



American Chamber of
AMCHAM
Commerce in Azerbaijan

Observations and Recommendations
for Improving Azerbaijan's
Business Climate

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Table of Contents

I. Introduction	6
II. Corruption	9
Corruption Generally	9
Corruption through “Monopolies”	12
Judicial Independence and Integrity	13
III. Taxation	14
Social Insurance Payments for Expatriate Employees	16
Personal Income Tax Rates	17
Double Tax Relief Clearance	18
Tax Refunds	20
Tax Inspections/Audits	21
Appeals	22
VAT Recovery	23
Loss Carry Forwards	23
IV. Customs	24
Electronic Documentation Processing	25
Bonded Warehouses	26
Revision to Customs Tariffs Law and Harmonized Customs Codes	27
Counterfeit Goods	28
Inter-Ministerial Issues Regarding the Import of Goods	29
V. Banking, Finance and Insurance	30
Banks as Tax Agents	32
Interest on Bank Reserves	32
Secondary Financial Markets	33
Development of Domestic Interbank Manat Market	34

Sovereign Eurobond Issuance	34
Withholding Tax on Payments to Foreign Banks	35
Bank Syndications/Collateral Agents	36
Insurance - Definition of Financial Services	37
Life Insurance and Retirement Savings	38
VI. Communications and Information Technology	39
Privatization	42
Intellectual Property Rights	42
Single ICT Regulatory Authority	43
VII. Labor	44
Overtime	45
Annual leave	46
Temporary Workers	47
VIII. Tourism	50
Lack of Coordination and Communication of Tourism Policy	52
Mandatory Health Inspections	53
IX. Agriculture	54
Coordination between Ministries	56
Quality Standards	57
Credit and Micro-Credit Programs	58
Infrastructure Improvements	59
Definition of Crucial Terms	60
X. Protection of Intellectual Property Rights	61

Introduction

As representatives of the international and local business community in Azerbaijan, we have a strong interest in seeing business succeed in Azerbaijan. Key to that success is a business environment which permits business to thrive. A healthy, competitive business climate is not only good for business but also for all the citizens of Azerbaijan through the creation of jobs and wealth.

Over the past eleven years, the Azerbaijani Government has done much to improve the business climate in Azerbaijan. Due to a far-sighted vision of the country's future, Azerbaijan has seen huge inflows of foreign investment in the oil and gas sector. While this sector will continue to be important, the Government recognizes that the development of the non-energy sector is crucial to Azerbaijan's future and the prosperity of its people. Further implementation of the government's current policy direction and continued reform of ills inherited from the Soviet period (as well as others of more recent vintage) will enable a stable and prosperous Azerbaijan to become the indispensable regional financial and support hub for the East-West trade route, the Caspian Basin and Central Asia.

The American Chamber of Commerce in Azerbaijan, as the leading advocate of business in Azerbaijan, supports the Government's initiatives to improve Azerbaijan's business climate. Our members have invested in every sector of Azerbaijan's economy and are uniquely placed to provide the Government with insight into the issues which need to be addressed to make Azerbaijan a highly competitive, attractive place to invest and do business.

Azerbaijan competes for investment with all the other countries in the world. In this region in particular, countries are aggressively

courting investors and working to make themselves more attractive to investors. While Azerbaijan has a healthy advantage in this region due to its natural resources and strategic location, it cannot become complacent in its efforts to further develop the economy through improvement of the investment climate.

Neighboring countries such as Russia, Georgia and Ukraine have reduced personal income tax rates to a point where Azerbaijan is now at a competitive disadvantage. Ukraine and Georgia have introduced visa-free travel for American citizens for periods of up to 90 days to their countries. Numerous other examples can be cited. If Azerbaijan is to maintain its competitive advantages, it must, in our view, lead the region in reform and innovation.

To assist the Government in that task, AmCham has prepared this document, our 2005 “White Paper”. In this White Paper, we identify, sector by sector, those issues which we consider the most important for improving Azerbaijan’s business climate and encouraging investment outside the successful oil and gas sector. While some of our comments are critical of certain aspects of the Azerbaijani business climate, we have also endeavored to make this White Paper as constructive as possible by providing suggestions for improvements and offering our assistance.

AmCham and its members understand the great promise that Azerbaijan presents. This White Paper has been prepared in the spirit of cooperation and in the hope that our contribution can help accelerate the process of Azerbaijan’s development, improving the business climate while increasing the prosperity of the country.

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. A recent example was the draft law *On Investment* which contained several clauses which AmCham believed were detrimental to improving the business investment climate. It involved considerable effort on the part of both AmCham's secretariat and board members even to obtain a copy of the draft law. Even then, it was not clear which of several drafts obtained was current or to whom representations should be made in respect of the draft.

Recommendations

- Draft legislation before the Milli Majlis should be made available to the public or, at least, representatives of the business community, business and legal consultants, etc.
- The draft of each piece of legislation, as amended and passed at the first, second and third readings in the Milli Majlis, should be made available as in the preceding recommendation.
- A contact person, perhaps both in the Milli Majlis Secretariat and in the President's Office, should be designated to whom comments and recommendations can be made and who will be responsible for ensuring that these reach the appropriate people, including Milli Majlis members.

Corruption

01. Corruption Generally

In global business circles, Azerbaijan is widely viewed as a country of pervasive corruption. Unfortunately, this is more than a problem of reputation and perception – in fact, systemic corruption has severely inhibited foreign investment economic development and the establishment of a justice system based on the rule of law. The government has begun a process which, if implemented rigorously and expanded where appropriate, could over time substantially reduce and in some sectors virtually eliminate the pernicious impact of corruption.

A year ago, the Government of Azerbaijan focused high-level attention on the country's serious corruption problems resulting in some significant and concrete progress. In January 2004, Azerbaijan adopted a comprehensive new anti-corruption law which took effect in January 2005. In March 2004, President Aliyev issued an executive decree endorsing the implementation of the National Action Plan (NAP) to combat corruption. In February 2004, Azerbaijan officially deposited instruments of ratification for Council of Europe's Civil and Criminal Conventions against Corruption. The Government has also begun the implementation of the European International Transparency Initiative in such entities as SOCAR, the Ministry of Economic Development and the State Customs Committee. These are steps in the right direction which AmCham strongly supports.

The new law and NAP, both of which are sound documents, call for greater accountability on the part of public employees and expand the scope of existing provisions dealing with bribery and conflict of interest. The new law, however, does not provide for special structures for the investigation and prosecution of cor-

rupt activities but focuses largely on preventative measures that enhance transparency and the accountability of government officials. Specifically, the law prohibits officials from hiring “close relatives” to positions subordinate to them and restricts government employees from accepting gifts over approximately \$55 and from engaging in business activity directly or through proxies. The law also requires that all government officials declare their annual income, with penalties for failure to disclose and perjury. These measures are necessary but not sufficient. Much more progress is necessary and further improvements are needed in furtherance of the measures already undertaken.

