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# IMPROVING STATE FINANCIAL SUPPORT FOR THE DEVELOPMENT OF SPECIAL ECONOMIC ZONES IN AZERBAIJAN

## Abstract

Special Economic Zones (SEZs) in Azerbaijan face significant challenges due to inadequate and inconsistent state financing, exacerbated by competing budgetary priorities such as post-conflict reconstruction and economic crises. The over-reliance on state funding has led to delayed development, stagnation in most SEZs, and disproportionate dependence on a single successful zone (Sumgait Chemical Industrial Park), which accounts for over 80% of national SEZ performance. Existing bureaucratic barriers, legislative rigidity, and the absence of private or hybrid financing models further constrain SEZ growth, limiting their potential to attract diversified investments, reduce unemployment, and drive economic diversification. This article aims to propose a reformed financial and management framework to address these systemic challenges. This study employs systematic analysis, quantitative analysis techniques, and generalization to investigate the operations of industrial parks and industrial districts in Azerbaijan and analyze their current performance indicators. It also compares Azerbaijan's SEZ financing mechanisms with foreign practices to evaluate their prospects and applicability. The results indicate that the improvement of state financing for SEZs in Azerbai-



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jan could lead to enhanced development. Based on these findings, the article recommends reforms to strengthen state financing mechanisms by implementing hybrid public-private financing models. Additionally, it suggests legislative reforms and increased private-sector participation to establish sustainable funding strategies, reduce reliance on state budgets, and improve SEZ performance metrics, such as economic diversification, export growth, and unemployment reduction, thereby fostering a competitive and corruption-resistant business environment.

## Key Words:

finance, government, incentives, investment, SEZ, tax.

**JEL:** H21, H39, H54.

2 tables, 6 figures, 24 references.

## Problem Statement

Achieving economic growth is a priority goal for Azerbaijan, as well as for many other countries around the world. Azerbaijani scholar Hasanli (2023) observed that different countries implement various measures to foster economic growth. This progress is typically reflected in key indicators such as Gross Domestic Product (GDP), exports, and reduced unemployment rates. A key driver of these indicators is investment, making the creation of incentive mechanisms a priority for government. Investment can come from the state, including public institutions, as well as from private enterprises. For companies, the main motivation for investment is to make a profit (Namazova, 2023). Consequently, investors are drawn to areas with low taxes and customs duties. Geographical location, investment purpose, access to energy supplies, and other considerations are very important for investors.

As a result, many high-capital corporations invest in developing countries, which offer several advantages that enhance business activities, the most important of which is cheap labor (Bamber et. al., 2014). Due to the incomplete development of the business environment in these countries, the number of unused vacant areas is relatively high. However, in addition to the positive aspects mentioned, there are also negative factors. These include:

Bureaucracy – In developing countries, there are significant bureaucratic barriers at the state level (Asaju & Ayeni, 2021). Companies wishing to start business activities in these countries must obtain various permits and approvals from state bodies. In addition, the creation of the company's production infrastructure must be approved by various state bodies and comply with the standards they set, resulting in time losses for investors.

Corruption – Corruption is observed more frequently in many developing countries (Bardhan, 2017). Examples include more frequent audits of companies, the issuance of documents in exchange for bribes, and other types of corruption. This hinders the creation of a competitive market and, most importantly, reduces the level of foreign investment in the country. Significant amounts of money from the budget are spent by the state to eliminate such corruption. At the same time, alternative methods are being developed and implemented in society to address the mechanisms through which corruption occurs.

Lack of a competitive market – Corruption in developing countries also creates conditions for some companies to become the main figures in the market. These companies, being close to high-ranking officials, can create barriers for other players in the market. In such cases, it becomes difficult for foreign and other investors to invest in this direction (Dixit & Stern, 1982).

Although the formation of the business environment in developing countries presents potential opportunities, existing obstacles hinder the creation of a competitive climate. As a result, investment activities in the country decline, leading to economic stagnation. The government must intervene directly to resolve this problem. It should create a designated area with a distinct legal regime, separate from the rest of the country, where business enterprises can operate comfortably. These characteristics are found in Special Economic Zones (SEZ).

