



Role of Special Economic Zones Policy in Increasing Azerbaijan's Economic Development

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Abstract: Special Economic Zones (SEZs) have become a significant feature of global economies, providing incentives for investment, and specifically examines the case of SEZs in Azerbaijan, focusing on government involvement in their development fostering mass production, boosting exports, and addressing unemployment. This article delves into the landscape of SEZs globally. Utilizing data collection and literature review methods, the research evaluates the performance and characteristics of Azerbaijani SEZs. The findings reveal that while Azerbaijani SEZs have shown growth, they have not fully realized their potential. Factors such as legislative reforms, government participation, and the nature of incentives offered have influenced their success. SEZs with foreign investment and strategic planning, such as the Sumgait Chemical-Industrial Park and Hajiqabul Industrial Estate, have fared better than others. However, some SEZs have struggled due to domestic market dynamics and short-term business strategies. To enhance the role of SEZs in the economy, the article proposes several strategies for the Azerbaijani government. Firstly, a shift in the SEZ strategy from mere stimulus areas to revenue-generating enterprises is recommended to ensure a steady income stream for the government and foster competitiveness. Secondly, exploring joint ventures in SEZ development, either through public-private or public-public partnerships, could attract diverse investment sources and alleviate financial burdens on the government. Lastly, restructuring SEZ legislation to offer long-term incentives and cater to the needs of larger corporations is advised, making SEZs more attractive for sustained investment and contributing to sector-specific development goals.



Introduction

Special economic zones (SEZ) are proliferating around the globe (Zeng, 2016). Due to the special rules and regulations, SEZ affects country's economy through different aspects. These zones also play significant role in the employment generation for the society (Aggarwal, 2007). In this article, we will discuss the definition, strength and advantages of SEZ located in Azerbaijan and government involvement in both financial and juridical matters. Article introduction is going to explain the definition of SEZ in the world economy and current SEZ activity, performance in the Azerbaijan. In this research, we want to find out government involvement in the SEZ and how they could develop this involvement.

In the world economy, SEZ has broader meaning. Every country has different type of SEZ, and they define SEZ according to their own law. In 2019, United Nations Conference on Trade and Development (UNCTAD) defines SEZ as "Geographically delimited areas within which governments facilitate industrial activity through fiscal and regulatory incentives and infrastructure support" (UNCTAD, 2019). In Azerbaijan SEZ defined as "a limited part of the territory of the Republic of Azerbaijan where a special legal regime is applied for the implementation of entrepreneurial activity". These 2 definition shows that main purpose of the SEZ is to boost and facilitate manufacturing through special administrative regulations and incentives.

However, in order to call some area as a SEZ it must meet some requirements. UNCTAD also made some research about and they concluded that SEZ must meet 3 essential requirements which is:

- a) To establish a Special Economic Zone (SEZ), the government must first identify a distinct geographical area, setting it apart from other territories. This selection process is critical as not all lands are suitable for industrial activities. It's essential for the government to choose a location with access to major transportation routes and preferably in rural areas to allow for future expansion of the SEZ (UNCTAD, 2019).
- b) Once the geographical zone is delineated, the government must institute economic and legislative incentives within that area to encourage production. These incentives typically involve tax breaks or exemptions, favorable loan terms, and streamlined administrative procedures. Such measures are pivotal in attracting manufacturers to invest and expand operations within the SEZ (UNCTAD, 2019).
- c) The establishment of infrastructural support and communal services forms the final requirement for an effective SEZ. The government must provide essential infrastructure such as warehouses, offices, and utilities, along with energy sources and communal services like internet connectivity and transportation. While some countries may consider this requirement insignificant, it is crucial for ensuring the smooth functioning of production and import-export activities within the SEZ (UNCTAD, 2019).

These requirements are essential to name a territory the Special Economic Zone. However, not all countries use these requirements at maximum capacity. For example, some countries create SEZ in little area, but, giving the best economic incentives to the residents while other countries create SEZ in larger area while giving smaller incentives to the residents.

