



Azerbaijan – Business Guide for UK Businesses

Executive summary

After the collapse of the Soviet Union in 1991, Azerbaijan became independent and started a transition from Soviet-style economy to a market-driven economy focusing on production and export of hydrocarbons.

With its favourable geographic situation at south-eastern border of Europe continent, Azerbaijan is a natural bridge between Europe and Central Asia. The country had always been more industrially developed than its neighbours Georgia and Armenia but had suffered from low levels of investment in sectors other than oil. Now, with strategic focus on agriculture and construction it has become more outward looking and although hydrocarbons are still its biggest source of revenue it is turning its attention to other sectors. Tourism, for example, is growing as Baku becomes a holiday as well as business destination.

Azerbaijan's economy is strong – The Economist magazine ranked it as the second fastest growing economy in the world between 2001 and 2010 - and is backed up by laws that make it attractive to the foreign investor.

Economic outlook

For businesses thinking of investing in Azerbaijan, the future is promising. Economic growth was high during the period 2006-10 at an average of 16.1% growth every year, and while this high level is not expected to be maintained (according to the Economist Intelligence Unit), it will stabilize at around 4% over the period 2011-15.

Similarly, Azerbaijan's currency, the Manat, is predicted to remain stable against the US dollar, meaning the forecast higher export revenue will further contribute to the country's economic growth. Intensification of competition between the EU and Russia for energy resources will also benefit Azerbaijan, the country making the most of its geography..

Azerbaijan is focused on increasing investment in non-oil sectors such as agriculture and manufacturing, although energy, currently contributing 40% of GDP, has been the main driver of growth in recent years. The Chirag oil field will come on stream in late 2013, which will boost production, alongside the development of the Shah Deniz field, expected for 2017 (see below).

Azerbaijan weathered the effects of the global economic downturn much better than its neighbouring countries. Oil production rose and GDP grew by 9.3% in 2009 which was the fastest rate in Eastern Europe over that period.



The Economist believes export revenue (mainly through oil) will dwarf imports – though imports for transport, communications and construction will rise. These will be the key sectors to watch. Since January 2010, exports have risen by 56.9% to USD15.7bn, while imports rose by 4.1% to USD4.5bn. Azerbaijan mainly imports machinery and foodstuffs from Russia, Turkey and China, while its main destinations for exports are Italy, France and Israel. The CIS accounts for USD2.8bn (or 14.1%) of Azerbaijan's total foreign trade turnover.

Geography

Azerbaijan benefits from its advantageous geographic location and excellent natural resources. Its fertile climate spans nine of the eleven existing climatic zones, ranging from humid subtropical climate to semi-arctic which creates unique opportunities in agriculture and tourism.

Its location on the very south-eastern border of Europe means that it serves as the natural bridge between Europe and Central Asia as well as being the most convenient route from the north-east of Europe to the Middle East. It also serves as the logistics hub for the Caspian region. Baku's infrastructure and sea and air terminal mean it is ideally placed for any business entering the Caspian Sea region.

The Caspian Sea oil and gas reserves are one of world's largest deposits. Azerbaijan also has deposits of precious metals, including silver and gold, ferrous and non-ferrous metals, and various raw materials for use in construction.

Trade and workforce

Azerbaijan enjoys favoured trade status under an EU Partnership and Cooperation Agreement. There are no general trade barriers or embargoes on the import of goods into Azerbaijan, and exports are not subject to customs duties or restrictions. Regulations exist only for the export of strategic commodities such as electricity, petrol, cotton and non-ferrous metals. Azerbaijan has 39 bilateral treaties on the mutual protection of investments. Several more treaties are currently being negotiated and it is also party to a number of multilateral treaties concerning foreign investment.

Production costs are competitive, and the government has put in place legislation to facilitate the creation of companies, limitations on corporate taxation, and laws to protect foreign direct investment.

Azerbaijan's workforce is both highly educated and skilled and inexpensive. The country is rich in engineering skills, and has a large R&D centre which operates in conjunction with a number of universities and colleges.