Overall, the NAP presents a comprehensive and ambitious plan for preventing, detecting, and prosecuting corruption within both the public and private sector. Some of the plan’s provisions, however, are vaguely worded but, more critically, most lack a firm date for implementation. That said, it is clear from the NAP that a revised law on notaries and licensing procedures will, if implemented, reduce the opportunities for corruption within the commercial sector and, in particular, within the privatization process.

While these anti-corruption initiatives are significant, much needs to be done to implement the law and the NAP. Specifically, while the Government of Azerbaijan continues to engage US and Council of Europe/GRECO (Group of States against Corruption) expertise, it has not taken the additional steps of amending related laws or staffing the Anti-Corruption Commission or Department for Fighting Against Corruption (DFAC) at the Prosecutor General’s Office. In fact, since passing the law, Azerbaijan has even taken some backward steps by quietly amending the new anti-

corruption law's requirement for financial disclosure by public officials to eliminate the need to disclose family member assets.

Recommendations

- The Prosecutor General's Office should take immediate steps to create, staff and train the Department for Fighting Against Corruption (DFAC).
- The law on the anti-corruption commission (ACC) should be finalized, and the ACC should be staffed and trained to handle corruption complaints.
- The Criminal Procedure Code should be amended to provide law enforcement agencies with the investigative tools necessary to ensure that the anti-corruption regime can be enforced properly and effectively.
- The draft money laundering law should be adopted and implemented so that corruption-related offenses can be prosecuted as money laundering offenses and illicit gains can be confiscated and forfeited.
- The financial disclosure law should be amended to include the assets of family members of government officials.
- The Criminal Code should be amended to provide for enhanced penalties for bribe-takers in government positions and immunity from prosecution to those who report these crimes.
- Codes of conduct for government employees should be adopted and enforced.

02. Corruption through “Monopolies”

Much has been said by both government officials and private business about the problem of informal monopolies in Azerbaijan. These so-called “monopolies” are better characterized as informal restrictions on competition maintained through influential contacts. Business interests well-connected to senior government officials often limit access to various local markets by influencing government agencies essential to a business’ success. This influence can be exercised either overtly or, more commonly, through preferential treatment in which “preferred” businesses do not experience the bureaucratic difficulties experienced by other market participants. This negatively distorts competition and inhibits economic development and job creation. A level playing field for all businesses is essential for a vibrant, healthy and growing economy which, in turn, would increase employment.

Recommendation

The Government should pass and enforce a Competition Code, as called for in President Aliyev’s May 29 anti-inflation decree, that legally defines unfair competition and specifies a mechanism to redress instances of same.

03. Judicial Independence and Integrity

A judicial system which is perceived as fair and unbiased is essential to the development of a strong investor-friendly economy. In a court system, perception is nearly as important as actual fact. The perception alone that local courts are subject to outside influences is sufficient to cause potential investors (i.e., employers) to avoid investing here. Unfortunately, in Azerbaijan, the court system is not only perceived as corrupt but numerous examples exist of judges accepting payments and instructions from litigants and third parties.

Judges in Azerbaijan point to flaws in the judicial selection process as one significant cause of corruption in their ranks. Specifically, it is commonly said that many judges are required to “buy” their judicial appointments, i.e., pay significant sums to secure their positions. Such practices bring the whole system of government into disrepute as they undermine the fair administration of justice.

Recommendations

Our recommendations above concerning corruption generally would also have a positive impact if applied to the judiciary as well.

The Government must take significant steps to eliminate corrupt practices in the judicial selection process.

Taxation

Tax law and its administration improved significantly in Azerbaijan for the first years immediately following AmCham's first White Paper in 2001. In our previous White Paper, we identified several areas in which both local and foreign business encounter tax problems. We are pleased to note that progress has been made in some important areas. For example, one improvement was the establishment of the Taxpayer Service Department which has already rolled out several programs directed at educating taxpayers. Additionally, the Tax Ministry's establishment of taxpayer forums on its internet site and publishing of articles and answers to taxpayers' questions in the *Vergiler* newspaper are also positive signs of the Ministry's interest in the development of transparent tax laws and practices.

In the past two years, however, some of our members report that tax administration has become less investor friendly. In practice, sometimes tax audits appear to be politically motivated. Incidences of freezing or 'writing-off' funds from bank accounts have become more frequent. Further, some of our members report that it is becoming increasingly difficult to obtain official certificates from some tax offices (e.g., tax receipts for expatriates). These developments particularly hamper investment into non-oil sectors, especially taking into account that Azerbaijan's neighbors (e.g., Georgia) are moving in a different direction with their tax regimes.

While a somewhat more transparent legislative amendment process has allowed foreign investors and business associations (including AmCham) to express their views on necessary changes to the Tax Code, these investors and business groups, however, are

not able to familiarize themselves with the changes under consideration by the Ministry itself. Further, we have not witnessed any intensive discussions with the tax authorities that would make the results of our involvement more tangible.

As with our first White Paper, this is not intended to be an exhaustive list of the problems and concerns that taxpayers have in Azerbaijan. There are a number of technical ambiguities and omissions in the current Tax Code which often give the tax authorities too much leeway to interpret the legislation in their favor. None of these particular issues have been included in this White Paper. Rather, we identify those issues which AmCham and the business people it represents believe are most important (including issues raised in our previous White Paper which, in our view, the government has not yet adequately addressed) and which need to be addressed to ensure further progress.

For a number of years, our Tax Committee has been active in efforts to improve tax legislation and administration by submitting suggestions for changes in tax legislation and regular discussions with officials of the relevant Governmental Bodies. The Tax Committee is keen to intensify our interaction with the Ministry of Taxes and other ministries and would be happy to share with the Government of Azerbaijan more detailed views and suggestions for further development of tax legislation.

01. Social Insurance Payments for Expatriate Employees

Although not considered a tax by law, social insurance payments are generally treated as taxes by employers and for this reason we include our comments regarding social insurance in this section.

Until the passage of a recent law, employers were not required to make social insurance payments for their expatriate staff. In October 2005, a law was adopted with no meaningful notice to the foreign business community, obligating employers to begin making social insurance payments equal to 22% of their expatriate employees' monthly salary. As expatriates neither use nor receive any benefit from Azerbaijan's social insurance system, this is unfair and will substantially increase the cost of foreign investment in Azerbaijan in the non-oil sector. We believe that social security matters relating to non-Azerbaijani citizens should be dealt with through bilateral international agreements.

Recommendation

The Government should take all steps necessary to prevent the draft law coming into force and continue to exempt expatriates from participation in the social insurance system.

02. Personal Income Tax Rates

Until the recent imposition of social insurance payments for expatriates, the single most pressing taxation issue was that of uncompetitive personal income taxation rates. Currently, the highest marginal rate for Azerbaijani personal income tax is 35% which applies to income in excess of AZM 3,000,000. Until fairly recently, this rate was comparable to other countries in this region. Russia, Georgia, Ukraine and Turkmenistan have now all reduced their personal income tax rate to a fairly low flat rate of tax (e.g., 13% in Russia and 12% in Georgia). This shift in rates has resulted, in our view, in Azerbaijan becoming significantly less competitive in attracting foreign investment. Interestingly, in Russia, after the rate was reduced to 13%, personal income tax collections actually increased.

