



Assessing economic diversification opportunities and challenges: The case of Azerbaijan

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Abstract

This paper, "Economic Diversification beyond oil sector: A case of Azerbaijan," critically examines Azerbaijan's historical and ongoing "heavy dependence on its rich oil and gas fields" since 1991, which has led to economic vulnerability and "Dutch disease symptoms" due to "unexpected fluctuations in oil and gas prices" from 2014. It investigates whether Azerbaijan has achieved its proposed diversification goals, identifies decisive non-oil sectors, assesses existing economic attainments, and explores the main barriers. The underlying argument is that despite strategic efforts, including the "Strategic Road Map introduced in 2016" and subsequent "new strategy plans after 2021", the economy remains "largely oil-dependent" and faces significant structural challenges. Employing an analysis of statistical facts, information from other articles, and the "Economic Diversification Index" components (PCA output, revenue, and trade), the study reveals "low overall diversification", with domestic production (PCA Output 99.41), fiscal revenue (PCA Revenue 83.04), and export diversification (PCA Trade 74.25) highly concentrated in the hydrocarbon sector. While "agriculture and IT services showed a bit of relative resilience" during the pandemic and the non-oil economy has begun growing faster post-2021 with increased non-oil tax revenue and exports, export composition remains "highly oil-dependent (still 88 percent)". The paper concludes that "diversification is an irreplaceable target and essential necessity" for "resilient sustainable growth" and highlights key non-oil sectors like "agriculture, tourism, logistics, and industry as key pillars", alongside new opportunities such as "Attraction of Foreign Direct Investment (FDI)", "Development in Renewable Energy", "Integration of Regions and Expansion in Trade", "Post-Conflict Reconstruction of Karabakh", and "Digital Transformation and Fintech Growth". Ultimately, overcoming "deep structural challenges" such as skill mismatch, weak institutional capacity, and limited SME financing requires continuous reforms and enhanced governance for national prosperity in the "post-oil era".

Keywords: economic diversification, non-oil sectors, Azerbaijan economy, sustainable growth, structural transformation

1. Introduction

To begin with, Azerbaijan, which has unique geographical position between Caucasus and Caspian Sea, has always been in center of attention of foreigners not only being in transitional region but also because of having rich resources. The region is distinguished by its oil and gas fields that the country's economy is dependent on. Late 19 century and early 20 century which Azerbaijan was under the control of Tsarist Russia the country, because of newly discovered oil fields, became one of the main attraction places and from that time Russia (both Tsarist and Soviet) hugely took

advantage of rich oil areas to transport to Russia and develop its industry. Following the collapse of Soviet regime in 1991, Azerbaijan as a young state faced very detrimental and horrible situations which putted its existence under question. Moving to 1993-1994, after arrival of national leader Heydar Aliyev to presidency, existed policies and new ones have been continued to integrate Azerbaijan to world economy to minimize previous situations and give a breath to both nation and state for further development. From that time the government implemented many policies and took notable steps to use these rich oil and gas resources to restore government budget, to attract foreign direct investment, to expand its relations with neighbors and other world economic players and to revitalize other sectors with the help of money coming from sales of oil and gas (Babayev, 2021).

Moreover, from 1991 until today the oil and gas sectors have been key factors for the economic growth of the state and their weight is still considered high even though certain enhancements in other sectors have been observed. Especially during 2008-2014, that was the peak for the oil revenue, inflow of money to country enabled the government to develop its construction sector and new investments have been directed to tourism and agriculture to build decent infrastructure. Despite all these achievements and huge amount of money inflow to country, unexpected fluctuations in oil and gas prices made the economy and indirectly society vulnerable to even small changes, and from 2014 sharp reductions is observed in oil revenue which resulted with devaluation of Azerbaijani currency.

Furthermore, the Azerbaijani government which has always been considering diversified economic model as priority not to face unprecedented and inexperienced situations started to give more attention diversification issue. In 2016, a new Strategic Road Map was prepared to pinpoint directions of economy and determine main development areas to achieve diversification and independence from mining industry to a certain extent. After 2021, attainments of policies which were previously introduced in Road Map to flourish the country were estimated, and core failed policies and application area were determined, and weaknesses of implemented policies were clearly found out and after comprehensive reassessment new strategy plans were introduced to follow to achieve national progress.

Besides, Azerbaijan from its initial times to today has somehow achieved its certain goals such as making the state the best one in Caucasus region, increasing GDP per capita, bringing foreign direct investment, developing economic relationships with strategic countries, building necessary infrastructure for all economic sectors, investing huge money to all non-oil sectors etc. Taking all these essential achievements into account, now very significant questions must be asked as follows:

Did Azerbaijan achieve its diversification goal as it proposed before?

Which sectors can play a decisive role in diversification?

What attainments the economy already has can boost further economic diversification?

What will be the main barriers in front of our objectives?

In this paper, I kindly want to discuss which paths Azerbaijan has followed to achieve its goals, to have resilient sustainable growth which mistakes the government has done and if diversification is still in the growth process, which barriers it faces and what it should implement to be on the right way. What the paper entails is not completely new, and I don't claim that it has considerable contributions to literature, mostly it will analyze main achievements towards diversification goals and some statistical facts and information which previously discussed by other articles will be taken to substantiate main arguments, and main addition of my discussion will be about raising awareness for the importance of certain internal ignorance that must be kept at the center of discussion and attention.

Key words: Azerbaijan, diversification, oil, non-oil, energy, economy

2. Azerbaijan's oil-dependent economic model

Since 1991 that Azerbaijan gained independence, it has built its economic model by referring largely on hydrocarbon resources, especially oil and natural gas reserves in the Caspian Sea. Starting its economic program focusing on mining sector, the government kept using this research wealth to shape the fiscal system, trade patterns, investment strategies and geopolitical relationships of the country.

