

EU BUSINESS CLIMATE REPORT AZERBAIJAN 2021

6TH ANNUAL EDITION



This project is
funded by the
European Union

COWI

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ITALY-AZERBAIJAN
CHAMBER OF COMMERCE



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InvestBaku
Investment Agency of Baku city

 **azpromo**
Export and Investment Promotion Agency
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FOREWORDS



Peter MICHALKO

Ambassador – Head of the Delegation

DELEGATION OF THE EUROPEAN UNION TO AZERBAIJAN

EU Business Climate Report Azerbaijan 2021 is the sixth 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 of 2021, the European Union remained Azerbaijan's main trading partner consisting of the \$15.2 billion trade turnover (45% of total trade turnover of Azerbaijan) and 51% of Azerbaijan's exports. For the last two years we were all engaged in a fight with global pandemic that had impact on our way of life, created various market volatilities, affected businesses and many more. It is good to see the situation and economic activity coming back to normal again, thanks to international cooperation and robust progress in vaccination. The EU and Azerbaijan cooperated closely also in this field that became one more example of our strong partnership.

Together with the position of the largest trading partner and largest export destination, the EU and its Member States are also the largest source of foreign investments in Azerbaijan. The activities of European investors will be another important factor for the economic and social recovery after the pandemic. With the Economic and Investment Plan, the EU started to support post-pandemic recovery using specific EU financial tools, including blending and guarantees, to foster sustainable development and to leverage public and private investment. The plan contains a set of flagship initiatives, which will shape concrete priority projects with tangible results jointly identified with the partner countries, taking into account priorities, needs and ambitions of the country. With the **"Team of Europe"** approach, the EU and its Member States continue to adjust their cooperation programs with Azerbaijan helping to address the most immediate needs such as strengthening public health system, mitigation of the socio-economic consequences of the pandemic, step-up investment into the human capital.

Year 2021 brought intensive activity at the highest level in bilateral relations by increasing our strong partnership and quality. The visits of President of the European Council Charles Michel and Commissioner for Neighbourhood and Enlargement Oliver Várhelyi to Azerbaijan in the summer 2021, as well as participation of President Ilham Aliyev at

the Eastern Partnership summit in Brussels in December 2021 brought strong impetus to our dialogue. The EU and Azerbaijan continue the work on the new legal framework for our relations - new comprehensive bilateral EU-Azerbaijan agreement will bring our partnership to a higher level and quality. At the same time, the EU shows its readiness to participate in the process of restoration and reconstruction work carried out in Azerbaijan, to contribute to the establishment of peace, security and prosperity in the South Caucasus, and to support efforts to reconcile the parties. The EU is also providing substantial financial support to demining, and it is ready to offer financial and technical support in the process of delimitation and demarcation of borders.

This sixth edition of the EU Business Climate Report not only provides an independent assessment of the current business climate, but also enables to see the changes in perspective compared to previous years. Last year for the first time we took into account European Green Deal and digital transformation tendencies in Europe. We continued this approach and included an overview on the green and digital opportunities for businesses in Azerbaijan in 2021.

We extended Business Forum outside of Baku with organisation of the business missions of European companies to regions of Azerbaijan and we are very much interested to continue.

This year the EU Delegation continued cooperation with Italy-Azerbaijan Chamber of Commerce (ITAZERCOM), Azerbaijan-France Chamber of Commerce and Industry (CCIAF), COWI Belgium and Invest Baku in preparation of this Report. We are pleased also with continuation of our cooperation with AZPROMO for many years.

The EU and Azerbaijan have significantly intensified and continued expanding cooperation and strengthening the bilateral relations in 2021. We will increase our efforts to achieve positive results in 2022.

Enjoy reading!

Sincerely,
Peter Michalko



Zibar HUSEYNOVA

Managing Director

AZERBAIJAN-FRANCE
CHAMBER OF COMMERCE
AND INDUSTRY
(AFCHAMBER)

For the last decade, the global economy has remained highly dynamic and requires timely adjustments of national policies. Creation of national business environment that would allow business to prosper can be achieved only via effective public-private dialogue and cooperation of a private sector and a government.

For the years of its publication, EU Business Climate Report became a valuable tool for the European business community in Azerbaijan to elaborate and to share their ideas, needs and suggestions with our partners in the state bodies and beyond. Last year's edition resulted in an honest exchange between the private and the public sectors and led to concrete policy changes which ultimately benefited the larger economy. We hope the current report will continue this good practice and even take it further.

The Azerbaijan-France Chamber of Commerce and Industry (AFChamber) is proud to be part of the EU-Azerbaijan Business Forum and contribute to the preparation of the EU Business Climate Report for the second year this time. I would like to thank all companies who took part in the survey and interviews, alongside co-authors of the report COWI Belgium, InvestBaku and the Italian Chamber of Commerce, for their valuable work in designing this study.

Sincerely,

Zibar HUSEYNOVA



Manuela TRALDI

President

ITALY-AZERBAIJAN
CHAMBER OF COMMERCE
(ITAZERCOM)

The Year After. What lies ahead? Starting from 2021, global business community faced new geopolitical scenarios, challenges and opportunities in post-pandemic economies. In this general context, the restored situations emerging in Azerbaijan along with consolidation of the 2020 peace agreements have begun to take a concrete shape, opening for European investors the vast potential related to the reconstruction plans of the liberated territories with green projects' opportunities and to the transformation of the country into a strategic energy and transport hub. Meanwhile, with over 8 billion scm transported via SGC-Trans-Adriatic Pipeline by 31 December 2021, Azerbaijan has reinforced its role in supporting Europe's energy security. Therefore, the assessment and analysis of the investment and business climate at this moment may provide a valuable glimpse of the future economic scenarios through the eyes and the expectation of the European businesses operating in Azerbaijan.

ITAZERCOM is particularly pleased and honoured to be a partner of the EU-Azerbaijan Business Forum 2020-2022 and co-author of this 6th edition of the EU Business Climate Report Azerbaijan, together with COWI Belgium, InvestBaku and the Azerbaijan-France Chamber of Commerce and Industry, whom we thank for their commitment and collaboration. I would like to express our gratitude to the EU Delegation to Azerbaijan for this opportunity and to AZPROMO for their precious cooperation.

More than ever this year, I would like to thank all participating companies and respondents who have continued to provide their valuable and irreplaceable contribution to this report, despite all difficulties.

We stand ready to support and look forward to the EU-Azerbaijan Business Forum events in 2022!

Sincerely,

Manuela TRALDI

INTRODUCTION

This report is an annual publication taking place in Azerbaijan since 2016 within **“EU-Azerbaijan Business Forum”** funded by the European Union. During the period 2020-2022 the assignment is being implemented by COWI Belgium in partnership with Italy-Azerbaijan Chamber of Commerce, Azerbaijan-France Chamber of Commerce and Industry, InvestBaku and in coordination with Export and Investment Promotion Agency of the Republic of Azerbaijan (AZPROMO) as part of the Ministry of Economy of Azerbaijan.

This report is prepared by the team of the “EU-Azerbaijan Business Forum” under supervision of Ulviya Abdullayeva, Task Manager, Delegation of the EU to the Republic of Azerbaijan. The principal writer of this report is Dr. Bogdana Aleksandrova-Efe, Team leader with the support of the local consultants Gulnara Mammadova, SME Expert, and Sevil Yahyayeva, Legal Expert. Support in research was provided by Zibar Huseynova, Managing Director of AFchamber, Manuela Traldi, President of ITAZERCOM, Aygun Aliyeva and Turkan Devrijova, MR Experts. The project was managed by Natalia Cardona, Head of Section, COWI Belgium and Fabio Montanari, Project Manager, COWI Belgium. Quality control for the assignment 2020-2022 is implemented by Ecorys.

The “EU-Azerbaijan Business Forum” would like to extend its gratitude for the effective coordination and informational support to the EU Delegation to Azerbaijan, Embassies of the EU member states in Azerbaijan, European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), European Training Foundation (ETF), Organisation for Economic Cooperation and Development (OECD); the following Eastern Partnership (EaP) regional initiatives: EU4Business, EU4Climate, EU4Digital, EU4Energy, EU4Environment; organisations for bilateral economic cooperation: Advantage Austria, Azerbaijan-Bulgarian Chamber of Commerce and Industry, and Italian Trade Commission (I.C.E.).

About the publication

The report has its goal to reflect the latest trends in the business climate of Azerbaijan from the perspective of European companies operating in the country. The 2021 edition is devoted to such important topics as business and investment climate, recovery of business during pandemics, and an overview of the local reforms aimed to attract investors and strengthen small and medium-sized enterprises (SMEs). The special focus of the report is dedicated to the latest developments in the country in line with the global strategic priorities as the development of a sustainable and green economy, digitalization of private sector, and equal access to economic opportunities for men and women.

The main target group for the survey includes European companies working in Azerbaijan, namely representatives of the EU and EFTA countries and the UK. Azerbaijani companies, whose main focus of business operations is related to cooperation with the EU were also invited to participate in the study. Conclusions presented in the report are based on results of the annual EU Business Climate Survey and face-to-face interviews conducted with owners and top managers of companies.

139 online responses & 27 interviews

The EU Business Climate Survey took place in October – November 2021 and collected a record number of responses never reached before within this study. The survey contained traditional for this study questions devoted to business, investment climate, ongoing reforms, and other relevant to the business environment topics. In addition to the survey, 27 deep interviews were conducted with representatives of agriculture, construction and engineering, consulting, ICT, oil and gas, tourism and hospitality, transportation and logistics, and other sectors.

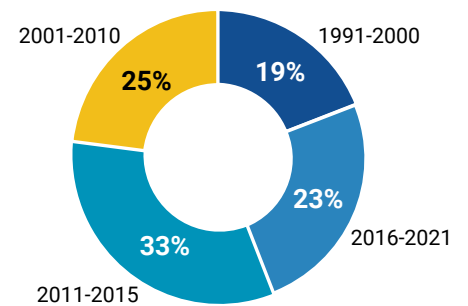
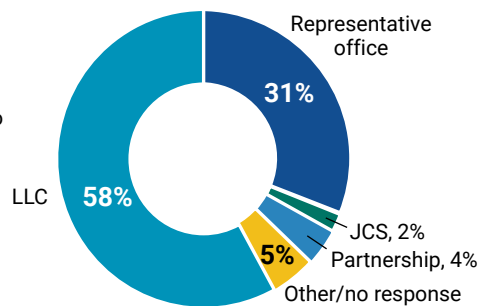
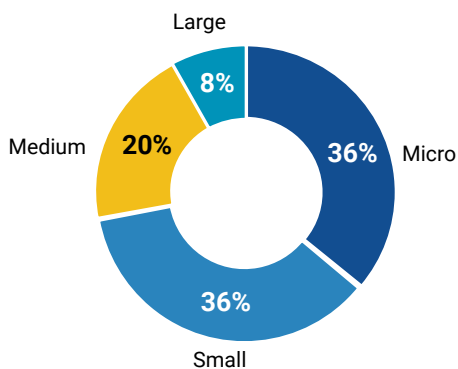
Participants of the survey 2021:

Over 90% of the companies that participated in the survey are SMEs. The majority of entities are operating in Azerbaijan as limited liability companies (LLC) (58%) or representative offices (31%) and are being present in the country for over 5 years (77%).

COVERAGE

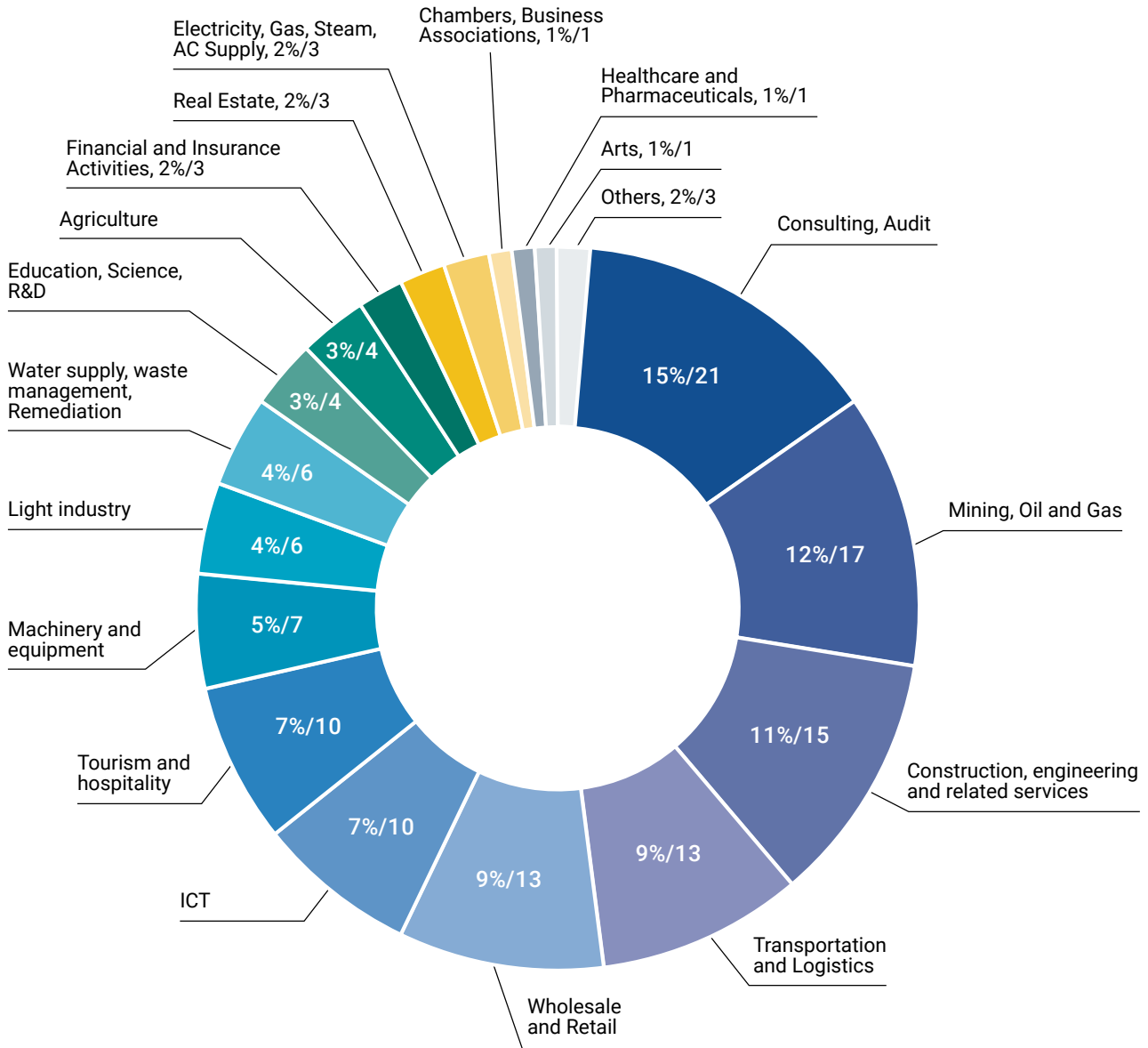
24 countries

The "EU Business Climate Report Azerbaijan 2021" represents the views of representatives from 24 countries in total, including 20 EU member states, 2 EFTA countries, the UK, and Azerbaijan.



19 sectors

Respondents represented 19 sectors of economy. The strongest representation demonstrated consulting and audit; mining, oil, and gas; construction and engineering; transportation and logistics; wholesale and retail; ICT; tourism and hospitality.



MAIN FINDINGS

BUSINESS CLIMATE 2021

The **COVID-19 pandemic** remains the factor with the strongest effect to business climate.

FACTORS WITH...



...**LESS INFLUENCE** than last year:

- Instability of oil prices
- Uncertain market developments
- Risk of slowing down reforms



...**MORE INFLUENCE** than last year:

- Lack of qualified employees
- Custom controls

MAIN INDICATORS

- Business evaluate situation in national economy in 2021 as **satisfactory**.
- **80%** of companies ready to choose Azerbaijan again for their business.
- **53%** plan further expansion of business.
- **37%** will operate within existing capacities.

- On a scale of "weak, average or strong", respondents evaluated **available state support** at somewhat above average.

- **Perception of local business climate** and **attitude of public authorities** remains rather neutral.

SECTORIAL OUTLOOK

- **The most optimistic sectors:** ICT, Construction and engineering, Transportation.
- **Neutral sectors:** Mining, oil and gas.
- **Pessimistic sectors:** Tourism and hospitality.

- **Sectors feel state support the most:** Tourism and hospitality; Mining, oil, and gas.
- **Sectors feel state support the least:** ICT.

- All sectors provided similar views on these aspects.

BUSINESS RECOVERY DURING THE PANDEMIC



52% of companies have reached or plan to soon reach pre-pandemic indicators.



88% of companies actively promote or support vaccination amongst their personnel.



12% of companies remain significantly affected.

47% confirm remaining negative effect from the pandemic to employment and work conditions.

91% of companies will be affected in case of renewal of pandemic-containment restrictions.

Business remains the most vulnerable to:

46% Remote work for personnel.

36% Slowing down or stopping of international connections.

29% Limitations of people gathering.

INVESTMENT CLIMATE 2021

Political and social stability in Azerbaijan remains the factor most appreciated by investors.



Factors improved the most:

- Ethics of business discipline
- Measures to eliminate corruption
- Quality of VET



Factors with negative dynamics:

- Rule of law
- Customs clearance procedures
- Customs tariffs

New opportunities in Karabakh and East Zangezur economic regions

54% of European companies ready to consider economic regions for investments.

14% of companies have already started work towards investment projects.



TOP 3 profiles attractive for investors



CIVIL CONSTRUCTION



ALTERNATIVE ENERGY AND GREEN PROJECTS



TRANSPORT INFRASTRUCTURE

LOCAL REFORMS

ADVANCED REFORMS

ASAN E-Taxation DOST centres SMBDA Migration Service

PROGRESSING REFORMS

E-Customs and Green Corridor Reforms of VET

DEMANDING FURTHER PRIORITISATION

Rule of law for investors Access to finance for business Transparency of public procurement

TRENDS IN LINE WITH GLOBAL STRATEGIC PRIORITIES

SUSTAINABLE AND GREEN ECONOMY

85% of companies applying principles of environmental awareness

TOP 3 environmental practises implemented by entities:

1. Energy efficiency technologies (34%)
2. Reduction of emissions (34%)
3. Use of highly recyclable materials (32%)

TOP 3 mechanisms for "greening" of private sector:

1. Financial support (56%)
2. Environmental regulations (40%)
3. Growing demand for green products (36%)

DIGITALISATION IN PRIVATE SECTOR

Main priorities for effective business digitalisation:

1. IT infrastructure
2. Digital skills
3. Cybersecurity

TOP 3 priorities for further improvements in local IT infrastructure:

1. Speed and quality of Internet (76%)
2. Conditions of Internet providers (48%)
3. Digital skills of personnel (40%)

EQUAL ACCESS TO ECONOMIC OPPORTUNITIES FOR WOMEN AND MEN

European investors involve **more female workers** in traditionally male-dominant sectors compared to their local colleagues

40% of employees in the companies are women

In over **20%** of European companies, women are represented in C-level positions

TOP 3 positions with the highest women representation:

1. Administrative personnel (79%)
2. Sales & marketing (48%)
3. Middle managers (39%)



EXECUTIVE SUMMARY

After last year's turbulences, Azerbaijan's economic and political environment returned to a more stable and predictable path in 2021. The annual EU Business Climate Survey found that European companies see the local economy improving this year and consider its performance as satisfactory (on a scale of "weak, "satisfactory, or strong"). Most indicators reveal some improvement testifying to **an overall recovery of the business environment** allowing companies to look to the future with more certainty and optimism. Over half of the respondents this year (53%) indicate that they have plans for future expansion and 37% plan to operate at the same capacity. 80% of European companies are ready to choose Azerbaijan again for their business operations, which is comparable to the last year's result.

Non-oil sectors remained important for further economic diversification of the country and appeared to be less impacted by last year's turbulence than the hydrocarbon sector. As in much of the world, **ICT** and **transportation** businesses in Azerbaijan grew during recent years and expect the continuation of this positive trend and further expansion of their capacities. Upcoming state projects with a substantial budget of USD 1.3 bn. announced by the government for investment in the Karabakh and East Zangezur economic regions added optimism to **construction and engineering** companies, which also have a positive outlook for upcoming years. Meanwhile, entities working in the **hydrocarbon sector** have been affected by various factors and demonstrate some level of frustration. The Trans-Adriatic Pipeline (TAP) within the Southern Gas Corridor (SGC) started operation and transported about 8 billion cubic metres of gas to Europe during its first year. At the same time, the sector continues to be affected by the pandemic, the global trend towards green and alternative energy sources and ongoing reforms in the largest state-owned company, SOCAR. The global negative trend in **tourism and hospitality** was also felt in Azerbaijan. Even though European companies representing the sector appreciated the state support provided, their performance remains well below the pre-pandemic level causing plans for downsizing in upcoming years.

The SME sector has a strong ability to recover after shocks and adapts fast to changing conditions, while the **COVID-19 pandemic** remains a serious contributor to uncertainty. During the 2021 survey – which was conducted after a few months since the pandemic-related restrictions were lifted in Azerbaijan – over half of the companies surveyed reported that they have already reached or plan to soon reach their pre-pandemic level of output. At the same time, about half of respondents still experience negative effect on employment levels and work conditions. Despite significant efforts made by the

private sector to adapt during the COVID-19 containment measures, many companies remain vulnerable with over 90% of respondents indicating potential negative effects in case of restoration of the restrictions. Business remains most sensitive to measures mandating distant work for personnel, closure of international travel, and limitations on gatherings. A majority of European companies (88%) take a pro-active position supporting the vaccination of their personnel to reduce the risk of new pandemic waves.

The **investment climate** this year demonstrates overall signs of recovery. Traditionally, access to the local market and strategic regional partnerships remain the main drivers bringing European companies to Azerbaijan. The efforts conducted by the government to attract investors, such as new investment treaties and actively developing industrial infrastructure (e.g. AFEZ, Aghdam Industrial Park, Araz Valley Economic Zone, and others), was appreciated by survey respondents. Ambitious plans for investment in the Karabakh and East Zangezur economic regions with a strong focus on alternative energy projects, the implementation of concepts of "green cities" and "green villages", as well as the impressive speed of first infrastructure projects, including the opening of Fizuli International airport in 2021, raised investment appetite among European businesses. Over half (54%) of respondents reported interest in upcoming projects in these regions, and 14% have already started active work in these economic regions. The main sectors of interest among respondents were in civil construction, alternative energy and transport infrastructure.

The country continues to implement reforms to improve the business environment with the aim of increasing economic growth and diversification. As during previous years, European companies considered the work of **ASAN** and **DOST centres**, **E-Taxation** platform, and **State Migration Service** to be effective. The break-through of the year came from the **Small and Medium Business**

Development Agency (SMBDA), which entered the top-5 most effective reforms according to European investors. European companies emphasise the strategic importance of the Agency for Azerbaijan and welcome its newly launched regional infrastructure (SMB Houses, SMB Friends, SMB Support Centres and others) and programmes to support SMEs. **The digitalisation of customs** and the effective functioning of **Green Corridor** remain crucial for foreign companies and were welcomed in recent years with high expectations. Although the reform remains in the Top-3 in the 2021 survey, it lost a position compared to last year due to still limited positive impact experienced by companies in practice so far. The same is also true of reforms to **Vocational Education and Trainings (VET)**, which is perceived as being effective by European businesses but did not yet lead to significant improvements in access to qualified workers in the market. Respondents hope for the further prioritisation of both reforms due to their potential to contribute to the improvement of the business and investment environment.

Despite the ongoing reforms in the judicial branch, which includes the establishment of mandatory moderation, commercial courts, and Judicial-Legal Council, **ensuring the rule of law** in regard to investors remains the most expected priority chosen by over half of the respondents in both 2020 and 2021. The **access to finance for business** this year also remains amongst the top requests but have yet to see significant progress. Both factors play a vital role in the overall wellbeing of the private sector in the country and require deep and structural changes. An announcement of upcoming state projects this year brought the **transparency of public procurement** back to the fore. Several changes to the tendering procedures introduced this year increased optimism and expectations on further improvement of this aspect.

Azerbaijan continues its movement towards global strategic priorities, including the development of a **sustainable and green economy**. With the support of EU initiatives, the country keeps strengthening its policy and legislative framework in this area. One of the important steps taken this year was the preparation of a new Nationally Determined Contribution (NDC), which foresees a reduction of emissions by 2030 of at least 35% and towards 40% compared to 1990 levels and development of a National Energy Efficiency Action Plan (NEEAP). The two new laws “On the Use of Renewable Energy Sources in the Production of Electricity” and “On the Efficient Use of Energy Resources and Energy Efficiency” have been approved, providing the basis for efficient use of renewables, and regulating relations between the public and private sector in the field of energy. Several steps have been made towards the development of a circular economy and SME greening. 85% of European businesses indicate that the application of environmental awareness is important in their work, which is 18% higher than last year. Amongst the

most popular practices are technologies on energy efficiency, reduction of emissions, and the use of highly recyclable materials. Financial tools were considered by respondents to be the most effective instrument to promote private sector greening, followed by environmental regulations and growing demand for green products in the market.

The digitalisation of the private sector kept progressing in Azerbaijan in 2021, enhancing its resilience to the impacts of the pandemic. The country made some progress toward increased accessibility and affordability of broadband connections and the speed of the internet, while its level remains lower than expected by European investors. However, the digital infrastructure remains significantly better in cities than in rural areas. European companies see further development of information technology (IT) infrastructure and digital skills of the population as essential for further digitalisation of the private sector. Due to the growth of online operations amongst businesses, there is a need to bring more attention to cybersecurity at the national policy level and raise awareness on this subject amongst companies.

Despite legislation prohibiting gender discrimination, ensuring **equal access to economic opportunities for women** in practice remains a challenge. Female workers remain in the minority in such sectors as construction (7%), transportation (16%), oil and gas (13%). The pay gap for similar work is estimated at 25%. The survey results show that European companies in Azerbaijan aim to follow a gender-balanced approach and, on average, hire more female workers than their local colleagues. The total share of women amongst the companies represented in the survey results in about 40%. The majority are involved in administrative work, sales, marketing, and middle-level management. In over 20% of the companies, women are also represented at the C-level management.