It is worth noting that we have previously, as a matter of policy, avoided commenting on tax rates. We were prompted to make the following recommendation, however, due to the significant disparity which now exists between the personal income tax rates in Azerbaijan and its neighbors (and competitors for new investment), this has become a serious issue which needs to be addressed in the nearest term.

Recommendation

We recommend that the personal income tax rate structure be revised to be more in line with the tax rates in other CIS countries, i.e., significant reduction of the highest marginal rate or introduction of a uniform flat rate of tax.

03. Double Tax Relief Clearance

Azerbaijan has signed a number of double tax treaties with other countries; this network widens every year. Even though current legislation does not impose a requirement to withhold tax in cases where double tax treaty protection is available, the tax authorities take the view that the tax must first be withheld and then refunded. In our view, the current Tax Code does not prohibit advance treaty exemption. Further, the decree of the Cabinet of Ministers dealing with the refund of overpaid taxes only provides a procedure for an offset or refund in the event of a tax overpayment. This decree does not impose a requirement to withhold and then apply for a refund. Further, Article 2.5 of the Tax Code specifically provides that provisions of the double tax treaties and any other international agreements override domestic legislation.

In Azerbaijan, unlike most jurisdictions, double tax treaty relief is on a refund basis only, i.e., taxes are withheld and paid, with the treaty benefits claimed via refund. This approach creates several problems.

In our experience, double tax treaty refund claims often trigger tax audits of the withholding agents, with the taxpayer often owing additional taxes and penalties equal to or greater than the sum which would have been recovered had the refund claimed under the double tax treaty actually been paid. In cases where tax has been withheld and paid to the Azerbaijani budget and a refund subsequently claimed by the taxpayer, it is often difficult to recover the overpaid taxes. Even after the tax authorities confirm the right to receive a refund, as a practical matter, few refunds are actually made.

These realities have a chilling effect on transactions between Azerbaijani tax residents and non-residents. For example, in the context of various services (e.g., leasing, management, loans) rendered by non-resident suppliers, the latter uniformly require that their fees be increased to compensate for any deduction for withholding. While Azerbaijani resident customers are free to seek refund for the “grossed up” payments from the tax withheld, foreign services become considerably more costly due to the inability to get a refund and, if a refund is ultimately paid, the significant delay in receiving the refund.

Most countries, including Azerbaijan’s CIS neighbors such as Russia and Kazakhstan, have successfully established pre-clearance procedures for double tax treaty relief. This pre-clearance procedure allows a non-resident taxpayer (or the resident withholding agent) to apply to the tax authorities for treaty-based advance exemption from withholding tax at source. The system is relatively simple and efficient and eliminates in many instances the need to apply for a refund.

Recommendation

We recommend that the tax authorities follow the provisions of international agreements to which Azerbaijan is a party and allow an advance exemption based on some basic documents (e.g., a certificate of tax residence of the recipient).

04. Tax Refunds

Azerbaijani tax law provides a clear description of the mechanism for refunding overpaid taxes for taxpayers not claiming relief under a double tax treaty. In accordance with the Tax Code, the excess tax, interest and financial sanctions paid must be refunded to the taxpayer within 45 days of the taxpayer's application. The amendments to the Tax Code in the last two years introduced tightened rules for the refund and offset of taxes. These procedures, however, are rarely followed in practice.

Generally, entities with ongoing business activities in Azerbaijan are compelled to carry-forward a refund due as an offset against future tax liabilities until the overpayment is exhausted. Even the offset process is subject to significant delays and administratively burdensome requirements from tax inspectors. Further, under the amended Tax Code, an extraordinary audit may be initiated where there is an offset of overpaid VAT or an application for a refund of overpaid taxes.

We are also aware of cases where companies deregistering their presence in Azerbaijan have attempted to claim their overpaid VAT. The refund claims resulted in penalties and sanctions for fabricated violations, repeated and unnecessary demands for additional documentation, and endless appeals to higher authorities without result.

Recommendation

First and foremost, the Government and Ministry of Taxes should make an affirmative commitment to require tax inspectors to follow the law and publicly available regulations on tax refunds and offsets and ensure that tax inspectors follow both the word and spirit of the law. The improvement to Azerbaijan's reputation as a place to do business would be significant. Regulations which permit tax inspectors to legally impose burdensome demands on taxpayers seeking a refund or offset should be amended or repealed.

05. Tax Inspections/Audits

We all understand that the tax authorities need to satisfy themselves that taxpayers are diligent in paying the correct amount of tax in accordance with tax legislation. The level of arbitrariness historically exercised in this process has been reduced, considerably by presidential decree but further improvements should still be made.

One of the concerns taxpayers have repeatedly raised about tax audits is that, after the conclusion of the tax audit, the tax inspector is required to issue a tax audit *Akt*, the final document in the audit process. A taxpayer can only rebut an *Akt* in the manner established by law, e.g., submission of a rebuttal letter or initiating an action in court. We believe that most issues included in an *Akt* could be resolved through further discussion with the tax inspectors or provision of additional documentary evidence.

Once tax inspectors finished their audit, it would be helpful if, as a matter of course, a draft *Akt* were presented to the taxpayer for discussion before the *Akt* is finalized. This would provide tax inspectors a further opportunity to confirm the accuracy of the issues which they have identified. This would provide a useful opportunity for clarification of any misunderstandings and avoid unnecessary rebuttals or court action.

Recommendation

The Ministry of Taxes should adopt a procedure granting a taxpayer ten (10) working days following presentation of a draft *Akt* to demonstrate and correct any errors in it.

06. Appeals

There have been a number of cases where a taxpayer has received a demand or ruling from the tax authorities with which it disagreed and the taxpayer had no option but to go to court – a time-consuming and expensive process. Additionally, once a tax audit *Akt* has been finalized and a rebuttal to the *Akt* has been submitted, the only remaining remedy available to a taxpayer is for the courts to decide the issue. We believe that there should be other opportunities to resolve the matter before going to court.

Recommendation

We recommend that an intermediate tribunal be created to hear the arguments for and against a tax ruling or *Akt*. The composition of the tribunal would require careful consideration, but a credible tribunal might consist of a tax lawyer, a reputable taxpayer and a representative from the Ministry of Taxes. Both the tax inspector and the taxpayer would make representations to the tribunal. If, once the tribunal issued its decision, the tax inspector and a taxpayer still failed to reach agreement, only then could the matter proceed to court. This system would reduce pressure on the court system, reduce the cost to both the Ministry of Taxes and the taxpayer, and give credence to the assertion that the Ministry of Taxes is looking to help taxpayers fulfill their tax obligations.

07. VAT Recovery

In Azerbaijan, “input VAT” is accounted for on a cash basis, while “output VAT” is done on an accrual basis. This creates an imbalance and, especially in view of the difficulties encountered by members in obtaining VAT refunds, imposes an additional burden on businesses.

Recommendation

The Tax Code should be amended so that the recovery of input VAT is on the same basis as output VAT, i.e., on a cash basis.

