



American Chamber of
AMCHAM
Commerce in Azerbaijan

Observations and Recommendations
for Improving Azerbaijan's
Business Climate

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I Executive Summary

Executive Summary

The American Chamber of Commerce in Azerbaijan believes that the Government of Azerbaijan's laudable programs for positive reform of its non-energy sector must do more to foster transparent competition and proceed at a faster pace if they are to succeed. With a view toward maximizing the benefits to Azerbaijan from the successful and timely transformation of the business sector, AmCham strongly supports the further development and rapid expansion of government measures to encourage growth in the crucial non-energy sector. Azerbaijan's capacity to compete in the international marketplace, and especially its capacity to compete against its regional neighbors, is the best guarantee of its ultimate success, prosperity and stability. To offer the advice and support of the business community to the government in its continuing pursuit of these goals, AmCham has prepared this 2008 iteration of its White Paper.

We believe that the surest pathway to sustainable economic security and growth for an Azerbaijan better-protected from the dangers of overdependence on revenues from sale of oil and gas lies in creation of and adherence to a medium to long term development plan for the country. Preparation of such a plan is the responsibility of government but this can best be achieved with the continuing input of the business community, which is the indispensable participant in the economic development of any nation. To assist in this process AmCham again urges in the strongest terms creation of a Government/Business Council to meet regularly for serious discussions at the ministerial level or higher and whose sole purpose would be to identify, define and propose solutions for problems which delay or retard expansion of competitive business activity or courses of action which would improve the government's financial stewardship through efficiency and cost savings.

A necessary first step toward enabling fuller and more effective participation of the business community in an advisory process is the prompt and unfettered distribution of information regarding planned legislation or regulatory action which could bring the legislative and regulatory framework into conformity with best practice. To begin to achieve this, we urge creation of an office at the Parliament whose function would be to make immediately and electronically available to the public and especially to the business and legal communities the text of all legislation pending before the Parliament from the time it is proposed through the drafts prepared for the first, second and third readings and the legislation in its final form.

To help the government to create a system which would encourage freer commercial activity and enhance its international reputation as an honest, fair and reliable trading partner, while rewarding both local and foreign-owned businesses which conform to internationally accepted business practices, AmCham proposes the following specific steps:

Taxation

- Bring the personal income tax rate in line with those of neighboring CIS countries.
- Eliminate the requirement for foreign workers to make social insurance contributions.
- Simplify pre-clearance procedures to ease refund of withheld taxes under

- double taxation treaties; prevent tax inspectors from imposing burdensome demands on taxpayers seeking refunds.
- Enable businessmen to pay or credit VAT only when the funds to be taxed are actually received or paid; and adapt the VAT refund submission process to conform to international best practice.
 - Introduce or amend changes to tax provisions, including temporary measures, only via changes to the Tax Code.

Banking, Finance and Insurance

- Create a single unified register of both moveable and immovable property; pass a new comprehensive law on secured transactions.
- Clarify the Civil Code to make it clear that the requirement for a general meeting of shareholders of a joint stock company to approve any transaction exceeding 25% of the company's shares does not apply to banks.
- The State Securities Committee should adopt liberal rules for the cross-border placement of domestically-issued Azerbaijani securities.
- Clarify the Civil Code to exempt banks from limitations on the value of bonds which may be issued by an issuer.

Customs

- AmCham is very pleased to have the opportunity to comment on the new draft Customs Code and to hold an open dialogue with Customs on issues affecting the business community.
- Customs should ease the import-export process by bringing its fees into line with those of its near neighbors and by encouraging development of a nationwide system of bonded warehouses.

Communications and Information Technology

- Establish an independent regulatory body for the IT sector.
- Privatize all government holdings in the IT sector and remove the government from commercial activity in the sector it also regulates.
- Enforce adherence to Azerbaijan's obligations to protect intellectual property rights under its several international agreements in that area.

Labor

- Social Protection Issues: Uncap both benefits and contributions; pay benefits in a timely manner; limit the employer's contribution to the social protection fund to 15% and that of the employee to 5% while ensuring that those who make 500 AZN or less per month pay no income tax or social protection contributions but still accumulate benefits.

Executive Summary

- Amend the Labor Code to enable leave records to be kept on a calendar year basis.
- Amend the Labor Code to permit overtime payments to unskilled workers in any situation but not to managerial or skilled workers.
- Reduce the number of holidays to a number approximating those of other neighboring countries.
- Review the pay levels of civil servants in light of inflation and increasing costs.

Tourism

- Ease entry at Heydar Aliyev International Airport through use of e-visas, distribution of entry forms on incoming aircraft, addition of more multilingual employees and signage for arrivals, enhanced efficiency of baggage handling and establishment of attractive and well-organized taxi services, hotel shuttles and rental car facilities to provide secure transport to the city.
- Provide multilingual tourist information brochures on hotels, tourist sites, restaurants, handicrafts, do's and don't's, currency conversion tables, simple phrases in Azerbaijani and other data at arrival booths at the airport, hotels, museums and other appropriate sites.
- Provide information to the Ministry of Tourism on airport arrival, hotel occupancy, etc., to enable the Ministry of Tourism to better develop statistics to support plans for development of the tourism sector.

Corruption

- Each ministry should create and submit a detailed and specific action plan by the end of December each year as required by the new National Strategy on Increasing Transparency and Combating Corruption specifying how it will increase transparency and combat corruption.
- The laws of Azerbaijan and 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. This includes allowing anonymous complaints, protections for whistleblowers, and a streamlining of procedures for investigating and prosecuting corruption crimes.
- The Government should fully fund and implement the new National Strategy on Increasing Transparency and Combating Corruption as well as the newly adopted ethics code for civil servants.
- The government should allow an independent, ethical and professional media, and provide strong government protection for freedom of the press, so journalists can report objectively on corruption free of reprisal
- The Government should pass and enforce a new Competition Code which defines both unfair competition and conflict of interest and specifies a mechanism for redress.