Historical Context and the Rise of the Oil Sector

The first and most significant and strategic effort was made in 1994 by signing the "Contract of the Century", a major agreement between the State Oil Company of Azerbaijan and a consortium of international oil companies and this has been considered the cornerstone of Azerbaijan's oil economy. After successfully gaining this opportunity, the government invested to Azeri-Chirag-Guneshli (ACG) oil fields for bringing it to a situation to maximize oil extraction and constructed Bakı-Tbilisi-Ceyhan (BTC) pipeline to make Azerbaijan key supplier of energy to Türkiye and Europe (Aybar, Rasulova & Qasimli, 2015).

Moving up to the mid-2000s, revenues from oil exports became the dominant locomotive of growth. According to statistics, between 2006 and 2014, time with high oil prices, triple in Azerbaijan's GDP, sharp reduction in poverty and essential improvements in public infrastructure and services were observed. The country through the State Oil Fund of Azerbaijan (SOFAZ) gathered copious fiscal reserves to finance national projects, particularly for the improvement of non-oil sectors and stabilize macroeconomic position (Bayramov and Orujova, 2017).

Macroeconomic Dependence on Oil

Oil-based economic model in Azerbaijan led to profound structural imbalances despite visible benefits of huge revenues and their consumptions. As of 2020:

1. Account of oil and gas revenues from export was calculated for around 90 percent
2. Share of oil income in state budget revenue was accounted over 50 percent
3. GDP growth was parallel with the rise in global crude oil prices

This heavy dependence on hydrocarbon resources made Azerbaijan's economy extremely vulnerable to global shocks in oil prices. As an example, the collapse of prices 2014-2016 triggered a recession, sharp devaluations of currency, rising inflation and a banking crisis. By referring to research results of Ibadoglu & Niftiyev (2022), this period was experienced with having weaknesses in the whole system, including poor risk management, unstable and brittle financial institutions and underdeveloped private sector.

Dutch Disease and structural Impacts

As other oil-rich countries Azerbaijan has also experienced so-called Dutch disease's symptoms, that abundance of natural resource boom leads to appreciation in currency, making non-resource sectors less competitive. This huge rise in oil exports resulted in inflation of the manat's real exchange rate, to a certain level ignoring strategies to develop agriculture, manufacturing and non-oil exports (Niftiyev, 2020).

At the early stages and 2000s of hydrocarbon era, public and private investment has been disproportionately directed toward the oil and construction sectors, with limited attention and spillovers to innovation, productivity and human capital development. Sectors with diversification potential remained underdeveloped, and the country's young and growing labor force did not overlap with employment generation.

Depletion Risks and the End of Easy Oil

Despite still having a sizeable number of reserves, in accordance with suggestions from experts, peak oil production has already passed. The country has been moving to the maturity phase of ACG field and keeping output amount stable will require higher investment in complex and enhanced recovery technologies. This strategy will not work in the long-term to fully replace the revenue although the government has been aiming to transition from oil to natural gas exports. Ultimately, facing transitions in global energy and diminished demand for fossil fuel in long-term state economy will be under risk if diversification level is not achieved as previously pinpointed.

Oil-dependent economic model of the country both resulted in rapid development in early post-independence and highly long-terms vulnerable situations. The volatility of oil market with also combination of signs in resource depletion and shift in global energy trends underlines limitations of growth strategy based on mono-sector, and inevitability and necessity of diversified economic model. The importance of serious and prompt transformation of economic foundation is the case

and the government must take responsibility to achieve this by promoting innovation, productivity and inclusion across a wide range of non-oil sectors.

3.Strategic Importance of Diversification

Diversified economic model is not an option for Azerbaijan, rather it is a strategic imperative. With economy historically driven by oil exports, Azerbaijan last 10 years faced multiple risks which are bound up with external volatility, finite resources and limited employment generation outside of the energy sector. Diversification is an irreplaceable target and essential necessity to turn the economy into a more resilient, sustainable and inclusive one. Through achieving diversification goal, the country intends to have attainments and improvements such as decent social well-being, reduction of vulnerability, promotion of competition and export potential, strengthening institutional quality, ensuring long-term sustainable economic growth and stability, and mitigating economic unpredictability and underperformance.

Improving social well-being and reducing vulnerability

While oil boom at early stages led to reduction in poverty and higher pensions, subsequent decline in oil prices and currency devaluation showed its negative impact on population's social circumstances, with sharp increase in official unemployment and poverty in 2020. The social protection system during that period and after that was deemed inefficient and series problems were observed in the pension system due to insufficient reforms and full reliance on state finances. Many investigations which conducted to analyze 2014-2020 years obviously reveal that Azerbaijan's large oil revenue and oil dependency have unintentionally created a socially vulnerable population. At this point, diversification without any doubt is strategically important to bring a more job stable market in non-oil sector into existence and achieve a robust society which will not be vulnerable to energy volatility anymore, and this will ensure social well-being in the long-term (Ibadoghlu and Niftiyev, 2020).

Promoting competition, enhancing competitiveness and export potential in global market

Industrial production mainly driven by oil, unstable national currency during devaluation period, and somehow monopolistic tendencies prevent the country to be in line with effective international trade development and accession of the state to World Trade Organization (WTO). It is crystal clear that the government was lacking to have an effective competition policy before Strategic Road Map policy, and this previously strengthened monopolies and put restrictions against participation of national economy in global value chain. After 2016 and particularly post-war period the government has been filling this gap and through more diversified economy, Azerbaijan will get a competitive and export-oriented non-oil sector, which enable it to easily integrate global market and reduce the obstacles to international trade. As an example of achievement towards diversity, development of crucial transport corridors which guarantees successful trade such as

Zangezur and Middle Corridors play a vital role to make Azerbaijan main transit zone between Asia and Europe (Huseynov et.al, 2023).