1 BUSINESS AND INVESTMENT CLIMATE 2021

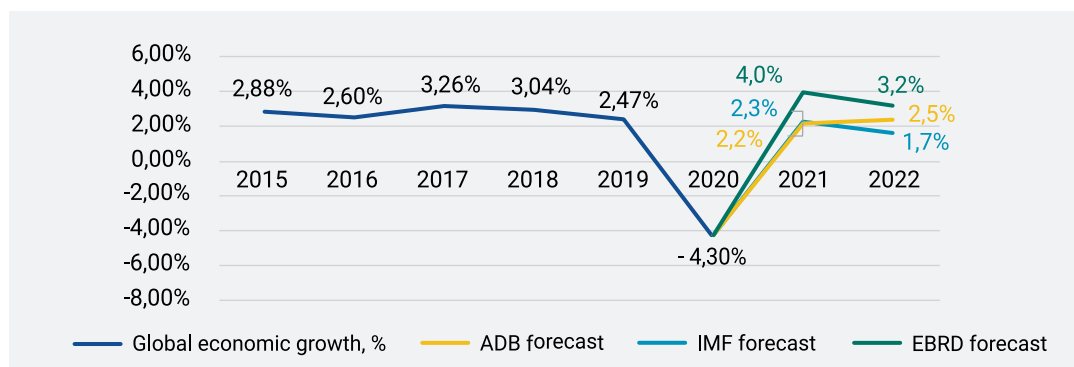
1.1 MACROECONOMIC OUTLOOK

The world continues its fight against the COVID-19 pandemic and its consequences which hold back the return to normal economic and social conditions and the full recovery of global economies. According to the International Monetary Fund (IMF), the global economy shrunk by 4.9% in 2020 and is expected to grow by 5.9% in 2021 and 4.9% in 2022.¹ The OECD forecasts 5.6% growth for 2021 and 4.5% for 2022² and the EBRD forecasts 5.5% growth in 2021 and 3.8% in 2022.³ Inflation and supply disruptions have hit both advanced and emerging economies, becoming an additional challenge for economies in 2021. In October-November 2021 inflation reached 5% in Germany and the UK, 2.8% in France, 3.7% in Italy, and 6.5% in the USA.⁴

Azerbaijan is an upper-middle-income country rich with oil and gas natural resources, which remains backbone of the economy, contributing around 35% of GDP and 90% of exports. The country has an ambitious agenda of diversifying its economy, giving a bigger role to non-oil sectors. Since 2016 Azerbaijan has implemented a broad agenda of reforms to enhance the business environment, strengthen non-oil sectors and support SMEs. As in other countries, the economy of Azerbaijan shrunk due to the COVID-19 pandemic in 2020, with a decline of 4.3%. The decline in the hydrocarbon sector reached 8.7% and the non-oil sector 2.6%. The government undertook measures to protect citizens and businesses including a package of support to the private sector worth 4.6% of GDP in 2020 and 0.3% of GDP in 2021⁴. The package included wage coverage, extended support measures related to taxes and loans for business, state guarantees and subsidies for existing loans, amongst others. It has also actively promoted the vaccination of citizens.

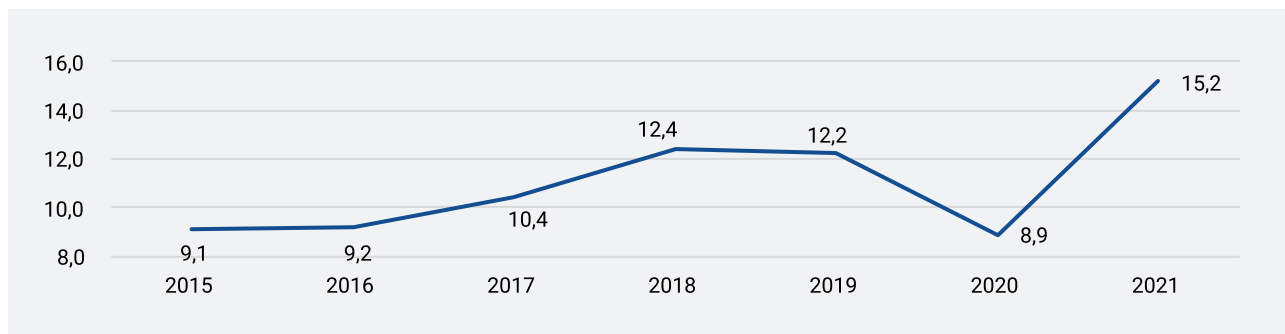
In 2021 Azerbaijani economy started its recovery. According to the State Statistical Committee, in January-November 2021, GDP increased by 5.3% in real terms compared with the same period of 2020. The growth of GDP in non-hydrocarbon sectors reached 6.4% compared to the same period in 2020.⁵ The IMF estimates GDP growth of 2.3% in 2021 and 1.7% in 2022⁶; the Asian Development Bank (ADB) estimates a growth of 2.2% in 2021 and 2.5% in 2022.⁷ The EBRD remains more optimistic in its forecast, estimating growth of 4% in 2021 and 3.2% in 2022.³ (Figure 1.1) According to the Ministry of Economy of Azerbaijan and Trading Economics, GDP for 2021 is expected to reach USD 50 bn.⁸

FIGURE 1.1 GDP dynamics in Azerbaijan (in percent per annum)



SOURCE: IMF, ADB, EBRD.

FIGURE 1.2 Turnover between Azerbaijan and the EU, bn. USD



SOURCE: The State Statistical Committee of the Republic of Azerbaijan

According to the Ministry of Finance forecast, the state budget revenues in 2022 will reach USD 15.5 bn., while expenditures will be USD 17.04 bn., resulting in a fiscal deficit of USD 1.5 bn. Inflation in the country in September 2021 reached 8.5% compared to 2.8% in 2020. International reserves remained relatively stable, at USD 7.0 bn. in September 2021, covering almost eight months of import³. Fitch rated Azerbaijan's debt at "BB+" in November 2021 (stable compared to 2020), however, the outlook improved from negative to stable.⁹

SME sector

The economic potential of SMEs in Azerbaijan remains underdeveloped. In 2020 there were 316,500 registered micro-, small and medium entrepreneurs, some 16.7% more than in 2019. SMEs accounted for 26.3% of non-oil exports in 2020. According to the OECD SME Policy Index 2020, SMEs generated 13.4% of value-added and 42.9% of total employment in 2018, compared to 60% of value-added and 60-70% of employment in OECD countries. As a share of the non-oil economy of Azerbaijan, SMEs generated 23.5% of value-added and 45% of employment¹¹. The government of Azerbaijan continues its support to the sector by strengthening SME development policy and infrastructure. The Strategic Vision 2025 sees the SME sector contributing 60% of national GDP, 70% of total employment and 40% of total non-oil exports.¹² The objective was also confirmed in "Azerbaijan 2030: National priorities for socio-economic development", which foresees further improvement of the business environment for the development of the SME sector.¹³ In 2021 the SMBDA continued expanding its services and infrastructure on a central and regional level, e.g., SMB Houses, SMB Friends, SMB Support Centres, etc.¹⁴

TABLE 1.1. Main economic trends in Azerbaijan 2021

EXPORT	Total export in 2019 was 19.6 bn USD, non-oil export 1.9 bn. USD Total export in 2020 was 13.7 bn USD, non -oil export 1.9 bn. USD Total export in 2021 (January – October) was 16.8 bn. USD, non-oil export 607.2 mln. USD
FOREIGN TRADE	Foreign trade turnover was 20.1 bn. USD during the first 8 months of 2021.
CONSUMER ACTIVITY	Consumer price index reached 176.9 by October 2021
INFLATION	Inflation grew moderately and remained at the level of 2.8% in July 2020, while it reached 11.1% in November 2021
EMPLOYMENT	Unemployment in 2020 was 6.27% and 6.4% by August 2021

SOURCE: World Bank¹⁰, State Statistical Committee of Azerbaijan

Cooperation with the EU

Azerbaijan is a strategic partner for the EU and an attractive market for European investors. The country plays an important role in the diversification of EU energy resources by bringing Caspian gas to the EU market. Since December 2019, a new TAP started its work within SGC and as for December 2021 delivered over 7 bn. cubic meters of Azerbaijani gas to the EU.¹⁵

The EU remains one of the largest trade partners for Azerbaijan. Total trade between the countries has grown since 2015 reaching about USD 12.2-12.4 bn. in 2018-2019. Following a COVID-19 related decline in 2020, trade rebounded in 2021, with a 70% increase and reached record USD 15.2¹⁶ (Figure 1.2), which is around 45% of the total turnover of the country this year. Amongst the EU countries with the biggest share in Azerbaijani import this year are Germany, Italy, France, Poland and Romania. Azerbaijan exports the most products to Italy, Croatia, Germany, Portugal and Spain.

The EU supports reforms in Azerbaijan, which lead to economic modernisation, diversification, and social development. The cooperation includes support to the population and the government with a focus on good governance, rule of law, fight against corruption, development of skills, and other measures. During recent years, the focus on climate change was also strengthened within bilateral cooperation. The projects implemented within the regional EU4Climate¹⁷, EU4Energy¹⁸, and EU4Environment¹⁹ initiatives aim to support Azerbaijan in the development of favourable policy and business environment for a sustainable and green economy. The EU4Digital supports the government and private sector towards digitalisation and strengthening cooperation on digital aspects both between EaP countries and with the EU.²⁰

The projects within EU4Business regional initiative support the SME sector in Eastern Partnership countries by improving access to finance, better business regulations, and trade opportunities. According to initial data reported in 2020, the total EU budget of EU4Business projects was EUR 56.1 mln. with 41% for access to finance, 33% better business development services, and 26% improving business environment. Around 17,600 SMEs were supported, and 1,275 jobs were created as a result of the activities implemented by 30 EU4Business projects in Azerbaijan.²¹ The EBRD²² and EIB²³ provide a line of lending and advisory products for the private sector to support SMEs producing innovative, sustainable, or high value-added products.

The list of the EU-funded projects supporting the private sector in Azerbaijan is available in [Annex 2](#).

The Eastern Partnership (EaP) Trade Helpdesk was established during the meetings as a part of EU4Business initiative. Launching of the Helpdesk is expected in spring 2022 and is expected to help boosting trade between the EaP countries and the EU.

On 15 December 2021, the heads of state of the governments of Armenia, Azerbaijan, Georgia, Moldova, and Ukraine, the representatives of the EU, and the heads of state or government of its member states met in Brussels on the occasion of the 6th Eastern Partnership Summit. The discussions focused on five key areas – economy, governance, the environment, digital, and society.

EU will seek to enhance cooperation including on the basis of the Joint Communication 'Eastern Partnership policy beyond 2020: Reinforcing resilience – an Eastern partnership that delivers for all', and as a result of the comprehensive consultation with and contributions from Member States, Eastern partner countries and other Eastern Partnership stakeholders. Strengthening resilience remains the EU's overriding policy objective under agenda of 'Recovery, Resilience and Reform', structured around the two pillars of governance and investment.

The new agenda for EaP countries will be underpinned by the regional Economic and Investment Plan to foster sustainable development and leverage public and private investment using EU's innovative tools, including blending and guarantees. This plan contains a set of flagship initiatives for each of the partner countries. There are five flagship initiatives identified for Azerbaijan.²⁴

THIS SIGNIFIES CONCRETE PRIORITY PROJECTS WITH TANGIBLE RESULTS TO BE IDENTIFIED JOINTLY WITH THE PARTNER COUNTRY TAKING INTO ACCOUNT THEIR NEEDS AND AMBITIONS:

- **Flagship 1:** Green connectivity – supporting the green port of Baku
- **Flagship 2:** Digital connectivity – supporting the digital transport corridor
- **Flagship 3:** Supporting a sustainable, innovative, green and competitive economy – direct support for 25,000 SMEs
- **Flagship 4:** Innovative rural development
- **Flagship 5:** Smarter and greener cities.

WTO Accession

Azerbaijan continues its negotiations on World Trade Organisation (WTO) accession and embeds the WTO principles and rules into newly adopted trade-related legislation and the domestic normative framework. Based on the information provided by the Azerbaijani government to the Working Party Members in 2021, a new version of the draft working party report was circulated in July this year. The next meeting of the Working Party to review the progress of the negotiations is expected to take place in 2022.²⁵

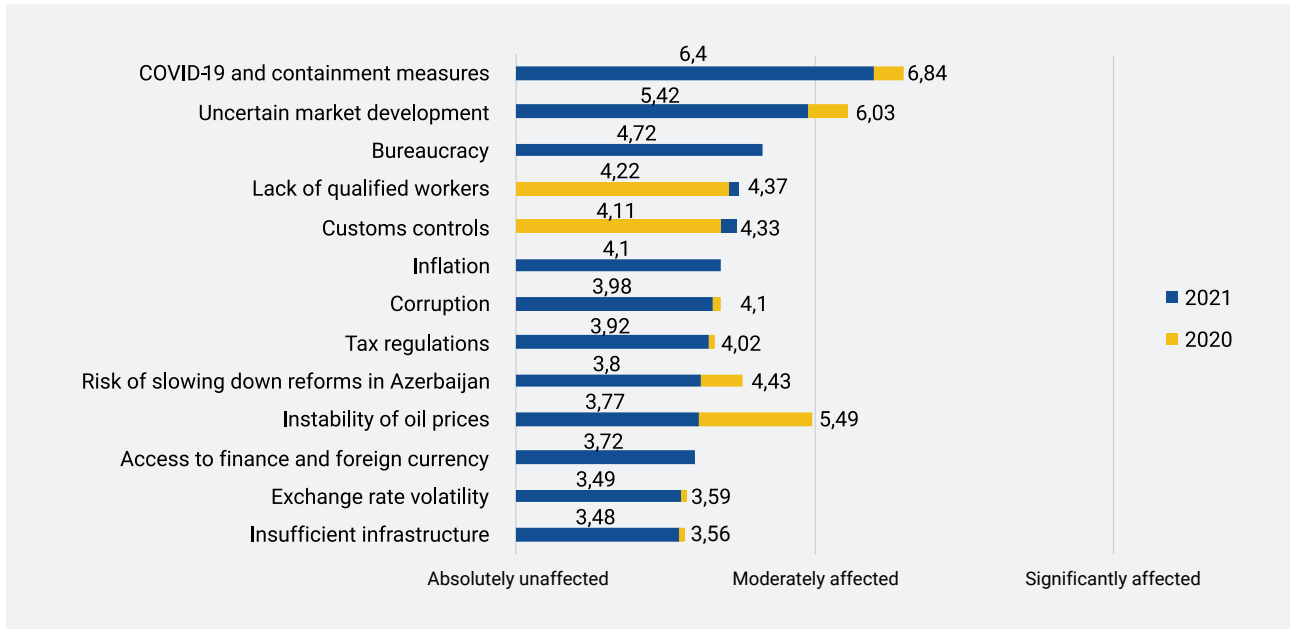
The European Union has continued its support to the government of Azerbaijan in the preparation of trade-related negotiations and the implementation of the domestic reform agenda. Since 2020 the EU-funded project "Strengthening the capacity of the government of Azerbaijan in the WTO Accession negotiations and other trade-related activities" has supported the preparation of new legislation, advised on institutional reforms and provided trade-related capacity building to the government of Azerbaijan and the private sector. Through this support, the European Union contributes to the development and implementation of a pro-active and modern trade policy in Azerbaijan and supports the country's economic strategy.

1.2 LOCAL BUSINESS CLIMATE: A SECTORIAL OUTLOOK

The 2021 survey reflects more optimism amongst European companies compared to last year. Improvements were tracked amongst the major indicators testifying to the start of the business recovery in the country. A growing share of the entities plan further expansion (53% compared to 47% in 2020) and about 80% of investors are ready to choose Azerbaijan again as a location for their business, which is comparable for the last year's result.

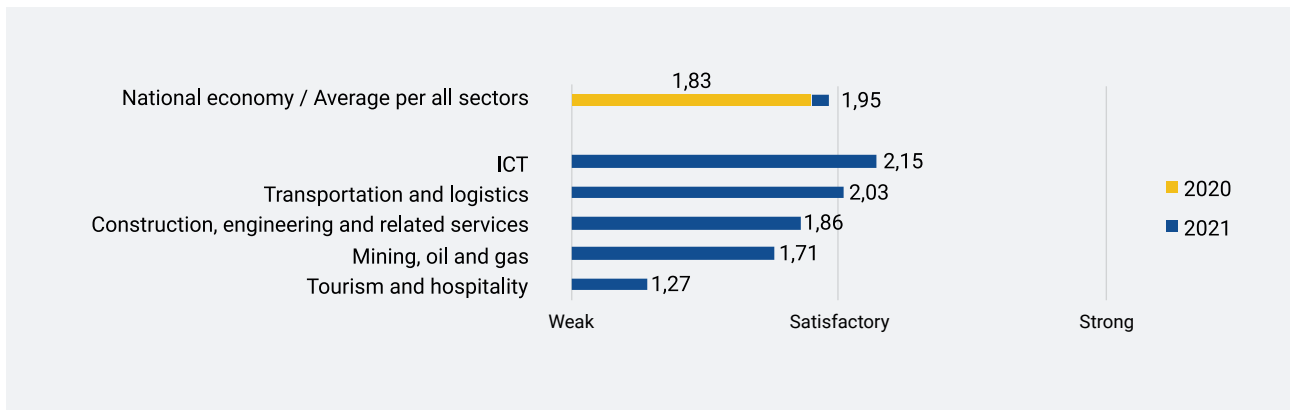
The most positive outlook and forecast this year were provided by such non-oil sectors as transportation and logistics, construction, engineering, and ICT. At the same time, entities working in the hydrocarbon industry remain affected by a combination of global and local factors. As in the rest of the world, tourism and hospitality businesses still experience the strongest consequences from the pandemic. European companies of all sectors provide similar views on the business environment in the country and appreciate the availability of the state support, especially the pandemic-related packages.

FIGURE 1.3 Impact of different factors on European companies in 2021



SOURCE: EU Business Climate Survey 2021

FIGURE 1.4 Views of European companies on economic situation in Azerbaijan and per sectors



SOURCE: EU Business Climate Survey 2021

Since Azerbaijan started deep reforms in 2016 aimed at economic diversification and enhancing business climate, the annual EU Business Climate surveys have tracked gradually growing satisfaction of European companies with the business environment in Azerbaijan every year. The positive trend was somewhat jeopardised in 2020 due to the COVID-19 pandemic, turbulence in energy prices, and uncertainty in the local market caused by a military conflict between Azerbaijan and Armenia. The 2021 survey brought a return to optimism for most of the factors influencing European companies. The COVID-19 pandemic remains the strongest factor affecting business, and the only factor that was considered by respondents to have impacted business more than "moderately" this year (Figure 1.3). This year, several factors significantly decreased their negative effects on the business climate compared to last year. Amongst them are "instability of oil prices", "risk of slowing down reforms in Azerbaijan", and "uncertain market development", which also testifies that the country is gradually returning to a more predictable development path. This year, European companies appeared to be more concerned only about the "lack of qualified workers" and "custom controls", which signals the need for further reforms in these areas.

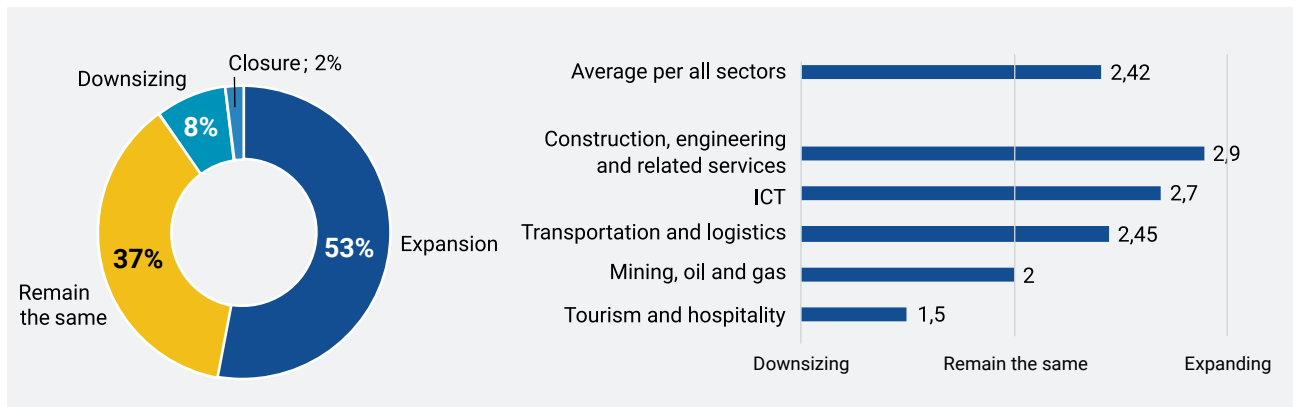
In general, European companies consider that the national economy is performing better this year than last, rating the economic situation at close to "satisfactory", on a scale of weak-satisfactory-strong (Figure 1.4). The pandemic opened new opportunities for companies operating in the information and communication technologies (ICT) sector thanks to increased digitalisation taking place globally. Representatives of the ICT sector seem to be the most optimistic about the situation in their sector in 2021 evaluating it somewhat stronger than those in other sectors and better than "satisfactory". During the interviews conducted within this study, the sector representatives confirmed their plans for further expansion due to the constantly growing demand for digital services.

The **ICT sector** in Azerbaijan demonstrated growth since 2020 reaching highest since 2016 share of value added within national economy (2%) as well as gross (2.2%) and net (1.9%) operating surplus.⁵ The results of the EU Business Climate Survey 2021 shows that the sector feels quite confident nowadays, optimistic about their future and less affected by the pandemic than other sectors.

In 2021 the mining, oil, and gas industry in Azerbaijan benefited from the growth of global prices and the start of commercial operation of a new TAP within the SGC, which provided direct access for natural gas from Shah Deniz gas field. By early December 2021, it had transported over 7 bn cubic meters of gas from Azerbaijan to Europe. However, responses provided by representatives of the sector seem to be somewhat more pessimistic than those from other sectors.¹⁵ The global pandemic and prioritisation of clean energies by emerging economies require serious reforms by fossil fuel companies. An ongoing transition period in the largest state-owned company of Azerbaijan SOCAR, which is shifting its management to Azerbaijan Investment Holding, put on hold some ongoing and planned projects.

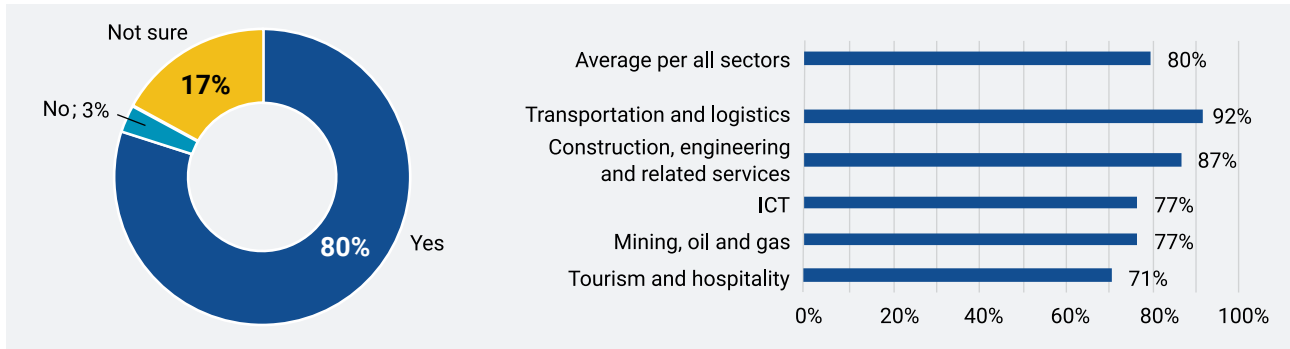
Mining, oil, and gas industries remain the backbone of the Azerbaijani economy, providing about 90% of total exports and about 35% of GDP. Around 60% of the state budget comes from the sector. The oil price shocks in 2014-2015 and 2020 highlighted the country's dependence on a single sector and brought political efforts to diversify the economy. The sector shrunk to 8.7% in 2020, and the EU Business Climate survey 2021 confirms difficulties still experienced by representatives of the sector due to a combination of global and local factors.²⁶

FIGURE 1.5 Plans of European companies for future development in Azerbaijan



SOURCE: EU Business Climate Survey 2021

FIGURE 1.6 Readiness of European companies to choose Azerbaijan as business location again



SOURCE: EU Business Climate Survey 2021

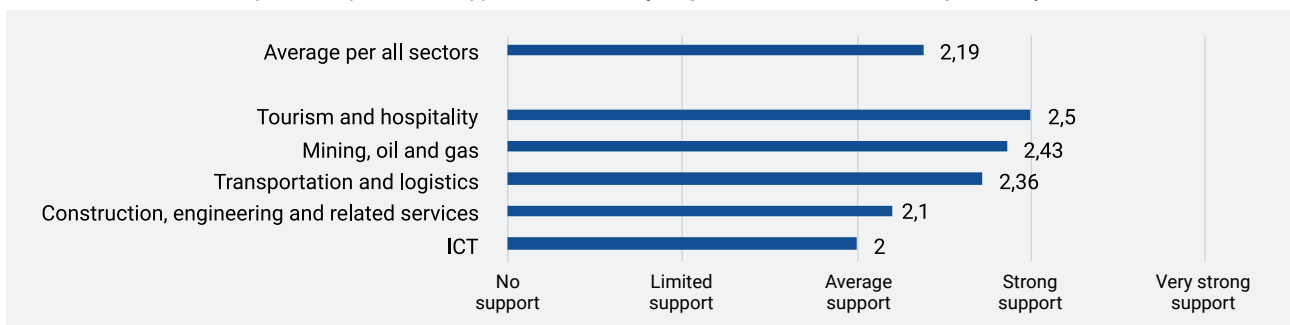
A traditional question addressed by the EU Business Climate Survey is devoted to plans of European companies for future work in the country. The responses in 2021 demonstrate a higher level of certainty and optimism than in 2020, with expansion planned by 53% of the respondents compared to 48% in 2020. Another 37% of the companies plan to remain the same size (26% last year). Around 10% of entities plan to downsize or exit from the market (similar to the last year) (Figure 1.5).

Significant sectorial differences exist regarding the companies' plans for further development in Azerbaijan. The construction and engineering sector looks to the future with the strongest optimism driven by the expectation of new projects, including newly announced opportunities in Karabakh and East Zangezur and other economic regions. Companies working in transportation, logistics, and ICT also foresee expansion driven by positive trends in these sectors. Entities working in mining, oil, and gas demonstrate some level of

uncertainty and rather intent to operate within existing capacities. The only sector predicting downsizing by the majority of its representatives was tourism and hospitality, which is suffering from the full range of pandemic effects.

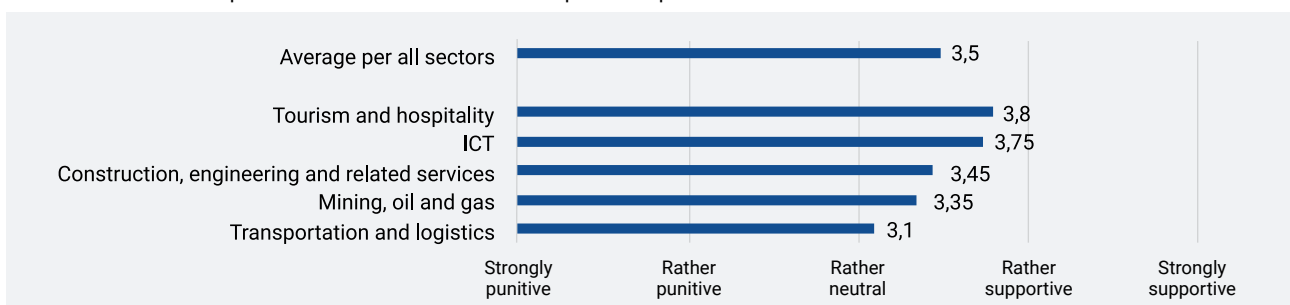
After several years of decline (by 15.2% in 2020, 6.1% in 2019 and by 8.8% in 2018), **the construction sector** in Azerbaijan demonstrate optimism and expect to grow in 2021 to about 9.1%. The industry is expected to continue its expansion at about 4.2-4.5% annually until 2025. The sector accounts for about 7% of GDP and the state budget in 2021 allocated AZN 2.2 bn (1.2 bn EUR) for the reconstruction of Karabakh and East Zangezur economic regions, which brought high expectations to the sector. The funds are expected to be spent on transport infrastructure, pipelines, civil construction etc.²⁷

FIGURE 1.7 Views of European companies on support from Azerbaijani government obtained during the last years



SOURCE: EU Business Climate Survey 2021

FIGURE 1.8 Attitude of public authorities in relation to European companies



SOURCE: EU Business Climate Survey 2021



As in last year, around 80% of European companies would choose Azerbaijan again as a location for their business. Amongst the sectors giving the highest score to this question (about 90%) are transportation and logistics as well as construction and engineering. Companies working in the ICT, mining, oil, and gas sectors provide close to the average responses followed by tourism and hospitality (Figure 1.6).