Of course, it depends on countries strategy and goals which decides the future of SEZ. In 2019, there are 5383 SEZs today and 4772 of these SEZ were built in developing countries. This figure alone shows that developing countries are relying to SEZ in order to boost their economy. Nowadays, SEZ is one of the integral parts of the economy and their numbers are increasing over time. For instance, between 2014-2019 more than 1000 SEZ were created in the world economy. Their impact on the country's economy is significant since they play as a catalyst for the economic growth. SEZ impacts are followed:

- a) The encouragement of investment in Special Economic Zones (SEZs) is driven by a combination of economic incentives, infrastructural support, and a specialized administrative regime. These factors collectively attract astute investors from around the globe, who view these zones as the initial stepping stones for economic development.
- b) With the establishment of enterprises within these zones, a natural progression towards mass production ensues. SEZ tax incentives serve as a catalyst for enterprises to ramp up production and increase sales volumes, thereby driving economic growth within the zones.
- c) The heightened levels of production also lead to increased export activities. Companies operating within SEZs are motivated to expand their presence in foreign markets by exporting their products, thereby enhancing their global reach and influence.
- d) Furthermore, the establishment of more companies within SEZs translates to a reduction in unemployment rates and encourages deurbanization. The influx of businesses creates job opportunities, providing employment for local populations. Additionally, this trend incentivizes individuals to relocate from urban areas to the territories where SEZs are situated, seeking employment and contributing to the growth of these regions.

These impacts are considered integral part of economic development and government is obliged to create such zones within their territories. However, these impacts have some limits depending on SEZ types. In world practice, not all SEZ are same and they are defined through their unique characteristics.

Table 1. Types of SEZ

Free Trade (Economic) Zone	Biggest and most expensive type of SEZ. Free Trade (Economic) Zones has perfect incentives for the residents. Most of the cases, it is a tax-free territory in the SEZ. It encourages every business in the production and import-export operations of the manufacturers through tax-free regime and legislative features.
Export Processing Zone (EPZ)	It has the same features with the Free Trade Zones. However, the main differences between Export Processing Zones and Free Trade Zones is the EPZ has benefits in export processes. Residents who make operations with the domestic businesses are subject to certain taxes.
Single Factory Zones	Single Factory Zones are created based on importance of establishment. For instance, some businesses are essential for the government and its operation necessary for development of certain sector. In Azerbaijan, Qaradagh Industrial Park considered this type of SEZ. Although it is called industrial park, it has elements of Single Factory Zones.

Free Ports	Free Ports are the essential player in the logistics and transports. It includes not only seaport but as well as airports, railway transport etc. The residents of these areas are exempt from tariffs. However, some taxes are applied based on rules and regulations
Specialized Zones (Industrial & Technological Parks)	Specialized zones are the most common SEZ type in the world. Many developing countries are using that kind of SEZ in order to industrialize the certain sector of economy.
Enterprise Zones (Industrial Estates)	These zones are smaller version of Specialized Zones and the main purpose of these SEZ is to develop certain part of the region.

Source: Pakdeenurit, Patcharee & Suthikarnnarunai, Nanthi & Rattanawong, Wanchai. (2014). Special Economic Zone: Facts, Roles, and Opportunities of Investment. Lecture Notes in Engineering and Computer Science. 2210.

As we can see, different types of SEZ are spread throughout the world. In today economy, some countries such as China, UAE developed their economy significantly, thanks to the SEZ immense success. In this article, we would make research about Azerbaijani SEZ and their role in in Azerbaijan development.

Research Method

This research will provide the general information about the Azerbaijan SEZ and their performance through years. In addition, this research will also provide us the government investment on this zone and government role in this financial matter. This analysis will give the overall information about the Azerbaijani SEZ.

