

# EU BUSINESS CLIMATE REPORT AZERBAIJAN 2020

5<sup>TH</sup> ANNUAL EDITION



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# FOREWORDS



## Kestutis JANKAUSKAS

Ambassador – Head of the Delegation

DELEGATION OF THE EUROPEAN UNION TO AZERBAIJAN

EU Business Climate Report Azerbaijan 2020 is a 5th edition aimed at better understanding of achievements and remaining challenges in EU-Azerbaijan economic cooperation and further improvement of the business climate.

During the challenging year 2020, EU remained Azerbaijan's main trading partner. Last year we all engaged into a fight with global pandemic. It changed our way of live, created various market volatilities, affected businesses and forced us to adapt in so many ways. With the "Team Europe" approach, EU and its member states adjusted their cooperation programs with partner Azerbaijan helping to address the most immediate health needs, strengthen public health system and to mitigate socio-economic consequences of the pandemic while continuing to support reforms and step-up investment into the human capital.

Despite the challenges and volatilities, we witnessing continuation of reforms in Azerbaijan. This 5th edition of the Report not only provides an independent assessment of the current business climate, but enables to see the changes in perspective compared to previous years.

Last year European Union launched European Green Deal and made emphasis on digital transformation and youth. This Report took into account these new tendencies in Europe and for the first time included an overview on green and digital opportunities for businesses in Azerbaijan.

The war in the autumn of 2020 was momentous for the entire South Caucasus region. The cessation of hostilities in November has brought about new opportunities but also new challenges. This Report is also touching upon the effect of these developments on businesses.

The EU Delegation is pleased having joined forces with Italy-Azerbaijan Chamber of Commerce (ITAZERCOM), Azerbaijan – France Chamber of Commerce and Industry (CCIAF), COWI Belgium and InvestBaku in preparation of this Report, and coordinated closely with AZPROMO.

I sincerely hope that businesses as well as the Government will find this Report useful for their work and planning as the EU and Azerbaijan continue expanding cooperation and work on the new legal framework of bilateral relations.

As 2021 is expected as year of hope, I would like to encourage EU businesses to have a new look into Azerbaijan, and at the same time wish Baku to embrace further openness while continuing reforms.

Sincerely,  
Kestutis JANKAUSKAS



## Manuela TRALDI

President

ITALY-AZERBAIJAN  
CHAMBER OF COMMERCE  
(ITAZERCOM)

Without any doubt, 2020 will be remembered as a year of difficult challenges, generating uncertainty, but also stimulating change in an entirely new environment. Governmental measures in support of business have gained an unprecedented importance, while the effects of the pandemic on the economy are ongoing and seem to be long-term and hard to predict.

Against this global background, during 2020, Azerbaijan has experienced the restoration of its territorial integrity and a long-awaited peace that is expected to bring prosperity and stability to the entire region. Due to the combination of these extraordinary factors, the assessment and analysis of the investment and business climate in the country at this moment, through the eyes and the perception of the EU companies, may have particular significance.

ITAZERCOM is extremely pleased to be partners of the EU-Azerbaijan Business Forum 2020-2022 and co-authors of this Report and thanks COWI Belgium, InvestBaku and the French Chamber of Commerce for their professionalism and excellent teamwork. We would like to express our gratitude to the EU Delegation to Azerbaijan for this opportunity and to AZPROMO for their precious cooperation.

Lastly, we would like to extend our most sincere appreciation to all the participating companies and respondents who have contributed to this report despite the difficulties. We stand ready to support throughout the EU-Azerbaijan Business Forum 2020-2022 and beyond!

Sincerely,  
Manuela TRALDI



## Zibar HUSEYNOVA

Managing Director

AZERBAIJAN-FRANCE  
CHAMBER OF COMMERCE  
AND INDUSTRY (CCIAF)

This is the fifth edition of the EU Business Climate Report Azerbaijan which has become a trusted tool among the public and private sector partners. It serves to improve the business climate in Azerbaijan by supporting the dialogue between the businesses and the Government, and to furthering the economic partnership between the EU and Azerbaijan.

Improving a business climate has never been more important than now during a global pandemic that altered virtually everyone's lives. Creating favorable business environment via partnership between the public and the private sectors is the only key to stabilise the economy during this period.

This year has also been a year of hope and extraordinary dedication. After almost three decades, Azerbaijan restored its territorial integrity which will make it possible to open a new chapter in the history. On behalf of CCIAF, I would like to commemorate the memory of martyrs fallen in the war and express our condolences to their families. We hope that the peace will prevail and bring prosperity to the region.

Azerbaijan French Chamber of Commerce and Industry is honored to be a partner of the EU-Azerbaijan Business Forum for 2020 alongside with COWI Belgium, InvestBaku and the Italian Chamber of Commerce. I would like to express my gratitude to our partners for their dedication and hard work despite these difficult times. I would also like to thank all companies which took part in the survey and wish them a successful, healthy, and prosperous year ahead.

Sincerely,  
Zibar HUSEYNOVA

# INTRODUCTION

This report is prepared within the annual “EU-Azerbaijan Business Forum” funded by European Union since 2015. The forum aims to promote the economic cooperation between the EU and Azerbaijan. During the period 2020-2022 the assignment “EU-Azerbaijan Business Forum” is being implemented by COWI Belgium in partnership with Azerbaijan-France Chamber of Commerce and Industry (CCIAF), Italy-Azerbaijan Chamber of Commerce (ITAZERCOM), InvestBaku and in coordination with AZPROMO as part of the Ministry of Economy of Azerbaijan. Quality control for the assignment 2020-2022 is implemented by Ecorys.

The “EU Business Climate Report Azerbaijan 2020” is the fifth annual study introducing the business climate in Azerbaijan from the perspective of European companies, operating in the country. The strong focus of the report is devoted to the progress in implementing the economic reforms taking place in the country since 2016. The reforms aim to diversify the local economy by enhancing non-oil sectors and strengthening small and medium sized enterprises (SMEs). Taking into consideration newly raised challenges and opportunities caused by the COVID-19 pandemic, as well as military operations in and around Nagorno-Karabakh in 2020, this report also includes a special section on the impact of these new factors on the business environment and European companies in Azerbaijan.

## 123 online responses

The anonymous online survey was held during September and October 2020 aiming to study the views of European companies about local business climate in 2020. The target group for the EU Business Climate Survey 2020 remained the same as per previous years and included around 400 European companies working in Azerbaijan, namely representatives of the EU and EFTA countries, the UK as well as Azerbaijani companies, whose main focus of business operations is related to cooperation with the EU.

The questionnaire this year was based on the previous survey editions and proposed to evaluate the business climate and the progress reached in implementation of reforms during the past year. A new section was introduced containing questions on the impact of the pandemic and the measures undertaken by companies and the Azerbaijani government to limit its negative impact.

The launch of the on-line EU Business Climate Survey 2020 was officially announced during the webinar on 18 September 2020 with participation of Ambassadors of the European Union, France and Italy, as well as Acting Director of AZPROMO. The invitations to the survey were distributed via official channels of the implementing organisations and information partners. As a result, 187 responses were obtained and after the quality check 123 responses were approved and included into the sample.

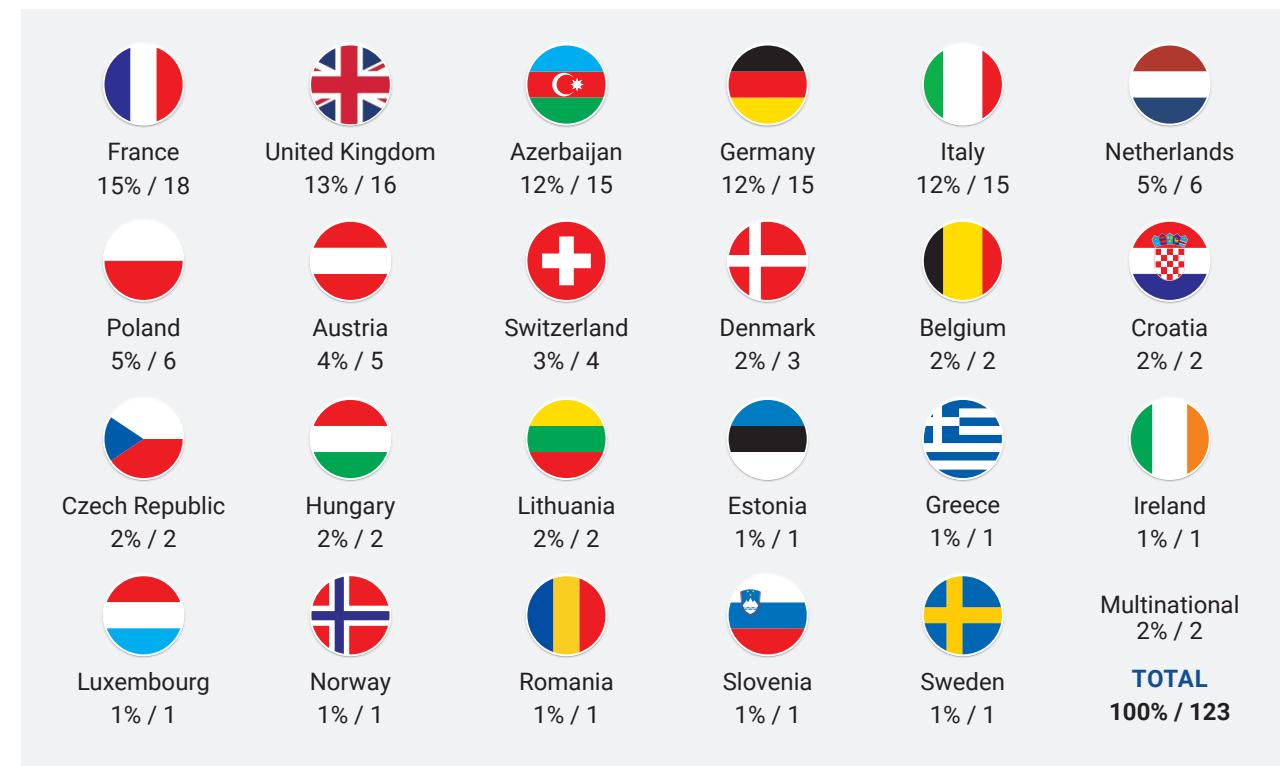
## 25 interviews

Additional data was collected via one-to-one interviews supplemented by an expert` discussion. Between October and November 2020, 25 interviews were conducted with the representatives of the consulting, oil and gas, transport and logistics, tourism, agriculture, hospitality, ICT, chemical and financial sectors. For interview were also invited representatives of bilateral chambers, offices for EU-Azerbaijan economic cooperation, as well as the banks, International financial institutions (IFIs) and the EU initiatives.

## Acknowledgment

The “EU-Azerbaijan Business Forum” would like to extend its gratitude for the effective coordination and informational support to the Embassies of the EU member states in Azerbaijan, European Bank for Reconstruction and Development (EBRD), the following organisations for bilateral economic cooperation: Advantage Austria, Azerbaijan Netherlands Business Hub, British Business group, Italian Trade Commission (I.C.E.), Polish Investment and Trade Agency (PAIH) and the following regional EU initiatives: EU4Business, EU4Climate, EU4Digital, EU4Environment.

# COVERAGE



## 23 countries

The “EU Business Climate Report Azerbaijan 2020” represents the views of representatives from 23 countries in total, including 19 EU member states, 2 EFTA countries, the UK, and Azerbaijan.

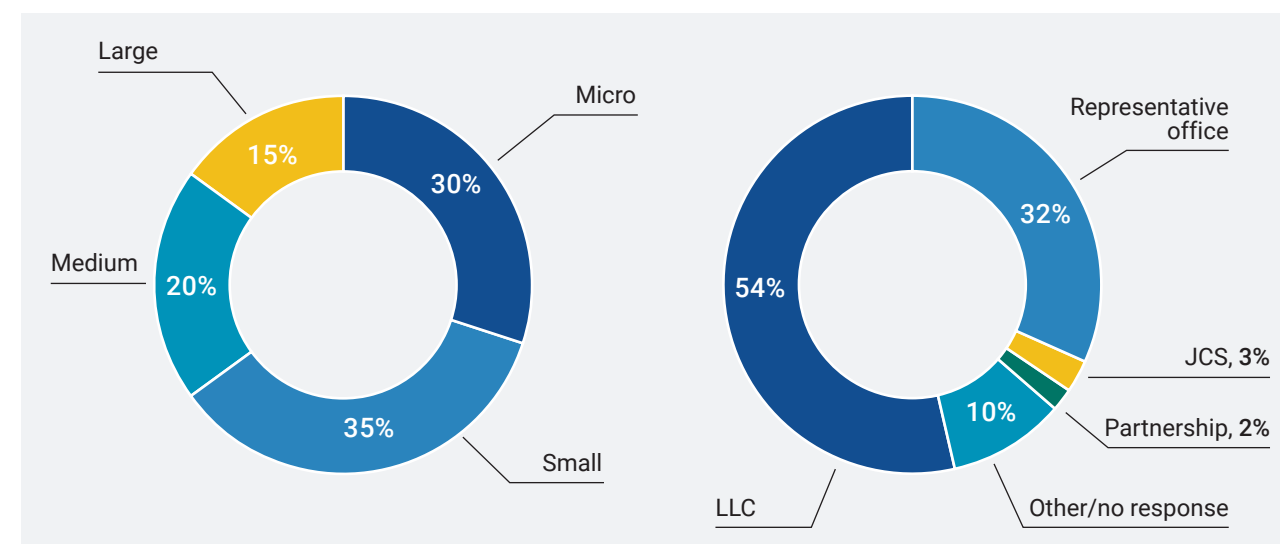
in non-oil segments of economy, including: consultancy, transportation and logistics, ICT, wholesale and retail, engineering, construction, education, science and R&D, machinery, equipment, agriculture, manufacturing, healthcare, tourism and hospitality, etc.

## 19 sectors

Respondents to the survey represented 19 sectors of economy. Most of the represented businesses operate

## Size and legal status

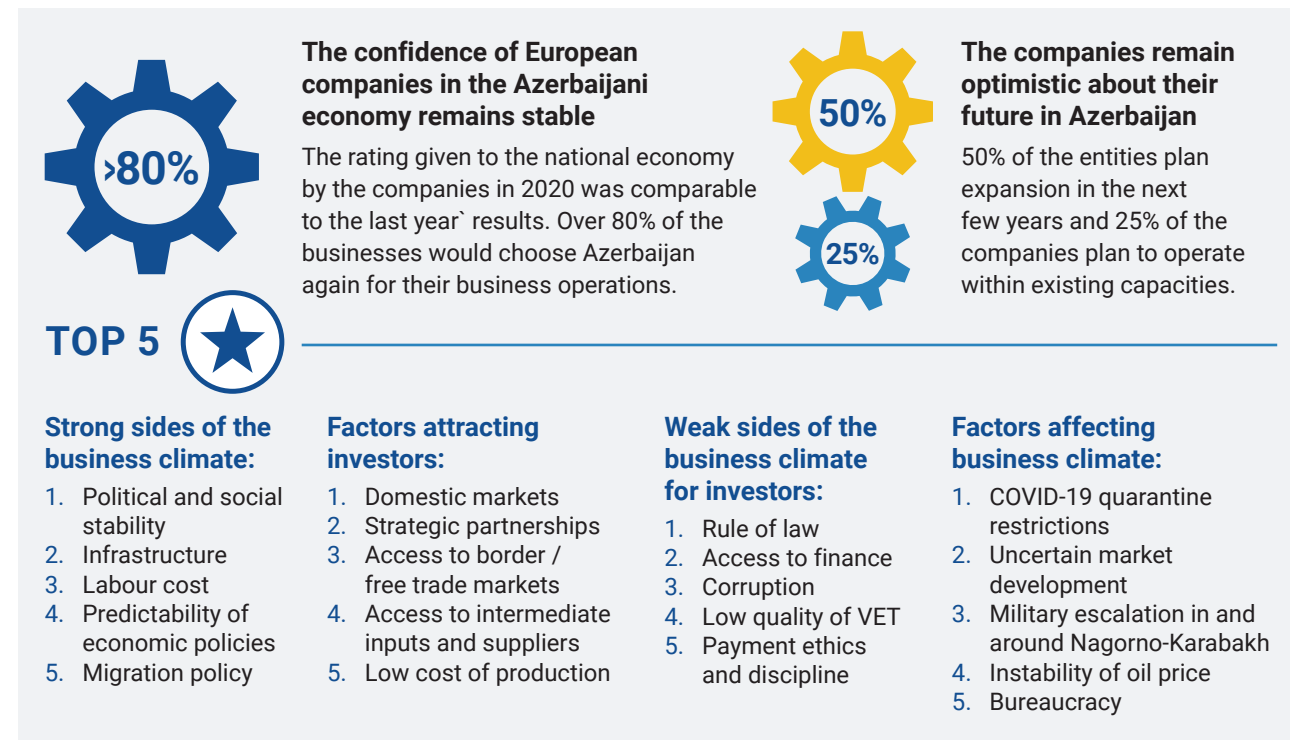
85% of the companies represented SMEs, operating in Azerbaijan either as limited liability companies (LLC) or as representative offices.



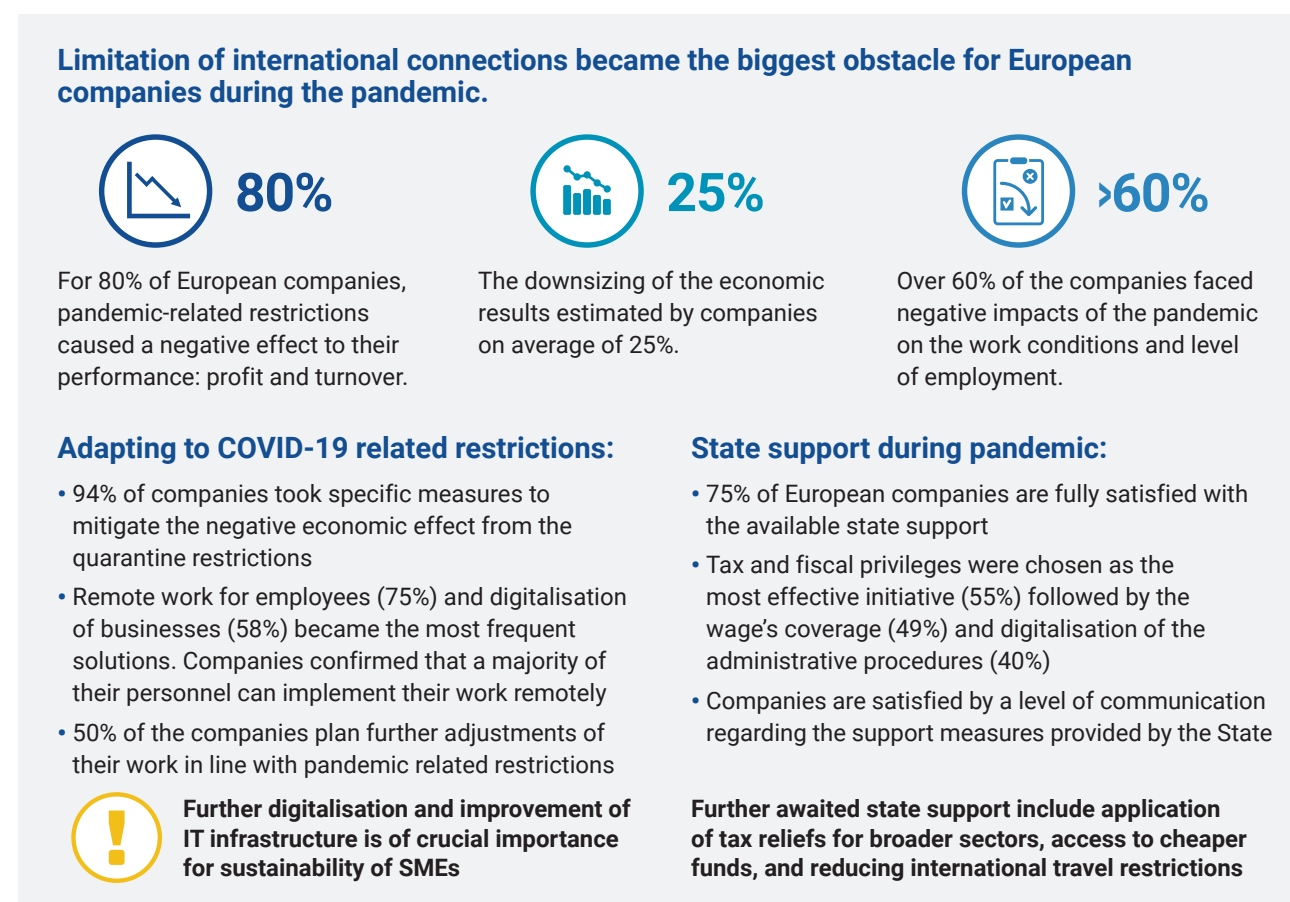


# MAIN FINDINGS

## BUSINESS CLIMATE 2020



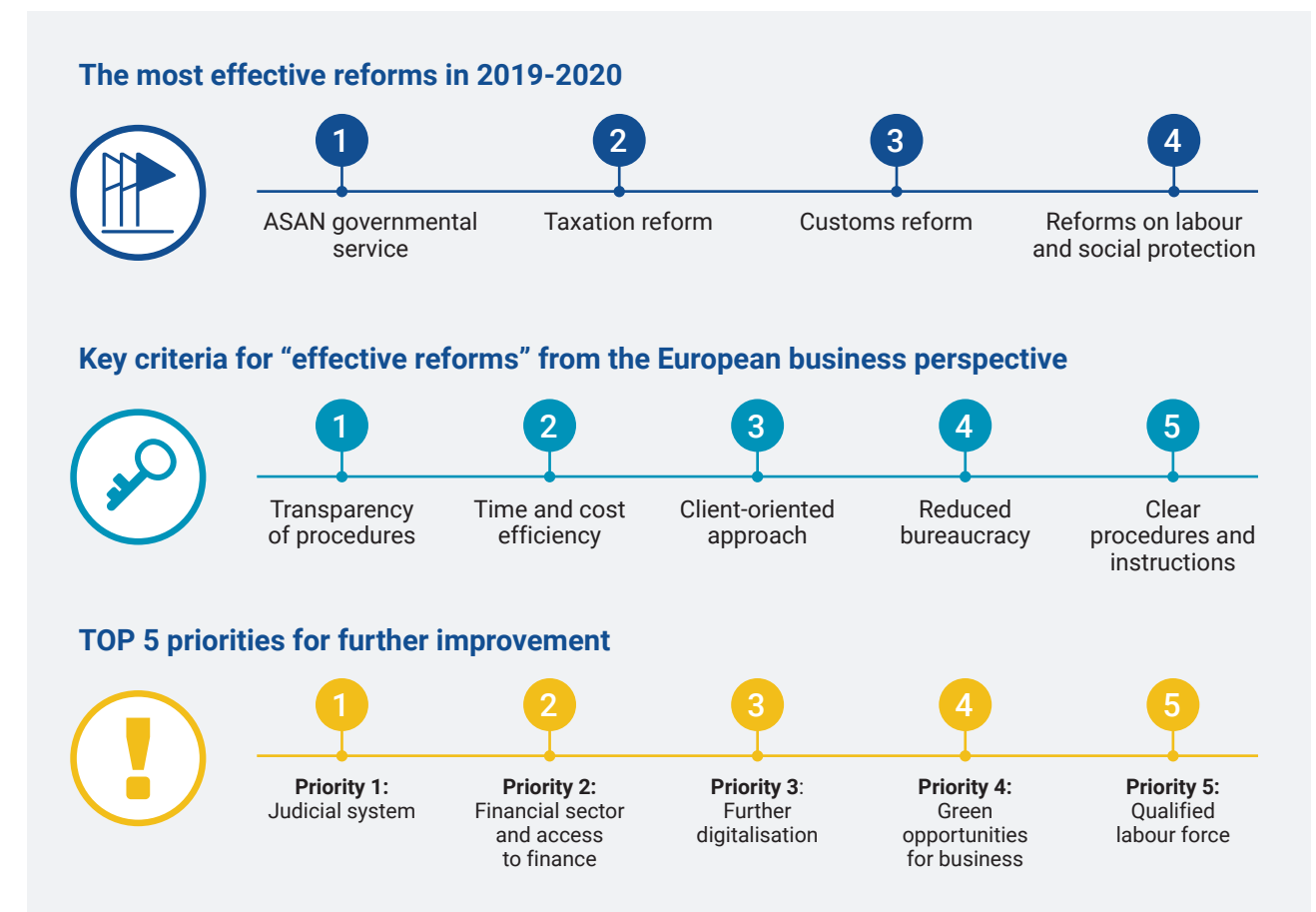
## COVID-19's EFFECT ON BUSINESSES



## IMPACT ON BUSINESS FROM MILITARY OPERATIONS IN AND AROUND NAGORNO-KARABAKH



## ECONOMIC REFORMS



# EXECUTIVE SUMMARY

The **European business community** in Azerbaijan represents the largest group of foreign investors with approximate 400 companies of European origin. The majority of European businesses are small and medium-sized entities operating in the non-oil sectors, which are of strategic importance for diversifying the local economy. The main findings of this report are based on the views of European companies, collected via a mixture of quantitative and qualitative methods such as the survey and interviews complemented by the desk research and a focus group discussion. Considering the aspiration of the Azerbaijani government to improve the business environment, diversify the economy and bring the SME sector to prosper, the opinions of European companies can help to determine main trends in the business and investment climate and provide a background for the future policy options.

Without a doubt, 2020 has become a year of extraordinary developments and economic turbulences for Azerbaijan the same as for the rest of the world. In 2020 Azerbaijani business environment was affected by a mixture of **global and local factors**, starting with the world pandemic and quarantine restrictions aggravated by the short-term shocks of the oil prices, which have impacted the economy since the first half of the year. Escalation in the Nagorno Karabakh and around riveted the attention of international community in the second half of the year becoming an additional factor challenging the business environment in the country. The military actions during October and November caused uncertainty for the private sector affecting significantly European companies in 2020 whose international businesses naturally demand certainty and sustainability of the local environment and effective cross-border cooperation.

The **COVID-19 containment measures** put in place by Azerbaijani government were one of the longest and strictest measures comparing with other countries in the region. The ability and readiness of the companies to adjust their work to the uncertainties and fast changes appeared to be crucial this year. Amongst the most common solutions, European businesses choose digitalisation and remote work for their personnel located in the country. Nevertheless, during survey 2020 the vast majority of the companies have confirmed the negative effect on their performance caused by the quarantine regime, which resulted in a moderate contraction of their turnover and profit. Negative implications have also been confirmed in regard to employment and work conditions of European entities.

Supporting the private sector to remain sustainable in this challenging environment, the Azerbaijani government launched a special **support package** prioritising SMEs in the most affected sectors. The proposed measures

were appreciated by the European business community and evaluated as effective, timely launched, and well-communicated policy response to the pandemic in comparison to the previous packages following the crisis in 2015-2016.

The military actions in and around **Nagorno-Karabakh** affected the business environment as well. On one side, European entities had to stop their operations in the facilities located close to the area of military action. Businesses operating in Baku and other regions continued their work as usual. According to the early insights provided, the military escalation somewhat affected the attractiveness of Azerbaijan for new foreign companies and investors, while the existing partners continued their regular work with the country. European businesses demonstrated their readiness to resist the short-term limitations caused by martial law. They said that possible prolongation of hostilities to mid or long-term would become a serious obstacle for continuing operations in Azerbaijan. However, with the end of the hostilities, European companies expect stronger prioritisation of the local economic reforms, looking forward to launching new ambitious infrastructure and economic projects aiming to restore the affected regions.

Despite the challenges mentioned above during 2020, the overall situation in terms of the local economy and the business climate doesn't seem so ominous for European companies. According to the responses obtained during survey and interviews; **Azerbaijan remains an attractive location** for European companies. Over 80% of European companies in 2020 confirmed their readiness to choose Azerbaijan again as a location for their economic activities. The national economy is assessed by the respondents as somewhat lower than the "satisfactory" level, however it keeps a stable image and did not lower its positions in 2020 comparing with previous years.

While the businesses are confirming the inevitable negative trends in their sectors and performance of their own companies in 2020, they also remain optimistic about the future and plan to continue their operations and expansions in Azerbaijan in the upcoming years.

The remaining stable enthusiasm despite of the above-mentioned challenges are connected in a way to the remarkable improvements in several aspects of the business environment were tracked this year. Since 2016 Azerbaijan has been prioritising the **economic reforms**. Following the announcement of the reforms, **ASAN** became the first successful example of an implemented change and for several years was remaining incommensurable champion amongst the entire reforms package in the EU Business Climate Reports. Progress in other aspects of the business environment took longer time before companies started to benefit from it. The results of the reports in 2018 and 2019 gave the first signs of positive dynamics in regard to **taxation and customs**. The progress was eventually clearly confirmed in 2020, adding these two reforms to the list of the leaders together with ASAN. European companies this year highly evaluated the improvements achieved in online taxation and customs clearance procedures. The latest changes introduced to the tax legislation have also gained appreciation amongst the businesses. European companies confirmed that the work of "Green Corridor" in place since 2019 has expedited and simplified the customs routine. An additional positive finding from the survey 2020 was the progress of **labour and social protection** reforms aiming at improving official employment and living standards in Azerbaijan. Their efforts of the government were well noticed and welcomed by the European business community.

Meanwhile, there is still a long way forward until all aspects of the local business environment will demonstrate balanced improvement. The **judicial system** in 2020 has been chosen as the priority reform by the majority of respondents of the survey. The judicial procedures remain ineffective and keep negatively affecting the image of the local rule of law and contract

enforcement, which are of crucial importance for investors. Unfortunately, the local justice infrastructure is still to be considered as bureaucratic and lacking transparency. As for the **financial sector**, European companies confirm improvements achieved in terms of sustainability after the crisis in 2015-2016, while the sector remains significantly dependent from the state funding and the local banks have limited international connections. The services of the banks targeting the business sector demand improvement. High interest rates and costs of banking intermediation together with remaining bureaucracy of the banking procedures create an unfriendly image for business. The efforts made by the government to improve the **labour market** including education and VET reforms is well noticed and add optimism to European companies. Besides the above, nowadays there is still a lack of progress felt by the market regarding access to local qualified workers. This remains one of the challenges to be tackled in cooperation with private and public sectors.

Despite the negative effect from the restrictions caused by the world pandemic, they also became a strong catalyst for the digitalisation affecting all spheres of life. The digital progress and transformation of Azerbaijani economy has proven to be an effective way to implement the local reforms and sustain the SME sector during the quarantine regime and beyond. The element of **digitalisation** has been brought in the present report as one of the top priorities demanding attention of the State in regards to improvement of ICT infrastructure and skills/ capacities of the population in Baku and the rest territory of the country. Another raising issue this year appeared to be the **green opportunities for SMEs**. Sustainable sectors have become the global trend and swiftly growing segment worldwide. Considering the promising natural resources of Azerbaijan, the projects on alternative energy and sustainable farming can create a background for new prospering non-oil sectors helping to diversify the local economy. Currently the European companies look forward to special opportunities under green projects targeting SMEs and hoping to be given priority by the local government.





# 1 AZERBAIJAN AS A DESTINATION FOR EUROPEAN INVESTORS

## 1.1 ABOUT AZERBAIJAN

### Azerbaijan

The Republic of Azerbaijan is the largest country in the Caucasus region in Eurasia. The country is situated on the crossroad of Eastern Europe and Western Asia and has access to the Caspian Sea. The territory of Azerbaijan is 86,600 km<sup>2</sup> and it includes 10 economic regions, 66 rayons or political districts and 77 cities. Azerbaijan includes the Autonomous Republic of Nakhichevan. Baku is the capital and the largest city of Azerbaijan. The country has land borders with the Russian republic of Dagestan to the north, Georgia to the northwest, Armenia and Turkey to the west, and Iran to the south.<sup>1</sup>

### Political system and government

Azerbaijan is a unitary semi-presidential republic and a secular state. The President of Azerbaijan is Ilham Aliyev. The National Assembly of Azerbaijan consists of 125 deputies.

### Population and labour market

As for 2020, the population in Azerbaijan is around 10.6 million people. 53% of the population lives in cities and 47% lives in rural areas. Azerbaijanis make up 92% of the country's population. The literacy rate in 2017 was 99.79%. The workforce in Azerbaijan was reported at around 5.07 million people. Average unemployment amongst active population according to the State Statistical Committee was around 4.5%.<sup>2</sup>

### Language

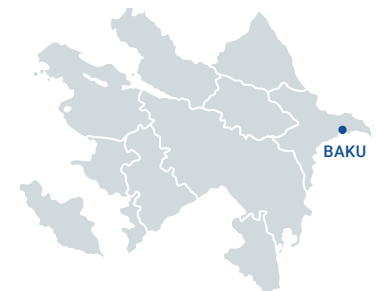
The official language is Azerbaijani, which is a Turkic language. Significant part of the population also speaks the Russian and Turkish languages. English plays significant role in education and business communication.<sup>1</sup>

### Currency

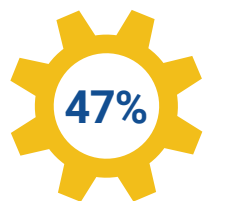
The national currency is the Azerbaijani manat (AZN), which is equivalent to 0.50 euro as for November, 2020.

