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# Problems Encountered during the Transition to Market Economy in Azerbaijan and Solution Attempts

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*After re-gaining its independence on 18 October 1991, the Republic of Azerbaijan started the transformation to the market-based economy and the integration into the world economy. The country's oil and natural gas reserves have been considered the main source for financing a range of government programs for reforms. On the one hand, these reserves had to be used effectively; on the other hand, there was a huge demand for foreign investment for extraction. To this end, Azerbaijan has signed "Contract of the Century" in 1994. Although Azerbaijan has wide oil and natural gas reserves, it has faced a number of difficulties in its transition path. This study analyzes these problems and reforms for solving them. One of the types of the problems related to the economic structure of the former Soviet Union: disruption of the economic ties between the republics resulted in a decline of production, high levels of unemployment and prices and consequently led to an economic recession in all of the republics. Another set of problems related to the lack of sufficient institutional bases to transform to the market economy. Moreover, internal conflicts between the political parties and groups for having authority as well as political chaos in the republic can be considered other serious problems during the transition period. Furthermore, Karabakh war and occupation of 20 percent of the Azerbaijani territory by the Armenian military forces had made the situation extremely complicated. Despite all of these extremes, Azerbaijan transformed to the market-based economy decidedly and even became one of the fast growing countries of the world. Even in 2013, with the GDP growth rate of 5.6 percent, Azerbaijan was a leader among growing economies. In parallel with this significant economic development, there is still a need for some socio-economic and institutional reforms in order to get a well-functioning market-based economy in Azerbaijan.*

**Keywords:** Azerbaijan, oil, natural gas, informal sector, energy resources, oil dependency

**JEL Classification:** P21

## 1. Introduction

After gaining its independence in October 18<sup>th</sup> 1991, Azerbaijan has launched a number of reforms to liberalize its economy and realize a smooth transition to market economy. Energy sources such as gas and oil

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reserves in the basin of the Caspian Sea were main instruments in achieving these targets. Efficient utilization of these resources served as a pre-requisite of these economic goals and hopefully Azerbaijan succeeded in that. Since 1994 Azerbaijan has started extensive utilization of Caspian energy resource in the name of economic, political and social reformation, regeneration, growth and independence. A number of resolutions were made and followed by contracts and project in order to produce oil and gas and distribute them to world market (Suleymanov, Zeynalov, 2012).

Other newly independent countries of Caspian Basin, Kazakhstan and Turkmenistan also decided to join this process by utilizing their potential oil and gas reserves with the aim of relieving pains of transition period to reorganize their economies. However existing pipelines had limited capacity and did not coincide with new routes to open up to world energy market, because they were set according to Soviet Union's planned economy and covered only Union countries. The Caspian Basin gained great importance immediately after the collapse of the Soviet Union and proclamation of independence by Caspian coastal countries, namely Azerbaijan, Kazakhstan, and Turkmenistan. Improvements in energy resources of the Caspian Sea became unavoidable for these countries for reformation of their economies and achieving integration to world economy. Especially foreign capital know-how were needed for efficient development of resources. In this regard, the three states invited western firms to invest in the region for energy resource extraction.

Azerbaijan and Kazakhstan wanted their oil revenues to flow rapidly to the country (Aras, 2005). Being one of the world's most important energy sources oil has a wider field of use among other sources of energy. Expenditure on extraction, transportation and distribution of oil comprise the biggest cost of petroleum products.

For all three countries methods for efficient use of the oil proceeds need to be worked out in order to improve non-oil sector and decrease the risk of oil dependency in the long run and achieve rapid economic growth and improvements in real income (Aras, 2008). Some of the macroeconomic indicators of Azerbaijan are displayed in the following table.

