



Economic Research Center

**The Effect of Current Financial Crisis on the Labor Market:
Case of Azerbaijan**

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The Effect of Current Financial Crisis on the Labor Market: Case of Azerbaijan

Abstract

The aim of this paper is to analyze the effect of the current financial crisis on the labor market in Azerbaijan and make relevant future policy proposals. Since it is an almost stylized fact that unemployment rate is affected by inflation rate I will show that despite Azerbaijan's vast resources, its still underdeveloped labor market was to some small extent exposed to the effects of financial crisis. I find slight evidence of effect of the crisis on the labor market status in Azerbaijan despite Azerbaijan's back up resources. I analyzed some recent years' trends in the labor market and justified their relation to the crisis.

Introduction

The current financial crisis is considered the most severe and lasting in the history of economics. Indeed, its impact is way beyond the scope of its origin. Not only it is a challenge to fight it but also it is still an open question how to estimate its impact on the global economy or specific countries and what policy conclusions to draw for the future. For this matter Azerbaijan is a special case since for already more than a decade Azerbaijan is experiencing very noticeable GDP growth. Only during the crisis the growth rate of GDP slowed down but still did not experience a negative rate, which indeed was a case in some countries like Mexico (Verick 2009). Azerbaijan has been very much dependant on oil revenues and it is crucial to estimate the effect of the current crisis on Azerbaijan when the oil prices had a big downturn. Nevertheless, despite the worldwide global financial crisis and the fall in international oil prices from 2008 highs, Azerbaijan's economy sustained a strong growth of 9.3% in 2009 (Asian Development Bank and Azerbaijan 2009).

The situation on the labor market is an important indicator for any economy in general. Labor market situation in transition economies is worth special attention since it is tied to many not only financial but also institutional aspects of the country's economy. It is clear that for healthy labor demand and supply balance there should be strong institutional back up. Transition economies face such problems like excess of supply, which in turn drives employers to set lower wages. Since there is no or very little subtle institutional regulation of hiring and firing, very big part of population takes venerable position on the labor market. In Azerbaijan, even though there has been a number of training and employment programs (ex.: State Strategy on Employment 2006-2015) provided by the government structures, the level of unemployment still has a big room for improvement.

The economy of Azerbaijan boosted through recent years due to its natural resources. Since global economy suffers from risen unemployment levels it is interesting how unemployment will behave in the case of Azerbaijan. For example, the U.S. unemployment rate has reached even 10 percent at the end of 2009. For comparison, it was

5% in 2007 (Bureau of Labor Statistics 2010). Employment rate declined at an unprecedented rate to just 58.5 percent, a level not seen since 1983 (Kirkegaard 2009). The EU countries have suffered substantially from the impact of global economic crisis (Eurostat 2009) as well. The impact of the recessions was not equally distributed among population: some suffered more than others did. Most of the people who suffered were young labor market enterers (Verick 2009).

Since employment rate is one of the main indicators of the country's economy it is crucial to evaluate its behavior in the crisis period. However, a lack of data slows down evaluation of the impact of the current financial crisis on the number of developing and transition countries. It is important to identify the most affected regions, sectors and most importantly - age groups in order to take appropriate policy actions. In general, evaluating employment levels in Azerbaijan is not a trivial task since most of the jobs created are in the informal sector of the economy. Even though in years 2003-2006 the growth in employment was quite high it was still less than in many successful transition countries like Estonia and Czech Republic and the jobs were created less productive, lower paying sectors, especially in agriculture (World Bank Report No. 44365-AZ. 2009).

In the first chapter of my paper I provide some historical background and specifics of the labor market in Azerbaijan as a successor state of USSR. In this chapter, I will analyze the history of the labor market development in the country and describe some policies implemented by the state in order to fight unemployment levels. In the second chapter, I will analyze the indicators of economic crisis in Azerbaijan. Third chapter defines most affected industries. In the fourth chapter I will divide people into age and gender groups and identify which group is the most vulnerable in the times of economic downturns. In the fifth chapter I perform a similar analysis but concerning the education levels. I will group people according to the highest degree they have obtained and then look at the number of officially unemployed among them in order to identify the causes of it and consequences during the crisis. The sixth chapter analyzes the trends in migration desires of the population at the time of the crisis. In addition, the last chapter concludes and provides ideas for further research and suggests policies.

Historical Background and Country Specifics

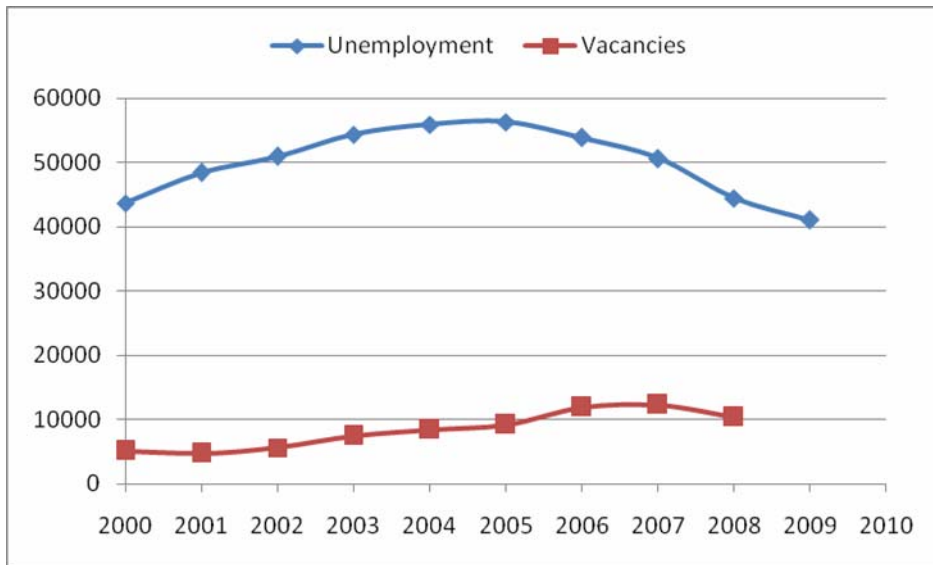
Azerbaijan as any other transition economy has experienced high levels of unemployment. This was mainly due to separation of the country from a bigger entity like USSR. Since unemployment was never a problem during Azerbaijan's communistic period the competitiveness in terms of "selling" their qualification

ns among people was low or just did not exist. On the other hand, being part of USSR set some certain level of basic labor specialization. After the collapse of Soviet Union there was a high demand in total restructuring of employee-employer relations. Education institutions which are basically the main way how the governments manages labor market still worked in the same manner and style as a typical successor country of USSR. Those institutions did not meet new demand formed on the market. This was basically a reason for such phenomena as high demand in employment and excess supply of labor force at the same time.