### Economy

Azerbaijan is rich with oil and gas resources. The country's hydrocarbon sector contributes over a third of the national GDP, amounting to over 90% of total exports and employing around 14% of the population. Azerbaijan was demonstrating a strong economic growth during the 1990s and 2000s. The transition to oil production led to a remarkable growth of Azerbaijan's GDP, reaching 26.4% in 2005 (2nd highest national GDP growth in the world), 34.6% in 2006 (world highest



53% of the population lives in cities



47% of the population lives in rural areas



growth) as well as 10.8% and 9.3% in 2008 and 2009 respectively.<sup>3</sup> Nowadays, the oil and gas industry accounts around 38% of GDP and employs 14% of the population.<sup>1</sup>

Heavy dependence on extractive industries has left Azerbaijan exposed to the negative effects of oil price volatility. Following an extended period of strong growth between 2001 and 2014, Azerbaijan was hit hard by a drop in oil prices and an economic slowdown in regional trade partners, that resulted in a contraction of GDP in 2016 and 2017. A modest recovery began in mid-2017, with the GDP growth reaching 1.4% the following year, supported by an increase in oil prices and more favourable economic conditions in the region. In 2019, the GDP grew to 2.2% and is expected to decrease by -3% in 2020 due to the outbreak of COVID-19. According to EBRD forecast, in 2021 Azerbaijan's GDP is expected to demonstrated positive dynamic and grow to 2.5%, what is a subject to uncertainty related to the future path of the pandemic and the oil market.<sup>4</sup>

### Strategic sectors and regional development

As a response to the economic downturn after the crisis in 2015 and 2016, the government set up plan for reforms in 12 strategic sectors. Amongst the sectors prioritised for diversification of the economy are agriculture, food production, tourism, logistics, ICT as well as other light industries. The government has also prioritised reforms targeted to strengthen SME sector via reducing bureaucracy, improving transparency of the economy and the business environment.<sup>5</sup>

Since 2017 within the EU-funded Project "Support to Rural and Regional Development Project", 16 districts within four economic regions Aran, Shaki-Zaqatala, Guba-Khachmaz, Mountainous Shirvan have developed their strategic directions for investments until 2025. For implementation of these documents 170 investment Projects have been prepared to fasten and ease attracting of investors. Amongst the target sectors are: sustainable agriculture and circular economy, innovations and green entrepreneurship, innovations in farming, agriculture and processing sector, digital and green

FIGURE 1. Turnover between Azerbaijan and the EU, billion USD



SOURCE: The State Statistical Committee of the Republic of Azerbaijan<sup>1</sup>

tourism sectors. Mapping of the economic regions and their strategic sectors are available in the [Annex 3](#).

In 2021 Lankaran economic zone including its 6 rayons will receive new opportunities for economic development with support on new EU4Lankaran programme. The fruit and vegetable production of the region is targeted by the programme and will get assistance and develop its capacity. It is expected that about 1000 actors of the fruits and vegetable value chain will benefit from the programme. The initiative will also target vulnerable groups, women, and youth, and about 4000 individuals are expected to benefit directly or indirectly from project activities and their impact i.e. on skill development, employment, and business opportunities.

### SME sector

The economic potential of SMEs in Azerbaijan remains underdeveloped. In July 2020, there were around 1.13 million registered SMEs and 87% of them were individual entrepreneurs.<sup>1</sup> In 2018, the SME sector generated 13.4% of GDP and 42.9% of total employment as compared to 60% of GDP and 60-70% employment in OECD countries. According to the Strategic vision 2025, the SME sector should contribute to 60% of the national GDP, represent 70% of total employment and 40% of total non-oil exports.<sup>6</sup>

The government of Azerbaijan is recognizing the importance of SMEs and is committed to create an environment in which SMEs can prosper. The number of measures have been implemented including the Law on Entrepreneurship, the Law on State Support for Small Business, the Law on State Registration and State Registry of Legal Entities, or Presidential Decree 1771 on governance structures for the support of SMEs. Significant progress has been made in creating institutional support structures, most notably the Small Medium Business Development Agency (KOBIA), but also the Council of Entrepreneurs, the initiative supporting family businesses (ABAD), among others. This caused significant improvement of Azerbaijan's position in OECD SME Policy Index 2020 comparing to the results of 2016, especially on indicators on institutional and regulatory framework.<sup>30</sup>

### Cooperation with the EU

Azerbaijan is an important partner for the EU and one of the attractive markets for European investors. The European Union is Azerbaijan's first trading partner, the biggest export and import market, and is the biggest investor for the country (with nearly €7 billion of direct investment). For the last five years, the turnover between the countries surpluses to 30% and reached the level about USD 13 billion per year, which nowadays is equal to about 40% of Azerbaijan's total foreign turnover.

The EU is the largest foreign grant donor to both government and civil society in Azerbaijan. The EU supports local reforms targeting good governance, the country's democratic institutions, social inclusion, and the rule of law. The countries cooperate in regards to environmental and climate goals, transport dialogue and cooperation, legal aid, fight against corruption, development of skills, etc. The EU supports diversification and modernisation of the Azerbaijani economy, including green, innovation sectors, and regional development. As for 2020, the EU assisted 13,000 companies\* with funding, training, and export support to new markets through the EU4Business initiative, contributing to the creation of over 3,300 new jobs.

Azerbaijan is a strategic energy partner for the EU and has joined EU4Energy initiative since 2017. The country plays a pivotal role in bringing Caspian energy resources to the EU market and currently supplying around 5% of the EU's oil imports. The Southern Gas Corridor, which construction was finished in 2020 is a strategic initiative to bring gas from the Caspian Sea to the European markets and is a key tool for enhancing the security of energy supplies in Europe.

\* Source from EU4business

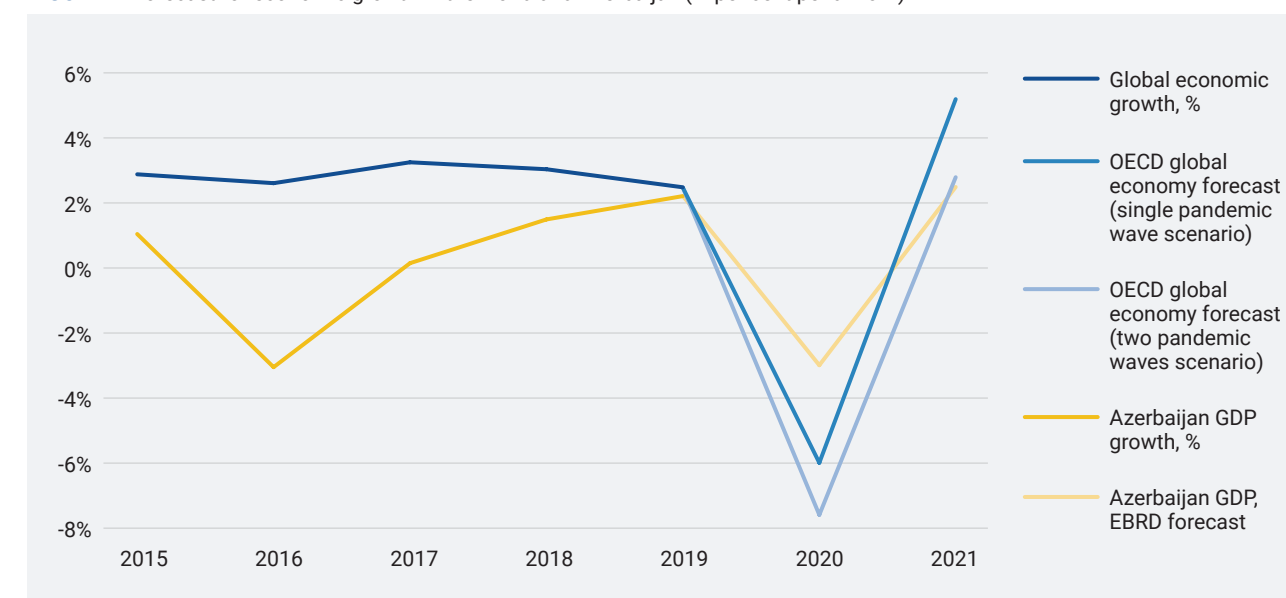
During the pandemic in 2020, the EU responded to the urgent needs of the EaP countries. As part of this, a tailor-made COVID-19 response package for Azerbaijan worth about €31.6 million was mobilized targeting support to the health sector, civil society, SMEs and farming, as well as strengthening of socio-economic resilience in the country.<sup>7</sup>

## 1.2 MACROECONOMIC OUTLOOK 2020

Since the beginning of the reforms in 2016, the GDP of Azerbaijan faced several ups and downs with an average growth of around 1% during this period. In 2020 Azerbaijan's economy has been severely affected by both the COVID-19 containment measures and the decline in global oil prices. The economic impact of COVID-19 has already proven to be severe and is identified as a reason for the strongest economic recession since the World War II and the Great Depression of the 1930<sup>th</sup>. The Organization for Economic Cooperation and Development (OECD) released an updated forecast in September 2020, foreseeing a reduction of a global economy i) by 6% in 2020 under a single-wave scenario of the pandemic and ii) by 7.6% under a second wave scenario in 2020. The forecast for 2021 predicts an economic growth of around 5.2% and 2.8% for each scenario, respectively.<sup>8</sup>

The pandemic in Azerbaijan has influenced the economic development, policy focus, and the local business climate. According to government officials, the economy was shrinking by AZN 120-150 million. (USD 70.7-88.4 million) per day at the peak of the national containment measures in April 2020. Between January and August 2020, Azerbaijan's GDP decreased

FIGURE 2. Forecast for economic growth in the world and Azerbaijan (in per cent per annum)



SOURCE: OECD, Economic forecast, September 2020<sup>8</sup>; EBRD, Outlook on Azerbaijan, November 2020<sup>4</sup>



by 3% compared to the previous year, according to the Azerbaijan's State Statistical Committee.<sup>1</sup> Based on the outlook of the EBRD, is expected that the GDP of Azerbaijan will decline by 3% in 2020 and increase by around 2.5% in 2021<sup>4</sup>, which is also lower than on average expected economic growth worldwide.

Despite the efforts made to diversify the local economy, Azerbaijan still remains dependent on the oil sector. The pandemic has caused a decrease in global demand for oil and gas and a drop in oil prices, which went far below the forecasted USD 55 per barrel for the state budget for 2020. The sharp drop of the oil prices to USD 20-30 per barrel in March and April 2020 caused a short-term shock to the market and an increased risk for devaluation. On August 6, the Parliament passed a revised 2020 budget which reflected a lower oil price (USD 35 per barrel). The planned deficit has been raised from 2.3% in the original budget to 12.4% of GDP. An increase in the planned transfer from the State oil fund (SOFAZ) to the budget should support the 1.7 AZN/USD exchange rate.<sup>9</sup> The main macroeconomic indicators in 2020 broadly reflected the economic downsizing and other economic trends caused by the world pandemic. (see Table 1)

As of 2019 the overall inward FDI stock in Azerbaijan reached about USD 32.3 billion and attracting foreign investors remains one of the main priorities in the economic policy of the country. During 2018 and 2019 years the volumes of the FDIs inflow were estimated at USD 1.4-1.5 billion what is far below the result before the oil and gas crisis 2014 with about USD 4.4 billion. Despite the attempts that have been made to diversify the inward investment portfolio, the oil and gas sector keeps bringing about 80% of the FDIs.<sup>13</sup>

According to UNCTAD, Global Investment Trend Monitor of October 2020, during the first 6 months of 2020, the contraction of the global FDI was already reached 49% and some developed economies reported a drop up to 75% comparing to 2019.<sup>14</sup> According to the available so far statistics of the Central Bank of Azerbaijan, the FDI in the first half of 2020 demonstrated positive dynamics and increased to 23.5% comparing to the same period in 2019. The most significant increase detected in the non-oil sector (38.4%) increased in share to 15.6%.<sup>2</sup>

TABLE 1. Main economic trends in Azerbaijan during January – July 2020 <sup>10 11 12</sup>

EXPORT	Levels of export decreased mainly due to oil and gas export reduction by 25.6% compared to the level of USD 9.1 billion in 2019. Non-oil export decreased by 8.7% and fell to USD 1.03 billion
FOREIGN TRADE	Foreign trade turnover decreased in real terms by 22.5% (imports down by 43.4%, exports down by 7.1%) between compared to the first half of 2019. The overall trade balance remains positive at USD 3.2 billion.
CONSUMER ACTIVITY	Consumer activity index fell by 7.3% and retail contracted by 2.1%. Food turnover increased by 3.5%, non-food products turnover fell by 7.5%.
INFLATION	Inflation grew moderately and remained at the level of 2.8% in July 2020
EMPLOYMENT	Unemployment amongst active population according to the State Statistical Committee was around 4.8% in 2019 <sup>1</sup> and was forecasted for 2020 by the Word Bank to reach around 5.5-6%.

SOURCE: OECD. COVID-19 crisis response in EaP countries. October 2020; Ministry of Economy of the Republic of Azerbaijan. Diplomatic Corps Presentation. September 2020; WB, Unemployment in Azerbaijan 2020

### 1.3 INVESTMENT INCENTIVES AND OPPORTUNITIES FOR EUROPEAN COMPANIES

Azerbaijan has prioritised the attraction of FDIs with a special focus on non-oil sectors. In 2019 the Ministry of Economy published a statement, confirming the priority sectors for attracting FDIs remained **chemical, metallurgical and energy industries, machine building and construction materials, light industries, food and agricultural sector, ICT, and tourism**.<sup>15</sup> **Renewable energy** remains a sector open to foreign investors and sector developing in Azerbaijan within support of the State Agency for Renewable Energy Sources, which has been established at the beginning of 2019 within the umbrella of the Ministry of Energy.<sup>15</sup> To attract attention of investors, a number of new investment incentives has been launched. Main regulations, legislation and infrastructure, which European companies may benefit from are summarised below.

Azerbaijan concluded the bilateral investments treaties and double taxation treaties with 44 and 53 countries respectively, including a number of European states. (see Table 2)

TABLE 2. Available agreements with European countries

TYPE OF AGREEMENT	EUROPEAN COUNTRIES WITH AVAILABLE AGREEMENT
Bilateral investment treaties	Austria, Belgium, Bulgaria, Croatia, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Latvia, Lithuania, Luxembourg, Norway, Poland, Romania, Switzerland, the UK**
Double taxation treaties	Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Slovenia, Spain, Sweden, Switzerland, the UK

SOURCE: Source: UNCTAD, Investment treaties<sup>16</sup>; AZPROMO, Doing Business in Azerbaijan, 2018<sup>1</sup>

\*\* The existing bilateral investment treaties with Bulgaria, Norway have not yet entered into force.

Azerbaijan also has free trade agreements (FTAs) with Russia, Ukraine, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkey, Uzbekistan, Moldova, and Belarus. Under the FTAs, goods can be imported from those countries free of customs duties.<sup>1</sup>

Even though Azerbaijan currently is not a member of the World Trade Organisation (WTO) yet, it actively continues its accession process. The ongoing aligning of internal legislation and procedures with what is required by the intergovernmental organisation testifies aspiration of the country to receive WTO membership status and enhances attractiveness of the local market for European investors.

While the projects related to oil and gas remain the most attractive for the investors, the government takes special measures to attract non-oil investments. The investors in Azerbaijan can obtain the "Investment Promotion Document" (IPD) in case of meeting certain criteria in terms of the sector, volume, and region of investment. To holders of an IPD can apply certain tax and customs holidays for a period of 7 years, namely a 50% reduction in profit and income tax; cancellation of land and property tax; exemption from VAT and customs duties on the imported equipment and technology. As of the 1st of September 2020, 455 IPDs were issued to 379 entities.

In August 2020, the new Investment Holding was established aimed to manage work of certain State-Owned Entities (SOE). Its objective is to increase the transparency of the SOEs, promote public-private partnerships (PPP), and prepare enterprises for privatisation, which brings new opportunities for the European investors. The list of companies shifting under the management of the Investment Holding was approved in November 2020 and includes 21 organisations from different sectors.<sup>17</sup>

#### LEGAL BACKGROUND

The legislation of Azerbaijan ensuring the protection of the foreign investors includes the "Law on the Protection of Foreign Investments" (1992)<sup>18</sup> and "Law of the Azerbaijan Republic on Investment Activity" (1995)<sup>19</sup>, which guarantee equality of the foreign and national investors, settle framework for the protection of the foreign investors against nationalization and requisition. Currently, the Ministry of Economy in cooperation with the International Finance Corporation (IFC) is preparing a new draft Law "On Investment Activity", aimed to replace the mentioned laws and cover a wide range of issues as standards of investment protection, dispute resolution mechanisms, main directions of state investment policy, etc.

#### Industrial areas

Currently, there are five industrial parks operating in Azerbaijan (see Table 3). In accordance with the Tax Code and the Law of the Republic of Azerbaijan "On customs tariffs," the businesses-residents of the industrial parks are exempt from corporate, land, and property tax, as well as value-added tax (VAT) for 10 years. Additionally, there are no customs duties applied for imported equipment and technology for 7 years. Industrial parks are also attractive due to other favourable provisions such as those related to available infrastructure, low rental rate, availability of special credits, simplified administrative procedures, concessionary tariffs for electrical and thermal energy, water and natural gas, waste management.

Four industrial quarters are operating in Azerbaijan regulated by the Presidential Decree dated October 2014 "On creation of industrial quarters and the organization of their activities" (see Table 4). In May 2015, the "Model provision on industrial quarters" was approved, stipulating the establishment of low rental rates for land parcels and construction; allocation of soft credits; simplification of administrative procedures; providing services to ensure efficient implementation of entrepreneurial activity, etc.

There are two hi-tech parks operational in Azerbaijan, namely Azerbaijan National Academy of Sciences High Technologies Park (operates since 2016 in the research and development, science and high technology sectors) and the Sumgait Technologies Park (established in 2009, with a broad list of the sectors represented such as oil and gas, agriculture, housing construction, logistics, energy production, melioration and water economy, industry and machine building, ICT).

#### Alat Free Economic Zone

The legislation establishing the Alat Free Economic Zone (AFEZ) was adopted in 2018 to intensify local and foreign investment in the non-oil sectors. AFEZ is located 65 kilometres south of the capital Baku, in the administrative territory of Garadagh, and has special rules and regulations. The special tax and customs regime foresee exemption from VAT, withholding tax or any other corporate tax, exemption from personal income tax, social security and other payments for foreign skilled personnel, exemption from customs duties on import of any foreign products or services. The legislation also foresees immunity from nationalisation for investors is Alat, as well as special protection of intellectual property rights. Alat has access to the Baku International Sea Trade Port, which in 2019 became the first Green Sea Port in the Caspian region and obtained EcoPorts certificate of the European Sea Ports Organization. This is flagging high environmental standards for potential investors.

TABLE 3. Industrial parks of Azerbaijan

INDUSTRIAL PARK	YEAR OF ESTABLISHMENT	SECTORS REPRESENTED
Sumgayit Chemical Industrial Park	2011	Chemicals, construction materials, machinery and equipment
Balakhani Industrial Park	2011	Recycling (motor oils, plastic, paper and cardboard products)
Mingachevir Industrial Park	2015	Light industry (textiles, leather, cotton products)
Garadag Industrial Park;	2015	Shipyard and ship repair
Pirallahi Industrial Park	2016	Pharmaceuticals, medicinal product packaging

SOURCE: OECD. Azerbaijan Linking Domestic Suppliers with Foreign Investors. 2019 <sup>20</sup>

TABLE 4. Industrial quarters of Azerbaijan

INDUSTRIAL QUARTER	YEAR OF ESTABLISHMENT	SECTORS REPRESENTED
Neftchala Industrial quarter	2016	Automobiles, fish feeds, plastic goods, pipes, paper products, mobile schools
Masalli Industrial quarter	2016	Furniture, mattresses, construction materials, woodwork, metal products
Hajigabul Industrial quarter	2017	Heavy engineering, special vans, composite materials, plastic products
Sabirabad Industrial quarter	2017	Wool, construction materials, car parts

SOURCE: OECD. Azerbaijan Linking Domestic Suppliers with Foreign Investors. 2019 <sup>16</sup>

The port closely cooperated with the European Union in operational efficiency, harbor management, environment, and risk management policies. The internal infrastructure of Alat includes an industrial training centre, one-stop-shop business appraisal and licensing, visa centre; Independent regulatory authority; facilities for international dispute resolutions, etc.<sup>21</sup>

### Infrastructure for the support of European companies

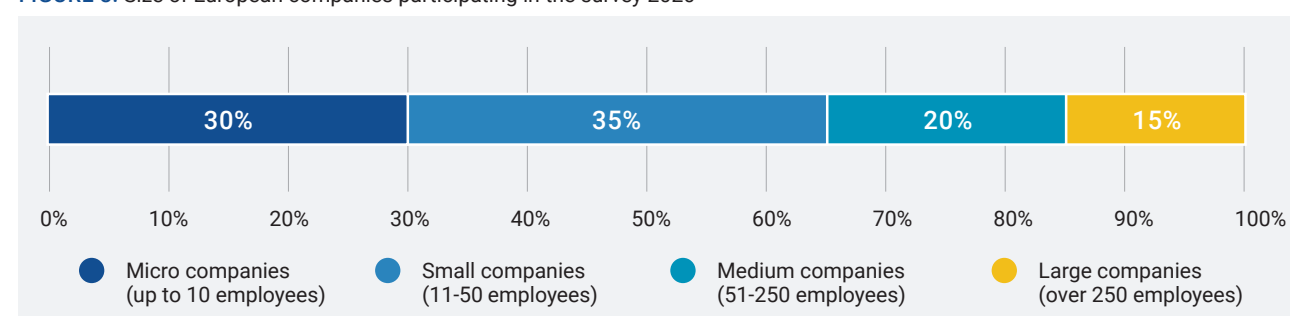
The State Institution for investment promotion is Azerbaijan Export and Investment Promotion Foundation (AZPROMO), a joint public-private initiative, established by the Ministry of Economy of Azerbaijan in 2003. The foundation is positioning itself as a “one-stop-shop” body, to assist foreign-based companies interested in investigating and utilizing investment opportunities in Azerbaijan.<sup>22</sup>

Small and Medium Business Agency (KOBIA) was established in Azerbaijan in 2018. The institution aimed to support all SMEs via direct programmes as well as building the SME support infrastructure in the country. The small and medium size European companies registered and operating in Azerbaijan may benefit from KOBIA support programmes and services.<sup>23</sup>

To obtain informational support, European companies may also contact the Embassies of their countries, as well as economic and trade support offices and bilateral Chambers, which represent the European business community in Azerbaijan and provide the companies with the services related to entering the Azerbaijani market and local operations.

European companies may also benefit from the regional and local projects for private sector, being implementing in Azerbaijan under the support of the EU. More details about this and other EU initiatives are available in [Annex 2](#).

FIGURE 3. Size of European companies participating in the survey 2020



SOURCE: EU Business Climate survey 2020

## 1.4 EUROPEAN COMPANIES PARTICIPATING IN THE EU BUSINESS CLIMATE SURVEY 2020

There are over 400 European companies working in Azerbaijan representing diverse sectors and the largest group of investors in Azerbaijan.<sup>8</sup> During September and October 2020, an online EU Business Climate Survey was conducted aimed to reach European companies in Azerbaijan and invited them to share opinions on the local business climate in 2020. In this year's survey, 123 companies from 23 countries including the EU, EFTA, the UK and Azerbaijan are represented. The largest representation in the Business Climate Survey 2020 had the companies from France, the UK, Germany and Italy, amounting to 10-15% of total responses per country. Active contributions were received also from companies coming from the Netherlands, Poland, Austria, Switzerland, and Denmark. (see [Annex 1](#), Q5). More details about the survey process are available in the [Methodology](#).

The majority of the European companies participating in the survey represent the small and medium-size enterprises, which is comparable with the results of the previous EU Business Climate Survey editions<sup>24</sup> (see [Annex 1](#), Q3). It worth mentioning, that a new definition of SMEs was introduced in Azerbaijan in 2018. It distinguishes between the different sizes of enterprises and is partially aligned with the EU definition, synchronizing the criteria related to the number of employees: micro (<10 employees); small (<50 employees), and medium (<250 employees).

Majority of the companies were established in Azerbaijan between 2001 and 2015, the years of the fastest economic growth in the country. This also indicates their

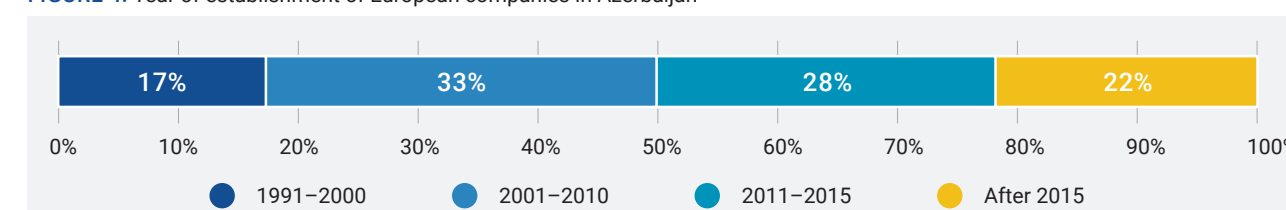
experience of working in Azerbaijan since economic reforms has been started and ensures reliability of the provided responses. ([Annex 1](#), Q6).

Foreigners are allowed to register business entities by opening a fully owned subsidiary, acquiring shares of an existing company, or creating a joint venture with a local partner. Foreign companies are also permitted to operate in Azerbaijan without creating a local legal entity by registering a representative or branch office with the tax authorities. The majority of European companies have a legal status of the limited liability companies (LLC) or representative branches.

Over 60% of the survey respondents are of European ownership: about half of the companies keep fully or the European ownership, and 12% more have European controlling share. A quarter of the companies confirm fully local ownership. The rest of the companies are varieties with different shares of the EU involvements. ([Annex 1](#), Q4, Q7)

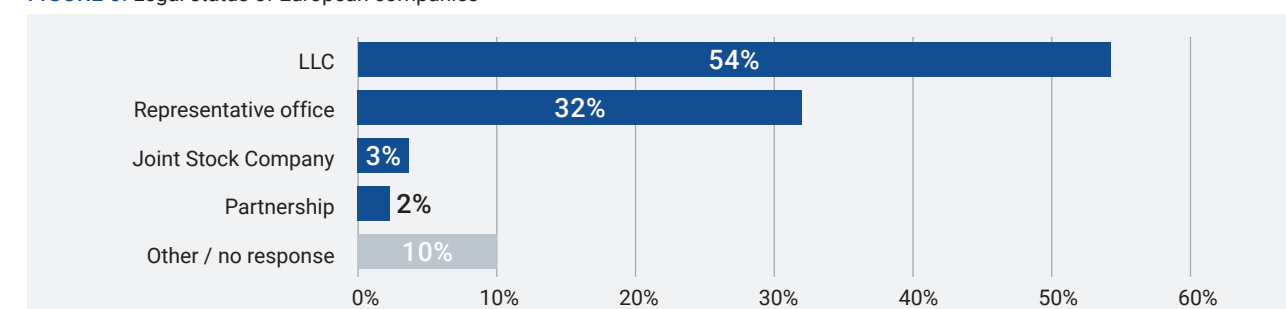
The 19 sectors of economy are represented in the survey 2020 in total, namely consulting and auditing; mining, oil and gas; transportation, logistics; ICT; wholesale and retail; engineering and construction; education, science and R&D; machinery and equipment; agriculture and manufacturing, etc. ([Annex 1](#), Q1). It worth mentioning, that representative of oil and gas sector account only 12% of the whole sample of the survey. Hence, the vast majority of European companies that participated in the survey 2020 represent the strategically important group of entities for the Azerbaijani economy, namely SMEs operating in non-oil sectors of the economy. Thereby, the findings of this report can help to determine the main trends in the business climate from the perspective of this group and provide a background for the future policy responses of the local government.

FIGURE 4. Year of establishment of European companies in Azerbaijan



SOURCE: EU Business Climate survey 2020

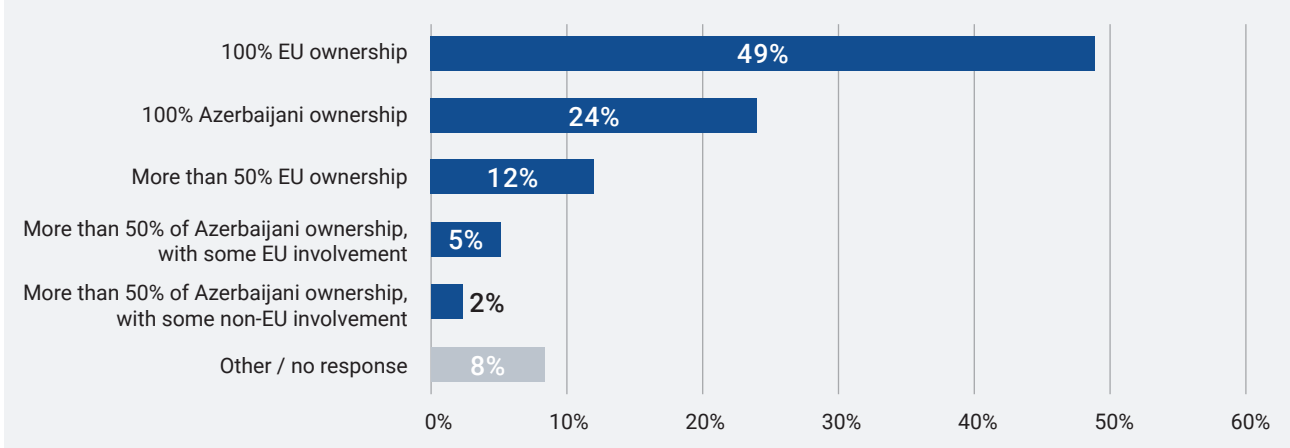
FIGURE 5. Legal status of European companies



SOURCE: EU Business Climate survey 2020

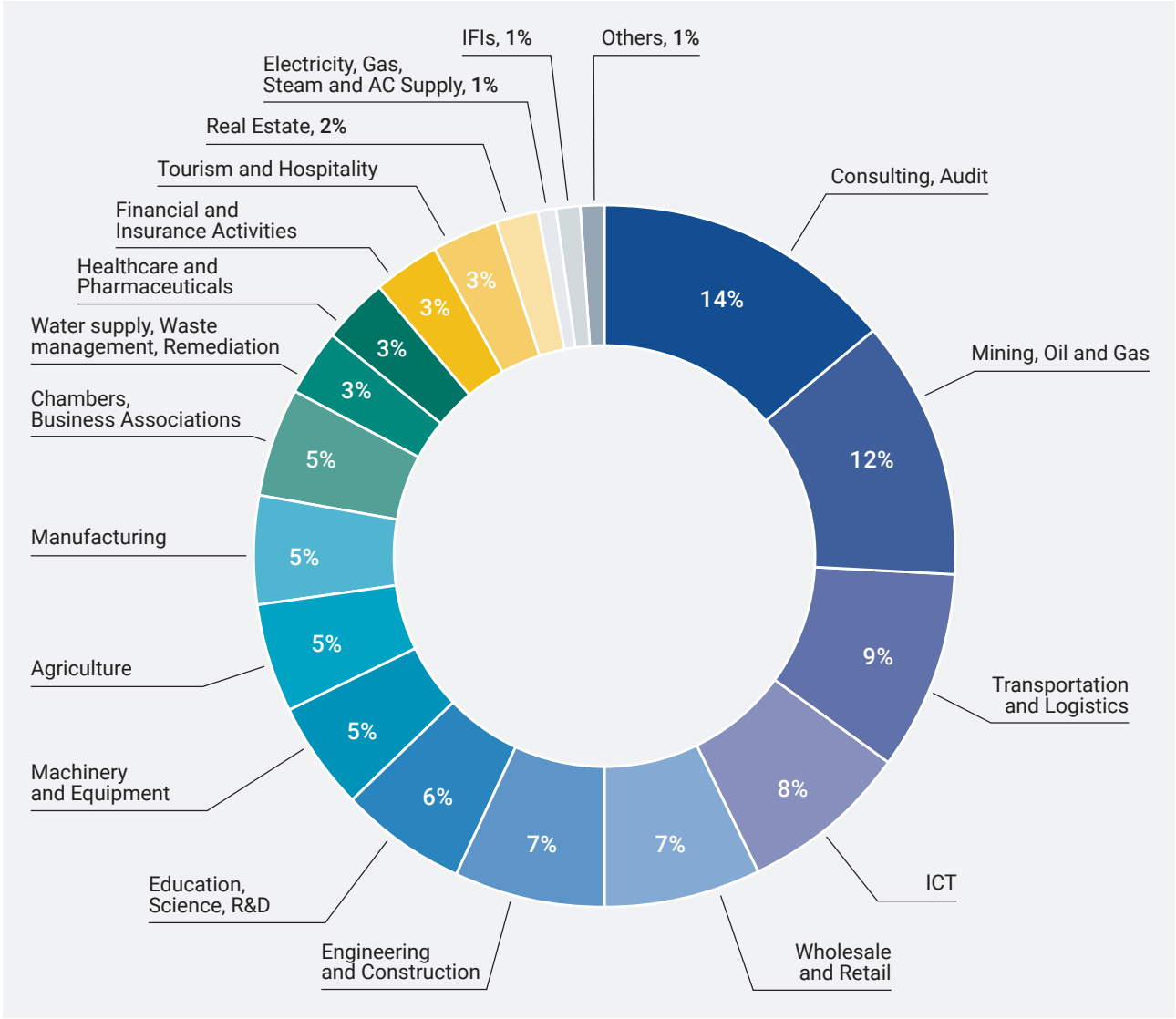


FIGURE 6. Ownership structure of European companies in Azerbaijan



SOURCE: EU Business Climate survey 2020

FIGURE 7. Profiles of the European companies in Azerbaijan



SOURCE: EU Business Climate survey 2020







## 2 BUSINESS CLIMATE 2020. CHALLENGES AND OPPORTUNITIES FOR EUROPEAN COMPANIES

### 2.1 BUSINESS AND INVESTMENT CLIMATE 2020

In 2020, the Azerbaijani business environment was significantly affected by the mixture of global and local factors, such as pandemic related restrictions, the volatility of oil prices, and military operations in Nagorno-Karabakh and around. Despite the new challenges, the confidence of European companies in the Azerbaijani economy remains stable. Similar to previous years, the businesses evaluate the political and social stability in Azerbaijan as the highest amongst the proposed local indicators. Amongst the sensitive factors for European companies in 2020 remain the insufficient level of rule of law, access to finance, payment discipline, corruption, and lack of transparency of public procurement. The main drivers for investors working in Azerbaijan remain access to markets and strategic partnerships. Despite the challenging environment in 2020, the companies remain optimistic about their future in Azerbaijan: a quarter of the companies plan to operate within the existing capacities and almost half of the surveyed companies plan expansion in the next few years.

