

Entrepreneurship Development  
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# NATIONAL AGENDA

ON IMPROVEMENT OF THE BUSINESS CLIMATE IN AZERBAIJAN

for 2012 – 2013



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## FOREWORD

Improvement of the business climate is one of the daily duties of many governments. Examples can be drawn from efforts of countries like USA, UK, Germany, Japan, France, Turkey and others that strive continuously to improve investment attractiveness of their economies for the foreign capital. Such policies should be pursued regardless of the development level of a country. In transition economies, including in Azerbaijan, both the government and the public should constantly watch out for opportunities to improve business climate for small enterprises.

After Azerbaijan regained independence in 1991, private enterprise started to develop with great pace spurred by the policy of transition from the Soviet command economy to the market economy system, adoption of pro-market legislation, creation of market institutions, macroeconomic stabilization, large-scale foreign investment in energy and other sectors, privatization of small and medium enterprises, land privatization and other such policies and measures.

As of the end of 2010, Azerbaijan had 207,120 registered small businesses.<sup>1</sup> Of them, 192,588 were registered individual entrepreneurs. Share of small businesses in the national value added stood at 2.9% in 2010;<sup>2</sup> they also held 6.7% of the national employment. The total value added created by small enterprises in 2010 was AZN 1.120 billion, and the total sales of small businesses in the same year exceeded AZN 3.835 billion,<sup>3</sup> which was 32% increase over 2009.

The above is demonstrative of successes of small business in the country. Nevertheless, studies and reports by the World Bank, International Finance Corporation, EBRD, Asian Development Bank, World Economic Forum, Fraser Institute, Heritage Foundation and other reputed international institutions and consulting companies, as well as national entities, including the Entrepreneurship Development Foundation (EDF) show that there is a substantial room for improvement of business climate in Azerbaijan.

With this in mind, the EDF and the Center for International Private Enterprise (CIPE – Washington, DC), in the framework of the Dialogue for Economic Reforms Project, supported development of a new version of the recommendations titled “The National Agenda for Improvement of Business Climate in Azerbaijan” (hereinafter “National Business Agenda” or “NBA”).

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<sup>1</sup> [http://www.azstat.org/statinfo/industry/az/010\\_3.shtml#s3](http://www.azstat.org/statinfo/industry/az/010_3.shtml#s3)

<sup>2</sup> [http://www.azstat.org/statinfo/industry/az/010\\_2.shtml#s2](http://www.azstat.org/statinfo/industry/az/010_2.shtml#s2)

<sup>3</sup> Exclusive of rural family households, see [http://www.azstat.org/statinfo/industry/az/010\\_1.shtml#s1](http://www.azstat.org/statinfo/industry/az/010_1.shtml#s1)

The first NA developed by EDF was presented to the government and the public back in 2009.<sup>4</sup> The Agenda included 53 specific recommendations in 14 policy areas (institutional reform, application of EU definitions with respect to small business, relaxation of the tax regime, licensing reform, improvement of the property registration system, etc.). In 2009-2011 the government, through adopting a number of important administrative acts (Presidential Decrees and Executive Orders, Resolutions of the Cabinet of Ministers) fully or partially accepted 21 out of 53 recommendations. In our opinion, this ratio demonstrates that our proposals were well substantiated. This does not mean, of course, that those decisions would not have been taken in absence of our proposals.

The present NBA, offered to the attention of policy makers, public associations and media, concisely describes proposals for further improvement of business climate in Azerbaijan in the second half of 2012 and in 2013. In developing the recommendations, EDF relied on a survey of 700 small business owners and 20 deep interviews with business persons, as well an analysis of a number of laws and normative acts regulating business activities in Azerbaijan. Recommendation of international institutions and experience from other transition economies were also taken into account.

This document is prepared for the government. It is thus very brief and makes specific recommendations about improving business climate in the country, especially for small businesses. Authors believe that given a requisite political will, these reforms can be fully implemented in 2012-2013. Some of the improvements described below can be carried out within a shorter time frame, namely one or two months.

