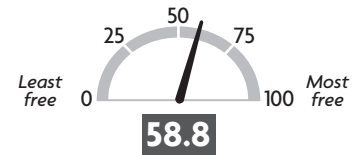


AZERBAIJAN

Economic Freedom Score



World Rank: **96**

Regional Rank: **16**

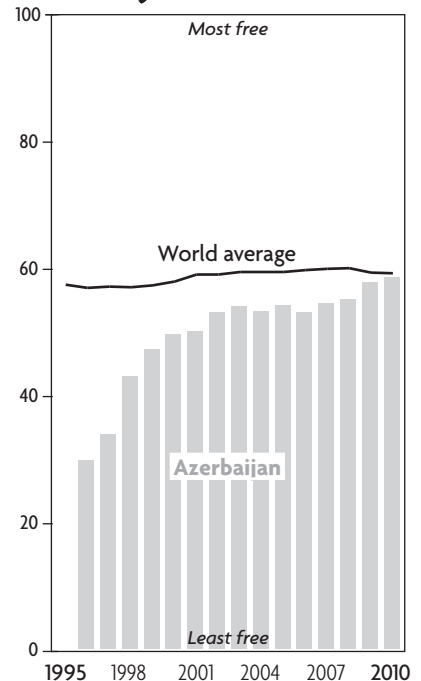
Azerbaijan's economic freedom score is 58.8, making its economy the 96th freest in the 2010 *Index*. Its overall score is 0.8 point higher than last year, reflecting a significant improvement in investment freedom offset by modest declines in several other factors. Azerbaijan is ranked 16th out of 41 countries in the Asia-Pacific region, and its overall score is above the regional average but just below the world average.

Azerbaijan's impressive economic growth has been driven mainly by oil and gas. Continued transformation and restructuring are needed, both to capitalize on Azerbaijan's well-educated labor force and tradition of entrepreneurship and to diversify production. The government has implemented wide-ranging reforms to improve economic freedom. Openness to global trade, relatively moderate taxation, streamlined business processes, and improved public-sector management have aided the transition to a market-based system.

Despite considerable gains in regulatory reform and economic diversification led by the services sectors, substantial challenges remain, particularly in implementing more institutional and systemic reforms. Property rights and freedom from corruption remain weak, and government interference and control hurt overall monetary stability and foreign investment.

BACKGROUND: Oil-rich Azerbaijan's dispute with Armenia over Nagorno-Karabakh has cost thousands of lives and much territory. Despite a cease-fire since 1994, over 500,000 Azeris from the disputed territory still live as refugees in Azerbaijan, and tensions with Turkey have increased because of Ankara's rapprochement with Armenia. Azerbaijan is exploring Russian mediation of the conflict with Armenia and Moscow's offers to buy and ship more of its natural gas to Europe. It also has suspended in-country foreign radio broadcasts. A constitutional amendment to abolish presidential term limits, passed by national referendum in 2009, will allow President Ilham Aliyev to seek a third term. Falling oil and gas revenues and shrinking foreign direct investment because of the 2009 global crisis have led to a budget deficit.

Country's Score Over Time



Quick Facts

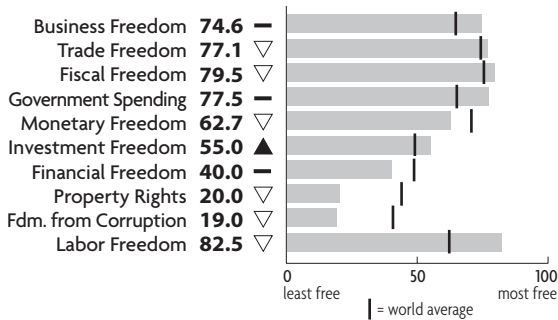
- Population:** 8.7 million
- GDP (PPP):** \$76.1 billion
 - 10.8% growth in 2008
 - 22.3% 5-year compound annual growth
 - \$8,765 per capita
- Unemployment:** 6.1% (2008)
- Inflation (CPI):** 20.8%
- FDI Inflow:** \$11 million

2008 data unless otherwise noted
Data compiled as of September 2009

How Do We Measure Economic Freedom?

