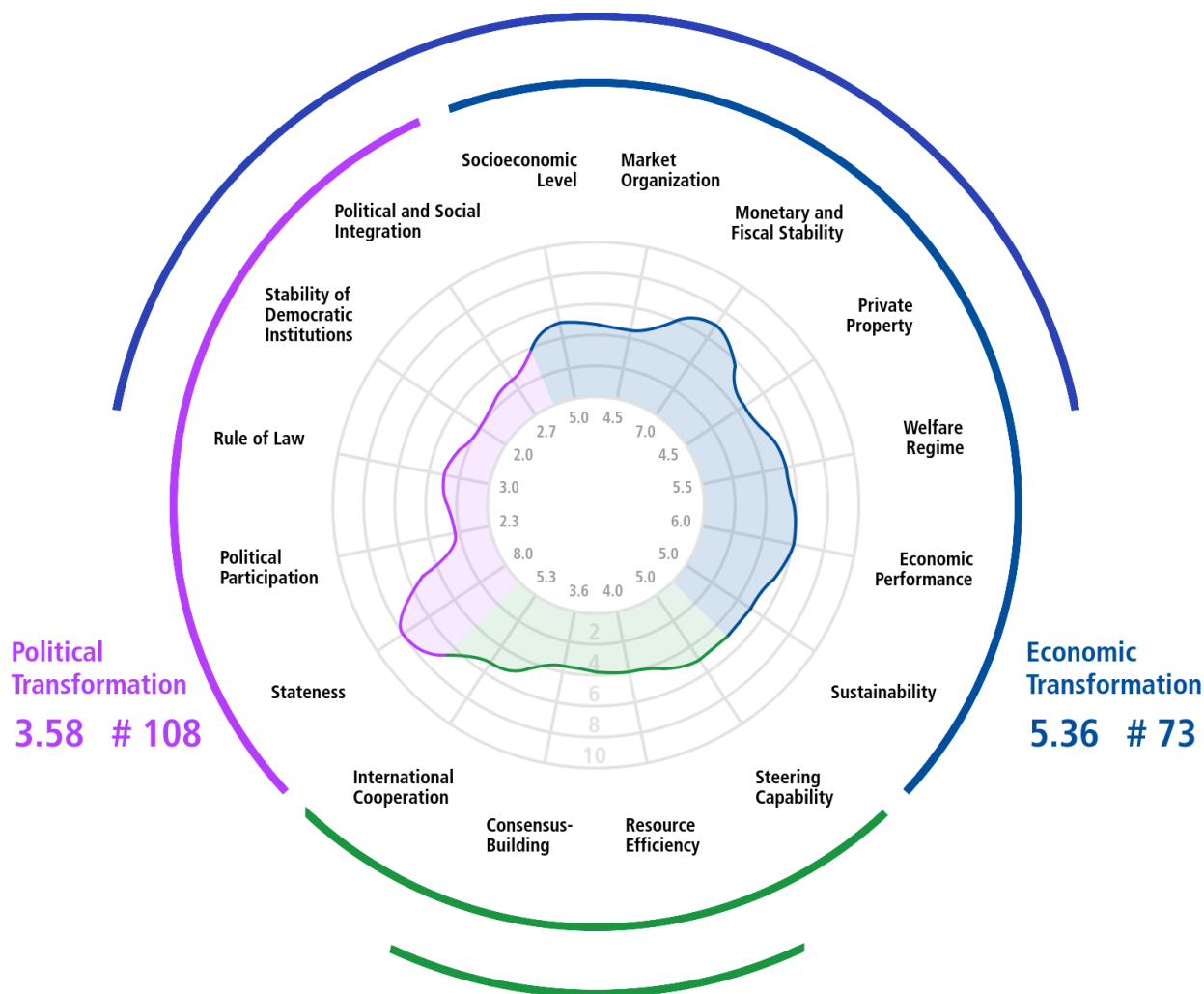


Azerbaijan

Status Index

4.47 # 95

on 1-10 scale out of 137



Political Transformation
3.58 # 108

Economic Transformation
5.36 # 73

Governance Index

3.98 # 97

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2022**. It covers the period from February 1, 2019 to January 31, 2021. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

| | | | | | | |
|--------------------------|--------|-------------|--------------------------------|--------------|----------------------|--------------|
| Population | M | 10.1 | HDI | 0.756 | GDP p.c., PPP \$ | 14452 |
| Pop. growth ¹ | % p.a. | 0.9 | HDI rank of 189 | 88 | Gini Index | 26.6 |
| Life expectancy | years | 73.0 | UN Education Index | 0.711 | Poverty ³ | % 0.0 |
| Urban population | % | 56.4 | Gender inequality ² | 0.323 | Aid per capita \$ | 12.1 |