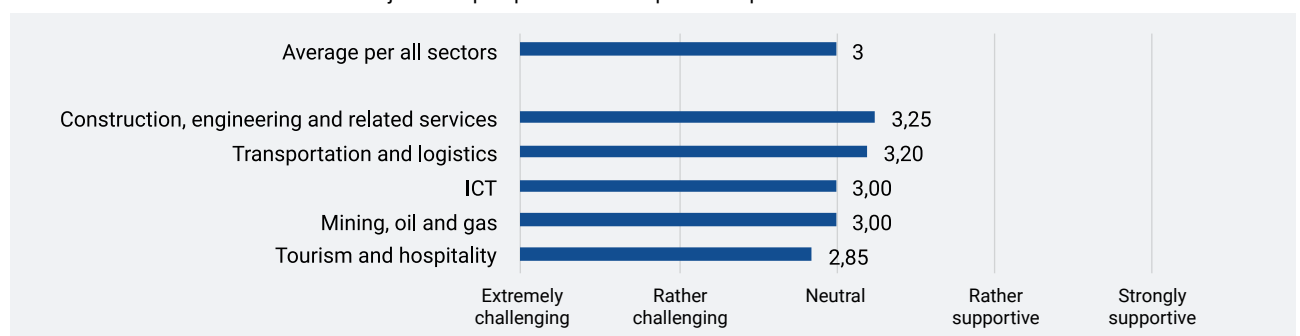
The transportation and logistics sector has seen continuous growth in the country over the last few years. The sector was prioritised for the country due to its favourable location connecting European and Asian markets. Another impulse to the industry came from railway and highway infrastructure development and ongoing reform in customs, which aims to minimise time and cost for clearance and increase cross-border traffic.

Transportation and logistics are considered a strategic sector and is one of the largest non-oil sector for Azerbaijan due to the location of the country, which allows it to build transport corridors connecting Europe and Asia. Despite the strong effect of the pandemic measures affecting passenger travels, the sector expanded in 2020, providing 7.1% value added to the national economy compared to 5.7% in 2019, and is expected to continue its growth in 2021. Azerbaijan continues to develop its transport infrastructure, attracting investments. The current transport infrastructure projects amount to about EUR 6.7 bn, which includes about EUR 2.7 bn. for the development of highways and EUR 1.8 bn. for railway infrastructure.⁵

European companies evaluated the availability of state support for business better than “average” (Figure 1.7). During the interviews, businesses emphasised that the pandemic-support packages were one of the most useful and accessible for a wide range of companies. The representatives of tourism and hospitality appreciated the support provided by the state more than others and evaluate it as “strong”. However, the sector remains affected by the pandemic, and the survey shows its evident lag in recovery compared to other industries across several dimensions. Another two sectors that see the state support as rather strong are transportation and mining, oil and gas. Companies working in ICT and construction feel less support while, evaluating provided measures as “average”.

The tourism and hospitality industry has been the most affected by the pandemic worldwide. According to the United Nations, World Tourism Organisation (UNWTO), international tourist arrivals in Europe in 2020 dropped by 69% compared to 2019 and remained at the same level in 2021 despite the lifting of the pandemic measures, travel restrictions, and global vaccination campaigns. In Azerbaijan, international tourist arrivals were down by 75% (in 2020) and 79% (in 2021) compared to 2019, almost back to 2011 levels.⁵ According to the UNWTO forecast, the sector is expected to reach the 2019 level not earlier than in 2023.²⁸

FIGURE 1.9 Business climate in Azerbaijan from perspective of European companies



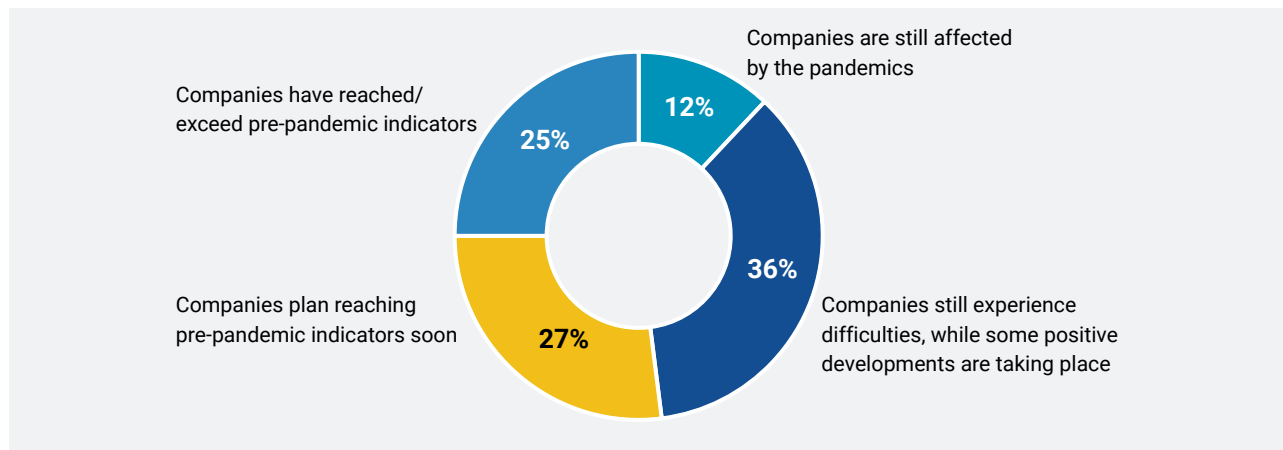
Despite obvious difference in the current economic situation in different sectors, European companies see the business climate in Azerbaijan at relatively similar level, as "neutral" (see Figures 1.8). The same is true regarding operational relations with public authorities (as bodies issuing licenses, permits, migration, tax authorities, etc.), which all industries describe as between "neutral" and "rather supportive" (Figure 1.9.). During the interviews, companies confirmed improvement in relations with public officers in Azerbaijan observed since 2016 due to increased digitalisation of public services together with attracting younger generations to work in public sector.

The obtained result gives a positive sign testifying neutrality of the state in approach to the different industries. However, the ambitious objectives of the country regarding economic diversification and the development of strong SMEs sector require a potent supportive business environment to enable rapid growth of the private sector. In this regard, the further reforms aimed to improve the country's business climate and develop a client-oriented mindset amongst the public authorities remain crucial.

1.3 BUSINESS RECOVERY DURING THE PANDEMIC

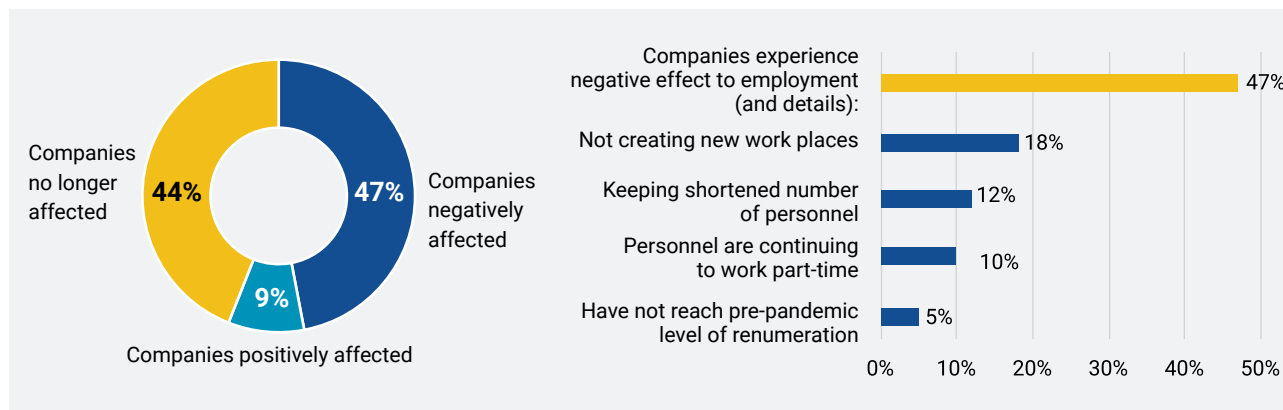
After the pandemic containment measures were lifted in Azerbaijan, 52% of European companies in the 2021 survey reported reaching outputs comparable to pre-pandemic levels. Another half of the respondents have not confirmed sustainable recovery yet and remain negatively affected in terms of economic outputs and employment conditions. Despite all measures undertaken to adapt work during the pandemic, business remains vulnerable to it. In case of a renewal of the containment restrictions, about 90% of European companies foresee negative consequences for their operations. Business remains most sensitive to measures mandating distant work for personnel, closure of international travel, and limitations on gatherings. To reduce risk of new pandemic waves, most European companies (88%) undertake a pro-active position in promoting and supporting the vaccination amongst their personnel.

FIGURE 1.10 Conditions of European companies after the quarantine measures were lifted in Azerbaijan



SOURCE: EU Business Climate Survey 2021

FIGURE 1.11 Remaining effect from the pandemics on employment and work conditions in European companies



SOURCE: EU Business Climate Survey 2021

Despite the tremendous effect of the pandemic on the economy, the SME sector demonstrates a high ability to recover. In the EU Business Climate Survey 2020, about 80% of European companies confirmed negative effects on their economic results, including profit, international and national turnover. In the 2021 survey after a few months since the pandemic related measures were lifted in the country, over half of the European companies say that they reached or plan to reach soon their pre-pandemic level of output. However, other businesses are still affected: about 36% of the respondents experience some difficulties, while for 12% the negative effect from the pandemics is still significant (Figure 1.10). From the sectorial perspective, the most pessimistic responses were provided by representatives of tourism and hospitality and mining, oil and gas entities. At the same time ICT, construction and engineering seem to be less affected or the fastest recovering sectors.

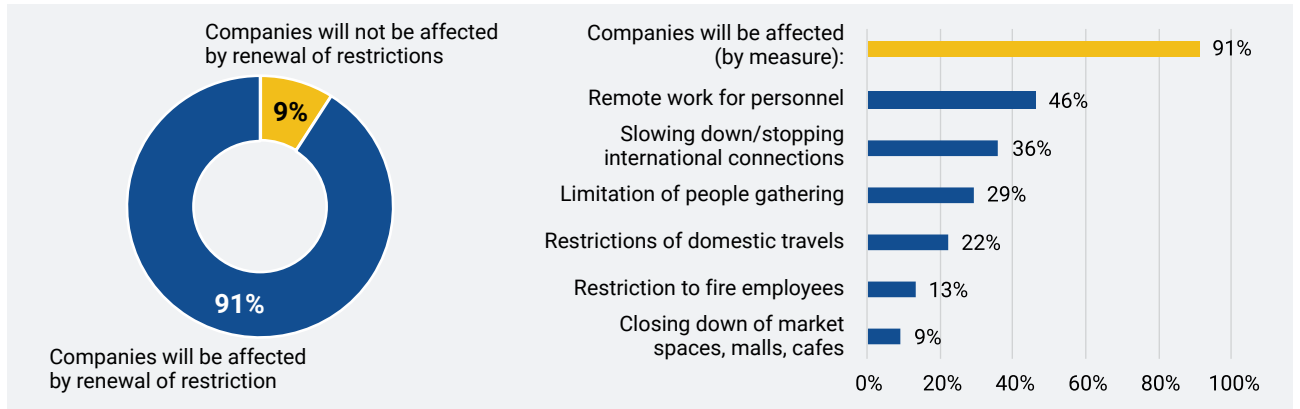
Negative effects from the pandemic on employment and work conditions were reported this year by 47% of the responding European companies (compared to 63% in 2020). Around 20% of the companies avoid the creation of new workplaces (42% in 2020), and about 10% of respondents maintain reduced personnel numbers or part-time employment (compared to 37% in 2020). In about 5% of the respondent companies, remuneration still has not reached the pre-pandemic level (compared to 33% last

year) (Figure 1.11). A significant share of the respondents which confirmed several negative labour market impacts were in the tourism and hospitality sector.

Despite all measures undertaken by the companies to adapt for work during the pandemic-containment restrictions, over 90% of the companies indicate that they will again be negatively affected in case of a new pandemic wave resulting to renewal of the containment measures. Measures particularly affecting European investors include remote work for personnel and limitations of international connections and people gathering (Figure 1.12).

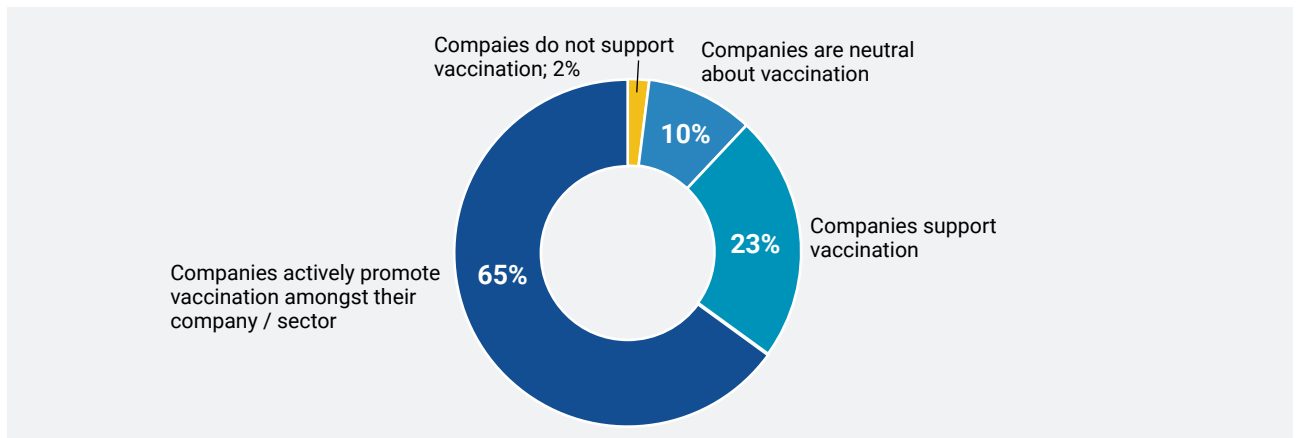
The vaccination of the population remains the most effective solution reduce effect from the pandemic to economies and life of the population. Hence, undertaking a successful vaccination campaign became a crucial task for all countries in 2021. According to the World Health Organisation (WHO), by December 2021 about 51% of the Azerbaijani population at age over 18 had received at least one dose of vaccine and 46% had received two doses.²⁹ The private sector in Azerbaijan supports vaccination and helps to promote it, as it is crucial to ensure stable work in most of the sectors. According to the 2021 survey, 65% of European businesses actively promote and 23% support the vaccination of their personnel. Only about 10% of companies remain neutral about it and 2% do not support the vaccination (Figure 1.13).

FIGURE 1.12 Forecast of European companies in case of renewal pandemic restrictions



SOURCE: EU Business Climate Survey 2021

FIGURE 1.13 Position of European companies on employees' vaccination



SOURCE: EU Business Climate Survey 2021

1.4 INVESTMENT CLIMATE AND OPPORTUNITIES

As in the rest of the world, FDI in Azerbaijan declined since the beginning of the pandemic, however, the local investment climate remains relatively stable in 2021. Access to domestic markets and strategic partnerships were traditionally chosen as main drivers attracting investors. In 2021 businesses emphasised growing political, social, and economic stability in Azerbaijan, and appreciated new investment treaties. As in previous years, several factors make the investment climate in the country challenging. These include rule of law, transparency of public procurement, and access to finance, all of which were evaluated low. Moreover, both indicators related to customs declined in 2021 compared to 2020.

New opportunities in Karabakh and East Zangezur economic regions were announced in 2021 accompanied by a promising budget that raised the interest of European companies. Over half of the respondents are ready to consider these territories for investment and looking forward to more details and the projects to be announced. Amongst the most attractive profiles for these territories, European investors choose civil construction, green and alternative energy projects, and transport infrastructure.

The world pandemic brought a sharp downturn in investment worldwide. The United Nations Conference on Trade and Development (UNCTAD) estimated that global Foreign Direct Investments (FDI) declined by 35-40% in 2020.³⁰ The OECD reports the same recovery in 2021, with FDI more than double 2020 levels (in the year to October 2021) and 43% higher than in pre-pandemic 2019 year.³¹

Investments in Azerbaijan have been slowing since 2017, and the negative effect from the pandemic in 2020 hit FDI even more, resulting in investments being 60% down compared to 2019. According to UNCTAD, FDI fell by two-thirds compared with recent years. FDI inflow to Azerbaijan fell to USD 507 mln. in 2020 compared to USD 1.5 bn. in 2019, while FDI outflows were just USD 825 mln. in 2020 compared to USD 2.4 bn. in 2019.³⁰ The Central Bank of Azerbaijan reports more encouraging results saying that the FDI inflows in 2020 increased from USD 4.2 bn. in 2019 to USD 4.5 bn with 86% of the funds going to the oil and gas industry, while the FDI to the non-oil sector fell to USD 606 mln. compared to almost USD 1 bn. in 2018 and 2019. The Central Bank also reports FDI growth of about 7% in the first nine months 2021 compared with the same period previous year, reaching to USD 3.7 bn.³²

Azerbaijan has bilateral investment and double taxation treaties with about 50 countries, including the majority of the EU member states, as well as Free Trade Agreements (FTAs) with several EaP, Central Asia countries, and Turkey. The country is holding an ongoing accession process with the WTO, which will further increase its attractiveness for European investors. The Investment Promotion Document (IPD) allows obtaining tax and customs holidays in the country for a period of seven years. Several industrial areas are operating and continuing their development in the country, which includes five industrial parks, four industrial quarters, and two hi-tech parks. The areas provide investors with lower rental rates, simplified administrative procedures and exemption from property tax, land tax, tax on income or profits for 10 years from the date of registration, and VAT on the import of machinery, technological equipment, and machines imported for production purposes, and customs duties for seven years.ⁱ

Atatürk Free Economic Zone (AFEZ) is currently developing and one of the promising industrial zones established next to Port of Baku to encourage local and foreign investment in the country's non-oil sector. AFEZ is covering an area of 850 hectares and is expected to start receiving investors in July 2022. Core clients of AFEZ are businesses engaged in high value-added and export-oriented manufacturing and services, internationally traded activities, using innovative technologies, and management experience. Businesses located within AFEZ are eligible for incentives, which include exemptions from value-added tax, withholding tax, or other corporate tax. Foreign skilled personnel in AFEZ are exempt from personal income tax, social security payments, and other similar taxes and payments. Import and export of any products or services from/to a foreign are exempt from customs duties and taxes, including value-added taxes. Foreign companies are allowed to remain, sole shareholders.³³

Access to the local market was chosen this year by 72% of investors as a factor attracting them to the country and by 80% of respondents in 2020. As during last year's survey, strategic partnership and alliances remain important for investors with 65% of 2021 respondents indicating this was a factor in their investment decision. The available investment treaties are becoming more visible and appreciated by the investors. 27% of European companies mentioned available in-country incentives as an attractive factor in 2021 compared to 17% in the previous year. Another positive trend is the strengthening of investors' focus on access to technologies or knowledge in Azerbaijan, which was chosen by 28% of respondents this year compared to 16% in 2020.

ⁱ More details on available investment treaties and industrial areas are available at the website of AZPROMO www.azpromo.az

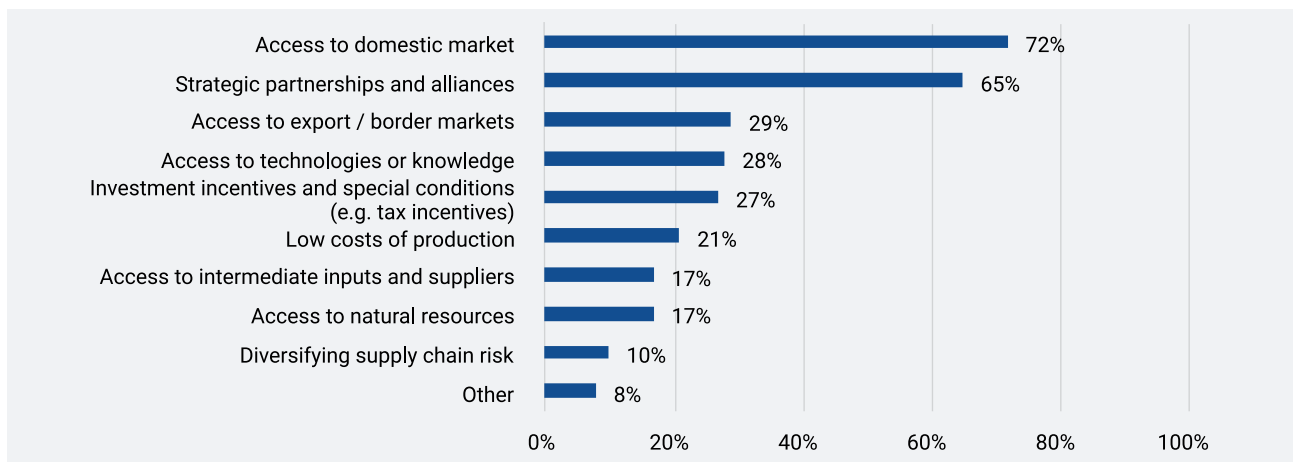
At the same time “access to export and border markets” is becoming less important and was mentioned by less than 30% of the respondents, compared to 37% in 2020. Other factors motivating investors include “low cost of production”, “access to intermediate inputs and suppliers”, “access to natural resources” and “diversification supply chain risk” remain the least important, similar to the last year’s results (Figure 1.14).

Every year the EU Business Climate Survey asks European companies to rate key indicators of the investment climate in Azerbaijan on a scale of weak-satisfactory-strong. This makes it possible to understand the general trends as well as the comfort of foreign investors implementing investment projects in the country (Figure 1.15). The survey captured the range of turbulences in 2020, but many indicators improved in the 2021 survey. For example, both “political and social stability” and “predictability of economic policies” improved in 2021, reflecting increasing predictability in the local

environment. Indicators on **migration, taxation policies, labour market**, and infrastructure of the country continue their moderate growth and are considered by investors as “satisfactory”. An obvious improvement in the eyes of European companies were the “**measures to eliminate corruption**” (from 15th place in 2020 to 11th place in 2021) as well as “**quality of vocational education**” (from 18th place in 2020 to 13th place in 2021). The positive dynamics of both indicators were driven by ongoing local reforms on digitalisation in the public sector and starting up a new VET system and infrastructure.

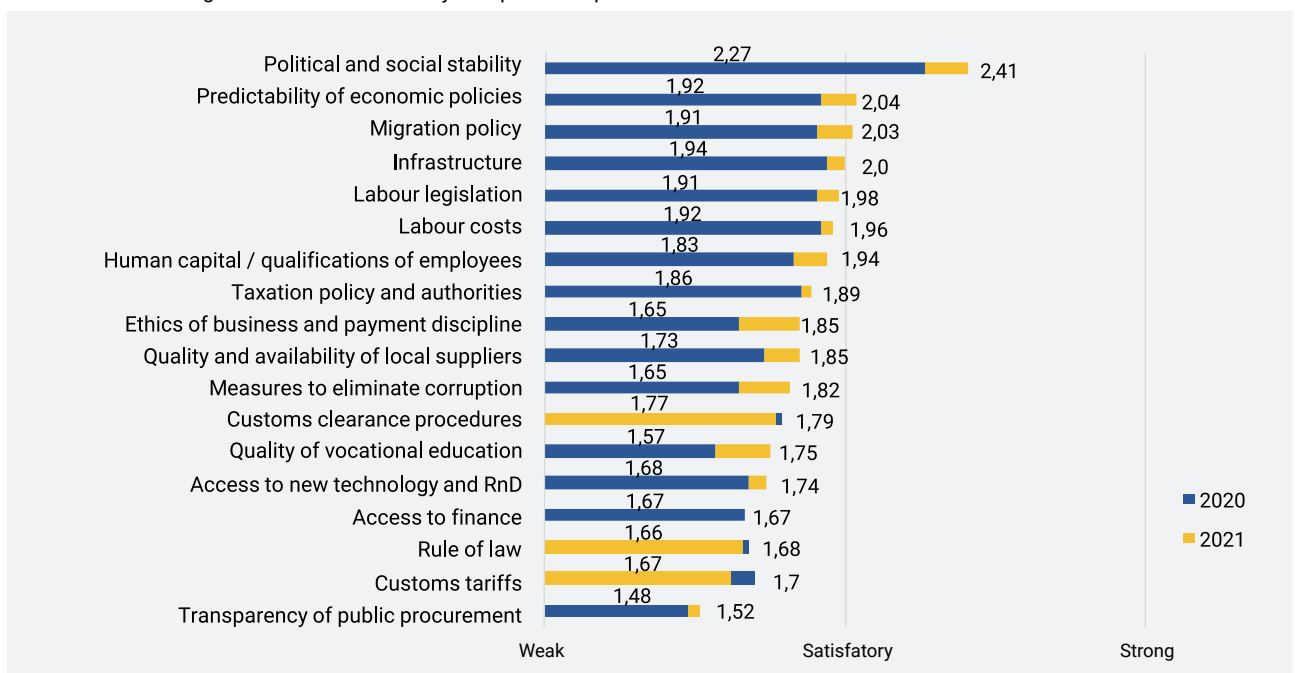
Despite the overall recovery demonstrated by the investment environment in 2021, several indicators continued their negative trends. For example, a “**rule of law**”, dropped from 13th place in 2020 to 16th in 2021, and “**access to finance**”, also moved one place down. As last year, “**transparency of public procurement**” holds the last position with somewhat higher results compared to 2020.

FIGURE 1.14 Factors attracting European companies to invest and/or do business in Azerbaijan



SOURCE: EU Business Climate Report 2021

FIGURE 1.15 Ranking of the local indicators by European companies



SOURCE: EU Business Climate Report 2021

This confirms the remaining challenges in regard to these aspects of the business environment and the growing need for their further prioritisation for improvement. (More details are available in Section 2.2.)

Year after year local suppliers keep improving, making foreign investors less dependent on offshore supplies. Over 20% of European investors confirmed their satisfaction with local suppliers this year. Amongst the indicators that demonstrated the strongest improvement is “ethics of business and payment discipline”. This aspect increased its positions to 9th position from 16th in 2020. A majority of investors see the need for further improvement of local suppliers. Priority challenges remain level of skills or capabilities, professionalism, and quality standards (Figure 1.16).

New investment opportunities in Karabakh and East Zangezur economic regions were announced by the government of Azerbaijan at the beginning of 2021 accompanied by a substantive budget of USD 1.3 bn. and in 2022, government plans to spend the same amount (USD 1.3 bn.)³⁴. The funds will be allocated for projects on the development of infrastructure, green/alternative energy projects, and cultural elements in the regions. In December 2021, President Ilham Aliyev announced the construction of a railway along the Zangezur corridor, which will restore the direct connection between Nachkhivan and the mainland³⁵. Moreover, the government announced the foundation of two industrial parks in the regions calls Aghdam industrial park and “Araz Valley Economic Zone” expected to further expand the investment opportunities of foreign companies. According to the latest statement of the Minister of Economy, as of November 2021, about 10 projects amounted to over EUR 20 mln. has already been submitted to the Ministry for the registration in the new industrial areas.³⁶ The economic regions actively developing their transport infrastructure. A new International Airport was built in the Fizuli district of Karabakh in 2021, and the construction of two more airports in Lachin and Zangilan is planned soon, which will promote the development of tourism in the region. The highway connecting Fizuli and Shusha was built in 2021 and the construction of Horadiz - Agband railway has been launched in February of 2021 which is planned to be completed at the end of 2022.³⁷

The concepts of “smart cities” and “smart villages” are expected to be important for the development of the economic regions. The foundation of the pilot “smart village” supplying the population with alternative sources of energy was laid in Aghali village of Zangilan district in 2021. The construction of 200 eco-houses, a smart school for 360 pupils, and a kindergarten for 60 children³⁸ is planned. The first large agreement on cooperation for the construction of a 240MW solar power plant in the Zangilan/Jabrayil regions was signed between the Ministry of Energy and BP on 3 June 2021³⁹.