See page 457 for an explanation of the methodology or visit the *Index* Web site at heritage.org/index.

azerbaijan's ten economic freedoms



BUSINESS FREEDOM — 74.6

Azerbaijan's overall regulatory environment has improved. Starting a business takes less than half the world average of 35 days. Obtaining a business license involves more than the global average of 18 procedures, but closing a business is relatively easy.

TRADE FREEDOM — 77.1

Azerbaijan's weighted average tariff rate was 3.9 percent in 2008. A weak legal regime, arbitrary customs administration, regulatory conflicts of interest, subsidies, import and export controls and restrictions, weak enforcement of property rights, and customs corruption add to the cost of trade. Fifteen points were deducted from Azerbaijan's trade freedom score to account for non-tariff barriers.

FISCAL FREEDOM — 79.5

Azerbaijan has a relatively high income tax rate and a moderate corporate tax rate. On January 1, 2010, the top income tax rate of 35 percent will be lowered to 30 percent, and the top corporate tax rate of 22 percent will be lowered to 20 percent. Other taxes include a value-added tax (VAT) and a property tax. In the most recent year, overall tax revenue as a percentage of GDP was 18.4 percent.

GOVERNMENT SPENDING — 77.5

Total government spending, including consumption and transfer payments, is relatively low. In the most recent year, government spending was 27.4 percent of GDP. Power supply and water companies remain in state hands.

MONETARY FREEDOM — 62.7

Inflation has accelerated rapidly, averaging 18.6 percent between 2006 and 2008. The government controls prices on most energy products and operates several state-owned enterprises. Monopolist importers in many sectors prevent declines in commodity prices from being fully passed on to consumers. Ten points were deducted from Azerbaijan's monetary freedom score to adjust for price-control policies.

INVESTMENT FREEDOM — 55

Foreign direct investment is allowed in most sectors. Investment in areas related to national security and defense is prohibited, and the government controls other key sectors, such as energy and communications. The regulatory sys-

tem has been improved, but non-transparency, corruption, weak legal institutions, politically connected monopoly interests, and informal bureaucratic control impede application of laws and regulations and hinder competition. The law provides that foreign investors be "not less favored" than local investors and allows repatriation of profits, revenues, and other investment-related funds as long as applicable taxes are paid. The exchange system is generally liberal; there are few restrictions on converting or transferring investment-associated funds into freely tradable currency. Foreign citizens and enterprises may lease but not own land. Expropriation may occur in the event of natural disaster, epidemic, or other extraordinary situation, and foreign investors are entitled to adequate compensation.

FINANCIAL FREEDOM — 40

Azerbaijan's banking sector has been growing rapidly. Bank credit has expanded by more than 50 percent per year since 2004. Prudential regulation and supervision have been the central bank's priority to contain potential risks from the rapid expansion. Private banks have grown faster than state-owned banks and account for around 60 percent of total assets. However, availability of long-term financial instruments remains limited. The market for government and corporate bonds remains small and illiquid. There are no limits on foreign ownership of domestic banks, and some international banks have opened representative offices. The state-owned International Bank of Azerbaijan still dominates the banking sector. The government sold a 50 percent stake in the state-owned Kapital Bank in 2007 and further privatized the bank in 2008.

PROPERTY RIGHTS — 20

Azerbaijan's judicial system, filled with bureaucratic requirements and generally seen as corrupt and inefficient, does not function independently of the executive. The poor quality, reliability, and transparency of governance, as well as regulatory abuse and poor contract enforcement, significantly impede the ability of many companies to do business.

FREEDOM FROM CORRUPTION — 19

Corruption is perceived as rampant. Azerbaijan ranks 158th out of 179 countries in Transparency International's Corruption Perceptions Index for 2008. Judicial and police corruption are widespread. Arbitrary tax and customs administration create opportunities for graft, regulatory practices favor monopolies, and corruption appears at all levels. Politically connected businesses seem to have benefited from government regulatory and other decisions and have achieved control of several lucrative sectors of the economy.

LABOR FREEDOM — 82.5

Azerbaijan's labor market is relatively free, and flexible employment regulations have been implemented as a result of recent reforms. The non-salary cost of employing a worker is moderate, and dismissing a redundant employee is not burdensome.