## 1. INSTITUTIONAL REFORMS

### 1.1. Consider establishment of a National Agency for Small Business;

It is advisable to establish a special government agency for supporting small business. Such institutions (albeit under different names), existing in a number of countries (e.g. USA, Canada, Russia, China, Czech Republic), aim to provide government support to small business development in their respective countries, i.e. initiate legislative changes conducive to small business, provide guidance and advice to newly established and existing start-ups, support lending to small businesses, shield them from undue government interference, analyze progress and problems in business development, etc.

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<sup>4</sup> [www.edf.az](http://www.edf.az)

1.2. Consider instituting a National Ombudsman for Small Business.

Another way of supporting small business is instituting an office of state or national Ombudsman on small business. These institutions (under different titles) exist in USA, Poland and other countries. In USA, this office exists alongside the Small Business Administration (which is an example of the previous approach). The National Ombudsman protects small businesses from excessive federal regulation, control or penalties. The National Ombudsman reports annually to the US Congress. The institution of a small business ombudsman also operates in EU where it serves as a point of complaint for entrepreneurs and business associations unsatisfied with perceived poor governance or mismanagement on the part of EU institutions.

## 2. FURTHER HARMONISATION OF THE NATIONAL DEFINITION OF SMALL BUSINESS ACTIVITIES WITH RELEVANT EUROPEAN DEFINITION

2.1. The classification to cover micro, small and medium business;

Small business classification in Azerbaijan is governed by Resolution of the Cabinet of Ministers of 18 December 2009. This classification is closer to European practice than the previous one (enforced by Resolution of 20 April 2004) but still falls far short of criteria stipulated by the European Commission (EC) in 2003 for breaking down SMEs into micro, small and medium-size businesses. In consideration of changing price levels and rising productivity in EU countries, EC regularly (once in four years) revisits the classification.

2.2. Sectorial principles to be lifted;

2.3. Relevant annual thresholds should be further increased

The above-described situation precludes a meaningful comparison of the role and development level of small entrepreneurship between EU and Azerbaijan and underestimates the contribution of small business to income and job generation and to other economic indicators. Further harmonization with the European

classification and using of same definitions of micro, small and medium business will facilitate application of European best practice in Azerbaijan and making correct comparisons and analyses on the role of small entrepreneurship in the national economy. Taking into account that EU is implementing various programs supporting small business, the above-described harmonization will also allow Azerbaijan to gradually benefit from these programs (in the framework of the EU Eastern Partnership).

### 3. REGULATORY REFORM

3.1. A special Commission to be established with representation of stakeholders (Government, business associations) and participation of area experts;

In many countries, the legislative and regulatory framework of business tends to become overcomplicated with time. Often, a given normative act is adopted to deal with a specific problem but its correspondence to existing norms is not carefully checked. The accumulated deadweight of such norm-making leads to existence of many redundant or even mutually contradictory norms. To deal with this problem, many countries implement regulatory reforms.

3.2. Assign the Commission to apply “sunset” principles to existing legislation and regulations (including orders of government agencies) which directly or indirectly regulates business activities, having regard to the following criteria:

- *Legality;*
- *Necessity;*
- *Conformity to market economy principles;*
- *Precision;*
- *Uniqueness.*

Generally, there are two ways in which such reforms can be accomplished: (i) bottom-up approach, or (ii) “sunset” principle. In the first case, problematic legal norms are identified and culled from the body of regulations one by one. This is relatively uncomplicated but takes long time as the reform depends on signals coming from the “bottom”, i.e. individual business people or officials who flag regulatory flaws on the case by case basis.

In the sunset approach, a customary presumption of legality associated with normative acts is removed. Within a certain pre-defined time from the date of adoption, all existing regulations “set”, i.e. lose legal force, unless a regulation is reviewed and proven to comply with the principles of necessity, legality and conformity to market economy rules.

