	84.5	87.5	90.3	89.9	85.9	87.4	88.1	87.3	87.4	86.1	83.0
Construction	90.4	81.8	77.3	87.0	76.1	72.0	75.3	76.0	84.5	84.3	84.5
Agriculture	97.8	96.9	99.4	99.0	99.2	99.7	99.3	99.4	99.4	99.8	99.8
Trade and services	97.8	99.3	99.0	99.1	99.0	99.2	99.7	99.7	99.8	99.8	99.6
Transport	37.5	46.1	76.8	82.0	75.4	75.3	78.1	77.7	77.1	78.5	81.7
Communication	80.2	79.6	80.3	72.9	80.4	78.6	76.3	76.6	76.8	80.0	81.0

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Indeed, the mining sector produces the main part of GDP (Table 2). This share was 42%, reached to 53% in 2007 and held more than 40% of GDP between 2009 and 2012. It demonstrates that from 2013 to 2014 the share of the mining sector has decreased due to the reduction in the crude oil production. The construction sector has played the second largest role (increased from 9% to 12%). Not only these activities, but also the share of the trade (from 6% to 7.8%), financial and insurance (from 1.4% to 2.4%), tourism (from 0.6% to 2.2%) sectors increased respectively. In spite of these growth, the principal activities, such as agriculture (from 9% to 5%), manufacturing (from 6.5% to 4.8%), transportation (from 5.2% to 4.5%), information and communication (from 2.2% to 1.8%) lost their previous position.

Table 2. Production of the GDP by types of economic activity, percentage of GDP

Section Name	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Mining	42.20	50.86	53.66	52.73	42.39	45.88	47.96	43.06	39.17	34.62
Construction	9.00	7.71	6.44	6.98	7.17	8.10	7.95	10.06	11.61	12.54
Trade	6.07	5.37	4.94	5.48	6.69	6.42	6.30	6.67	7.13	7.88
Agriculture, forestry and fishing	9.09	7.09	6.70	5.60	6.12	5.52	5.08	5.14	5.37	5.27
Manufacturing	6.49	5.77	4.98	4.71	5.53	4.74	3.99	4.24	4.22	4.77
Transportation and storage	5.20	4.67	5.65	5.14	6.75	5.58	5.11	4.92	4.42	4.50
Financial and insurance activities	1.38	1.33	1.51	1.77	2.14	1.16	1.37	1.97	2.17	2.40
Accommodation and food service activities	0.56	0.54	0.57	0.76	0.97	1.04	1.45	1.64	1.84	2.17
Information and communication	2.13	1.96	1.67	1.54	1.88	1.86	1.59	1.73	1.74	1.81

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Investments to the sectors of the economy has been divided unequally (Table 3). The crucial part of the investment directed to the industry due to the advancement in the oil-gas sector. Thus, even though the percentage decreased from 80% to 44%, industry was the most attractive sector for the investment. At the same time, the share of investment to agriculture (from 0.7% to 2.1%) and transportation (from 6.6% to 13.9%) doubled, but the percentage of the final output of these sectors in GDP impaired. The investment to the construction sector went up 12.6% and its share in GDP advanced too. It is surprisingly interesting that, in the modern technological world, the number of investment fell from 2.1% to 0.9%.

Table 3. Volume of investment in fixed by sectors of economy, as percentage.

Years	Industry	Agriculture, forestry and fishing	Construction	Transportation and storage	Information and communication
2004	79.6	0.7	0.4	6.6	2.1
2005	72.4	0.7	0.8	9.0	2.7
2006	68.9	1.0	0.2	10.1	3.4
2007	61.4	3.3	0.1	10.0	2.4
2008	42.7	3.4	0.7	20.1	1.7
2009	41.8	3.5	0.4	22.2	1.8
2010	43.2	4.4	1.2	24.7	2.1
2011	41.9	3.4	1.8	19.7	2.4
2012	39.2	4.2	3.2	17.0	2.1
2013	42.0	3.2	4.0	20.0	1.1
2014	43.4	2.1	12.6	13.9	0.9

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Undoubtedly, the capital: Baku city is the main location to produce the gross output of the economy due to the centralised production facilities and the higher urbanisation level. The second and third regions are Aran and Ganja-Gazakh respectively (Table 4).

Table 4. Ratio of output production by the economic regions of the country, current prices of the corresponding years, as percentage

Location	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Baku city	79.6	80.2	79.4	76.0	77.2	76.0	73.9	72.2	72.9	69.8
The regions	20.4	19.8	20.6	24.0	22.8	24.0	26.1	27.8	27.1	30.2

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

In light of all these, the Azerbaijan government has adopted several state programs in order to enhance the non-oil sector.

