

Azerbaijan's international investment activity in terms of globalization and Strategic roadmaps for the national economy of Azerbaijan

Açar sözlər: beynəlxalq investisiya, tədiyyə balansı, iqtisadi şok, pul siyasəti, stagflyasiya, strateji yol xəritələri, KÖS, beynəlmillələşmə, “Start-up” layihəsi, valyuta məzənnələri, devalvasiya, deflyator, MPC, MCS və APC

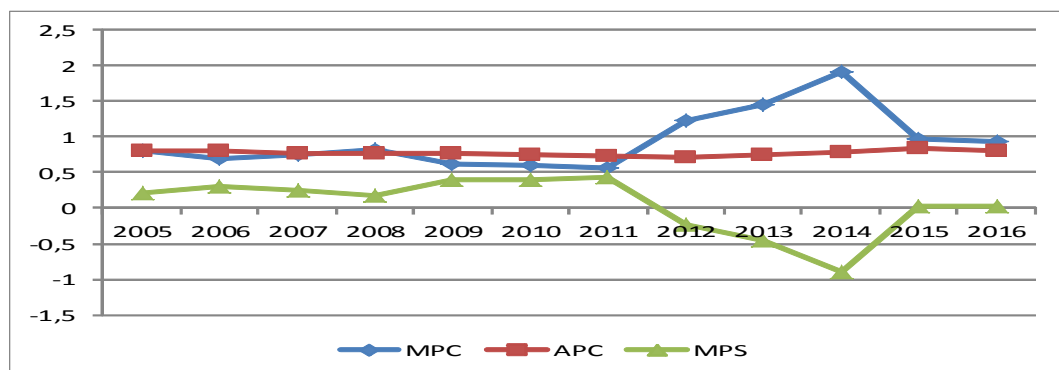
Key words: international investment, balance of payments, economic shock, monetary policy, stagflation, Strategic roadmaps, SME, internationalization, “Start-up” project, exchange rates, devaluation, deflator, MPC, MCS and APC

Ключевые слова: международные инвестиции, платежный баланс, экономический шок, денежно-кредитная политика, стагфляция, стратегические дорожные карты, МСП, интернационализация, проект “Start-up”, обменные курсы, девальвация, дефлятор, MPC, MCS, APC

1.1 Introduction

The international investment activity of a country is the main content of its national economy's sustainable development [10, p.1]. The appropriate investment activity level either allows to improve the structure of national production [21, P. 54] or helps to achieve optimal indicators in the main state balance sheet, which is the balance of payments (BOP). [6. P 3] Thus, it allows softening of the impact of various global economic shocks on developing countries' economies. [9. P 61-83]

Until recently, monetary policy was the main mechanism of the Azerbaijan's stabilization policy, as well as the way of maintaining a fixed exchange rate of the national currency, which did not allow the economy to be unbalanced (during 2006-2014 1 USD = 0,787 AZN) ¹. Simply put, the trade balance account had been balanced to the export of the capital account at a fixed exchange rate parity, and that was the way of achieving BOP equilibrium via official USD reserves.



The devastating consequences of the global financial crisis have led to the widening and

¹ <https://www.cbar.az/assets/3587/2.16.pdf>

deepening of the world's financial and commodity markets' failures [28. 7-13]. This has led to a decrease in purchasing power due to the cheapening of the national currency, and, as a result, to increased consumption via increase in savings spent. Those can be seen in the calculations (MPC, MCS and APC)²

As a result, it became reasonless to go along with the policy of the national currency's support by using financial interventions from the country's main financial institutions (MFAR, CBAR, and SOFAZ).