Various studies corroborate the need of conducting a regulatory reform in Azerbaijan. To do this, we recommend taking stock of existing regulations in each area or sector. This stock-taking can be done by special commissions comprising officials and representatives of business associations. Legal norms falling short of the declared principles of *Legality, Necessity, Conformity to market economy principles, Precision, and Uniqueness* must be either abolished or amended until the compliance is achieved. Regulations that have passed the test are included in the normative registry accessible to domestic and foreign entrepreneurs and other citizens. The registry is placed at websites of all government ministries. Regulations not included in the registry by the deadline of completion of the regulatory reform are automatically invalidated.

## 4. RELAXATION OF THE TAX REGIME

4.1. Increasing the turnover threshold for the simplified taxpayers;

As evident from research, many small enterprises, keen to remain within a threshold set for a simplified tax system, underreport their turnover. Although the threshold was already raised in the Tax Code three years ago, it appears advisable to do so again.

4.2. Develop tax booklets for various areas of small business activities and publish them en masse;

The Tax Code is a very bulky and complex document. As it is structured by tax types and not by types of economic activities, a small entrepreneur has difficulty comprehending and applying the Tax Code directly. Thus, it is important to develop tax guides for various small business areas (retail, restaurants, catering, beauty parlors, laundries, dry cleaners, tailor's, etc.) and publish them for mass use.

4.3. From 2013 on, allow up to 20% capital deduction from taxable profit of SMEs.

To promote larger investment in SME development, it is recommended to exempt part of whole of investment expenses from the profit tax.

## 5. REFORM OF THE LICENSING SYSTEM

5.1. Speed up presentation to Milli Majlis (Parliament) of the draft Law on Licenses and Permits developed in the framework of the Decree of the President of the Republic of Azerbaijan of 26 October 2011. Discussion of the draft Law with business associations and other stakeholders not to be overlooked.

Azerbaijan is the only state of the former USSR where licensing is not yet regulated by a separate statutory law. Naturally, this situation was not conducive to entrepreneurship development and, consequently, the Presidential Decree of 26 October 2011 set a task of developing such draft law. The Decree stated: "studies demonstrate that numerous permits from various government entities are required in order to engage in entrepreneurial activities. This state of affairs, in turn, negatively affects business development, job generation and investments to real economy. Improvement of the current situation would require enhancement of the system of granting special approvals (licenses) and permits." The Decree instructs that a relevant law draft should be developed within three months and establishes a number of criteria for drafting a law. Along with those criteria, it is important to abide by the following principles when developing the law:

- 1) the necessary minimum of activities subject to licensing;
- 2) granting of licenses by a special central government entity;
- 3) prevention of monopolistic abuse by licensed entrepreneurs of their position;
- 4) coordination of licensing with other inspection and control functions of government agencies;
- 5) except for licensing for purely fiscal purposes (e.g. casinos), setting low licensing fees and reasonably long license terms (at least 5 years);
- 6) substantial grounds for revoking a license.



## 6. IMPROVEMENT OF THE PROPERTY REGISTRATION SYSTEM

6.1. Enactment of a single legislation governing all property registration issues;

6.2. Apply a one-stop shop system as envisioned in the Presidential Decree of 23 May 2011 to property registration issues.

Studies shows that the process of registering property rights takes an unjustifiably long time and involves applying to several government bodies and collecting and presenting a large number of documents. Many documents required to register the title of natural and legal persons to real estate that they themselves constructed are extraneous (or have already been collected from an applicant for granting a construction permit). In some cases, a document required is nothing more than a written confirmation from a state body that another document has been issued.

Furthermore, the current package of regulatory requirements does not clearly prescribe which government agencies and in what sequence an applicant has to address, nor does it set a specific timeframe for government agencies to respond to applications submitted.

## 7. STRENGTHENING OF THE PUBLIC INFORMATION SYSTEM

7.1. Allocate one hour of public TV and radio air time per week (on Saturdays) to announce and comment on all public decisions and normative acts adopted within the past week;

7.2. Engage private consulting entities (through tenders, paid for by public

Investors need to be aware of all government decisions, legislative amendments and other relevant information that may affect their business. An informed investor is a successful investor. Government should strive to provide equitable and unimpeded access to information for investors. Otherwise, crooked officials gain from controlling information, and businesses are burdened with additional informal payments.