08. Loss Carry Forwards

Under the most recent amendments to the Tax Code, the period over which losses can be carried forward was reduced to only three years, from five. For significant projects, this is too short a period to recover start up losses. If Azerbaijan is seriously interested in investment outside the oil and gas sector, this period needs to be longer.

Recommendation

The loss carry-forward provisions should be returned to five years (as it was prior to the amendment).

Customs

AmCham regards the State Customs Committee as among the most responsive elements of the Government in the resolution of specific problems of individual companies. With that in mind, the SCC has maintained a successful dialogue with AmCham, whose members represent a broad cross-section of the international business community in Azerbaijan. In particular AmCham applauds the SCC's action in creating a businessmen's working group (to which AmCham belongs) which meets regularly with the SCC Chairman to discuss and resolve both specific and systemic problems affecting the relations between the business community and Customs. If used properly and with active follow-up, this working group can become an effective instrument for a more efficient and transparent commercial sector in Azerbaijan.

Building on the relations developed and information and understanding gained during the past five years of dialogue, AmCham continues to work with SCC to create awareness of the issues that the business community sees as key to a successful partnership with the Government of Azerbaijan and its development potential in all sectors of industry. A number of those issues focus on desirable systemic change; others are of a more general nature.

01. Electronic Documentation Processing

The SCC has made progress in upgrading the system of electronic documentation processing. Seven of the 45 customs posts have been outfitted with touch-screen systems which enable customers to access laws and regulations pertaining to import and export. The remaining posts are scheduled to be similarly equipped by the end of 2005. Efforts are also underway for the installation of a computerized system in 2006 which will enable importers and exporters, using their own business computers, to track their goods within the customs system.

Recommendation

AmCham recommends that the electronic documentation system include bar coding and tracking to enable the pre-clearance of goods prior to their arrival in Azerbaijan. Such a system would make the current cumbersome clearance process faster, more efficient and reduce opportunities for illegal behavior on the part of customs officials.

02. Bonded Warehouses

The protocol for bonded warehouses has been realized through the establishment of a limited bonded area operated by Murphy's Freight Forwarding International and a similar area operated by Bertling-Caspian for BP. Our members and the business community would like to see these protocols extended and bonded warehouses established for use by the entire Azerbaijan business community.

More widely available bonded warehouses would create the opportunity for companies to bring in consignment stocks of goods, delaying the payment of customs duties and VAT until such time as the goods are introduced into the domestic market. Goods could also be re-exported elsewhere in the Caspian Region without customs duties and VAT, thus creating a Caspian regional hub for warehousing and supply.

Recommendation

The Government of Azerbaijan should permit, on a transparent basis, the establishment of additional bonded warehouses in appropriate locations including Baku International Airport and the industrial seaports.

03. Revision to Customs Tariffs Law and Harmonized Customs Codes


In our view, revisions to customs tariffs and the harmonized Customs Code are essential to bring clarity to the customs duty schedules in a format that follows international practice. The SCC has demonstrated sensitivity to this issue by presenting and discussing with AmCham its revised Customs Tariff Law which included Harmonized Customs Codes on certain goods which, when adopted, will share a common language with that of other customs codes used worldwide. AmCham supports this initiative and looks forward to its implementation so that local customs practices conform to the internationally recognized standards of the World Customs Organization (WCO).

High duties not only make Azerbaijan less competitive with neighboring countries generally but also encourage illegal arbitrage in goods by unscrupulous importers. Azerbaijan's import duties are often so much higher than those of neighboring countries that it is possible to purchase duty-paid goods in a neighboring country, smuggle them into Azerbaijan, and sell them for a handsome profit.

We also note with approval the discussions between the SCC and experts from the United States and Europe on customs harmonization. A number of the recommendations made by these studies have been fulfilled and progress has been made. Regrettably, these efforts have produced less than they might have, due in part to SCC resistance to change but also due in part to some impractical recommendations by some foreign experts.

Recommendations

We recommend that, wherever possible, future interactions be-



tween international structures and the SCC adopt the largely successful patterns of cooperation between the SCC and UNDP for the European-sponsored SCAT anti-narcotics program or for the American-supported Export Control Program related to the control of traffic in WMD and their precursors.

We also recommend that Azerbaijan's import duties be reduced to match those of its neighbors.

04. Counterfeit Goods

Although progress has been made, the flow of counterfeit goods into the market place is still a significant problem. The interdiction of counterfeit goods needs to be made a higher priority.

Recommendation

Greater efforts should be made to stem the flow of counterfeit goods.

05. Inter-Ministerial Issues Regarding the Import of Goods

Regulatory requirements and the interpretation of laws and regulations regarding imports sometimes vary between the SCC and ministries or other governmental agencies. Some Government structures have internal rules, not publicly available, concerning imports which add unnecessary burdens to the existing legal requirements. This leads to confusion and lack of business predictability which inhibit the growth of business activity. AmCham's ongoing dialogue with the SCC will highlight these issues.

Recommendation

We recommend that the SCC (or some other appropriate agency) take the lead in the Cabinet of Ministers to harmonize throughout the Government of Azerbaijan all import regulations and their implementation.

Banking, Finance and Insurance

Since our last White Paper, we have observed significant improvements in the banking, finance and insurance sector for which we commend the Government and encourage it to continue and redouble its efforts in this regard. Notable efforts have been made toward Azerbaijan's qualifying for IMF Article VIII conditionality which will ultimately make the Azerbaijani manat fully convertible, i.e., all the restrictions on transfers will be removed. Additionally, the new Banking Law has clarified and modernized the banking secrecy rules and payment system reforms have been introduced.

Recognizing that an effective system of registering pledges and mortgages is essential to the development of the credit industry in Azerbaijan, the Government has improved the laws on taking collateral and securing loans. Unfortunately, the unified mortgage register and a register of pledges of movable property are not yet operational. As these are essential to the development of a long-term credit industry in Azerbaijan, AmCham strongly encourages that the Government cause these registers to become operational as soon as possible.

In the insurance sector, the Ministry of Finance, as the regulator of insurance market in Azerbaijan, has established Insurance Advisory Council chaired by Deputy Minister Azer Bayramov. Alongside with the Ministry's officials representatives of leading insurance companies are members of the Council, including several AmCham members. One of the objectives of the Council is the development of Azerbaijan's insurance legislation. AmCham appreciates the establishment of the Council and hopes that the Council will be a powerful force to move Azerbaijan toward in-

ternational standards of insurance practice. One issue AmCham would like to see the Council address is the recent amendment to the insurance laws concerning reinsurance operations (effective August 6, 2004) which, in our view, are contrary to the declared policy of having Azerbaijan move toward internationally accepted business principles.

Notwithstanding these generally positive developments, we identify here areas which we believe require urgent attention to help assure the continued development of Azerbaijan's banking system and insurance industry.

01. Banks as Tax Agents

Currently, Azerbaijani banks are deemed to be tax collection agents for the government and are obligated to supervise the payment of their customers' tax and similar payments such as social contributions. Penalties are imposed on banks for the failure of their customers to make these obligatory payments. This is an unnecessary and costly burden on the operations of Azerbaijani banks.