**Table 1. Main socio-economic indicators of Azerbaijan**

	2000	2008	2009	2010	2011	2012
Population (thousand)	8 114.3	8 897.0	8 997.6	9 111.1	9 235.1	9 305.1
Total GDP (mln \$)	5 272.8	48 852.5	44 297.0	52909.3	63402.5	64412.5
GDP per capita (\$)	662.9	5 603.3	5 018.2	5922.0	7 003.4	7 206.5
Total investments (mln AZN)	967.8	9 944.2	7 724.9	9905.7	12 776.4	13 776.4
Foreign trade volume (mln \$)	2 917.3	54 926.0	20 824.5	27960.8	36 326.9	36 529.9
Exports (mln \$)	1 745.2	47 756.0	14 701.4	21360.2	26 570.9	26 670.9
Imports (mln \$)	1 172.1	7 170.0	6 123.1	6600.6	9 756.0	9 859.0
State budget revenues (mln AZN)	714.6	10 762.7	10 325.9	11403.0	15 700.7	17 360.7
State budget expenditure (mln AZN)	764	10 774.2	10503.9	11765.9	15 396.2	17 796.2
Personal income (mln AZN)	4 047.3	20 735.4	22 601.1	25607.0	30 633.5	32 633.5
Average salary (mln AZN)	44.3	274.4	298	331.5	363.1	423.1
Official unemployment	43 739	44 481	41 100	38 966	38 330	37 330
CPI (ratio to the previous year)	101.8	120.8	101.5	105.7	107.9	105.9
PPI (ratio to the previous year)	129.7	123.4	80.6	130.5	133.5	123.5

Source: NSCAR 2012

Caspian energy resources were a motivating factor and in parallel with foreign capital inflows to the country, the international financial institutions started to increase the loans to Azerbaijan. During the last period of the Soviet Union, the process of collapse caused chaotic environment where distribution of state property and social wealth for the purposes of personal use was commonplace. From this point, bribery and corruption inherited from the Soviet system of society was one of the severe social issues. Although some changes were made to deal with bribery and corruption, the presence was long felt widely in the general population. Formal and informal tax systems were available. The regulatory role of informal taxes, was greater than the regulatory role of official duties (Aras, 2005).

## 2. Overview of the Azerbaijani Economy after Independence

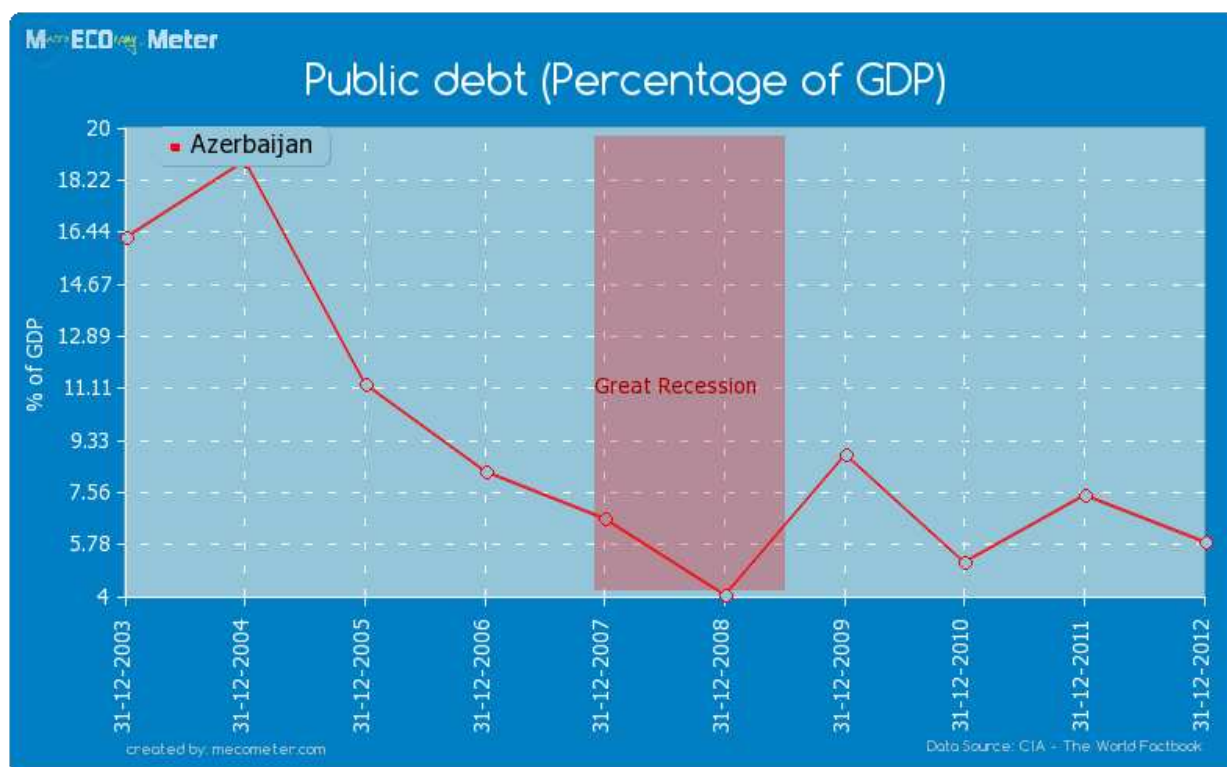
After the declaration of independence most important resources in reforms to achieve Azerbaijan's economic objectives for the realization of the country's free market economy were energy resources of the Caspian Sea consisting of oil and natural gas reserves.