Strengthening Institutional Quality

Azerbaijan has also been experiencing weakness in institutions such as regulatory uncertainty, limited rule of law and more importantly fragmented policy implementation, and these shortcomings lessen applied efforts do diminish dependence on oil. The current government should pay more attention to eliminate these deep issues to guarantee improvement of governance, transparency, and coordination and to control corruption cases requires more reforms in judicial independence. In addition to this, a new public service model, such as ASAN service, has been playing an active role in improving government-citizen interactions. Institutions such as Small and Medium Business Development Agency (SMBDA) and AZPROMO have also actively participated in supporting SMEs, promotion of non-oil exports and attract investment. Considering these as important steps to move a more quality institutional system, they are not in sufficient level and a strong institutional framework will facilitate policy implementation and resource allocation, and this one more time signal why it is backbone of successful diversification (Ahmadov and Valiyev, 2019).

Ensuring long-term sustainable economic growth and stability

As mentioned in other parts of the paper, Azerbaijan has already started to implement its previously planned and decided policies toward sustainability and stability. In one of his speeches, president Ilham Aliyev pointed out that " for us a post-oil period has already started, and we should forget about oil and gas". When going back to 2000s and following this period till 2020, incomplete transition process and lopsided structure in industry had been observed which was lessening long-term sustainable growth and development in the country. During this period (2019), European Bank for Reconstruction and Development (EBRD) considered Azerbaijan in comparison with other Eastern partnerships less resilience in development due to claiming a failure in achieving a more diverse economy over 30 years. Diversification achievements after 2020, particularly moving to 2030 targets, will overcome problems and weaknesses stem from structure and guarantee sustainability in economic growth that not only rely on finite resources as president highlighted in 2018 (Abdullayev et.al, 2024).

International Benchmark

Azerbaijan can adapt affordable models offered and successfully applied by other resource-rich countries, let's look at those countries.

1. United Arab Emirates: Through Vision 2021 and Vision 2030, cities like Dubai and Abu Dhabi have been turned into main logistic, finance and tourism hubs, with powerful private sectors and global investment appeal.

2. Kazakhstan: the country through its "Kazakhstan 2050 Strategy" has diversified its infrastructure and industrial base, particularly in transport and agricultural zones.

3. Norway: Norway, which is the most notable example for Azerbaijan, converted its oil wealth into a sovereign wealth fund while simultaneously keeping its robust industrial and technological sectors at the high level.

Azerbaijan with unique context can learn from these countries' experiences since strategic lesson in consistent: with the correct form of combination of governance, policy reform and investment human capital, Azerbaijan can also escape resource dependence and build its unique enduring and resilient economic competitiveness (Abdullayev et al., 2024).

4. Analysis of non-oil sectors towards Diversification

Azerbaijan considers development of its competitive non-oil sectors crucial to successful jump to a diversified and resilient economy. These sectors both offer broad growth opportunities, employment and enhance regional development, technological advancement. When the government turns its head to diversification and so sustainability, it identifies agriculture, tourism, logistics and industry as key pillars for them.

Agriculture

Agriculture sector in Azerbaijan economy is distinguished by its significance for employing 35 percent of labor force in 2024, contributing considerably to food security and rural livelihoods. After independence, particularly after fluctuations in oil prices which made structural and sectoral changes urgent, the sector has seen renewed investment under the Strategic Road Map and the State Program for Agricultural.

Within the sector there are some key crops such as pomegranates, tomatoes, hazelnuts, grapes and cotton that are export-oriented commodities and their weight in agricultural revenue is huge. In 2024, the share of agriculture in GDP is calculated a bit over 6 percent and in upcoming years this amount is planned to increase to 10 percent. In addition, the share of agricultural products in non-oil exports is 23 percent in 2024, but its share in overall exports is 2-3 percent which is very low (Ismayilov, 2024). For the modernization of the sector some initiatives such as agro-parks, irrigation infrastructure development, and digital agricultural platforms (like "Agroservis") have been implemented, and after 2010s countless amount of subsidies, tax exemptions, and rural development grants have been provided to farmers to maintain development level.

However, this sector also experiences certain challenges such as poor and outdated farming methods, small and fragmented landholdings, and limited access to finance and markets that led not potentially take its advantages. To make this sector one of the main and true drivers of

diversified economy, agriculture needs deeper integration with processing, storage, and export logistics (Gulaliyev et.al, 2019).

Tourism

Locating between Caucasus mountains and having unique natural landscape bring Azerbaijan to a good position and because of cultural heritage and historical sites the tourism sector is rapidly growing, and each year number of visitors and tourists to the country increase. Karabakh region for its potential and future contribution to this sector in the near future should be mentioned here.

Promotional compaigns such as "Visit Azerbaijan" and "Experience Karabakh" by the government have been launched to boost awareness. To attract both regional and global tourist infrastructure projects, including ski resorts (Shahdag, Tufandag), national parks, and restorations of cultural heritage are being funded (Ahmadov et.al, 2021). Prior to Covid-19 sector GDP share is calculated around 4-5 percent according to the Azerbaijan Tourism Board and it is expected to exceed this amount in coming years (The World Travel & Tourism Council (WTTC) forecasts 8.2 percent share of GDP by 2025).

