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CARBON PRICING AND GREEN TAX INCENTIVES AS TOOLS FOR ECONOMIC DIVERSIFICATION IN AZERBAIJAN: A POST-COP29 PERSPECTIVE

Açar sözlər: karbonun qiymətləndirilməsi, ekoloji vergitutma, iqtisadiyyatın diversifikasiyası, COP29, CBAM, bərpa olunan enerji təşviqləri, yaşıl iqtisadiyyat.

Ключевые слова: ценообразование на углерод, экологическое налогообложение, диверсификация экономики, COP29, CBAM, стимулы для возобновляемых источников энергии, зеленая экономика.

Keywords: carbon pricing, green taxation, economic diversification, COP29, CBAM, renewable energy incentives, green economy.

The global trend toward decarbonization has placed unprecedented pressure on fossil-fuel-dependent economies to reconstitute their fiscal and economic policies. Carbon pricing is recognized as one of the most powerful climate-related policy instruments to reduce emissions in a flexible manner [1]. For developing and transitional economies built around natural resource extraction, the global push for environmental taxation creates a fundamental tension: reconciling climate policy with the need for economic diversification. Azerbaijan provides a compelling example in this context. Oil

and gas make up two-thirds of its GDP, ranking it among the top 10 countries most dependent on fossil fuels globally. Hydrocarbons account for 90% of export income and 60% of government revenue [2]. While the country's development approach has resulted in noticeable prosperity, the recent economic growth has mostly relied on the oil and gas industry. This reliance on fossil fuels has had environmental and social costs: pollution impacts Azerbaijan's land, soil, and air, while progress in human capital development and other economic sectors has fallen behind [3]. The hosting of COP29 in Baku in November 2024 marked a significant milestone. Azerbaijan, often seen through the lens of its oil and gas wealth, is increasingly repositioning itself as an active participant in the global climate agenda, aligning its national development goals with climate mitigation efforts despite its hydrocarbon legacy [4].

This article explores the connection between green fiscal policy and economic diversification in Azerbaijan. It covers several related areas: first, an assessment of Azerbaijan's reliance on fossil fuels and the need for diversification; second, a review of existing green tax incentives and their effectiveness; third, an evaluation of Azerbaijan's preparedness for formal carbon

pricing; fourth, an analysis of external pressures, especially the EU CBAM; and finally, a set of evidence-based policy recommendations. This study employs a qualitative policy-analysis methodology based on documentary review of official Azerbaijani strategies, international reports from the World Bank, OECD, EDB/CAREC and IEA, and comparative benchmarking with other resource-dependent economies.

The economic foundation for environmental taxation is based on the Pigouvian approach, which argues that taxes on activities causing negative externalities can correct market failures by aligning private costs with social costs [5]. In the case of greenhouse gas (GHG) emissions, carbon pricing—whether through direct carbon taxes or cap-and-trade systems—aims to incorporate the environmental costs of carbon-intensive production and consumption. The dual-dividend hypothesis, proposed by Goulder (1995) and Bovenberg and de Mooij (1994), suggests that environmental taxes can offer a «double benefit»: lowering environmental damage while also generating revenue that can be used to reduce distortionary taxes on labor and capital, thus promoting economic efficiency and growth [6, 7]. This framework is especially relevant for resource-dependent economies, where reliance on volatile commodity revenues creates structural vulnerabilities that green taxation could help mitigate. Recent research has highlighted that environmental taxation serves multiple roles beyond just reducing emissions. It is seen as a vital fiscal tool that discourages harmful consumption by addressing negative externalities and encouraging the use of renewable energy [8].