Many countries, including Azerbaijan, have SEZs, which are considered an excellent tool for revitalizing and developing a country's economy. The state directly participates in the creation of SEZs and, in many cases, in their financing. However, there are instances where the state plays an indirect role. Decentralized governance models, as seen in India's smart cities-linked SEZs (Roy, 2016), could help alleviate bureaucratic bottlenecks in Azerbaijan. A comparative study by economists Stiglitz and Pieth (2016) suggests that SEZs need corruption-resistant governance mechanisms to improve their conditions.

Special Economic Zones in Azerbaijan face significant challenges due to inadequate and inconsistent state financing, exacerbated by competing budgetary priorities such as post-conflict reconstruction and economic crises. The over-reliance on state funding has led to delayed development, stagnation in most

SEZs, and a disproportionate dependence on a single successful zone (Sumgait Chemical Industrial Park), which accounts for over 80% of national SEZ performance. Existing bureaucratic barriers, legislative rigidity, and the absence of private or hybrid financing models further constrain SEZ growth, limiting their potential to attract diversified investments, reduce unemployment, and drive economic diversification. Addressing these issues requires reforms to enable alternative financing mechanisms, private-sector participation, and legislative adjustments to foster sustainable SEZ development.

**This article aims** to propose a reformed financial and management framework for SEZs in Azerbaijan to address systemic challenges such as inconsistent state funding, bureaucratic inefficiencies, and over-dependence on a single successful zone. By analyzing international best practices and Azerbaijan's current SEZ financing mechanisms, the study seeks to advocate for hybrid public-private financing models, legislative reforms, and enhanced private-sector participation. The goal is to establish sustainable funding strategies that reduce reliance on state budgets, diversify investment sources, and improve SEZ performance metrics–including economic diversification, export growth, and unemployment reduction–while fostering a competitive and corruption-resistant business environment.

## Literature Review

There is no standard, universally accepted definition of special economic zones (SEZs). According to UNCTAD (2019), SEZs are geographically delineated areas within a country where governments adopt more liberal economic regulations than those applied nationally to foster foreign direct investment, export promotion, and industrial development. Farole & Winkler (2011) define SEZs as clearly demarcated areas where tailored regulatory frameworks, fiscal incentives, and administrative benefits are provided to stimulate industrial competitiveness and regional economic development. Cheng (2019) suggests that SEZs can act as catalysts for cross-border trade. Aggarwal (2010) describes SEZs as designated areas where governments apply a distinct and favorable economic policy framework–including reduced duties and streamlined regulations–to promote industrial activity and integrate local economies into global markets.

The reason for differences in approaches to SEZs is that each country defines SEZs based on its own legislation. Each country creates and manages SEZs in various formats and legal regimes. The purpose of establishing SEZs is to attract foreign investment and stimulate local investors. When creating an SEZ, the state allocates a special area for it. This area must be close to major highways and transportation hubs so that resident companies can easily export their products to various regions and abroad. A special legal regime is also implemented in SEZs to strengthen the activities of investing companies. Through this special legal regime, resident companies in SEZs are exempt from many tax and customs duties. At the same time, the state offers concessional loans to support their full financing. SEZs also have auxiliary infrastructures for the comfortable operation of business entities. For example, SEZs have production facilities that can assist in production and warehouses for storing products. These features distinguish SEZs from other areas and encourage investors to invest in these zones. These characteristics of SEZs help strengthen the business environment in the country and contribute to economic growth.

To achieve economic growth, SEZs target the following indicators:

- Increase in investment: Investment is the main driver of economic growth. An increase in investments leads to an increase in the number of businesses in the country, which in turn affects the following indicators.
- Reduction of unemployment: An increase in the number of businesses generates a greater demand for labor in the country, which reduces the number of unemployed people.
- Increase in production and exports: An increase in the number of businesses will lead to an increase in production and exports in the country.
- Diversification of the economy: Various business entities operate across different industries and services in the country, resulting in a more diversified economy.