Since 1994, Azerbaijan's oil and natural gas agreements with international companies and common activities in this context have allowed the re-establishment of the infrastructure in the energy sector through the introduction of advanced modern technologies. For example, with the realization of the first stage of the "Contract of the Century" not only the problem of the evaluation of oil stocks in Azeri - Chirag - Guneshli project was successfully solved, but also Azerbaijan has benefited from new oil production technology in the Caspian Sea and modern systems for export of Caspian oil to world markets were established. Azerbaijan has gained the opportunity to renew its energy industry assets by transferring the modern technology to the country and has established institutions and organizations that contribute to the development of oil and gas industry worldwide. Thus, modern research, oil and gas extraction, processing and transportation technologies have been exploited extensively.

In this regard, projects and agreements related to the production and export of Caspian energy resources opened a new page in the history of Azerbaijan's energy industry. In today's global competitive environment, the new state administration of Azerbaijan determined variety of economic development programs, development policies and strategies in order to realize the transition to market economy. It is of strategic importance to make a conscious and systematic analysis of the country's resources and potential opportunities and make a SWOT Analysis in order to develop a new strategy and use the resources in the best way. From the perspective of investing in different sectors, a preliminary strategic step must be to conduct a non-empirical analysis of the country's economy in terms on the macroeconomic, sectorial and non-economy spheres. (Aras, 2005)

Strengths of Azerbaijan's economy in terms of macroeconomics can be listed as following:

- Presence of stable macroeconomic environment in general and especially in terms of price stability: The last 20 years have seen a single digit inflation rate. Prices have remained very stable.
- Low proportion of external debt to GNP: macroeconomic instability was observed in the first years of its independence in the country, namely until 1995 due to the political, economic instability, as well as Nagorno-Karabakh conflict with Armenia. However after the political stability was reached in the country in 1996, and after implementation of certain economic policies, instability left itself to stable growth. Thus, favorable macroeconomic indicators have dominated in the country for nearly 20 years (Suleymanov, Zeynalov, 2010). The following is public debt as a percentage of GDP:



**Figure 1.** Public debt as a percentage of GDP (2003-2012)

Source: <http://mecometer.com/whats/azerbaijan/public-debt/>

- Stable exchange rate: Although, from time to time Manat appreciated against the dollar and euro, in the long run it showed a stable trend. Azerbaijan left "Ruble Zone" in 1992, and since then the national

currency, Manat, was put in circulation. In the first stage, the Manat circulated together with Russian ruble in the country until 1994 when Manat has become the only official currency. As significant portion of the imports were made with ruble, Manat began to lose value against the ruble in 1993 when prices in importing countries, especially in Russia began to rise as a result of price liberalization. On the other hand, the crisis in the banking sector in 1993-94 and negative expectations regarding the value of Manat caused Manat to depreciate against the currencies of other countries. Manat has displayed stable a trend since 2000. On 1st January 2006, as a result the denomination, nominal value of Manat was reduced 5000 times. One Manat was determined to be worth about 1.2 U.S. (Aras, Suleymanov, 2010). The rate of Manat has not changed much for nearly seven years except for very short exchange rate volatility and at times Manat has gained value compared to the dollar. Exchange rates remained stable as economic and political stability provided in the country. According to the World Bank data exchange rates (AZN to USD) were on average 0.80 between 1994 – 2003 and 0.79 between 2009 – 2013