Sources (as of December 2021): The World Bank, World Development Indicators 2021 | UNDP, Human Development Report 2020. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

During the reporting period, the consolidation of authoritarian rule in Azerbaijan continued. Snap parliamentary elections in February 2020 did not meet international standards for free and fair competition. However, some notorious high-ranking state officials were fired, and corrupt local level administrators detained on corruption charges. These developments, in addition to the appointment of some young professionals to ministerial posts, raised hopes for a possible opening of the country to real reforms and changes. However, in reality, these changes resulted in even more monopolization of political and economic powers in the hands of the ruling Aliyev family.

The economic downturn since 2014 – due to falling oil prices – accelerated when oil prices plummeted again in the spring of 2020. As a result, four banks lost their licenses in April – May. Public discontent with the government due to economic and social problems, which did not show any signs of improvement, grew. This discontent grew further after a strict lockdown was introduced by the government due to the coronavirus outbreak and renewed attacks by the government against its critics during the pandemic. Dissatisfaction was also fueled by insufficient social assistance payments introduced by the authorities to mitigate the negative impact of the coronavirus crisis.

Initially, the authorities hesitated to acknowledge the existence of COVID-19 cases in the country. However, when authorities in foreign countries announced positive test results among people traveling from Azerbaijan, the government succumbed. Subsequently, it introduced strict lockdown rules, including curfews and closed international borders. These measures were applied intermittently throughout 2020. A task force and a Coronavirus Response Fund were established, and dozens of specially equipped module hospitals were set up to deal with the pandemic. However, poor management of the repatriation of Azerbaijani citizens who remained abroad after closure of the borders, as well as the excessive use of power by local police while implementing the lockdown resulted in a couple of clashes of citizens with law enforcement. Yet, in general the response of the Azerbaijani authorities to the outbreak was assessed positively by the WHO and

other international organizations. The Azerbaijani government expressed its solidarity with foreign states affected by the coronavirus and donated \$5 million to the WHO. COVID-19 statistics provided by the authorities showed that by January 31, 2021, 2,408,050 people had been tested. At the time, the total number of confirmed cases was 230,219 and 223,315 infected had recovered, while 3,132 patients died.

The situation in the country drastically changed after the unfreezing of the conflict between Armenia and Azerbaijan over Nagorno-Karabakh. Azerbaijan, after receiving unprecedented support from its ally Turkey, launched an armed offensive in September 2020, which resulted in a military victory and the recapture of most of the territory lost in the early 1990s. The hostilities stopped after a Russia-brokered truce on November 10. The success of the military boosted the approval ratings of the president to record highs and cemented his power. Still, in spite of the victory, the conflict is far from being resolved and the presence of Russian peacekeepers and Turkish military observers has created a very fragile and complicated geopolitical configuration in the region.

History and Characteristics of Transformation

In the early 19th century, Russia incorporated Transcaucasia into its territory. Among the conquered lands were those that constitute today's Republic of Azerbaijan, where the majority of the population were Turkic-speaking Shi'a and Sunni Muslims. Under Russian rule, a new class of national intelligentsia emerged, which modernized the local society and transformed the Muslims of the South Caucasus into secular Azerbaijanis.

Following the fall of the Russian empire in 1918, the Azerbaijani Democratic Republic was established. Although this young nation-state was dismantled by the 1920 Bolshevik invasion, the process of nation-building in Azerbaijan continued to grow and strengthen under Soviet rule.

During Gorbachev's perestroika, the dispute between Azerbaijan and Armenia over Nagorno-Karabakh reignited the Azeri nationalist movement. This movement, led by the People's Front, positioned itself as an alternative political force to the Soviet leadership of the country. On October 18, 1991, Azerbaijan declared its independence and, a few months later, the People's Front overthrew the last communist leader, Ayaz Mutallibov, amid the escalating war with Armenia. In June 1992, the leader of the People's Front, Abulfaz Elchibey, was elected president of Azerbaijan in the country's most democratic election in recent history. Elchibey negotiated the withdrawal of Soviet troops from Azerbaijan with Russian President Yeltsin. However, a year later, he was overthrown in a military coup allegedly backed by Russian security forces. When a civil war was imminent, the country's former communist leader (1969-82) and Politburo member of the Communist Party of the Soviet Union (1982-87), Heydar Aliyev, seized the opportunity to take power.

