

# **WORLD TRADE ORGANIZATION AND AGRICULTURE OF AZERBAIJAN POLICY PAPER**



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# **WORLD TRADE ORGANIZATION AND AGRICULTURE OF AZERBAIJAN**

## **Policy paper**

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## **1. Introduction**

Azerbaijan applied to become a member of the World Trade Organization (WTO) in 1997. Although more than 25 years have passed since then, our country has not yet become a member of the organization. Although bilateral and multilateral negotiations for joining the organization have intensified in recent years, it is not yet clear when the process will end.

Agriculture is one of the areas to be paid special attention to in negotiations for admission to the WTO. Because agriculture is of special importance to Azerbaijan. The potential opportunities for the development of the agricultural sector in Azerbaijan are quite wide and there are real opportunities to increase the export potential. Therefore, it is very important to focus on agriculture for admission to the WTO and to take into account the interests of the future development of agriculture in our country. Because the development of agriculture is not only a matter of food security but also a matter of national security of the country. It is no coincidence that this approach is reflected in the concept of national security of a developed country like the United States. In this article, I have tried to examine the problems that Azerbaijan's agricultural production may face during our country's membership in the WTO.

## **2. The WTO's approach to agriculture**

The WTO is an international organization established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT). The WTO is the only international organization that defines the global rules of trade between nations. Its main function is to ensure that trade is conducted in a balanced, unhindered, predictable, and free manner. The goal is to improve the welfare of the population of the member countries. The WTO regulates international trade relations on the basis of multilateral trade agreements. Although the organization is new, the multilateral trade system was created within the framework of the GATT in the 1940s and 50s<sup>1</sup>.

Currently, the WTO has 164 members, covering 98% of world trade<sup>2</sup>. The number of observer countries reaches 25, including Azerbaijan. Membership negotiations with the remaining 24 countries, excluding the Vatican, are ongoing. Decisions are made by consensus of all members. Although decision-making is possible on the basis of a majority vote, in practice such a situation has not yet occurred in the WTO. However, such cases were observed in the GATT, the predecessor of the WTO. WTO decisions are ratified by national parliaments in all member countries.

The main purpose of the World Trade Organization is to facilitate the widest possible liberalization of international trade and to create a strong basis for fair competition so that economic development can be achieved and a higher standard of living can be achieved among people.

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<sup>1</sup> [https://www.wto.org/english/thewto\\_e/history\\_e/history\\_e.htm](https://www.wto.org/english/thewto_e/history_e/history_e.htm)

<sup>2</sup> [https://www.wto.org/english/thewto\\_e/history\\_e/history\\_e.htm](https://www.wto.org/english/thewto_e/history_e/history_e.htm)

For admission to the WTO, the status of countries is distinguished and some conditions are associated with this status. According to these conditions, tariff concessions include the transition period (market access) and the amount of domestic and export subsidies in agriculture. Market access involves the reduction of tariff and non-tariff barriers to trade by WTO members. The WTO Agreement on Agriculture requires tariffs to be reduced as follows:<sup>3</sup>

- Average reduction of 36% for developed countries over six years with a minimum reduction of 15% per tariff line;
- Average reduction of 24% by developing countries over ten years with a minimum reduction of 10% per tariff line

The period of transition to tariff concessions is provided for a maximum of 25 years and can be applied to third-world countries. The duration of concessions may be different for developing countries. For example, Moldova was given 4 years, Georgia 5 years, Kyrgyzstan 7 years, and Latvia 9 years during the transition period due to tariff concessions for admission to the WTO. Less developed countries are exempted from tariff reductions. But they must carry out a process called "tariffication" – replacing non-tariff barriers with tariffs or setting "binding tariff levels" with no future increases.

The second important issue is related to the relative quotas set for the volume of export subsidies in agriculture. This quota is given in the amount of 10 percent of the total volume of subsidies for developing countries, and 5 percent for developed countries. The quota is based on the relative size of the export markets of the respective countries. Because when the agricultural subsidies of partner countries are different, it has a negative impact on international competition and general trade. The main requirement of the Uruguay Round was to regulate and reduce domestic aid.

