



Executive Summary

The overall investment climate in Azerbaijan continues to improve incrementally, although very significant challenges remain. Over the past few years, the Government of Azerbaijan has worked to integrate the country more fully into the global marketplace, attract foreign investment, diversify its economy and maintain growth. Robust expansion in Azerbaijan during 2013 was driven by the non-oil economy, especially public spending on infrastructure. Economic diversification continues to be a stated goal of President Aliyev and the government, but substantial economic challenges remain for Azerbaijan, particularly the implementation of long-term institutional reforms. Although Azerbaijan has continued to welcome and attract significant foreign investment to further develop its energy sector, inefficient government bureaucracy, weak legal institutions, requests for illicit payments for cross-border transactions, and predatory behavior by politically-connected monopolistic interests hinder investment outside of the oil and gas sector and present challenges for U.S. companies. Azerbaijan has worked to improve its regulatory system over the past several years, but a continued lack of transparency and allegations of corruption remain key problems in this area.

Under Azerbaijani law, foreign investors may engage in investment activities not prohibited by law. Private entities may freely establish, acquire and dispose of interests in business enterprises. Foreign citizens, organizations, and enterprises may lease, but may not own land. The Law on the Protection of Foreign Investments protects foreign investors against nationalization and requisition, except under certain specified circumstances. A Bilateral Investment Treaty between the United States and Azerbaijan provides U.S. investors with recourse to the International Center for the Settlement of Investment Disputes. The average length of time that international business disputes take to be resolved, either through the court system or through negotiations and/or arbitration between the two parties, varies widely.

Azerbaijan has a liberal exchange rate system and, in general, there are no restrictions on converting or transferring funds associated with an investment into freely usable currency at a legal, market-clearing rate. Yet Azerbaijan has an underdeveloped financial services sector – of which banking comprises more than 90 percent – that inhibits economic stability, growth and diversification. While there are no state-owned enterprises that officially have been delegated governmental powers, companies such as the State Oil Company of the Azerbaijan Republic (SOCAR), Azerenerji (electricity) and Azersu (water) – all of which are closed joint-stock companies with majority state ownership and limited private investment – enjoy quasi-governmental or near-monopoly status in their respective sectors. Corporate social responsibility (CSR) is a relatively new concept in Azerbaijan and local companies generally consider basic charitable donations and paying taxes as acts of social responsibility. Although the government announced its intention to create special economic zones in 2003 – and passed a law to establish such zones in 2009 – currently there are no foreign trade zones or free ports operating in Azerbaijan. There have been no known acts of political violence against U.S. businesses or assets, nor against any foreign owned entity.

1. Openness to, and Restrictions Upon, Foreign Investment

Over the past few years, the Government of Azerbaijan has worked to integrate the country more fully into the global economic marketplace, attract increased **foreign investment**, diversify its economy and maintain positive growth during the global financial crisis. Robust expansion in Azerbaijan during 2013 was driven by the non-oil economy, which received a boost from continued public investment. While the oil sector is just emerging from a recession, public spending especially on infrastructure, is contributing to higher growth rates in the non-oil sector.

Economic diversification continues to be a stated goal of President Aliyev and the government, despite what appears to be diminished zeal for economic reform compared to a period of rapid reform from 2007 to 2009, which led the World Bank to name Azerbaijan as one of the top ten global reformers in its 2009 Doing Business report. Less than expected oil production – and its concomitant impact on oil revenues – may refocus Azerbaijan on the need for quick and comprehensive reforms, including completing its WTO accession process.

Consequently, substantial economic challenges remain for Azerbaijan, particularly with regards to the implementation of long-term institutional and systemic reforms that are critical to strengthening the foundations for economic freedom. Although Azerbaijan has continued to attract significant **foreign investment** to further develop its **energy** sector throughout the past decade, inefficient government bureaucracy, weak legal institutions, requests for illicit payments for cross-border transactions, and predatory behavior by politically connected monopolistic interests hinder investment outside of the oil and gas sector and present challenges for U.S. companies.

The score and rank of Azerbaijan in the most current World Bank Doing Business Report, Heritage Foundation Economic Freedom Index, Transparency International Corruption Index, World Bank Gross National Income (GNI) per capita, and Global Innovation Index for Azerbaijan are included in the table below.

The Government of Azerbaijan officially welcomes **foreign direct investment (FDI)**, but the recognition of its importance to the development of a robust and diverse economy still lags in some parts of the government. The laws on the books favor foreign direct investment, thorny investment disputes can arise when a foreign investor or trader's success threatens well-connected or favored local interests.

The Law on Protection of Foreign Investments permits foreign direct investment in any activity in which a national investor may also invest, unless otherwise prohibited by law. Prohibited areas include those relating to national security and defense. The Government of Azerbaijan also exerts some measure of control over other key sectors, such as **energy and communications**. Foreign investments have complete and unreserved legal protection granted by this law, as well as by other laws and international contracts. The law provides that Azerbaijan will treat foreign investors in a manner not less favorable than the treatment accorded to national investors and allows the repatriation of profits, revenues and other investment-related funds as long as applicable taxes have been paid.