**Table 3.** Official exchange rate (US\$ per AZN, period average).

	1994-1998	1999-2003	2004-2008	2009-2013
Azerbaijan	0.80	0.80	0.79	0.79

Source: <http://data.worldbank.org/indicator/PA.NUS.FCRF/countries/1W-AZ?display=default>

- Presence of cheap labor: Due to the high rate of unemployment in the country, wages are low. According to data of 2013, the minimum wage in the country is 105 Manat, the average wage is around 360 Manats. Payment for labor as a factor of production is advantageous in terms of total cost. This is another factor that encouraged investment in the country.
- Non-economic Strengths can be listed as follows:
- Education level of the population: Despite difficult conditions preceded by decline in the economic situation, people's interest in education was still unchanged as a continuation of the Soviet tradition. Literacy rate in the country is 98%, of which 60 % is highly educated. In each country, primarily for economic development, political stability and this stability will continue to be the managers. Beyond doubt that, each country needs primarily political stability for economic development and strong-willed administrators to pursue these goals. Political stability will serve as an indicator of uninterrupted execution of the economic programs and give confidence to the markets.
- There was still need for continued political stability in Azerbaijan gained when Heydar Aliyev came to power. Uncertainties were drawn to the minimum level with election of President Ilham Aliyev and it increased positive expectations.
- Strategic location: Asian countries are important for the U.S. and European countries because of their strategic location in the corridor to Europe and as well as their bordering with Iran and Russia. Azerbaijan added a new link to the chain of global economic relations with the agreement signed in 1998 in Baku which envisaged transfer of historical Silk Road to 21<sup>st</sup> century as a communication, transportation and energy transport corridor. Silk Raod served as a historical route for caravans carrying the riches of the East to the West for centuries passed by, Tajikistan, Georgia and Armenia, as well as five of the Turkish Republic. The weaknesses of the national economy from macroeconomic perspective are as follows:
- The unemployment problem: Official statistics in Azerbaijan express that the unemployment rate is around 1.5%, but with different calculations and information provided by international organizations, and in the opinion of experts, the ratio is between 16-25%. Therefore, unemployment in the country is high. One of the reasons for high unemployment level, is that around 1 million people were exposed to forced migration after the occupation of Karabakh by Armenians. On the other hand, closure of many companies which were not competitive enough and compatible with modern production, constitute the most important ratio in the number of unemployed.
- Migration of educated and skilled workers abroad: Due to lack of employment opportunities for educated and skilled workforce, many of them emigrated overseas. The majority of skilled and educated workforce moved to Russia, Turkey, Iran. It is noteworthy that among those who left the country in this way, the higher proportion is made up of young and middle-aged people. This "Brain drain" process has increased more in recent years.
- The share of oil and oil revenue in exports is around 90%. On the other hand, the 75% of budget revenues are derived from petroleum and petroleum-related fields. Thus, as the budget is dependent on the oil revenues and oil revenues in turn are dependent on the world market conjuncture, Azerbaijan has confronted with danger of the 'Dutch Disease' (Sabiroglu, 2001). The following table displays the

dynamics of transfers from State Oil Fund to state budget between 2003-2012.

**Table 2. Transfers from SOFAZ to state budget (2003-2012).**

Year	Transfers from State Oil Fund (mln AZN)	Share of the transfers from State Oil Fund in total budget revenues, %	Share of the transfers from State Oil Fund in GDP, %
2003	100.0	8.2	1.3
2004	130.0	8.8	1.5
2005	150.0	7.2	1.2
2006	585.0	1.1	3.2
2007	585.0	9.7	2.1
2008	3800.0	35.3	9.5
2009	4915.0	47.6	14.2
2010	5915.0	51.9	14.3
2011	9000.0	57.3	18.0
2012	9905.0	58.1	19.8