- Court judgments should be enforced in a fair and timely manner. Open public access should be provided to all court proceedings and judicial decisions. All Appeals Court, Supreme Court and Economic Court decisions should be made publicly available via media and internet. There should be full compliance with the Council of Europe standards for judicial independence.
- The legislative database, originally created with US funding, should be kept fully operational and updated.

Conclusion

Through this White Paper, the business community offers specific advice on steps which we believe would contribute to the success of the government's efforts to develop within Azerbaijan a transparent, competitive and vibrant business climate. From this we hope to see the creation of efficient and effective business enterprises which not only operate successfully within Azerbaijan's national marketplace, but which also over time come to compete successfully internationally - the badge of a truly successful company grown in a fertile business environment. With the goals in mind of an Azerbaijan which is first an example of successful national business development, then the necessary regional support hub for the Caspian Basin, and finally a recognized and admired global competitor, AmCham will build upon this White Paper to propose to the government a vision statement for business development during the course of the balance of 2008.

Executive Summary

II Taxation

A harmonious and competitive tax regime is a key element of an attractive and favorable business climate and the long-term development of the country. With this in mind AmCham, through its Tax Committee, has been active in efforts to improve tax legislation by sharing its views and suggestions with various governmental bodies.

In our 2005 White Paper, we recognized that the tax authorities had introduced some important and desirable changes. We, however, pointed out that our members were generally reporting an increase in harassment from the tax authorities. We also made a number of suggestions for improvements in legislation. Few of those suggestions were adopted. We have, therefore, once again identified those issues which AmCham and its members believe are most important for a healthy economy and we hope that we will be more successful on this occasion in achieving the reforms and changes that we believe are necessary.

Among the factors impeding the development of business which were identified in earlier White Papers included the frequent use of freezing or 'writing-off' orders sent to the taxpayers' banks; difficulties with obtaining official certificates from the tax offices (e.g., tax receipts for expatriates). These continue to be problems which discourage new investment. In particular, we note examples where the tax authorities have resorted to such measures without (a) having made any serious attempt to discuss matters with the taxpayer and (b) issuing 'freezing' orders before the statutory notice period has expired. We strongly urge the tax authorities to communicate more freely and openly with taxpayers and to use such measures as freezing orders as a last resort, not a first response.

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. 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. However, we have not witnessed a consistent desire on the part of the tax authorities to consult and involve the business community in general and AmCham in particular, to further a joint goal of establishing a more business-friendly tax environment.

As with our previous White Papers, our recommendations below are not intended to be an exhaustive analysis of the problems and concerns that taxpayers have in Azerbaijan. Rather, we identify those issues which AmCham and the business people it represents believe are most important and which need to be addressed to ensure further progress.

It is also important to note that, as in earlier years, the comments and recommendations below have been discussed with various international organizations, such as the IMF, USAID and others.

01 Personal Income Tax

A critically pressing taxation issue is the distorting and anti-competitive rate structure which is applied for personal income tax. We welcome the recent increase from AZN 12,000 to AZN 24,000 p.a. in the lower 14% income tax band. This is an encouraging development but we note that the highest marginal rate for Azerbaijani personal income taxes at 35% (which applies to annual income in excess of AZN 24,000) continues to be considerably higher than in Russia, Georgia, Ukraine, Turkmenistan and other countries in the region (e.g., Turkmenistan has a flat rate of 10%, Georgia 12%, Russia, Tajikistan and Ukraine 13%). There is strong evidence that a big increase in tax collection has followed the reduction in personal income tax rates.

In our view, the failure to cut income tax rates dramatically makes Azerbaijan significantly less competitive in attracting foreign investment, especially in the non-energy sector. High income tax rates merely encourage businesses to remain in the shadow economy and discourage them from entering the formal sector. High income tax rates also discourage employment.

Recommendation

We recommend that the personal income tax rate structure be revised in a manner which would be more in line with the tax rates found in other CIS countries; where the average rate is 19%. This would imply a significant reduction of the highest marginal rate or the introduction of a uniform flat rate, which over the medium term is likely to generate more revenue. In particular, AmCham proposes that the higher rate band be reduced from 35% to 20%. In order to encourage employment, AmCham further proposes that a 'nil' tax band be reintroduced for income below, say, AZN 500 per month.

02 Social Insurance Payments

In addition to personal income tax, we believe that, in assessing the cost of hiring labor, we must include social security costs. These very high costs continue to be a real impediment to business investment and the encouragement of employment and we urge a reduction in rates, in particular as more of the social security burden (e.g., sick leave benefits) has been shifted directly to the employer.

Furthermore, until the passage of a 2005 law, employers were not required to make social insurance payments for their expatriate staff. From 1 January 2006, the law requires employers and employees to make social insurance payments equal to

22% and 3% of expatriate employees' monthly salary. Given that PSA contractors and many NGOs are exempt from these social insurance payments, the burden falls primarily on foreign investment in the non-oil sector, the sector which needs the greatest incentives for development and expansion. Furthermore, expatriate employees rarely, if ever, take advantage of the benefits of the Azerbaijani social security system and in the vast majority of cases their corporate employers provide benefits in excess of those being provided by the State. Consequently, foreign investors and their employees gain no advantage from paying Azerbaijan social security contributions. We urge, therefore, a return to the position prior to the 2005 law with exemption from social security contributions for expatriate staff.

Recommendations

- Reduce the total of employers' and employees' social security contribution to 20% instead of the current 25%.
- The obligation on employers and employees to pay social insurance contributions for their expatriate staff should be repealed. Naturally, foreign employees will not be entitled to Azerbaijan pensions or other social security benefits unless the employer/employee chooses to make voluntary contributions.

03 Double Tax Relief Clearance

In our experience, in cases where tax has been withheld and paid to the Azerbaijani budget and a refund subsequently claimed by the taxpayer, it is extremely 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. Double tax treaty refund claims often trigger tax audits of the withholding agents, although the tax agent's tax position has no relevance to whether taxes withheld should be refunded. AmCham believes this is an abuse of the tax authorities' powers.

