Study of Small and Medium Enterprises in Azerbaijan
Study of Small and Medium Enterprises in Azerbaijan

Baku, January 2009
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<tr>
<td>AMFA</td>
<td>Azerbaijani Micro-Finance Association</td>
</tr>
<tr>
<td>APA</td>
<td>Azerbaijani Press Agency (APA news agency)</td>
</tr>
<tr>
<td>AVIS</td>
<td>Automated Unified Information System</td>
</tr>
<tr>
<td>AZM</td>
<td>Azerbaijani manat (replaced as of 2006 with AZN)</td>
</tr>
<tr>
<td>AZN</td>
<td>New Azerbaijani manat (AZN 1 = US$ 1.245 as of Dec 29, 2008)</td>
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<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
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<tr>
<td>CPT</td>
<td>Corporate Profit Tax</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FIAS</td>
<td>Foreign Investment Advisory Service</td>
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<tr>
<td>IE</td>
<td>Individual Entrepreneurs</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IRB</td>
<td>Inspections Registration Book</td>
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<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>MED</td>
<td>Ministry of Economic Development</td>
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<tr>
<td>NBA</td>
<td>National Bank of Azerbaijan</td>
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<tr>
<td>NEF</td>
<td>National Entrepreneurship Fund</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<tr>
<td>OSS</td>
<td>One-Stop-Shop</td>
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<tr>
<td>PIT</td>
<td>Personal Income Tax</td>
</tr>
<tr>
<td>SECO</td>
<td>Swiss State Secretariat for Economic Affairs</td>
</tr>
<tr>
<td>SMB</td>
<td>Small and Medium Business</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
</tr>
<tr>
<td>SSC</td>
<td>State Statistic Committe</td>
</tr>
<tr>
<td>SSPF</td>
<td>State Social Protection Fund</td>
</tr>
<tr>
<td>SST</td>
<td>Social Security Tax</td>
</tr>
<tr>
<td>TIN</td>
<td>Taxpayer Identification Number</td>
</tr>
<tr>
<td>VAT</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td>WB</td>
<td>World Bank</td>
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<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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Foreword and Acknowledgements

IFC, with the support of SECO, presents the results of the first survey of the business environment in Azerbaijan. The survey has been undertaken by IFC’s Azerbaijan Business Enabling Environment Project. The objective of this survey was to assess the existing conditions for doing business in Azerbaijan in 2008 and to develop recommendations for improving them.

This report is based on the results of a survey of managers of more than 1,800 small and medium enterprises (SMEs), conducted in late 2007/early 2008, representing all its regions and key sectors of the economy. The survey also included the sub-populations of individual entrepreneurs. Detailed information on the realities of the business enabling environment that are faced by these segments of the population is presented here; it is hoped that the empirical data from this survey will be used by various stakeholders to stimulate the business environment and make the procedures more efficient and transparent.

During the first year since its launch, the IFC Azerbaijan Business Enabling Environment (BEE) Project has benefited from close interaction with many public and private institutions operating in the country, as well as a number of international organizations. The project would like to thank the government of Azerbaijan, with whom the project signed a Memorandum of Understanding in August 2008. The project would also like to extend gratitude to the Ministry of Economic Development, with which it developed a longstanding relationship, to the Ministry of Taxes, Ministry of Justice and other State authorities that have been vital partners during the last several months of the project’s work.

The report was produced by the project staff, including: Ilham Abdullayev, Boris Divjak, Vusal Gafarov, Fakhriyar Jabbarov and Ruhiyya Isayeva. Valuable information and support was provided by the World Bank and International Monetary Fund Offices in Baku, the Doing Business Team in Washington DC and the SECO Office in Baku. In the course of the data collection and verification, a large number of SME managers in Azerbaijan were contacted and consulted. Important technical and logistics assistance was also provided by Dina Nicholas and Sabina Majidova. Numerous individuals and organizations contributed generously to the preliminary review of this report, including the IFC staff in the Central and Eastern Europe region: Craig Bell, Ruslan Mehdiyev, Nadezhda Sinelnik and Vyacheslav Zhuk of the Belorussian BEE Project; Ekaterine Avaliani and Irina Kokaia of the Georgian BEE Project; Sanda Liepina, Christopher Miller and Sanjukta Mukherjee from the Moscow IFC Office; Aliya Azimova, the IFC Country Officer in Azerbaijan; and Michael Edwards from the Europe and Central Asia Private and Financial Sector Development in the World Bank, Washington. Editing and structural inputs were generously provided by: Adham Abdullayev and Aleksey Novikov from the Uzbekistan BEE Project, Teresa Ha in IFC Moscow and Sarah Cruikshank Ockman in IFC Ukraine. 

Baku, 2009
Executive Summary

The report examines closely the key areas of the business life cycle. Observations are based on the comprehensive survey of businesses conducted in late 2007 and early 2008 on a statistically representative sample of 1800 entrepreneurs, and additionally in-depth interviews with businesses operating in Azerbaijan, as well as a review of the legislative framework in Azerbaijan. The report looks at the experience of the small and medium sized companies as well as individual entrepreneurs in dealing with various administrative aspects of doing business in the country and the problems they face. This is then compared against the good international practices and recommendations are being made to the Azerbaijani authorities in making improvements in every specific area of the business life cycle. The key findings and the subsequent recommendations are summarized below.

1. The business climate in Azerbaijan is steadily improving, while further reforms are being planned

Azerbaijan has been listed as the top global reformer by the IFC/World Bank’s 2009 Doing Business report, with improvements in seven out of ten indicators of business environment reform. Azerbaijan moved far up the global rankings, from 97th place to 33rd, in the overall ease of doing business. This increase recognized a number of important legislative and institutional reforms that visibly improved the investment climate of the county.

<table>
<thead>
<tr>
<th>Ease of...</th>
<th>DB 2009 rank</th>
<th>DB 2008 rank</th>
<th>Change in rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doing Business</td>
<td>33</td>
<td>97</td>
<td>+64</td>
</tr>
<tr>
<td>Starting a Business</td>
<td>13</td>
<td>66</td>
<td>+53</td>
</tr>
<tr>
<td>Dealing with Construction Permits</td>
<td>155</td>
<td>160</td>
<td>+5</td>
</tr>
<tr>
<td>Employing Workers</td>
<td>15</td>
<td>67</td>
<td>+52</td>
</tr>
<tr>
<td>Registering Property</td>
<td>9</td>
<td>63</td>
<td>+54</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>12</td>
<td>25</td>
<td>+13</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>18</td>
<td>110</td>
<td>+92</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>102</td>
<td>143</td>
<td>+41</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>174</td>
<td>176</td>
<td>+2</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>26</td>
<td>27</td>
<td>+1</td>
</tr>
<tr>
<td>Closing a Business</td>
<td>81</td>
<td>78</td>
<td>-3</td>
</tr>
</tbody>
</table>

This SME Report focuses on specific administrative and regulatory costs to doing business in Azerbaijan, covering some of the same areas as the Doing Business study, but using a survey methodology. In addition to the snapshot of the current environment, it closely examines the features that businesses identify as being very important and hindering their further expansion. The SME Report is problem-solution oriented and
critically examines all areas of operations, while IFC remains committed to working with the Government of Azerbaijan in further improving the environment.

Common problems faced by the SME sector include: (a) restricted competition and uneven treatment of certain economic players, such as preferential treatment of large or state-owned enterprises; (b) a tax system that requires additional enhancement, as currently business engage in evasions, under-reporting, and other illicit practices; and (c) use of informal means to settle issues.

In addition to these generic problems, this survey report examines individual areas of the business life cycle. These are divided in the following categories: registration, licensing and permits, business inspections, access to finance, taxation, and foreign trade, while tax payment procedures are seen as comparatively least troublesome.

2. Several regulatory and administrative areas require immediate attention

According to the survey results, comparatively most difficult procedure for entrepreneurs is related to obtaining permits and other formal requirements enabling operations. A third of respondents mentioned this procedure to be difficult or very difficult. Compulsory certification procedures, inspection by controlling authorities, business registration, as well as obtaining licenses were also seen as difficult by a quarter of all entrepreneurs at the time of the survey (late 2007/early 2008).

Some of these issues tend to emerge as relatively troublesome in all transition economies and from that point of view, Azerbaijan faces similar SME development problems and may benefit from solutions successfully implemented elsewhere. Improvements in the business climate are well evident, yet businesses do layout the reform priorities as they perceive them (see the charts below).
3. Successful registration one-stop shop implementation led to considerable savings

In 2008, the Azerbaijani government, with IFC support, introduced the “one-stop shop” system for business registration, which significantly simplified the process for entrepreneurs to register a business. This endeavor combined procedures with several government institutions into a single registration step and therefore made and extraordinary effort much to the convenience of the entrepreneur. Prior to introducing the one-stop-shop, entrepreneurs needed to complete 13 procedures with a number of government agencies, legally requiring 33-34 days to start up a business as legal entity in Azerbaijan. According to 2009 Doing Business Report, Azerbaijan’s ranking on starting a business increased significantly to the 13th global position: only 6 procedures and 7-8 days are now required to start up a business, of which the formal one-stop shop registration takes three days. In addition, client satisfaction was recorded in the in-depth interviews with the private sector following the single-window establishment. Business registration is now being carried out by the Ministry of Taxes through a very advanced information system that connects 14 such offices across the country.

While acknowledging the government’s success in carrying out the reforms, this study also outlines further possible improvements. To bring business registration closer to best international practices, the government may consider introducing several advanced tools in a single related law: an improved register of businesses, on-line application forms, automatic registration etc. The pre-registration process may benefit from removing the requirement to obtain a confirmation of the legal address of the company from the proposed landlord and notarization of the foundation and relevant registration documents.

4. Business licensing and permits should be thoroughly reviewed and modernized

A simplified licensing and permits system has a great impact on the development of a sound business climate. With the adoption of the Presidential Decree No. 782 on Licensing Rules license issuance procedure, validity period of a license, list of activities subject to licensing, licensing fees etc. were closely defined, effectively reducing the number of licensable activities from 240 to 56. This in turn led to a reduction of the number of entrepreneurs requiring a license, as well as reduced financial and human resources engaged in obtaining a license.

While licensing remains more coherent and consistent, there is no single legal act that outlines a precise list of permits and authorizations and lays out a clear issuance procedure. As a result, there is little control over the issuance of permits or authorizations by various government institutions. The report finds that the scope of coverage of most permits is not precise and their application in individual cases is subject to ad hoc decisions of public officials that leave room for discretionary power. Addressing these issues would significantly improve the business climate.

As a matter of priority, the government should start reforming the permit system by undertaking an inventory of all permits and other documents currently issued in Azerbaijan and then streamlining the issuance process by adopting an appropriate legal act. At the same time, the government should also conduct an individual review
of each formality. Special attention should be paid to ensuring general security, safety, health and environmental protection. Other legislative improvements include fast, simple and transparent issuance rules, duration of permits, etc.

5. Reform of business inspections needs an additional boost

The Presidential Order No. 69 on the Inspection registration book improved planning and co-ordination of inspections, reducing the total inspection burden (time spent on-site, number of inspectors involved, related costs), while the Presidential Order No. 790 on the Presence of Ministry of Economic Development representative during inspections introduced certain quality standards of the on-site inspections and prescribed their conduct and reporting. The survey analysis shows that the most frequent administrative procedures entrepreneurs face remain business controls and inspections (annually, 80 percent of survey respondents underwent some form of on-site inspections at an average of one inspection a month). Inspectors are required to record each inspection in the specialized registration books, and that the Ministry of Economic Development (MED) officials are present during inspections. Yet, these requirements are sometimes informally ignored, which often suits entrepreneurs themselves, thus avoiding complex inspection procedures.

Recommendations include systems to streamline and simplify the inspections, particularly following a review of the licensing and permits regime, and to make their rules and procedures more transparent and accountable. In addition, assigning inspections based on periodic risk assessment would make them more efficient. As a result, authorities can provide timely notice of an upcoming inspection, and conduct them in accordance with legally established procedures. Entrepreneurs can have access to transparent checklists and sanctions mechanisms to ensure compliance. Finally, inspections may also consider shifting towards advising businesses and serving them as an education facility.

6. Innovative financing options to SMEs should be explored

Access to finance is one of the major challenges that Azerbaijani entrepreneurs face, in that three out of four entrepreneurs experience difficulties while seeking operational financing. Nevertheless, further development of National Entrepreneurship Fund (NEF) demonstrates government’s vision and adherence to a structured approach to the development of entrepreneurship. The Fund continues to provide significant means for the businesses, thus improving their overall access to finance. Accessibility of the banks and their services as improved, while the cost of borrowing and the time required to process requests has been reduced. There are now 142 operating credit organizations in Azerbaijan, 46 of these commercial banks. However, over 90 percent of business start-ups and working capital are largely financed privately by the entrepreneurs themselves or through private borrowing as a result of complex lending requirements. Limited availability of the credit funding and restrictive conditions, such as short or non-existent grace period and high interest rates, as well as expensive processing payments, make loans less attractive for entrepreneurs. An improved communication with clients would increase demand for financing and, consequently, lead to increased supply.
Further development of Central Credit Registry (established in 2005) and the expanded set of information available have all led to the Azerbaijan’s 12th position in the 2009 Doing Business Report in the related section. Further work may lead towards establishment of a functional credit bureau, surpassing the existing register of loans and offer commercial services, thus enhancing mutual trust between creditors and borrowers.

7. Taxation calls for simplification, leveled playfields and greater transparency

During the past decade the Azerbaijani taxation system underwent numerous reforms resulting in considerable improvement of the system. Very commendable are the customer relations, with the Ministry of Taxes setting up of a Call Center (a simple telephone number 195) that provides taxpayers with information on different aspects of taxation, thus increasing user friendliness. Moreover, the Online Tax Office enabled on-line submission of tax returns and internet-based exchange of other tax related information (https://www.e-taxes.gov.az/) speeding the process and lowering the administrative costs to both: companies and the Ministry.

Noticeably improved transparency of VAT collection at the Ministry and decrease in the administration (number of payments and tax returns, and less time spent on tax compliance), all lead to a significant rise in 2009 Doing Business ranking: from 143 to 102 position globally.

The simplified tax regime is very efficient in fostering the growth of SMEs, but the shift between simplified and standard tax systems increases the tax burden significantly and encourages underreporting by businesses, leading to a shadow economy and corruption. Tax compliance is mostly pursued through repeated tax inspections, which are often directed at smaller size companies. Among the possible improvements, the report prioritizes reviewing the VAT threshold and consolidating further the simplified tax, while reducing the number of VAT and social security reports by introducing a unified tax reporting.

8. Mostly larger entities engage in foreign trade

The government reforms also focused at facilitating and liberalizing foreign trade, and at the time of writing a ‘one-stop shop’ principle in the customs procedures was being introduced. The participation of smaller legal entities and individual entrepreneurs in foreign trade still remains considerably low: only 2 percent of legal entities that participated in the survey engage in exports and 8 percent in imports, as indicated by the IFC survey data. For as long as the exports of raw materials, dominantly oil, are prioritized, development of the non-oil SME sector will be somewhat hindered.

Complicated and costly foreign trade procedures represent major constraints for import/export activities, resulting in lower competitiveness of exports and higher pricing for imports. Standardization and certification requirements also represent an obstacle to foreign trade. Imported goods need to meet local quality requirements even if they conform to international standards, and many goods require approval from various state authorities. Export products, on the other hand, lack internationally recognized certificates facilitating access to the major markets. In addition, bureaucracy within the executive agencies, as well as insufficient competition in a number of foreign trade logistics and administrative areas add to the complexities.
## Policy Recommendations

### Business Registration

<table>
<thead>
<tr>
<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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</table>
| Inconsistent practices detected in the registration process particularly in the offices other than Baku | 1. Lack of external and independent monitoring mechanisms ensuring same standards of operations of all the registrations offices. | ■ Introduce the “silence is consent” principle in the law at the end of the three-day consideration period for automatic granting of the registration certificate;  
■ Introduce internal sanctions for non-observance of deadlines by officials. | ■ Fewer possible delays in the application reviewing process and reduced opportunities for possible informal settlements as well. |
| Remaining shortfalls in the new registration system result in a more expensive and longer registration process | 1. Remaining excessive requirements in the law adding to the registration cost and the time associated with it;  
2. Lack of a top-class software solution enabling e-registration;  
3. Lack of simplified and comprehensive business registry for consultative purposes;  
4. Lack of simplified liquidation procedure during bankruptcy of legal entities;  
5. Excessive requirements in the rules for opening, operation, and closing of bank accounts;  
6. Requiring individual entrepreneurs to provide a separate document (reference) confirming the place of their residence. | ■ Simplify the pre-registration process by removing the requirement to obtain confirmation of the legal address of the company from the proposed landlord and notarize relevant registration documents;  
■ Introduce an electronic registration framework that will provide a unified approach for transferring information from the applicant to the regional registration office, cutting out unnecessary paper forms and introducing a modern, user-friendly internet-based application;  
■ Introduce the possibility to open a bank account through the registration offices in on-line regime – access offered at the same terms to all interested banks;  
■ Update the Ministry of Taxes’ internet site by providing a centralized information service so the entrepreneurs can get on-line access to information on other existing business, as well as their certain financial reports (after appropriate legislative changes);  
■ Simplify the liquidation procedure for legal entities by completing the process through the “one-stop-shop”, except in the cases of claims by third parties which call for a judicial intervention;  
■ Make appropriate amendments to the Rules on opening, operation, and closing of bank accounts to further simplify the registration process. | ■ Reduced time and costs for the entrepreneurs to register their business;  
■ Improved quality and correctness of filed information;  
■ Verified consistency with other register data;  
■ Improved legal and validity controls;  
■ Less manual input;  
■ Operational single-point-registration;  
■ Immediate detection of, and feedback on errors provided;  
■ Pre-registration procedures simplified by referrals to specific articles of the law instead of providing notarized memorandum of incorporation and articles of association;  
■ Reduced number of steps required: no need to obtain and return the notification form to registration office. |
### Study of Small and Medium Enterprises in Azerbaijan

#### Problems

<table>
<thead>
<tr>
<th>Problems</th>
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<tr>
<td>Entrepreneurs have insufficient knowledge of their rights and obligations (especially in the regions)</td>
</tr>
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</table>

#### Sources of Problem

1. Lack of a tailored public awareness campaign leads to an insufficient understanding of the process.

#### Recommendations

- Increase the legal awareness of entrepreneurs through:
  - Simple brochures distributed to entrepreneurs;
  - Clear procedural maps, available in registration offices;
  - Broadcast further public service announcements on television focused on procedural changes.

#### Expected Effect

- Improved access to information and transparency of the entire process.

#### Business Licensing

<table>
<thead>
<tr>
<th>Problems</th>
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<tbody>
<tr>
<td>Process of issuance or revoking is inappropriately defined, with many obstacles and informal practices</td>
</tr>
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</table>

#### Sources of Problem

1. Lack of clear grounds for issuance of licenses and their refusal;
2. Lack of clear grounds for refusal of the application;
3. Informal settlements in the issuance process stimulated by the public officials and business sector alike;
4. Low level of professional training of officials issuing licenses.

#### Recommendations

- Streamline the process by:
  - Creating clear checklists on the basis of which licenses are being granted or denied in order to simplify and shorten internal decision-making procedures;
  - Allocating clearer responsibilities to the regulating authority, so that less inter-ministerial or legal consultations are needed.
  - Introduce the “silence is consent“ principle for all licensing bodies at the end of an e.g. 15-day consideration period so that a license is automatically granted unless an explicit refusal is issued.
  - Organize trainings and seminars for officials.

#### Expected Effect

- Reduce discretion in the licensing bodies and increase transparency or the internal procedures for granting licenses;
- Fewer or no delays in the application reviewing process;
- Financial resources for entrepreneurs economized;
- Reduced waiting time to entrepreneurs in dealing with the licensing procedures;
- Greater productivity of SMEs by faster commencement of operations.
<table>
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<tr>
<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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<tbody>
<tr>
<td>Coverage of licenses and their issuance process insufficiently defined and unclear</td>
<td>1. Lack of clear regulatory framework specifying the circumstances in which a new activity can be licensed.</td>
<td>■ Introduce clear grounds for introduction of new licenses, provided that the new licenses: – Require government control for protection of public health and safety, as well as environmental protection; – Relate to allocation of scarce resources; – Do not foresee additional or specific requirements.</td>
<td>■ Fewer licenses that do not comply with the principles of market economy and free trade; ■ Lower expenses for entrepreneurs dealing with licensing procedure; ■ Faster development of priority sectors in the country.</td>
</tr>
<tr>
<td>Preferred treatment provided to state-owned companies vs. private enterprises</td>
<td>1. Presidential Decree gives a clear competitive edge to state-owned companies entering into licensable activities.</td>
<td>■ Eliminate preferred treatment of state-owned companies by leveling the playfield and applying same rules to all business entities.</td>
<td>■ Transparent management and allocation of scarce resources between state owned companies and private enterprises based on bona fide competition encouraged.</td>
</tr>
<tr>
<td>Duration of licenses inappropriate and unnecessarily overregulated process</td>
<td>1. Administrative barriers within license issuing authorities; 2. Certain licenses are subject to periodic renewal.</td>
<td>■ Ensure that all licenses are issued for a fixed period of time as provided for by the Licensing Rules; ■ Consider lifelong licenses, and allow specific short-term activities through permits instead.</td>
<td>■ Lower licensing costs for enterprises and fewer number of licenses; ■ Less frequent and less demanding re-application for licenses; ■ Lower total costs to business and issuing authorities in the licensing process; ■ Increased tax collection in the state budget from greater number of operating entities.</td>
</tr>
<tr>
<td>Lack of knowledge of entrepreneurs hindering their rights and obligations</td>
<td>1. Lack of access to appropriate and timely information for entrepreneurs.</td>
<td>■ Increase the legal awareness of entrepreneurs through: – Simple brochures distributed to entrepreneurs; – Clear procedural maps, available in license issuing agencies; – Improved dialogue between the private sector and government by stimulating seminars, training, and informational round-tables; – Public service announcements run in media and focused any procedural changes.</td>
<td>■ Reduced time spent by entrepreneurs in dealing with licensing procedures; ■ Reduced financial and human resources of SMEs for dealing with licensing procedures; ■ Higher profits for entrepreneurs; ■ Increased tax revenues for the government.</td>
</tr>
</tbody>
</table>
## Business Permits

<table>
<thead>
<tr>
<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
</tr>
</thead>
</table>
| Overregulated and non-transparent permit system, with many overlaps, duplications | 1. Lack of unified and clear legislation on permits and similar administrative formalities and requirements; 2. Uncontrolled introduction of new permits by government agencies adding to the lack of legislative clarity. | - Review the number of permits, their scope and issuance process and create a registry of all permits;  
- Identify by law the list of government agencies that may issue permits and the related aims of such permits;  
- Stipulate clear grounds for the introduction of new permits, providing that these permits must:  
  – Require government control for protection of public health and safety, as well as environmental protection;  
  – Relate to allocation of scarce resources;  
  – Not foresee additional or specific requirements. | - Reduced entry cost for new businesses and cost of operations for the existing ones;  
- Increased number of active companies;  
- Increased tax revenues;  
- Fewer permits that conflict with the principles of market economy and free trade;  
- Reduced expenses to entrepreneurs;  
- Faster development of priority sectors for the country. |
| Process of issuance, revocation of permits is unclear and burdensome     | 1. Lack of unified and clear legislation;  
2. Lack of coordination between the government agencies;  
3. Low level of professionalism on the part of officials issuing permits.                                                                                          | - Adopt a procedural act on granting permits;  
- Introduce the “silence is consent” and “self-certification” principles in the act;  
- Specify in the act a uniformed permits issuance procedure and provide a checklist of generic grounds for its refusal;  
- Introduce the “one-stop-shop” principle for issuance of certain types of more common business permits;  
- Monitor procedural practices and establish ethics standards and performance evaluation for issuing officials;  
- Increase the level of legal, procedural and institutional awareness of officials through seminars and trainings. | - Reduced time and associated fees that entrepreneurs spend on obtaining permits;  
- Improved overall process and reduced possibility of arbitrary decision-making by officials;  
- Reduced administrative burden on entrepreneurs;  
- Greater transparency and confidence building between entrepreneurs and officials;  
- Accelerated process of issuance of permits through a more professional behavior of officials;  
- Fewer inclinations of the private sector to engage in illicit activities of offering unofficial payments. |
<table>
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<tr>
<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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</table>
| Virtually all entities face a large burden of official on-site inspections | 1. No regulatory limitation on the number of inspections; 2. No efficient mechanism of control over state authorities. | - Agencies without a risk based inspection (RBI) system should develop it;  
- Tighten control over state agencies to reduce the number of “informal” inspections. | - More efficient distribution of regulatory authority’s resources;  
- Reduced number of complaints by entrepreneurs;  
- Greater compliance of SMEs with standards and regulations;  
- Total number of annual inspections of SMEs reduced;  
- Mechanisms encouraging entities to voluntarily comply developed as well as effectively sanctioning violating entities;  
- Opportunity for abuse by either side minimized;  
- Increased efficiency of business management. |
| Lack of knowledge of entrepreneurs of their rights and obligations | 1. Lack of access to information by entrepreneurs. | - Increase the legal awareness of entrepreneurs through:  
  - Simple step-by-step guides made available to entrepreneurs;  
  - Clear procedural maps, available in issuance office;  
  - Increase dialogue between the private sector and government by holding seminars, training, and informational round-tables;  
  - Broadcast public service announcements on television focused on procedural changes. | - Introduction of higher standards regulating the procedure of obtaining permits;  
- Improved access to information;  
- Lower opportunities for unofficial payments;  
- Increased legal protection of entrepreneurs. |
| Permits need to be renewed too frequently | 1. Lack of unified and clear legislation. | - Extend the validity period of permits by adopting the law on granting permits following their thorough reassessment. | - Reduced expenses for entrepreneurs;  
- Reduced workload for government agencies and thus costs of their operations. |

**Business Inspections**
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<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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</table>
| Most inspections end in sanction: official fines or informal ‘settlements’| 1. Non-transparency in decision-making on inspections; 2. Overregulation of technical inspections (outdated Soviet-time or overly complex new requirements); 3. Weak institutions handling appeals against illicit actions of inspectors; 4. Low legal awareness of entrepreneurs. | - Introduce inspection certificates that specify penalties for failure to comply with the regulation;  
- Introduce sanction mechanism to be launched only by judiciary decision;  
- Simplify the technical requirements for business units;  
- Increase legal awareness of entrepreneurs. | - Inspectors prevented from illegally interfering with business operation and thus minimized opportunity for abuse of office;  
- Businesses less inclined to offer unofficial payments and thus stimulate corruption;  
- Increased compliance with established standards and regulations;  
- Increased business community’s legal awareness;  
- Codified and uniformed inspection procedures;  
- Effective mechanisms for inspection appeals established, resulting in complaints being properly handled. |
| Mechanisms for protection and appeals against unlawful actions of inspectors are practically inoperable | 1. Non-transparency in decision-making on inspections; 2. Inspection system is inefficient. | - Introduce inspection certificates specifying penalties for failure to comply with the regulation;  
- Introduce sanction mechanism to be launched only by judiciary decision;  
- Increase legal awareness of entrepreneurs. | - Existence of genuine appeals against on-site inspection procedures;  
- Increased compliance with established procedures and rules;  
- Increased legal awareness of business community’s increase inspectors’ liability in terms of determining legal pressure methods;  
- Inspectors prevented from illegally interfering with business operation and minimize opportunity for abuse of office. |
## Business Taxation

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<th>Problems</th>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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</table>
| Graduation from the simplified to the standard tax regime leads to increase of tax burden | 1. High tax rates of the standard tax regime. | - Index threshold against inflation;  
- Consolidate both turnover tax and social security tax (SST) into a simplified tax;  
- Reduce the overall tax burden imposed under the standard tax regime. | - Greater satisfaction of entrepreneurs with the tax policy, code and regulations;  
- Less inclination of the private sector to stimulate corruption;  
- Greater compliance rate and thus reduction of the “shadow economy”, tax evasion and corruption;  
- Increased tax revenues;  
- Increased number of tax-paying businesses. |
| Tax Compliance and tax administration is burdensome, inconsistent, unclear and changes too frequently | 1. Same tax accounting for SMEs and large taxpayers;  
2. Large number of tax reports and payments;  
3. Tax accounting procedures are not sufficiently clear and in line with best international practice;  
4. The procedures for conducting tax inspections are not sufficiently clear and the oversight of the inspectors and inspections is not satisfactory. | - Introduce simplified accounting for individual entrepreneurs and SMEs;  
- Reduce the number of reports and payments all business entities are required to make, especially the number of SST reports (from 12 to 2, or ideally just 1 report per year), and providing for quarterly VAT reporting option for SMEs;  
- Consolidate tax reporting, i.e. introduce unified tax accounting and reporting that would allow submission of a single tax report for all or several taxes:  
  - Streamline tax accounting procedures;  
  - Reduce the number of contacts between tax officials and entrepreneurs by encouraging electronic tax reporting;  
  - Introduce risk management principles in planning and conducting inspections, focusing the verifications on the businesses where higher returns are expected;  
  - Introduce clearer and more elaborate regulation of tax inspections (especially powers and obligations of tax inspectors), limiting their scope to tax specific areas, yet also increasing the supervision over tax inspectors and sanctioning any violation by tax inspectors.  
- Tax Code and the related legislation and bylaws should be changed as infrequently as possible and effective dissemination of such amendments to the business community is commendable. | - Reduced time and direct costs for tax administration for both businesses and the government;  
- Reduced number of reports for submission;  
- Reduced number of errors committed by entrepreneurs when reporting, hence the cost and time for rectifying them;  
- Increased legal certainty and predictability for entrepreneurs;  
- Internationally verified simplification of tax compliance and tax system (e.g. by Doing Business report);  
- Reduced number of direct contacts between entrepreneurs and tax officials and less unofficial payments;  
- Government resources redirected from overregulated tax procedures to an efficient use of compliance monitoring and reforming the system;  
- Budgetary savings as a result of the more efficient use of public resources. |
### Problems
**Certain taxes lead to double taxation or inappropriate incentives and behavior**

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<tr>
<th>Sources of Problem</th>
<th>Recommendations</th>
<th>Expected Effect</th>
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</thead>
<tbody>
<tr>
<td>1. Existence of corporate profit tax (CPT) and dividend tax causes double taxation of corporate earnings;</td>
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</table>
| 2. Personal income tax (PIT) rate is high, especially coupled with 3 percent SST and PIT bracket thresholds are not indexed for inflation. | • Eliminate double taxation of corporate earnings by allowing for a deduction of dividend under CPT;  
• Introduce flat rate for PIT (remove tax brackets), consolidating 3 percent SST to PIT, lowering current high 35 percent PIT rate to 10 percent and indexing the PIT threshold income for inflation. | • Greater rate of reinvestment in business development of SMEs;  
• Fewer incentive to hide revenues and forge expenses – resulting in a lower discrepancy between the ‘black books’ and the official accounting records;  
• Fewer unofficial contacts and corruption reported;  
• Lower rate of unreported employment and increased formal hiring and employment;  
• Greater rate of voluntary compliance by businesses and less frequent imposition of sanctions related to compliance;  
• Increased tax revenues. |

### Access to Finance

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<th>Expected Effect</th>
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</table>
| **Loan terms not favorable to SMEs:** high interest rates, high collateral requirements, and short maturity | 1. Most banks cannot attract long-term and cheap resources for on-lending to SME’s;  
2. Insufficiently transparent SME operations result in banks adding probable risks to the cost of the loans;  
3. Banks prefer to lend for consumer goods, which in their opinion is less risky. | • Ensure better positioning of the commercial banks to obtain low-interest credit lines from international financial markets and channel them to fund SMEs (e.g. through: diversification of financial products such as equity, needs-based guarantees etc.; softening collateral requirements for SME credit lines etc.);  
• Intensify operations of the National Entrepreneurship Fund (NEF) by systematically researching and then improving applicability and transparency of its operations;  
• Develop and implement mechanisms of alternative guarantees to SMEs;  
• Improve and monitor banking sector performance in loan issuance. | • Increased number of applications, approved loans and the amounts lent to SME’s;  
• Increased number of banking customers;  
• More banking products and loans offered in the market with longer maturity and competitive pricing. |
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<tbody>
<tr>
<td>Low mutual awareness and understanding among SMEs and banks</td>
<td>1. Inappropriate SME operational practices lead to mistrust; 2. Banks run no active awareness campaigns aimed at SMEs, so businesspeople have insufficient understanding of their services.</td>
<td>1. Unify numerous legislative acts regulating export and import issues in a single Customs Code; 2. Improve the structure and language of the Customs Code and fill in the gaps in the customs legislation; 3. Develop and disseminate a binding summary of export/import procedures, the required paperwork, costs, and time periods for each step.</td>
<td>Increased legal awareness and compliance of entrepreneurs; Reduced costs of compliance; Fewer unofficial payments reported by either customs officials seeking or the businesses offering and thus stimulating corruption.</td>
</tr>
<tr>
<td>Custom legislation is complicated, unclear and changes too often</td>
<td>1. The language and structure of the custom legislation is complicated; 2. Laws related to foreign trade are dispersed through many separate legislative acts.</td>
<td>1. Unify numerous legislative acts regulating export and import issues in a single Customs Code; 2. Improve the structure and language of the Customs Code and fill in the gaps in the customs legislation; 3. Develop and disseminate a binding summary of export/import procedures, the required paperwork, costs, and time periods for each step.</td>
<td>Increased volume of exports and lower cost of exporting; Higher proportion of revenues retained by exporters; Improved trade balance for the national economy; Larger number of exporters in possession of the recognized international certificates for their products;</td>
</tr>
<tr>
<td>Export procedures are complicated and discourage SMEs from engaging in exporting activities and trade abroad</td>
<td>1. Export of large number of goods are subject to various approvals by the state authorities; 2. Excessive number of state authorities are involved in processing of export documents;</td>
<td>1. Reduce the number of documents required for exporting; 2. Reduce the number of state authorities involved in exporting; 3. Eliminate double certification by allowing export of goods with internationally recognized certificates; 4. Eliminate the requirement for full advance payment in exports where applicable; 5. Increase accountability of customs and railway service officials to eliminate the cases of bribery.</td>
<td>Increased volume of exports and lower cost of exporting; Higher proportion of revenues retained by exporters; Improved trade balance for the national economy; Larger number of exporters in possession of the recognized international certificates for their products;</td>
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<tr>
<td>Problems</td>
<td>Sources of Problem</td>
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<tr>
<td>3. Excessive number of documents is required for exports; 4. Double certification of goods; 5. Faxed documents are not accepted by customs authorities and obtaining hardcopies delays the exports.</td>
<td></td>
<td></td>
<td>Increased exports and improved positioning of the Azerbaijani non-oil goods and services in foreign markets.</td>
</tr>
<tr>
<td>Import procedures are complicated and discourage SMEs from engaging in importing activities and in-country trade</td>
<td>1. Import of large number of goods are subject to various approvals by the state authorities; 2. Excessive number of state authorities are involved in processing of import documents; 3. Excessive number of documents is required for imports; 4. Goods bearing international conformity markings are subjected to mandatory conformity assessment; 5. Unclear rules for assessment of import value and lack of mechanism for the settlement of disputes related thereto; 6. Absence of bonded warehouses.</td>
<td>• Reduce the number of documents required for importing and introduce acceptance of faxed import documents in accordance with international practices; • Reduce the number of state authorities involved in importing; • Eliminate requirement of conformity assessment on products marked with international markings of conformity such as “CE” marking originating in Organization for Economic Co-operation and Development (OECD) countries; • Introduce more consistent, predictable, simple and uniform rules for the assessment of import value and establish a mechanism for quick resolution of disputes arising in connection with this; • Encourage the establishment of bonded warehouses; • Develop code of conduct for customs and railway service officials to eliminate the cases of bribery.</td>
<td>Increased number of SMEs engaged in imports; Greater diversification and quality of products available at lower prices; Reduction of discretionary powers of customs officials, thus number of arbitrary decisions; Less frequent corrupt practices of businesses and customs officials reported.</td>
</tr>
<tr>
<td>Problems</td>
<td>Sources of Problem</td>
<td>Recommendations</td>
<td>Expected Effect</td>
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<tr>
<td>Technical regulation is outdated and fails to integrate with the internationally used standards</td>
<td>1. Technical regulation system is not coherent; 2. Many standards are outdated; 3. Excessive number of products are subject to mandatory certification; 4. Lack of testing facilities that comply with the international standards.</td>
<td>- Separate the standardization and certification functions by establishing independent laboratories issuing certificates; - Review the list of standards and abolish the ones not necessary on the grounds of health and safety in a market economy; - Consider adopting international standards to avoid the “maintenance cost” of the system; - Apply the risk-based approach by determining which goods and services need to be certified in order to exclude non-risky categories from mandatory certification and by abolishing the mandatory certification requirement for services; - Create internationally required laboratory facilities to certify Azerbaijani commodities according to internationally adopted standards in order to facilitate their export.</td>
<td>- New cost saving options for entrepreneurs; - Increased occurrence of entrepreneurs marketing their products as being in compliance with international standards; - Reduced running expenses for the agencies responsible for elaboration of standards; - Faster and cheaper access to international markets for Azerbaijani exporters; - Increased competitiveness of the Azerbaijani economy (goods and services), as verified by international competitiveness ratings (e.g. Competitiveness Index).</td>
</tr>
<tr>
<td>Variation of customs tariffs for similar types of goods, raw materials and processed goods discourages import/export</td>
<td>1. Customs tariffs significantly differ with respect to similar type of goods and raw materials and fully-processed goods; 2. VAT exemptions discourage trade with non VAT exempt goods.</td>
<td>- Approximate customs tariffs for similar type of goods, raw materials and fully-processed goods in order to encourage import/export; - Introduce uniform tariff rates for similar types of goods; - Eliminate VAT exemptions to avoid distortions.</td>
<td>- Distortions caused by unreasonable tariffs lowered or eliminated; - Incentives for customs officials to trade between classes of goods or apply ‘preferential treatment’ in exchange for unofficial payments regulated and reduced; - More simple and less costly calculation of customs payments increasing certainty and compliance.</td>
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</tbody>
</table>
Introduction

Geography, history and demographics

The Republic of Azerbaijan is an independent country located in the Caucasus region of Southeast Europe, encompassing a total area of 33,440 square miles. The country shares borders with the Russian Federation’s province of Dagestan to the north, Georgia to the northwest, Armenia and Turkey to the west and southwest, Iran to the south, and the Caspian Sea to the east.
The capital and largest city of Azerbaijan is Baku. Azerbaijan Republic includes one Autonomous Republic of Nakhchivan and 66 administrative regions (rayons). About one fifth of the territory of the Republic of Azerbaijan, including Nagorno-Karabakh region and 7 rayons adjacent to this area have been occupied by Armenian military forces.

