

BTI 2014 | Azerbaijan Country Report

Status Index	1-10	4.71	# 88 of 129	
Political Transformation	1-10	3.92	# 100 of 129	➔
Economic Transformation	1-10	5.50	# 67 of 129	➔
Management Index	1-10	3.96	# 97 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2014 – Azerbaijan Country Report. Gütersloh: Bertelsmann Stiftung, 2014.

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Key Indicators

Population	M	9.3	HDI	0.734	GDP p.c.	\$	10623.9
Pop. growth ¹	% p.a.	1.3	HDI rank of 187	82	Gini Index		33.7
Life expectancy	years	70.6	UN Education Index	0.760	Poverty ³	%	2.8
Urban population	%	53.9	Gender inequality ²	0.323	Aid per capita	\$	21.9

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

After a period of serious crises, Azerbaijan's situation stabilized in 2011 – 2012. In the preceding two years, the country had dealt with Russia's invasion and dismemberment of neighboring Georgia; a global financial crisis that brought an end to its double-digit growth; and a push to normalize Turkish-Armenian relations that ignored Azerbaijan's interests and worsened the country's relations with its main international partners, the United States and Turkey. In early 2011, Azerbaijan succeeded in containing domestic ripple effects of the Arab Spring.

By comparison, the last two years have been uneventful. The country has not conducted national elections, which tend to involve domestic and international controversy, and its regional environment has been relatively calm. If anything, Azerbaijan has seemed to stagnate domestically, in comparison with the rapid economic development of the past five years. Economically, the country has failed to sustain the double-digit growth that fueled the government's growing assertiveness. In fact, the country's mainstay, oil production, has actually declined each year from 2011 to 2013, and an expected boom in natural gas production is several years off. While oil industry partners are partially to blame for this situation, it nevertheless serves as a powerful reminder of Azerbaijan's overreliance on hydrocarbons, and of their finite nature. Moreover, the government has done little to kick the habit of unsustainable transfers from the country's oil fund – a third of its assets each year go to the state budget – that it used to keep the economy afloat during the financial crisis.

In political terms, Azerbaijan has similarly stagnated. A strong executive authority continues to dominate the system, but informal powerbrokers remain more important than formal institutions – a fact that reduces the power of the president to control the domestic situation. There was no change in the makeup of the cabinet, despite the fact that many ministers had served in their positions for 15 years, until early 2013, when the minister of education was replaced by a younger and Western-educated person. From 2012 onward, however, opposition activists perceived a tightening of the political space, as the government passed laws restricting NGO funding and

cracked down on opposition demonstrations. It is unclear whether these measures are related to the upcoming presidential election in autumn 2013, as many analysts believe.

Azerbaijan's foreign relations were more dynamic in the period under review. Most important was the conclusion of negotiations with Turkey over the transit of natural gas, negotiations that had dragged on for years and delayed phase two of the giant Shah Deniz gas field development. The outcome was ideal for Azerbaijan, whose state oil company will own 80% of a new trunk line to be built through Turkey. This helped normalize relations with Ankara following controversies over Turkey's aborted attempt to normalize relations with Armenia. Similarly, relations with Washington normalized during this period, though Baku continues to lament the absence of Western engagement in regional security affairs. By contrast, Azerbaijan has felt increasingly squeezed between Russia and Iran. Moscow has redoubled its efforts at forcible reintegration of the former Soviet space, a process Azerbaijan wants no part of. This contributed to the decision to end Russia's lease of the Gabala Radar Station. As for Iran, it has stepped up its rhetoric against Azerbaijan's secular system of government, and Iranian agents were reportedly involved in planned attacks on U.S. and Israeli interests in Azerbaijan.

Perhaps the most negative development has been the downward slide of the conflict resolution process over the Armenian-Azerbaijani conflict over Nagorno-Karabakh. The Organization for Security and Co-operation in Europe (OSCE) mediation process is moribund, illustrated by Washington's failure to nominate a replacement for the U.S. co-chair in the negotiation process. In the absence of a serious international effort to manage and resolve the conflict, the situation has deteriorated as Azerbaijan and Armenia both engage in steps that move the conflict toward escalation rather than resolution.

History and Characteristics of Transformation

Azerbaijan's independence from the Soviet Union occurred at a time of economic devastation and war with neighboring Armenia, and was the result of a movement for national independence led by Soviet-era dissidents in the Popular Front. This group formed the country's first post-communist government in June 1992.

In contrast with the states of Central Europe or the Baltics, Azerbaijan had little history or tradition of independent statehood to fall back on. Its first taste of freedom, in 1918 – 1920, does provide a point from which to draw some symbolic continuity. But in real political terms, that period offered little in terms of insight, precedent or practical guidance on how to run a state. Neither did the much longer period of Soviet rule; yet unfortunately, this latter era left strong and lasting marks on Azerbaijan's political culture. Indeed, many if not most of the country's high officials remain products of the Soviet system. While Azerbaijan's tradition of 19th-century liberal intellectuals is unique in the Muslim world, the last half-century offers little in that vein from which to draw. Thus, no strong traditions or institutions exist to regulate the political sphere.

The transition to independence was for most people mainly a negative experience. Generally speaking, the Popular Front government stuck to its democratic principles, but it failed to consolidate democratic institutions, manage the economy effectively or win the war with Armenia. The 1991 – 1993 period did provide a taste of personal freedom, however; the country's first president, Abulfaz Elçibey, never saw his personal integrity or democratic principles questioned. The period thus left Azerbaijan with an experience of liberty that most other Central Asian states never had. Still, when the Popular Front government collapsed in 1993, Azerbaijan appeared to be the quintessential failed state. It had lost a war and seen half its economic production disappear, while the state had abdicated central tasks including taxation, defense, the payment of salaries to officials and pensioners, the maintenance of public order, and its monopoly over the use of force. With the state failing, a parallel system of economic distribution emerged to fill the vacuum. This could be called institutionalized corruption, or more accurately, neo-feudalism.

Azerbaijan has come a long way toward institutionalizing state authority and formalizing the institutions of power and governance since those days. However, the formative years of the 1990s created vested interests and forms of social and political interaction that have yet to be undone, and that continue to determine the functioning of political relations in the country. Most crucially, these forms of interaction reflect the continued predominance of informal networks of power.

Azerbaijan's Soviet-era strongman, Heydar Aliyev, stepped in to take control and to rebuild the state, mainly using the remaining Soviet structures and Azerbaijan's oil wealth. He succeeded in normalizing Azerbaijan's economy, building a functioning state and putting the country on the map; but this took place within the framework of a semi-authoritarian system, a managed political environment that allowed for elements of dissent and pluralism but remained controlled by the executive. This system has remained in place following the transition of power from Heydar Aliyev to his son Ilham, resting essentially on the same power base.