Source: <http://budget.az/budget/en/main?content=526>

- Slow processing in the privatization of large enterprises.
- Although bureaucracy and corruption declined each year, it is still important problem of the transition process. On the other hand, there is injustice in the distribution of income. In particular, the economic situation of workers in oil and petroleum-based sector is very good while income level of workers in other sectors is very low. Consequently, certain proportion of the population is headed for luxury consumption. The middle layer is not yet formed in the country.
- Monopoly and unfair environment for competition: One of the major problems faced by businesses in the country is the existence of monopoly or unfair competition environment. The existence of monopolies in certain areas of the private sector hampers the development and efficient use of resources. It also causes chaotic increase in the prices from time to time.
- Fluctuations in exchange rates due to lack of confidence in the domestic currency. In the first years of independence, the inflationary process and devaluations in Manat, as a result of the political and economic crises caused people's distrust against the domestic currency.
- The informal economy: the ratio of informal economy in the country's GNP is high. In fact, Azerbaijan ranks high among CIS states the volume of the informal economy. According to official data of the informal economy corresponds to somewhat 18%-20 of GDP. However, in some evaluations, the informal economy is calculated to be greater than the economic activity. According to World Bank experts, the volume of the informal economy is more than 60% of GDP. This ratio which is considered to be off the record corresponds to 8-10 billion dollars. Some experts argue that this ratio is 80%. Despite different figures, in general, high informal economic activities are observed.
- Lack of adequate infrastructure and old technology: Agriculture and livestock watering systems are inadequate. On the other hand, technology needed for agriculture and animal husbandry is both old and inadequate. Facilities essential for tourism, such as transportation and accommodation are incomplete and outdated too. Also, on the industrial sector, inadequate and outdated technology infrastructure is observed. This does not allow producing and manufacturing good quality and cheap products for export to the world market. High dependency on oil and natural gas production cause lack of interest in the development of other sectors. After the banking crisis in the first years of independence, banking sector located in the center of the financial sector has not developed yet. Failure to carry out the privatization of large-scale enterprises has been the most important factor in the underdevelopment of the securities market. Due to low levels of income, the development of the insurance sector has been hampered.
- Existence of sectored monopoly: Presence of monopoly in some sectors has an adverse effect on the price and the quality of the products produced in those sectors, and is an obstacle to the efficient use of production resources.
- Dutch Disease Hazard: Since exports and foreign investments are oriented towards oil and natural gas production, export products comprise mainly oil and natural gas and budget is also oil revenue dependent, it is obvious that the country's economy is reliant on oil and gas industry. This dependency has further increased since 2006, with the boom in the oil exports.
- Imbalance in regional development: On the other hand, as most economic operations and tax revenues are collected in or around Baku, most of firms and companies agglomerated in Baku, the regional economic

structure displays dependence from Baku.

- After independence in relation to the production of oil and natural gas, the energy sector has been at the center of attention of foreign and domestic investors. Again, skilled labor was also trying to find more jobs in this sector. As a result of accumulation of both investment and skilled labor in a single sector, serious progress has not been made in other sectors.
- Following are non-economic weaknesses:
  - Regional transport barrier: after the Armenian invasion, 130 km of railway transportation that joined Nakhchivan and other regions of the country has been occupied. Therefore the road and rail transportation between Nakhchivan Autonomous Republic of Azerbaijan and other regions cannot be made due to Nagorno-Karabakh territory, occupied by the Armenians. Today passenger and freight transportation to Nakhchivan can be done through Iran.
  - Mindset change: In the process of transition from the Soviet regime to democracy and free market economy, change of mentality has not yet finished and is rather incomplete. The problems are still evaluated with a view similar to the Soviet system. This in turn implies settlement of market economy in the country. Mindset change is a long process, of course and requires time.
- Threats to economy:
  - Oil price fluctuations. Fluctuations in oil prices are the most economically significant threat.
  - Continuation of the problem of Nagorno-Karabakh: Nagorno-Karabakh has not escaped from Armenian occupation yet. There are still conflicts at times in borders. If the problem is not resolved with dialogue there is a tendency to get the occupied lands by force which means the country is likely to be faced with war. This problem is causing a deterrent effect from the point of foreign investors, especially to invest in non-oil sector. Up to 2012, 70% of investments comprising a total of 100 billion dollars are foreign investment. From foreign investments, only 30% of the direct investments were invested in non-oil sector. There were no serious investments in non-oil sector by domestic entrepreneurs.
  - Border countries: Occasional political and social problems in Georgia, problems in Dagestan Autonomous Republic arising from Chechnya and Iran's political structure and its tough relation with international community has also had an adverse effect on foreign and domestic investors. Investment held in Azerbaijan, especially large-scale investments, will be made taking into account not only domestic market potential, but also other countries in the region. When Azerbaijan's border countries experience some problems from time to time, it leads to problems at the border and negatively impact foreign trade. Tense relations in the region and sensitive policies led by the country also adversely affect the foreign trade (Aras, 2005).
  - The status of the Caspian Sea: Inability to determine the status of the Caspian Sea caused negative effects on the country's economic development. Because of this controversy, some of the oil companies do not want to invest in oil production in these beds. Along with petroleum and natural gas reserves, very important fish and caviar resources of the Caspian Sea cannot be used efficiently and involved in economy. On the other hand, the problem of environmental pollution in the Caspian sea and harmful externalities have their negative effects on the economy. Caspian Sea status issue is the obstacle to the development of sea transport.
  - The absence of outlet to seas and oceans: In the absence of the country's outlet to seas and oceans it is not possible to integrate into intercontinental transport and this deprives country from benefitting from maritime transport.