Aliyev managed to bring stability to Azerbaijan by negotiating a cease-fire with Armenia, appeasing Russia by entering the CIS and subduing local warlords. But his most important achievement was the “contract of the century,” whereby Western companies were invited to develop Azerbaijan’s oil fields. Aliyev embarked on a strategic initiative to build oil and gas pipelines in order to help Europe diversify its energy supplies away from Russia. Yet, Aliyev failed to bring about much-needed democratic reforms.

In 2003, when Heydar Aliyev passed away, power was transferred to his son, Ilham, which marked the first dynastic transition of power in the post-Soviet sphere. Ilham Aliyev maintained the energy policies of his father but continued to narrow opportunities for independent political activities, the media and civil society to grow. In 2009, in a highly contested referendum, the constitution was amended and the two-term limit on the presidency was lifted. This amendment allowed Ilham Aliyev to run for a third term in a much-criticized election.

In 2016, another referendum was held which extended the presidential term from five to seven years and expanded presidential powers, thereby further strengthening the regime’s authoritarian nature. In 2017, President Aliyev appointed his wife as first vice president and effectively concentrated the power in the hands of his family. In April 2018, Aliyev was elected for a fourth term in office in snap elections, this time for seven years.

Aliyev cemented his power further after the successfully waged war with Armenia in autumn of 2020, which resulted in a military victory for Azerbaijan and the return of most territories lost during the conflict in the early 1990s. However, the war also resulted in the arrival of Russian and Turkish military in the country as peacekeepers, a situation which places the country in a fragile geostrategic balance. In addition, the economy, which is heavily dependent on fuel commodities, remains the ruling elite’s primary vulnerability.

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

The most important development in the reporting period was the 44-day military campaign in late 2020 during which Azerbaijan regained control over most of its internationally recognized territory lost in a war with Armenia in the early 1990s.

However, the deployment of Russian peacekeeping forces as well as Turkish military observers to separate the warring sides and maintain the truce, increased Azerbaijan's dependence on those two large neighbors. Apart from this, Azerbaijan's government enjoys an unchallenged monopoly on the use of force in the country.

The entire population, irrespective of race, gender, religion or ethnic background, is legally guaranteed full citizenship. After the collapse of the Soviet Union, Azerbaijan's state identity faced some challenges but generally endured and it continues to grow in strength. The current government has thus far successfully promoted loyalty to the state through school curricula, textbooks, state propaganda, etc.

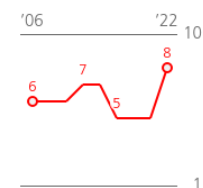
However, the personality cult built around former President Heydar Aliyev (father of the current president) has been linked to the consolidation of state identity. This policy is likely to be questioned in the future. For instance, in 2000, the government introduced the Flower Day celebrations which commemorate Heydar Aliyev's birthday on May 10. In 2016, two young activists spray-painted graffiti on the main statue of Heydar Aliyev in the capital on the night between May 9 and 10, calling the holiday "Slave Day." Subsequently, both activists were arrested and sentenced to 10 years imprisonment on trumped-up drug charges. In 2019, however, both were released by presidential pardon. Most importantly, following the protest the authorities stopped the annual celebrations of Flower Day.

The single major challenge to the legitimacy of the nation-state has come from the Armenians in the country's Nagorno-Karabakh Autonomous Oblast, who launched a separatist movement just before the collapse of the Soviet Union. Hostilities between

Question
Score

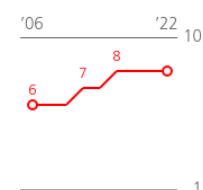
Monopoly on the
use of force

8



State identity

8



the two sides escalated into a major war after 1991. Azerbaijan lost control over Nagorno-Karabakh and the adjacent seven districts. A ceasefire was agreed upon in 1994. In late September 2020, Azerbaijan launched a military offensive, which ended with a Russian-brokered peace deal on November 10, 2020. Azerbaijan took back control of most of the territories lost in the early 1990s. The successful military campaign against Armenia boosted the president's popularity enormously.