Aghdam Industrial Park was established in May 2021 by Presidential Order.⁴⁰ The industrial park will cover an area of 190 hectares, and as of December 2021, 74 hectares have been cleared of mines. The Park will consist of 33 large enterprises as well as small manufacturing and service businesses working in the industry, construction, logistics, food production, etc. It is expected that about USD 110 mln. will be invested in Aghdam with the creation of 330 jobs. According to the statement of the Agency for the Development of Economic Zones, initially up to USD 14.7 mln. is planned to be invested into Aghdam Industrial Park, and up to USD 58.8 mln. will be spent at a later stage.⁴¹

Araz Valley Economic Zone will be created in the East Zangezur economic region and cover a territory of 200 hectares. The establishment of the industrial area is prescribed by the Presidential Decree of the Republic of Azerbaijan dated 4 October 2021⁴². So far, about 105 hectares (52%) of the territory have been cleaned from mines. The industrial park will provide the necessary infrastructure for carrying out entrepreneurial activities by organising logistics and applying modern technologies, manufacturing, processing (recycling), and sale of competitive industrial products which will be used for the provision of services, contributing to the effective work and development of entrepreneurship.

FIGURE 1.16 Feedback of European investors on local suppliers



According to the EU Business Climate Survey 2021, over half of the European businesses (54%) report interest in possible investments in Karabakh and East Zangezur economic regions. However, only 14% of the companies have already taken steps towards future investments, while 40% are still waiting for a good opportunities and announcement of the projects. 34% of the respondents are not yet considering investments in the economic regions, but are open for such possibility in future and only 12% of European businesses do not consider investment opportunities to the economic regions (Figure 1.17).

Civil construction, alternative energy, green projects, and transport infrastructure are amongst the most attractive profiles for investments in Karabakh and East Zangezur economic regions and were chosen by over 30% of the respondents. Agriculture and manufacturing were prioritised by a quarter of European companies and may also be considered as a promising direction for investment in these regions (Figure 1.18.).

During interviews, European companies emphasise that lack of information and details about available or planned investment projects remains the main inhibitory factor, which does not allow start investment planning and bring the investment intentions to practical stage.



Without doubt, European companies are interested in investment opportunities in liberated territories, especially related to the development of “smart cities” and alternative energy projects. However, after announcements of the general concept has been made by the government, further communication with the private sector was very limited. As of today, there is no clarity about available or planned investment projects, so the companies start shifting their focus toward more certain opportunities.”

CEO of a European construction company

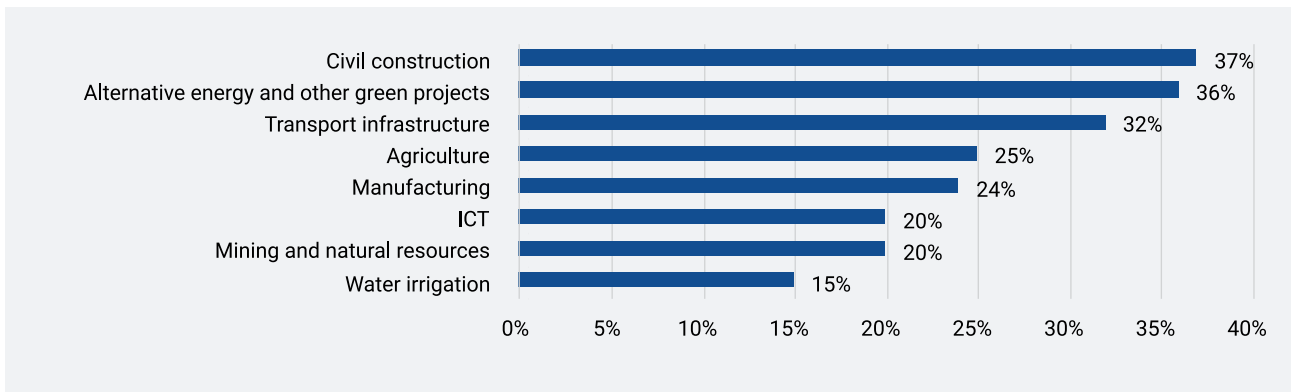
FIGURE 1.17 Readiness of European companies to invest to Karabakh and East Zangezur economic regions



SOURCE: EU Business Climate Report 2021

As part of the economic investment plan, the European Union is going to allocate a financial package of EUR 2 bn. to Azerbaijan in early 2022. The EU confirms its readiness to participate in the process of restoration and reconstruction work carried out in Azerbaijan, to contribute to the establishment of peace in the South Caucasus, and to support efforts to reconcile the parties. The EU is also ready to provide financial and technical support in the process of delimitation and demarcation of borders, and demining territories. With this regard, the transparency of public procurement in Azerbaijan is again gaining more attention. It remains important to align the existing procedures of the procurement with good international practice to ensure effective implementation of the EU economic investment plan.

FIGURE 1.18 Investment profiles considered by European companies in Karabakh and East Zangezur



SOURCE: EU Business Climate Report 2021



Azərbaycan Respublikasının
Kiçik və Orta Biznesin
İnkişafı Agentliyi



Azərbaycan Respublikasının
Kiçik və Orta Biznesin
İnkişafı Agentliyi

2 REFORMS IMPLEMENTED IN AZERBAIJAN

2.1 PROGRESS WITH LOCAL REFORMS

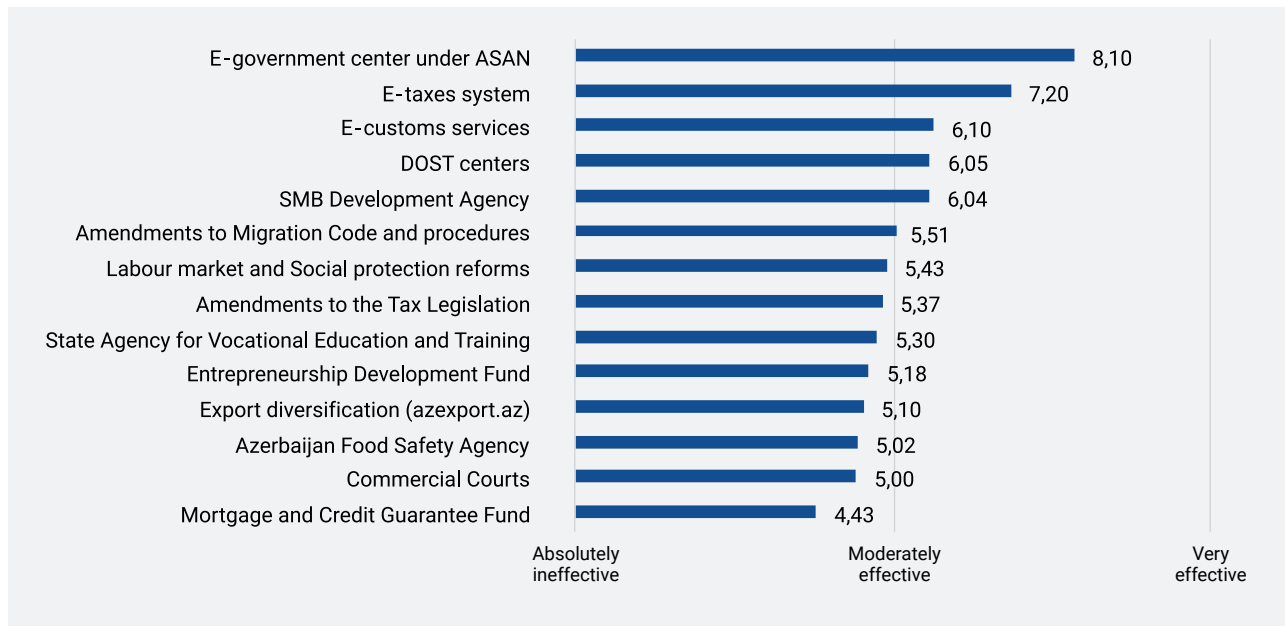
The digitalisation of public services traditionally remains at the top of the local reforms' ranking in the 2021 survey. The **ASAN** and **E-tax** platforms confidently hold the top lines as stable and easy-to-use tools, effectively implementing their tasks as well as reducing bureaucracy, speeding procedures and enhancing transparency. E-customs is one of the most anticipated reforms for foreign businesses and is ranked as the third most effective reform for the second year in a row. Meanwhile, the customs-related procedures obtained more criticism this year due to the slow elimination of the technical issues related to the e-platform as well as still time-consuming decision-making procedures at the operational level.

European companies positively evaluate the work of the **DOST** centres, which provide social and labour-related services and continued expansion of their branches in 2021. **SMBDA** became the breakthrough of the year and was considered among the top-5 reforms in the survey. The Agency effectively expanded its portfolio of initiatives and infrastructure in regions, ensuring access of SMEs to its supporting network. Despite the challenges caused by closed borders and quarantine, the **State Migration Service** of Azerbaijan remains true to its client-oriented approach during the period of uncertain personnel rotation. Although the market did not feel the improvement in terms of access to qualified workers yet, the companies remain optimistic about reform on new **VET** infrastructure and expect the new training eco-system to scale up its work to cover the accumulated needs.

As a response to turbulence in the oil and gas sector in 2014-2015 causing negative consequences for the Azerbaijani economy, the government took a strategic decision to promote economic diversification and reinforce non-hydrocarbon sectors. Since then, the country has implemented reforms designed to improve the business environment, attract foreign investors and strengthen SMEs working in non-oil sectors. The policy foundation for reforms became the Strategic Roadmaps (2016)¹² as well as updated "Vision 2030: National priorities for robust socio-economic development in Azerbaijan"¹³ adopted in February 2021. Since the first reforms had been launched, European companies have shared their views and insights on the ongoing progress and effectiveness of recently established bodies. Results obtained in 2021 are reflected in Figures 2.1. and 2.2.

As in previous years, reforms aimed at digitalising public services obtained the highest appreciation of the business community. Since 2016 European companies have chosen the **ASAN** as the flagship reform. It operates with the support of the E-Gov Development Centre, significantly reducing bureaucracy, speeding public procedures, and reducing corruption risks. When comparing ASAN with other available digital platforms, European companies emphasise clarity of procedures and a client-oriented approach aspiring to satisfy individual or company requests.

FIGURE 2.1 Views of European companies on ongoing local reform and recently established bodies



SOURCE: EU Business Climate Survey 2021

European businesses usually use the ASAN platform for company registration and obtaining licenses and permits, e-signature (ASAN-Imza), migration and visa-related services (ASAN Visa) as well as obtaining permissions for off-line workers during strict COVID-19 containment quarantine.

During the last year, ASAN continued to expand its initiatives for enterprises. In addition to ASAN Support to Family Business (ABAD) Programme in February 2021 a new “Azerbaijan 500 ASAN start-up programme” was launched within a partnership of State Agency for Citizen Services and Innovations and “500 Startups” company and sponsored by Pasha Holding. The initiative provides support to Azerbaijani start-ups to enhance their knowledge and skills as well as facilitating access to investors. It also contributes to the overall development of the innovation ecosystem and infrastructure in the country.⁴³ The program consists of online and offline trainings and events for start-ups. In total, 367 participants were selected among 1268 applicants. In the final phase in September 2021, 10 start-up teams presented their projects to investors.⁴⁴

Efforts to reform taxation also continue to receive positive feedback from European companies. Respondents reported the growing effectiveness of **E-taxation**, which reduces the time for tax reporting and remains crucial for fighting the shadow economy. During interviews, European investors describe E-taxation as a user-friendly and stable platform sufficient for their operational needs. Companies are also satisfied with the responsiveness of tax authorities to individual requests for technical clarification as well as on fixing technical issues at the e-platform. **New Amendments to the Tax code**⁴⁵ were introduced in December 2021 and came into force in January 2022. In line with positive changes bringing more clarity to international taxation, the changes

introduced the Controlled Foreign Company concept, as well as some exemptions in VAT, offshore, and other taxes, several serious steps have been taken to reinforce controlling mechanisms and reporting requirements which are expected to increase accounting workload. The new legal act has also significantly expanded the rights of tax authorities for identifying tax evasion schemes including previously audited periods as well as added obligations of taxpayers and increased financial sanctions for violations. The new measures were a logical continuation of efforts to tackle the shadow economy, and their efficient implementation will require impartial and effective supervision from the government to avoid abuse and punitive behaviour from tax officers towards business, which was slowly improving over the last five years and have just started to positively impact the local business-climate.

The launching of e-services at customs has been one of the most anticipated reforms by foreign businesses since 2016. It aims to reduce time and cost for customs clearance procedures. The **E-customs and Green Corridor** started their full operations in 2018-2019 and received strong appreciation the companies in the EU Business Climate Report 2020, especially thanks to the elimination of brokers and reduction of corruption risks and operational costs and time for clearance.⁴⁶ E-customs remain in the top-5 reforms in 2021, although with a somewhat lower score than last year (6.1 compared to 6.26 in 2020). The slight decline was also tracked regarding customs clearance procedure and custom tariffs (Figure 1.15.). During face-to-face interviews, companies confirmed complications at customs connected to a still a high number of technical problems using the e-platform requiring off-line interventions with customs authorities, which were also challenging to conduct during periods of COVID-19 related restrictions.

Another aspect causing delays in clearance is related to the still time-consuming decision-making process in relation to recent liberalisations measures. In such conditions applying zero-tax or special conditions for clearance remain challenging and makes customs procedures unpredictable in terms of time.

However, European companies appreciate openness for the dialogue demonstrated by the Chairman of the State Customs Committee and remain hopeful to start obtaining all benefits from ongoing reforms. In 2021, in line with Article 7.7 of the WTO Trade Facilitation Agreement⁴⁷, the State Customs Committee, with support of the EU-funded project, continued to review existing regulations and develop a normative framework for the Authorised Economic Operator programme, which is expected to become another mechanism liberating customs clearance for business operators.



Effective and predictable customs procedures are crucial for the development of logistics and transportation. The structural reform on customs taking place in Azerbaijan probably requires more time to start satisfying raised expectations of the private sector. In 2021 neither the new digital platform nor Green Corridor does not work yet as they are supposed to. Due to a big number of new regulations and procedures, the customs officers remain extra cautious and inclined to pass decision-making prerogative to higher-level managers. So, the containers which are supposed to pass control fast within Green Corridor are becoming subjects of additional investigations.”

CEO of European transportation
and logistics company

Amongst the social reforms, the companies leave positive feedback about the work of **DOST centres** operating as a single window providing social and labour services for all groups of the populations. In 2021 two more DOST centres opened (Baku DOST Centre #4 and Absheron

DOST Centre). The agency plans its further expansion to 17 physical centres by 2025 in different regions, including the agency in Shusha to be opened in 2022. In 2021 DOST Agency conducted several programmes in cooperation with international organisations, such as United Nations Development Programme (UNDP), International Labour Organisation (ILO), the United Nations Population Fund (UNPF), and others. As international confirmation of its efficiency, DOST Agency was included to the list of finalists in the European Social Services Award (ESSA 2020) announced by the European Social Network.⁴⁸ The survey also tracks positive trends in regards to ongoing **labour and social protection** reforms in Azerbaijan, which include the regular increase of the minimum wages and comprehensive COVID-19 response supporting different groups of the population including contract-based employees, low-income employees and unemployed as well as special support to individual entrepreneurs. At the same time, the positive effects of pandemic-related measures have levelled out due to the challenging situation in the economy, growing inflation, and unemployment taking place during the last years' pandemic environment.

The champion amongst the reforms in the EU Business Climate Survey 2021 appeared to become the **Small and Medium Business Development Agency (SMBDA)**, which significantly improved its position compared to the last year (6.04 points in 2021 compared to 5.1 in 2020) and holds its position amongst the top-5 most effective reforms. Despite the fact that foreign investors still have limited experience of working with the agency, they are aware of the services and programmes introduced by SMBDA to support SMEs and consider them as useful and efficient. After starting its operations in 2018 the agency built its infrastructure in Baku and regions providing public services to businesses via “SMB Houses” (including e-SMB House), and consulting, support services based on “SMB Support Centres”. As of 2021, SMBDA services cover 25 regions via the chain of “SMB Friends” operating as a bridge working with the agency and other public institutions. In 2021 the Agency kept expanding its portfolio of programmes for business, including funding for market research, grant support for start-ups, training on digitalisation, lending, PR, and other topics. Access to market remains amongst the main focuses of the agency and it assists SMEs in participation in fairs, exhibitions, etc. In the next years SMBDA plans to continue the expansion of its infrastructure and programmes, including new initiatives on access to finance in cooperation with SME Development Fund.¹⁴ From the perspective of European companies, the launching of a national-level body dedicated to SME support testifies priority on the development of small and medium business announced by the government and remain crucial for diversification of the economy.



There is a real demand in the country for such institution as SMBDA. Contrary to large companies, small business always remains more vulnerable and need special support, especially at the initial stages of development. But developed SME sector then becomes a backbone of a country guarantying its economic diversification and competitiveness, which is in line with Azerbaijani strategic vision. Hence, the establishment of such s body at the national level was the right step to make. And it seems that last year SMBDA seriously scaled up its activities because we always hear about them even though we have not worked with them directly yet.”

CEO of a European consulting company

Migration procedures in Azerbaijan in 2021 continued their improvement from the perspective of European businesses. Despite the challenges that the pandemic brought to migration worldwide, companies remain satisfied with the work of the **State Migration Service of Azerbaijan**. During the period of strict COVID-19 related measures and closed borders, investors had to apply frequently to the Service with regards to changes in rotation plans, updates in work permits, etc. According to the feedback provided, the Service remained open for communication and aimed to meet needs in a timely fashion during this challenging period. The majority of the migration services are now available in digital format within the ASAN umbrella and the fourth year in a row obtained the highest results in the “ASAN service index”, confirming their high quality and efficiency.⁴⁹ Another important advance for investors in 2021 was the opening of access to up-to-date data on remaining quota for personnel by countries, which was presented by Chief of State Migration Service during a meeting with foreign companies organised by AFchamber in June 2021. The new option allows foreign companies to track and effectively plan rotation of the personnel and was appreciated by European businesses.



Our company has representative offices in several countries and the last years were extremely challenging in terms of rotation of personnel, which was impossible to plan due to constantly updating quarantine restrictions in every location. We experienced a lot of difficulties on this matter, however not in Azerbaijan. In contrast, the local migration service demonstrated understanding and was always trying to be helpful. This is one of the best our experiences of cooperation with state service in Azerbaijan so far.”

CEO of a European engineering company

In 2021, the government of Azerbaijan continued its support for the **reforms of VET**, which includes further evolution of VET governance, development of infrastructure, enhancing connectivity of VET with the private sector and reforming its financing mechanisms. The State Agency on Vocational Education (SAVE) under the Ministry of Education is the leading institution in VET governance cooperating with the Lifelong Learning Unit in the Institute of Education and the Education Quality Assurance Agency. Another part of work is ongoing within umbrella of the Ministry of Labour and Social Protection of the Population (MLSP).⁵⁰

The strongest appreciation from the private sector continues to obtain the efforts made to update curricula and VET standards, aligning the qualifications of students with the needs of the market. In 2021, six existing specialities were updated, and 19 new VET specialities were developed (4 on technical and 15 on higher-technical courses) in line with labour market requirements. For the first time, 840 students were admitted to 15 newly created higher technical vocational education courses in Baku, Ganja, Barda and Gabala.⁵⁰ The various government initiatives continued to bring closer the private sector to VET development this year. Another important step during the last years became creation of the legal framework for recognition of competencies acquired through informal and non-formal schemes carried out by the Education Quality Assurance Agency.



Azerbaijan continued modernising its VET infrastructure, including renovation of facilities in over a dozen vocational schools and re-equipment of over 60 VET institutions. For the first time, three vocational education centres in Baku, Gabala and Ganja, received the status of public legal entities, and Ismayilli Training Centre received the status of Vocational Education Center. For 2021-2022, an online student admission process was carried out in 66 vocational schools. As a result, the number of applicants increased by 26% compared with last year, and the number of students admitted by 12.5%. In total, there were 72 vocational education institutions with 24,623 admitted students this year.⁵¹ MLSP is strengthening the role of State Employment Agency in the organisation of short-term training courses for unemployed people in Vocational Training Centers (VTCs). In 2021, four VTCs (in Baku, Goychay and Ganja cities) are delivering short-term training courses and their number is planned to be increased to 10 by 2030.

Despite the significant progress, the capacity of new VET infrastructure at current stage and the amount of its alumnus are not yet enough to cover accumulated in the market gap in access to qualified workers. European companies keep stressing this aspect via the survey (Figures 1.3., 1.15.) and see a need to further prioritise the reform until it starts bringing practical changes to the labour market. Considering the high interest in VET reform demonstrated by European companies every year, we provided more details on its progress in [Annex 3](#).

2.2 FURTHER IMPROVEMENTS AWAITED BY EUROPEAN COMPANIES

European investors continue to see the **ensuring of rule of law** as the main area to be prioritised to enhance the local business climate. The changes made during recent years are considered by investors as minor procedural changes which do not solve the core issues. Improving perceptions of the judicial branch of government will require comprehensive reforms to enhance transparency and impartiality of the courts.

Upcoming ambitious state projects brought attention from investors and put the **public procurement** system amongst the top priorities for further improvement. Several changes to the legislation were introduced during 2021 and these added some clarity to the procedures and some optimism to the private sector. Companies expect further prioritisation in this area to ensure equal and transparent competition for the forthcoming opportunities.

Despite the overall stabilisation of the financial sector after turbulences 2014-2015 the still limited **access to finance for business** remains the weak point. The State Entrepreneurship Development Fund and IFIs` programmes provide affordable targeted lending to the private sector but cannot satisfy the appetite of the whole market. There is a need to enhance the availability of cheaper funds for local banks. At the same time, the work with SMEs needs to continually enhance their financial literacy and transparency as well as ensure skills to prepare lending projects.

A traditional question in the EU Business Climate Survey is devoted to the expectations of European companies in terms of further reforms. This question, together with other collected indicators, makes it possible to compile complex pictures on the lags between reform expectations and implementation (Figure 2.2.). Amongst the strongest priorities this year remain reforms devoted to the rule of law, the financial sector, and access to finance. Results of the 2021 survey also confirmed the growing demand for transparency of public procurement. Within top-5 priorities are ongoing reforms on customs and VET, suggesting that these reforms have not yet resulted in expected improvements (see Section 2.1). Although the accession to the WTO was not prioritised in the 2021 survey, the ongoing process has the potential to improve a number of the top aspects chosen by the companies from the practical perspective. The WTO underpins the rule of law and requires its member states to adopt and implement multiple trade facilitating measures at the border. Moreover, the accession commitments cover immigration-related aspects. In this regard, by embedding WTO principles and regulations into domestic legislation, Azerbaijan addresses the local reforms that European investors expect the most.

As during previous years, European businesses see ensuring the rule of **law regarding to investors** as a crucial reform to be prioritised in Azerbaijan. The reform was chosen as a priority by most respondents in 2021 (52%), which is similar to last year's result (51%) and confirm a strong request for effective and independent justice.

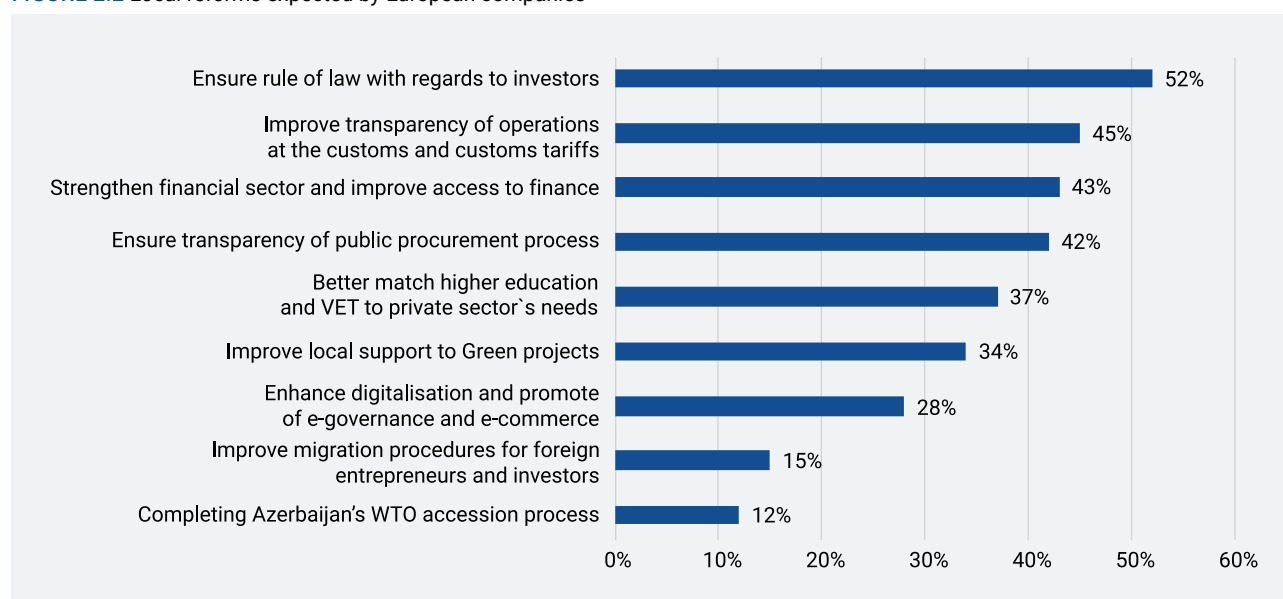
Since the reform on the judicial legal system was launched in 2016 and intensified by a Presidential decree in 2019⁵², several important steps have been taken. The establishment of Commercial Courts in 2019 aimed to enhance the effectiveness of commercial disputes resolutions. However, these courts are not evaluated by businesses as effective yet (Figure 2.1.).

Certain measures were taken to increase the qualifications of commercial judges under the EU projects and otherwise, however this still requires further improvement via intensive and regular trainings devoted to the commercial topics. Enforcement procedures also remain problematic. Enforcement offices are overloaded and lack effective mechanisms to implement courts` decisions. The alternative mechanisms for enforcement, as well as services of private enforcement that were mentioned in the above- said Presidential Decree have not been introduced yet in Azerbaijan.⁵²

Amendments to the Law of the Republic of Azerbaijan on the Judicial-Legal Council, implemented in July 2020 became an attempt to enhance efficiency of the courts but received critical comments from the international community. Under the changes, the activities of the judges (except for the first time appointees), will be assessed by the Judicial-Legal Council and in case of professional shortcomings, as well as systematic shortcomings in the application of substantive and procedural law, their powers shall be terminated prematurely. However, the Council is chaired by a representative of the executive branch empowering the body to terminate judges, which does not help the development of independent judiciary in the country in line with the principles enshrined in the Constitution of the Republic of Azerbaijan (1995).⁵⁴

Digitalisation of justice procedures in Azerbaijan was implemented via the launching of an e-court system introduced in 2014, allowing attorneys to file the complaints electronically using their electronic signatures to reduce bureaucracy and promote transparency of adjudication. The E-court platform is already operational and has begun to bring positive results. At the same time, it requires further development to ensure technical ability to meet all needs related to the justice process.