### **3. Problems Encountered during the Transition to Market Economy in Azerbaijan and Solution Attempts**

Within the framework of SWOT analysis of Azerbaijan's economy, both internal strengths and weaknesses of economy and external opportunities and threats faced by the country economy were listed.

The first strategic step by foreign and domestic investors on investment decisions will be made by looking into strengths and weaknesses of the domestic economy and by taking into account the opportunities and threats of economy seen from outside.

It would be appropriate to invest in the area where strengths are in alignment with the opportunity. Only after this step they will be able to decide whether to further invest in terms of sub-sector, products and regions. After the first step it is necessary to get legal and diplomatic support and assurance, as well as build up individual relationships.

The strengths and weaknesses mentioned in the analysis above are important to determine which sectors, how and in what manner to invest in order to achieve economic development of the country. On the other hand, threats and opportunities of the country economy are important for political forces to decide on which programs, projects to implement in order to achieve economic development and integration into the world economy (Aslanlı, 2004)

State administration should make and implement right decisions by harmonization of strengths and opportunities. On the other hand, strategic decisions and policies should be developed by transforming weaknesses into strengths and threats to opportunities. (Bağırzade, 2009)

The government should take more realistic, steady and reassuring steps and provide incentives in the creation of the necessary investment climate. It should identify factors threatening economic activities, adversely affecting the investment climate, should determine political and social policies to relieve weaknesses and take actual steps in accordance with the policies. Azerbaijan has trading partnership with more than 150 countries, is a member of many international and some regional organizations. The oil contracts and international support to these contracts, that support, the oil companies investing in the country give confidence and establishes high investment environment in the country.

- Early transition to a free market compared to other countries in the region. Azerbaijan is much ahead of the newly independent republics in terms of the transition to a free market economy in and carrying out the legal and institutional infrastructure.
- The country which attracted most investments among newly independent countries. Most foreign investments in the region among other countries gained independence is seen in Azerbaijan. This would be a positive indicator for investors in other sectors.
- Being among petroleum and natural gas exporter countries. As a result of work done after the discovery of the new oilfields work done; Azerbaijan joined the chain of oil exporting countries since 2005 and gas exporting countries since 2006. This was the most important opportunity for attracting foreign investment and integrating to world economy.

Non-economic Opportunities are:

- Being on the trade routes and historical intersection: Azerbaijan is geographically located on very important historical New Silk Rode transit route which links the two continents and three sea basins.
- Progress made in the transition to democracy: Azerbaijan is much ahead of the newly independent countries in the region in terms of transition to democracy. This feature allows the country to become a main market for investments in the region.
- Existence of a more stable and democratic government among the countries of the region.
- The political stability and the government's democratic attitude gained after Heydar Aliyev came to power, was an effective factor for investors to prefer Azerbaijan in the region.

