

MINISTRY OF EDUCATION OF THE REPUBLIC OF AZERBAIJAN
AZERBAIJAN STATE ECONOMIC UNIVERSITY
INTERNATIONAL MAGISTRATION AND DOCTORATE CENTER

MASTER DISSERTATION

ON THE TOPIC

“Analysis of Factors Affecting Foreign Direct Investment in Azerbaijan”

Asgarov Ulvi Abil

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Elm andı

I Asgarov Ulvi Abil swear that I have written my master's dissertation on "Analysis of Factors Affecting Foreign Direct Investment in Azerbaijan " in full compliance with scientific ethics and rules of reference and reflecting all the sources I use in the bibliography.

AZƏRBAYCANDA BİRBAŞA XARİCİ İNVESTİSİYALARA TƏSİR EDƏN AMİLLƏRİN ANALİZİ

XÜLASƏ

Mövzunun aktuallığı: Bu dissertasiya işi Azərbaycanda Birbaşa Xarici İnvestisiyalara (BXİ) təsir edən amilləri müəyyənləşdirmək və mövcud olan məlumat bazası əsasında ekonometrik analizlər tətbiq edərək həmin amillərin təsirini statistik cəhətdən ölçmək məqsədi daşıyır. Neftlə zəngin Azərbaycan iqtisadiyyatı inkişaf etdirmək və davamlı böyümə əldə etmək üçün xarici kapitalı ölkəyə cəlb etməkdə nəzərəçarpan maraq göstərmişdir. Tədqiqatın nəticələri xarici sərmayəçilərin yatırım qərarları vermədən öncə xüsusi diqqət etdikləri aspektlərə aydınlıq gətirməyə əvəzsiz yardım etmiş olacaqdır.

İşin məqsədi: Araşdırmanın əsas və ən vacib məqsədi Azərbaycanda Birbaşa Xarici İnvestisiyalara təsir edən faktorları üzə çıxarmaq və həmin dəyişənlərin əhəmiyyətlik dərəcəsini mövcud olan statistik metodlarla ölçməkdən ibarətdir.

İstifadə olunmuş tədqiqat metodları: Dissertasiya qeyd olunmuş məqsədə nail olmaqdan ötrü içərisində “Azərbaycanda İnvestisiya Vəziyyəti” hesabatı da daxil olmaqla müxtəlif məqalə və hesabatlardan bəhrələnmişdir. Həmçinin, Valeriya Botrik və Lorena Skaflikin müəllifi olduqları BXİ-nin 3 ölçüsü (bunlar, Siyasi, Biznes və İqtisadi hədudlarla çərçivələnir) ideyası bu tədqiqatın əsas özəyini təşkil edir.

Tədqiqatın informasiya bazası: Tədqiqat 2-ci mənbədən toplanmış məlumat bazası əsasında aparılmışdır. Bura Dünya Bankı, Dövlət Statistika Komitəsi, Mərkəzi Bank, və digər mütərəqqi mənbələr daxildir. 1996-2018-ci illər aralığını əhatə edən rüblük məlumatlar mövsümi dəyişkənliklərin təsirindən təmizlənmiş, və heteroskedastiklik testindən keçirilmişdir.

Tədqiqatın məhdudiyyətləri: Baxmayaraq ki, dissertasiya mövzusu mövcud olan bütün məlumatlardan istifadə edir (əhatə etdiyi dövr olaraq), sağlam və yekdil bir fikir bildirmək üçün bu məlumat bazası yetərli olmaya bilər. Həmçinin, bəzi dəyişənlər üçün rüblük məlumatlar olmadığından illik məlumatlar rüblüklərə çevrilmişdir. Bu da həmçinin real mənzərədən fərqli nəticə almağa gətirib çıxarda bilər, lakin müəllif bunun əhəmiyyətli dərəcədə kiçik bir ehtimal olduğuna inanır. Digər cəhətdən, istifadə olunmuş məlumatlar 2-ci mənbədən götürüldüyündən məlumat bazasının keyfiyyəti, onun toplanması zamanı yol verilə bilər qüsurlar barədə suallar ortaya çıxma bilər.

Tədqiqatın elmi yeniliyi və praktiki nəticələri: Bu dissertasiya işi mövzunu tətbiq edilən statistik metodlarla Azərbaycan üçün araşdırılan ilk işlərdən biridir. Nəticə olaraq tədqiqat spesifik olaraq hansı faktorların XBİ-yə hansı əmsal və əhəmiyyətlik ilə təsir etdiyini ortaya qoyur.

Nəticələrin istifadə olunma biləcəyi sahələr: Tədqiqatın nəticələri həm iqtisadi inkişafı BXİ-lər hesabına artırmaqla bağlı məşğul olan hökumət orqanları həm də Azərbaycana maraq göstərən potensial investorlar üçün əhəmiyyətli ola bilər.

Açar sözlər: Birbaşa Xarici İnvestisiya, iqtisadi inkişaf, korrupsiyaya qarşı mübarizə, ticarət, institusional keyfiyyət.

ANALYSIS OF FACTORS AFFECTING FOREIGN DIRECT INVESTMENT IN AZERBAIJAN

Abstract

Relevance of the research: This work aims to unearth determinants of Foreign Direct Investment in Azerbaijan by applying econometric analysis on historical data. Oil-rich Azerbaijan demonstrated burning interest on attracting foreign wealth into the country in order to boost the economy and maintain sustainable development of real sector. Findings of the research is going to shed more light on the key areas that foreign investors weight in most before taking capital allocation decision into the country.

Objective of the research: First and primary important objective of the research is to identify determinants of Foreign Direct Investment in Azerbaijan and thanks to available past figures statistically measure their effects on the variable.

Applied research methods: Paper focuses on articles by different scholars on business and economic environment of the country and various reports and statements including “Azerbaijan Investment Climate Statement”. Valerija Botric and Lorena Skuflic’s three dimensions of FDI constitute building blocks of the project which are: Policy framework, business facilitation, and economic conditions of target country.

Information base of the research: The paper is fashioned on the secondary data available through World Bank, State Statistical Committee, Central Bank of Azerbaijan Republic and other reliable sources. Data is collected on quarterly basis and seasonally adjusted from 1996 till 2018. Heteroskedasticity of the data is tested through unit root test and the problem resolved at 1st level if it arose.

Restrictions of the research: Although the paper is utilizing available all data (in terms of time frame), it may indeed be insufficient to form conclusive opinion. For some variables quarterly data was not available therefore annual data adjusted for quarterly which may distort real picture. For research purposes only secondary data has been utilized which increases questions quality of data and therefore it would be huge advantage for future researchers of the matter to collect primary data through questionnaires and interviews.

The novelty and practical results of investigation: This research is a pioneer in the field to specifically focus on identifying and measuring degree of importance of factors most valued by overseas investors interested in capital contribution into Azerbaijan. The paper precisely identifies statistically significant factors which may act as a practical insight for both practitioners of the topic and decision making authorities.

Scientific-practical significance of results: Findings of the research can be invaluable for both government bodies committed to boost economic development through Foreign Direct Investment inflows and organizations or individuals interested in new venture opportunities.

Key words: Foreign direct investment, economic growth, control of corruption, openness, institutional quality.

ABBREVIATIONS AND SIGNS

AZPROMO	Azerbaijan Export and Investment Promotion Foundation
CBAR	Central Bank of Azerbaijan Republic
CIS	Commonwealth Independent States
EAEU	Eurasian Economic Union
EB	Bureau of Economic and Business Affairs
EU	European Union
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
IMF	International Monetary Fund
SOCAR	State Oil Company of Azerbaijan Republic
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollars
VAT	Valued Added Taxes
WAIPA	World Association of Investment Promotion Agencies
WB	World Bank
WIPO	World Intellectual Property Organization

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INTRODUCTION

After announcement of independence in 1991, Azerbaijan faced with some political and economic difficulties (Coskun & Mammadova, 2015). One of the main obstacles for country was Karabagh war in way of achieving sustainable economic growth. Only since middle 1990s Azerbaijan started experience progress in economic term. Oil reserves played pivotal role for joining world trade. Thanks to oil, Azerbaijan became one of the most attractive market for non-native investors (Coskun & Mammadova, 2015). Flow of foreign capital was best opportunity in favor of involving the country among more developing countries. This paper seeks to discuss the question of “Whether investment climate of country is in adequate pitch to stimulate foreign capital holders provide capital to country”. With the purpose of providing satisfying answer for central question, the piece investigates the factors that identify level of FDI in the country. “The host country determinants of FDI may be grouped into three categories: policy framework for FDI, economic conditions, and business facilitation” (Botric & Skuflic, 2006).

Taking into account the role of government regulations in FDI, the study intends to discover to what extent government incentives are satisfactory to attract non-native investors. It comprises government laws, regulations, and also how they are executed. In recent years, Azerbaijan took some steps on making more pleasurable investment climate, but still unsolved problems remain in face of implementation of these regulations, such as, inability of getting satisfactory results on constructing anti-corrupt system.

Business facilitation is an essential component in the economy and plays key role in FDI. Annual observations of this determinant make us have optimistic ideas about availability of investment environment. Openness of economy, market size, and ease of doing business in specific country taken under control, while making quantitative

analyzing of business climate. Predominantly, considerable increase in score of easy of doing business noticed.

Economic performance and FDI has more complex relationships in comparison to other casual elements. Efficiency of economy catches eye of external capital owners and at the same time, reasonable quantity of FDI lead economic growth of country. The piece proposes to discuss, whether entrance of foreign companies into market is significant than domestic investment.

This work aims to unearth determinants of Foreign Direct Investment in Azerbaijan by applying econometric analysis on historical data. Oil-rich Azerbaijan demonstrated burning interest on attracting foreign wealth into the country in order to boost the economy and maintain sustainable development of real sector. Findings of the research is going to shed more light on the key areas that foreign investors weight in most before taking capital allocation decision into the country.

First and primary important objective of the research is to identify determinants of Foreign Direct Investment in Azerbaijan and thanks to available past figures statistically measure their effects on the variable.

Paper focuses on articles by different scholars on business and economic environment of the country and various reports and statements including “Azerbaijan Investment Climate Statement”. Valerija Botric and Lorena Skuflic’s three dimensions of FDI constitute building blocks of the project which are: Policy framework, business facilitation, and economic conditions of target country.

The paper is fashioned on the secondary data available through World Bank, State Statistical Committee, Central Bank of Azerbaijan Republic and other reliable sources. Data is collected on quarterly basis and seasonally adjusted from 1996 till 2018. Heteroskedasticity of the data is tested through unit root test and the problem resolved at 1st level if it arose.

Although the paper is utilizing available all data (in terms of time frame, it may indeed be insufficient to form conclusive opinion. For some variables quarterly data was not available therefore annual data adjusted for quarterly which may distort real picture. For research purposes only secondary data has been utilized which increases questions quality of data and therefore it would be huge advantage for future researchers of the matter to collect primary data through questionnaires and interviews.

This research is a pioneer in the field to specifically focus on identifying and measuring degree of importance of factors most valued by overseas investors interested in capital contribution into Azerbaijan. The paper precisely identifies statistically significant factors which may act as a practical insight for both practitioners of the topic and decision making authorities.

Findings of the research can be invaluable for both government bodies committed to boost economic development through Foreign Direct Investment inflows and external organizations or individuals interested in new venture opportunities in Azerbaijan.

CHAPTER I. THE NOTION OF FOREIGN DIRECT INVESTMENT AND AZERBAIJAN

1.1. The Concept of Foreign Direct Investment

For decades FDI has been considered as an indispensable chunk of red-tape-free and well-organized business environment, and a considerably booster of economic growth. Nevertheless, advantages of FDI is not likely to build up on its own and at the same pace around the various states, fields of economy and communities. In-country regulation framework and the multinational investment structure play a crucial role in driving in oversea investors and enjoying all the positive externality of the FDI (Guasch, et al., 2007). Inward FDI receivers by and large face the most difficulties in the sense that those nations are in need of maintaining responsible, comprehensive and enforceable atmosphere within the economy that would encourage oversea investors to feel confident enough to invest in that particular economy (Yu, et al., 2010).

Foreign direct investment is the investment made by the government in another country in manufacturing or service sectors by either acquiring a company or extending its business abroad. Typically, it is through bonds and stocks (Lexicon, 2019).

As a rule, FDI refers to asset introductions from abroad that put resources into the manufacturing economy and are generally favored over different structures of oversea funding since they are not creating liability, does not cause instability and the returns of the investors is dependent on the quality of the penetration plan and its implication (Carril-Caccia & Elena, 2018). FDI moreover encourages global exchange and spread of know-how, aptitudes and innovation. Financial Times approaches standard “10%” benchmark definition of the control with a critical mindset, arguing that may smaller portion of shares enable control in publicly held companies. (Lexicon, 2019) On top that, control of information, technological advancement, administrative

expertise can be more crucial for an individual firm rather than mere majority percentage of voting rights (Lexicon, 2019).