In the WTO, subsidies are classified into boxes according to their types. These boxes are named according to the colors of the traffic light: green box (permitted), amber box (slow down - reduced), and red box (forbidden).

The WTO Agreement on Agriculture does not use a "red box", instead referring to production subsidies as a "blue box". As there are more complex issues in the agricultural sector compared to other sectors of the economy, an additional **development box** was added to the agricultural sector. Special benefits included in these programs are reflected in Article 6.2 of this Agreement. These concessions, called "Special and Differential Treatment" (S&D), are usually more beneficial to developing countries than the general rules contained in the WTO Agreement.

**Amber box:** The amber box contains subsidies regulated by Article 6 of the WTO Agreement on Agriculture. The mentioned article states that subsidies to the agricultural sector are

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<sup>3</sup> <https://wto.az/saheler/kend-teserrufati/>

permitted, but restrictions are applied. This category includes domestic production subsidies. Countries that agree with this box are agricultural countries.

The state has the right to set the prices of goods and services in the agricultural sector and can provide subsidies to encourage increased production.

At the same time, it should not be overlooked that subsidies are restricted: the "de minimis" subsidies amount to 10 percent of annual agricultural production for developing countries. In developed countries, this figure drops to 5 percent. It should also be noted that the 30 WTO member countries are allowed to apply more subsidies, but these rights are increasingly limited as the WTO reforms continue.

The WTO Agreement on Total Aggregate Measurement of Support states that subsidies are directed to the agricultural sector as a whole and not to a specific product. This destroys the concept of strategic products for WTO member countries, that is, the state cannot provide financial support for the production of specific products to be exported. One of the main issues in the recent WTO negotiations was the reduction of subsidies and the elimination of "aggregate restrictions". Currently, negotiations are underway to amend Article 1 and Appendices 3 and 4 of the WTO Agreement on Agriculture, which would mean a more liberal approach to agricultural trade.

**Blue box:** This is also called the "amber box with conditions" and is a box of agricultural subsidies that come with certain conditions. These conditions are designed to reduce distortion. Any support that would normally be in the amber box, is placed in the blue box if the support also requires farmers to limit production. At present, there are no limits on spending on blue box subsidies.

**Green box:** Subsidies eligible as part of the green box must not distort trade, or at most cause minimal distortion. They have to be government-funded and must not involve price support. They tend to be programmes that are not targeted at particular products, and include direct income supports for farmers that are not related to current production levels or prices. They also include environmental protection and regional development programmes. These subsidies are therefore allowed without limits, provided they comply with the policy-specific criteria set out in Annex 2. For example, green box support includes direct financial support to farmers that is not linked to current production levels and prices, support to farmers for agricultural restructuring, including direct payments to farmers under environmental and regional support programs.

**Development box:** Article 6.2<sup>4</sup> of the Agreement on Agriculture allows developing countries additional flexibilities in providing domestic support. The type of support that fits into the developmental category are measures of assistance, whether direct or indirect, designed to encourage agricultural and rural development and that are an integral part of the development

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<sup>4</sup> [https://www.wto.org/english/docs\\_e/legal\\_e/14-ag\\_01\\_e.htm#articleVI](https://www.wto.org/english/docs_e/legal_e/14-ag_01_e.htm#articleVI)



programmes of developing countries. They include investment subsidies which are generally available to agriculture in developing country members, agricultural input subsidies generally available to low-income or resource-poor producers in developing country members, and domestic support to producers in developing country members to encourage diversification from growing illicit narcotic crops.<sup>5</sup>

### **3. Expectations from WTO membership**

Admission to the WTO is a country-specific process that can take anywhere from three to fifteen years. Azerbaijan's membership in the WTO is important in terms of improving legislation that does not meet international standards in the field of regulation, intellectual property, and investments. Admission to the WTO will allow Azerbaijan to predict its trade policy, increase transparency, and increase trade with international partners. Investors are mainly looking for countries with a more favorable investment climate and predictable investment policies to invest in foreign countries. WTO membership makes a significant contribution to attracting foreign investments, with a positive impact on investment due to the principle of "transparency" of the WTO. At the same time, foreign entrepreneurs invest more in countries where another principle of the WTO, "national treatment" (non-discrimination between foreign and domestic entrepreneurs) is applied.