Given the salience of informal networks, Azerbaijan has two political systems. The first, formal one separates government from opposition. The second, informal system features a host of actors, mostly officeholders in the government whose interests often diverge so much that they have fought proxy wars against one another and struggled over sectors of the economy. In this system, the president is the primary decision-maker, but even the president's influence does not extend to the core interest sectors of some of the most powerful informal power brokers. Such a system, governed by ad hoc relations rather than rules and institutions, presents daunting challenges to the transformation of Azerbaijan into a Western-style liberal democracy.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

Azerbaijan's central authorities have firm control over the country's territory, with the exception of the territories occupied by Armenia. This area, which constitutes about 17% of the country's entire territory, includes the former Nagorno-Karabakh Autonomous Oblast and seven surrounding regions. Most of these occupied territories remain empty, as Armenians have scarcely attempted to settle them – nor does Armenia in fact have the capacity to do so, in spite of periodic settlement drives, such as the current settlement of ethnic Armenians from Syria. As outsiders have been barred from entry to these territories, allegations of widespread smuggling and drug trafficking have not been corroborated.

Monopoly on the
use of force

7

There are also small areas in the Caucasus Mountains often used by radical Islamists, such as the Forest Brothers and other terrorist organizations, from which to threaten the security of the country. Government forces struggle with these groups along the border with Russia and Georgia. These groups do not control a given territory, but rather use forests to hide and survive.

The Azerbaijani constitution guarantees full citizenship rights to its entire population, irrespective of race, gender, ethnic or religious background. This guaranty is generally observed in practice. Even though Azerbaijan is a multiethnic and religiously heterogeneous country, most residents accept Azerbaijani citizenship and the inclusive concept of the nation-state.

State identity

7

The only question mark for the future – given the extensive hostility engendered by two decades of conflict between Azerbaijan and Armenia – is the extent to which the ethnic Armenians of Karabakh, nominally Azerbaijani citizens, would be accepted as citizens in practice following a possible peace deal. The Armenians of Karabakh, having declared independence with foreign support, do not accept their inclusion into Azerbaijan, a refusal that the rest of the world recognizes.

There are some marginal radical groups, which either support a vision of an Islamic state or advocate separation from the country (as is the case with some marginal radical Lezgin groups). Radical Islamic forces criticize the concept of a secular nation-state in favor of Islamic rule. This ideology lacks public support, though it is receiving increasing support from Iran and non-state actors in the Middle East and North Caucasus.

Despite formal acceptance of the nation-state and access to citizenship, many ethnic groups are underrepresented and neglected by both executive and legislative branches of government. Human rights defenders continue emphasizing the persecution of non-traditional religious groups, as well as the attempts to assimilate and silence ethnic minorities.

Azerbaijan is a secular state, and the legal order is defined by civil law. Religious organizations and members of the clergy are forbidden from participating in elections. However, Islamic traditions often influence the decision-making process, especially when it comes to gender issues or the celebration of some religious holidays. President Aliyev himself attends religious celebrations and sends greetings to Jewish, Muslim and Christian communities on religious holidays.

No interference of religious dogmas

9

Since 2010, major political debates have raged in the country over the issue of Islamic dress, particularly headscarves for girls in public schools. Islamic groups have strongly opposed the country's headscarf ban and demonstrated to obtain the right for girls to wear headscarves in school. The issue continues to be a mobilizing force for religious groups, who continue pushing it with considerable and vocal support from Iran.

Over the past 20 years, the Azerbaijani government has developed fairly detailed and comprehensive administrative structures both at the federal and provincial levels. These provide services to the population ranging from law and order to education, social services, health care and transportation.

Basic administration

7

Due to the Soviet legacy of large and centralized government, most people still expect the government to take care of basic services. Some analysts believe that the scope of government functions is too broad, failing to leave enough room for NGOs or municipalities to exist and operate freely. Moreover, the quality of services provided, while improving, remains uneven and leaves much to be desired.

The most serious problem of the administration is corruption, which permeates all levels of administration and renders the implementation of services uneven and inequitable. That said, oil wealth has enabled the state to improve the delivery of services in the past several years.

2 | Political Participation

Azerbaijan regularly holds presidential, parliamentary and municipal elections. Over the past 18 years, however, all of them have been marked by serious irregularities and fraud.

Free and fair
elections
3

Although the technical aspects of the elections, such as the organization of the voting process and the preparation of polling stations, have improved, the campaign period is still characterized by an unequal distribution of power between the ruling party and opposition forces. The latter have restricted access to the media, and are not allowed to stage street rallies, meet voters or campaign in public areas. Ballot stuffing and the fraudulent tabulation of votes are widespread. The latest parliamentary election, in 2010, was no exception. It was criticized by international observers and the local opposition as another in a series of unfair, unfree national elections. Thus, the parliament today lacks even a single truly oppositional member. Public trust in the electoral process remains very low.

In 2013, Azerbaijan will hold presidential elections. A year before these, the pressures on oppositional forces once again began to grow, including the incarceration on dubious grounds of several opposition politicians.

In Azerbaijan, the ruling party has a monopoly on power, and ensures that opposition candidates do not win election to legislative, executive, municipal or judicial bodies. At the national level, the president exercises control over the governance of the country. However, his power is limited by entrenched interests within the state elite, often holdovers from the communist period who constitute an impediment to reform, and who bring to mind medieval barons. This elite has nevertheless transformed over the past decade; whereas it originally was composed mainly of regionally based interest groups tied to the old regime, these groups have been transforming into comparatively modern, business-focused entities that nevertheless remain closely tied to a node of political power, normally a government minister. In 2013, the only positive development was the replacement of the minister of education with a younger and more reform-oriented figure, but this did not change the character of the system.

Effective power to
govern
2

Some 2,000 NGOs are active in Azerbaijan. It has become easier in recent years to form and register an NGO. The government has established a state council for the support of NGOs, which gives financial assistance to NGOs to implement various projects. Many young people, especially in the cities, are involved in some form of association, whether political or focused on broader civic goals. The rights of association and assembly are guaranteed by the constitution. However, there have been informal restrictions on the freedom of assembly since 2003, when opposition forces clashed with police after the presidential elections. Police forces today prevent

Association /
assembly rights
4

any attempts by youth or opposition groups to stage street rallies. Most members of the opposition forces are frequently harassed by the authorities, and their activities are significantly hindered. Trade unions remain weak.

In 2012, the government tightened registration rules for foreign and foreign-funded NGOs. Assembly rights also suffered after 2011 opposition protests and January 2013 civil protests in different parts of the country. Each wave of anti-regime protests was followed by a harsher crackdown on civil liberties and further persecution of political dissent. In November 2012, in response to the 2011 protests, Azerbaijan's parliament adopted amendments to the law on public assembly. In accordance with the changes to the law, fines were significantly increased for the organization of and participation in unsanctioned public gatherings.