Enhancing the local environment for non-oil sectors and sustainability of the economy remains an unaltered priority for the country since 2016. At the same time, world rankings indicate some contradictions in the development of the business climate. Azerbaijan demonstrated a sharp improvement of its positions in the Doing Business ranking since 2018. After lifting its positions from 57<sup>th</sup> to 25<sup>th</sup> place, the country was evaluated as 34<sup>th</sup> in 2020<sup>22</sup>. However, at the time of writing this report, the Review of data irregularities has been published by the WB improving its positions in several indicators in 2020 (getting electricity, enforcing contracts, and trading across borders) and bringing the country to 28<sup>th</sup> position in 2020 and the list of top 10 improvers in the Doing Business<sup>25</sup>. At the same time, the Global Competitiveness Report by the World Economic Forum indicates a moderate decrease in Azerbaijan's positions since 2016. During the years 2014 to 2016, the country undertook 35-37<sup>th</sup> positions amongst 138 countries.



In 2019 the country’s ranking decreased to 20 stages and resulted in 58th position amongst 141 countries.<sup>26</sup>

Since the EU Business Climate Report in Azerbaijan has been launched in 2016, European companies indicate some improvements in the business climate, while broadly evaluation remains at the similar level.

In the EU Business Climate Survey 2020, the companies were asked to evaluate the local economic environment. Despite the negative macroeconomic trends, the confidence of European companies in the Azerbaijani economy remains stable in 2020 as compared to the previous year, while the economy is still evaluated somewhat lower than “satisfactory” level. At the same time, the views of the entities on their own businesses and the economic situation in their sectors look more pessimistic this year comparing to 2019 and was evaluated somewhat lower. (Annex 1, Q9).

The most negative evaluation of the situation in 2020 has been made by representatives of the transportation, logistics, wholesale and retail, tourism and hospitality as well as consulting and audit sectors. At the same time, representatives of oil and gas, agriculture, ICT, and engineering and construction sectors assessed their sectors and entities more stable.

Amongst the proposed local indicators of business and investment climate the political and social stability in 2020 has been traditionally rated the highest. The indicator for several years remains on the top in the EU Business Climate Reports and the only one evaluated higher than the “satisfactory” level. This confirms a sufficient level of confidence in the Azerbaijani business environment and future policies. When compared to the previous 2019 year, the most positive dynamics in 2020 demonstrated the following local indicators: “infrastructure”, “custom tariffs”, and “predictability of economic policies”. The latter is becoming especially important during this uncertain period of the global economic turbulences. Negative dynamics were observed for the local indicators such as “qualifications of employees”, “payment discipline”, and “measures to eliminate corruption”. The factors related to labour market, taxation, and immigration remain at the same level as last year. As seen also in the previous years, the “quality of vocational education” and “transparency of the public procurement” remain at the bottom of the ranking (see Annex 1, Q23).

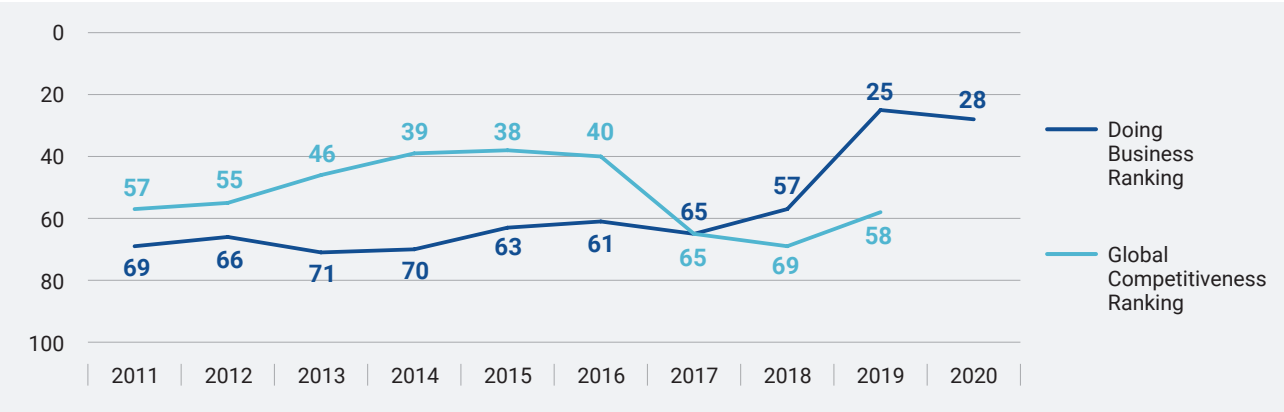
Every year within the EU Business Climate Reports, European companies are asked about the major factors motivating them to conduct business in Azerbaijan. In 2020, the responses remained to a large extent the same

as in previous years. The domestic market and strategic partnerships remain the main factors driving European companies to do business in Azerbaijan, followed by access to export of free trade and border markets, what is broadly in line with the traditional investors motivation for launching businesses abroad. (Annex 1, Q8)

Despite the challenging period, about half of European companies remain optimistic about their future in

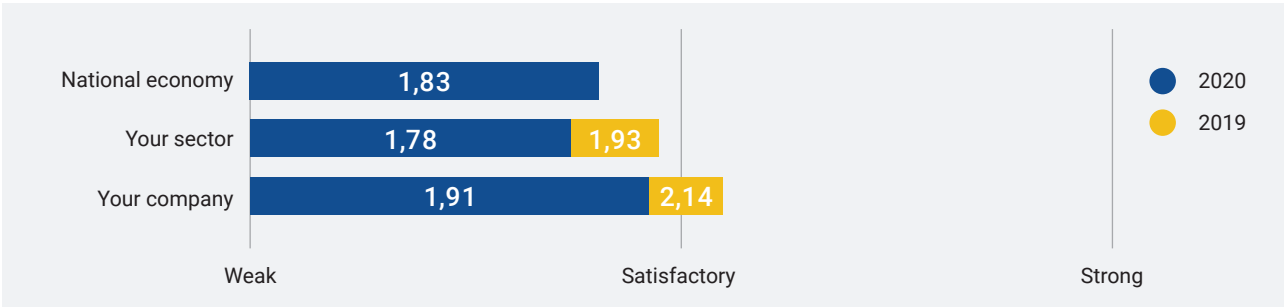
Azerbaijan and plan their expansion during next years. Amongst the sectors provided the most optimistic forecasts are oil and gas, construction and agriculture. Despite the obvious negative trends in economy in 2020 mainly caused by the pandemic, the indicated findings are comparable with the previous years. For example, 44% and 53% of European companies were planning their expansion in 2019 and 2018 respectively. At the same time, the pandemic added a level of uncertainty to the companies.

FIGURE 8. Position of Azerbaijan in global rankings 2011-2020



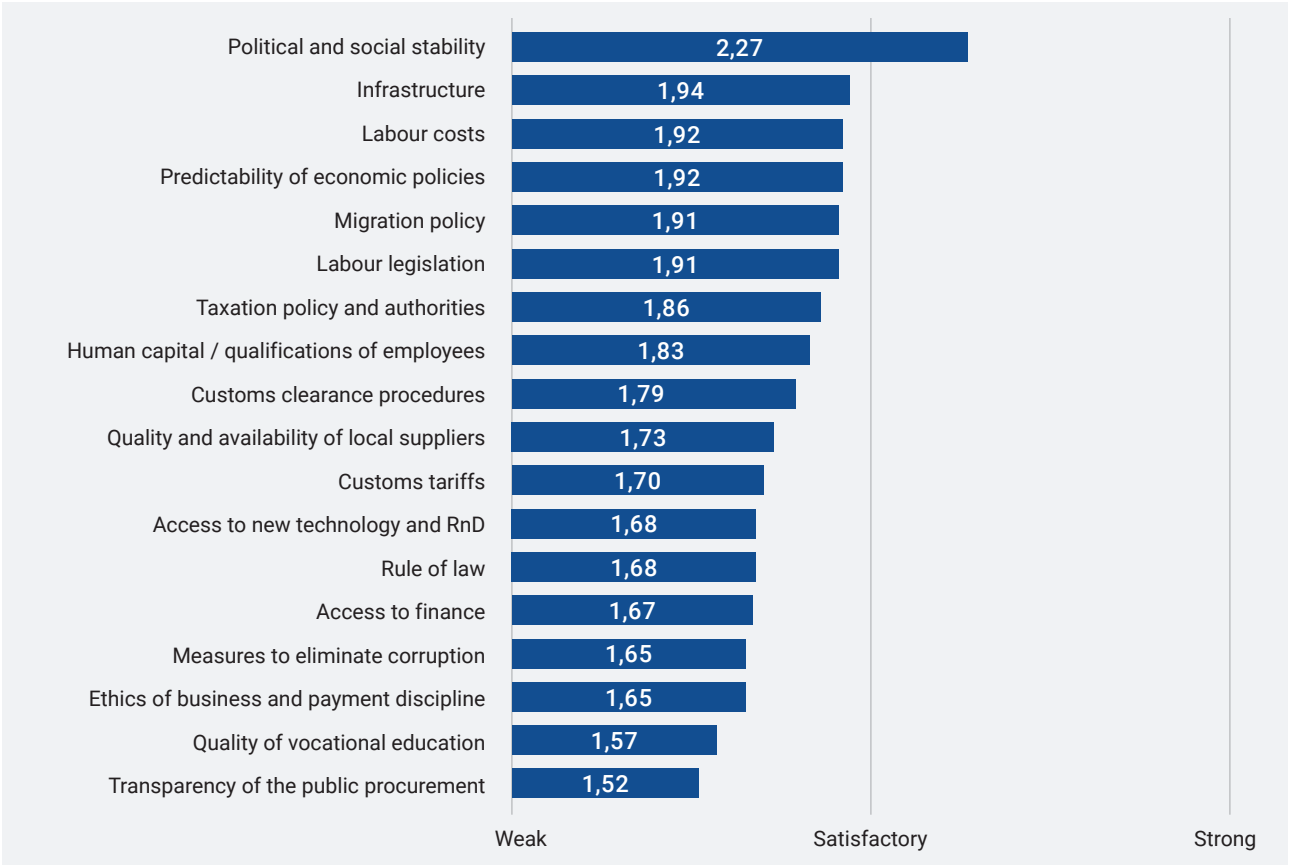
SOURCE: WB, Doing Business Report 2020, Review of data irregularities; WEF, Global Competitiveness Report 2019

FIGURE 9. Views of European companies on the economic situation in 2020



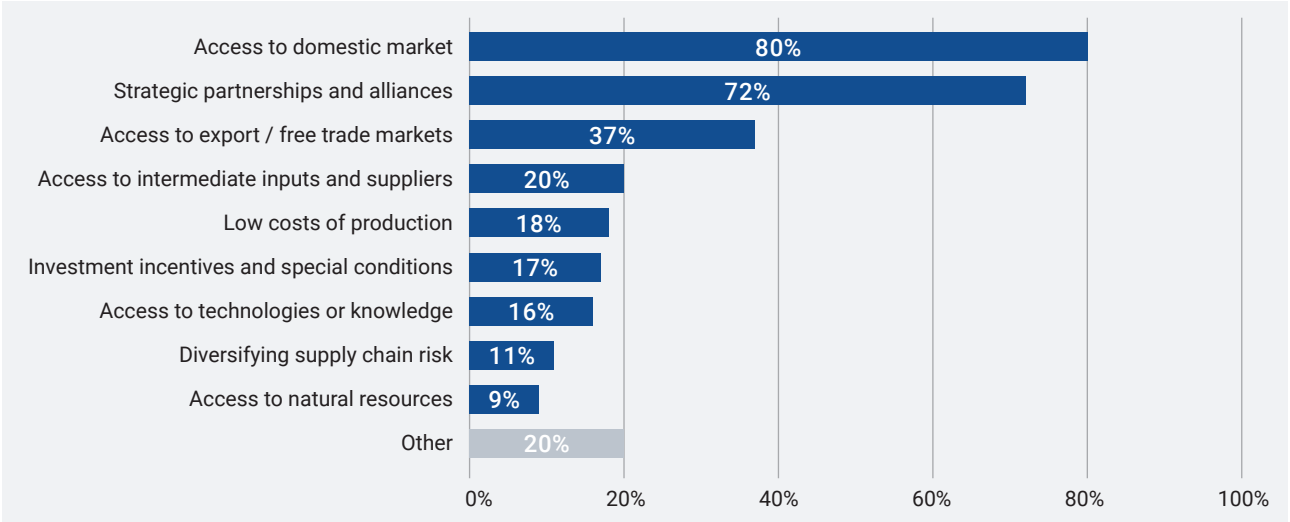
SOURCE: EU Business Climate Survey 2020; EU Business Climate Survey 2019

FIGURE 10. Ranking of the local indicators by European companies



SOURCE: EU Business Climate survey 2020

FIGURE 11. Factors attracting European companies to invest and/or do business in Azerbaijan

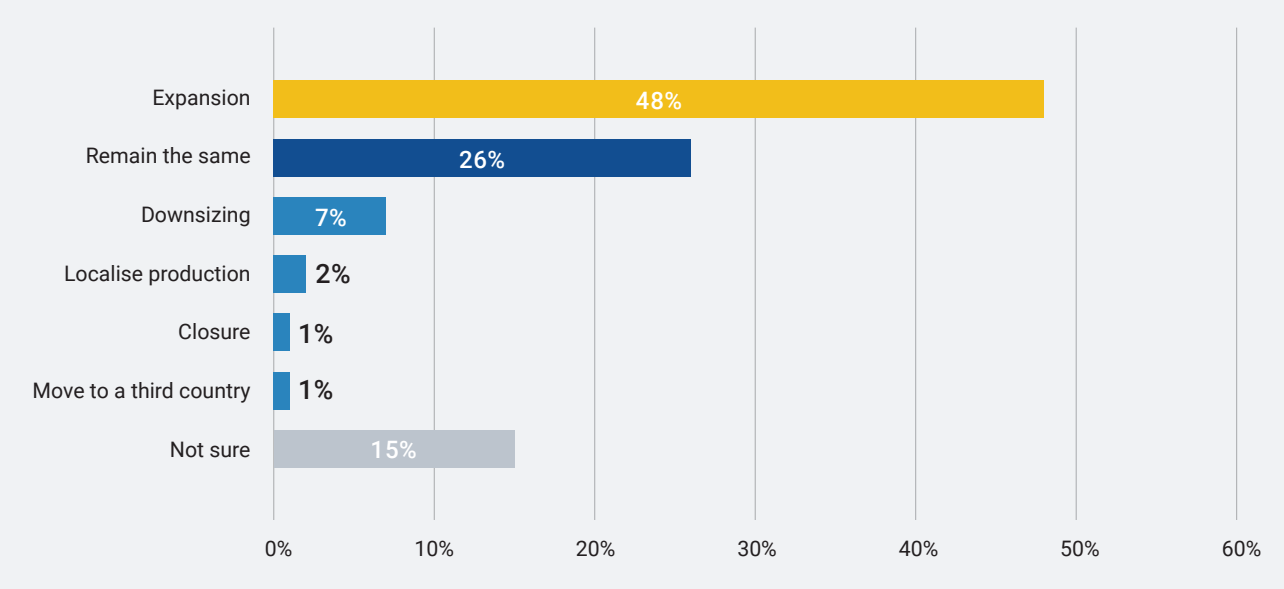


SOURCE: EU Business Climate survey 2020

In 2020 the share of companies ready to operate within the same capacities decreased to 10% comparing to the 2019 and 2018 EU Business climate results and 15% of the companies could not foresee future developments. About 10% of the companies gave a negative forecast for the upcoming years, mainly predicting their downsizing. The negative forecasts were given mainly by tourism and hospitality and transportation sectors, which are the most affected by the pandemic in 2020. Only 2% of the companies consider stopping of their operations in Azerbaijan, mainly closure or moving to a third country, what is similar to the results of the previous years (see Annex 1, Q20).

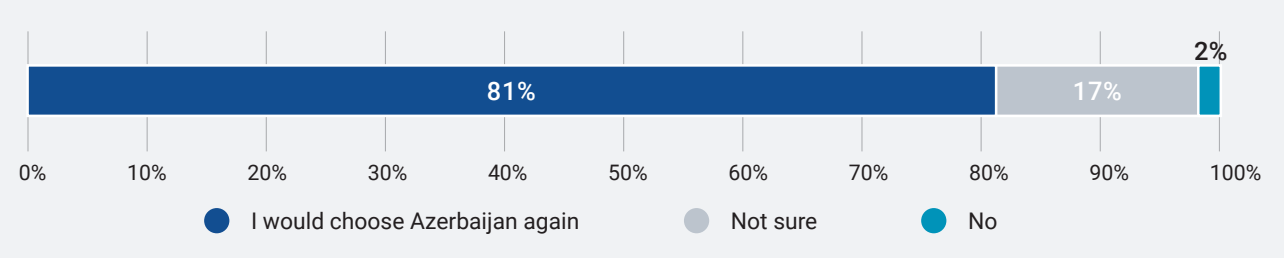
Another positive message received, is that over 80% of European companies would choose Azerbaijan again as the country of their operation (see Annex 1, Q20.1). For comparison, in the “EU Business Climate Reports” 2018 and 2019, this answer was given by 66% and 75% of the companies, which is confirming growing confidence and satisfaction of European businesses of the local business environment. As an only alternative to Azerbaijan, European companies unanimously chose Georgia among the countries in the Caucasus region.

FIGURE 12. Forecast of the companies on their development for the next few years



SOURCE: EU Business Climate survey 2020

FIGURE 13. Readiness to choose Azerbaijan again as location for business



SOURCE: EU Business Climate survey 2020

## 2.2 COVID-19 EFFECT TO EUROPEAN BUSINESS IN AZERBAIJAN

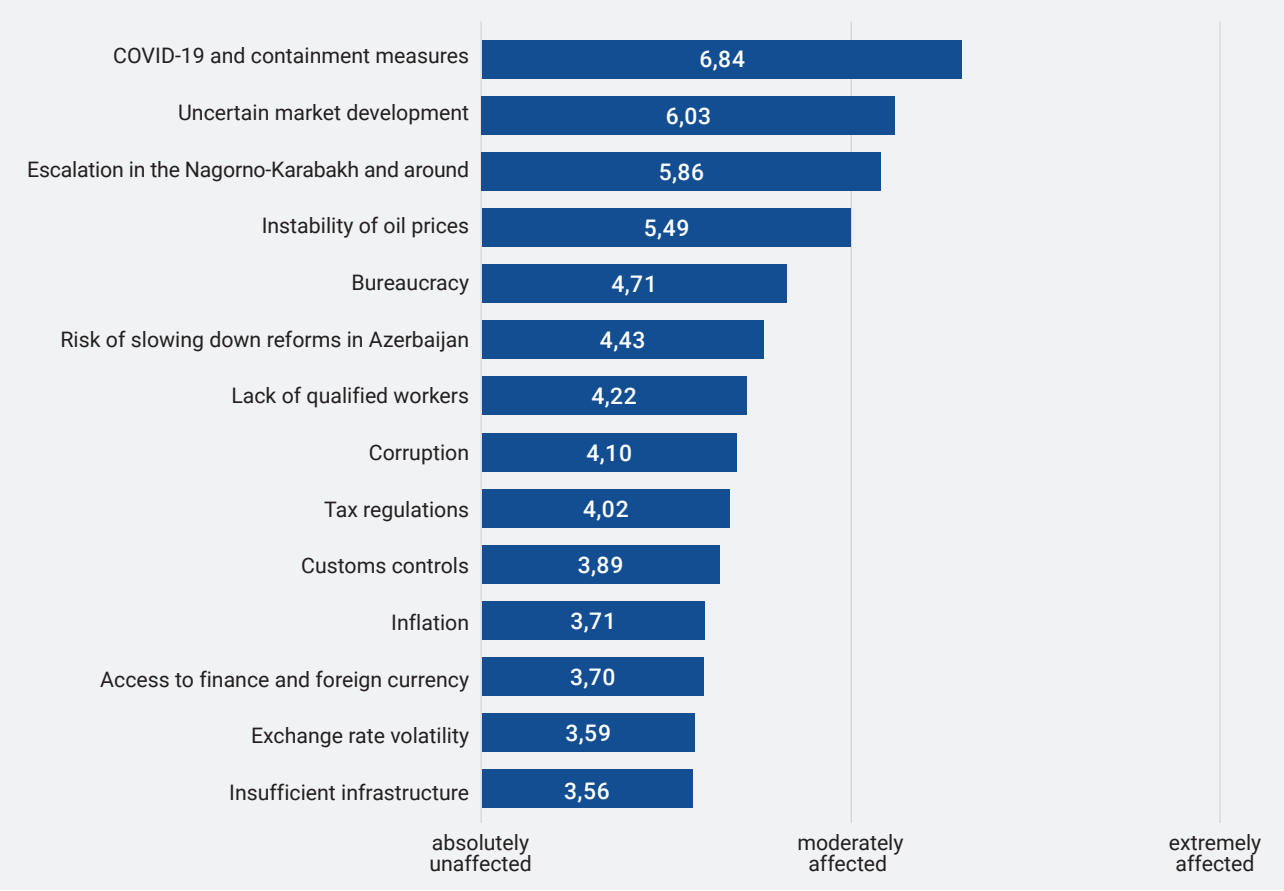
The slowing down of the international connections became the biggest obstacle for European companies during the quarantine regime in Azerbaijan. The pandemic-related restrictions had a strong impact on the business operations: 80% of the European entities confirmed a decrease of their profit and reduction in domestic and international turnover. The level of intensiveness of these effects was assessed as being somewhere between “moderate” and “significant”. Over half (64%) of the companies also confirmed a negative impact on employment and work conditions in their entities. The most common effects appeared to be cancellations of plans to create new workplaces (42%). One third of the companies shifted employees to part-time work (37%), and confirmed reduction of the salaries and other remunerations (33%).

According to the survey, the COVID-19 pandemic and related containment measures became in 2020 the most affecting factor for European companies in Azerbaijan. The pandemic together with generally uncertain market development, activation of military operations in and around the Nagorno-Karabakh, as well as instability of the oil prices have had a great impact on the local business environment, overshadowing other country issues, such as bureaucracy and corruption, which were at the top of this list in the previous years. (see Annex 1, Q10).

### COVID-19 restrictions

The Presidential Decree “On measures to protect public health and strengthen the fight against coronavirus infection in the Republic of Azerbaijan” announced on 19 March<sup>27</sup>, just a week after the World Health Organisation (WHO) recognised a world pandemic. Starting from 24 March, the authorities introduced a special quarantine regime in Azerbaijan, which includes border closures, mandatory quarantine of citizens returning from abroad, the prohibition of mass gatherings, restriction of domestic movements, closure of retail outlets, airports, and transportation hubs, social distancing, and disinfection of public spaces. Pandemic also became a reason for the first suspending of “ASAN Visa” service since it was launching in 2016.

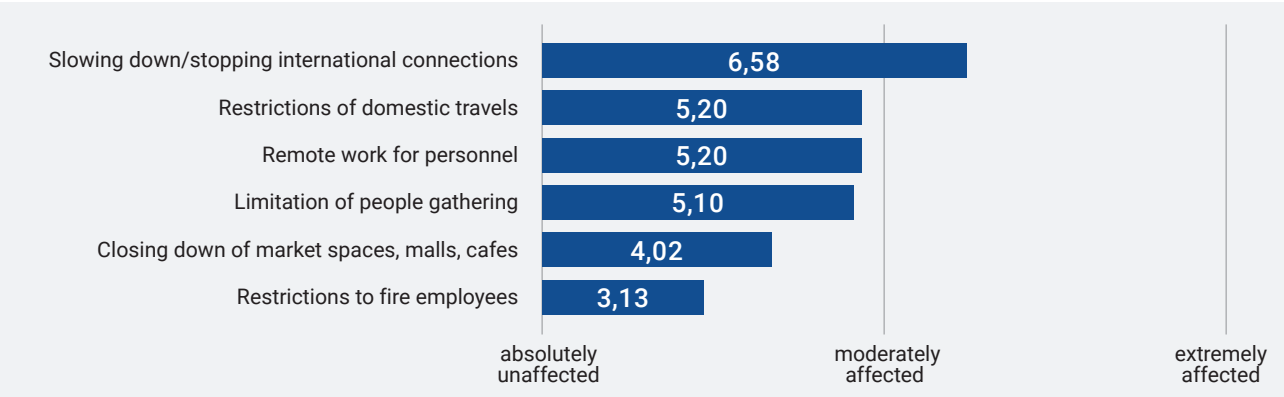
FIGURE 14. Impact of the different factors on European companies in 2020



SOURCE: EU Business Climate survey 2020



FIGURE 15. Evaluation of effect of COVID-19 containment measures on European companies



SOURCE: EU Business Climate survey 2020

No doubt, the introduced measures have had a great effect on the business environment and some of the sectors appeared to be almost blocked by the new restrictions, namely tourism, hospitality industry, entertainment, and passenger transportation.

The survey results showed, that the limitations related to international connections affected European companies stronger than other imposed measures. This restriction became an only measure passing the moderate level of impact towards the extreme point. During the interviews, the companies explained, that high sensitivity to foreign connections is caused by the international nature of their businesses, which foresees cooperation with the home countries, headquarters, foreign suppliers, and depends on the foreign skilled workers, etc. Other containment measures in Azerbaijan such as restrictions of domestic travels, introduction of remote work for personnel, and limitations of people gathering in social settings also negatively affected European businesses, however, their impact was assessed close to moderate (see Annex 1, Q11).

The interview results showed that even during the international lockdown, some of European businesses kept searching for international suppliers. These companies were asked about the reasons for this. As already indicated in the previous years, it seems that one of the most common obstacles for sourcing from the local suppliers remain insufficient quality standards, absence of the local alternative products as well as lack of skills and capabilities of the local suppliers (see Annex 1, Q14.3).

Effect on the performance of companies

To better assess the consequence of COVID-19, European companies were asked in the survey 2020 to specify the effect of the quarantine regime on the performance of their businesses. According to the answers provided, 80% of the entities confirmed the effect related to the decrease of the profit, domestic and international trade.

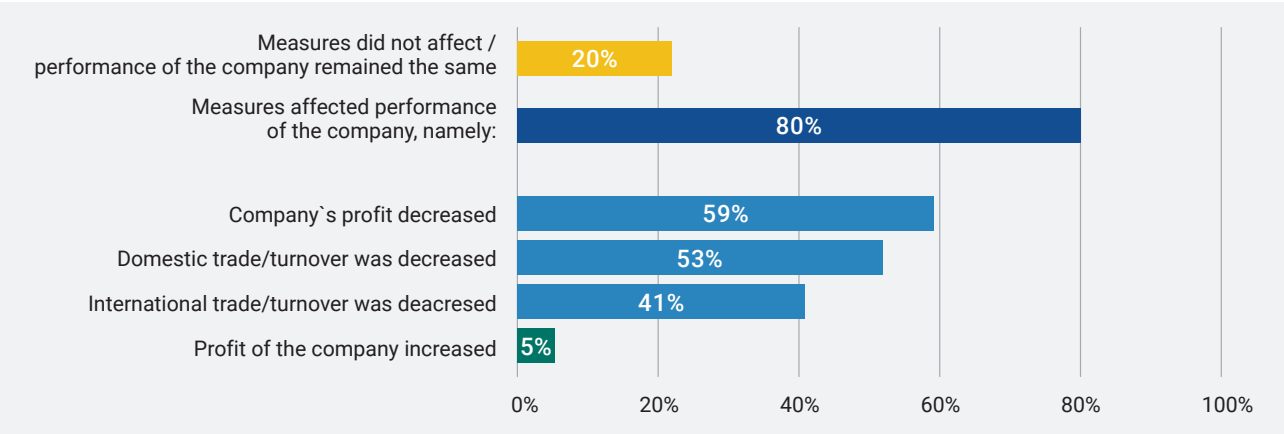
The survey also proposed to evaluate the downsizing of the mentioned indicators in percentage. The results show, that the average shrink of European businesses in 2020 was about 25% in terms of their turnover and profit, what is assessed as “moderate” and “significant” levels of effect by the companies. Meanwhile, for the rest 20% of the entities, the quarantine regime did not cause any change to their performance, and only a very limited part of the companies somewhat increased their profit (5% of the entities) (see Annex 1, Q12; 12.1).

“The pandemic became something extraordinary, what none of us could imagine a year ago. And the scale of its affect to the whole humanity is terrifying. I believe, there are no companies, which would not feel influence of pandemic and the quarantine regime. All the businesses are affected to some extent directly or indirectly.

CEO of a European company  
(consulting company)

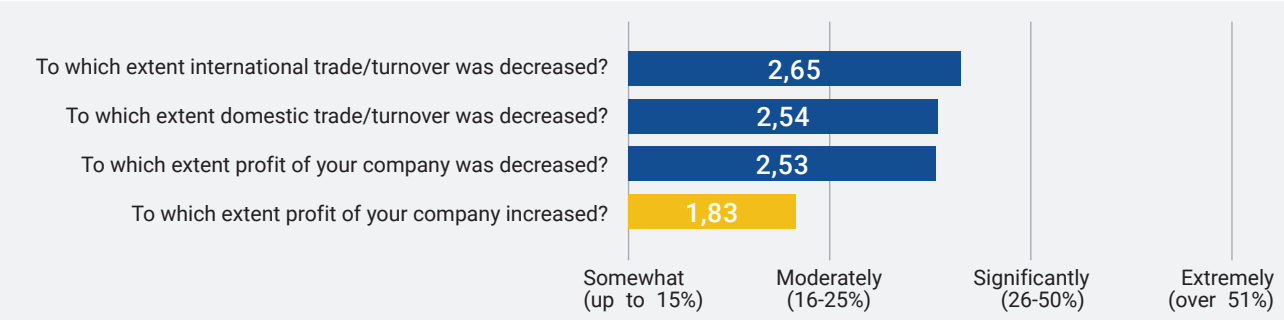
During the interviews, the companies emphasized that the first months of the quarantine regime were the most difficult because of the “shock effect”, when most of the businesses and the population stopped and waited for future developments. According to their views, it is still too early to fully estimate the financial losses of

FIGURE 16. Effect of the quarantine restrictions on the performance of European companies



SOURCE: EU Business Climate survey 2020

FIGURE 17. Intensiveness of the consequences resulting from the quarantine regime



SOURCE: EU Business Climate survey 2020

the companies, as the dynamics of the local economy is changing every month and the commercial results depend on the future developments related to the pandemic and local restrictions.

Effects on employment

One of the strongest effects of the pandemic has been reflected in global employment. The OECD estimated that the average unemployment rate among OECD countries could rise in 2020 to 9.2% under a single wave scenario and 10.0% under the second wave scenario. Unemployment amongst the active population of Azerbaijan according to State Statistical Committee was about 4.8% in 2019<sup>1</sup> and is forecasted for 2020 by the Word Bank to reach around 5.5- 6%.<sup>2</sup>

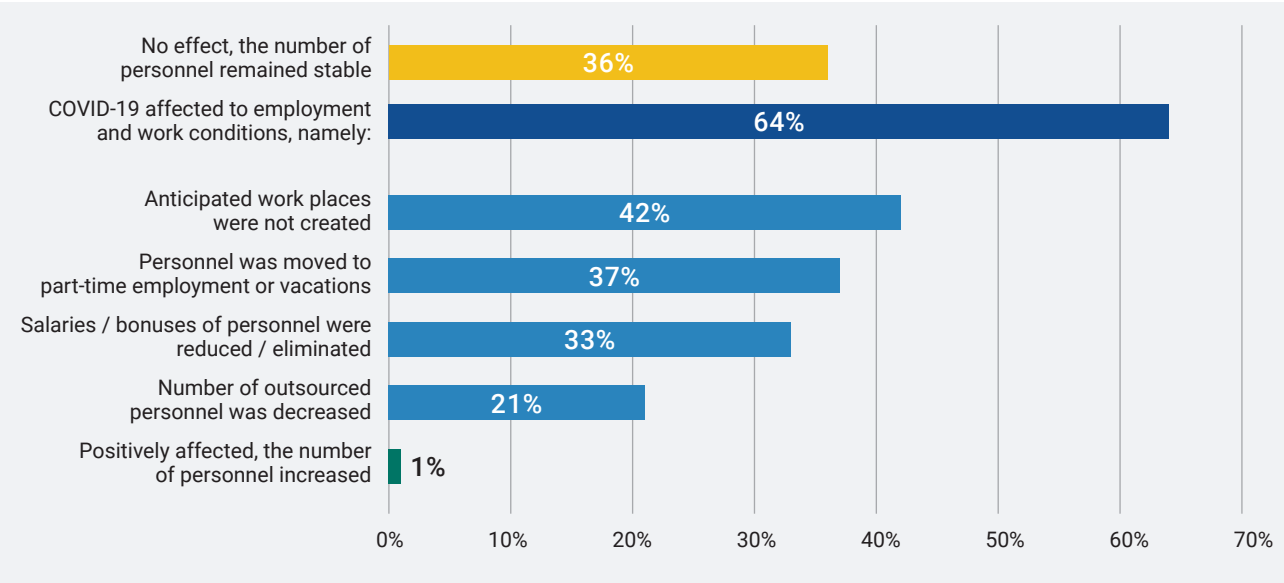
Over half of the respondents confirmed that there is an impact of the quarantine regime on the employment and work conditions in their companies (64%). The most common negative effect relates to the cancellation of plans to create new workplaces (42% of companies). One third part of the companies confirmed that there was an effect of the quarantine regime on their existing staff, e.g. shifting employees to part-time work (37%), reduction of the salaries and other remunerations (33%).