The objectives of the Republic of Azerbaijan in becoming a member of the World Trade Organization are as follows<sup>6</sup>:

- To accelerate the process of integration into the world economy system;
- To benefit from the concessions given to each other by the countries that are members of the WTO;
- To carry out trade operations with most countries of the world based on the general rules adopted by the WTO;
- To achieve an increase in assistance to the economic reforms carried out in the country by international organizations, as well as developed countries;
- To attract more foreign direct investment after applying WTO rules;
- To access the WTO's dispute settlement mechanism.

The goals of the government of Azerbaijan are as follows:

- Provision of various types of assistance (for animal and plant health standards, technical standards, telecommunications, etc.) to developing countries;

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<sup>5</sup> [https://www.wto.org/english/tratop\\_e/agric\\_e/agboxes\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm)

<sup>6</sup> <https://wto.az/azerbaycan-ve-utt/utt-ye-uzvluk#%C3%9Czv-olmaqdam%C9%99qs%C9%99d>

- Determination of the limit (de minimis) on subsidizing agriculture at the limit of 10% intended for the developed countries (5% for the IEOs);
- Acknowledgment of the importance of taking into account the special needs of developing countries during the preparation and implementation of technical regulations, standards, quality assessment procedures, and sanitary-phytosanitary measures in accordance with the TBT and SPS agreements of the WTO;
- Provision of technical assistance to the developing countries provided for in the SPS, TBT, TRIPS, and other agreements of the WTO, etc.

The focus is on agriculture, which is one of the leading sectors of the country's economy. For this reason, special demands are made against the WTO during the negotiations. The last round of negotiations was held on July 27, 2017, in Geneva. During the meeting, the Azerbaijani side demanded the following concessions from the members of the Working Group:

- 10% de minimis (from the value of goods produced in the agricultural sector)
- Total Support Indicator capacity of \$ 1 billion (across subsidies from all sources)
- Additional support for the restoration of agricultural lands after the liberation of the occupied territories of Azerbaijan (Nagorno-Karabakh and surrounding districts)
- The possibility of allocating subsidies in accordance with Article 6.2 of the WTO Agreement on Agriculture

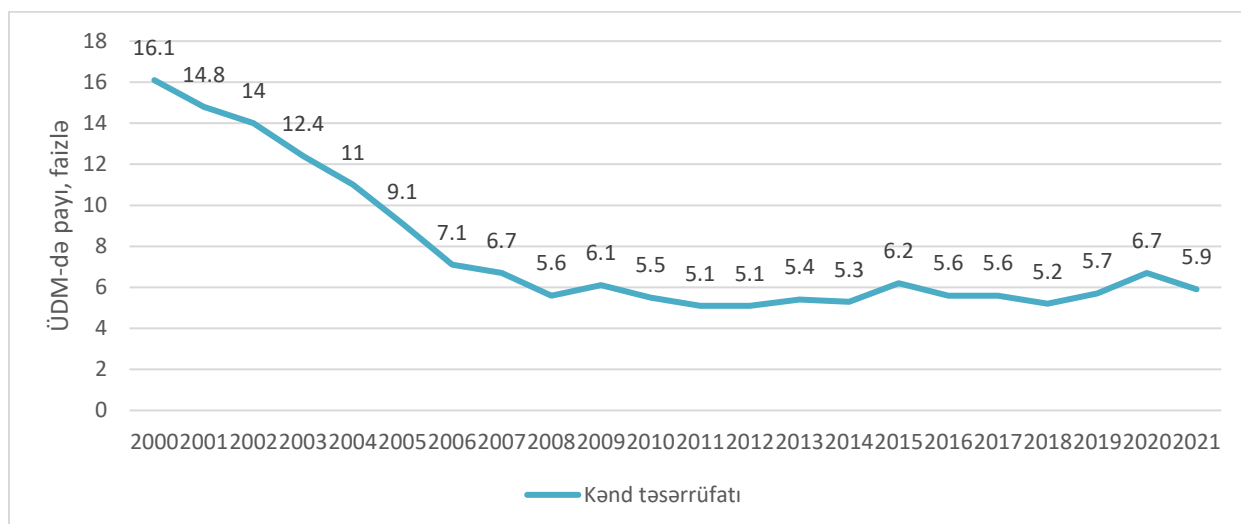
#### **4. The state of agricultural production in Azerbaijan**