More than for 15 years a stable macroeconomic situation was ensured via spending the accumulated foreign exchange earnings from high oil export revenues that kept the high solvency of the population but attached the economy to raw materials' production. In many countries, where the economy is based on the export of natural resources, such as Russia, Kazakhstan, Venezuela and etc., funds from export income are used to support national currency. Long-term imbalance of the external equilibrium in BOP, which took place due to the reduction in the volumes and costs of the exports, and the volume of imports, has led to a cheapening of the national currency (Tab. 1 and 2)

Table 1. Main macroeconomic indicators

Year,	GDP, Growth rate, %	GDP deflator	Non-oil GDP Growth rate, %	Capital investments Growth rate, %	Nominal income of population Growth rate, %	Consumer Price Index Annual average, %	Trade balance mlrd. doll	Budget deficit (-)
2010	105.0	111.3	107.9	121.2	113.3	5.7	19.7	-363.5
2011	100.1	117.8	109.4	127.3	119.6	7.9	24.3	306.0
2012	102.2	101.5	109.6	118.0	113.8	1.1	22.2	-135.0
2013	105.8	99.6	109.9	115.1	108.0	2.4	21.4	352.8
2014	102.8	98.7	106.9	98.3	104.8	1.4	18.9	-308.4
2015	101.1	91.1	101.1	88.9	105.7	4.0	5.8	-286.5
2016	96.9	114.7	95.6	73.9	108.7	12.4	4.2	-241.2
2017	98.9	117.5	102.4	100.1	107.6	14.0	3.5	-538.7

<https://www.cbar.az/assets/3566/1.1.pdf>

A sharp double devaluation drove to an increase in prices not only for the imports of final consumer goods but also to the equal increase in the prices of domestic production, which is based on imported components and equipment (Tab. 2 and 3). At the same time, applying the regime of "controlled floating" up to the national currency made it possible to curb the inflation and stop the threat of imminent stagflation. We can observe this almost in all submitted tables for all indicators, starting from 2015. (particularly in Table 2: CPI, TB, BD indexes). Today, the volumes of domestic production are not able to satisfy the domestic demand in the local consumer markets. Low oil prices era created significant challenges for the economy of Azerbaijan. Thus, the key impact channels on the national economy, under the new conditions are foreign balance (balance of payment), domestic balance (public financing, including strategic currency reserves; private investment requirement → economic growth → macroeconomic stability), including banking and finance sector (financial stability). [4. P 5]

The solution to this problem is to increase the investment potential of business structures by developing their internationalization strategy and including them into the world's transnationalization processes. Kazakhstan, Iran, and Russia face the same problems and make efforts to diversify their economies too.

² Self analyse

Table 2. Nominal and real effective exchange rates of Azerbaijan manat to foreign currencies, % (December 2000=100%)

Year	Nominal effective exchange rate		Real effective exchange rate	
	total	non-oil sector	total	non-oil sector
2000	100.0	100.0	100.0	100.0
2001	105.3	110.1	97.2	96.4
2002	97.3	105.8	86.9	87.1
2003	85.5	95.8	75.2	75.4
2004	80.2	91.2	74.2	73.8
2005	92.1	101.8	85.8	81.4
2006	90.0	101.5	89.0	84.5
2007	85.4	97.1	95.1	89.1
2008	100.1	117.2	121.8	114.1
2009	98.3	119.1	115.5	110.0
2010	104.2	123.2	127.7	115.3
2011	108.1	131.9	134.2	121.6
2012	108.3	131.3	130.3	114.8
2013	108.1	139.0	131.5	120.3
2014	124.5	173.1	146.6	140.7
2015	89.7	132.9	110.0	107.6
2016	66.3	96.3	91.3	86.3

<https://www.cbar.az/assets/3570/1.6.pdf>

The dependence of the country's economy, the state budget and the currency on oil should be decreased in order to increase the level of sustainable development. Because oil proceeds significantly affect domestic demand in goods and services, fluctuations in oil prices distort the economic stability in the country. For example, as a result of average 11.5 percent change in the annual growth rate in 2004-2014, companies' forecasting potential was limited and there was a decrease in investment in the private sector. Besides, due to the fact that oil proceeds are the main source of foreign currency, changes in oil prices cause the national currency of the country to lose its value. [Strategic roadmaps for the national economy of Azerbaijan/ 7]