In 2015, the authorities started to accelerate their fight against religious terrorism by tightening legal provisions, including stripping citizenship from those participating in armed terrorist groups. Subsequently, the citizenship of hundreds of Azerbaijanis was revoked on the grounds of their participation in wars in the Middle East as members of terrorist organizations.

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. Although society has preserved its overwhelmingly secular nature, from time to time religious groups try to be active in political life.

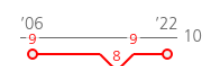
The authorities have implemented multiple measures to ensure the loyalty of the growing number of believers. The government forces all Muslim groups to accept the legal authority of the semi-official Caucasus Muslim Board and its leader, which is difficult to achieve due to confessional differences and theological barriers. Vigorous policies to regulate religious education and to increase government control over mosques, sermons and religious communities have also been implemented. As part of these policies, the Foundation for the Promotion of Moral Values was established in 2018. In April 2019, the head of the state agency responsible for regulating religious life announced that more than 1,000 clerics and religious community leaders were receiving wages via this foundation.

The state provides basic services such as health care, education, tax collection, social security and transportation through its fully functioning bureaucratic system and infrastructure, although the quality and standards of these services are not sufficiently advanced. Corruption, bribery and inefficiency are still the biggest problems. However, the increasing number of public centers run by the Azerbaijani Service and Assessment Network (ASAN) across the country and the range of services they provide has augmented efficiency in some areas by increasingly reducing mid- and low-level bureaucratic corruption. In January 2021, there were 16 ASAN service centers. Five operated in the capital and the remainder in other cities.

In January 2020, the gradual introduction of mandatory health insurance started throughout the country. The initial plan was to complete the three-stage process in 2020. However, the COVID-19 pandemic caused delays and the second stage was only launched in January 2021. According to the World Health Organization (2015), 89% of the population of Azerbaijan has access to improved sanitation facilities and 87% to improved drinking water. There have also been some noticeable improvements in public transportation services in Baku.

No interference of religious dogmas

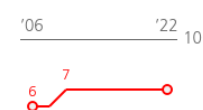
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1

Basic administration

7



1

Azerbaijan inherited the Soviet regional administrative system, which has remained largely unchanged since 1991. The administrative offices in the provinces and cities are led by heads of executive offices, who enjoy relative independence and vast administrative powers. They take personal responsibility for economic performance and social well-being, as well as for political stability and the promotion of public loyalty to the regime in their respective provinces.

In 2020, the COVID-19 pandemic caused major disruptions in such basic services as public transportation, childcare, daycare and schooling due to the strict and lengthy lockdowns the government imposed during the first and second waves of the pandemic. For instance, vital to the capital, Baku's subway system was shut down during the hard lockdowns in place intermittently throughout the year and was thus closed for approximately more than half of the year. Also, schools were closed most of the time.

2 | Political Participation

In a highly disputed referendum in 2009, the constitution was amended, lifting the two-term limit on the presidency. In 2016, another referendum was held, which increased the term of the presidency from five to seven years and introduced a vice presidency. Both referendums were held in highly repressive environments. In February 2017, the president appointed his wife as the first vice president, thus strengthening the ruling family's grip on power. In April 2018 snap elections, Ilham Aliyev was elected president for a fourth term in a row, this time for seven years.

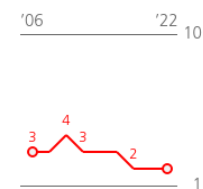
A snap parliamentary election held on February 9, 2020 – before coronavirus-related restrictions were introduced – did not render any significant change to the political life of the country. According to the Organization for Security and Cooperation in Europe (OSCE) Office for Democratic Institutions and Human Rights (ODIHR), the restrictive legislation and political environment prevented genuine competition. Significant procedural violations during the ballot count were observed. Once again, parliament convened without a viable opposition and the government continues to lack checks and balances. Parliament remains a rubber-stamp legislature.

Election commissions are composed overwhelmingly of regime loyalists who carry out orders from the presidential office. The ruling party exercises extensive control over news and information content and enjoys enormously disproportionate coverage. Election days are marred by multiple voting, ballot stuffing, interference with vote counting and other irregularities.

Distrust in the fairness of elections seriously reduces public interest in contests for municipal seats as well. Major cities, including the capital, do not have elected mayors. In a municipal election held in December 2019, a number of young independent political activists nevertheless decided to run. One of these activists,

Free and fair elections

2



Vafa Naghi, was elected a member of the municipality in her native village, despite threats, pressure from the election commission and a relentless smear campaign launched by the local authorities against her.