The study of A.Coskun mostly concentrated on investment directed to oil sector and correlative relationship between investment and economic growth (Coskun & Mammadova, 2015). It is fundamental to note that share of oil in FDI is at noticeable level. Attraction of more investors causes increase in not only oil but also non-oil sectors. Growth of FDI affects human capital contribution, transfer of technology in a positive way (Coskun & Mammadova, 2015). C. R.Shiells was aimed to identify capital flows into CIS countries and investment climate of noted countries (Clinton, 2003) . Net FDI inflows per capita in CIS countries are low compared to other countries. Underdeveloped banking system comes up with difficulties to invest for small and medium size companies, thus buries the sustainable growth (Clinton, 2003).

Other than economic factors, institutional quality play vital role in investment climate of Azerbaijan, additionally, weak legal regulatory, complicated licensing requirements are main obstacles to set up healthy investment environment. The final report of J. Gunther attempted to analyses and make suggestions for design of investment policy in Azerbaijan (Gunther & Jindra, 2009). The research advocated that administrative body need to pay more attention to diversify income from oil and concentrate on discovering technique to develop market-seeking investment (Gunther & Jindra, 2009). Since the major motive of extraneous investors is “resource seeking” with purpose of encompassing absence of market seeking investment, market size and income per capita required to scrutinize.

The paper of V.Botric and L.Skuflic discusses the critical factors that have marked influence on FDI. Variance in price of factors of production and market size are main clues for capital owners to make decision to which countries they invest. The piece argued that regardless of countries, elements of FDI classified as: economic policy, economic performance and business climate .

The challenge to pull in FDI among nations has been intense, particularly in late decades. Thusly, the issue of deciding the elements that guarantee the allure of an economy and government strategies for FDI is one of the key themes that is in the spotlight of simply logical research, just as viable investigations of global associations and national governments. (Yasmin, et al., 2003).

1.2. Contribution of Foreign Direct Investment to Economic Development

Producing nations, developing economies and states experiencing significant change have come progressively to see FDI as a wellspring of GDP growth and renovation, revenue increase and work engagement. Nations have eased their FDI systems and sought after different tactics to pull in venture. They have focused to the question of how best to seek after local strategies to expand the advantages of alien capital in the local economy. The examinations of Foreign Direct Investment for Growth endeavors fundamentally to reveal insight into the issue, by concentrating on the general impact of FDI on macroeconomic development and other welfare-improving procedures, and on the channels through which these advantages produce results. The general advantages of FDI for productive nation economies are recorded in great details.

Given the proper national strategies and an essential degree of advancement, a prevalence of studies shows that FDI triggers innovation overflows, helps human capital arrangement, contributes to beneficial barter economy among nations, makes an increasingly focused business condition and upgrades enterprise improvement. These add to higher financial development, which is the most intense device for declining neediness in poor nations. Also, in addition to the clear monetary advantages, FDI may aid to improve natural and communal circumstances in the receiving nation by, for instance, moving "cleaner" innovations and prompting all the more communally mindful trade methods. (Markus & Ögütçü, 2002)

FDI in extraction industry possesses the ability to create unprecedented incomes that to be utilized to reinforce the host economy and reduce countrywide destitution. How significant role does FDI have to facilitate the move from meagre community to affluent nation? Customary models to ascertain the estimation of FDI to improvement depended upon ordinary investigation of similar preferred position: worldwide firms

give cash-flow to put the host economy's abundant asset, under-developed labor force, enabling the nation to do what its normal enrichment permitted all the more effectively.

Yet, this conceptualization currently demonstrates to be extremely immobile. At the point when worldwide companies fabricate plants that are incorporated into their global network and market domination plans, they bring a bundle of the board, innovation, and quality control strategies that places the host nation at the front line of best practices of the planet. To improve their very own situation in worldwide markets, global companies redesign the capacities of these plants ceaselessly to keep them at the cutting edge in the multinational markets. (Jude & Levieuge, 2017)

The question of how financial development contributes to economic growth has drawn attention of many researchers. For instance, it has been claimed that advanced financial system may soar economic growth in low or middle income countries (Hassan, et al., 2011). In contrast, T. Koivu believed that quantitative measure of financial sector (e. g. credit to private sector) does not accelerate sustainable GDP growth (Koivu, 2002).

In the work of Hassan, Sanchez, and Yu (2011), authors believe that well-functioning financial sector encourages economic development, yet healthy conditions within financial system lacks in some developing countries. In these countries fiscal policy and trade plays an effective role than finance. By means of Granger Causality Test, these scholars documented that domestic credit to private sector and trade is positively and significantly correlated with growth in European & Central Asian countries.

T. Koivu make a statement that Interest Spread significantly discourages economy, whereas each additional credit allocated to private sector does not accelerate prosperity of states (2002).

It has been asserted by Nabila Asghar and Zakir Hussain that poor structure of financial system and inefficiency provide room for limited benefits for economy in developing nations. Foreign Direct Investment and technological innovations assist constructing better financial system (Asghar & Hussain, 2014).

Study of Jülide Yildirim, Nadir Öcal, and Mahmut Erdogan (2008) tracked footprints of credit and deposit amount rates on economy of Turkey in 2 consecutive half-decades of 1991-1995 and 1996-2001. The scholars announced that vast amount of deposits hindered economic escalation, due to less demand for supplied capital, by contrast credits to both businesses and individuals heartened it (Yildirim, et al., 2008).

1.3. Comparative Analysis of Azerbaijan's FDI with Neighbor Countries

The past 25 year has seen striking development in FDI streams everywhere throughout the world. This is because of the way that numerous nations, particularly under-developed nations, see FDI as a significant component in their general system for financial advancement (Ahmeti, 2016).

FDIs add to the monetary advancement of host nation in two primary manners: i) They incorporate the growth of residential capital and ii) The upgrade of proficiency through the exchange of new innovation, promoting and administrative aptitudes, advancement, and best practices. Besides, FDI has the two advantages it comes with its own expenses: i) its effect [effect of FDI] is controlled by the nation's particular political and socio-economic conditions all in all, and ii) the degree of free capital movement pre-condition, the likelihood of losing the investor and negative effect on local investment are typical side-effects that recipient country should cope with. (Ahmeti, 2016).

Oil-rich Azerbaijan's hydrocarbon industry has consistently been appealing for outside venture: out of \$77.8 billion of FDI to the nation's economy from 2000 to 2017, more than 85 percent, or \$ 66.8 billion, went to the resource-rich areas (State Statistical Committee of Azerbaijan Republic, 2018).

In addition, outside speculators had deficient enthusiasm for the nation's non-oil/gas part, particularly the production business during that period. Slight appetite of oversea capital owners for Azerbaijan's non-extractive enterprises is unquestionably provocative, as they had directed funds vigorously in the oil and gas areas. So as to accomplish an expansion in FDI streams to these areas, steps ought to be taken to distinguish and dispose of the variables that compel outside capitalists. The adequacy and competency of the Government's choices on advancing venture movement is likewise among the issues, which ought to be rethought (Mehdiyev, 2018).

United Nations Conference on Trade and Development anchors in its annual World Investment Report that Worldwide FDI streams proceeded with their slide in 2018, falling by 13 percent to \$1.3 trillion (United Nations Conference on Trade and Development, 2019). The decay – the third back to back year's fall in FDI – was predominantly because of enormous scale repatriations of amassed remote income by United States transnational companies in the initial 6 months of 2018, after tax policy changes presented in that nation toward the finish of 2017. The levy-driven fall in the first 6 months of 2018 (which finished 40 percent lower than a similar period in 2017) was padded in the subsequent half by expanded exchange movement. The estimation of international merger and acquisitions (M&As) rose by 18 percent, energized by United States multinational entities utilizing liquidity in outside associates that was never again hampered by tax obligations (United Nations Conference on Trade and Development, 2019).

A study by World Bank revolutionizes the previous works on the work it entails thoughts and ideas of more than 700 individuals who are on the leading chair of many multinational corporations worldwide. The research lists different aspects affecting level of foreign capital invested which includes:

- 1) Involatile and safe political system (more than half of depositors rank this as a very vital aspect and 37 percent as a vital aspect);
- 2) Law and regulations (40 and 46 percent, correspondingly);
- 3) Large domestic market size (42 and 38 percent); and
- 4) Macroeconomic stability and favorable exchange rate (34 and 44 percent).

Following aspects include: Available talent and skill of labor (28 and 45 percent); Good physical infrastructure (25 and 46 percent); Low tax rates (19 and 39 percent); Low cost of labor and inputs (18 and 35 percent); Access to land or real estate (14 and 28 percent); and Financing in the domestic market (16 and 28 percent). In this study,

stockholders also count in certainty and competence in the execution of legal cases. By the way, depositors proportionate following factors as very important and important respectively: transparency and predictability in the conduct of public agencies” (37 and 45 percent), investment protection guarantees provided in the country’s laws (45 and 36 per cent), ease of obtaining government approvals to start a business and to own all equities in the company (36 and 41 percent). Investment incentives, such as tax holidays (21 and 35 percent), having a preferential trade agreement (14 and 40 percent) and having a bilateral investment treaty (15 and 36 percent) are ranked further below (The World Bank, 2019).

Some sub-global institutions, in conjunction with transnational growth establishments, perform investigations on FDI movements. Specifically, outcomes on Azerbaijan in such communications directed inside Eurasia and CIS attract more attention. As an example, the Eurasian Development Bank’s Report “Monitoring of Mutual Investments in CIS Countries 2017” outlines that till finish of 2016, cumulative direct investment by Azerbaijan in CIS and Georgia come up to \$2.4 billion. Though, as an addressee of FDI initiating from CIS nations and Georgia, Azerbaijan’s successes as a capital attractor are moderately modest: \$0.91 billion (\$0.89 billion of that came from Russia) (European Development Bank, 2018).

“EAEU and Eurasia: observation and Analysis of Direct Investments 2017”, another statement by the Eurasian Development Bank, highlights that Azerbaijan is the most biggest investor amongst CIS, that aren't followers of the Eurasian Economic Union, meanwhile the typical yearly surge of Azerbaijani FDI in not-CIS Eurasian nations was forty one percent throughout the 5-year period (2012-2016) (European Development Bank, 2018). Till the end of 2016, the whole quantity of Azerbaijan’s unswerving funds to the countries within the area touched \$16.9 billion and virtually simple fraction of all Azerbaijani funding are focused in Turkey, as per the communication (European Development Bank, 2018).

FDI to Azerbaijan is dropped dramatically by 1.46 billion United States Dollars reaching a low of 1.4 billion USD (2017: USD 2.86) according to data represented by UNCTAD World Investment Report (United Nations Conference on Trade and Development, 2019). Current trend agrees with movement in FDI levels of the CIS and South-East Europe countries. Introduction of FDI into the country is mainly focused on the resource extensive sectors (i. e. oil and gas). Nevertheless, one of the upmost (if not the first) economic goals of the administration is the diversification of the revenues of the nation and increasing portion of the FDI in those areas such as holiday business, information and communication technologies, transportation, and agriculture.

According to the reporter (UNCTAD) the overall cumulative level of the foreign direct investment of Azerbaijan is roughly around 31 billion US dollars, entailing 68 per cent of the Gross Domestic Product of the nation in 2018. Among others Russian Federation maintains leadership as an investor in terms of net United States Dollars invested in Azerbaijan. This act can be explained by the fact that Azerbaijan not only possesses one the crucial geographic position in the region (i. e. access to the Middle East and Iran, as well as on the intercept of the trade route to European Market from the China) and the country also enjoys sufficient stocks of oil and gas resources in the Caspian Sea.

The government of the Azerbaijan Republic has demonstrated a position that extremely emphasizes the vitality of the developing current investment atmosphere. Therefore, it may not be fair to consider the existing 25th position of the country among 180 different states in Doing Business report of the World Bank is a mere coincidence (Mehdiyev, 2018).

66% of states within the EU's investigation explicit they might invest in Azerbaijan Republic once more; moreover, eighty nine per cent of these firms suppose their investments to stay stable or expand (Azernews, 2018).

The government founded one time shop to issue corporate authorizations and licenses (United Nations Conference on Trade and Development, 2019).

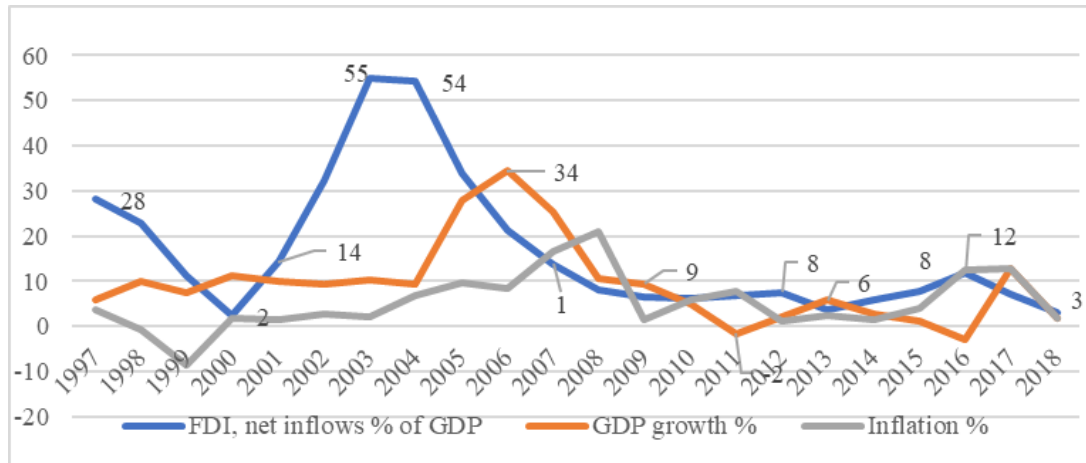
Gazprombank of Russian Federation at the moment of negotiation on the development of 2 SOCAR chemical compound plants which is estimated to be around USD 880 million, within which Gazprombank would invest around \$500 million, furthermore as a USD 260 million to modernize Azerikimya enterprises. Moscow is additionally cashing in Azerbaijan's construction, trade, services, banking, insurance, data technologies, transportation and agriculture industries. (Mehdiyev, 2019).