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, etc.) 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, the cost of foreign services becomes 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.

In most countries, including Azerbaijan's CIS neighbors such as Russia and Kazakhstan, the pre-clearance system is relatively simple and efficient and eliminates in many instances the need to apply for a refund. Although the Ministry of Taxes adopted new tax treaty administration regulations on 19

November 2007, allowing advance exemption for dividends, royalties and interest, various artificial limits have been imposed which reduces the practical value to taxpayers of the new procedures, which procedures are in themselves burdensome.

Recommendation

We recommend that the tax authorities simplify and extend the tax exemption pre-clearance procedure so as to allow any non-resident taxpayer (or resident withholding agent) to apply to the tax authorities for treaty-based advance exemption from withholding tax at source. Such pre-clearance procedures have already been successfully established in the majority of countries in Europe and the CIS.

04 Tax Refunds

Azerbaijani tax law provides a general description of the mechanism for refunding overpaid taxes to 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 have attempted to claim their overpaid VAT and their refund claims resulted in penalties and sanctions for alleged 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 both the word and spirit of the law. Regulations which permit tax inspectors to legally impose burdensome demands on taxpayers seeking a refund or offset should be amended or repealed.

05 VAT Recovery

The current system of VAT deduction, whereby input VAT may be credited only after payment of the invoice, has created an inconsistency in the VAT crediting mechanism. Specifically, it creates an inconsistency between the time when a transaction occurs and the time when a VAT credit may be claimed. This is because VAT registrants are required to pay VAT on their sales on an accrual basis (i.e., immediately when the sales transaction is invoiced) but the credit on VAT for purchases can be claimed only when money is actually transferred to a seller. This system not only artificially raises business costs but it also does not provide sellers with an incentive to issue a tax invoice unless they are certain the money has been received by them. This may adversely impact VAT collections and exposes buyers to additional commercial risk.

Recommendation

We recommend that the amount of payable and creditable VAT should be based on a cash basis (i.e., VAT should only be paid or credited when VAT monies have been received or paid).

06 VAT Return Submission Process

VAT registrants are required to submit VAT returns and different attachments every month. The VAT return form is unnecessarily complex, as are the attachments. This system of submitting complicated returns, together with numerous documents. This is not consistent with the VAT practice adopted by most countries, which allows taxpayers to submit a simple, typically one page, tax return without attachments. The common practice at the time of the submission of the return is to check whether or not the return is completed properly and whether or not it is arithmetically accurate. All other checks/verifications should be carried out on the taxpayer's business premises during an audit.

Recommendation

Azerbaijan should follow international best practice. The VAT return form should be simplified and the requirements regarding the submission of multiple documents with the VAT return must be abolished. Checks/verifications may be carried out during audit visits at the taxpayers' business premises. In view of the new VAT accounts established from the beginning of 2008 and together with the cash basis treatment we have advocated, a more simplified tax form is unlikely to lead to any tax loss.

07 Special VAT accounts for VAT payers

The special VAT accounts introduced from 1 January 2008 have raised considerable concern among the business community. It is too early to tell how efficiently these will work but AmCham members are concerned that legitimate VAT repayment claims will be denied by the tax authorities

08 Tax Code and other laws

The Government of the Republic of Azerbaijan has adopted a comprehensive tax code. The idea behind this is to develop it as a self-contained tax law, which makes not only tax administrators' lives easier but also helps taxpayers and others interested in the Azerbaijani tax system substantially. With all tax related provisions included in one law, there is no need to reference different independent pieces of law.

However, the Government has increasingly resorted to legislating tax provisions through decrees or ministerial decisions. While such practices avoid the considerable time required to introduce and pass legislative amendments in Parliament, it undermines the broader objective behind the introduction of a self-contained tax law, namely, simplicity and transparency.

Recommendation

We strongly recommend that all tax provisions, including those intended to be temporary measures, be introduced/amended only through changes in the Tax Code.

09 Private sector participation

Businesses play an important role in any tax system as payers of various taxes as well as collecting agents of commodity-based taxes and withholders of income taxes. They can provide valuable input to the government in the formulation of tax policy and tax law. When the Tax Code was first introduced, AmCham was delighted to play an active role and commended the Government on its wide public consultation and information. However, since then it has become increasingly more difficult for the business community in general, and AmCham in particular, to make recommendations. In large part, this is because draft legislation is no longer made publicly available for consultation. Certain AmCham members are provided with copies of draft legislation in confidence which impedes AmCham's ability to discuss and comment on draft legislation in good time.

Recommendation

We recommend that AmCham, as a representative of the private sector, be more actively involved in the tax policy and law formulation process. Draft legislation should be released to the AmCham Tax & Customs Committee on a non-confidential basis simultaneously with submission to the Milli Majlis.

III Banking, Finance and Insurance

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., no restriction on transfers. Additionally, the new Law On Banks has helped clarify and modernize banking secrecy rules and payment system reforms have been introduced.

Notwithstanding 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. While some of the proposals may appear to be quite limited in scope, we believe that these seemingly minor "technical" revisions would significantly strengthen the banking, finance and insurance sectors with a minimum of effort.

01 Taking Security - Pledges and Mortgages

Immovable Property Register

Recognizing that an effective system of registering pledges and mortgages is essential to the development of the credit industry in Azerbaijan, the Government has made a significant structural improvement by establishing the State Register of Immovable Property, a central registrar for registering interests in land, buildings and other immovable property. To be useful, the registrar must operate efficiently. Our members uniformly report, however, that the administration and operation of the registrar is slow and corrupt, with large unofficial payments routinely demanded to perform what is essentially a clerical function.

Lack of a Central Register for Pledges of Movable Property

While already mandated by law, no central register for pledges of movable property is yet operational. This has a direct adverse effect on the local economy. Several of our members with worldwide operations generally are willing to finance the sale of their products to commercial customers. In Azerbaijan, however, these companies are unwilling to do so due to the lack of a central register in which a pledge of the financed products may be registered. As a result, a valuable source of finance is unavailable to local businesses.

