

Efficient Water Supply as the Mainstream for the Development of the Agricultural Sector



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The President of the Republic of Azerbaijan, by his Order from 12 January 2015, announced 2015 the year of agriculture.¹ The purpose was to stimulate and expedite further development of agricultural sector in Azerbaijan. In his numerous speeches, the President has raised importance of agricultural sector in Azerbaijan's economy and in ensuring food security in Azerbaijan. According to the economic indicators, agricultural sector amounts more than 5% of GDP in Azerbaijan, which, according to World Bank data, is less than in several developing countries such as Turkey (8%), Malaysia (8.9%), China (9.1%) and others.² This indicates possibility for further potential growth of this area's proportion within Azerbaijan's economy.

In this article, we will cover the main steps made by Azerbaijani government to ensure agricultural development, global trends in agricultural sector and analysis of water issues in Azerbaijan and propositions on how these issues can be allocated.

Accomplishments

During the last several years, Azerbaijani government has taken numerous steps in order to improve agricultural sector. This includes various tax incentives, state subsidies for farmers, adopting various legislative acts for further regulation of this sector and others.

Strategic Roadmap

One of the main documents adopted is Strategic Roadmap on Production and Processing of Agricultural Products in the Republic of Azerbaijan ("Strategic Roadmap on Agriculture").³ This Roadmap envisages main priorities/strategic goals for development of agricultural sector in Azerbaijan. These priorities include:

- Strengthening institutional potential to ensure sustainability of food security;
- Ensuring easier access to financing;
- Development of science, educational and informational

consulting systems within the agricultural sector;

- Ensuring easier access of agricultural products to markets;
- Other strategic goals.

Agricultural Cooperation

The other important step by the Azerbaijani government was adoption of the Law "On Agricultural Cooperation".⁴ The named Law focuses on establishing agricultural cooperatives with the purpose of stimulation of development of agricultural sector in Azerbaijan as well as to create large-scale agricultural enterprises and to increase competitiveness of agricultural products. The Law stipulates that cooperatives may be requested to produce and supply agricultural products for state (public) needs. It also states that municipalities shall adopt local and regional development programs for cooperatives. Cooperatives shall also benefit from certain stimulating measures, including low interest credit and leasing terms as well as from the creation of credit guarantee fund.

Tax Incentives

Yet another important step in favor of the agricultural sector in Azerbaijan was introduction of numerous amendments to the Tax Code of the Republic of Azerbaijan.

It is important to note that in Azerbaijan individuals are exempt from personal income tax on the earnings made from the sale of agricultural products.⁵ Enterprises are exempt from profit tax from the earnings made on the sale of agricultural produce until 1 January 2019.⁶

Previously there was a significant ambiguity in the tax



¹ Order of the President of the Republic of Azerbaijan, 12 January 2015

² <http://data.worldbank.org/indicator/NV.AGR.TOTL.ZS>

³ Approved by the Decree of the President of the Republic of Azerbaijan, dated 6 December 2016

⁴ Approved by the Decree of the Republic of Azerbaijan, dated 18 July 2016

⁵ Article 102.1.11 of the Tax Code

⁶ Article 106.1.14 of the Tax Code

treatment of the production and sale of the agricultural products as there were no clear-cut definitions for these in the Tax Code. The recent amendments introduced definition of a production of agricultural products which is defined as:

- feeding and breeding of animals and birds (including in a special farms, automated stall systems, etc.);
- acquisition of products (in its original form, without changing chemical composition and canning) from livestock;
- cultivation of plants.

In the meantime, sale of agricultural products is defined as the sale of livestock, products obtained from livestock (in its original form, without changing its chemical composition), plant products (without changing their natural form or composition, without canning).

Moreover, according to the recent amendments to the local tax legislation VAT shall be calculated from trade mark-up during retail sale of agricultural products manufactured in the Republic of Azerbaijan. To benefit from such privileges, manufacturers should keep a separate record of the agricultural products.

Other steps

Over the past few years, Azerbaijan has signed several agreements with other countries in the area of agriculture. These include agreement with Israel on cooperation in the area of agriculture and memorandum of understanding with Qatar in relation to cooperation in the area of agriculture.

Global trends

In the era of globalization, trends in various sectors, including agriculture, may influence similar sectors in other countries. Azerbaijan is no exception. While improving separate areas of agricultural sector or amending the legal framework for this sector, global trends shall be taken into account and their deeper analysis will be helpful. Therefore, in order to better understand the potential future of agricultural sector, we need to get familiarized with global trends in this sector.

According to the analysis of main drivers of global agriculture by KPMG, there are nine megatrends that will define the world's agricultural landscape for future decades. These megatrends are:⁷

(1) Growing demand for basic agricultural products

The main factor for such growth is an increase of world's population, which is estimated to rise up to 10 billion people by 2050. Based on estimations and calculations, which includes income growth forecasts, dietary allowance and growth of population, the demand in food will grow by 60-70% by 2050.

(2) Urbanization and growth of middle class

It is expected that an average GDP per capita will grow to USD 28,000 by 2040 from USD 14,000, according to OECD. Following such growth, population of developing countries will change its dietary patterns, which will include a greater share of grain crops, sugar, vegetables, meat and other. Therefore, total energy value of consumed

food is expected to grow to 3000 kcal from 2619 kcal per person per day.

(3) Technological digitalization of agricultural production

It is expected that in the future, agricultural producers will use relevant data from satellites, drones, weather stations and etc. Agricultural robots will take greater role in product processing and packaging processes. Product processing will probably use nanotechnologies and 3D food printing.