Therefore, SEZs refer to areas where local governments institute preferential policies–such as reduced tariffs and simplified customs procedures–to foster a competitive business environment for both domestic and foreign investors (Steenbergen & Javorcik, 2017). Therefore, the state directly participates in the financing of SEZs. However, the state’s participation in this process is not always successful. Thus, when an SEZ is financed by the state, management and supervisory functions fall directly to the state. In such cases, the negative aspects previously mentioned may also affect the SEZ, and thus the SEZ will be unsuccessful.

## Methodology

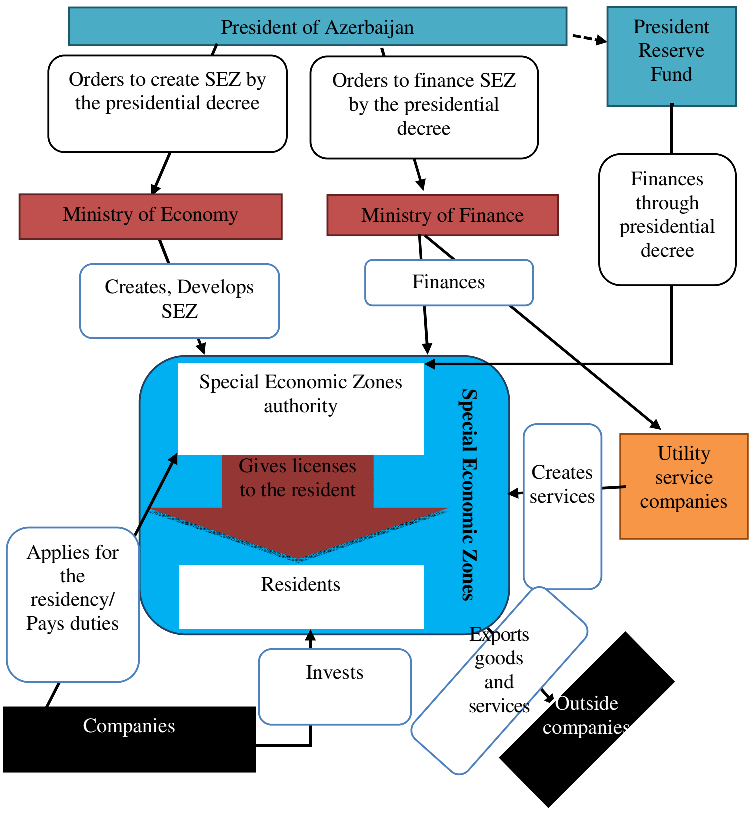
The study employs systematic analysis and generalization to examine the operations of industrial parks and industrial districts in Azerbaijan. Quantitative analysis techniques are used to analyze key financial data and present the key performance indicators (KPIs) of SEZs, such as production volumes, export volumes, and investment levels, in order to observe trends and variations over time. Additionally, a comparative analysis is conducted by comparing Azerbaijan’s SEZ financing mechanisms with international best practices to assess their prospects and applicability.

## Research Results

Currently, there are several types of SEZs in Azerbaijan. These include «industrial parks» and «industrial districts» («industrial zones»), and «free economic zones». All the mentioned industrial parks are financed by the state, more precisely, by the state budget and the Presidential Reserve Fund. Industrial districts are financed by the Azerbaijan Investment Company, which also receives these funds from the state budget. Figure 1 shows the scheme of state financing of SEZs operating in Azerbaijan.

*Figure 1*

**State funding procedure for SEZs in Azerbaijan**




Source: author's own work.

In Azerbaijan, capital investments (investment expenditures) play a significant role in economic spending. These expenditures are directed toward state institutions, government agencies, and public enterprises operating within the country, and they often exceed the allocated budget. Non-essential projects are either financed in phases or postponed to subsequent years, which frequently delays their implementation. The Azerbaijani government's investment in SEZs is presented in Table 1.