In 2006, Azerbaijan’s population reached a level of almost 8.5 million, an increase of 2.9 percent since 2003. The increase stems from the high cumulative growth of Azerbaijan’s urban population, which accounted for 4.9 percent within the same period, in contrast to 0.7 percent cumulative growth among the rural population.

The working age in the country is set between 15 and 61 years old for men and 15 to 56 for women. More than half of the population has reached secondary level education by age 15. 11.3 percent of citizens obtained higher education, specialized secondary education was completed by 11.9 percent and secondary by 52.2 percent. Secondary and higher education levels have shown modest increases since 2004.

**Azerbaijani Economy**

Since independence, Azerbaijan has gone through a transition process that has been more dramatic than other ex-Soviet and EU accession countries (Table 1), characterized by a deeper recession at the beginning of the 1990s, followed by a catch-up period: Azerbaijan’s GDP per capita (in PPP) was 51.5 percent of the Ex-Soviet/CIS average in 1992 and 73 percent in 2007. Before the oil boom, this recovery process has been permitted by steady non-oil GDP growth, at 4.3 percent on average between 1997 and 2001 and in double digits in 2002-2004 (Table 1), driven by services and construction. In 2004, the non-oil economy still accounted for 68.4 percent of total GDP. It was a stable economy, with inflation in low single digits and consolidated expenditures representing 37.7 percent of non-oil GDP.

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2 Source: combined official Azerbaijani statistics and the World Bank 2008 data.
Table 1. The Azeri economy after independence (1992-2007)

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</thead>
<tbody>
<tr>
<td>GDP growth (%)</td>
<td>-15.2</td>
<td>7.8</td>
<td>10.6</td>
<td>11.2</td>
<td>10.2</td>
<td>26.4</td>
<td>34.5</td>
<td>25.0</td>
</tr>
<tr>
<td>Oil GDP gr.</td>
<td>-10.6</td>
<td>9.9</td>
<td>3.6</td>
<td>0.6</td>
<td>2.5</td>
<td>66.3</td>
<td>63.1</td>
<td>36.8</td>
</tr>
<tr>
<td>Non-Oil GDP gr.</td>
<td>-18.4</td>
<td>4.3</td>
<td>13.8</td>
<td>14.9</td>
<td>13.6</td>
<td>8.3</td>
<td>11.6</td>
<td>11.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-19.1</td>
<td>5.9</td>
<td>6.4</td>
<td>5.6</td>
<td>4.6</td>
<td>7.5</td>
<td>0.9</td>
<td>4.0</td>
</tr>
<tr>
<td>Industry (non-oil)</td>
<td>-19.6</td>
<td>-0.4</td>
<td>8.9</td>
<td>22.2</td>
<td>9.9</td>
<td>14.8</td>
<td>4.1</td>
<td>7.9</td>
</tr>
<tr>
<td>Construction</td>
<td>-6.0</td>
<td>25.5</td>
<td>105.0</td>
<td>61.0</td>
<td>41.9</td>
<td>2.0</td>
<td>8.5</td>
<td>16.0</td>
</tr>
<tr>
<td>Services</td>
<td>-15.3</td>
<td>9.5</td>
<td>6.0</td>
<td>8.0</td>
<td>8.9</td>
<td>9.6</td>
<td>18.2</td>
<td>12.5</td>
</tr>
<tr>
<td>GDP per capita (PPP), % of CIS countries average</td>
<td>42.0</td>
<td>44.1</td>
<td>45.0</td>
<td>45.7</td>
<td>46.1</td>
<td>54.0</td>
<td>64.7</td>
<td>73.0</td>
</tr>
<tr>
<td>GDP per capita (PPP), % of EU 10 countries</td>
<td>30.3</td>
<td>23.6</td>
<td>25.8</td>
<td>27.0</td>
<td>27.8</td>
<td>33.2</td>
<td>40.3</td>
<td>46.4</td>
</tr>
<tr>
<td>Inflation (pa)</td>
<td>827.7</td>
<td>-0.5</td>
<td>2.8</td>
<td>2.2</td>
<td>6.7</td>
<td>9.7</td>
<td>8.4</td>
<td>16.6</td>
</tr>
<tr>
<td>Oil fiscal revenues as a % of non-oil GDP</td>
<td>N/A</td>
<td>4.7</td>
<td>15.9</td>
<td>16.2</td>
<td>14.8</td>
<td>17.6</td>
<td>32.0</td>
<td>39.5</td>
</tr>
<tr>
<td>Non-oil fiscal revenues as a % of non-oil GDP</td>
<td>N/A</td>
<td>21.0</td>
<td>22.3</td>
<td>21.6</td>
<td>24.6</td>
<td>27.4</td>
<td>29.9</td>
<td>33.2</td>
</tr>
<tr>
<td>Poverty rate, total</td>
<td>68.1</td>
<td>49.0</td>
<td>44.6</td>
<td>39.7</td>
<td>28.5</td>
<td>24</td>
<td>20.8</td>
<td>15.8</td>
</tr>
</tbody>
</table>

**Memo**

| Non-Oil GDP, US$ Mill   | 1.662                       | 3730.3                      | 4.300| 5.088| 5.962| 7.402 | 9.750 | 12.955|
| Population, Millions (mid year) | 7.53 | 8.00 | 8.17 | 8.23 | 8.31 | 8.39  | 8.45  | 8.55  |

1 (1993-1996),
2 Latvia, Lithuania, Estonia, Hungary, Czech Republic, Poland, Slovenia, Slovakia, Romania, Bulgaria;

**Sources:** Azerbaijan authorities and World Bank staff estimates.

Going forward, the government’s principal policy challenge will be to maintain macroeconomic stability during a period of rapid economic growth. However, it will struggle to contain the inflationary pressures exerted by a combination of growing budget expenditures on welfare and infrastructure projects, and a large increase in foreign currency inflows from oil exports.

The openness of the economy to foreign investment and import competition coupled with the domestic business climate determines the competitiveness of domestic markets. Competitiveness entails not only issues of market access as embodied in tariffs and narrowly conceived non-tariff barriers. It also entails market access implications for domestic policies and regulations, as well as treatment afforded to foreign and domestic investor firms. Higher levels of competitiveness usually generate not only higher rates of economic growth but also help improving competitiveness of domestic firms, both local- and foreign-owned and, by the same token, contribute to better export performance.
The state, ultimately responsible for assuring competitiveness of domestic markets combined with an investment-friendly business environment, faces transformation from a traditional role of micromanager into that of a facilitator of business activities. This is not an easy transformation: beginning in the 1990s, many states have successfully reduced the scope of state functions in economic development while strengthening their administrative capacity to reduce the costs of doing business and exposing businesses to domestic and external competition. Indeed, institutions creating a level playing field for business under stable regulatory conditions are critical to economic development. This in turn is what constitutes good economic governance.

Business climate in Azerbaijan

In 2008, Azerbaijan was cited as a top 10 reformer by the IFC/World Bank’s Doing Business report, with improvements on seven out of 10 indicators of business environment reform. Azerbaijan started operating a one-stop-shop in January 2008 that halved the time, cost, and number of procedures to start a business: registrations increased by 40 percent in the first six months. Azerbaijan also eliminated the minimum loan cutoff of $1,100, more than doubling the number of borrowers covered at the credit registry. Taxpayers can now file and pay their taxes online. Azerbaijan’s extensive reforms moved it far up the ranks, from 97th to 33rd, in the overall ease of doing business.


Another comparable index ranks Azerbaijan somewhat more critically: the Index of Economic Freedom score for Azerbaijan is 58, making its economy the 99th freest in the 2009 Index. Its overall score is 2.6 points higher than last year, reflecting notable improvement in business and labor freedom. Azerbaijan is ranked 17th out of 41 countries in the Asia–Pacific region, and its overall score is slightly less than the world average.

As a transforming economy, Azerbaijan still faces substantial challenges. Financial freedom, investment freedom, property rights, and corruption remain a significant challenge, and an underdeveloped judicial system is inadequate to efficiently protect intellectual property rights, according to the Heritage Foundation.

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Today, Azerbaijan remains ranked low in Transparency International’s Corruption Perception Index, which in 2008 placed it 158 out of 180 listed countries, with a score of 1.9 out of a possible 10 (no corruption)\(^4\). At the beginning of 2004, the government adopted a series of anti-corruption measures aimed at increasing transparency and reducing corruption. Unfortunately, implementation of many of these laws, including the law requiring financial disclosures by public officials, has been slow or inadequate.

In the summer of 2007, the government again focused its attention on combating corruption and took several positive steps aimed at tackling the problem of corruption. First, the government adopted a new National Strategy on Increasing Transparency and Combating Corruption. Second, the government adopted an ethics code for civil servants. The New Anti-Corruption National Strategy, set to run from 2007 to 2011, replaces and expands upon Azerbaijan’s previous State Program on Combating Corruption (2004-2006).

Since independence, Azerbaijan has taken great strides in bringing its legislative framework into conformity with best practice. The government has also ensured that members of the public have access to legislation and knowledge of it. A significant barrier to the business community’s contribution to the improvement of Azerbaijan’s investment climate, however, is the lack of timely information about proposed legislation before it is adopted. Draft legislation is rarely announced in advance and the business community is given little or no opportunity to comment on it.

1. Methodology

1.1 Background

The survey of the business environment is a product of the IFC Azerbaijan Business Enabling Environment Project. This national level survey of small and medium enterprises and individual entrepreneurs in various sectors of the Azerbaijani economy is the first of its kind to be implemented in the country. The survey was conducted from Nov 2007-Jan 2008.

1.2 Purpose of survey

The main objective of the survey is to measure regulatory and administrative barriers adversely affecting the growth, development, and operations of the private sector in Azerbaijan. The empirical survey data and subsequent recommendations to Azerbaijani state authorities are expected to stimulate the debate for reform of the regulatory and administrative environment for the private sector in various procedures, such as the followings:

- State registration of business units;
- State control and inspections over existing business units;
- Licensing of activities carried by business units that require special permission;
- Obtaining permits/approvals for launching and continuation of business activities;
- Certification of products and services of existing business units;
- Import and export operations;
- Taxation;
- Analysis of the entrepreneurial financial indicators;
- Relations between private sector and financial institutions.

1.3 Sampling strategy

The survey used a probability-based sampling methodology in which the firms were selected for interview according to a known non-zero probability. The major advantage of this method was that from a sound sample, statistical inferences can be made about a larger population (at national, regional or sector levels).

In order to make sure that the sample distribution was representative of the Azerbaijani economy, the sample framework was based on the incidence and distribution of
entities nationwide from the official statistical data provided by the State Statistical Committee of the Azerbaijan Republic as of January 1, 2007. The stratification of the sample was based on: (i) sectors of the economy defined by the State Statistics Committee; (ii) size and type of enterprise, defined as number of employees; and (iii) regions. Tables 1.1, 1.2 and 1.3 show the distribution of the official data and the distribution of the survey sample.

Stratified random sampling is used to capture all the sectors of economic activity, including firm classification and geographic distribution of the business entities’ universe. In other words, in order to make the sample selection representative of a sector, firm type and region, the selected sample fully represents the larger economic picture.

### 1.4 Firm classification in the Azerbaijani economy

According to decree No. 57 of the Cabinet of Ministries of the Republic of Azerbaijan on Identification of the Small Entrepreneurship Subjects by Types of Economic Activity dated April 20, 2004, small businesses are defined as follows according to sector:

- In the construction and industry – number of employees of less than 40 person and annual turnover of less than 200,000 Azerbaijani manats (~$247,000);
- Agriculture – number of employees of less than 15 people and annual turnover of less than 100,000 Azerbaijani manats (~$123,500);
- Wholesale trade – number of employees of less than 10 people and annual turnover of less than 300,000 Azerbaijani manats (~$370,500);
- Other branches – number of employees of less than 5 people and annual turnover of less than 100,000 Azerbaijani manats (~$123,500).

There is no official definition of midsize legal entities in Azerbaijan. IEs are classified as small enterprises while legal entities are further classified as either small or all the others that make up the SME sector. Therefore except for the large companies, all other registered businesses fall within the category of SMEs.

In terms of regional coverage, the survey was conducted in the urban areas of eight regions (Absheron, Ganja-Gazakh, Sheki-Zagatala, Lenkoran, Guba-Khachmaz, Aran, Yukhari Garabakh, Daglig Shirvan) and the capital city Baku. The survey does not cover the occupied territories of the Republic of Azerbaijan and Nakhchivan.

In terms of sample size, 873 individual entrepreneurs and 893 legal entities’ were interviewed during the survey, for a total of 1,776 respondents in the sample. The respondents were the owners or top managers of private sector small and medium enterprises and individual entrepreneurs, responsible for decision making.

Since retail and wholesale trade individual entrepreneurs form the largest share of economic subjects (58 percent of the entrepreneurs), a decision was taken to reduce their number, since the scope of their business operations is less complex and thus less informative. Their share was therefore halved. This was done with an aim to increase
the share of economically active companies in the sample. After that all weight coefficients were calculated and used during the analytical process.

1.5 Data collection

The survey was conducted by an independent survey company commencing in autumn 2007. The main survey instrument was a written questionnaire with 134 questions, which was pilot-tested before commencing the fieldwork. The questionnaire covered the following procedures: business registration, obtaining licenses, permits and certificates, access to finance, inspections, taxation, and foreign trade regimes.

1.6 Qualitative method of data collection

In addition to the probability-based quantitative method of data collection as described above, the survey also used qualitative means to gather information through meetings with industry experts, practitioners, and focus groups discussions.

Qualitative methods to gather information are often used during identification of a problem, and when trying to understand the scope of a problem when information gaps exist in the data. Since the survey had to do with quantification of different regulatory procedures, key informant interviews and focus groups were organized to understand for example, average expenditures and average time required for particular procedures.

In-depth interviews with experts were conducted to understand the details of several special procedures. For example, meetings with experts such as professional agents/lawyers dealing with business registration were organized to understand the steps and procedures relating to business registration.

Focus group discussions with entrepreneurs were organized in order to identify the most problematic procedures for entrepreneurs, and also to understand and interpret the empirical survey results. The focus groups, of five-seven participants, were led by an experienced moderator; a total number of 10 focus group discussions were held. Topics included business registration, permits, and inspections.

1.7 Distribution of official data and survey sample, by sector of activity

The sampling frame was prepared in accordance with the official statistics data for Azerbaijan for the last available year the information was fully processed. The tables below serve the purpose of indicating the sampling strategy for the IFC’s SME survey. The total breakdown includes a split between IEs and SMEs in the ratio 85:15 percent. The lower two tables present the split by the economic activity.
### Table 1.1 Distribution of official data and survey sample, for all business units

<table>
<thead>
<tr>
<th>Scope of activity</th>
<th>Official statistics</th>
<th>Survey results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>IE</td>
</tr>
<tr>
<td>Agriculture, hunting and forestry / Fishing</td>
<td>7,995</td>
<td>2,439</td>
</tr>
<tr>
<td>Mining/ Manufacturing / Electricity, gas and water supply</td>
<td>4,967</td>
<td>2,506</td>
</tr>
<tr>
<td>Construction</td>
<td>2,684</td>
<td>412</td>
</tr>
<tr>
<td>Wholesale and retail trade; Repair of motor vehicles, household and personal goods</td>
<td>130,408</td>
<td>119,510</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>10,564</td>
<td>10,066</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>19,660</td>
<td>18,850</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>262</td>
<td>0</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>4,898</td>
<td>2,243</td>
</tr>
<tr>
<td>Public administration and defense; compulsory social security</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Education</td>
<td>186</td>
<td>0</td>
</tr>
<tr>
<td>Health and social work</td>
<td>585</td>
<td>0</td>
</tr>
<tr>
<td>Other community, social and personal service activities</td>
<td>20,272</td>
<td>15,733</td>
</tr>
<tr>
<td>Private household with employed persons</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Extra-territorial organizations and bodies</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>202,482</strong></td>
<td><strong>171,759</strong></td>
</tr>
</tbody>
</table>

### Table 1.2 Distribution of official data and survey sample, by sector of activity for individual entrepreneurs

<table>
<thead>
<tr>
<th>Scope of activity</th>
<th>Official statistics</th>
<th>Survey results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% from total</td>
</tr>
<tr>
<td>Agriculture, hunting and forestry / Fishing</td>
<td>2,439</td>
<td>1.4%</td>
</tr>
<tr>
<td>Mining/ Manufacturing / Electricity, gas and water supply</td>
<td>2,506</td>
<td>1.5%</td>
</tr>
<tr>
<td>Construction</td>
<td>412</td>
<td>0.2%</td>
</tr>
<tr>
<td>Wholesale and retail trade; Repair of motor vehicles, household and personal goods</td>
<td>119,510</td>
<td>69.6%</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>10,066</td>
<td>5.9%</td>
</tr>
<tr>
<td>Scope of activity</td>
<td>Official statistics</td>
<td>Survey results</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
<td>---------------------</td>
<td>----------------</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>% from total</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>18,850</td>
<td>11.0%</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>2,243</td>
<td>1.3%</td>
</tr>
<tr>
<td>Public administration and defense; compulsory social security</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Education</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Health and social work</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Other community, social and personal service activities</td>
<td>15,733</td>
<td>9.2%</td>
</tr>
<tr>
<td>Private household with employed persons</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Extra-territorial organizations and bodies</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>171,759</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Table 1.3 Distribution of official data and survey sample, by sector of activity for small and medium enterprises

<table>
<thead>
<tr>
<th>Scope of activity</th>
<th>Official statistics</th>
<th>Survey results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% from total</td>
</tr>
<tr>
<td>Agriculture, hunting and forestry / Fishing</td>
<td>5,556</td>
<td>18.1%</td>
</tr>
<tr>
<td>Mining/ Manufacturing / Electricity, gas and water supply</td>
<td>2,461</td>
<td>8.0%</td>
</tr>
<tr>
<td>Construction</td>
<td>2,272</td>
<td>7.4%</td>
</tr>
<tr>
<td>Wholesale and retail trade; Repair of motor vehicles, household and personal goods</td>
<td>10,898</td>
<td>35.5%</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>498</td>
<td>1.6%</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>810</td>
<td>2.6%</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>262</td>
<td>0.9%</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>2,655</td>
<td>8.6%</td>
</tr>
<tr>
<td>Public administration and defense; compulsory social security</td>
<td>1</td>
<td>0%</td>
</tr>
<tr>
<td>Education</td>
<td>186</td>
<td>0.6%</td>
</tr>
</tbody>
</table>
### Scope of activity

<table>
<thead>
<tr>
<th>Scope of activity</th>
<th>Official statistics</th>
<th>Survey results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% from total</td>
</tr>
<tr>
<td>Health and social work</td>
<td>585</td>
<td>1.9%</td>
</tr>
<tr>
<td>Other community, social and personal service activities</td>
<td>4,539</td>
<td>14.8%</td>
</tr>
<tr>
<td>Private household with employed persons</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Extra-territorial organizations and bodies</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30,723</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

### Annex 1.1 Focus group discussions

Moderator guide were developed for the focus group discussions. As an example, the focus groups guide on permits is presented below.

1. **Dear participants, as far as we know, for doing business you need to get permits from state agencies. Could you please indicate what permits you obtained (and from which agencies)?**
   [Moderator takes a note of all indicated permits on the board. Ask again if there are any additions to be made to the list.]

2. **Could you please describe why you need these permits or for what purpose this permit is provided?**
   [Moderator asks about the most common permits.]

3. **Please describe how you obtain the permits? Please indicate everything in details, even things that you considered not significant.**
   [Moderator listens to one participant and after each contribution checks it with others to identify whether this information is common to others.]

4. **We drew an approximate outline of obtaining permits and would like to ask whether you agree with this plan or you have any comments or suggestions?**
   [After the answers of respondents moderator continues.]

5. **Now, let us check these data. I need to learn from each of you four figures a) how much time on average is required for you to pass this stage b) which expenditures you regularly make or are you ready to made at this stage c) how many people are required for solving this stage; d) how often you have to renew these permits?**
   [Figures are put next to icons. If several figures were indicated then average figure is written. If figures are too different then reasons are clarified.]

6. **Now, let’s talk about common characteristics of obtaining the permits. Who in your enterprise is dealing with this task? Is this person familiar with obtaining permits? How much are you (or your authorized person) aware of the procedures provided by law for obtaining permits?**

7. **At the end we would like to request that you talk about any not standard issues, questions, situations or cases that you or your enterprise faced during the process of obtaining permits?**
   [If interesting remarks come up the moderator solicits the opinion of other participants, even if they have never faced this situation. It is important to ask them to consider other perspectives.]
2. SMEs in Azerbaijan

The aim of this chapter is to present information on the size and the economic dimension of the micro, small and medium sized sector in Azerbaijan. This is required in order to understand its development dynamics, impact on the economy and the reflection of the current problems burdening the sector on their operations.

As the country’s economy has grown in recent years, mainly as a result of its burgeoning oil industry, the number of small and medium enterprises (SMEs) has also grown. However, the growth in SMEs does not reflect the contribution of this entrepreneurial sector to the GDP. The growth of the oil sector results in the growth of the non-oil sector almost as ‘free-riders’ in the general economic boom. The recent trends yet indicate a slower growth of the non-oil sector, i.e. its shrinking compared to the oil industry in proportional terms.

Micro and small and medium sized entrepreneurship in Azerbaijan is divided into two groups: individual entrepreneurs (i.e. sole owners of the enterprise without forming a legal entity); and small and medium enterprises (i.e. legal entities). All individual entrepreneurs are legally considered small enterprises by default, whereas those registered as legal entities are classified according to two indicators: number of employees and annual turnover.
The increase in the SME sector reflects its growing importance to the country’s economy. This is clearly demonstrated in the expanding number of registered entities, but even more so the increasing number of employees, either hired or formally registered. Nevertheless, approximately 90 percent of all the labor force within the entrepreneurship community is employed by IEs.

The increase in the SME sector reflects its growing importance to the country’s economy. This is clearly demonstrated in the expanding number of registered entities, but even more so the increasing number of employees, either hired or formally registered. Nevertheless, approximately 90 percent of all the labor force within the entrepreneurship community is employed by IEs.

Table 2.1 Number of employees of IEs and SMEs

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No of subjects</td>
<td>Total No of employees</td>
<td>No of subjects</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>17,028</td>
<td>68,565</td>
<td>11,982</td>
</tr>
<tr>
<td>(legal entities)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual Entrepreneurs</td>
<td>144,406</td>
<td>292,654*</td>
<td>166,558</td>
</tr>
<tr>
<td>Total</td>
<td>161,434</td>
<td>361,218</td>
<td>178,540</td>
</tr>
</tbody>
</table>

* Official sources do not contain information on the average number of employees working for individual entrepreneurs (IE). This calculation was done based upon the empirical evidence, using the formula: (Average number of employees per small enterprise – 2) x number IE = Total number of employees working for individual entrepreneurs.

According to the State Committee for Statistics’ data and some calculations based upon these indicators, the role of SMEs in the country’s economy is growing, particularly in its contribution to the private sector.
Meanwhile, the number of small and medium enterprises (SME) per 1,000 residents shows that there is potential for the sector to grow even more, providing a significant contribution to the GDP and enterprise growth.

2.1 Individual entrepreneurs

The individual entrepreneur is an individual person (sole owner), who is involved in entrepreneurial activity without forming a legal entity and has unlimited liability.

Individual entrepreneurs represent the majority of the SME sector, as far as the number of enterprises and the number of employed are concerned. According to the State Committee for Statistics' data, 93 percent of the local entrepreneurs are registered as individual entrepreneurs.
As indicated in the survey, it is simpler for entrepreneurs to operate in the formal economy as individual entrepreneurs for a number of reasons:

1) The registration process is simpler for the individual entrepreneurs than for legal entities;

2) The expenses for the registration process, license and permits are much lower for individual entrepreneurs;

3) In businessmen’s opinion, individual entrepreneurs are more often checked by the local or regional branches of the inspection services compared to SMEs, since the headquarters of ministries and agencies do not have a list of registered IEs. Legal entities must register with ministries and agencies’ headquarters; therefore, they are checked by these government structures, with whom it is not always easy to come to reach an informal settlement.

In 2007, one in four entrepreneurs on average invested in fixed assets of his enterprise using mainly internal sources of financing (personal savings/family capital). The low investment level can be partially explained by the limited access to external financing sources (see chapter Access to finance), as well as by insufficient confidence in the business environment.

As the country’s overall economy grows, this corresponds to an increase in income for entrepreneurs. If the growing income on the one side increases consumer income, then on the other side it creates the financial foundation for the development of individual and small-scale entrepreneurship, which, in turn, should cover the growing consumer’s needs. Thus, during the 2004-2006 period (according to official data from the State Statistics Committee), the number of individual entrepreneurs grew significantly (the aggregate average annual growth was, on average, 6 percent), and at the beginning of 2006, there were about 171,000 IEs.

Individual entrepreneurs represent the largest category of SMEs in the country, as far as the quantity and share of income are concerned.
The economic opportunities in Baku, employment shortages in some regions, and low profitability in agriculture create seasonal employment and migration. According to official data, the population of Baku is slightly more than two million people, but this figure does not include people formally registered in other places in the country, yet living in the capital. Some experts believe that a more realistic figure of Baku’s population is twice the official indicator, or four million. Hence Baku, followed by Sumgayit and Ganja, remain the most populated cities in the country. The proportions of individual entrepreneurs and SMEs favor the three most populated cities of the country; the total number of individual entrepreneurs in Baku, Sumgayit, and Ganja equals 42 percent of the whole country. These entrepreneurs work mainly in the consumer market, i.e. the dominating share is employed either in the trade area, or in the services area.

Individual entrepreneurs are predominantly involved in activities requiring minimal investments and giving quick income, especially trade. Only a small number of individual entrepreneurs are involved in manufacturing, requiring high initial investments, which bring income after a relatively long period of time. Individual entrepreneurs hire on average three employees on either full or part-time basis, paying them an average monthly salary of $185.

<table>
<thead>
<tr>
<th>Table 2.2 Statistical information on IE activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annual turnover</td>
</tr>
<tr>
<td>Average profit</td>
</tr>
<tr>
<td>Employees number</td>
</tr>
<tr>
<td>Average monthly salary</td>
</tr>
</tbody>
</table>

![Chart 2.6](image)
2.2 Small enterprises

A small enterprise is a private legal entity meeting the requirements of the Cabinet Council Decree on Criteria for defining SMEs.

By the beginning of 2006, there were about 12,000 small enterprises registered in the country, which corresponds to 6.6 percent of the whole SME sector. The annual growth indicator from 2005 to 2006 was 2 percent. This indicator is lower than the corresponding growth of the sector, reflecting the small number of entrepreneurs that opt to become more structured by registering their business as a legal entity.

As in the case with individual entrepreneurs, smaller firms are mainly located in large cities. Thus, the total number of small enterprises in Baku, Sumgayit, and Ganja equals 56 percent of the total number in the country. (Sumgait is included in the Aran region, Ganja is included in the Ganja-Gazakh region).
The “typical” small enterprise has the following characteristics:

Table 2.3 Statistical information on SME activity

<table>
<thead>
<tr>
<th></th>
<th>Average annual turnover</th>
<th>Average profit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AZN 250,000</td>
<td>$309,000</td>
</tr>
<tr>
<td>Average profit</td>
<td>AZN 30,000</td>
<td>$37,000</td>
</tr>
<tr>
<td>Employees number</td>
<td>15 people (full and part-time)</td>
<td></td>
</tr>
<tr>
<td>Average monthly salary</td>
<td>AZN 150</td>
<td>$185</td>
</tr>
</tbody>
</table>

Unlike individual entrepreneurs, legal entities are involved in a much greater variety of economic sectors. Thus, if 69 percent of individual entrepreneurs are involved in trade, then, among legal entities only 28 percent are in trade.

2.3 Main source of investments: own funds

One important indicator for measuring the growth of the SME sector is the level and the source of the investments made by entrepreneurs into their businesses. Research shows that local entrepreneurs seldom make capital investments in expanding their business. Thus, in 2007, only 28 percent of entrepreneurs invested in their enterprises.

A large portion of these investments are financed from the entrepreneurs’ personal money. Only a small number of entrepreneurs apply for external financing with the purpose of receiving financial support for investments. The chapter on Access to finance elaborates on the reasons for the low level of commercial funding and provides recommendations on overcoming the current limitations.

In the entrepreneurs’ opinion, the stable growth in income, the potential for market development, as well as their business experience allows them to achieve satisfactory turnover. However, as seen in the course of focus group discussions, a significant part of their profit is spent on rent.

The number of entrepreneurs in Baku that lease some premises for their business activity equals more than half, while in the regions only 26 percent of entrepreneurs rent their commercial premises.
According to the entrepreneurs’ own views expressed through in-depth interviews, in the capital, where about 60 percent of the enterprises are located on the leased premises, prices for the lease accounts for 30 to 40 percent of the enterprises’ profits. Closer to the capital’s center and on the active streets of the city, locations with direct exit to the street are leased for different types of activity, and change tenants sometimes several times a year. This is explained by the fact that the enterprises’ profit and their income are frequently insufficient to cover the high rental rates. Accordingly, the entrepreneurs who manage to cover the high expenses of the rental rates, as a rule are forced to shift their investment needs to a lower priority.

2.4 State subsidies for SME development

The Government of Azerbaijan provides three different plans for SME support. The largest of them is the Azerbaijani Investment Company (AIC) that invests in companies by taking equity stakes of at least $1 million, providing venture capital. The National Entrepreneurship Fund (NEF) provides highly subsidized loans (up to $3.2 million in value) to SMEs. Finally, the Mortgage Fund also provides highly subsidized loans for a special purpose. All three funds rely heavily on the state oil revenues and issue debt at below market rates.

According to the Ministry of Economic Development data, in 2007 NEF allocated more than $112 million in the form of such subsidized loans aimed supporting local entrepreneurship. These credit lines were allocated to 882 small businesses in 56 cities and regions of the country. The interest of the entrepreneurs in receiving subsidized loans increases the demand for the fund’s activity, which in turn called for a greater allocation of public funds for the purpose. Thus, during the first half of the year, the fund allocated an additional $66.5 million to entrepreneurs for subsidized loans. The system of resource allocation and the details of the beneficiaries, including how the subsidies were spent, remain largely non-transparent.

---

According to the IFC survey, more than half of the entrepreneurs face the problem of access to finance, i.e. insufficiency of financial resources to grow their businesses. The number of enterprises that received loans from the designated fund amounts to only 1 percent of those who faced difficulties in access to finance. Moreover, the average loan size, according to the fund’s 2007 report, is $127,000. The figure suggests that the loans were not distributed to the smaller enterprises and individual entrepreneurs, but in fact to larger companies, whose turnover and profit margins allow for larger scale borrowing. Given the IFC survey data, the average loan size from NEF more than triples IE’s annual turnover (which stands at $42,000) and is about the half of the annual turnover of SMEs ($250,000).

2.5 Legal environment and SME confidence

2.5.1 Legal unpredictability – higher cost of compliance

Over the last decade, Azerbaijani legislation has undergone substantial improvement and systematization through the enactment of new laws in line with best international practices, the introduction of numerous amendments to the existing laws, and the abrogation of dysfunctional and obsolete laws. As a result of these reforms, Azerbaijan was named the top reformer for 2007-2008 in Doing Business 2009.

Among many others, the Tax Code has been amended 19 times since it came into effect on January 1, 2001 and 30 amendments have been made to the Civil Code since it became effective on September 1, 2000. Considerable amendments were made to the law on State Registration and State Register of Legal Entities in connection with the introduction of a one-stop-shop system in the registration of commercial legal entities. Relevant changes were made to the Tax Code as well. Among the more notable improvements in the legislation was the adoption of Presidential Decree No. 782 on Improvement of Rules of Issuance of Special Permits (Licenses) for Certain Types of Activities dated September 2, 2002. These rules unified the licensing issuance rules for all types of licenses, approved the list of activities subject to licensing, determined the amounts of state duties for the issuance of licenses, and designated the license issuing authorities and the authority supervising the license issuance process. Also the law on Mortgage adopted April 15, 2005, broadened the mortgage market by providing the necessary legislation that was lacking before.

Such legislative volatility, while intended to improve the business environment in practice, also has negative effects on businesses, especially individual entrepreneurs and SMEs, who are less able to stay abreast of frequent legislative changes.

The complexity of the laws and legislative instability, coupled with the insufficient means for dissemination of laws, contributes to a poor legal awareness of entrepreneurs. In Azerbaijan, new legislative acts are published in two official newspapers and three official publications depending on the type of legislative act. However, no authority is officially responsible for the effective dissemination of information about new legislative acts. Nor are they published online, or if published, are usually not up-to-date, and again, no authority is officially in charge of the publication of laws online. To keep track of legislative developments, an entrepreneur needs to subscribe to official newspapers and
publications and constantly follow-up with the publishers in order not to miss publications, since delays in publishing are not unusual. In fact, at times even having the texts of laws available may not be sufficient, as understanding the impact of new legislation may, more often than not, require legal expertise. Although entrepreneurs may file inquiries with the state authorities to obtain official explanations with regard to legislative matters, the procedures for processing such inquiries are too complicated and time consuming to be efficiently used in the fast-moving business world.

Box 2.2 The role played by MED in the support of entrepreneurship

The Department of Entrepreneurial Development Policy has played a positive role in the improvement of the business environment in Azerbaijan.

It has prepared the State Program for the Development of Small and Medium Enterprises for 2002-2005.

It has drafted the Presidential Decree on Measures for the Development of Entrepreneurship signed by the President on April 30, 2007, which envisaged improvement of the business environment, especially business establishment and registration procedures, and collaborated with the WB and IFC in the implementation of a one-stop-shop principle in corporate registrations.

View from an entrepreneur:

“I am running a small business and I don’t have sufficient legal expertise and time to follow the changes made to the laws, nor can I afford a lawyer to advise me on these. Therefore, most of the time I find out that I am cheated by officials. My opinion is that if these changes are necessary, then the government must provide free and comprehensive consultation to businesses on these changes.”

2.5.2 Institutional development of entrepreneurship

The existence of a central state agency that advocates for entrepreneurship and supports policy changes is important for developing and strengthening the business environment. In Azerbaijan, the authority in charge of this function is the Ministry of Economic Development, namely its Department of Entrepreneurial Development Policy. The department is responsible for the preparation and implementation of state programs for the development of entrepreneurship, the provision of financial and non-financial support to entrepreneurs, and the development of regulation policies concerning entrepreneurial activities.


2.5.3 Legal disputes

Most entrepreneurs tend to avoid courts in the settlement of economic disputes. Such a tendency is related to the mistrust towards courts in general formed over the years. Also the following observations may explain the low level of court applications: influential businessmen/officials are said to receive decisions in their favor; the procedures are non-transparent, allowing for unofficial payments during the process; the process can become very lengthy, and therefore unacceptable for dynamic entrepreneurship; the process can become very costly, so entrepreneurs risk going through the entire process and losing more money in the long run.

2.5.4 Expectations of entrepreneurs

More than half of entrepreneurs viewed 2007 as more favorable for conducting business compared to the previous year.

However, one-third of entrepreneurs still see potential for improvement.
Despite the fact that entrepreneurs evaluate the situation around the business environment as changing in a positive sense, at the same time half of them do not agree with such statements, as:

1) The local authorities clearly and steadily obey all laws and standards of the central government body;
2) The local authorities assist in business development by providing equal conditions for conducting business;
3) Government representatives interpret the laws and standard acts and regulate business activity in an adequate and predictable manner;
4) The business environment in my city contributes to the development of investment and business;
5) The business environment in my city is better than in other regions of the country.