About 20% of the companies decreased the number of outsourced/contracted staff. Almost none of the entities provided new employment opportunities this year (see Annex 1, Q13).

“In spring our company was not able to operate and paying the salaries was challenging. In the last months the quarantine was lifted, and our business operations stabilised, but in case there would be a second wave of the pandemic, we foresee facing the same challenge.

CEO of a European company  
(transportation and logistics)

FIGURE 18. Effect of the quarantine regime on the employment and work conditions of the companies



SOURCE: EU Business Climate survey 2020

2.3 ADAPTING OF BUSINESSES TO THE QUARANTINE REGIME

The success of businesses in 2020 was dependent on the readiness and ability of companies to adjust the operations according to the quarantine regime. The vast majority of European companies operating in Azerbaijan took some sort of adaptation measures (94%). Digitalisation of businesses (58%) and remote work for personnel (75%) became the most frequent solutions in the companies. Hence, further digitalisation of the private sector and the availability of sufficient IT infrastructure in Azerbaijan is of crucial importance for sustainability of the private sector. In case of further extension of the quarantine regime, half of European businesses will keep adjusting their work, 42% plan to operate in the current format and 8% will suspend their activities.

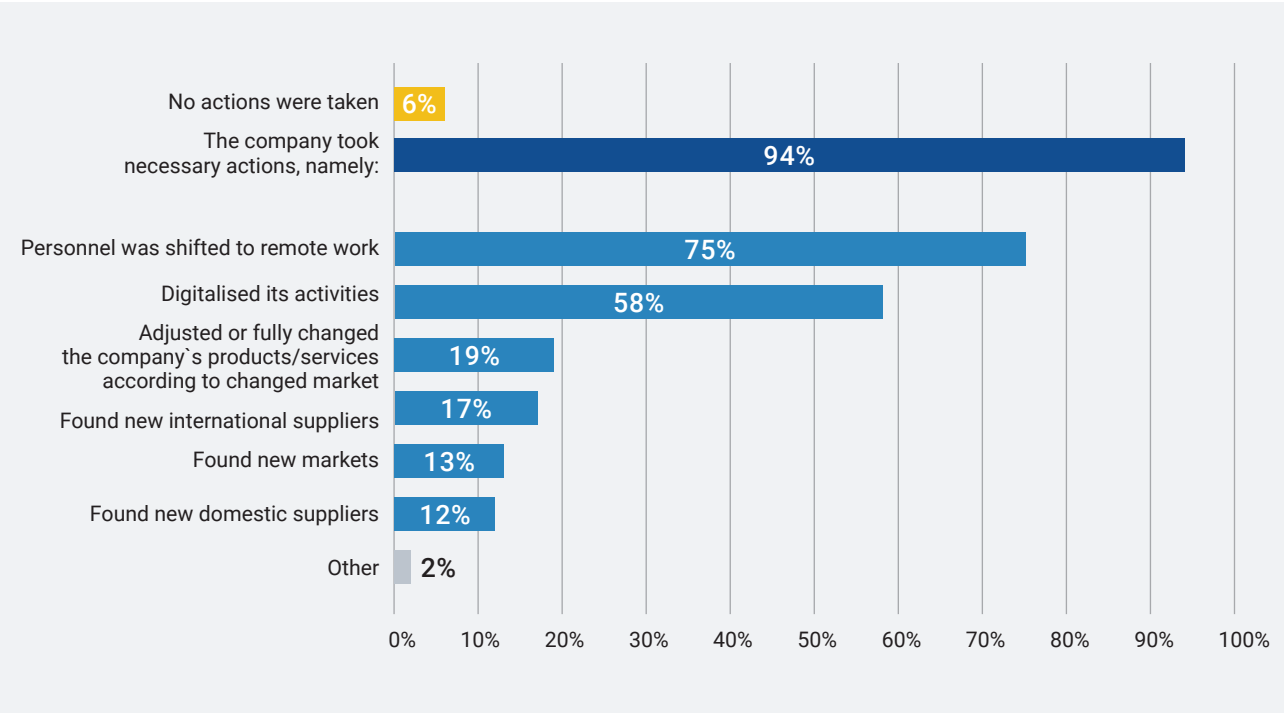
Since March 2020 the businesses are adapting their operations to the new reality brought by the quarantine regime in Azerbaijan, which appeared to be relatively long-lasting compared to other countries. 94% of European companies confirmed that they had adjusted their business operations in line with the changing environment. The interviewed European businesses stressed that the sustainability of their work this year was strongly dependent on readiness and ability to provide a robust reaction and adjust the operations accordingly.

When the quarantine was announced, we immediately started to adjust our company to online work. In one month, we returned to our normal level of work and in a few months our company even scaled up its sales. This happened because our competitors couldn't yet adapt at that time and their clients came to us.

CEO of a European company (machinery and equipment sector)

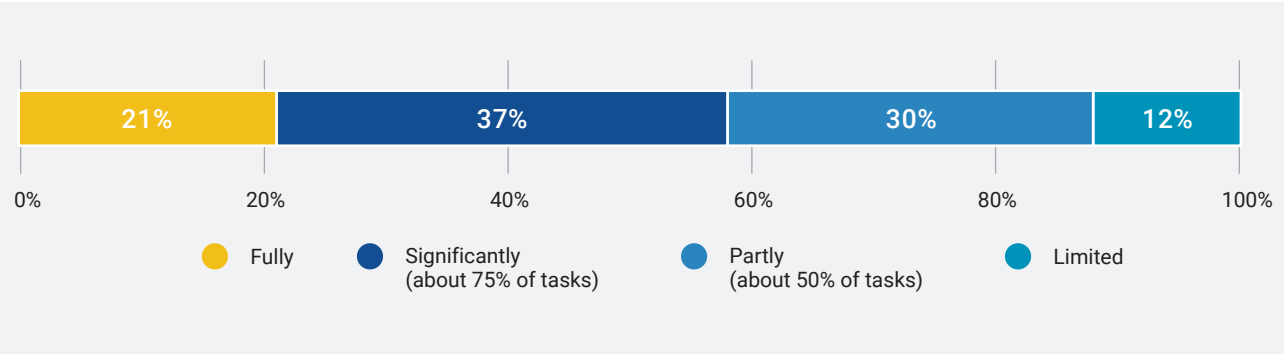
Amongst the most common and effective adaptation measures, European companies named the remote work for personnel and digitalisation of their business activities (see Annex 1, Q14). The majority of European businesses digitalised their activities in 2020 including some companies, which fully shifted their work to an online format. Only 12% of the companies applied limited digitalisation due to the specificity of their sectors (see Annex 1, Q14.1). The respondents emphasized that an average level of business digitalisation in Azerbaijan cannot be assessed according to the responses provided by

FIGURE 19. Measures undertaken by European companies to minimise the impact of the quarantine regime



SOURCE: EU Business Climate survey 2020

FIGURE 20. Ability of European entities to digitalise their business



SOURCE: EU Business Climate survey 2020

European companies. Due to the international nature of their businesses, which naturally foresee remote connections with foreign infrastructure, European companies had been better prepared for the online work prior to the pandemic than average local businesses. This includes the availability of the approved online procedures and protocols, software, good quality internet connection, etc.

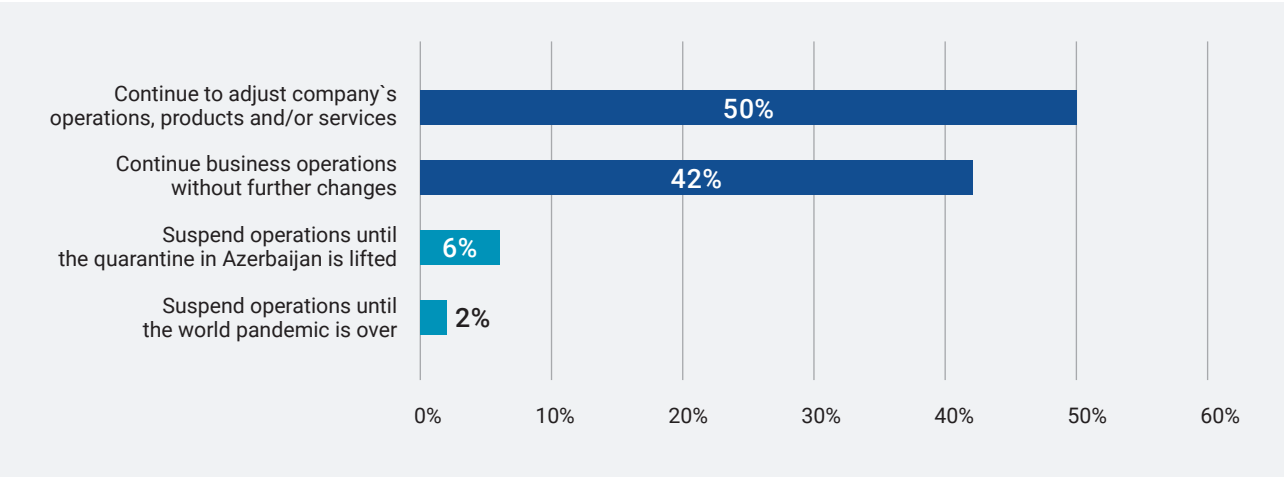
The personnel of European companies also demonstrated their readiness for remote work. In the first months of the quarantine regime, many of the companies organised special internal trainings for their staff to help them adapt to the new work format (see Annex 1, Q14.2).

European companies were asked about their plans in case the quarantine regime in Azerbaijan will be extended for additional 3-6 months. Despite of the

tremendous effect of the pandemic related restrictions to the economy and business environment, over 90% of the companies are ready to continue business operations during quarantine regime: a half of the entities plan to continue adjusting their businesses in case of further extension of the quarantine regime and over 40% of European companies will continue their business operations in a current format. This may also be explained by the fact, that majority of European companies target the local market, which remains available during pandemic restrictions. Meanwhile, about 8% of European companies will not be in a position to continue their work under current restrictions and foresee suspending their operations until the quarantine is lifted in Azerbaijan or the pandemic is over (see Annex 1, Q19). Such negative forecasts were given by representatives of the most affected sectors as transportation, tourism and hospitality.



FIGURE 21. Plans of European companies in case of further extension of the quarantine regime in Azerbaijan



SOURCE: EU Business Climate survey 2020

Quarantine in Azerbaijan is one of the longest and one of the strictest comparing to most of the EU and EaP countries. We see that the government makes efforts to support affected sectors, but for our type of business it is impossible to continue long-term operations under such restrictions.

CEO of a European company (tourism and hospitality)

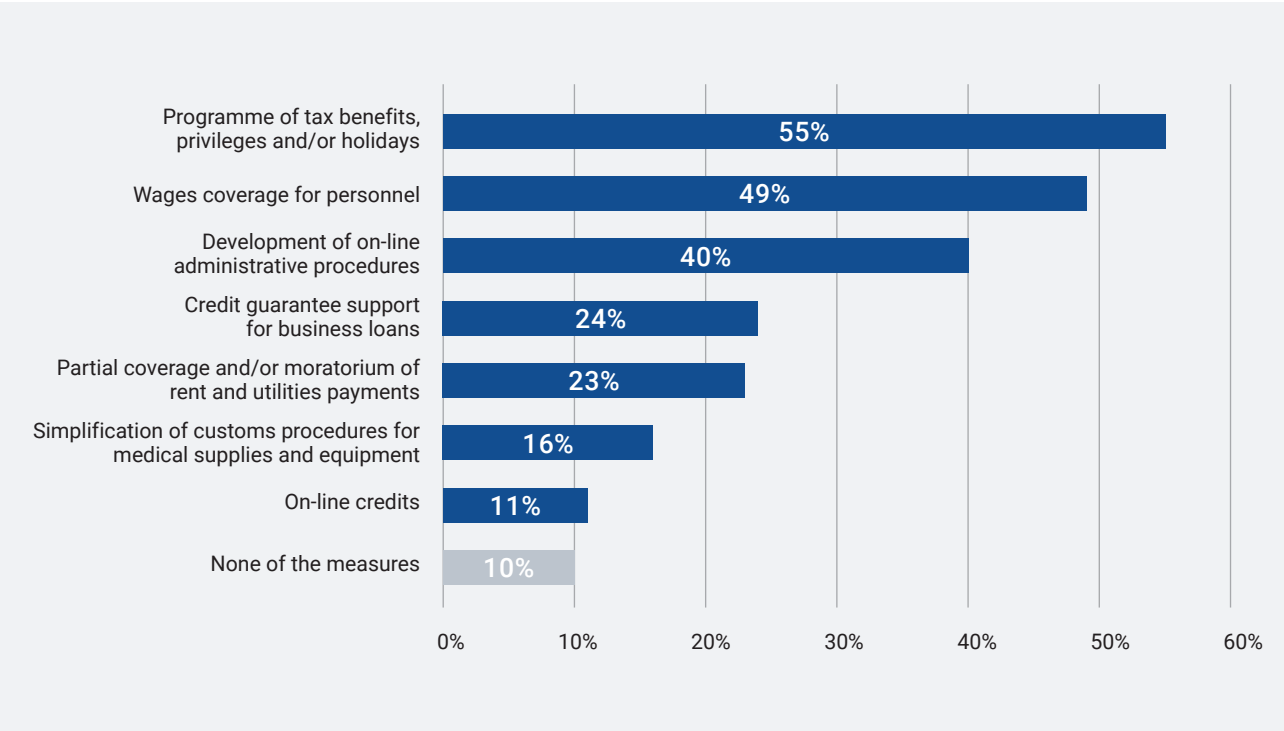
At the time of writing this report, it became obvious that the quarantine regime will be extended for some period into 2021. So, further digitalisation of the private sector and the availability of sufficient IT infrastructure in Azerbaijan is of crucial importance for the sustainability of the local economy (see Section 3.3).

2.4 STATE SUPPORT DURING PANDEMIC

European companies are generally satisfied with the state support during the pandemic, its accessibility, and the level of communication (75%). The most appreciated has been the initiative related to tax and fiscal privileges (55%), followed by the wage's coverage of personnel working in the most affected sectors (49%) and digitalisation of the administrative procedures (40%). The most frequent recommendations on further improvement of the state support were related to the application of tax reliefs for broader number of sectors indirectly affected by the quarantine regime, enhancing access to cheaper funds, and liberating the international travels.

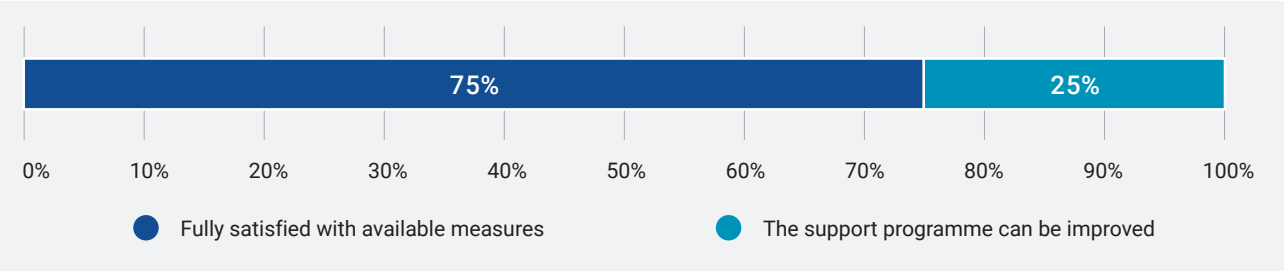
On 4 April 2020, the government of Azerbaijan announced the measures to reduce negative impact from the coronavirus. The support programme with a budget of USD 1.47 billion (4.85% of GDP) targeted businesses sectors and groups of population, most affected by the global pandemic and related restrictions.<sup>28</sup> The adopted action plan includes direct financial support to private entrepreneurs affected by the pandemic (USD 47 million); wage subsidies (USD 127 million), tax exemptions (USD 68 million), support to passenger transport enterprises (USD 165 million); state guarantees and subsidies on interest rates (USD 300 million); subsidies of the interest rate on existing bank loan portfolio (USD 600 million).<sup>7</sup>

FIGURE 22. Effectiveness of different state support measures during pandemic



SOURCE: EU Business Climate survey 2020

FIGURE 23. Expectations regarding additional support measures from the government



SOURCE: EU Business Climate survey 2020

The priority was given to the most vulnerable categories, such as SMEs and representatives of the most affected sectors, including manufacturing, tourism, hospitality industry and entertainment, transportation, wholesale and retail, etc. The current approach is aligned with the international practice; however, it faces a certain degree of criticism from European companies, which believe that the tax reliefs should apply to a wider range of businesses affected by the quarantine regime. There should be flexible criteria not only connected to a certain sector but also to the performance of the companies during pandemic.

According to the results of the EU Business Climate Survey 2020, the initiative related to tax and fiscal privileges were considered the most appreciated measures by the European business community, followed by the wages coverage for the personnel of the most affected sectors and digitalisation of the administrative procedures for the business (see Annex 1, Q17).

This year the government made a swift and robust policy response to the situation and the support for SMEs came right on time. There are appropriate initiatives and the communication was timely and proper. This is a way better response, than what we saw after the oil crisis in 2016.

CEO of a European company (transportation and logistics)





European participants confirm, that during these months' sufficient communication in relation to the quarantine restrictions is provided by the government, keeping the businesses and the population up-to-date with new developments. A special website was set up to inform citizens about the containment measures, and to provide access to digital services such as online education, e-health, and entertainment.

During the one-to-one interviews, European companies compared the current state support related to COVID-19 with the previous policy response after the oil price crisis in 2015 and 2016. The mostly positively were assessed the current speed of the response, quality and variety of the currently provided tools. One of the positive points raised related to the accessibility of the announced programmes. The companies confirmed that the businesses eligible for the state support have received both the reliefs and expected funding.

75% of the companies think that the available measures are sufficient and they do not expect additional actions from the government. The most frequent suggestions about possible additional measures were related to the expansion of the eligibility criteria for state support to broader number of sectors indirectly affected by the quarantine regime, enhancing access to cheaper funds, and liberating the international travels. (see [Annex 1](#), Q18).

” Many sectors are indirectly affected by the pandemic and the state support programmes should also consider this fact. For example, our sector and our company are not eligible for the state support. But as for every consulting firm, our income is directly connected to the business operations of our clients and many of them are having a crisis now. So, our performance was also significantly decreased.

Manager of a European company  
(consulting and audit)

## 2.5 MILITARY OPERATION IN AND AROUND NAGORNO-KARABAKH

Military escalation in and around the Nagorno-Karabakh had a limited effect on the businesses operating outside of the affected area. The major difficulties of business were related to the limitation of access to the Internet and social networks, especially due to the fact that ICT was a crucial tool for remote work during the pandemic. A possible extension of the military actions was considered by European companies as the biggest threat that could affect the business environment significantly. While the military operation somewhat affected the attractiveness of Azerbaijan for new foreign companies and investors, the existing investors and companies in Azerbaijan continued their business as usual. After the ceasefire was agreed, the businesses expected launching of new projects and investment opportunities in affected areas as well as stronger prioritisation of the economic reforms in general.

The protracted Nagorno-Karabakh conflict has affected Azerbaijan's economy and development for many years. In 2020, the hostilities between Azerbaijan and Armenia elevated in July, and the 44-day long war followed in September-November.

The active military operations started after the online EU Business Climate Survey 2020 had already been published. Hence, limited quantitative data could be collected as regards its effect on the business environment. Nevertheless, the survey results showed that the military conflict was considered as the 3rd strongest factor affecting the local business climate in 2020 after COVID-19 and uncertainty of the market's developments (see [Annex 1](#), Q10).

To collect more information about the views of the European companies on the effect of military escalation on their businesses, this subject was proposed for discussions during one-to-one interviews held in October and November. Based on the interviewees' feedback, the following conclusions were made:

- The military escalations had limited effect on the businesses operating outside the area of the military conflict. The companies located in Baku continued their business as usual;
- The projects ongoing in the regions neighbouring the areas affected by the military operations were interrupted and the companies re-located their teams. Some impact was felt by the businesses operating in

- Ganja, the second largest city of Azerbaijan, located close to Nagorno-Karabakh;
- The limitations related to the ICT during the time when the martial law was enforced, had a significant effect on the business routine due to remote work format during the pandemic;
  - The businesses were ready to put on hold the projects and cope with the short-term limitations caused by the martial law, but were afraid that possible prolongation of the military actions to the mid and long-term period would become a strong obstacle for companies to continue their work;
  - The military operation may have temporarily affected the international attractiveness of Azerbaijan for new European companies and investors, while the existing companies operating in the market continued their regular business activities;
  - Despite the above-mentioned impacts, European companies emphasized the importance of the reestablishment of government's control over the conflict-affected territories for the citizens and the economy of the country.

The signature of the tripartite "Statement by the President of the Republic of Azerbaijan, Prime-Minister of the Republic of Armenia and President of the Russian Federation" established the ceasefire.

After the ceasefire was achieved and the military conflict stopped, European businesses expect even a stronger prioritisation of economic reforms in Azerbaijan due to a need for recovery and attracting investments. The companies are looking forward to new projects and investment opportunities in the territories related to the road and irrigation infrastructure, civil and industrial construction, ICT, as well as development projects in the agriculture sector.

” I believe, that after the conflict is over new opportunities for investment will raise in the recovered territories. Most probably, they will include large projects devoted to the civil construction and infrastructural recovery of these territories. No doubt, this will be interesting for European investors.

Head of the European  
business support organisation



## 3 PROGRESS WITH LOCAL REFORMS

Since 2016 Azerbaijan is implementing reforms to diversify the economy and strengthen the non-oil sectors with a special focus on SMEs' growth. Their main objectives are to reduce bureaucracy, corruption as well as to make economy more transparent, what should result in improvement of the local business climate.

According to the World Banks' "Doing Business 2020" report, Azerbaijan joined the top 10 "reformer countries". Over the period from May 2018 to May 2019, the government implemented four reforms related to registration of real estate rights, loans, and protecting minority shareholders. At the same time the country demonstrated a lack of progress on structural reforms related to the private sector, corruption reduction, enforcement of intellectual property rights and judicial transparency.<sup>22</sup> According to the OECD SME Policy Index 2020, Azerbaijan significantly improved an institutional and regulatory framework and entrepreneurial learning since 2016. Moderate improvements were also observed as regards the access to finance, public procurement and innovation policy.<sup>30</sup>

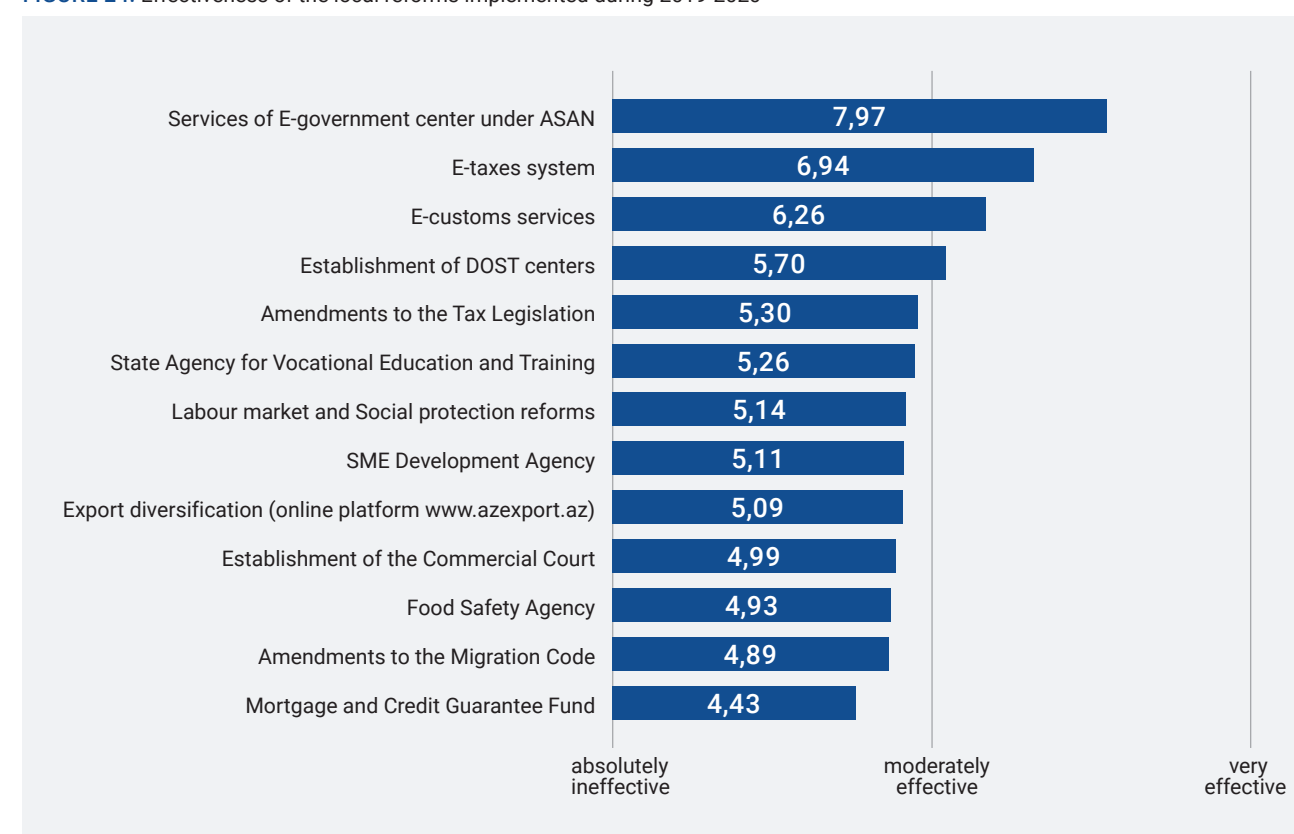
Since 2016, the EU Business Climate Report in Azerbaijan implements an annual monitoring European companies' views and assessments of the progress in implementation of the local reforms. The monitoring is based on the anonymous feedback provided by the survey participants.

The reforms ranked the most effective as perceived by European businesses in the 2020 survey, remain broadly the same comparing to the last year' results. Namely ASAN, tax and customs related reforms as well as improvements in the labour market obtained the highest points from European companies (see [Annex 1](#), Q21). More details about the top-evaluated reforms and the reasons behind are available below.

In worth mentioning, that aside the extraordinary factors affected the business climate in 2020, as the world pandemic and Nagorno-Karabakh conflict, European companies consider the "risk of slowing down the local economic reforms" as one of the major threat for the local business climate (see [Annex 1](#), Q10). This reveals the expectations of European business community from the progressing reforms remain high. During the interviews businesses confirm, the reforms are considered as effective mechanism to improve the environment for SMEs in non-oil sectors, which majority of European companies represent.



FIGURE 24. Effectiveness of the local reforms implemented during 2019-2020



SOURCE: EU Business Climate survey 2020

### 3.1 ASAN GOVERNMENTAL SERVICE

According to the surveyed European companies, ASAN remains the flagship local reform in Azerbaijan and the high-liner of the annual EU Business Climate Report since 2017. The “single window” concept together with the client-oriented approach and sufficient transparency of the procedures is keeping ASAN at the top of the annual ranking.

Operating under the State Agency for Public Services and Social Innovations, ASAN keeps developing over the years a portfolio of its services and remains the flagship example of the local reform in Azerbaijan and the high-liner of the annual EU Business Climate Report since 2017.

European companies apply to ASAN for the business-related services, including tax, customs, consular and

financial services, e.g. the registration of the company in Azerbaijan, obtaining licenses and permits, visas and migration documents, work and residence permits for the foreign qualified workers, insurance, transportation documents, hotline consultations, etc. During the quarantine regime in 2020, ASAN has been operating as a platform for obtaining quotas and registering the workers which could not work remotely and had to be present at their workplaces.

During the one-to-one interviews European companies summarised the main aspects keeping ASAN at the top of the reforms` list, namely:

- The “single window” concept and availability of wide range of the services;
- Strong client-oriented approach aiming to satisfy requests of the applicants;
- Sufficient digitalisation, which results in lower level of bureaucracy;
- Clear available instructions for each service resulting in economy of time for preparation and application;
- Sufficient transparency and lower corruption risks.



”

The fundamental difference, which we feel when we come to ASAN is that they see in us their clients and they try to help and satisfy our needs. And until the other state institutions change their mindset and keep positioning themselves as controlling and punitive bodies, ASAN will remain at the top of this ranking.

Owner of a European company

Considering the wide range of services provided by ASAN it is not always appropriate to compare it with other reforms, targeting purely the business operations. In a broad perspective, the attitude and client-oriented mindset demonstrated by ASAN can be applied to other reforms of the public institutions.

#### ADDITIONAL INFORMATION

Azerbaijan Service and Assessment Network (ASAN) was established in 2012 by the Presidential Decree and operates as a “single window” bringing together over 300 public services implemented by 10 different state and private institutions. The services provided by ASAN are related to different spheres of life and needs of individuals and entities, including ASAN-Visa, ASAN Payment and ASAN Finance platforms. As for today, there are 20 ASAN centres functioning in the country with a “Mobile ASAN Service” allowing to provide services on the field as well.<sup>31</sup>



## 3.2 TAX REFORM INCLUDING E-TAX AND AMENDMENTS TO THE TAX CODE

After several years of prioritising improvement in taxation, the survey in 2020 confirmed a progress in relation to this aspect. European companies appreciate both the new tax reliefs and the online taxation procedures. There is a need for further promotion of the electronic taxation, which will result in better transparency of the economy. The attitude of the tax authorities to businesses still needs to be improved. The companies expect positive dynamics in this regard after the latest organisational reform, shifting the Tax Service under the Ministry of Economy.

The ranking proposed this year divides the tax reforms into 2 groups, namely digitalisation of the taxation (e-tax) and the changes embedded in the tax legislation (amendments to the Tax Code). European companies welcomed both aspects, however, the advantages of the e-tax system ranked higher than the changes to the tax legislation.

In 2020, the quarantine regime and related measures became an additional catalyst for activation of all digital services including in relation to taxation. During the interviews European companies confirmed that the possibility to use an online tax declaration reduces the bureaucracy and improves time efficiency of the reporting procedures. The businesses believe that further promotion of the e-tax system and its use by a larger amount of local companies in Azerbaijan will reduce the “shadow economy” and improve the business climate. To ensure further progress with introduction of the online taxation, there is a need for awareness raising campaigns and trainings for businesses.



At the beginning of this reform our clients-SMEs were resisting to use of the on-line tax reporting, which seemed for them too difficult. But after some time, they adapted and realised the significant advantages which this system brings.

Manager of a consulting company

The ongoing since 2016 changes to the tax legislation include a number of investment incentives, measures to balance tax burden, reduce shadow economy and employment and tax reliefs during COVID-19 pandemic. The introduces changes were considered useful and effective by European companies.

Relations of the companies with the tax authorities remains an issue which needs attention and further improvement. According to the feedback, the controlling and punitive attitude of the tax authorities during their interaction with businesses significantly decreases satisfaction in domain of the local business environment. During the interviews several specific issues were raised, including unauthorized actions of the tax authorities.

As far Azerbaijan aspires to develop its private sector and attract investments, it is important to keep a balance between the fair tax burden and effective tax administration. The institutional reform in 2019 that resulted in moving the State Tax Service under the Ministry of Economy somewhat increased optimism in this area. Merging of these two institutions under one umbrella is expected to enhance coordination of their policies and improve client-oriented attitude during work with business.

### ADDITIONAL INFORMATION

In 2016 the Decree “Rules for the issuance of the Investment Promotion Document” and amendments to the Tax Code have been approved allowing the entities eligible for IPD to have a number of tax reliefs, including a 50% reduction in profit, income, property and land, VAT and customs taxes on imported equipment for 7 years. The Law “On Customs Tariff” set tax exemption framework for residents, managing organizations and operators of industrial and technology parks eligible for IPDs.

The “Amendment Law”, which came into force in January 2019 is aimed to improve the labour environment by providing stimulus for official employment and banning registration of the personnel as individual entrepreneurs. The changes introduced are in line with the tax policy announced by the President Ilham Aliyev in 2018, with the motto “from shadow to light” and aiming to build reliable relations between the state and taxpayers and reduce “shadow economy” and “shadow employment”.

In June 2020, the President approved amendments to the Tax Code, providing tax benefits to businesses affected by the COVID pandemic<sup>30</sup>. The amendments grant a one-year exemption from land and property tax to the most affected sectors. Income taxpayers will also receive a 75% exemption and taxpayers filing under simplified procedures a 50% exemption. The rental property tax in the COVID-19 affected sectors is reduced from 14% to 7%.

## 3.3 REFORMS OF THE CUSTOMS SYSTEM

Effectiveness of the on-line customs was highly evaluated by European businesses. Amongst the strongest effects of the reform, the companies mentioned improvement in transparency, bureaucracy reduction and elimination of brokers from the market. The businesses are also satisfied with the advantages of the “Green Corridor”, which significantly improved speed of the customs procedures. At the same time, companies believe that it is important to further prioritise the customs improvement, namely ensuring sufficient work of all new facilities and online procedures, provide instructions about the new tools in a friendly format and improve client-oriented approach in customs as well as further improve the customs tariffs.