According to the reports of the Ministry of Economy of the Republic of Azerbaijan, GDP increased 3.2 times, the non-oil sector rose by 2.6 times in the last decade. By comparison, in all action reports of these state program, the government emphasizes the achievements in the economy. On the other hand, the current economic situation makes evident that these activities do not have crucial impact on the economy.

3.1. Agriculture

Agriculture is one of the traditional sectors for the Republic of Azerbaijan. As a matter of fact, 58% of land area can be used for the agricultural purposes (Table 5).

Moreover, the irrigated land equal 30% of the agricultural land and it ensures better environment for the production. However, 53% of the total population live in urban areas due to the better living standards (Figure 5). According to the data the State Statistical Committee of the Republic of Azerbaijan, in agriculture all categories of farms have produced 5,225.8 million of manat gross output.

Table 5. Agricultural land, as percentage

Indicator Name	2013
Agricultural land (% of land area)	57.70
Agricultural irrigated land (% of total agricultural land)	29.65

Source: The World Bank (2016)

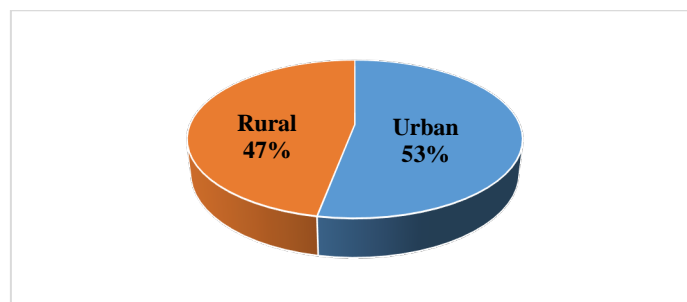


Figure 5. Division of total population by area, %

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

After getting independence in the Republic of Azerbaijan the production level of the main agricultural products declined dramatically (Figure 6-8).

Thus, the number of cotton production fell 5 times from 1991 to 1997 and the same level continued till 2003, in 2005 doubled in comparison with previous years.

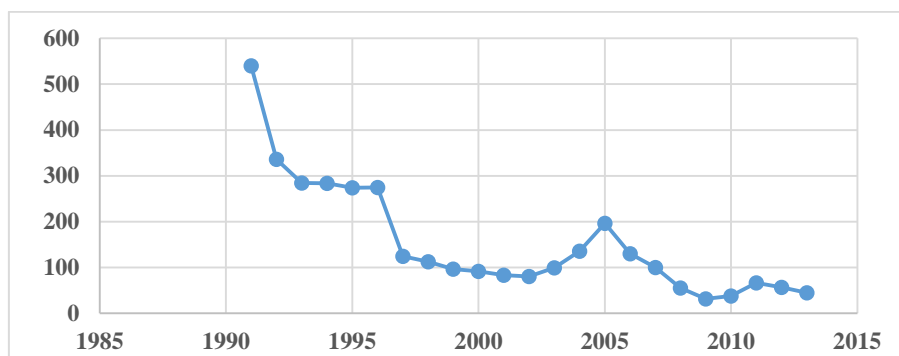


Figure 6. Cotton production, 1,000 ton

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Not only cotton, but also grape and tea productions has lost their position due to the higher costs (Table 6) and less access to the required agricultural equipment, tool, and materials.