Under Azerbaijani law, foreign investors can participate – according to existing legislation – in the privatization of state and municipal properties, and can invest in Azerbaijan through joint ventures with local companies or by establishing subsidiaries that are wholly-owned, as well as through representative offices and branches of foreign legal entities. Azerbaijani law also provides a ten-year grandfather clause in the event new legislation less favorable to foreign investors is adopted; however, this provision does not apply to changes in tax legislation. In 2008, Azerbaijan transferred responsibility for registering representative offices of foreign businesses, and the creation of business entities with foreign ownership, to the Ministry of Taxes based on the so-called “one-stop-shop” principle that greatly simplifies the registration process and reduces waiting times. The registration of representative or branch offices of foreign non-commercial entities was not, however, transferred to the Ministry of Taxes; such entities still are required to register with the Ministry of Justice. The “online registration” system of legal entities has been available since February 2012. Registering a representative office or branch with the tax authorities should take place within one month from the start date of operations. Terminating a representative office’s or branch’s activities should be reported to the authorities one month prior to the termination of operations. A representative office or branch is the locally registered site of a foreign legal entity and has “non-resident” status with regards to Azerbaijani tax, legal, and currency regulations. The representative office is not subject to any taxes on its profits, as its activities are strictly limited to providing representative services to its head office. Both the representative office and branch are responsible for the timely payment of all other applicable taxes, such as personal income tax and Azerbaijani social security payments for employees.

Over the past few years, Azerbaijan has been engaged in the process of updating several key pieces of legislation that impact the business environment. It passed a new Customs Code in September 2011, and in response to a specific Moneyval recommendation, passed a Corporate Criminal Liability law in 2012. A new version of the Competition Code is currently undergoing revision in Parliament, and some observers expect the law to pass finally in 2014. Azerbaijan’s **Bankruptcy** Law, which does not function effectively and is rarely used, continues to be a hindrance, as does its weak credit reporting institutions. Another hindrance to foreign direct investment is the difficulty of getting established Azerbaijani businesses to adapt to standard investor-friendly practices, such as those associated with the concept of good corporate governance or international accounting norms.

TABLE 1: The following chart summarizes several well-regarded indices and rankings.

Measure	Year	Rank or value	Website Address
TI Corruption Perceptions index	2013	128 of 177	http://cpi.transparency.org/cpi2013/results/
Heritage Foundation’s Economic Freedom index	2013	81 of 177	http://www.heritage.org/index/ranking
World Bank’s Doing Business Report “Ease of Doing Business”	2013	71 of 189	http://doingbusiness.org/rankings

Global Innovation Index	2013	105 of 142	http://www.globalinnovationindex.org/content.aspx?page=gii-full-report-2013#pdfopener
World Bank GNI per capita	2012	6,220 USD	http://data.worldbank.org/indicator/NY.GNP.PCAP.CD

2. Conversion and Transfer Policies

Azerbaijan has a liberal exchange rate system and, in general, there are no restrictions on converting or transferring funds associated with an investment into freely usable currency at a legal, market-clearing rate. The Central Bank of Azerbaijan (CBA) has required that cash transactions be conducted in Azerbaijani manats since 2001. Foreign companies and individuals may have both AZN and foreign currency accounts at a local bank. All settlements within Azerbaijan, including the payment of an employee salary, should be made in AZN with a few exceptions. Permission from the CBA is required to collect revenues in foreign currency in the territory of Azerbaijan. The Baku Electronic Currency Exchange System (BEST) was launched in July 2002 and **currency conversion** is carried out through the Baku Interbank Currency Exchange Market (BICEX) and the Organized Interbank Currency Market. The average time for remitting investment returns is two to three business days. In more recent years, additional requirements relating to the disclosure of the source of currency transfers have been imposed in an attempt to reduce illicit transactions.

No systematic difficulties exist in obtaining **foreign exchange**. Cash exchange is carried out at numerous currency exchange points and many cash machines will distribute both Euros and U.S. Dollars, in addition to Azerbaijani manats. In 2007, Parliament amended existing legislation to eliminate **custom duties** for cash currency exports, a step in line with **WTO** requirements. The country's strategic monetary reserves grew by 9 percent to over 50 billion USD as of December 2013. The official currency reserves of the Central Bank of Azerbaijan increased to 14.1 billion USD as of December 2013.

3. Expropriation and Compensation

The Law on the Protection of Foreign Investments protects foreign investors against **nationalization** and **requisition**, except under certain specified circumstances. The nationalization of property can occur when authorized by parliamentary resolution, although there have been no known cases of nationalization or requisition against foreign firms in Azerbaijan. Requisition – by a decision of the Cabinet of Ministers – is possible in the event of natural disaster, an epidemic, or other extraordinary situation. In the event of nationalization or requisition, foreign investors are entitled by law to prompt, effective, and adequate compensation.