Similar to the e-tax reform, the online procedures in customs were positively evaluated by European companies. It took a few years until European business start to give clear positive feedback and confirm that improvements have taken place in this regard. The electronic system ranked in the 2020 survey higher than other customs aspects (tariffs, operations, etc.). According to European companies, one of the most significant benefit of the e-declarations is elimination of the intermediaries (brokers), which had been an indispensable element of the customs system before. Amongst other positive changes are reduction of the bureaucracy, time and costs for the customs clearance, and improvement of its transparency.

Improvements of the customs procedures that resulted in time reduction and less administrative burden have been particularly appreciated. European companies have been satisfied with the “Green Corridor”, which started to operate since 2019 and foresees fast clearance procedure when meeting the specific conditions in relation to the absence of outstanding tax liabilities, availability of a registered warehouse, etc.

At the same time, the further improvement of the customs procedures became one of the most expected improvements according to the 2020 survey (see Annex 1, Q23). European companies expect further prioritisation of the customs’ reform especially in relation to reducing the corruption risks, improvement of the customs tariffs, ensuring sufficient capacity of the online platform and minimising its breakages or errors. To intensify the progress with customs there is a need

in further awareness raising amongst the businesses about online customs procedures, their advantages and clear user-friendly instructions for their use. It is also important to improve the client-orientation on the customs by introducing the tools for fast feedback about work of the on-line platform and satisfaction from the customs procedures.

The most contradictory appeared to be new customs regulation related to the passengers travels rather than to business transaction. The new obligations related to the customs clearance of the consumer goods with the value over USD 300 was raised by several companies during the interviews, as it causes additional regulations and controlling procedures for usual consumer goods during the travels.



For the last years the customs improved its services for businesses, but not for the population. The new regulation foresees declaring every importing item which costs over USD 300. This innovation cannot bring significant income to the state budget, but it definitely affected the comfort of the usual travellers.

Owner of a European company  
(machinery and equipment)

### ADDITIONAL INFORMATION

According to the Order “On additional measures to continue reforms in the customs system” approved in 2016 Azerbaijani customs started their reform foreseeing expansion of electronic customs services, minimising the number of paper documents and procedures required for customs clearance, and establishment of a “Green Corridor”. The “Green Corridor” started its operation in 2019.

Since 2016 several reductions and customs reliefs have been embedded for the investors operating in the industrial parks and quarters, regulated by the law “On Customs Tariff”. The special conditions on customs clearance of imported equipment and materials were also included into the Law on “Alat Free Economic Zone



### 3.4 LABOUR AND SOCIAL PROTECTION REFORM INCLUDING DOST CENTRES

In 2020 the European companies emphasised their appreciation in regard to the latest progress made in the area of labour and social protection in Azerbaijan. This includes measures aimed to enhance official employment and establishment of the DOST centres, which work as “single windows” for all categories of the population, including employers and employees, as well as improvement of the minimum wages.

The reforms on labour market and social protection have been implemented by the Ministry of Labour and Social Protection of Population aiming to cover the impact of the previous devaluations and to improve access of the population to the social services and were welcomed by the European companies. In the survey 2020 the newly launched DOST centres were listed among the top 5 most important reforms, even though their services are not directly connected to the every-day business operations of European companies.



There is a good impression about reforms introduced by the Ministry of Labour. They affect a large amount of population including the employees as well as other groups of population requiring social protection. And the changes in the living standards definitely affect the business environment.

CEO of a European company

During the interviews the businesses emphasised the importance of the measures recently introduced by the government, aiming at improving official employment in the country and social protection of the population (see Section 3.2). The social reform package introduced in 2019 with a budget of AZN 3.9 billion (USD 2.3 billion) is equal to about 17% of of the annual state budget spending's and covers over 4 million of people.

The latest changes to the legislation, foreseeing the increase of the minimum wages, pensions and national living wage twofold and caused the rising hopes of European companies on improvement of the living standards and consumer consumption in Azerbaijan. The introduced change brought Azerbaijan to the front lines amongst the CIS countries as for the purchasing power and improve the situation on the market for businesses.

#### ADDITIONAL INFORMATION

The Ministry of Labour and Social Protection of Population has been created over 130 services and integrated 22 services into the Electronic government platform. The Ministry plans to provide its services with a “single platform” concept in order to ensure transparency in the field of labour, employment, social protection, innovative management, etc.

Since 2018 an Agency for Sustainable and Operative Social Provision (DOST) and related to it centres were established by the Presidential Decree.<sup>32</sup> The DOST infrastructure provides services for different groups of the population, including the services on the labour relations between employers and employees. In 2018 and 2019 the amendments to the Tax Code targeted the improvement of the official employment. During 2019 was introduced the package of reforms foreseeing increase of the minimum wages and i salaries in the state funded institutions.

### 3.5 OTHER REFORMS

#### SME Development Agency

The establishment of the SME Development Agency (KOBIA) in June 2018 within the Ministry of Economy became a crucial step, confirming the government's intention to strengthen the Azerbaijani SME sector<sup>19</sup>. The Agency operates as the policy implementing body. Nowadays KOBIA is developing its own infrastructure in Baku and in the regions to ensure access by the target audience to its services, including establishment of the so-called “SME Friends”, focal points aimed to support local SMEs in rural areas. The first House of SMEs was opened in the Khachmaz region in 2020, providing a “single-window” platform for the state and private services from business planning and marketing to access finance and export promotion.

KOBIA somewhat improved its ranking position in the EU Business Climate Report since 2019, however, it did not reach the top 5 of the listed reforms in terms of its effectiveness for European companies. During the interviews European businesses highlighted the importance of creation of such agency devoted purely for the SME sector, but also confessed their limited knowledge about activities of the KOBIA and lack of

experience in cooperating with it. Therefore, it seems relevant to raise awareness of European business community about the KOBIA and its services, which the foreign SMEs operating in Azerbaijan can benefit from.

#### Export diversification online platform

In order to support non-oil export, the government established an online export hub AZEXPORT.AZ, which contains catalogues of the products of Azerbaijani origin and aimed at their promotion to the foreign markets.<sup>33</sup> This platform as well as other available so far initiatives for supporting export, face scepticism by European companies. The reason of this is a generally fragmented attitude to the export promotion in the country. Considering that the non-oil sectors represent only 10% of total Azerbaijani exports, the diversifying of the foreign trade require a stronger systematic approach. Nowadays the Ministry of Economy with support of the EU funded Project “Support the Government of Azerbaijan in Development of Export Strategy” works on the state Export Strategy that is expected to become a grounding long-term policy to improve and diversify the Azerbaijani export.

#### Food safety agency

The Food safety Agency was established in 2017. The creation of the Agency was welcomed by European companies who provided positive feedback in this regard. The Agency implements the following services related to the import and export activities: legal regulation of food safety standards, risk assessment, official registration of food products and their packaging materials, issuing of food safety certificates to exported food products, state control over food safety and protection of rights of food product consumers at all stages of food supply chain, including food production, supply, packaging, storage, transportation and trading, use in catering and service sector, utilization and disposal as well as implementation and regulation of state policy in the aforementioned areas.<sup>34</sup>

#### Amendments to the Migration code and visa procedures

Comparing to the previous years, the work permits still remain an issue for some companies. A few years ago, services related to the work permits were introduced in the ASAN single window. This made the procedure more friendly for business, but did not solve the problem in entirety. Nowadays, Azerbaijan has quota for the personnel from every country, but there is no access to the up-to-date information about remaining quotas during the year, what makes work permits unpredictable and planning of the personnel rotation challenging. Lack of the information leads to unexpected refusals of work permits especially in the period at the end of a year. Ensuring access to up-to-date information about remaining quotas would become a step to solve this

issue and would allow European companies to effectively plan personnel rotation and make the procedures in this regard more transparent.

Despite the technical challenges with the quotas, European companies during interviews provided a positive feedback about operation of the State Migration Service, demonstrating open and client-oriented approach. The Service was established in 2007<sup>35</sup> and for the years businesses collected positive record about its support, including introduction of electronic services and regular meetings with entrepreneurs.

#### Better regulation in relation to licenses and permits

The major changes in relation to licenses and permits have been made in 2015 and significantly improved the regulation environment, namely:

- The number of required permits has been reduced four-fold, from more than 330 to 86;
- The licensed types of activities were reduced from 59 to 37;
- The number of state bodies issuing licenses were decreased from 23 to 4;
- The time duration of issuing a licence was reduced from 15 days to 10 working days.
- Possibility to obtain the relevant documents via single window ASAN centres.

Further liberalisation after 2015 has its focus mainly on the digitalisation and improving speed of the procedures and their transparency. Separate measures have been put in place to raise awareness amongst businesses about the procedures and regulations.

#### Completing Azerbaijan WTO accession process

During 2020, Azerbaijani government continued its activities related to the WTO accession negotiations. The Ministry of Economy and other governmental bodies have regularly interacted with the WTO Secretariat and its Members on accession matters. The decision-making processes involving trade-related legislation and institutional reforms continued to be pursued. Examples of these efforts include, among others, the work towards the establishment of the national trade facilitation committee, the adoption of the Charter of the Anti-Monopoly and Consumer Market Control State Service and a new Law “On Technical Regulation”, which entered into law in March 2020. With regard to competition, a new version of the Competition Code is under preparation. These developments further align the institutional and legislative framework in Azerbaijan to what is required for WTO accession. To support the efforts of the government, the EU launched a project “Strengthening capacity of the Government of Azerbaijan in the WTO Accession negotiations and other trade related activities”,\* which will provide technical assistance during 2020-2021.

\* [www.wto.az](http://www.wto.az)



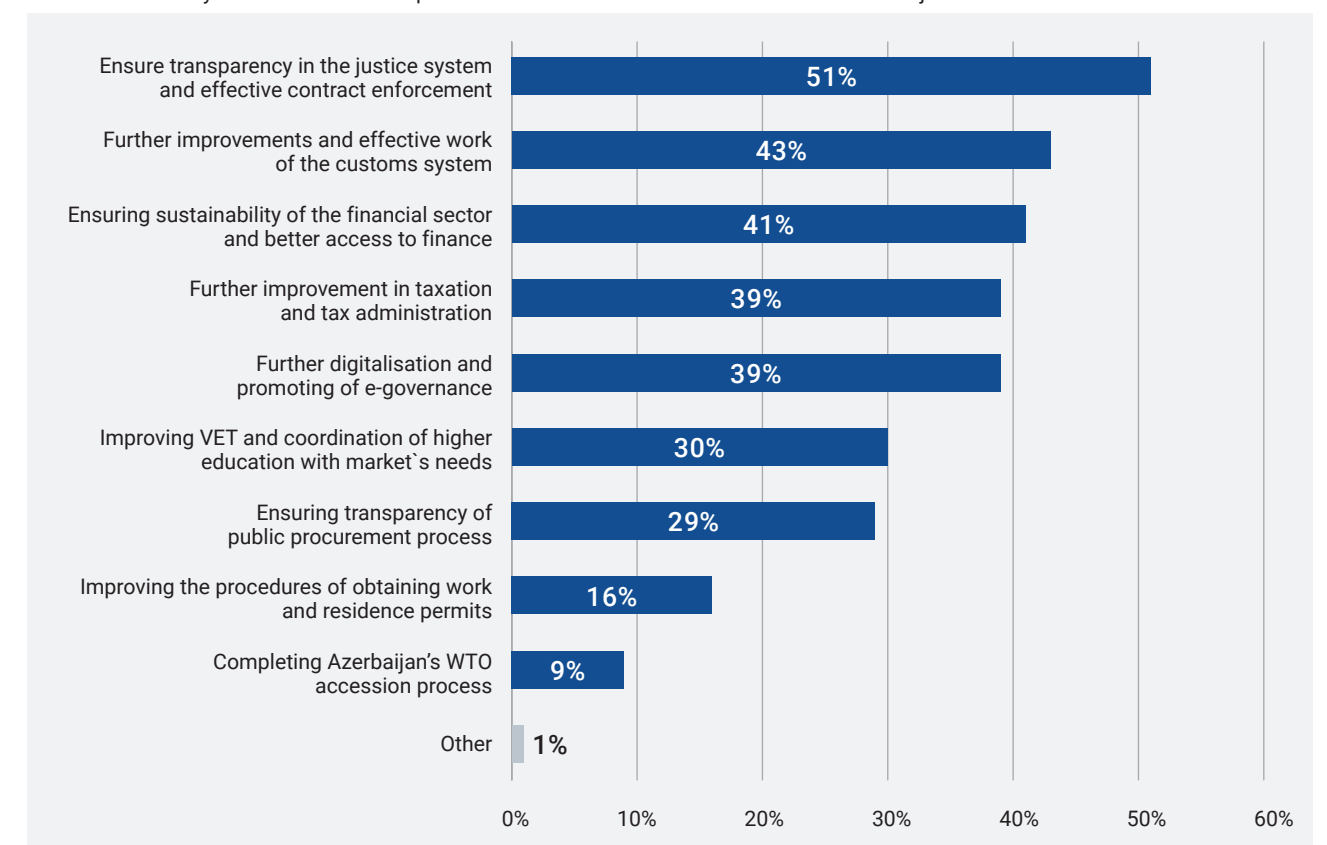


## 4 PRIORITIES FOR FURTHER IMPROVEMENT

While there is a number of aspects leading to positive results in 2020, e.g. tax and customs related reforms described in the Chapter 3 (Sections 3.2, 3.3), others aspects were not confirmed yet as improved by European companies.

Amongst the top priorities given to the further reforms (Annex 1, Q22) are justice system (Section 4.1), financial sector and access to finance (Section 4.2) and vocational education and trainings (VET) (Section 4.5). The lack of progress in these aspects were confirmed during interviews. In addition, the relevant indicators were evaluated in the survey 2020 amongst the lowest: the “rule of law” obtained 13<sup>th</sup> place out of 18, “access to finance” 14<sup>th</sup> and “quality of VET” 17<sup>th</sup> place out of 18. (Annex 1, Q23). Digitalisation became crucial this year due to the remote work during pandemic and was confirmed by European businesses demanding further prioritisation (Section 4.3). The results of the interviews also identified the green development for SMEs as another priority sector, which yet lacks progress in Azerbaijan (see Section 4.4).

FIGURE 25. Priority reforms to further improve the business and investment climate in Azerbaijan



SOURCE: EU Business Climate survey 2020



## 4.1 TRANSPARENT JUDICIAL SYSTEM AND EFFECTIVE COURTS

Further reforms in the judicial system were chosen as a priority by over half of all respondents in 2020. In the last couple of years, several steps have been made by the government, however, businesses still do not feel a lot of improvement in this aspect. Additional measures are needed to ensure an effective work of the newly established commercial courts and improve the enforcement mechanisms and institutions. There is a recognised lack of reforms and transparency in the Ministry of Justice and the judicial institutions. European companies await liberation of the administrative burden and reduction of the bureaucracy in the supervised by the Ministry institutions.

The rule of law and transparency of the judicial system have always been crucial factors for investment decisions. A stable, transparent and independent legal environment will foster investor's confidence and make the local market even more attractive to the European businesses.

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As soon as the rule of law is ensured in a country, the business will find its way with the rest of the issues.

CEO of a EU company

The results of the 2020 survey confirmed that ensuring transparency of the legal system, effective contract enforcement, and impartially administered settlement of the commercial disputes remain the most awaited aspects to be improved in Azerbaijan. Such reform was considered as imperative by more than half of European companies surveyed (see Annex 1, Q22). The existing “rule of law” was ranked far below the average indicators (see Annex 1, Q23). Moreover, corruption is still remains amongst the factors negatively affecting the business environment. During the interviews, it became obvious that European companies see the highest corruption risks at the current not yet reformed judicial procedures and authorities.

During the interviews, the EU companies welcomed the creation of the specialised Commercial Courts. However, in their views, there is a need for further steps to ensure effective work of these special institutions. The first priority should be given to enhancing the qualifications of the judges on topics related to commercial operations and regulating their workload. Another important step should be a reduction of bureaucracy and ensuring effective work of e-document flow in the courts, which would improve their transparency and accelerate the procedures.

While the courts are giving hope for upcoming improvements, the enforcement remains a challenge. The Enforcement Office was considered by European companies in the 2020 survey as ineffective and untransparent. Moreover, there seems to be a lack of alternative mechanisms to enforce the courts' decisions. European businesses believed that there is a need to reboot the Enforcement Office and introduce alternative enforcing mechanisms in line with the international good practices.

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In Azerbaijan is more difficult to enforce a court decision than to win a case. There is a lack of mechanisms for the enforcement, so we usually just wait for a company to enforce the court decision voluntarily. The enormous workload of the enforcement officers creates additional impediment for the enforcement of the court decisions.

Partner of a Legal consulting company

European companies stress, that the improvement of the justice system is a long-term process for every country. After the infrastructure and mechanisms are established and begun to operate it takes additional time for the judicial system to gain an international reputation as a transparent, impartial, and effective. While the domestic judicial system is establishing its improved adjudication and enforcement mechanisms, it is important to provide businesses with a right to adjudicate the disputes in foreign courts. A good example of such platform in Azerbaijan is the Alat Free Economic Zone<sup>17</sup>, which is

an extraterritorial free zone with its own independent courts. **Nowadays some of European companies are shifting their registration to Alat to get access to these courts.** This confirms high demand of the businesses for transparent and impartial judicial procedures.

The Office of the Business Ombudsman is not yet established in Azerbaijan. However, the local Appeal Councils are considered by European companies as quite effective alternative institutions. The Councils are operating within the executive bodies since 2016 and consider the claims against decisions made by the public authorities. According to the received feedback, the Appeals Councils have established a proven record as an effective forum to solve disputes instead of bringing the cases to the courts. In June 2019 a new Tax Ombudsman office was established in Azerbaijan within the former Ministry of Taxes and now is integrated into the Ministry to Economy. It seems to be too early to assess the effectiveness of this new body.

From the perspective of European businesses, there is still a lack of reforms in the Ministry of Justice. The Ministry and the institutions under its umbrella remain bureaucratic, operating with a limited use of the electronic procedures and with a lack of a client-oriented mindset. This creates an impression in the minds of European business community that the whole system is still archaically run, lacks transparency and, hence, still does not respond well to the needs of the business community. A fair example may be the private notaries, who started to be broadly present in the market since 2015. Despite the private status and better service-oriented approach, these notaries follow the same procedures leading to excessive administrative burden for businesses caused by the current regulations prescribed by the Ministry. Another example relates to bankruptcy procedures. Due to their complexity, many companies choose to freeze their activities instead of pursuing a liquidation process. As result, this leads to serious statistical distortions in regard to the number of entities operating in the country.

### ADDITIONAL INFORMATION

The latest significant reform related to courts and dispute resolutions took place in 2019 under the Presidential Decree “On Intensifying the Reforms in the Judicial Legal System”. It aims to increase the effectiveness of the justice mechanisms, including the establishment of specialised courts, enforcement of court decisions, as well as, to provide possibilities to develop mediation and arbitration practices.<sup>36</sup> In the same year, the Law “On mediation” was approved setting a framework for alternative dispute resolutions.

## 4.2 STABLE FINANCIAL SECTORS AND BETTER ACCESS TO FINANCE

The sustainability of the financial sector grew after the crisis in 2015-2016. Over 40% of the respondents chose the financial sector as a priority for further improvement, which made it the top-3rd awaited reform in 2020. The business awaits developments in regard to the following aspects i) ensuring further sustainability of the banking sector; ii) ease access to finance / cheaper credits for business, iii) improvement of international connections of the local banks and iv) availability of the competitive banking services.

The banking sector of Azerbaijan was hit by two crises during the last decades: the global financial crisis in 2008 and the world oil prices plunge in 2015-2016. After the last turbulence, several steps has been made by the government to stabilise and strengthen the sector, what resulted in the improvement of Azerbaijan's position in a number of global rankings over the last years and improved trust in the country among international partners.

The financial sector in general and the banks in particular started their recovery and demonstrated positive dynamics. Nowadays amongst the strong sides of the sector are sufficient capitalization and liquidity of the local banks. Deposit dollarization (61% at end of 2019) and loan dollarization (35%) ratios have declined since the 2015 crisis, but remain above their pre-2014 levels and could accentuate the impact in the event of a disorderly devaluation. The Fitch Banking System Indicator (BSI) rated the Azerbaijani banks as ‘B’ grade in July 2020. The International Bank of Azerbaijan (IBA) has returned to profitability with large capital buffers and improved asset quality after a debt restructuring in 2017. However, it continues to have an unhedged open currency position of USD 0.7 billion as of June 2020 (2017: USD 1.9 billion).<sup>37</sup>

In 2020, new challenges in the sector arose in relation to the GDP and economy's contraction caused by the world pandemic, volatility of oil prices, and activation of military operations in the Nagorno-Karabakh and around. This provoked a mixture of new threats and negative trends for the sector, most of which are also relevant to the banking sector worldwide. Inflation grew moderately in 2020 compared to 2019. According to the Central Bank, it remained at the level of 2.8% in August 2020



and can potentially grow to the level of 3.0-3.2% until the end of the year.<sup>38</sup> The expectation about devaluation in 2020 grew during the oil prices-related short-term crisis in the spring of 2020 and during the military conflict but subsided thereafter. To prevent a market turmoil the government made several statements ensuring stability of local currency and the exchange rate, which reassured the business community.

Even though the world pandemic itself has a limited impact on the banking operations, the banks' revenues in Azerbaijan were affected due to the negative impact on the economy from the quarantine regime and slowing down of the international trade and investment activities. According to the information provided during the interviews, the IFIs and the investment banks present in Azerbaijan have been overcoming the challenges during this period quite well, whereas the local banks have been affected stronger and the negative impact is expected to continue until the pandemic is over. One of the reasons for this is the consumer loan portfolio of the local banks, which depends on the salaries of individuals and profits of small businesses, which are the most affected by the quarantine restriction groups. According to the information provided by the local banks, they are trying to update the portfolio and partly refinance debts from the funds available from the state support programmes. As for the individual clients, banks are going through a restructuring process for the accredited portfolio.

In 2020 four more banks lost their licenses, namely the "Atabank" OJSC, the "AG Bank" OJSC, the "NBCBank" OJSC, and the "Amrah Bank" OJSC.<sup>39</sup> This brought the number of banks in the country from 45 in 2015 to 26 in 2020. Due to the most recent wave of bank closings, the banking sector's non-performing loans (NPL) level is moderate and had fallen slightly from 8.3% in 2019 to 7.3% in May 2020.<sup>40</sup> During the interviews, European businesses were quite optimistic about the ongoing "natural selection" of the banks, which, in their opinion, can result in a healthier economy and stronger banking sector when the weak banks will disappear and other banks will become stronger.

Azerbaijan has a comprehensive legislation regulating the banking sectors, however, there is still a limited amount of international and foreign banks in the country. This leads to a lack of international connectivity and slower development of the banking sector, as well as to low diversification of the funding sources. Significant dependence of the financial institutions on national sources and especially the state funds, might be considered as a threat to their sustainability. Nevertheless, in 2020 it also provided stability for the sector during the military operations in and around Nagorno-Karabakh and prevented the sector to be hit by the contraction of the external funding possibilities.

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The banking sector is always a good reflection of the real economy. The State remains one of the major lenders of the economy, which is an obstacle to the independence and sustainability of the banking sector.

CEO of a financial institution

Several technical issues were reported by European companies in 2020 in relation to the bank procedures, including a significant level of bureaucracy, high cost of banking intermediation, especially as regards the exchange of the foreign currency. One of the obstacles in international trade operations with Azerbaijan nowadays is the lack of the banking intermediation services for international trade. While factoring and forfaiting services are provided, there are still no services for documentary remittance, which is a payment technique offering increased flexibility for the financial management and which reduces risks of trading parties. Currently, the foreign trade operations with Azerbaijani stakeholders are conducted either on a full prepayment basis in case of importing or on a "payment due upon receipt" basis in case of exporting, with both approaches imposing risks on the parties located in Azerbaijan.

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With the absence of the standard international trade procedures, the companies in Azerbaijan take all the risks on themselves. There is a need to initiate a project for the local banks to exchange experience with European banks and start to provide these services in Azerbaijan. Moreover, it is a good occasion for the local banks to earn additional money on intermediation.

Owner of a EU company in Azerbaijan



Access to finance in Azerbaijan remains challenging, mostly because of the high interest rate for business credits. Since 2016 the interest rate of the Central Bank of Azerbaijan have ranged between 8 and 10%<sup>40</sup>, however, the rate for business credit has been higher, between 16 and 20% and even reaching 30% in some of the banks<sup>41</sup>. Expensive funds extend the payback period for commercial projects of SMEs and may often result in projects' cancellations.

One of the reasons for the current expensive credits, mentioned by the banks, are the costly funds of the Azerbaijani banks, which mostly consist of individual and corporate deposits. Another reason for the high interest rates is a current risk assessment model being applied by the local banks, especially for starting new lending projects, especially for micro, small businesses, and start-ups, which also results in high interest rates.

Recently, the government has made efforts to provide entrepreneurs with cheaper credits by rebooting the State Entrepreneurship Development Fund<sup>42</sup> within the Ministry of Economy. The authorized capital of the Fund was set at 1.9 billion manats (\$1.1 billion) and the loans are issued from 5,000 (\$2,933) to 50,000 manats (\$29,326) for a period of 3 years; from 50,000 to 1 million manats (\$586,510) for 5 years; and from 1 million to 10 million (\$5.87 million) for 10 years. The annual loan rate is at 1% for the banks, which results in a maximum 5% on average for final consumers.

The Fund prioritises the projects in agriculture, food, sustainable farming, tourism, light industries and other priority non-oil sectors of the economy. The target group of the Fund are local start-ups and SMEs, while the foreign companies have equal rights to apply for funding if their projects are in line with priority directions of the Fund. Despite the Fund being an effective tool, it cannot replace the banks in terms of the volume of credits demanded by the market economy, thus it remains of critical importance to enhance access to finance via the Azerbaijani banks.

#### ADDITIONAL INFORMATION

After the crisis 2015-2016 a few institutions were established: Financial Market Supervisory Authority (FIMSA, 2016), the Private Credit Bureau (2018) and Mortgage and Credit Guarantee fund (2016), which was a result of expanding of the Mortgage Fund with the guarantee features. FIMSA achieved progress in updating banking regulation, risk management, and developing a monitoring framework. In November 2019, it was liquidated with all its authorities being transferred to the Central Bank of Azerbaijan.

The approval of the Presidential Decree in February 2018 on resolution of problem loans of individuals issued after the devaluation of the national currency in 2015 helped to improve the asset quality across the sector. Under the decree, the part of individual's loan debt under USD 10,000 that increased after the devaluation in AZN terms, will be repaired at the expense of the state budget.<sup>43</sup>

The State introduced several instruments in 2020 in order to alleviate the negative effects of the COVID-19 pandemic and the related volatility in international oil markets on the economy. The State provides subsidies for interest accrued on SMEs' loans in line with the "Rules for subsidizing interest rates on the existing loan portfolio of businesses operating in areas affected by the coronavirus (COVID-19) pandemic".<sup>44</sup> The Central Bank of Azerbaijan has announced its proposed regulatory relief measures aimed at supporting banks, non-bank credit organizations, insurance companies, investment companies, and bank borrowers during the ongoing COVID-19 pandemic. The measures include temporary regulatory reliefs e.g. reductions in Capital Requirements by 100bps and holidays for Loan Loss Provisions on COVID-19 Restructured Loans and expire on 1 January 2021. Currently, it is considering to extend these measures until 1 January 2022.<sup>45</sup>

Additionally, the blanket deposit guarantee insurance was extended. The scheme was first adopted in 2016 to safeguard financial stability and boost confidence amid times of macro-financial volatility and an economic downturn. In March 2020, the authorities decided to extend the blanket guarantee for an additional nine months to strengthen confidence in the banks during the pandemic. The scheme covers all depositors' funds irrespective of the amount and currency denomination.<sup>46</sup>



### 4.3 FURTHER DIGITALISATION

Further digitalisation is important for Azerbaijan from two main perspectives i) as an effective way for implementing local reforms, enhancing the transparency of the economy, and bureaucracy; ii) as a way to stabilise the SME sector and minimise the negative impact of the pandemic. There is a need to ensure a sufficient IT infrastructure with a high speed and quality of the Internet especially at the regional level and in rural areas. It is important to raise awareness of businesses about new online procedures and benefits of digitized work. Further actions should be taken to improve the computer literacy of the population and reduce resistance to digital transformation amongst the public authorities.

The quarantine restrictions and shifting of the businesses to remote work significantly improved available online procedures and readiness of the population to work remotely. This trend was confirmed and highly appreciated by European businesses in Azerbaijan. To foster further effective digitalisation, it is important to provide access to the ICT infrastructure, as well as to enhance the relevant skills amongst the population. In the WB World Telecommunication/ICT development database 2018, Azerbaijan was ranked the highest amongst the EaP countries according to the share of population actively using the Internet (up to 80%)<sup>47</sup>. In the 2020 Digital Quality of Life Index, Azerbaijan was ranked at 40th place among 85 surveyed countries. The highest point was received for the internet affordability (3rd place), while the quality of the Internet (51), electronic governance (56) and electronic infrastructure (47) were assessed as moderate and low.<sup>48</sup>

At the same time, the reforms foreseen in relation to the business environment (e.g. liberation of the ICT market, extension of the digital payment systems) still have a long way ahead. During the last years, the numerous measures has been announced by the government, however, the business in 2020 still assess the local IT infrastructure for business digitalisation as somewhat below the satisfactory level. (Annex 1, Q15)

According to the provided responses, the most awaited improvements are related to the speed and quality of the

Internet, as well as conditions of providers, including the terms for connecting to the internet network (Annex 1, Q16). One of the main concerns highlighted by European companies during the interviews relates to the significant difference in access to the Internet in Baku and other regions, especially in rural areas.

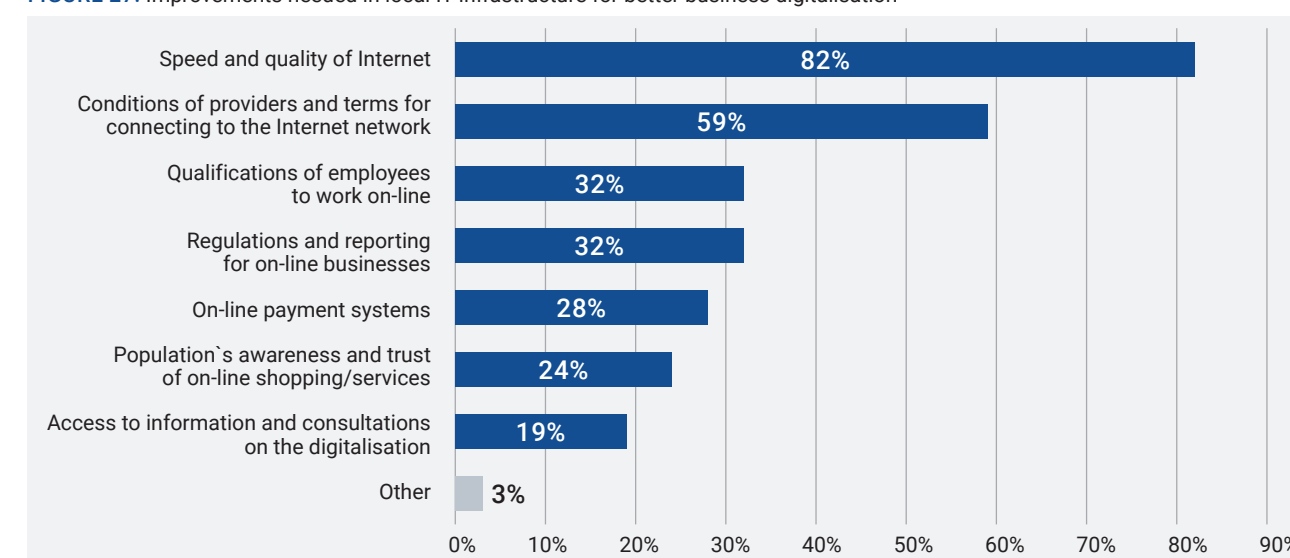
European companies also seek liberalisation and better connectivity of Azerbaijan to the international e-commerce platforms and online payment systems, which has remained on the business agenda in the last years and would provide new opportunities for the companies in Azerbaijan. Some progress in this regard is expected to be achieved in 2021 via participation of Azerbaijan in the Harmonisation of Digital Markets programme implementing within EU4Digital regional initiative (2019-2022). The programme foresees harmonisation of the e-commerce regulations between the EU and EaP countries. Since 2021 businesses in Azerbaijan will be able to benefit from virtual warehouses linked with the e-marketplace in the EU. This is expected to ease the e-commerce between Azerbaijani and the EU and enhance the accessibility of European market for Azerbaijani SMEs.<sup>29</sup>

As regards readiness of population for online work, the businesses confirm, that age and location remain important factors. While younger generations (under 35-40 years) usually have stronger computer literacy and are more open for remote work opportunities, older generations often resist digital work. From the perspective of European companies, location implies the mindset and skills of labour force: inhabitants of rural areas have lower level of readiness for online work comparing to those located in urban areas.

The digitalisation progress in the public sector during the quarantine regime has brought optimism to European business community and has raised the expectations about further implementation of the local reforms related to online work. However, the companies still observed resistance to online services amongst public officers, especially representatives of the older generation. This can be a result of a low level of skills, mindset factors as well as the attempts to keep personal influence on the decision-making processes.