Realization upon Pledged and Mortgaged Property

Under current Azerbaijani law, to enforce a pledge or mortgage, the pledged or mortgaged property must be sold at a public auction. This inflexible approach imposes unnecessary expenses and constraints on secured creditors. As a result,

both local and, in particular, foreign financiers are reluctant to extend credit and lend funds secured by property located in Azerbaijan. If they are willing to do so, financiers charge higher interest rates to compensate for the increased risk associated with an inflexible and inefficient system.

Recommendations

- The administration and operation of the State Register of Immovable Property should be improved so that interests in immovable property are promptly and accurately registered without demanding "unofficial" fees.
- A register of pledges and other interests in movable property should be created as required by current law. Subject to improvement of the operation of the State Register of Immovable Property, we would support a single unified register of both movable and immovable property.
- Overall, we recommend that a comprehensive law on secured transactions be developed and adopted as a matter of priority to introduce a system which is reliable, efficient and reasonably simple and which, in non-consumer commercial transactions, permits the flexibility required in modern finance. In addition to creation of a unified register, at a minimum a new law should eliminate the requirement that pledges be enforced through a public auction and clarify and expand the types of property and property interests which may be used as collateral.

02 Internal Bank Loan Approvals

The adoption of the new Law On Banks introduced an inconsistency with the existing Civil Code. Banks in Azerbaijan are organized as open joint stock companies. Article 99.3 of the Civil Code requires that a transaction of an open joint stock company with a value exceeding 25 percent of the company's net assets be approved its general meeting of shareholders. This general provision is facially applicable to all open joint stock companies, including banks. The Law On Banks, however, has different requirements specifically tailored to the highly regulated and tightly supervised banking industry. As applicable to banks, Article 99.3 creates confusion and interferes with the carefully balanced requirements of the Law On Banks.

Recommendation

Article 99.3 of the Civil Code should be amended to expressly state that it is inapplicable to banks.

03 Cross-Border Placement of Domestically-Issued Azerbaijani Securities

Azerbaijani law does not specifically regulate the cross-border placement of domestically-issued Azerbaijani securities. Although Article 1078-15.13 of the Civil Code provides that the rules of cross-border placement are determined by "the relevant body of the executive power", i.e., the State Securities Committee, such rules have not yet been adopted. This absence of regulation creates considerable uncertainty (and, consequently, legal risk) as to the feasibility of a direct placement abroad of locally issued debt securities and, as a result, delays development of the local securities market.

Recommendation

The State Securities Committee should adopt liberal rules for the cross-border placement of domestically-issued Azerbaijani securities.

04 Limitation on Bonds Issue

Under Article 1078-11.5 of the Civil Code, the aggregate par value of bonds (i) authorized but unissued and (ii) issued and outstanding may not exceed the issuer's charter capital or the security granted by the issuer for the bonds. This imposes a considerable limitation on local and cross-border issuance of bonds by Azerbaijani banks, requiring complex and costly structuring to enable them to access international capital markets.

Recommendation

Given that Azerbaijani banks are already governed by specific legislation, i.e., the Law On Banks, Article 1078-11.5 of the Civil Code should be amended to expressly state that it is inapplicable to banks.

05 Overseas Transfer of Manats

Currently, the Azerbaijani manat is not transferable outside Azerbaijan. While there is no express prohibition, it is implied by Azerbaijani currency regulation. In 2002, the National Bank issued the Rules On the Regime of Foreign Currency Operations of Residents and Non-Residents in Azerbaijan regulating the overseas transfer of foreign currency. The National Bank, however, has not yet established

rules on the overseas transfer of the manat. Liberal rules on overseas transfer of Azerbaijani manat are necessary to make it fully convertible.

Recommendation

The National Bank should elaborate and approve liberal rules for the overseas transfer of Azerbaijani manat.

06 Manat Accounts of Foreign Entities

Azerbaijani banks are prohibited from opening manat accounts for foreign companies without a branch or representative office in Azerbaijan. This creates an unnecessary limitation, requiring that foreign investors, asset management companies and hedge funds wishing to open manat accounts with Azerbaijani banks find it necessary to enter into complicated derivative and foreign exchange transactions simply to have a local manat account.

Recommendation

The National Bank should amend the rules on opening bank accounts in Azerbaijan to allow foreign companies without a local branch or representative office to open accounts with Azerbaijani banks.

07 Derivative Transactions

Financial derivatives are an important aspect of risk management in most countries. While Azerbaijani banks, insurance and other financial services companies would benefit from financial derivatives to better manage risk, Azerbaijani law has introduced an apparently unintended risk for derivative transactions. The Civil Code, reasonably in our view, makes gambling claims unenforceable. Gambling is defined as an agreement not pursuing any economic purpose under which participants make profit or sustain losses at least partially dependent on uncertainty or chance. This includes transactions with commodities or securities having the character of gambling. As Azerbaijani law already expressly authorizes derivatives, including those where the parties assume risks which are not under their control, derivative transactions should not be regarded as gambling. Due to the uncertainty and risk created by the definition of gambling, however, foreign financial institutions are more reluctant to enter into derivative transactions with Azerbaijani counterparties, including banks.

07 Derivative Transactions

Recommendation

Given that Azerbaijani banks are already governed by specific legislation, i.e., the Law On Banks, Article 1078-11.5 of the Civil Code should be amended to expressly state that it is inapplicable to banks.

08 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.

09 Secondary Financial Markets

As we have noted in our White Papers since 2001, Azerbaijan's financial markets for short-term government debt (treasury bills), repo agreements and other local debt instruments are poorly developed. In many jurisdictions, treasury bills are used as the basis for determining the most favorable market interest rates and to provide additional liquidity in 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.

10 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 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 through 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.

11 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.

