

Can BRICS Membership Reduce the Role of the Dollar for Azerbaijan?

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Abstract

Currently, the prevailing trends in the Azerbaijani economy — such as declining foreign currency revenues, increasing imports, underutilization of non-oil export potential, sharp loss of the manat's purchasing power, appreciation of the real effective exchange rate, and rising levels of dollarization of deposits¹ — provide severe grounds for abandoning a fixed exchange rate regime. These factors are creating increasing pressure on the manat's exchange rate year by year. Can Azerbaijan counteract this process by joining BRICS and the Shanghai Cooperation Organization? Can BRICS membership reduce the role of the dollar for Azerbaijan? This article will first attempt to answer these questions through our research.

Key words: Azerbaijan, BRICS, SCO, US Dollar, Chinese Yuan, Manat, sanction, SPFS, SWIFT,

Introductions

Discussions on this topic have intensified since July 3, when the Shanghai Cooperation Organization (SCO) summit in Astana adopted the "Joint Declaration on Establishing a Strategic Partnership between Azerbaijan and China," in which Azerbaijan expressed its desire to join BRICS. Eight days after the declaration was signed, on July 11, Sahiba Gafarova, the Speaker of the Milli Majlis, delivering a speech at the plenary session of the X Parliamentary Forum of BRICS countries, marking the first official step towards realizing Azerbaijan's intention.

Since its inception, BRICS has increased its share in the global economy by 10.2 percent over the past 15 years. In 2023, the total GDP of BRICS countries accounted for 35.7 percent of global GDP based on purchasing power parity. The rapid expansion of the Chinese economy has mainly driven this growth. Additionally, the total population of the expanded BRICS group has reached approximately 3.5 billion, or 45 percent of the world's inhabitants. BRICS member countries are characterized by their dynamic economies, which are vibrant and full of potential, and their large consumer markets.

¹ Ibadoghlu, Gubad, Devaluation of manat: expectations and realities. Available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4895347

However, their global influence, role, and impact in international organizations differ from their economic scale or population.

Regarding the financial market share of BRICS currencies, the proportion of the US dollar² in international settlements has increased from 85 percent 15 years ago to 88 percent in 2022, while China's share has risen from 1 percent to 7 percent. During the same period, the euro's share in international settlements fell from 39 percent to 31 percent, and the Japanese yen decreased from 19 percent to 17 percent. Additionally, on October 18, 2023, the yuan replaced the euro as the second most used currency in the SWIFT financial messaging system for the first time in international settlement history. Following the top three, the list of 10 major currencies in this system includes the Japanese yen, Saudi riyal, Indonesian rupiah, Thai baht, UAE dirham, Vietnamese dong, and British pound sterling. Asian currencies, led by the yuan, constitute half of this list. Since BRICS' formation, transitioning to national currencies in international settlements has been most successful for the yuan. We believe that the yuan will continue to strengthen its status as the second most popular currency for international payments, with mutual settlements in national currencies playing a significant role among BRICS and SCO member states.

However, despite efforts to reduce the role of the dollar in emerging markets through the creation of BRICS+ and SCO+ formats after other countries join BRICS and SCO, the dominance of the US dollar in international settlements still causes disappointment among members. This is because, due to the significant portion of global commodity trade, particularly oil and gold, conducted in dollars, the importance of the US dollar remains high in commodity-dependent economies like those³ of Argentina, Brazil, South Africa, Ethiopia, Russia, Saudi Arabia, UAE, and Iran⁴.

For Azerbaijan, the leading position of the oil and gas sector in the national economy presents similar challenges. According to the State Customs Committee's statistics⁵ on

² Triennial Central Bank Survey of foreign exchange and Over-the-counter (OTC) derivatives markets in 2022 // <https://stats.bis.org/statx/srs/table/d12.3>

³ Georgios Georgiadis et al., "Fundamentals vs. Policies: Can the US Dollar's Dominance in Global Trade be Dented?," European Central Bank, Working Paper no. 2574, July 2021, <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2574-664b8e9249.en.pdf>

⁴ The United Nations Conference on Trade and Development (UNCTAD) identifies these six countries, as well as Iran, as having commodity-dependent economies based on 2019–2021 data and uses a threshold of commodity exports accounting for 60 percent of total merchandise exports. See "The State of Commodity Dependence," UNCTAD, accessed October 28, 2023, <https://unctad.org/topic/commodities/state-of-commodity-dependence>.

⁵ https://customs.gov.az/uploads/foreign/2024/2024_6.pdf?v=1721280905

Azerbaijan's foreign trade for January-May 2024, the share of goods in the oil and gas sector in total exports was 87.63 percent.

According to 2023 customs statistics⁶, about 50 percent of Azerbaijan's foreign trade turnover is with the EU, USA, and UK, while 20 percent is with BRICS members. Last year, 30.65 percent of foreign trade was with Italy, and 14.95 percent with Turkey. Russia and China, founding members of BRICS, are Azerbaijan's third and fourth largest trading partners, respectively.