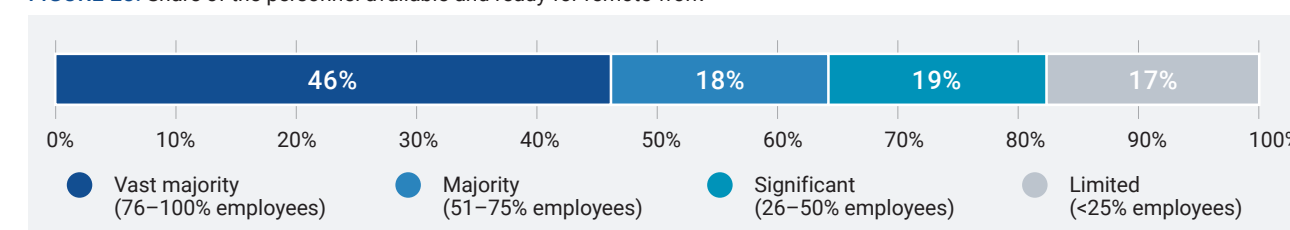
During the interviews, the companies emphasised that due to their international nature they already had had the on-line procedures and necessary software for remote

FIGURE 27. Improvements needed in local IT infrastructure for better business digitalisation



SOURCE: EU Business Climate survey 2020

FIGURE 28. Share of the personnel available and ready for remote work



SOURCE: EU Business Climate survey 2020

work before the pandemic started. The quarantine regime rather intensified and scaled-up the online work.

European companies did not have complains on the readiness of their personnel to on-line work. According to the EU Business Climate Survey 2020, 75% of European companies shifted their personnel to remote work and about 60% of them digitalised their business operations. Some companies (14%) informed about full digitalisation (Annex 1, Q14). In most of European organisations (60%) majority of the employees were ready for the remote working conditions; they possessed relevant skills and equipment at home. In-house trainings introduced to help personnel with adaptation to the new environment were a usual practice in spring 2020.

There is a need for a complex approach to foster further digitalisation of private sector in Azerbaijan, which would include the following main elements:

- Improvement of the quality and accessibility of the IT infrastructure with a special focus on the regional level and rural areas;
- Further improvement of the computer literacy amongst the population with a focus to rural inhabitants and older age groups;
- Awareness raising and special training programmes for public officers on digital transformation and related new tools;

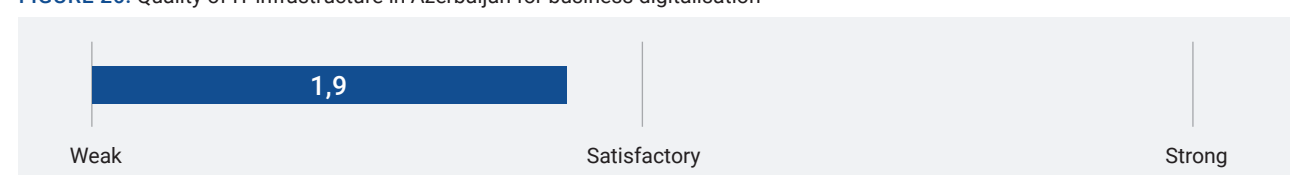
- Awareness raising amongst the business community on new available online administrative procedures and tools;
- Introduction of special tools for prompt reporting of problems with recently launched administrative online procedures in order to enable their timely solutions.

Support to further digitalisation of Azerbaijani SMEs will also be provided via EU4Digital initiative, which since 2021 foresees development of the Guidance to enhance ICT Entrepreneurial ecosystem, as well as creation of the regional Capital Venture Fund for hi-tech start-ups. This will ensure access to finance for SMEs at all stages of their life cycle (incubation, acceleration, and internationalisation) and also educate both start-ups and investors to increase the quality of business ideas and minimise the investment risks.<sup>29</sup>

#### ADDITIONAL INFORMATION

Strategic vision for ICT development targets development of ICT sector including major three components: i) improvement of governance structures, and strengthen ICT; ii) increase productivity and operational efficiency of the business environment iii) digitize government and social environment. The Ministry of Transport, Communication and High Technologies is a central governmental body responsible for implementing the ICT policy and development of the infrastructure, approval of tariffs, etc.

FIGURE 26. Quality of IT infrastructure in Azerbaijan for business digitalisation



SOURCE: EU Business Climate survey 2020





#### 4.4 GREEN OPPORTUNITIES FOR BUSINESS

Azerbaijan has a unique potential for development of the green economy, namely the solar and wind energy, significant size of agricultural lands and other natural resources. At the same time, abundance of the traditional energy resources and strong price-orientation of the local consumption are slowing down the sustainable development of the country. There is a need to prioritise green SME policy in Azerbaijan. Its main components should include i) access to cheaper funds for sustainable projects, ii) tax and customs reliefs for the green SMEs, iii) awareness-raising programmes amongst business and population about the green practices and sustainable consumption.

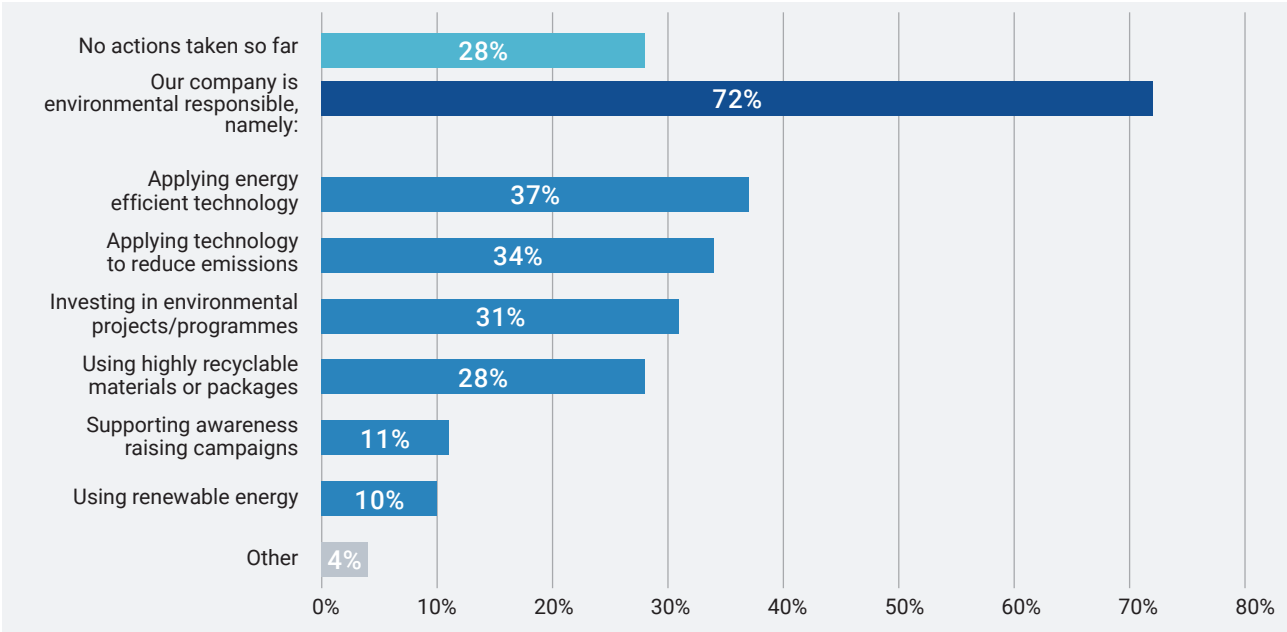
There is momentum for green growth in the EU as well as globally. The European Green Deal<sup>49</sup> provides an action plan to boost the efficient use of resources and move to a circular economy while restoring biodiversity and cutting pollution. This will help the EU to reach carbon neutrality by 2050. The Green Deal drives new investments into the greening of all parts of the economy and the transition will create exciting new business opportunities for enterprises in Azerbaijan if they can seize the moment.

” Azerbaijan is a paradise for alternative energy projects due to the abundance of natural sun and wind energy. The only stimulus which SMEs need is the lending for alternative energy with a rate lower than 10%. As far as the funds are available, this sector will become profitable and the businesses will start developing the alternative energy projects themselves.

Owner of a European company

**In 2020 the EU Business Climate Survey for the first time asked European businesses about the available Green practices on their entities.** The obtained results were quite positive. Over 70% of European entities in Azerbaijan operate in line with the principles of environmental awareness. The most common practice appeared to be the application of technologies for energy efficiency (37%), reduction of emissions (34%), investments into environmental projects and use of sustainable materials or packages.

FIGURE 29. Environmental responsibility among European companies in Azerbaijan



SOURCE: EU Business Climate survey 2020

The interview results showed that companies struggle with the absence of the special Green programmes and opportunities in Azerbaijan. As long as traditional energy remains available and affordable in Azerbaijan, the prioritisation of the Green economic development will be a challenge. Current petroleum products account for over 90% of Azerbaijan’s exports and the oil and gas industry makes up about 38% of Azerbaijan’s GDP<sup>1</sup>.

Azerbaijan has put in place a variety of different strategic and sectoral planning documents that call for a greener economy, however, their impact so far has been limited. Although Azerbaijan has introduced legislation to improve environmental protection and support the green economy, there is a need to implement programmes targeting green development of SMEs. This includes the tax and customs benefits that are currently available for green businesses operating in designated Special Economic Zones. As regards the deployment of renewable energy: the longer is the payback period for renewable energy installations, the more challenging is for SMEs to start this business, due to financial constraints. Special lending programmes targeting renewable energy projects would support development of this sector in Azerbaijan.<sup>33</sup>

The EU Green Deal foresees a creation of more business opportunities for green enterprises, as well as adopting great resource efficiency lowering operating costs. However, many enterprises are not aware of the benefits and see it as a potentially risky endeavour. Overall, the SME sector needs information about what are the economic benefits of adopting green practices, what resources are available to support them, and help them take

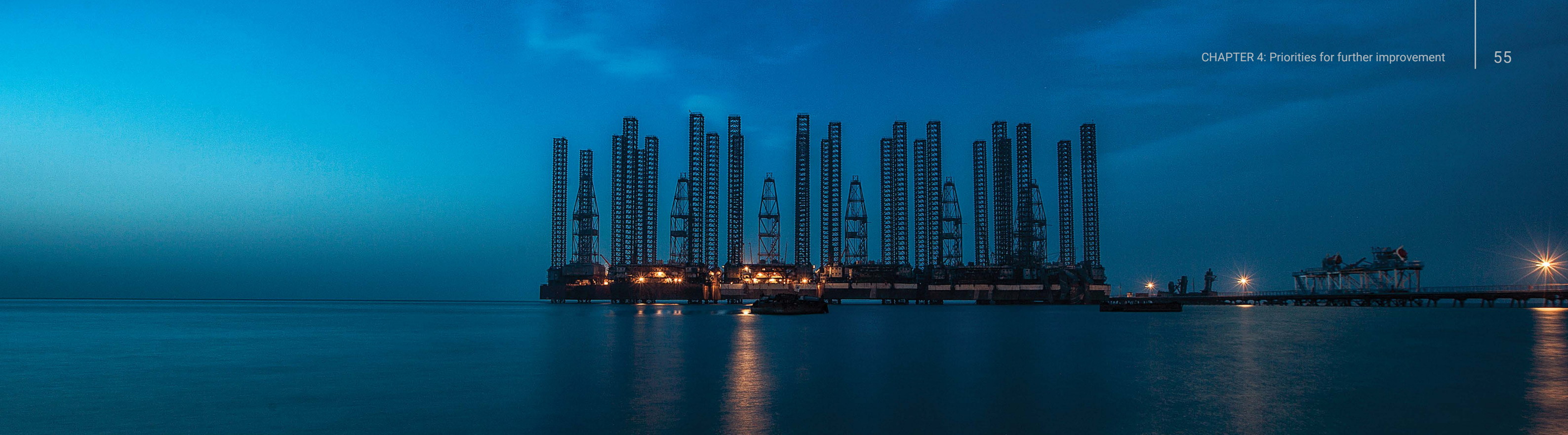
full advantage of the business opportunities. Integrating support for entrepreneurs and business development with a holistic approach to greening the economy will help to bridge that gap and encourage enterprises to seize the moment and join the green economy.

Another sector with promising potential for sustainable development in Azerbaijan is agriculture. The size of the agricultural land in the country is 4.8 ha, including 2.1 million ha of arable land. Despite prioritisation of the agricultural development to diversify the economy, the share of the sector in the GDP remains at the level of 6%, presenting the highest non-oil contribution and ensuring the largest employment share (39%)<sup>1</sup>. Considering that Azerbaijan in 2020 got access to the significant water resources in the recovered territories, agriculture is expected to continue its development in the next years.

The interview results showed that the major obstacles for sustainable farming in Azerbaijan remains the strong price-oriented mindset of the local consumption patterns and the lack of awareness about the benefits of organic production and its pricing. In this regard, sustainable farming needs support from the government in terms of awareness-raising and promotion in Azerbaijan amongst both, SMEs and consumers.

During the EU initiative “Greening of the economy in the Eastern Partnership countries” (EaP GREEN) in 2013-2017, Azerbaijan had received support to accelerate the transition to a “green” economy. Seven SMEs demonstrated impressive results after passing the Resource Efficiency and Cleaner Production (RECP) audit and improving their environmental efficiency.





Currently the European Union supports two regional initiatives in the EaP. The EU-funded “EU4Environment” Programme (2019-2022) with a budget of EUR 20 million, supports Azerbaijan, as well as five other EaP countries in their environment-related action, demonstrating and unlocking opportunities for greener growth, and setting mechanisms to better manage environmental risks and impacts. The initiative is implemented by the OECD, UNECE, UNEP, UNIDO, the World Bank. Several activities will be implemented in Azerbaijan by UNIDO and OECD, which will allow companies to benefit.<sup>50</sup>

- At least 15 SMEs will be assessed using RECP methodology to develop action plans focusing on increasing their productivity while decreasing resource use and impact on the environment;
- At least 20 SMEs in two pilot regions will be joining RECP Clubs hosted by municipal authorities. The companies will receive peer coaching and guidance on applying RECP methodology and developing relevant action plans;
- The KOBIA will obtain support in developing an online Green Business Self-Assessment Tool, to provide SMEs with tailored guidance on how to improve their environmental performance and connect them with further resources to enact changes (such as the RECP Clubs). The portal will launch in 2021;
- The majority of industrial enterprises located in the two selected regions will be engaged in an Industrial Waste Mapping pilot exercise learning about Circular Economy principles and practices and identifying the options of better waste management and industrial symbiosis.

The initiative “EU4 Climate” (2018-2022) with a budget of EUR 8.8 million supports governments in the EaP region

to take action against climate change and to switch towards a low-emissions development and climate-resilient economy. EU4Climate is implemented by the UNDP and supports countries in implementing the Paris Agreement and improving climate policies and legislation with an ambition of limiting climate change impact on citizens' lives and making them more resilient to it.<sup>51</sup>

Azerbaijan takes part in “EU4Energy” regional programme, which is designed to support the aspirations of participating countries to implement sustainable energy policies and foster co-operative energy sector development. Within the programme two cities of Azerbaijan Icherisheher and Mingachevir have joined the Covenant of Mayors, which is the world largest movement for local climate and energy actions. The cities are keen to reduce the CO2 emissions up to 30% by 2030 and developing action plans to reach the target. In 2020 a number of other cities of Azerbaijan have also declared their interest to join the Covenant of Mayors and nowadays are at the final stage of the adhesion process.<sup>58</sup>

#### ADDITIONAL INFORMATION

Through its partnership with the EU under the Eastern Partnership Summit Declarations, the government of Azerbaijan has made commitments to green the economy. Azerbaijan's strategic economic planning document “Azerbaijan 2020: Look into the future” makes that clear by integrating environmental concerns and recognising the ecological challenges of the oil and gas sector. The document sets a target to achieve “sustainable socio-economic development from an ecological point of view”.

## 4.5 AVAILABILITY OF THE QUALIFIED LABOUR FORCE

There is a growing gap in Azerbaijan between labour resources and skilled labour force. In the last years, the government made an effort to reboot the VET system. European companies in Azerbaijan have welcomed these reforms and remained optimistic about their future impact. However, there is still a limited impact from these reforms has been felt by the market. It is important to improve the image of VET in Azerbaijan, scale-up capacities of the new VET infrastructure, and anchor its extensive partnership with the private sector. Another growing issue in the market has become the lack of qualified middle-level local managers, which needs attention and relevant policy response from the government.

In the EU Business Climate Survey 2020, the indicators related to the labour market are scored high. Out of 18 proposed local indicators the “labour costs” obtained the 3<sup>rd</sup> place followed by “migration policy”, “labour policy” (5<sup>th</sup> and 6<sup>th</sup>) (see [Annex 1](#), Q23). At the same time, European companies are concern about a growing gap between available labour resources and skilled workers in Azerbaijan. It should be emphasized that in 2020 for the first time the indicator “qualification of employees”

in the EU Business Climate Survey, tumbled to the 8<sup>th</sup> place from the top-ranking positions in the previous three editions 2017-2019.

The gap between the labour resource and the skilled workforce also confirms the Global Competitiveness Index 2020 by the World Economic Forum. In the publication, Azerbaijan's “Skills of the workforce” was ranked 27 positions lower than the “Labour market” (48<sup>th</sup> and 21<sup>st</sup> positions respectively). This indicates an unused potential of labour resources in Azerbaijan.<sup>53</sup>

Effective VET is crucial for aligning the labour market to the needs of the private sector. The VET reform in Azerbaijan has been started since 2016 and is based on the dual practice, which foresees partnership with employers during the education period in order to satisfy the interests of the private sector. For the last years 24 new equipped vocational education centres were established based on 55 vocational schools and lyceums. Important step became an opening of the Baku State Vocational Education Centre for Industry and Innovation in 2019, which is based on good practices of the Republic of Korea and will educate specialists for industrial work and work with innovation technologies.

European companies welcome the establishment of the new facilities for VET and provide positive first impressions about ongoing reforms. At the same time, there is a limited impact has been felt by the private sector so far and the companies still have difficulties to access skilled workers. It is also too early evaluating the satisfaction of European companies from qualifications of the personnel graduated



from the new VET schools, as the first students of the new VET infrastructure are still continuing their education and will graduate in upcoming years.

As the current stage it is important to keep priority of the VET related reforms, improve its image amongst young generations, scale-up capacities of the new infrastructure and anchor their extensive partnership with the private sector.

Another problem related to qualifications is the lack of qualified middle-level local managers, who play an important role in the economic development of companies. This gap in the labour market is more difficult to resolve, due to the fact that such specialists cannot be trained during a short period of time. The factors that led to this gap are “brain drain” and lack of coordination of the market’s needs with the high education.

For the resolution of this issue in a short-term perspective, the businesses expect further liberation of the migration policy, which would allow bringing missing personnel from abroad. Another option could be launching the “brain return” programs for qualified Azerbaijani professionals. These could be more costly and time-consuming measures to undertake. From the long-term perspective, it is important to ensure sufficient coordination between the needs of the market and the education in Azerbaijan and ensure good quality of secondary and high education.

”

Nowadays as a result of the digitalisation, the businesses better evaluate their gaps in the KPIs. This is boosting demand for qualified middle-level managers on market and their absence is more complicated task to solve comparing to the lack of junior personnel or workers.

CEO of a consulting company

Meanwhile, the resolution of the problems with the involvement of the skilled personnel also depends on the expectations of the private sector on the labour costs. The low wages announced in the local statistics raise expectations of the investors and brings to the disproportions with the real cost of the qualified workers on market.

”

Involvement of high-level local professionals’ costs for companies in Azerbaijan significantly higher, than average wages announced by the statistics. If companies wish to hire highly experienced employees, they should be ready to pay fair salaries to them.

Owner of a European company

To increase the understanding of the importance of the access to qualified workers for the economic growth in Azerbaijan, the EU supports a number of projects, e.g. granted projects for development of the regional infrastructure”; “Support to the establishment of Regional Industrial VET Competence Centre in Ganja”; “Establishment of Regional VET Centre of Excellence in Lankaran Economic Region”; establishment of Gabala State Vocational Education Centre, Gakh Vocational School, pilot “dual” VET system on 4 qualifications in agricultural and tourism spheres in Ismayilli Vocational Education Center; development of Barda Vocational Lyceum as a “business and social partner” and “exemplary model” for employers and other stakeholders. In a partnership with the German Federal Ministry for Economic Cooperation and Development (BMZ), the EU is also co-financing the project “Private Sector Development and TVET in South Caucasus”.

#### ADDITIONAL INFORMATION

Azerbaijan announced the VET reform in 2016 by adopting the “Strategic Roadmap for Vocational Education and Training 2016–2025”<sup>54</sup>. The same year, the State Agency of Vocational Education<sup>55</sup> under the Ministry of Education was established. The Law on Vocational Education and Training<sup>56</sup> and the Employment Strategy 2019–2030<sup>57</sup> were adopted during 2018-2019.

Between 2016 and 2020 the number of VET institutions has been reduced twofold (from 114 to 76). 24 new equipped vocational education centres were established based on 55 vocational schools and lyceums. They offer training in 168 vocational programs, 33 of which are new.<sup>57</sup> At the next stage, the pilot VET institutions will be established, such as a vocational school, a lyceum, professional training and education centres.







## ANNEX 1

# RESULTS OF THE EU BUSINESS CLIMATE SURVEY 2020

We are grateful to everyone who participated in this survey, conducted in September and October 2020. We appreciate your time and input to our research. The collected opinions allowed us to prepare an overview of the current business climate in Azerbaijan for European businesses and provide recommendations for its improvement. We are glad to present the key findings in this report and hope for our continuous cooperation in the next years.

**Target group:** European businesses and investors present or interested to work in Azerbaijan and Azerbaijani companies doing business with the EU

**Total population:** ~ 400 companies

**Gross # responses obtained:** 187

**# responses approved for the sample:** 123

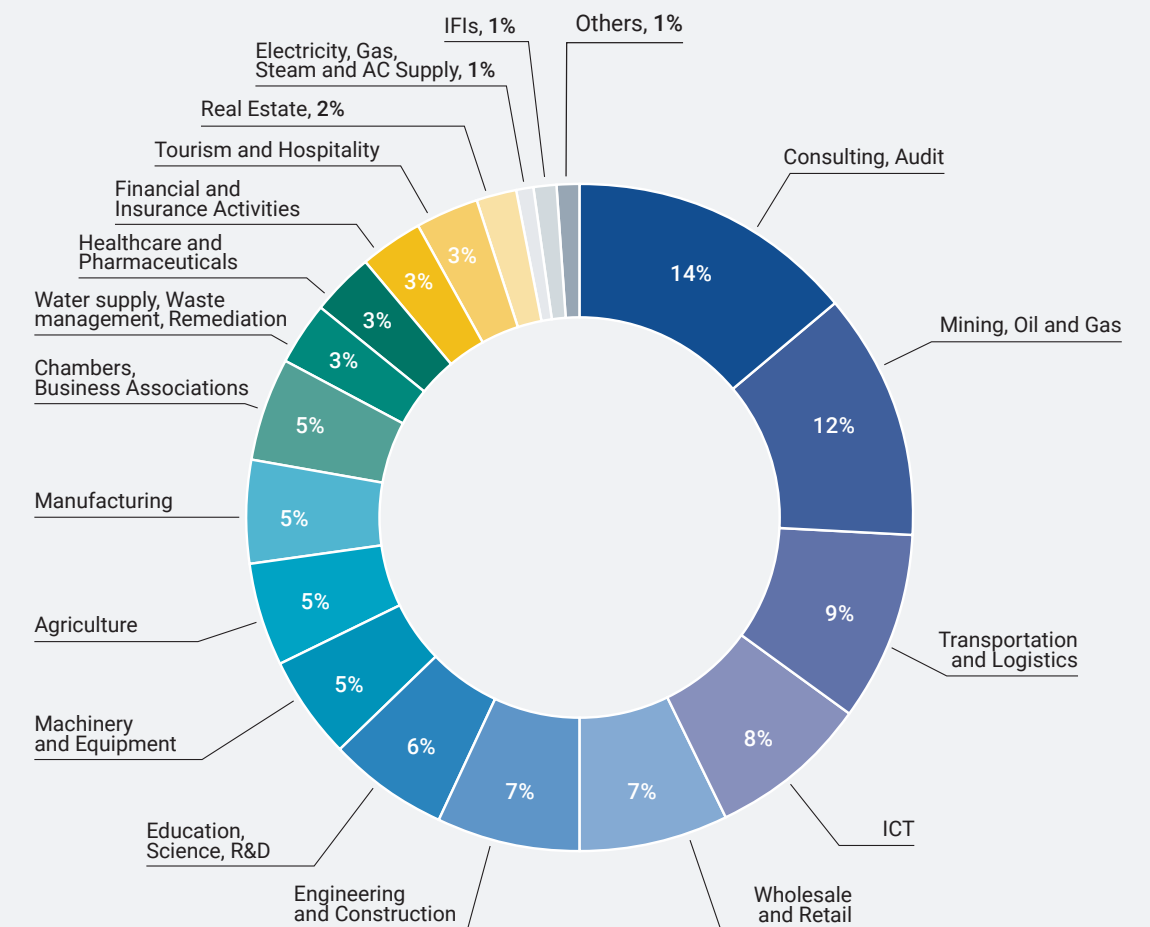
**Number of countries represented:** 23

**Number of sectors represented:** 19

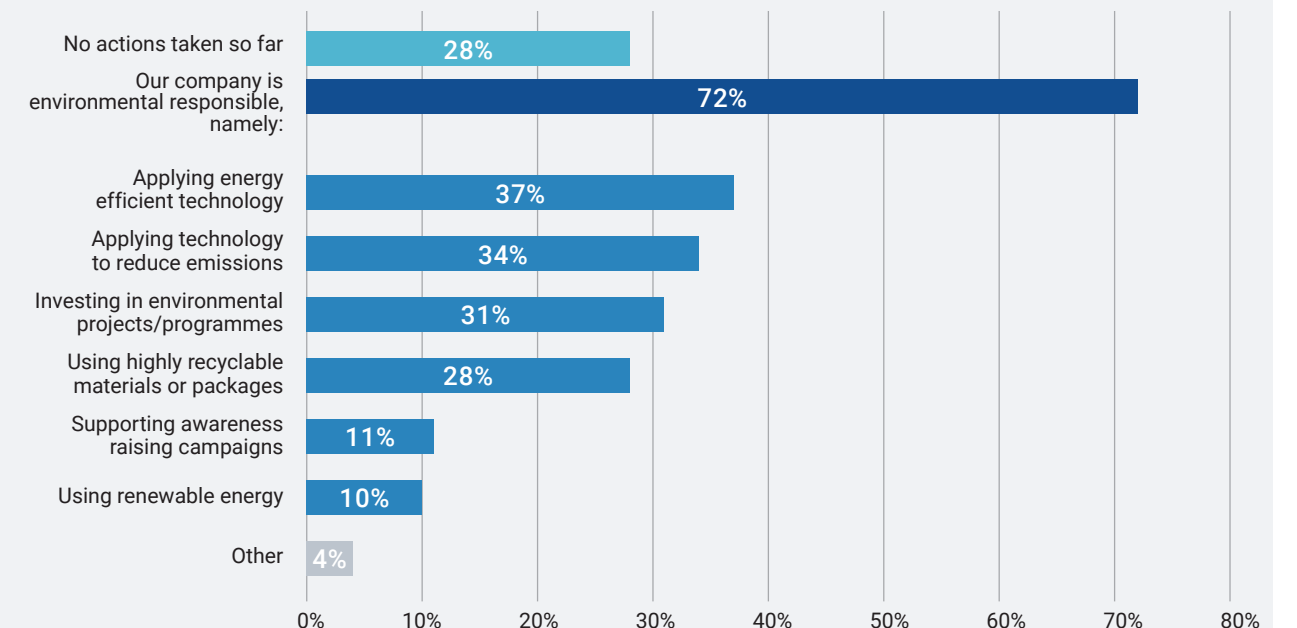
**Timeline of the survey:** 15 September – 25 October 2020

## BUSINESS DEMOGRAPHY

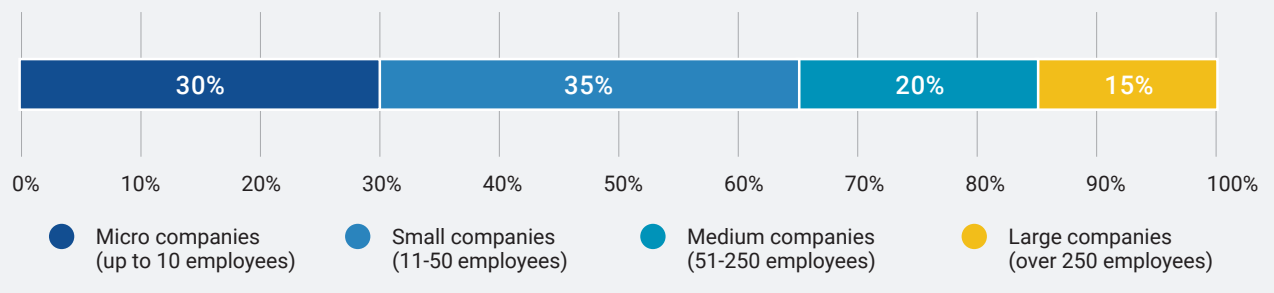
### Q1. What is the profile of your company? (One answer)



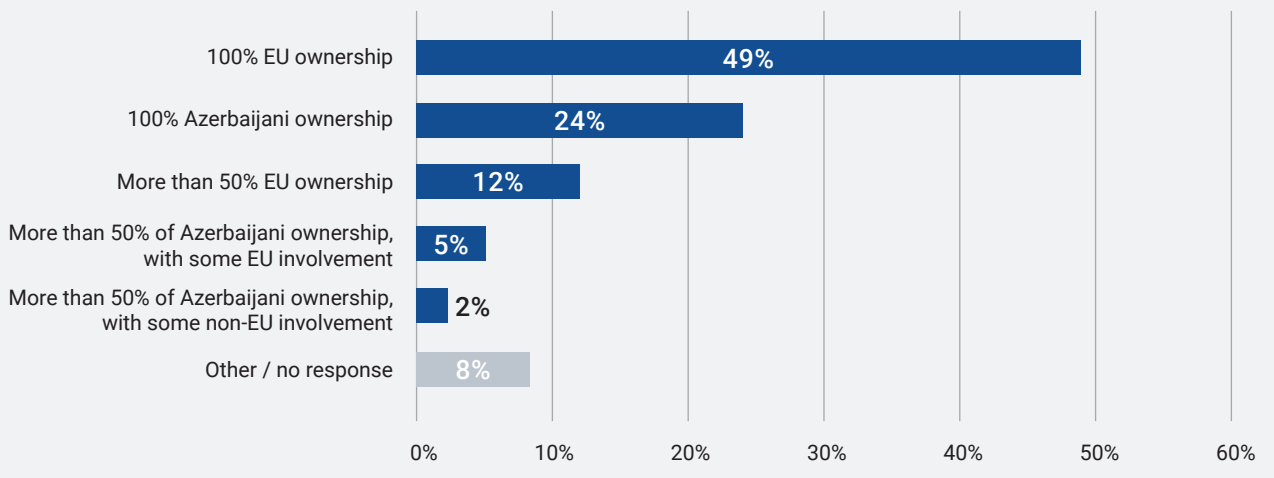
### Q2. Does your company to any extent operate under principles of environmental awareness? (Multiple answers are allowed)



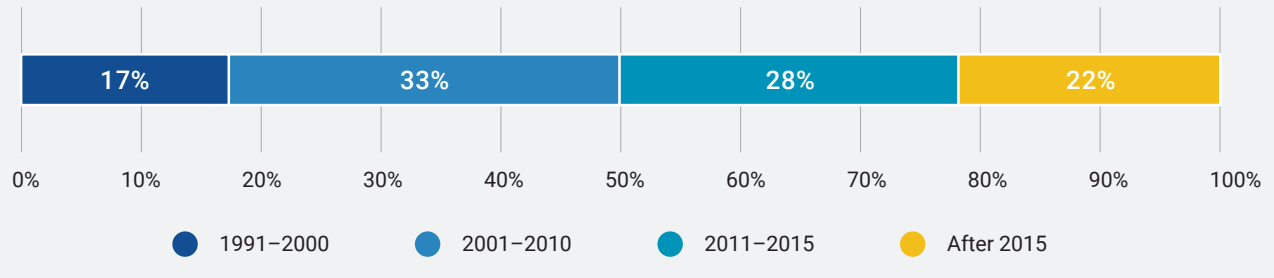
Q3. Please specify the size of your company as for the number of employees (One answer)



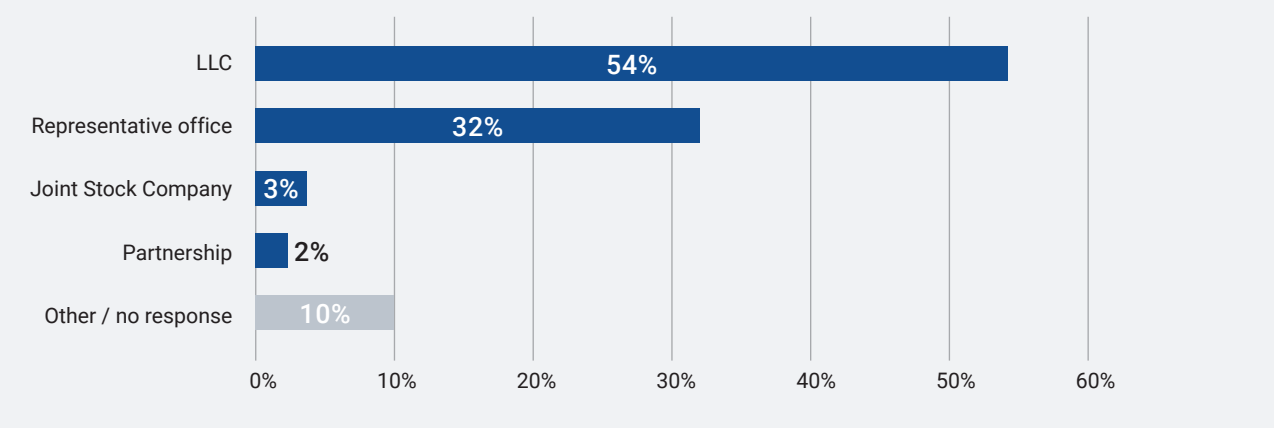
Q4. What is the ownership structure of your company? (One answer)