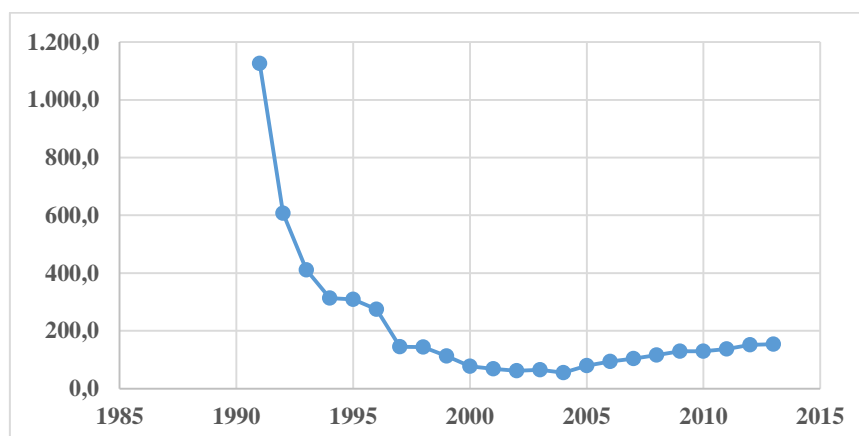


Figure 7. Grape production, 1,000 ton

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

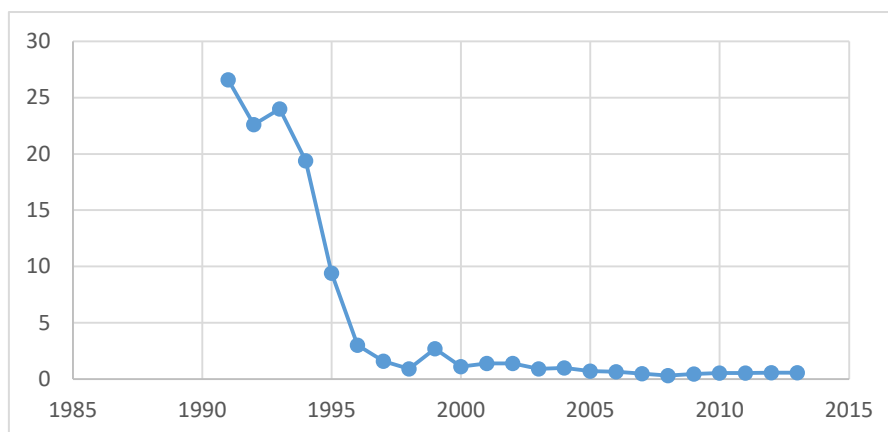


Figure 8. Tea production, 1,000 ton

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Table 6. Cost of the agriculture harvests of private owners, AZN

The name of the indicators	2005	2008	2009	2010	2011	2012	2013	2014
Row cotton, per quintal	22	31	35	37	45	36	52	69
Tobacco, per quintal	32	49	61	37	53	60	50	25
Green tea leaf, per quintal	26	44	72	75	52	92	93	90
Potato, per quintal	11	20	20	30	41	29	21	25
Fruit and berry, per quintal	7	23	19	23	30	35	24	31
Grape, per quintal	11	22	18	21	29	35	29	30

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

3.2.Industry

The mining industry shows an upward trend with more than 50% from 2000 to 2005 and 70% from 2006 to 2014. Besides that, the share of the extraction of crude oil and natural gas has been more than 95% of the mining industry. On the contrary, the manufacturing industry holds 20% of the gross output in 2014 with the downward trend (Table 9).

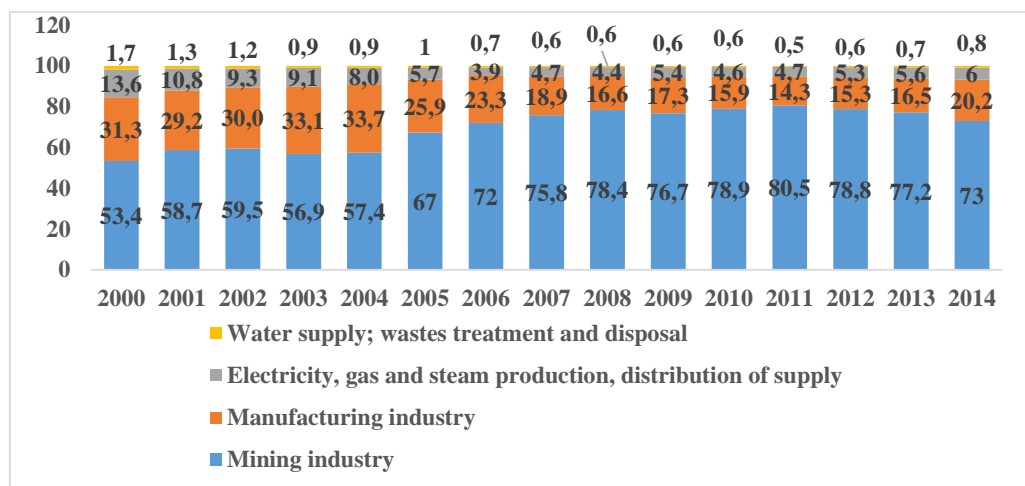


Figure 9. Sectorial structure of industry, relative to gross total, percentage

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

The share of the manufactory of refined petroleum products has been about 50% of the gross output in the manufactory industry. Subsequently, the food products and construction materials have been the second and third highest part of the manufactory industry.

Table 7. The structure of the manufactory industry, as percentage of total

Activity	2014
Manufacture of refined petroleum products	47.03
Manufacture of food products	9.90
Manufacture of construction materials	8.42

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

3.3.Trade

The trade sector of the economy has elevated due to the higher share of the oil-gas products in the export. In 2008, the trade balance changed by 466% in comparison with the previous year's Figure. The main reason of this significant change is related to start of the operation of the international oil pipelines.

Table 8. Dynamics of foreign trade relation

Years	Trade Balance, in million of USD	Turnover % change from previous year
2008	40,586.00	466.60
2009	8,578.30	37.90
2010	19,959.50	106.50
2011	24,649.70	104.00
2012	24,507.70	95.50
2013	22,129.10	102.70
2014	21,086.70	95.80

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

The technological products: including the machinery and mechanical appliances, electrical equipment, apparatus and metals, agricultural products, chemicals, mineral products are the main part of the import (Table 9).