*Table 1*

**Azerbaijani government investment in SEZs**

| Name | Date | Area (hectares) | CapEx (million USD) | Projected operating expenses per year (million USD) | | | |
|---|---|---|---|---|---|---|---|
| | | | | 2024 | 2025 | 2026 | 2027 |
| Sumgait Chemical-Industrial Park | 2014 | 583.5 | ~255.1 | 6.48 | 7.06 | 7.66 | 8.28 |
| Balakhani Industrial Park | 2014 | 10.15 | ~63.8 | 0.41 | 0.44 | 0.48 | 0.53 |
| Mingachevir Industrial Park** | 2015 | 26 | ~58.5 | This zone's maintenance costs including CapEx are covered by the resident company | | | |
| Pirallahi Industrial Park | 2016 | 30 | ~31.3 | 0.58 | 0.62 | 0.67 | 0.74 |
| Qaradagh Industrial Park** | 2017 | 72 | ~29.1 | This zone's maintenance costs including CapEx are covered by the resident company | | | |
| Neftchala Industrial Districts | 2017 | 10 | 12.8 | 0.58 | 0.64 | 0.69 | 0.74 |
| Masalli Industrial Districts | 2017 | 4.7 | 9.6 | 0.44 | 0.48 | 0.53 | 0.56 |
| Hajiqabul Industrial Park | 2017 | 60 | 32.2 | 1.02 | 1.11 | 1.20 | 1.31 |
| Sabirabad Industrial Districts | 2017 | 20.3 | 14.8 | 0.67 | 0.74 | 0.79 | 0.86 |
| Alat Free Economic Zone* | 2018 | 873.74 | 460 | This zone's maintenance costs are covered by the developer company | | | |

| Name | Date | Area (hectares) | CapEx (million USD) | Projected operating expenses per year (million USD) | | | |
|---|---|---|---|---|---|---|---|
| | | | | 2024 | 2025 | 2026 | 2027 |
| Aghdam Industrial Park* | 2021 | 190 | ~58.8 | 2.63 | 2.89 | 3.14 | 3.42 |
| «Araz Valley Economic Zone» Industrial Park* | 2021 | 200 | ~58.8 | 2.72 | 2.96 | 3.23 | 3.51 |
| Nakhcivan Industrial Park* | 2024 | 300 | n/a | n/a | n/a | n/a | n/a |

Notes: *These SEZs are still under construction. **Residents of these zones have been created before the SEZs themselves. Source: author's own research based on data from the Ministry of Economy of Azerbaijan.

The figures in Table 1 were converted from Azerbaijani manat to U.S. dollars using CEIC data (https://www.ceicdata.com/en/indicators). It should be noted that the Mingachevir and Qaradagh industrial parks were created before the SEZ itself. Consequently, their total CapEx (including government financing) was $165.9 million and $470 million, respectively.

Delays in funding have been observed in the SEZs operating in Azerbaijan. For instance, the first SEZ established in Azerbaijan, the Sumgait Chemical Industrial Park, was created in 2014. From its inception, this industrial park has been financed in phases, primarily due to the 2015 oil crisis. The economic downturn caused by the crisis prevented the government from allocating the necessary funds for the park, which in turn slowed its development.

Despite these delays, the involvement of SOCAR's carbamide and polymer plants, which were attracted by the government, contributed to the park's growth. Additionally, the attraction of numerous foreign private investors further strengthened the Sumgait Chemical Industrial Park. Currently, this park accounts for 85% of the overall indicators for industrial zones in the country. However, we believe that with full and uninterrupted funding, its performance could have been even higher.

Following the Second Karabakh War in 2020, the liberated territories required significant financial support, leading the government to allocate over 2 billion AZN annually for reconstruction. This, however, reduces the amount of capital investments available for the overall economy. As a result, many organizations, including SEZs, may face challenges in securing state budget funding, which could negatively impact their development.

Therefore, enhancing the government’s funding mechanisms for SEZs is crucial. To achieve this, Azerbaijan should improve the funding structure for SEZs beyond reliance solely on the state budget. As seen in many other countries, Azerbaijan can utilize extrabudgetary funds and alternative state financial resources to support SEZ development more effectively.