FIGURE 2.2 Local reforms expected by European companies



To reduce the burden of the court system, Azerbaijan introduced an impartial mechanism for alternative dispute resolution. Effective from 1 July 2021, Amendments to the Mediation Law⁵⁵, set out mandatory participation in the preliminary mediation procedure as a prerequisite to filing the disputes arising from the commercial, family, as well as labour relations to local courts. Per the Rules on Training and Professional Development of Mediators mediation training institutions provide initial training and professional development of mediators.⁵⁶ As for January 2022, more than 300 mediators have successfully passed the training and around 250 of them joined the Mediation Council.⁵⁷

Mediation is applied in many European countries but only in some of them it remains mandatory (e.g. Italy, Greece). Efficient mediation, especially in relation to commercial disputes, requires pro-active and experienced professionals-mediators leading parties to the settlement as well the development of a culture for alternative dispute resolutions. In case of Azerbaijan, development of such good practice will require some time. Another important factor for efficiency of mediation is personal presence of parties during the mediation procedure, which nowadays is also not a case in Azerbaijan and have to be ensured.

It is worth mentioning that resolution of the problems related to the rule of law in the country require long-term actions and depend not only on the implementation of internal reforms but also on their promotion and communication to the private sector in the country and internationally. For example, during interviews, law firms confirm their awareness about reforms and some progress resulting in better procedures and transparency. However, from the perspective of regular European companies, the system keeps its image as bureaucratic, untransparent, and lacking reforms, which drives them to continue choosing foreign adjudication. In this regard, some European companies remain optimistic about the establishment of the international court in the territory of **AFEZ** and hope for further expansion of this practice to other infrastructure for investors. Such practice can become a quick way to provide access to trusted courts for investors while the national justice branch continues its reforms and improvements, provided that the independence of these international courts is ensured both formally and in practice.

Another strong signal on prioritising of investors` rights protection can be made via the country`s WTO accession, which foresees making all required adjustments to the regulatory and institutional frameworks so that attributes of a rule of law system are duly and effectively implemented and applied. Amongst the key attributes of the rule of law principle ensured in multiple provisions of the WTO Agreements are transparency in the development and adoption of legislation; application, implementation and administration of laws, regulations



As legal consultants whose everyday work is connected to the legal system, we can see improvements in operational work and transparency of judges over the past several years, even though the introduced changes still do not meet best international practice in this area. On another hand, these reforms were not sufficiently communicated to the private sector. So, from the perspective of the average company little has changed. Unfortunately, most foreign investors remain sceptical about their ability to effectively protect their rights in Azerbaijani courts and prefer subjecting potential disputes to the international arbitration. And this remains a serious challenge for the international image of the country.”

Partner of a European legal consulting company

and other measures relating to trade in goods and services in a uniform, impartial and reasonable manner at all levels of government. In this way, the fact of WTO membership of the country would provide extra tools to affirm investors` rights in case of infringement.

Expansion of budget expenditures for projects and announcement of new opportunities in Karabakh and East Zangezur economic regions strengthened the interest of the private sector in **public procurement procedures and their transparency** in Azerbaijan. The topic was chosen as a priority by 42% of respondents in the EU Business Climate survey 2021 compared to 29% last year. According to the available international overviews, public procurement in the country lacks sufficient transparency. Procurement procedures were assessed in 2019 within Transparent Public Procurement Raking (TPPR) implemented by the Institute for Development of Freedom of Information (IDFI) and obtained 27th place amongst 31 countries with a result of 55.2% (compared to Georgia with 86.1% / 3rd place and Ukraine with 97% / 1st place).⁵⁸

According to the current Public Procurement Law⁵⁹, projects with the price between AZN 50 thou. to USD 3 mln. (from EUR 26 thou to 2.66 mln.) are to be implemented through open tender procedures via a special e-procurement platform. Even though the platform has been working in the country for three years, it continues to be seen by the private sector as a complicated tool lacking user-friendly manuals. Such a situation, where only the bidders that have trained specialists, could actively participate in tenders, creates a barrier for micro/small companies and start-ups that are not well-trained in this sphere.

However, the main drawback of public procurement is the lack of transparency of the e-platform as well as the Azerbaijani regulatory environment, which does not contribute to avoiding conflicts of interest. Information on local companies' ownership in Azerbaijan is closed for the public, and public officials are not obliged to disclose their assets. The information provided on the results of tenders is inappropriate to conclude on their efficiency. The platform does not ensure access to tender-related documents, including candidates' applications, bids offered by tender participants, decisions of tender commissions, contract information, etc. Moreover, according to the data published by the Chamber of Accounts of the Republic of Azerbaijan, the share of the procurement implemented via open tenders (e-platform) decreased over the years and for the 2020 year it comprises only about 30% of the total number of open tenders conducted. At the same time, procurements from a single source increased their share and reached almost half of the total state expenditures last year.⁶⁰

In 2021 Azerbaijan made several attempts to enhance the transparency of the procedures via changes to the legislation, which brought optimism to international partners strongly supporting these initiatives. However, while the changes introduced so far have rather made a positive impact on the liberalisation of the system, they did not solve the problems of transparency of the decision-making process and final beneficiaries. Amongst the changes introduced in 2021, the greatest implications for European companies are those that make local registration of a company an obligatory condition for its participation in the tenders. That is, if the foreign legal entity wins the tender, but does not either already have a permanent establishment or does not create a permanent establishment registered for tax purposes in Azerbaijan, it will be unable to sign the public procurement agreement.

AMENDMENTS TO THE LEGISLATION:

Significant amendments were made on 27 May 2021 to the Public Procurement Law, which set a single internet portal that ensures the implementation of public procurement by electronic means. The amendments also covered the following procedures: a) preliminary determination of the qualification compliance of consignors; b) procedure for calculating participation fees; c) involvement of the micro, small and medium-sized enterprises into public procurement; d) composition of the tender commission; and e) terms of signature of the sales and purchase agreement with tender winner.

According to the amendment made on 3 December 2021, to the Public Procurement Law, the execution of the public procurement agreement with non-resident legal entities or individuals for (i) construction, (ii) construction-assembly and (iii) installation of production plants were made subject to the permanent establishment or division of non-permanent establishments registered for tax purposes in the Republic of Azerbaijan.

In addition, on 20 December 2021, the Cabinet of Ministers of the Republic of Azerbaijan adopted the Rules of Amount, Payment and Usage of the Funds for Participation in the Purchases Carried out via E-procurement by the Method of an Open Tender or Request for Quotations.

Strengthening the financial sector and ensuring access to finance came in third place amongst reform priorities, just as last year, and was chosen by 43% of European companies (41% in 2020). After the shock experienced during the crisis 2015-2016, structural reforms led to significant improvement in the financial sector, however, respondents consider that it still requires prioritisation. As of November 2021, the sector keeps its "B" score in Fitch's Banking Industry Risk Indicator (BIRI), although there has been some improvement in credit fundamentals in recent years. The deposit dollarisation ratio fell to 45% at the end of the 3rd quarter of 2021 (compared to 61% at end-2019 and 57% in late 2020) but is still well above the 'BB' median of 18%. The financial sector in the country remains oligopolistic and mostly represented by local banks including the largest, International Bank of Azerbaijan (IBA), which is majority-owned by the Azerbaijani government. For the last five years, 23 banks were closed due to high non-performing loans (NPL), lack of liquidity, foreign exchange gap and poor asset quality. According to official data, in November 2021 the NPL level decreased to 5.5% compared to 7.3% in May 2020 and 8.3% in 2019.

Despite the overall positive trends, the sector remains sensitive to global turbulences during the pandemic including growing inflation, which reached 6.2% in November compared to 5.7% in October 2021 and 2.8% in December 2020.^{9, 32}

With growing sustainability of the financial sector, the focus of European companies year by year shifting towards the remaining lack of affordable loans. While there is sufficient proposition of consumer and short-term loans on the market, long-term lending for business remains scarce. During interviews, local banks noted that a significant share of deposits are held in foreign currency. This makes the risk-assessment for long-term financing in local currency challenging, resulting in increased interest rates. Central Bank re-financing lines at the base rate would become an effective tool, however, they are usually very limited or not available. There are also no swap solutions available with the Central Bank which would allow local banks to swap USD liquidity on long term and route the liquidity to the projects that demand long term lower cost financing in local currency (e.g., industrial projects). The limited centralised resources for local banks have been dictated by the Central Bank policy efforts to control inflation and remove the pressure on foreign exchange rates.

The Azerbaijani financial market remains dependent on local funding. Available external funds are provided mainly by International Financial Institutions (IFIs), including European banks' targeted programmes. The EBRD works in the country with a total portfolio of EUR 801 mln. In 2021 the bank financed eight projects with a corresponding Annual Bank Investment (ABI) of EUR 34 mln. – all in the private sector.⁶¹ The EBRD works with both private and sovereign clients prioritising digital, inclusive, and green projects and provides long-term financing both in local and hard currencies.

The bank of the European Union – EIB, provides targeted lending for programmes in the EaP region, including Azerbaijan. The bank operates in line with EU and Azerbaijani priorities and reinforcing "Team Europe" support for the country and expanding the European-Azerbaijani partnership. In 2021, EIB prioritized the development of social and economic infrastructure, protection of the environment, climate change mitigation and adaptation, innovation, as well as support to SMEs, with EUR 1.3 bn. across EaP countries.²³ More details on the projects provided by the European banks are available in [Annex 2](#).

Due to transparency issues, banks are cautious lending to new projects or start-ups with limited history and/or pledge security packages. Syndicated lending, which allows several financial institutions to pool risk and ensure better control over the projects, remains underdeveloped in Azerbaijan. At the same time, local businesses on average still lack transparency, and their capabilities to prepare lending projects are



One of the ongoing issues with limited long-term funding available with commercial banks for the project is linked to the fact that the financial sector regulator being the Central Bank has also a role of a policy maker and prioritise the monetary policy challenges, like targeted inflation, over the immediate needs of the real economy demand for the long-term funding in local currency.”

Managing director of
a European financial institution

underdeveloped. Hence, trainings on financial literacy for SMEs implemented by SMBDA and other business-support organisations remain an essential tool to enhance the preparedness of the private sector for effective lending.

The State Entrepreneurship Development Fund remains one of the few available in the market mechanism for high-risk lending. The institution provides concessional financing – long term loans (up to 10 years, and up to 5 years grace) with a fixed interest rate up to 6%. During 2020 the fund received 1,072 applications with a total amount of AZN 179.8 mln. (EUR 93.2 mln.). Of these, 886 applications of AZN 88.5 mln. (EUR 45.9 mln.) were approved.⁶² Hence, the fund keeps prioritising small credits over more substantive lending projects. In October 2021 the fund began to merge with Azerbaijan Investment Company under the Ministry of Economy for its transformation to the Azerbaijani Fund of Business Development.⁶³ European companies remain positive about this reform, expecting increased funding to the private sector as a result. Another available tool to reduce banks' risk is the state Mortgage and Credit Guarantee Fund, which is not considered effective so far by European companies (see Figure 2.1) due to the complexity of the procedures, which remain bureaucratic and time-consuming.



3 LOCAL TRENDS IN LINE WITH GLOBAL STRATEGIC PRIORITIES

3.1 SUSTAINABLE AND GREEN ECONOMY

In recent years, Azerbaijan, with support of the EU regional initiatives has continued its work towards sustainable economy. Steps taken include the ratification of international agreements and the development of the local policy framework to promote the green economy, as well as launching of global initiatives and local support mechanisms for “greening” of the private sector. Special support this year was provided to switch to alternative energy sources and several flagship investment projects have been launched in the country.

The results of the EU Business Climate Survey testify growing number of the companies amongst European business community in Azerbaijan that apply principles of environmental awareness. The share of such entities reached 85% in 2021, an 18% increase compared to the previous year. Amongst the most popular practices are the application of technologies on energy efficiency (34%), reduction of emissions (32%), and use of highly recyclable materials (32%). The majority of businesses (56%) see financial support as the most effective mechanism to stimulate the “greening” of the private sector, followed by environmental regulations (40%) and growing demand for green products in the market (36%).

Strategic priorities

Azerbaijan has taken several steps towards a more sustainable economy. In 2016 the country signed the Paris Agreement and submitted its first NDC. The NDC included a quantitative target of 35% greenhouse gas emissions reduction by 2030 compared to 1990 levels. In 2019, Azerbaijan joined the Eastern Europe Energy Efficiency and Environment Partnership (E5P), strengthening its cooperation on energy and environment goals via participation in several regional EU initiatives.¹⁷ Sustainable goals were also included in recently adopted local policies. One of the five top priorities of “Azerbaijan 2030: National priorities for social-economic development” prescribing strategic directions for internal policies is Priority on Clean Environment and “Green Growth” (including 5.1. High quality ecological environment and 5.2. Green energy space). This priority calls for “applying environmentally friendly technologies, the use of clean energy sources, waste recycling and the rehabilitation of contaminated areas as an important contribution to efforts to maintain greenhouse gas emissions in line with international standards”.¹³

In June 2021 Azerbaijan, with support from the EU4Climate initiative, submitted its 4th National Communication to support the integration of climate change considerations into relevant policies and actions. In addition, an updated NDC was prepared and submitted to the government foreseeing reduction of emissions by 2030 of at least 35% and towards 40% compared to 1990 levels.¹⁷ In December 2021 a public consultation was held within EU4Climate on a draft of “Low-emission development strategy in Azerbaijan 2050.”

The event brought together senior officials and representatives from the Ministry of Ecology and Natural Resources, Ministry of Economy, Ministry of Energy, Ministry of Finance, Ministry of Agriculture, Ministry of Transportation and National Hydro-Meteorological Service. As of 2021 eight Azerbaijani cities are participating in the Covenant of Mayors initiative supporting municipalities in the target to reduce CO₂ emissions to 30% by 2030.⁶⁴

The country is moving forward on its sustainable energy pathway supported by EU4Energy. In 2021, the initiative contributed to the development of a new Law “On Efficient Use of Energy Resources and Energy Efficiency”⁶⁵ approved in August 2021 and the first NEEAP. More support is expected to come from a recently launched EU-funded project “**Support for further improvement of energy efficiency in Azerbaijan**” which aims to develop a regulatory framework and energy certificate scheme for buildings. The project will also support the government with the introduction of minimum energy performance requirements and energy labelling for priority groups of energy products.

Several steps for the greening of SMEs were taken during 2021 with the support of EU4Environment. A new online self-assessment tool for greening SMEs was launched in cooperation with SMBDA. Work on the circular economy has begun, bringing Azerbaijani SMEs closer to embracing the practices and benefits from it. In August 2021 an online event on the circular economy and resource efficiency took place in the country followed up by the launching of Industrial Waste Mapping activities in two regions of the country.⁶⁶

Two Resource Efficient and Cleaner Production (RECP) Clubs were launched for enterprises in Baku and Ganja regions in collaboration with two national universities. Additionally, an agreement has been reached under the E5P project for Ganja to become the first participant in the renewal of the waste management system. Currently, the SMBDA considers evaluating the potential for greening SMEs and including relevant support measures in its operations.¹⁹

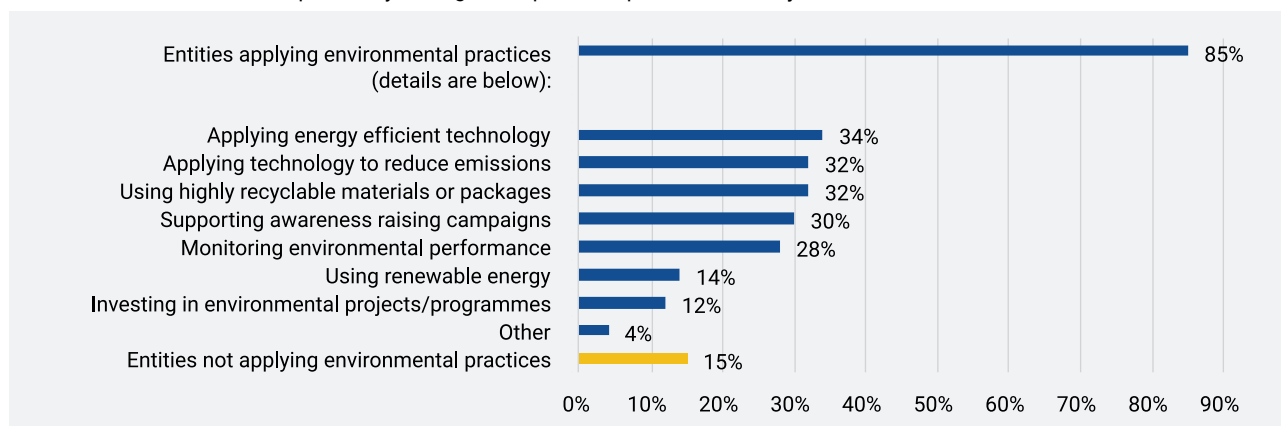
Decreasing renewable freshwater resources in Azerbaijan in absolute terms (evaluated between 9-27% during 2000-2017) and remarkable increase of the population (about 22% during the same period) brought attention to the need for effective water management. The recent Action Plan on Rational Use of Water Resources was adopted in July 2020 and covers 2022.⁶⁷ Nowadays, the government develops a new strategy from 2022 onwards. A new European Union support programme, “Water Resources and Environmental Data”, is going to be launched in early 2022 within the EU4Environment umbrella. The programme has a budget of EUR 12.75 mln. and will be implemented during 2022-2024 by a Consortium of the European Union Member States Austria and France, OECD and UNECE. It is expected that it will contribute to further green transformation of EaP countries, including Azerbaijan, in line with the EU Green Deal and the SDGs. The programme is aimed to support more sustainable use of freshwater resources through improved water policies and practices and enhance the sound environmental statistics to ensure greater availability of policy-relevant data for protecting and more sustainably using all natural resources.¹⁹

More details on the projects implemented with support of EU initiatives in Azerbaijan are available in the [Annex 2](#).

Environmental practices of SMEs

Given the importance of private sector “greening” for moving the country towards a more sustainable economy, the EU Business Climate Survey continued to explore environmental practices implemented by European companies. According to the survey responses, the share of European companies applying principles of environmental awareness in Azerbaijan grew by 18% compared to last year and reached 85%. The highest importance is attached to applying technologies for energy efficiency (34%) and reduction of emissions (32%). The use of highly recyclable materials (32%), support of awareness-raising campaigns (30%), and monitoring of environmental performance (28%) also increased amongst the private sector since 2020 (Figure 3.1).

FIGURE 3.1 Environmental responsibility amongst European companies in Azerbaijan



SOURCE: EU Business Climate Survey 2021

To explore the effectiveness of different stimuli for the green transformation of the private sector, the 2021 survey introduced a new question about the most efficient measures that can stimulate the “greening” of the private sector (Figure 3.2). The companies see financial support and stricter environmental regulations as the two most effective measures (selected by 56% and 40% of respondents, respectively). Growing demand for green products on the market is another stimulus (36%). Other effective measures include regulatory relief for companies applying environmental management and “green” public procurement requirements. Free consultancy on pollution reduction technologies and recognition and awards for environmentally friendly technologies although still somehow effective, obtained lower appreciation from the private sector.

Support to the switch to alternative energy sources

For several years, the Azerbaijani government has worked on comprehensive incentives and a new regulatory framework for renewable energy projects. An important step in 2021 was the adoption of two new laws on the use of renewable energy sources and the production of electricity. A further signal came through the introduction of “green cities” and “green villages” concept and the prioritisation of green and alternative energy projects in Karabakh and East Zangezur economic regions, which received strong interest from European investors (see Section 1.3).

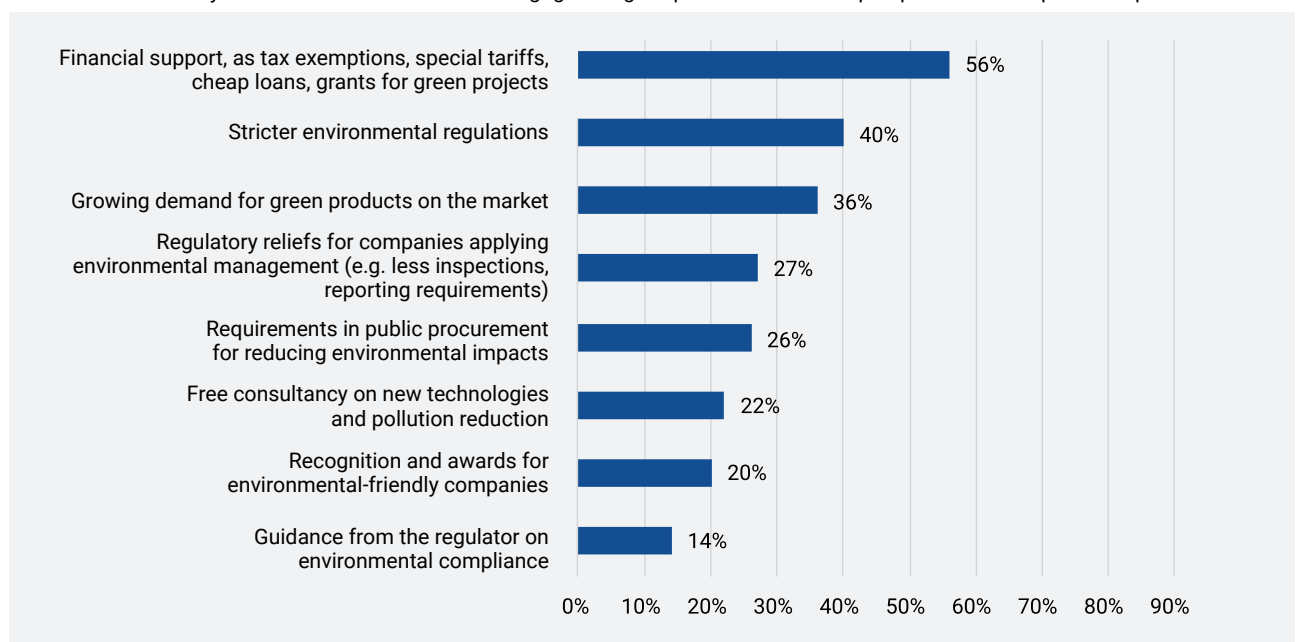
According to the World Bank’s (WB) data, the country nowadays has just 1.3GW of installed renewables capacity, although it does have a potential capacity of more than 180GW in solar and wind power.¹⁰ Two ambitious alternative energy projects were launched

in 2021, with a total cost of USD 500 mln. The new projects foresee the development of the country’s inaugural facility with 240MW wind and 230 MW photovoltaic energy implemented by Saudi Arabia and UAE companies. Implementation of these projects is estimated to quadruple the country’s wind capacity and raise its solar capacity sevenfold, demonstrating its significant capacity in this domain and bringing it closer to the official goal of increasing renewables’ share of the electricity mix to 30% by 2030.⁶⁸

A law “On the Use of Renewable Energy Sources in the Production of Electricity”, was adopted in May 2021.⁶⁹ The Law determines the legal, economic and organisational basis for the use of renewable energy sources in electricity generation. It also prescribes guaranteed tariffs, the procedure for selection of investors, and licensing. In addition, certain incentives are being proposed for investors in renewable energy source projects in Azerbaijan, including guaranteed offtake, guaranteed connection, priority in transmission and distribution, and long-term land leases.⁷⁰

A law “On the Efficient Use of Energy Resources and Energy Efficiency”⁶⁵ was adopted in August 2021 and will come into force in July 2022. The law regulates relations arising in the field of production, storage, transmission, distribution, sale and consumption of energy. The newly adopted law defines standards, and procedures for a more effective examination of energy use and efficiency, establishing Energy Efficiency Fund, and prescribing new procedures of labelling and measuring energy consumption.⁷¹

FIGURE 3.2 Efficiency of different measures stimulating “greening” of private sector from perspective of European companies



3.2 DIGITALISATION OF PRIVATE SECTOR

Despite some improvements taking place in Azerbaijani IT infrastructure over the last years, European companies keep seeking for its further prioritisation as crucial factor for digitalisation in the private sector. As last year, the strongest request relates to enhancing the speed and quality of the internet (76% of respondents) followed by conditions of internet providers (48%) and digital skills of the personnel (40%). Rural areas require special attention, as they suffer from a remarkable gap in digital infrastructure compared to the larger cities.

Together with active digitalisation, cybersecurity has become more important. Nowadays European companies feel neutral about digital security in the country and rely more on the internal bridges rather than measures at the state-level. The entities see this aspect as growing its importance, emphasise a need for its stronger development and raising awareness of the private sector on secure digital work.

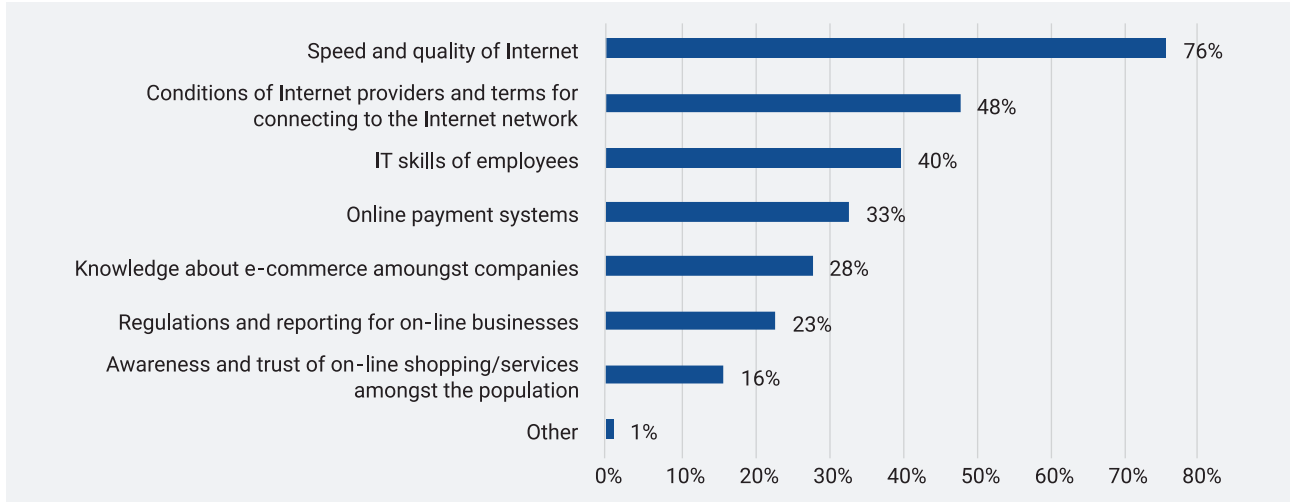
Digitalisation is gaining crucial importance for the private sector and improving its resilience to the pandemic. Shifting business processes online and intensifying e-commerce remains one of the most common ways for the private sector to sustain business during pandemic-related restrictions and uncertainty of economic development. According to the World Bank's enterprise surveys, the pandemic has accelerated the use of digital tools for companies of all sizes in Azerbaijan. More than 60% of small and 70% of medium-sized enterprises in Azerbaijan have increased their online activity within the last two years.¹⁰ According to the result of the EU Business Climate Survey 2020, 58% of European

companies in Azerbaijan last year were increasing digitalisation process as a response to the pandemic restrictions.⁴⁴ In 2021, the Central Bank reported continuous growth of e-commerce in the country. During January-November it reached AZN 6.1 mln. (EUR 3.2 mln.) an increase of 78% compared to the same period in 2020.³²

During the last decade, the Azerbaijani government has prioritised the development of the digital economy, as reflected in "Azerbaijan 2030: National Priorities for Socio-Economic Development" (2021)¹³, which outlines the major priorities and will be followed up by more detailed planning documents. With the growth of the digital economy, the quality of IT infrastructure becomes crucial and consists of several main components, including digital infrastructure, availability of skills, and the regulatory framework in a country. For the second time, this year's EU Business Climate Survey contains several questions devoted to IT infrastructure. In both years, European companies choose factors related to digital infrastructure as an uncontested priority. Quality and speed of the internet were chosen by 76% of respondents and conditions of internet providers were prioritised by almost half of European companies in 2021, which is comparable to the 2020 results (Figure 3.3).