12 Bank Syndications/Collateral Agents

As even the largest Azerbaijani banks cannot by themselves grant large loans for the increasing number of significant projects in Azerbaijan requiring finance, local banks have been largely excluded from providing finance for these projects. To help remedy this, in 2003, the National Bank of Azerbaijan distributed to local banks its Methodological Guidance on Granting Syndicated and Joint Credits by Banks, essentially a how-to for Azerbaijani banks to arrange syndications and make syndicated loans. Notwithstanding the National Bank's commendable effort, a local loan syndication market has not developed due to the lack of laws addressing issues such as syndication structures and collateral agents, security agents, paying agents and collection agents - all necessary for loan syndication. Without this additional legal framework, a local syndication market is unlikely to develop and local banks will be effectively precluded from participating in this lucrative and important market and their ability to finance Azerbaijan's development will remain limited.

Recommendation

Amendments to the Civil Code and other laws should be adopted to address this gap in Azerbaijani law.

13 Insurance - Definition of Financial Services (Tax)

In Azerbaijan, consistent with international practice, financial services are exempt from certain taxes such as VAT. Similarly, in 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 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."

14 Life, Personal Accident 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 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, as well as premiums paid by an employer for life and personal accident insurance are excluded from taxable income and are not be subject to income tax, without regard to whether these plans are arranged locally or overseas.

IV

Customs

Customs

Our 2005 White Paper described the State Customs Committee (SCC) as "among the most responsive elements of the Government in the resolution of specific problems of individual companies" and noted the successful dialogue between AmCham and the SCC. Thereafter, our relationship diminished and became less productive. We are pleased to report, however, that our relationship has recently taken a pronounced turn for the better and that the SCC is actively undertaking a broad range of reforms and improvements responsive to the concerns of the World Trade Organization, European Union and AmCham.

Specific areas of progress and of member concern include:

01 Regular Dialogue

AmCham and the SCC had earlier enjoyed frequent discussions which were useful to resolve specific member problems. After more than three years, this process has been recently resumed with the participation at the highest levels of the SCC. Deputy Chairman Safar Mekhtiyev also spoke to our members at our monthly AmCham luncheon, providing an overview of the dynamic process of change and reform currently underway at the SCC. He took questions from the membership following his address; three senior SCC officials remained after the lunch for private discussions with individual members regarding customs-related issues.

Recommendation

The SCC should maintain its open dialog with AmCham with a view to ensuring that the business community's concerns with customs in Azerbaijan are promptly heard and acted upon.

02 New Customs Code

The SCC has made good on its promise to deliver an advance copy of the draft version of the new Customs Code currently under consideration by the Government. Deputy Chairman Mekhtiyev has publicly called for AmCham to provide comments and suggestions based on the draft. The Board will review the text of the draft and prepare comments. Preparation of a new code is expected to contribute significantly to the need for systemic change within the customs system which AmCham has emphasized in the past.

Recommendation

A new Customs Code adopting modern and efficient world standards should be adopted in the nearest future.

03 Negotiations with the World Customs Organization

For over a year, the SCC has engaged with the World Customs Organization and other countries regarding harmonization of Azerbaijani customs procedures and practices with those of other regional, European and WCO member nations. This process also goes directly to the subject of systemic change within the SCC system. These negotiations address issues of ongoing concern to AmCham, such as the disparity between Azerbaijani customs fees and those of its neighbors for the import of the same items, monopolies, etc. The Board anticipates a more detailed discussion of the state of these negotiations and the issues involved during our upcoming meeting.

Recommendations

- The total cost of customs clearance should be made competitive with that of other countries in the region.
- Customs clearance procedures should be adopted which ensure that speedy and efficient clearance of goods at Azerbaijan's customs border.

04 Electronic Document Processing and Warehousing

For some time, the SCC has been improving its system of electronic documentation processing but has not finally acted on recommendations from AmCham and others that the system include bar coding and tracking to enable pre-clearance of goods and the more efficient and transparent passage of goods through the customs system. Deputy Chairman Mekhtiyev, however, reports considerable progress on the construction of modern customs checking and storage facilities at all overland border crossing points. Electronic facilities are being set up which are to include bar coding and which also include the most advanced detection systems for truck-borne cargo. Indeed, the customs post at Astara, where many of these facilities are already operable, has already detected and seized two large shipments of illegal narcotics entering from Iran.

Extensive warehousing facilities are either already built or under construction at these border crossing points. The facilities include open-air, indoor and refrigerated storage. The possibility that these facilities might be bonded or that bonded warehouses might be constructed nearby is under consideration but this issue has remained unresolved in Azerbaijan for some time. AmCham recognizes that this matter will not be decided solely by the SCC and that final resolution may await formal approval of planned free economic zones. Nevertheless, we emphasize the importance of bonded warehouses to the expansion of business activity in Azerbaijan, especially in the critical non-energy sector.

Recommendation

AmCham strongly recommends that the Government permit establishment of bonded warehouse facilities in the very near future.

05 Improved Conditions of Employment for Customs Officials

With a view toward reducing the incentive for corruption among SCC officials, the SCC has substantially raised the salaries of all their employees during the past year. Additionally, the SCC has begun construction of a modern health clinic which will provide medical care for its employees and their immediate families. The Board anticipates a detailed briefing on these and other measures to improve working conditions of customs employees during our upcoming meeting with the SCC.

Recommendation

The SCC should aggressively pursue measures, including a robust monitoring and enforcement system, to minimize corruption among SCC officials.

V Communications
and Information
Technology

Communications and Information Technology

To bring Azerbaijan into conformity with international best practices, including those of the World Trade Organization, European Union and the countries with highly developed information and communications technology (ICT) markets, AmCham continues its cooperation with the Government to create a business-friendly environment in ICT sector and achieve the national goal of transitioning to a fully competitive ICT sector. AmCham attributes this to the enthusiasm of the Minister of Communications and Information Technologies, Dr. Ali Abbasov.