*Table 2*

**Azerbaijani SEZs’ key performance indicators**

| Indicators | Unit | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Total SEZ production | Million USD | 568.59 | 730.18 | 1357.47 | 1636.06 | 1863.12 |
| Total SEZ export | Million USD | 186.88 | 209.29 | 564.29 | 637.29 | 581.76 |
| Total SEZ investment | Million USD | 427.53 | 184.88 | 145.71 | 52.06 | 119.06 |

Source: Author’s own work based on data from Economic Zones Development Agency (n.d.).

As observed, while the key efficiency indicators of SEZs continue to grow, there have been sharp declines in investment volumes. Additionally, a significant portion of these indicators is attributed to the Sumgait Chemical Industrial Park. Between 2019 and 2023, production volumes at the Sumgait Chemical Industrial Park were $484.3 million, $ 665.8 million, $1278.9 million, $1594.9 million, and $1747.2 million, respectively.

Regarding exports during the same period, the figures were: $162.6 million (2019), $197.6 million (2020), $515.9 million (2021), $607.8 million (2022), and $551.2 million (2023). However, investment figures show a significant decline over the years. Between 2019 and 2023, investment from the residents amounted to: $409.3 million (2019), $174.3 million (2020), $132 million (2021), $44.5 million (2022), and $96.1 million (2023), respectively.

Based on these figures, it is evident that the Sumgait Chemical Industrial Park accounts for more than 80% of the overall performance of SEZs operating in Azerbaijan. This means that any disruption in the park’s activities would lead to a severe decline in SEZ performance across the country.

We believe that the success of the Sumgait Chemical Industrial Park is largely due to its vast allocated territory and significant financial resources. The park covers nearly 600 hectares and hosts over 30 prestigious state-owned and private enterprises as residents. Excluding the parks planned for the Karabakh region, the next largest park is the Garadagh Industrial Park, which covers only 72 hectares and has just one resident. These factors have contributed to Sumgait Chemical Industrial Park's superiority over other SEZs.

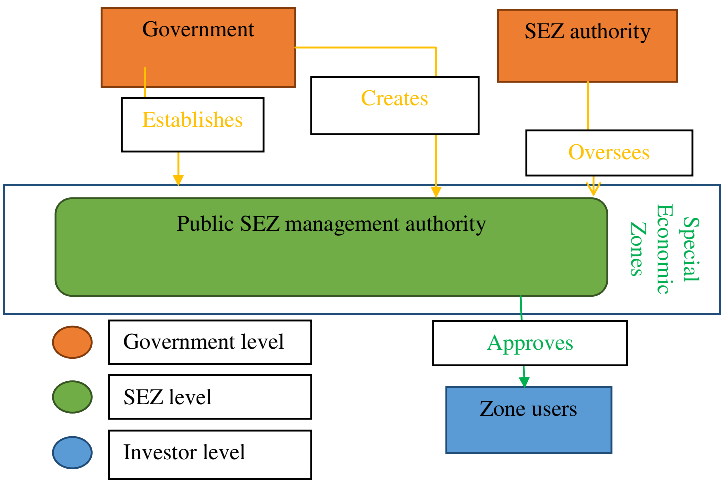
## Discussion

All the SEZs operating in Azerbaijan have been financed from the state budget. This method has negatively impacted the development of SEZs, resulting in the stagnation of the operations of many zones. In order to prevent this, the government must revise the mechanism of financing SEZs.

In global practice, there are three types of SEZ financing mechanisms: state-funded, privately funded, and hybrid financing. Figures 2-4 illustrate the state-funded, private, and hybrid management models.