There is little differentiation between how entrepreneurs in the regions and in the capital evaluate the business environment.

The SME sector analysis, as well as the focus groups with entrepreneurs, showed that the business environment in Azerbaijan has been developing rapidly, but there are some common problems in administrative procedure. The scope and frequency of inspections, and the high requirements for permits, licenses, and mandatory certification are the most complex administrative procedures hindering the development of local entrepreneurship. These administrative barriers, coupled with the difficulties in obtaining external financing, high rental payments and the inadequacy of infrastructure all negatively impact the growth of the SME sector.

The procedures, to which many entrepreneurs are subject, will be covered in further separate chapters. The analysis of the related processes reveals the problems entrepreneurs face and also helps to make recommendations for eliminating superfluous barriers and obstacles to develop entrepreneurship.
3. Business Registration

In January 2008, the business registration process in Azerbaijan underwent drastic changes and resulted in introducing a "one-stop-shop" mechanism for business registration. Since the IFC survey data covers figures prior to the January 2008 reform, this chapter will initially examine the previous registration system and then analyze the current "one-stop-shop" system based on the results of focus groups and information provided by the Ministry of Taxes.

According to the IFC survey data, the registration of individual entrepreneurs could have been completed within 11 days with some amount of financial resources in cases when entrepreneurs also opened a bank account.

The registration of legal entities took 11 days on average and was not always transparent. Therefore, the procedure involved multiple steps at various agencies with a significant amount of unofficial payments.

The complex and multi-step registration process was the main reason for widely spread unofficial contacts. This in turn was forcing entrepreneurs to allocate a large amount of financial and human resources while dealing with business registration.

Main Findings
Prior To
Introducing
One-Stop-Shop

Registration for individual entrepreneurs:
- Average duration – 11 days;
- Average cost – 267 Azerbaijani manats ($330);
- A total impact estimated at about 1 percent of their annual profits.

Registration for legal entities:
- Average duration – 11 days;
- Average cost – 270 Azerbaijani manats ($333);
- A total impact estimated at about 1 percent of their annual profits.

3.1 Registration: the legal framework

In order to legalize their status as a business entity, entrepreneurs had to register with relevant government agencies. There was a different registration system for legal entities and individual entrepreneurs. As subsequent chapters will illustrate, this also has a different impact on cost and profit of legal entities and individual entrepreneurs.

The registration system in Azerbaijan used to be regulated by the following legal acts:
The Law No. 560 IIQ on State Registration and State Registry of Legal Entities dated December 12, 2003;
- The Civil Code dated September 1, 2000;
- The Tax Code dated July 11, 2000;

Requirements for registration with government agencies like the Ministry of Justice, Ministry of Taxes, Social Protection Fund and State Statistic Committee were also regulated by their internal guidelines and regulations.

3.2 Registration of legal entities

The registration of small and medium companies posed a significant barrier to business. The multi-step and complicated procedures requiring a large number of documents made the process even more complicated. The entrepreneurs expressed the view that the situation of unclear admission and registration procedures with little degree of transparency made it necessary to pay some additional fees to have the registration completed within a reasonable time.

The registration of legal entities was mainly regulated by the Law on State Registration and State Registry of Legal Entities.

Box 3.1 Legal forms of legal entities

According to the Civil Code the following legal entities exist in Azerbaijan:
- Business Partnerships and Companies;
- Subsidiary;
- Dependent Business Company;
- General Partnership;
- Limited Partnership;
- Limited Liability Company;
- Additional Liability Company;
- Joint Stock Company;
- Open Joint Stock Company;
- Closed Joint Stock Company;
- Cooperatives.

According to the law, legal entities had to register with local registration departments of the Ministry of Justice, with the exception of legal entities with foreign investment and financial/credit institutions, which must register with the central office of the Ministry of Justice. State registration of legal entities consisted of 13 steps (see Annex 3.1).
According to the law previously in place, on average the overall registration of legal entities should have been completed within 30-34 days and included almost 33 documents. However, survey and focus groups results illustrated that in practice it took around 11 days. For example, confirmation of the legal address, notarization of documents, depositing the charter capital in a bank, and payment of the state registration fee (steps 1-3) could have been completed in one day. Moreover, the possibility of making unofficial payments could also speed up the registration process significantly (see Box 3.2). The average cost (including official and unofficial payments) for business registration was approximately 270 Azerbaijani manats ($333) while the approximate portion of official payments varied from 130-150 Azerbaijani manats ($160-185).

Box 3.2 According to surveyed entrepreneurs, unofficial payments and personal relationships between entrepreneurs and officials may speed up the registration process as follows:

1. In case of unofficial payment, registration with the Ministry of Justice (step 4) could have been completed within one-two days instead of five days;
2. Although not required by law, in practice the draft seal approved by the Ministry of Justice should have also been submitted to the seal producing company, and therefore step 5 could have been completed simultaneously with step 4;
3. In case of unofficial payment, registration with the State Statistics Committee (step 6) could have been completed within one-two days instead of five days;
4. In case of unofficial payment, registration with the tax authorities (step 7) could have been completed within one-two days instead of five days;
5. In case of unofficial payment, registration with the Social Protection Fund (step 8) could have been completed one-two days instead of five days;
6. As survey data confirmed, most of the small and medium companies in Azerbaijan were not VAT payers, therefore, these type of companies usually did not need to register as VAT payers with the tax authorities. Moreover, in case of unofficial payment, step 10 could have been completed in one-three days instead of seven days;
7. Opening a permanent bank account and returning the notification duplicate(s) to the tax office and the Social Protection Fund (steps 11 and 12) sometimes could have been completed in one day.

As survey results reveal, entrepreneurs usually hired specialized lawyers providing assistance with registration by means of unofficial payments. Though the majority of entrepreneurs registering their business resorted to unofficial payments, almost 41 percent of respondents considered the overall procedures as not complicated. This result also confirmed the need to increase the legal awareness of entrepreneurs.

View from an entrepreneur:

“To be honest, it is easier to pay some money to the practicing lawyers or officials to speed up the registration process. Although it is more expensive for me, at least I don’t have the headache of trying to convince officials to accept my documents…”

According to the survey results, among other key issues, the entrepreneurs indicated the extensive number of required documents (29 percent), the extensive number of various procedures (25 percent) and the lengthy registration process (12 percent) as troublesome (see Chart 3.1).
3.3 Registration of individual entrepreneurs

Even before introducing the one-stop-shop system, the registration of individual entrepreneurs was a simpler process compared to the registration of legal entities and was mainly regulated by the Tax Code. The process consisted of six steps (see Annex 3.2).

Since the majority of entrepreneurs usually did not have to open a permanent bank account and also did not have to collect and notarize a number of company documents, in practice the registration of individual entrepreneurs could have been completed in four-five days. As focus groups revealed, unofficial payments also played a role in the registration process and could significantly reduce the overall duration of registration. Moreover, steps 4 and 5 could have been completed in one day. Again, however, the overwhelming majority of entrepreneurs undergoing registration procedures had to pay unofficial payments; survey results illustrated that almost 59 percent of respondents considered the overall procedures as not complicated (see also Chart 3.2). This result also confirms the necessity of increasing the legal awareness of entrepreneurs.
3.4 Economic impact estimate

According to survey data, SMEs and individual entrepreneurs lost on average 1 percent of their annual profit to undergo the registration process. (Note: IFC survey data is accurate and should not be changed).

3.5 Introducing registration one-stop-shop

In light of difficulties faced by entrepreneurs during the business registration process and Azerbaijan’s relatively low ranking in the Doing Business report, the government of Azerbaijan expressed its strong commitment to reforming the registration system which was followed by two presidential decrees in late 2007. Consequently, the Ministry of Taxes with its regional registration offices throughout the country was appointed as a primary agency responsible for “one-stop-shop” registration. In other words, the Ministry of Taxes became a state registry of business entities through the already established AVIS software system.

Survey data does not cover the latest “single window” reform which has significantly streamlined the business registration process in Azerbaijan. Therefore, this analysis of the current “one-stop-shop” system is based on the results of focus groups and information provided by the Ministry of Taxes. According to the Ministry of Taxes, in only three months after introducing the one-stop-shop, the overall number of newly registered legal entities reached 2,100 across the country. This is a substantial improvement compared with the same period of the previous year.

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President’s Decree No. 2458 on Measures for Organization of “One-Stop-Shop” Registration of Businesses dated October 25, 2007.
8 Prior to reform this function was carried out by the Ministry of Justice.
9 The number of companies registered with the Ministry of Justice in 2007 was 5087.
3.6 The new legal framework

Prior to introducing the one-stop-shop, appropriate amendments were made to a number of legal acts. As a result, the new registration system does not require any additional assistance from professional lawyers and is regulated mainly by:

- The Law on State Registration and State Registry of Legal Entities;\(^\text{10}\)
- The Civil Code of the Republic of Azerbaijan;
- The Tax Code of the Republic of Azerbaijan;
- Methodical instructions of the Ministry of Taxes.\(^\text{11}\)

Entrepreneurs are no longer required to present exhaustive and comprehensive corporate charters. Hard or electronic copies of standardized two-page corporate charters can be freely obtained from the local registration offices. According to the Civil Code there is no precise amount required for charter capital. In practice, minimum charter capital maybe any amount starting from 5 or 10 Azerbaijani manats ($6 or 13). The state registration fee remains unchanged and currently it is 11 Azerbaijani manats ($13.5).

3.7 Registration procedure for legal entities

According to the law, after review and absent any deficiencies or grounds for rejection, a decision to issue the certificate on registration must be issued within three days from the date of acceptance of the consolidated application. While the law specifies limits for the amount of time the agency can take to process applications, it does not provide for any formal procedures in respect of sanctions for non-observance of deadlines by issuing authority during application process nor does it establish the "silence is consent" principle. Upon receipt of extract from the state registry, the applicant then has a three-week period to inform the register about any errors or discrepancy.

A consolidated application form was introduced to implement effectively the one-stop-shop registration service. This application form comprises all information required for registration with the local tax inspectorate, as well as State Social Protection Fund (SSPF) and State Statistics Committee (SSC). This means that entrepreneurs do not need to go through the various government agencies, just the local registration office (see Chart 3.4). The consolidated application form is used when applying for the registration of a new legal entity and updating previously registered information. Furthermore, the taxpayer identification number (TIN) has been introduced as a unique ID for all legal entities. This means that the taxpayer registration is being conducted as a part of the business registration process.

Opening a permanent bank account for companies requires the issuance of a special authorization form (the notification duplicate) by the local tax authority (in the same local registration office where the limited liability company is registered). The notifica-

\(^{10}\) Law No. 560 IОQ. On State Registration and State Registry of Legal Entities, dated 7 February 2008.

\(^{11}\) Methodical Instructions on State Registration of Commercial Entities dated March 29, 2008.
The business must open its permanent bank account within ten days of the issuance of the notification duplicate. The one-stop-shop has also introduced the possibility for opening a bank account online through the registration office. This option removes the requirement to obtain the notification duplicate from the registration office, present it to the bank, and then return it back to the tax administration. However, at present, the online opening of a bank account applies only to a limited number of banks. The total number of banks in Azerbaijan is far larger, which means that most entrepreneurs still need to obtain the notification duplicate from the tax authorities, present it in person to their bank and then return it back to the tax office. According to the current National Bank regulation\(^{12}\), the bank should fill in the required information and return the portions of the notification duplicate to the tax authority – a legal requirement that is not being applied in practice.

Nevertheless, as a result of introducing the one-stop-shop, the business registration process has been simplified. Entrepreneurs need only seven documents (see Box 3.3) and must undergo six procedures to register their business compared to previous thirty three documents and thirteen procedures (see Chart 3.5 and Annex 3.1).

However, depending on circumstances, the overall registration process can be completed even faster. Confirmation of the legal address, notarization of documents, deposit of the charter capital in a bank and payment of the state registration fee (steps 1-3) sometimes can be completed in one day. Moreover, the help desks at the one-stop-shop were established at each registration office to provide entrepreneurs with detailed information on required documents and filling the application forms.

**Box 3.3 Entrepreneurs need only seven documents to register their business with registration office**

1. Application form. The following shall be stated in the application form:
   - If the founder is an individual: name, surname, patronymic name, information on place of residence, identity card (series, number, the date of issue and issuing authority, address);
   - If the founder is a legal entity: name, legal address, and registration number;
   - If the application form is signed by authorized representative: name, surname, patronymic name, information on place of residence, identity card (series, number, the date of issue and issuing authority, address), and power of attorney.
2. Founding documents — the charter of the entity approved by the founder or his/her legal representative, resolution on establishment and approval of its charter;
3. Bank receipt confirming the payment of the state registration fee;
4. If the founder is a legal entity – notarized copy of the certificate on registration (extract from state registry) and the charter;
5. If the founder is an individual: copy of his/her identity card;
6. A document confirming the legal address of the entity that is going to obtain the status of legal entity (this document may be a notarized rental agreement, lease, or free-of-charge use contract, or notarized agreement on use of legal address of object’s proprietor (owner), or document confirming the ownership over the object).
7. In case of appointment of an authorized representative, a copy of his/her identity card.

### 3.8 Registration procedure for individual entrepreneurs

Introducing the one-stop-shop also affected positively the registration of individual entrepreneurs. Thus to register with the local tax office, individual entrepreneurs only need:

- Standard application form;
- Identity card;
- Information on place of residence.

According to the Tax Code, the registration of individual entrepreneurs must be completed within two days from the date of acceptance of the application form. However, the Tax Code does not provide for any formal procedures in respect of sanctions for non-observance of deadlines by issuing authority during the application process nor does it establish the “silence is consent” principle.

As with legal entities, the taxpayer identification number (TIN) has been introduced as a unique ID for all individual entrepreneurs. This means that entrepreneurs do not need to go through the various government agencies and only have to apply to
the local tax inspectorate for registration (see Chart 3.6). The one-stop-shop has also introduced the possibility for opening a bank account by the tax office online, and therefore removed the requirement of obtaining and returning the notification form to the tax office by the bank or entrepreneur\textsuperscript{13}. However, as was stressed in the previous section, since online banking is applicable only to a limited number of banks, in most cases entrepreneurs still have to obtain the notification duplicate from the tax office, present it in person to the bank, and then return it back to the tax authorities.

As a result of the reform, individual entrepreneurs need to submit only three documents to the registration office and must undergo two procedures (see Charts 3.7 and Annex 3.2) to register.

Since the majority of individual entrepreneurs do not usually open a permanent bank account, in practice the process can be completed even faster than illustrated in Annex 3.2.

\textsuperscript{13} According to the National Bank’s regulations on opening of the bank accounts, the bank must fill in the required information and return the portions of the notification duplicate to the tax authority.
3.9 Unofficial payments

As in-depth interviews with entrepreneurs reveal, unofficial payments may still play a role in the registration process, particularly in the regions. Legal entities resort to unofficial payments more often than individual entrepreneurs since the procedure for registration is more complicated. This confirms the assumption that the lack of sanctions for non-observance of deadlines as well as pre-registration procedure (such as confirmation of the legal address and notarization of foundation and other registration documents) creates additional opportunities for corruption.

View from an entrepreneur:

“Although it takes around three days to register a company with the registration office, I had to spend ‘some money’ apart from the state registration fee. These are mainly costs for notarization of documents.”

3.10 Recommendations

3.10.1 Introduce the “silence is consent” principle

Introduce the “silence is consent” principle at the end of the three-day consideration period, as well as sanctions for non-observance of deadlines by officials. Registration should be granted if an explicit refusal decision is not made. Therefore, if no response is entered into the system within a given time limit, the registration certificate is automatically granted.

Expected impact

By introducing the “silence is consent” principle and sanctions for non-observance of deadlines, the government can prevent possible delays in the application review process. This will reduce opportunities for informal settlements as well.

3.10.2 Streamline the pre-registration procedure for legal entities

Simplify the pre-registration process by removing the requirement to obtain a confirmation of the legal address of the company from the proposed landlord and notarize foundation and relevant registration documents.

Expected impact

Reduced time and costs for the entrepreneurs to register their business.

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14 IFC survey data covers figures prior to January 2008 reform.
15 The overall assessment of the new registration system through the survey is due early 2009. IFC’s current recommendations based on the analysis of legislation, focus group results and report of the Norway Registers Development assessing the capacity of the Ministry of Taxes to lead the registration process prior to launch of the “one-stop-shop” project in January 2008.
3.10.3 **Introduce the electronic registration system**\(^\text{16}\)

An electronic registration system will provide a unified approach for transferring structured information from the applicant to the regional registration office, moving away from the limitations of the traditional paper form (or an electronic representation thereof) into a modern, user-centric Internet-based application. The framework will utilize an intuitive, logically structured user-dialogue that responds to the choices and inputs provided by the user. The transactions can be temporarily stored in a messaging system so that the applicant can finish the registration process at his/her own convenience. The final transaction should be signed either online using digital signatures or a sub-prime signature combining the hard copy reference and signature page. Electronic registration will also require introducing electronic signatures by establishing a specialized agency responsible for certification of e-signature. Introducing the electronic registration system will also simplify the pre-registration procedures in terms of referring to specific articles of the law instead of providing notarized memorandum of incorporation and articles of association. Upon completing the electronic registration, the applicants should automatically be informed of the possibility to provide electronic tax declarations instead of submitting those documents in person.

**Expected impact**

- Reduced time and costs for the entrepreneurs/entities (especially for those which are being established in rural areas outside the locations of the regional offices);
- Improved quality and correctness of filed information;
- Verification of the consistency with other register data;
- Logical legal and validity controls;
- Reduced need for manual input;
- Single-point-registration;
- Immediate detection of, and feedback on errors.

3.10.4 **Open business registry to the public**

The Ministry of Taxes’ home page should be further updated by providing an information service for entrepreneurs by which they can check the availability of a name for their business entity as well as to get online access to the information on other existing business entities, in addition to information related to the tax administration activities. It is recommended that the Ministry of Taxes’ home page should be linked to the registration of the centralized state register for searching the register about entity names and addresses.

Expected impact

- Reduced time for entrepreneurs to register their business;
- A greater precision in locating and determining the details of other business parties;
- Avoidance of the duplication of registered names of legal entities;
- Simple and free procedure for receiving information about existing legal entities and possible partners in a business activity.

3.10.5 Further reduce the number of documents required for registration of individual entrepreneurs

Delete from the Tax Code the provision requiring submission of the document evidencing the applicant’s place of residence.

Expected impact

This will result in reduced time and costs for entrepreneurs.

3.10.6 Modify the procedures for opening, operating and closing bank accounts

Notwithstanding the possibility of online opening of bank accounts through the registration office (it is applicable to a limited number of banks), the rules for opening, operating, and closing bank accounts still require entrepreneurs to present to the bank the notification duplicate issued by the tax authorities, as well as notarized copies of a number of documents. Procedures for opening, operating, and closing of bank accounts need to be consistent with the principle of one-stop-shop registration. Therefore, the letter of the law needs to be brought in line with current practice, which has rendered the law outdated and superfluous. In addition, the banks should strictly follow the aforementioned rules and return the notification duplicates to the tax authorities instead of forcing entrepreneurs to do so.

Expected impact

Multiple effects include:

- Reduced number of documents to be presented to the bank;
- Reduced time and costs for the entrepreneurs;
- Reduced volume of work for banks and registration offices.
3.10.7 Simplify the liquidation procedure for legal entities

Simplify the procedure for voluntary liquidation of the company by formalizing the process through the one-stop-shop provided that no creditors’ claims are submitted. This means that the liquidation process should be completed by the registration office upon submission of the application form together with all documents required by law. Thereafter, the registration office should publish this information in the official newspaper and its web site, setting up a deadline for claims. If no creditor claim is submitted, the registration office officially liquidates the company. In case of claims of third parties, the issue must be settled through the court and in line with the requirements of the Law on Bankruptcy, which in turn, should be the legal basis for the registration office to liquidate the company. However, other types of liquidation proceedings that require a much more elaborate process like, for example, insolvency leading to restructuring or bankruptcy are not usually implemented through the one-stop-shop. Therefore, it is recommended to review the Law on Bankruptcy thoroughly and all relevant legal acts on business liquidation to reveal all gaps and shortcomings of the current system, and consequently simplify the liquidation procedure. Furthermore, the experience of other countries in which the liquidation process is linked to one-stop-shop business registration should be studied as well.

Expected impact
As a result, time and costs will be reduced further, while more companies would be liquidated, leaving much clearer statistics of the economy and the tax base.

3.10.8 Increase the awareness of entrepreneurs of their rights and obligations

The following tools can be used:
- Easy-to-read brochures on the new registration model distributed to entrepreneurs;
- Clear procedural maps, samples of charters, and other registration documents available in registration offices;
- Public service announcements on television, focused on presenting information on procedural changes.

Expected impact
This will lead to improved access to information, particularly outside Baku, and could positively affect the registration procedure, allowing for growth in the number of local companies. This in turn will have an impact on the local economy, supporting development of local entrepreneurship.
Annex 3.1 *Comparison of business registration process before and after ‘one-stop-shop’*

**BUSINESS REGISTRATION BEFORE ‘ONE-STOP-SHOP’**

Step 1. Obtain confirmation of the company’s legal address from the proposed landlord – 1 day

Step 2. A notary notarizes founding and relevant registration documents – 1 day

Step 3. Deposit the charter capital in a bank and obtain a receipt; pay the state registration fee and get a receipt – 1 day

Step 4. File documents with the Ministry of Justice – 5 days. Required documents:
1. Standard application form;
2. Receipt confirming payment of the state fee payable for registration;
3. Statement on payment of the charter capital;
4. Notarized copy of founders’ IDs;
5. Founders’ application to registration authority – notarized;
6. Draft statute (charter) signed by the founders – 2 copies;
7. Draft of seal and stamp (it is not provided for by law, however, in practice it was required by the Ministry of Justice).

Step 5. Obtain a company seal – 1 day

Step 6. Register with the State Statistics Committee to obtain a permanent statistics code – 5 days. Required documents:
1. Standard application form;
2. Copy of the charter;
3. Copy of certificate on state registration;
4. Copy of extract from the registry of business entities;
5. Decision of the founder or resolution of the general meeting of founders on appointment of manager to the legal entity.

Step 7. Register with the local tax inspectorate – 5 days. Required documents:
1. Standard application form;
2. Notarized copy of the charter;
3. Notarized copy of certificate on state registration;
4. Notarized copy of extract from the State Registry of Business Entities;
5. Notarized copy of certificate on statistic registration;
6. Notarized copy of confirmation of the legal address;
7. Decision of the founder or resolution of the general meeting of founders on appointment of manager to the legal entity;
8. Information on the individual founder. This is a standard information sheet that shall be duly signed by the manager of LLC and sealed with the company stamp;
9. Information on founder – legal entity. This is a standard information sheet that shall be duly signed by the manager of LLC and sealed with the company stamp;
10. When founder is a legal entity – notarized copy of the company’s statute, certificate on state registration, statistics registration certificate, TIN;
11. Copy of LLC manager’s ID.

*continued on next page*
Step 8. Register with the State Social Protection Fund and obtain registration number – 5 days. Required documents:
1. Standard application form;
2. Notarized copy of the charter;
3. Notarized copy of certificate on state registration;
4. Notarized copy of extract from the State Registry of Business Entities;
5. Notarized copy of certificate on statistics registration;
6. Notarized copy of tax ID (TIN tax payer's identification number);
7. Notarized copy of evidence of the legal address;
8. Decision of the founder or resolution of the general meeting of founders on appointment of manager to the legal entity;
9. Copy of LLC manager’s ID.

Step 9. Register with employment centers (simultaneous with step 8) – 2 days

Step 10. Register for VAT purposes – up to 7 days (if needed, depending on turnover)

Step 11. Open a permanent bank account – 1 day. Required documents:
1. Standard application form;
2. Notarized copy of the charter;
3. Notarized copy certificate on state registration;
4. Notarized copy extract from the state registry of commercial entities;
5. Notarized copy of certificate on statistics registration;
6. Copy of tax ID (tax payer’s identification number);
7. Decision of the founder or resolution of the general meeting of founders on appointment of manager to the legal entity;
8. Stamp and signature sample card – notarized;
9. A special authorization form — “notification duplicate” — issued by the local tax authorities (where the LLC has been registered) and addressed to a bank where the LLC account is to be opened. The notification duplicate must be issued by the tax authorities within two days upon LLC application;
10. A special authorization form — “notification duplicate,” which is issued by the local department of the State Social Protection Fund (where the LLC has been registered) and addressed to a bank where the LLC account is to be opened. “Notification duplicate” must be issued by SSPF within two days upon LLC application.

Step 12. Return the notification form(s) to the tax office and local department of the State Social Protection Fund - 1 day

Step 13. Obtain workbooks for employees from the Ministry of Labor and Social Protection (this step is required when the employer hires employees without previous work experience) – 1 day. Required documents:
1. Standard application form;
2. Reference issued by the Employment Centre (of the Ministry of Labor and Social Protection) confirming the number of employees.
BUSINESS REGISTRATION AFTER ‘ONE-STOP-SHOP’

Step 1. Obtain confirmation of the company’s legal address from the proposed landlord – 1 day

Step 2. A notary notarizes application and relevant registration documents – 1 day

Step 3. Deposit the charter capital in a bank and obtain a receipt; pay the state registration fee and get a receipt – 1 day

Step 4. State registration with the tax authorities (including registration as a taxpayer) – 3 days

1. Standard application form;
2. Founding documents — the charter of the entity approved by the founder or his/her legal representative, resolution on establishment and approval of its charter;
3. Bank receipt confirming the payment of the state registration fee;
4. If the founder is a legal entity — notarized copy of the certificate on registration (extract from state registry) and the charter;
5. If the founder is an individual — copy of his/her identity card;
6. A document confirming the legal address of the entity (this document may be a notarized rental agreement, lease, or free-of-charge use contract, or notarized agreement on use of legal address of object’s proprietor (owner), or document confirming ownership of the property;
7. In case of appointment of an authorized representative, a copy of his/her identity card.

Step 5. Obtain a company seal – 1 day

Step 6. Open a permanent bank account – 1 day. Required documents

1. Standard application form;
2. Notarized copy of certificate on state registration;
3. Notarized copy of the charter of the company;
4. Stamp and signature sample card — notarized;
5. A special authorization form — “Notification duplicate” issued by the local tax authorities (where the LLC has been registered) and addressed to a bank where the company’s account is to be opened.

Comment: according to the rules for opening, operating, and closing of bank accounts the bank must fill in the required information and return the portions of the notification duplicate to the tax authority. In practice however, most applicants still have to return the notification duplicate to the tax authorities in person.
PROCESS MAP OF ONE-STOP-SHOP BUSINESS REGISTRATION

PRE-REGISTRATION
3 Days

ENTREPRENEUR

Obtain a confirmation of the legal address (if applicable)
Land-lord

Notarization of all required documents
Public notary

Deposit the charter capital and pay state registration fee
Commercial bank

REGISTRATION
3 Days

State registration
One-stop-shop
Registration office
Tax Ministry

POST-REGISTRATION
3 Days

Obtain a company seal
Seal maker

Open a permanent bank account
Commercial bank

Return the notification duplicate
Registration office

STARTING OPERATION

Note: In case of online opening of a bank account entrepreneur has to go through 5 steps. This means that there is no need to return notification duplicate to the registration office.
REGISTRATION FOR INDIVIDUAL ENTREPRENEURS BEFORE ‘ONE-STOP-SHOP’

Step 1. Registration with local tax inspectorate – 2 days. Required documents:
1. Standard Application form;
2. ID card;
3. Documents confirming the place of residence.

Step 2. Registration with Social Security Fund – 5 days. Required documents:
1. Copy of ID card;
2. Notarized copy of certificate of registration as a taxpayer;

Step 3. Registration with State Statistic Committee – 5 days. This step is required when entrepreneur opens a permanent bank account. Required documents:
1. Copy of ID card;
2. Certificate of registration as taxpayer.

Step 4. Open a permanent bank account – 1 day. Required documents:
1. Standard application form;
2. ID Card;
3. Stamp or signature sample card – notarized;
4. Copy of tax ID (tax payer’s identification number);
5. A special authorization form — “Notification duplicate” issued by the local tax authorities (where entrepreneur has been registered as a taxpayer) and addressed to a bank where entrepreneur’s account shall be opened;
6. A special authorization form — “Notification duplicate” which is issued by the local department of the State Social Protection Fund – (where entrepreneur has been registered) and addressed to a bank where entrepreneur’s account shall be opened.

Step 5. Return the notification duplicate(s) to the tax office and local department of the State Social Protection Fund – 1 day

Step 6. Obtain workbooks for employees from the Ministry of Labor and Social Protection (this step is required when the employer hires employees without previous work experience) – 1 day. Required documents:
1. Standard application form;
2. Reference issued by the Employment Centre confirming the number of employees.
REGISTRATION FOR INDIVIDUAL ENTREPRENEURS AFTER ‘ONE-STOP-SHOP’

Step 1. Registration with tax authorities — 2 days. Required documents:
1. Standard application form;
2. ID card;
3. Documents confirming the place of residence.

Step 2. Open a permanent bank account - 1 day. Required documents:
1. Standard application form;
2. ID Card;
3. Signature sample card — notarized;
4. Copy of tax ID (tax payer's identification number);
5. A special authorization form – “Notification duplicate” issued by the local tax authorities (where entrepreneur has been registered as a taxpayer) and addressed to a bank where entrepreneur's account shall be opened.

Comment: according to the Rules for opening, operating, and closing of bank accounts the bank must fill in the required information and return the portions of the notification duplicate to the tax authority. In practice however most applicants still have to return the notification duplicate to the tax authorities in person.
4. Business Licensing

The Government of Azerbaijan has recognized the importance of administrative constraints in the licensing regime and has subsequently implemented a number of actions to simplify the system. Among the most significant of these legal acts was the Presidential Decree approving the Rules on Granting Licenses17 (hereafter “Licensing Rules”), which substantially reduced the number of licensable activities. According to this decree the Ministry of Economic Development is responsible for providing control and administration over licensing procedures, while different ministries or government agencies are involved in sector licensing. Despite these legislative changes, there are still some problematic areas that need further actions from the legislative and procedural perspective.

One problem is that the licensing regime discriminates between state owned and private companies. According to Presidential Decree No. 31018 enterprises or organizations established by a Presidential Decree or funded by the state budget can engage in licensable activities without a license. While it is appropriate to require licenses to manage and allocate limited natural resources, this legitimate regulatory purpose is not met when the licenses are used to limit competition between the public and private sectors.

In addition, the list of licensable activities might also be streamlined. For example, specific sectors of the economy such as tourism, which is important for fostering economic development, is subject to licensing which is difficult to justify from an economic perspective.

Main Findings

- About 36 percent of entrepreneurs need to obtain at least one license;
- Duration of the application process and the cost of licenses is different for individual entrepreneurs and small and medium enterprises:
  - Individual entrepreneurs spend on average 276 Azerbaijani manats ($340) and 10 working days to obtain one license;
  - Small and medium enterprises spend on average 564 Azerbaijani manats ($696) and 15 working days to obtain one license.
- Nearly 37 percent of surveyed entrepreneurs who obtained a license in 2007 claim to have resorted to unofficial payments.

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17 Presidential Decree No. 782 on Improvement of Regulations for Granting Special Permits (Licenses) for Some Types of Activities dated September 2, 2002.
18 Presidential Decree No. 310 on Improvement of Regulations of Granting Special Permits (Licenses) for Certain Types of Activities dated March 28, 2000.
4.1 Licensing: the legal framework

A license is a document which is required for continued activity of a certain type or requiring a particular expertise\(^{19}\). Therefore, if a business requires a license according to the law, an entrepreneur must obtain the required license before starting his/her activity.

Box 4.1 Definition of a license provided for by the Licensing Rules

**Paragraph I – General Provisions**

“A license represents an official document, authorizing legal entities, as well as individuals engaged in entrepreneurial activity without creating a legal entity irrespective of their organizational and legal form, to implement certain types of entrepreneurial activity.”

The licensing regime in Azerbaijan is mainly regulated by the following legal acts:

- Presidential Decree No. 782 on Improvement of Regulations of Granting Special Permits (Licenses) for Some Types of Activities dated September 2, 2002;
- Resolution of the Cabinet of Ministers No. 174 on Additional Conditions for Issuance of Special Permits (Licenses) for Certain Types of Activities dated November 7, 2002.

The adoption of these legal acts was a substantial step forward in terms of streamlining the overall licensing regime. Thus, licensing rules set up:

- General provisions for the licensing of certain activities;
- License issuance procedure;
- Validity period of a license;
- Time frame for processing with application for a license;
- Procedure for suspension and cancellation of a license;
- List of activities subject to licensing;
- Government agencies issuing licenses;
- Licensing fees.

The Cabinet of Ministers Decree No.174 in turn specifies additional conditions for specific activities subject to licensing.

However, there is still room for further improvement of the Licensing Rules from the legislative and procedural point-of-view. Even though the Licensing Rules and Resolution No. 174 of the Cabinet of Ministers specify that no other document other than those identified in these regulations can be requested from a license applicant, it is clear from various laws that, in some cases at least, additional documents are required\(^{20}\). For example, the list of documents required to obtain a banking license are


set out in the law on Banks\textsuperscript{21}, while the documents required for obtaining broadcasting license are listed in the law on Television and Radio Broadcasting\textsuperscript{22}.

Pursuant to Article 2 of the Licensing Rules, where deemed necessary, a license-issuing authority can apply to other government agencies for an opinion in connection with the specificities of a licensed activity. It appears that an opinion may be required by a license-issuing authority to clarify an aspect of licensed activity about which it may not have specific knowledge. The circumstances in which this official opinion may be required are not elaborated in the Rules.

If the applicant is refused a license, an official response to this effect must explain the grounds for such refusal. However, the Licensing Rules do not contain a list of specific grounds on which the issue of a license can be refused and leave this matter to be resolved by the specialized laws that deal with specific sector licenses. The analysis suggests that specialized licensing laws do not necessarily comply with the framework licensing law or fail to set clear, predictable, and transparent criteria for obtaining licenses (see Box 4.2). This in turn leaves a certain degree of discretionary power to licensing bodies.

Box 4.2 The procedure for receiving air transportation license is unclear

Under the Licensing Rules, the State Administration for Civil Aviation is empowered to issue a license for the carriage of cargo and passengers by air transport. However, this agency does not currently issue such licenses in practice. Commercial flights are operated on the basis of air operator certificates issued by the State Concern Azerbaijani Airlines, even though one air operator certificate states that “flight operations specified on the present certificate come into effect upon obtaining a special permit (license).”

While the Rules specify limits for the amount of time agencies can take to process applications (15 days), they do not provide for any sanctions for non-observance of the deadlines by licensors during the application process nor do they establish the “silence is consent” principle. As a result, the time to obtain a license in practice may vary and the licensing applicant can adversely be affected by the delays.

4.2 Licensing coverage

Adoption of the Licensing Rules reduced the number of licensable activities from 240 to 30. However, subsequent amendments to the Rules have increased the number of licensable activities from 30 to 56 (see Chart 4.1). Nevertheless, the current situation represents a significant step forward in terms of number of activities subject to licensing.

\textsuperscript{21} Dated March 30, 2004.
\textsuperscript{22} Dated June 25, 2002.
Reduction in the number of licensable activities also had an impact on the number of entrepreneurs obtaining licenses. According to the survey data, around 37 percent of individual entrepreneurs and 31 percent of small and medium enterprises conduct a licensable activity. Although the survey data covers only 2007 this can be considered an improvement compared to previous years, given that prior to adoption of the Licensing Rules the number of licensable activities was 240 (see Chart 4.2).

It is also worth noting that some of the licensable activities provided for by the Licensing Rules can be removed from the list. Tourism is a vivid example. In light of the importance of tourism for further economic development of the country, it is considered unnecessary to license this type of activity. Furthermore, the risks in tourism sector are lower compared to other sectors which also makes it unnecessary to license.

4.3 Licensing procedure

The licensing rules set up basic procedures and documents required for issuance of licenses, while the Cabinet of Ministers’ Decree No. 174 specifies additional documents specifically defined for each activity (see Box 4.3).23

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23 Cabinet of Ministers’ Decree No. 174 dated November 7, 2002 on Additional Conditions for Issuance of Special Permits (Licenses) for Certain Types of Activities.
Box 4.3 General and specific documents required to issue a license

General documents:

a) Application form. The following shall be stated in the application form:
   - for legal entities: its name, organizational and legal form, legal address, number of account and the name of the bank, type of activity;
   - for natural persons – name, surname, patronymic name, information on identity card (series, number, the date of issue and issuing authority, address), type of activity.
b) Copy of the state registration certificate of the legal entity;
c) Copy of the tax registration certificate;
d) Copy of a lease agreement or ownership certificate confirming the right to use the premises mentioned in the application;
e) Receipt confirming the payment of the state license fee.

Specific documents:

Subject to the type of activity specific documents are defined by the Cabinet of Ministers (i.e. Cabinet of Ministers’ Decree No. 174).

For example: to obtain a customs broker license, the applicant must also submit: (i) an official document which confirms that the applicant employs certified customs clearance specialists; (ii) information confirming that an insurance contract has been concluded in connection with its activity and a copy of the insurance contract; and (iii) information about the conditions which confirm that he/she can engage in customs brokerage.