1.2 Problem Statement:

The investment activity of the country covers all levels of the economy. Starting with the analysis of the macroeconomic and the institutional structure of the country's investments, it is necessary to identify the main investment advantages of the national economy, and those will affect the investment activity of the Azerbaijan's national enterprises. In this case, it is better to focus on small and medium-sized enterprises. [Tab. 2 and 4]

Table 3. Foreign Investments (mln. USD)

	2010	2011	2012	2013	2014	2015	2016
Total foreign investment	8 247,8	8673,9	10314,0	10540,9	11697,7	10719,1	10161,1
Financial Loans	3 405,9	3692,5	3135,5	2655,8	1880,6	2210,2	2197,8
Oil industry	2 955,3	3407,8	4287,8	4935,2	6730,7	6622,7	5617,4
Enterprises with joint and foreign investment	659,6	886,0	1094,5	1041,0	1318,5	860,4	1706,2

Decades ago, SME in Azerbaijan were not a matter of interest for some economic and political reasons. Most of our national enterprises were large scaled state companies such as trusts and concerns. While small enterprises accounted for 83% of all companies, their contribution to the value added was only 3%, although this indicator shows better results comparing to 2010 when it was only 1.7%. Their contribution to total employment has also increased from 5.9% in 2010 to 7.9% in 2013. [6. P. 238] The majority of SME operate in trade and vehicle repair sectors (32,7% in 2013). The other sectors with a significant presence accordingly are construction (23.4%), transportation and storage (11.3%) .

For a long time, the activity of small and medium-sized businesses was mainly considered within the national market. It was believed that a low level of production facilities' development does not allow local SMEs to produce goods in large quantities and meet the international quality standards. However, in the contemporary world, nobody could isolate SME from globalization processes and now they have all the opportunities to start their business abroad or to widen the existing ones in Azerbaijan into another country and reach the international markets. [7, P 233] Internationalization became a real strategy of expanding SME's activity scope beyond national borders and territories, and that strategy allows the companies not only to provide their export-import operations but also to carry out international investment activities, where they can act both as investors and recipients. [5, P. 249-276]

Generally, Azerbaijan has made some progress in facilitating the SME's access to finance since 2012 SBA assessment. This includes the "Start-up" project and the National Fund for Entrepreneurships' support. However, the access to finance remains to be the major obstacle for the SME's growth in Azerbaijan. According to the 2014 MSME Access to Finance Demand Survey in Azerbaijan, the use of loans in Azerbaijan stays low, (15% only, while in the other Eastern partnership countries this figure is approximately 31%) regardless of the industry and size of the enterprise (World Bank, 2015). Therefore, more than 90% of enterprises rely on internal funds for working capital, which is the highest ratio among the countries of the Eastern Partnership. For example, in 2014 the National Entrepreneurship Support Fund allocated 295 million of Azerbaijan manats (about 255 million euro) of subsidized lending for 5,560 enterprises. In the future, the evaluation of the existing mechanisms will be important to determine their impact on closing SMEs' financing gap. [8, P242]

As international experience shows us, exports allow small and medium-sized enterprises to access new markets quickly with relatively low investment and to acquire valuable experience. [3, P. 7-20] Most of these SMEs enter the foreign markets with specific products that differ by their technological and unique qualities from the products of the large multinational corporations [2, P. 236-252]. And that's why they have their own specific niche. On the other hand, these small companies gain access to the investment resources of the foreign states. Running out individual companies, joint ventures and other forms of entrepreneurial activity allows them to obtain loans and various grants. Particularly this situation is well observed with the introduction of MNCs into the domestic market of the country and their interaction with the domestic firms. [10, P 617-644]

Nowadays, Azerbaijan faces a large-scale challenge of modernizing the economy and diversifying exports in order to reduce the dependence on raw materials' exports, which reached more than 73% of all Azerbaijani exports by 2015 (Tab. 2). However, only a few of the small and medium-sized firms in Azerbaijan send their products to export - one in 100 firms, while in Germany - one out of three.³ The reason of it is that the internationalization level of SMEs in Azerbaijan remains weak: on average, the share of direct or indirect exports of industrial SMEs is only 8% of the total amount of their sales. Efforts to stimulate exports of SMEs are still in their infancy, and support remains uneven. The difficulties faced by SMEs, while trying to achieve economies of scale at the level necessary to enter the international markets and build appropriate networks, and the relatively small size of domestic markets - all this underscores the importance of building up the existing support. [8, P 197] That is why we need to develop the internationalization strategy for Azerbaijan's SME sector and the question is how.