Imperfections on Investment Climate:

In terms of the availability of investment climate in Azerbaijan, number of negative factors such as the lack of the necessary legal arrangements, the high rate of tax, bribery, corruption and the presence of monopoly are among the issues of concern for entrepreneurs. Competition policy is considered as one of the essential elements in countries in transition. Lack of the same conditions in the economy hinders the activities of businessmen, thus preventing economic development. Some measures have been taken by the government of Azerbaijan for the removal of inequality in the economy. The adoption of the program to fight against corruption is such an example. Because of high tax rates, the private sector tends to hide economic activities. A large part of private enterprises are giving wages to the majority of their staff unofficially. In fact, informal economy is perceived as illegal production and sales of weapons, narcotics and pornographic products. However in Azerbaijan, informal economic activities are carried out mainly in the areas of the simple production, trade and services. (Bağırzade, 2007). In some evaluations made, the informal economy is recorded to be greater than legal economic activities. 80% of foreign investment in Azerbaijan's seems to be in oil sector. It is worrying to observe that sectoral investments also mainly fall under this category and a significant part of GDP is formed from oil revenues. Price changes in the world market due to the one-sided development of the petroleum sector also cause fluctuations in GDP. This situation was clearly seen in the 1998 Russian crisis.

Briefly, Azerbaijan is faced with a hazard of "Dutch syndrome," which is expressed as the collapse of the other regions or sectors as a result of rapid development of a specific region or a sector.

When economic development is based on the export of natural resources alone, this means only a small group of the population benefit from them, and depletion of these reserves result in a decrease in the living standards of the majority which contradicts to the principles of social justice. Therefore, when the economy relies only on natural resources sector, this would undermine the independency of the countries in both internal



and external relations.

High dependency of economy on energy sector will cause negative results on the socio-economic situation. Circulation of potential and skilled labor in the energy sector will adversely affect the development of other sectors. Spending of oil revenues in the purchase of imported goods, especially if consumer goods are imported rather than capital goods, the country's trade balance will turn to negative. In order to defeat the risk of "Dutch syndrome", policies such as strengthening foreign investment flows to Azerbaijani economy, and provision of all necessary conditions for fulfillment of these investments must be among the main objectives for the government. (Bulut, Suleymanov, 2012) The first step should be provision of favorable climate for investments. To realize this first of all non-commercial risks must be eliminated, and regulations on the tax rates, the tax collection system and ethics, and necessary arrangements for administrative and legal regulations for securing foreign capital and for optimization of the tax and customs systems should be made. Besides the Dutch Disease, there are several other caused by foreign capital: the country's increased external debt; diversion of foreign investment into fast revenue-generating activities such as raw material and service areas; presence of very little investment in the country's manufacturing industry; aggregation of almost all investment in Absheron; negligibly small amount of foreign capital in other regions. Despite the fact that the advice and borrowings from international financial institutions played a major role in macroeconomic stabilization in the country, very little progress is observed in the increase in efficiency, levels and yields of production in the real sector and also in socio-economic problems such as social security. One of the major problems faced by operators in the country is tendency to monopoly. Monopolization of certain areas by companies or businessmen hinders the development of private entrepreneurship and even leads to closure of some companies. Monopoly and unfair competition is hampering the development of the private sector in Azerbaijan. The existence of monopoly results in chaotic rises in prices.

#### 4. Conclusion

Briefly, Azerbaijan is facing a hazard of "Dutch syndrome," which is expressed as the collapse of the other regions or sectors as a result of rapid development of a specific region or a sector. Even beyond dependence on one sector, Azerbaijan is facing with the danger of dependency on one region. The conclusion drawn from analyses of Azerbaijan's economic development after independence is that, in the 1991-1996 period there was significant progress in almost all parameters. Starting from 1996 stability was ensured and there were positive developments further with the exception of negative effects of Russian (1998) and (2008) world economic crisis.