4.3.1 Duration of the application process

Upon filing an application, the application itself and the accompanying documents must be registered in a special journal kept by each license-issuing authority. After review and absent any deficiencies or grounds for rejection, a decision to issue the license must be adopted within fifteen days from the date of acceptance of the application. If the documents are in any way deficient, the applicant should be informed of the deficiencies in writing within five days. After the deficiencies are eliminated and the documents are re-submitted, the new application is reviewed within five days, after which an appropriate decision should be issued.

The survey data shows that in practice individual entrepreneurs spend on average 10 days to obtain a license, while small and medium enterprises spend on average 15 days (see Chart 4.3). However, to complete the licensing procedures whether within 10 or 15 days, requires entrepreneurs to use in some cases unofficial solutions24.

24 For further details see the next section.
While the Rules specify limits for the amount of time agencies may take to process applications, they do not provide for any sanctions for non-observance of the deadlines by licensors during the application process nor do they establish the “silence is consent” principle. This in turn negatively affects the overall application review process. Therefore, it is advisable to introduce the “silence is consent” principle, which can prevent delays and unofficial payments during the application process and reduce the processing time. The principle is based on the following assumption: government officials have to respond to the application of a citizen or entrepreneur in a fixed time period, otherwise the applying citizen/entrepreneur is endowed with the right to the service (license) without a decision from the government official (i.e. tacit authorization).

Moreover, pursuant to the Rules, where deemed necessary, a license-issuing authority can apply to other government agencies for an opinion in connection with the specificities of a licensed activity. This request must be (i) reviewed by the authority receiving the request for the opinion within 5 days and (ii) followed by the issue of an official opinion. However, the circumstances in which this official opinion may be required are not provided for by the rules and leave this matter at the discretion of licensing agencies.

### 4.3.2 Cost of licensing

According to the survey results, the average cost of licensing (including official and unofficial payments) varies between the individual entrepreneurs and small and medium enterprises (for a detailed breakdown of the surveyed companies and respective sectors, please consult Table 1.1). Individual entrepreneurs spend on average 276 Azerbaijani manats ($340) while small and medium enterprises spend on average 564 Azerbaijani manats ($696) for receiving a license (see Chart 4.4). Moreover, nearly 39 percent of individual entrepreneurs and 25 percent of surveyed SMEs who obtained a license in 2007 resorted to unofficial payments (see Chart 4.5). These figures confirm the assumptions that licensing procedures are unclear and some cases of unofficial payments still exist in the licensing procedure. It is worth noting that the high volume of unofficial payments for licensing can be significant hindrance for start-up entrepreneurs to entry into business.
Another factor which makes the licensing procedure expensive for entrepreneurs is de facto short validity period of some types of issued licenses. Pursuant to the Licensing Rules, licenses shall be issued for the period of five years (for production of alcoholic beverages and ethyl (drinking) alcohol - three years, for import - one year). However, focus group results reveal that it is difficult to obtain some types of licenses. As a result the entrepreneurs are forced to start operating without the appropriate license, which leads to further informal arrangements. Usually, the period for which such approvals are granted varies from 1 month to 1 year. A license for transportation of passengers within cities (particularly taxi) is a vivid example of that. This in turn requires entrepreneurs to allocate a significant amount of financial resources every month.

**View from an entrepreneur:**

“I am a taxi driver and I know that the license for transportation of passengers within the city must be issued for five years. The problem is that along with other documents the taxi drivers have also to submit the contract with the management of parking garage. However, the management of parking garage is not interested in having such contracts. This why the Ministry of Transportation refuses to issue a license. As result after bribing the ministry’s official and without receiving any official document I have to get verbal permission to carry out my activity every month.”

Although one in three entrepreneurs undergoing licensing procedures claims to have made unofficial payments, almost 63 percent of respondents consider the overall procedures as not being complicated. This also confirms the necessity of increasing the legal awareness of entrepreneurs of their rights and obligations.

### 4.4 Economic impact of licensing

As survey results show, entrepreneurs obtaining a license have to allocate financial resources as well as time and human resources in order to obtain a license. As a result, their cost consists of: (i) direct costs for obtaining licenses and, (ii) indirect costs due to allocation of labor resources for obtaining a license, and loss of profits for new entrepreneurs, who cannot start their business without the needed licenses. According to the economic data provided through the IFC survey, it has been calculated that both individual entrepreneurs and small and medium enterprises lose on average 1 percent of their annual profits in the year the license is issued (see Chart 4.6).
4.5 Recommendations

4.5.1 Further improve the Licensing Rules from legislative and procedural viewpoint

1.1. Specify the circumstances in which a license-issuing authority can apply to other government agencies for an opinion in connection with the specifics of a licensed activity;

1.2. Specify a list of grounds on which the issuance of a license can be refused;

1.3. Introducing the “silence is consent” principle for all licensing bodies at the end of 15 days consideration period, which means that a license should automatically be granted if an explicit refusal decision is not made.

Expected impact

- By specifying the circumstances in which a license-issuing authority can apply to other government agencies as well as grounds on which the issue of a license can be refused, the government will reduce the degree of discretionary actions by the licensing authorities. This in turn would prevent government agencies from being biased in terms of rejection of the application for a license and can make the overall decision-making process more transparent;

- Likewise, by introducing the “silence is consent” principle, the government can prevent delays in the application review process, and subsequently the time spent by entrepreneurs dealing with licenses can be reduced significantly;

- As a result, transparent and shortened decision-making process for issuing licenses may save financial resources of entrepreneurs and therefore, create higher profits and tax revenues for the government.

4.5.2 Elaborate clear grounds for introduction of new licenses in the licensing rules

Specify clear grounds for introduction of new licenses, provided that these licenses:

- Require government control for protection of public health and safety, as well as environmental protection;

- Relate to allocation of scarce resources;

- Do not foresee additional or specific requirements.

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25 See also Annex 4.1.
Expected impact
When specifying a clear basis for introduction of new licenses, the government will be able to prevent the introduction of licenses that are not in line with the principles of a market economy. This could in turn reduce expenses of entrepreneurs and foster rapid development of priority sectors for the country.

4.5.3 Eliminate the discrepancy between state-owned companies and private enterprises when entering into licensable activities
Eliminate the discrepancy between state owned companies and private enterprises when entering into licensable activities related to allocation of scarce resources.

Expected impact
The impact of the reform would be a more transparent management and allocation of scarce resources between the state-owned companies and private enterprises based on bona fide competition.

4.5.4 Ensure that all licenses are issued for same period as provided for by the Licensing Rules
This step can prevent cases when entrepreneurs are able to start licensable activity based on oral and discretionary permission of license issuing official. In addition, lifelong issuance of licenses may be considered, while allowing specific short-term activities to be regulated through permits instead.

Expected impact
This reduces official and unofficial payments, as well as time spent for renewal of licenses. This in turn can lead to increased profits and more taxes paid to the state budget.

4.5.5 Increase legal awareness of licensing procedures among entrepreneurs
Increase the legal awareness of entrepreneurs through:
- Simple brochures distributed to entrepreneurs;
- Clear procedural maps, available in issuance offices;
- Seminars, training, and informational roundtables aimed at increasing dialogue between the private sector and government;
- Public service announcements run on television and focused on presenting information on procedural changes.

Expected impact
- Reduced time to be spent by entrepreneurs for dealing with the licensing procedures;
- Reduced financial and human resources of entrepreneurs for dealing with the licensing procedure;
- Higher profits for entrepreneurs and increased tax revenues for the government.
Annex 4.1 Checklist of issues for drafting the Law on Granting Licenses

**General Issues:**
- What law governs licensing?
- Who issues these regulations and how are they issued?
- Is the purpose of the law clearly stated?
- Does the law state who is subject to it (e.g., business entities, individuals, NGOs)?
- Does the law contain all necessary definitions? (e.g., definitions of license, licensing, violation, etc.)
- Does the law state the objectives of licensing (e.g., a limited list of legitimate regulatory purposes)?
- Does the law prohibit the use of licensing for certain purposes (e.g., fiscal policy/revenue generation)?
- Does the law state the principles of licensing (e.g., simplicity, impartiality, transparency)?
- Does the law contain a list of all activities that shall be subject to licensing?
- Does the law specify the licensing body responsible for issuing each license?
- Does the law categorize activities subject for licensing according to level of potential impact on health, safety, and the environment?
- Does the law specify terms of validity for the licenses?
- Under what circumstances may the government establish new licenses?
- Does the law provide for mechanisms for review and evaluation of existing or new licenses?

**Application Procedure:**
- Does the law specify procedures for obtaining extensions to validity periods?
- What are the rights and duties of the licensing authorities?
- What are the rights and duties of an applicant?
- Does the law provide an exhaustive list of documents required for each license?
- Does the law contain a disclaimer stating that the licensing agency may not ask the applicant to submit other documents other than those specified in the law?
- Does the law specify reasons for which the licensing authorities may deny applications for licenses and their extensions?
- Does the law specify limits for the amount of time agencies may take to process applications?
- Are the procedures for application and fees publicly accessible?
- Is there a one-stop-shop application process or web-based application system?

**Costs:**
- Does the law clearly indicate the cost of each license?
- Do licenses have fixed costs or do costs depend on the lengths for which the licenses are valid?
- If the law does not precisely specify license fees, does it contain a "cost-only" provision?
- If licensing fees are to be fixed in lesser legal instruments, does the law include a provision limiting the number of times fees may be changed within a one year period?
- Does the law specify whether fees will go to the state budget or to individual licensing agencies?

**Decision Making:**
- Who is the authorized person / body to decide on the application?
- Are there legally set deadlines / timeframes to respond to the applicant?
- Does the law establish the "silence is consent" principle?
- Does the law provide the reasons for denying or suspending a license?

**Appeals:**
- Does the law specify procedures by which applicants may appeal the decisions of licensing authorities?
- Does the law specify detailed hearing procedures?
- What kind of authority is responsible for examining appeals cases?
- What is the time limit for hearing cases?
- In what cases may the appellate authority reject appeal requests?
- What forms of legal redress does the appeals process offer successful appellants?

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5. Business Permits

The permit system currently represents a substantial administrative burden for running a business in Azerbaijan. The overall system has not reformed since the collapse of the Soviet Union and poses a large burden for entrepreneurs.

Unlike the licensing regime a uniform regime for issuing permits does not exist in Azerbaijan. As a result, the lack of clear legislative requirements compels entrepreneurs to use unofficial payments while going through the permit procedure. Official and unofficial payments in turn generate a substantial burden for business in Azerbaijan. The aforesaid problems are caused by the absence of an integrated system regulating the purpose and function of permits: the areas of their application, the agencies issuing them, the cost of processing, and time periods for issuance and cancellation.

Currently there is neither a clear definition of what a permit is nor a review mechanism to analyze its legal basis, regulatory purpose, or efficiency. As a result, virtually any government agency, executive authority or municipality issues permits and their number is unknown. The right to acquire or lose a permit is anticipated with different regulations and depends on the operation in question. Generally, the technical procedure is done in accordance with the Law on General Administrative Procedure, which is the general systematic law for operating before state agencies when the procedure for realization of rights and interests is in question.\(^\text{27}\)

A non-standardized permits regime poses the following risks:

- Public institutions can use the lack of control over issuance of permits as an opportunity to supplement the budget of the relevant institution;
- There are often opportunities for unofficial payments.

Main Findings

- About 81 percent of entrepreneurs have at least one permit. On average entrepreneurs need three permits to conduct business activities;
- Duration of the application procedure and the cost of permits are variable:
  - Individual entrepreneurs spend on average 136 Azerbaijani manats ($167) and four working days to obtain one permit;
  - Small and medium companies spend on average 250 Azerbaijani manats ($308) and eight working days to obtain one permit.
- Nearly 30 percent of surveyed entrepreneurs who obtained permits in 2007 resorted to unofficial solutions.

\(^\text{27}\) For further details see FIAS 2007. Azerbaijan Licensing and Permits System.
Based on the IFC survey estimates, business sector annually spends some 35 million Azerbaijani manats ($43.2 million) in direct, indirect and opportunity costs to obtain the necessary permits. If only a third of these costs are to be relieved by the cuts in permits, the private sector would be saving 11.6 million Azerbaijani manats ($14.3 million) each year. Likewise, the government would have direct savings of almost 5 million Azerbaijani manats ($6.17 million) on associated labor costs.28

5.1 Permits: the legal framework

According to the Civil Code of the Republic of Azerbaijan, legal entities can start their activity from the date of their state registration, with the exception of activities requiring a special permit – a license29. However, the survey data shows that in practice entrepreneurs must also obtain a number of permits to start their business activity.

A permit is a document that gives the applicant a right to undertake a specific action. The Azerbaijani legislation does not provide for a unified definition of permit. For the purposes of this report, a permit is used to refer to any type of permit documents as defined in Box 5.1.30 The absence of a legal definition creates confusion, both among issuing agencies and entrepreneurs. Furthermore, entrepreneurs often confuse permits with licenses, which is a special permit to conduct an activity on a regular basis.31

Box 5.1 Definition of a permit document

A permit document means a decision made and issued to a business entity by designated bodies in any form granting the right to any act or specific activities to be performed in the course of a business process.

Permit document can be in the form of permission, approval, and opinion or in the form of any other document which is issued for the above purposes:

1. Permission – authorization of the issuing agency giving the applicant the right to accomplish an action and/or realize an activity;
2. Approval – consent of the issuing agency with the accomplishment of the activity and/or realization of activity;
3. Opinion – a resolution based on an authorized agency’s examination or analysis of goods/products, regarding the possibility to perform an activity and/or realization of activity;
4. Any other legal form serving the abovementioned purposes (certification, authorization, conformity assessment, permissions or payment of fees for any business activity, or any legal document giving official permission to carry out a business activity).

29 Articles 44.1 and 44.2 of the Civil Code dated September 2000 (with further amendments).
31 President’s Decree No. 782 dated 2 September 2002 on Improvement of Regulations of Granting Special Permits (Licenses) for Some Types of Activities (with further amendments).
The current permit system in Azerbaijan has two origins:

1. The rules and technical requirements governing permits which were elaborated during Soviet times and have not been brought in line with requirements of a modern market economy;

2. During the past years, the government adopted a number of legal acts in order to regulate the development of a market economy.

Consequently, the current permit system is characterized by inconsistencies due to lack of a systematic approach. This means that there is:

1. No clear definition of what constitutes a permit;
2. No exhaustive list of permits;
3. No defined procedures for issuance and revocation of permits;
4. No defined validity period of permits;
5. No defined cost for obtaining permits.

Moreover, the lack of clear principles governing the permits system has led to the introduction of a number of permits from different government agencies without a clear legal basis and, which may conflict with the sound principles of the market economy. Box 5.2 shows an example of state regulation of permits in the European Union countries that sets up a balance between freedom of entrepreneurship, protection of the population, and state regulation\(^3\).

**Box 5.2 Permits in the European Union**

**Basics**

Permits in the European Union are based on risk management. Permits are used as a tool to protect consumer's health and safety and to protect the environment. Constitutional court prevents abuses, overseeing the list of permits introduced by the state bodies.

**Overall constitutional principles:**

- Parliamentary law should define whether a specific activity requires a permit;
- A permit can only be required and issued if envisaged by the law.

**Law defines key criteria:**

- Object and activities subject to permits;
- Material and procedural criteria for issuing permits;
- Responsibility of permit issuing bodies;
- Fees associated with issuing permits;
- Opportunities for appealing decisions and other legal measures in cases of denial or issuance delay (such as "silence is consent").

**Types of permits:**

- Administrative preventive permits: i) as a condition to undertake and commence certain activity; ii) issued by a single decision of a public institution (e.g., environmental permits, construction permits);
- Registration and notification system: i) individual decided whether he/she can meet the conditions of the law; ii) activity can be commenced after registration or notification; iii) public institution is entitled to control the fulfillment of the defined conditions and criteria and can prohibit to carry out an activity (i.e., catering services, retail food shops).

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\(^3\) Based on materials of the conference "Permits and approvals in Entrepreneurship Activity." Minsk, Belarus, December 20, 2006.
5.2 Permits coverage

The Azerbaijani legislation does not clearly specify the number of government agencies entitled to issue permits, nor does it provide for the list of permits needed to carry out a business. As a result, government agencies can introduce permits sometimes independently and according to specific requirements. This leads to wide coverage of activities subject to permits, differentiated issuance procedures, different cost for issued permits and variable time periods for application review.

According to the survey results, of the total of all the entrepreneurs who needed to obtain a permit in 2007 (81 percent of the total), 23 percent of individual entrepreneurs and 17 percent of SMEs required it for the start-up purposes (see Chart 5.1). This means that permits are needed not only to start a business, but also to continue activity. Since entrepreneurs are vulnerable if the permit is not issued or renewed, the permits issuance process opens the door for unofficial ways to solve issues and results in higher expenditure (see also section 5.4).

According to survey results, the Ministry for Emergency Affairs, the Ministry of Taxes, and the Ministry of Labor and Social Protection cover the large majority of permits (see Chart 5.2).

Many normative legal acts that regulate the issuance of permits sometimes are not thoroughly examined. There are many cases in which different government agencies demand double requirements from entrepreneurs. Double regulation is observed in the form of “certification + permit issuance.” This requirement forces entrepreneurs to obtain a permit for the action or product which has already undergone the certification procedure. In these cases, one agency could take over both of these instructions. The Law on Foodstuff\(^{33}\) is a vivid example of double requirements (see Box 5.3).

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\(^{33}\) The Law on Foodstuff, dated November, 18 1999, No. 759.
Chart 5.2

The Ministry for Emergency Affairs, the Ministry of Taxes and the Ministry of Labor and Social Protection most frequently require permits (% of respondents obtaining permits)

Box 5.3 An example of duplicative permits for sale of foodstuff

According to article 7 of the Law on food-stuff, in order to sell foodstuff, the entrepreneur must obtain a hygiene certificate from the Ministry of Health to provide conformity of the foodstuff with hygiene standards. In addition, according to article 11 of the aforementioned law, the entrepreneur should also obtain an approval from the Ministry of Ecology and Natural Resources if he/she needs to use label “medical”, “deistic” or “ecologically clean” on the foodstuff.

One way to optimize the process would be to amend the law and transfer authority to a single agency.

There are also cases of duplicative permits within one agency. For example, according to the Cabinet of Ministries’ decree No. 214, to hire a foreigner in the Republic of Azerbaijan the employer must obtain a work permit from the Ministry of Labor and Social Protection. However, when the employer transfers the hired foreigner to another work (within the same organization) he/she must obtain a new work permit from the same ministry. It remains questionable why the Ministry’s approval is needed for an action which already requires having a work permit. In addition, the functions of different permit issuing government agencies overlap. Analysis of legislation shows that there are a number of cases of overlapping permits when two different government agencies issue permit for the same type of activity (see Box 5.4).

34 Cabinet of Ministers’ decree “On approval of Regulations on issuance of personal permits for carrying out of paid labor activity in the territory of the Azerbaijan Republic by foreigner and specimen of this personal permit” dated 6 December 2000, No 214.

35 Rules on issuance of permits for placing advertisement. Approved by the President’s Decree dated 3 November 2001, No. 596; and Statute on placing and operation of advertisements within the territory of Baku City. Approved by the Decree of Baku City Mayor, dated September, 6 1999, No 892.
According to article 3.1 of the Rules on issuance of permits for placing advertisement, the Ministry of Transportation is authorized to issue permits for placing advertisement on the roads and adjacent zones. However, pursuant to the Statute on placing advertisement within the Baku City, permits for placing advertisement within Baku (including streets and roads) shall be issued by the Advertisement Department of the Baku City Council. Therefore, it is unclear which government agency is responsible for issuing permits for placing advertisement in the streets of Baku.

5.2.1. Number of permits depends on the area of activity

On average, each SME needs to obtain three permits per year. The number of required permits is related to the legal form and area of activity of enterprises. As Chart 5.3 illustrates individual entrepreneurs operating in the field of health/social work and hotel/restaurant business need more permits compared to SMEs working in the same field. This is in stark contrast to a common international practice whereby smaller enterprises and particularly individual entrepreneurs are subject to lower and simpler regulations than the larger companies operating in the same type of business.
5.3 Permits issuance and revocation procedures are unclear and vague

At present there is no single legal document that provides for a clear guidance on permits issuance procedure. Even in cases in which the need to obtain a certain permit is required by some legal acts, some of these acts do not foresee the list of documents required to obtain permits, the official cost of a permit, and the duration of the application review process. The validity period of permits is not clearly defined by the legislation either. Most of the permits are issued for a short and varying period of time, which in turn requires entrepreneurs to renew them on a frequent, usually annual basis. In order to renew a permit an entrepreneur has to undergo the same procedures and pay the same amount of fees as established for a new permit issued for the first time.

The lack of clear and unified regulation leaves significant amount of discretion on the permit issuing authority and unpredictability for the permit holder. This in turn paves the way for unofficial payments and consequently, affects negatively the overall application review process. Furthermore, many of permit-issuing procedures have not been published in relevant publications and are therefore accessible only for government institutions. The permit issuing process has thus become very complicated for entrepreneurs. Remarkably, the fact that it takes on average eight days to receive one permit for an SME and four days for an individual entrepreneur is often a result of unofficial payments provided in order to obtain a permit (see chart 5.4).

![Chart 5.4](image)

The number of days required to prepare all documents and receive permit in Azerbaijan (means days)

**Chart 5.4**

View from an entrepreneur:

“… I have to spend eight days in order to obtain a permit. But I have to pay extra money, which is the only way to receive the permit quickly.”
5.4 Permit expenses

Azerbaijani legislation does not have clear provisions on issuance fees for all permits. However, it does not mean that payments are not made in practice. The current legislative framework leads to situations in which entrepreneurs sometimes cannot distinguish between official and unofficial payments (see Chart 5.5).

![Chart 5.5](chart5.5.png)

**Average amount of expenses (official and unofficial) paid for obtaining one permit by SME and individual entrepreneurs**

5.5 Economic impact of permits

Entrepreneurs have to allocate financial, as well as human and time resources in order to obtain necessary documents from government agencies. As a result, due to wasted time, entrepreneurs lose additional profit. Moreover, staff members dealing with obtaining required documents cannot focus properly on operational work. According to economic data provided through the IFC survey, it has been calculated that individual entrepreneurs lose on average 1.7 percent of their annual profits, while SMEs spend around 0.4 percent of their annual profit (see Chart 5.6).

![Chart 5.6](chart5.6.png)

**Economic impact of permit expenses**
5.6 Main problems faced by entrepreneurs while obtaining permits

A non-standardized permits regime and lack of control and transparency over issuance of permits pose the risk of unofficial solutions. This means that there are often opportunities for arbitrary decision-making.

Around 54 percent of surveyed entrepreneurs who went through the permits procedure faced certain difficulties and consider the overall procedure as complicated (see Chart 5.7). It should be noted that among the most difficult problems entrepreneurs list: the large number of documents, lengthy procedures, low level of professionalism of public officials, lack of information, and unofficial payments (see Chart 5.8).

The vagueness of permit issuance procedure and large number of required documents create considerable difficulties while obtaining permits and force entrepreneurs to appeal to unofficial payments. The low level of professionalism of public officials and insufficient legal literacy of entrepreneurs significantly complicate the overall procedure as well. According to our survey results every third entrepreneur has to pay unofficial payments while obtaining permits (see Chart 5.9). Relationships between entrepreneurs and officials have been transformed into closer relationships, where rather than unofficial payments, other means like presents, invitations to lunches, and other services are used to solve the issues.
5.7 Recommendations

5.7.1 Reduce permits number and coverage

This can be implemented in the following way:

As a first step, the government should undertake an inventory of all permits currently issued in Azerbaijan. Next, an inter-ministerial working group (including private sector representatives) should be set up to review the existing permits through the "guillotine" approach or an alternative deregulation mechanism. The "guillotine" approach can be used to reduce outdated and redundant permits with a single piece of legislation and under a limited time period (see Box 5.5). Chart 5.10 illustrates the steps to be taken within the "guillotine" approach as well as criteria for reducing permits:

Chart 5.10 Guillotine process map

<table>
<thead>
<tr>
<th>Process</th>
<th>Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Cabinet of Ministers requests all regulators to submit complete list of all permits they issue</td>
<td>Initial list of all permits issued in Azerbaijan</td>
</tr>
<tr>
<td>Interministerial working group, including private sector representatives, reviews lists provided</td>
<td>Comprehensive review of permits on list against objective criteria; corresponding reduction of permits not in line with criteria</td>
</tr>
<tr>
<td>The recommendations of the permits review become legally binding</td>
<td>• Only permits on the list continue to exist</td>
</tr>
<tr>
<td></td>
<td>• Process repeated for all new permits</td>
</tr>
</tbody>
</table>

Sample review criteria

1. Outdated;
2. Contradicting to general market conditions;
3. Issued for revenue generation;
4. Issued for non-hazardous business activity;
5. Duplicate other administrative procedures;
6. Used as source of information when the information can be received from third parties.
Box 5.5. **What is the “regulatory guillotine”?**

The “guillotine” approach implies a comprehensive review of the current stock of permits and approvals, and requires state agencies to substantiate the existence of each. Those permits that have no apparent benefits are sent to the guillotine at a date specified by the government. The guillotine approach was designed to reduce regulatory costs in a limited period of time and prepare countries for more sustainable reforms. This simplification strategy was used in various forms by OECD countries in the 1990s, and since then has been adopted in many transitional economies as well.

Assessments of the regulatory simplification suggest that such reforms:
- produce rapid results (3–18 months) in cutting hundreds or thousands of regulations and reducing regulatory costs on businesses;
- improve understanding and management of the regulatory problem by mapping out the full scale of regulatory interventions;
- increase reform capacities by reducing the political and administrative costs of reform and eroding the capacities of insiders to block change;
- create the processes and organizational conditions for continued reform to the regulatory role of the public sector; and
- stimulate the development of active private partners for reform that will be useful in sustaining momentum.

**Expected impact**

The number and coverage of permits will be reduced and therefore, which will lower the entry cost for new businesses and the cost of operations for existing companies. This in turn will have a positive impact on the number of active companies and will contribute to the state budget in the form of increased tax revenues.

5.7.2 **Streamline the issuance process.**

Streamlining the issuance procedure includes:

1. Adopting the Law on granting permits (see also Annex 5.2);

2. Introducing the “silence is consent” principle. This means that government official has to respond to the application of an entrepreneur within a fixed time. If the time limit lapses without an explicit response from the official, the application is considered granted (tacit authorization). However, the silence is consent principle does not extend to all administrative procedures and therefore shall be applied to less risky activities;

3. Introducing the “self-certification” principle to increase level of trust to entrepreneurs. This means that the applicant has to comply with legislation, acknowledging full responsibility in case of non-compliance with normative acts. It should be noted that “self-certification” should only be applied to small scale construction and low risk business activities or actions. Moreover, there should be a time limit for official response that contains a reasonable time for rejection of application (see Box 5.6);

Box 5.6 **An example of self-certification**

An entrepreneur has a right to begin construction without receiving a special permit, notifying the state agency about beginning construction. At the same time, the entrepreneur assumes the burden of responsibility, to the extent that the constructed building can be demolished by a state agency in case of non-compliance with normative acts.
2.4. Specifying in the law a uniform permit application procedure as well as list of grounds on which the issue of a permit can be refused.

Expected impact
As a result, the clear issuance procedures would reduce costs in time and money that entrepreneurs have to spend for obtaining permits. Additionally, the “silence is consent” and “self-certification” principles, as well as legally substantiated grounds for refusal would improve the overall process and reduce possibility of arbitrary decision-making by officials. For example, in Italy the self-certification process alone led to the reduction in administrative paperwork by 84.5 percent and with it, all related costs to entrepreneur as well as the public administration.

5.7.3 Set up clear grounds for introducing new permits provided that these permits should:

- Require government control for protection of public health and safety, as well as environmental protection;
- Relate to allocation of scarce resources;
- Not foresee additional or specific requirements.

Expected impact
By setting up clear basis for introducing new permits, the government will be able to prevent introduction of permits that conflict with the principles of a market economy and free trade. This could in turn reduce expenses of entrepreneurs and foster rapid development of priority sectors for the country.

5.7.4 Reduce the burden of permit renewals.
This should be carried out by extending the validity period of permits in accordance with a thorough assessment of the full inventory of permits. This step will reduce the need for renewals.

Expected impact
Less frequent renewals would reduce the expenses of entrepreneurs and reduce workload of government agencies and with it costs of their operations.

5.7.5 Introduce the “one-stop-shop” principle for issuance of certain types of permits.
According to this principle, the applicant does not need to pass through all agencies, but only to apply and receive documents in one department. It is advisable to adopt a one-stop-shop procedure for sectors requiring multiple permits, for example construction. The following steps should be made for introducing an effective one-stop-shop:

Subject to the nature of each permit, establish an authority responsible for the clear functioning of the one-stop-shop;

Create an effective mechanism for coordination between state bodies engaged in permit issuance;

Identify rights and responsibilities of each state agency engaged in the issuance process;

Clarify clear deadlines for document review.

Box 5.7 Setting priorities

A one-stop-shop is far more intensive to operate and requires substantial back-office process re-engineering among the various administrations involved, whereas the “silence is consent” and “self-certification” approaches are quicker to introduce institutionally and organizationally. Therefore, it is recommended to start with the guillotine review and the introduction of both “silence is consent” and “self-certification” in an initial phase of the project and then move to a second phase with the creation of a one-stop-shop once it becomes clear that the public administration has the appropriate capacity in place.

Expected impact

Application of the one-stop-shop would increase the standards of administrative operations and reduce the burden for entrepreneurs in terms of time and money spent. One-stop-shop would also reduce the number of “unofficial” settlements between entrepreneurs and officials.

5.7.6 Increase the legal awareness of entrepreneurs and government officials.

The following tools can be used:

- Simple brochures distributed to entrepreneurs;
- Clear procedural maps, available in issuance offices;
- Seminars, training, and informational roundtables aimed at increasing dialogue between the private sector and government;
- Public service announcements on television presenting information on procedural changes.

Expected impact

While introducing higher standards regulating the procedure of obtaining permits, improved accessibility to information, decreased opportunities for unofficial payments and increased legal protection of entrepreneurs supplement the reforms in terms of direct benefits.
Annex 5.1 Procedure for obtaining conformity certificate for retail sale of foodstuff produced in Azerbaijan

Step 1. Submit a standard application form to the State Agency for Standardization, Metrology and Patent or certified private agency. The following shall be stated in the application form:

- for legal entities: its name and legal address;
- for individuals – name, surname, patronymic name, information on identity card (series, number, the date of issue and issuing authority), type of activity.

The following documents shall be attached to the application form:

a) For food stuff produced in a serial order:

- normative – legal documents (if necessary);
- copy of certificate on quality control (if available);
- protocols of tests carried out by the producer;
- copy of hygienic certificate (to be issued by the Ministry of Health within 10 working days, cost -3 Azerbaijani manats ($ 3.70) + expenses related to laboratory expertise);
- copy of veterinary certificate for the foodstuff of animal origin (to be issued by the Ministry of Agriculture within 7 days, cost - 5 Azerbaijani manats ($ 6.17) + expenses related to laboratory expertise);
- copy of phytosanitary certificate for the processed food stuff of plant origin (issued by the Ministry of Agriculture within 5 days, cost -1 Azerbaijani manat ($ 0.81) + expenses related to laboratory expertise);
- copy of special permit required by the law.

b) For food stuff produced in a lot order:

- copy of contract;
- protocols of tests carried out by the producer (if available);
- copy of hygienic certificate (to be issued by the Ministry of Health within 10 working days, cost -3 Azerbaijani manats ($ 3.70) + expenses related to laboratory expertise);
- copy of quality certificate issued by the producer (if available);
- copy of veterinary certificate for the foodstuff of animal origin (to be issued by the Ministry of Agriculture within 7 days, cost - 5 Azerbaijani manats ($ 6.17) + expenses related to laboratory expertise);
- copy of fitosanitary certificate for the processed food stuff of plant origin (issued by the Ministry of Agriculture within 5 days, cost -1 Azerbaijani manat ($ 0.81) + expenses related to laboratory expertise).

Step 2. Receive conformity certificate within 15 days from the date of acceptance of the application form by certifying agency – official cost: 16, 80 Azerbaijani manats ($ 20.70) for each day of the application review process.

NOTE: conformity certification process includes the following stages:

- review of the submitted documents;
- selection of mechanism for certification; selection of laboratory for testing a foodstuff;
- making appropriate decision on the application;
- selecting sample from, and identification of the food stuff;
- testing sample of the food stuff;
- subject to results of the test, issuance or refusal of conformity certificate

Conclusion:

Total number of days (including collecting of necessary documents) required for obtaining conformity certificate is approximately 33 days:
Approximate amount of official payments is 270 Azerbaijani manats ($ 333).

Focus group results:

Total number of days (including collecting of necessary documents) required for obtaining conformity certificate is approximately 11–13 days:
Approximate amount of official and unofficial payments is 2000-2300 Azerbaijani manats ($ 2470 - 2840).
PROCESS MAP FOR OBTAINING CONFORMITY CERTIFICATE FOR SALE OF FOODSTUFF PRODUCED IN AZERBAIJAN

DE-JURE

ENTREPRENEUR

1. Obtain all required documents from the government agencies
   
   17 days

2. Submit an application form and relevant documents
   
   State Agency for Standardization/certified private agency
   
   1 day

3. Receive a conformity certificate
   
   State Agency for Standardization/certified private agency
   
   15 days

Total number of days: 32-33

Total official costs: 270 Azerbaijani manats ($333)

DE-FACTO

ENTREPRENEUR

1. Obtain all required documents from the government agencies
   
   8-9 days

2. Submit an application form and relevant documents
   
   State Agency for Standardization/certified private agency
   
   1 day

3. Receive a conformity certificate
   
   State Agency for Standardization/certified private agency
   
   3 days

Total number of days: 13

Total official and unofficial costs: 2300 Azerbaijani manats ($2840)
Annex 5.2 Checklist of issues for drafting the Law on Granting Permits

General Issues:
- What law governs permits and other certifications?
- Who issues these regulations and how are they issued?
- Is the purpose of the law clearly stated?
- What is the legal status of permits issued to business entities?
- Does the law state who is subject to it (e.g., business entities, individuals, NGOs)?
- Does the law contain all necessary definitions? (e.g., definitions of permits, issuance of permits, violation, etc.)
- Does the law state the objectives of issuance of permits (e.g., a limited list of legitimate regulatory purposes)?
- Does the law prohibit the use of permits for certain purposes (e.g., fiscal policy/revenue generation)?
- Does the law state the principles of issuance of permits (e.g., simplicity, impartiality, transparency)?
- Does the law contain a list of all activities that require obtaining permits?
- Does the law specify the agency responsible for issuing each permit?
- Does the law categorize activities that require permits according to the level of potential impact on health, safety, and the environment?
- Does the law state the objectives of issuance of permits (e.g., a limited list of legitimate regulatory purposes)?
- Does the law specify terms of validity for the permits?
- Under what circumstances may the government establish new permits?
- Does the law provide for mechanisms for review and evaluation of existing or new permits?

Application Procedure:
- Does the law specify procedures for obtaining extensions to validity periods?
- What are the rights and duties of the permit issuing authorities?
- What are the rights and duties of an applicant?
- Does the law provide an exhaustive list of documents required for each permit?
- Does the law contain a disclaimer stating that the permit issuing agency may not ask the applicant to submit other documents other than those specified in the law?
- Does the law specify reasons for which permit issuing authorities may deny applications for permits and their extensions?
- Does the law specify limits for the amount of time agencies may take to process applications?
- Are the procedures for application and fees publicly accessible?
- Is there a one-stop-shop application process or web-based application system?

Costs:
- Does the Law clearly indicate the cost of each permit?
- Do permits have fixed costs or do costs depend on the lengths for which the permits are valid?
- If the Law does not precisely specify fees for obtaining permit, does it contain a “cost-only” provision?
- If fees are to be fixed in lesser legal instruments, does the law include a provision limiting the number of times fees may be changed within a one year period?
- Does the law specify whether fees will go to the state budget or to individual permit issuing agencies?

Decision Making:
- Who is the authorized person / body to decide on the application?
- Are there legally set deadlines / timeframes to respond to the applicant?
- Does the law establish the “silence is consent” principle?
- Does the law provide the reasons for denying or suspending permit?

Appeals:
- Does the law specify procedures by which applicants may appeal the decisions of permit issuing authorities?
- Does the law specify detailed hearing procedures?
- What kind of authority is responsible for examining appeals cases?
- What is the time limit for hearing cases?
- In what cases may the appellate authority reject appeal requests?
- What forms of legal redress does the appeals process offer successful applicants?

6. Business Inspections

According to the research results, as well as focus groups, inspections are one of the four main obstacles entrepreneurs cite as impeding the development of their business.

**View from an entrepreneur:**

“In our country, it was always easier to create the business, i.e. go through the registration process, receive the license for the activity and the corresponding certificates. But to keep and secure the duration of the business created – here is a real problem, which not all can manage.”

The absence of a single state-issued and formally approved guidebook on conducting inspections and the uncertainty of the requirements in the course of inspections give state inspectors wide possibilities while limiting the entrepreneur’s rights.