Foreign relations

Azerbaijan is a member of the United Nations, the Organisation for Security and Cooperation in Europe (OSCE), NATO's Partnership for Peace, the Euro-Atlantic Partnership, the World Health Organisation, the GUAM Organisation for Democracy and Economic Development, the European Bank for Reconstruction and Development, the Council of Europe, the International Monetary Fund and the World Bank. Azerbaijan became a member of the Council of Europe in 2001.

Azerbaijan's foreign policy is preoccupied with settling the Nagorno-Karabakh conflict. Azerbaijan and Armenia are still officially at war, although a ceasefire has been in place since May 1994. Since



the start of the conflict, 800,000 ethnic Azerbaijanis and 230,000 ethnic Armenians have been displaced from their homes.

Azerbaijan maintains strong relations with the US and EU, developing trade and strategic ties with both. A bilateral investment treaty between the US and Azerbaijan has been in effect since 2001. Azerbaijan has also signed a Partnership and Cooperation Agreement with the EU, designed to harmonise Azerbaijani and European law.

Politics

Azerbaijan is a presidential republic. The President, Ilham Aliyev, is the head of state and the Prime Minister is the head of government. Executive power rests with the President, the Prime Minister and the Cabinet of Ministers. The President is also the Supreme Commander-in-Chief of Azerbaijan's armed forces. The National assembly (Milli Majlis) is the legislative branch of the government. The New Azerbaijan Party (YAP) currently holds the majority of seats in Milli Majlis.

Law

Azerbaijan's legal system is based on the civil law. Its highest judicial authority is the Constitutional Court, which resolves disputes between the legislative, executive and judicial branches of government and gives formal interpretations of the Constitution and other laws. The civil law of Azerbaijan considers the 1995 Constitution, acts adopted via referendum and legislation passed by the Milli Majlis as the primary sources of law. The Supreme Court, the Appellate Court, the Economic Courts and the General Jurisdiction Courts are subordinate to the Constitutional Court and hear only those cases that are within their jurisdiction. The Constitutional Court also considers international treaties to which Azerbaijan is a signatory as a source of law. This means that international agreements take precedence over national law in case they contradict.

Business and investment landscape

Azerbaijan possesses approximately seven billion barrels of oil reserves and two trillion cubic metres of proven natural gas reserves. Over \$60 billion has been invested in Azerbaijan's oil industry by global oil majors operating in the BP-led Azerbaijan International Operating Company (AIOC) consortium. Oil production under the first Production Sharing Agreements (PSAs) with AIOC began in November 1997.

Currently, Azerbaijan exports over 529,000 barrels of oil per day. In 2006, the \$4 billion Baku-Tbilisi-Ceyhan (BTC) pipeline pumped its first oil from Baku to the Turkish port of Ceyhan. This pipeline was designed to transport 1 million barrels per day, with inflow from both Azerbaijani-produced oil and Kazakhstani oil, which is shipped across the Caspian to Baku. Azerbaijan's natural gas output increased by 11.2% in 2010.

The country's non-energy economy posted double-digit growth in 2008, spurred by growth in the construction, banking and real estate sectors, but has since slowed following the global recession.

Azerbaijan is no longer as reliant on trade with Russia and the other former Soviet republics as Europe and Turkey increasingly become key trading partners. In the longer term, the country is looking at ways to supplement its oil exports with growth in non-energy sectors and is seeking foreign and private investment in order to achieve this.



Shah Deniz

Shah Deniz is an offshore gas field, discovered in 1999 off the southern coast of the Caspian Sea. It is the largest accumulation of offshore gas in Azerbaijan, covering about 860 sq km. It holds approximately 1.5-3 billion barrels of oil and 50-100 billion cubic metres of gas for extraction. It is expected to become one of the primary sources for Europe's future natural gas supplies, via the planned Nabucco pipeline or alternative routes. BP has a 25.5% stake in it, alongside other partners which include Statoil (25.5%); SOCAR (10%); Total (10%); LukAgip (an Eni-LUKoil joint venture, 10%); Naftiran Intertrade Co. (10%); and TPAO (9%).