In 2013, further restriction were introduced on the ability of NGOs to raise funds. While this appeared motivated primarily by fear of Russian or Iranian intervention in the upcoming elections, it affected all NGOs indiscriminately.

The political climate in the country grew increasingly restrictive in 2012 – 2013, which most analysts link to upcoming presidential elections. Freedom of expression severely suffered in 2011 – 2013 as a result of a series of anti-regime protests. Azerbaijan's freedom of press ranking, assigned by Reporters without Borders, dramatically decreased in 2011 and 2012. In 2011 alone, more than 50 journalists were attacked and subjected to persecution by the government. The independent mass media was under particularly intense pressure during the two international events hosted by Azerbaijan in 2012: the Eurovision Song Contest and the Internet Governance Forum. Throughout 2012, nine journalists were imprisoned in Azerbaijan, in comparison to one such imprisonment in 2011 and 2010.

Freedom of
expression
3

Azerbaijan abolished censorship in 1997. Citizens are relatively free to express their views, even if these are critical of the government. This expression takes place especially freely on the Internet through various Web sites and blogs. TV and radio channels nevertheless remain largely closed to opposition figures and critical debate, although some criticism of social problems does take place. Print is generally freer, though organizations are periodically harassed. On several other occasions, journalists have been attacked and beaten. In spite of this, regular citizens do not live in a climate of fear; they can express themselves relatively freely and have access to opposition views.

3 | Rule of Law

The executive branch continues to dominate the other branches of the government, and there is practically no functioning system of checks and balances in the country. Parliament continues to remain a rubber-stamp body, rarely challenging the executive

Separation of
powers
3

office. What separation of powers exists, remains only on paper. Parliament has spent considerable resources in the past few years building up its internal capacity in terms of hiring and training new staff, building and equipping new offices, and expanding international relations. Yet there is little political will to challenge the executive branch. Thus, the vertical power structure in the country remains strong, and most strategic decisions are made by the president.

The country's judiciary is formally independent, yet this branch's decisions are often heavily influenced by political considerations, especially in political cases, or they are influenced by corruption. Some reforms, such as the election and training of judges, have been aimed at strengthening the judicial branch. While the administrative capacity of courts may have improved, their political independence has not.

Independent
judiciary
4

In 2011, a series of flawed trials were held by the government in the aftermath of 2011 street rallies. As a result, several dozen opposition activists were convicted on different charges, ranging from possession of drugs to conspiracy. Judicial independence continued to deteriorate during the last two years. More than 280 families were displaced by legally sanctioned evictions aimed at making more space for Eurovision's facilities in Baku on the eve of the event. Demolitions under the first lady's urban renewal plan are other results of judicial weakness.

Traditionally, Azerbaijani law enforcement bodies have avoided prosecuting public officials for corruption, even though a state anti-corruption commission was established several years ago.

Prosecution of
office abuse
4

Following the revolutions in Egypt and Tunisia, the Azerbaijani government launched a public campaign against corruption in January 2011. Dozens of mid-level officials were arrested. President Aliyev himself spoke publicly on TV about the campaign. Public servants have been warned against abusing their powers or ill-treating citizens. The campaign appeared to peter out gradually, and has not changed the overall situation in the country.

However, the leaking of video tapes appearing to involve negotiations of large bribes for parliamentary seats have roiled Azerbaijani society and unsettled the government. But the majority of officials arrested on corruption charges occupied low- to mid-level positions.

The recent reawakening of civil activism, in part inspired by the Arab Spring, has led to further pressure on civil rights and liberties in Azerbaijan. Law enforcement brutality and human rights violations were reported by many human rights organizations in the aftermath of the 2011 opposition-staged rallies and January 2013 protests against abuse in the army. The crackdowns on opposition activists,

Civil rights
4

independent media and all other forms of anti-regime protest included trials, detentions, intimidation and physical assaults.

Although civil rights are protected by the constitution and the rule of law, cases of police brutality take place on a rather frequent basis. The Office of the Ombudsman has worked during the past several years to detect and prosecute such cases. This office nevertheless remains weak. The population remains largely uneducated as to the extent of its civil rights.

4 | Stability of Democratic Institutions

Although democratic institutions exist on paper, they can only function within the framework of an authoritarian regime. Certain rules and procedures govern these institutions' integration into the decision-making process, such as the necessity for a budget debate in the parliament and parliament budgetary approval. However, all of these institutions remain weak. Media groups, NGOs and political parties are more vocal, but are also often ignored by the executive branch.

Performance of
democratic
institutions
2

Democratic political culture is relatively limited. While strong backing for the concept of democracy exists in the population, politically active groups do not consistently respect these principles. In public, the government and executive authorities stress democratic institutions and the building of democracy as a long-term goal, but they do not live up to these principles in practice.

Commitment to
democratic
institutions
2

That said, a generational change is slowly taking place within the governing authority, meaning that Soviet-educated people are leaving government, and that the number of individuals exposed to Western education is gradually growing. This has yet to produce concrete results, but could ultimately change the makeup of the bureaucracy. Similarly, opposition parties are nominally supporters of democracy, but have a practice of boycotting elections. Overall, the existing system of informal rules and informal power continues to prevail, with incentives to create a new democratic system comparatively weak.

5 | Political and Social Integration

Azerbaijan has a very fragmented party system. Some 40 political parties exist in the country, of which four to five are major opposition parties that influence the national discourse. The ruling party remains dominant and wealthy. Opposition parties are often harassed and excluded from the decision-making process. Moreover, the character of opposition parties is determined by the personality of their leaders, who command the personal loyalty of party members. These leaders have remained in power in their parties for almost two decades, a period during which ideas have given way to inertia. This has further decreased the parties' legitimacy. In the past several

Party system
3

years, opposition parties have fragmented and declined in strength, largely as a result of the government's financial resources absorbing most talent in society.

In 2011, an amendment to the law on political parties was adopted, increasing the minimum number of registered party members from 1,000 to 5,000. As a result of this change, roundly criticized by the Venice Commission, a number of small parties are expected to face difficulties with registration.

There are many interest groups in the country, focusing on issues including gender, human rights and the Karabakh War, among others. They are active in the media and use Internet resources to mobilize public support. In the past few years, youth groups and alumni groups of various Western countries have been particularly active. Interest groups tend to concentrate in the capital city of Baku. But the ability of these networks to affect the political system is severely limited. In the past year, a growing number of demonstrations have been held in Azerbaijan, but these appear poorly organized and rarely develop into lasting pressure groups.

Interest groups

4

Surveys in Azerbaijan conducted by the Caucasus Research Resource Center (CRRC), as well as recent research by Collins and Owen, show a generally high level of respect for democracy and support for strengthening the rule of law. Whereas countries like Russia see relatively weak support for democracy, popular support for the concept in Azerbaijan is roughly at the level of Western countries, with over three-quarters of the population expressing support in principle. However, data is contradictory given the rise in support for Islamic Shari'ah principles, support now expressed by more than a quarter of the population. Thus the support for democracy is general and shallow, rather than developed. Furthermore, the approval of democracy in surveys often coincides with high approval of the president and preference for a paternalistic form of governance.