*Figure 2*

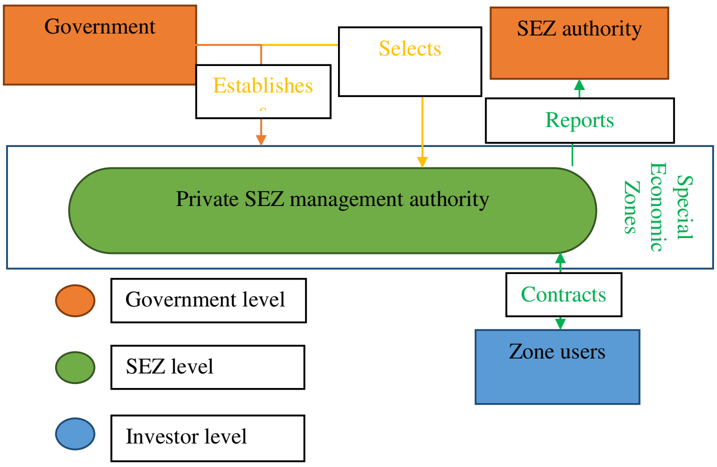
**Public management model**




Source: adapted from UNCTAD (2019).

*Figure 3*

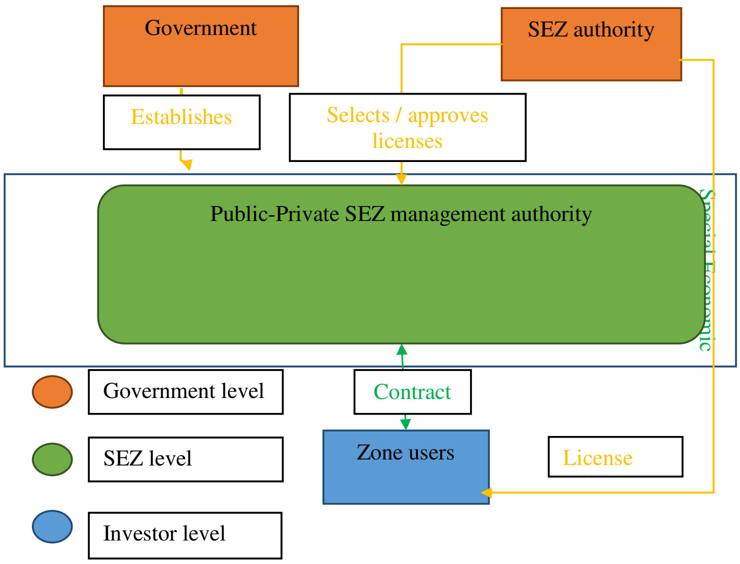
**Private management model**




Source: adapted from UNCTAD (2019).

*Figure 4*

**Hybrid management model**

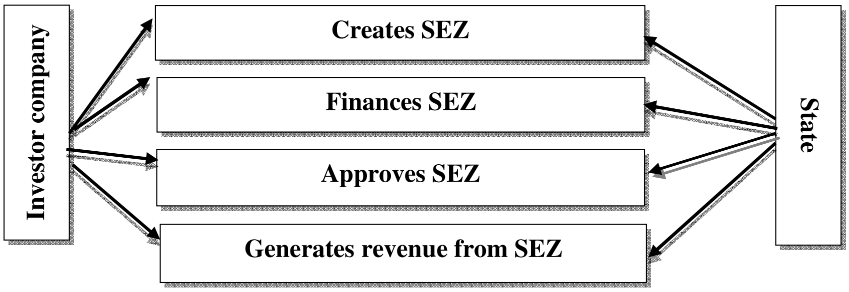



Source: adapted from UNCTAD (2019).

All types of SEZs operating in Azerbaijan follow the public management model. For the development of SEZs in Azerbaijan, it is essential to change this model and enable SEZs to be financed through alternative sources. Therefore, it is necessary to involve various corporations in the process of improving SEZ financing in Azerbaijan. These corporations could hold the «operator» status within the SEZs. Depending on the public management mechanism, a part or the entire financing responsibility would be transferred to the operator. The operator companies would directly participate in the management of the SEZ and would be responsible for its development and monitoring the admission of residents. As a result, the operator could grant resident status to projects with a long-term operating horizon and strong business plans. Moreover, the operator company could establish its production chain within the SEZ and, at the same time, attract other related companies to the zone to build the production chain. In addition, when operator companies face financial difficulties, they could obtain preferential loans from the government, indirectly allowing them to finance the SEZs. At the same time, a certain amount of funding from the state budget could be allocated to the SEZ management authority and distributed across the SEZs. Figures 5 and 6 illustrate the proposed financing and management mechanism for SEZs.