Azerbaijan still has weaknesses that prevent it to use its potential such as poor service quality, connectivity, lack of language support to tourists and seasonal shortages. Besides, special focus is needed to put on eco-tourism, health tourism (Naftalan) and cultural tourism and this will make the country a regional leader in sustainable tourism (AzerNews, 2024).

Transport and Logistics

Due to being in Caucasus which is transit between East and West, Azerbaijan has a strategic advantage in the logistics and transport sector. Because of this preference, the government has heavily invested in transit infrastructure, including:

1. Bakı-Tbilisi-Kars railway
2. Baku International Sea Trade Port in Alat
3. Road corridors under Middle Corridor/Trans-Caspian route
4. Digitalization of customs and integrated logistics zones

Implementation of these initiatives successful have made Azerbaijan main logistics hub within initiatives such as China's Belt and Road and EU's Global Gateway. Azerbaijan by enhancing its role as a connector between Central Asia, Europe and Middle East will increase its revenue in non-oil through port services, transit fees and industrial activities of trade facilitations (Abdullayev et al., 2024).

Industry and Manufacturing

Diversification in industry has been in process through the development of industrial parks and clusters concentrated on light manufacturing, petrochemicals, and food processing. Main examples are as follows:

1. Sumgait Chemical Industrial Park which is differentiated with its capacity in producing fertilizer, polymers, and construction materials
2. Mingachevir Textile Park is famous for to be a part of "Made in Azerbaijan" brand initiative
3. Ganja Techno Park that largely focused on electronics and light machinery to meet certain part of domestic demand

These are the main drivers of industry and manufacturing sectors which are supported by the government providing concessional loans, tax exemptions, and export support. Huge domestic demand and its proximity to emerging markets force the country to improve this sector and make it one of the engines of diversification. Of course, this sector also reveals some challenges such as low productivity, technological gaps, limited innovation and dependence on state-led investment. To maximize the sector's contribution to diversification and GDP, greater involvement of the private sector and powerful links to global value chains are indispensable.

Information about each sector obviously indicates that those hold significant potential to reshape the country's economic landscape. Sustainability because of successful diversification will require reforms in institutions, improved access to finance, skilled human capital and robust public-private partnerships (Aybar, Rasulova & Qasimli, 2015).

5. Economic Diversification Index and The Economy after the Covid-19 pandemic

Economic Diversification Index

In this section, as discussed in the whole paper, discussion of diversification is continued by particularly demonstrating index of Azerbaijan and its reasons. Diversification index as shown in the first picture of visualization is based on PCA average rate. Here PCA (Principal Component Analysis) average consists of 3 main components which are PCA output, PCA revenue and PCA trade. Let's look at what these terms represent.

1. PCA Output: This component shows diversification in domestic production, indirectly sectoral contribution to country GDP. It can be understood in a way how many sectors contribute meaningfully to GDP and whether the economy relies on a single sector (oil) or has a balanced mix (agriculture, manufacturing, services). The index number of this component is quite high

(99.41) for Azerbaijan, and it approves more concentration on few sectors (still concentrated in oil, construction and services, [picture 4](#))

2. PCA Revenue: this component focusing on fiscal revenue concentration tells us that the economy is either dependent on a narrow source of income or abundant sources (usually oil taxes and royalties). In other way, this measures government revenue sources and resilience of public finance. This component's index number is also high (83.04) and it indicates the budget heavily relies on oil or a narrow tax base (dominated by oil revenues from SOFAZ, SOCAR).

3. PCA Trade: this component (the most decisive component for those who export commodities) reflects export diversification of the country and measures product diversification in export, whether export is concentrated in one or two commodities (like oil and gas) and exposure to global price shocks. Without any doubt, export basket of Azerbaijan is concentrated (oil and gas takes huge share of export) and index number of relative component (74.25) confirms this argument ([picture 5](#)).

Taking the results of Global Economic Diversification Index for Azerbaijan ([picture 1](#)), PCA average is 85.57 which obviously confirms low diversification of Azerbaijani economy. This modest performance in the EDI comes from the economy's structural concentration in the hydrocarbon sector, limited export base and being vulnerable to external demand and volatility in price ([picture 2](#)). There is still trade and revenue diversity lag although the country has achieved improvement diversification in domestic output to a certain level after 2016's reforms towards diversification.

The impact of pandemic on the economy and main shifts and reforms after that

As happened in other economies, during pandemic period, specially from early 2020 to early 2021, Azerbaijan economy was negatively influenced and the country faced with sharp, but short-term economic contraction ([picture 3](#)). The main reasons for the economic decline of the country were the reduction in oil prices, lockdowns and trade disruptions.

1. GDP went down by (-4.3) percent, in which the oil sector experienced a higher reduction (-7.2) percent than the non-oil sector (-2.6) percent (in [picture 4](#), line of non-oil sector is above than line of oil sector)

2 Since oil revenues ([picture 5](#) shows reduction in oil exports) went down because of their low price, export and fiscal revenues also decreased

3. Due to border closures and consumer restrictions, tourism and hospitality sectors as a specific sector of service faced severe contraction, almost 50 percent

4. The state also experienced considerable slow growth in construction and transport activities due to delayed public investments and the reduction of demand in logistics

5. By contrast to these vulnerable sectors observed during this period, however, agriculture and IT services showed a bit of relative resilience to external shocks and internal lockdown. The agriculture sector's main benefits stemmed from increased domestic food demand and seasonal labor dynamics, while in the IT sector, because of working remotely and e-governance initiatives, increased digital adoption and accelerated the use of internet and digitalization process in the entire system.