Table 9. Structure of imports by a product, (share in total volume, %)

Groups of products	2014
Machinery and mechanical appliances, electrical equipment, apparatus	28.1
Base metals and articles of base metal	13.6
Prepared food-stuffs; beverages, spirits and vinegar; tobacco	9.7
Vehicles, aircraft, vessels and associated transport equipment	8.8
Products of the chemical	7.8
Mineral products	4.9
Vegetables products	4.6
Pearls, precious stones, precious metals and articles thereof	4.6

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

The local demand of the economy has been supplied by Russian Federation, Turkey, Great Britain, Germany, China, US and Ukraine (The State Statistical Committee of the Republic of Azerbaijan, 2016). Without a doubt, the mineral products, mineral fuels, mineral oils including crude oil form the crucial part of the export with 92.5% of the total export. Agricultural and industrial products hold less part of the total volume.

Table 10, Structure of exports, 2014, (share in total volume, %)

Groups of products	2014
Mineral products, Mineral fuels, minerals oils	92.50
Vegetables products	1.50
Prepared food-stuffs; beverages, spirits and vinegar; tobacco	1.40

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

3.4. Tourism and services

The tourism industry has been the main public revenue for some countries around the world. However, this situation is so different for Azerbaijan. Azerbaijan has four seasons including all types of natural touristic attractions.

Table 11 displays the number of tourists by the countries. The tourists from Turkey, Russian Federation and UAE are in the first three position in the list.

The total number of hotels, similar facilities, capacity and number of the rooms have grown significantly (Table 12).

Table 11. Number of tourists by countries, 2014

Country	Number of tourists, person
Turkey	35,405
Russian Federation	15,373
UAE	6,388
Iran	2,527
Germany	1,358
Georgia	1,341

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

Table 12. Main indicators of hotels and similar establishments

Description	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total number of hotels and similar establishments, unit	285	320	370	452	499	508	514	530	535
Capacity, bed places	24,706	25,483	28,286	30,571	30,793	31,979	32,834	33,951	35,652
Number of rooms, unit	11,403	11,829	12,789	13,964	14,158	14,815	15,898	16,559	17,363

Source: The State Statistical Committee of the Republic of Azerbaijan (2016)

4. DISCUSSIONS

Azerbaijan economy has own specific characters. Apart from that all available statistics have revealed that, the oil-gas sector affects whole economy. All things considered, the economic growth has shown some fluctuations and throughout the decade, the economic growth level of Azerbaijan economy indicates that oil-gas sector had impact on the growth output.

Some people believe that the main reason for the decline in production of non-oil sector, particularly related to the collapse of the socialist system, and other group claims that the money from oil-gas exports made the economy be passive to grow and diversify itself. If we can take the first idea, it is different in other post-soviet countries. They could achieve to maintain the traditional economic sectors' productivity. However, it gives us reason to concentrate on the boom in the oil-gas sector. Nowadays, most of the officials and economic experts try to emphasize the importance of the non-oil sector in Azerbaijan. This research clearly shows the less effective performance of the government in even official state statistics.

5. CONCLUSIONS

The percentage non-oil output has advanced in 2015 due to the gradual economic growth and drop in the oil prices and production level. In addition to this, the private sector plays crucial role in the economy with more than 80% of the gross output. Another key thing to remember is the GDP structure by types of the economic activities. The mining, construction and trade sectors are producing the major part of the gross output. Similarly, the huge part of the investment has been directed to the industry, construction and transportation activities.

However, the productivity level of the agricultural and information communication sector has been less in the recent years.

Throughout the decade, the capital region has been the centre for the whole of the industry and the economy.

The government has adopted the several state programs, in order to diversify the economy and ensure the regional development. Unfortunately, even these activities could not change the situation.

The agricultural sector was the main driver of the Republic of Azerbaijan during Soviet Union. After all, the tradition products of the agricultural industry has dropped almost to zero level. The mining activities have more than 70% in the gross industrial products. On the other hand, this activities main focuses on the oil-gas sector. Ultimately, the oil-gas products hold more than 92% of the export and the technological and prepared food products are the main imported goods. Though the tourism sector has the potential to foster the whole economy, it has less share in the gross output.

6. IMPLICATIONS

All things considered, Azerbaijan could not achieve to ensure the sustainable economic development and to reduce the dependence on the oil-gas sector. By all means, if the government want to change situation, they should start economic reforms with the eliminating the challenges and obstacles for the entrepreneurs and have to ensure the competitive and fair tax environment for the local and foreign investors.

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