The EU has prioritized the development of the Southern Gas Corridor, which might transport Azerbaijani gas through Georgia, Turkey, and Europe (Azernews, 2018). Italia is in discussions to take a position in reprocessing of waste tires to get and export alternative energy (Mehdiyev, 2018).

President Aliyev conjointly signed a decree establishing a trade zone space next to the Alyat haven, set sixty five metric linear unit south of capital of Azerbaijan. According to the recently amended Customs Tariff law, entrepreneurs bringing in long-term fixed assets for priority sectors are exempted of taxes up to seven years (Mehdiyev, 2018).

For analysis purposes of trend of FDI this paper looks at dynamics of Foreign Direct Investment Inflows as a percentage of Gross Domestic Product in the timespan from 1997 to 2018. From 1997 till 2000 the portion of FDI in GDP declined significantly from being 28% in 1997 to around 2% in 2000 (The World Bank, 2019). This sudden drop can be explained by factors like weak economic conditions, political instability and economic “contribution” of occupation of Nagorno Karabakh region and its 7 surrounding regions by Armenian military forces.

Graph 1. Trend of FDI, GDP and Inflation in Azerbaijan



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

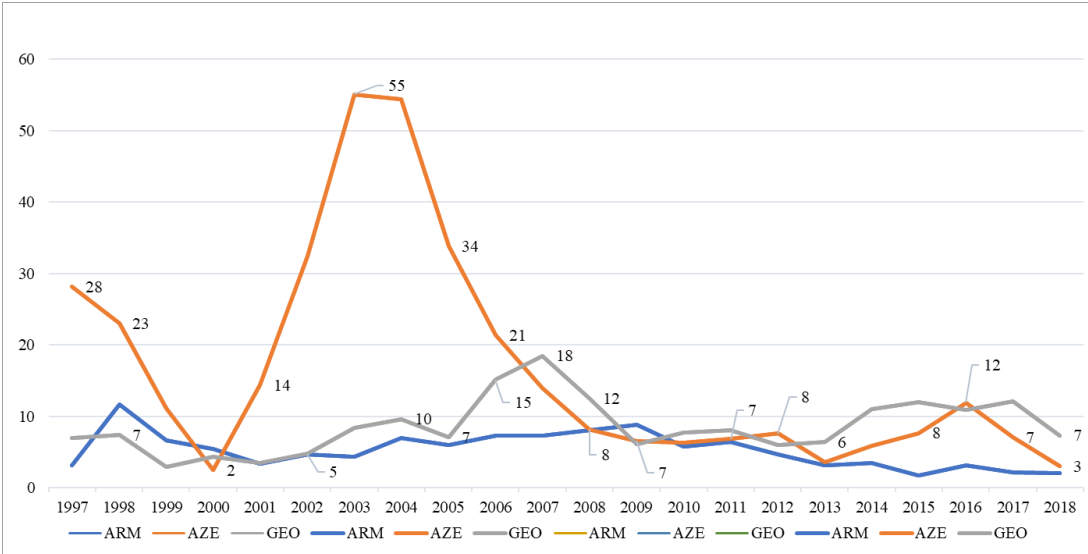
However, thanks to the Profit Sharing Agreement signed with big oil companies worldwide and commencement of works in Azeri-Chirag-Guneshli platform, FDI inflows started to surge up considerably starting from 2000. This upward trend peaked up of 55% of total GDP in 2003. Unfortunately, the country could not maintain the pace of increase in FDI inflows as a percent of GDP, thus experienced sudden decline in FDI levels. This drop continued till year of 2013 in which the bottom of decline was observed at level of 4% of Gross Domestic Product. Afterwards a slight growth of FDI was maintained in annual terms till 2016.

It is noteworthy that agility of the increase intensified slightly from 2015 to 2016. The reason of such pattern is administrative devaluation of Azerbaijani Manat against US dollars by more than 2 times and consequent decline in GDP presented in USD. Regrettably, upward balling tendency in FDI as percent of GDP could not be preserved and decline in FDI levels made to arrive at almost same portion of GDP as it was recorded in 2000. Comparing trend of Foreign Direct Investment in world market as a percent of GDP worldwide against Azerbaijan, trend was unmatching till 2008, but afterwards, the variables followed almost same pattern thus it fluctuated around 7-8%

of GDP 4-year period after 2008 and dropped in 2013 to 4% and went up threefold till 2015-16 and dropped far ahead to around 3% of GDP (The World Bank, 2019).

In order to examine position of Azerbaijan in terms of FDI level, comparison of the inward FDI as a per cent of Gross Domestic Production is conducted among Azerbaijan, Georgia and Armenia from 1997 to 2018 (The World Bank, 2019). Overall, capital owners in other countries were more willing to contribute their funds into economy of Azerbaijan rather than to Armenia and Georgia. Rich natural resources of Azerbaijan can be interpreted as a key motive for preserving such positive spread.

Graph 2. Inward FDI in Azerbaijan, Georgia, Armenia



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Till 2000 FDI level decreased in all three countries, however, the fall was 2 times in Azerbaijan from 1 billion USD to 0.5 billion USD, whereas the trend was smoother in Armenia and Georgia. As a result, in 2000, level of FDI was around 0.1 billion US dollars. Although after beginning of new century all 3 countries received FDI in increasing amount for around half a decade, in Azerbaijan a sudden upward push detected in FDI flows reaching a summit of 4.7 billion US dollars in 2004.

Despite the fact that Azerbaijan's FDI stagnated at about 4.6 and 4.7 billion US dollars for around 3 years, interest of overseas investors into both Armenia and Georgia's economy was mounting up. Global financial crises of 2008 made investors approach allocation of their funds more cautiously and hence amount of FDI into countries under investigation fell down considerably (in 2007-2009 period 65% and 37% down in Georgia and Azerbaijan respectively, in Armenia with one year lag decline was 44%).

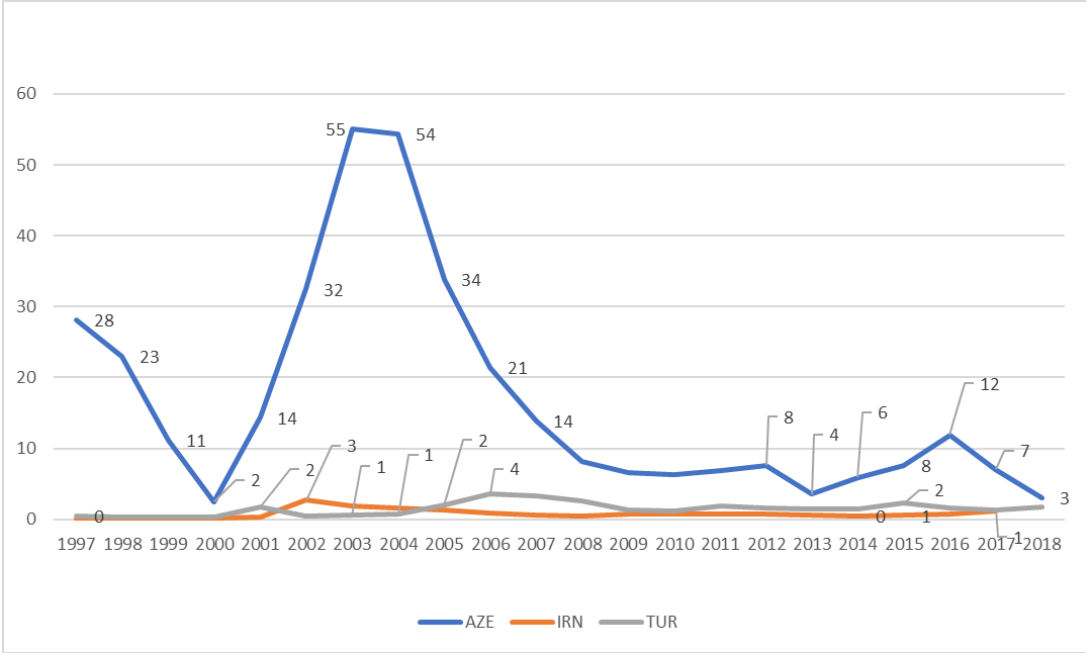
Recovery from the recession was relatively quick in Azerbaijan that country could achieve all-time record of Foreign Direct Investment at around 5.3 billion US dollars, while Georgia barely received 1 billion US dollars, 2 times higher of cash that investors directed to Armenia. Nonetheless, such unprecedented peak position of overseas investment receipts for Azerbaijan did not last long and followed by hasty bust at 10-year lowest of 2.6 billion dollars in contrast figures for Armenia was fluctuating around at the same level and Georgia was experiencing a slight upward trend. Following 3 years investors' confidence to economy of both Azerbaijan and Georgia increased which subsequently translated into more FDI inflows, where Armenia suffered steady and slow decline.

On the other hand, observed volatile nature on the level of FDI flows in Georgia and Azerbaijan continued to rule in and sudden drop observed reaching to around 1.5 billion FDI stocks inward in 2018. For both countries. This was second smallest spread monitored between Georgia and Azerbaijan's annual FDI arrivals after 2000. Armenia maintained a quarter billion foreign investment into direct economy for 2017 and 2018 (The World Bank, 2019).

Even though in terms of absolute US dollars invested the level of FDI in Azerbaijan was higher than other 2 countries, namely Georgia and Armenia, in terms of percentage of FDI in GDP Azerbaijan lost its leadership in 2007 while the unstable leadership was maintained by the Georgia since then (The World Bank, 2019).

Similar comparison of FDI introductions is made of Azerbaijan against remaining neighbor countries, using 2 different pools. In the first pool of evaluation, countries like Turkey and Iran is assessed. The results illustrate that Azerbaijan again hold a leader position from 1997 to 2018 for the ratio of inward FDI to GDP, yet the trend was the most volatile as well.

Graph 3. Inward FDI as percentage of GDP in Azerbaijan Iran and Turkey



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

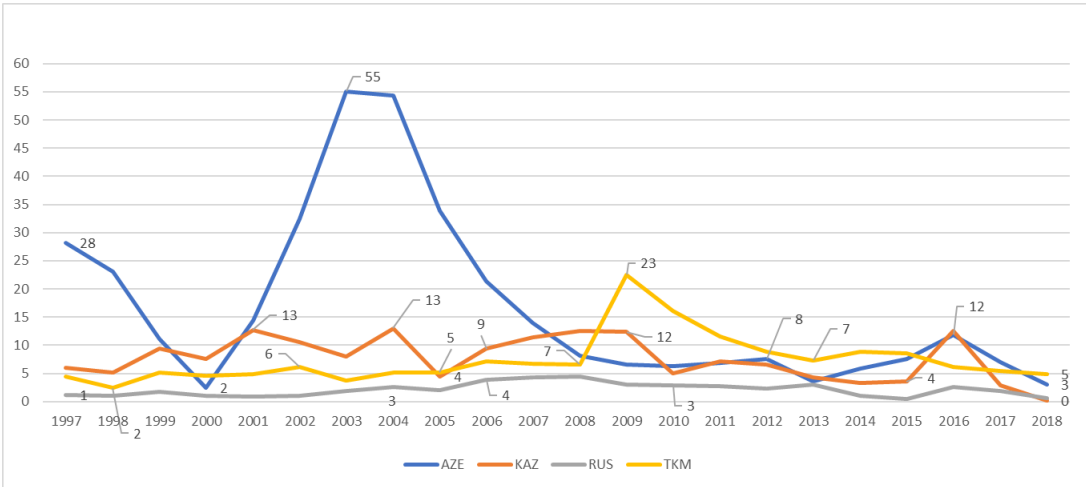
Iran attracted least FDI as percentage of GDP into the country barely hitting peak of 3% of GDP in 2002 and the ratio was moving in between 1 and 0 per cent throughout following years till 2018.

On the other hand, Turkey seemed to some extent more attractive to investors in terms portion of FDI inflows as a percentage of GDP. The nation maintained stagnant ratio of about 2% with peak of 4% in 2006 and busts of 0% in 1997-2000 and 2002. Still a glance at the FDI inflows in terms of in current US dollars, suggests a different story. Until 2003, leader for the level of FDI in absolute USD invested changed simultaneously among Turkey, Iran and Azerbaijan which was at its maximum of 4

billion US dollars in 2003. Later, Turkey took advantage of huge inflows of foreign capital that the figure peaked at its highest record of 22 billion US dollars, for the period under investigation, in 2007. In contrast investors was hesitant to make next contribution into Azerbaijan or Iran. As result the introduction of foreign capital was barely touching 4-5 billion US dollars.