Recommendation

In accordance with international practice, the Tax Code should be amended to remove Azerbaijani banks as tax agents for the government and relieve banks of the obligation to supervise their customers' tax payments.

02. Interest on Bank Reserves

As in most countries, commercial banks in Azerbaijan are required by law to maintain a deposit with the central bank, the National Bank of Azerbaijan (NBA). In most countries, the central banks pay interest on these mandatory reserves. This interest can be used by banks which need additional liquidity. Typically, banks using this interest on their reserves must pay interest on the funds used, i.e., the central bank's rediscount window. Contrary to internationally accepted practice, however, NBA does not pay interest on the mandatory reserves of Azerbaijani banks. This deprives local banks of access to relatively inexpensive funds which would enhance the liquidity of the local bank market.

Recommendation

In accordance with internationally accepted practice, the National Bank of Azerbaijan should adopt regulations which would permit locally licensed banks to earn interest on their mandatory reserves and permit banks to borrow that interest when necessary.

03. Secondary Financial Markets

As we noted in our first White Paper in 2001, Azerbaijan's financial markets for treasury bills, foreign exchange, repo agreements and other local debt instruments were poorly developed. Since that time, a fledgling market had developed for trading domestic treasury bills. This was an important step for the development of local capital markets. Unfortunately, that limited market was essentially destroyed by the government policy of repurchasing its own internal debt which resulted in an insufficient number of domestic treasury bills in circulation to support a local market to trade in them. In many jurisdictions, treasury bills are used as the basis for determining the most favorable market interest rates and to provide additional liquidity in the local currency. These markets also absorb excess cash liquidity in the local market, reducing inflationary pressures.

Recommendation

The government should issue and keep in local circulation sufficient manat denominated bonds to promote the development of local capital markets.

04. Development of Domestic Interbank Manat Market

While important steps have been taken to modernize the rules governing the international transfer of funds, the rules governing transfers between local banks are still seriously deficient. For example, local banks are still not permitted to have short-term banking relationships with other Azerbaijani banks. Due to this restriction, local banks are not allowed to clear Azerbaijani manat transactions via other banks. Rather, the National Bank of Azerbaijan maintains a monopoly on this type of transaction. This has precluded the development of a local interbank manat market.

Recommendation

The National Bank should take immediate steps to permit Azerbaijani banks to clear Azerbaijani manat transactions through other local banks.

05. Sovereign Eurobond Issuance

Around the globe, and in the countries of Eastern Europe and the CIS in particular, governments and businesses rely on the placement of foreign currency-denominated debt to obtain relatively low cost, often fixed-rate, funds to finance their activities. The interest rates on these bonds are determined by a number of factors, but the single most important of which is the rate at which the national government is able to place its own international debt. A national government's Eurobond is known as the country's "sovereign benchmark" as businesses and municipalities, as a general matter, cannot obtain better terms for their debt offerings than the national government.

The countries of the CIS have been extremely successful in placing Eurobonds on international markets, generally at interest rates lower than are available through bank loans. More importantly, these

international debt placements have opened the door for local businesses and municipalities to access international debt capital markets as well. Unfortunately, companies in Azerbaijan do not have access to this important source of international finance due to the Government of Azerbaijan's lack of interest in issuing its own sovereign benchmark bond.

Recommendation

The Government of Azerbaijan should access international debt capital markets through the issuance of a sovereign Eurobond to establish a benchmark rating for Azerbaijani debt, thereby creating favorable conditions for local companies (and, with some legislative changes, municipalities) to obtain lower cost financing through international capital debt markets.

06. Withholding Tax on Payments to Foreign Banks

Interest and other charges paid to foreign banks are generally subject to 10% withholding tax. As all foreign commercial banks uniformly require that the payments to them by local borrowers be adjusted (“grossed-up”) to compensate for the withholding, the cost of funds from foreign banks is substantially increased. Given that few, if any, local banks have the ability to finance large projects, Azerbaijani borrowers are generally limited to borrowing from tax-exempt multilateral institutions. Eliminating this cost differential between borrowing from multilateral institutions and foreign commercial banks would open up additional sources of financing to Azerbaijani borrowers and lower the cost of borrowing.

Recommendation

Interest payments and other charges to foreign commercial banks should be exempt from withholding and other taxes.

07. Bank Syndications/Collateral Agents

Given their relatively small size, even the largest Azerbaijani banks find it difficult to provide financing for even small projects. In other jurisdictions, banks large and small are able to overcome this difficulty by pooling their resources and spreading the risk through loan syndications in which two or more banks (and often dozens) each fund a portion of the overall loan. To secure the loan, a single security trustee or collateral agent is appointed to hold (and, if necessary, enforce) the pledge or other security interest on behalf of all the lending syndicate banks.

In Azerbaijan, however, this option is not readily available due to the lack of a defined legal framework for syndicated loans and security trustees/collateral agents.

Recommendation

Amendments should be made to the Civil Code and other laws to expressly permit the use of collateral agents to hold and enforce security for bank syndications and other transactions where lenders need or wish to have a third party to act a security agent, payment agent and/or collection agent.

08. Insurance - Definition of Financial Services

In Azerbaijan, consistent with international practice, financial services are exempt from certain taxes such as VAT. Similarly, in the most jurisdictions, insurance and reinsurance brokerage activities are considered to be financial services. In Azerbaijan, while Article 13.2.14.7 of the Tax Code makes clear insurance and reinsurance activities are financial services, it does not specifically mention insurance and reinsurance brokerage activities. The Azerbaijani tax authorities have used this ambiguity to argue that these are not financial services even though these activities are included in insurance industry under the law *On Insurance*. This uncertainty has hindered the development of insurance and reinsurance brokerages which are an important component of a healthy insurance industry.

Recommendation

Article 13.2.14.7 of the Tax Code should be amended to specifically include insurance and reinsurance brokerage activities as “financial services.”

09. Life Insurance and Retirement Savings

To provide the citizens of Azerbaijan the ability to save for retirement, the Government should encourage the development of a life insurance and pensions market. As more and more young people become employed, they need to be encouraged to save and plan for the future. In more developed insurance markets, life insurance and pension funds are accepted practice as a way to plan for future financial needs. However, in order to encourage people to take out such policies and to encourage life insurance and pension companies to provide this coverage, incentives are needed, such as tax relief on the contributions paid by individuals which are then invested by these companies.

Recommendation


Article 98.2.5 of the Tax Code should be amended to provide that employee contributions to retirement and pension plans are excluded from taxable income and are not be subject to income tax, without regard to whether these plans are arranged locally or overseas.

Communications and Information Technology

Responding in part to repeated entreaties over several years from AmCham and other elements of the business community, President Ilham Aliyev replaced the Minister of Communications in early 2004 with the reform-minded Ali Abbasov. At the same time the President expanded the responsibilities of the Ministry and renamed it the Ministry of Communications and Information Technology. AmCham stands ready to offer its advice and services to the Ministry to speed the pace of reform intended by the President and the Ministry.