Moreover, the "Passage of Goods by Transaction Character" section of the Foreign Trade Report of the Republic of Azerbaijan shows that, excluding state credit and its repayment, settlements in freely convertible currency (FCC) accounted for 77.68 percent of exports and 63.48 percent of imports in the first half of 2019⁷, while settlements in national currency (NC) accounted for 0.26 percent of exports and 0.07 percent of imports. In the first half of 2024⁸, FCC accounted for 45.49 percent of exports and 71.23 percent of imports, while NC accounted for 0.84 percent of exports and 0.02 percent of imports. As seen, over the past five years, the share of FCC in exports decreased by 32.19 percentage points, while its share in imports increased by 7.75 percentage points. Changes in the share of NC in export and import operations were not significant. The main reason for the decrease in FCC in exports is that, after the imposition of sanctions and embargoes by the West on Russia following its military intervention in Ukraine, Azerbaijan's non-oil export goods are mainly sold in the Russian ruble in this market. Consequently, Russia's ambassador to Azerbaijan, Mikhail Yevdokimov, stated in an interview with "Izvestiya" newspaper⁹ that "in 2023, trade turnover reached \$4.4 billion, with mutual settlements in national currencies exceeding 54 percent. This means we are moving away from the dollar and euro in our relations with Baku."

However, this year, a new problem has arisen in the use of national currencies in trade settlements between the two countries due to the 14th sanctions package announced by the European Union (EU). The "Financial Sector Measures" of the EU's 14th sanctions package¹⁰ prohibit operations using the Russian Central Bank's Financial Messaging System (SPFS) outside Russia, as well as transactions with third-country banks using SPFS. Additionally, operations that facilitate transactions supporting Russia's defense-

⁶ https://customs.gov.az/uploads/foreign/2023/2023_12.pdf?v=1705581222

⁷ https://customs.gov.az/uploads/foreign/2019/2019_6.pdf?v=1640608742

⁸ https://customs.gov.az/uploads/foreign/2024/2024_6.pdf?v=1721280905

⁹ <https://iz.ru/1647749/valentin-loginov/ispolzovanie-natsionalnykh-valiut-rossii-i-azerbaidzhana-prevysilo-54>

¹⁰ https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/sanctions-adopted-following-russias-military-aggression-against-ukraine_en

industrial base with banks and cryptocurrency providers in Russia and third countries are also banned.

It should be noted that, after the EU imposed the 14th package of sanctions against SPFS, developed by the Russian Central Bank to replace the SWIFT system, trade partners from Azerbaijan are also at risk of falling under secondary sanctions for any connections with Russian organizations. This naturally creates difficulties in carrying out foreign trade operations with Russia in national currencies.

On the other hand, Western banks immediately reject not only payments associated with the Russian SPFS but also any payments connected to the Chinese transfer system CIPS. This complicates settlements in national currencies within the BRICS format. Despite these challenges, BRICS countries are interested¹¹ in increasing the share of settlements in national currencies in trade and de-dollarization. In this context, India, a founding member of BRICS, is taking measures to internationalize its national currency¹², Russia is opting for settlements in rubles to evade Western sanctions, and China is prioritizing squeezing out the euro in capital markets. However, it should be noted that the introduction of the euro in 2002 had little impact on the dominance of the US dollar over the past 22 years, so the likelihood of the Chinese yuan posing a significant threat to the dominance of the dollar in international settlements is low.

An analysis of BRICS summit documents from 2014-2022 and financial projects considered by the New Development Bank (NDB) from 2016-2022 shows¹³ that in recent years, BRICS countries have been discussing the formation of an independent financial infrastructure and the issuance of a single currency. Furthermore, BRICS countries are striving to increase the role of their national currencies by using existing or agreed mechanisms. For instance, the NDB's strategy for 2022-2026 plans to increase the share of financing provided by the bank in national currencies to 30 percent by 2026, including debts and credits.

Another notable point is that the People's Bank of China (PBOC) has pegged the daily reference exchange rate for its managed currency to the US dollar, setting it at 7.0947

¹¹ International trade Settlement in Indian Rupees (INR) // RBI/2022-2023/90. Circular No.10.

URL: <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12358&Mode=0>

¹² Далдеган У., де Борба В. Концепция развития БРИКС: анализ проектов, финансируемых НБР // Вестник международных организаций. 2023. Т. 18. № 4. С. 7– 33 (на русском и английском языках). doi:10.17323/1996-7845-2023-04-01

¹³ New Development Bank General Strategy for 2022-2026: Scaling Up Development Finance For A Sustainable Future // https://www.ndb.int/wp-content/uploads/2022/07/NDB_StrategyDocument_Eversion-1.pdf

per dollar to maintain exchange rate stability. Similarly, the manat in Azerbaijan has been pegged to the US dollar for nearly a decade. Thus, the manat's exchange rate is stable only in relation to the US dollar, while it fluctuates against other currencies, including BRICS national currencies, and has been appreciating over a long period.

It appears that the monopoly of the dollar in international settlements will continue in this decade as well. Currently, about 48 percent of SWIFT settlements worldwide are in US dollars. Consequently, the US dollar remains central, while the yuan achieves another noteworthy point is the People's Bank of China (PBOC) pegging its managed currency's daily reference exchange rate to the US dollar at 7.0947 per dollar. This move, which was made in current year, is aimed at maintaining exchange rate stability and has significant implications for the global currency market. Similarly, the manat in Azerbaijan has been pegged to the US dollar for nearly a decade, showcasing its reliability in the market. This stability, however, is only against the US dollar, as the manat's value fluctuates against other currencies, including BRICS national currencies, and has been appreciating over a long period.

Conclusion

The US dollar's dominance in international settlements, particularly in SWIFT transactions, is not a short-term trend. It is expected to persist in the coming decade, providing a stable foundation for the global financial system. Approximately 48 percent of SWIFT settlements worldwide are conducted in US dollars, underscoring its enduring global influence. This dominance is further highlighted by the limited success of the yuan in the Asian region, making the prospect of a US Dollar - Chinese Yuan duopoly in international settlements a distant one.