One of the main goals of the government throughout the transition period is decreasing unemployment rate and poverty. Several state programs on decreasing unemployment level have been approved in recent decade. Several of them are State Strategy on Employment 2006-2015, State Program on Youth and State Program on Regional Development. These programs were directed into creating non-oil sector work places. The main idea of creating non-oil sector jobs is using oil and natural gas sector money in order to boost other sector productivities. In terms of State Strategy on Employment program there should be several phases. During the first phase, that covers time period 2007-2010 and is actually during the economic crisis, the decrease in unemployment during this period was very high. Unemployment level actually decreased to around 6 percent in 2009, which is a promising indicator if compared to different countries with similar socio-economic conditions such as other CIS countries.

Table A2 the number of employees who lost their jobs was the highest in 2009 which might be a simple lagged effect of the pick of the crisis in 2008. The indicator for 2009 increased by 188 percent compared to the previous year. However, dismiss by reduction of the staff actually diminished since 2006 from 5.3 to 2.6 percents out of all employees leaving their work place (see Table A2). Along with this, in 2008 out of 43503 applicants to the state employment services 31144 obtained a job by the help of the state office. In 2009 the number of people provided by job placement assistance was 28,382. Evaluation the effect of state-run programs cannot be plainly based on these figures. Since program effects cannot be simply estimated by the resulted outcome. Because there is no proof that those people would not find jobs without the assistance of the state. In order to assess the true effect of the program there should be carried appropriate pre- and post research that would enable us to separate the effect of the program from the number of people who actually obtained a job placement. This also should be done in order to avoid overregulation of the labor market. Overregulation might cause diminished demand for employees. However, in peculiar case of Azerbaijan it is clear that some external shock to its labor market relations might be helpful. Graph 1, for example provides an imperfect dynamics of labor market supply demand structure. Even though the gap between two graph narrows by time there is still substantial difference.

Graph 1. Number of people with official unemployment status vs. vacancies



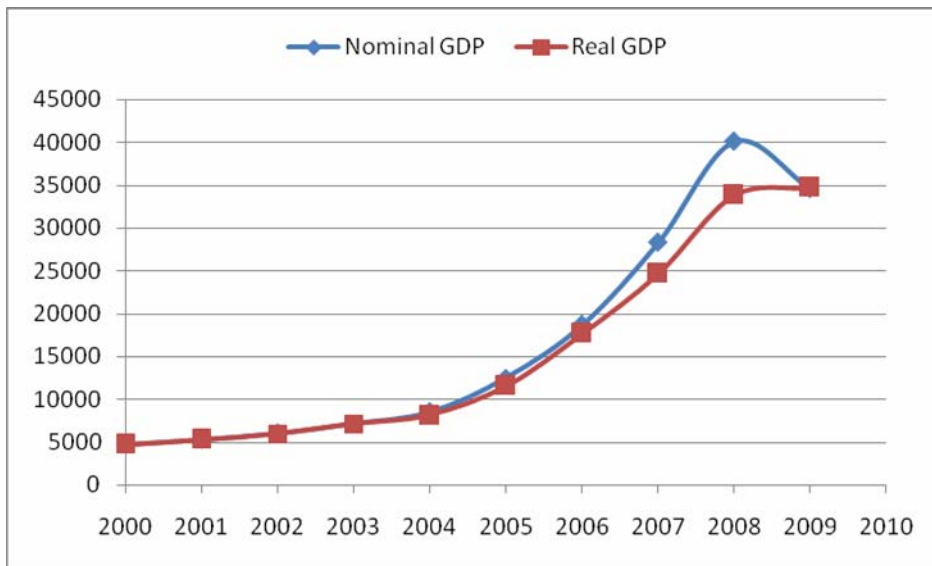
Determinants of the Crisis in Azerbaijan

Azerbaijan's economic growth is highly dependent on the oil and natural gas sectors. Vast natural resources have been a major driving force of Azerbaijan's economy throughout its history. If for instance in 2009 Azerbaijan's GDP constituted 34578.7 millions of AZN, it is primarily due to oil and gas sector revenues. GDP of the oil and natural gas sector constituted 18895.5 million of AZN (see graph 5). These numbers clearly indicate Azerbaijan's reliance on oil product. Current world crude oil prices changes had a major impact on Azerbaijan's economy and was the major source of economic downturn. Table 1 provides Nominal and Real GDP of Azerbaijan for 2000-2009 in constant 2000 prices. Real GDP is calculated using CPI. It is important to note that in the year of 2008 nominal GDP drops but real GDP continues to rise slightly. This is due to sudden drop in consumer price index. Graph one provides nominal and real GDP values for the 2000-2009. Graph 4 provides jumps of world crude oil prices and therefore, hydrocarbon-sector GDP jumps. Graph 3 and 4 show the GDP growth rates and illustrates GDP compared to oil and gas industry GDP respectively.

Table 1. Source: Azerbaijan State Statistical Committee.