AmCham and its ally, the Turkish Businessmen's Association, joined with the embassies of the United States, United Kingdom and Germany, as well as the German-funded GTZ to form an ICT Advisory Council which would offer to the Ministry a specific roadmap of measures and questions designed to encourage and enable reforms which, over time, would lead to a transparent and investor-friendly ICT sector in Azerbaijan, priced and operated in accordance with accepted international norms. Discussions within the Advisory Council led to the crafting of a vision paper and a list of questions and proposals which were presented to Minister Abbasov in March 2004.

AmCham is also pleased that the Minister subsequently appeared as guest speaker at one of our monthly AmCham luncheons at which he described how the Ministry is working toward many of the goals outlined in the March 2004 proposals. Additional follow-up included several one-on-one meetings between the Minister and the President of AmCham as well as frequent contacts between Ministry officials and representative of the Advisory Council.



AmCham's efforts to work with the expanded Ministry to promote specific business-friendly reforms in the ICT Sector have not been completely successful - yet. However, we have made more progress faster in this endeavor than in any other we have undertaken with any other government ministry in Azerbaijan. AmCham attributes this stellar record to the energy and enthusiasm of Minister Abbasov in carrying out the reform policies of the President. Improvements attained in this brief period include:

- Fees: Internet fees for subscribers and costs for leased copper lines have been reduced to normal international levels. There has been a twenty percent reduction in the cost of international phone calls and a small reduction was made on the costs of satellite circuits.
- Internet Speed: Internet speed is increasing – several high speed internet options are available via cable and satellite download. Ping timeout is falling and beginning to approach normal levels.
- Regulatory Body: At the recommendation of the World Bank and AmCham, the Ministry has created a new regulatory body. However, the new body is wholly subject to the Ministry and does not incorporate within its purview several other regulatory elements of the Government of Azerbaijan which deal with aspects of the ICT Sector. Moreover, the Ministry has recently contracted with the United States Trade and Development Agency for an extensive study on the legal and regulatory reforms necessary to bring the practices of the Ministry in line with international norms. It is not clear, however, why the Ministry would form a new regulatory body in advance of the conclusions of the TDA-funded study.

- Manufacturing: The Minister strongly supports establishment in Azerbaijan of a “technopark” where ICT Sector equipment would be assembled or manufactured. He has proposed this step within the councils of Government and to the Academy of Sciences and he has asked that AmCham join in support of the concept at the appropriate moment.

Despite the substantial progress achieved during the past year, there remain several ICT issues which continue to concern AmCham. As would be expected, these are issues for which change is most difficult and we recognize that more time is necessary. Nevertheless, we make the following recommendations.

01. Privatization

It appears that the Government has decided to retain ownership of dominant ICT entities, modernizing them before privatizing them on the theory that this will add value for future sales. AmCham feels that the Government will not be able to anticipate the needs and demands of future investors and that the retention of what will amount to a near monopoly by the Ministry in an area which it regulates will discourage potential investors.

Recommendation

We recommend that the Government privatize its revenue-generating enterprises and let the new owners decide what modernization is desirable and appropriate.

02. Intellectual Property Rights

Bootleg copies of software and DVDs remain readily available in Azerbaijan and some television stations continue to broadcast movies using bootleg DVD's as their source. One firm continues to rebroadcast television programs without the permission of the company which owns the rebroadcast rights for those programs.

Recommendation

AmCham recommends a renewed and effective effort to protect intellectual property rights which are violated in these instances to bring Azerbaijan into line with its obligations under the World Intellectual Property Treaty and the tenets of the Council of Europe while enhancing confidence in the ICT sector of the business community. The Ministry should work closely with the State Customs Committee to preclude the import of "bootleg" DVDs, CDs and software, and with security authorities to end local com-

mercial copying of these in violation of the intellectual property rights of the owners.

03. Single ICT Regulatory Authority

As mentioned above, while the Ministry has created a new regulatory body, the new body does not have within its purview several regulators with authority in the ICT Sector.

Recommendation

If a single ICT regulatory body cannot be created at this time, AmCham proposes that a senior level point of contact be named, within the Ministry who would be designated to meet regularly with AmCham and other interested bodies to discuss and receive proposals regarding ICT issues and who would be empowered to speak for the several committees and other groups involved in ICT regulation.

Labor

After careful consideration, AmCham has concluded that the following three (3) issues are the most important matters requiring legislative review. In making our selection from among the many issues that face employers and employees, we have limited ourselves to areas which are either considered unfair, from an objective viewpoint, to either employer or employee, or would, if our suggestions are implemented, encourage greater employment generally.

01. Overtime

Under the law prior to the Labor Code (1999), entitlement to leave depended on the nature of the employee's job. The distinction may, very loosely, be referred to as one between white-collar (managerial, professional and skilled) and blue-collar (unskilled) workers. The latter were entitled to 21 calendar days of annual leave. Overtime was in most cases prohibited for blue-collar workers but, where it was permitted, had to be specially remunerated. White-collar workers were entitled to 30 calendar days annual leave but the employer was not required to pay for overtime as this was deemed to be compensated in the higher annual leave entitlement.

Following the introduction of the new Labor Code in 1999, the overtime provisions for both white-collar and blue-collar workers were aligned. As a result, it is no longer legally possible to require white-collar workers to work overtime except in very limited 'emergency' situations and such overtime must be additionally remunerated. Despite this change, white-collar workers retain their entitlement to 30 calendar days basic annual leave. We believe this gives rise to a substantial increase in costs to employers. We also believe that the restrictions on the circumstances in which overtime may be performed considerably reduce an employer's flexibility in organizing work and encourage employers (including government offices) to implement illegal procedures.

We also believe the restrictions on overtime, designed to permit an employee sufficient rest, are unnecessary as there is no restriction on an employee taking a second job.

Recommendation

Repeal Articles 99(2), 101, Labor Code. This will then permit overtime in all situations.

Amend Article 165, Labor Code by adding a new paragraph at the end of sub-Article 1 which will read, “No payment pursuant to this Article 165 shall be made in respect of overtime work performed by employees falling within the categories listed in Article 114(3).”

02. Annual leave

The Labor Code contains contradictory provisions concerning annual leave entitlement. When reading Article 134, it appears that leave may be carried forward (deferred) to another year. But, when reading Article 135, it turns out that under no circumstances may main leave be carried forward, i.e., the implication is that only additional leave may be carried forward.

Article 136 of the Labor Code states that basic and additional leave shall be granted together. But this provision contradicts Article 137, under which an employee is allowed to take his leave in parts – in other words, an employee is entitled to divide his leave into several parts.

Recommendation

Amend Article 134(1) as follows: ‘Leave may be deferred for valid reasons, as specified in this Article 134.’

Amend Article 135(1) as follows: ‘It shall be prohibited not to provide main leave for two consecutive years.’

Repeal Article 136(1). This reads: Main leave as provided in Article 114 of this Code shall be granted together with additional leave as provided in Articles 115 and 116 of this Code.