Approval of
democracy

n/a

The 2012 CRRC survey on Social Capital, Media and Gender in Azerbaijan revealed a generally low level of social trust among the public. However, as with many other post-Soviet societies, the bulk of social capital in Azerbaijan is centered in rather homogenous family and kinship circles and to a lesser extent in groups of close friends. Membership in such associations is based on the rights of birth, marriage or high interpersonal trust. Hence, although there is vibrant social capital within these private groups, participation in formal civil association, such as membership in NGOs, remains limited.

Social capital

3

In the capital city, the population's general level of trust is low, though many people engage with associations and civic groups. These organizations often serve common interests and are not necessarily based on trust, however. In provincial areas, the level of trust is higher, but often at an informal level that does not result in the establishment of civic organizations. More broadly, society remains accustomed to demanding action from the government rather than engaging in self-help.

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Socioeconomic
barriers
5

Azerbaijan has made significant gains in the fight against poverty. In the past decade, the official poverty level has dropped from over 50% to under 10%, and close to 1 million jobs were created, according to official figures. The country's socioeconomic development has been driven by the booming energy sector, but this also trickles down to other sectors such as construction, tourism, services, technologies and transportation. The entire population has been affected by this growth.

In 2010, the United Nations Development Programme (UNDP) office in Baku announced that Azerbaijan made the biggest jump in the world in the Human Development Index (HDI) ranking over the past five years. At the same time, oil income has led to a rapid growth in income inequality. This has evidently not yet been properly captured by available data on Gini coefficients, in which Azerbaijan ranks relatively well (with a Gini coefficient of 35 to 40).

The only population groups facing specific disadvantages are refugees and internally displaced persons (IDPs) from the occupied territories. The poverty level among these groups tends to be higher, but even there significant progress in terms of fighting unemployment and poverty has been made: All tent camps have been eliminated, and refugees have been provided housing. Nevertheless, the divide between Baku and the countryside has grown. Indeed, figures on enrollment in higher education suggest the growing exclusion of people from poorer and more remote regions of the country from educational opportunities that could in turn provide for social advancement.

Azerbaijan has not been able to compensate for the relative fall in women's participation in society, economy and politics that was associated with the collapse of the Soviet Union; in fact, the patronage structures that have dominated the country are strongly male-focused. Political power lies mainly in the hands of Azerbaijani Turkish Muslims, but Muslim minorities such as the Lezgins, Talysh and Kurds are well-integrated and represented at the highest levels.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	44291.5	52906.0	65952.8	68726.9
GDP growth	%	9.3	5.0	1.0	4.5
Inflation (CPI)	%	1.4	5.9	7.8	1.1
Unemployment	%	5.7	5.6	5.4	-
Foreign direct investment	% of GDP	6.5	6.3	6.8	7.7
Export growth	%	8.1	24.2	3.6	-
Import growth	%	-5.3	1.3	35.6	-
Current account balance	\$ M	10174.9	15040.4	17144.9	14977.4
Public debt	% of GDP	11.8	11.1	10.1	11.6
External debt	\$ M	4771.0	7209.0	8427.3	-
Total debt service	\$ M	347.8	411.1	1872.5	-
Cash surplus or deficit	% of GDP	-0.1	-0.3	1.3	-
Tax revenue	% of GDP	14.1	12.2	12.2	-
Government consumption	% of GDP	13.8	10.9	10.1	10.3
Public expnd. on edu.	% of GDP	3.2	2.8	-	-
Public expnd. on health	% of GDP	1.3	1.2	1.1	-
R&D expenditure	% of GDP	0.25	-	-	-
Military expenditure	% of GDP	3.3	2.8	4.7	4.6

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

Azerbaijan has developed rather solid elements of a market economy, such as clear rules for the registration of businesses, a tax code, banking services, anti-monopoly measures, anti-corruption measures, a court for economic affairs, and procedures for tenders and state purchases. However, these procedures are often violated by corrupt officials, who seek advantageous positions or contracts for their own businesses. In the past several years, business registration has been simplified, tax functions were placed online and anti-corruption measures have been strengthened.

Market-based
competition
4

The government has followed the example of Georgia in reducing the administrative hurdles for setting up business and public service halls that minimize interaction between state officials and citizens, reducing avenues for corruption. The World Bank's Doing Business report has noted Azerbaijan's significant progress. Nevertheless, the informal sector remains substantial, and large contracts are awarded not through competitive bidding but by state order. There have been frequent cases of privatization of large state enterprises or redistribution of ownership that have taken place without reference to legal procedures or market rules. In practice, the large businesses in the country are divided among oligarchs who double as ministers or heads of government agencies.

Azerbaijan has solid laws and legal frameworks in place to combat monopolies, but these rules are not enforced. This is especially true when it comes to awarding state contracts to private companies. Monopolies are often tied to government officials, and have been especially prevalent in the export/import sector. The customs committee is notorious for using customs procedures to prevent unwanted companies from importing or exporting certain products. The country is rife with rumors about which ministers control the export or import of certain foods or construction products. As a result, market prices are very high, which causes public dissatisfaction. If anything, oligarchic control over sectors of the economy is growing more entrenched with time, often requiring presidential intervention for the resolution of problems.

Anti-monopoly
policy
3

Azerbaijan is gradually integrating into the world economy, especially in the area of energy exports. Small amounts of agricultural products and machinery are also exported. As for imports, the country trades with most Commonwealth of Independent States (CIS) countries, the European Union and Middle East regions. The only exception is Armenia, with which Azerbaijan refuses to engage in trade and commerce. In January 2012, a new customs code, aimed at raising customs standards in accordance with international standards, entered into force.

Liberalization of
foreign trade
5

Significant barriers hinder local entrepreneurs' ability to bring products into or out of the country for sale. In this regard, the customs committee has been very corrupt and a major obstacle to trade. Negotiations between Azerbaijan and the WTO regarding trade liberalization or membership have yet to yield tangible results. Meanwhile, Azerbaijan has a significant potential to develop into both an east-west and north-south trade corridor. The problem is that corruption in the transport sector practically renders this potential moot, as high informal fees and long wait times are required to move cargo across Azerbaijan.

Azerbaijan's banking sector has boomed, with solid international standards and practices in place. Today there are about 40 banks in the country, but the central bank has been trying to decrease their numbers by increasing capital requirements. Retail banking is rather competitive. Large state enterprises often choose banks under order from the government. The International Bank of Azerbaijan, which is still state-

Banking system
6

owned, continues to dominate the market. Another major state-owned bank, Kapital Bank, was finally privatized in 2009.