6. Share of non-oil sectors in GDP was high in comparison with other years since the oil sector was more affected by the pandemic and lost its dominant share to certain level, but still dominant

7. During this pandemic period and economic downturn, unemployment experienced its maximum rate (7.2) percent due to mainly lockdowns (picture 6).

Overall, the main and decisive reason for economic reduction was still the consequence of the decline in oil prices. This concrete and clear fact in 2020 resembles 2015's period and says that in the case of oil price fluctuations, mainly oil reduction period, the country will face sharp reductions in oil revenues and so that decline of GDP.

The government for mitigation purposes this crisis took some initiatives and implemented a stimulus package worth approximately 5 percent of GDP to show its support on health infrastructure, wages, SMEs and tax deferrals. These strategic efforts somehow helped cushioning the private sector and a smoother post-pandemic recovery was enabled.

From late 2021, the reduction in unemployment (6 percent), rise of oil price and recovery of oil exports as done before pandemic period, increase in GDP (growth rate 5.6 percent in that year) have been achieved and still in the process. Particularly, from 2022 the non-oil economy has been growing faster than oil sector, and this indicates both economic resilience and some attainments in diversification goals.

Main policy shifts and structural reforms are as follows:

1. Economic resilience, digital transformation and regional development (especially in Karabakh) were prioritized by the government
2. Increase in non-oil tax revenue has reached from AZN 7 billion in 2019 to AZN 16 billion in 2023 due to new stimulus measures and tax reforms, and the policy continues for further improvement
3. The country has been experiencing expansion of non-oil exports at 1.7 billion from 2020 to over 3.35 billion in 2023.

Despite these recovery and shifts which stimulate the development of the economy, export composition remains highly oil-dependent (still 88 percent), SMEs in non-oil sectors still face limited access to finance, and in informal sectors unemployment and underemployment are still one of the main challenges.

6. Opportunities and New Boundaries

When thinking about diversification goal or getting rid of dependence on mining sector, Azerbaijan considering both internal and external opportunities and new boundaries stands at the critical juncture to reshape its economic structure. Azerbaijan following global shifts such as the green transition and digital transformation and their alignment with regional economy which offer a favorable context gained opportunity to redefine its development model. Besides, Azerbaijan can explore promising frontiers and diversification by reform momentum, using its geographical preferences and post-conflict reconstruction potential.

Attraction of Foreign Direct Investment (FDI)

Attracting sustained and strategic foreign direct investment into non-oil sectors is one of the most important attempts to accelerate diversification. Azerbaijan has already achieved this goal to a certain level by establishing a framework of investment promotion, as follows (Mammadova, 2023):

1. The Alat Free Economic Zone, that is distinguished by offering tax breaks, land access and purely simplified licensing
2. The country has strategic investment agreements with such as Türkiye (main player in the Middle East and Caucasus region, a transit country between Azerbaijan and Europe), UAE (acting in Persian Gulf and new finance center), Italy (main strategic ally in Europe and main place for energy distribution), and China (rising global power and recently penetrating in whole world, from 2025 relationships entered new era by with the presidential visit)
3. To guarantee protection of foreign investors' rights, repatriation of profits and dispute resolution mechanisms have been in action

Azerbaijan have been trustworthy for foreign investors since its resolution of regional conflict and the government has been taking very remarkable efforts to build well-functioning business climate, and combination of infrastructure development and digitized custom systems to this makes it more attractive to investors in sectors such as agribusiness, renewable energy, logistics, manufacturing and tourism. As addressed in previous section of the paper, Azerbaijan should prioritize macroeconomic stability, regulatory transparency and a more predictable and competitive private sector environment for further enhancement of FDI inflow.

Development in Renewable Energy

Azerbaijan considers renewable energy as a shift from fossil fuels a strategic opportunity and even a necessity. If keeping its oil and gas reserves outside of discussion, it has significant potential in solar, wind, and hydroelectric power, particularly in southern and western parts and in the liberated Karabakh region. In 2020, new and crucial energy agreements with Masdar (UAE) and ACWA Power (Saudi Arabia) have been signed for the purpose of increasing installed capacity in

renewables by several hundred megawatts. The country, in addition, set a target to generate 30 percent of electricity by actively using renewable sources by 2030.

Creation of green energy zones in Karabakh and East Zangezur regions empowers the environmental targets of Azerbaijan's 2030 strategy (Calibar.az, 2024). According to officials, next 5-10 years considerable development in renewable energy will play effective role in diminishing dependence on fossil fuels, attract green finance and raise Azerbaijan's position as a clean energy exporter.

Integration of Regions and Expansion in Trade

Azerbaijan's unique geographical position between Asia and Europe gives a chance to serve as a key logistics and trade bridge. Considering the advantage, the country has been investing through regional cooperation platforms such as the Middle Corridor, Belt and Road Initiative (BRI), and TRACECA in:

1. Rail and Road links which connect Georgia, Türkiye and Central Asia
2. Modernization of the Baku International Sea Trade Port
3. Integration of customs and logistics IT systems

There is a two-sided effect in which trade corridors enable the country to contribute its diversification and achieve diversification and reshape trade goals to expand to global markets. The government's active attempt to be acceptable to WTO, and trade liberalization efforts also enhance Azerbaijan's abilities to diversify its export products, particularly in agriculture, processed foods, textiles and digital services (Dunya, 2024).

Post-Conflict Reconstruction of Karabakh

Following the 2020 Second Karabakh war Azerbaijan immediately declared construction projects in liberated regions, and this offers an unprecedented opportunity to pilot a diversified and inclusive economic model. The government through pledging billions of investments started to rebuild collapsed towns, transport infrastructure, energy grids, and social services (Mammadova, et.al, 2021).