4. Dispute Settlement

Disputes or disagreements arising between foreign investors and enterprises with foreign investment, state bodies of Azerbaijan, and/or enterprises, public organizations and other legal

entities of Azerbaijan, are to be settled in the **court systems** of Azerbaijan or, on agreement between the parties, in a court of **arbitration**, including international arbitration bodies. The judiciary consists of the Constitutional Court of the Republic of Azerbaijan, the Supreme Court of the Republic of Azerbaijan, the appellate courts of the Republic of Azerbaijan, trial courts, and other specialized courts. The Supreme Court and appellate courts have civil, criminal, administrative, economic, and military panels. Trial court judgments may be appealed in appellate courts and the judgments of appellate courts can be appealed in the Supreme Court. The Supreme Court is the highest court in the country. Under the Civil Procedure Code of Azerbaijan, the judgments of the appellate court are published within three days of issuance but may, in exceptional circumstances, be published within ten days. The Constitutional Court has the authority to review laws and court judgments for compliance with the Constitution. The decisions of the Constitutional Court are published.

The procedure for the enforcement of foreign judgments in Azerbaijan is established by the Civil Procedure Code. The Code only requires the enforcement of foreign judgments either pursuant to an international treaty or based on the principle of reciprocity and provides that foreign arbitral awards may be enforced in Azerbaijan, only so long as they do not contravene local legislation or public policy, and if reciprocity exists. A **Bilateral Investment Treaty** between the United States and Azerbaijan – which came into effect in 2001 – provides U.S. investors with recourse to the International Center for the Settlement of Investment Disputes.

Azerbaijan has entered into several other bilateral treaties – principally with neighboring states – to facilitate the enforcement of foreign judgments, and is a party to the 2004 Commonwealth of Independent States (CIS) Convention on Mutual Legal Assistance in Civil, Family and Criminal Cases. In addition, Azerbaijan is a party to the Convention on Resolving Business Disputes, dated March 20, 1992 (also known as the Kyiv Convention). Azerbaijan also is a party to the World Bank Convention on the Settlement of Investment Disputes between States and Nationals of Other States, as well as being a member of the Multilateral Investment Guarantee Agency (MIGA). Azerbaijan is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which provides for binding international arbitration of investment disputes between foreign investors and the State.

The Supreme Court is responsible for recognition and enforcement issues. The law does not provide specific periods for consideration of applications on the recognition and enforcement of foreign judgments. The average length of time that international business disputes take to be resolved, either through the court system or through negotiations and/or arbitration between the two parties, varies widely.

5. Performance Requirements and Investment Incentives

Azerbaijan has not yet developed or implemented special **incentives** to attract foreign investment. A law permitting the creation of Special Economic Zones (SEZs) was passed by Parliament in December 2009, but no such zones have been established to date. The law provides a legal basis and framework for the establishment and operation of territorial zones. There are plans to develop an SEZ in Alat, a commercial seaport under construction, and the Baku Heydar Aliyev International Airport. (See section below on SEZs.)

On December 21, 2012, the Azerbaijani Parliament passed amendments to the **Tax Code**, which included an exemption from income, land, and property taxes for business parks in the area of information technology and other industries to be established in Azerbaijan. The amendments also envisage tax and customs privileges for the residents of industrial and technological parks for a term of seven years.

Performance requirements are generally not imposed on new investments, but investors that participate in the **privatization** process often assume specific obligations regarding future investment and employment. Foreign investors are not normally required to purchase from local sources or export a certain percentage of output. Except for certain state monopolies, there is no explicit requirement that nationals own shares in enterprises. Investors in Production Sharing Agreements (PSAs) assume obligations and requirements as provided within the PSA.

There are currently no formal legal requirements for employment of host country nationals, though this policy could eventually be reviewed by Parliament. Additionally, there is an overall limit on the number of foreign workers permitted in Azerbaijan, as well as sectorial limits. Employers wishing to hire foreign workers in Azerbaijan must obtain a license from the Ministry of Labor. Foreigners who wish to work in Azerbaijan must register with local authorities at their place of residence and obtain **work permits** from the Ministry of Labor. Sole proprietors, heads of representative offices, and branches of foreign legal entities and their deputies, short-term (three months or less) secondees, accredited foreign **media** representatives, **education** specialists, diplomats and international civil servants do not require work permits. As of July 2009, the State Migration Service (SMS) decreed a one-stop shop system for work and **residency permits**. According to this single window principle, within seven days of application, foreigners applying for residence and work permits should receive these documents, although not all applicants experience this level of efficiency. The fee to acquire a one-year license for a migrant worker is equal to 1,000 AZN (approximately 1,250 USD).

Despite this, major U.S. and other international firms have increasingly encountered problems registering their expatriate employees with the SMS. One of the issues has been the requirement for a certificate attesting that a foreign worker is free from yellow fever, hemorrhagic virus, HIV, Hepatitis B and C, and mental disorders. The process was streamlined in 2012 after business complaints, but it should be noted that the SMS still will only accept health certificates from approved medical facilities in Azerbaijan. The new regulations require that all foreign visitors who stay in Azerbaijan more than 3 days – both official and personal guests – must register with the SMS. Visitors staying less than 3 days do not need to register. Travelers staying at major hotels in Baku will have the **registration** done when they check in. Those staying in private homes or lesser known hotels will have to register themselves. Registration is the traveler's responsibility and can result in a \$380 - \$500 fine that must be paid before being allowed to depart Azerbaijan.