The world financial crisis of 2008 negatively affected the country's banking sector. Most banks stopped issuing loans and the government had to bail out several banks. In the pre-crisis period, banks issued loans for the purchase of cars, household items and technical equipment, as well as for small business operations, the purchase of homes and repair works. The mortgage law passed by the government in 2007 significantly boosted the availability of loans for home purchases. In 2010, the law was amended so that only low-income families were eligible.

Among the key improvements in the banking sector in 2012 were the influx of investments, the expansion of non-cash payment infrastructure, as well as some steady progress with privatization of the only state-owned bank in the country, the International Bank of Azerbaijan. Another notable event was the decrease of the discount rate from 5.25% to 5% aimed at increasing credit expansion and boosting commercial banks' loan strength. In 2012, in order to strengthen capital positions of new and operating banks, the National Bank of Azerbaijan increased the capital threshold.

Significant informal barriers hinder the ability of businesses and farmers to win loans from banks, especially low-interest loans subsidized by the government. Few foreign-owned banks operate in the country. Most local banks have expanded the number of their regional branches over time.

8 | Currency and Price Stability

While pursuing its policy of targeting the exchange rate as a means of keeping corruption at bay, the National Bank of Azerbaijan in 2012 established a minimum capital requirement for all banks operating in the country. Ever since the 1992 – 1993 period of hyperinflation, the fight against inflation has been the main focus of the government's economic policy. Although rising state oil revenues in the 2003 – 2008 period also caused serious inflation, often reaching 25%, inflation rates have decreased, to around 8% in 2012. In the 2009 – 2010 period, the central bank took significant actions to prevent the depreciation of the local currency, the manat, by injecting dollars into the market. Some economists estimated that this effort to preserve macroeconomic stability cost the government \$30 million per month. In some instances, the government has also acted against monopolies, which tend to push prices upward. For example, farmers' markets have been created in the capital city in order to prevent monopolies from increasing the price of food products.

Anti-inflation /
forex policy

7

Throughout the period under review, Azerbaijan's external debt remained low. However, the non-oil fiscal deficits remained fairly high, threatening the stability of government's long-term fiscal policy. Attempts to maintain stable exchange rates for the manat against the dollar also continue to pose a challenge for the government in controlling price stability.

Macrostability
6

The government has established the State Oil Fund, which accumulates the revenues from oil and gas exports. This institution has helped preserve macroeconomic stability by limiting the flow of oil revenues into the state budget. Currently, the fund has accumulated \$34 billion. Nevertheless, the expanding state budget and often uncontrolled spending, resulting from insufficient planning and the need to satisfy popular demand, has caused some inflation and distorted macroeconomic stability. However, GDP has risen very fast in the past decade, and broad macrostability has been accompanied by political stability.

9 | Private Property

Throughout the 2011 – 2013 period, private property rights came under attack as a result of government-sanctioned evictions and demolitions of private houses in several districts of Baku. Private property is generally respected in Azerbaijan, but hurdles remain for the sale, registration and use of land, housing and other property. State officials frequently interfere with legal processes in order to extract bribes. There have also been cases of large-scale enterprises being taken away from their owners and given to new owners by government fiat. Thus, politically motivated infringements on property rights remain a problem.

Property rights
4

Private companies are viewed as the primary engine of the economy, and government officials themselves often establish private companies, though through proxies. A solid legal foundation supports the private sector's functioning. According to the State Committee on Property Affairs, over 600 businesses were privatized throughout the country in 2012. In addition, shares of 32 joint-stock companies and 620 facilities were also privatized in 2012.

Private enterprise
7

However, private companies are not yet immune from government pressure or interference. If businesspeople are in trouble with the government, they can be subjected to biased and unexpected tax inspections. Privatization procedures are well-defined, but preference is often given to companies with strong government connections. The "one window" registration system has resulted in an increase in the number of businesses over the past few years.

10 | Welfare Regime

In 2011 – 2013, the key achievements in the development of social safety nets in the country included the increase of the minimum wage by 10% and the expansion of social assistance programs. The government continued to implement previously launched social programs, such as one ensuring reliable food provision for the population (2008 – 2015) and the program for poverty reduction and sustainable development.

The government has recently conducted major improvements in this area, repairing orphanages and houses for the elderly; building housing for IDPs; establishing personal social security accounts for almost 2 million citizens through the state social protection fund; providing aid to victims of floods, fires and other natural disasters; and constructing hospitals in every region of the country. The poverty rate has been reduced in recent years. It will take time for human capital in these institutions to be developed, and the health and education sectors remain very poorly run. But results are already visible, as the government has become relatively effective, at least by post-Soviet standards, in providing assistance during emergency situations. IDPs and refugees still receive free education, free electricity and gas, and monthly food allowances. Another major area of improvement was the targeting of social benefits. As a result of a 2008 reform, social benefits are now given only to poor families, and not to all as was previously the case. Pension levels still remain low. The government's growing expenditure has helped alleviate some social problems, but the application remains uneven. However, as noted by the Social Watch 2013 report on Azerbaijan, the country's social standards still lag behind those achieved by its less economically developed neighbors Armenia and Georgia.

The constitution guarantees equal rights for all. In practice, all persons generally have equal opportunities for education and work. However, religious dogmas often prevent young girls from attending school in the country's rural areas, and although a class of professional women exists both among the older, Soviet-trained generation and the younger, Western-trained one, government offices are predominantly staffed by men. Ethnic groups lacking a strong proficiency in the Azerbaijani language are at a disadvantage in terms of finding jobs, especially in state agencies, yet ethnic origin does not appear to be a factor hindering hiring more broadly. Personal connections play a huge role in terms of finding employment.

Women's status within society dropped somewhat in the aftermath of the Soviet collapse, and social structures remain male-dominated. But educated women are often found in professional positions in the capital. Because fewer women receive adequate education, particularly in rural areas, Azerbaijan ranks badly on the Gender

Social safety nets
6

Equal opportunity
6

Equality Index and lags behind not only Eastern European countries but also its neighbors Armenia, Georgia and Russia.

Regional origin has tended to be important in Azerbaijan: Groups from western Azerbaijan and the Nakhichevan exclave have been privileged with access to power and influence. Nevertheless, these regional divisions are gradually becoming less important as Azerbaijan becomes more unified, regional identities weaken, and abilities and professional skills become increasingly important assets.

11 | Economic Performance

For the past decade, Azerbaijan's economy has boomed thanks to oil and gas revenues, general macroeconomic stability has been maintained, and inflation, on the whole, has been controlled. The government has taken measures to develop the non-oil sectors of the economy by giving loans to farmers, establishing mortgage loans, and promoting tourism, healthcare and education. However, these efforts largely remain stymied by a combination of corruption and elements of the "Dutch Disease." GDP growth, in the double digits in the 2005 – 2010 period, has slowed to barely positive in 2011 and 3.8% in 2012. Foreign direct investment (FDI) remains tightly concentrated in the oil and gas sector, and attracting FDI to the non-oil sector remains one of the country's most pressing tasks.

