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Development dynamics of Azerbaijan's tax system and its impact on foreign economic relations

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Since regaining its independence, the Azerbaijani economy has prioritized the efficient management of financial resources, particularly the establishment of a modern tax system. Against the backdrop of dominance by the oil and gas sector, the need for economic diversification, improvement of the business environment, and attraction of investors have become key priorities. Tax policy plays a critical role not only as a main source of government revenue but also as a tool to stimulate business activity. According to the State Tax Service, large-scale reforms carried out in the country have significantly boosted business development, the creation of a liberal tax environment has improved the investment climate, and expansion of the economy and growth in investment flows have been observed [1].

Azerbaijan's tax system has a rich historical background. Tax authorities were first established in 1919 during the period of the Azerbaijan Democratic Republic with the creation of a Tax Inspectorate [1]. After restoring independence in 1991, the administrative structure inherited from the Soviet era was updated. In October 1991, the tax service became an independent body, separated from the Ministry of Finance [1].

On February 11, 2000, by Presidential Decree, the State Tax Inspectorate was abolished and the Ministry of Taxes was established in its place, and the new "Tax Code" came into force. The adoption of the Tax Code in 2000 laid the foundation of Azerbaijani tax law, defining the rights and obligations of tax subjects, types of taxes, rates, and

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payment procedures. In subsequent years, the Code underwent numerous amendments: during 2002-2003, tax administration was improved with the introduction of electronic services; in 2010, the launch of the "online document circulation" system initiated the automation of document processes. In 2020, another structural reform led to the abolition of the Ministry of Taxes, and its functions were transferred to the State Tax Service (STS), which became subordinate to the Ministry of Economy. This reform aimed to align tax policy implementation with a unified fiscal strategy.

Between 1993 and 2024, the formation of Azerbaijan's tax system was marked by the establishment of various institutions, the adoption and development of the Tax Code, and modernization of administration. The modernization of tax authorities, the implementation of electronic services, and regular updates to the Tax Code have aimed to enhance efficiency in accordance with international practices.

The impact of tax burdens and structure on foreign trade and investment is widely discussed in economic theory and practice. In Azerbaijan, this relationship is particularly significant, as the majority of the country's exports relate to the oil and gas sector and the operations of foreign companies. Thus, tax policy has both direct and indirect effects on investment attractiveness and export capacity. General experience shows that high corporate and income tax rates can reduce investment, yet broadening the tax base is essential to increasing revenues. For example, in recent years, part of the tax burden has been temporarily relieved for the non-oil sector of Azerbaijan's economy (e.g., tax incentives for investment projects, tax exemptions in special economic zones). However, extensive tax relief measures narrow the tax base. IMF research indicates that non-oil tax revenues in Azerbaijan fall below potential, mainly due to widespread exemptions and reliefs [4].

Furthermore, the World Bank recommends improving the efficiency of the tax system by strengthening tax administration and ensuring equitable taxation (e.g., reducing the tax burden on large enterprises and maintaining stable tax levels on labor income). Official statements from the Ministry of Taxes emphasize that "the tax burden for the business environment is extremely important" and working groups are focused on reducing both the tax burden and the time required for compliance [1]. Optimizing social insurance contributions for micro and small entrepreneurs is also

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relevant in this context, aiming to reduce financial burden and stimulate economic activity [1].

In terms of tax burden structure, the main sources of tax revenue in Azerbaijan are corporate income tax and value-added tax (VAT). According to the latest OECD report, in 2022, corporate tax accounted for 32.4% and VAT for 26.4% of total tax revenues [5].

This structure directly affects foreign trade, as taxation of every operation in the value chain influences the final price of export and import transactions. Thus, while tax reductions have contributed to lowering import costs and domestic expenditure, they have also led to reduced revenue. One of the key recommendations for achieving a more balanced tax burden is to broaden the tax base and limit tax exemptions. For instance, OECD advises reducing the number of special (lowered) tax rates by broadening the base [6].

Such practices, by lowering tax rates, preventing tax evasion, and strengthening tax administration, allow for improved tax collection. Consequently, the Azerbaijani government aims to gradually lower tax rates, broaden the base, and make tax administration more transparent and competitive. This approach will foster long-term economic growth and attract foreign investment.