Improvements in the ICT sector include:

- **Fees:** Internet subscriber fees and the cost of leased copper lines have been reduced as a first step toward achieving international standards. Monthly subscriber fees for fixed lines were increased, allowing the cost for outgoing long distance calls to be reduced.
- **Internet Speeds:** Internet speed is increasing and now reaches to 6.6 Gbps via fiber optic channels. The ping timeout is falling and beginning to approach international standards.
- **Regional Innovation Zones and Local Manufacturing:** With the assistance of a consulting company, the Ministry is currently developing a project to create "regional innovation zones" (including "techno parks" and "virtual innovation zones") and an international data transit center. These are intended to encourage investment in local production and exports of electronic equipment and software.
- **Free Economic Zones:** The Ministry of Economic Development has produced a draft law on free economic zones, with benefits for manufacturing (including computer manufacturing and software development). The draft law also proposes adoption of a unified tax at the rate of 2%, social insurance tax of 5% and income tax of 10%.

01 Independent Regulatory Body

Key to a competitive ICT environment in Azerbaijan is a transparent and predictable regulatory environment with a level playing field for all participants. This is a prerequisite to attracting additional investment to the local ICT sector. The Government has recognized this in its national ICT strategy for 2005 - 2008. To that end, the Government is considering whether the ICT sector regulatory body should be independent or part of the Ministry. In our view, the regulatory body must be completely independent of any governmental body which participates in the ICT sector on a commercial basis and competes with other ICT market participants. If the Ministry retains any financial interest in the commercial activities of ICT market participants, the regulatory body must be separate and independent of the Ministry. Stated differently, the ICT regulator cannot also be a competitor - which would be inherently unfair.

Recommendation

The Government should establish a regulatory body for the ICT sector completely independent of any entity or governmental body which participates in the ICT sector on a commercial basis or competes with ICT market participants.

02 Privatization

Notwithstanding the national ICT strategy and related action plan which calls for the privatization of joint ventures and state-owned telecommunications enterprises, the Government still retains at least partial ownership of enterprises with a dominant position in the ICT market. The Government has suggested that that these enterprise should be modernized before privatization to increase their market value and attract investment. AmCham respectfully disagrees with this position. In our view, not only is the Government not in the best position of anticipate the needs of future investors but the Ministry's continued commercial involvement in the area it regulates already discourages investment in the sector. Equally important, international experience shows that investors will pay more for telecommunications enterprises which have not been "modernized."

Recommendation

AmCham recommends that the Government privatize its revenue-generating enterprises now, letting the new owners decide what kind of modernization is desirable and appropriate.

03 Customs Duties

To create a competitive local market, appropriate tariff regulation is essential. There is significant variation in the import tariff rates for IT and telecommunication industries which not only distorts allocation of resources and undermines growth but also introduces a significant level of discretion for customs officials to classify products.

The tendency is to classify IT products as telecommunication products which are generally subject to a 15% tariff while IT products have a 3% tariff. Another serious problem is the tariff structure for IT products which encourages imports of finished products at the expense of components and spare parts. For example, the duty for personal computers is 3% but 10% percent for computer

components, a significant disincentive for computer assembly businesses to operate in Azerbaijan.

Azerbaijan's customs duties for computers and peripherals are uncompetitive in the region. In Georgia, Turkey and Turkmenistan duty for these products is 0%. To be a leader in this industry in the region, Azerbaijan must create business friendly conditions.

Recommendation

Tariffs for IT and communications products should be rebalanced to become more cost-based and remove existing subsidies and inefficiencies. We recommended that tariffs for both IT and telecommunication products, as defined in the Information Technology Agreement (ITA) of the World Trade Organization be reduced to 0%.

04 Intellectual Property Rights

Bootleg copies of software and DVDs remain widely available in Azerbaijan and some television stations continue to broadcast movies using bootleg DVDs. Some channels continue to rebroadcast television programs without authorization or agreement with the owner of the rebroadcast rights.

Recommendation

AmCham recommends a renewed and effective effort to protect intellectual property rights 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. The Ministry should work closely with the State Customs Committee to stop the import of pirated DVDs, CDs and software, and with security authorities to end illegal local commercial copying.

VI Labor

After careful consideration, AmCham has concluded that the following six issues are the most important labor 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.

AmCham also believes that the Social Protection Fund's aggressive auditing of employers is giving rise to serious concern about its practices. AmCham, therefore, makes the following recommendations:

01 Reduce the level of contributions

AmCham believes that the current structure of social fund contributions is a significant impediment to the creation of new jobs and is unfair in its application of benefits to employees.

The cost to an employer of hiring labour is a major component of the overall cost of doing business. If the cost is high, the employer will cut back on recruitment or not make new investments. In addition to income taxes, social fund payments greatly increase the cost of employment. The total cost of hiring a new employee at marginal rates is equal to 83% of the net salary. Such a high cost of hiring new staff is a serious deterrent to employers and is not competitive with the costs of its main trading partners in the non-oil sector. AmCham has reason to believe that many businesses are locating in Georgia, in particular, in part to take advantage of lower staff costs even though those employers would have preferred to have their regional base in Azerbaijan. Consequently, Azerbaijan is losing business to neighboring countries. AmCham believes that, if the labor market is to grow and business to thrive, the overall cost of labor must be reduced and reduced substantially. AmCham also believes that a lower 'nil' band for both income tax and social security contributions will boost employment significantly.

Recommendations

AmCham recommends that social fund contributions be reduced as follows:

- the employer's contribution be reduced from 22% to 15%;
- increase the employee's contribution to 5%;
- the first AZN 500 of an employee's income should be exempt from both income tax and employers' social contributions.

02 Cancellation of Maximum Limit on Payment for Social Benefits

As social fund contributions (currently 3% is deducted from the employee's salary and the employer makes an additional contribution of 22% of gross salary) are not capped by any maximum amount, AmCham believes social benefits payments also should not be capped by any maximum limit (currently the limit on maternity leave benefit is 1250 AZN.) AmCham believes that, though there may be good reasons to limit benefits, taking into consideration that contributions are not capped it is reasonable to expect that benefits should also not be capped.