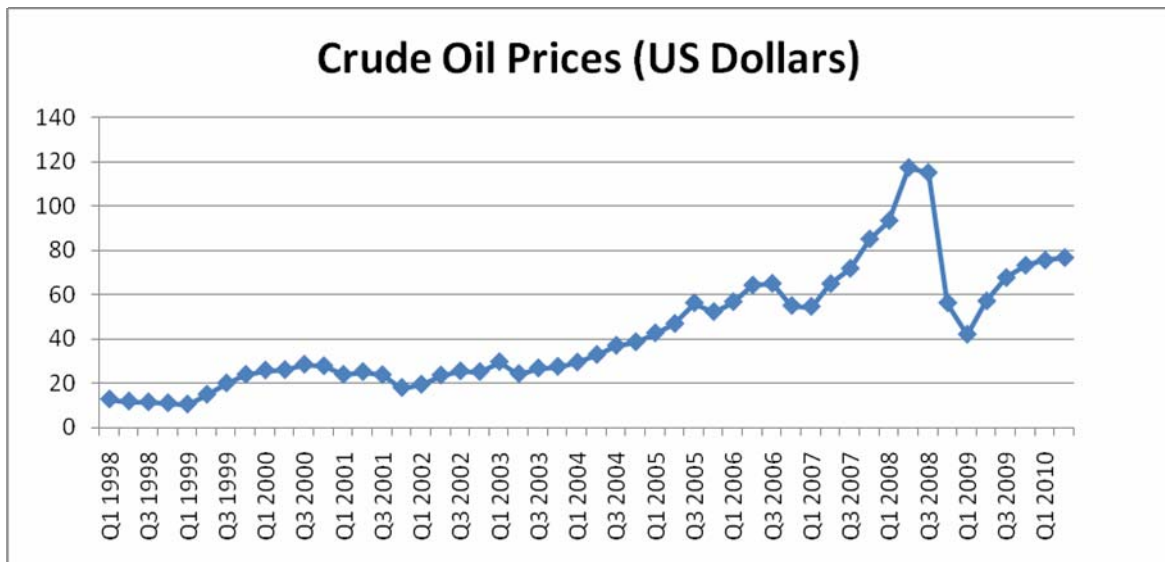
Year	Nominal GDP (mln AZN)	Real GDP (in 2000 prices - mln AZN)
2000	4718.1	4718.1
2001	5315.6	5315.6
2002	6062.5	6003.641
2003	7146.5	7146.5
2004	8530.2	8131.593
2005	12522.5	11611.77
2006	18746.2	17704.74
2007	28360.5	24724.54
2008	40137.2	33834.66
2009	34578.7	34749.04

Graph 2. Real and Nominal GDP

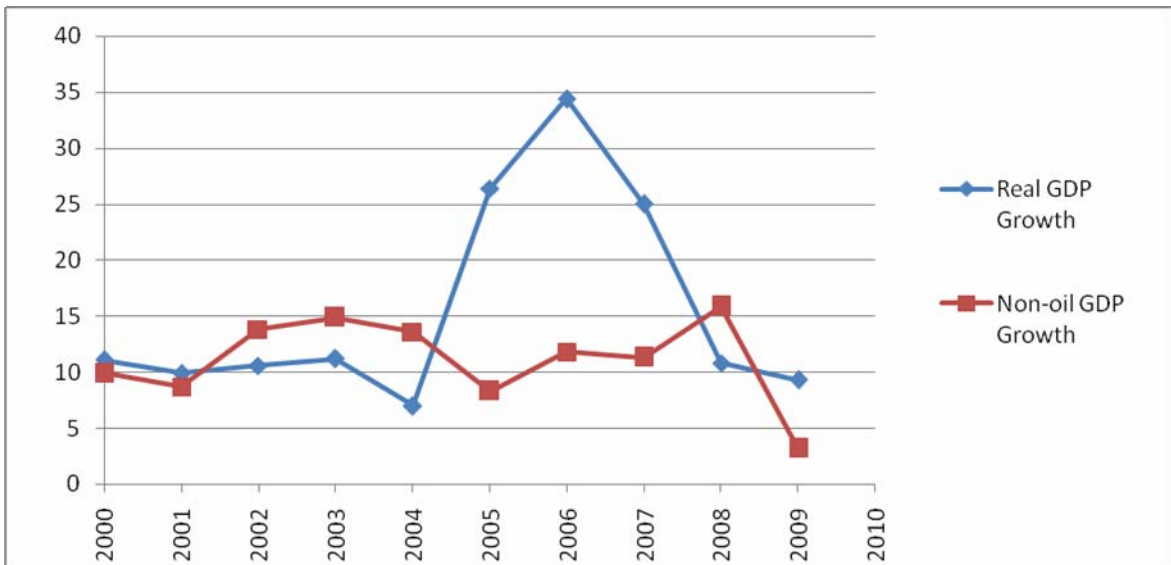


Since Azerbaijani economy is mainly dependent on oil industry revenues the behavior of GDP and non-oil GDP is very different. For example, Graph 3 shows the growth rate of real GDP and real non-oil GDP. Graph 3 shows that growth real GDP growth rate in 2007 dropped around 40% of the previous year's indicator. The largest drop in non-oil sector GDP was between 2008 and 2009 was roughly 20% drop in growth rate (see graph 4).

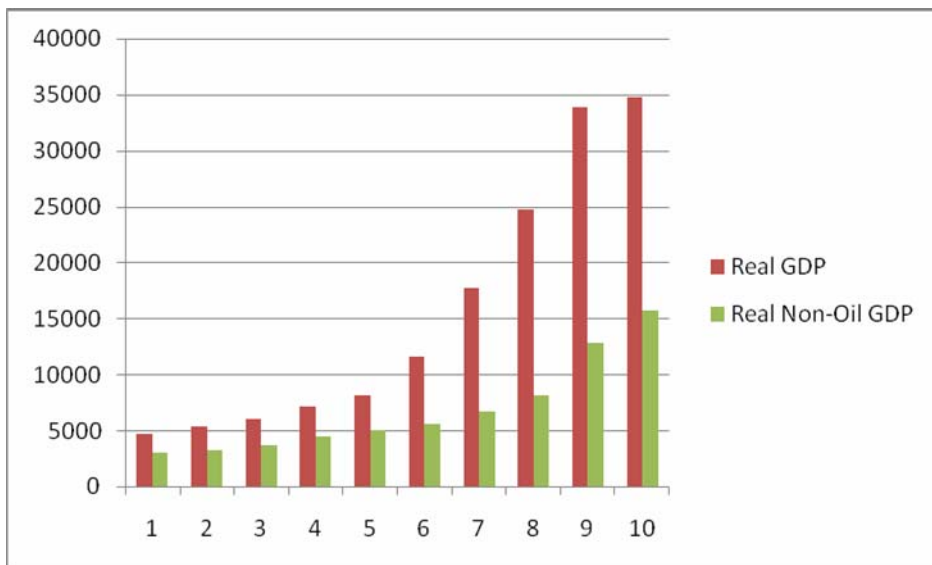
Graph 3.