Karabakh and East Zangezur regions which are main places for realizing "smart cities" and "green zones" purposes are envisioned as hubs for:

1. Sustainable agriculture (application zones of organic farming and smart irrigation techniques)
2. Eco and cultural tourism
3. Renewable energy plants (solar and wind)
4. Industrial and logistics clusters

It is super clear that the Azerbaijani government has been giving a life to these regions not only symbolic purposes but also economic interests and it shows how Azerbaijan is committed to innovation and sustainability (AzerNews, 2024).

Digital transformation and Fintech Growth

Azerbaijan, which has been rapidly advancing its agenda for digital transformation which spans public services, private enterprise, education and finance, considers its initiatives successful under the "Digital Azerbaijan 2022-2025" strategy and this includes:

1. Expansion internet and 5G readiness
2. Developing digitization of government services (e-taxes, e-customes, ASAN services)
3. Supporting Fintech startups and mobile payment systems
4. Promoting digital literacy and importance of coding in schools

Excluding the last one, other initiatives should be considered successful to a certain level, and this should be a signal for further improvement in these fields. A well-developed digital ecosystem not only trigger enhancement of economic efficiency, support of SMEs and opening new export markets in IT services and fintech but also leads to improvement of governance, reductions in corruption and strength of resilience against external shocks (Huseynov et.al, 2025).

Azerbaijan's future development and successful diversification seem too large depend on these emerging opportunities, from foreign investment and renewable energy to regional integration and digital innovation. The government should guarantee effective coordination between the government, business and civil society to capitalize listed opportunities which are indispensable for resilience in economy, competitiveness and prosperity in the post-oil era.

7.Conclusion

Economic development and considerable level of growth have been achieved due to oil wealth, however, this dependence on hydrocarbons increased vulnerability of country to global market shocks and caused limited enhancement of more diverse and inclusive economy. Taking these gaps seriously, the government has been adapting well prepared strategic directions for the purpose of achieving diversification such as at first stage the Strategic Road Map (2016-2022) and after its assessment, Azerbaijan Strategy (2022-2030)

In non-oil sectors notable progress has been observed, particularly in agriculture, tourism, logistics and renewable energy, and new investments in infrastructure and digital transformation indicate their importance by offering new frontiers for growth. To guarantee the achievement of more inclusive and green growth, post-conflict reconstruction in Karabakh will be key player and it reveals unique opportunities to diminish dependence on hydrocarbons.

However, certain deep and structural challenges such as skill mismatch, weak institutional capacity, limited SME financing and huge regional disparities remain main constraints in front of progress. To succeed in diversification goal at a significant level, reforms must be applied such as support to private sector, enhancing governance, giving special attention to vocational education and university management and sustainability alignment, and all processes should be checked timely not to cause shortcomings.

To sum up, Azerbaijan that has been on right direction towards diversification goal regularly should criticize its steps and implementations in a critical manner and open new discussion topics to community to take advantage of their real assessments and recommendations since national prosperity and high level lifestyle of people are core values and purposes of the state and government, even they are reasons for existence of these institutions.

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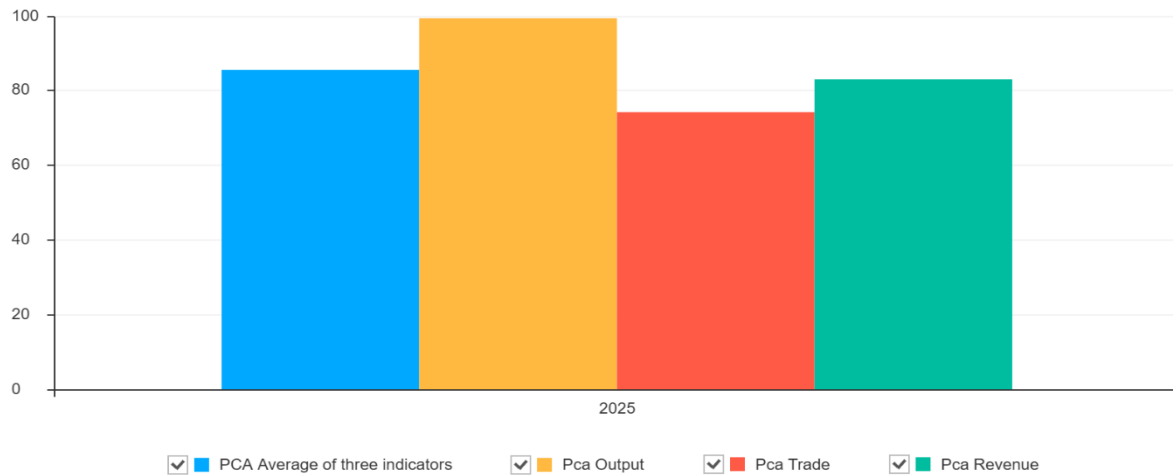
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Appendix