After launching of reforms in 2016, the number of fixed broadband subscriptions changed insignificantly reaching around 20 per 100 inhabitants in 2020, compared to 18.5 in 2016.⁷² The number of broadband Internet users per 100 population increased from 72 to 83 over the same period. Access to broadband internet also became more affordable with a decrease in the average tariff cost from 1.2 AZN in 2016 to 0.9 in 2020 for 20 hours.⁵ According to the independent Speedtest Global Index, which automatically tracks speed of uploads and downloads worldwide, the average speed of fixed broadband in Azerbaijan in 2021 increased by 9% compared to the beginning of COVID-19 pandemic resulting in an average download speed of 17-18 Mbps, bringing the country to 122nd place out of 178 countries.

FIGURE 3.3 Aspects of IT infrastructure to be prioritised from perspective of European investors



SOURCE: EU Business Climate Survey 2021

For comparison in Russia this indicator reaches 63-64 Mbps (50th place), in Ukraine 52 Mbps (57th place), Armenia 34-35 Mbps (88th place), Turkey 26-27 Mbps (103rd place) and Georgia 20 Mbps (116th place).⁷³

IT skills of employees became more important this year compared to the 2020 survey (Figure 3.3). As a result of reforms in the education system, digital skills have been embedded in the existing legislation as one of the key competencies for VET and lifelong learning, including national qualifications framework (NQF), general education legislation, and State Standards for VET.⁷⁴ While there is a lack of reliable data on the digital skills amongst the population, the share of employees using a computer in Azerbaijan increased by only about 5 percentage points during the last five years and in 2020 around 35% of people use computers at work. An even smaller share of employees (around 30%) uses the internet.⁵

Many respondents reported a significant rural-urban gap in digitalisation and IT infrastructure (Figure 3.4). Around 60% of respondents in Baku and other large cities have access to the internet while only around 40% do so in other regions.⁵ At the same time, the gap does not affect the majority of investors, as Baku remains the main business centre of the country. However, further prioritisation of regional development will require reduction of this asymmetry and improvement of the digital infrastructure in regions.

Together with business digitalisation, cybersecurity became essential and reached the peak of attention in 2020 during the military conflict between Azerbaijan and Armenia, which was followed by multiple cyberattacks affecting the work of the majority of e-resources in the country. According to the Global Cybersecurity Index (GCI) prepared by International Telecommunication Union (ITU), Azerbaijan in 2020 rose to 15th place and took 40th place amongst 194 countries better than the neighbouring Georgia and Iran. The index assesses the level of cyber security in 5 key areas – legal framework, technical training, organisational issues, human resources, as well as communication and cooperation.⁷² European companies reported feeling "neutral" in Azerbaijan in terms of their digital work

(Figure 3.5). However, they rely strongly on internal company cybersecurity bridges rather than on measures implemented on the national level.

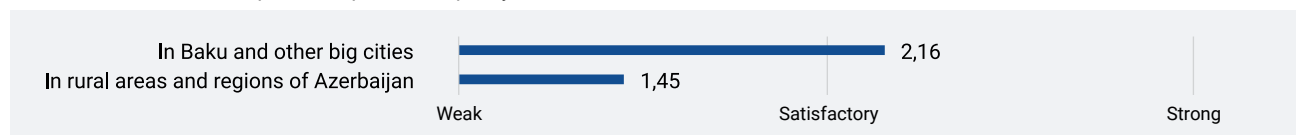
Currently, no state policy document defines priorities in the area of cybersecurity and no systematic programmes for awareness-raising amongst SMEs exist on the topic. Some initiatives take place within the Ministry of Digital Development and Transport or initiated by the private sector aiming to raise awareness and improve skills of the population and private sector (i.e., Cyber Academy and Cybersecurity Week).

The regional **EU4Digital** initiativeⁱⁱ has been supporting digital transformation in Azerbaijan since 2019 via work of its central project EU4Digital Facility. Enhancing of digital skills remains amongst the main priorities and includes support on digital skills measurement and implementation of relevant strategies. An important step this year was the establishment of Digital Skills and Jobs Coalition in Azerbaijan aimed to further support digital skills in the country. The initiative also includes work to increase the country readiness towards mutual recognition of trust services and boosting the start-up ecosystem in Azerbaijan.

The initiative contributes to the development of eCommerce through the cross-border pilot launched in May-June 2021 in cooperation with Azerexport.az. The eCommerce solution develops "virtual warehouse" allowing Azerbaijani SMEs to sell their products on eBay marketplace in Germany. This solution is expected to become a new tool for entrepreneurs that operate in various regions of Azerbaijan to introduce and expand the range of products to European markets and beyond.

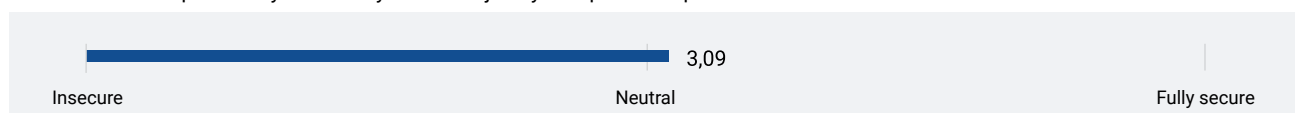
During the recent years continuous support was provided by EU4Digital to the preparation of the EaP regional documents, such as Regional Roaming Agreement based on the EU practice (which is expected to reduce the roaming prices in the region by almost 90% within 5 years) and the Regional Spectrum Agreement, aimed at harmonizing the usage of spectrum resources among EaP countries and with the EU for future 5G technology.²⁰

FIGURE 3.4 Views of European companies on quality of IT infrastructure in urban and rural areas



SOURCE: EU Business Climate Survey 2021

FIGURE 3.5 Perception of cybersecurity in Azerbaijan by European companies



SOURCE: EU Business Climate Survey 2021

ⁱⁱ More details about projects and activities within EU4Digital initiative are available at the website www.eufordigital.eu

3.3 EQUAL ACCESS TO ECONOMIC OPPORTUNITIES FOR MEN AND WOMEN

Despite the comprehensive legislation of Azerbaijan ensuring equal access to economic opportunities for different genders, in practice, women still fall behind men on several important indicators. In crucial for the country economic sectors as mining, construction and transportation women represent minorities with the shares not exceeding 15% of the total workers. The pay gap for similar work in the country reaching about 25% and on average the estimated earning of women is 45% less compared to men.

The 2021 survey shows that women represent about 40% amongst the teams of responding companies. More than that, European companies tend to employ larger shares of female workers to their entities than domestic companies do. The majority of them are involved in administrative work, sales, marketing, and middle-level management. In about 20% of responding companies, women are also represented at the C-level management.

Protection of women and equality of genders is ensured in different legal acts and the Constitution of the Republic of Azerbaijan (2006).⁵⁴ The Government ratified numerous international conventions on gender equality including the ILO Convention on Equal Remuneration, ILO Convention on Discrimination (Employment and Occupation), UN Convention on Equal Opportunities and Equal Treatment for Men and Women Workers: Workers with Family Responsibilities, and others. The local framework includes the law "On State Guarantees of Equal Rights for Women and Men" (2006)⁷⁵, Action Plan on prevention of gender-biased sex selection (2020)⁷⁶ and other strategic policy documents.

Yet these legal frameworks have not brought remarkable results and the country still falls behind the majority of its regional neighbours in terms of equal access to economic opportunities for women. According to the Global Gender Gap Report (GGGR) 2021 by the World Economic Forum, the country ranked 23rd on the gender dimension out of 26 in Eastern Europe and Central Asia

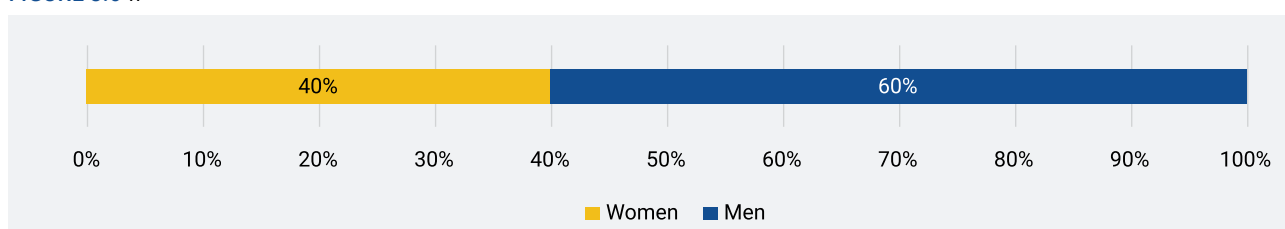
region.⁷⁷ The Sustainable Development Report tracks the progress of countries towards SDGs reports stagnation on Gender Equality goal in Azerbaijan in 3 out of 4 indicators.⁷⁸

The population of Azerbaijan is almost equally represented by women (50.1%) and men (49.9%) with a high literacy rate reaching 99% and a minimal gender gap in both primary (92-93%) and secondary (88-89%) education. However, the relative gender equality in school changes as people enters the labour market. For example, the unemployment rate for women in 2020 was 8.4% which is 40% higher than for men (6%). There are also significant gender disparities amongst workers in different sectors. The sectors that employ the most women are education (62% of employees are female), human health, social work (73%), and art, recreation (78%). While other sectors employ considerably more men, including construction (7%), electricity (11%), mining (13%), and transportation (16%).⁵

This is the first year the EU Business Climate Survey included questions devoted to gender segregation and women's roles in their entities. Even though European businesses tend to work in male-dominant sectors (e.g., construction, mining, transportation, engineering, ICT), female representation reaches 40% of the total workers amongst the companies surveyed (Figure 3.6). Local companies working in the same sectors would be expected to employ females in around a quarter of all positions (Annex 4).

The traditional views on social roles, when men are considered as breadwinners while women are children's caretakers, are one of the main barriers to women's professional growth. Women represent only 21% of private entrepreneurs in Azerbaijan and are the majority in only one single sector (education, 64%) and minorities in all other sectors, including transportation (2%), construction (4%) mining (5%). According to GGGR, only 35% of managerial positions in all sectors are occupied by women in Azerbaijan. The existing gender-based payment gap for similar work reaches about 25% on average.⁷⁷ In some industries, differences between average men's and women's salaries reach about 40% (e.g. mining, financial, and insurance activities) and even exceed 50% (professional, scientific, and technical activities).⁵ All mentioned results in asymmetry to almost 45% in average estimated earned income in favour of the male population.

FIGURE 3.6 w



SOURCE: EU Business Climate Survey 2021

The results of the 2021 survey show that women in European companies are mostly involved in administrative work (79% of the respondents, Figure 3.7.). Sales and marketing remain the most balanced profile of work from a gender perspective. Women also represent about 40% of mid-level managers and occupy 32% of technical and operational positions in European entities.

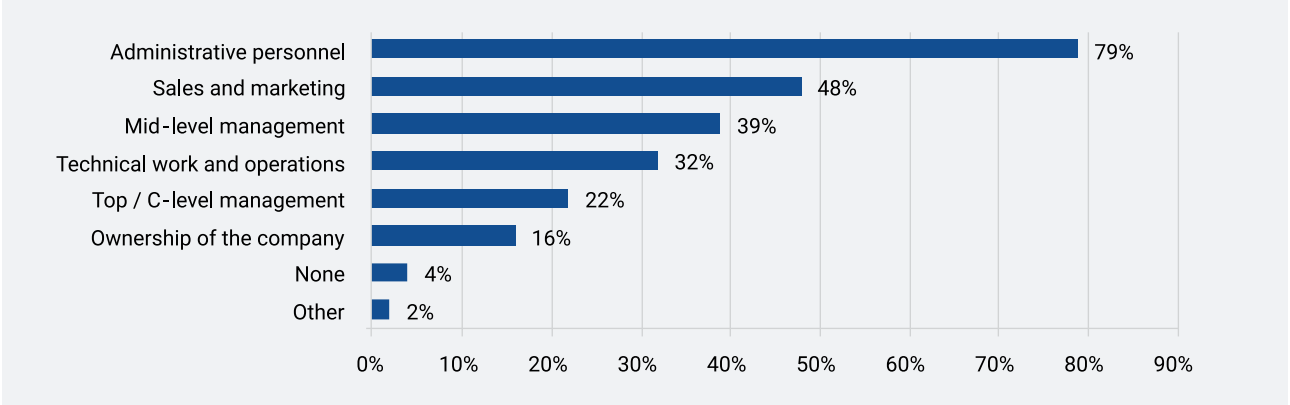
One of the most challenging gender disparities in all countries remains the involvement of women in high-level positions. 22% of the respondents have women represented at the C-level of the organisation and 16% of businesses are owned or co-owned by females. According to the Gender Diversity Index by European Women on Boards 2020, conducted amongst the EU countries, on average 19% of the companies have a woman in at least one of the C-level positions.⁷⁹ This indicator was last estimated for Azerbaijan in 2013 by the World Bank when just 2.4% of C-level positions were occupied by females.¹⁰

The EU supports this important gender and economic aspect in Azerbaijan via projects contributing to the economic empowerment of women. Amongst the most significant ongoing initiatives is “Women in Business” programme, implemented by the EBRD. The programme includes business advice, training and mentoring to women-led companies. In 2019, 90 women entrepreneurs in Azerbaijan received loans to a total value of EUR 575,000, and almost 3,000 women benefitted from the consultancy services. As a result, turnover amongst the supported companies rose by EUR 18.8 million, and 1,268 new jobs were created. Another project “Socio-Economic Empowerment and Development of Small-Scale Vulnerable Rural Families in Dashkasan, Goranboy and Samukh Rayons of Azerbaijan” supports female employment in rural areas. As a result, 900 women were involved in 30 Community-based Women Groups (CWG) in 30 villages. During 2018-2020, 30 CWGs and 88 individuals were provided with the necessary equipment for the development of their businesses, and 747 women participated in management, mobilisation, leadership and inter-group relations trainings.²¹

One of the most under-evaluated resources in Azerbaijani economy is the female labour force. An average professional woman in Azerbaijan has high education and fluently speaks three or four languages, which you can hardly imagine even in countries with advanced economies. In our team, women have an equal share and are represented at all levels. According to the internal evaluation we perform, there is no gender-based gap in the operational KPIs, and I may surely say that women on average have better working discipline. Thus, I believe, one day economic sanity will supersede social traditions. And the sooner this happens, the better it is for the economy of this country.”

General Director of a European machinery company

FIGURE 3.7 Women representation in European companies in Azerbaijan per main positions



SOURCE: EU Business Climate Survey 2021



ANNEX 1: RESULTS OF EU BUSINESS CLIMATE SURVEY 2021

Participants: European businesses present or interested to work in Azerbaijan and Azerbaijani companies doing business with the EU partners

Number of responses: 139

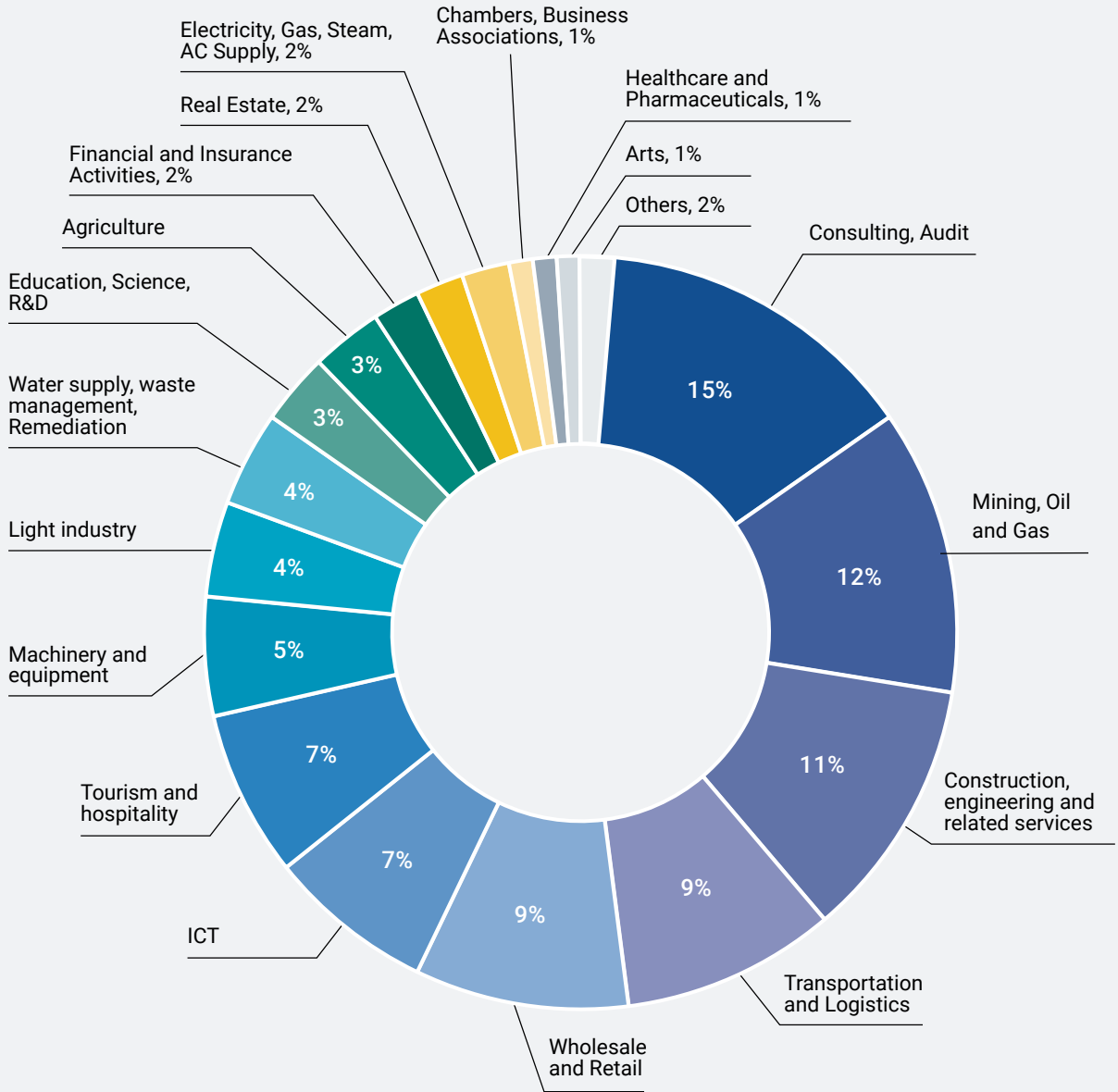
Number of countries represented: 24

Number of sectors represented: 19

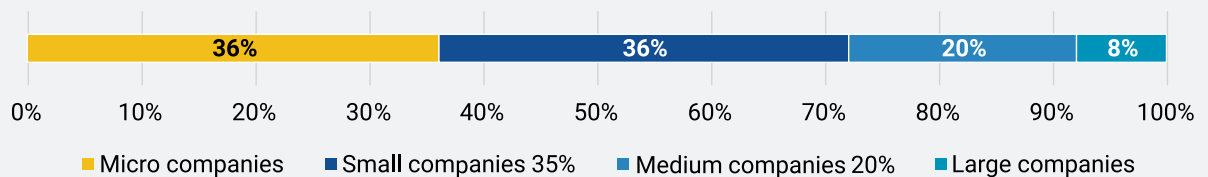
Timeline of the survey: October – November 2021

PARTICIPANTS OF THE SURVEY

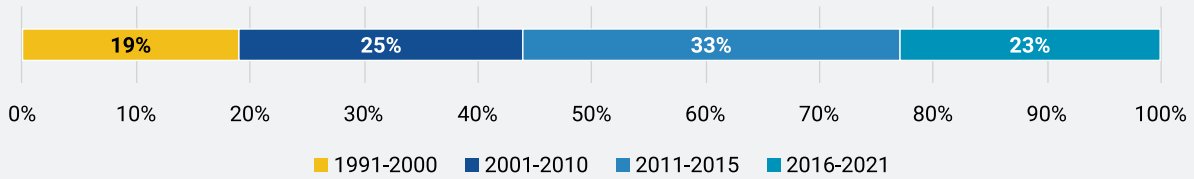
PROFILE OF THE PARTICIPATING COMPANIES



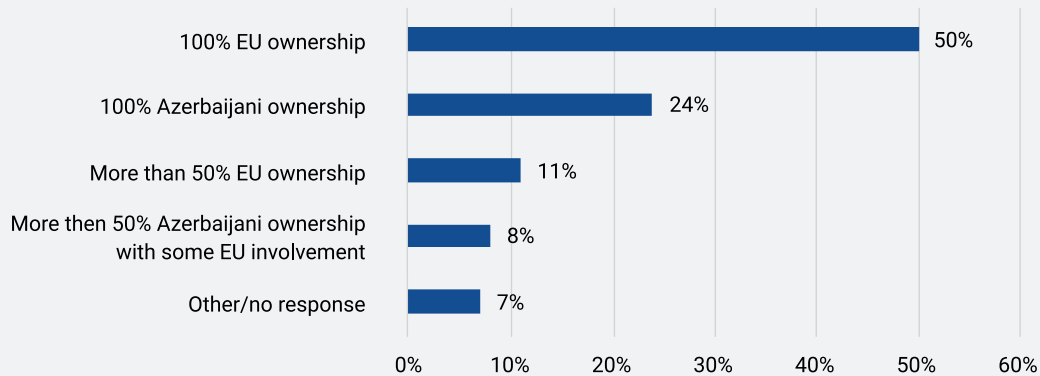
SIZE OF THE COMPANIES PER NUMBER OF EMPLOYEES



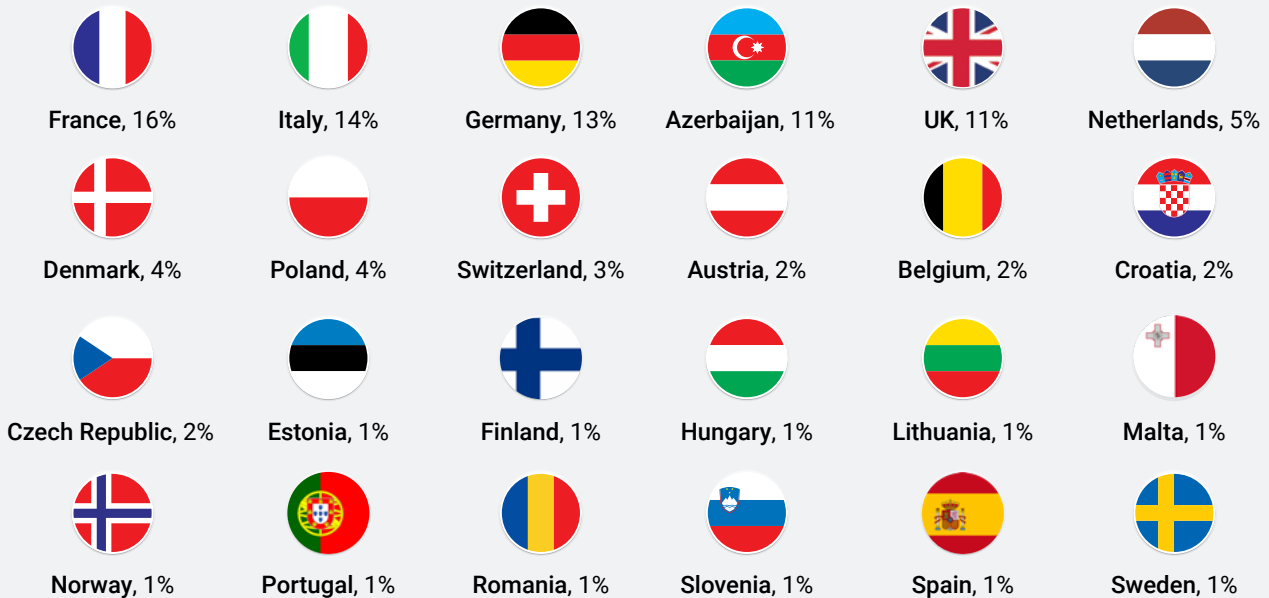
YEAR OF ESTABLISHMENT IN AZERBAIJAN



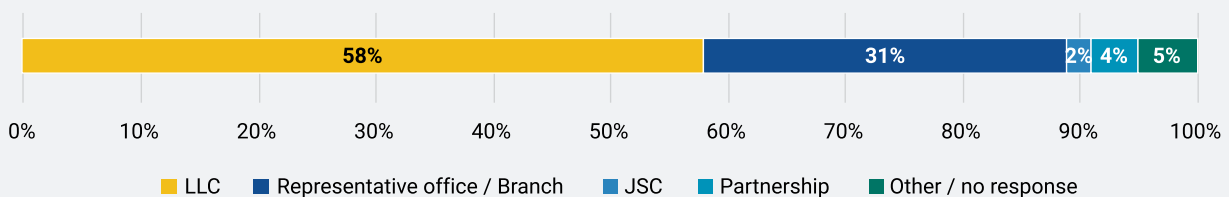
OWNERSHIP STRUCTURE OF THE COMPANIES



COUNTRIES REPRESENTED BY THE COMPANIES

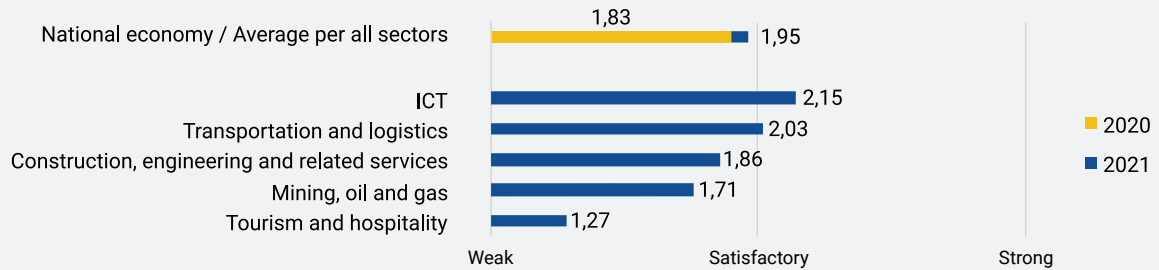


LEGAL STATUS OF THE COMPANIES IN AZERBAIJAN

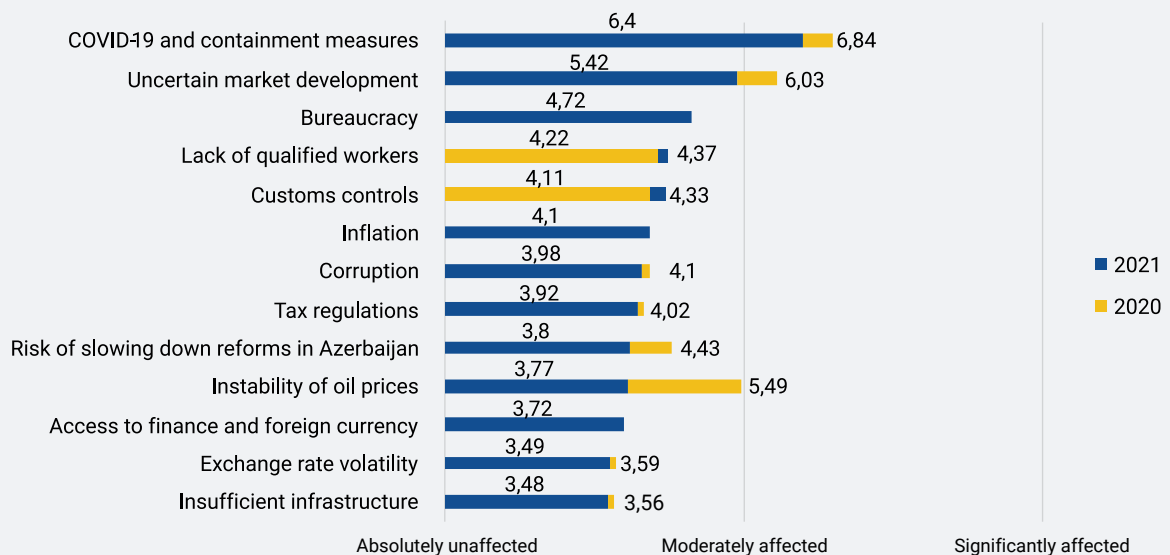


BUSINESS CLIMATE 2021. SECTORIAL OVERVIEW

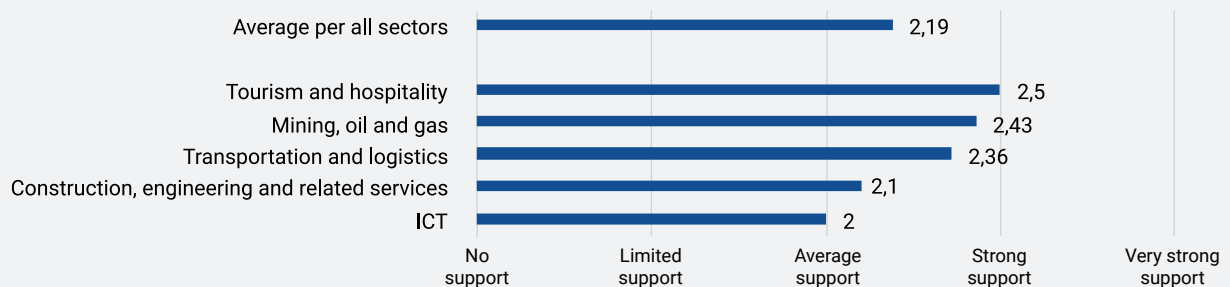
Q1. How do you assess the situation in 2021 in Azerbaijan?