Graph 4.



Graph 5. Real GDP vs. Non-Oil Sector GDP



Most Affected Industries

Although Azerbaijan has experienced a rapid GDP growth in the recent decade most of it is due to vast natural resources particularly hydrocarbon-sector. This was mostly a reason of unbalanced growth, which in turn led to sectoral and regional disproportion in GDP. Some regions are mostly engaged in unproductive agricultural occupation. Development of some sectors and regions result in narrow employment opportunities in some parts of the country, especially in rural areas. In aggregate this has very negative impact and leads to migrations to cities and low productivity in agriculture. It is very crucial for policy makers to evaluate the impact of the crisis when Azerbaijan's labor force is mainly concentrated in low productive agriculture. From one point of view, because of this agricultural occupation of the population their underdeveloped self-sustained households might not experience much of the impact of the crisis. In order to assess the effect of the crisis I will try to determine industries that have been affected the most.

Another problem of associating effect of crisis on unemployment rates is that in many countries despite the prediction of negative unemployment growth rate, some countries still experience positive one. Examples would South-East Asia and the Pacific regions. Given the fact that unemployment is the exception for individuals in countries without adequate or any social protection, the impact of the reduction in growth is felt more in terms of deterioration in the quality of employment rather than a decline in its volume (C.P. Chandrasekhar and Jayati Ghosh 2010). Given that unemployment rate in Azerbaijan did not increase, but had a small decline, it could also be a case that the aggregate unemployment rate wasn't affected or the effect was very insignificant, but as a result of labor reallocation the number of people working in worse conditions increased and salaries decreased. In aggregate the labor market indicator were not altered much but on the level of individual, there have been changes in labor conditions.

Average annual real wage has been steadily increasing in all industries. However, the fastest increase was in 2006 was in financial activities and constituted 77%. in 2007 it was 64% growth for other community, social and personal service activities, 2008 – increase of 43% in Education, 2009 – 45% in Public Administration and Defense, Social security. In the recent years the biggest growth rate observed was mostly in government sectors. The lowest growth rate in 2006 is also in social services. In 2007 construction exhibits the lowest growth rate, and in the next 2 years - Real estate, renting and business activities. The lowest wages are in Agriculture, Hunting and Forestry and Fishing, Fish Breeding. The highest average monthly wage belongs to mining sector, which is not surprising in Azerbaijan, however, the gap between the lowest industry specific average wage and the highest is striking. In 2009 the gap is 945 AZN. This wage gap is another proof of economy growth unbalanced towards certain sectors (see Graph A3).

GDP of Azerbaijan suffered a lot from the world crude oil price fall (see graph 4). In 2009 the portion of GDP attributed to oil and Natural Gas sector fell down 7.9 percentage points, which was the largest decrease for the last decade. However, the most affected industry can be considered manufacturing industries, which diminished almost 1% since 2007. Agriculture and Hunting has an interesting trend in GDP share: it is steadily decreasing until 2008 and then has a sharp decrease of 0.9 percentage points in 2009, which can also be considered a lagged crisis effect and might be a proof of the theory of reallocation labor into less productive and lower paid occupations. Apart from the labor reallocation hypothesis there is no direct proof of it in the distribution of employed population by kinds of economic activity. The distribution changed very insignificantly throughout the last years. However, the aggregate level data on employment cannot disprove it as well.

Most Affected Age Groups

Financial crisis and even small economic downturns can affect different people in completely different ways. Some groups are more vulnerable, some are more persistent to such shocks. Moreover, unemployment has some hysteresis effect and the vulnerable part of the population will still keep being so for some time until the economy recovers. This is why it is important to determine the most affected groups and make the policy for unemployment reduction more group targeted.

Literature suggests that youth can be considered as the most affected part of population by financial downturn (Verick 2009). One of the reasons why it is so is because young labor market entries do not possess advanced knowledge of job seeking skills. People with more experience have higher potential during the interview, they have the skill to present themselves. Even such small things as managing your own CV can be problematic for fresh graduates. However, the most important reason is that during recessions and increased labor supply and decreased labor demand makes employers to raise their choosing criteria. All these above listed facts cause fresh graduates longer job seeking period and unemployment. Moreover, unemployment among young people can have a long term social impact concerning crime rates or even unemployment spells.

Unemployment among young people in Azerbaijan can be a big problem, since one of the above mentioned reasons were that employers demand more skilled staff than before and Azerbaijan has a peculiar problem in matching labor market demand with education and training provided by educational institutions. This makes young people in Azerbaijan even more defenseless in terms of economic downturn.

In order to test whether there is an effect of economic downturn on unemployment I will take yearly unemployment rates and GDP per capita constant at 2000 prices and draw a joint graph of them. Then I will separate unemployment rates for different age groups and see how the effect of crisis differs for them.

It is also important to note that the biggest part of Azerbaijani GDP comes from oil revenues but the labor force that is involved in oil industry is disproportionately small. This is why to somehow clean the data from inconsistencies I will use only non-oil sector GDP for the sake of comparison. Due to unavailability of unemployment rates within different age groups I will use the proportion of a certain age group among the overall number of people who received unemployment status. However, when interpreting the results it is important to note that with the widely spread shadow economy in Azerbaijan it is not easy to define unemployment. So the person might be listed unemployed but still receive rather permanent income, or be unemployed and not registered. Another problem is that some people might be officially unemployed but still receiving income from the unknown source. One should also keep in mind that the official unemployment status holder is an imperfect proxy for the share of a certain age group among unemployed. These are the reasons why we have to treat the graphs with caution.