Presently, many small companies obtain relevant information when they are inspected. Lack of publicly available information is particularly hard on

funds) to provide free consulting and advise to entrepreneurs.

small entrepreneurs – they don't have resources like intelligence units and PR departments that are used by larger companies. Therefore, strengthening of the public information system in the manner proposed here is especially beneficial for smaller companies.

Currently, small companies can obtain free advise from local units of the Ministry of Economic Development. But their capacity is limited. Extension of consulting services to small businesses is possible by engaging private consulting firms through using public funds.

## 8. REFORM OF THE CONSTRUCTION PERMIT SYSTEM

8.1. Simplify a construction permit system;

Currently, the number of procedures required for obtaining a construction permit in Azerbaijan is as high as 30. Not surprisingly, it takes 212 days on average to secure a permit. These figures are reported in Doing Business 2012. Consequently, Azerbaijan is in the 172<sup>nd</sup> position among 183 countries for this indicator whereas Azerbaijan's overall position is 66<sup>th</sup>. Therefore, construction permits is one area that pushes Azerbaijan's down the list in this authoritative survey.

8.2. Apply a one-stop shop principle to construction permitting.

The Administrative Rules for e-Services proposed at the website of the State Committee for Urban Planning and Architecture state that the service is informative and has been partly automated.

## 9. DEVELOPMENT OF SMALL BUSINESS INFRASTRUCTURE

9.1. Create business incubators in 3 to 5 regional

Studies show that high rental and utility costs are among most serious impediments to business

centers, i.e. Ganja, Sumgayit, Lankaran and Quba;

development. Creation of business incubators (particularly outside of Baku) with fully or partially subsidized costs would significantly reduce their negative impact. Business incubators also allow business start-ups to save on telephone and internet connections, clerical assistance and other service personnel.

9.2. Develop a pilot project on creating a industrial park at one of universities in Baku.

Small business often has significant innovative potential in developing, using and generating the need for business and technological innovation. In Europe, innovation centers have begun to be established since 1980s. Quite commonly, they are created as or form central elements of industrial park where production-oriented small enterprises, R&D centers and companies, education institutions, business infrastructure (showrooms, warehouses, security services, residential areas for workers, etc.) congregate in a manageably small area. It is recommended to develop a project and implement a pilot industrial park in Azerbaijan.

## 10. CURBING UNDOCUMENTED SALES

10.1. Update and enhance decisions previously adopted in this field;

Studies show that undocumented commercial activities breed pervasive law violations by companies and officials alike. Staring from one end of a value chain, they may travel or affect other businesses and all too often makes them easy targets for bribe extortion by unscrupulous government representatives. A number of legal acts prohibiting undocumented commercial activities have been previously adopted, but they remain unenforced. Our business survey demonstrates that undocumented activities are characteristic for movement of both imported and domestically produced goods across the country. Even large diversified Azerbaijani companies sometimes pass their products on to a distribution network without proper invoices and other documentation. It appears necessary to

10.2. Create a mixed commission of state authorities and representatives of the public to conduct a few mass campaigns to inspect the issuance of relevant sales documents against actual goods and services sold.

strengthen provisions of existing normative acts and increase sanctions for undocumented commercial activities.

As long as undocumented sales remain a major corruption-inducing factor, conducting regular mass campaigns to weed them out may be effective. A significant reduction of undocumented sales would improve economic statistics, increase government's tax revenues and reduce health and environmental risks of potentially harmful products.

## 11. REGULATING INSPECTIONS

11.1. Accelerate development of a draft law as stated in the Decree of the President of the Republic of Azerbaijan of 15 February 2011 "On regulating business inspections and protecting entrepreneurial interests";

Inspections are important. The matter is, on what grounds, how often and by whom they should be administered. There is no legislation in Azerbaijan that would regulate these issues in a systemic way. Precisely for this reason, development of such a draft law is assigned in the Decree 383 of the President of the Republic of Azerbaijan of 15 February 2011 "On regulating business inspections and protecting entrepreneurial interests". The draft shall be developed by the Cabinet of Ministers. It is vital to discuss the draft with stakeholders (entrepreneurs, business associations, NGOs dealing with business developments, individual experts).