It is interesting to note that even though Azerbaijan and Iran started to observe a downward movement starting from 2016 and 2017 respectively, Turkey even had increasing amount of foreign investment inflows. Consequently, for 2018 Azerbaijan, Iran and Turkey’s FDI receipts were around 1, 3 and 13 billion US dollars respectively. Increasing interest in Turkey’s economy can be response of investors to the availability of relatively cheap lira and labor source within the country (The World Bank, 2019).

Graph 4. Inward FDI as percentage of GDP in AZE RUS, KAZ and TRM



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Analysis of second pool of countries (Azerbaijan, Russia, Kazakhstan and Turkmenistan) suggests that Russia is one of the leaders in terms of net inflows. Azerbaijan and Turkmenistan interchangeably exchanged last 2 places for net FDI receipt throughout the period. Kazakhstan by far the second most attractive country in the eyes of profit maximizers from alien nations (The World Bank, 2019). Such volatile

nature of FDI inflows is one of the motivations of research paper to unearth historical factors affecting FDI into Azerbaijan.

To pull in remote direct capital, outside financial specialists must know the nation and the advancement possibilities, business and venture condition in the nation and potential variations in this condition. The research recognizes four sorts of FDI dependent on the reasoning of FDI inflows into the nation:

- a) resource motivated;
- b) marketplace (trade-place size and openness) seekers;
- c) tactical benefit searching;
- d) hunters of productivity to reduce expenses.

The paper found that, contingent upon the cause of inspiration and the kind of funding, financial specialists respond contrastingly to political system's new rules adopted in the target nation and to the general investment condition of the nation (Dunning & Lundan, 2008). As indicated by them, fund holders who are searching for tactical benefit and vital resources are not elastic to changes in the venture atmosphere, while those who are searching for motivating forces to reduce costs are progressively delicate to changes that can change their expenses. Manufacturing sphere of economy among others is more likely to look more appetizing (Dunning & Lundan, 2008).

Starting from mid-2015, the ruling system of Azerbaijan has taken and executed actions to expand the commercial and investment condition in the nation (streamlining the way toward getting licenses and allows) and expanded the ban on governmental review of business activities until 2021 to empower venture (for instance, the implication of the paper "Investment Promotion Certificate" and the tax reduction for people who get this testament is legitimate for 7 years from the date of its receipt, just as full exclusion from customs obligations when bringing in mechanical hardware for

industry areas with the most elevated need) to establish techno-parks (full exception from customs obligations and duties, VAT including, when bringing in innovative gear by resident persons from modern and mechanical parks for the purpose of development and innovative work outpouring for a long time from the date of receipt of the equipment), to help national income and to guard local traders, just as encourage non-oil send-outs (Mehdiyev, 2018).

Data on investment impetuses, trade and investment condition, was distributed in three languages on the site of the Azerbaijan Export and Investment Promotion Corporation (Azerbaijan Export and Investment Promotion Corporation, 2019). According to the site, Azerbaijan at present has double tax agreements with 51 nations and mutual investment concurrences with 47 nations (Azerbaijan Export and Investment Promotion Corporation, 2019). Web content of AZPROMO has extended essentially over the past few years. Be that as it may, the data on the AZPROMO site is more restricted than the data from the World Association of Investment Promotion Agencies (WAIPA). Indeed, even the workplace of the US Department of State for Economic and Trade Affairs (EB) of US published more detailed data about the business and venture condition in Azerbaijan.

Also, a report entitled “Favorable tax environment for foreign investments in the Republic of Azerbaijan”, distributed on the site of the Ministry of Taxes, was not refreshed in an opportune way. Macroeconomic markers are obsolete. It covers the most recent data in 2017 (Ministry of Taxes, 2019). It should be refreshed with changes to the enactment in 2019 and past. It is critical to grow and refresh the data represent Azerbaijan and the nation's business condition on the planet in timely manner. As per worldwide specialists, foreign capitalists are increasingly intrigued by data about the future advancement of the nation than in the present condition of venture, since this data enables them to survey their future desires.

Therefore, it is significant that data distributed on the Internet and different sources mirrors the potential and advancement of different parts of the nation's economy, just as the present circumstance.

CHAPTER II. MODEL AND DETAILED EXAMINATION OF INDIVIDUAL FACTORS AFFECTING FDI

2.1. Methodology

This paper is fashioned on the basis of quantitative research on investment climate of Azerbaijan in the sense of drawing foreign direct investment, contribution of FDI on economy of host country, and its relationship with domestic investment. The research data in this project is drawn from mainly secondary sources. The time span is from 1996 until 2018 collected quarterly. Paper focuses on articles by different scholars on business and economic environment of the country and various reports and statements including “Azerbaijan Investment Climate Statement”. Valerija Botric and Lorena Skuflic’s three dimensions of FDI constitute building blocks of the project which are:

- Policy framework,
- Business facilitation, and
- Economic conditions

of target country. Likewise, the research is focused on following factors:

- Variables affecting Institutional Quality
- Variables relating to Economic Development
- Other Overall Economic Variables

The paper will aim to unearth critical factors affecting Foreign Direct Investment in Azerbaijan. Paper designed in a way that factors for different types of investors could be differentiated in detail. Thus, it acknowledges that resource seeking investors may prioritize factors like future oil prices, whereas, investors in service industry may rank this factor as its least priority.

2.2. Formula and Model

The model for the paper has been built on the following formula:

$$Y = \beta_1 + \beta_2 * IQ + \beta_3 * ED + \beta_4 * OV + \varepsilon$$

where:

Y is logarithmic function of Foreign Direct Investment into Azerbaijan

β_1 is a constant of linear function

IQ indicates variables related to institutional quality and represented by logarithmic function of subsequent variables:

- *Business Freedom*
- *Control of Corruption*
- *Global Competitiveness*
- *Government Effectiveness*
- *Regulatory Quality*
- *Voice and Accountability*
- *Political Stability*
- *Rule of Law*

ED shows variables linked to economic development and entails itself logarithmic function of followings:

- *GDP growth*
- *Openness*
- *Investment Freedom*

OV shows details of other general economic variables which is comprised of logarithmic function of variables listed below:

- *Cost of labor*

- *Inflation*
- *Unemployment*
- *Overall quality of infrastructure*
- *Oil prices*
- *Oil production*

ε represents other variables not included in model

Data for the model has been obtained from secondary sources like WB's world development indicators, World economic forums' publications, Central Bank of Azerbaijan Republic and State Statistical Committee. The acquired information is arranged on quarterly schedule from 1996 up to 2018. Total number of observations is 33 after adjustment. This can be seen as a weakness of the regression nevertheless it is the most available data up to date of research. Research's result has been analyzed for heteroskedasticity using Harvey test. As a result, since probability value for chi square was statistically significant at 95% confidence interval no problem of heteroskedasticity has been detected. All variables have been adjusted for seasonality and logarithmic functions of them are being included in the regression model.

The results of regression are outlined in the table below.

Table 1. Significant variables identified through regression

Variables	Coefficient	Std. error	P-values
Business freedom	107.99	3.29	0.0049**
Corruption control	11.92	2.45	0.0268*
Global competitiveness	15.82	2.02	0.0618*
Gover.-t effectiveness	-22.55	-3.49	0.0033**
Investment freedom	12.93	3.31	0.0048**
Political stability	16.13	3.77	0.0018**
Labor cost	11.62	3.50	0.0033**
Rule of law	-33.69	-3.11	0.0070**
Voice and accountab.-ty	-14.23	-3.03	0.0084**
Oil price	-0.21	-1.78	0.0960*

** indicates 95% confidence, whereas * indicates 90% confidence

Source: Analysis of author on EViews program

2.3. Analysis of Variables Relating to Institutional Quality

2.3.1. Business freedom

Business freedom is an overarching measure for the performance of regulatory control, health of environment maintained by the government. Of every nation, the rating for freedom of business is between 0 and 100, with 100 being equivalent to the freest corporate environment. The quantitative score is extracted from a collection of measures of how difficult it is to start, run and close a company. The ranking is based on 10 factors, all weighted equally, using data from the World Bank's Doing Business study:

- starting a business — procedures (number);
- starting a business — time (days);
- starting a business — cost (percentage of income per capita);
- starting a business — minimum capital (percentage of income per capita);
- getting a license — procedures (number);
- getting a license — time (days);
- obtaining a license — cost (percentage of sales per capita);
- closing a business — time (years);
- closing a business — cost (percentage of estate);
- and closing a business — recovery rate (cents per dollar).

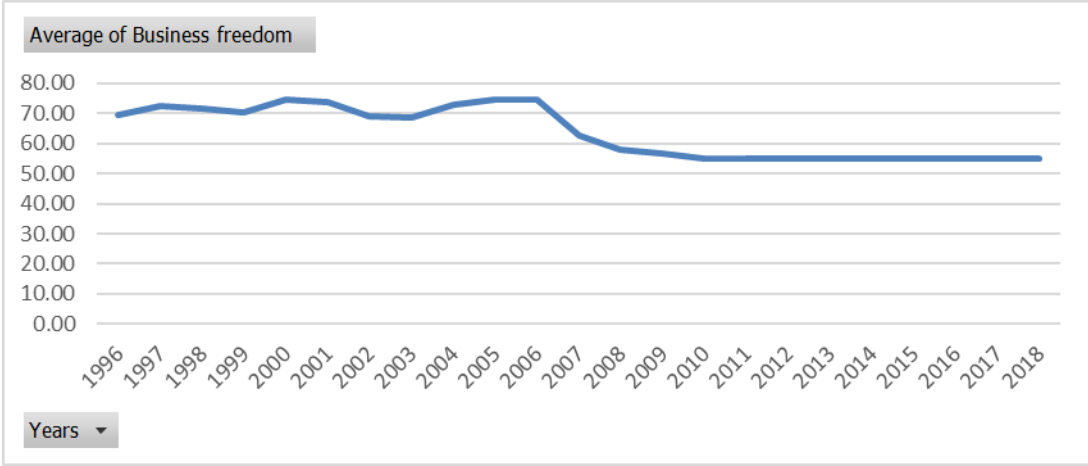
Each of these raw factors is converted to a scale of 0 to 100, after which the average of the converted values is determined. Using the following equation, each factor is translated to a scale of 0 to 100:

$$\mathbf{Factor\ Score = 50 * factor\ average / factor}$$

based on the country data ratio for each factor, multiplied by 50. For instance, it takes on average 18 procedures worldwide to obtain the necessary licenses. The 14 licensing

procedures in Canada are a factor magnitude greater than the average, resulting in a ratio of 1.29. The ratio multiplied by 50 leads to the final score of 64.5 (The Heritage Foundation, 2020).

Graph 5. Business freedom



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Azerbaijan’s ranking in terms of business freedom had shown generally stable trend at around 50-60 percentile rank. Our model suggests that the effect of this variable over FDI is statistically significant at 95% confidence interval. Coefficient obtained from the regression for the business freedom is around 108.

Azerbaijani government has been implementing “One Window” procedures in the country since end of first decade of 21st century. The country is determined to continue reforms in the field of business registration. Thanks to these reforms in only takes less than four days to finalize sign-up procedure with tax office. Ministry of Justice of Azerbaijan Republic is responsible for registering not-for profit organizations.

Starting from 2016, a brand-new sea port has been transformed into a free trade zone. The Alat Free Economic Zone is positioned a mere of around 50 kilometers of the capital. The new free trade zone offers multiple advantages to entrepreneurs interested in new venture opportunities. According to recently adopted Customs

legislation, businesses are freed from paying taxes on fixed assets brought into the country for starting a production entity, for a period of seven years. The free economic zone is coordinated in a spot where it connects European nations to Asia and Iran to Russia through Caspian Sea. The utterly important strategic positioning enables the country to have relatively strong country as a transit country. Moreover, current and further developing transportation network of Azerbaijan is connected to the Free Trade Zone which promises even more return for the country from the transit fees. (Port of Baku, 2019).

All crucial railway links connecting Azerbaijan to neighbor countries converges in the Alat economic zone. These directions of these railways entail:

- From Alat to Russian Federation
- From Alat to Georgia up to Black Sea and Turkey.
- From Alat to Iran and Persian Gulf (Port of Baku, 2019)

As of now, approximately more than $\frac{3}{4}$ of shipment are using the port for transit to other countries, whereas less than $\frac{1}{4}$ of the materials imported is for local market (for instance, gasoline, building supplies, farming goods and so on). The new economic zone will benefit not only the country but also businesses of the regions like Europe, Asia. By the time it is planned that the cargo capacity of the port will surge as the transit companies more and more discover advantages of the new economic zone. The government believes that increasing regional importance of the new economic zone will empower the country to have more of strategic role an independent political player in the area. The port is going to offer additional services for its customers which are grouped under 2 headings:

a) All-purpose Cargo Services, as well as storing, stacking and acceptance, classification, merging and delivery.

b) Logistics-plus, together with rewrapping, modifying, assemblage, excellence check, overhaul, self-embellishing, newscast equipment loading, retain of merchandises and handover and in-container vestment muster (Port of Baku, 2019).

By taking such measures government is aiming to highly improve ease of doing business provide assurance to investors in terms of legislative and infrastructural support.