Recommendation

AmCham recommends to repeal the 2007 amendment to the Law on Social Insurance (namely, 1250 AZN limit on Maternity Leave and other limits), and return the situation to that prevailing before the amendment.

03 More efficient payment of benefits and less aggressive auditing

AmCham members report that the Social Protection Fund remains inefficient in its payment of social benefits (e.g. maternity benefit) and that often causes hardship to the employee. Furthermore, the Social Protection Fund's aggressive auditing of some employers is generating ill will. Some of our members have reported that legitimate items such as business expenses are being wrongly subjected to demands for social contributions.

Recommendations

- The Social Protection Fund should pay benefits in a timely manner.
- The Social Protection Fund should listen to the concerns of employers and to apply the law in a reasonable and fair manner.

04 Records of Vacations and Leaves

Currently, Article 138(4) of the Labor Code states: "For the purpose of accuracy in the granting of vacations, leave records must be kept according to employees' work years." Since employees' work years are different, this results in unnecessary complexity and bureaucracy which increases the potential for errors. It also creates problems in vacation planning at the beginning of the year. We consider it is logical to adopt the calendar year as the work year and, where an employee is employed for less than a full calendar year, that leave entitlement be apportioned accordingly.

Recommendation

We recommend amending Article 138(4) to read as follows:

"For the purpose of accuracy in the granting of vacations, leave records must be kept according to the calendar year."

05 Overtime

Background: Under the law prior to the Labor Code of 1999, entitlement to leave depended on the nature of the employee's job. The distinction may, very loosely, be referred to as one between managerial/skilled workers and unskilled workers. The latter were entitled to fewer days of annual leave (21 days) and overtime was in most cases prohibited for such workers (and, if necessary, had to be compensated). Skilled workers were entitled to more annual leave (30 days) 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 skilled and unskilled workers was aligned. As a result, it is no longer legally possible to require managerial/skilled or professional workers to work overtime except in very limited 'emergency' situations and such overtime must be additionally remunerated. Despite this change, all workers now have an entitlement to 30 calendar 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 the employee sufficient rest, are illogical as there is no restriction on an employee taking a second job.

Recommendations

- Repeal Articles 99(2) and 101 of the Labor Code. This will then permit overtime in all situations.
- Amend Article 165 of the 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)."

VII

Tourism

Tourism

AmCham recognises the potential for the tourism sector to become an important contributor to the economy of Azerbaijan. We make some suggestions here which we believe are crucial for this development. In this regard, we would also like to commend the Ministry of Culture and Tourism and other contributing ministries and organizations for their efforts to improve the overall tourism business climate with certain changes in laws and procedures to better the overall services in this field. Below are a few of the positive changes we have noticed and welcome:

- Standardization and star certification of hotels in Azerbaijan.
- Identification of the seven tourism routes for visitors to Azerbaijan.
- Development, together with UNDP of Tourist Information Offices in Baku, Shamakhi, Khachmaz, Shaki, Ganja, Nakhchivan, Lankaran and Quba and the provision of information, maps, etc.
- Development and conservation of national parks.
- Conservation and restoration of historical monuments and other sites of interest.
- Implementation of an official tourism website.
- Establishment of the Azerbaijan Tourism Institute.
- Tourism training provided to the regions by the Azerbaijan Tourism Institute.
- Development of regional sustainable projects with NGOs for the development of tourism and the economies of certain regions.
- Development of local handicraft production and sales.
- Production of a promotional film which has been broadcast on CNN and Euronews channels.

For the further development of tourism in Azerbaijan we have the below suggestions which we believe will be of great importance for the future of this sector.

01 Information Program for Tourism Operators

Tourism specialists are not made aware of their legal responsibilities.

Recommendation

Implement an information program (which could be through the tourism website) on tourism-specific legal responsibilities and liabilities of tourism operators.

02 Delays Purchasing a Visa on Arrival

While AmCham welcomes the fact that many tourists can obtain their visas on entry, the procedures for doing so are tedious and give a poor impression of the country to tourists on their arrival. The process of issuing a visa is prolonged as one has to get into line three times - first at border control, then at the visa desk and then again at the border control counter. This unnecessarily bureaucratic procedure merely prolongs the entry process for others as well as for the tourist.

Recommendation

Visa forms can be given out during the flight before landing to those who do not have a visa and thereby save time. It is also advisable that these people go directly to the visa section prior to getting into the immigration queue thereby saving time and avoiding double work for the border control officer as well as the incoming tourists. Although several border control officers speak good English, it would be helpful to the development of tourism if more visa and border control officers had reasonable English language skills or if one or more officers was clearly identified as being able to assist with language problems.

03 Airport Departures

Heydar Aliyev International Airport, the main international airport in Baku, although much improved from its condition a few years ago, could be made more welcoming for visitors. The queue at customs on leaving the country is often chaotic as is baggage handling. The 'duty-free' shops are often more expensive than in the city itself and the range of goods on offer, though more than before, is still limited. There are also few food outlets and the inability to take Azerbaijan currency out of the country makes it difficult for visitors to spend money at such places.

Recommendation

Permit travellers to take a limited amount of Azerbaijan currency with them (e.g. AZN 200 max.). This will allow visitors to spend money in the airport shops after check-in. There should also be a currency exchange booth after check-in to permit visitors to exchange any Azerbaijani currency they still have left.

04 Airport Tourist Information Office

The airport has no tourist information office, shuttle service or other services such as rent a car, etc.

Recommendation

A tourism information office should be set-up for tourists to be able ask information concerning transportation, taxi prices, limousine services, hotels, city sites, etc. A safe/secure bus service to the center of the city would also be helpful.

05 Tourism Development Plan

Azerbaijan appears to lack a proper development plan to further the market in tourism.

Recommendation

If a comprehensive plan of tourism development exists, which evaluates the country's resources such as history, culture, religion, climate, nature, sea, business, conferences/conventions, etc., this should be made more widely known. If no such plan exists, one should be developed.

06 Foreign Language Signage

It is very difficult to find English or European language information or books in museums and other sights of interest.