Not having a clear understanding of the frequently changing, strict, sometime unpredictable and contradicting requirements, it is easier for the entrepreneur to solve the problems related to the inspections through channels other than legal solutions. Given their relative frequency, the practice becomes almost a permanent solution to the on-site visits of the inspectors:

**View from an entrepreneur:**

“The inspector’s work consists in coming, and my duty – to meet him in such a way so as to not spoil our relationship.”

As mentioned above, inspections preparation and on-site visits are not regulated by specific legal norms. The norms that exist do not sufficiently clarify how the inspections are prepared, conducted, what is being checked, and how and what the reporting and penalizing mechanisms are. There have indeed been legal attempts to more strictly regulate the inspections, but in practice, this remains an unclear area of the public sector. Therefore in most agencies the informal means of ensuring compliance still exists. Entrepreneurs are still inclined to resolve or circumvent standards’ requirements in an informal way and the readiness of the inspectors to accept informal payments have created a vicious circle.
The most significant legal act in inspections regulation is the President’s Decree on Containment of Intrusions Impeding Entrepreneurship’s Development, dated September 28, 2002, No. 790. It gives instructions to a score of government authorities to act in a courteous and rational manner when dealing with the private sector in order not to hamper its growth. The key areas from the decree are annexed to this chapter.

- **Who is being inspected?**
  The IFC survey of enterprises shows that in 2007, 80 percent of the active enterprises were subjected to inspections from the relevant authorities. In 2007 a total of 81 percent individual entrepreneurs and 70 percent of legal entities were inspected, so legal status does not have significant impact on the likelihood of inspections.

- **How often do inspections happen?**
  About nine inspections were on average conducted for every SME. IEs are checked more often than legal entities – 11 times, while the legal entities face seven inspections per year on average.

- **Which agencies are the most active in conducting inspections?**
  In 2007, each enterprise was visited with the aim of inspection on average by 3 government agencies. However, depending on the area of business activity, the type and number of inspections may vary. Across all sectors, Tax Ministry, Ministry of Emergency Situations, and Ministry of Labor and Social Protection conduct most on-site inspections.

- **What are the consequences?**
  More than half of inspections result in no direct consequences, i.e. it appeared that the business was conducted according to the legal requirements and standards. Yet 43 percent of all the inspected entrepreneurs faced direct consequences in the form of penalties and/or unofficial payments.

### 6.1 The majority of all active enterprises are subjected to inspections

Having examined the conduct of inspections, a number of problem areas have been noted.

#### 6.1.1 Excessive number of inspections

As was stated before, inspections are the main regulatory levers of the government in relation to the entrepreneurs. Inspections force the entrepreneurs to conduct their activity in accordance with the standards, which are mandatory in one or another country. But, an excessive number of inspections may become an obstacle for the development of the private sector.
The frequency of inspections to enterprises coupled with different consequences for individual entrepreneurs as opposed to SMEs also remain a key factor impeding business growth. The overall burden to the private sector comes in form of the amount of working hours lost to it, which otherwise may be dedicated to doing business. On average, all enterprises are subjected to almost monthly on-site inspections.

View from an entrepreneur:

“I can’t imagine even one month without an inspection. Problems in my enterprise have not been identified for almost a year and a half, but the inspectors visit me monthly.”

The frequency and the selection of inspected subjects are not done systematically, resulting in uncertainty for the business. The process of legal sales and securing supplies is already cumbersome enough, as is ensuring adequate resources for further investment and growth, while on top of it all, frequent inspections add more uncertainty to the challenges businesses face. Summing up, the inspection criteria are very non-transparent if existent at all and surely do not correspond to the risk levels the inspected businesses may be posing to the society, environment or any forms of safety otherwise.
6.1.2 There is no effective mechanism for monitoring inspection activities

Despite many sector directives, the legal acts do not define the rules on inspections that would bring the on-site check-ups in line with commonly used international standards. These standards typically define common principles, reasons, and frequency of inspections by the state agencies, as well as establish complaints procedures at higher levels. However, in the case of Azerbaijan, each related authority refers to a different variety of legal acts, which in turn results in a different inspection regime by each agency. As a result, several inspectors check the same business entity.

Entrepreneurs’ responses appear to confirm significant issues in the area of inspections. For example, based upon the IFC’s end-2007 results, 79 percent of all enterprises questioned were subjected to inspections at a minimum of once per month. The list of most frequently visited inspections include: the Tax Ministry, Ministry of Emergency Affairs, Labor and Social Protection Ministry, Ministry of Economic Development (MED), and Health Ministry.

Results of the survey showed that a great deal of attention should be paid to the entrepreneurs’ knowledge increase in the area of inspections. Despite the Presidential order which requires all entrepreneurs to be provided with registration handbooks, 26 per cent of entrepreneurs still do not use this tool for inspection registration. Moreover, majority of inspections are carried out without the presence of MED representative, which contradicts the requirements of relevant legal documents.

According to the rules, the MED representative must control the process of due inspection execution in accordance with the existing legislation. However, given the lack of clarity over what the legislation governs the conduct of inspection, the assistance the MED representatives can provide the businesses with during the inspections remains somewhat limited.

6.1.3 Absence of an effective mechanism for the inspection planning

A significant step in eliminating of the cause of concerns related to the quantity and extent of the inspections may be taken by introducing a structured system into inspection planning. The trade and catering sector are more exposed to inspections than any other areas of the economy. In most other countries, the inspections

Box 6.1 The Rules on MED Representatives’ Participation in the Inspections

The Rules on MED Representatives’ Participation in the Inspections of the Entrepreneurs’ Activity by State Authorities (Excluding Tax Authorities), dated December 6, 2002, were adopted to perform the President’s Decree #790, dated September 28, 2002. These rules define the procedure of MED participation in the inspection process in relation to the business entity. According to the rules, the state authority, planning to conduct an inspection, must notify MED on the place, date, and purpose of the inspection three days before the inspection. In the course of inspection, the MED representative must control the process of due inspection execution in accordance with the existing legislation.
are planned according to the health risk levels and/or potential safety concerns. Construction follows suit, even though it probably does not fall in either category. As the following charts show, besides the exposure of these branches to inspections, many state authorities engage in controlling them.

**Inspections extent by sectors of activity**

- Trade and public catering
- Construction
- Other production, textile
- Service
- Agriculture, food production

**Extent of inspections conducted by the state services for different sectors of activity**

- Economy Ministry
- State Standard
- Force Major Ministry
- Health Ministry
- Ministry of Industry
- Tax Ministry
- Labor Ministry
- Ecology Ministry
- Ministry of Agriculture

**View from an entrepreneur:**

“The inspector knows that if he closes my café, let’s say, for a week, I will lose part of my clients. To attract clients, especially in such a highly competitive sector as ours, is not easy. That is why I do all I can to prevent my business from stopping.”

A relatively high cash turnover may explain why a large percentage of the respondents in these industries were forced to make informal payments in order to see a positive inspection result – 26 percent. Risking being out of operations for any period of time is probably a greater threat than settling the inspection issues in an informal way.
6.1.4 Entrepreneurs are not aware of their rights

The type of legal incorporation will significantly determine the frequency of inspections and this is why the report examines the difference between individual entrepreneurs and legal entities.

Chart 6.5

Individuals are subjected to almost 40 percent more inspections, compared to legal entities

The research results show that individual entrepreneurs are checked more often than others. In depth interviews offered further evidence that a higher awareness of the legal rights of businessmen can be of significant assistance. Enterprises with an improved understanding of their legal rights were checked less regularly and the findings were more favorable to them. SMEs are rarely subjected to illegitimate inspections, which is not the case with micro enterprises, as illustrated above. This difference corresponds to the maintenance of the Inspections Registration Book; those who keep it updated have a cleaner inspection record.

Chart 6.6

Registered SMEs are subject to inspections less often

For all enterprises

For enterprises, that were checked

Number of inspections by legal status of business entity

<table>
<thead>
<tr>
<th>Legal entities</th>
<th>Individuals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Emergency Situations</td>
<td>9</td>
</tr>
<tr>
<td>Ministry of Economic Development</td>
<td>5</td>
</tr>
<tr>
<td>Ministry of Agriculture</td>
<td>3</td>
</tr>
<tr>
<td>Ministry of Taxes</td>
<td>6</td>
</tr>
<tr>
<td>Ministry of Health</td>
<td>12</td>
</tr>
<tr>
<td>Ministry of Transport</td>
<td>0</td>
</tr>
<tr>
<td>Ministry of Labour and Social Protection</td>
<td>0</td>
</tr>
<tr>
<td>State Committee on Land</td>
<td>0</td>
</tr>
<tr>
<td>State Agency of Standardization</td>
<td>0</td>
</tr>
<tr>
<td>Local executive power</td>
<td>0</td>
</tr>
</tbody>
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Chart 6.5

Individuals are subjected to almost 40 percent more inspections, compared to legal entities

Number of inspections by the legal status of business entity

<table>
<thead>
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</tr>
<tr>
<td>Local executive power</td>
</tr>
</tbody>
</table>
In comparison, 74 percent of individual entrepreneurs maintain the Inspection Registration Book, while 84 percent of SMEs maintain one on-site.

6.2 Inspection outcomes

It is important to view the possible outcomes of the on-site inspections in order to analyze possible recommendations. However, many of the inspections are reported not to result in any kind of formal sanctions: this is to say, the company operates regularly and the inspection may not have been required. This brings into question the purpose of such inspections and their frequency.

More than half of the inspections do not bear consequences to SMEs

Consequences after check-ups

- 43% Consequences took place
- 57% No consequences

To reveal a clearer picture about the low effectiveness of the existing system of inspections, it is necessary to compare the indicators for the inspections of two groups of enterprises: enterprises that faced consequences (in form of penalties or other sanctions), and those with no consequences.

For the year 2007, about 1 million unsuccessful inspections were conducted

Average number of inspections for ones who had them

- 12 Consequences took place
- 10 No consequences

Based upon the research, in 57 percent of the enterprises, about 10 inspections without consequences are conducted per year.
IFC’s analysis showed that only half of the inspections undertaken during the year result in consequences. These consequences can be, conditionally, divided into two groups: official sanctions and non-official means of solving a problem.

### 6.2.1 The administrative fine, the key on-site penalty available to inspectors

According to the existing legislation in the area of inspections regulation and execution, there are a number of administrative penalties for the deviation from mandatory requirements, including administrative fines, but also several others. The practice of the inspections execution shows that the official inspections typically end with an administrative fine imposed.

**Chart 6.9**

More than three-quarters of the inspections, which resulted in consequences, end in administrative fines.

<table>
<thead>
<tr>
<th>Inspection consequences (where they were)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative fine</td>
<td>48%</td>
</tr>
<tr>
<td>Fine+Other</td>
<td>24%</td>
</tr>
<tr>
<td>Other</td>
<td>28%</td>
</tr>
</tbody>
</table>
Other consequences include: financial sanctions, repeated inspection of the same entity, suspended enterprise activity, asset confiscation, annulment of the functioning agreements, and non-official payments.

The practice of imposing fines causes some dissatisfaction among the entrepreneurs. In depth interviews with entrepreneurs show that minor issues that do not harm safety and health standards end in fines being imposed.

View from an entrepreneur:
“Inspectors give us no conditional time to eliminate the problem or drawback. Even if this criterion was entered in the number of the mandatory norms recently, or when this is the first violation of the enterprise, you can’t expect understanding from the inspector. They immediately impose a fine. They do not worry much about the fact that I will eliminate this problem eventually.”

6.2.2 Half of the entrepreneurs who face inspection consequences make unofficial payments
No matter what type of consequence the enterprise faces and what the violation was, half of on-site inspections also result in unofficial payments being made.

In the entrepreneurs’ opinion, the informal relations develop as a result of several issues that govern the course of on-site inspections:
- The inspections process and decision-making by the inspectors are not transparent;
- Technical requirements are over-regulated;
- The appeals system is not satisfactory;
- Entrepreneurs do not know their rights.
6.2.2.1 The inspections process and decision-making by the inspectors are not transparent

In-depth research showed that entrepreneurs are not familiar with the common rules of the inspections execution as well as their responsibilities and rights while meeting the inspectors. This fact significantly reduces the chance that the entrepreneur will challenge the inspector’s findings.

In addition to the inspections rules, it is necessary to inform the entrepreneurs about the sanctions that could be imposed if an enterprise is found to be in breach of standards and other legal requirements.

6.2.2.2 Technical requirements are over-regulated

According to the respondents, inspectors frequently require adherence to the top-class minimum quality requirements of goods and services. The entrepreneurs, in turn, consider these requirements too demanding since in order to meet such standards one runs additional expenses, which they often can not afford. In such cases, the entrepreneurs often make an agreement with the inspector to turn a blind eye to this business. Reasonable questions arise: do the myriad of standards only exist to make compliance next to impossible or extremely expensive? And how business friendly is such a practice? In addition, by expanding the focus and the attention of inspectors, some important matters of safety, health and environmental issues may be overlooked, which pose a risk to society.

View from an entrepreneur (on fire inspections):

“The inspector requires that I observe the highest safety standards and explains it by the risk my enterprise’s activities may pose to the public safety. In no way can I fully observe these standards. Naturally, I make ‘arrangements’ with the inspector on how to bypass such strict standards and continue my activities. My question is: after I bribe the inspector, does it mean I no longer pose a risk to the society?”

a) Many standards are secret and inaccessible

Respondents cited a key issue that many norms and standards remain inaccessible for entrepreneurs. For example, the rules on fire safety can be found in several books or charters of different agencies responsible for fire prevention. Without an approved, unified document accessible to everybody, the entrepreneurs likely will not know where all these standards are available and the all the details they contain.

Naturally, the lack of transparency of the norms benefits inspectors, since the entrepreneur has a small likelihood of knowing and understanding the details regulating the enterprise’s activity, and therefore can easily be controlled and fined by the inspectors:
View from an entrepreneur:

“I am a partner of a foreign company and one of the main requirements of my foreign partners is the observance of all safety norms at the workplace. For the purpose of receiving information and clear directives from the regulating agency, I visited the local fire safety service management. On my request for all fire safety norms and standards, the local management chief stated that this information is confidential and cannot be disseminated, since it is reflected in the internal reporting and service codes. How, in your opinion, can I ensure observance of those norms, which are required from me, if I have no idea what they are?”

b) Requirements are based upon obsolete rules

Survey respondents frequently claimed there are some requirements that were used in the past and possibly were relevant then, but as of today these requirements need to be revised and modernized because of the changes in business activity.

View from an entrepreneur:

“Why do we need so many sinks for different products? Abroad, due to modern types of detergent and cleaning means, it is allowed to use one kitchen sink for different items. But according to our requirements, I have to install, at the minimum, three sanitary areas. My café’s kitchen will be the size of the main hall, which is unrealistic.”

View from an entrepreneur:

“There are some norms for trade, which are basically leftovers from the Soviet period. It is necessary to review these standard requirements, because when they were issued, the term ‘private business’ was alien to everybody, the population in the cities was smaller, and, correspondingly, the number of services was significantly lower, so the [requirements] could be posted in the most suitable parts of town. There are no more ‘specialized’ places, and we base ourselves as we find appropriate. Yet the old requirements exist and we regularly pay the inspectors to get around these obsolete norms. We need to change the legislation and stop this awful practice.”

c) The administrative fines often set up in a discretionary manner

Sometimes the size of the fine makes the unofficial payment a less costly i.e. an economic option. The scale is only being communicated during the on-site inspection, with an aim to stimulate the entrepreneurs to engage in discussions over an alternative settlement.
View from an entrepreneur:
“The satisfied inspector will not impose the highest measures of administrative penalty. Therefore, as a rule, they don’t impose a fine on me. But sometimes, when they have to meet the fine collection’s monthly planned amount – they may impose an insignificant fine on me, in addition to the bribe.”

6.2.2.3 The appeals system is not satisfactory
In general, entrepreneurs do not appeal inspection findings due to two main reasons: (a) entrepreneurs do not want to appeal; and (b) entrepreneurs have no trust in a positive solution to the legal challenge.

a) Why entrepreneurs do not complain
The prevalent opinion of entrepreneurs is that for the successful continuation of their business activity, they need to maintain so-called ‘good relations’ with inspectors and state officers.

View from an entrepreneur:
“I can’t say that everything is ideal in my enterprise. The inspector turns a blind eye to some problems, and I in turn pay for it. But even if I wouldn’t have any problems, I would never complain against the inspector anyway. Why would I complain and spoil the relations with him, what will that change?”

b) Why entrepreneurs do not believe that a legal challenge can be positive
The research shows that the entrepreneurs do not believe it would be beneficial to complain or file suits against individual inspectors or government services.

View from an entrepreneur:
“To complain about an inspector – equals a serious headache. Firstly, it is difficult to prove any wrongdoing of the inspector, but he will prove a lot against you. Secondly, the court’s visits and expenses for the proceedings will take so much time and money, that it may be infinitely easier to ‘come to an agreement’ with the inspector. Thirdly, why spoil my relations with the inspector and the service, which he represents. They may blacklist me and my enterprise and then I have at a minimum to relocate to another district, because all the officers will work with me only officially, which is a very, very complicated situation. And finally, even if I prove my point legally and the inspector is displaced, another one will come and nobody knows if he will be even trickier to deal with.”
6.2.2.4 Entrepreneurs do not know their rights

If an entrepreneur has a good understanding of the legislation, he or she will face fewer problems with inspections. The research showed that the entrepreneurs who are better informed of their rights and duties as well as of the inspectors’ authority are subjected to inspections to a lesser degree than the others.

a) The mechanisms for protection from inspectors’ actions are not functioning

Based on the analysis of the two previous problems, the following conclusions can be reached on inspections:

- The inspectors can visit the enterprise when they want and as often as they want;
- Inspectors can check everything related to their scope of operations;
- Inspectors unilaterally select sanctions for the enterprises when a violation is discovered during the inspection;
- The entrepreneurs, as a rule, remain insufficiently informed of their rights and inspections norms and requirements.

Therefore, the two key problems surrounding the on-site inspections can be summarized as follows: the process and decision-making of the inspectors are not transparent; and there is a clear absence of a systemic planning system. It appears that the decrees and laws that were issued for the entrepreneurs’ protection from excessive inspections are not yet effective and possibly add to the overregulation of this area.

In 1999 and 2002 a number of decrees were issued designed to protect entrepreneurs from any excessive administrative burden caused by the inspections, including:

- During planned or non-planned inspections, all regulatory agencies of the country must register the inspection in the inspection registration book (President’s Decree # 69, dated January 7, 1999);
- All inspections (except for taxation) should be executed in the presence of a MED representative (President’s Decree # 790, dated September 28, 2002).

However, according to the survey respondents, the implementation of these decrees falls short of meeting the intended aims.

6.3 The Inspections’ Registration Book

According to the entrepreneurs’ statements, this book is provided by the MED. Nevertheless, currently 25 percent of the enterprises do not use this book. Based on the legislation, the inspections that are not registered in this book are not official. As a result, a minimum of 25 percent of all enterprises are subjected to non-official inspections.

But the presence of the Inspection Registration Book (IRB) does not guarantee that the inspection conducted at the enterprise will actually be officially registered and entered in this book.
As can be seen from the chart above, only half of the inspections are duly registered. The problems are two-fold:

(a) Three agencies that are most active in running inspections, do not register their inspections in more than 60 percent of the cases;

In-depth discussions with the entrepreneurs make it clear that the usage of the inspections registration book was insufficiently explained to entrepreneurs as the instrument was launched. A fundamental issue that remains unclear is whether the book records are the right of the entrepreneur or a responsibility of the state inspectors.

Since a large number of visits and inspections are conducted in an informal way, both sides are keen to maintain such visits off-record.

**View from an entrepreneur:**

"By requiring [to record the inspection in] the registration book, I may trigger the comeback of the inspector. But later he will come in a larger group and then I will be severely fined. I will not achieve anything essential by my request to register an inspection, except only spoil my relations with the inspector. And my goal is to make money, and not pay attention to these administrative side activities."

It is simply not profitable for the inspector to register his attendance in the inspections registration book.
The absence of the IRB registration leads to an increase in actual visits/inspections of the enterprises. As a matter of fact, nobody can really tell the actual number of inspections executed in Azerbaijan in any given sector or place.

6.4 MED’s representative presence at the inspections

According to the President’s Decree dated 2002, all inspections, except for taxation, should be conducted in the presence of a MED representative at the place of inspection. This requirement should lower the pressure created by inspections, as well as reduce the practice of non-official payments during the inspections.

Yet, as in the case of inspections’ registration in the IRB, the requirements providing for the presence of MED representative are not being observed. The chart below shows the frequency of MED participation in the 2007 inspections:

Despite the fact that the about 60 percent of the enterprises are inspected, practically all inspections by relevant authorities were conducted without a MED representative.

It is necessary to note that throughout the country, in 90 percent of the cases, the inspections were conducted without a MED representative.

Despite the entrepreneurs’ low level of legal awareness, it appears that they are aware of the requirement to have a MED representative’s presence during the on-site inspections. Many also knew their right to be able to request a MED presence, if absent. Therefore, why do businesspeople not request their attendance? In answering this question, one draws parallels with the number of respondents who fail to register inspections in IRB.

The explanation is again quite similar – it is all about maintaining “friendly” relations with the inspectors and not wanting to spoil a relationship where informal arrangements are made possible. Any invitation of a MED representative may be seen as
going in the opposite direction. In this case, the inspection would take a formal course and entrepreneurs estimate that the end result would be more costly for them.

View from an entrepreneur:

“Why do I need the MED representative? I run the risk of paying even higher fines or making a greater informal payment. Besides, even the inspector, whom I know, will punish me by making me pay higher bribes on another occasion. Therefore, it only makes sense that we complete this process as soon as possible with as little external interference as possible.”

6.5 Inspections and regular visits – different concepts for the entrepreneur

Business inspections materialize in different forms and are formally known by a variety of names, such as: business review, on-site check, investigation, control, or monitoring, yet all practically suggesting – inspecting public officials checking on the business on the spot.

The survey shows that most entities in Azerbaijan are subjected to inspection one way or another. Further analysis reveals that approximately 20 percent of all enterprises do not undergo inspections. However, the in-depth interviews with these enterprises go to show that every month business are still inspected in one or more of several monitoring formats as described above.

View from an entrepreneur:

“For me on-site checks, monitoring, investigations all represent inspections of some sort. Except by calling it different allows the inspector not to formally enter it in the book of registration records, and can come to my company without a MED representative.”

According to the in-depth interviews, the total number of these visits equals approximately six per month, which amounts to 72 visits per year per each business. Thus, the number of inspections by state agencies equals about 80 visits per year for any enterprise.
6.6 Recommendations

6.6.1 Establish an efficient system of government control

An efficient system of government control includes three components:

1) a risk assessment system;
2) a standard procedure for conducting inspections and presenting findings, addressing also frequency and duration of inspections;
3) checklists to be used by inspectors based on revised and up-to-date regulations on the technical requirements for compliance.

Expected Impact

With these elements in place, the system of government control will be able to perform its main function, which is to encourage compliance with the law and prevent violations.

6.6.2 Implement risk-based selection mechanisms of SMEs to be inspected

On the basis of risk assessment, the volume of inspections can be reduced without endangering the public. This approach has three elements:

1. Each control authority identifies, within the scope of its area of expertise, potential public and environmental safety hazards inherent in the range of business activities. The authority then categorizes businesses according to the degree that such hazards typically exist in those businesses;
2. For each category, the frequency of inspections is determined based on the potential risk: high-risk businesses are inspected often, medium-risk businesses are inspected much less often; and low-risk businesses are exempt from inspection;
3. Where a business falls into a risk category to be included in the list of planned inspections, the frequency of inspections of a particular business further depends on its record with respect to inspection findings. Thus, if a business consistently abides by all applicable laws, it need not be inspected as frequently.

The degree to which actual risk is a factor in targeting businesses for inspection reflects the degree to which best practices are operating in the country.

In international best practices, the control authorities focus on high-risk and high-occupancy enterprises such as chemical plants, cinemas and theaters, railway stations, educational facilities, supermarkets, and businesses where there is a high probability of non-compliance because of previous violations.

A risk-based inspection system must be flexible enough to include some exceptions with regard to random inspections. However, the authority to conduct such inspections should be limited so as not to allow government agencies to undermine the underlying principles of the risk-based approach. A random inspection should be conducted only if there is a clear threat to the public or the environment, under very
clearly defined circumstances, or as directed by the court. The validity of any other rationale should be assessed with the underlying principles of the risk-focused system in mind.

**Expected Impact**

The risk-based approach involves limiting the frequency and duration of inspections. Most government agencies, if given free rein, will inspect a business frequently and for unnecessarily long periods of time, which diverts substantial human resources from the core business activity. Thus the authority to run inspections will be clearer and the frequency and duration reduced, hence easing the overall inspection burden on enterprises.

### 6.6.3 Key elements of the reform of government control; introduce consistent procedures for all stages of inspections

The following key elements will be important in improving the inspection system:

- authorities provide timely notice of an upcoming inspection;
- inspectors present substantial proof of their authority to conduct the inspection;
- inspections are conducted following checklists (a series of questions and a list of requirements on which compliance is inspected);
- decisions resulting from the findings of an inspection are based on clearly defined criteria (including that sanctions may be imposed only by a strictly defined range of officials).

The requirements to be met by businesses and inspected by an inspecting authority should be contained in a single document in the form of a checklist and made publicly available.

Additional necessary reform steps include eliminating duplication of responsibilities between government agencies and clearly defining the rights and responsibilities of inspectors in carrying out inspections.

**Expected Impact**

By applying the aforementioned recommendations, entrepreneurs will be aware of the requirements applicable to their businesses and will know which deficiencies they need to correct.

Elimination of duplications ensures the efficient use of government resources by demarcating the areas in which a particular government agency exercises control.

### 6.6.4 Shift the approach to inspections toward advice and prevention of offenses

One way to address this would be to revise the overall approach to inspections. Control authorities should shift their focus from detecting violations and imposing sanctions to providing advice and enhancing prevention. Inspections should seek not to punish but to prevent and educate. International experience has shown that, after
an inspection, advice and an explanation of the findings are much more effective than fines in ensuring future compliance.

The government could draw on the policy of many countries in Europe, which regulate the outcome rather than the process of compliance. Entrepreneurs are free to choose from a broad range of tools and methods of achieving safety, with due regard for new technologies.

**Expected Impact**

Lower cost of compliance for entrepreneurs and a greater variety of choice for compliance lowers the necessary inspections frequency and thus eases the administrative burden on the enterprise. Timely provision of technical advice from the inspection also increases mutual trust and enhances adherence to the standards and other requirements. Business inspections should not be seen only as a punishment mechanism but also as a service that provides guidance.

Annex 6.1 *Presidential Decree No. 790 on Containment of Intrusions, Impeding Entrepreneurship’s Development, dated September 28, 2002*

This decree provides a number of instructions addressed to specific government agencies that may engage in inspecting activities. Such assignments, addressing the corresponding state institutions, are formulated in this decree, and particularly:

(I) *To the Internal Affairs Ministry*: liquidate the Economic Crimes Investigation Department of the Ministry of Internal Affairs, forbid the interference of law enforcement bodies into entrepreneurs’ activities (besides cases based on court decisions), stop the unnecessary interference by state road police in the operation of transportation, improve its work, reduce its personnel by 15 percent.

(II) *To the Tax Ministry*:
- Eliminate the drawbacks of the existing tax payment system, including the illegal advance tax payment;
- Prohibit tax inspections in situations that exceed the ones provided by the legislation, as well as inspections that are unrelated to the Ministry’s authorities;
- Decrease the number of on-site tax inspections, and stop duplicating the work of tax inspectors and other non-justified inspections;
- Enforce the responsibilities of tax agency officials provided by the legislation and improve taxpayers’ service;
- Undertake measures to provide timely and objective examinations of complaints related to the actions of tax agency officials;
- Prohibit tax bodies from limiting the economic activities of entrepreneurs, including their operations on bank accounts;
- Provide operations on the tax control in accordance with the legislation.

(III) *To the State Customs Committee*: Reduce illegal intrusion in entrepreneurs’ activity, improve operation of the customs committee, increase control in relation to smuggling and inform the President of Azerbaijan on the work being performed.

(IV) *To the Ministry of Communications and Public Health, as well as to the leaders of other corresponding central executive bodies* — eliminate the illegal inspections conducted by these bodies and their structures, and the obstacles created to entrepreneurs, and introduce measures to limit further interference in entrepreneurs’ activities.

(V) *To the Heads of the Executive Authority of the cities and regions*, in a 10-day period (from this decree date), liquidate different structures performing control and inspection functions of these bodies (departments, managements, centers, bureau, etc.).

continued on next page

(VI) To the Council of Ministers:
- Study the effectiveness of the mechanisms regulating the issue to entrepreneurs of the different types of certificates, testimonies, special permits, and other similar documents conducted by the central and local bodies of the executive power;
- Decrease the number of employees of the Tax Ministry's subdivisions that perform the control-inspection functions by 40 percent and does not meet international standards; undertake corresponding measures for the start of the ministry's training center;
- To eliminate unwarranted tax inspections, work with the President's office to prepare and approve corresponding legislative acts within a month's time, which will regulate the functions of control performed by the state tax bodies;
- Prepare a standard/legal act that establishes a simplified accounting system for small-scale entrepreneurs;
- Establish mechanisms to enable an entrepreneur to make tax-related payments directly from his/her bank account to the state's budget accounts;
- Allow entrepreneurs to enter into partnership agreements with some state bodies that can perform checking and control functions of its activities;
- Enact measures to increase the effectiveness and usage of the Inspections book within a month's time.

(VII) To the Ministry of Economic Development (MED):
- Provide all entrepreneurs with the Inspections book, conduct analysis of all of the books' recordings related to inspections, and, twice a year, inform the President of Azerbaijan on this matter;
- Create an operative communication system with entrepreneurs, systematize and consolidate the information on impediment and illegal interferences of entrepreneurs' activities; direct this information to the corresponding bodies to take measures, and constantly inform the President of Azerbaijan on the results.

(VIII) All state organizations were informed that inspections by state bodies (except the tax bodies) can be done on the entrepreneurs' site in cases established by the legislation, and only with the participation of the Economic Development Ministry's representative.

(IX) To the Ministry of Justice, undertake measures according to the legislation that limit or eliminate the illegal intrusions into entrepreneurs' activities by public bodies.
7. Business Taxation

The Tax Code of the Republic of Azerbaijan, the first attempt at the codification of Azerbaijani tax legislation, came into effect on January 1, 2001 and resulted in substantial improvement of the Azerbaijani taxation system. In an attempt to improve the taxation system further, the Tax Code has been amended 19 times since its adoption. Notwithstanding these amendments, a closer study of the tax system coupled with the survey results reveals that the Azerbaijani tax system, including tax legislation and tax administration, is still inefficient and impedes the development of Azerbaijan’s private sector.

In the Investment Climate Report, based on a survey conducted by the World Bank among 350 Azerbaijani firms in 2005, the taxation regime (tax administration and tax rates) and corruption were indicated as three major problems for Azerbaijani businesses, with a quarter of the firms regarding the taxation regime as the main constraint to doing business (see Table 7.1).

<table>
<thead>
<tr>
<th>No.</th>
<th>Area</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tax administration</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Tax rates</td>
<td>23</td>
</tr>
<tr>
<td>3</td>
<td>Corruption</td>
<td>21</td>
</tr>
<tr>
<td>4</td>
<td>Access to financing</td>
<td>8</td>
</tr>
<tr>
<td>5</td>
<td>Customs and trade regulations</td>
<td>8</td>
</tr>
<tr>
<td>6</td>
<td>Permits and Licenses</td>
<td>8</td>
</tr>
</tbody>
</table>


Two recent surveys conducted by the World Bank and IFC reveal that not much has changed since 2005. According to the 2009 Doing Business report Azerbaijan ranks 102 among 178 economies in the ease of paying taxes (Table 7.2). The survey conducted by IFC in late 2007 revealed that tax administration is still a burden and is ranked fifth out of the six most difficult regulatory issues in Azerbaijan.
The bulk of individual entrepreneurs and more than half of SMEs operate according to a simplified tax regime. Although the tax burden imposed under the simplified tax regime is not very high, a difference between the tax rates under the standard and simplified tax regimes either discourage businesses from growing bigger, thus holding back their expansion, or push them into the informal economy, thus encouraging tax evasion and corruption.

Table 7.2 **Azerbaijan in Doing Business 2009**

<table>
<thead>
<tr>
<th>Area</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ease of doing business</td>
<td>33</td>
</tr>
<tr>
<td>Starting a business</td>
<td>13</td>
</tr>
<tr>
<td>Dealing with construction permits</td>
<td>155</td>
</tr>
<tr>
<td>Employing workers</td>
<td>15</td>
</tr>
<tr>
<td>Registering property</td>
<td>9</td>
</tr>
<tr>
<td>Getting credit</td>
<td>12</td>
</tr>
<tr>
<td>Protecting investors</td>
<td>18</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>102</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>174</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>26</td>
</tr>
<tr>
<td>Closing a business</td>
<td>81</td>
</tr>
</tbody>
</table>


Firms operating in the formal economy face high tax rates and cumbersome tax administration procedures of the standard tax regime as their businesses grow. On the one hand, compliance with the tax system – preparing and filing numerous tax reports and making tax payments – is time consuming and expensive; and on the other hand, tax compliance is primarily enforced by tax inspectors, who have broad discretion as the execution of these inspections is not sufficiently elaborated in the tax legislation. This provides room for corruption and unofficial contacts, and in recent years tax inspections and rates of administrative fines have increased considerably. For instance, VAT payers are required to file a monthly return together with enclosures thereto, which is difficult and time demanding. The 2009 Doing Business report shows that Azerbaijani businesses spend as many as 376 hours to comply with the Tax Code and social protection laws, and make the necessary payment arrangements with the tax and social protection authorities, whereas Kazakh businesses spend on average 271 hours to deal with taxes.

The complexity and vagueness of the tax legislation and low level of entrepreneurs’ legal awareness also contribute to the above problems, nurturing unofficial settlements.
Main Findings

- According to the IFC survey, 95 percent of individual entrepreneurs and 60 percent of SMEs prefer to operate according to the simplified tax regime;
- The move from simplified tax regime to standard tax regime (VAT) leads to a significant increase of tax burden, encouraging tax evasions;
- Under the Tax Code, an SME or individual entrepreneur operating under the simplified tax regime is taxed at 2-4 percent of its taxable turnover;
- Under the Tax Code, an SME operating in the standard tax regime must pay, among other taxes, 22 percent corporate profit tax and 10 percent dividend tax;
- Under the Tax Code, an individual entrepreneur operating in the standard tax regime must pay, among other taxes, 14 and 35 percent personal income tax;
- As the 2009 Doing Business results indicate, in one year Azerbaijani businesses have to make on average 23-34 payments and dedicate 376 hours to comply with the tax requirements; according to the IFC survey, every year Azerbaijani businesses make seven visits to the tax authorities.

7.1 Taxation: the legal framework

The Tax Code is the central instrument for regulating tax issues. It sets forth the powers and duties of the tax authorities, the rights and obligations of the taxpayers, the penalties for violation of tax legislation, rules for appealing against the actions and inactions of tax authorities, tax administration procedures, and regulations for all types of taxes collected in Azerbaijan.

The tax issues that need more detailed regulation are governed by legislative acts of the state authorities at different levels, primarily the Cabinet of Ministers and the Ministry of Taxes (MoT).

The Azerbaijani tax system are collected at three levels (i) state, (ii) the Nakhchivan Autonomous Republic, and (iii) municipal/local:

1. Personal Income Tax (PIT);
2. Corporate Profit Tax (CPT);
3. Value Added Tax (VAT);
4. Excise Tax;
5. Corporate Property Tax;
6. Corporate Land Tax;
7. Road Tax;
8. Mining Tax;
9. Simplified Tax;
10. Individual Property Tax;
11. Individual Land Tax.

Under the Tax Code, VAT must be paid by the 20th day of the month following the end of the reporting period. That is, the number of VAT payments depend on the taxpayer’s VAT obligations. Methodologically, when payments can be made electronically, it counts as a single payment according to the Doing Business tax methodology.
Items 1-9 are collected at the first level (state taxes), while items 10-13 are collected at the third level (municipal/local taxes); state taxes payable in the Nakhchivan Autonomous Republic constitute the taxes collected at the second level.

In addition to these taxes, businesses are required to pay social security tax (SST) with respect to each employee at 22 percent of the qualifying gross income paid to an employee, and also to withhold 3 percent of the employee’s gross income as SST.

The MoT is the authority in charge of tax collection and tax control with respect to the state taxes. In cases involving payment of customs duties, tax control is exercised by the customs authorities.

The Tax Code differentiates three taxation regimes: standard, simplified, and special.

The Tax Code allows the establishment of special tax regimes. Such regimes may provide for various exemptions and simplified tax administration procedures. A special tax-exempt status accorded to businesses engaged in agricultural production may serve as an example of special tax regimes.

Simplified and standard tax regimes and the current problems associated with their application are discussed in the respective sections below.

7.2 Simplified tax regime

Certain businesses that are not required to register for VAT, such as those engaged in transportation of cargo or passengers are simplified tax payers; and businesses with taxable turnover less than 22,500 Azerbaijani manats ($27,800) within the last three months may opt for the simplified tax regime. Under the simplified tax regime, taxpayers based in Baku pay 4 percent, and those outside Baku pay 2 percent of their gross proceeds as simplified tax.