2.3.2. Control of corruption

This metric tests the degree to which public power is exercised for private gain, including both small and large forms of corruption, as well as political and private interest "capturing" the State. It also tests the quality and efficacy of the policy and institutional system of a country for preventing and fighting corruption. Countries are measured on the following factors:

- the incidence of large-scale corruption and small-scale corruption at all levels of government;
- the impact of corruption on a country's "attractiveness" as a business place;
- the amount of "irregular payments" connected with import and export licenses, public contracts, services, tax assessments and court decisions; nepotism, cronyism and bribery in the civil service; the estimated cost of corruption as a share of the annual sales of a company;
- the alleged involvement of elected officials, border officials, tax inspectors, judges and magistrates in corruption
- the strength and efficacy of anti-corruption legislation, policies, and structures in a government;
- public confidence in politicians' financial honesty;

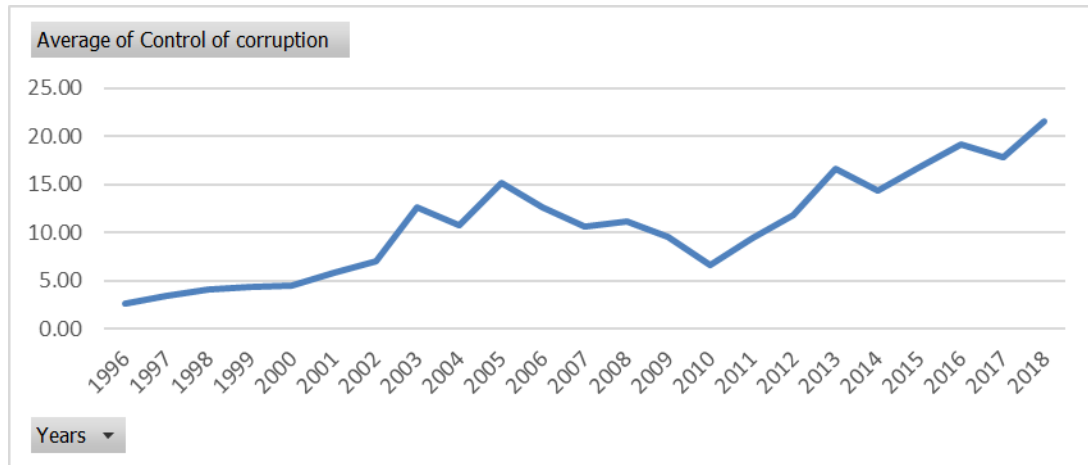
Corruption prevents economic development by increasing premiums, lowering efficiency, preventing investment, diminishing trust in public bodies, reducing the

creation of small and medium-sized enterprises, weakening public financial management systems, and undermining health and education expenditure.

Bribery can also multiply poverty by trying to slow economic growth, by distorting public expenditure on the wealthy and well-connected, by concentrating public investment in unproductive projects, by encouraging a more regressive tax system, by siphoning funds away from essential public services, by adding a higher level of risk to low-income investment decisions (Lambsdorff, 2003).

Foreign investors are very keen to increase the level of money they put into the economy if they see a positive turnaround in corruption index for the country. Azerbaijan's fight against this invisible enemy has been unfortunately slow and less effective in comparison with neighboring countries and other emerging economies. Although introduction of e-gov concept and ASAN service centers can be seen as a huge leap forward, these actions only prevent corruption present at individual level (among ordinary citizens and small bureaucrats). However, instance of corrupt actions and lack of transparency at level of government bodies constitutes much larger percentage of overall corruption. One the key areas of focus in this regard must be on state purchases. Unfortunately, still most of the government purchases are realized without an open tender rather by using only one source. Presence of "officer-businessman" reality, highlights questions about justness and transparency of trend decisions made on government purchases.

Graph 6. Control of Corruption.



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Transparency international claims that the lack of checks and balances on the powers of the executive, the absence of political opposition, the complex bureaucratic environment and high levels of red-tape united through deficiency of prosecution of the anti-bribery law base and the government's suppression on activists and the independent journalists, fashion the flawless breeding arena for corruption. An independent and efficient judiciary helps keep governments in check and guarantees the rule of law (Mungiu-Pippidi, 2015). The source argues that since the separation of power in Azerbaijan exists only on paper, the executive heavily interferes and has the last say in court decisions regarding political, economic and other publicly sensitive cases. Thus, although the administrative capacity of the courts has improved, their political independence has actually deteriorated (Bertelsman Foundation, 2016).

Close ties between business and politics is another major initiative for corrupt actions of government officials. Since the fall of the Soviet Union, most large enterprises in the country have been privatized, however many are now controlled by monopolies tied to high-ranking government officials (Bertelsman Foundation, 2016). Many small, and especially midsized, businesses are also owned by the oligarchs and informally tied to their large businesses (Bertelsman Foundation, 2016). Moreover,

monopoly-holding officials see off possible competitors by restricting their access to the domestic market and forcing them out of business (Bertelsman Foundation, 2016).

However, despite all the critics, since 2010, Azerbaijan demonstrated strong improvement in control of corruption index climbing all time high ratio. It is noteworthy though such drastic improvements country's position is significantly lower than world average and its Caucasian neighbors. Azerbaijan need to implement (The World Bank, 2019).

OECD in its report on Anti-corruption reforms of Azerbaijan highlighted action points categorized under 28 headings for the country in order to deepen the fight against the corruption. Among them included integration of civil society into Judicial-Legal Counsel, implementation of judicial reforms, making mandatory asset declaration for government officials including judges, timely reporting and scrutiny, increasing transparency over public procurement (OECD Anti-Corruption Network for Eastern Europe and Central Asia, 2016).

According to the model, control of corruption does have statistically significant effect to determine level of FDI on Azerbaijan based on historical data. Significance is effective within 95% confidence interval with coefficient of around 12.

2.3.3. Global competitiveness

The Global Competitiveness Report grades nations constructed on the Global Competitiveness Index. The index has been reported on theoretical and empiric analysis which are built on more than 110 determinants, a great majority of these are collected from Executive Opinion Survey and other part from publicly available data such as UN or WB. The index takes into account among others following factors to determine competitiveness of a country:

- institutes
- infrastructure

- involatile macroeconomic environment
- healthcare and education systems
- advancement of financial markets
- market size
- innovations and use of technology.

Azerbaijan improved in this index throughout the years and could maintain its position among top 50 countries for last few years. The model suggests that this indicator has positive impact on the FDI with a coefficient of 0.027. That is to say that a unit improvement in global competitiveness ratio may cause 2.7% improvement in FDI level into the country. Nevertheless, the link between FDI and Global Competitiveness Index is not significant within 90% confidence interval.

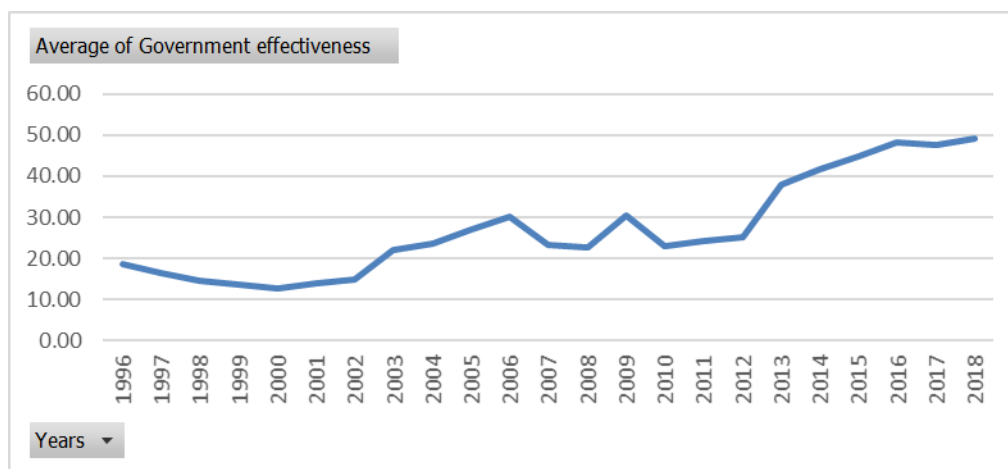
2.3.4. Government effectiveness

This index has been devised by the World Bank to determine quality of government services, effectiveness of public policies, and their implementation. The computation of index embeds 47 variables (such as quality of bureaucracy, distribution of infrastructure, goods and services). According World Bank index of government effectiveness is sourced by the public service quality, civil service appropriateness, public policy formulation and execution sufficiency and independence, trustworthiness of government and central bank. Azerbaijan has been experiencing significant boost in government effectiveness since 2012 as per data presented by World Bank (The World Bank, 2019). Nevertheless, such improvement had just arrived in world median in 2016.

Although Azerbaijan has improved significantly in this rating since 1996, it is noteworthy that it is considerably below than the level of effectiveness of Georgian government according to the World Bank. Regression leads us to the idea that government effectiveness has significant potential to contribute to higher FDI levels

within 90% confidence interval. The relationship is like a percentage improvement in government effectiveness may translate into 16% increase in foreign capital inflows.

Graph 7. Government effectiveness.



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

It is suggested that to boost the government effectiveness political systems need to boost accountability, even further advance integration of IT to services provided by the government bodies, encourage scrutiny of implemented policies and programs by parliament and non-governmental organizations, independent expert groups. According to Moody's report recently CIS countries has progressed dramatically in government effectiveness thanks to newly adapted reforms (Moody's, 2019). However, the report specially highlights that factors of good governance like control of corruption, rule of law are of the areas that there is a lot of room for improvement (Moody's, 2019).

2.3.5. Regulatory quality

This index measures legislation base of the country and its implementation, enforcement. Having property rights and protection of foreign investors over the just and independent juridical system improves a country's rating.

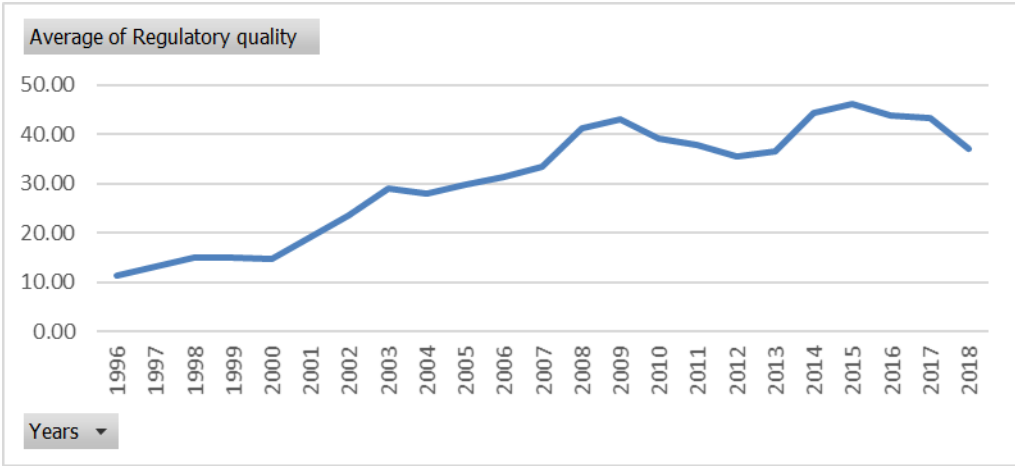
According to the regression assessment, positive dependency between FDI and regulatory quality exists (i.e. Azerbaijan's foreign investors are eager to invest more

into the country if they see improvement in the country’s rating) in contrast such relationship is not statistically significant. In Azerbaijan, several important areas that experienced considerable restructuring for refining the general commercial environment for tycoons comprise the procedures for requesting building licenses, admission to and ease of receiving electricity, registering property, receiving loan, shielding depositors, disbursing duties and levies, international transactions and undertaking liquidation.

In recent years Azerbaijani authorities have made concerted efforts to leverage digital technology and modern processes to reform how business is done in the South Caucasus and Caspian regions country.

For example, the launch of a single window service in the capital’s executive authority, known as Baku City Executive Power, has streamlined the process for obtaining a construction permit, reducing the processing time by 80 days and pushing the cost down by about \$7,500. A new credit bureau and a unified collateral registry have eased access to credit for entrepreneurs. And increasing transparency within the land administration system has made it easier for registering property. In addition, minority investors are safeguarded by the central government, which has increased shareholders’ rights and their role in major corporate decisions.

Graph 8. Regulatory quality



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

The 2019 Doing Business report identified cross-border trade in Azerbaijan as being faster and safer, thanks to streamlined electronic customs procedures and implementing what is known as the “green corridor” gating system. The gating system, which went into effect in August 2016, requires transportation companies to complete an electronic declaration that is assessed based on risk. Goods can be imported into the country without additional checks should they comply with all the pre-screening requirements required to use the corridor.