President Ilham Aliyev is the uncontested ruler of the country. In 2017, he appointed his wife the first vice president. In 2019, by firing the head of the powerful state police, Ramil Usubov, and the chief of the presidential administration, Ramiz Mehdiyev, Aliyev cemented his grip on power further. However, in 2019 and in the first three-quarters of 2020 the president's approval ratings were declining and discontent with the authorities steadily rose. This situation led the president to announce the start of major reforms which, however, did not produce any tangible results. Rigged parliamentary elections in 2020 deepened distrust of the authorities and the decline in presidential approval ratings continued. The situation drastically changed in autumn 2020 when Azerbaijan launched a successful military campaign against Armenia. The military victory genuinely boosted the president's popularity to unprecedented highs.

Parliament and local municipal representatives, despite being nominally elected, remain powerless actors in the policymaking process. Meritocracy in the bureaucratic system is compromised by deep-rooted clientelism, cronyism and nepotism. Traditionally, two major regional groups connected to the regime (Nakhichevanis and ethnic Azerbaijanis from Armenia) have dominated the system. Since 2003, groups connected to the president's wife have challenged the monopoly of these two regional groups among high-ranking officials and the demand for skilled professionals paved the way for meritocracy. Hence, in 2019 – 2020, some relatively young professionals were appointed to ministerial and other high-ranking posts.

The freedoms of assembly and association are guaranteed by the constitution, but severely restricted in reality. In January 2019, the opposition led by the Popular Front Party and the National Council for Democratic Forces – an umbrella group of opposition parties – held the largest rally in recent years, demanding the release of political prisoners and reforms. This rally was permitted by the authorities. However, immediately afterwards, the government effectively banned demonstrations by refusing to issue permits.

In October 2019, the Popular Front Party held an unauthorized demonstration in the capital, which was violently dispersed. Police detained scores of protesters, including the leader of the Popular Front. Short- and long-term arrests and imprisonment of Popular Front members intensified in 2019 and 2020. On July 14, 2020, after an Azerbaijani general and other military personnel died in a military clash with Armenia, and despite the strict lockdown rules due to COVID-19, thousands of pro-war demonstrators poured into the streets of the capital demanding retaliation. The protesters broke into the parliament building. The government again responded by detaining Popular Front members. In a nationally broadcasted speech, President Aliyev accused the Popular Front Party of masterminding the violence to overthrow the government.

Effective power to govern

2

'06 '22 10



Association / assembly rights

3

'06 '22 10



Since the introduction of the strict lockdown in spring 2020 due to the pandemic, meetings in open and closed spaces were strictly prohibited. All schools, mosques, wedding salons and funeral venues were shut down as well. These restrictions remained in place as of January 2021. In general, the public upheld the rules. However, their legality, necessity and proportionality were widely questioned in local social media. Excessive use of power by local police was a matter of particular concern and resulted in a couple of resonating incidents. Sharing videos and photos by the police of those who broke the lockdown rules were regarded by many local observers as an attempt to publicly chastise citizens in order to spread fear.

As it is indicated in the EU's Joint Staff working document, Cooperation Implementation Report on Azerbaijan, published in mid-December 2020, "safeguarding human rights and fundamental freedoms in Azerbaijan continues to be of concern. The operating space of Civil Society Organizations remains restricted. The grant registration procedure remains long and challenging for most CSOs, hindering EU support of civil society in Azerbaijan. The Council of Europe expressed deep concern over the freedom of association, including the legislation on NGOs, freedom of assembly, freedom of expression and media freedom as well as the plight of reported political prisoners."

The constitution of Azerbaijan guarantees freedom of expression. However, there are no independent TV and radio channels or print media in the country. According to the 2020 World Press Freedom Index, Azerbaijan ranked 168th out of 180 countries (166th in 2019). In February 2020, the OSCE Representative on Freedom of the Media, Harlem Désir, said that harassment of and violence against media in Azerbaijan is deplorable.

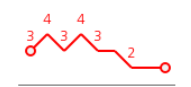
The government always highlights that the access to the internet is unrestricted, and that the number of users is increasing. However, the 2020 Freedom on the Net report classified the internet in Azerbaijan as "not free," representing a step back from the previous report when it was classified as "partially free." Bloggers who criticize the government, especially on Facebook, are constantly pressured, persecuted and jailed. In recent years, troll attacks on critics of the government from fake profiles on social media accounts have been among the popular methods employed by the authorities to harass independent voices and opponents of the regime.