Businesses engaged in the transportation of cargo or passengers within the territory of Azerbaijan and those carrying out construction of residential buildings are payers of simplified tax regardless of their taxable turnover.

SMEs paying simplified tax are exempt from VAT, CPT, and corporate property tax; individual entrepreneurs availing themselves of the simplified tax are exempt from PIT and VAT. Both groups of simplified tax payers, however, do pay SST. Moreover, tax payers engaged in the construction of residential buildings are not exempt from VAT under the simplified tax regime.

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39 However, in certain cases, individual entrepreneurs and SMEs that operate in the simplified tax regime end up paying VAT. See analysis in paragraph 7.3.5 below.
The IFC survey demonstrates that the simplified tax regime is used by about 80 percent of individual entrepreneurs and SMEs (See Charts 7.1 and 7.2). Such a large percentage is indicative of the simplified tax regime’s effectiveness, while it may also be regarded as a sign of the widespread shadow economy.
The IFC survey reveals that one in five entrepreneurs in Azerbaijan conceals about 30 percent of its income from the taxation and one in three entrepreneurs spend 20 percent of his or her profit on unofficial payments, thus increasing corruption. The impact of corruption on SMEs is usually more negative and conspicuous than on large-scale enterprises, as such enterprises normally are in a more vulnerable position. Also, the effect of corruption on SMEs is felt more, as in most countries the SMEs’ contribution to the economy, especially on employment, is greater than that of large enterprises.

Table 7.3 Unofficial payments made to government officials

<table>
<thead>
<tr>
<th></th>
<th>IEs</th>
<th>SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unofficial payments</td>
<td>36%</td>
<td>31%</td>
</tr>
<tr>
<td>Earnings</td>
<td>7%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Turnover concealed from taxation

<table>
<thead>
<tr>
<th></th>
<th>IEs</th>
<th>SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concealed turnover</td>
<td>22%</td>
<td>14%</td>
</tr>
<tr>
<td>Earnings</td>
<td>30%</td>
<td>28%</td>
</tr>
</tbody>
</table>

As the figures and analysis above show, Azerbaijani tax reporting and payment procedures need to be simplified, especially for individual entrepreneurs and SMEs. In the most progressive countries, smaller enterprises benefit from more simplified tax reporting as it is generally understood that simplified tax reporting is sufficient to cover the business transactions conducted by such enterprises. The application of simplified tax reporting reduces both the entrepreneurs’ cost of compliance and increases tax revenues by cutting government’s expenditures on tax administration.

Moreover, the VAT threshold is affected by strong inflationary pressures in Azerbaijan as the threshold is not indexed for inflation, which further aggravates the problem.

7.2.1 The shift from the simplified to the standard tax regime results in a considerable increase of tax burden, thus creating incentives to avoid entering formal business or discouraging registered businesses from further expansion

The simplified tax regime with 2-4 percent tax rate is rewarding for new businesses, as it provides newly established businesses with time to establish themselves and grow. However, the difference between the tax burdens of simplified and standard tax regimes is very substantial. An SME moving to the standard tax regime has to pay 18 percent VAT instead of 2-4 percent turnover tax, 22 percent CPT on its corporate profit, property tax, and has to bear the administrative cost associated with bookkeeping, more in-depth tax inspections, and making at least 12 tax payments a
year. Such a drastic increase in tax burden is obviously a drive for a business to hide or “adjust” its turnover in order to avoid the shift to the standard tax regime. Similarly, individual entrepreneurs moving to the standard tax regime are obliged to pay 14 and 35 percent PIT.

7.3 Standard tax regime

Taxpayers with a turnover for the last three months exceeding the VAT threshold of 22,500 Azerbaijani manats, as well as taxpayers that may not take advantage of the simplified tax regime as enlisted in Sub-Section 218.2 of the Tax Code, such as businesses producing excisable goods and non-governmental pension funds, are required to file an application to register for VAT upon the expiration of the three-month period. Except for businesses engaged in the construction of residential premises that are simplified tax payers, all other VAT registrants operate in the standard tax regime and are the payers of taxes enlisted above (7.1, 3rd paragraph).

The main tax obligations for SMEs and individual entrepreneurs under the standard tax regime are tabulated on the next page.

7.3.1 Administrative hassle of compliance with Azerbaijani tax requirements is very time consuming and costly

It is crucial that a tax system complies with the general level of economic development of a country and is consistent with the institutional capacity of taxpayers. In fact, a system with unreasonable requirements for SMEs, high tax rates, and relatively complex taxation accounting and inspections hinders the development of businesses and forces entrepreneurs to search for alternative solutions, such as tax evasion. Therefore, instead of promoting tax compliance, the relatively complicated tax system partly or completely pushes entrepreneurs into the “shadow economy.”
Table 7.5 **Main tax obligations of an IE and SME**

<table>
<thead>
<tr>
<th>Taxpayer</th>
<th>Tax</th>
<th>Tax Base</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SME</strong></td>
<td>CPT</td>
<td>Gross annual worldwide income less deductible expenses (in case of a non-</td>
<td>22 percent</td>
</tr>
<tr>
<td></td>
<td>Corporate</td>
<td>resident taxpayer, only income derived from Azerbaijani source)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Property Tax</td>
<td>On the average annual book value of the fixed assets</td>
<td>1 percent</td>
</tr>
<tr>
<td></td>
<td>Withholding</td>
<td>Dividends, interest, and certain other payments paid by, or due to such</td>
<td>10 percent</td>
</tr>
<tr>
<td></td>
<td>Tax</td>
<td>entities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corporate</td>
<td>Lands owned or used in Azerbaijan</td>
<td>Depending on location, quality and size of the land plot</td>
</tr>
<tr>
<td></td>
<td>Land Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>IE</strong></td>
<td>PIT</td>
<td>Taxable gross income (connected with employment, entrepreneurial or non-</td>
<td>Annual income: Up to AZN 24,000 ($29,880): 14 percent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>entrepreneurial activities) less deductions allowed under the Tax Code</td>
<td>Above 24,000 p.a. ($29,880): AZN 3,360 + 35 percent on the amount exceeding AZN</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Individual</td>
<td>On the book value of the fixed assets</td>
<td>Asset specific</td>
</tr>
<tr>
<td></td>
<td>Property Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Individual</td>
<td>Lands owned or used in Azerbaijan</td>
<td>Depending on location, quality, and size of the land plot</td>
</tr>
<tr>
<td></td>
<td>Land Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Both SME</strong></td>
<td>SST</td>
<td>Gross income paid to employees (salaries and other eligible remunera-</td>
<td>22 percent paid by an employer</td>
</tr>
<tr>
<td><strong>&amp; IE</strong></td>
<td></td>
<td>tions), starting 2006 gross income paid to foreign employees also taken</td>
<td>3 percent withheld from an employee’s salary</td>
</tr>
<tr>
<td></td>
<td></td>
<td>into account for this purpose.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>VAT</td>
<td>Turnover of goods and services within Azerbaijan, as well as importation</td>
<td>18 percent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>of goods</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Road Tax</td>
<td>Vehicles owned or used in Azerbaijan</td>
<td>Depending on the capacity of engine of a vehicle.</td>
</tr>
<tr>
<td></td>
<td>Excise Tax</td>
<td>Release of excisable goods from the production site</td>
<td>Goods specific</td>
</tr>
<tr>
<td></td>
<td>Mining Tax</td>
<td>Minerals extracted within the territory of Azerbaijan</td>
<td>0.02 gapik – 26 percent of the wholesale price of the minerals</td>
</tr>
</tbody>
</table>
Box 7.1 What is the Shadow Economy?

By definition, the shadow (or informal) economy constitutes activities that are not recorded by the government.

One of the main reasons for the very existence of the informal sector is entrepreneurs’ attempt to find a shelter from government-induced distortions such as excessive taxes, regulation, and bribery. Companies that conceal some of their transactions pay lower taxes, thereby shifting the tax burden onto the taxpayers who operate legally. Such companies operating within the law, however, do not have to waste resources to conceal their activities, and therefore can develop and achieve optimum growth. This premise is supported by the Doing Business (2005) project, which found that, “on average, in the 10 developing countries sampled, the output of shadow enterprises was 40 percent less than that of legal businesses operating in the same economic sectors.” Therefore, operating in the shadow economy is also harmful for the businesses themselves since they have limited ability to attract external funding. Companies that understate their profit to avoid taxes are also deprived of other opportunities — low financial indicators do not permit them to secure bank credit or use the services of leasing companies.

Although in comparison with the previous year, Azerbaijan has made significant progress in reducing the number of tax payments (from 30 to 23), the 2009 Doing Business report indicates that the number of tax payments is still higher than in certain neighboring economies such as Kazakhstan, where businesses make just 9 tax payments per year and spend 271 hours on tax compliance (Table 7.6). Moreover, IFC survey results indicate that on average Azerbaijani businesses have to visit tax authorities for various reasons seven times a year, and their employees spend approximately 3 percent of their working hours on the preparation of tax reports.

Table 7.6 The administrative burden for compliance with tax requirements in Azerbaijan is high compared to that of Kazakhstan

<table>
<thead>
<tr>
<th></th>
<th>Azerbaijan</th>
<th>Kazakhstan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>VAT, number of payments per year</strong></td>
<td>1-12&lt;sup&gt;41&lt;/sup&gt;</td>
<td>1</td>
</tr>
<tr>
<td>Compliance time, hours</td>
<td>162</td>
<td>92</td>
</tr>
<tr>
<td><strong>SST, number of payments per year</strong></td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Compliance time, hours</td>
<td>134</td>
<td>74</td>
</tr>
<tr>
<td><strong>CPT, number of payments per year</strong></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Compliance time, hours</td>
<td>79</td>
<td>105</td>
</tr>
<tr>
<td><strong>All taxes, number of payments</strong></td>
<td>23</td>
<td>9</td>
</tr>
<tr>
<td>Compliance time, hours</td>
<td>376</td>
<td>271</td>
</tr>
</tbody>
</table>

Source: IFC/World Bank 2008

However, despite these complexities in tax reporting, only 16 percent of individual entrepreneurs and 11 percent of SMEs indicated in the IFC survey that tax payments and reporting procedures are problematic issues (Charts 7.3 and 7.4). Based on interviews with focus-group respondents, there are indications that a number of entrepreneurs are prepared and willing to engage in illicit payments in order to simplify reporting and controls.

<sup>41</sup> See previous comment/footnote.
In 2006, the Ministry of Taxes successfully launched the Automated Unified Information System (AVIS), which allows taxpayers to submit their tax reports electronically. The hotline for the Ministry of Taxes has been functioning since 2003 and is also available to taxpayers that need consultation on tax issues. These two services were very much welcomed by the focus group respondents.

However, despite the option to submit tax reports via registered or electronic mail, many entrepreneurs prefer to submit them in person in order to resolve outstanding issues when meeting tax officials. This may also be partly due to a low level of Internet usage among entrepreneurs. Another reason is that, in general, entrepreneurs have little knowledge of legal issues. Meanwhile, according to the official statistic of the Ministry of Taxes the number of entrepreneurs submitting tax reports electronically has been significantly increasing over the past years and peaked at 72 percent in April 2009, (source: Ministry of Taxes, 2009).

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42 According to the IFC Survey, 28 percent of SMEs and 9 percent of individual entrepreneurs use internet during their daily work.
View from an entrepreneur:

“Instead of spending time and money tinkering with the intricacies of CPT reporting, I would rather pay a ‘service fee’ to a tax official, whom I have been known for a long while, to prepare my reports. In the long run, it is less costly and time consuming.”

7.3.1.1 The frequency of VAT reports and time schedule for filing reports with respect to certain taxes is not efficient

Currently, VAT payers are required to file quarterly SST reports, and monthly VAT returns together with annexes, such as tax invoices, and make monthly SST payments. Yet best practice shows that by cutting the annual reporting requirements, both the government budget and the businesses may benefit in terms of cost savings.

The time schedule for filing reports with respect to different taxes is not time and cost-effective either. For instance, tax reports for land tax must be submitted by May 15, whereas the same deadlines for corporate property tax, CPT, and road tax reports are by March 31. Establishing the same deadline for the filing of all annual tax reports may decrease the administrative expenses and correspondingly the number of visits with the tax authorities.

7.3.1.2 The calculation of taxes is complicated, especially for SMEs that can not afford hiring consulting services

Recent years, tax compliance has become easier due to the tax consultation services offered to tax payers. However, the difficulty in calculating taxes, especially calculation of CPT and PIT, coupled with the obscurities in tax legislation and the lack of uniform interpretation of laws is another hurdle for businesses. Any additional simplification would lead to less outsourcing of bookkeeping that currently adds to cost of doing business.

The fiscal year with respect to CPT is the calendar year. However, taxpayers must pay 25 percent of the tax paid in the previous year in advance, within 15 days of the end of each calendar quarter. As an alternative, the taxpayer may opt to apply to the current quarter’s gross income the ratio of tax to gross income in the previous year. An advance payment for a taxpayer without activity in the previous year is calculated on a cumulative quarterly basis in accordance with the tax rates effective in the current year. Advance tax payments must not be less than 75 percent of the profits tax due. The tax authorities must be notified of the payment within 15 days of the end of the relevant quarter.

To file tax returns, taxpayers must pay any balance of taxes before the due date (for legal entities and permanent establishments, March 31 of the year following the relevant fiscal year). Upon request, CPT returns may be deferred by up to three months if taxes due have been paid.

Any amounts overpaid may be netted against other taxes due. Despite the fact that under the Tax Code, the taxes overpaid may also be refunded, according to entrepreneurs, this is a difficult, if not an impossible, procedure in practice.
7.3.2 Tax inspections negatively affect businesses and increase corruption

Box 7.2 Tax Inspections

Tax inspections can be conducted off-site and on-site. An off-site tax inspection must be carried out on the basis of documents in the possession of the tax authorities or provided by the taxpayer as well as other documents that reflect the calculation and payment of taxes, and documents on the taxpayer’s business activity. Off-site tax inspections must be carried out within 30 days from the date the taxpayer provides the documental basis for tax calculation and payment. An on-site tax inspection must cover the period not exceeding three calendar years of taxpayers’ activity related to profit, income, property, road, and land taxes. As for other taxes, on-site inspection must cover the period not exceeding three years, including the year of inspection. On-site tax inspection can be conducted on a scheduled date with 15 days substantiated written notice prior to inspection, whereas unannounced tax inspections can be conducted in urgent circumstances enlisted in the Tax Code, such as the discovery of misrepresentation in tax reporting (a taxpayer may instigate such inspection as well). A taxpayer may sue tax authorities for violations of inspectors.

Tax compliance is most often pursued through tax inspections, which as a result of incomplete regulation leave a high degree of discretion to the tax inspectors that are as such prone to corruption. A typical example of these procedures is the so-called “chronometry measurement,” which is supposed to determine the yearly income of businesses based on a subjective evaluation of generated revenues during inspections, creating a clear conflict of interest and leaving ample room for unofficial payments.

In accordance with the IFC survey, an average of one in four entrepreneurs, regardless of the legal status of its enterprise, makes unofficial payments during inspections. Many companies prefer entering the shadow economy and paying unofficial taxes in order to remain competitive rather than paying a heavy tax burden.

As mentioned in page 91 of the Business Inspections chapter, 81 percent of all individual entrepreneurs and 70 percent of SMEs, as surveyed by IFC, are being inspected every year. Of those, approximately 90 percent claim to have been inspected by the Ministry of Taxes. When it comes to the results of inspections, the IFC survey showed that one in five inspected entrepreneurs was penalized during the last 12 months; and more than half of inspections were closed without any sanctions, but the rest of inspections resulted in penalties (on average 334 Azerbaijani manats, or $412) or unofficial payments. Moreover, 59 percent of all inspections conducted by the Ministry of Taxes are not registered in the registry of inspections that entrepreneurs are required to maintain.

7.3.3 CPT and dividend tax result in double taxation of corporate earnings

Dividends paid by an Azerbaijani resident are subject to a 10 percent withholding tax. Thus, corporate earnings are taxed twice: first as 22 percent CPT, and then as 10 percent dividend tax, if such income is distributed to stakeholders. Such double taxation of corporate earnings reduces capital returns and makes equity financing less attractive for investors as unlike interest payments, dividends are not tax deductible. This leaves the businesses with a limited choice: debt financing, which as a rule is used...
for short-term goals since it is not often desirable for new businesses with unstable cash flows to pay interests.

To address this issue some countries, including Latvia, Estonia, Ukraine, Slovakia, and Kazakhstan to some extent, have already abolished double taxation of corporate earnings, eliminating either CPT or dividend tax or by allowing for the deduction of dividends under CPT.

Another problem associated with CPT and PIT is the limited loss carry forward period of three years with respect to PIT, and five years (in case of losses arising in connection with dealing with property, three years) with respect to CPT. Such short loss carry forward periods discourage investments in activities involving more unstable income generation or later capital returns. The provisions in most other countries allow for considerably longer loss carry forward periods. For instance, it is 10 years in Russia.

7.3.4 High PIT rates discourage the growth of individual entrepreneurs and push them into informality and tax evasion; the high social security rate is the main cause of widespread unofficial employment

PIT rates in Azerbaijan are among the highest in the CIS countries43. For example, in Russia PIT is set at 13 percent, while in Ukraine it is at 15 percent. Currently, the PIT rate is 14 percent in the first tax bracket, which applies to personal income up to 2,000 Azerbaijani manats, and 35 percent in the second tax bracket, which applies to income exceeding 2,000 Azerbaijani manats (with income up to 2,000 Azerbaijani manats always taxed at 14 percent rate). As the figures show, first of all, the difference between the tax bracket rates is substantial, and secondly, the threshold is very low. Moreover, the personal income of an individual is also subject to 3 percent SST44, which may be regarded as double taxation of an individual's personal income connected with his/her employment. The Tax Code exempts a certain part of personal income from PIT. Such exemptions, however, do not make much difference for the PIT tax burden45. Such a situation creates strong incentive for individual entrepreneurs to conceal their taxable income and for employees not to oppose unofficial employment, which employers favor as a result of very high (22 percent) SST. These same reasons create dual bookkeeping and a widespread in-cash salary system, where an employee is paid official salary of a nominal amount and an unregistered in-cash salary of a substantially higher amount. For this reason, it comes as no surprise that the employees working without employment agreements constitute certain percentage of the total labor force.

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43 According to the study by Rup Khadka. 2007, Reforming Azerbaijan’s Tax System to Increase Competitiveness of the Non-oil/Gas Private Sector, the average CIS rate was 19 percent, World Bank 2008 Contestability of Domestic Markets.
44 Overall SST rate is 25 percent of all qualifying amounts received by an employee. 22 percent of SST is paid by an employer and remaining 3 percent is withheld from the employee’s income by the employer.
45 For instance, under the Tax Code, if an individual’s monthly income is less than 200 Azerbaijani manats, and if their yearly income is less than 2,400 Azerbaijani manats, the part of the monthly income equaling to the monthly average salary or the part of yearly income equaling to 12 times the monthly average salary is exempt from PIT.
7.3.5 The cumbersome VAT administration and malfunctioning VAT rebate system create incentives for tax evasion and unofficial contacts

Under the Tax Code, all VAT payers, regardless of their size, must submit monthly VAT reports, amounting to 12 reports per year. Given the tax handling systems that large taxpayers usually have, monthly reporting is not likely to be burdensome for them. However, for SMEs, monthly VAT reporting is too frequent and increases the costs of tax compliance. In IFC’s opinion, to reconcile the interests of the tax authorities and entrepreneurs, the number of VAT reports for smaller taxpayers should be reduced to four per year; the change from quarterly to monthly VAT reporting would be a one-off timing adjustment mandated by taxpayer’s turnover exceeding the established threshold for this purpose. Such reforms may reduce the costs of compliance for SMEs and the tax authorities.

Box 7.3 Simplification of VAT filing has proved to be cost efficient for SMEs

In many countries, reduction of filing frequency of VAT reports proved to be cost saving for SMEs. For example, small businesses in the UK (as well as in most European countries) with an annual turnover below 1,350,000 British sterling ($2,100,000) can opt for an annual accounting scheme. Under this scheme, the taxpayer is obliged to make monthly or quarterly installments based on an estimate of his total VAT liability.

Similar systems are in operation in other countries. In New Zealand, for example, taxpayers generally are obliged to file every two months, while SMEs can opt to file a return only twice a year and filing can be timed to coincide with the accounts reporting date. In Canada, returns are normally filed within one month of the reporting date, while small firms have three months after their reporting date to file their returns. Among CIS countries, in Ukraine, taxpayers with annual turnover less than 300,000 Ukrainian hryvnia ($40,000), may opt to file VAT returns quarterly.

Yet another nuance in VAT system is connected with VAT rebates. When a non-VAT seller purchases products from a VAT supplier who charges VAT on his sales, a non-VAT seller is not entitled to reclaim the VAT he has paid on purchase price. In this event, such a seller acts as an “end-user” and carries the burden of VAT. To offset for the VAT, the seller has to sell the purchased products for higher (less competitive) prices. Thus, according to tax code, the simplified tax payers are not entitled to VAT rebates (since the majority of simplified tax payers are not VAT payers). Such a situation de facto increases the seemingly low tax burden of the simplified tax payers.

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7.4 Recommendations

7.4.1 Make the graduation from the simplified to the standard tax regime less burdensome, by:
- Indexing VAT threshold for inflation;
- Consolidating into the simplified tax both turnover tax and SST; and
- Reducing the overall tax burden imposed under the standard tax regime47.

Expected impact
These measures may create a more favorable business environment for individual entrepreneurs and SMEs, and contract the “shadow economy” by reducing tax evasion and corruption, which will, in return, lead to an increase in tax revenues and number of registered businesses.

7.4.2 Simplify the tax compliance, especially for individual entrepreneurs and SMEs, by:
- Introducing simplified (different) accounting for individual entrepreneurs and SMEs;
- Reducing the number of reports and payments individual entrepreneurs and SMEs are required to make, especially reducing the number of reports with respect to SST from 12 to two reports, or ideally to one report per year, and providing for a quarterly VAT reporting option for SMEs; and
- Further streamlining tax accounting procedures.

Expected impact
As a result of these measures tax compliance will become less time consuming and less expensive both for businesses and the government. Having a lower volume of reports to check, tax authorities will redirect their resources to more value added work. Clearer tax accounting procedures will reduce the number of mistakes by entrepreneurs, hence the cost and time for rectifying them, at the same time increasing certainty for entrepreneurs will allow them to assess their incomes more accurately. Simplification of tax compliance and the tax system and further reduction of contacts with tax officials will discourage unofficial payments.

7.4.3 Improve tax administration by:
- Simplifying tax payments by consolidating them with an option to pay more frequently and reducing the number of taxes wherever possible;
- Introducing risk management principles in planning and conducting inspections, focusing verification on the businesses where higher returns are expected;

47 These recommendations are the result of consultations with, and research by the World Bank. Reference is made to World Bank 2008 Contestability of Domestic Markets.
Introducing clearer and more elaborate regulation of tax inspections (especially, powers and obligations of tax inspectors), limiting their scope to certain areas; increasing the supervision over the tax inspectors and aggravating the penalties for violations of law by tax inspectors.

**Expected impact**

As a result of improvement of tax administration, businesses will spend less time and resources on tax payments and the government’s costs and time on processing tax payments will reduce in parallel. Businesses will have less incentives to conceal their revenue and will not need to make unofficial payments, which will reduce corruption. Application of risk management principles will help the government to redirect its resources from unnecessary tax procedures to more efficient use. More efficient regulation of inspections will decrease the scale of corrupt practices.

7.4.4 **Reduce or eliminate the following taxes which represent an obstacle to business growth, by:**

- Eliminating double taxation of corporate earnings by allowing for a deduction of dividend under CPT or PIT;
- Introducing a flat rate for PIT (remove tax brackets), consolidating 3 percent SST to PIT, lowering current high 35 percent PIT rate to 10 percent and indexing the PIT threshold income for inflation48.

**Expected impact**

These measures will create additional incentives for companies to invest in business development, and will reduce their incentives to hide revenues and increase expenses. Reduction/elimination of SST will reduce unofficial employment, increase employer’s incentive to hire more and increase employees’ income, and make more employees eligible for social benefits in the future.

7.4.5 **Provide for wider free business consultations for individual entrepreneurs and SMEs and organize workshops, seminars, and similar events to increase entrepreneurs’ legal awareness**

**Expected impact**

Access to tax and accounting consultations would facilitate tax filing and accounting for smaller businesses. Increased legal awareness of entrepreneurs will reduce unofficial payments and the time required to deal with tax payments and tax inspection procedures, positively affecting entrepreneurs’ profits and state tax revenues.

48 See footnote 47 above.
8. Access to Finance

8.1 Overview of the Azerbaijani financial system

Based on the data of the National Bank of Azerbaijan (NBA) as of January 1, 2008, there are 46 banks operating in the country, out of which 21 banks have some foreign capital participation. In six banks, the foreign capital share ranges from 50 percent to 100 percent (in 13 – less than 50 percent), and two banks act as subsidiaries of a non-resident bank.

According to official data, the cumulative capital of the commercial banks, their assets and credit investments significantly increased in 2007. On January 1, 2007, the assets were 3.8 billion Azerbaijani manats (equivalent to $4.7 billion) and at the beginning of 2008, this indicator reached 6.7 billion Azerbaijani manats (equivalent to $8.3 billion), a 78 percent increase. The cumulative capital of the banks on the January 1, 2007, was 603 million Azerbaijani manats ($744 million), and as of January 1, 2008, it reached 1 billion Azerbaijani manats ($1.4 billion).

At the beginning of 1996, there were 200 banks with a total capital of $4.2 million in Azerbaijan. However, by January 2001, the numbers of banks had decreased to 59, with total capital of $532 million. At the end of 2006, 44 banks were active: two state banks, 20 with foreign capital participation, and 22 commercial and/or joint stock banks. On January 1, 2007, the consolidated capital of these banks was $693 million.

As of the beginning of 2008, 142 lending agencies operated in Azerbaijan, including 46 mainly undercapitalized commercial banks dominated by the state-owned International Bank of Azerbaijan (45 percent of total banking assets) and 96 non-bank credit institutions, whose share in total assets and total capital are less than 3 percent. According to NBA requirements, the minimum amount of a bank’s capital must exceed $12 million as of July 1, 2007. At the end of 2007, the total assets of the banking system were $7.7 billion. The consolidated credit portfolio amounted to $5.1 billion, 43 percent of which was held by state-owned banks.

50. National Bank’s monthly reports for January 2007 №1 (83) and January 2008 №1 (95).
51. Exchange rate for January 2001 was 4.550 Azerbaijani manats to $1.
The growth of bank branch networks (from 374 branches in 2005 to 485 in 2007) appears insufficient given the scale of current growth in the economy; the penetration rate is well below some transition countries and the EU. The total number of bank branches in Azerbaijan per 10,000 inhabitants is about 0.54, which is much lower than in Ukraine (2 branches per 10,000 inhabitants), Uzbekistan (3) and Spain (10).

The banking system remains quite small relative to the size of the economy. Even with high assets and the growth of loans and deposits in Azerbaijani banks over the past few years, total banking assets were only about 26.7 percent of GDP, with loans accounting for about 19 percent and deposits only 13 percent at the end of 2007 – a much lower ratio than the 35-60 percent of GDP characteristic of the advanced transitional economies of Central and Southeastern Europe.
8.2 Financing SME operations

In market economies, banks and other non-bank financial institutions, such as leasing companies and credit unions, are the main providers of financing. This chapter evaluates the activity of the banking environment in Azerbaijan as it relates to SMEs, examining how the credit conditions influence the development of local entrepreneurship.

Main Survey Findings:

- Access to finance was indicated as a key problem by 73 percent of the entrepreneurs;
- SMEs do not consider banks to be an effective mechanism for financing their businesses – the share of bank credits was only:
  - 4 percent of all investments into fixed assets;
  - banks usually do not issue credits for equity;
  - only 7 percent of financing for working capital is from banking sources.

Based on IFC’s research, the penetration of bank credits as a share of SMEs’ financing for fixed assets was only 4 percent, with a similar percentage for the financing of working capital.
More than 90 percent of entrepreneurs use their own assets for their operating capital and asset acquisition. Thus despite the presence of 46 active commercial and state banks, only approximately 5 percent of entrepreneurs used banking services for their financing needs.

Entrepreneurs cite several reasons why they do not view banks as an effective source of financing:

### 8.2.1 Credit terms are unfavorable for SMEs

According to the research, 77 percent of the entrepreneurs never applied to a bank or any other financial institution for capital.

![Chart 8.5](chart)

**Did you (your enterprise) ask for credit or credit line for the last 12 months**

- **Apply**: 23%
- **Didn’t apply**: 77%

Four out of five entrepreneurs indicated that the most important problem for them is access to finance, outshining even issues like tax rates.

![Chart 8.6](chart)

**EDM’s representative’s level of presence at the check-ups**

- Access to financing: 80%
- High interest rates: 70%
- Corruption: 60%
- Competitors’ working practice in the abnormal sector: 50%
- Access to land: 40%
- Licenses and permits for the business: 30%
- Other: 20%
The survey also shows that access to finance is troublesome for all sectors of the Azerbaijani economy.

The loan application process and lending availability are the main sources of problems related to the increase in access to finance.

As a rule, access to credit is based on the bank’s terms for SME lending:

- Interest rates;
- Securitization of the credit;
- Period of borrowing.

**a) Reason #1 – Interest Rates**

According to the survey data, more than half of the entrepreneurs who required external financing did not go to the bank for credit because they believe that interest rates are too high.

If the data on SME profitability is compared with the interest rates for credits serviced by the entrepreneurs, one can see that the borrowing terms are simply not affordable.
Average indicators of the profitability and interest rate for the credits

Chart 8.9
The loan interest rates on the credits greatly exceed profit levels of SME’s

View from an entrepreneur:
“While the loan is being serviced, one should not only forget making a profit, but probably also be prepared to add extra money out of one’s own pocket.”

b) Reason #2 – Securitization On Credits

The second reason for refusal/denial of commercial lending is the demanding guarantee requirements. The survey results show for three out of five enterprises that were refused lending, the reason given was that the security for the credit was not acceptable for the banks.

According to the research data, practically all borrowers must provide guarantees to receive a credit. Observations and in-depth analysis shows that the banks prefer real estate as collateral (pledge) to secure crediting. In-depth interviews with the entrepreneurs, as well as the fact that 60 percent of the entrepreneurs conduct their business on a leased premises, demonstrates that entrepreneurs can only use their living accommodations as collateral. In the entrepreneurs’ experience, the balance between the collateral cost and the requested credit amount is usually about a ratio of 2:1.

Moreover, survey respondents claim that even if the collateral exceeds the amount of the requested credit by twofold, it is still impossible to obtain credit based on this security, unless the real estate is located in Baku, Ganja, or Sumgayit.

View from an entrepreneur:
“The banks are not interested in the premises or plots of land in the regions. They explain it by the fact that it is afterward practically impossible to sell these premises.”

Some lending agencies provide microcredits, where small items such as jewelry are requested as a means of security. The credit amount in such agencies typically equals $150-$10,000. To receive credit from the microcrediting agencies, one needs to provide collateral corresponding to 20 and 600 grams of gold for these amounts53.

53 Interview with senior credit officer of World Vision, held on September 15, 2008.
c) Reason #3 – Period Of Loan

Currently, credits for SME financing are given by commercial banks in Azerbaijan mainly for six- to 18-month maturity periods (see Table 8.1).

Table 8.1 Terms and average interest rates for credits by commercial banks in Azerbaijan (data from the NBA Annual Report 2007)

<table>
<thead>
<tr>
<th>Period (months)</th>
<th>1-3 months</th>
<th>3-6 months</th>
<th>6-9 months</th>
<th>9-12 months</th>
<th>12-36 months</th>
<th>36-60 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate for crediting in AZN (%)</td>
<td>17.5</td>
<td>18.6</td>
<td>15.6</td>
<td>19.5</td>
<td>18.5</td>
<td>10.4</td>
</tr>
<tr>
<td>Interest rate for crediting in hard currency (%)</td>
<td>14.7</td>
<td>17.4</td>
<td>17.9</td>
<td>20.7</td>
<td>14.9</td>
<td>19.1</td>
</tr>
</tbody>
</table>

Based on respondents’ experience, credit terms remain insufficient for companies planning to make capital investments (see example in the Chart 8.11).

Chart 8.10
The banks’ primary reason for refusal: non-acceptable co-guarantors or security for crediting, presented by the enterprise (more than one answer was possible)

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unacceptable credit security or co-guarantor</td>
<td>60%</td>
</tr>
<tr>
<td>Enterprise’s insufficient profitability</td>
<td>30%</td>
</tr>
<tr>
<td>Incomplete application for the credit</td>
<td>10%</td>
</tr>
<tr>
<td>Problems with the credit history</td>
<td>5%</td>
</tr>
<tr>
<td>Concern related to the amount of the already existing indebtedness</td>
<td>0%</td>
</tr>
</tbody>
</table>
Case study of a Baku-based glass and window manufacturing business obtained through an in-depth interview held in July 2008.

Loan granting process is regulated by the internal regulations of commercial banks and relevant legal requirements of the National Bank.

There are a number of reasons why the banks impose such rigid conditions on lending:

8.2.2 The majority of banks cannot attract long-term low-cost resources for subsequent SME refinancing

Banks in Azerbaijan are operating in complex financial market conditions and need to offer high returns in order to attract deposits from individuals and legal entities (see Table 8.2).

<table>
<thead>
<tr>
<th>Table 8.2</th>
<th>Conditions (terms &amp; interest rates) for deposits by commercial banks in Azerbaijan (data from the NBA Annual Report 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Legal entities</td>
</tr>
<tr>
<td>Interest rate for deposit in local currency, %</td>
<td>11.4</td>
</tr>
<tr>
<td>Interest rate for deposit in dollars or euros, %</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Taking into account the bank’s margin, this rate is reflected in the interest rates of the credits offered.

8.2.3 SME operations are often not transparent, which force banks to incorporate the possible risks into the credit cost

According to the survey data, 25 percent of the enterprises conducts one third of their business in “shadow” operations (see Chart 8.12).
Correspondingly, actual performance results are not reflected in the financial and accounting reporting and the formal figures are always worse than the actual data. Therefore, banks cannot evaluate the genuine volumes and results of company operations. This in turn limits the banks’ ability to assess creditworthiness and possible loan issuance. In addition, the banks must rely on “double bookkeeping” and informal accounting records, when assessing clients, as they underwrite on such “black” financial records.

Although there is an embryonic state-run credit bureau functioning in Azerbaijan as of 2005, the absence of a fully-fledged credit bureau prevents the commercial banks from effectively accumulating and exchanging information on borrowers’ records (see Box 8.1).

**Box 8.1** Credit bureau functions in Azerbaijan are partially realized by the credit registry

The Central Credit Registry began functioning in the NBA on January 1, 2005. The registry was created as a result of a World Bank advisory services project. According to the NBA’s internal documents, commercial banks operating in the country must send information on all credit portfolios to the registry for individual loans exceeding $1,000 issued to legal entities and for all loans exceeding $5,000 issued to an individual. The information is sent in an electronic form to the registry and stored in a database for three years (then the information is stored in an archive).

Banks sending data to the registry also have access to the database and can receive credit histories for potential clients, which may also be applying for credits with other banks. Requests for credit reports are sent online. The cost of these services is $1 for the borrowers and $2 for the banks.

The credit registry system, nevertheless, is at an early stage of its development. This is especially true in the case of the credit information available on individuals. Therefore, the effectiveness of the credit registry’s database to help assess the creditworthiness of an individual credit borrower is limited.

All this introduces additional uncertainty for the SME crediting banks and bears additional risks. In trying to minimize these risks, the lenders reduce the credit maturity periods and put forward higher demands for their own security. Grace periods are too short or nonexistent, which makes it difficult for any non-trade business to invest in medium to long-term operations.

_**View from an entrepreneur:**_

“If the agricultural enterprise is located in the countryside, I have no opportunity to get a loan. The bank requires collateral in the city center. Nobody wants my house, garage, country cottage, or even a lot of land in the regions.”

**8.2.4 Banks prefer to focus on lending for consumer goods, which in their view is less risky**

The credit market for consumer goods is rapidly developing in Azerbaijan. Maturities and interest rates in the consumer market are significantly more attractive for the banks, compared to SME crediting. In cases of default, the banks always have the opportunity to repossess the goods that have been bought using the credit. Very often, these are goods, such as cars, which are in demand and can easily be sold on the secondary market.
8.3 Poor mutual understanding between banks and SMEs

All in-depth interviews with the entrepreneurs demonstrated that they had a poor knowledge and understanding of the services and information that banks offer. This corresponds to the lack of adequate and full information the banks have on their clients.

Often businesspeople who have never applied for a credit complain about the terms and conditions offered by banks that they have learned by word of mouth, rather than direct experience with banks.

What are the underlining reasons for this mutual lack of trust?

8.3.1 SME operations are not transparent

As mentioned earlier, SMEs do not necessarily account for a significant part of their operations (this problem is reflected in details in Section 1.2).