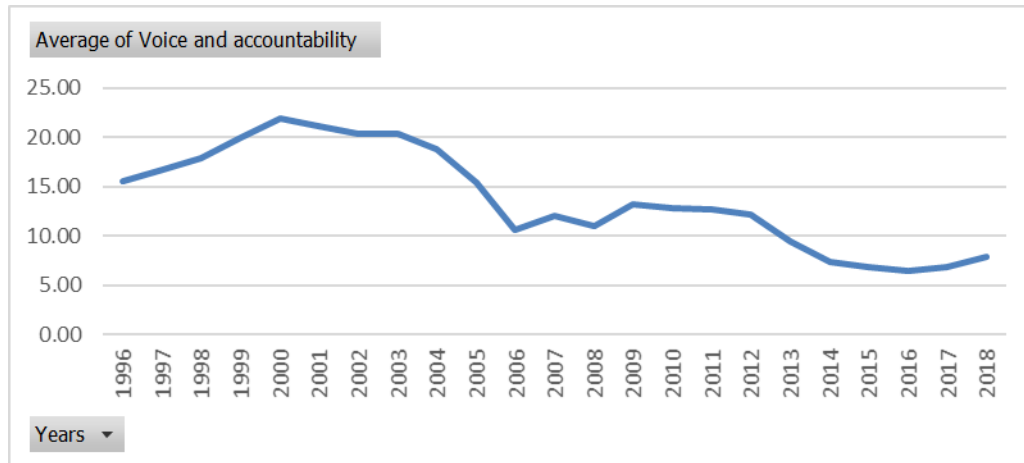
Mentioned transformations assisted Azerbaijan derive at rank 25 worldwide, just in advance of Austria, Thailand, Kazakhstan and Spain. The index placed Azerbaijan 32 steps ahead from where it was just a 12-month early, at 57 in the 2018 report, which was subtitled “Reforming to Create Jobs.”

Caspian region neighbors Russia and Kazakhstan plunged three and eight positions, respectively, to numbers 31 and 27. Iran also dropped several positions, from 124 in the 2018 report to 128 in the 2019 edition. Turkmenistan, another Caspian region country, was not included in the rankings.

2.3.6. Voice and accountability

This is the key factor according to the model that foreign capital holders take into account before making their investment decisions. This index is one of fundamentals that investors use to estimate trustworthiness of the economic system.

Graph 9. Voice and accountability



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Each investor is interested to minimize its risks and to face as less uncertain situations as possible. Therefore, having a country with higher voice and accountability ratio means less riskier investment in future. Our model confirms this was of reasoning as voice and accountability variable is one of the significant determinants of the foreign direct investment in Azerbaijan having a coefficient of 14 within 95% confidence interval.

2.3.7. Political stability

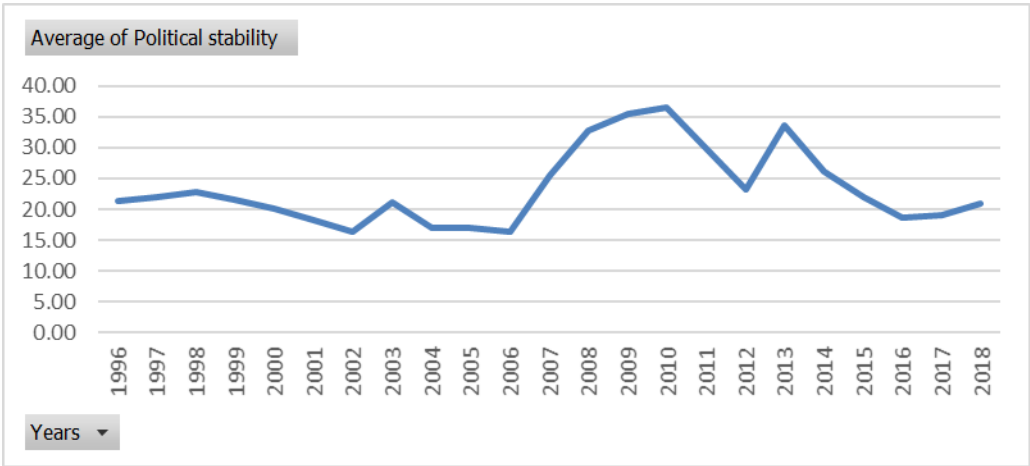
This measure is supposed to be one of the key drivers of the investor's future capital placement decisions. Particularly risk averse investors would be more hesitant to invest in economies where political stability is a mere unattainable desire. However, this assumption is not true in all cases specially in situations where returns are substantially higher than expected losses from instable political environment. In addition, in special cases governments can create "heaven" for foreign investors in a particular industry whereas country may be in the middle of political turmoil.

Azerbaijan has been politically stable for the analyzed period even though country has ongoing conflict with Armenia due to invasion of Nagorno Karabakh by Armenia. The country is suffering from 20 percent occupation of its lands and more

than a million refugees. Although there are several UN resolutions on Nagorno Karabakh conflict, none of them is followed by the Armenia and as a result the bloody invasion is far from ending. Having such conflict in territories of the country not only discourages some risk-averse investors to place huge funds into the economy of the country, but also restricts the country's spare funds to help the boost economy which is actually spent on military.

On the other hand, internal policy of the country provides comfort to citizens and helps to avoid any turmoil like coup attempts, politically driven terror attacks and so on. Such stable environment is the reason that country enjoys current level of foreign investment specially into the oil sector. Thus fact of occupation and current conflict did not stop investors to invest in oil industry of the country starting from 1990s.

Graph 10. Political stability in Azerbaijan



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

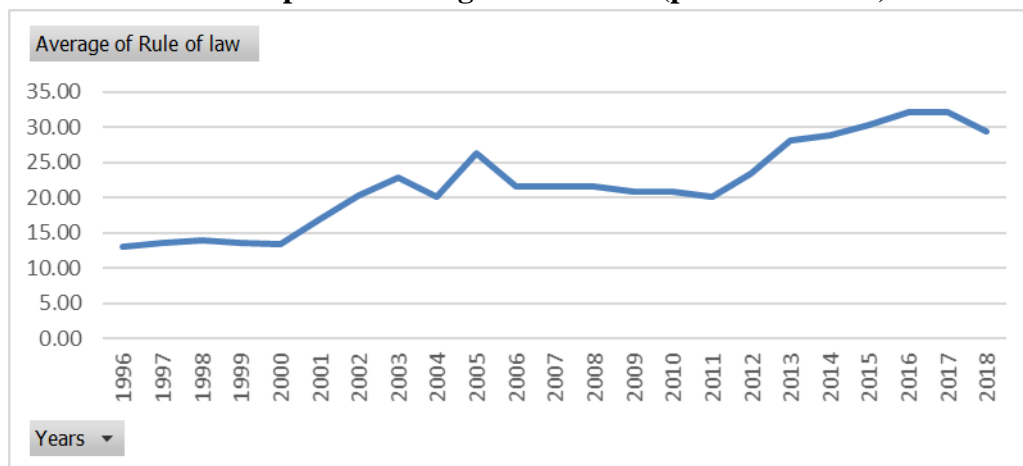
Unsurprisingly our model reconfirms that political stability index has been significant factor considered by oversea investors while making investment decisions into Azerbaijan. Per model coefficient is 16 within 95% confidence interval thus suggesting a percent upward movement in political stability index can translate into 16% boost in country's stability level.

2.3.8. Rule of law

This represents a durable system of laws, institutions, norms, and community commitment that delivers accountability. Investors are willing to invest in their money within countries where “king is not the law, but the law is the king”. They need comfort that independent court system can provide justness into the possible law cases their company may face. Our model reconfirms this assumption of investors. It suggests that a percent improvement in the rule of law index can lead to 34% increase in FDI into country all else constant. This finding can be a crucial for decision makers in the sense attracting more of foreign direct investment into the country. United Nations Development Program has following recommendation to boost the rule of law in countries struggling with maintaining good level of it (United Nations Development Program, 2011):

- a) Cope with heirloom conflict
- b) Advance individual safety
- c) Help to grow entree to Justice System for all residents
- d) Distribute assurance and equal rights to Women
- e) Measure the impact
- f) Speed-up partnerships among different interest groups

Graph 11. Average Rule of law (percentile rank)



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

Unfortunately, international image of the country in rule of law aspect is not one of the overwhelming. Major issues that country is very closely criticized on are related to holding free and fair elections, independence of juridical system, in some instances unequal treatment of political parties, and media freedoms.

2.4. Analysis of Variables Relating to Economic Development

2.4.1. GDP growth

Economic growth has been driven mainly by the oil sector. Overall trend shows Azerbaijan had been managing to maintain mainly positive growth trend throughout a timespan of 22 years since 1996.

From 1996 up to 1998 the country made a huge leap in term of GDP growth. The 10-fold increase made country to achieve 10% annual increase in Gross Domestic Product. Following this, growth trend of total economic output stagnated at around mentioned level till 2004.

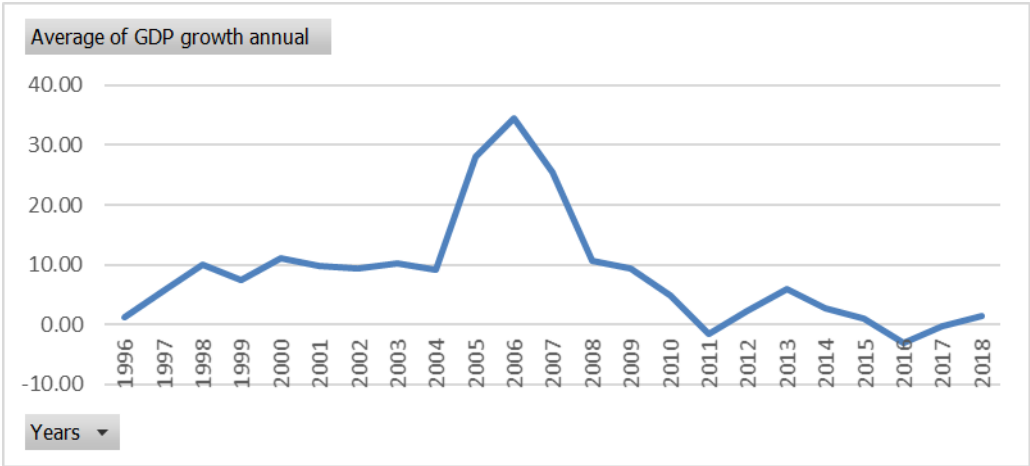
Thanks to opening of Baku-Tbilisi-Ceyhan pipeline beginning from 2005 country experienced a considerable increase in GDP growth. A peak of development in Gross Domestic Product was in 2006 at around 34 per cent.

Unfortunately, rapid boom is followed by a similarly sharp bust and the growth level arrived in its previous level as it was in 2004. This downward trend is further continued due to Global Recession and saw its lowest point in 2011 with a -1.6 per cent annual decline in gross output.

The country recovered from the recession in consecutive 2 years and arrived in 5.8 per cent growth figure per annum. However, crash in global oil prices stagnated growth and caused a decrease in the variable hitting next negative record of 3 per cent annual shrink-down in 2016. Those years national currency was being devaluated 2 times and both organizations (specially banks) and individuals suffered its effects. As the oil prices recovered country again improved the economy and reached 1.2 per cent growth in 2018.

It is noteworthy that other countries in South Caucasus has also experienced almost similar trend. Azerbaijan was dominant in yearly GDP growth rate among its neighbors, but this leadership had been lost in 2010 and almost never recovered.

Graph 12. Annual GDP Growth (in percentages)



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

As it is clear from the abovementioned facts, Azerbaijan’s economic growth rate is closely dependent on hydrocarbon resources of the country and its market volatility. The government’s efforts to increase contribution of non-oil sector to the economy has been hugely unsuccessful as more than 90 per cent of GDP was formed thanks to oil and gas industry of the country.

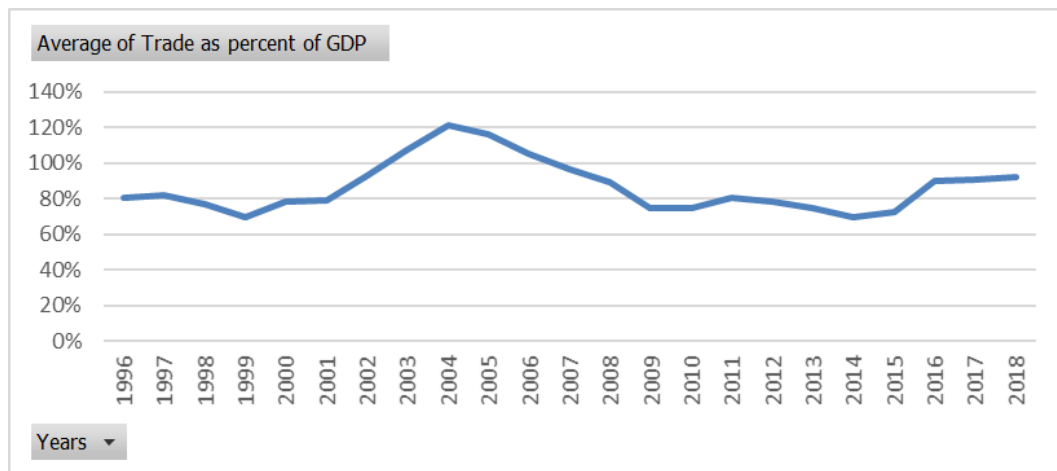
In studies of previous scholars, it was claimed that GDP growth is one of the stimulators of foreign direct investment inflows into the country. There is no doubt that there is a chance of bilateral relationship between GDP growth and FDI. The model demonstrates that GDP growth has no statistically noteworthy contribution to bring in foreign ventures into Azerbaijan.

According to the regression analysis, GDP growth has a potentially encouraging effect to attract more of Foreign Direct Investment. Nevertheless, such bond is not proved to be statistically significant.

2.4.2. Openness

Openness of country is measured as trade activities as a percentage of GDP. It is unearthed by the model that trade has positive impact on attracting foreign direct investment inflows into the country. Thus, coefficient is at 14.2% but this measure is not statistically significant as the p value is more than 10 %.