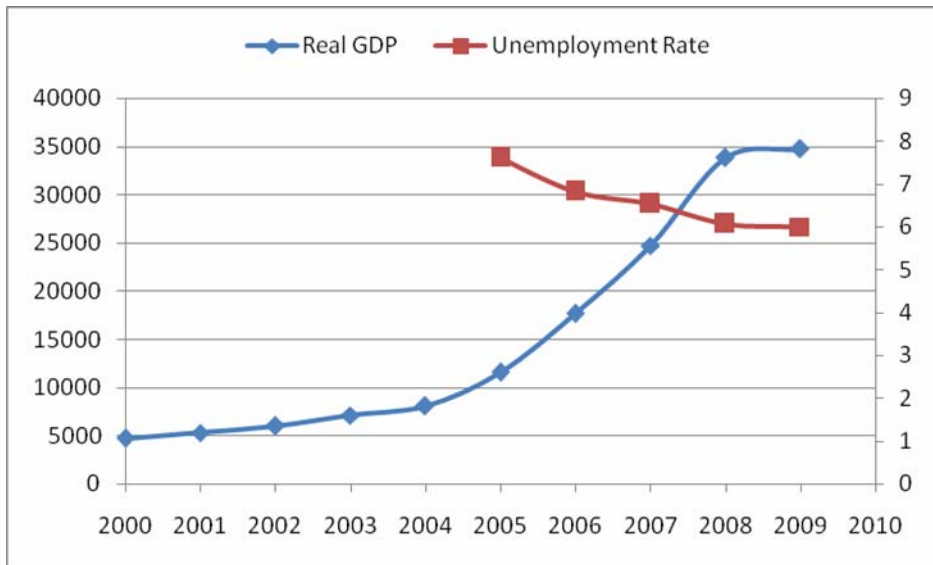
The graphs ignore pre-retirement age people for both genders because their share in the number of people who receive unemployment status is insignificantly small. Graph 5 shows yearly changes in unemployment rate and GDP. From this graph it is clear that unemployment level in Azerbaijan is steadily decreasing. Even if the literature predicts

(cite) a big increase in unemployment there is no such thing in Azerbaijan. On the contrary, unemployment levels were continuously decreasing even in the period of the most severe part of the crisis.

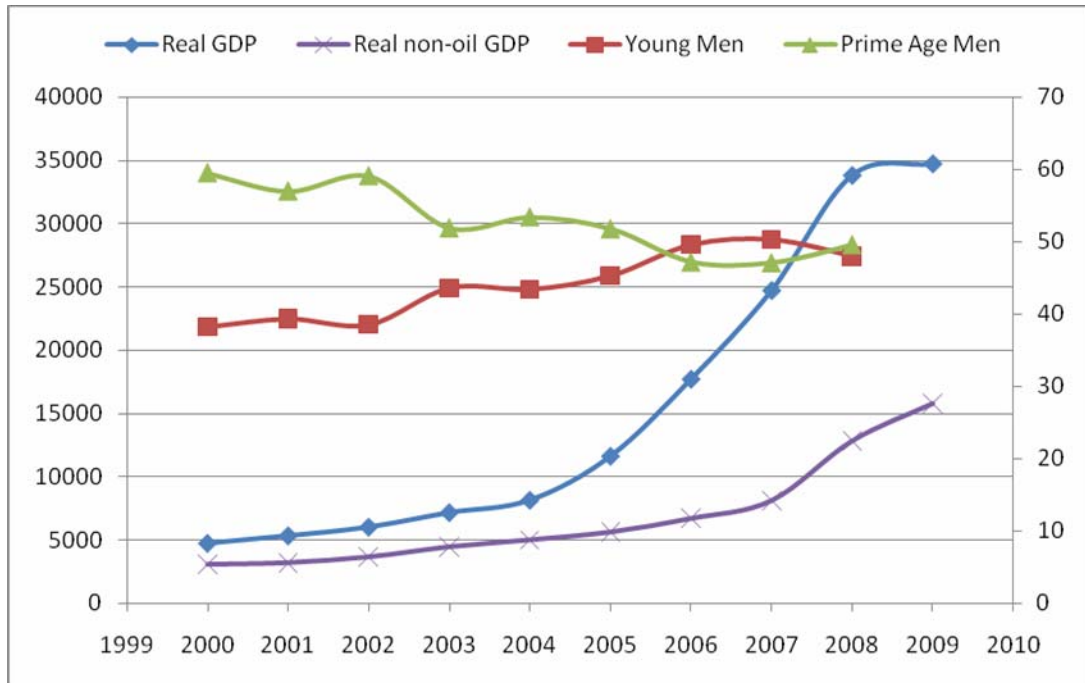
The relevant literature predicts young people to be more vulnerable during the crisis time. However, if we look at the graphs, during economic crisis we see very slight downward slope among the share of young men in the total males who received official status of unemployed. On the contrary, to the common expectations the prime age men, defined from 30 through prepension age, unemployment graph experiences slight upward trend during the crisis period. The results of graph 5 and 6 are not in line with the literature and empirical studies on US and European countries (Verick 2009). The similar inconsistency with the literature is in case of women unemployment. Share of young women among those who received the status is having a steep downturn even prior to crisis. The share of prime age women graph has an inflection point prior to crisis and has a steep upward trend up until 2008. Unfortunately, due to unavailability of the data it is difficult to analyze the after crisis slope of these shares.

However, one can argue that in terms of Azerbaijan's specific needs and demands on the labor market and non-availability of education system to supply the needs of the employers, young people might be even though less experienced, but also much more willing to learn to adjust the employer expectations and of course has less salary expectations. The capability of the labor market to give such preferences to potential employees can also be a result of undeveloped contracting and weak labor unions. In the case of US and European states (Eurostat 2009), youth is the first group of people whom economic crisis hits the most. Particularly, the crisis hits the most those who are at the entry of the labor market, for instance, newly graduates. The employee does not have to bear any legal consequences of so called "discriminating" among more and less experienced. An employer basically speaking chooses not to hire, rather than firing existing workers. In Azerbaijan due to labor union weakness or absence the process of firing and hiring newly graduates for the lower money that the job is worth seems to be a common trend. It seems that Azerbaijan has different impact of crisis on unemployment than other countries. According to graphs prime age women are the most vulnerable group.