Agriculture is the main occupation in Azerbaijan, and the majority of people working in this sector are engaged in economic activities to meet their personal needs rather than for commercial purposes (Figure 1). This suggests that the scope of the threat posed by this sector will be wide and effective. In this case, the villages are the most problematic area for Azerbaijan's admission to the WTO.

Agriculture is an important part of the non-oil sector of Azerbaijan's economy. This sector provides food products that constitute the main part of consumer demand. Although there has been an expansion in agricultural output in the past few years, the conditions are not right to significantly increase production. The share of agricultural production in the GDP decreased from 16.1 percent to 5.5 percent during the period 2000-2010, when the influence of the oil sector on overall economic growth was particularly strong. During 2010-2020, the share of agricultural production in GDP increased from 5.5 percent to 6.7 percent.

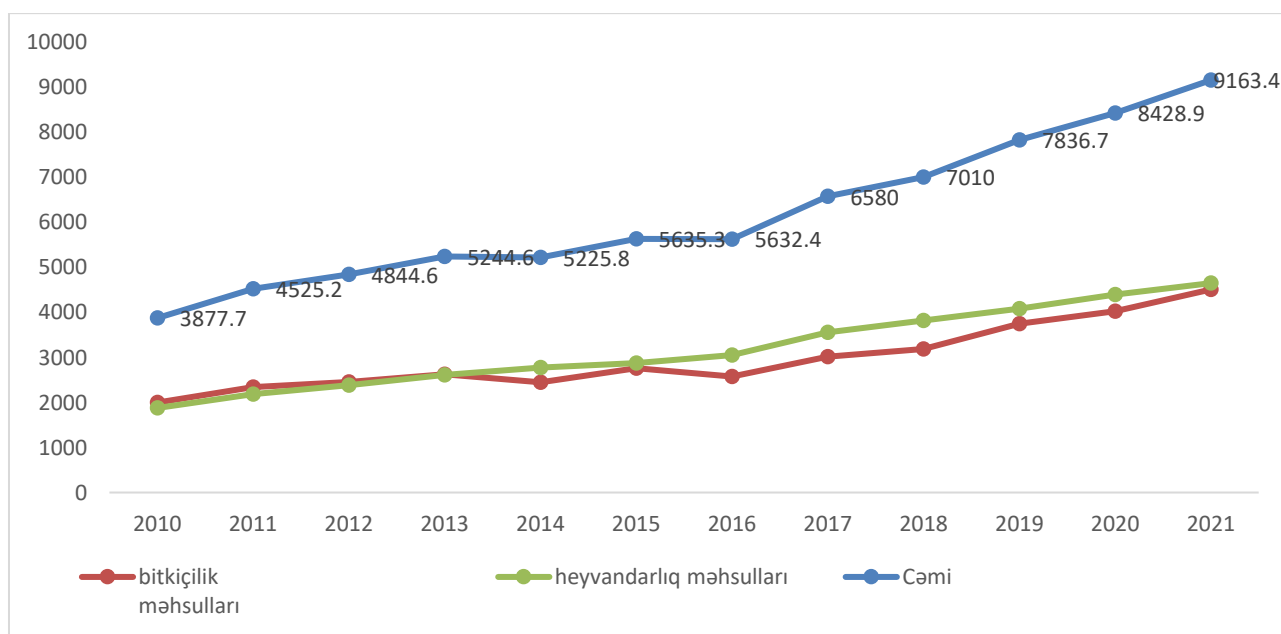
**Figure 1: Share of agricultural production in GDP (in percent)**