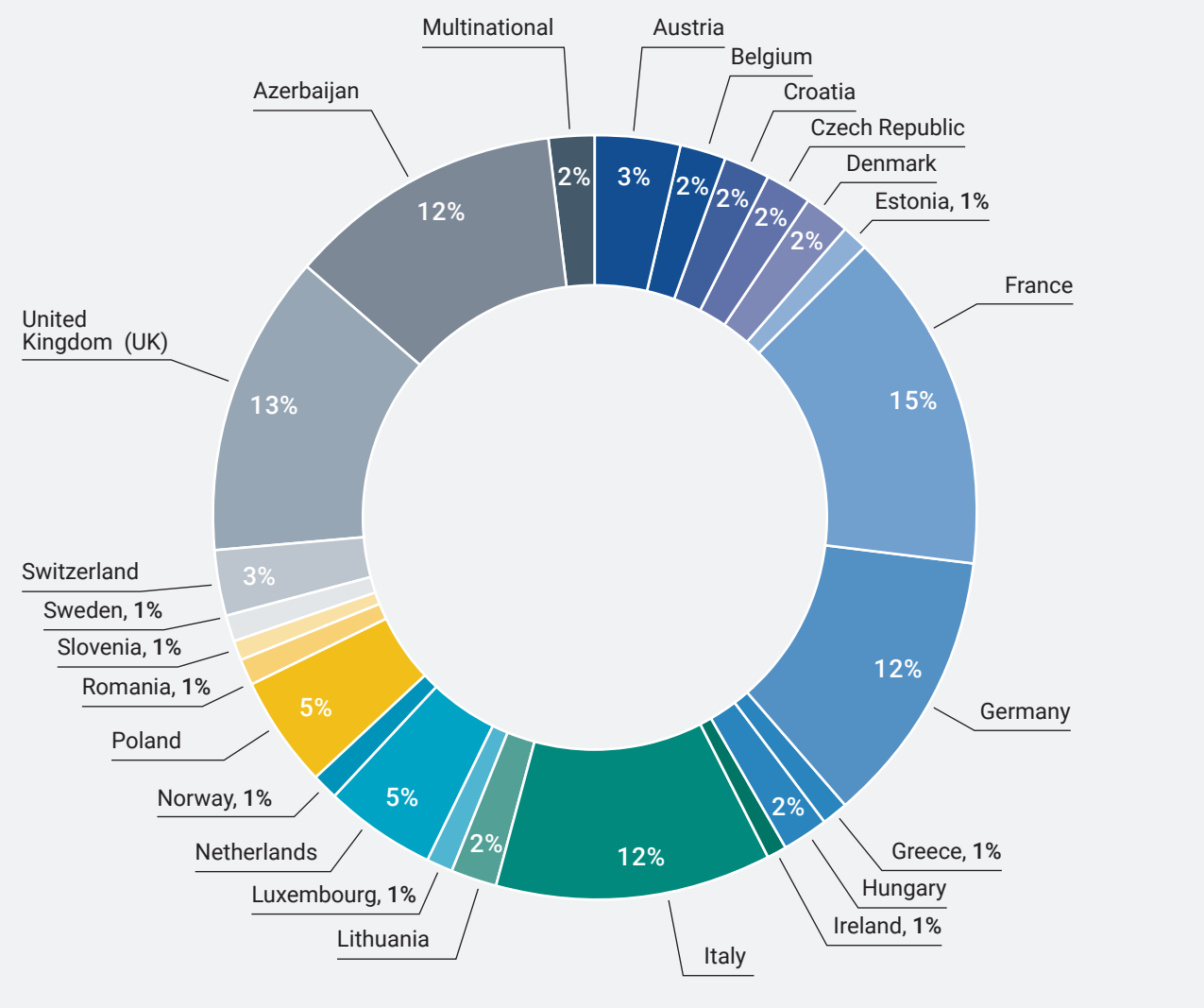
Q6. When was your company established in Azerbaijan? (One answer)



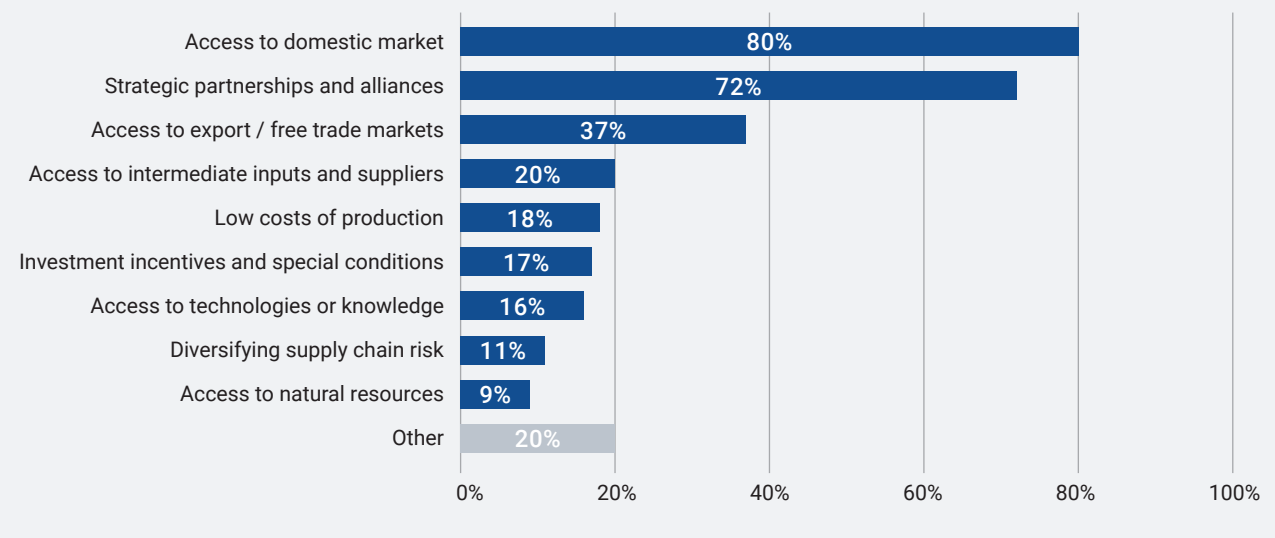
Q7. What is the legal status of your company in Azerbaijan? (One answer)



Q5. Which country does your company represent? (One answer)



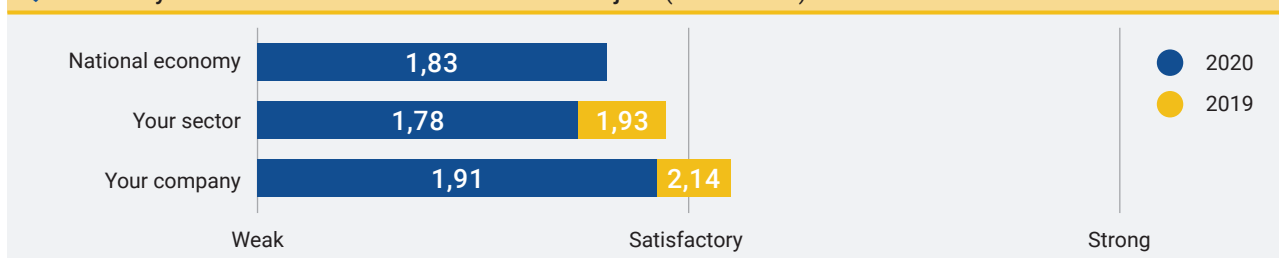
Q8. What are the most important factors that attracted your company to invest and/or do business in Azerbaijan? (Select 3 that apply)



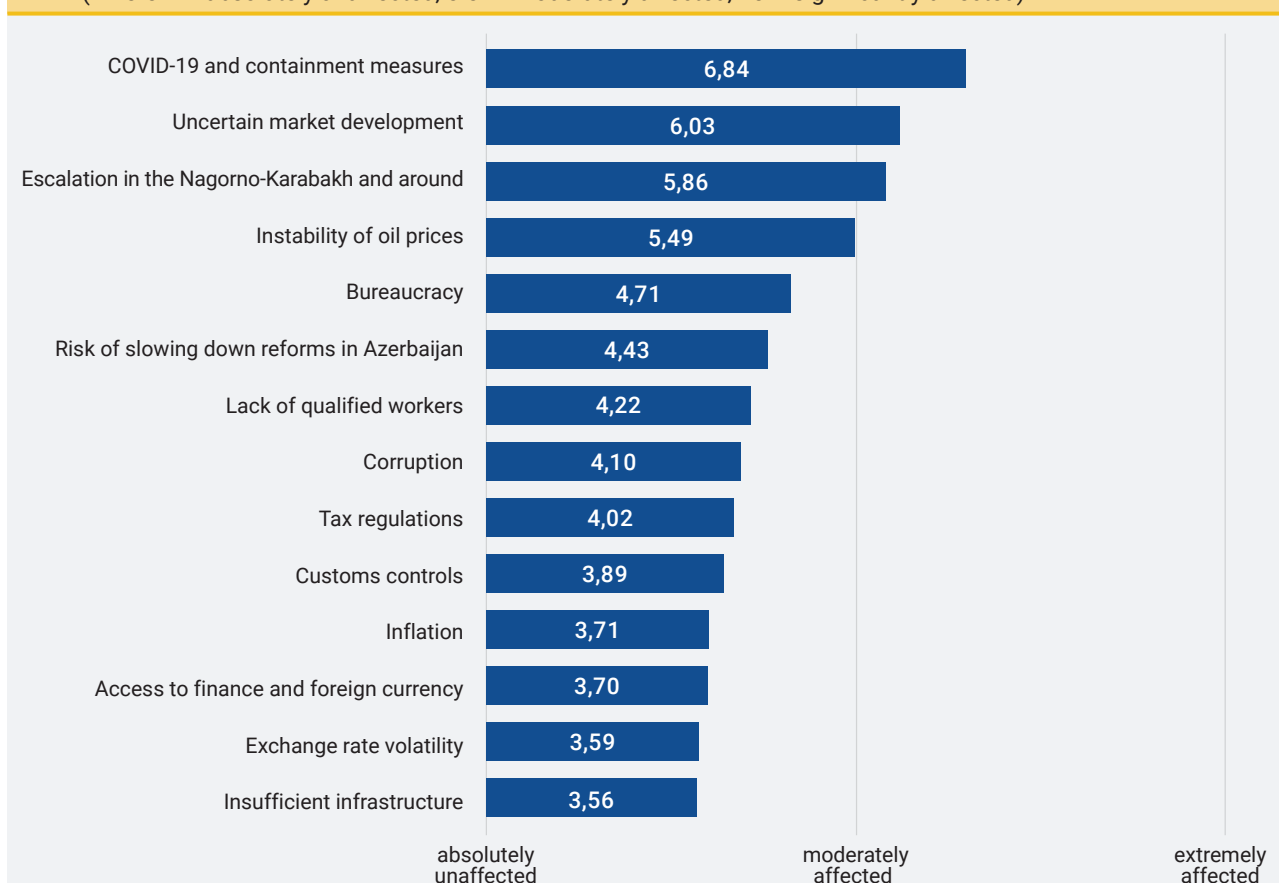


## BUSINESS CLIMATE 2020 AND COVID-19 IMPACT TO COMPANIES

**Q9. How do you assess the situation in 2020 in Azerbaijan? (One answer)**



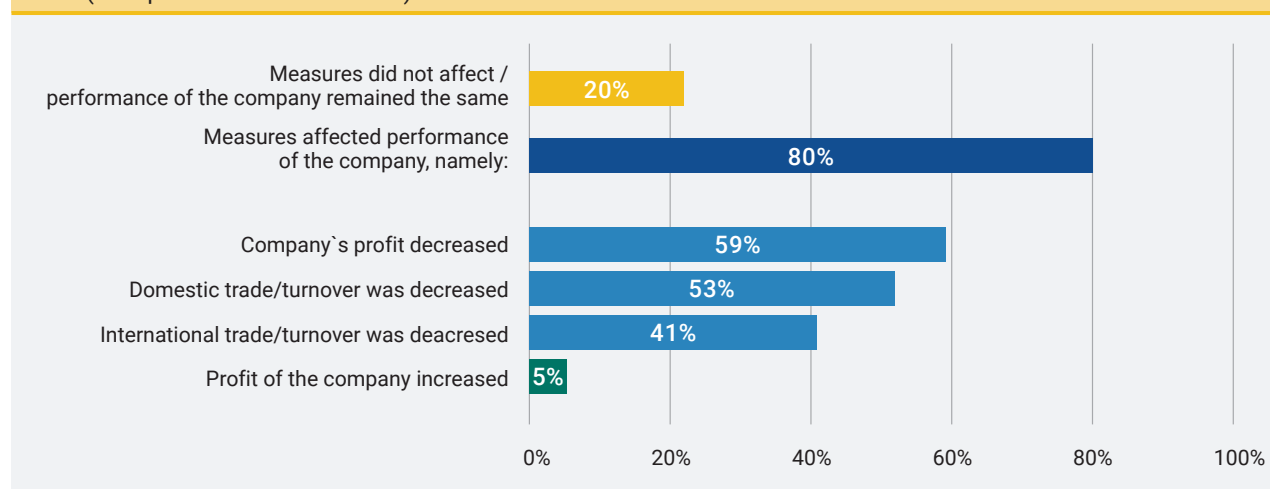
**Q10. Please, rate the impact of the factors below for your company in 2020 from 1 to 10**  
(Where 1 – absolutely unaffected, 5.5 – moderately affected; 10 – significantly affected)



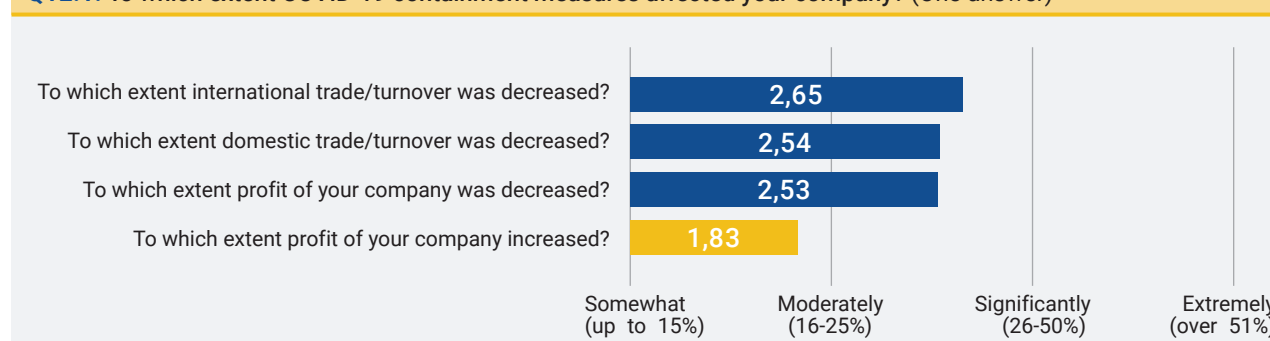
**Q11. Which COVID-19 containment measures in Azerbaijan had the strongest effect on your company?**  
Please, rate from 1 to 10 (Where 1 - absolutely unaffected, 5.5 – moderately affected; 10 - significantly affected)



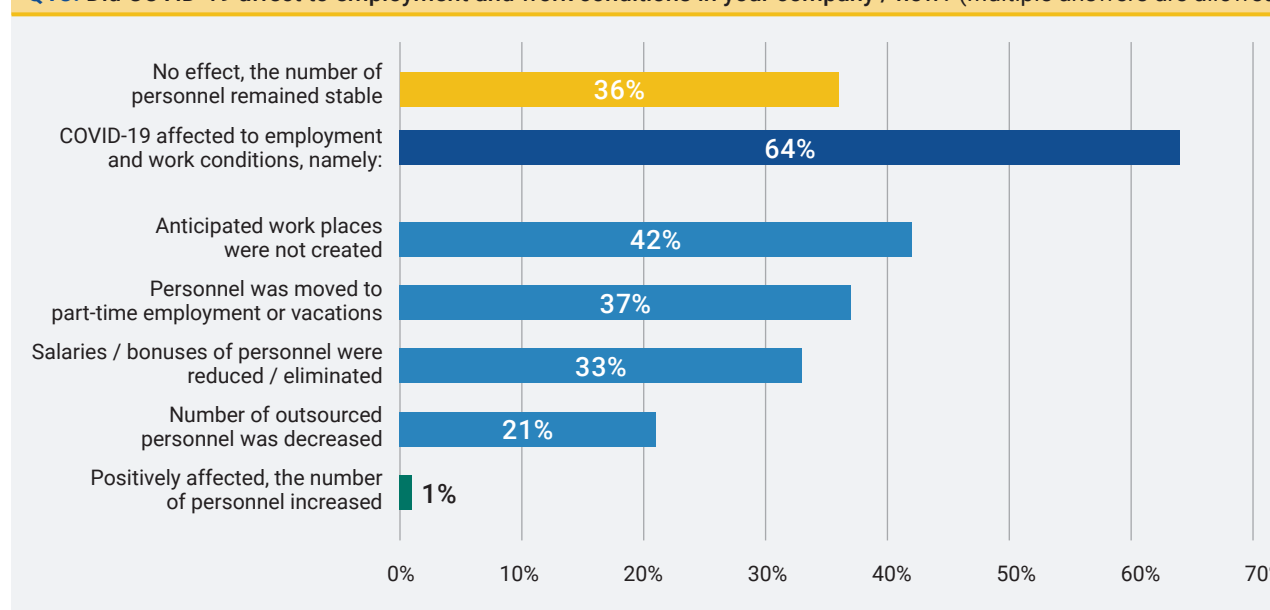
**Q12. Was the performance of your company affected by COVID-19 containment measures / how?**  
(Multiple answers are allowed)



**Q12.1. To which extent COVID-19 containment measures affected your company? (One answer)**

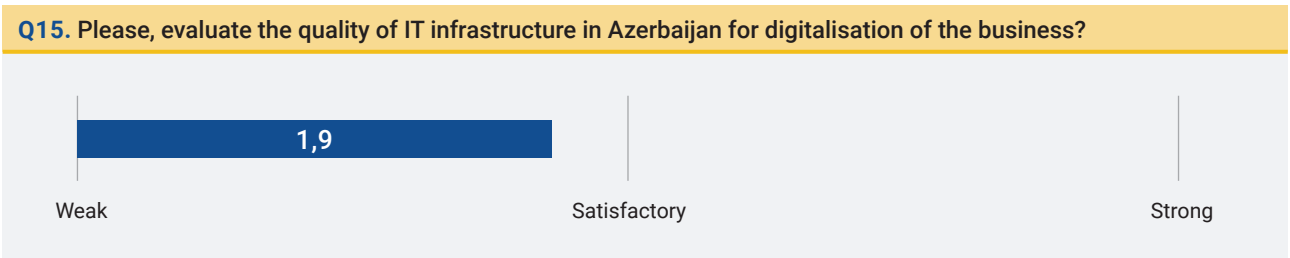
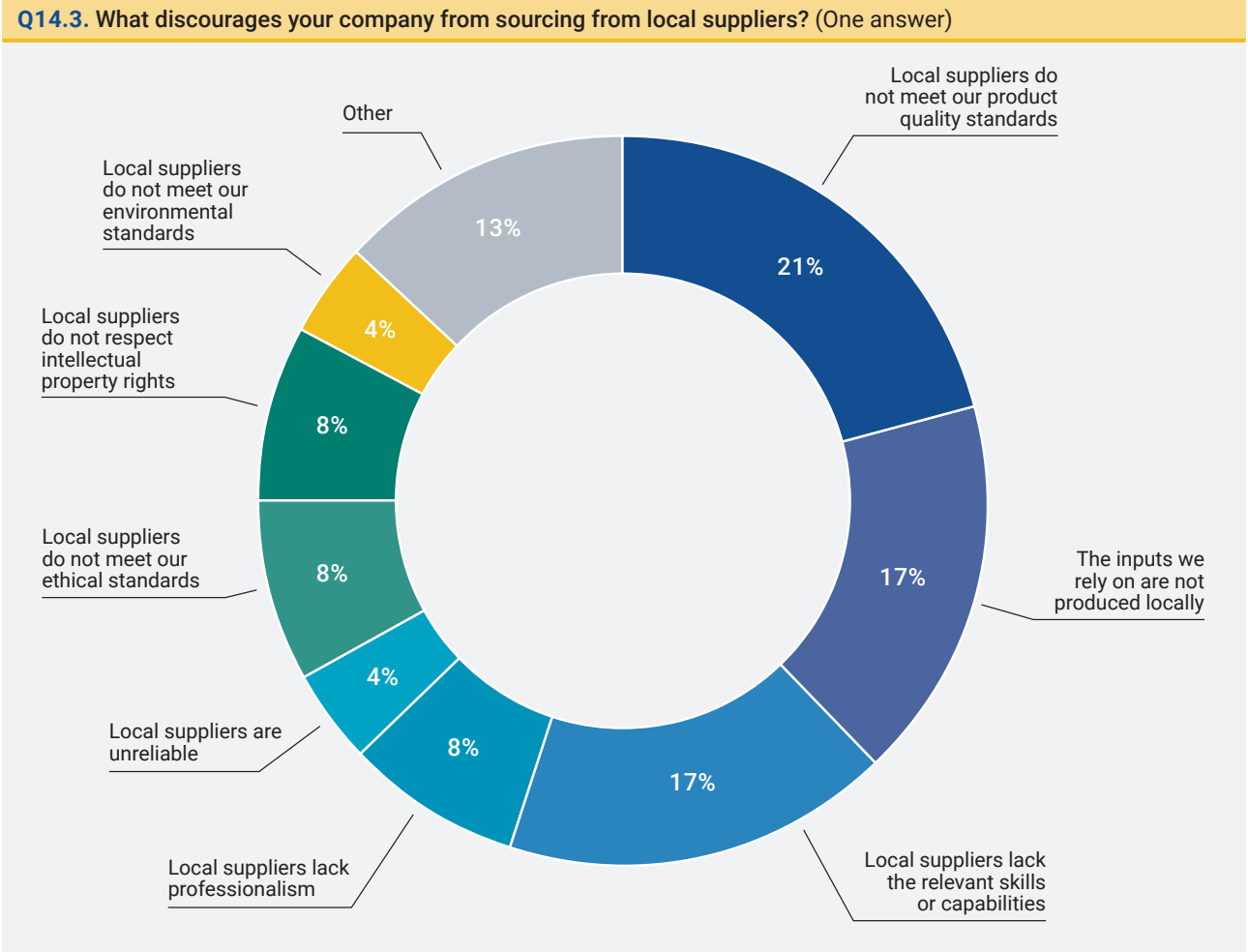
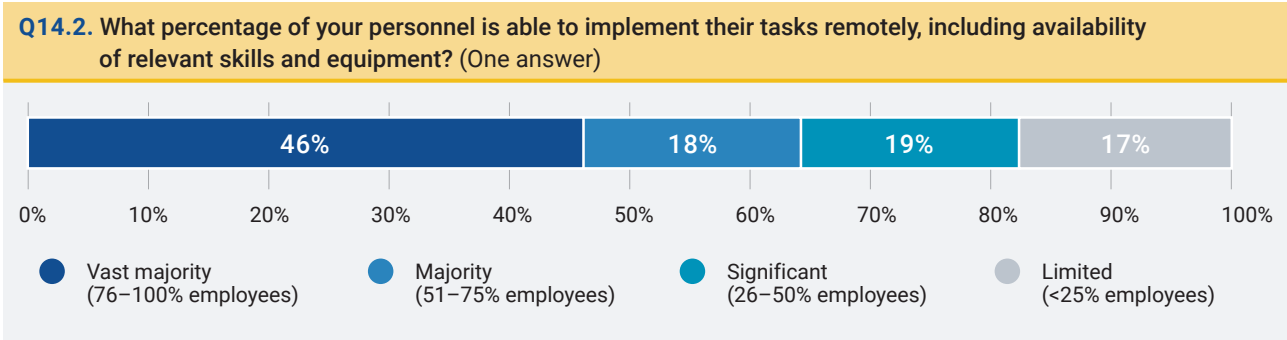
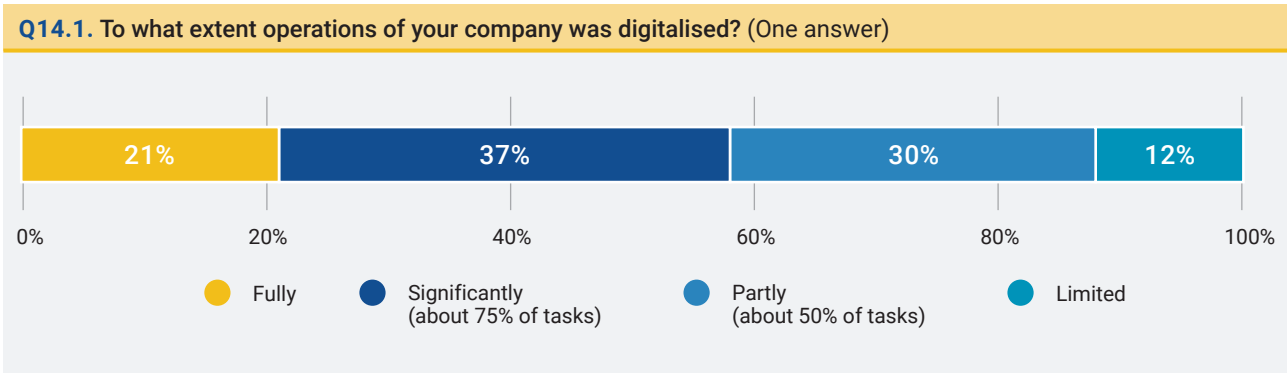
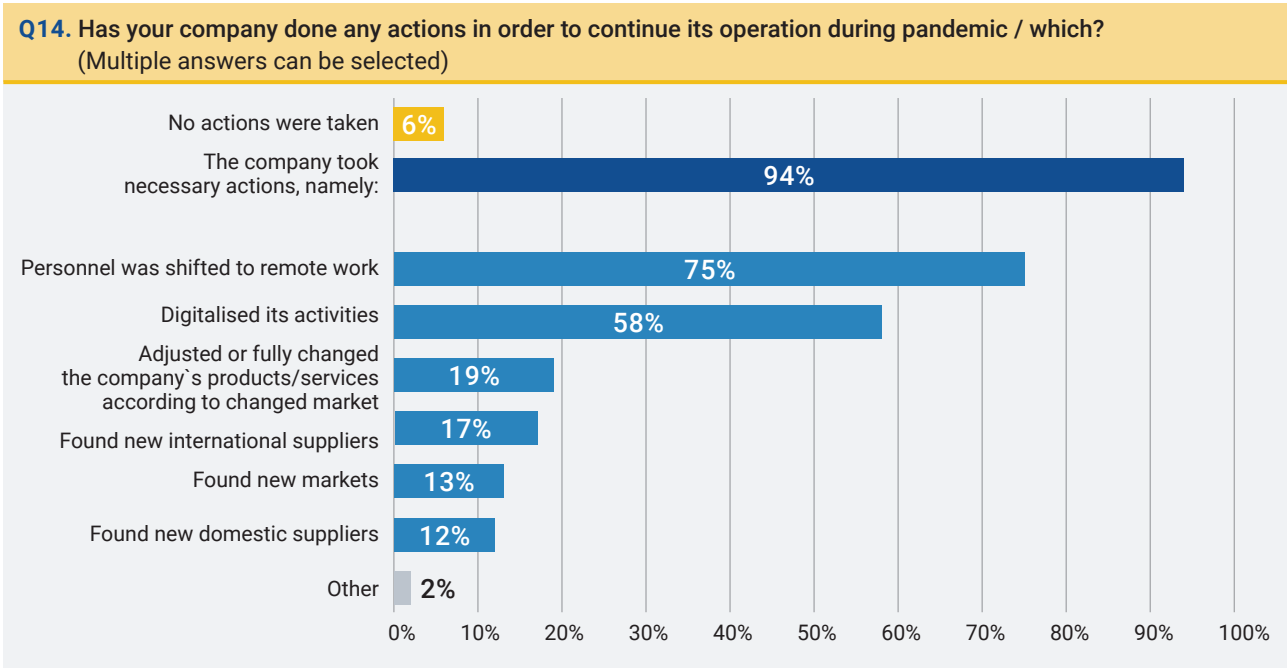


**Q13. Did COVID-19 affect to employment and work conditions in your company / how? (Multiple answers are allowed)**



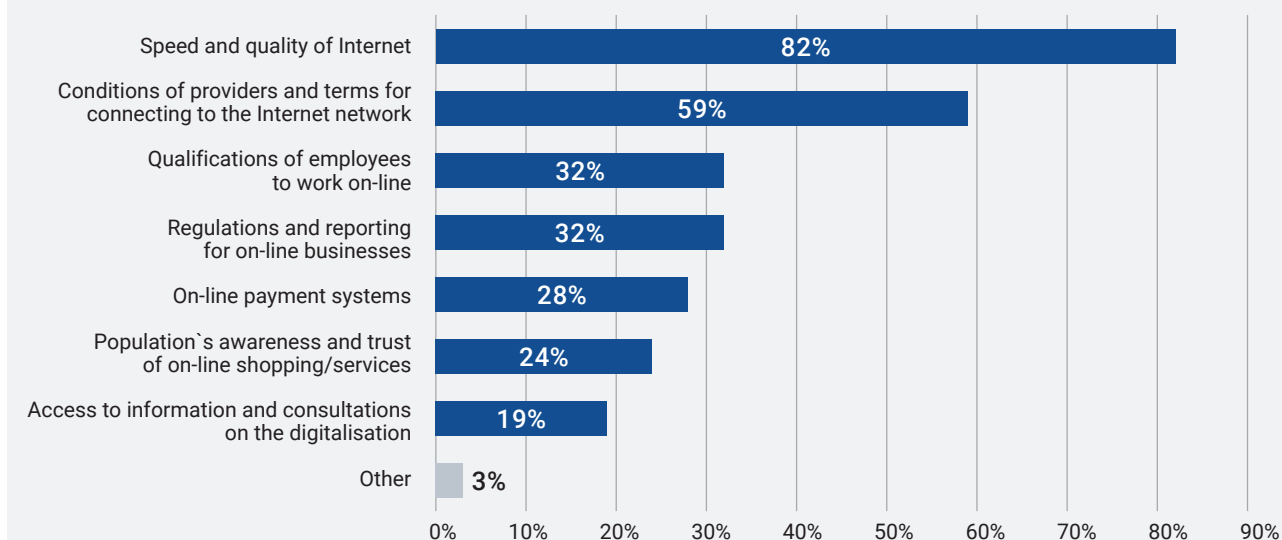


ADAPTATION OF COMPANIES TO NEW ENVIRONMENT

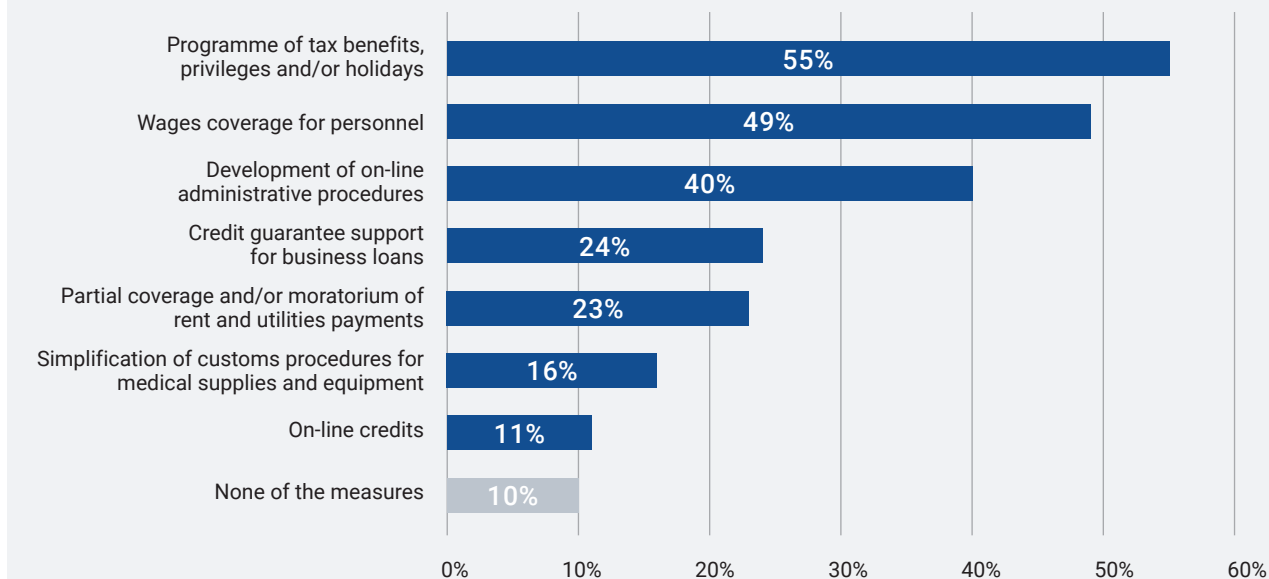




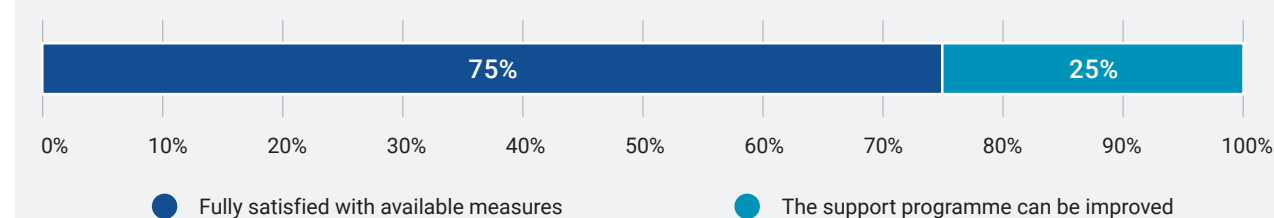
**Q16. Please, specify which areas of IT infrastructure can be improved in order to help business to digitalise more effectively (Multiple answers can be selected)**