*Figure 5*

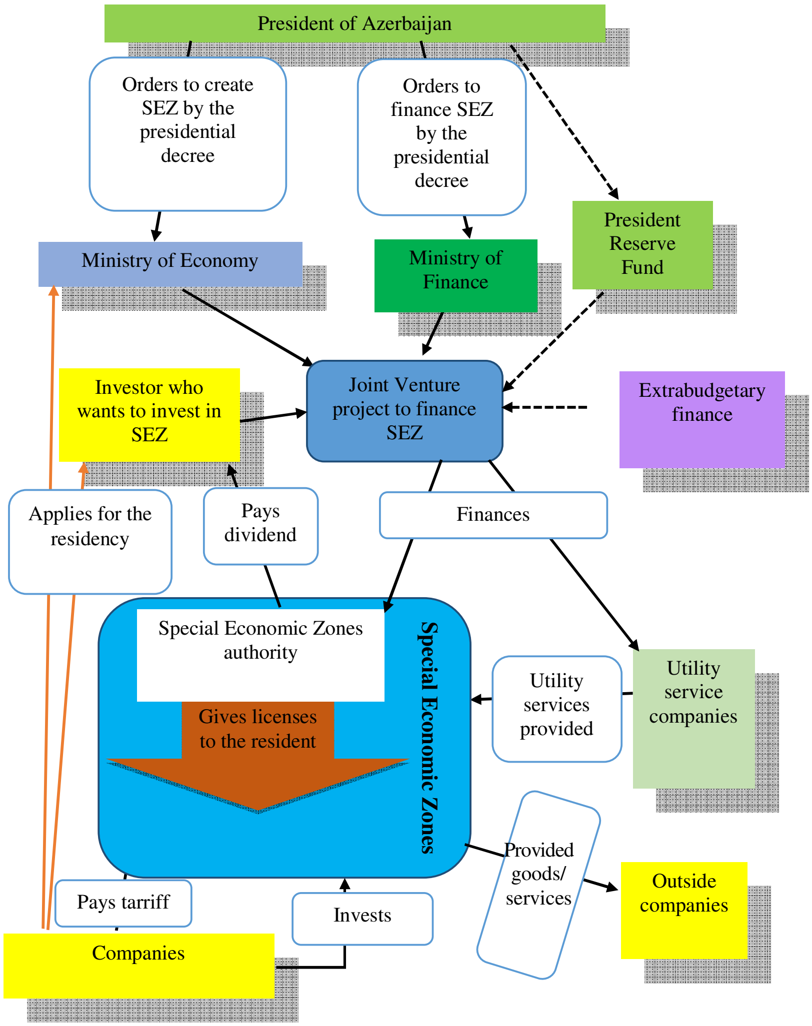
**Public-private partnership in SEZ**




Source: author's own work.

*Figure 6*

**Suggested system for SEZ finance**




Source: author's own work.

The proposed approach would have a positive impact not only on the development of SEZs, but also on the state. Under this method, the government would refrain from financing the SEZs. In addition, by transferring the management mechanism to the SEZ operator, the government would only perform the supervisory function, which would help ensure that the operator effectively performs its main supervisory duties. Ultimately, this would significantly reduce the dependence of SEZs on the government budget.

The proposed method is not used in the neighboring countries. However, Asian countries such as India and Vietnam are practicing this method. They lease and sell these areas to private investors to develop them. The private sector then becomes the operator and starts creating its own supply chain. According to the Asian Development Bank report on SEZs, out of the 100 SEZs owned by these countries, more than 70% of the SEZs belong to the private sector and the rest belong to the public sector and the government (Mangal, 2019). This method has brought a lot of investment to these countries. For example, the accumulated registered investment in Vietnam was $145 billion in 2018 (Tien & Nuong, 2020). In India, the exports from the Indian SEZ residents accounted for 19.9% of the country's total exports (Pathan, 2017). Both of these countries are emerging economies, and their continuous reforms in the SEZ sector boost this development.