On a larger scale, the absence of accurate information hampers the sector analyses performed by the banks and adversely affects their interest in working with this market segment. Thus, leading to another problem:

8.3.2 Banks do not actively conduct information campaigns targeting SMEs and entrepreneurs are insufficiently informed about the services banks offer

In many respects, the attractiveness of any bank service often stems from advertisements and promotional campaigns aimed at promoting the particular service.
Yet in-depth interviews demonstrate that entrepreneurs receive information about banking services from third parties and not as a result of the banks’ communications with the business community.

View from an entrepreneur:
“I personally have no experience working with a bank, but I heard from others and read in the press about the problems entrepreneurs have had who do work with banks. Only businesspeople with financing problems, which cannot be solved by any other direct means, go to the bank. As I’m capable of dealing with my finances and face no problems, I do not need to go to a bank.”

8.3.3 Credit bureaus bridge such confidence gaps
A credit bureau is an institution that collects information on the borrower’s credit history from creditors and from general sources. The bureau accumulates information on individual entrepreneurs and SMEs, such as payment history on previous credits (particularly defaulting payments) and information on court decisions and bankruptcies, and then makes a comprehensive credit report, which is sold to creditors.

Currently, there is only one credit registry and it does not meet the typical credit bureau standards. A number of limitations prevent the credit registry from expanding into a proper credit bureau:

a) The registry information is closed for the non-banking financial institutions
Currently, 96 non-banking credit institutions operate in Azerbaijan. The target market for these non-banking credit institutions includes small farmers, trade and service SMEs, and individual enterprises, which mostly produce consumer goods, i.e., the target group for these microcrediting institutions includes mainly SMEs of various sorts. Not having accurate credit information on borrowers causes the microcrediting organizations to introduce tougher requirements (e.g., higher interest rates, shorter terms) in order to mitigate risk.

b) Registry information does not offer a detailed analysis of the client
Unlike the registry, a credit bureau processes the information received: it generalizes, classifies, and sells clients credit reports (histories) to the banks. The registry services include only a small portion of the bureau’s possibilities.

Box 8.2 Examples of a successful credit bureau
Experience throughout the world demonstrates the variety of forms a credit bureau can take. In some countries, such as the U.S., Brazil, and Argentina, the majority of credit bureaus are private enterprises, functioning with the purpose of capitalizing from the information services provided. In addition there are some local credit bureaus, created by the trade chambers and associations as commercial institutions operating in these countries.
Box 8.2 Examples of a successful credit bureau (continue)

In Japan and in the majority of European countries, as a rule, credit bureaus are created as private companies, owned by a creditors’ consortium. In the United Kingdom there are two independent credit bureaus, fully independent from the lenders. In Finland and Belgium, credit bureaus are controlled or licensed by the governmental agencies.

Credit bureaus operating in Germany have formed a union of eight regional partnerships, which are independent in legal and economic relationships — the Common Credit Provision Protection Partnership (SCHUFA). Their owners and simultaneously partners are: commercial banks, savings banks, cooperative banks, as well as the firms offering credit cards, construction savings and mortgage banks, leasing partnerships, as well as consumer goods enterprises and equity investment funds, offering monetary or commodity credits for consumer goods to individuals.

In most countries, credit bureau databases are formed through years of hard work; in the U.S., Canada, Finland, and South Africa, credit bureaus began to function at the end of 19th and early 20th century. In other countries, such as Italy, credit bureaus were established only recently and are growing rapidly and in demand as a service. In some Latin American and Asian countries, credit bureaus are in the establishment stage, accumulating small volumes, primarily negative (defaulting) records; but these are the first steps on the way to integrating larger databases.

The volume of the information exchanged using the credit bureaus’ service is large. In the U.S., Belgium, Brazil, United Kingdom, Japan and Germany, the number of reports provided exceeds the population.

The protection of creditors rights is the basis for a functioning credit bureau. In countries with weak legislative and legal protection, borrowers can be dishonest and stop making loan payments, even while solvent. Therefore, legislative protection of creditors rights not only through the monitoring system using credit bureaus’ databases, but also through the judicial and arbitration system is essential in all countries. Some arbitration courts have been known to refuse a complaint from a creditor, if no attempt was made to obtain the borrower’s records from the credit bureau before the loan approval.

For the growth of SMEs, credit bureaus can play a crucial role. By increasing the volume of transactions, the database expands to include a multitude of different datasets received from creditors, as well as from the companies themselves, not only relating to the activity of the borrower, but on their financial standing, as well as about their other creditors, stockholders, and managers. Besides providing the standard reports on credit operations as a statistic risk-management, credit bureaus perform functions as rating agencies. The largest and oldest global agency is Dun & Bradstreet, which currently holds data on more than 48 million companies, 10 million of which are located in the U.S.

In addition to private credit bureaus, many countries have a state credit registration institution — Public Credit Registers (PCR). This institution was historically formed for registration of mortgages on real estate, later to be expanded to other types of leases. This too may be a valuable source of relevant data.

The main difference between a PCR and a credit bureau is that for the former, participation is mandatory, established by corresponding rules (except in Finland and Sri Lanka, where participation is voluntary). As this takes place, all information is standardized (for example, credits above an established level, issued for a defined time period) and is credit-focused rather than borrower focused.

In the majority of countries, PCRs are controlled by central banks. Exceptions are: Chile, Costa Rica, and Peru, where they operate under the banking supervision agency, as well as Finland, where management has been transferred to a private entity. Access to information is granted only to authorized employees of the central bank (primarily to support the database and to adhere to strict observance of confidentiality) and reports are provided to financial institutions.

Credit bureaus provide different types of reports on credit operations depending on the availability of the information on the potential borrower, credit types, and most important, the degree of details required by the creditor. The simplest report contains information on previous defaulted payments and bad loans — so called “black” or “negative” data. The most detailed reports - “white” or “positive” - contain complex information on assets and liabilities of the borrower, guarantees and debt structure according to the lending terms, his business, and, sometimes, family history. The report’s price depends on the degree of details provided. The basic report’s price is relatively low and fluctuates from $1 in the U.K. and U.S., to $2 in Italy, and $3 in Argentina. The most developed credit bureaus compile the borrowers’ credit ratings, based on their characteristics and credit history, as well as data for compiling statistical models, promote the use of financial instruments, help evaluate credit costs, and establish and regulate credit limits.

Experience shows that the exchange of information, which credit bureaus facilitate stimulates the expansion of the bank credit portfolio in relation to GDP by approximately 20 percent. In addition, credit risks are lowered significantly, and, correspondingly, provisions for bad loans decrease. Thus, increased access to financial information positively affects credit efficiency and as a result positively affects GDP growth and labor productivity.
8.4 Recommendations

The following solutions will make financing more accessible to entrepreneurs and reduce the cost of borrowing:

8.4.1 The banking sector must liberalize and develop to the point of being able to borrow for SME targeted financing

While this is a macroeconomic development policy matter, further liberalization and more flexible sector conditions that would enable banks to borrow in larger amounts will ultimately increase the volume of their lending to smaller businesses.

Expected Impact

The ability to tap into a larger pool of financial capital available at international markets would enable banks to lend at more favorable conditions to the SMEs:

- this would help reduce the interest charged to SME loans (currently at 24 percent per annum), eliminating the key reason for entrepreneurs’ dissatisfaction;
- larger financial resources would enable banks to expand the maturity periods and offer a longer grace period to their lending, which would also work toward meeting the clients’ needs.

8.4.2 Expand the National Entrepreneurship Fund’s operations

NEF, otherwise discussed in the SME Overview section of this publication, has an average loan size of $127,000. This appears to target larger entities than SMEs, since that amount size is the half of the annual turnover of SMEs and is more than three times greater than the annual turnover of IEs. Additionally, such subsidized funds need to be channeled in a transparent manner with equal conditions applying to all. The most feasible option exercised in similar developing economies was managing such public funds through the banking sector.

Expected impact

A transparent and well channeled funds may result in multiple positive effects:

a. A greater transparency and accountability toward the revolving fund;

b. NEF supports the development of the banking sector; and

c. NEF provides improved access to finance for SMEs.

8.4.3 Develop and implement the mechanisms so that SMEs can provide alternative collateral

Other countries’ experience shows that alongside subsidized credit line allocation, there are various mechanisms aimed at improving the borrowing conditions for entrepreneurs. Other options have been used to minimize risks for the banks while supporting entrepreneurial development.
**THE ITALIAN EXPERIENCE: CONFIDI**

Italian SMEs used to face a credit crunch problem, due to non-transparent financial reporting. The banks would frequently require SMEs to provide an amount as an individual collateral or security for the bank’s risk exposure. In order to provide the SMEs with a form of guarantee that would please the banks’ requirements, the business associations developed a new form of (partial) credit guarantee called CONFIDI (i.e., “shared crediting”).

The operating mechanism of CONFIDI call for provision of the credit insurance and the risk is proportionally distributed among its participants. Up to 50 percent of the credit risk encountered by the banks while lending for a project was covered. Every participant in the association would contribute to its functioning (typically 2-5 percent of the credit amount). CONFIDI provides a guarantee based on the following principles:

- **Dual “risk inspection”:** before each participant receives the guarantee, the firm is evaluated by CONFIDI, and then by the bank-creditor;
- **“Risk consolidation”:** CONFIDI services a large number of small borrowers, thus diversifying the risk portfolio.

**CONFIDI facts:** by the end of 2004, there were about 1,000 CONFIDIs in Italy. They provided guarantees in the amount of €7 billion ($8.8 billion) for credits totaling €20 billion ($25 billion), which consisted of about 12 percent of the entire crediting volume to SMEs.

**THE UZBEK EXPERIENCE: CREDIT INSURANCE**

Credit insurance is a widespread instrument for limiting credit risks, simplifying crediting for financial institutions. The creditor can insure a part of the credit with an insurance company, which facilitates the bank crediting process. The insurance company analyzes the project and evaluates the possibility of the risk at some conditions, i.e., the share of risk, as well as the price. The insurance covers up to 50 percent of the credit amount (40-50 percent on the average), and the premiums are 5-6 percent of the credit amount.

*Adapted from:* Business Environment in Tajikistan as seen by Small and Medium Enterprises, 2006, IFC.

### 8.4.4 Stimulate a general education campaign on products and services offered by the banks

Despite the rise in the total number of the lending institutions in Azerbaijan, the credit portfolio does not correspond to the institutional trend. Moreover, the study points to a profound lack of mutual understanding and information sharing between the banks and the intended clients, i.e., to a poor marketing strategy. This is partly an underlying cause for the low lending rate.

**Chart 8.13**

<table>
<thead>
<tr>
<th>Share of enterprises who had problems with financing that applied for a loan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Apply</strong></td>
</tr>
<tr>
<td>21%</td>
</tr>
</tbody>
</table>

**Did the enterprises facing problems with financing accessibility, apply for the credit or credit line**
The charts above confirm that the entrepreneurs who find the lending terms restrictive and expensive are at the same time often the very persons who never approached a bank to borrow money.

The awareness campaign should thus go beyond an individual bank’s commercials and must be focused on preparing a database that will offer comparative lending terms, which are widely disseminated to the business community – through business associations, for example. A collective effort is required with some leadership from the relevant state authorities to bridge the communication gap between the two economic sectors. Internet portals, booklets, specialized publications, and outreach to the business community though the daily media are the usual means of communicating economic reforms globally.

In addition, individual banks should be encouraged to undertake market research and investigate their client profiles, including potential clients. Marketing activities of the banks are still in an embryonic stage and clearly insufficient. To that extent, the public sector may assist in organizing roundtables, seminars, trainings, and conferences that bring the two sectors together and help to build a lasting commercial relationship.

**Expected Impact**

All this will help increase the quality of service and client satisfaction, leading to further borrowing and a quicker turnover of the available credit funds, spurring greater economic activity for the SME sector.

Improved banking services will in turn result in SMEs maintaining cleaner records and operations, which adds to better tax compliance and improved revenues for the public sector – a “win-win” strategy for every stakeholder in this field.

**8.4.5 Set up a credit bureau**

The country should move away from the incomplete state-run registers and move towards setting up a full-scale, ideally privately managed credit bureau that would include all the financial institutions.

**Expected Impact**

Implementation of the proposed measures will help promote in the medium and long-run:

- Increase in the total volume of credit to SMEs;
- Real growth in number and turnover of SMEs;
- Improved conditions for financing, including: lower interest rates, longer maturity periods, introduction of grace periods, and lessening of collateral requirements.
9. Foreign Trade

The volume of foreign trade in Azerbaijan has increased over the first five months of 2008 in comparison with the same period in 2007 by almost 70 percent in export transactions and 23 percent in imports. However, the recent statistical data provided by the State Customs Committee shows that the role of SMEs in export transactions has decreased by 5 percent, while the volume of import transactions with SMEs participation has increased 8 percent. According to the same source, oil and oil products constituted 98 percent (94 percent crude oil) of Azerbaijani exports in 2008, which indicates that Azerbaijani exports are structured around one single product; furthermore, Azerbaijan exports the raw material so it receives insignificant gain from processing the oil.

Main Findings

- 66 percent of individual entrepreneurs and 38 percent of SMEs consider import procedures as problematic;
- According to the State Customs Committee statistics, 94 percent of exports within the first 8 months of 2008 consisted of crude oil;
- Only 2 percent of the survey respondents have carried out export transactions, and 8 percent have carried out import transactions;
- Mainly larger companies are engaged in foreign trade.

The share of the private sector’s involvement in export transactions is considerably low compared to the public sector. In contrast to export transactions, import operations are mainly managed by the private sector.

Despite recent reforms in foreign trade, import and export procedures still need to be improved to encourage engagement of more entrepreneurs. Legal analysis and in depth interviews in fact show that in order to carry out certain import/export transactions, entrepreneurs have to go through a complicated process of gathering numerous documents and dealing with various government agencies. Also, administrative barriers within the supervisory agencies further complicate the overall problems faced by entrepreneurs in import/export transactions.

In Azerbaijan, tariffs on raw materials and semi-processed products (9 percent) are higher than on fully processed products (8 percent). Compliant businesses are required to pay VAT and other customs payments on imported goods as they pass Azerbaijani customs territory no matter when the imported goods (raw materials and semi-processed products) are intended to be used. Since (1) there is no effective procedure to reclaim the duties paid and VAT rebate is very complicated, and (2) no bonded warehouses are available for the temporary storage of imported goods, the majority of businesses balk at using imported raw materials and semi-processed products in their production, since the output is likely to be more expensive than the imported fully processed goods of the same type. As a consequence, compliant businesses have very strong disincentives to engage in foreign trade.

9.1 Foreign trade: the legal framework

Efficient import/export procedures are critical to facilitating trade and creating an enabling environment for the economic development of the country. If customs policy does not maintain equal treatment, significant economic damage and distortions can occur in the domestic market, driving honest and compliant traders out of business. Customs regulation must ensure that export/import tariffs are applied consistently and uniformly to all traders to prevent economic distortions.

To achieve this, Azerbaijan has adopted more than 30 legal acts so far to regulate foreign trade operations and payment of customs duties, tariffs and fees. The principal legal acts establishing Azerbaijani foreign trade regime are enlisted in Annex 9.1.

The Customs Code, the main document in the regulation of customs issues, sets forth the rules for customs clearance, levying customs duties, passage of goods and vehicles through customs borders, customs control and customs policy, and designates customs authorities, delineates the rights and obligations of customs authorities and persons using customs borders, and regulates other fundamental issues related to customs operations.

Under the Customs Code an importer may choose one of the 15 customs regimes listed in Box 9.1, and may any time switch to another regime if the nature, quantity, origin, and destination of goods allow. However, the Customs Code fails to provide clear and comprehensible guidelines on the application of customs regimes (See Box 9.1).

The free trade regime is the most prevalently used customs regime. It is applied for importation of goods on the basis of agreements. Under this regime an importer of goods has no obligation to move the goods out of country in the future, and it is required to pay all other taxes, duties, and other customs payments.

Bonded or customs warehouses are used for the temporary storage of imported goods where, during the term of storage, no customs duties or taxes are paid. Although the Customs Code provides for the establishment of bonded warehouses, according to a verbal inquiry with the Customs Committee, no bonded warehouses have been established so far.
Box 9.1 **Customs regimes under the Customs Code**

1. Free trade (imports);
2. Re-import;
3. Goods in transit;
4. Bonded warehouse;
5. Duty-free shop;
6. Processing within a customs area;
7. Processing under customs’ control;
8. Temporary import (export);
9. Customs free zone;
10. Free warehouse;
11. Processing outside a customs area;
12. Export;
13. Re-export;
14. Disposal by destruction; and
15. Release in favor of the state.

As the list of legal acts above indicates, regulation of many important issues related to customs operations not regulated by the Customs Code is diffused among the numerous other legal acts enacted on the basis of the Customs Code.

The Decree on Foreign Trade is one of the most important of such legal acts. This decree ratified the rules on regulation of import/export transactions in Azerbaijan. Under the Decree on Foreign Trade, the residents are free to export goods produced, manufactured or re-manufactured in Azerbaijan subject to certain restrictions provided by the decree. All the goods (except goods that can be exported upon the approval of the Cabinet of Ministers, or in the cases when an export contract shall be registered with MED) produced, manufactured, or re-manufactured in Azerbaijan must be exported with a customs declaration. These rules also establish that contracts on import transactions concluded by residents on their own account, by way of consignment or on credit without state guarantee (except goods, such as weapons and nuclear materials, which can be imported or exported with the appropriate approval of the Cabinet of Ministers, or in cases when an export contract should be registered with MED) must be performed with a customs declaration.

Furthermore, the Decree on Foreign Trade provides for the list of goods that can be imported or exported upon approval from the authorities designated by the decree. However, the decree is not sufficiently elaborate on the grounds for refusal to issue such approvals, leaving much discretion to government officials and reducing the certainty on the side of entrepreneurs.
Foreign trade with certain category of goods is subject to specific requirements established by special laws. For example, the law on Export Control sets up basic rules for carrying out state control over import and export of goods for civil, military, and other purposes enlisted by the law as goods under export control. The law requires obtaining a special permit to export, re-export, import, re-import, and transit such goods. Pursuant to Resolution No. 230 of the Cabinet of Ministers on Amendments to Certain Legal Acts in Connection with the Implementation of the Law on Export Control dated December 15, 2005, residents are required to obtain a special permit to export and import goods under export control for civil and military purposes. According to the Decree on Foodstuffs, foodstuffs exported to the EU countries are subject to quality certification.

As observed from the number of legal acts, customs legislation is still dispersed throughout different forms of laws and decrees and unclear in certain aspects, and, therefore, further streamlining and unification may create much certainty in this area.

9.2 The role of individual entrepreneurs and SMEs in foreign trade

Participation of small and medium businesses in foreign trade should be fostered, since on the export side it might facilitate the transformation of the export structure from raw materials to processed goods, while on the import side it might reduce entry constraints into the Azerbaijani markets of goods otherwise unavailable, or available in limited quantity and quality.

Notwithstanding the government reforms aimed at facilitation and liberalization of foreign trade, IFC survey results indicate that the contribution of SMEs and IEs to foreign trade still remains considerably low.

![Chart 9.1: IFC Survey: Percentages of IE’s and SME’s that have not conducted import and export operations during 12 months](chart.png)

- Exported: 2%
- No export: 98%
- Imported: 8%
- No import: 92%
As Chart 9.1 illustrates, 98 percent of individual entrepreneurs and SMEs have not conducted any export transactions, and 92 percent have not engaged in import operations.

The majority of individual entrepreneurs and SMEs do not even find it necessary to be involved in import/export operations, as they believe that operating domestically can earn as much profit as they may gain from import/export operations. However, a much smaller group of individual entrepreneurs and SMEs indicates that the complicated import/export and customs clearance procedures are the reasons for not getting involved in foreign trade operations. Taking into account that the complexity of import/export procedures is the main cost factor of engaging in foreign trade, we may conclude that this is the major contributing factor making import/export operations unattractive for the majority of entrepreneurs.

The situation might well testify to higher market concentration due to economies of scale that larger firms are able to achieve, but it might also reflect the fact that only a limited number of selected exporters (mainly larger SMEs) have a well-developed knowledge of administrative procedures and influential connections that are necessary for successful conduction of foreign trade.

However, the participation of SMEs in import operations is higher, albeit insignificantly, than in export operations, which is to a large extent demand-driven, since there is a high demand for imported goods that cannot be satisfied by a small number of larger importers. Although import penetration of SME is expanding, the trade remains largely restricted to fewer large players so far as official statistics demonstrate this.

According to the survey, the majority of SMEs that have conducted import operations during the last 12 months are involved mainly in community, social, and personal services (16 percent) and wholesale trade and retail trade (11 percent) (See Chart 9.2).

View from an entrepreneur:

“To have the necessary documents issued for import, one should not wait and see what customs authorities will say; they will find a problem regardless. You should engage with all agencies involved to ensure the process flows smoothly.”
As revealed by IFC survey, low participation of individual entrepreneurs and SMEs in foreign trade is mainly due to the complexity of import/export procedures. More specifically, bureaucratic maze and corruption stemming from: complex and changing customs legislation, excessive bureaucracy, arbitrary customs decisions, import and export restrictions, lack of financial resources and difficulties in access to existing finance add to the cost of trade and create major concerns and barriers for individual entrepreneurs and SMEs to engage in foreign trade.

9.2.1 Import and export procedures need further streamlining to encourage the participation of individual entrepreneurs and SMEs in foreign trade


According to the IFC survey, import/export procedures in Azerbaijan were considered to be one of the three most complicated set of procedures. Survey respondents indicate that it takes four to five days on average until their imported goods are cleared from a customs point and an additional one to three days is needed to export (See Table 9.1).
Table 9.1 A comparison of the procedures necessary to import and export standardized cargo of goods in Azerbaijan and Georgia

<table>
<thead>
<tr>
<th>Nature of Export Procedures (2008)</th>
<th>Duration (days)</th>
<th>Cost (in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Azerbaijan</td>
<td>Georgia</td>
</tr>
<tr>
<td>Document preparation</td>
<td>28 5</td>
<td>150 255</td>
</tr>
<tr>
<td>Customs clearance and technical control</td>
<td>7 2</td>
<td>250 140</td>
</tr>
<tr>
<td>Ports and terminal handling</td>
<td>5 2</td>
<td>375 235</td>
</tr>
<tr>
<td>Inland transportation and handling</td>
<td>8 3</td>
<td>2,300 750</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>48 12</strong></td>
<td><strong>3,075 1,380</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nature of Import Procedures (2008)</th>
<th>Duration (days)</th>
<th>Cost (in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Azerbaijan</td>
<td>Georgia</td>
</tr>
<tr>
<td>Document preparation</td>
<td>28 8</td>
<td>170 255</td>
</tr>
<tr>
<td>Customs clearance and technical control</td>
<td>8 2</td>
<td>275 150</td>
</tr>
<tr>
<td>Ports and terminal handling</td>
<td>6 2</td>
<td>375 235</td>
</tr>
<tr>
<td>Inland transportation and handling</td>
<td>14 2</td>
<td>2,600 700</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>56 14</strong></td>
<td><strong>3,420 1,340</strong></td>
</tr>
</tbody>
</table>


In fact, to fulfill an import or export operation, an entrepreneur needs to complete overly complicated procedures, obtain numerous documents, and visit/contact various state agencies. For example, pursuant to chapter VI of the Decree on Foreign Trade, in order to complete the customs declaration procedure (and formalize an export transaction), an entrepreneur is required to submit the following documents to the customs authorities: (1) the code issued by the State Statistic Committee; (2) an export contract signed with foreign entities; (3) documents evidencing origin of exported items; (4) documents evidencing prepayment of exported items or letter of credit issued by the relevant bank; (5) in cases provided for by the decree, approval of the Cabinet of Ministers or positive opinion of MED; (6) customs cargo declaration; and (7) in case of exportation of sea food from Azerbaijan to the EU countries, a quality certificate.

To perceive the real difficulty of this procedure, it is necessary to take into account that for obtaining each of these documents, an entrepreneur needs to file other documents with other authorities, which is often time consuming and costly.

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55 As a result of application of “one stop shop” to corporate registrations, the State Statistics Committee no longer issues certificate on registration of an entity. Instead, the registration number assigned to an entity by the Ministry of Taxes substitutes for the statistics code previously issued by the Statistics Committee. Therefore, the enlisting of this document in the rules appears to be obsolete, and is expected to soon be amended to reflect the current situation.
Moreover, import and export of certain group of products, such as construction services, legal consultancy services, is subject to approvals by various authorities, which creates further complications for SMEs involved in import/export activities and exclude the majority of SMEs. Such approvals can be justified with respect to certain goods, such as pharmaceuticals, veterinary articles, and even some construction services, given the apparent associated risk to life and property of consumers. However, this requirement seems excessive or overregulated with respect to a significant portion of goods and services, as the risks associated with them are not substantial.

As evident from the analysis above, Azerbaijan needs to simplify further the procedure for export and import if it hopes to boost foreign trade, which is central to economic growth of every country.

### 9.2.2 Technical regulation is complicated

The Azerbaijani system of standardization and certification represents another serious constraint to foreign trade operations of entrepreneurs as in-depth interviews and legal analysis reveals.

On the one hand, exported goods need to be in compliance with international standards to be competitive internationally, as Azerbaijani national standards are not recognized in the international markets. On the other hand, since Azerbaijani law requires exported and imported goods to comply with national standards as well, entrepreneurs have to bother with double certification, which increases time and costs spent.

On the import side, Azerbaijani law requires that internationally certified goods be submitted to Azerbaijani standardization authorities for domestic recognition, which, again, creates double certification, adding to the complexity of foreign trade procedures. Consequently, even the products marked with international markings of conformity, such as the “CE” marking originating in OECD countries need to pass complicated conformity assessment process.

In Azerbaijan, the authority in charge of standardization, the Agency for Standardization, Metrology and Patent (the “Standardization Agency”), also issues certificates of compliance for products and services, as well as certificates authorizing the use of marks of conformity. More effective would be if these functions are delegated to different authorities. Moreover, some other state agencies also issue certificates that in most cases duplicate the certificates issued by the Standardization Agency (see Box 9.2).

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**Box 9.2 Certification and standardization**

Standardization and certification are two processes within a system aimed at ensuring both product quality and safety of the consumer, which should be divided and considered separately. Standardization refers to the establishment of a range of voluntary norms and requirements for products with mandatory requirements set forth in technical regulations. Certification is a process, whereby the state authorities should verify the compliance of products with the established norms, rules, and standards and document it in the form of certificates. In order to avoid conflict of interest, these two functions are usually separated and delegated to different bodies: standards are issued by special state agencies, while certification is conducted by independent authorized institutions.
The comprehensive system of mandatory standards dating back to the Soviet Union has been largely retained in Azerbaijan. Unfortunately, the current system is extremely costly to administer and maintain up-to-date, and represents a serious obstacle to foreign trade, as it is not always recognized by other countries. In addition, Azerbaijan is currently unable to administer the complex and demanding standards system properly, which requires well-equipped laboratories, a highly qualified staff, and effective enforcement capacity. Although the present system of standards is applicable indiscriminately to domestic and foreign producers, the concern might be raised that the present system fails the WTO requirement of being ‘least trade restrictive’. In comparison with EU requirements, whereby only 4 percent of the commodity list is subject to compulsory certification, Azerbaijani standardization and certification system is overreaching and in certain areas creates more inefficiencies than efficiencies both for government and businesses (see Box 9.3).

Box 9.3 Azerbaijani certification requirements are overreaching

According to the list of goods subject to mandatory certification approved by Resolution No. 343 of the Cabinet of Ministers on Implementation of Certification of Products and Services dated July 1993, all the foodstuff are subject to mandatory certification. This includes certificate of compliance with the state standards issued by the State Agency for Standardization, Metrology and Patent and hygiene certificate issued by the Ministry of Health for all products; phytosanitary, and veterinary certificate from the Ministry of Agriculture, where applicable.

Generally, the lists of goods subject to mandatory certification were enacted in 1993 and have not been amended since. The lists were drawn irrespective of the risk associated with these products, and do not follow clear rules in classifying the goods, thus subjecting the entire categories of goods, such as furniture, seafood, etc., to mandatory certification rather than focusing only on very specific products.

In a market economy, it is usually in the interest of the producers to comply with the set standards, which enables them to do business with larger companies requiring minimum standard levels. Knowledgeable consumers then have a choice to decide between certified and non-certified products, automatically leading producers to self-certification of their products.

Also the requirement that each consignment of products must be certified appears to have no rationale other than creating an additional burden for individual entrepreneurs and SMEs. IFC survey findings indicate that 42 percent of individual entrepreneurs and 60 percent of SMEs were required to submit each consignment of products for certification.

Box 9.4 Example of risk-based technical regulation adopted in the European Union56

The system of technical regulation of the European Union is closely linked to risk assessment, where the state develops necessary manufacturing standards based on the risk level. An example for such regulation is Directive 89/109/EEC, which sets basic safety requirements for equipment manufacture. All safety requirements in this document are grouped according to risk level. According to this document, the manufacturer should conduct risk assessment of equipment application to identify all possible risk factors, and introduce the necessary manufacture changes accordingly. This directive also provides risk reduction guidelines.

There also appears to be a serious gap between the strictness and a number of certification requirements on paper and the implementation capacity of certification agencies. Realistically, the gap needs to be closed at both ends. Implementation capacity of the relevant services and their labs needs to be strengthened, while requirements need to be reduced and focused on areas with serious health and safety concerns. Additionally, a risk-based approach, which is widely used in the European Union, could be applied in Azerbaijan (see Box 9.4).

The certification process is made even more complicated by the fact that entrepreneurs have difficulty in obtaining information on new or existing requirements from state agencies. For instance, the texts of national standards on the basis by which certification is carried out are not publicly available and may only be obtained (with a great deal of difficulty) from the Standardization Agency and some other agencies involved in dealing with certification. As a result of the numerous compulsory requirements, the majority of entrepreneurs use unofficial ways to obtain a certificate. According to the IFC survey, 31 percent of individual entrepreneurs and 64 percent of SME participants indicated that they used unofficial ways to have certificates issued.

**View from an entrepreneur:**

“If you want to work lawfully, you must deal with officials that are likely to find issues. As a result you lose time and money and eventually have to come to an agreement with that official anyway. Therefore, it is far more convenient to do it via the informal way.”

Regulation of the official cost of certification is not uniform, leaving certification authorities with the discretion to set the fees. According to IFC survey findings, entrepreneurs spent an average 11 days and 258 Azerbaijani manats ($320) to obtain one certificate. In addition, on average a certificate is valid only 19 months, which means the entrepreneurs have to go through the certification procedure every 2 years.

### 9.3 Main difficulties faced by IEs and SMEs in importing

While few businesses participate in foreign trade, the survey results showed that about 66 percent of IEs and 38 percent of SMEs consider import procedures as problematic. The main problems entrepreneurs face in importing are difficulties related to transportation, high customs tariffs, bureaucracy in customs authorities (inviting to pay unofficial payments), and unclear customs value assessment methods. Survey respondents believe that various types of administrative barriers and excess bureaucracy together make up the third major problem faced by entrepreneurs in importing (see Chart 9.3).
Table 9.2 *Average costs for imports*

<table>
<thead>
<tr>
<th>Actions</th>
<th>Average official expenses</th>
<th>Average additional expenses</th>
<th>General expenses as a percentage of import value (average)</th>
<th>Duration: average number of days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certificate from the State Service for Control over the Consumer Market under MED</td>
<td>1229 AZN $1520</td>
<td>260 AZN $321</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Standardization Authorities</td>
<td>100</td>
<td>125</td>
<td>700</td>
<td>865</td>
</tr>
<tr>
<td>Licenses for Import</td>
<td>700</td>
<td>865</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Permits for Import</td>
<td>1332</td>
<td>1645</td>
<td>2887</td>
<td>3564</td>
</tr>
<tr>
<td>Customs Clearance</td>
<td>7417</td>
<td>9160</td>
<td>1527</td>
<td>1885</td>
</tr>
<tr>
<td>Import Tariffs</td>
<td>21678</td>
<td>26763</td>
<td>9000</td>
<td>11111</td>
</tr>
<tr>
<td>VAT</td>
<td>52257</td>
<td>64515</td>
<td>500</td>
<td>617</td>
</tr>
<tr>
<td>Sanitary Control</td>
<td>505</td>
<td>623</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Transportation Costs</td>
<td>4392</td>
<td>5422</td>
<td>334</td>
<td>412</td>
</tr>
<tr>
<td>Customs Warehousing</td>
<td>270</td>
<td>333</td>
<td>600</td>
<td>741</td>
</tr>
<tr>
<td>Expenses incurred making payments for customs duties</td>
<td>-</td>
<td>-</td>
<td>418</td>
<td>516</td>
</tr>
</tbody>
</table>

While few businesses participate in foreign trade, the survey results showed that about 66 percent of IEs and 38 percent of SMEs consider import procedures as problematic. The main problems entrepreneurs face in importing are difficulties related to transportation, high customs tariffs, bureaucracy in customs authorities, and unclear customs value assessment methods. Survey respondents believe that corruption, bureaucracy, and overreaching powers granted to state authorities together make up the third major problem faced by entrepreneurs in importing. These may be regarded as the main source of other problems associated with imports (see Chart 9.3).

*These figures should be treated with caution as they are based on a small sample of survey respondents.*
9.3.1 Transportation of imported goods is the number one problem in importing

As the IFC survey shows, one of the main difficulties faced by entrepreneurs in importing is associated with the transportation of goods. While transporting, entrepreneurs pass through a score of controls by border officials.

One of the major issues in import operations is high transportation cost. In Azerbaijan, railways are often used to transport the imported/exported goods (see Chart 9.4), yet 45 percent of the respondents indicated railway control as a major problem in importing (see Chart 9.3). In light of this fact, it appears that the costs incurred by entrepreneurs during railway transportation are one of the largest contributors to the overall costs of transportation of their goods. As seen in Table 9.2 above, an entrepreneur spends on average 4,392 Azerbaijani manats ($5,422) for official payments and 334 Azerbaijani manats ($412) for related costs, including unofficial payments, which make up 8 percent of the overall import value. However, as the Azerbaijani railway service is not yet meeting international standards, delays and improper handling of goods may result in additional costs.

9.3.2 High costs associated with foreign trade is the second most serious problem in importing

The highest official expenses incurred by entrepreneurs for imports arise due to VAT payments, import tariffs, fees for customs clearance and transportation costs, followed by considerably lower costs associated with obtaining import permits, certificates, passing sanitary control, and fees for storage of goods in customs warehouses (for customs payments see Box 9.5).

During the imports of goods, entrepreneurs also have to make other additional payments, which, in certain cases, may significantly add to the costs (see Table 9.2 above). Such additional expenses also arise in connection with obtaining import approvals, in customs clearance, in dealing with standardization bodies, in paying fees for storage of goods in customs warehouses, in regard to VAT and transfer of money for the payment of customs duties, transportation costs, and other costs.
The customs clearance procedure may also prove to be burdensome for IEs and SMEs. When the procedures are carried out outside of normal working hours, the custom clearance payments are more expensive (doubled). For certain types of goods there may be different rates of duty depending on the season of the year (see Box 9.6).

Although Azerbaijani law provides for exemptions to the payment of custom duties for importation of certain categories of goods, these exemptions as a rule do not benefit smaller firms as they mainly relate to petroleum operations of state enterprises (see Box 9.7).

**Box 9.5 Customs payments**

The Customs Code distinguishes among the following types of payments to the customs authorities:

- Customs duties;
- VAT;
- Excise tax;
- Road tax;
- Fees for customs clearance;
- Fees for the storage of goods;
- Fees for customs’ supervision of goods;
- Fees for the provision of information and consultation services;
- Fees for the issuance of a preliminary decision;
- Fees for participating in customs auctions;
- Other payments.

**Box 9.6 Customs clearance payments under the Customs Code**

The general rates for customs clearance depends on the cost of goods in (in Azerbaijani manat and US$):

- for goods with a value up to 1,000 ($1,235), the fee is 10 ($12);
- for goods with a value from 1,001 ($1,236) to 10,000 ($12,346), the fee is 50 ($62);
- for goods with a value from 10,001 ($12,347), to 100,000 ($123,457), the fee is 100 ($123);
- for goods with a value more than 100,001 ($123,458), the fee is 275 ($340).

**Box 9.7 Imports exempt from import duties:**

- goods imported for petroleum operations in connection with certain exploration, development, and production-sharing agreements, and transportation agreements related to hydrocarbons.
- equipment and materials imported into Azerbaijan for the production of passports and personal identification cards.
- goods imported using financial aid, loans, and technical grants of international organizations, foreign governments, and foreign persons in accordance with intergovernmental and international treaties of Azerbaijan.
- operations related to the transfer of fixed assets, movable or other property to the State Oil Fund pursuant to agreements on the exploration, development, and production sharing of hydrocarbons, export pipelines, and other similar arrangements entered into by Azerbaijan or legal entities representing Azerbaijan.
9.3.3 Economically unjust tariffs create strong incentives to incorrectly classify goods

Frequent misclassification (willful or negligent) of goods by entrepreneurs, as well as customs officials, is another problem associated with imports. The substantial differences among tariffs applied to similar/related goods may create incentives for entrepreneurs to classify their goods so that the customs burden is less than it should be. For example, there is significant variation in the import tariff rates for the IT and telecommunication industries, which not only distorts the allocation of resources and undermines growth, but also introduces a significant level of discretion for customs officials to classify products. The tendency is to classify IT products as telecommunication products, which are generally subject to a 15 percent tariff, while IT products have a 3 percent tariff. Another serious problem is the tariff structure for IT products, which encourages imports of finished products at the expense of components and spare parts. For example, the duty for personal computers is 3 percent but 10 percent for computer components, a significant disincentive for computer assembly businesses to operate in Azerbaijan. This is one example substantiating the distortions irrationally fixed tariffs may cause. In the light of these considerations, it is paramount that Azerbaijan’s tariff policy be revisited and further improved.