During the COVID-19 pandemic, some social media users who criticized the quarantine rules and police behavior were detained by law enforcement and forced to issue video apologies. Others endured short-term imprisonment. In May 2020, the co-chairs of the U.S. Helsinki Commission, Representative Alcee L. Hastings and Senator Roger Wicker, issued a statement saying that "during the pandemic the Government of Azerbaijan further squeezed its people's access to free expression, media, and information through arrests, fines, harassment, and possibly torture."

Freedom of expression

2

'06 '22 10



It should be noted that social media and independent web TV act as watchdogs and play a significant role in forcing the government to take public concerns into account. In some cases, the authorities have succumbed to pressure from social media, and it remains the most viable tool empowering critical voices in the country. During the six-week war between Armenia and Azerbaijan in autumn 2020, the Azerbaijani leadership partially blocked access to social media platforms, arguing that this was done to prevent Armenian provocations.

3 | Rule of Law

The executive branch dominates the other branches of the government, and there is practically no functioning system of checks and balances in the country. All important decisions are effectively made by the presidential administration, and parliament merely rubber-stamps them. There is no independent judiciary. The courts are corrupt and often operate as a punitive mechanism in the hands of the executive power.

No state emergency due to COVID-19 was declared. Yet, the government introduced one of the most restrictive lockdowns in the world. In July 2020, the Ministry of Internal Affairs reported that more than 193,000 persons were fined for breaking quarantine rules, 17,820 of them for not wearing masks, and 788 were imprisoned for short terms. During these hard lockdowns, criticism of police behavior increased due to their generally inadequate conduct and in some instances the disproportionate use of force. The public complained that instead of preventing the spread of coronavirus, police prioritized imposing fines.

On September 28, 2020, the president declared martial law in major cities and some regions due to renewed hostilities with Armenia. A curfew was imposed in these cities and regions from 9 p.m. to 6 a.m. On December 12, 2020, martial law was lifted.

Although professional examinations are included in the selection process for judges, political loyalty to the regime, assessed through background checks and interviews, remains the top priority. The government heavily interferes and has the last say in court decisions on political, economic and other sensitive cases. Thus, while the administrative capacity of courts may have improved, their political independence has rather deteriorated. No significant improvements have been made in combating widespread corruption in the courts. In the rulings on ordinary civil and criminal cases, corruption is still a significant deficiency, heavily interfering with decision-making.

Defense attorneys play a largely formal role and have minimal influence over court rulings. The bar association is also controlled by the executive and disbars lawyers who are independent and critical of the government. Disciplinary procedures continue to be used as a means to put pressure on lawyers. Independent lawyers with

Separation of powers

2

'06 '22 10



Independent judiciary

3

'06 '22 10



experience in human rights advocacy were not admitted to the bar association during the reporting period. Plus, until January 2018, lawyers outside the bar association were able to practice non-criminal law. But since a new law, enacted in January 2018, only bar-approved members have been allowed inside a courtroom.

The European Court of Human Rights (ECHR) remains the widely trusted last chance for justice-seekers in Azerbaijan.

The oligarchic system is based on cronyism, nepotism, clientelism, high-level corruption and personal loyalty rather than the rule of law. In fact, high-level oligarchs are immune from legal prosecution. However, breaches in personal loyalty to the president are severely punished.

Beginning in late 2019, there has been a string of arrests of public officials. Heads of executive branches in several regions, unpopular among the broader public, were the main targets of law enforcement. However, there were arrests of central government officials as well. The arrested were accused of embezzlement, abuse of power and bribery. Moreover, during the COVID-19 lockdown, the General Prosecutor's office carried out operations around the country against local officials who were charged with illegally issuing exemptions to the country's isolation rules and of stealing food aid intended for people in need.

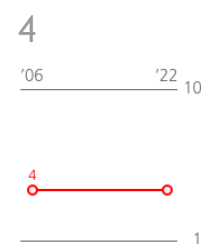
The president described these arrests as part of the "irreconcilable fight against corruption and corrupt officials" he had launched. However, the public was skeptical. Those prosecuted were relatively low-level regional officials, while central government officials and powerful oligarchs are engaged in corruption on a far greater scale. Most importantly, these arrests were not intended to change the system itself and they are frequently used to punish state officials who have fallen from grace. They are also used to cement authoritarian rule by promoting an image of a good president and his bad bureaucrats.