Registration may be done in person, by mail or via e-mail to qeydiyyat@migration.gov.az. If registering via e-mail the traveler should scan and send the following information:

- SMS registration form

- Passport biographic page
- Azerbaijani visa
- Entry stamp in passport

The registration form is only in Azerbaijani but may be completed in English.

The business community has registered its concerns about a number of other issues with the SMS and requested clarification on: exit and entry authorizations; police registration; the possibility of submitting photo copies as opposed to original documents when applying for a visa extension; the possibility of the early submission of documents for extending one's stay; the reduction of state duties for work permits issued for less than a year; and discrepancies between validity dates on permit cards versus the actual date when the cards are received. The new Migration Code adopted in August 2013, however, reflected a number of business-friendly proposals submitted by the American Chamber of Commerce in Azerbaijan.

6. Right to Private Ownership and Establishment

Under Azerbaijani law, foreign investors may engage in investment activities not prohibited by law. Private entities may freely establish, acquire and dispose of interests in business enterprises. However, in practice, access to markets, credit and other business operations is often impeded by licensing and other regulatory requirements, and by politically connected business interests that can mobilize the powers of the state to their advantage. In sectors of interest to certain senior government and political figures, competition is actively impeded through administrative barriers.

Legislation regulating real **property rights** include the Law on Mortgage (2005), the Land Code of the Republic of Azerbaijan (1999), the Law on Land Reform (1996), the Law on Land Leasing (1999), and the Law on Land Market (1999). Azerbaijani citizens and legal entities, including enterprises with foreign investment, can legally own, buy, sell, and trade property. Following the 1999 Land Code, which remains in effect today, foreign citizens, organizations, and enterprises may lease, but may not own land. Expropriation may occur in the event of natural disaster, epidemic, or other extraordinary situation.

7. Protection of Property Rights

Amendments to the Civil Code adopted in 2004 and 2007, which allow authorities to forcibly purchase and **expropriate property**, have created opportunities for the abuse of property rights. The poor quality, reliability and transparency of governance, as well as regulatory abuse and inconsistent contract enforcement, have exacerbated this problem.

In 2006, the Government centralized the processing of residential **real estate** transactions through a network of notary offices under the Ministry of Justice. Since 2013, Azerbaijan's State Real Estate Registry Service at the Committee for Property Issues has been the lead agency that manages the real estate registration system.

The Government of Azerbaijan has been working with the World Bank to improve the property registration system, but the system remains awash with bureaucratic requirements and is generally seen as corrupt and inefficient. The January 2014 Index of Economic Freedom – compiled by the Wall Street Journal and the Heritage Foundation – gave Azerbaijan poor scores on private property rights and freedom from corruption.

In the mid-1990s, Azerbaijan began implementing a national system for registering and protecting intellectual property rights (IPR) with the assistance of the World Intellectual Property Organization (WIPO), of which it is a member. Azerbaijan enacted improved copyright legislation (Law on Copyright and Related Rights) in 1996, patent legislation (Law on Patents) in 1997, and trademark protection legislation (Law on Trademarks and Geographic Names) in 1998. Azerbaijan also is a party to the Convention Establishing the World Intellectual Property Organization, the Paris Convention for Protection of Industrial Property, and the Berne Convention for the Protection of Literary and Artistic Works. Azerbaijan is a party to the Geneva Phonograms Convention, and acceded to the two WIPO Internet treaties in 2005.

As part of its WTO accession program, Azerbaijan has continued to develop a range of WTO-consistent IPR legal and regulatory reforms, which could significantly strengthen IPR rights and enforcement protections, if they were consistently enforced. Azerbaijan amended its copyright legislation in 2008 and formed an anti-piracy commission in May 2010, with representatives from various ministries charged with enforcing existing legislation. Most recently, Azerbaijan adopted a new Law on the Provision of Intellectual Property Rights and Fight against Piracy in May 2012. This new law brings Azerbaijan's intellectual property regime more closely in line with the WTO Trade-Related Intellectual Property Rights (TRIPS) agreement, and satisfies many of the requirements and expectations of Azerbaijan's WTO Working Party members. According to the State Copyright Agency, during 2013 piracy in the field of book printing dropped from 61% to 30%, from 90% to 68% in the market of audiovisual products, and from 96% to 87% in the field of software. The Business Software Alliance put the software piracy figure at 87% in 2011.

Despite this progress, pirated software, movies, books, clothing and other luxury items are widely available in Azerbaijan.

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at <http://www.wipo.int/directory/en/>.

Embassy point of contact: Michael Durnan DurnanMJ@state.gov

Local lawyers list: http://azerbaijan.usembassy.gov/legal_info.html

8. Transparency of the Regulatory System

The Government of Azerbaijan has worked to improve its **regulatory system** over the past several years, but a continued lack of transparency and allegations of corruption remain key problems in this area. The lack of transparent policies and effective laws to establish clear rules and foster **competition** are particularly serious impediments to foreign direct investment.