According to official macroeconomic statistics, the share of tax revenues in GDP in Azerbaijan has steadily increased since 2014. For example, in 2022, the tax-to-GDP ratio was 19.6%, significantly higher than the 18.4% recorded the previous year [5]. Between 2014 and 2022, this ratio grew from 17.2% to 19.6%, with the highest level recorded in 2020 at 20.3%. According to OECD, in 2022, 32.4% of tax collections were from corporate taxes, and 26.4% from VAT. Compared to other regions, Azerbaijan's share of social insurance contributions is high (around 32%), while personal income tax remains relatively low (6%).

Statistical data indicates that taxes collected from the non-oil sector are increasing: in 2023, despite a decline in oil and gas sector taxes, non-oil taxes rose moderately due to a broader payment base and improved administration. IMF and World Bank data also show that in 2024, as oil revenues declined, the tax share of the non-oil sector stabilized.

According to official statistics, in January-September 2022, Azerbaijan's foreign trade turnover was \$41.256 billion. Exports amounted to \$30.963 billion and imports to \$10.293 billion, resulting in a positive trade balance of

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\$20.670 billion [2]. In January-July 2023, turnover was \$26.333 billion, exports were \$16.777 billion, and imports were \$9.557 billion, yielding a surplus of \$7.220 billion. In 2024, these figures slightly declined: by year-end, foreign trade turnover reached \$47.4 billion, exports were \$26.3 billion, and imports were \$21.1 billion [3].

Azerbaijan's FDI inflow has been variable in recent years. According to the State Statistics Committee, in 2023, \$6.658 billion in FDI was attracted, slightly up from \$6.276 billion in 2022. Growth in non-oil sector investments and tourism projects supported this increase. For example, in the first nine months of 2024, the volume of currency-generating projects in Azerbaijan rose by 8%, approaching 20 billion manats (according to Central Bank data). The World Bank notes that investment in infrastructure projects under macroeconomic stability conditions strengthens the economy.

Accumulated statistical data confirms that the Azerbaijani government is expanding the tax base to diversify tax revenues and increase non-oil income. Simultaneously, trade volume reflects the country's economic potential. In this economic environment, the stability of investment and trade balance depends on tax policy, which in turn requires a low tax burden, transparency, and a stable legal framework.

A comparison of tax system structures and outcomes with other countries shows that different models create various conditions for economic growth and foreign investment. For instance, Georgia implemented radical tax reforms from 2004-2012, transitioning to a simplified system [8]. In 2004, Georgia sharply reduced tax rates (personal income tax to 18%, corporate to 15%, and VAT to 20%) and introduced electronic declaration systems, transforming into a business-active country [7].

These reforms resulted in economic strengthening and increased state revenues. Estonia, since the early 1990s, has applied a model that serves as an example: all income is taxed at a flat rate of 20%, and corporate profits are taxed only when distributed (reinvested earnings are exempt) [8].

With very few exemptions, Estonia maintains a broad tax base, ensuring simplicity and competitiveness. As a result, Estonia has consistently ranked high in the International Tax Competitiveness Index. Turkey, being a larger economy, implements a centralized tax system. In 2024, Turkey attracted \$11.3 billion in FDI, reflecting the outcome of economic reforms and investments in digital infrastructure [9]. OECD's

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recommendations for Turkey emphasize broadening the tax base and simplifying VAT rates [6].

These examples demonstrate that reducing the corporate tax burden and increasing transparency improve the investment climate.

It can be concluded that between 1993 and 2024, Azerbaijan's tax system has undergone significant institutional and legal development. The establishment of independent tax authorities, adoption and continual improvement of the Tax Code have expanded the country's fiscal capabilities [1]. The share of tax revenues in GDP has increased over the past decade, reaching 19.6% in 2022 [5].

Furthermore, the analysis of trade and investment flows reveals that reducing the tax burden and broadening the base help boost exports and attract investment. Comparative experience shows that sustainable economic development requires a tax policy that is simple, transparent, and investor-friendly [7]. At the current stage, for further enhancement of tax policy, the above recommendations should be followed, and tax and foreign economic policies should be implemented as complementary strategic tasks. This approach will strengthen the competitiveness of Azerbaijan's non-oil economy and expand international trade and investment relations.

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