To conduct economic research about current situation of Azerbaijani SEZ, we have to numerous methods to apply there. In this article, we used data collection method which is first and foremost method in this research. Azerbaijani SEZ hasn't researched thoroughly in these periods. In addition, when we conduct a research database is a key source for the analysis, so we have to rely the performance data about Azerbaijani SEZ. In this research, quantitative data is taken priority since it shows the overall results of Azerbaijani SEZ. In qualitative data section, we used Tax and Custom code of Azerbaijan, rules and regulations about SEZ, UNCTAD and so forth. Ethical considerations and commercial secrecy were given attention during the data collection. In this research, some of the data are confidential and used approximate numbers based on general information.

Another method was used in this research is the literature review. Azerbaijani SEZ were not analyzed carefully, but international SEZ experience and situations examined very well. This method involves educating and absorbing academic papers, publications from government authorities, reports and international organizations. Their vast information helps us to understand SEZ and analyze it efficiently.

Analysis of this article will show us the general information about Azerbaijani SEZ and their performance. In addition, research shows us the drawbacks of the Azerbaijani SEZ in current situation. Finally, at the end of the research some suggestions has been made for the improvement of the Azerbaijani SEZ.

It is necessary to acknowledge the limitations and drawbacks of this study as well. There have some constraints in this study. First of all, the reliability of the data which is the main obstacle in this research. Azerbaijani SEZ key performance indicators were not in examined in early years and as a result, these indicators were wrong through different years. In addition, some financial indicators are confidential, and authors must consider that in their research as well.

Result and discussion

Azerbaijan is one of the developing countries located in Caucasus mountains. It has rich oil and gas resources which pumped up the economy of the country. However, the first oil crisis happened at 2015, weakened the Azerbaijani economy. Before the 2015, 1 USD was equal to 0.78 manat and in 2015, oil crisis devaluated Azerbaijani currency (Hasanov, Bayramli & Al-Musehel, 2019). As a result, 1 USD is now equals to 1.70 manat (Khankishiyev, 2017). Oil crisis also damaged the market environment and forced investors to leave the Azerbaijani market. In order to prevent oil dependence, Azerbaijan has to diversify his economy and increase non-oil sector role. In addition, government knew this was forthcoming in the future period and this needs a preventive measure before that happened. So, Azerbaijan has created its first SEZ in 2014 (Aliyev, 2014).

Nevertheless, in order to create a proper SEZ for the economy, government must investigate global trend, economic goals of the country, desire of enterprises and so forth. These requires expenses from government budget and this cost is just the small part of what is to come. SEZ are considered government area and state must bear the initial capitalization. For the purpose of high capitalization cost Azerbaijani government created Specialized zones which is most common and cheapest version of SEZ. However, Azerbaijan have created not 1 but 2 SEZ in the 2014 in order to rectify this economic situation. These are called Sumgait Chemical-Industrial Park and Balakhani Industrial Parks. These SEZ were the first experience for Azerbaijani economy. Unfortunately, lack of experience, oil crisis in 2015 and lack of funding from government, these parks didn't succeed in their early phase. For example, Azerbaijan government spent 149 million manat to establish phase 1 of Sumgait Chemical-Industrial Park and phase 1 of this park was 295.62 hectare (Turan.az, 2015). When it was created the initial zone of Sumgait Chemical-Industrial Park was the 505.64 hectare and with the expansion of this zone, total area of this park is 583.5 hectare now. Balakhani Industrial Park was smaller compared to Sumgait Chemical-Industrial Park and size of this SEZ was 10 hectares.

Azerbaijani SEZ has different rules and regulations based on their type. For example, industrial estates are the smallest version of Azerbaijani SEZ and the incentives in this zone are quite low and residents of this SEZ can't receive any incentives. However, they are getting some incentives through "Investment promotion paper". Residents of the industrial estates can obtain this paper and this paper gives the owner some discounts on certain taxes. Holder of this paper receives 50% discount on income/profit taxes and 100% discount on property and land taxes (economy.gov.az, 2023). In addition, this paper exempts import VAT taxes and

custom fees for importing technological equipment's and machines. These discounts are in power for 7 years. Last incentive is the holder of this paper could loan money from government at special discount.