(4) Biotechnology as growth factor

Development of new technologies that will allow using fewer resources to increase agricultural production is one of the main trends in the present. In addition, genetic improvements will be crucial in order to boost the production, without implying the creation of genetically modified organisms – GMOs.

(5) Limitation of land resources

Intensive use of land in the last 50 years has resulted in degradation of soil, water and biological resource. Approximately 25% of global land used today is degraded. As a result, the price of land is increasing.

(6) Growth of biofuel consumption

The main driver for increase of consumption level of biofuel are the regulating measures taken by governments. Such regulations depend on the willingness of governments to reduce carbon dioxide emissions and create additional income for agricultural producers. It is estimated that demand for sugar cane and vegetable oil for bio fuel will



grow by 28% and 14% respectively.

(7) Globalization

In the period of globalization, the level of competition rises, which implies that the competitors have to be big enough to compete on the global stage. Therefore, it is expected that such competition, including in agricultural sector, will further force agricultural producers to merge.

(8) Climate change

As a result of global warming, the number of extreme climatic events grows. This will possible create risks agricultural business including return on investment risks.

(9) Restricted global trade

Most governments actively support their agricultural industry. In order to ensure the free trade, countries will need to enter into bilateral agreements on free trade with other countries, as WTO agreements do not effectively liberalize the trade among countries.

⁷ <https://assets.kpmg.com/content/dam/kpmg/ru/pdf/2016/12/ru-en-services-for-agri-companies.pdf>

Water issues

Water resources are vital for sustainability and development of agricultural industry. According to OECD, farming accounts for approximately 70% of water used today.⁸ Currently, effective management of water resources remains a major challenge for most of countries. The major concerns in relation to water management are:⁹

- increasing competition for access to water;
- decreasing water quality;
- need to expand access to safe drinking water;
- deteriorating groundwater supplies;
- threat from global warming.

Considering the vital role the water resources play for agriculture industry, in order to achieve further development of agricultural sector in Azerbaijan, the closer look into water issues shall be ensured. As such, water issues were not missed in the Strategic Roadmap on Agriculture. Improvement of water supply and creation of mechanisms for sustainable use of water resources were included as priorities within the named roadmap.

Government's support with regards to water issues has intensified in the later years, as new artesian/sub artesian wells were ordered by the President to be built.¹⁰

Water relations are regulated with number of legislative acts, including the Water Code of the Republic of Azerbaijan ("Water Code"). According to the Water Code, ownership over water objects can be state, municipal and private.¹¹ Although, the Water Code allows private ownership of water objects, there are limitations with regards to such ownership. More specifically, the Water Code states "Small water reservoirs, situated on the private land areas, not having hydraulic connection with the other water objects and flows, can be given in private ownership..."¹², which limits participation of private businesses in the wider range of water relations, such as ownership of larger water objects. For the purposes of this article, one of the proposed ways to develop agricultural sector is to establish water industry as a business, which may be regulated by the government through OJSC Azerbaijan Melioration and Water Administration. It will determine relationship between businesses and consumers, ensure fair distribution of water to farmers and other industries.

Involvement of private businesses to the broader water relationship, granting these businesses with more access to water objects will, probably, add competition to this sector and will enable easier access for farmers and small agriculture companies to water resources. In addition, private businesses will be interested in effective delivery of water to the end consumer with the minimum loss or leakage, as such leakages will result in financial losses for these businesses. Moreover, involvement of private sector will promote innovation and will result in use of new technologies within the water sector. Similar process is currently implemented in Turkey, where, similar to Azerbaijan, water consumers

establish irrigation associations ("IA"). In 2011, the new Irrigation Associations Law was enacted, which redefined the status of IAs from "local administration associations" to "public legal entities", subjecting them to an administrative and technical audit and opening the possibility of the relevant state authority taking back the management of IAs and either exercising management itself or outsourcing it to the private sector by selling irrigation canals to private enterprises.¹³ Therefore, Azerbaijani government shall look at water sector (for agricultural purposes) as a separate industry, not as a supporting sub sector for other industries.

Conclusion

As seen from the above, the Government of Azerbaijan has taken numerous steps in order to support and stimulate development of agricultural sector. Among others, one of the main steps is approval of Strategic Roadmap on Agriculture. This Roadmap includes strategic goals and priority steps until 2025 and strategic view on the further period. Notwithstanding to the undertaken steps, water issues need more attention and requires institutional changes. Therefore, further involvement of private sector in this area accepting water issues as a separate industry will be helpful for addressing water matters in the agricultural area, as irrigation is a vital component of agricultural production in most developing countries, where use of technology is more limited than in developed countries. In the meantime, the global trends need to be carefully analyzed. Azerbaijan has an ambition of becoming one of the leading countries in agricultural area, therefore the main trends within agriculture and related spheres need to be tracked.



Author's biography

Mr. Seymur Niftaliyev is a Manager at the Law Practice of KPMG in Azerbaijan. He is currently involved in advising clients with legal assistance on corporate, banking, agricultural, FATCA, migration, contract and other areas. Seymur was also involved in development of various internal policies for leading companies, including conflict of interests, procurement and other policies.

Mr. Niftaliyev holds LL.M. in International Commercial Law from City University London and Bachelor degree in International Public Law from Baku State University.

¹³ Law on Irrigation Association, Republic of Turkey

⁸ <http://www.oecd.org/environment/wateruseinagriculture.htm>

⁹ <http://www.oecd.org/environment/resources/Council-Recommendation-on-water.pdf>

¹⁰ <http://president.az/articles/17174>

¹¹ Article 15, the Water Code

¹² Article 14, the Water Code