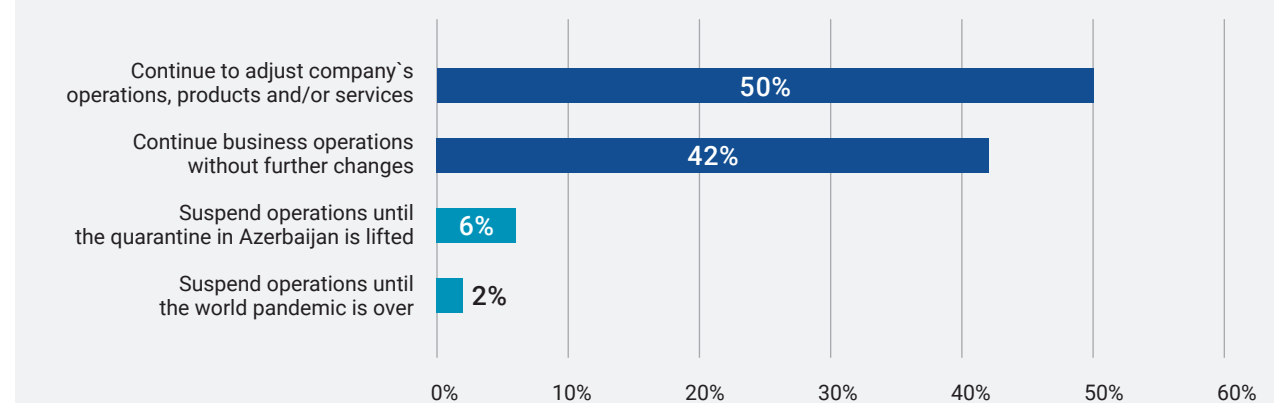
**Q17. Which measures of Azerbaijani government to support business during COVID-19 pandemic are appeared to be the most effective, from your perspective? (Multiple answers can be selected)**



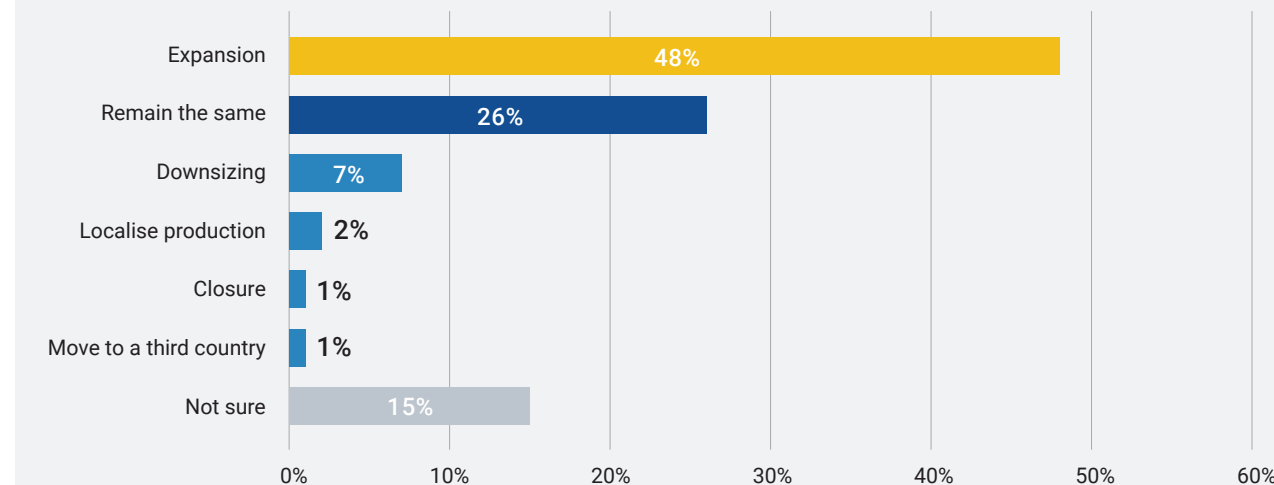
**Q18. Is there any more measures can be implemented by the government of Azerbaijan to support your company? (One answer)**



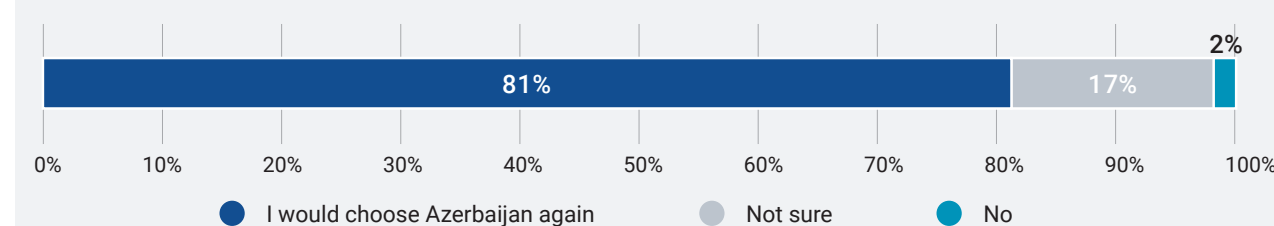
**Q19. What will be action of your company if the quarantine is extended for the next 3-6 months? (One answer)**



**Q20. What is the most likely direction of your company's development over the next one to two years in Azerbaijan? (One answer)**



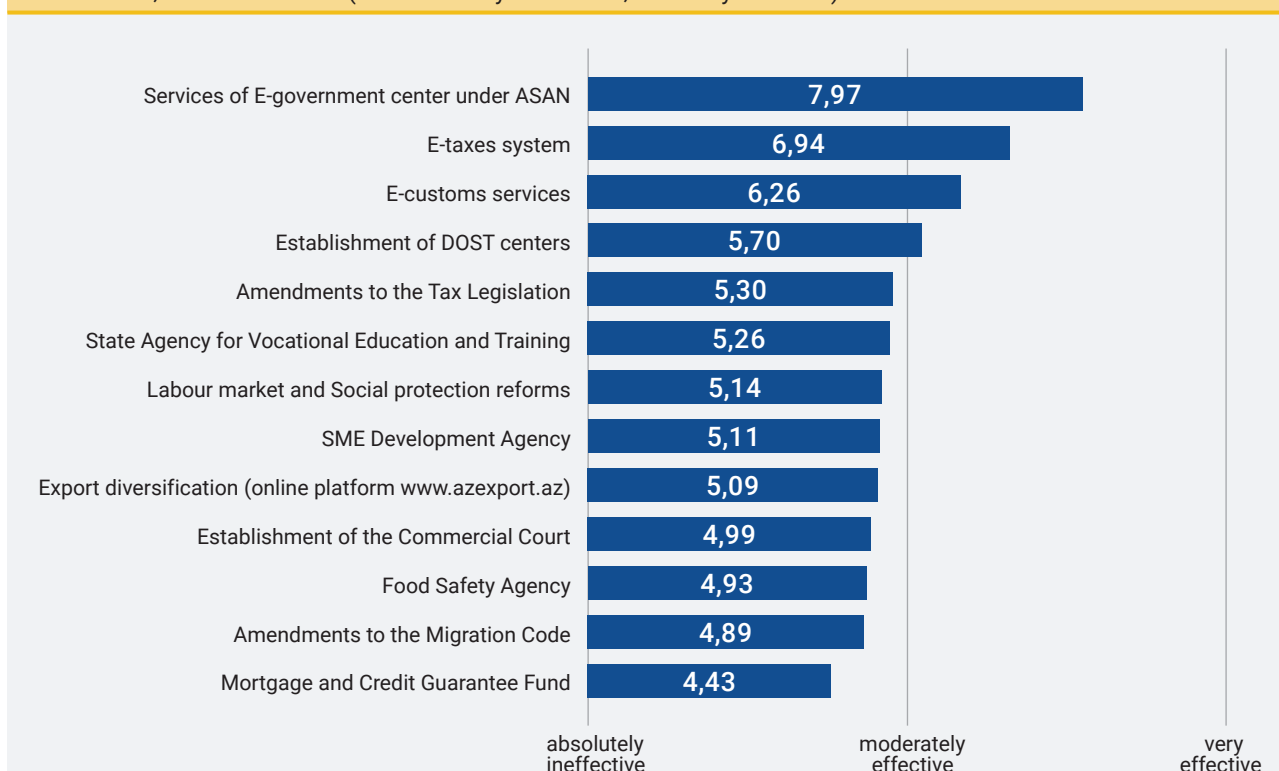
**Q20.1. Would you choose Azerbaijan again as a preferred location for your business? (One answer)**



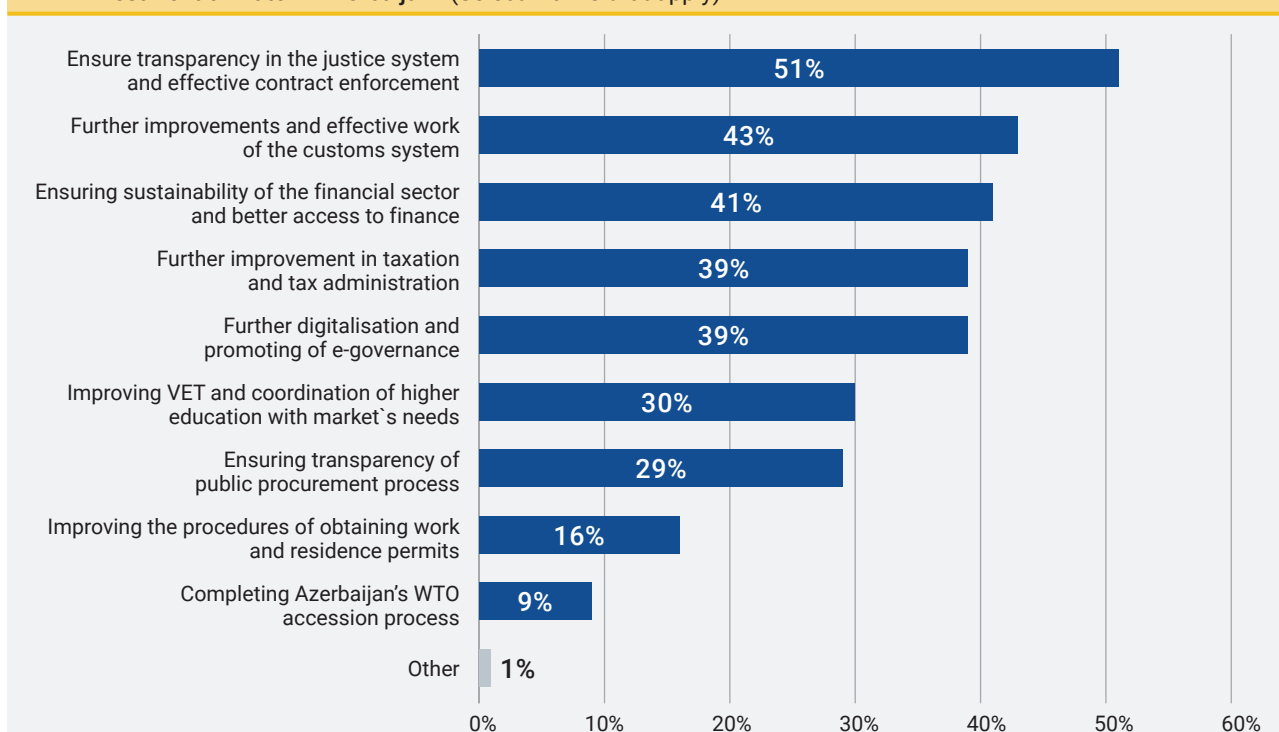


## REFORMS-METER. SNAP SHOT

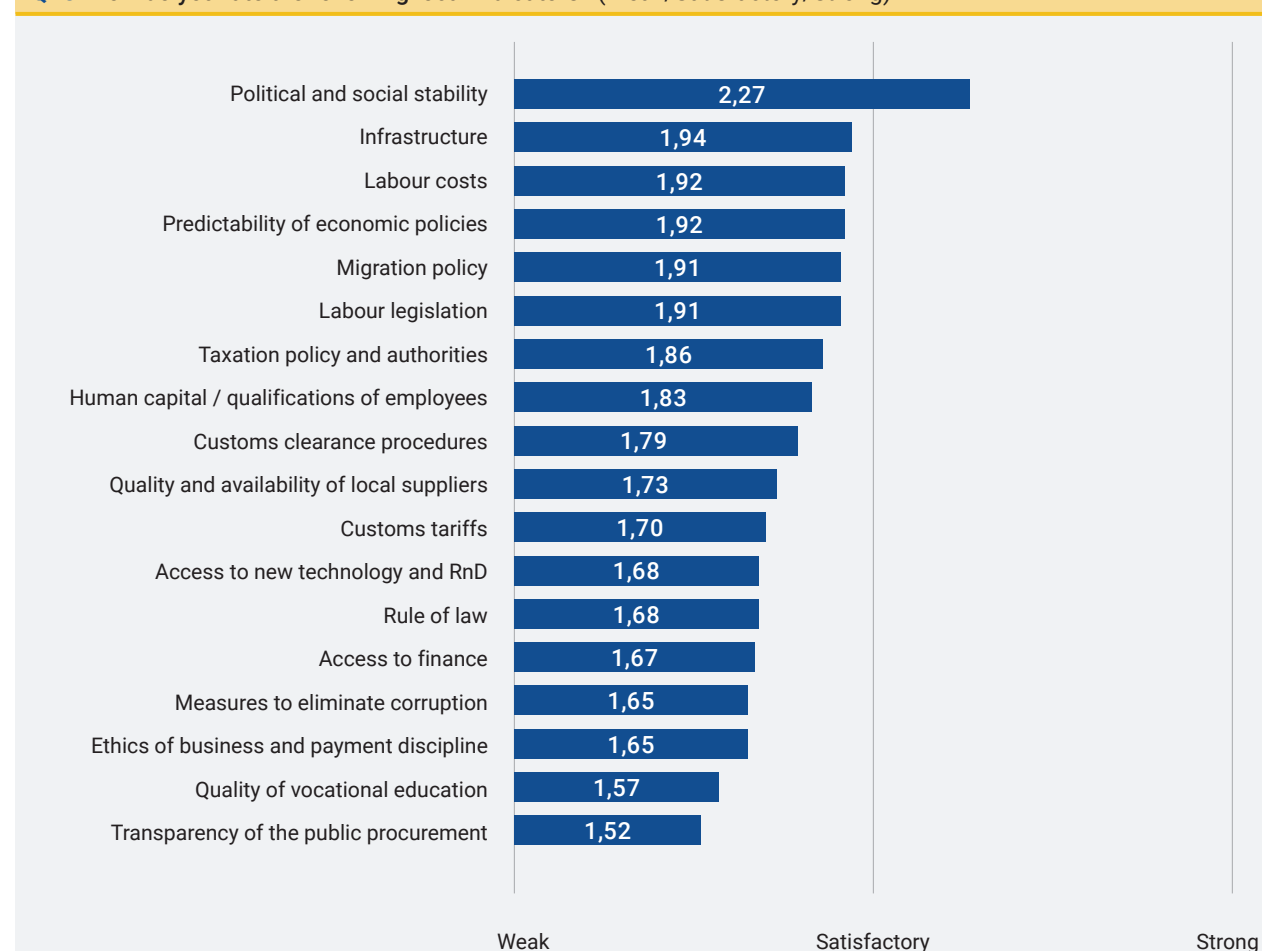
**Q21. In 2019-2020 Azerbaijan continued to implement internal reforms. How effective they are, from your perspective, for improving the business and investment climate?**  
Please, rate from 1 to 10 (1 – absolutely ineffective, 10 – very effective)



**Q22. Which of the following reforms do you consider most important to further improve the business and investment climate in Azerbaijan? (Select max. 3 that apply)**








**Q23. How do you rate the following local indicators? (Weak/Satisfactory/Strong)**










# ANNEX 2








## OPPORTUNITIES FOR BUSINESS WITHIN THE EU SUPPORT









You may find below the list of the regional and local projects for private sector development implementing in Azerbaijan with support of the European Union.

NO	NAME OF THE PROJECT	TIME-LINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
EU4BUSINESS INITIATIVE							
1	Support to Transformation and Achievement of Excellence in Pomegranate Value Chain (STEP)	2019 – 2023		✓		Azerbaijan Pomegranate Producers and Exporters Association	
2	“From Kitchen to Business” Food Promotion and Women Empowerment Action	2019 – 2022		✓		Ward - Women's Association For Rational Development	
3	EU4Business: Connecting companies	2020 – 2022		✓	✓	EUROCHAMBRES	
4	Azerbaijan Hazelnut and Pomegranate Initiative (AHPI)	2017 – 2022		✓		Cultivating New Frontiers in Agriculture	
5	Strengthening of agricultural advisory services	2019 – 2021		✓			
6	Assistance to farmers to develop the sustainable value chains on soft fruit and vegetable production in the rural regions of Azerbaijan	2019 – 2021		✓			
7	Promoting local food production and agri-business owners through advisory services, the creation of new value chain models and agri-tourism development	2019 – 2021		✓			

NO	NAME OF THE PROJECT	TIME-LINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
8	Development of sustainable and inclusive local agri-food systems in north-west region of Azerbaijan	2019 – 2021		✓		FAO Partnership and Liaison Office in Azerbaijan	
9	Improved Support for Entrepreneurial Development in Rural Areas	2019 – 2021		✓		EKVITA	
10	Improved Promotion and Marketing of Traditional Food Products	2019 – 2021		✓		Integrated Regional Development of Azerbaijan (IRDA)	
11	COVCHEG: Community-based Value Chain Enhancement in the Greater Caucasus Mountains area in Azerbaijan	2018 – 2021		✓		Slow Food in partnership with Azerbaijan Tourism Board (ATB)	
12	Promoting Community-based Agritourism as a Rural Regeneration Strategy	2017 – 2021		✓		Local Governance Assistance Public Union	
13	Entrepreneurship for Youth	2018 – 2021		✓	✓	Junior Achievement Azerbaijan	
14	Accelerating development of sustainable micro-entrepreneurship in rural regions of Azerbaijan (ADSMIRRA)	2018 – 2021		✓		Azerbaijan Micro-finance Association	
15	Support to the Government of Azerbaijan in creating more enabling SME's environment and to enhance their competitiveness	2020 – 2021			✓	KOBIA in cooperation with the EU	
16	Support the Government of Azerbaijan in Development of Export Strategy	2019 – 2021			✓	AZPROMO in cooperation with the EU	
17	Support further development of Alternative Dispute Resolution services and Specialised Courts in Azerbaijan	2021			✓	Ministry of Justice of Azerbaijan in cooperation with the EU	



NO	NAME OF THE PROJECT	TIME-LINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
18	Socio-Economic Empowerment and Development of Small-scale vulnerable rural families in Dashkasan, Goranboy and Samukh rayons of non-Absheron regions of Azerbaijan (SEEDS project)	2018 – 2020		✓	✓	SOS Children's Villages	
19	Support to the development of small family businesses in the Sheki-Zagatala Economic Zone through ABAD regional centre in Balakan	2017 – 2020		✓		"ABAD" public legal entity	
20	The agricultural initiatives for market-driven income generation in the Telishli ecomigrant community	2017 – 2020		✓		Ecological Society "Ruzgar"	
21	Supporting the Government of Azerbaijan in implementation of the Annual Action Programme 2017 "European Union for the Lankaran Region of Azerbaijan"	2019 – 2020			✓		
22	Support to EU-AZ Business Forum	2020 – 2022		✓	✓	COWI Belgium, ITAZERCOM, CCIAF, InvestBaku.	
23	Technical Assistance Project for The Implementation of The Support to Rural and Regional Development (SRRD) Programme in The Republic of Azerbaijan	2017 – 2020			✓	Government of Azerbaijan; Ministry of Economy	
24	EU4Business – The EU Local Currency Partnership Initiative: the European Fund for Southeast Europe (EFSE)	2018 – 2039	✓				
25	Structural Reform Facility: World Bank component	2018 – 2023			✓		
26	Women in Business	2015 – 2022	✓	✓			
27	Mayors for Economic Growth	2017 – 2020		✓	✓		
28	WBG technical support to the implementation of the Mayors for Economic Growth initiative	2016 – 2020		✓	✓		

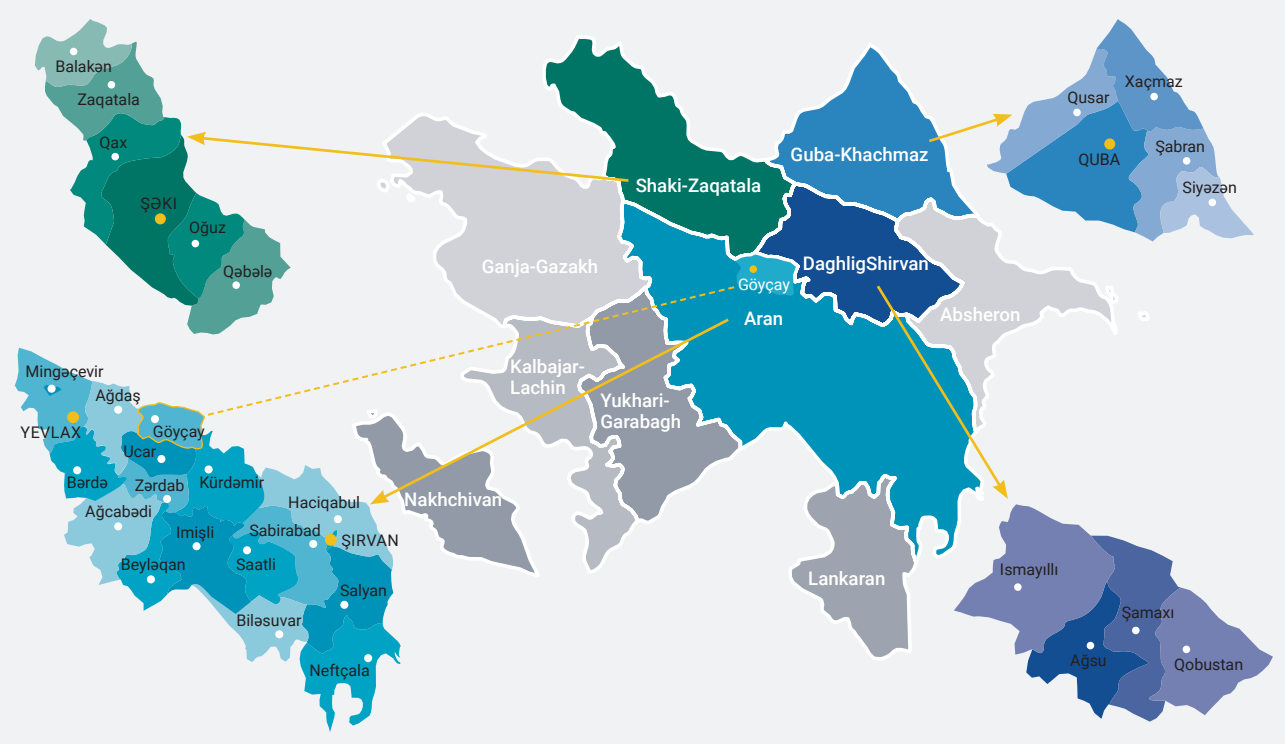
NO	NAME OF THE PROJECT	TIME-LINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
29	Eastern Partnership: Ready to Trade - an EU4Business initiative	2017 – 2020		✓		Eastern Partnership (EaP)	
30	EU4Business: From Policies to Action	2017 – 2020		✓			
31	Framework for Capacity Building to support Financial Intermediaries in Azerbaijan and Georgia	2009 – 2019	✓				
EBRD IMPLEMENTED PROJECTS							
32	Azerbaijan Agricultural Financing Facility	2015 – 2020	✓		✓	EBRD, Azerbaijan Agricultural Financing Facility (AzAFF)	
33	FINTECC - Finance and Technology Transfer Centre for Climate Change	Ongoing, started in 2017	✓	✓		EBRD	
34	AZERBAIJAN: Financial Intermediaries Capacity Building Technical Cooperation Programme	2019 – 2021			✓	EBRD	
EU4ENVIRONMENT INITIATIVE							
35	EU4Environment	2019 – 2022		✓	✓	OECD, UNECE, UNEP, UNIDO, WB	
EU4CLIMATE INITIATIVE							
36	EU4Climate	2018 – 2022			✓	UNDP	
EU4DIGITAL INITIATIVE							
37	eCommerce pilot between Armenia, Azerbaijan, Georgia and Germany	2021-2022		✓	✓	EY	
38	EU4Digital to support high-tech start-ups through design of EaP DISC Capital Venture Fund and Guidebook for ICT Entrepreneurial Ecosystem Capacity Building		✓	✓		EY	



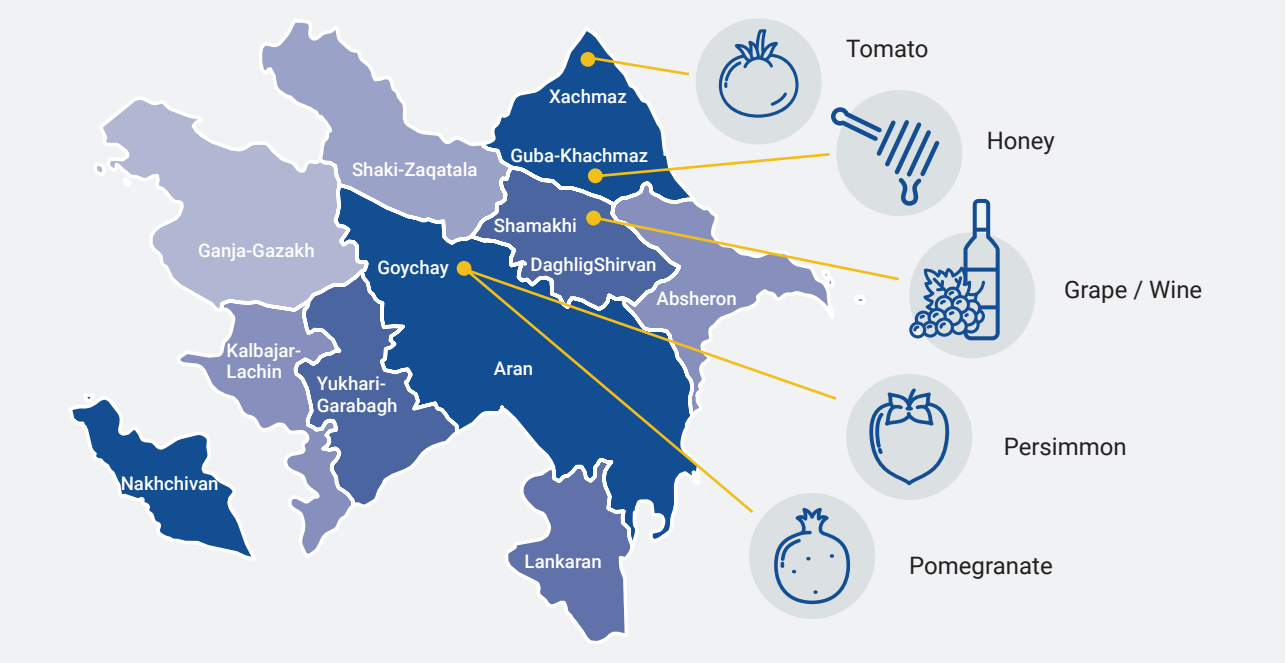
# ANNEX 3

## ECONOMIC REGIONS AND THEIR STRATEGIC SECTORS

Geography of the economic regions and 16 districts in 4 economic regions targeted by the EU technical assistance project



170 investment projects appraised under EU technical assistance project in the strategic sectors per economic regions



SOURCE: EU technical assistance project for the implementation of the support to rural and regional development program



## METHODOLOGY

### Survey

The quantitative data for the Report was collected via anonymous online survey, which took place in September-October 2020.

The structure of the questionnaire 2020 was significantly updated comparing to the previous years and designed with the aim to reflect new global and local factors causing significant impact to the business climate in Azerbaijan in 2020, namely the world pandemic, volatility of oil prices and military conflict in and around Nagorno-Karabakh. The questionnaire contained 23 questions with 5 sub-questions and was split to 4 sections: i) business demography; ii) business climate 2020 and COVID-19 impact to companies; iii) adaptation of companies to new environment; iv) reform-meter snap shot.

The target group for the survey 2020 remained same comparing to the previous years, what is about 400 European companies operating in Azerbaijan: the business of EU member states, EFTA countries, and the UK origin. The database of European companies was collected via cooperation with the Embassies of the EU member states in Azerbaijan as well as via open sources. To sample were also included Azerbaijani companies, whose main business operations are related to cooperation with the EU. At the final stage the database was proof-checked and updated via contacting the companies.

The start of the on-line survey was officially announced at the webinar on September 18 with participation of Ambassadors of the European Union, France and Italy, as well as Acting Director of AZPROMO. The links to the survey were distributed via official channels of the implementing organisations as well as via the social media pages of the project. The bilateral Chambers of the European countries in Azerbaijan as well as offices for trade economic cooperation were invited for informational partnership.

As a result, 187 filled individual application forms were obtained and after the quality check 123 responses were approved to the sample. The sample represents businesses from 22 European countries, and Azerbaijan. The largest representation in the sample have French, British, Italian, German and Azerbaijani businesses with

similar shares about 12-15%. The respondents work in 19 sectors of economy and mostly represent SME sector (85%). Since the survey was distributed via the open channels and each of the company had an equal chance to respond, and since the obtained samples represent companies of various size, sectors and countries, and operating in Azerbaijan during different period of time, the assumption can be made that the sample represents the population of European businesses in Azerbaijan. The expected confidence interval is 0.95 with the following margins of error 0.0736.

### Interviews

At the second stage the qualitative data was collected via deep interviews with representatives of European companies and organisations. 25 interviews were conducted during October and November with the companies of 8 sectors having the largest representation in the survey, namely: consulting, oil and gas, transport and logistics, tourism, agriculture, hospitality, ICT, chemical and financial sectors. Other group of the organisations participating in the interviews were bilateral Chambers and offices for trade and economic cooperation.

### Focus-group

After the draft Report was developed, the main findings were presented for a discussion and confirmation at the focus group with participation of 8 experts, representing the European business community and having deep expertise in certain sectors. After the focus group the final version of the Report was approved.

### Desk research

Materials used for preparation of this Report include official sources of information, as legislation of Azerbaijan, bulletins of State Statistics Committee of the Republic of Azerbaijan, publications of the Center for Analysis of Economic Reforms and Communication of the Republic of Azerbaijan and international organisations: ADB, EBRD, ETF, OECD, WB, IMF, UN, UNCTAD, etc.

## ACRONYMS AND ABBREVIATIONS

ABAD	ASAN Support to Family Business Programme
ADB	Asian Development Bank
AFEZ	Alat Free Economic Zone
ASAN	Azerbaijan Service and Assessment Network
AZN	Azerbaijani manat (currency)
AZPROMO	Azerbaijan Export and Investment Promotion Foundation of the Republic of Azerbaijan
BPS	Basis points
BSI	Banking System Indicator
CCIAF	France-Azerbaijan Chamber of Commerce and Industry
COVID-19	Coronavirus disease 2019
DOST	Agency for Sustainable and Operative Social Provision of the Republic of Azerbaijan
EaP	Eastern Partnership
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ENP	European Neighbourhood Policy
EFTA	European Free Trade Association
ETF	European Training Foundation
EU	European Union
EU Delegation	Delegation of the European Union in Azerbaijan
EUR	Euro
EY	Ernst&Young
E-customs	Electronic customs system
E-tax	Electronic taxation system
GDP	Gross Domestic Product
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FIMSA	Financial Market Supervisory Authority
JCS	Joint Stock Company
IBA	International Bank of Azerbaijan

I.C.E.	Italian Trade Commission
ICT	Internet and communications technology
IDI	Internet and communications technology Development Index
IPD	Investment Promotion Document
IT	Internet technology
IFI	International Financial Institution
INVESTBAKU	Investment Agency of Baku
IMF	International Monetary Fund
ITAZERCOM	Italy-Azerbaijan Chamber of Commerce
LLC	Limited liability company
NPL	Non-performing loans
OECD	Organisation for Economic Cooperation and Development
PAIH	Polish Investment and Trade Agency
PPD	Public-private dialogue
RECP	Resource Efficiency and Cleaner Production
R&D	Research and development
SME	Small and medium size enterprises
SOE	State-Owned Company
SOFAZ	State Oil Fund of the Republic of Azerbaijan
KOBIA	Small and Medium Business Development Agency of the Republic of Azerbaijan
VAT	Value-added tax
VET	Vocational education training
WB	World Bank
WTO	World Trade Organisation
UK	The United Kingdom of Great Britain and Northern Ireland
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNEP	United Nations Environment Programme
USD	United States dollar

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- <sup>29</sup> EU4Digital official website
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