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FDI in Azerbaijan in 2021: Developments and Challenges

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Introduction

Attracting foreign direct investment is now more important for Azerbaijan than ever before. Against the background of global uncertainty, the development of the non-oil sector and the diversification of the economy have become even more priority. On the other hand, there has been a decline in oil production in recent years, and even though high oil prices, the country's revenue from energy sales is lower than compared to the period before 2014.

It also maintains the priority of attracting foreign investment in the liberated territories of Azerbaijan considering that a number of countries are closely involved in the restoration of territories and implementation of building-back infrastructure projects. It is clear that after the recovery and reconstruction phase, there will be a serious need for foreign investment to create new jobs. In this regard, the issue of attracting foreign investment is even more important.

Foreign investment is important for Azerbaijan in terms of technology, innovation and the transfer of modern traditions to the country. In this sense, foreign investment is not just money, but also the import of innovation.

Recent surveys confirm that there is a need to intensify efforts to improve the investment climate, especially to strengthen the institutional framework. Despite the simplifying of registration and other procedures and the sharp reduction in the number of days and costs required for these procedures in recent years, a single window system has not yet been established to receive applications from foreign investors. This is very important in terms of attracting new foreign investors in spite of the fact that the volume of investments in the Azerbaijani economy has reached \$ 280 billion ([PwC, 2022](#)).

Historical observation reveals that the oil and gas sector attracted the largest share of foreign investment. Nevertheless, the government of Azerbaijan prioritized four non-oil sectors to diversify the country's economy. These sectors are agriculture, tourism, information and communications technology (ICT), and transportation/logistics.

In fact, over recent years some measures were taken in order to improve the business climate and general state of economy. Significant measures include elimination of redundant business license categories, empowerment of “Azerbaijan Service and Assessment Network (ASAN)”, simplified customs procedures and reforms in the tax regime.

Encouraging foreign investors to invest in the country's economy is crucial for the stimulation of an economic rebound. Since Azerbaijan competes globally to attract foreign investment, the provision of competitive incentives to invest and more vibrant investment climate are the main essentials.

Literature review

High dependency on resources leads to the risks of vulnerability to external factors and creates additional risks for the development of the economy. The dependency of Azerbaijan on its resources was studied by [Bayramov and Orujova 2017](#), revealing country's vulnerability to external shocks and fluctuations in the oil market.

The correlation between the flow of Foreign Direct Investment (FDI) to the country and environmental issues was studied by [Mukhtarov et al. 2019](#). It was revealed that while on the one hand, FDI has a positive impact on economic growth, it may lead to environmental degradation on the other since increased consumption of energy causes greenhouse (CHG) emissions.

Given that economic diversification remains a main priority for the government of Azerbaijan, the necessity to assess the distribution of FDI to the country in accordance with the sectors emerges. In the case of Azerbaijan, the bulk of external investment goes to finance the extractive sector of the economy ([Ahmadova et al.2020](#)).

Recent indicators of the country outlined in the Doing Business Ranking illustrate steady development in the investment climate. Azerbaijan has improved its investment climate via strengthening the institutional, regulatory and operational environment for companies to operate in the country. The country ranked 57 in the Doing Business 2018, 25 in 2019, 34 in 2020.

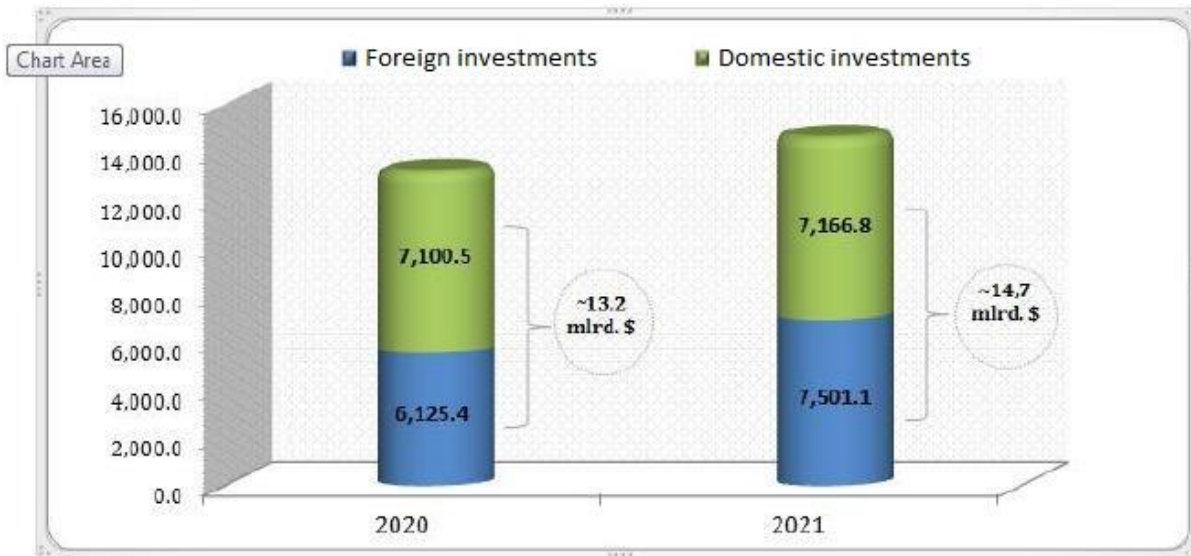
The government of Azerbaijan has an ambitions plants towards development of renewable energy, which goes along with investments attracted to this sector. The study covering potential scenarios to the investments in renewable energy in Azerbaijan was conducted by [Kerckhoff, 2019](#).