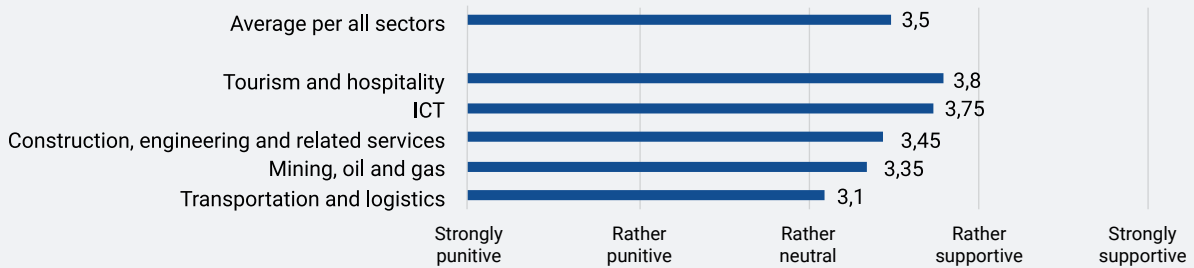
Q2. How strong the following factors affected your company and sector in 2021?



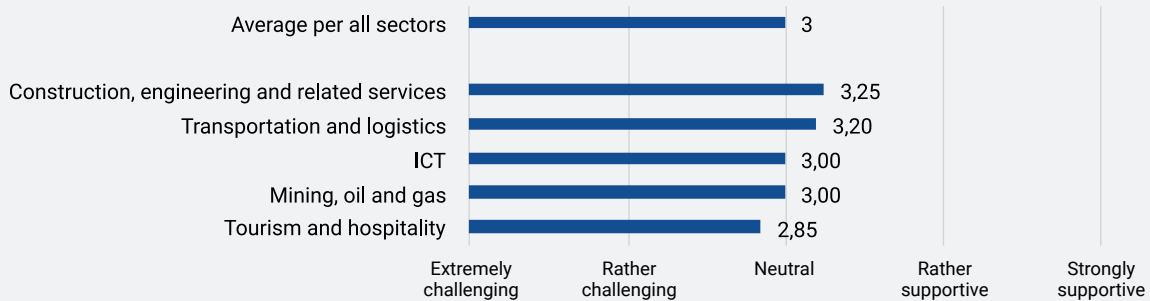
Q3. Does your company and sector receive special support from the Azerbaijani government during the last years? (e.g. sector-specific legislation, tax incentives, other programmes)



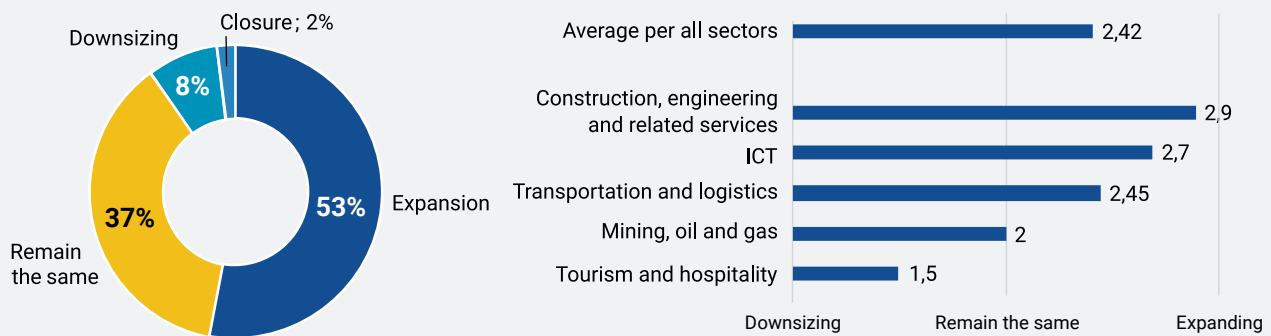
Q4. Please, choose the statement which better describes operational relations between your company and public authorities in Azerbaijan (bodies issuing licenses, permits, migration, tax authorities, etc.).



Q5. Based on your experience, how you evaluate business climate in Azerbaijan for your company?



Q6. What is the most likely direction of your company's development over the next years in Azerbaijan?

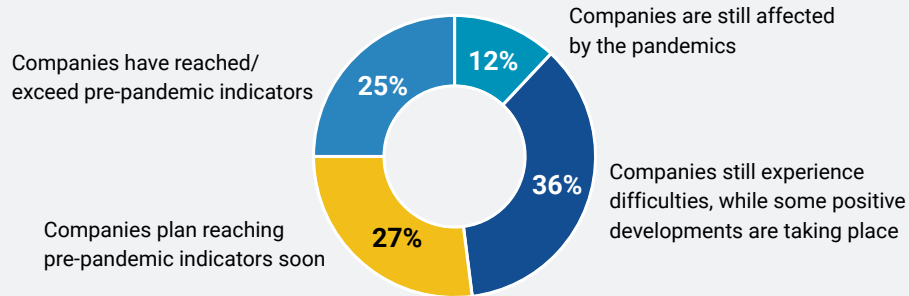


Q7. Would you choose Azerbaijan again as a preferred location for your business?

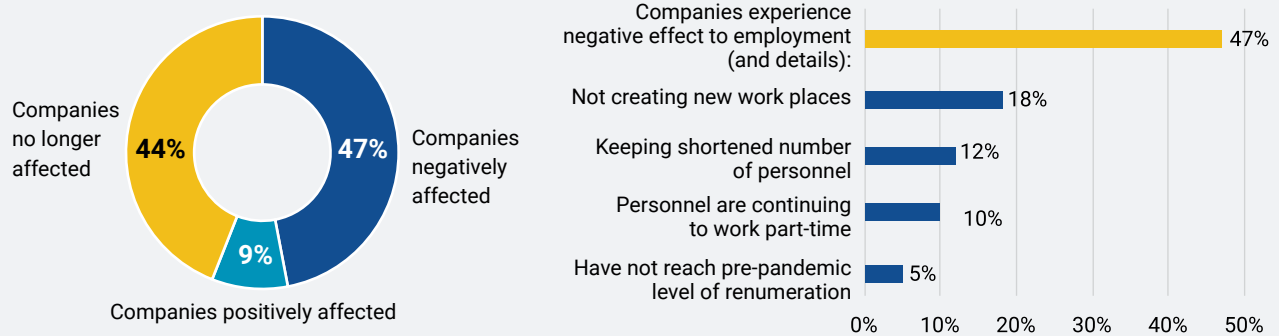


RECOVERY OF BUSINESS DURING PANDEMIC

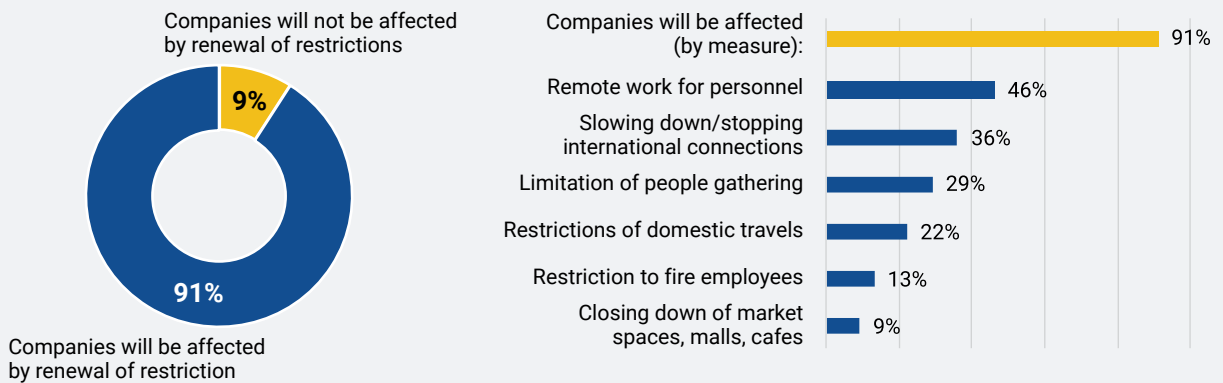
Q8. What is current condition of your company after the quarantine measures were lifted in Azerbaijan?



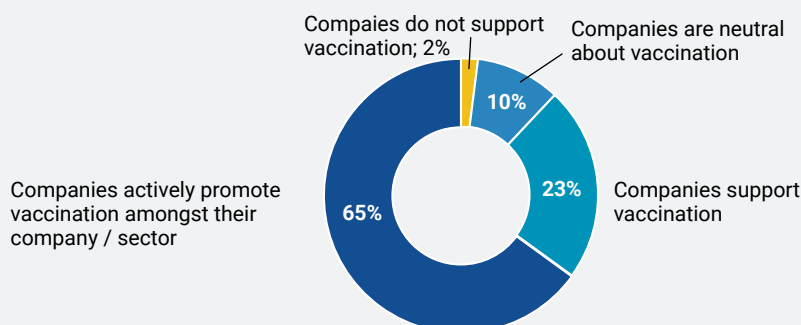
Q9. Does COVID-19 pandemic still affect employment and work conditions in your company / how?



Q10. In case of a new pandemic wave, restoring of which measures would have the strongest negative effect to your company?

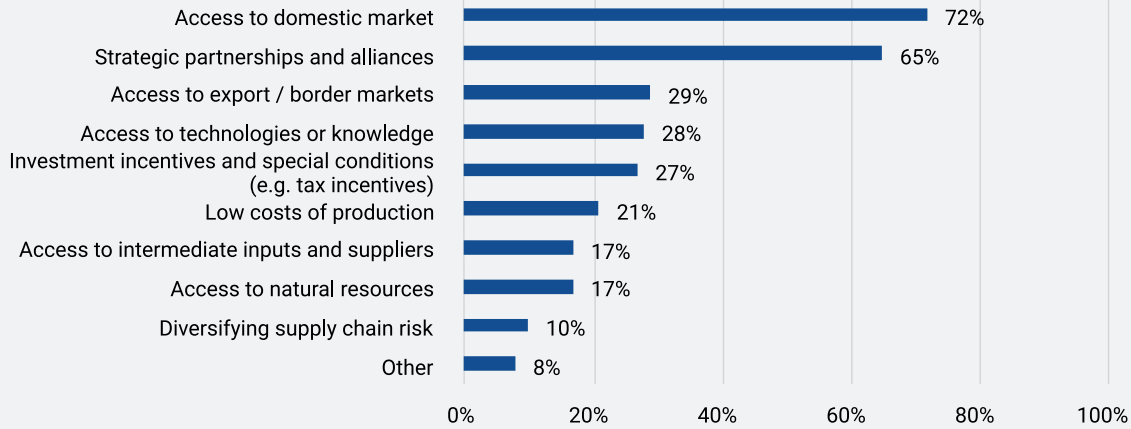


Q11. Does your company support or promote vaccination amongst your employees?

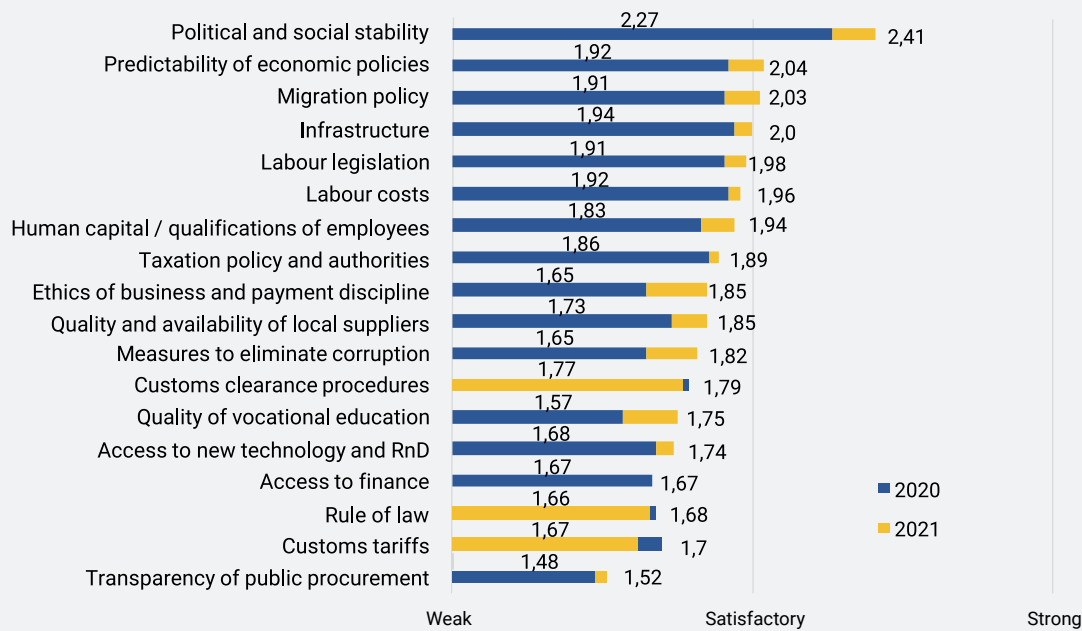


INVESTMENT CLIMATE 2021

Q12. Which factors attract your company to invest and/or do business in Azerbaijan?



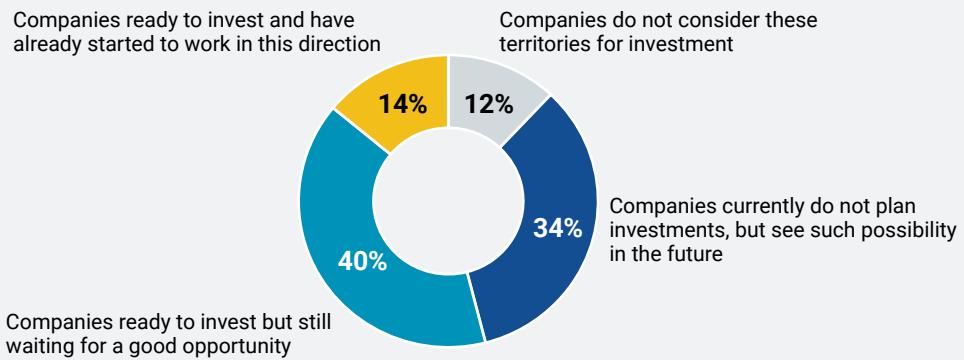
Q13. How do you rate the following local indicators?



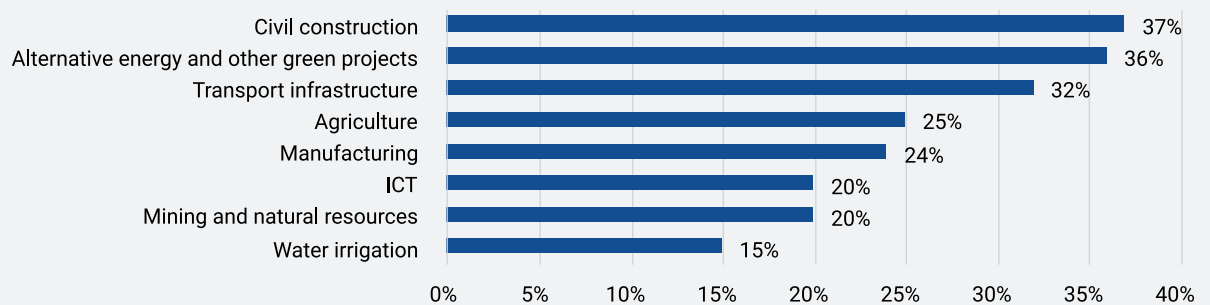
Q14. Whether the local suppliers fully meet expectations of your company or choose the factors to be improved?



Q15. Does your company consider Karabakh and East Zangezur economic regions as potential place for investment in the nearest years?

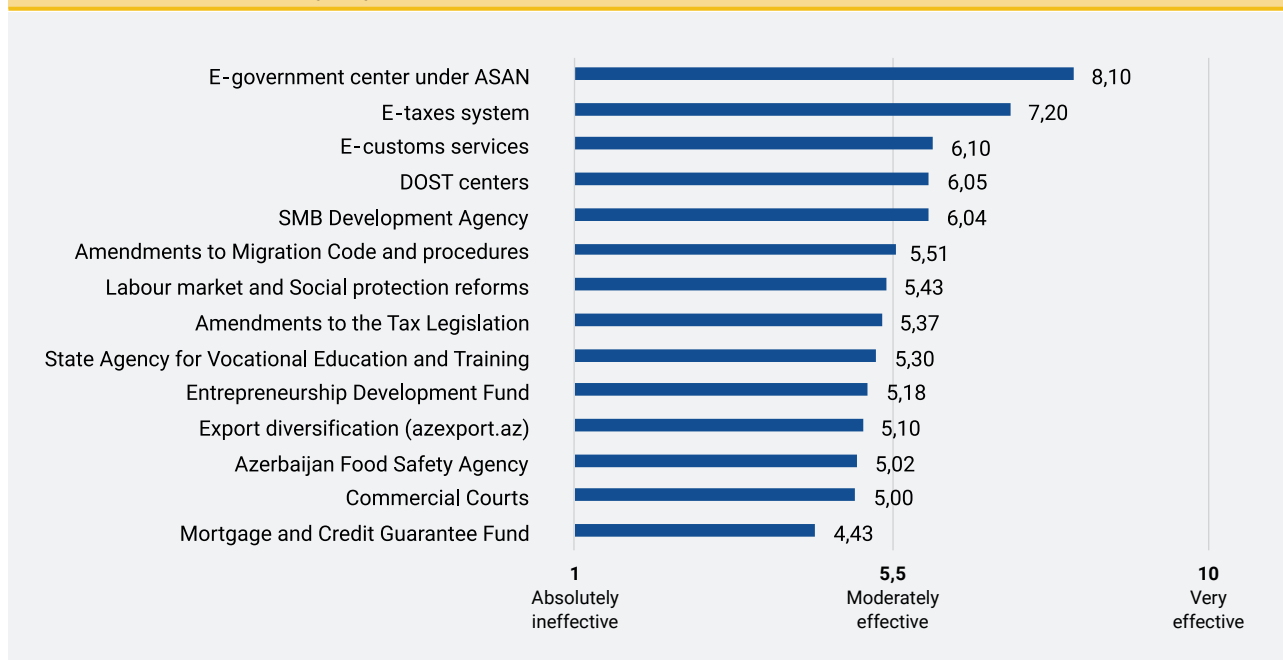


Q16. Which profile of investment you consider for Karabakh and East Zangezur economic regions?

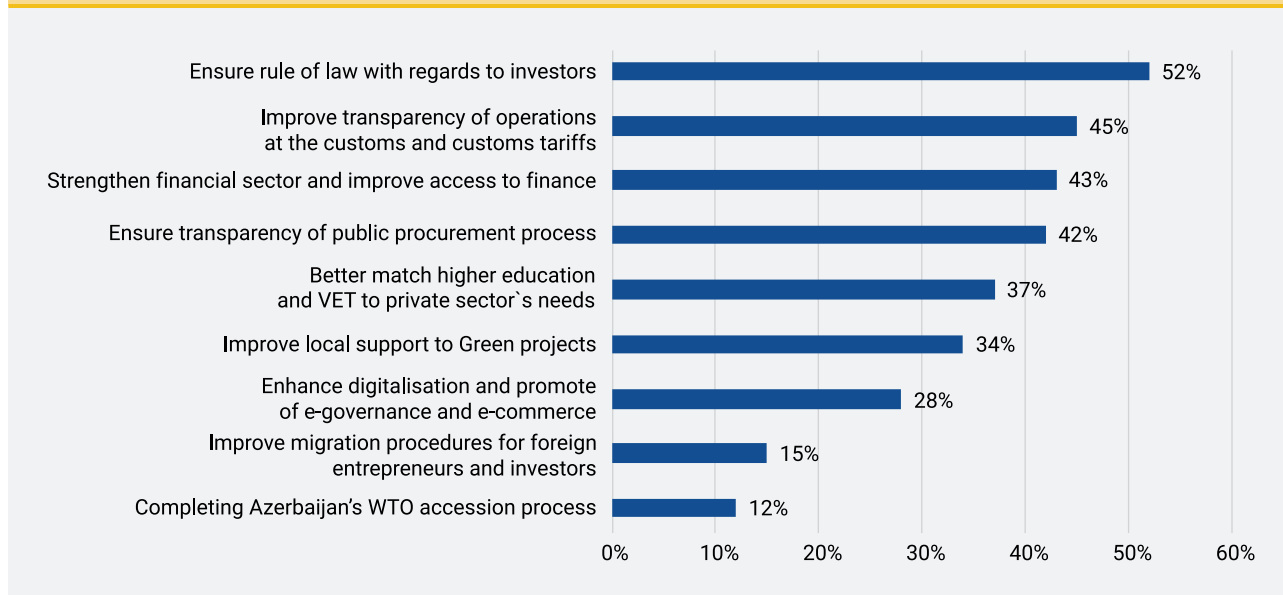


LOCAL REFORMS

Q17. Below we listed recently established bodies and reforms being implemented in Azerbaijan. How effective are they, in your opinion? Please, rate from 1 to 10

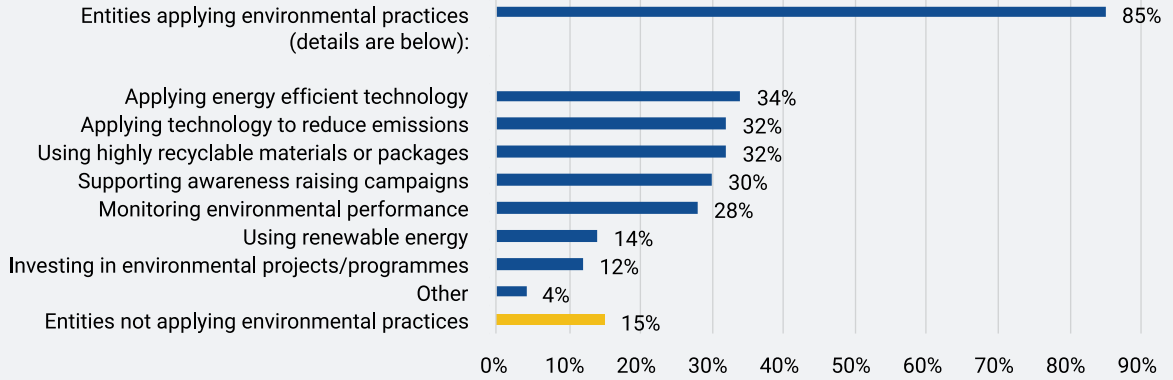


Q18. Which reforms, in your opinion, should be prioritised to further improve the business climate in Azerbaijan?

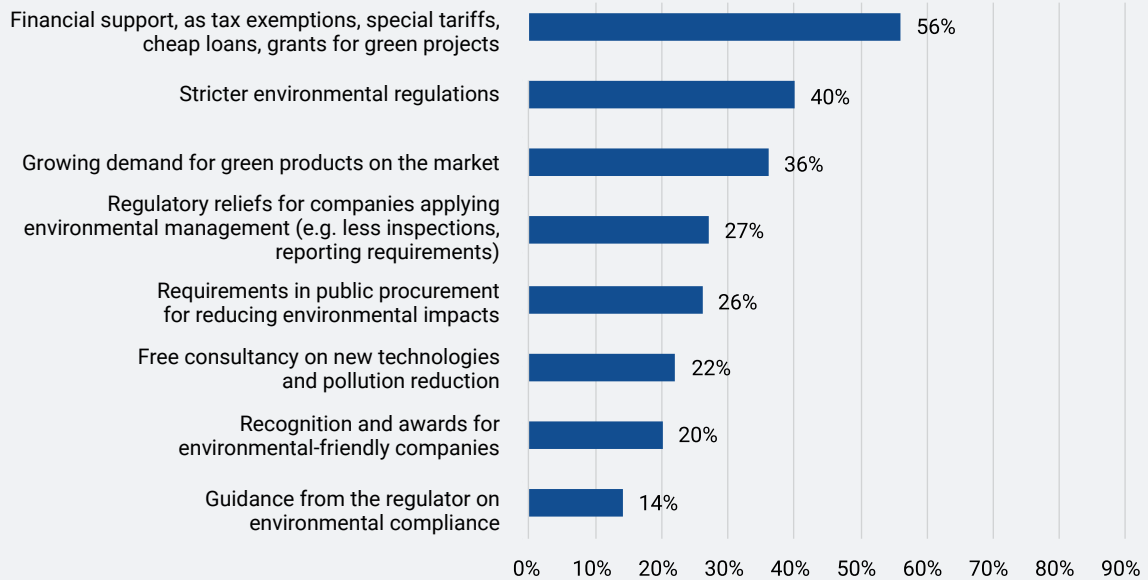


SUSTAINABLE ECONOMY

Q19. Does your company to any extent operate under principles of environmental awareness? (Multiple answers are allowed)



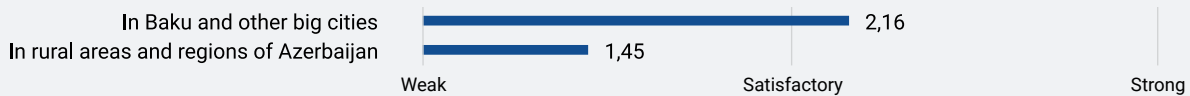
Q20. What would stimulate your company to further develop "green"?