Informal bureaucratic control mechanisms often interfere with the application of laws and regulations and hinder competition. While laws and decrees usually are published in one of the country's official newspapers, as well as online, implementation often is delayed while regulations are developed; those regulations, in many instances, are not published or distributed. Politically connected businesses benefit from government regulatory and other decisions to achieve effective control over lucrative sectors of the economy, and U.S. companies have been among those impacted. Powerful state-owned enterprises, such as the Azerbaijan State Caspian Shipping Company (CASPAR) and Azerbaijan Airlines (AZAL), have regulatory authority that they can exploit to block **new entrants** into the market – a clear conflict of interest. Major businesses are run by senior government officials or other politically-connected individuals who wield inordinate influence on the market economy; these monopolistic actors often exercise their political connections and economic power in a manner that discriminates against or unfairly burdens foreign investors or foreign-owned investments.

In August 2013, Azerbaijan's Parliament passed a law on the regulation of inspections in **entrepreneurship** and the protection of the rights of entrepreneurs. Following the law, businesses are to be divided into high, medium, and low risk groups, with the frequency of inspections regulated by these risk categories. Entrepreneurs who have not committed legal infractions for a certain period of time are categorized as low risk groups, which will result in less frequent inspections.

In October 2011, the President of Azerbaijan issued a decree calling on the Cabinet of Ministers to develop a Law on Licenses and Permits. The IFC and USAID have provided assistance in this effort. Despite plans to adopt 29 national accounting standards, so as to be in line with International Financial Reporting Standards (IFRS) by 2009, as of 2014 audited financial statements have only been adopted in banking and **finance**.

9. Efficient Capital Markets and Portfolio Investment

Azerbaijan has an underdeveloped **financial services** sector – of which banking comprises more than 90 percent – that inhibits economic stability, growth and diversification. Non-bank financial sector staples such as capital markets, insurance, and private equity are in the early stages of development. The banking sector has primarily benefited from the effects that high oil prices have had on the non-oil economy, significant government spending, and the rapid expansion of higher margin retail and micro-lending.

With around 45 private banks, Azerbaijan's banking sector is fragmented; the fragmented structure reinforces oligarchic control of the economy and holds back private sector growth, as smaller firms find it difficult to finance expansion. Foreign ownership in the banking sector is limited to 50 percent ownership on an aggregate basis; currently there are around 22 banks in Azerbaijan with some investment by foreign capital. Because banks rarely compete directly against each other for market share, they have little incentive to offer competitive terms. Commercial loan **interest rates** offered by banks in early 2014 varied in the range of 16-34 percent.

Total banking sector assets were 26 billion USD as of January 1, 2014, with the top five banks holding almost 58 percent. The majority state-owned International Bank of Azerbaijan (IBA) accounts for approximately one-third of the country's banking assets, but has had problems meeting minimum capital adequacy requirements. The Central Bank of Azerbaijan (CBA) has been focused on encouraging consolidation in the sector and, in August 2012, the CBA raised the minimum capital requirement from 10 million AZN (12.7 million USD) to 50 million AZN (63.7 million USD), effective January 1, 2014. However, the increase in the capital adequacy ratios failed to consolidate the banking sector as anticipated.

In its June 2013 report, the International Monetary Fund (IMF) noted that efforts to strengthen capital markets would facilitate the financing of the non-oil sector. The IMF also noted that the 2013 change in the Commercial Secrets Law, discouraging the disclosure of shareholders of companies, is a step in the wrong direction as it raises concerns about open competition for private sector activities and is against international disclosure principles on beneficial ownership. On the positive side, the Azerbaijan Mortgage Fund – administered by the Central Bank – has helped fuel a growing **mortgage** market and improved **credit** access by households. Microfinance – the only significant source of non-bank financing to small businesses – has taken off in Azerbaijan.

Several on-going and planned projects designed to strengthen Azerbaijan's financial services sector, including the Capital Market Modernization Project (CMMP), diversification of the State Oil Fund's (SOFAZ) investment strategy, and Pension Reform, present opportunities for U.S. firms providing asset management and global custodian services.

Though the Baku Stock Exchange (BSE) was established in 2000, the securities market still is at an early stage of development. The Capital Market Modernization Project is an attempt by the Government of Azerbaijan to build the foundation for a modern financial capital market, including the development of market infrastructure and automation, and the strengthening of the legal and market frameworks for capital transactions. One major hindrance to the growth of the stock market is the difficulty in encouraging established Azerbaijani businesses to adapt to standard investor-friendly practices of good corporate governance that are required of publically listed companies. In February 2012, the State Oil Company of Azerbaijan realized its first corporate bond offering, the main purpose of which was for financing of capital investment. SOCAR has two bonds, one maturing in 2017, and a second in 2023. Yields are approximately 3.4 percent for the 2017 paper, and 5.5 percent for the bond maturing in 2023. Azerbaijan issued over-subscribed Eurobonds totaling 1.25 billion USD, with a demand for four billion, on March 10, 2014. The bonds were issued for a period of 10 years with a yield of five percent per annum. The State Oil Fund of Azerbaijan, established in 1999, had 35.8 billion USD in assets as of January 1, 2014, and is the world's 24th largest sovereign wealth fund, according to the Sovereign Wealth Fund Institute. Beginning in 2012, SOFAZ embarked on a slow process to diversify its conservatively invested holdings away from short-to-medium term fixed income instruments into public equities, gold, and real estate.