In particular, with the rapid development of oil and natural gas industry in the 2000s, a very large improvement in basic economic parameters were recorded, and it is expected to continue in the coming years. Thus, despite all the positive and negative processes in economy after independence, between 1991-2013 GDP volume (in other words, Azerbaijan Economy size) increased about 120 times, per capita GDP volume raised 400 times, state budget expenditures 280 times, the total foreign trade volume 30 times, exports 10 times, while imports increased 10 times. Today with all the basic quantitative parameters on the economy, Azerbaijan is a leader in the South Caucasus. Azerbaijan's foreign debt was U.S. \$ 5.688 billion at the beginning of 2013. This amount corresponds to 13.6% of GDP. By the amount of external debt per capita, Azerbaijan is ranking in the middle compared with the CIS countries. But despite all the positive developments and government strategies and policies implemented after independence in Azerbaijan, there are still certain problems experienced in the economy. The most important problems can be listed as follows:

- High dependency of the economy on the oil sector,
- Absence of economic growth model generating employment,
- Regional inequalities, inefficiency of the agricultural sector,
- Socio-economic problems endangered by the occupation of Nagorno-Karabakh and the surrounding regions by Armenia,
- High interest rates, high tax burden, underdeveloped public services,
- The low rate of incorporation, weak corporate governance tradition,
- "Cash economy" is common, artificial monopoly, informality, corruption and various infrastructure problems exist.

The following policy measures may be effective for the solution of the current problems in the economy:

- Sustainable economic development, increasing employment, poverty reduction, reducing injustice in income distribution, reducing regional inequalities and ensuring horizontal balance between regions,

following government policies in the framework of government's 2008-2012 and 2013-2015 regional development programs which aim development of non-oil sector.

- The applicability of the laws and in the process of transition to market economy and benefiting from the experience of developed countries of the world. The country should transform from natural resources-based economic growth model to high technology and efficiency-based model of economic growth. In order for this, it is important to promote the new technology transfer to the country, to build and develop techno-parks, to implement most perfect models of science and economics cooperation, to establish optimal sized economic agents and apply modern production and management systems that lead to improved efficiency in resource allocation and productivity, to improve quality of education, particularly in technical fields.
- Efficient utilization of approximately \$ 50 billion accumulated in the Oil Fund in 2013. These resources must be used effectively and efficiently in both local and offshore investments in order to further increase and guarantee post petrol period.
- In order to reduce poverty and income inequality, existing policy mechanisms for poverty alleviation need to be developed and fiscal policy instruments in reducing income inequality should be used in an active way.
- To ensure the continuity of policies against inflation and minimize its negative impact on the economic system.
- Influence of Interest policies must be promoted in order to divert informal savings into investment in formal sector. From this point the gap between average interest rates on deposits and average return of capital in informal sector must be minimized. Interest on investment loans must be low enough in order to encourage investment activities in the formal sector.
- It is essential to ensure continuity of foreign exchange earnings in the long run which are important elements of macroeconomic stability in the country. Policy measures need to be taken, with the purpose of reducing dependency of export incomes on oil, by increasing the export potential of non-oil sector.
- In order to ensure budget balance sustainability and increase effectiveness of socio-economic functions of budget, there is a need to reduce its dependency on oil revenues and raise the ratio of continuous source of income such as taxes in budget.
- Policies that encourage foreign investment in the non-oil sector should be developed. These policies will boost economic development and limit the effects of informal sector.
- State incentive mechanisms need to be developed for entrepreneurs. In this regard, promoting the expansion of cheap lending mechanisms of National Fund of Support for Entrepreneurship for new entrepreneurs, the development of the incentives mechanism to the agricultural sector to increase the efficiency, the expansion of the state support for entrepreneurs in terms of science and know-how, development of the mechanism of awarding entrepreneurs by the state will be some of effective measures.
- Entrepreneurship infrastructure should be developed. In that regard, the development of the capital and insurance markets, the creation of specific industrial zones, developing necessary infrastructure for consulting services and exhibition industry is important.
- Ensuring the rights and interests of entrepreneurs in the country should be raised further. It is mandatory to raise the level of entrepreneurs' unification, to prevent delays in formal procedures and to protect copyright and intellectual property.
- Necessary policies should be developed to fight against informal economy. In this aspect preparation of state programs to fight against the informal economy, creation of official central institutions, the development of statistical data, stiffening of penalties, removal of legal gaps are important measures to take.

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