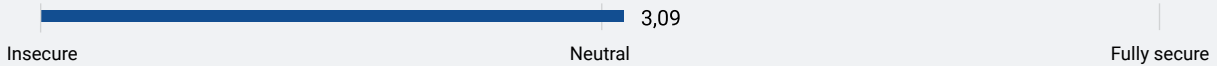


BUSINESS DIGITALIZATION

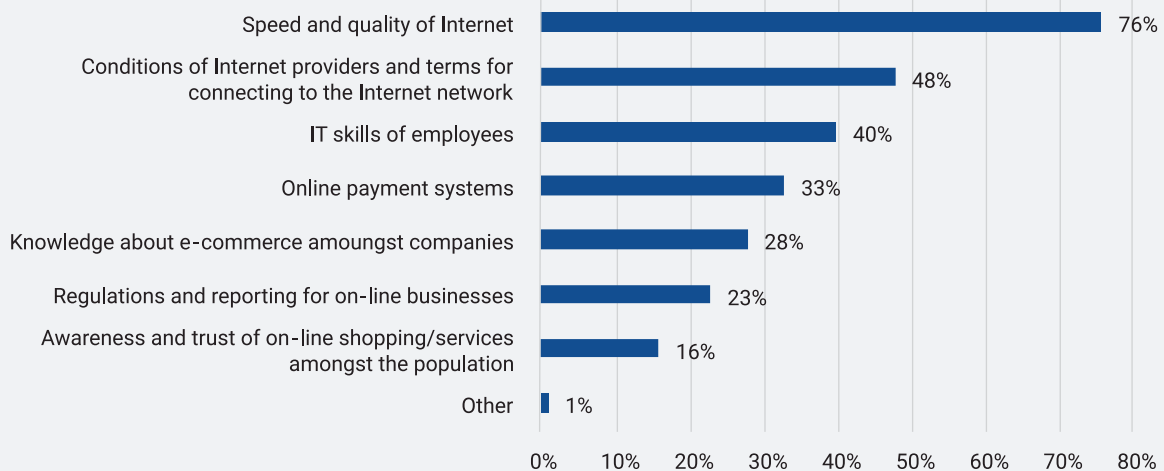
Q21. Please, evaluate the quality of IT infrastructure in Azerbaijan for digitalization of the business?



Q22. To which extent your company feels confident in terms of cybersecurity in Azerbaijan?



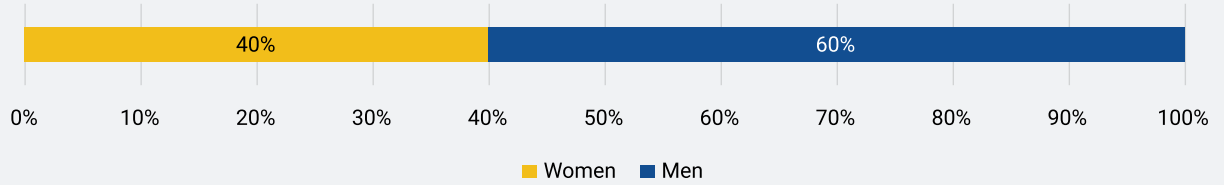
Q23. Which aspects of IT infrastructure should be improved to help business to digitalise more effectively?



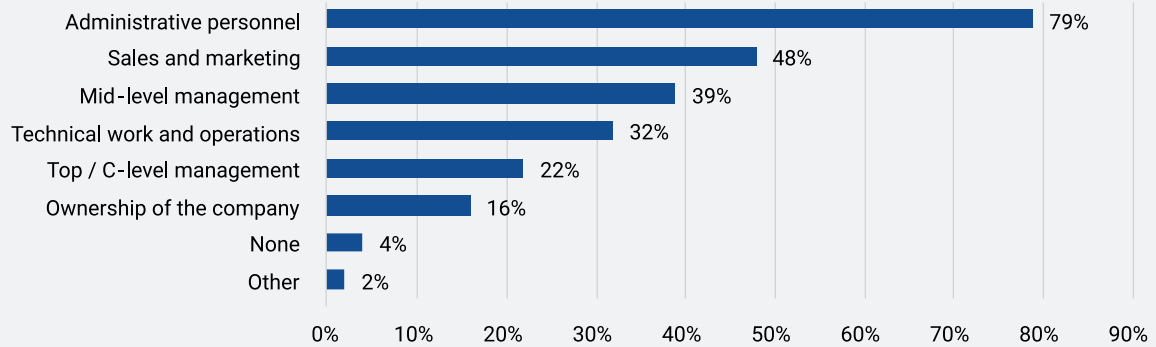


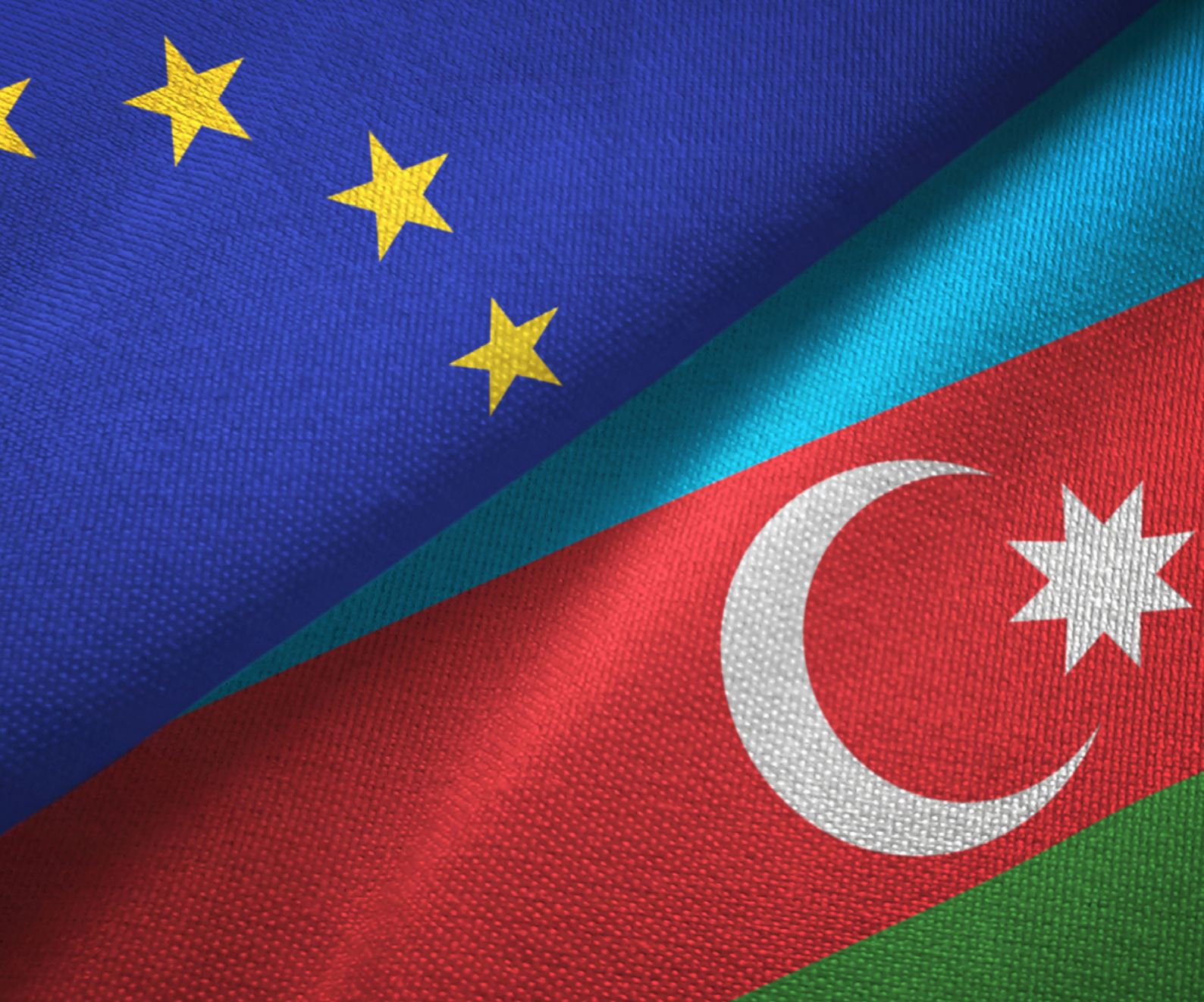
GENDER SEGREGATION

Q24. What percentage of the personnel in your company are women?



Q25. In which positions women are the most represented in your company?




















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.

Please, scan **QR codes** to learn more details.

NO	NAME OF THE PROJECT	TIMELINE	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)	01/2019 – 12/2023		✓		Pomegranates Producers and Exporters Association of Azerbaijan	
2	Developing innovation-driven and sustainable civil society in Azerbaijan	01/2020 – 11/2023		✓	✓	UNDP	
3	"From Kitchen to Business" Food Promotion and Women Empowerment Action	01/2019 – 12/2022		✓		Women's Association for Rational Development	
4	Supporting women's entrepreneurship during COVID-19	01/2020 – 09/2022		✓		Azerbaijan Micro-finance Association	
5	Azerbaijan Hazelnut and Pomegranate Initiative (AHPI)	01/2017 – 06/2022		✓		CNFA Europe	
6	EU Azerbaijan Business Forum 2020-2022	02/2020 – 12/2022			✓	COWI Belgium SPRL	
7	Support to Development of a Rural Business Information System	02/2020 – 8/2022			✓	International development Ireland	
8	Support the Government of Azerbaijan in development of export strategy and support in its implementation	11/2020 – 4/2022		✓	✓	Planet	
9	Support to Azerbaijan Standardisation Institute for implementation of the National Plan for harmonizing national standardisation system with international requirements	5/2020 – 4/2022			✓	Bundesrepublik Deutschland	
10	Support to the government of Azerbaijan in creating more enabling SME's environment and to enhance their competitiveness	1/2020 – 2/2022		✓	✓	European Profiles S.A.	

NO	NAME OF THE PROJECT	TIMELINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
EU4BUSINESS INITIATIVE							
11	Support to the State Statistical Committee and the State Tax Service under the Ministry of Economy to strengthen collection, harmonisation, analysis, publishing and dissemination of business statistics	6/2020 – 4/2022			✓	Statistics Finland, Statistics Lithuania, Statistics Netherlands	
12	Improved Support for Entrepreneurial Development in Rural Areas	5/2019 – 2/2022		✓			
13	Improved Promotion and Marketing of Traditional Food Products	5/2019 – 4/2022		✓		BSI INTERNATIONAL PROJECTS	
14	Twinning “Support to State Customs Committee of Azerbaijan in accession to the Convention on Common Transit Procedure, Convention on Simplification of Formalities in Trade in Goods and implementation of the New Computerised Transit System”	6/2020 – 3/2022			✓	Agenzia Delle Dogane E Dei Monopoli	
15	2018 NIP decision share – Green for Growth – Extension to Neighbourhood East II	12/2018 – 12/2040	✓			KfW	
16	Promoting Green Lending in the Eastern Partnership	4/2020 – 12/2040	✓			KfW	
17	EU4Business – The EU Local Currency Partnership Initiative: the European Fund for South-East Europe (EFSE)	12/2018 – 6/2039	✓			KfW	
18	Eastern Partnership SME Finance Facility – Phase II KfW	3/2017 – 12/2032	✓			KfW	
19	Eastern Partnership Trade Helpdesk	1/2020 – 1/2024		✓		International Trade Centre	
20	Structural Reform Facility: World Bank Component	9/2018 – 5/2023			✓	WB	
21	EU4Business: Connecting Companies	1/2020 – 1/2022		✓		Eurochambres	

NO	NAME OF THE PROJECT	TIMELINE	TYPE OF SUPPORT			IMPLEMENTING ORGANISATION	MORE INFORMATION
			ACCESS TO FINANCE	BUSINESS DEVELOPMENT SERVICES	BUSINESS ENABLING ENVIRONMENT		
EBRD PROJECTS							
22	Women in Business	12/2015 – 12/2022	✓	✓		EBRD	
23	Eastern Partnership SME Finance Facility – Phase II EBRD	12/2016 – 12/2022	✓			EBRD	
24	EU4Business EBRD Credit Line (SME Competitiveness Programme in Eastern Partnership)	12/2019 – 12/2026	✓			EBRD	
25	Azerbaijan Agricultural Financing Facility	2015 – 2021	✓		✓	EBRD, Azerbaijan Agricultural Financing Facility (AzAFF)	
26	FINTECC – Finance and Technology Transfer Centre for Climate Change	Ongoing, started in 2017	✓	✓		EBRD	
27	AZERBAIJAN: Financial Intermediaries Capacity Building Technical Cooperation Programme	2019 – 2021			✓	EBRD	
EIB PROJECTS							
28	Green for Growth Fund II)	2013 –	✓			EIB	
29	Accessbank Azerbaijan Loan for SMEs	2014 –	✓			EIB	
EU4ENVIRONMENT INITIATIVE							
30	EU4Environment	2019 – 2023		✓	✓	OECD, UNECE, UNEP, UNIDO, WB	
EU4CLIMATE INITIATIVE							
31	EU4Climate	2019 – 2022			✓	UNDP	
EU4DIGITAL INITIATIVE							
32	EU4Digital Facility	2019 – 2022		✓	✓	EY Lithuania	



ANNEX 3: VET TRANSFORMATION IN AZERBAIJAN

RECENT DEVELOPMENTS IN VET

In 2021, the various government initiatives continued to bring closer the private sector to VET development in Azerbaijan. The VET Law and the Strategic Roadmap for VETⁱⁱⁱ facilitate and demonstrate companies' involvement in VET. Partnership with the private sector is considered crucial to ensure the quality and relevance of VET concerning the needs of the labour market. Accordingly, the State Agency for Vocational Education (SAVE) under the Ministry of Education (MoE) has initiated cooperation with the private sector over the past few years.

In 2021, the modernisation of the vocational education institutions under the MoE continued. For 2021/2022, an online student admission process was carried out in 66 vocational schools. As a result, the number of applicants increased by 26% compared with last year, and the number of students admitted by 12.5%. New presidential decrees on November 5th 2021, about change in "Education law" and "Vocational education law" allow the credit transfer system to be implemented in high vocational education and the recognition of accumulated credit points in higher education. This new regulation gives vocational education opportunities and a pathway to the next level of education (higher education).

Ministry of Labour and Social Protection of Population (MLSP) is implementing reform in the vocational training, aimed to adults. The objective is to strengthen the role of State Employment Agency (SEA) in the organisation of short-term training courses (up to 6 months) for unemployed people and jobseekers. As part of the ongoing reforms, the legal status of the SEA was changed to that of a public legal entity in 2020. There is

a comprehensive plan on developing Vocational Training Centers (VTCs): i) expansion of the infrastructure of VTCs; ii) improvement of the legal/institutional system; and iii) improvement of the quality of the training content. In 2021, four VTCs are delivering short-term training courses for adults to support them in finding a job. According to the Employment Strategy^{iv}, the number of VTCs will be increased from four to 10 by 2030.

REFORMING THE FINANCING OF VET

The MoE allocates resources for VET schools considering various factors, such as school size, the number of students, expenditure for the school, etc. One of the strategic targets identified in the VET Strategic Roadmap is to build an outcome-based robust financing system. The objective is to incorporate a performance-based rewards mechanism for vocational education institutions and teaching staff to ensure the efficient use of funds and improve the quality of VET provision. Furthermore, priorities have been set to identify additional public, private and international funding sources to support the development of the VET system. It is also important to develop a strategy for monitoring and managing non-budgetary funds in the VET schools. The funding is planned to provide flexible solutions to issues such as the financial stimulation of teaching staff and an improvement of the material base, infrastructure and equipment. A Fund for the Development of VET was established in August 2020. Its mandate includes the provision of financial assistance for the development of vocational education.

ⁱⁱⁱ [Strategic Roadmap for VET](#)

^{iv} [The Employment Strategy](#)

EVOLUTION OF THE VET GOVERNANCE

The VET governance in Azerbaijan is evolving. The State Agency on Vocational Education (SAVE), established in 2016, is the leading institution in the field. Its authority is limited to VET institutions under the Ministry of Education (MoE). The two recently established bodies that will play an essential role in further implementation of the AzQF⁴ are the Lifelong Learning Unit at the Institute of Education and the Education Quality Assurance Agency. The Education Institute develops educational standards and curricula and curriculum and assessment issues, and the Lifelong Learning Unit will act as a focal point for the AzQF.

The Education Quality Assurance Agency was established in December 2019 by reorganising the former Accreditation and Nostrification Department of the Ministry of Education into the newly public legal entity. The main tasks related to managing the processes of (i) accreditation of educational institutions; (ii) recognition of foreign credential; (iii) recognition and validation of non-formal and informal learning; and (iv) providing advice and methodological support for the development of internal quality assurance systems in education institutions. For quality assurance at the VET school level, the regulations on monitoring vocational education institutions as of March 2018 provide for the monitoring of VET institutions in curricula, personnel, educational infrastructure, and teaching processes. SAVE implements the monitoring.

VALIDATION OF NON-FORMAL AND INFORMAL LEARNING (VNFIL)

The latest additions to the Law (Article 17.4 in 2018 and 2020) introduced the possibility of validation of non-formal and informal learning in vocational education through examination. In line with this addition to the Law made on June 12th 2018, on August 5th, 2020 the Cabinet of Ministers approved the "Rules of carrying out examination and issuing of the document confirming the professional qualification of citizens for the purpose of an assessment and recognition of the knowledge, skills, competence and experience acquired by citizens through non-formal and informal forms of vocational education".

Following the Rules, assessment and recognition is carried out by the Education Quality Assurance Agency under the Ministry of Education of the Republic of Azerbaijan. Therefore, the main stakeholders are the Ministry of Education and the Education Quality Assurance Agency. The other stakeholders are:

- MLSPPP (as a member of Assessment Commission for assessment and recognition process in accordance with the Article 5.2 of the Rules);
- Employers (as members of Assessment Commission);
- State Agency on Vocational Education under Ministry of Education.

The assessment and recognition process is linked to the "National Qualifications Framework for Lifelong Learning of the Republic of Azerbaijan" approved on July 18th, 2018.

EU SUPPORT TO VET IN AZERBAIJAN

The EU AAP 2018 Education for Employment programme of EUR 14.4 M signed in December 2019 seeks to:

i) develop the legal and institutional basis at all levels of education according to the requirements of an Outcomes-Based Qualification System (OBS) for Lifelong Learning (LLL); ii) design a credit system and improve quality-assurance in VET; iii) modernise selected VET institutions for delivering competency-based training; and iv) enhance the system for skill needs/anticipation and develop mechanisms for assessment of competences to minimise skills mismatch. Implementation of the programme started beginning of 2020 and will be completed by the end of 2024.

As part of this EU AAP 2018, since October 2020, UNDP has implemented an action "VET for the future: development of VET providers' excellence in Azerbaijan" of approx. 5.6 MEUR. The objective is to support the Government of Azerbaijan in creating a high-quality VET system. This action aims to provide continuing support to the State Agency for Vocational Education (SAVE). The focus is on creating a coherent national VET system, addressing institution building, system development and system delivery issues. Overall, the focus is on three main pillars: Introduction of innovation in selected VET providers; Infrastructure and equipment modernisation in selected VET providers; Development of networking and capacity building for all VET providers in Azerbaijan.

Another EU-funded project, part of the EU AAP 2018, which is foreseen to start towards the end of 2022, will aim at quality improvement in vocational education by introducing self-assessment, peer reviews and performance monitoring mechanisms. It will support SAVE in the development of policy and procedures for quality assurance in the VET system.

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3. [The German-Azerbaijani Chamber of Commerce \(AHK Azerbaijan\), Vocational Education at Absheron Peninsula and beyond](#)

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March 2022

⁴ National Qualifications Framework for Lifelong Learning of the Republic of Azerbaijan



ANNEX 4: GENDER GAP AMONGST EMPLOYEES IN AZERBAIJAN

ECONOMIC ACTIVITY	PRIVATE ENTREPRENEURS BY MAIN SECTORS IN 2020, %		AVERAGE SALARIES AMONGST ALL EMPLOYEES BY MAIN SECTORS, 2020			SEX DISTRIBUTION BY SECTORS, LOCAL COMPANIES, 2020		SEX DISTRIBUTION BY SECTORS, EU COMPANIES IN AZERBAIJAN, 2021	
	WOMEN	MEN	WOMEN, AZN	MEN, AZN	PAY GAP, %	WOMEN, %	MEN, %	WOMEN, %	MEN, %
Agriculture, forestry and fishing	23,9	76,1	379,8	450,1	15,6	23,9	76,1	33	67
Mining	5,1	94,9	2081,3	3455,4	39,8	12,7	87,3	34	66
Manufacturing	17,0	83,0	452,8	710,2	36,2	25,3	74,7	49	51
Electricity, gas and steam production, distribution and supply	6,8	93,2	584,6	712,7	18,0	11,2	88,8	20	80
Water supply; waste treatment and disposal	7,1	92,9	439,9	623,6	29,5	34,8	65,2	39	61
Construction	3,8	96,2	666,8	800,2	16,7	7,2	92,8	29	71
Trade; repair of transport means	20,9	79,1	458,5	541,3	15,3	25,2	74,8	35	65
Transportation and storage	2,1	97,9	616,5	938,3	34,3	16,2	83,8	40	60
Accommodation and food service activities	15,4	84,6	489,1	557,4	12,3	28,1	71,9	56	44
Information and communication	19,8	80,2	877,2	1168,4	24,9	28,8	71,2	24	76
Financial and insurance activities	26,9	73,1	1196,9	2021,8	40,8	35,3	64,7	45	55
Real estate activities	28,7	71,3	458,2	683,4	33,0	30,7	69,3	33	67
Professional, scientific and technical activities	34,0	66,0	736,3	1547,3	52,4	43,7	56,3	n/a	n/a
Administrative and support service activities	34,2	65,8	325,7	484,3	32,7	33,2	66,8	50	50
Public administration and defence; social security	34,2	65,8	325,7	484,3	32,7	26,2	73,8	25	75
Education	64,4	35,6	822,1	1006,1	18,3	73,3	26,7	63	37
Human health and social work activities	34,9	65,1	483,4	612,0	21,0	77,6	22,4	63	37
Art, entertainment and recreation	12,9	87,1	480,0	692,3	30,7	62,0	38,0	100	0
Other service activities	30,7	69,3	454,9	657,2	30,8	34,4	65,6	58	42
TOTAL (PROJECTED TO ALL # EMPLOYEES)	21,3	78,7	552,1	744,0	25,8	39,5	60,5	40	60
Average (projected to sectorial data)						33,2	76,8	44	56

*Based on data of State Statistical Service of Azerbaijan and results of EU Business Climate Survey



METHODOLOGY

QUANTITATIVE DATA / SURVEY

The quantitative data for the Report was collected via an anonymous online survey, which took place in **October – November 2021**. The **questionnaire 2021** is based on the previous surveys and adjusted to current local and global trends in 2021. The questionnaire contained 25 questions and was split into six sections: i) indicators of business and investment climate; ii) business recovery during pandemic; iii) reform-meter snapshot; iv) green economy; v) digitalisation; vi) gender segregation within companies.

The **target group** for the survey 2021 remained the same compared to the previous years. It includes 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, bilateral Chambers, organisations of bilateral economic cooperation and accomplished via open sources. The sample also includes Azerbaijani companies, whose primary business operations are related to the collaboration with EU partners. The database was proof-checked and updated by direct contacts with the companies.

The online questionnaire was distributed to companies via official channels and advertised on official web pages of the implementing organisations and the "EU-Azerbaijan Business Forum". After the quality check of the obtained applications, **139 responses were approved to the sample, which** represents businesses from 24 countries, including 23 European countries and Azerbaijan. The largest representation in the sample has companies of French, Italian, German, Azerbaijani and British origin, with shares between

11-16%. The respondents work in 19 industries, and over 90% represent the SME sector.

Since the survey was distributed via the open channels and each of the companies had an equal chance to respond; and since the obtained samples represent companies of various sizes, sectors and countries and operating in Azerbaijan during different periods 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 margin of error 0.049.

QUALITATIVE DATA / INTERVIEWS

At the second stage, the qualitative data was collected via deep interviews with representatives of European companies and organisations taking place from **November 2021 – to January 2022**.

Twenty-seven interviews were conducted with the companies of seven sectors having the most significant representation in the survey, namely: consulting and audit; mining, oil and gas; construction, engineering and related services; transportation and logistics; wholesale and retail; ICT; tourism and hospitality. Another group of the organisations that participated in the interviews were bilateral Chambers and European offices for trade and economic cooperation, the EU banks, initiatives and projects, as well as international organisations.

DESK RESEARCH

Statistics and materials used for the preparation of this report include official Azerbaijani sources of information, such as legislation of Azerbaijan, State Statistics Committee of the Republic of Azerbaijan, Centre for Analysis of Economic Reforms and Communication of the Republic of Azerbaijan, the Central Bank of the Republic of Azerbaijan, and official state media; and publications of international organisations, such as ADB, EBRD, EIB, ETF, ILO, IMF, ITU, OECD, UN, UNCTAD, UNDP, UNEP, UNPF, UNWTO, WB, WHO, and others.

ACRONYMS AND ABBREVIATIONS

ABAD	ASAN Support to Family Business Programme
ABI	Annual Bank Investment
ADB	Asian Development Bank
AFchamber	France-Azerbaijan Chamber of Commerce and Industry
AFEZ	Alat Free Economic Zone
ASAN	Azerbaijan Service and Assessment Network
ASAN-Imza	ASAN Easy Signature services
ASAN Visa	ASAN services for visa issuance procedures
AZN	Azerbaijani manat (currency)
AZPROMO	Azerbaijan Export and Investment Promotion Foundation of the Republic of Azerbaijan
BIRI	Banking Industry Risk Indicator
bn.	Billion
COVID-19	Coronavirus disease 2019
CWG	Community-based Women Groups
C-level	Chief level
DOST	Agency for Sustainable and Operative Social Provision of the Republic of Azerbaijan
E5P	Eastern Europe Energy Efficiency and Environment Partnership
EaP	Eastern Partnership
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EFTA	European Free Trade Association
ESSA	European Social Services Award
ETF	European Training Foundation
EU	European Union
EU Delegation	Delegation of the European Union in Azerbaijan
EUR	Euro
E-court	Electronic courts system
E-customs	Electronic customs system
E-tax	Electronic taxation system
GDP	Gross Domestic Product
GCI	Global Cybersecurity Index
GGGR	Global Gender Gap Report
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
JSC	Joint-stock company
IBA	International Bank of Azerbaijan
I.C.E.	Italian Trade Commission
ICT	Internet and communications technology
IDFI	Institute for Development of Freedom of Information
ILO	International Labour Organisation
IPD	Investment Promotion Document

IT	Internet technology
ITU	International Telecommunication Union
IFI	International Financial Institution
INVESTBAKU	Investment Agency of Baku
IMF	International Monetary Fund
ITAZERCOM	Italy-Azerbaijan Chamber of Commerce
KPIs	Key performance indicators
LLC	Limited liability company
Mbps	Megabits per second
MLSPP	Ministry of Labour and Social Protection of Population of Azerbaijan
mln	Million
MW	Megawatt
NEEAP	National Energy Efficiency Action Plan
NDC	Nationally Determined Contribution
NPL	Non-performing loans
NQF	National Qualifications Framework
OECD	Organisation for Economic Cooperation and Development
RECP	Resource Efficient and Cleaner Production
R&D	Research and development
SAVE	State Agency on Vocational Education
SDGs	Sustainable development goals
SME	Small and medium size enterprises
SGC	Southern Gas Corridor
SMBDA	Small and Medium Business Development Agency of the Republic of Azerbaijan
TAP	Trans-Adriatic Pipeline
thou	Thousand
TPPR	Transparent Public Procurement Raking
VAT	Value-added tax
VET	Vocational Education and Training
VTC	Vocational Training Center
W	Watt
WB	World Bank
WHO	World Health Organisation
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
UNEP	United Nations Environment Programme
UNPF	United Nations Population Fund
UNWTO	United Nations World Tourism Organisation
USA	United States of America
USD	United States dollar



PUBLICATION

The EU Business Climate Report Azerbaijan 2021 is prepared within the “EU-Azerbaijan Business Forum” 2020 – 2022 funded by the European Union.

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Special thanks to the EU Delegation to Azerbaijan and our partners InvestBaku, ITAZERCOM and AFChamber for providing with photographs.

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