Pension reform has also been a priority issue for the Government of Azerbaijan, with the goal of increasing pension payments while minimizing projected shortfalls due to rising wages and demographic shifts. Since 2008, the Government of Azerbaijan has been working on a reform

strategy for the State Social Protection Fund (SSPF). Reforms in 2006 and 2010 improved the reliability of the pension system, but the system remains financially unsustainable and its dependence on annual transfers from the budget has been steadily increasing over time. Fitch Ratings affirmed Azerbaijan's long-term foreign and local currency IDRs and its senior unsecured bonds at 'BBB-'. The Outlook on the IDRs is Stable as of October 2013. In January 2014, Standard & Poor's affirmed the BBB-/A-3 long and short-term sovereign credit ratings on Azerbaijan with a stable outlook. Additionally, a September 2013 Moody's Investors Service report said that the stable outlook of Azerbaijan's Baa3 foreign and local-currency bond ratings reflected the government's (1) low government debt; (2) its sustained fiscal surpluses over the past couple of years; and (3) strong net creditor position due to the sizable foreign assets that it has accumulated. It concluded that these strengths will help to shield the economy from internal and external shocks.

10. Competition from State-Owned Enterprises

While there are no **state-owned enterprises (SOEs)** that officially have been delegated governmental powers, companies such as the State Oil Company of the Azerbaijan Republic (SOCAR), Azerenerji (electricity) and Azersu (water) – all of which are closed joint-stock companies with majority state ownership and limited private investment – enjoy quasi-governmental or near-monopoly status in their respective sectors. Azerbaijan maintains that the state must retain a controlling stake in companies operating in the mining or oil and gas sectors – strictly limiting foreign or domestic private investment in these sectors, exclusive of those companies that have entered into a PSA.

The International Bank of Azerbaijan (IBA) – founded in 1992 – is the only state-owned bank still operating in Azerbaijan. IBA is the largest bank in Azerbaijan, with roughly one-third of banking sector assets. IBA was partially privatized in 1994 – with the Government of Azerbaijan maintaining a 50.2% controlling stake – but a 1998 presidential decree to completely privatize the bank has not yet been implemented, both for political reasons and issues with the overall health of the bank. **Privatization** efforts again made little progress in 2013, as officials from IBA and the Central Bank of Azerbaijan (CBA) argued that stability should come before privatization. The CBA made a capital injection of 100 million AZN in March 2012, raising questions about IBA's stability. The CBA also argues that finding the right private investors for Azerbaijan's largest bank will take some time. According to the IMF, IBA forms 35 percent of the banking sector in Azerbaijan, so the bank's future problems would inevitably affect the whole banking sector.

11. Corporate Social Responsibility

Corporate social responsibility (CSR) is a relatively new concept in Azerbaijan. Larger foreign entities do tend to follow generally accepted CSR principles – mainly in line with their international corporate ethos – and aim to educate their local partners, who generally consider basic charitable donations and paying taxes as acts of social responsibility. The American Chamber of Commerce in Azerbaijan established a Corporate Social Responsibility Committee in October 2011 to encourage companies to embrace the concept of social responsibility and encourage a positive impact through activities and dialogue with relevant stakeholders. The

Committee unites a number of companies that have established CSR programs with companies interested in exploring the concept further. The American Chamber of Commerce also has published a guide on Corporate Social Responsibility for businesses in Azerbaijan.

12. Political Violence

There have been no known acts of **political violence** against U.S. businesses or assets, nor against any foreign owned entity.

13. Corruption

Pervasive **corruption** – including bribery of **public officials** – continues to be a major challenge for U.S. and other international firms operating in Azerbaijan. Although anti-corruption legislation is in place, corrupt practices permeate all spheres of public life. Officials from the lowest ranks of the civil service to the top echelons of government are believed to benefit from systemic corruption in the country.

The Government of Azerbaijan recognizes that corruption is a problem but, to date, laws and regulations to combat corruption have not been effectively or consistently enforced. Azerbaijan has made modest progress in implementing a 2005 Anticorruption Law, which created a commission with the authority to require full financial disclosure from government officials.

On September 5, 2012, President Aliyev issued a decree for a National Action Plan on Open Government and a National Action Plan on Combating Corruption. ASAN service centers created by the State Agency for Public Service and Social Innovations, under the President of the Republic of Azerbaijan, were established in July 2012 by Presidential decree and became operational in February 2013. These centers provide 23 government services from nine state entities, including the registration of commercial legal entities and tax payers, notary services, state registration of civil status acts, and the renewal of identity cards/passports of citizens. ASAN centers are intended to provide more transparent and accountable services through a “one window” model that reduces opportunities for rent-seeking and petty government corruption.