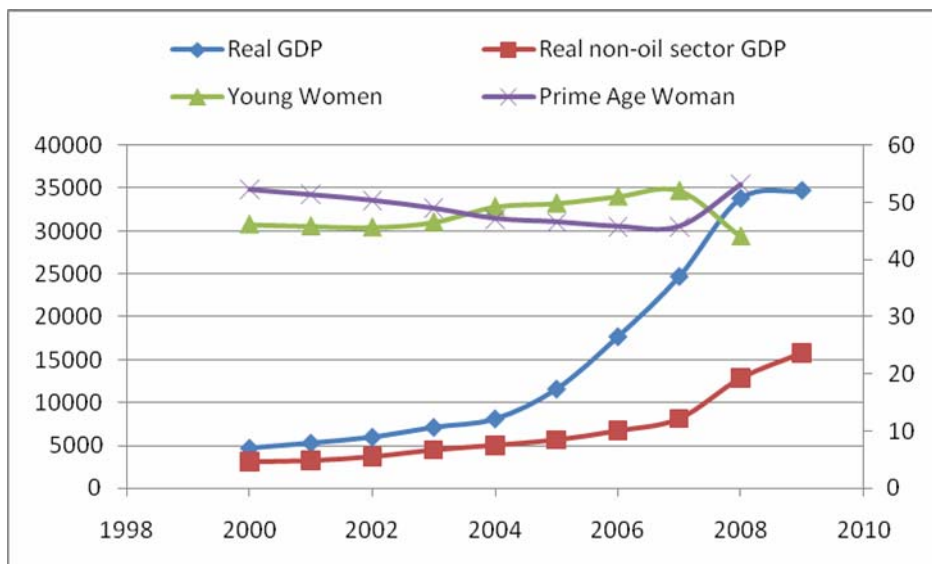
Graph 5. Real GDP in constant 2000 AZN vs. Unemployment rate



Graph 6. Share of young and prime age men over all men received unemployed status vs. GDP



Graph 7. Share of young and prime age women over all women received unemployed status vs. GDP



Effect on People by Education level

Despite the effect of crisis on age groups there also can be a different effect on people with different education levels. Table A1 from appendix provides data up until 2008 and divides people into four categories of education levels: higher, secondary special, general secondary, incomplete secondary. The table clearly illustrates that people who suffer the most are the most educated ones. Men with secondary special education had always had a very high participation rate in the unemployment office, however it is decreasing. Male participation level with higher education level is also high and most importantly is increasing with a steep slope. The similar situation is with women who received a status of unemployed: the most educated ones suffer the most. However in the case of women the numbers of unemployed with secondary special education is much higher than with higher, however, both are increasing. The participation in labor office activities reaches its highest in 2008 for people with higher and secondary education. This may be caused by the oversupply of education in certain spheres left as heritage from USSR, which shows itself in a stronger way during current economic downturn.

Migration of Labor Force

After collapse of USSR, many successor countries experienced outflow of working force from the country. Later, the desire to live abroad has become a common trend among CIS and a number of other countries. In some countries this is a very acute phenomena, in others just a mild tendency. According to the recent sociological research of Gallup group among the CIS countries around 24 percent of people want to move to another country for temporary work, 25 percent to study or to take part in work and study programs and 13 percent would like to move for permanent stay (Neli Esipova, Julie Ray 2010).

The desire to leave the country of origin regardless of the purpose is quite high and in some countries reaches dangerous numbers. It is notable that the percentage of people who want to move temporarily is much higher than the desire for permanent stay. However, the results are questionable from the point of view that people who were questioned have not been on temporary work abroad. In order to establish the dynamics it is not enough to know the desires, but also survey people who are now involved in some temporary stay case, or those who are back. Another bias that the survey might have is that the people

Comparing countries with relatively low GDP the wish to leave the country of origin permanently is not the highest in the chart except for Moldova. If we take a look at Tajikistan, Turkmenistan and Uzbekistan, we note that despite their low GDP the desire to leave the country permanently is very low. This phenomena could be attributed to very acute cultural specificity of these countries. The highest percentage of those who want to leave the country permanently are in Moldova and Armenia. Armenia's case could be explained by its large Diaspora over the world (Neli Esipova, Julie Ray 2010).

Azerbaijan, the number of people who want to leave for temporary work is high but compared to the rest of the region is the smallest. Unfortunately, the desire to study or participate in work and study program has the lowest determinants in Azerbaijan. It is

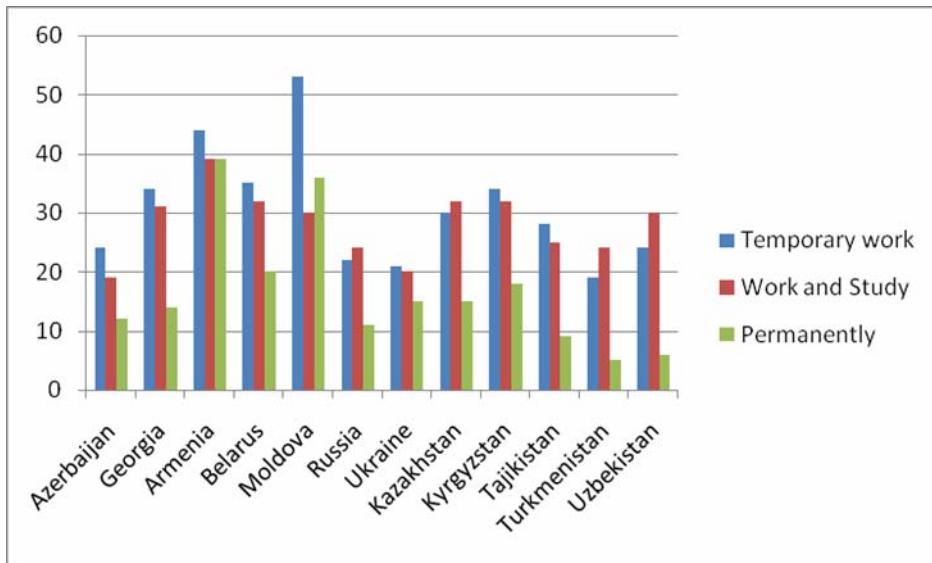
crucial to encourage people for such programs, by doing so the gap between what education system offers and the labor market demands can be reduced. Azerbaijani government has already started encouraging studying abroad and invested substantial amount of money into potential human capital. Since 2006 there is an established state program that gives opportunities to talented students to get education in the number of top schools abroad. Nevertheless, the desire to study abroad among Azerbaijanis is the lowest among other countries in the region. This might be due to the fact that the knowledge of opportunities is somehow biased towards urban population, or the access to the knowledge is not public enough.

Desire to Migrate Permanently, for Temporary Work or Study. Source:
Gallup Research.