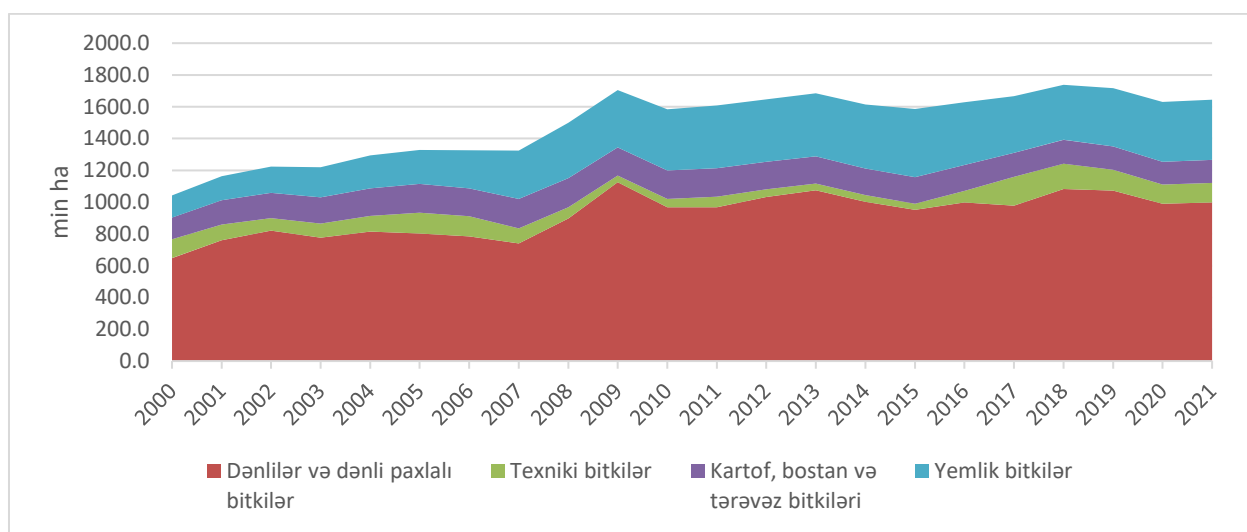


During 2021, products worth 9,163.4 million manats were produced in the agricultural sector. 4,652.4 million manats of the agricultural products produced in the country were allocated to animal husbandry, and 4,511 million manats to crop production. In exchange for the high rate of growth of animal husbandry compared to the area of crop cultivation, as well as the expansion of grain-growing areas with extensive methods, where relatively low value-added is created, due to the decline in the production of other products with high value-added, the share of crop production in the structure of total agricultural production decreased from 57.5 percent in 1995 to 49 percent in 2021.

**Figure 2: Total agricultural output, at actual prices, in million manats**



Since the 2000s, the extensive development of farmland has been noticeable. The main reason for this is the increase in the number of private entrepreneurs after independence. Compared to 1990, in 2021, the cultivated areas increased by 12.4 percent and reached 1,644.5 thousand hectares.