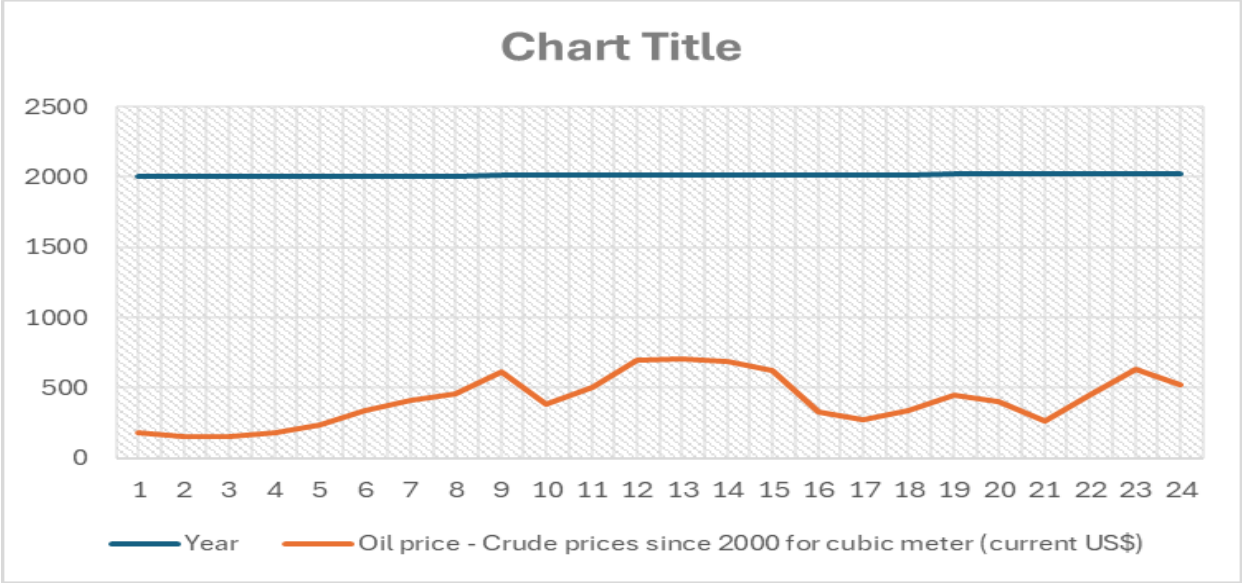
Picture 1: Economic Diversification Index with indicators



Date	PCA Average	PCA Output	PCA Trade	PCA Revenue
2025	85.57	99.41	74.25	83.04

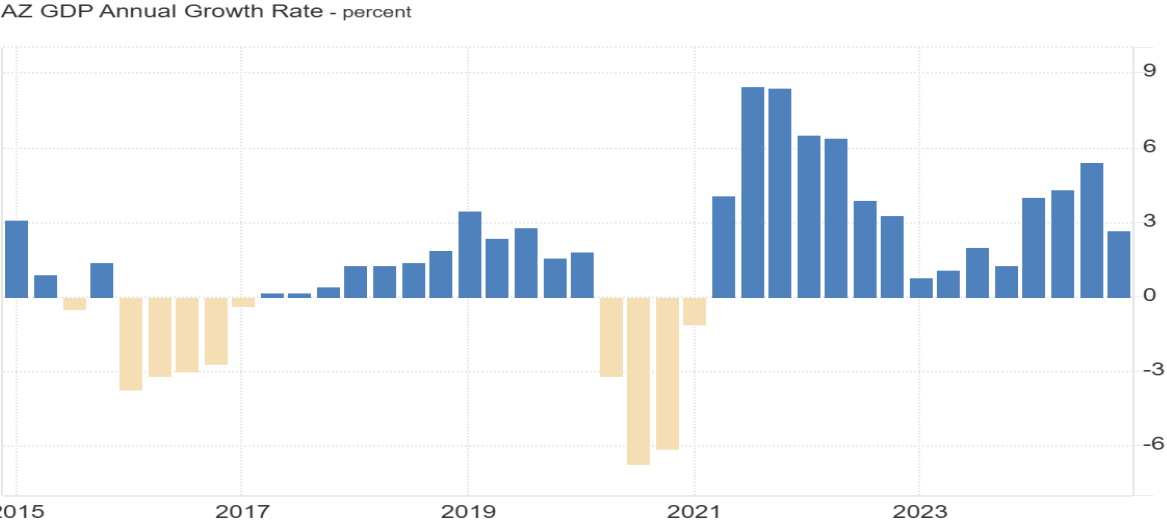
Source: [Azerbaijan - Global Economic Diversification Index](#) (Global Economic Diversification Index)

Picture 2: Crude Oil prices from 2000 to 2024



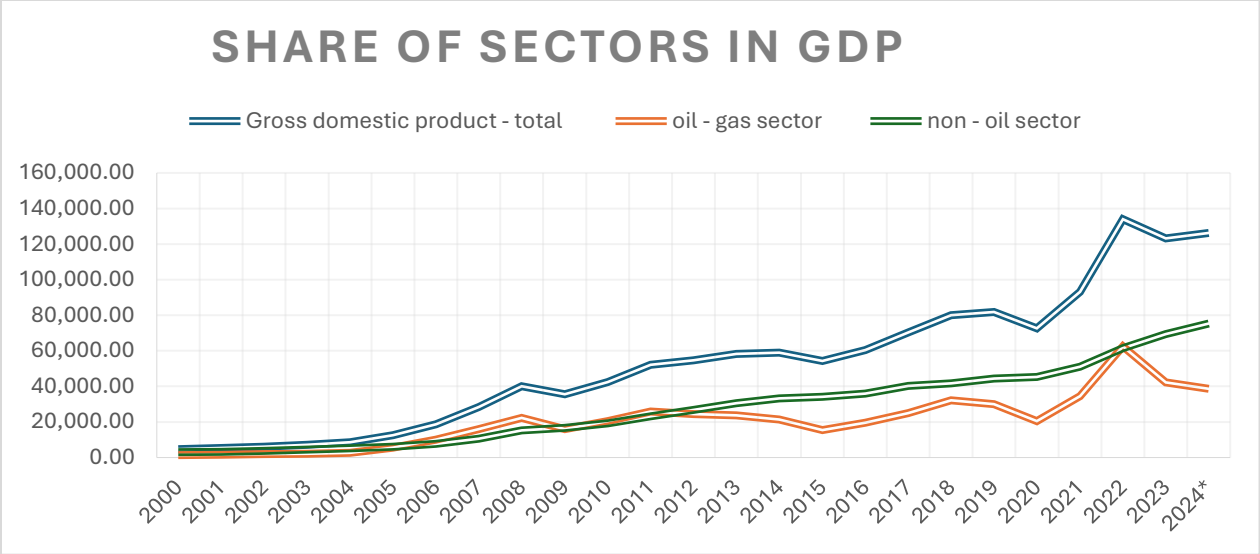
Source: [Crude oil prices](#) (Our World in Data) and chart prepared by the author