Industrial parks, however, has some bigger incentives. For example, residents receive 100% discount on income/profit, property and land taxes (Tax code of Azerbaijan, 2023). Furthermore, they are free from paying import VAT taxes and custom fees for importing technological equipment's and machines (Custom code of Azerbaijan, 2023). These discounts are in power for 10 years. Residents also gets energy resource and communal services at special rate and government will do their initial administrative procedure (such as getting permission from the government agencies) on their behalf.

Azerbaijan is currently building their first FEZ in its history. Apart from other SEZ in Azerbaijan, this FEZ has significant advantages. Located in Alat village, this zone provides special bonuses for the residents. For instance, residents exempt from VAT, Withholding, property and other corporate taxes. Subsequently, residents are from the custom duties and taxes on import to the free zone and export from the free zone. Residents also free from social security and other similar tax payments for the workers. Alat Free Economic Zone Authority is the owner of this zone and it guarantees investors safety. They protect investors property from nationalization, expropriation measures. This zone also removes restrictions on payment on foreign currency.

Table shows the data about the Azerbaijani SEZ between 2014-2023:

Table 2: Azerbaijani SEZ

SEZ	Date of establishment	Total area (in hectare)	Capital Expenditure (in million manat)	Total value of produced goods (in million manat)	Total value of exported goods (in million manat)	Total investment (in million manat)
<i>Sumgait Chemical-Industrial Park</i>	2014	583.5	~200	10 336	3 611	5 836
<i>Balakhani Industrial Park</i>	2014	10.15	~50	242.4	22.9	52.5
<i>Mingachevir Industrial Park</i>	2015	26	~60	272.2	234	159
<i>Pirallahi Industrial Park</i>	2016	30	~50	46	-	36.7
<i>Qaradagh Industrial Park</i>	2017	72	~50	889	3.1	847.1

<i>Neftchala Industrial Estates</i>	2017	10	22.1	150.4	0.7	46
<i>Masalli Industrial Estates</i>	2017	4.7	16.6	11.9	-	2.1
<i>Hajiqabul Industrial Estates</i>	2017	15.2	38.3	162.3	1.3	45.6
<i>Sabirabad Industrial Estates</i>	2017	20.3	25.4	2.9	-	6.6
<i>Alat Free Economic Zone*</i>	2018	873.74	783.7	-	-	-
<i>Aghdam Industrial Park*</i>	2021	190	~100	-	-	-
<i>“Araz Valley Economic Zone” Industrial Park*</i>	2021	200	~100	-	-	-

*These SEZ are still under construction

Source: Author's own research

These zones are vital for Azerbaijani economy and government plays significant role in their development. Every SEZ type in Azerbaijan were financed (or will be financed) through different channels. All Industrial estates were financed and managed by “Azerbaijan Investment Company” CJSC. This company is government enterprise whose main purpose is to support non-oil sector through government investment. Industrial parks also financed by government as well. Out of 7 Industrial parks, 2 of them are considered Single Factory Zones which sole enterprise operates in the zone. Qaradagh Industrial Park and Mingachevir Industrial Park has sole enterprise that plays crucial role in the region and that parks were created after their creation and government financed these zones to upgrade their communal services. Nonetheless, all these industrial park investments covered by government budget. All these Industrial zones were covered by government investment. Alat FEZ, however, will be created based on public-private partnership. Government will finance communal and energy resources while rest of the infrastructure projects will be financed by private developers. They will create infrastructure and lease it to the residents of the Alat FEZ. Government will provide roughly 25% of total capital expenditure (BCG, 2017).

In Azerbaijan, state plays crucial role in the SEZ establishment. This tendency also appears at the other countries as well. However, many countries create SEZ to stimulate some sector. In reality, government and any SEZ owner could generate revenue through leasing and other duties.