Some of the national statistics remain troubling: More than 90% of the country's exports continue to come from the oil and gas sector, for example, while more than 90% of the taxes collected come from the capital city of Baku. The state budget remains heavily subsidized by the State Oil Fund. Indeed, the transfers from the oil fund to the budget amounted to less than \$1 billion in 2007, but to over \$12 billion this year, almost a third of the fund's assets. In other words, the oil fund appears to be failing its main purpose of saving the oil windfall for future use. Instead, the country has grown dependent on large yearly transfers from the fund amounting to between a third and two-fifths of the budget. This is especially problematic as Azerbaijan's oil production is likely to gradually stagnate, and the income cannot realistically be replaced by the growing export of natural gas.

12 | Sustainability

Since Azerbaijan declared 2010 the year of the environment, major investments have been made in the environmental field. These have improved drinking water quality with new pipelines, water reservoirs, canals, and purification stations. A state program on environmental cleanup was adopted, slated to cover the next 10-year period. A separate project has been established to preserve forests and national parks.

Output strength
6

Environmental
policy
6

Cleanup of oil-polluted areas is taking place. There are plans to build wind turbines in the suburbs of Baku.

Enforcement of regulations has been a problem, as in other areas, and the environmental legacy of several hundred years of oil exploitation in the Absheron peninsula will take time to reverse; the effects of Soviet-era polluting industries are particularly problematic. Though a significant improvement is underway, the boost of activity in 2010 – 2011 does not seem to have been sustained.

Azerbaijani secondary schools and universities remain in very poor shape, plagued by corruption, inefficient teaching, a lack of textbooks and computer equipment, and poor facilities. The general level of education in the country remains low, and spending on education has not taken off. Quite to the contrary, as the country's GDP has grown, spending on education in relative terms has decreased sharply from an average of 18% to 20% of overall state spending in 2005 – 2006 to less than 12% in 2009; and it declined from 3.2% of GDP in 2009 to 2.8% in 2010, the last year for which figures are available. Spending on research and development as a proportion of GDP stands at an extremely low 0.2%, and Azerbaijan has the second-lowest tertiary education enrollment ratio among the 15 post-Soviet states. The chief problem is that the Ministry of Education remains unreformed.

Some positive steps have been taken with respect to creating new institutions of higher education. In 2012, expenditures on education were increased, particularly with the assistance of the State Oil Fund, which allocated over \$10 million for study abroad programs for Azerbaijan's young people. The Azerbaijan Diplomatic Academy, which is in the process of being transformed into a full university, operates outside the auspices of the Ministry of Education and has a reputation for being free of corruption. Similarly, a tourism institute and a branch of the Moscow State University have opened. However, education remains perhaps the most neglected sector in the country. The appointment of a young, United States-trained lawyer and former deputy minister of economy, Mikayil Jabbarov, as minister of education in early 2013 provides hope that the sector will finally receive the attention it desperately needs. However, that remains to be proven.

Education policy /
R&D
4

Transformation Management

I. Level of Difficulty

Azerbaijan has relatively favorable conditions for governance, including rich natural resources and an educated population. Yet several factors impede its development. First, the Armenian occupation of a sixth of the country's territory and the constant threat of renewed war puts the country in a difficult situation. Negotiations between the Armenian and Azerbaijani presidents have produced little by way of results. The conflict has been escalating in parallel with the absence of serious international attention, to the point that the risk of renewed war is considered to be growing.

Structural
constraints

6

Second, great-power rivalries associated with the country's landlocked geopolitical location make things difficult. Russia, Iran and other powers compete for influence over Azerbaijan, and in the period under review, the regional situation worsened. U.S. efforts to bring about normalization of Turkish-Armenian relations ignored Azerbaijan's interests, and tensions between Iran and Azerbaijan have grown, owing to growing Iranian interference in the country's domestic affairs. Official Baku continues to walk a careful line in terms of foreign policy, but these rivalries are beyond Baku's control – it can have only a limited effect, but is strongly affected by what others do.

Third, transnational criminal groups and terrorist organizations pose another threat. In 2012, authorities thwarted planned Iranian-sponsored terrorist attacks against Israeli and American targets in the country.

Fourth, Azerbaijan is landlocked, dependent on foreign countries for the export of the oil and gas that comprise the overwhelming majority of its foreign earnings. Finally, Azerbaijan still suffers from the Soviet legacy, including the absence of infrastructural connections to world markets. These connections have slowly been built over the past decade, but much remains to be done.

Azerbaijan's civil society traditions are very weak. In terms of indigenous traditions, Azerbaijan is an authority-accepting and rather hierarchical society, in which the population has no tradition of organizing to obtain results. Still, in the context of the broader Muslim world, Baku in the late 19th century developed its own intelligentsia and culture, which could have been an embryo of modern civil society. That potential

Civil society
traditions

7

was crushed by the seven decades of Soviet rule; civic organizations during the Soviet period were controlled by the totalitarian state. Moreover, the 1937 purges more or less physically eliminated the nascent Azerbaijani intelligentsia. It was only in the 1970s that it can be said to have emerged from these ashes. Most current NGOs were established by intellectuals and lack funding. Only a few of the country's NGOs genuinely seek to solve a social problem and form voluntary associations in the Tocquevillian sense.

The Nagorno-Karabakh conflict, which has ethnic tensions at its roots, remains the only violent conflict in the country. Although a ceasefire has been in effect since 1994, and no major military activities are underway, sporadic outbreaks of violence do take place. These have been escalating in the past three years, leading to worries of renewed war. Representatives of minority ethnic groups, such as the Lezgin and the Talysh, have in the past advocated for separation, but at the moment remain quiet. Social dissatisfaction and religious radicalism are other potential sources of violent conflict in society. In April 2012, there were clashes between armed Islamist militants and police in the second largest city, Ganja. There have been violent clashes between police forces and religious radicals, with Iranian interference serving to press these groups into action. In 2012 - 2013, a series of public demonstrations were repressed by police.

Conflict intensity
4

II. Management Performance

14 | Steering Capability

Abundant oil revenues and overall political stability have allowed the government and the president to engage in long-term thinking, and enabled them to start planning major government programs. Low-level officials often try to rush project implementation in order to please the president or meet the demands of the electoral cycle. Nevertheless, several strategic projects have developed a long-term focus, including state programs on youth, ecological cleanup, socioeconomic development and educational reform. Large construction projects have also been implemented, with significant long-term funding attached.