Neighboring countries such as Georgia and Kazakhstan have more advanced legislation regarding SEZs. For instance, businesses operating in Georgian SEZs are subject to 0% corporate income tax, VAT, property tax, and import/export duties (PwC, 2025). In contrast, businesses operating within the country are subject to a corporate tax rate ranging from 4% to 15%, along with other tax and customs obligations. Kazakhstan's SEZs also offer businesses a variety of tax and customs incentives, including exemptions from import customs duties and VAT on goods imported for production, as well as reduced corporate tax rates (0% to 10%) for export-oriented activities. Additionally, companies benefit from property tax exemptions for up to 10 years and reduced utility tariffs, which help reduce operating costs. These incentives are designed to encourage investment and boost industrial development in the country (Konysbek, 2022).

In Azerbaijan, SEZ residents receive various tax and customs incentives, including exemptions from import customs duties and VAT on goods imported for production, as well as reduced corporate tax rates, especially for export-oriented activities. Additionally, businesses in SEZs enjoy property tax exemptions for up to 10 years and potential reductions in social security contributions and utility costs. These incentives are designed to attract investment and boost industrial development. Azerbaijani SEZs offer similar incentives to those provided by Kazakhstani SEZs. Both countries have adopted the principles and frameworks established by Russia's SEZs, which share comparable structures and incentives.

Based on the research, it can be concluded that all SEZs operating in Azerbaijan have been established and developed with state budget funding, and their legislative framework is very similar to the Russian SEZ legislation and practice. The government has hindered the development potential of SEZs through this policy. Furthermore, according to Article 5.1 of the Law on the Creation of Special Economic Zones, the sources of financing for SEZs are determined by the relevant executive authority. From this, it can be concluded that the government can use other sources to finance SEZs and no barriers have been set in this process.

## Conclusions

The analysis of SEZ financing has revealed several problems in this area. Financing SEZs solely through the state budget has proven insufficient due to the limited financial capacity of the national budget. Currently, the only successful SEZ is the Sumgayit Chemical Industrial Park. This park accounts for the majority of performance indicators among all SEZs operating in the country. The success of this park is due to its favorable location and the establishment of resident companies by other state enterprises.

To improve the operations of SEZs in Azerbaijan, reforms are necessary. SEZs are regarded as key drivers of investment activity and foreign investment inflows into the country. Furthermore, the special tax and customs regimes applied within these zones encourage residents to produce large volumes of products, which contributes to the reduction of unemployment in the country.

Based on the above analysis, we consider it essential to find alternative financing sources and change the management model of SEZs to ensure their development. These changes will enable the government to achieve full financing of SEZs despite limited budgetary resources.

The main scientific novelty of this research lies is examining the improvements to the state financing mechanism and management of SEZ under current conditions in Azerbaijan. The main focus of the analysis is on the role of state budget participation in financing SEZs. If applied to Azerbaijan's SEZs, the results will strengthen the operations of existing SEZs and facilitate the reliable establishment of future SEZs in the country.

In light of the above, we propose the following recommendations for improving SEZ financing:

First, it is important to utilize extra-budgetary funds and involve the private sector in the creation and organization of SEZs. The availability of alternative sources of funding will mitigate delays or limitations in financing SEZs. This will ensure that SEZs are organized and developed to the highest standards.

Second, it is necessary to introduce an operator status in SEZs. This will relieve the government of the task of finding residents. Operators will accept and evaluate residents independently. They will lease infrastructure and land plots to accepted residents and charge fees for their activities. For example, in the UAE, fees range from AED 2,000 to 5,000 depending on the type of resident and SEZ. These fees cover membership, annual activity, infrastructure usage, and rent. The government will evaluate the operation of the zone and, through negotiations with operator companies, determine what further actions need to be taken for further SEZ development.

Third, to ensure the effectiveness of the above proposals, certain legislative changes must also be made. The extension of the concession periods for SEZs and the imposition of lighter tax conditions for residents after the concession period ends should be considered. These changes will support the long-term operations of operators and enhance the prospects of SEZs.

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