Graph 13. Trade as a percent of GDP



Source: State Statistical Committee of Azerbaijan. <https://www.stat.gov.az> 01.01.2020 Developed by author

The positive relationship can be explained by the fact that each investor is willing to utilize established trade arrangements with international community. The investor who produces new service/goods is concerned about the tariffs that is required to settle before making the outcome of production available to the end consumer. Azerbaijan's export encouraging trade arrangements is one of the factors that foreign investors enjoy.

2.4.3. Investment freedom

A range of investments restrictions (burdening red tape, land ownership limitations, the expropriation of investment without fair compensation, foreign exchange controls, capital controls and security issues, lack of basic investment infrastructures etc.) are assessed in the Investment Free Index. Model claims that

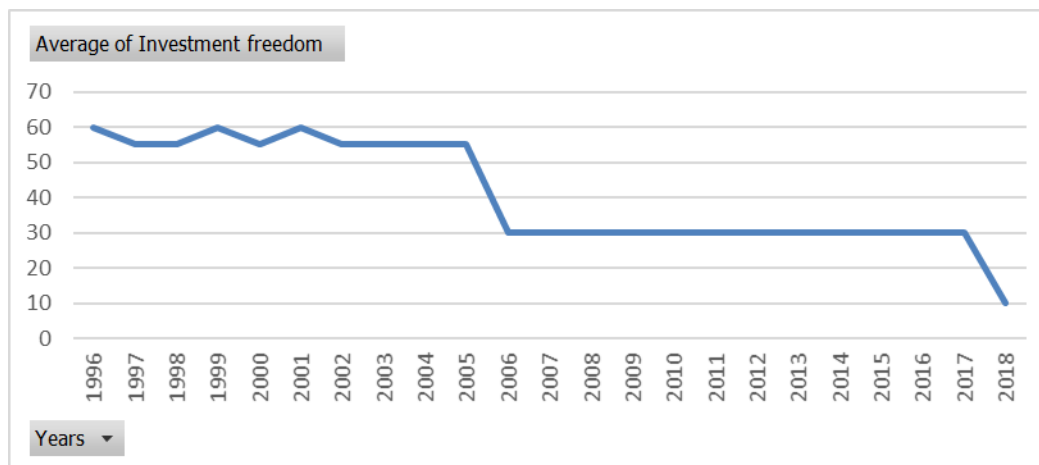
investors value this index seriously before taking investment decisions into Azerbaijan. Covariance obtained out of model is at 13%, within 95% confidence interval.

Such key information could not stay away from attention of decision makers of the country. Therefore, in the light of above, President of Azerbaijan Republic enforced an order dated 18.01.2018 to further endorse investment activities and protect rights of the capitalists in the country. The substance of order is to provide grounds for the adoption of a new legislation to protect investors' rights and introduce alternative dispute resolution methods for foreign capital holders. Azerbaijan has made progress in its economic freedom scores since first being included in the Index in 1996. The country's economy is now on the verge of joining the ranks of the "mostly free". GDP growth, however, has remained stagnant for the past five years. To set the conditions for greater economic freedom, the government will need to focus on improving government integrity and judicial effectiveness, and that will require significant institutional changes in the current political system, the overlapping of corporate and political interests, and the economy's highly concentrated ownership structure.

According to the statement of the US Department of State on the Azerbaijan investment climate, published in May 2015, under Azerbaijani law, foreign investors may engage in investment activities not prohibited by law. Private entities are allowed to establish, acquire and dispose of interests freely in business enterprises. Residents of overseas countries, alien entities, and businesses is allowed to rent land, however the legislation prohibits land ownership of those individuals or firms.

Given to the report, the country has worked to integrate more fully into the global economic marketplace, attract increased foreign investment, diversify its economy and maintain positive growth. The country proceeds to follow the strategy of attracting foreign direct investment to support economic diversification.

Graph 14. Investment freedom (percentile rank)



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

The government of Azerbaijan approved the Law on Protection of Foreign Investments in late 1992 on which full legal protection was provided for international investors. The law also ensures equal treatment towards both foreign and local investors and enables the repatriation of profits, revenues and other investment-related funds as long as applicable taxes have been paid.

The Law on the Protection of Foreign Investments protects foreign investors against nationalization and requisition, excluding certain specified circumstances. The nationalization of property can occur when authorized by parliamentary resolution, although cases of official nationalization or requisition against foreign companies have not been recorded in Azerbaijan.

An exemption from income, land, and property taxes for business parks, for example in the sector of information technology, in Azerbaijan has been created at the new amendments made to the Tax Code in 2013. These amendments also provide tax and customs privileges for the residents of industrial and technological parks for a term of seven years. The ability of foreign companies to take part in subsidized research and development programs financed or subsidized by the government in Azerbaijan is not restricted.

The country has been member of several international organizations specialized in protections of ownership rights. For instance, WIPO is perfecting methods and procedures to protect the intellectual property rights of individuals or organizations residing in member countries. Azerbaijan ratified conventions on Protection of Industrial Property, Protection of Literature and Art Works, along with this the nation has endorsed application of WIPO decrees applicable to online world since early 2005.

2.5. Analysis of Other General Economic Variables

2.5.1. Cost of labor

Minimum wages in Azerbaijan has been at relatively low level compared to developed western countries and no significant improvements has been observed in the last decade (State Statistical Committee of Azerbaijan Republic, 2018). Up to 2005 minimum wages was below than 30 manats per month. As the economy improved so that the minimum wages and it took over an 100 AZN per month level in 2013. The movement in next 5 years growth in minimum was steady and slow barely reflecting an adjustment for inflation. However, it is noteworthy that starting from 2019 considerable measures taken to increase the minimum wages hitting a record of all time high at 250 manats per month (State Statistical Committee of Azerbaijan Republic, 2018).

Previous researches on the matter explains that low level of minimum wages can preserve comparative advantage among other countries to attract Foreign Direct Investment. Still, as more foreign capital introduced into the country it announces spillover effect in terms of progressing skill and knowledge of labor market participants where can be base for increase in wages and salaries. Considering moving into new country and high reestablishment costs, the multinational firms tend to stay in the country with gradually increasing wages until the point where economic advantage of moving out would outweigh spiking labor costs.

Graph 15. Average monthly real salary



Source: State Statistical Committee of Azerbaijan. <https://www.stat.gov.az> 01.01.2020 Developed by author

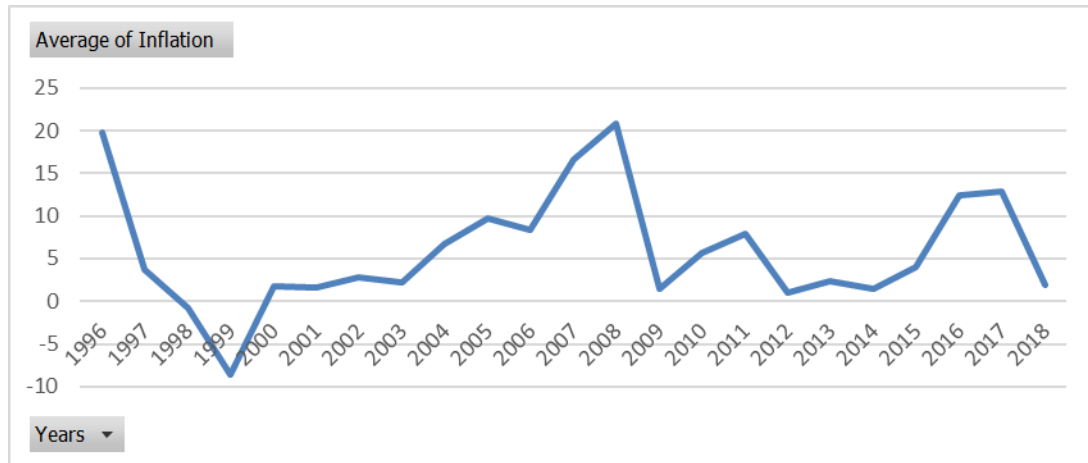
The critics of the country’s minimum wage policy resonates that application of “one-fit-for-all” style minimum wages is not just and different industrial sectors need to require individual approach while setting-up minimum wages.

The model surprisingly indicates a positive significant relationship between minimum wages and FDI. Though, such effect can be sourced from another 3rd variable that may have positive effect both on minimum wages and FDI, such as oil prices, state budget or any other.

2.5.2. Inflation

The model proposes that inflation have slight negative effect on foreign direct investment with a coefficient of 0.68% but tie is insignificant statistically. This can be explained by the fact high inflation levels flushes away real returns made by the oversea companies. In addition, it may be ground for high costs of production and squeezed margins.

Graph 16. Average Annual Inflation (CPI)



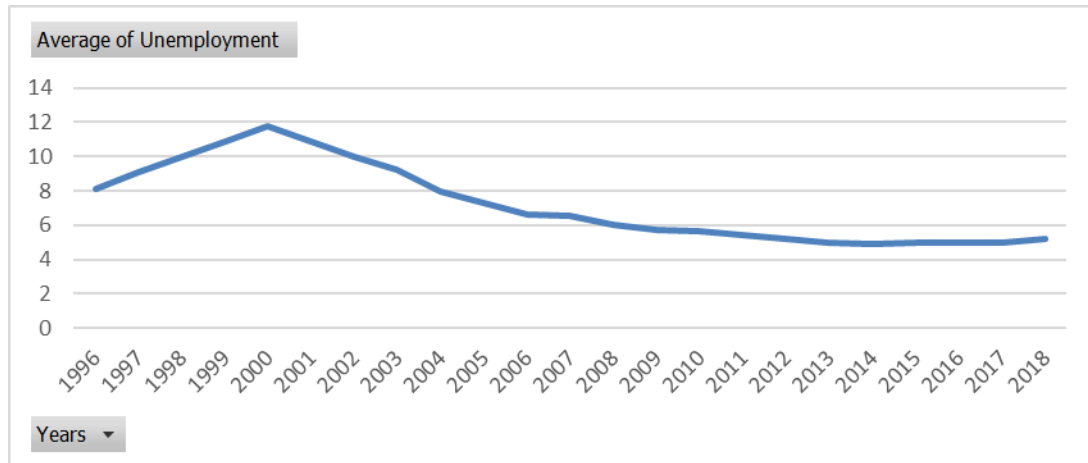
Source: Central Bank of Azerbaijan Republic. <https://www.cbar.az> 01.01.2020 Developed by author

Over the spectrum, Azerbaijan maintained stable inflation rates specially thanks to tight exchange regime and monetary controls by Central Bank. However, there have been some distortions from stable inflation rate specially during global financial crisis of 2008 and oil price crush of 2015-16. Government regularly anchors to target stable 1 digit inflation rate by overseeing the procrastination of application of flexible exchange rate regime. The critics are of the opinion that in the long-term having stable exchange rate with manat pegged against US dollars may have devastating financial costs for the nation, since, it requires constant flow of the foreign currency into the market.

2.5.3. Unemployment

Unemployment rate in the country has been relatively stable for last decade with little volatility. Country's average rate of unemployment was around 5-6%.

Graph 17. Average annual unemployment



Source: State Statistical Committee of Azerbaijan. <https://www.stat.gov.az> 01.01.2020 Developed by author

High unemployment rates may be indicative of deep lying structural problems of economy and therefore discourage foreign investment. However, as the model suggests it is not the case for Azerbaijan and no statistically significant linkage between unemployment and FDI has been identified.

2.5.4. Overall quality of infrastructure

Infrastructure in Azerbaijan is in the phase of reestablishment. Thanks to oil industry country has been leading the region for its advanced infrastructure. To support this statement, Baku was the first in the region to have railroad since even end of 19th century. Thus Baku-Sabunchu-Surakhany railway was used to carry crude oil extracted from the fields. According to website of Azerbaijan Railways total length of the railways in the country is nearly 3,000 km. Approximately 27% of those are two-sided tracks. Current infrastructure enables the cargo to be carried to east to west and south to north easily (Azerbaijan Railways, 2020). Such advantage empowers country's strategic importance as a corridor between civilizations. Country has adopted 4-year state program on development of railway infrastructure in 2010. The program prioritizes agile growth in the sector which includes wagon and locomotive fleet

renewal, road, power supply, signaling and communication, major overhaul of other industries, transition from alternating to direct current, modernization of technical facilities and other important tasks (Azerbaijan Railways, 2020).