In 2013, Azerbaijan’s modest improvements in combating petty corruption were reflected in the global anticorruption watchdog Transparency International, which ranked Azerbaijan 128 out of 177 countries on its Corruption Perceptions Index, up from 139 a year before. Popular opinion identifies the State Customs Committee as the institution of greatest concern to businesses in Azerbaijan, followed by the Ministry of Taxes – though the reputation of the tax authorities has enjoyed some improvement in the past year as corruption-reducing reforms have been implemented. Transparency’s 2013 Global Corruption Barometer – which examined bribery involved in people’s contact with customs, education, the judiciary, land related services, medical services, the police, registry and permit services, tax authorities and utilities – found that roughly 50% of Azerbaijani respondents had paid a bribe to one of the nine service providers in the twelve preceding months. Azerbaijan is a party to the United Nations Convention against Corruption (UN Convention) and a signatory to the Council of Europe Criminal and Civil Law Conventions. Azerbaijan is not currently a party to the Organization for Economic Cooperation and Development Anti-Bribery Convention.

Azerbaijan has also been a participant in the Extractive Industries Transparency Initiative (EITI). In 2009, Azerbaijan became the first participating country to become fully compliant with EITI requirements. Azerbaijan's EITI reports do not currently provide data on a company-by-company basis – which is optional – but citizen groups in Azerbaijan are encouraging companies to do so.

14. Bilateral Investment Agreements

Azerbaijan has signed agreements on mutual protection of investments with 39 countries – including the United States – and on the avoidance of double taxation with 40 countries. On October 18, 2000, the U.S. Senate ratified the Treaty between the Government of the United States of America and the Government of the Republic of Azerbaijan Concerning the Encouragement and Reciprocal Protection of Investment – commonly known as a “**Bilateral Investment Treaty**” (BIT). The United States and Azerbaijan exchanged instruments of ratification on July 3, 2001, and the treaty entered into force on August 2, 2001. The United States currently does not have a taxation treaty with Azerbaijan, but both countries are parties to the OECD Convention on Mutual Administrative Assistance in Tax Matters. Additionally, Azerbaijan does not currently have a bilateral free trade agreement in place with the United States.

Azerbaijan also has **bilateral investment protection agreements** with the following countries: Austria, Belarus, Belgium, Bulgaria, China, Croatia, Egypt, Estonia, Finland, France, Georgia, Germany, Greece, Iran, Israel, Italy, Jordan, Kazakhstan, Korea, Kyrgyzstan, Latvia, Lithuania, Lebanon, Moldova, Norway, Pakistan, Poland, Qatar, Romania, Saudi Arabia, Syria, Switzerland, Tajikistan, Turkey, UAE, Ukraine, the United Kingdom, and Uzbekistan.

15. OPIC and Other Investment Insurance Programs

The **Overseas Private Investment Corporation (OPIC)** and the U.S. Export-Import (ExIm) Bank are open for business in Azerbaijan, providing political risk insurance and financing lines, as well as financing and loan guarantees. Azerbaijan is also a member of the Multilateral Investment Guarantee Agency (MIGA), and the European Bank for Reconstruction and Development. The World Bank, Asian Development Bank, and other third-country institutions are active in providing financing and insurance for investment in Azerbaijan.

OPIC has repeatedly provided funds for numerous banks operating in Azerbaijan in order to expand their Small and Medium Enterprise (SME) lending portfolio, including 4.8 million USD to Rabita Bank in 2008 and 7.3 million USD to Turan Bank in 2009. In 2011, OPIC provided Muganbank a loan guarantee for 10 million USD to expand its operations, targeting SME borrowers. OPIC has also provided 1 million USD and 3 million USD, respectively, to FinDev and CredAgro for microfinance lending. In 2012, OPIC provided loan insurance to Viator Microcredit Azerbaijan LLC (500,000 USD), NBCO Vision Fund Azercredit LLC (2 million USD), and FinDev again (1 million USD). In 2013, OPIC signed a memorandum with Turanbank for a loan in the amount of 7 million USD with a term of seven years for SME financing.

In its 2013 annual report, the Export-Import Bank of the United States (Ex-Im Bank) stated that it has outstanding insurance and loan guarantees for Azerbaijan in the amount of 117.3 million USD, primarily in support of aviation and telecommunications sales. In 2011, Ex-Im Bank endorsed a 116.6 million USD loan with a ten-year repayment period to finance the Azerbaijani space agency's purchase of the AzerSat-1 satellite from Orbital Sciences. In addition, in December 2013, Ex-Im approved a 640.7 million direct loan to the Turkish arm of the State Oil Company of Azerbaijan to finance the export of American-made oil refinery equipment that will be used to build a refinery on Turkey's western coast.