SOFAZ

SOFAZ is the \$13 billion State Oil Fund of Azerbaijan, which was created in December 2000 to ensure macroeconomic stability for the future, to promote investment in non-oil sectors of the economy, and to boost the transparency of oil revenue management. Revenues from oil field developments go directly into SOFAZ, which also helps counter inflation.

Investment and privatisation

Azerbaijan lawmakers have been quick to evolve the law in conjunction with the government's strategic goal of creating an attractive investment environment.

In addition to being free from restrictive licensing regulations, foreign businesses in Azerbaijan are protected by guarantees of: free profit repatriation; protection from nationalisation; and protection from changing legislation. The government supports privately held enterprises, including those operated by foreign nationals or those with foreign capital.

By 2010, 75% of Azerbaijan's economy had been privatised. The process of privatisation began in 2002, and is still taking place. The Azerbaijan State Statistics Committee says that 30.3% of total capital investments in Azerbaijan are in the oil sector. Overall capital investments in the economy of Azerbaijan in 2010 made more than US\$ 10 billion, which is 21.2% larger than in 2009.

Telecoms, IT and media

Azerbaijan's mobile phone market is growing fast. Eight out of ten Azerbaijanis now own a mobile phone, and the market for providers is becoming increasingly competitive. Azercell is the largest, while Bakcell and Azerfon are also significant players, the latter in co-operation with Vodafone. The government monopolises landline telecommunications, and there are approximately 15 landline telephones per 100 people.

Azerbaijan currently has 10 television stations and 22 radio stations. There were 1.5 million Internet users in the country according to a report published in 2008.

Banking

Growth in Azerbaijan's finance sector has been rapid, and the past few years have seen a good deal of consolidation. There are approximately 150 financial institutions operating in Azerbaijan. Over forty of these are foreign or local banks. The Central Bank of Azerbaijan is the regulator and policymaker. Until recently, foreign participation in Azerbaijan's banking sector was limited but this has now changed: foreign investors can now own stakes in Azerbaijan banks of up to 50%. Monetary policy has expanded in the wake of the global financial crisis – the refinancing rate has been cut from 15% to 2% and the reserve requirement ratio reduced sharply from 12% to 0.5%.



Construction

The construction industry in Azerbaijan is competitive and busy. Construction projects are plentiful, driven by oil and gas exports, infrastructure, and the demand for new homes, hotels and regeneration. Despite a decline in 2009, the construction industry in Azerbaijan was growing again in 2010. Baku is undergoing a number of regeneration projects which are expected to have reached completion by 2012.

Agriculture

Agriculture forms 6% of Azerbaijan's GDP, employing 39% of its labour force. With such climatic and ecological diversity, Azerbaijan has had a strong agricultural sector since pre-Soviet times. It adopted a policy of deregulation following the collapse of the Soviet Union in 1991, and it allowed up to 99% of its agricultural sector to be privatised. With privatisation came the shift in focus to producing profit-yielding crops and increasing self-sufficiency, and Azerbaijan focused on the cultivation of vegetables, tobacco, tea, cotton, and grain. Notably, Azerbaijan also cultivates specialist, rare and valuable crops such as pink grapes and persimmon.

Tourism

As host of the 2012 Eurovision Song Contest, Baku is preparing to become the focus of attention as a tourist destination. International hotels such as Radisson and Hyatt have already opened, and a Four Seasons, Hilton and Marriott are under construction alongside many regeneration projects in the capital. Sites of historical interest such as Shirvanshakh's palace, the Walled City of Old Baku or Sheki Khan Residence, are expected to attract large numbers of tourists. Outside the capital there is potential for the development of mountain ski resorts, beach resorts, and mineral baths and health spas.