The global landscape of carbon pricing has grown considerably in recent years. As of the latest assessments, 75 carbon pricing instruments (CPIs) are in use worldwide [1]. The OECD's Effective Carbon Rates 2025 report provides detailed 2023 data with updates through 2025,

covering 79 countries that together account for 82% of global greenhouse gas emissions [9]. Green tax incentives serve as a complementary fiscal strategy to carbon pricing—rather than penalizing emissions, they encourage clean investment and production. Emerging and developing economies face a USD 2.2 trillion annual investment gap for financing the energy transition, and green tax incentives such as income tax holidays, accelerated depreciation, and import duty relief on clean technologies can help attract vital investment [10]. The International Institute for Sustainable Development (IISD) has conducted thorough assessments that reveal key patterns. Green tax incentives are most effective when governments combine them with other policies such as national energy plans, power purchase agreements, local content requirements, and affordable financing through public or development banks [10].

The literature on resource-dependent economies has long identified the «resource curse» or «paradox of plenty» as a phenomenon where natural resource wealth can paradoxically hinder broader economic development [11, 12]. Recent empirical research specific to Azerbaijan confirms these trends. Results show that the oil sector's share of GDP has decreased from 41% to 27.5%, while non-oil exports and R&D expenditures have been increasing; however, the high proportion of oil revenues in the state budget remains, indicating that full diversification of the fiscal structure has not yet been achieved [13]. The World Bank has warned that Azerbaijan's development path remains vulnerable to fluctuations in global energy markets and that the country will struggle to fulfill its strategic goals if it continues to depend on oil and gas rents, noting challenges from global decarbonization [3].

Azerbaijan's economy has been characterized by deep structural dependence on oil and gas

since the development of major Caspian energy resources in the 1990s. The oil and gas sector accounts for approximately 90% of the country's exports and between 30% and 50% of its GDP depending on oil prices, and the dynamics of this sector substantially influence economic growth through both industrial activity and consumer spending linked to employment and salaries [14]. More recent data from Climate Strategies confirms that fossil fuels remain the backbone of the Azerbaijani economy, with the oil and gas sector representing 35.3% of GDP in 2023 and oil and gas revenues comprising 51.5% of total budget income [15]. The Azerbaijani government has articulated diversification as a core strategic priority. The country has adopted Azerbaijan 2030: National Priorities for Socio-Economic Development as its main framework for policy reforms [16]. Yet diversification progress remains limited. Economic diversification still has far to go, and dependence on the oil and gas industry will persist for years [14]. Based on current estimates, the country's oil reserves are expected to be depleted within the next 25 years [3], creating an urgent timeline for transformation.

Azerbaijan has the potential to be a renewable energy powerhouse, with offshore wind potential in the Caspian Sea estimated at 157 GW—vastly exceeding its current total power capacity of 8 GW from all sources [17]. The government has set increasingly ambitious targets: while the initial target was a 30% share of renewables by 2030, the country now aims to integrate approximately 2.7 GW of solar and wind capacity by 2035, which would elevate green energy's share to between 40–45% of total installed capacity [18]. Fiscal policy—through both carbon pricing and green tax incentives—represents a critical enabler for translating this potential into reality.

Azerbaijan has progressively expanded its portfolio of green tax incentives, particularly in

the renewable energy sector. In the tax reforms of the last five years, Azerbaijan has introduced several tax incentives to support the transition to a green economy, covering not only consumer vehicles such as electric cars and their chargers but also the transition of industries to renewable energy [19]. The current incentive framework for renewable energy producers is comprehensive. Azerbaijan offers the following tax incentives: exemption for income of private electricity production by residential consumers from renewable energy sources with a capacity limit of up to 150 kW; profit of renewable energy producers based on Public Private Partnership or Power Purchase Agreements up to 30 years is exempted from income tax; and VAT and customs duties for the import of machinery, technological equipment, and devices by renewable energy producers are waived [20]. Additional incentives have been documented. Renewable electricity producers are exempt from property tax imposed on legal entities for renewable energy installations with a nominal capacity of 0.1 MW and above for ten years from the date of their commissioning, and are similarly exempt from land tax for land plots occupied by such installations for the same period [21]. Furthermore, at the end of 2024, the government included responsibility for procurement in the support mechanism and provided 30-year tax incentives to encourage investment not only in green projects but also in broader economic activities [22]. In late 2024, the government also proposed exempting entrepreneurs engaged in renewable energy production from income tax, corporate tax, property tax, and land tax [22].