Depends on these incentives and strategy of the government, they could create different kind of SEZ. In Azerbaijan, they used most common SEZ types such as Industrial parks

and Industrial estates and both together considered as an Industrial zone. Industrial zone's main objective to support new enterprises to establish their production chain in Azerbaijan. These supports are considered for short term since most of the incentives has some period. In addition, government are not keen to spend additional money on these zones due to economic downturn and high cost of these zones. Furthermore, government are not interested to generate revenue on these zones to replace tax income from these enterprises. Research also showed us evidence on Alat FEZ capital expenditure.

However, government expenditure wasn't paid off fully. For instance, data shows that between 2018-2023, the production

- a) In the Sumgait Chemical-Industrial Park was 232.5 million manat, 823.4 million manat, 1131.9 million manat, 2174.2 million manat and 2970.3 million manat respectively. Rest of the 292 million manat worth production were produced between 2014-2018;
- b) In the Balakhani Industrial Park was 8 million manat, 16.1 million manat, 25.9 million manat, 47.9 million manat, 57.3 million manat and 85.6 million manat respectively. Rest of the 2 million manat worth production were produced between 2014-2018;
- c) In the Mingachevir Industrial Park was 16 million manat, 46 million manat, 17 million manat, 77.2 million manat, 57.3 million manat and 58.2 million manat respectively. Rest of the 1 million manat worth production were produced between 2015-2018;
- d) In the Pirallahi Industrial Park was 0.1 million manat, 0.3 million manat, 4.3 million manat, 9.3 million manat, 15.6 million manat and 16.1 million manat respectively. Rest of the 0.3 million manat worth production were produced between 2016-2018;
- e) In the Qaradagh Industrial Park was 102 million manat, 86 million manat, 58.5 million manat, 48 million manat, 38.2 million manat and 40.6 million manat respectively. Rest of the 516 million manat worth production were produced between 2013-2018;
- f) In the Neftchala Industrial Estate was 26.6 million manat, 32.9 million manat, 32 million manat, 30.5 million manat, 16.8 million manat and 11.5 million manat respectively.
- g) In the Masalli Industrial Estate was 0.3 million manat, 1.5 million manat, 1.5 million manat, 2.6 million manat, 3.3 million manat and 2.6 million manat respectively.
- h) In the Hajiqabul Industrial Estate was 0 manat, 0.1 million manat, 1 million manat, 4.7 million manat, 38.1 million manat and 118.3 million manat respectively.
- i) In the Sabirabad Industrial Estate was 0 manat, 0.1 million manat, 0.1 million manat, 0.1 million manat, 0.3 million manat and 2.3 million manat respectively.

These numbers show that SEZ in Azerbaijan is growing but it is not observed in all SEZ. Lack of geographic allocation, low rate of foreign investment, shortage of government investment decreases the SEZ potential.

Conclusion

This article aims to discuss the SEZ situation in Azerbaijan and using international method to flourish the Azerbaijani SEZ. Research shows that Azerbaijani SEZ are thriving but not as

expected. Absence of legislative reform and lack of government role in the SEZ crippled SEZ development in the early stage. It can be shown in the other indicators as well. The reason behind is many investors are domestic enterprises who want to use these short-term benefits. However, current business environment in Azerbaijan is not sustainable and can't last in long-term. As a result, many businesses in SEZ start to fail. For example, Neftchala Industrial Park production was 26.6 million manat but in 2023 it fell to 11.5 million manat. Other SEZ such as Sumgait Chemical-Industrial Park and Hajiqabul Industrial Estate are successful due to the foreign investment and good business plan. In addition, financing liberated zones pushes state to be more prudent in their financial reserves.