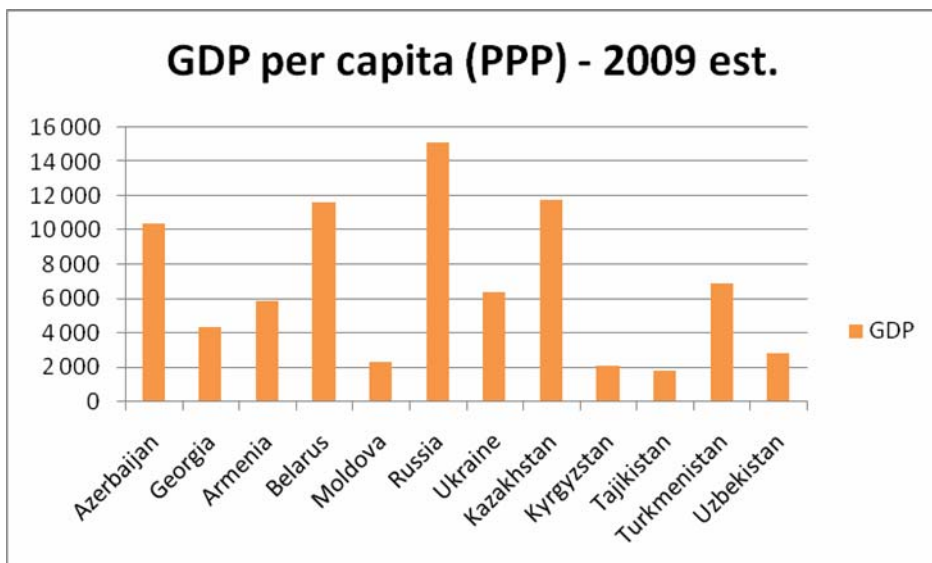
CIS countries including Georgia and Turkmenistan

<i>Would like to move to another country:</i>	<i>for temporary work</i>	<i>to study abroad/participate in work-study program</i>	<i>Permanently</i>
CIS (total)	24	25	13
Caucasus	31	27	18
Azerbaijan	24	19	12
Georgia	34	31	14
Armenia	44	39	39
European CIS	23	24	13
Belarus	35	32	20
Moldova	53	30	36
Russia	22	24	11
Ukraine	21	20	15
Central Asia	27	30	10
Kazakhstan	30	32	15
Kyrgyzstan	34	32	18
Tajikistan	28	25	9
Turkmenistan	19	24	5
Uzbekistan	24	30	6

The difference between countries can be seen from the following diagram



GDP for 2009 in US dollars. Source: CIA World Factbook



Conclusions and Further Policy and Research Suggestions

In this paper I evaluated the effect of current crisis on the labor market in Azerbaijan. I have found no severe damage caused by downturn in the economy. In order to establish the most affected age group I compare GDP (PPP) and the share of unemployed of the certain age group among the overall number of unemployed in this gender group. As an imperfect proxy I use the number of officially registered people at the unemployment office, who received a status of unemployed. I find inconsistency with the relevant literature, however I keep in mind that that the indicators are quite rough. On the other hand, such results can be brought up by undeveloped contracting and weak or no labor union power on labor market.

Another “grouping” of people that should be analyzed in order to estimate the effect of current crisis is the division of people by the level of their education. The data on the distribution of people who received unemployment status clearly states that the most affected groups are those with higher and secondary special education. This may be interpreted as another proof of the incapability of the education system to fulfill the employers’ demand for the skilled work and a certain mismatch between education system and labor market, the consequences of which are enhanced by the ongoing crisis.

Like many other transition countries Azerbaijan is a subject to temporary and permanent outflow of labor force from the country. However, a closer look at the CIS countries similar data reveals the fact that Azerbaijan compared to the rest of the countries in former USSR is not subject to big permanent outflow of labor force even in the times of the economic crisis.

Since Azerbaijan has undeveloped labor union concept and a big mismatch in education system and the needs of the labor market it would be useful to evaluate unemployment programs run by the government in order to estimate their real effect or whether there is one. Even though there has been provided by the state unemployment support program and services for job seekers it is still impossible to evaluate them on the basis of how unemployment rates decrease. Because unemployment rate might naturally decrease based on other changes in economy, not based on the effect of state-run program. Additionally, since the government heavily finances State Employment Office and its projects for alleviation of poverty rates through diminishing employment rates, the money and results of the projects should be treated with caution. It has been argued extensively that governments should not make any deficit financing in order to fight recession. For these reasons, along with the strategic program of the government there should be a process of its constant evaluation via surveys which would contain information on how many people find a job, how many actually lose it after finding, what is the satisfaction level and whether the trainings provided were helpful. This can be done through sample surveys or

tracking a sample of people through the time they apply until specific point in time. This kind of analysis would be helpful in order to separate the natural unemployment rate decrease and the effect of the program.

Overall, the paper finds no severe damage to the unemployment rate in the country. However, a certain reallocation among industries and redistribution of labor between age and education level groups took place.

Appendix

Table A1. Distribution of people who received unemployment status by level of education

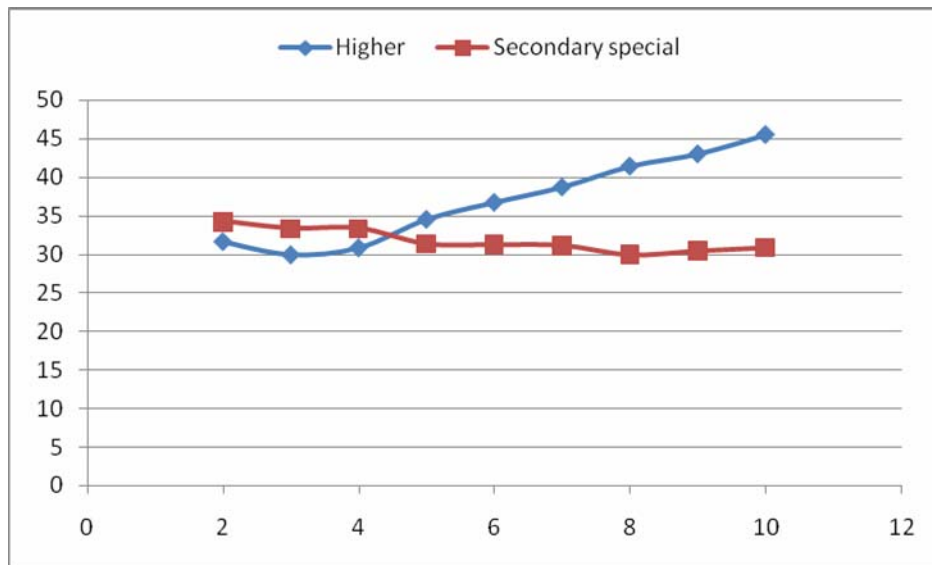
	Higher	Secondary special	General secondary	Incomplete secondary
Male				
2000	31.6	34.3	29.7	4.4
2001	29.9	33.4	32.6	4.1
2002	30.8	33.4	31.2	4.5
2003	34.5	31.4	29.6	4.5
2004	36.7	31.3	27.4	4.6
2005	38.7	31.2	26	4.1
2006	41.4	30	11.8	2.9
2007	43	30.5	10.9	2.3
2008	45.5	30.9	8	2.1
Female				
2000	23.8	33.5	37.7	5
2001	22	35.5	37.6	4.9
2002	22	36.9	35.6	5.5
2003	21.8	37.5	35.2	5.5
2004	22.8	37.6	35	4.6
2005	23.1	38.1	34.2	4.6
2006	24.1	36.2	18.3	3
2007	25.8	37.9	16.5	2.5
2008	28.8	41.2	11.7	2.6