Present investment climate in Azerbaijan

Taking into account the post-pandemic environment, 2021 was considered comparatively challenging in terms of FDI flow. Regional instability as a result of post-war period also played its significant role in the assessment.

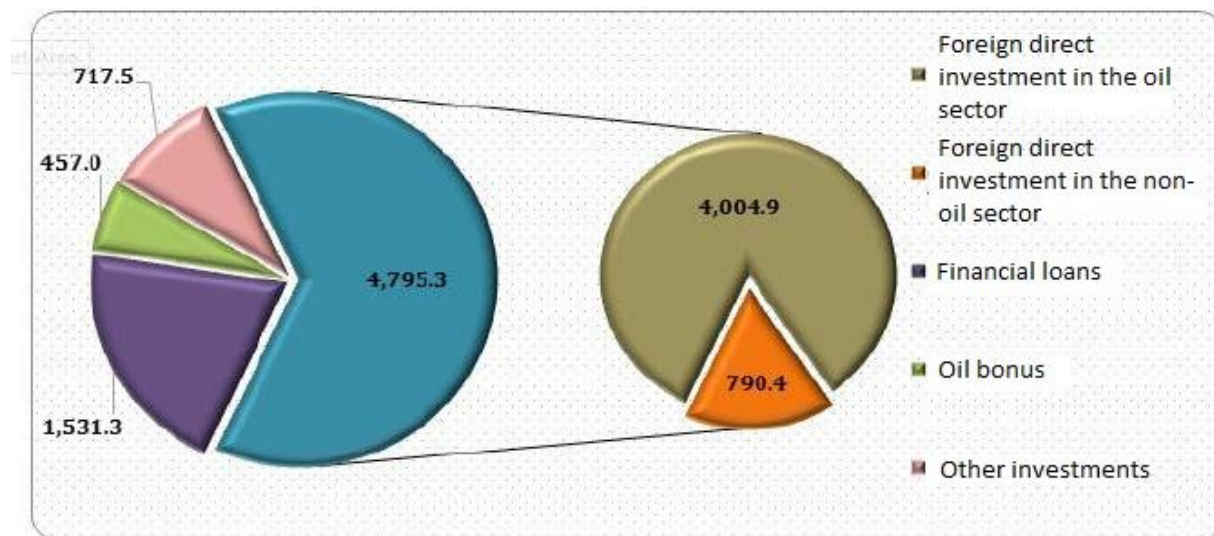
In 2021, the volume of total investments in the country's economy increased by 10.9 percent compared to the same period of the previous year in nominal terms and amounted to 14.7 billion US dollars, where 51.1% fell on foreign investment. The share of foreign investment in total investment increased by 4.8 percentage points compared to the same period in 2020.

Graph 1. Investments in the country's economy, in USD mln.



During the reporting period, direct investments (63.9%) occupied the largest part of the structure of foreign investment in the country's economy. In that period, 83.5% of a foreign direct investment referred to the oil sector, and the rest to the non-oil sector. 20.4% of foreign investments were financial loans, 15.7% were oil bonuses and other investments.

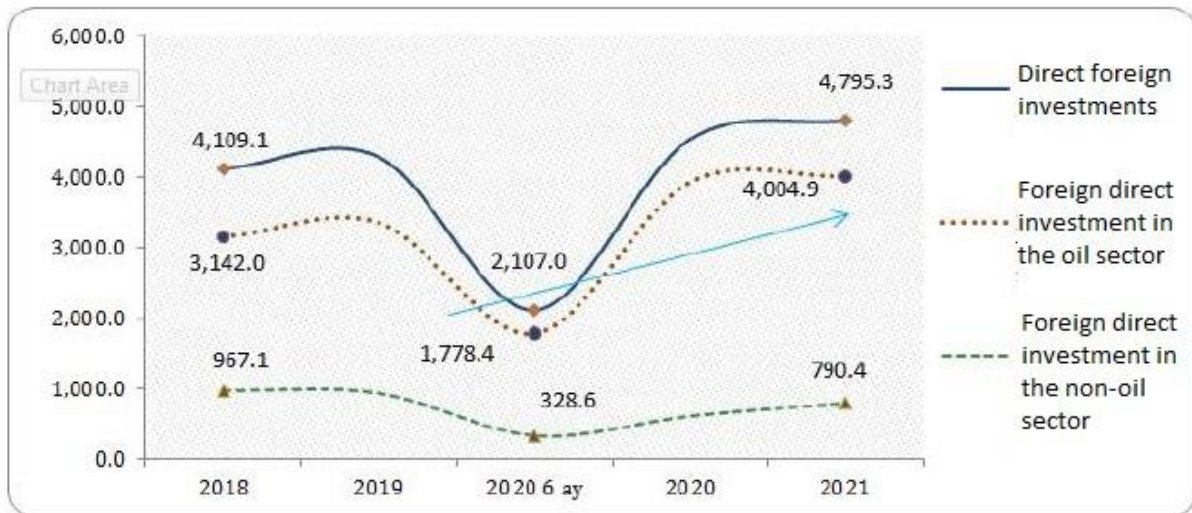
Graph 2. Structure of foreign investments in the country's economy, in USD mln