9.3.4 Long list of documents add to the burden of importing

Currently, to consummate an import transaction, an entrepreneur is required to submit 14 documents, 6 out of which appear to be redundant. The number of documents can be reduced to 8, leaving the italicized documents in plain text format in Box 9.9.

The documents indicated as redundant in Box 9.9 neither generate information of particular relevance, nor provide the trader with a document that may assist their cause. For instance, the certificate of origin is of relevance to customs authorities only for statistical purposes, as long as imports are not subject to preferential tariff treatment: it is in the interest of an importer to obtain it because otherwise he/she will incur extra payments for duties. However, according to the best international practice, the number of documents must be limited to bill of landing, commercial invoice, and customs import declaration.

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Box 9.8 An excessive number of documents are required for imports

Requirement for 6 out of 14 documents cannot be justified. The titles of redundant documents are in bold italics.

1. Bill of lading (freight);
2. Cargo release order;
3. Certificate of origin;
4. Commercial invoice;
5. Contract with supplier;
6. Customs import declaration;
7. Customs transit document;
8. Import license;
9. Packing list;
10. Shipping invoice;
11. Tax certificate;
12. Technical standard/health certificate;
13. Terminal handling receipts; and

Chart 9.5
The main difficulties faced by IEs and SMEs in exporting (%)*

* These figures should be treated with caution as they are based on small sample of survey respondents.
9.4 Key difficulties faced by exporting SMEs

The IFC survey shows that about 51 percent of individual entrepreneurs and SMEs engaged in exports consider export procedures as problematic. In particular, bureaucracy in customs authorities, payment of customs tariffs, and complicated customs procedures were mentioned as the main obstacles in exportation (See Chart 9.5).

In addition to the above, official and unofficial expenses made by SMEs increase the cost of exporting and discourage smaller businesses from engaging in export operations.

According to the survey, the highest official expenses made by SMEs while exporting arise for payment of export tariffs, fees for custom clearance and transportation costs, followed with general expenses and costs associated with obtaining of export licenses (See Table 9.3). However, SMEs also must make other additional expenses while paying for customs clearance, besides the export tariffs and transportation costs. Remaining costs in exporting arise in obtaining compliance and quality certificates from the state authorities in charge of certification and standardization, obtaining a transaction passport and passing the sanitary control.

### Table 9.3 Average costs for exports

<table>
<thead>
<tr>
<th>Actions</th>
<th>Average official expenses</th>
<th>Average additional expenses</th>
<th>General expenses as a percentage of export value (average)</th>
<th>Duration: average number of days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certificate from the State Service for Control over the Consumer Market under MED</td>
<td>357 AZN 441 $</td>
<td></td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Standardization authorities</td>
<td>200 AZN 247 $</td>
<td></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Licenses for export</td>
<td>1400 AZN 1728 $</td>
<td></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Customs clearance</td>
<td>2890 AZN 3568 $</td>
<td>2058 AZN 1667 $</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Export tariffs</td>
<td>3222 AZN 3978 $</td>
<td>1900 AZN 1539 $</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Obtaining transaction passport</td>
<td>300 AZN 370 $</td>
<td></td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>Sanitary control</td>
<td>288 AZN 356 $</td>
<td></td>
<td>15</td>
<td>6</td>
</tr>
<tr>
<td>Transportation costs</td>
<td>2664 AZN 3289 $</td>
<td>1590 AZN 1288 $</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Miscellaneous expenses</td>
<td>2000 AZN 2469 $</td>
<td>1940 AZN 1571 $</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Customs warehousing</td>
<td>270 AZN 333 $</td>
<td>600 AZN 0 $</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Expenses incurred making payments for customs duties</td>
<td>- AZN 418 $</td>
<td></td>
<td>27</td>
<td>5</td>
</tr>
</tbody>
</table>
Moreover, due to the underdeveloped production industry, Azerbaijani exports mainly consist of raw materials and semi-processed goods. Smaller firms face many constraints that prevent them from competing effectively in other markets: the lack of necessary knowledge and financing, the inability to meet foreign regulatory requirements, and inadequate quantity and quality of products for foreign buyers. The administrative problems faced when exporting are similar to those of imports.

Currently, to complete an export an entrepreneur is required to submit nine documents, four of which seem excessive. The number of documents should be reduced to five, limiting it only to the documents in plain text format in Box 9.10. However, according to best international practice, the number of documents should be limited to the bill of lading and commercial invoice only.58

As described above for imports, export documents should not be mandatory, as in many cases it is in the exporter’s own best interest to possess certain documents. An exporter will obtain a certificate of origin if his destination offers preferential access for Azerbaijani products. Similarly, an exporter whose shipment goes beyond Georgia, Turkey, or Iran will undergo any procedure to secure a transit document. The sales contract required for export may also be excessive given that a commercial invoice is required. A customs transit document should not be required at all in that case. But if it is a compulsory document, as it is in Azerbaijan or Armenia (however, not in Georgia), then a requirement to also submit a transit document appears excessive59.

The export of goods requires approval of MED, in addition to approval of the designated authorities or license; to obtain these approvals dozens of other documents must be provided. A country that experiences low foreign trade volumes and that wants to encourage the export of fully processed goods should stimulate exports through institutional help and less restrictive legislation. For step-by-step illustration of export procedure see Chart 9.6.

Box 9.9 An excessive number of documents are required for exports. Requirements for 4 out of 9 documents cannot be justified. The titles of redundant documents are italicized

| Requirements for 4 out of 9 documents cannot be justified. The titles of redundant documents are in bold italics. |
| 1. Bill of lading (freight); |
| **2. Certificate of origin;** |
| 3. Commercial invoice; |
| 4. Customs export declaration; |
| 5. Export license; |
| 6. Packing list; |
| **7. Power of attorney;** |
| 8. Selling contract; and |
| **9. Transit document.** |

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9.5 Recommendations

9.5.1 Simplification, unification, and proper dissemination of customs legislation by:

- Unifying the numerous legislative acts regulating export and import issues in the Customs Code;
- Improving the structure and language of the Customs Code and filling in the gaps in the customs legislation; and
- Development and dissemination by customs authorities of a binding summary of import/export procedures, the required paperwork, costs, and time periods for each step.

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Standardized cargo of goods means any type of goods that is not subject to approval of the Cabinet of Ministers for export, or goods that can be exported without registering the export contract with MED. The lists of these goods are provided in the Decree on Foreign Trade.
Expected impact
More comprehensible legislation will increase the legal awareness and compliance of entrepreneurs and reduce their costs.

9.5.2 Simplification of export procedures by:
- Eliminating the requirement of full advance payment in exports where applicable;
- Reducing the number of documents required for exporting;
- Reducing the number of state authorities involved in exporting;
- Eliminating double certification by allowing export of goods having internationally recognized certificates; and
- Increasing accountability of customs and railway service officials to eliminate the cases of bribery.

Expected impact
These measures will lead to the increase in the volume of exports and decrease in the cost of exporting; therefore, higher income for exporters and more revenues for the national economy. Possibility to export with international certificates (certificates of conformity, quality certificates, etc.) will encourage exporters to obtain such certificates for their goods, which will increase acceptance of Azerbaijani goods in foreign markets.

9.5.3 Simplification of import procedures by:
- Reducing the number of documents required for importing and introducing acceptance of faxed import documents in accordance with international practices;
- Reducing the number of state authorities involved in importing;
- Eliminating the requirement for conformity assessment on products market with international markings of conformity such as the “CE” marking originating in OECD countries;
- Encouraging the establishment of bonded warehouses; and
- Increasing accountability of customs and railway service officials to eliminate the cases of bribery.

Expected impact
As a result of less costly and less complicated import procedures, smaller businesses can engage in imports, which will benefit all, especially consumers, by supplying diverse and quality products for lower prices. Application of more transparent rules in conformity assessment may eliminate some rent seeking practices.
9.5.4 Removal of the barriers to foreign trade related to technical regulation (standardization and certification) by:

- Separating the standardization and certification functions;
- Reviewing the list of standards and abolish the ones not necessary on the grounds of health and safety in a market economy;
- Considering the possibility to adopt international standards to avoid the ‘maintenance cost’ of the system;
- Applying the risk-based approach by determining which goods and services need to be certified in order to exclude non-risky categories and services from mandatory certification, while making the standardization of other goods voluntary;
- Shifting from end-product certification to process certification;
- Abolish the requirement that each consignment of products must be certified; and
- Creating internationally required laboratory facilities to certify Azerbaijani commodities according to internationally adopted standards to facilitate their export.

Expected impact

Reduction of the coverage of certification would result in additional cost savings for entrepreneurs. As a result of adoption of international standards “maintenance cost” for the authorities responsible for elaboration of standards would be reduced. Possibility to certify Azerbaijani commodities with internationally accepted standards would allow Azerbaijani exporters easier access to international markets. Process certification would allow identification of risky components at the early stages of product development and will thus increase efficiency of certification. Improvement of technical regulation will increase competitiveness of Azerbaijani goods and will create a possibility for entrepreneurs to market their products in compliance with international standards.

9.5.5 Rationalize customs tariff rates and other customs payments by:

- Approximating customs tariffs for similar type of goods, raw materials and fully-processed goods not to discourage import/export of any of them or introducing uniform tariff rate;
- Introducing uniform tariff rates for similar types of goods; and
- Eliminating VAT exemptions to avoid distortions it causes.

Expected impact

As a result of these reforms, possible distortions caused by excessive tariffs will be eliminated. Approximation of customs tariffs or establishment of a uniform tariff rate alongside the abolishment of VAT exemptions will reduce the incentives and ability of customs officials to trade between classes of goods or apply “preferential treatment” in exchange for unofficial payments. Moreover, these measures will also ease calculation of customs payments.
9.5.6 Accelerate WTO accession of Azerbaijan by bringing the legislation in line with WTO requirements and institutionalization of business participation in the WTO accession process

WTO accession will have substantial positive impact on the development of foreign trade in Azerbaijan by increasing foreign parties’ confidence in Azerbaijani businesses.

Annex 9.1 Main Legislative Acts Regulating Foreign Trade

- The Customs Code of 1997;
- Presidential Decree No. 609 On Further Liberalization of Foreign Trade in the Republic of Azerbaijan dated June 24, 1997 (hereinafter the “Decree on Foreign Trade”);
- Law No. 772-IQ On Export Control dated October 24, 2004 (hereinafter the “Law on Export Control”);
- Law On Customs Tariffs of 1995;
- Resolution of the Cabinet of Ministers No. 91 On Import-Export Duty Rates dated April 22, 1998;
- Resolution of the Cabinet of Ministers No. 11 On the List of Imported Goods Exempt from Value Added Tax dated January 31, 2005;
- Resolution of the Cabinet of Ministers No. 20 On Approval of Excise Tax Rates Applicable to Goods Imported into Azerbaijan dated January 19, 2001;
- Resolution of the Cabinet of Ministers, No. 80 On Import-Export Duty Rates and the Fees for Customs Clearance Operations dated April 12, 2001;
- Resolution of the Cabinet of Ministers No. 135 On Rules for Issuing Quality Certificates for Foodstuffs Exported to the EU Countries dated July 13, 2005;
- Resolution of the Cabinet of Ministers No. 185 On Stimulation of Export in Certain Business Activities dated July 26, 2006;
- Law No. 430-IQ On Culture dated February 6, 1998;
- Presidential Decree No. 782 On Improvement of Regulations of Issuing Special Permits (Licenses) for Certain Types of Activities dated September 2, 2002;
- Presidential Decree No. 218 On Regulation of Export of Foodstuffs to the EU Countries dated April 1, 2005 (“Decree on Foodstuffs”);
Chart 9.4
Goods exportable upon approval by certain state authorities

Wild animals and plants, especially those protected under the Convention on the Internal Trade of Endangered Species of Wild Fauna and Flora, raw materials extracted from wild animals and plants for the production of medicines (including snake poison); materials depleting the ozone layer

Ministry of Health

Wild animals and plants, especially those protected under the Convention on the Internal Trade of Endangered Species of Wild Fauna and Flora, raw materials extracted from wild animals and plants for the production of medicines (including snake poison); materials depleting the ozone layer

Ministry of Ecology and Natural Resources

Information about the location of natural resources and thermal energy

State Land and Cartography Committee

Phytogenous foodstuffs

Ministry of Economic Development

Controlled psychotropic substances

Ministry of Health

Works of art and antiques

Ministry of Culture and Tourism

Inventions, “know-how,” and results of scientific-research works

State Agency for Standardization, Metrology and Patents

Ministry of Health
Chart 9.5
Goods importable upon approval by certain state authorities:

- **Insecticides**
  - Ministry of Agriculture

- **Wild animals and plants under the Convention on the Internal Trade of Endangered Species of Wild Fauna and Flora**
  - Ministry of Ecology and Natural Resources

- **Veterinary drugs and substances**
  - State Veterinary Control

- **Medicines and medical equipment, including controlled psychotropic substances**
  - Ministry of Health

- **Construction related services**
  - State Committee for City Building and Architecture, Ministry of Emergency Situations, and Ministry of Ecology and Natural Resources

- **Transportation services, vehicle forwarding services**
  - State Railway Office, Caspian Shipping Company, State Civil Aviation Administration, Ministry of Transportation

- **Communication-related services**
  - Ministry of Communications and Technology

- **Advocacy and other legal services**
  - Ministry of Justice
Conclusion

The government of Azerbaijan has taken major steps in reforming the business environment in the last several years, passing the key laws and strengthening the related institutions, which all has streamlined the business registration, but also licensing system, property relations, investment protection, paying taxes and contract enforcement. All this resulted in a dramatic improvement in the IFC/World Bank Doing Business ranking, which now lists Azerbaijan as being the 33rd country in the world in terms of ease of doing business and also the top global reformer in the current year. While some of these enforcements and reforms immediately boiled down to the ultimate beneficiary – entrepreneurs – others may take a little longer for the effects to come to full fruition. Therefore, a number of other global comparative instruments, relying more on the business sector perception may not have echoed the sentiment of the Doing Business 2009 report.

Indeed, the SME survey conducted by IFC in late 2007 and early 2008 on a sample of almost 1,800 IEs and SMEs, as well as the in-depth interviews conducted with the private sector portray a picture of the numerous administrative procedures that remain overly complicated and costly. This is particularly true in the area of business permits and similar official authorizations, business inspections, taxation, etc., in which the official authorities have a significant role to play in terms of further modernization, simplification and reforms, but also access to finance, where the financial institutions must do better in acquainting themselves with the private sector, so that lending can be cheaper, faster, and better targeted.

The most cumbersome procedures remain business permits, where Azerbaijan is an infamous leader in the number of estimated permits (but also various other opinions, authorizations, approvals, etc.) required per each business, the costs associated with their issuance, and lack of clarity in respect of their duration. Business inspections too remain worrying: they are very frequent, the regulations of their conduct are non-transparent and sanctions are most often arbitrary, resulting in a demand and supply of unofficial payments. Taxation of commercial activities is insufficiently defined, leading to maintenance of dual accounting records for SME tax evasion. Reforming the policies, rates and the system, alongside further administrative simplification would strengthen the fiscal revenues and elevate the public and business trust in this important public authority.
Azerbaijan has been long pending a thorough review of its legislation: aimed at elimination of various duplications and overlaps, streamlining the outdated provisions and practices, and termination of all the non-market practices and incentives that have favored very few at the expense of developing many. The government indeed shows its inclination and often very specific steps and tools in tackling these in the long run, but the work must boil down from overarching strategies and concepts to the set of specific measures, including development targets and indicators demonstrating progress among the SMEs, similar to the business survey presented in this publication.

The recommendations laid out in this report have the potential for short-term effects and long-term impact for the business environment in Azerbaijan. IFC’s Azerbaijan Business Enabling Environment Project remains committed to working with the government of Azerbaijan to help enact these reforms.
References

List of Laws

5. Law No. 1064 on Customs Tariffs dated June 20, 1995.
10. Resolution of the Cabinet of Ministers No. 135 on Rules for Issuing Quality Certificates for Foodstuffs Exported to the EU Countries dated July 13, 2005.
13. Presidential Decree No. 782 on Improvement of Regulations for Issuing Special Permits (Licenses) for Certain Types of Activities dated September 2, 2002.
14. Presidential Decree No. 218 on Regulation of Export of Foodstuffs to the EU Countries dated April 1, 2005.
17. Law No. 560-IQ on State Registration and State Registry of Legal Entities dated February 7, 2008.
23. Law No. 883-IQ on Mortgages dated April 15, 2005.
27. Rules on issuance of permits for pacing advertisement. Approved by the President’s Decree dated November 3, 2001, No. 596.
28. Statute on placing and operation of advertisements within the territory of Baku City. Approved by the Decree of Baku City Mayor, dated September 6, 1999, No. 892.
Statistical Annexes
SME Overview

Chart A1.1
SMEs, by Type of Business
(% of respondents)

Chart A1.2
SMEs: Start-ups vs. Existing Businesses
(% of respondents)
Chart A1.3
**Individual Entrepreneurs, by Sectors of Activity** (% of respondents)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Respondents (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale Trade and retail trade</td>
<td>69%</td>
</tr>
<tr>
<td>Agriculture, hunting and forestry</td>
<td>2%</td>
</tr>
<tr>
<td>Repair of motor vehicles, household and personal goods</td>
<td>1%</td>
</tr>
<tr>
<td>Agro-processing</td>
<td>2%</td>
</tr>
<tr>
<td>Construction</td>
<td>0%</td>
</tr>
<tr>
<td>Other community, social and personal service activities</td>
<td>7%</td>
</tr>
<tr>
<td>Transport and storage</td>
<td>11%</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>6%</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>1%</td>
</tr>
<tr>
<td>Repair of motor vehicles, household and personal goods</td>
<td>1%</td>
</tr>
<tr>
<td>Mining</td>
<td>0%</td>
</tr>
<tr>
<td>Health and social work</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
</tr>
</tbody>
</table>

Chart A1.4
**Small and Medium Companies, by Sectors of Activity** (% of respondents)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Respondents (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale Trade and retail trade</td>
<td>28%</td>
</tr>
<tr>
<td>Agriculture, hunting and forestry</td>
<td>18%</td>
</tr>
<tr>
<td>Other community, social and personal service activities</td>
<td>15%</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>9%</td>
</tr>
<tr>
<td>Repair of motor vehicles, household and personal goods</td>
<td>7%</td>
</tr>
<tr>
<td>Construction</td>
<td>7%</td>
</tr>
<tr>
<td>Agro-processing</td>
<td>4%</td>
</tr>
<tr>
<td>Transport and storage</td>
<td>3%</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>3%</td>
</tr>
<tr>
<td>Health and social work</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>2%</td>
</tr>
<tr>
<td>Mining</td>
<td>1%</td>
</tr>
</tbody>
</table>
Chart A1.5
Breakdown of Individual Entrepreneurs by Regions (% of respondents)

Chart A1.6
Breakdown of Small and Medium Companies by Regions (% of respondents)
**Chart A1.7**

**Individual Entrepreneurs Where Key (Major) Owners of Business Include Women**

(\% of respondents)

- Key owners of business include women: 89% (11%)
- Key owners of business doesn’t include women: 11% (89%)

**Chart A1.8**

**Small and Medium Companies Where Key (Major) Owners of Business Include Women**

(\% of respondents)

- Key owners of business include women: 86% (14%)
- Key owners of business doesn’t include women: 14% (86%)

**Chart A1.9**

**Usage of Internet on a Daily Basis, by Type of Business**

(\% of respondents)

- No, we don’t use internet on daily basis:
  - Individual entrepreneurs: 9% (91%)
  - Small & Medium companies: 28% (72%)
- Yes, we use daily internet:
  - Individual entrepreneurs: 91% (9%)
  - Small & Medium companies: 72% (28%)

**Chart A1.10**

**Ownership Rights of Individual Entrepreneurs for the Following Resources**

(\% of respondents)

- Industrial premises
- Habitat premises/buildings used for business purposes
- Separate premises or buildings including incomplete constructions
- Land with buildings
- Land without construction buildings
- Land for agricultural purposes

*Note: The chart is not fully visible in the image.*
Chart A1.11
Ownership Rights of Small and Medium Companies for the Following Resources
(\% of respondents)

<table>
<thead>
<tr>
<th>Resource</th>
<th>Only owned</th>
<th>Only leased</th>
<th>Don’t have at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial premises</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Habitat premises/buildings used for business purposes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Separate premises or buildings including incomplete constructions</td>
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<td></td>
</tr>
<tr>
<td>Land with buildings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land without construction buildings</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Land for agricultural purposes</td>
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</tbody>
</table>

Chart A1.12
Estimation of Challenges in Procedures While Doing and Developing Business Activity (Individual entrepreneurs)
(\% of respondents who crossed the procedure)

<table>
<thead>
<tr>
<th>Challenge</th>
<th>0%</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
<th>25%</th>
<th>30%</th>
<th>35%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payment procedures (VAT system)</td>
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<tr>
<td>Compulsory certification procedures</td>
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<tr>
<td>Inspections by controlling authorities</td>
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<td>Business registration</td>
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<td>Tax payment procedures (VAT system)</td>
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<td></td>
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<tr>
<td>Obtaining licenses</td>
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<td></td>
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<tr>
<td>Obtaining permits and other permissive documentation</td>
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</tbody>
</table>

Chart A1.13
Small and Medium Companies; Estimation of Challenges in Procedures While Doing and Developing Business Activity
(\% of respondents who crossed the procedure)

<table>
<thead>
<tr>
<th>Challenge</th>
<th>0%</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
<th>25%</th>
<th>30%</th>
<th>35%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtaining licenses</td>
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<td>Obtaining permits and other permissive documentation</td>
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<tr>
<td>Business registration</td>
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<tr>
<td>Compulsory certification procedures</td>
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<tr>
<td>Tax payment procedures (VAT system)</td>
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<td></td>
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<tr>
<td>Tax payment procedures (Simplified system)</td>
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</tr>
</tbody>
</table>
Three Major Types of Obstacles for Business Development (Individual entrepreneurs) (% of respondents)

Access to financing (cost and obtaining) 72%
High tax rates 21%
Corruption 21%
Competitor’s activity in shady sectors 14%
Access to land (cost and obtaining) 13%
Licensing and business permits 10%
Tax regulatory 10%
Customs control 6%
Access to power supply (cost and obtaining) 6%
Other 14%

Small and Medium Enterprises; Three Major Types of Obstacles for Business Development (% of respondents)

Access to financing (cost and obtaining) 77%
High tax rates 18%
Access to land (cost and obtaining) 17%
Competitor’s activity in shady sectors 13%
Access to power supply (cost and obtaining) 11%
Corruption 10%
Licensing and business permits 5%
Customs control 4%
Access to transport infrastructure (cost and obtaining) 3%
Other 11%
Chart A1.16
Entrepreneurs View Concerning Some Issues Around Business Activity (Individual entrepreneurs) (% of respondents)

Chart A1.17
Entrepreneurs View Concerning Some Issues Around Business Activity (Small & Medium Enterprises) (% of respondents)

Chart A1.18
Average Turnover, by Type of Business (manats)

Chart A1.19
Average Profitability, by Type of Business (manats)
Registration

Chart A2.1
Entrepreneurs Registered in 2007* (% of respondents)

* All charts relate to the period before introduction of one-stop-shop business registration.

Chart A2.2
Breakdown of the Registration Duration, by Type of Business (Individual entrepreneurs) (% of respondents)

Chart A2.3
Breakdown of the Registration Duration, by Type of Business (Small & Medium Enterprises) (% of respondents)
### Chart A2.4
**Breakdown of the Registration Cost, by Type of Business (Individual entrepreneurs)**
(% of respondents)

<table>
<thead>
<tr>
<th>Cost Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>up to 50 manats</td>
<td>37%</td>
</tr>
<tr>
<td>51-100 manats</td>
<td>27%</td>
</tr>
<tr>
<td>101-500 manats</td>
<td>23%</td>
</tr>
<tr>
<td>over 500 manats</td>
<td>12%</td>
</tr>
</tbody>
</table>

### Chart A2.5
**Breakdown of the Registration Cost, by Type of Business (Small & Medium Enterprises)**
(% of respondents)

<table>
<thead>
<tr>
<th>Cost Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>up to 50 manats</td>
<td>12%</td>
</tr>
<tr>
<td>51-100 manats</td>
<td>24%</td>
</tr>
<tr>
<td>101-500 manats</td>
<td>42%</td>
</tr>
<tr>
<td>over 500 manats</td>
<td>21%</td>
</tr>
</tbody>
</table>

### Chart A2.6
**Need for Unofficial Payments During Registration Process (Individual entrepreneurs)**
(% of respondents)

- Made unofficial payments: 26%
- Didn’t make unofficial payments: 74%

### Chart A2.7
**Need for Unofficial Payments During Registration Process (Small & Medium Enterprises)**
(% of respondents)

- Made unofficial payments: 33%
- Didn’t make unofficial payments: 67%
Chart A2.8
Three Major Problems Occurred During Registration (Individual entrepreneurs) (% of respondents)

Chart A2.9
Three Major Problems Occurred During Registration (Small & Medium companies) (% of respondents)
Licensing

Chart A3.1
Existence of Licenses by Type of Business (Individual entrepreneurs)
(% of respondents)

Chart A3.2
Existence of Licenses by Type of Business (Small & Medium Enterprises)
(% of respondents)
Chart A3.3
Existence of Licenses by Type of Business & Sectors of Activity (Individual entrepreneurs)
(% of respondents)

Chart A3.4
Existence of Licenses by Type of Business & Sectors of Activity (Small & Medium Enterprises)
(% of respondents)
Chart A3.5
Obtaining of Any Licenses During the Last 12 Months (% of respondents)

Yes: 9%
No: 81%

Chart A3.6
Obtaining of Any Licenses During the Last 12 Months (% of respondents)

Yes: 5%
No: 95%

Chart A3.7
Need for Unofficial Payments During Obtaining License (Individual entrepreneurs) (% of respondents)

Made unofficial payments: 39%
Didn’t make unofficial payments: 61%

Chart A3.8
Need for Unofficial Payments During Obtaining License (Small & Medium Enterprises) (% of respondents)

Made unofficial payments: 25%
Didn’t make unofficial payments: 75%
Chart A3.9
Three Major Obstacles to Obtaining a License (% of respondents)

Chart A3.10
Three Major Obstacles to Obtaining a License (Small & Medium Enterprises) (% of respondents)
Permits

Chart A4.1
Existence of Permits by Type of Business (Individual entrepreneurs)
(% of respondents)

Chart A4.2
Existence of Permits by Type of Business (Small & Medium Enterprises)
(% of respondents)

Chart A4.3
Obtaining of Any Permits During the Last 12 Months by Regions (Individual entrepreneurs)
(% of respondents)
Chart A4.4
Obtaining of Any Permits During the Last 12 Months by Regions (Small & Medium Enterprises)
(% of respondents)

Chart A4.5
Existence of Permits by Type of Business and by Authorities (Individual entrepreneurs)
(existence of permits, %)

Chart A4.6
Average Cost of Obtaining All Permits, by Type of Business
(manats)
Chart A4.7

Existence of Permits by Type of Business and by Authorities (Small & Medium Enterprises)

(existence of permits, %)

Chart A4.8

Average Number of Permits

(number of permits)

Chart A4.9

Breakdown of the Number of Permits

(% of respondents)
Chart A4.10
Time Required to Obtain All Permits, by Typology of Business
(days)

Chart A4.11
Need for Unofficial Payments During Obtaining Permits, by Type and Location of Business (% of respondents)

Chart A4.12
Three Major Obstacles to Obtaining Permits (Individual entrepreneurs) (% of respondents)

Chart A4.13
Three Major Obstacles to Obtaining Permits (Small & Medium companies) (% of respondents)
Finance

Chart A5.1
Purchasing Tangible Assets (Individual entrepreneurs)
(% of respondents)

- Purchased assets: 26%
- Did not purchase any asset: 74%

Chart A5.2
Purchasing Tangible Assets (Small & Medium Enterprises)
(% of respondents)

- Purchased assets: 41%
- Did not purchase any asset: 59%

Chart A5.3
Financial Sources for the Purchase of Tangible Assets (among purchasers).
Financial Sources for Working Capital
(% of respondents)

- Internal funds / reinvested profit: 94%
- Funds borrowed from a private commercial bank: 4%
- Other sources: 2%

Financial sources for the purchase of tangible assets (among purchasers)
Financial sources for working capital
Chart A5.4
Application for Credit or a Credit Line Over the Last 12 Months (Individual entrepreneurs) (% of respondents)

Chart A5.5
Application for Credit or a Credit Line Over the Last 12 Months (Small & Medium Enterprises) (% of respondents)

Chart A5.6
Reasons for Not Applying for Loan (Individual entrepreneurs) (% of respondents)

Chart A5.7
Reasons for Not Applying for Loan (Small & Medium Enterprises) (% of respondents)
Chart A5.8
Number of Applications for Credit or a Credit Line Over the Last 12 Months by Type of Business
(% of respondents)

Chart A5.9
Reason Why Application Were Rejected a Loan or a Credit Line During the Past 12 Months
(% of respondents)

Chart A5.10
Results of Loan Applications by Type of Business (Individual entrepreneurs)
(% of respondents)

Chart A5.11
Results of Loan Applications by Type of Business (Small & Medium Enterprises)
(% of respondents)
Chart A5.12
Average Interest Rate (annual)
(% of respondents)

Chart A5.13
Existence of Additional Payments
(% of respondents)

Chart A5.14
Value of Collateral
(% of respondents)
Inspection

Chart A6.1
Entrepreneurs, That Underwent at Least One Inspection, by Type of Business (% of respondents)

Chart A6.2
Entrepreneurs That Underwent at Least One Inspection, by Sector of Activity (% of respondents)
Chart A6.3
Entrepreneurs That Underwent at Least One Inspection, by Location of Business (% of respondents)

- Ganja-Gazakh: 88%
- Absheron: 86%
- Baku: 81%
- Sheki-Zagatala: 79%
- Aran: 76%
- Daglig Shirvan: 76%
- Guba-Khachmaz: 74%
- Lankaran: 64%
- Yukhari Garabakh: 63%

Chart A6.4
Average Number of Inspections During Last 12 Months (among who had any inspections) (number of inspections)

- Repair of motor vehicles, household and personal goods: 14
- Hotels and restaurants: 12
- Wholesale Trade and retail trade: 12
- Agro-processing: 10
- Transport and storage: 8
- Agriculture, hunting and forestry: 7
- Real estate, renting and business activities: 5
- Other community, social and personal service activities: 1
Chart A6.5
Small and Medium Enterprises: Average Number of Inspections During Last 12 Months (among those who had any inspections) (number of inspections)

Chart A6.6
Distribution of the Number of Inspections (Individual entrepreneurs) (% of respondents)

Chart A6.7
Small and Medium Enterprises; Distribution of the Number of Inspections (% of respondents)
Chart A6.8
Authorities That Made Inspections (Individual entrepreneurs) (% of respondents)

Chart A6.9
Small and Medium Enterprises; Authorities That Made Inspections (% of respondents)
Chart A6.10
Breakdown of Number of Authorities That Made Inspections in One Business Unit, by Type of Business (% of respondents)

Chart A6.11
Breakdown of Number of Inspections in One Business Unit, by Location of Business (Individual entrepreneurs) (% of respondents)

Chart A6.12
Small and Medium Enterprises; Distribution of Number of Inspections in One Business Unit, by Location of Business (% of respondents)
Chart A6.13
Breakdown of Number of Inspections in One Business Unit, by Sector of Activity (% of respondents)

Chart A6.14
Breakdown of Number of Inspections in One Business Unit, by Sector of Activity (% of respondents)
Chart A6.15
Existence of Any Penalties Based on the Inspection Findings (Individual entrepreneurs)
(% of respondents)

Chart A6.16
Small and Medium Enterprises; Existence of Any Penalties Based on the Inspection Findings
(% of respondents)

Chart A6.17
Average Charges for Penalties (among those who had any penalties), by Type of Business
(manat)

Chart A6.18
Average Cost of Inspections (including unofficial payments), by Type of Business (among those who had any charges)
(manat)
Chart A6.19
Average Duration of One Inspections, by Type of Business (days)

Chart A6.20
Existence of Registration Book For Inspections, by Type of Business (% of respondents)

Chart A6.21
Registration of Inspections and Presence of MED Representatives During Inspections by the Inspection Authorities (Individual entrepreneurs) (% of respondents)
Chart A6.22
Registration of Inspections and Presence of MED Representatives During Inspections by the Inspection Authorities (Small & Medium Enterprises) (% of respondents)

Chart A6.23
Existence of Consequences of Inspections, by Type of Business (% of respondents)

Chart A6.24
Consequences of the Inspections (among who had any consequences) (Individual entrepreneurs) (% of respondents)
Chart A6.25
Small and Medium Enterprises; Consequences of the Inspections (among those who had any consequences)
(% of respondents)

Chart A6.26
Need For Unofficial Payments During the Inspections, by Type of Business
(% of respondents)
Taxation

Chart A7.1
Type of Taxation System Used by Enterprises to Pay Taxes, by Type of Business (% of respondents)

<table>
<thead>
<tr>
<th>Type of Taxation System</th>
<th>Individual entrepreneurs</th>
<th>Small &amp; Medium companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free of tax</td>
<td>95%</td>
<td>12%</td>
</tr>
<tr>
<td>VAT system</td>
<td>28%</td>
<td>60%</td>
</tr>
<tr>
<td>Simplified system</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Chart A7.2
Type of Taxation System Used by Enterprises to Pay Taxes, by Sector of Activity (% of respondents)

- Agriculture, hunting and forestry
- Agro-processing
- Construction
- Wholesale Trade and retail trade
- Repair of motor vehicles, household and personal goods
- Hotels and restaurants
- Transport and storage
- Real estate, renting and business activities
- Health and social work
- Other community, social and personal service activities

Legend:
- Simplified system
- VAT system
- Free tax
Chart A7.3
Small and Medium Enterprises; Type of Taxation System Used by Enterprises to Pay Taxes, by Sector of Activity
(\% of respondents)

Chart A7.4
Number of Paid Taxes, by Type of Business
(\% of respondents)
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List of Government and Local Taxes, Fees, and Other Compulsory Budget Payments Paid by Enterprises, by Type of Business (% of respondents)

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Average Number of Paid Taxes, by Type of Business (number of taxes)

Chart A7.7
Average Number of Visits to Tax Office for Tax Reports’ Submissions During the Last 12 Months, by Type of Business (number of visits)
Chart A7.8
Reported Share of Businesses Concealing Turnover, by Type of Business and Location
(% of respondents)

Chart A7.9
Reported Share of Businesses Concealing Turnover, by Type of Business and Location
(average share of sales)

Chart A7.10
Reported Share of Businesses Making Unofficial Payments, by Type of Business
(average share of businesses)

Chart A7.11
Reported Share of Sales Made for Unofficial Payments, by Type of Business
(average share of sales)
Chart A8.1

Reasons for Not Getting Involved in Export Trade
(% of respondents)

- No need: there is a demand for products in the local market: 99%
- Complexity of export procedures other than customs clearance: 0.6%
- Complexity of customs procedures: 0.4%
- Need to make unofficial payments: 0.3%
- Cost of export procedures: 0.2%
- Lack of information about external market: 0.2%
- The products are not competitive in the external market: 0.1%
- Unequal level of trade dealers: 0.1%
- 100% advance payment requirement: 0.1%

Chart A8.2

Reasons for Not Having Imported Goods/Services
(% of respondents)

- No need for imports: 97%
- Complexity of import procedures other than customs procedures: 1.7%
- Complexity of customs procedures: 1.5%
- Cost of import procedures: 1.1%
- Need to make unofficial payments: 0.6%
- Unequal level of trade dealers: 0.3%
- Restrictions on payments under import contracts: 0.3%
- Lack of information on the external market: 0.2%
Chart A8.3
Usage of Optional (not compulsory) Standards While Manufacturing the Products, by Type of Business
(% of respondents)

Chart A8.4
Manufacture of Enterprise Products Subject to Compulsory Standardization, by Type of Business
(% of respondents)

Chart A8.5
Average Number of All Certificates (Among Certificate Holders), by Type of Business
(number of certificates)

Chart A8.6
Obtaining of Compulsory Certificates During the Last 12 Months
(% of respondents)
Chart A8.7
Average Time Required to Obtain a Certificate, by Type of Business
(days)

Chart A8.8
Average Cost of Obtaining One Certificate, by Type (manat)

Chart A8.9
Requirement to Present Product Samples of Each Consignment of Goods for Certification (% of respondents)

Chart A8.10
Share of Businesses That Made Unofficial Payments While Obtaining Certificates, by Type of Business (% of respondents)