³ <http://www.azpromo.az/en/export/export-promotion>

1.3 Significance of the Study

In the modern world, internationalization has become an important development trend for small and medium-sized businesses [11, P. 23-32]. For a long time, large corporations were the main players on the world markets, but today no company can be isolated from the process of globalization and the international competition. The development of the technologies and internationalization allows small companies to act internationally, to be international importers or exporters of goods, and even importers and exporters of investment. When SMEs' activity is limited only by the export-import operations, it became dependent on the international trade fluctuations. Although the investment activity allows SME to join the economic and production structure of foreign countries and respond promptly to the challenges of the world's economy. [12, P. 1072-1092]

However, the process of internationalization and entering the new markets can be difficult. Available resources, knowledge, and experience often are not enough to develop operations in the new foreign markets. This problem is called the liability of newness/smallness (Stinchcombe 2012). It means that when starting activities abroad, SMEs face the same barriers as start-ups do - they need to look for the necessary resources, build relationships with the stakeholders and prove their legitimacy. Besides, small and medium businesses are more restricted in the available options for development, as they are limited in resources. Access to financing is limited to own savings, so the strategy of internationalization often represents by simple exports, since they cannot afford investments, as large companies do. [9, P. 121-134]

That's why internationalization is a crucial strategy for SMEs who want to survive and succeed in the contemporary world. And here are some advantages of internationalization:

1. When entering the international markets, SMEs increase their client base, as the result of available expansion to new markets. This leads to increased revenues and the opportunity to reinvest for further growth.

2. Internationalization allows SMEs to have access to all the resources needed at a lower price and to the resources that are not enough in the home region.

3. Internationalization makes it possible to achieve the economies of scale, especially if the production volumes of the company were limited in the domestic market, because of its saturation or intense competition

4. Internationalization helps to improve productivity and reduce the production costs, due to the fact that company can take the advantage of differences in currency exchange rates, tariffs, prices, etc.

5. And the most important point - internationalization allows SMEs to distribute their risks among different countries and reduce the dependence on domestic markets. Thus, the company has more chances to survive and develop.

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Xülasə

“Qloballaşma şəraitində Azərbaycanın beynəlxalq investisiya fəaliyyəti və Azərbaycan Respublikasının milli iqtisadiyyat perspektivi üzrə Strateji Yol Xəritəsi” adlı məqalədə Azərbaycanın makroiqtisadi vəziyyəti təhlil olunaraq qloballaşma şəraitində beynəlxalq investisiya fəaliyyətinin istiqamətləri təhlil olunur. İzah olunur ki, müasir qlobal iqtisadi böhran şəraitində Azərbaycanın beynəlxalq investisiya siyasətinin yeni konsepsiyası irəli sürülməsi istiqamətində “Azərbaycan Respublikasının milli iqtisadiyyat perspektivi üzrə Strateji Yol Xəritəsi” həlledici rola malikdir. Bu sahədə ilk növbədə dünya transmilləşmə prosesində iştirakımızı gücləndirərək KOS-ın inkişafına üstünlük vermək lazımdır. Məqalədə qeyd olunur ki, kiçik və orta müəssisələrin beynəlmilləşməsində daha az sərmayə sərf etməklə onların beynəlxalq rəqabətqabiliyyətini artırmağa zəmin yaradılır. Şirkətlərin daxili bazarda daha da möhkəmlənməsi, üstəgəl dövlət dəstəyi əldə edilməsi əsasında ölkənin milli iqtisadiyyatında istehsal strukturun və istehlak bazarın təkmilləşdirilməsinə, ölkəyə xarici investisiyaların cəlb edilməsinə münbit şəraitin yaradılmasına imkan yaradılacaqdır.