The volume of foreign direct investment increased by 5.9% in nominal terms compared to 2020. During the reporting period, an increase of 2.1% in the volume of direct investments in the oil

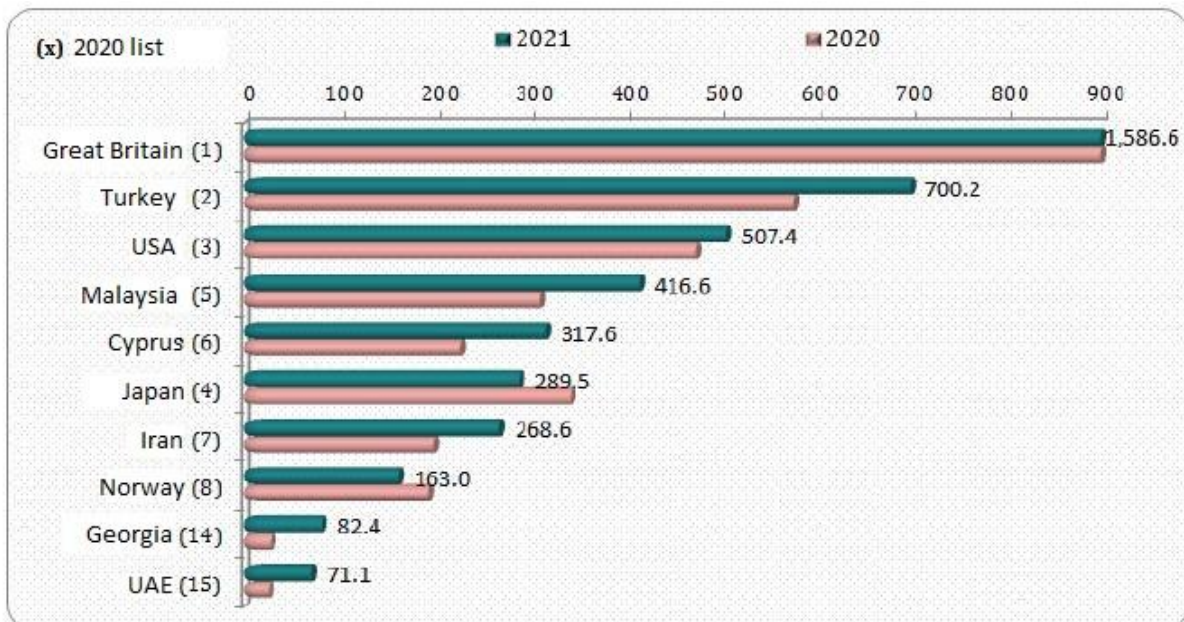
sector compared to the previous year was observed, while in the non-oil sector an increase was composed of 30.5%.

Graph 3. Dynamics of foreign direct investment in the country's economy, in USD mln



In 2021, as in the previous year, the United Kingdom (USD \$ 1.6 billion) took first place among the countries allocating foreign direct investment in the economy of Azerbaijan. The list of top three countries remained unchanged, with second Turkey (USD 700.2 mln) and the third US (USD 507.4 mln). During the reporting period, the share of the United Kingdom in the total volume of foreign direct investment was 33.1%, the share of Turkey was 14.6%, and the share of the US was 10.6%.

Graph 4. Top ten countries by the volume of direct investment in the country's economy, in USD mln.



The countries investing the most in the non-oil sector in 2021 were the US (USD 144.7 mln), Georgia (USD 82.4 mln), and the UAE (USD 71.1 mln).

Conclusion

Foreign investors must be aware of the country and its expected development perspectives, business and investment climate, as well as potential changes to this environment.

In Azerbaijan, foreign investments enjoy complete legal protection under the Law on the Protection of Foreign Investment, the Law on Investment Activity, and guarantees contained within international agreements and treaties.

Nevertheless, to increase the flow of FDI to the country, there is a need for additional policies for the facilitation and acceleration of several processes.

The Foreign Investment Laws provide the legal framework for foreign investment in the country. They stipulate the types of entity foreign companies can invest in along with general rights and guarantees provided to foreign investors. In this regard, the first recommendation refers to the development of one-stop-shop principles.

Secondly, the importance of the acceleration of the processes related to the Alat free trade zone (FTZ). A government decree established a FTZ next to the Port of Alat dates to 2016. However, while the legal framework is in place, implementing regulations are still pending.

Given that international businesses prioritize the further extension and deepening of tax reforms, some measures have to be taken in this regard, respectively.

Yet, the efforts made so far to transform the economy and attract new FDI are recognized and appreciated by foreign businesses, need for implementation of some amendments remains.

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