In order to increase SEZ role in economy, government must change their expectations on SEZ, and government have to enact following strategies:

- a) Changing SEZ strategy—Firstly, government must change his view on the SEZ. Currently, Azerbaijan government see their SEZ not as enterprise but as an area to stimulate businesses. Government must shift that strategy first to achieve SEZ success in the future. Thus, could lead many opportunities for the government as well. By doing that, government could use SEZ to generate revenue and compensate some tax. Thus, lead steady income for government as well. In addition, demanding steady income from the residents pushes them to become more active in the competitive business environment.
- b) Joint Venture on SEZ—This is most vital part in the forming SEZ. Current tendency of Azerbaijani strategy is to finance Qarabagh region. Azerbaijan had been in war against Armenia and after 30 years of occupation, Qarabagh had been freed by Azerbaijani army. However, Qarabagh had been in occupation for 30 years and this region turned into warzone. In addition, many people have been live in refugee in other regions of Azerbaijan. So, government have to spend massive capital to restore Qarabagh region for the next 10 years. In this dire situation, government has to cut money from other sectors and SEZ sector is one of them. In order to rectify this problem, government has to create or maintain SEZ by Joint Venturing. This could be in many forms such as public-private partnership or public-public partnership. In world experience both has been used by different countries, but their numbers are less than government owned SEZs. For instance, Georgian government invited Chinese investors to create “Free Industrial Zone Hualing Kutaisi 2” SEZ. This is considered public-private partnership. In 2018, Poland enacted a law to establish the “Poland Investment Zone”. This new regime enabled investors to benefit from preferential conditions in the entire territory of Poland (UNCTAD, 2019).
- c) Restructuring SEZ—Currently, Azerbaijan SEZ doesn't have long term incentives. Apart from Alat FEZ, other SEZ is not advantageous for the businesses. Especially big corporates are interested in the long-term investment where they could get profit from it. Industrial zones current regime is not suitable for the big corporates. In order to attract such enterprises, government must reform current SEZ legislation. Furthermore, current legislation has some drawbacks which can't attract foreign enterprises. They

must extend incentive period or make infinite while giving special discount on specific taxes. Furthermore, state needs to change the focus on the SEZ. Most SEZ are created to nourish certain sector in the country. For instance,

These changes would increase the effectiveness of Azerbaijan SEZ in the future. Changing SEZ strategy would also open new paths for the Azerbaijani government. With the new strategy's government don't have to bear the all cost and risks of all SEZ procedure. In addition, government doesn't have to find out investment source for the SEZ as well. Thus, would boost economic indicators of the country while not spending too much money on it.

In conclusion, this article has explored the landscape of Special Economic Zones (SEZs) globally, focusing particularly on Azerbaijan's SEZs and the government's involvement in their development. SEZs have become integral to many economies worldwide, providing incentives for investment, stimulating mass production, increasing exports, and mitigating unemployment. In Azerbaijan, the establishment of SEZs was seen as a strategy to diversify the economy away from oil dependence, especially in the wake of the 2015 oil crisis.

The research methodology employed in this study involved data collection and literature review, shedding light on the performance and characteristics of Azerbaijani SEZs. The data revealed that while SEZs in Azerbaijan have seen growth, they have not fully reached their potential. Factors such as legislative reform, government involvement, and the type of incentives offered have influenced their success.

It was observed that Azerbaijani SEZs, particularly those with foreign investment and strategic planning like the Sumgait Chemical-Industrial Park and Hajiqabul Industrial Estate, have fared better compared to others. However, certain SEZs have struggled due to domestic market dynamics and short-term business strategies.

To enhance the role of SEZs in the economy, the article proposes several strategies for the Azerbaijani government. Firstly, a shift in the SEZ strategy from mere stimulus areas to revenue-generating enterprises is recommended. This could lead to a steady income stream for the government and foster a more competitive business environment.

Secondly, the article suggests exploring joint ventures in SEZ development, either through public-private or public-public partnerships. This could alleviate financial burdens on the government and attract diverse investment sources.

Lastly, restructuring SEZ legislation to offer long-term incentives and cater to the needs of larger corporations is advised. This would make SEZs more attractive for sustained investment and contribute to sector-specific development goals.

In conclusion, the evolution of Azerbaijani SEZs requires strategic shifts and reforms to realize their full potential in diversifying and bolstering the national economy. By implementing the proposed strategies, the Azerbaijani government can optimize SEZ performance and contribute to sustainable economic growth in the country.

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