Table A2

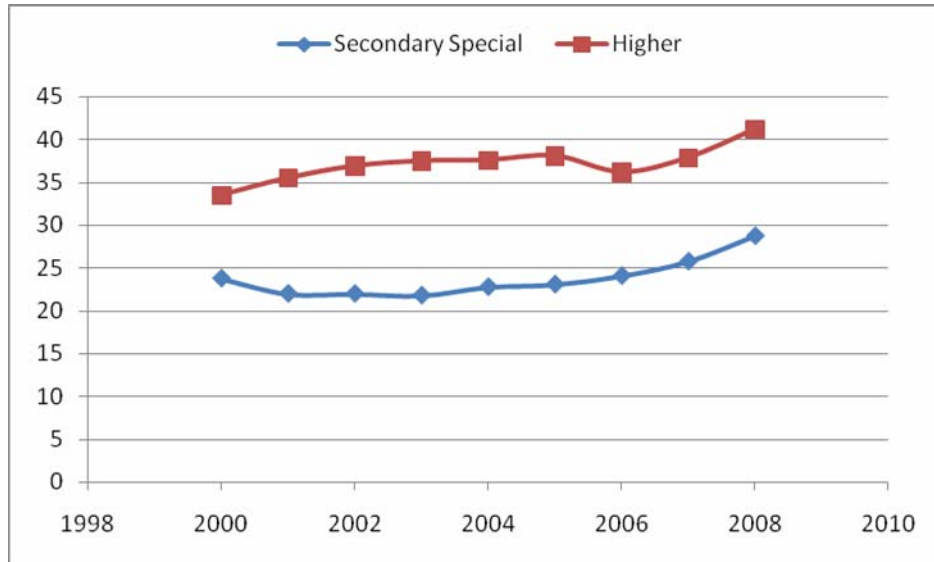
. Number of fired employees

Year	Persons
2003	11351
2004	21568
2005	7927
2006	6012
2007	5074
2008	3037
2009	8747

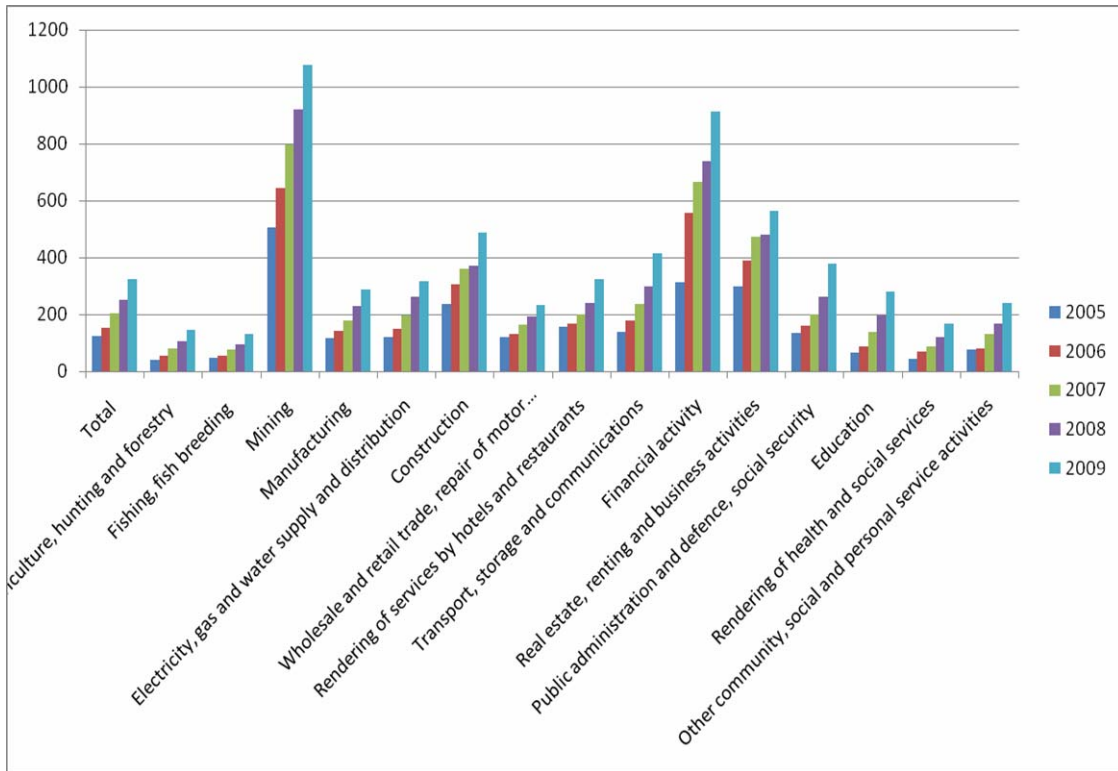
Graph A1. Distribution of men who received unemployment status by level of education



Graph A2. Distribution of women who received unemployment status by level of education



Graph A3. Average real wages by sectors in constant 2005 AZN



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