Picture 3: Annual Growth Rate of GDP



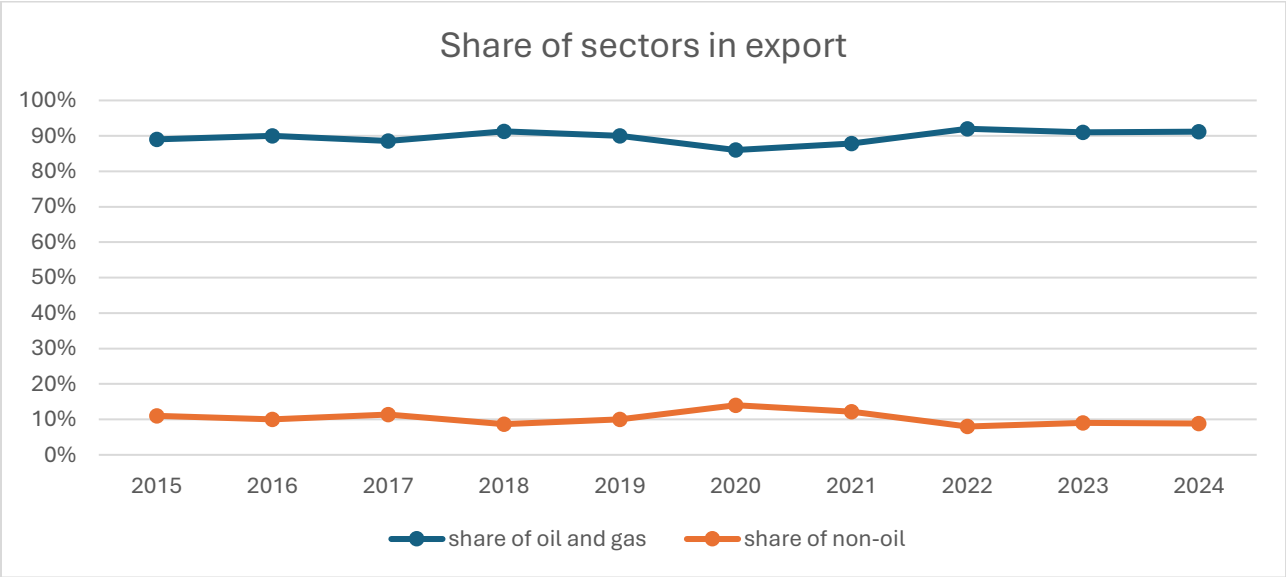
Source: [tradingeconomics.com](#) | The State Statistical Committee of the Republic of Azerbaijan

Picture 4: Share of sectors in GDP, calculated as manat



Source: prepared by the author according to State Statistics Committee’s indicators

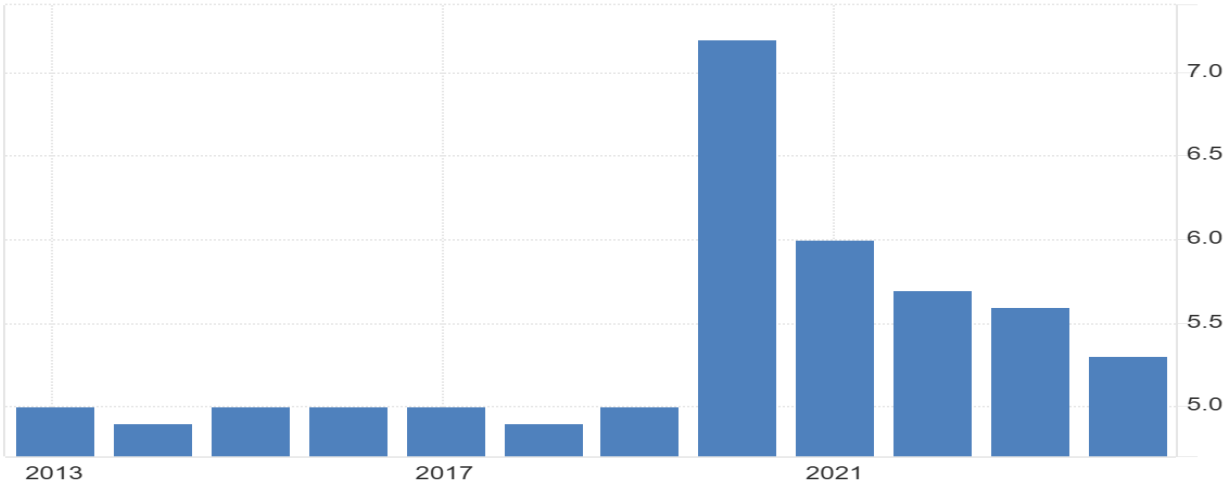
Picture 5: Share of sectors (oil and non-oil based) in exports



Source: prepared by the author according to State Statistics Committee’s indicators

Picture 6: Unemployment rate

AZ Unemployment Rate - percent



Source: tradingeconomics.com | The State Statistical Committee of the Republic of Azerbaijan