The government was much less efficient at implementing its foreign policy. The key priorities outlined by the regime were the peaceful resolution of Nagorno-Karabakh conflict, the elimination of risks to security and territorial integrity of the country, and the strengthening of regional stability. While peaceful negotiations with Armenia have failed to bring positive results throughout 2011 – 2012, tensions with Iran

Question
Score

Prioritization
5

continued, exacerbated by Iran's attempts to raise concerns over the minority rights of Lezgins, an ethnic minority in southeast Azerbaijan.

Domestically, the government's main policy priority was the implementation of a pluralist democracy, supported by the market economy and the rule of law. In reality, however, the last two years have been marked by the decline of democratization, the entrenchment of authoritarianism and the reduction of civil and political freedoms.

Due to the increase in oil and gas revenues, implementation of projects and policies has improved over the past decade. The only real constraints remain widespread corruption and the lack of qualified personnel. Government agencies often have good ideas and projects, but are unable to find the right people to implement them. The education sector and the quality of graduates retard the country's social and economic development.

Implementation

4

Moreover, there have been several examples in which the government has launched megaprojects that have partly or completely failed. The construction of the largest flag pole in the world, which later had to be taken down, is one example. Other projects, such as the Baku-Kars railway and Baku-Oguz water pipelines, have suffered significant construction delays and overspending. Government officials often rush project implementation, compromising the quality of the work; moreover, the overspending often appears related to the siphoning of money off projects for officials' private purposes.

Nevertheless, when the government attaches high priority to a project, it tends to successfully implement it, such as large strategic projects in the energy and transportation spheres. The diversification of the economy and the reduction of its reliance on oil revenues continued to be among the government's main economic priorities during the period under review, and a slight increase in real GDP, as a result of growth in non-oil sectors, was achieved in 2012. Modest progress was also made on other economic priorities: negotiations for accession to the WTO and opening cross-border trade.

Unlike the relatively effective implementation of economic policy priorities, the government has been less successful in decentralizing the political system and facilitating democratic reform. The main obstacles are the unwillingness of the ruling regime to introduce changes in political governance, the entrenchment of the country's elites, and their reliance on autocratic, patrimonial methods of governance.

The strengthening economy and rising oil revenues have made government officials bolder and more arrogant. With less need for Western money, they often brush aside Western ideas, consultancy and advice. On the other hand, the country has been independent for nearly 20 years, and some local experience has accumulated. The government continues to work with the World Bank, the United States Agency for International Development (USAID) and other donor agencies on some know-how

Policy learning

4

projects. As a whole, however, stovepiping and top-down management remain the rule.

15 | Resource Efficiency

Wasteful budgetary spending is very common in Azerbaijan. Little transparency exists with respect to the awarding of government contracts. Government officials care very little for savings or conservative fiscal policy. Mismanagement and the abuse of public funds are also very common. This has partly to do with the mentality of a newly oil-rich country. The sense that there will always be oil and the country will always be rich is pushing government officials toward inefficient spending. The same applies to the way the government treats its Western-educated staff members, who often remain outside key decision-making positions. However, the government has in recent years made considerable investments in infrastructure development and in sending students abroad for education. During the past two years, the government has been fairly effective in balancing the state budget. For instance, in 2012 revenue rose to 5.7% of GDP. The main problem in resource efficiency is the substantial corruption that plagues most public spending.

Efficient use of assets

4

Policy coordination is a major problem for the government. Conflicts between the various ministries and ministers prevent effective coordination of state programs. State policies are often developed in such a rushed manner that no time is allowed for coordination with other state agencies. Every minister has the sense of being an independent monarch, lacking responsibility or accountability to other colleagues. There is no sense that the cabinet of ministers functions as a unit.

Policy coordination

3

Moreover, key cabinet members have their own private economic interest that often involves a near monopoly on a certain sector of the economy. As a result, an informal understanding exists as to what sector is controlled by what oligarch, and, as a result, some forms of coordination are simply off-limits for other stakeholders.

The government shows only limited interest in combating corruption, although the anti-corruption law was passed some time ago, and a state commission on the issue was established with the head of the presidential administration as its chairman. Corruption has a centralized nature, however, with the economy and state agencies divided between potent powerbrokers. Nevertheless, institutions under the direct control of the president have tended to demonstrate more integrity. Several state agencies, including the Ministry of Foreign Affairs, the State Exams Committee and the State Oil Fund are fairly scrupulous. However, the large majority of government institutions are badly compromised.

Anti-corruption policy

3

An unprecedented anti-corruption campaign, announced by the president to prevent an Arab Spring-type scenario manifesting in Azerbaijan during the 2011 anti-regime

protests, was short-lived and only resulted in the arrests of low-level officials. Unlike Georgia and Armenia, Azerbaijan failed to cooperate with international organizations on implementation and improvement of anti-corruption policies. Indeed, the 2011 anti-corruption campaign lacked both changes to legal provisions and implementation of specific anti-corruption policies. An influential study by Börzel and Pamuk (2011) found that the 2011 fight against corruption in Azerbaijan led to the strengthening of the executive's apparatus and the expansion of its control over society, and that it was, on the whole, based more on internal political struggles than a desire to root out corruption for the long term.

16 | Consensus-Building

In a general sense, all the country's major political parties agree that Azerbaijan must be developed into a market economy and a democracy. Some minor radical Islamic groups and parties do not share this vision. However, the ruling party has its own vision of strategic development toward that pro-democratic, pro-market end, preferring the perpetuation of stability and controlled growth to liberal democracy, free and fair elections, and market-based competition. Government officials often proclaim that democracy was not built in one day in the West, and that gradual development is needed. The opposition disagrees.

Consensus on goals
6

The ruling party has a very strong grip on power, and power is furthermore not transparent. Real power is vested in individuals rather than in the functional government offices. This has meant that pro-reform forces, which are actually numerous within the government, have lacked sufficient influence to push through a reform agenda, except in specific areas. Some state agencies try to hire young, Western-educated staffers to implement policies in a more efficient manner, but power is overall in the hands of policymakers who do not favor radical democratization or market reforms. The case of the Azerbaijan Diplomatic Academy is telling: When the president sought to develop a leading educational institution that would operate with integrity, that development had to transpire outside the realm of the Ministry of Education, indicating the pervasive nature of the opposition to reform in many state sectors. Another worrying trend is that the opposition has incorporated Islamic parties and groups, potentially weakening its separation of religion from politics.

Anti-democratic
actors
3

In spite of its official pro-democracy stance, the ruling regime is the main anti-democratic veto actor in Azerbaijan. Not only did the incumbent fail to facilitate democratic reform in national or local governance, but signs of growing authoritarianism became unignorable in the last two years. Crackdowns on independent media, persecution of political dissent, and further reduction of civil

liberties were among the main indicators of the ruling regime's anti-democratic nature.