16. Labor

A **Labor Code** that took effect in 1999 still regulates overall labor relations. The workweek generally is considered to be 40 hours. The right to strike exists, though industrial strikes are rare. Azerbaijan is a member of the International Labor Organization (ILO) and has ratified more than 57 ILO Conventions. Azerbaijan has an abundant supply of skilled and unskilled laborers; however, companies repeatedly cite problems hiring skilled professional staff, which likely is a result of the decline in the quality of education, economic shifts and labor emigration. The collapse of the old Soviet industrial sector during the 1990s resulted in large numbers of Azerbaijanis becoming unemployed or underemployed. Government sources estimate the rate of **unemployment** at five to six percent, but other sources conclude the figure is 20% or more, with underemployment being much higher.

As of January 1, 2014, both the **minimum monthly wage** and the base compensation for pensions were set at 160 USD. The average monthly salary in 2013 rose to 540 USD, representing a 6% increase over the average salary in 2012. Azerbaijan currently is working with the World Bank and the European Union on a program to reform the state pension system. There has been a significant rise in **migrant workers** over the past five years; the International Organization for Migration's 2011 estimate places the number at 113,118, most of which are from neighboring countries, such as Georgia, Russia, Turkey, and Iran. The SMS also receives frequent appeals from foreigners seeking refugee status in Azerbaijan, most of whom are from Pakistan and Afghanistan, and some from Iran.

17. Foreign Trade Zones/Free Ports

Although the government announced its intention to create **special economic zones** in 2003 – and passed a law to establish such zones in 2009 – currently there are no foreign trade zones or free ports operating in Azerbaijan. Despite this, Azerbaijan's Cabinet of Ministers Resolution No. 199, signed on December 25, 2009, has approved simplified rules for **customs** controls, customs checkpoints, customs clearance of goods, and the crossing of vehicles and individuals at the boundaries of special economic zones. According to these rules, customs checkpoints may be established in the zones by the State Customs Committee. For these purposes, electronic control and declarations may be used. Under the new rules, goods imported into and exported from these zones are not subject to import duties and VAT, or customs duties and taxes.

Certain ministries – the Ministry of Economy and Industry, the Ministry of Finance, and the Ministry of Information and Communications Technologies – continue to discuss plans for creating special economic zones, including a petrochemical complex, regional innovation zones to boost development of the **telecommunications** sector and turn Azerbaijan into a regional **information and communications** technologies hub, and a special zone to encourage the production of renewable energy.

18. Foreign Direct Investment and Foreign Portfolio Investment Statistics

TABLE 2: Key Macroeconomic data, U.S. FDI in host country/economy

	Host Country Statistical source*		USG or international statistical source		USG or international Source of data (Source of Data: BEA; IMF; Eurostat; UNCTAD, Other)
Economic Data	Year	Amount	Year	Amount	
Host Country	2013	73.1	2013	No data	<a href="http://www.worldbank.org/en/cou
ntry">http://www.worldbank.org/en/cou ntry
Gross Domestic Product (GDP)	2012	68.7	2012	66.6	
<i>(Billions U.S. Dollars)</i>	2011	65.9	2011	65.9	
	2010	52.9	2010	52.9	
	2009	44.2	2009	44.2	
Foreign Direct Investment	Host Country Statistical source*		USG or international statistical source		USG or international Source of data: BEA; IMF; Eurostat; UNCTAD, Other
U.S. FDI in partner country (<i>Millions U.S. Dollars, stock positions</i>)	2013	No data	2013	No data	(BEA) click selections to reach. <ul style="list-style-type: none"> • Bureau of Economic Analysis • Balance of Payments and Direct Investment Position Data • U.S. Direct Investment Position Abroad on a Historical-Cost Basis • By Country only (all countries) (Millions of Dollars)
	2012	No data	2012	No data	
	2011	No data	2011	No data	
	2010	No data	2010	No data	
	2009	No data	2009	No data	
Host country's FDI in the United States (<i>Millions U.S. Dollars, stock positions</i>)		No national data available	2013	No data	(BEA) click selections to reach <ul style="list-style-type: none"> • Balance of Payments and Direct Investment Position Data • Foreign Direct Investment Position in the United
			2012	0	
			2011	0	
			2010	0	

			2009	0	States on a Historical-Cost Basis • By Country only (all countries) (Millions of Dollars)
Total inbound stock of FDI as % host GDP (<i>calculate</i>)	Year	No national data available	-	-	
	2013				
	2012				
	2011				
	2010				
	2009				

* Azerbaijani (host country) statistical sources:

<http://www.stat.gov.az/source/finance/indexen.php>

**TABLE 3: Sources and Destination of FDI
Azerbaijan, 2012**

Direct Investment from/in Counterpart Economy Data					
From Top Five Sources/To Top Five Destinations (<i>US Dollars, Millions</i>)					
Inward Direct Investment			Outward Direct Investment		
Total Inward	11,118	100%	Total Outward	7,515	100%
Turkey	1,933	17%	Turkey	3,355	45%
Norway	1,847	17%	Georgia	2,724	36%
United Kingdom	1,471	13%	Switzerland	592	8%
Iran, Islamic Republic of	910	8%	France	105	1%
Netherlands	670	6%	United Arab Emirates	105	1%

"0" reflects amounts rounded to +/- USD 500,000.

Source: <http://cds.imf.org>

19. Contact Point at Post for Public Inquiries

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