03. Temporary Workers

Employers often need to fill temporary vacancies for skilled and semi-skilled positions (secretaries, clerks, accountants, etc.) but may not know the exact length of employment at the outset. In such situations, employers do not wish to make a commitment to take on new staff, even on short-term contracts. In many countries, employers resolve this difficulty by applying to agencies which supply temporary workers. These agencies are responsible for paying salaries, withholding taxes, providing employee benefits, etc. The system of agencies greatly increases employer and employee flexibility. It allows employers to react quickly if there is a sudden demand without bearing the risk of employing a large number of short-term workers. At the same time it allows workers the flexibility to work or not to work as they feel necessary.

This type of arrangement, however, under current law, creates difficulties for the agency supplying temporary workers. If the agency enters into short-term employment contracts of employment, it becomes liable for providing all employment-related benefits (annual leave, service-related leave, maternity benefits, sick leave, etc.). Often these benefits cannot be predicted or the costs fully recovered from the company to which the services are provided. We would like to see greater flexibility both in terms of providing benefits (e.g., an employee should be allowed to agree with the employer to carry forward annual leave) and with respect to contractual terms (such employees should be explicitly permitted to enter into short-term contracts expiring when their services are no longer necessary).

Recommendation

Insert a new Article 47A in the Labor Code, 1999, to read as follows:

Article 47A. Temporary Contracts

1. Any contract of employment which does not specify a fixed term but states that the contract shall expire after the completion of a particular task or the occurrence of a stipulated event shall be permitted and shall be referred to for the purposes of this Article 47A as a “temporary contract”.
2. A temporary contract shall be subject to all the provisions of labor legislation except that the following shall apply:
 - a) A new employment contract shall not be required in the event of the transfer of the employee to a job falling within another profession, specialty or position and Article 59 (Transfer to Another Job) of this Code shall be construed accordingly;
 - b) An employee working under a temporary contract may perform a job at another company (whether or not the job of another employee) without additional compensation and Article 61 (Performance of Another Employee’s Job) of this Code shall be construed accordingly.
 - c) For the avoidance of doubt, for the purposes of a temporary contract, the employer shall be the person with whom the employee enters into a contract of employment, whether or not the services of the employee are provided directly to or at the premises of that employer.
 - d) The employment contract of an employee under a temporary contract shall state the place of work as being the principal place of work in the Republic of Azerbaijan of the

employer whether or not this is the actual place of work for the employee.

- e) Articles 78 (Individuals Given Preference During Redundancy), 79 (Employees Whose Employment Contracts Cannot be Terminated), and 133(3) (Order of Preference for Vacations) of this Code shall not apply to employees on temporary contracts.
- f) Employees under temporary contracts shall be permitted to request a deferral of any vacation from one year to the next or following years.

Tourism

AmCham commends the new Ministry of Youth, Sports and Tourism for its efforts to date to improve the business climate for the tourism business in Azerbaijan. Although much remains to be done, it is now much easier to in principal tourism activity under the Ministry than it was under its predecessor State Committee for Tourism. Following the recommendations of the World Tourism Organization (WTO), the Ministry has been instrumental in implementing several important improvements, including:

- Reduction of visa prices for short-term visitors to Azerbaijan;
- Identification of seven tourism routes which are to receive Tourist Information Centers;
- Implementation of a tourism development plan with the assistance of UNDP;
- Launching a new official tourism website.

Many other improvements, however, have occurred as a result of through general taxation, regulatory and licensing changes in which The Ministry of Tourism was not involved. Similarly, many of the improvements needed to develop tourism further in Azerbaijan lie outside the Ministry's authority, including:

- Further taxation benefits to encourage regional tourism;
- Infrastructure improvements such as transportation, roads and electricity;

- Telecommunications improvements to expand connectivity and service availability in smaller urban and rural areas, including improvements in internet access and television reception (Ministry of Communications and Information Technology);
- Conservation and development of national parks (Ministry of Ecology);
- Conservation and development of museums and other sites of special interest (Ministry of Culture); and
- Handicraft development (Ministry of Culture).

Understanding the inherent difficulty of inter-ministry coordination, AmCham has identified the following as the most pressing issues for business operating in the tourism sector.

01. Lack of Coordination and Communication of Tourism Policy

The principal impediment to private sector development in tourism is the lack of coordination and information sharing among the governmental, international, and private sector organizations. Additionally, considerable duplication of effort and critical gaps exist because organizations are unaware of what other organizations are doing. Two examples of unnecessary duplication of effort due to the lack of coordination can be seen in the development of a marketing strategy where Eurasia Foundation was unaware of the World Tourism Organization report and the USTDA project follows the Citizens Democracy Corps (CDC) report for OSCE.

Within the Ministry itself there is a need for greater openness, not just on budgetary matters but also on making “public” documents available to private sector companies. The authors of the CDC Report waited for over a month to get a copy of the national strategy document before finally giving up. This type of information is critical to companies needing to understand the government’s plans for development within the sector.

Recommendation

AmCham recommends the establishment of a working group headed by the Minister of Youth, Sports and Tourism, which would include high-level officials from the Ministries of Finance, Tax, Communication, Culture, the Customs Committee and others, as well as representatives from AmCham and other business groups. This group would address issues in the tourism sector in a transparent, coordinated fashion and participated in the preparation of the National Tourism Strategy, which should be prepared and revised in a transparent manner.

02. Mandatory Health Inspections

The employees of companies engaged in tourism are currently required to undergo mandatory state health inspections. In practice, these checks are non-existent and usually dispensed with by a \$15 payment. We believe that approved medical services would provide a superior service. This would not only improve the quality of health care for workers but also provide further stimulus for the private health sector.

Recommendation

We recommend allowing companies to opt out of the state-required health checks and allow companies to use approved private medical services for their employees.

Agriculture

While overall economic progress in Azerbaijan has been very positive recently, the agriculture sector has been sorely neglected. Since independence, agricultural production has declined by more than 50% and Azerbaijan's agriculture has evolved into small-holder farming, mainly for subsistence and the domestic market. Clearly this is not the best use of the country's rich soils, wide agricultural plains and varied climatic conditions, not to mention that 45% of the population lives in rural areas, many in poverty. In order to avoid the "Dutch Disease," achieve broad, equitable growth and reduce poverty, Azerbaijan must focus attention and resources on revitalizing the agricultural economy.

In spite of its decline, agriculture is still the largest employer, providing seasonal jobs to some 30% of the labor force (vs. only 3% for the oil and energy sector) and contributing about 20% to GDP. It is the second largest (and potentially largest) export sector with large potential markets in the Middle East, Europe and the former Soviet Union.

Two major challenges face the Government in agriculture: 1) to provide the legal and regulatory environment that will allow agricultural markets to work, and 2) to ensure that financial and credit facilities better serve agriculture. Agriculture markets include not only the farmers who till the soil and tend the sheep, but also all the agricultural input, supply and service industries as well as processing, transport, distribution and export industries that link the original producer to the final consumer. An analysis of the current status of agriculture in Azerbaijan clearly shows that crops requiring further processing are in decline while subsistence crops and those that can be marketed directly by the

farmer are doing reasonably well. This underscores the need to revitalize agricultural processing and ancillary industries to increase rural productivity and incomes. These value-added processing and ancillary industries such as wineries, mills, gins or canning factories, are essential to serve as markets for domestic farm production and to compete with imports.