As of early 2026, Azerbaijan has not yet implemented a formal carbon pricing instrument—neither a carbon tax nor an emissions trading system. However, active policy discussions and international technical assistance programs are underway to evaluate options and build insti-

tutional capacity. The Partnership for Market Implementation (PMI) Program in Azerbaijan is supporting the country to strengthen its readiness for domestic carbon pricing and participation in international carbon markets under Article 6 of the Paris Agreement, including assessing existing carbon price incentives, evaluating instruments, and developing recommendations on the most suitable options [16]. A significant milestone was the International Forum on Carbon Pricing held in Baku in September 2024, organized by IOTA in collaboration with Azerbaijan's State Tax Service [23]. The World Bank recommends that Azerbaijan start with an upstream carbon tax levied on the carbon content of all fuels at the point they enter the economy, utilizing the existing excise duty system, which would cover 60% of all emissions; over time, Azerbaijan could consider expanding the scope of the tax and transitioning to an emissions trading system, with an essential component being the use of revenue to support low-income households through cash transfers [24].

The European Union's Carbon Border Adjustment Mechanism represents a paradigm shift in international climate and trade policy. The CBAM is the EU's tool to put a fair price on carbon emitted during the production of carbon-intensive goods entering the EU, and to encourage cleaner industrial production in non-EU countries [25]. For Azerbaijan, the CBAM creates both risks and strategic opportunities. If importers can prove that a carbon price has already been paid during the production of imported goods, the corresponding amount can be deducted [25]. This creates a powerful fiscal incentive for Azerbaijan to implement domestic carbon pricing: doing so would allow the country to retain carbon revenues domestically rather than ceding them to the EU [26].

Any analysis of green fiscal policy in Azerbaijan must reckon with the scale of fossil fuel

subsidies. Reducing fossil-fuel subsidies can lower the burden on the budget and help reduce the budget deficit, with savings that can be re-allocated to other more urgent social and environmental priorities [27]. Azerbaijan has made commitments to subsidy reform. As part of its climate commitments under the Paris Agreement, Azerbaijan has pledged to reduce emissions by 35% by 2030 and is working towards the gradual elimination of fossil fuel subsidies by the same year [16].

Drawing on the preceding analysis, the following policy recommendations are offered for Azerbaijan's policymakers: Consistent with World Bank recommendations [24], Azerbaijan should introduce an upstream carbon tax levied on the carbon content of fuels at the point of entry into the economy, utilizing the existing excise duty framework. An initial rate of \$4–10 per ton of CO₂, with a pre-announced escalation pathway, would provide price certainty for investors while allowing gradual adjustment. Over time, consideration should be given to transitioning toward an emissions trading system as institutional capacity develops. Azerbaijan should develop a concrete roadmap for phasing out fossil fuel subsidies, as committed under its Paris Agreement pledges [16]. Subsidy savings and carbon tax revenues should be partially redirected to direct cash transfers for vulnerable households, investment in energy efficiency for low-income residences, and green skills training programs for workers transitioning from fossil fuel industries. The current portfolio of renewable energy tax incentives [20, 21] should be consolidated into a transparent, time-bound incentive framework with clear eligibility criteria and sunset clauses. Additional incentives should be considered for energy efficiency investments, green hydrogen production, and electric vehicle manufacturing. Importantly, incentives should be designed to complement—not substitute for—carbon pricing, ensuring

coherent price signals across the fiscal system. Azerbaijan should establish a dedicated inter-ministerial working group to assess the country's exposure to the EU CBAM across all covered sectors [25], develop monitoring, reporting, and verification (MRV) systems for industrial emissions, and explore how domestic carbon pricing revenues can be structured to qualify for CBAM deductions. Revenues from carbon pricing and fossil fuel subsidy reform should be channeled into a dedicated Green Fiscal Revenue Fund, modeled partially on Norway's sovereign wealth fund principles but oriented specifically toward financing the green transition. Azerbaijan should establish clear institutional mandates for carbon pricing implementation, improve energy statistics and GHG emissions data collection, and develop transparent reporting mechanisms for green fiscal policies.