The government is generally interested in preserving stability. For this reason, all potential conflicts, whether they have a religious, ethnic or social basis, are prevented and suppressed. Members of radical Islamic groups are often arrested. Social programs are implemented to satisfy the demands of the people. Ethnic cultural centers have been established. However, the ruling elite is often viewed as composed mainly of Azerbaijanis coming from Nakhichevan and Armenia. This creates considerable tensions in society, because people from other regions fear they lack equal access to power. Furthermore, the government has often sought to suppress dissent rather than engage in consensus-building.

Cleavage /
conflict
management
4

In 2011, a number of civil protests and opposition-organized rallies held in the capital led to the government's increased clampdown on civil society. While persecution of civil activists continued, the government imposed tighter regulations on foreign-funded NGOs. As part of its offensive on civil society, the government closed the Baku office of the international Human Rights House Foundation. In 2012, the presidential chief of staff alleged that several NGOs operating in the country presented a threat to national security.

Civil society
participation
3

Although civil society is rather weak and dependent on government or foreign funding, civil society actors and their opinions are occasionally taken into consideration by the state. This is especially true if civil society actors seek active partnership with the government, refrain from accusations or harsh criticism, and establish trust and some channels of bilateral cooperation. These views are not always integrated into the decision-making process, but in a general sense, NGOs are able to express themselves and seek influence. Many such civil society organizations are funded and supported by the state. As estimated by Freedom House, the number of such government-organized non-governmental organizations (GONGOs) increased in 2011 – 2012. In 2009, the government set aside state funds for the support of NGOs in an attempt to strengthen the civil society sector, but also to make it more pro-government.

Most of the regime's political prisoners and enemies have been freed. Former President Mutalibov remains in exile, and the ruling party evidently has no intention of allowing him to return to the country. The same is true of Rasul Guliyev, the former parliamentary speaker, who is in exile in the United States. The parliament has still not adopted a law on former presidents' status, and has done little to recognize the service of former President Elchibey. Some opposition groups have been unhappy that not a single statue has been built in memory of Elchibey or the founder of the Azerbaijan Democratic Republic, Mammad Emin Rasolzade. This

Reconciliation
3

issue has created tension between the opposition and the ruling party, and hinders societal consensus on the country's past.

17 | International Cooperation

Azerbaijan's government generally cooperates well with international partners, especially in the area of economic development and poverty reduction. The World Bank, the United States Agency for International Development (USAID) and the Asian Development Bank are among the government's biggest partners, but this cooperation has shown only modest results.

Effective use of support

6

In the past few years, the government has been more assertive in its actions and negotiation tactics. For example, on the issue of WTO accession, the government has resisted reforming its customs, tax and agricultural procedures, even though such reform would bring long-term benefits.

In January 2011, major agreements were signed between the Azerbaijani government and the European Union in several areas of joint cooperation, including education, capacity building, and the reform of state agencies. However, in 2013, Azerbaijan sought to curtail the activities of the OSCE office in the country, and has moved to reduce the presence of international NGOs in the democracy field, such as the U.S. National Democratic Institute.

The Azerbaijani government has been rather consistent in fulfilling its promises to the international community. It maintains a strong peacekeeping presence in Afghanistan; sends aid to Haiti, Pakistan, Afghanistan and other countries; and fulfills its obligations with regard to international law, conventions, and commercial and trade contracts. For example, Azerbaijan is the only oil-producing former Soviet state not to have sought a renegotiation of contracts with foreign companies. In some instances, Azerbaijan has canceled agreed upon NATO activities or other military discussions, based on fear of Moscow's reaction or other geopolitical circumstances. However, Azerbaijan has actively sought to boost its international presence and strengthen its foreign relationships, and thus tries to respect its international obligations. The only question marks surround Azerbaijan's commitments to European institutions in the field of democracy and human rights, particularly the Council of Europe, which has grown increasingly critical of Azerbaijan's record in the area. The country's poor record of human rights has also been criticized by the European Union and many international organizations.

Credibility

7

On the one hand, Azerbaijan is a locomotive of regional cooperation, actively investing in Georgia, Russia, Romania, Turkey and the Central Asian republics. It promotes east-west and north-south energy and transport corridors; builds railways, ports, transport hubs and airports; and has expanded its presence in regional

Regional cooperation

6

organizations such as the Black Sea Economic Cooperation (BSEC), the Economic Cooperation Organization (ECO) and CIS.

On the other hand, Azerbaijan continues to refuse to cooperate with Armenia, opposes the opening of the Turkish-Armenian border, and has been reluctant to engage in public diplomacy or confidence-building measures with Armenia before the occupied territories are freed. The country has remained compliant with the rules of regional and international organizations, except on the issues of democracy and human rights.

Strategic Outlook

The Azerbaijani government has managed to sustain its grip on power by providing its citizens with security, stability and oil money. Yet in a rapidly changing world, swept by globalization, democratization, Internet communications, information flows and economic interdependence, it will be increasingly difficult for the Azerbaijani government to stick to this formula, especially as oil production in the country is actually declining. While the revolutions across the Middle East did not spread to the former Soviet sphere, they did remind the country's government that the power of the regime can be shattered if economic development and the delivery of social services falter. Thus, the government's success will partly depend on whether it moves toward much-needed reforms that focus on accountability, anti-corruption measures and good governance. Doing so would allow the country to better its economic performance and would provide new energy to the economy, which is currently heavily dependent on the oil and gas sector. If the political will to engage in reform were to develop, Azerbaijan's non-oil economy would benefit greatly. Competition would lower prices and the population would reap the benefits. So far, however, it seems that the political will to engage in such reform is not present. Yet the future of Azerbaijan, and, in the long term, the future of the ruling elite, depend on the progress of reform.

Meanwhile, Azerbaijan's reluctance to engage in meaningful political liberalization is complicating its relationship to European institutions, particularly the Council of Europe and the European Union, where Azerbaijan is part of the latter's Eastern Partnership. In the long run, it will be impossible for Azerbaijan to continue to participate in these institutions while rejecting further liberalization. While Azerbaijan has made a strategic choice to move toward a Western system of governance, it has yet to implement the measures that follow logically from this strategic choice.

Azerbaijan will continue facing considerable challenges in the international domain, primarily from Russia and Iran. The relationship with Iran is going from bad to worse. Much of this is due to the rise of the radical Islamic movement in Azerbaijan and the apparent support this movement receives from Tehran. Urgent steps are needed to curb this radical Islamism and prevent the flow of young people into these radical groups. However, this cannot be done solely through restrictive measures. As for Russia, Azerbaijan has come under increasing pressure to join Moscow-centric institutions that seek to reintegrate the former Soviet space. Baku's resistance to these pressures all but guarantees a worsening relationship with the former colonial overlord.

Overall, Azerbaijan must take steps to build accountability in its state institutions and reduce corruption in order to liberalize its political and economic landscape and reduce barriers to effective governance and entrepreneurship. The financial resources and political stability available to the country today provide ample opportunities for such reform.