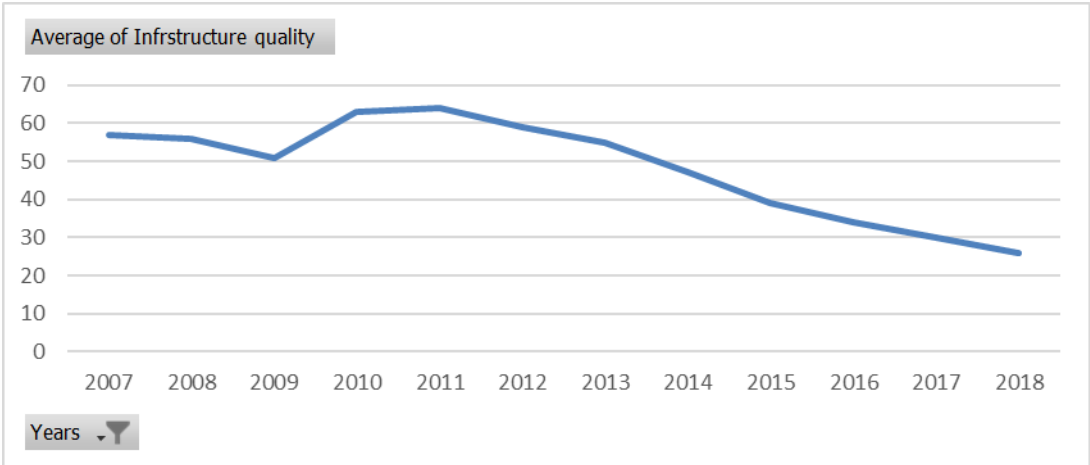
Road infrastructure is also one of the priorities of the leadership of the country. After independence from Soviet Union economy of the country was degrading rapidly and so that the road infrastructure was no exception. War Chechnya broke-up the road ties with Russia and war started by Armenia on Nagorno Karabagh further deepened the fallout. As a consequence, 20% of the area of the country was occupied (around 3000 km well-established automobile road) and direct and shortest road link with Nakhchivan collapsed. Thus, in last decade of 1990s due to harsh economic conditions government budget only enabled current repair and maintenance works. Almost no capital fixtures and reconstructions works were not performed during these times (Azerbaijan Automobile Road State Agency, 2020). The country is located on E-70 International Highway connecting Europe to Asia through South Caucasus.

State program on social-economic development of regions covering 2004-2008 Baku-Guba-Russian Federation, Baku-Shamakhi-Yevlakh, Khojasan-Lokbatan-Yevlakh-Ganja, Ganja-Gazakh-Georgia highways were reconstructed. In the course of 5 years starting from 2008 in the capital 26 road junctions, bridge and 88 pedestrian crossings were established. Not only capital and highways, but also avenues of suburb regions of the capital have been reconstructed and this process is still in progress. The total length of road infrastructure in the country is around 17500 kilometers including more than 1400 bridges and tunnels.

According to presidential decree number 1638 dated 18 October 2017, Azerbaijan Automobile Roads State Agency was established. This move was made to further increase efficiency and transparency of the government structure.

One of the utterly important factors of the infrastructure is availability of sustainable energy and well established energy network. Azerenerji OJSC is a government entity responsible for production, distribution, management and maintenance of energy network of the country. Currently energy demand of country is mainly met by the local production through thermal power plants, biggest of which includes “Azerbaijan” – 2400 Mvt, “Janub” – 780 Mvt, and Sumgait – 525 Mvt. Country’s energy network is mainly concentrated in big cities like Baku, Mingachevir, Sumgait and Shirvan. The infrastructure was found during Soviet era to support industrialization of the country. However, it lacked major renovations for decades after collapse of the Soviet Union. Although, starting after mid of first decade of 21st century government started directing considerable sums of money to energy sector addressing long-waiting need of the reconstruction. Nevertheless, nationwide energy crisis in 2018 caused by a crash in largest thermal power plant named “Azerbaijan”, raised questions on efficient and transparent utilization of funds by “Azerenerji”. Even if big cities enjoy continues electric supply 24/7 the infrastructure on which the system operates needs major overhaul specially in suburban areas.

Graph 18. Infrastructure quality (percentile rank)



Source: World Bank, www.worldbank.org 01.01.2020. Developed by author

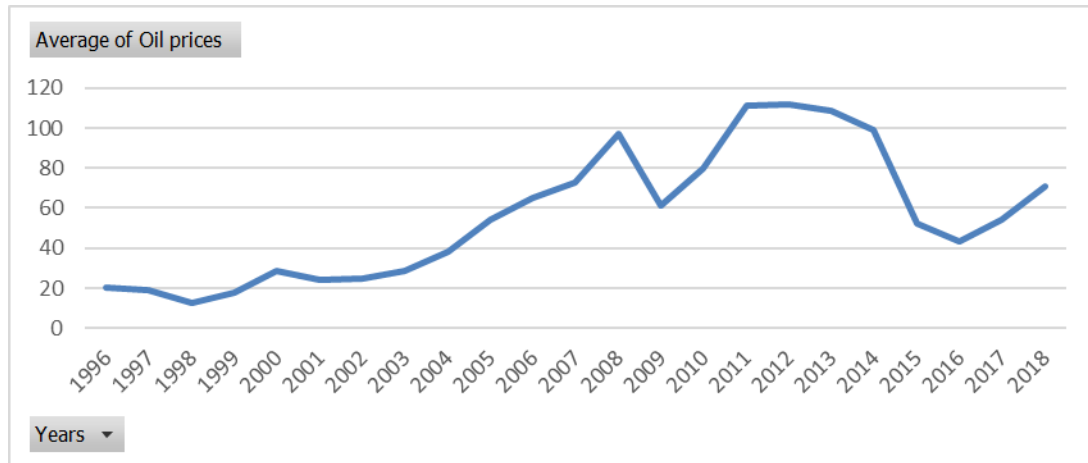
Government authorities understand vitality of the energy infrastructure for the nation, therefore, it is planned to increase the energy output by 1000 Mvt during next 5-10 years, further diversify energy production and increase contribution of alternative energy sources (Presidential Administration of Azerbaijan, 2016).

The regression analysis performed suggests no statistically significant dependency between foreign capital flows and level of overall quality of infrastructure.

2.5.5. Oil prices

Oil prices in global markets always demonstrates its volatility compared to other commodities. The price is affected by both political and economic factors. A gaze to the trend of the oil prices in the course of the research period suggests that the consideration for a barrel of oil was stagnating around 25-30 USD per barrel up to year of 2004. After this date, prices started to climb up and reached a peak of 121 dollars per barrel in second quarter of 2008. Later the price bubble burst hitting a low of 44 USD per barrel in the first quarter of 2009. Thanks to Arab spring world markets increased purchase of crude oil, stockpiling their spare oil reserves. This led to second upward movement in crude oil prices in the till 2012 reaching around 112 USD per barrel. Later prices stagnated at around this level for 2 consecutive years. This is followed by a second sudden drop in prices until 2016. The unexpected drop strained foreign currency reserves of the Central Bank of Azerbaijan Republic and made the body to announce devaluation of national currency against US dollars. As a result, manat lost approximately 118 percent of its initial value. Prices started to slowly recover afterwards till 2018 for around 60 USD per barrel.

Graph 19. Oil Prices



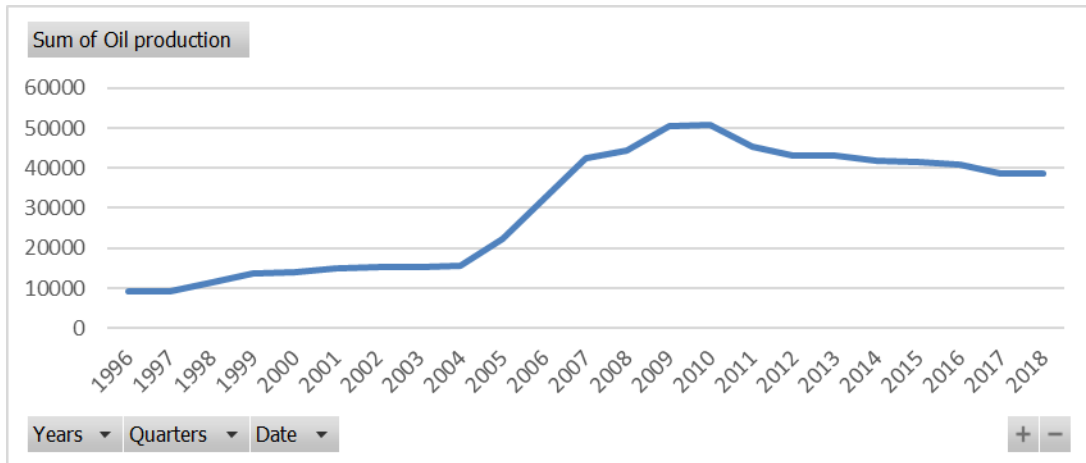
Source: State Statistical Committee of Azerbaijan. <https://www.stat.gov.az> 01.01.2020 Developed by author

The regression model suggests a small negative relationship between foreign capital inflows and oil prices. General notion to explain this phenomenon is that foreign investors are willing to invest if they see high returns. Thus, as prices go up investors made their mind about an investment decision and start initial tranches of capital injections. However, as we saw above oil prices tend to be volatile and each boom in prices is followed by a bust. For this reason, there is a lag to see a positive movement of oil prices translated into positive capital inflows. To sum-up although model suggests a possibility of negative oil prices to encourage foreign capital flows the coefficient is relatively small and it can be due to lag as explained above.

2.5.6. Oil production

Crude oil extraction in Azerbaijan generally followed the same pattern as changes in oil prices. That is to say oil production generally was increasing during high oil prices and decreasing during relatively low market conditions.

Graph 20. Oil production in Azerbaijan in thousand tons



Source: State Statistical Committee of Azerbaijan. <https://www.stat.gov.az> 01.01.2020 Developed by author

This trend continued in this way until 2010, but afterwards country experienced slow and steady decline in oil production. Current oil wells gradually ending their useful lives, and new perspective extraction wells are to be located in further into the Caspian Sea which require additional development costs. Although the country still continues its investment into potential new wells, in the long run it is obvious that oil reserves will run-out and for this reason the government plans to transform the nation from oil extracting into natural gas extracting country. For this purpose, SOCAR has started works in Umid-Babek gas field. The reserves in the new potential field is estimated to be around 1000 billion cubic meters.

The regression model did not prove any direct, statistically significant relationship between changes in crude oil extraction and level of alien capital inflows into Azerbaijan's economy.

CHAPTER III. CONCLUSION, DISCUSSION AND APPLICATION OF FINDINGS

3.1. Summary of Findings

For many years countries saw an opportunity to develop their economy through attracting foreign investment into the country. Azerbaijan experienced huge growth in oversea capital introductions thanks to its noticeable energy reserves specially since signing so called “Contract of Century”, a profit sharing agreement between huge oil corporations of world economy and the government of the country. However, obtaining more sustainable growth utterly depends on ability of country to diversify the economy and increase the portion of non-oil revenue in state budget. Having said that, one the priorities of the country is to focus attention of worldwide investors into the country and make the conditions more appealing for them.

The question of exactly which factors are mostly valued by alien investors has been a hot topic for the country for decades. This study tries to identify and shed light on the few of those aspects in depth by applying statistical analysis on the most available data for the country.

In conclusion as research indicates reasons relating to institutional quality (factors like business freedom, control of corruption, political stability, rule of law), economic development (investment freedom), and other general economic variable (such as cost of labor and oil prices) had played great importance for foreign investors while investing into Azerbaijan.

There are still a few major challenges in front of country to be solved to attract specially relating to increasing rule of law, reducing corruption, providing transparency and effectiveness in government policies and measures.

Nonetheless, sooner or later these obstacles must be resolved as oil dependent economy is in need of fresh foreign capital in a range of different sectors so that sustainable growth of the country can be maintained in the long-run

3.2. Discussion and Application and Perspectives

For the purpose of improving economy through Foreign Direct Investment inflows, as the research suggests, country is in need of advancing its quality of institutions as a priority. Current ongoing reforms for the purpose of democratizing economy and government bodies are warmly welcomed by international community. However, such reforms need to be complex enough to cover almost all spheres of the life including juridical, execution and parliamentary systems altogether. This can be seen as a major challenge ahead of current government nonetheless measures taken indicates determination of the state to achieve concrete results through the reforms.

This study and further researches on the subject may foster the initiatives of the government while constructing policies for attracting foreign direct investment into the country. Since, it specifically unearths crucial variables based on past dataset, the trustworthiness research increases and opens door for further applications.

In future researches on the topic it is recommended to apply other aspects (specifically variables relating to things like current location, level of social services) using more complex regression models and test whether or not current results are confirmed. For purposes of this research, only secondary data has been utilized which increases questions quality of data and therefore it would be huge advantage for future researchers of the matter to collect primary data through questionnaires and interviews.

RESULTS, SUGGESTIONS, AND LIMITATION

The first and utmost purpose of the study detect and test statistical significance of the aspects that influences decisions of foreign capital owners while taking investment decisions. The paper concludes that variables related to institutional quality plays the most crucial role in attracting foreign direct investment into the country. The effect of Business Freedom, Control of Corruption and Political Stability are the most statistically significant variables per findings of the paper.

The Azerbaijan government has been continuing its efforts to increase country reputation in the eyes of the foreign investors by applying continuing reforms in the country. Such transformations are closely watched by international community with surplus of funds ready to invest. Having identified the variables having potential to affect decision of potential investors, it can be suggested for the authorities of the country to construct and implement future policies in a way that it is driven by a scientific research and promises attainable results with maximum efficiency.

In upcoming examinations of the subject, for researchers it can be suggested to count in various different pieces of influencers (such as things linked geographic location, level of social services, access to oceans etc.) by means of further intricate regression mockups and assess whether or not recent outcomes are deep-rooted. The study takes advantage of merely secondary statistics. This may lead to skepticism on excellence of figures and consequently. For this reason, that can be vast benefit for upcoming academics of the issue if they could build the research on a data accumulated by primary sources like surveys and discussions with potential investors.

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