11.2. Create a commission (including representatives of business associations) to assess efficiency of the introduction of the single registry of inspections.

Generally, in the last two years the President signed two important decrees (of 13 April 2010 and of 15 February 2011) regulating inspections. The decrees require all inspections to be recorded in a single data registry. Accordingly, since 1 May 2011 all inspections are recorded in an inspections registry maintained by the Ministry of Justice.

## 12. RULE OF LAW AND FAIR TRIAL

12.1. Consider introducing jury trials for review of business related cases in courts;

Regretfully, lack of fairness on the part of judges is still a widespread complaint. Business people complain that it is not law but force that carries courts. The legislation in Azerbaijan provides for establishment of the jury institution but its implementation is indefinitely postponed. Perhaps, it may not be feasible to try all cases by jury as yet, but it may be possible to do so in business cases. The matter requires a complete and careful consideration. Uninterested business persons, representatives of business association and media representatives may serve as jury members for such trials.

12.2. Establish a commission (with representation from the Supreme Court, MED and business associations) to monitor court cases filed by entrepreneurs.

Establishing a commission with representation from the Supreme Court, MED and business associations to monitor court cases filed by entrepreneurs may also be very beneficial.

## 13. FOREIGN TRADE FACILITATION

13.1. Most crucial step in this direction would be to improve rules and reduce foreign trade duties, i.e. reduce the number of requisite documents, streamline granting and receipt of these documents, reduce foreign trade duties, etc. These improvements are preconditions for Azerbaijan's accession to WTO in the near future.

In the World Bank's Doing Business 2012 Report, Azerbaijan takes the 170<sup>th</sup> place (among 183 countries) in the ease of doing foreign trade. Parameters such as number of documents required for export and import (8 and 10, respectively), time required for export and import transactions (38 and 42 days), cost of exporting and importing of a standard container (USD 2,905 and 3,405) pushes Azerbaijan in such an unfavorable position. Among neighboring countries, Georgia is 54<sup>th</sup>, and Armenia is 104<sup>th</sup>.

## 14. CORPORATE SOCIAL RESPONSIBILITY: FROM COMPULSORY TO VOLUNTARY ENGAGEMENT

14.1. Government to expressly offer to entrepreneurs to inform the Government about cases of compulsion to public and social activities;

Local authorities (and sometimes even central government agencies) rely on business people to provide various public and social services (e.g. repair schools and roads, aid refugees, etc.). Corporate social responsibility is an important value of modern business; it can be promoted but it should be always realized voluntarily, without compulsion. Currently, a business person not wanting to risk relationship with local authorities feels obliged to do what is asked of him.

14.2. Local executive authorities to be expressly prohibited to compel entrepreneurs to engage in public and social activities;

How to change this situation? First of all, a special public act (a law, decree or order) shall prohibit central and local authorities from compelling business owners to engage in public and social activities as a matter of the government policy. This should be widely announced so that every business person is aware of that. A hotline should be established where business persons can report breaches of this prohibition.

14.3. Adopt a relevant decision about promoting and awarding entrepreneurs voluntarily engaged in public and social activities.

As for promoting social engagement of business, this could be done both by the state and by the public. Clearly, the Government has more resources to do that. Crafting appropriate promotion mechanisms and ways of applying them would be an obvious starting point.

## 15. REINFORCING ANTIMONOPOLY POLICIES

15.1. Speed up enactment of the Competition Code;

Currently, the antitrust legislation is based on four statutory laws. But as these do not meet contemporary requirements, the Government has developed and presented to the Parliament a draft

15.2. Establish a special

independent antimonopoly institution (under the Presidential Administration or Milli Majlis).

Competition Code.

Enactment of the Code is crucial but establishment of an independent antimonopoly institution will also be an important step.