The role of the Government is key: to provide the legal and regulatory framework for a level playing field; to provide the legal framework for a private agricultural credit and finance system; to provide and maintain basic rural infrastructure and to support new technology and education in the agricultural sector. This is necessary to avoid over dependence on the energy sector, reduce poverty and provide equitable growth.

AmCham strongly encourages priority attention to the agriculture sector. In the long term, a larger share of Azerbaijan's national budget needs to be allocated to improve and maintain basic rural infrastructure such as roads, irrigation, market information systems, wholesale market facilities and electricity. Investment in agricultural support systems such as agricultural education in public schools, agricultural extension services and agricultural research. This would send a signal to the private sector that the Government is serious about promoting the agriculture sector - from small farmers to large processors and exporters, in Azerbaijan.

01. Coordination between Ministries

As in other sectors discussed here, AmCham recommends a coordination of effort between the Ministries of Agriculture, Taxes, Economic Development and Justice and the State Customs Committee. Agriculture is a sector where the main issues (taxes, customs, tariffs, registration and land titling) do not lie within the domain of a single ministry. Before substantial investment will come to the agricultural sector, investors need to know the “rules” and know that the rules are consistent throughout the government.

Customs requirements also need to be clarified and simplified. For example, the duties on importing seed differ from importing the same product for consumption, and seed is subject to a 3-year testing requirement. This means the Azerbaijan farmer must always use “outdated” technology. Additionally, customs requirements need to be clear, consistent and transparent to all, including not only the importer but everyone in the customs departments as well.

Recommendation

A task force should be established amongst the relevant ministries with the necessary authority to coordinate the harmonization of rules and regulations relating to agriculture and agribusinesses between various ministries and other government entities.

02. Quality Standards

Quality and standards in Azerbaijan are not competitive. Azerbaijani agricultural products do not meet international quality standards, either for export or to compete with imports. Azerbaijani quality standards need to be revised to international standards. Codex Alimentarius is a commission of the Food and Agricultural Organization and World Health Organization created to harmonize the standards for food production and processing and offer assistance to countries that lack the resources to conduct the extensive research needed to create sound standardization on their own. Azerbaijan has not yet joined while Turkey, Georgia and Armenia are already members.

Recommendation

AmCham recommends that Azerbaijan join the Codex Alimentarius which would be a key first step to improving the quality and standards of Azerbaijan agricultural products.

03. Credit and Micro-Credit Programs

Access to credit and finance are not adequate to serve current needs. Banks simply are unable to make loans for agricultural activities. Small farmers have difficulty obtaining loans to buy seeds or fertilizer, resulting in low productivity. Many wheat mills, cotton gins, canning factories, wineries and breweries are in disrepair or closed, resulting in a lack of markets for farmer's products. Currently, insufficient systems (such as a credit guarantee program) have been developed to encourage innovation, and support existing small and micro-credit projects of NGOs and other organizations.

Recommendation

AmCham recommends that the government of Azerbaijan pass legislation and establish a regulatory environment that will encourage credit and financial assistance to the agricultural sector, small as well as large. We also recommend that the Government advocate and promote micro-credit programs to ease developmental obstacles.

04. Infrastructure Improvements

While AmCham understands budgetary constraints, the Government has not adequately maintained farm-to-market roads, irrigation systems, market information systems, electricity or other essential infrastructure and has not provided access to state-of-the-art technology, seeds and agricultural inputs.

A visit to any of Azerbaijan's agricultural regions makes obvious the lack of basic infrastructure required for a thriving and prosperous agricultural sector. A look at the current agricultural technology, seeds and plant varieties will show that Azerbaijan is using past year's technology and is, therefore, unable to compete in international markets. There is some improvement on infrastructure around country but more improvement is needed as budgetary realities permit.

Recommendation

In addition to the infrastructural improvements noted above, AmCham recommends placing a greater emphasis on the agricultural sector as a means of increasing employment and easing the burden on imported production. This would include strengthening the responsiveness of the Ministry to include training programs for farmers in the use of modern farming techniques, hybrid seeds, insecticides and fertilizers as well as access credit programs to give substance to the training.

05. Definition of Crucial Terms

Terms need to be defined for consistent enforcement of regulations. For example, the definitions of “farmer” and “agriculture business” are unclear. Farmers are exempt from tax, but a farmer who also processes meat for sale becomes a “business” subject to tax and other restrictions. Similarly, the definition of “agriculture” is too narrow to accommodate the development of agriculture in Azerbaijan. Other key terms are not defined consistently and transparently throughout Government.

Recommendation

We recommend that legal terms related to agriculture be consistently and comprehensively defined, including the terms “farmer” and “agriculture business”. Terms like “agriculture” should be defined broadly to include the input, supply and service industries as well as processing, transport, distribution and export.

Protection Of Intellectual Property Rights

In Azerbaijan, failure to protect intellectual property rights is a problem which encompasses the jurisdictions of several ministries and other elements of government. As a UN member, Azerbaijan is a signatory to the World Intellectual Property Organization Treaty. As a member of the Council of Europe, Azerbaijan accepts the tenets of that organization regarding the protection of patents, trademarks and copyrights. Further, under the Constitution of Azerbaijan, its responsibilities under these treaties must be fulfilled and take precedence even over the laws of Azerbaijan other than decisions taken by referendum or the Constitution itself. All of the above impose upon Azerbaijan the obligation to protect intellectual property rights, yet their violation is routine.

Uncertainty regarding the safety of a product or a manufacturing process can be a major stumbling block to the decision of any firm to do business in Azerbaijan where that business involves sale or production of a product for which the intellectual property right constitutes a major element of its value.

The very nature of this issue precludes the availability of reliable statistics but, anecdotally, one can see:

- pirated copies of CDs and DVDs for sale at shops and kiosks throughout Baku;
- pirated copies of computer software for sale at computer shops;
- local television stations which broadcast pirated versions of first-run films, often those which are at the same time showing legitimately at the Azerbaijan Cinema;

- a firm which illegally rebroadcasts satellite television programs using for this purpose the broadcast tower which belongs to the Ministry of Communications and Information Technology;
- widespread sale of counterfeit medicines and drugs which violate the patent rights of the international pharmaceutical companies which developed them; and
- the common sale of counterfeit cigarettes.

Recommendation

As the responsibility for the import, broadcast, and sale of products in violation of the intellectual property rights of their owners and legitimate licensees is divided among a number of ministries, state committees and other elements of government, AmCham recommends that the Prime Minister and the Cabinet of Ministers institute a renewed and effective effort to protect intellectual property rights which are violated in these and other instances to bring Azerbaijan into line with its obligations under the World Intellectual Property Organization Treaty and the tenets of the Council of Europe.

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