**Figure 3: Plantation areas of agricultural crops, by all economic categories**

The main part of the arable land (61%) is used for planting grain and leguminous crops. 23% of the arable land is used for fodder crops, 9% for potatoes, melons, and vegetable crops, and 7% for technical crops. In order to develop the agricultural sector, the government announced a large subsidy program in 2019 (effective from January 1, 2020). The program provides annual payments to farmers and companies in the agricultural sector. Subsidy for planting crops is calculated by multiplying the base amount by the yield factor. The base amount is predetermined by the state and is currently equal to 200 AZN. The coefficient of the product is also predetermined. For example, the coefficient of wheat for 2022 is 1.05, which means that the farmer/company receives 210 AZN for each acre. Relatively high coefficients are applied to stimulate the cultivation of some crops. For example, the coefficients for planting soybeans (1.3), millet (1.05), corn (1.05), and rice (1.8) are greater than 1.0. Before starting cultivation, farmers register their land and inform the relevant authorities about the crops they will grow. They are then given the full subsidy amount and these funds are transferred directly to specially issued payment cards called "Farmer cards". A farmer can withdraw only 25% of the full amount in cash. The remaining amount should be spent without cash in the places reserved for the sale of seeds, fertilizers, and other agricultural products. In the period between planting and harvesting, the competent authorities check whether everything is in order (especially whether the declared crop is grown). A one-time subsidy is given to 6 newly opened fruit farms. 11,000 manats are allocated for the establishment of lemon and kumquat orchards, 9,000 manats for the establishment of tangerine and orange orchards, 5,000 manats for the establishment of pomegranate orchards, 4,900 manats for olives, and 4,400 manats for hazelnut farms.

However, the measures taken to develop the agricultural sector have not yet produced the desired results. For example, in 2021, the largest import category of Azerbaijan was food products, accounting for 27% of the whole. Wheat imports alone accounted for approximately \$ 331 million, or 6% of total imports.

The main problem of farm subsidies is the destabilization of markets. Such artificial measures by governments can lead to overproduction, distorted product selection, etc. While governments subsidize some products, others are left out, or some groups of products receive more funding. Unless the subsidized products or their amount are very precisely defined, it may result in the overproduction of some products and the underproduction of others.

In many cases, subsidies benefit large agricultural companies or wealthy farmers rather than small and poor farmers. There are two reasons for this. A major drawback of Azerbaijan's subsidy program is that the amount of subsidy given per acre is fixed. It is given in full even to the largest landowners, except for wheat cultivation. The amount of subsidy is reduced by 20% for farmers with more than 20 hectares of land during wheat cultivation. It should be noted that the main purpose of subsidies is to protect small farmers in the local market and create conditions for their growth. But if the subsidies are not properly planned, they only lead to the easier enrichment of big entrepreneurs. Furthermore, the largest landowners benefit from economies of scale (eg, owning machinery instead of renting), so their profit margins exceed those of ordinary farmers, which distorts the purpose of these subsidies.

## **5. Conclusion and recommendations**

The lack of development of the agricultural sector in Azerbaijan hinders the full realization of the country's potential in this field. In this regard, WTO membership and adaptation of existing standards to international practice can increase productivity in the country's agriculture. This, in turn, can lead to important changes both in terms of reducing dependence on imports and increasing employment opportunities. At the same time, the government's arguments and concerns about the negative consequences of WTO membership are not insurmountable. By implementing the appropriate changes, it is possible to minimize the existing risks for WTO membership and benefit from the membership benefits. Another point is that in the government's approach to WTO membership, political issues come to the fore more than economic factors.

The following steps can be recommended for WTO membership:

- Liberalization of the business environment and improvement of the competitive environment in the country;
- Development of incentive mechanisms for the purpose of attracting foreign direct investments to the country and improvement of the legal framework related to the protection of foreign investments;
- Increasing participation in the adoption of economic decisions, especially in the field of customs and tax policy, ensuring the participation of entrepreneurs in the decision-making process that can affect their activities;
- Carrying out educational work in state bodies dealing with the management of the economic activity, as well as among entrepreneurs regarding the innovations that will be applied as a result of membership in the WTO;

- Preparation of special policy mechanisms and programs related to poorly developed agricultural areas with limited opportunities to compete with imported products.

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Reference to IDI is compulsory when using information.

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