



**ADA UNIVERSITY**

**SCHOOL OF PUBLIC AND INTERNATIONAL AFFAIRS**

**MASTER OF ARTS IN DIPLOMACY AND INTERNATIONAL AFFAIRS**

**CAPSTONE PROJECT**

**Understanding the low levels of FDI Inflows to Azerbaijan in Non-Oil Sectors: Sectoral  
Trends and Investment Barriers**

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**Baku, Azerbaijan**

**May 12, 2025**

**ADA UNIVERSITY**

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## **Abstract**

*This capstone project examines the consistently low levels of Foreign Direct Investment (FDI) in Azerbaijan's non-oil sectors, identifying the main structural and policy-related obstacles to diversification. The three main causes analyzed are market concentration and state dominance, regulatory and bureaucratic obstacles and infrastructure and trade-related costs. The study looks at how strong state-owned businesses, weak institutions and lack of transparency discourage investors from investing in non-oil sectors, by using official statistics, expert interviews and comparative analysis with neighboring countries like Georgia and Armenia. The paper proposes three policy options to address these causes, which include prioritizing institutional reforms over expanding incentive programs, reducing barriers to investment through regulatory reform, and Addressing infrastructure and trade related costs .*

*Then it assesses the effectiveness of each policy option in creating an environment that is more accessible, investor-friendly and competitive. The findings highlight the necessity for a strategic change toward strengthening institutions, decreasing market concentration and systemic trade constraints to fully maximize non-oil business's potential in Azerbaijan, enhancing the regulatory framework to promote transparency and predictability in the investment sector, particularly attention is drawn to improving infrastructure quality and reducing trade costs which are important fact for making Azerbaijan a more attractive destination for foreign investors beyond the oil and gas industries.*

## **Keywords:**

**Foreign Direct Investment, Investment in Azerbaijan, Non-oil Investment, Investment Barriers, Sectoral Trends.**

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## **List of Abbreviations**

AIH-Azerbaijan Investment Holding

FDI-Foreign direct investment

GDP- Gross Domestic Product

HCOJ - High Council of Justice

## Chapter 1. INTRODUCTION

Foreign Direct Investment plays an important role in the economic development of every country, contributing greatly to a country's GDP growth and job creation. Azerbaijan is one of the countries that attracts a high percentage of FDI annually. Azerbaijan has seen FDI inflows of 8-9 % of GDP on average in recent years, which is relatively high compared to many developing economies (Central Bank of Azerbaijan, 2024). But these investments are highly concentrated in specific sectors, namely, the oil and gas sector, while efforts to increase investments in non-oil sectors have had a low rate of success. The Azerbaijani government throughout the years has introduced incentives to foreign investors, such as tax exemptions, free economic zones and industrial parks and simplified licensing procedures, which all aim at attracting investment beyond the oil and gas sector (Invest in Azerbaijan, Why Azerbaijan: FDI in Azerbaijan). However, it has not provided for much increase in FDI inflows to non-oil sectors. Recent data from the Central Bank of Azerbaijan shows that in 2024, 79.3 % of total FDI was concentrated in the oil-and-gas sector, showing ongoing reliance on energy investments<sup>[1]</sup> (Central Bank of the Republic of Azerbaijan, n.d.). Although FDI in non-oil sectors has increased by 2.7 %, this amount is still lower compared to the oil and gas sector.

According to insights shared by Dr. Sarvar Gurbanov, professor of Economics at ADA University, the decline in FDI inflows to Azerbaijan has persisted since 2004, with FDI net inflows standing at only 0.3 % of GDP by 2023.

Further insights were shared by a local expert Samir Aliyev as part of this research. According to the expert, about 81 % of FDI inflows into Azerbaijan still go to the oil industry, despite a recent 6 % annual growth rate in FDI inflows. On the other hand, the non-oil sector only received \$ 1.4 billion in 2024, which is a 32 % decrease from the previous year.

According to the “Strategy of socio-economic development of the Republic of Azerbaijan in 2022-2026”<sup>[2]</sup> (The President of Azerbaijan, 2022), FDI in the non-oil and gas sector makes up about \$790.4 million and the strategy targets an increase of 10-15 % annually. However, a question arises regarding whether this goal is actually being achieved and if the policies implemented to achieve it are effective. Incentives seem like a proper way of addressing this question, however, all those incentives listed above do not produce any results.

Our study looks at the main causes of why FDI in non-oil sectors is low despite the incentives and policies implemented by the Azerbaijani government, particularly exploring the sectoral trends and barriers and what structural changes need to be made to address this problem. The project has identified regulatory, structural and legal causes of the problem, which will be addressed in detail in Chapter 2.

## **1.1. Methodology**

This project focuses on understanding the low levels in FDI inflows to Azerbaijan by defining the investment barriers and exploring the trends in the sectors. It analyzes the trends in FDI inflows to Azerbaijan, focusing on non-oil sectors, identifies key causes of low FDI rates, including weak governance, infrastructure costs and market concentration, evaluates the effectiveness of government incentives and explore the reasons why they do not increase FDI inflows and provides policy recommendations on how to attract more FDIs in non-oil sectors with investment potential.

The qualitative methodology is used in this project. While the secondary data is collected through the studies in this area, the primary data is collected through the semi-structured and in-depth interview process with two experts specializing in the investment sector

in order to gain insight on the main causes of the problem, potential policy recommendations and expert opinions on investment trends.

We chose to use the how and why questions through interviews in order to gain a deeper understanding of the investment sector in Azerbaijan. Interviews were held with investment experts and researchers specialized in this field. Our first respondent was Dr. Sarvar Gurbanov, an Associate Professor at the School of Public and International Affairs at ADA University. The second respondent was Samir Aliyev, the member of the Board of the Center For Support For Economic Initiatives.

The interviewees were informed about the main purpose of the project and the procedure of the interview process prior to the interview. The voluntary participation of the interviewees were provided with their own consent. Two interviews were conducted: one in English in person, and the other in Azerbaijani via Zoom. Each interview lasted approximately 40 minutes. The interview questions are the following:

1. How would you describe the current state of Foreign Direct Investment (FDI) inflows to Azerbaijan?
2. Which non-oil sectors currently receive the most FDI in Azerbaijan, and which sectors struggle to attract foreign investment?
3. The Azerbaijani government provides various incentives (e.g., tax breaks, industrial parks, investment certificates) to attract FDI. Why do you think these incentives have not been fully successful in increasing investment?
4. How does the informal economy in Azerbaijan affect FDI inflows?
5. How do Azerbaijan's infrastructure and high trade costs affect foreign investment decisions?