Azerbaijan stands at a consequential juncture. The confluence of depleting fossil fuel reserves, growing international climate governance mechanisms like the EU CBAM, and the political momentum generated by COP29 creates both urgency and opportunity for a fundamental recalibration of the country's fiscal framework. This study has demonstrated that while Azerbaijan has taken meaningful steps in establishing green tax incentives for renewable energy [20, 21, 22], the absence of a formal carbon pricing mechanism represents a significant gap in its green fiscal toolkit. The persistence of substantial fossil fuel subsidies [27] further undermines

the effectiveness of existing incentives by maintaining distorted energy price signals. Carbon pricing, when designed appropriately with attention to revenue recycling, social protection, and institutional capacity [24], can serve as a powerful instrument for economic diversification. It generates a new, non-extractive revenue stream; it creates market incentives for investment in clean technologies; it enhances export competitiveness in an era of border carbon adjustments; and it signals Azerbaijan's credibility as a committed partner in global climate governance. The pathway forward requires careful sequencing: beginning with an upstream carbon tax at modest rates [24], gradually reforming fossil fuel subsidies [27], strengthening green tax incentives [10], and building toward participation in international carbon markets [1]. To be globally competitive, Azerbaijan needs to focus on decarbonization, innovation, human capital, and diversification, and greening a number of sectors can propel Azerbaijan's economy towards these objectives while reducing greenhouse gas emissions [3]. The post-COP29 era offers Azerbaijan a unique window to translate symbolic climate leadership into structural economic transformation. Whether the country seizes this opportunity will depend on the political will to implement the fiscal reforms analyzed in this study—reforms that are not merely environmental in character, but foundational to Azerbaijan's long-term economic resilience and prosperity.

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**AZƏRBAYCANDA İQTİSADİYYATIN DİVERSİFİKASIYASI MEXANİZMLƏRİ KİMİ
KARBONUN QIYMƏTLƏNDİRİLMƏSİ VƏ YAŞIL VERGİ STİMULLARI:
COP29-DAN SONRAKİ DÖVRÜN PERSPEKTİVLƏRİ**

XÜLASƏ

Məqalənin məqsədi COP29-dan sonrakı dövrdə Azərbaycanda karbonun qiymətləndirilməsi və yaşıl vergi təşviqlərinin iqtisadi diversifikasiyada rolunu təhlil etməkdir. Tədqiqat çərçivəsində ekoloji vergitutma mənzərəsi, karbon qiymətləndirməsinə hazırlıq və Aİ-nin Karbon Sərhəd Tənzimləmə Mexanizminin (CBAM) təsiri qiymətləndirilir. Tədqiqatın praktik əhəmiyyəti isə iqlim siyasəti və CBAM tələblərinə uyğun konkret vergi islahatları üzrə yol xəritəsinin təqdim edilməsindən ibarətdir.

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**ЦЕНООБРАЗОВАНИЕ НА УГЛЕРОД И ЗЕЛЕННЫЕ НАЛОГОВЫЕ СТИМУЛЫ КАК
МЕХАНИЗМЫ ДИВЕРСИФИКАЦИИ ЭКОНОМИКИ В АЗЕРБАЙДЖАНЕ:
ПЕРСПЕКТИВЫ ПОСТ-COP29 ПЕРИОДА**

РЕЗЮМЕ

Целью статьи является анализ роли ценообразования на углерод и зеленых налоговых стимулов в диверсификации экономики Азербайджана в пост-COP29 период. Оценивается ландшафт экологического налогообложения, готовность к углеродному ценообразованию и влияние пограничного углеродного корректирования ЕС (CBAM). Практическая значимость состоит в разработке дорожной карты налоговых реформ, соответствующих климатическим целям и требованиям CBAM.

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