Recommendation

Explanatory and directional signs should at a minimum, be in English. As a way of raising funds for museums museums should provide books, postcards, guides, maps, etc in English and other languages and have English-speaking tourist guides to explain the museums or area of interest. Having qualified English-language tour guides available at historical sites and places of interest would also be helpful.

07 Azerbaijani Handicrafts

Not many handicrafts are available for purchase. Although there has been an increase in souvenirs for sale, many are not made in Azerbaijan.

Recommendation

Handicrafts are one of the main items which attract tourist discretionary spending and allow the people from the regions to produce handmade crafts. We suggest that, together with the Association of Handicraft Artists, a project be implemented to attract the attention of the regions to produce more handicrafts. These items can be sold in all areas of interest such as museums, monuments, hotels and airports.

08 Tourism Data Collection

There is a lack of strong statistical and market research data concerning the tourism sector and, therefore, it is difficult to estimate or calculate the impact of this sector on the whole economy.

Recommendation

A system of reporting by customs authorities and hotels, motels, resorts and other facilities should be provided to the Ministry of Tourism or the State Committee of Statistics for verification.

VIII

Corruption

01 Corruption Generally

International observers continue to report widespread corruption throughout Azerbaijan's judicial, legal and economic sectors. Likewise, the global business community continues to view Azerbaijan as a country of pervasive corruption. Beginning in 2004, the Government adopted a series of anti-corruption measures aimed at increasing transparency and reducing corruption. Unfortunately, implementation of many of these laws, including the law requiring financial disclosure by public officials, has been slow or inadequate, allowing corruption to persist and increase concurrently with the increase of oil revenues into the country. 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.

In the summer of 2007, the Government again focused its attention on combating corruption and took several positive steps aimed at tackling the problem of corruption. First, the Government adopted a new National Strategy on Increasing Transparency and Combating Corruption. Second, the Government adopted an ethics code for civil servants. The New National Anti-Corruption Strategy, set to run from 2007 to 2011, replaces and expands upon Azerbaijan's previous State Program on Combating Corruption (2004-2006). While the Government generally proclaimed the old state program to be a success, the call for wide-ranging improvements in the new National Strategy implicitly acknowledges the many shortcomings in the implementation of the earlier plan. Similar to the format of the old plan, the new strategy consists of two parts: the National Strategy outlines the Government's anti-corruption policy and commitments, and the Action Plan identifies specific measures and activities to be implemented within general timeframes.

The new National Strategy commits the Government to undertake a number of important reforms in a wide range of areas, including adoption of a comprehensive anti-money laundering/counter-terrorist financing law, increasing accountability in government purchasing, improvement in the operations of the anti-corruption commission, streamlining government licensing and regulation, and increasing transparency throughout government operations. Unlike the prior plan, the new strategy also requires systematic monitoring and public reporting on implementation. This provision provides an opportunity for the business community to participate in the process and introduce accountability for failures in implementation. These are positive steps that can lead to significant improvements.

A critical review of the new National Strategy must acknowledge, however, that many of the measures included in the action plan simply re-state old commitments, and that others are vague as to how and when they will be implemented or what indicators will be used to measure success. There are also other shortcomings, including the unwillingness of the Government to expand the membership of the Anti-Corruption Commission to include members of civil

society or to create an independent advisory committee to the commission.

The positive steps mentioned above are also tempered by the Government's failure to commit to reforms in a number of other areas that are inextricably intertwined with combating corruption. Among those noticeably absent are measures supporting the independence and integrity of the parliament and the media. Also missing, despite its obvious significance, are any specific budgetary commitments either from the state budget or from the various ministries for implementing the action plan. Whether Azerbaijan's newest National Strategy will signal a strengthening of the Government's political will to tackle corruption in a meaningful way, and whether it will result in meaningful change, will only become clear with its implementation.

Recommendations

- Each ministry should create and submit a detailed and specific action plan by the end of December each year as required by the new National Anti-Corruption Strategy specifying how it will increase transparency and combat corruption consistent with Azerbaijan's international obligations.
- The laws of Azerbaijan and the Criminal Procedure Code should be amended in order to provide law enforcement agencies with the investigative tools necessary to ensure that the anti-corruption regime can be enforced properly and effectively. This includes allowing anonymous complaints, protections for whistleblowers, and a streamlining of procedures for investigating and prosecuting corruption crimes.
- 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 implemented and all public officials should file the required financial disclosure forms.
- The draft Conflicts of Interest Law should be adopted and implemented.
- The Anti-Corruption Department of the Prosecutor General's Office should increase its staff and take a more aggressive approach to investigating and prosecuting high level public corruption.
- The government should allow an independent, ethical and professional media, and provide strong government protection for freedom of the press, so journalists can report objectively on corruption free of reprisal.

Corruption

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 business is essential for a vibrant, healthy and growing economy which, in turn, would increase employment.

Recommendation

The Government should pass and enforce a new Competition Code which defines unfair competition and specifies a mechanism for redress.

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. Azerbaijan's justice system also continues to be perceived as being corrupt and subject to outside influences and bribes. 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 of inappropriate judicial behavior exist of judges accepting payments and instructions from litigants and third parties.

Many positive steps have been taken during the past four years to correct these problems and perceptions. Most significantly is that new judges are now selected through a competitive merit-based exam process. This merit-based system, combined with organized high level training, will go a long way to creating judicial independence in Azerbaijan. To increase the positive benefit from these reforms, the government should go even further by taking steps to increase the transparency of the more subjective oral exam phase of the judicial selection process, as well as increasing the transparency of the judicial evaluation and disciplinary processes.

Recommendations

- All judges should be required to file financial disclosure forms and steps be taken to enforce this requirement.
- Open public access should be provided to all court proceedings and judicial decisions.
- The legislative database, originally created with US funding, should be kept fully operational and updated.
- Court judgments should be enforced in a fair and timely manner.
- Strict conflict of interest rules for judges should be developed and implemented.
- The Council of Europe standards for judicial independence should be enforced.

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