The reawakening of civil activism, particularly among the younger generation inspired by the Arab Spring and the popularization of social networks, has led the government to launch a major crackdown against political dissent, civil society, human rights activists, the media, international NGOs and youth organizations.

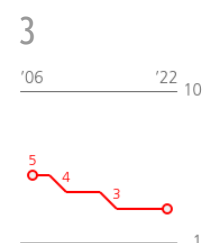
Legally, Azerbaijan is fully committed to gender equality – the constitution contains relevant provisions, and the country has signed numerous international conventions. Nevertheless, patriarchal norms and values are still dominant in society. Hence, Azerbaijan ranked 94th out of 168 countries in the 2020 Global Gender Gap Report of the World Economic Forum.

Even though Azerbaijan has decriminalized homosexuality, there is still serious infringement on the rights of sexual minorities. The country remains the worst place in Europe to live as an LGBTQ+ citizen, according to the 2020 ILGA-Europe Rainbow Index.

Prosecution of office abuse



Civil rights



During the COVID-19 pandemic, the country's borders were closed and Azerbaijani citizens in many foreign countries experienced great difficulties returning home. The most dramatic events happened on the Azerbaijani-Russian border. Around 600 Azerbaijanis gathered on the Russian side of the border wanting to return home. However, Azerbaijani authorities allowed only a limited number to enter the country, saying that "the return of citizens is being implemented in stages as resources allow." This led to protests and violent clashes of Azerbaijani citizens – trying to chaotically cross the border – with Russian law enforcement.

In addition to closing land border crossings (entry being only possible by air), movement into and out of the many regions, including the capital Baku was repeatedly prohibited during the national lockdowns. A SMS-permission system to leave one's place of residence in these regions was imposed as well. This permission was issued once a day for three hours (initially for two hours) and was required when one wanted to leave one's residence to purchase food, other necessities and medicines and to use banking, postal and other services, as well as for medical purposes. The last time it was imposed was from December 14, 2020 to January 18, 2021.

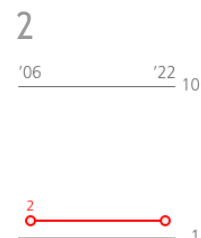
4 | Stability of Democratic Institutions

Azerbaijan is a consolidated autocratic state with democratic institutions existing only nominally. In reality, all power is vested in the hands of the executive. Since 1995, parliament has been dominated by the ruling New Azerbaijan Party, and the government has gradually restricted opposition parties by manipulating elections. The government imitates a multiparty system. It tolerates only parties that agree not to criticize the government. In 2002, a referendum was held to eliminate party-list proportional representation, leaving a majoritarian (single-member constituency) system. Since the 2010 elections, only political parties that did not challenge the authority of the government and operated under its broad supervision have been given seats in parliament (the so-called systemic opposition). Real (non-systemic) opposition parties are not represented.

The judiciary is also under full control of the executive. However, if a separation of powers occurs and there is the political will to fight corruption, the judiciary will be professionally able to meet its obligations as a democratic institution.

There are neither elected mayors of cities nor elected regional governors. Regional and city legislatures do not exist either. All power is concentrated in the hands of heads of local executives appointed by the president.

Performance of democratic institutions



The government always stresses its commitment to building a democracy and strengthening democratic institutions. However, the continuous crackdown on political opponents, civil society and the media only testifies that this is just a lip service.

The secular, nationalist Popular Front Party remains the most radical opposition to the ruling elite in the country – as such, the key non-systemic political party. In one of his speeches during the early stage of COVID-19 outbreak, the president aggressively criticized this party calling its members “traitors,” “fifth column” and “enemies who receive money from abroad aiming to destroy Azerbaijan.” “Therefore” – he added – “during the existence of the disease – the COVID-19 outbreak – the rules of completely new relationships will apply... There will be no place for traitors and corrupt representatives of the fifth column in the new political configuration.” Consequently, there was an increase in administrative detentions of Popular Front members due to alleged violations of quarantine rules. The Popular Front’s leadership, its members and allies were subject to various forms of multiple persecutions during the reporting period.

5 | Political and Social Integration

Azerbaijan is a consolidated autocratic state dominated by one ruling party. However, there are 59 registered political parties in Azerbaijan. Officially, 11 political parties are represented in the state legislature, ten of which are in the opposition. Yet, in reality, all the so-called opposition parties in parliament are controlled by, or reliant upon, the ruling party and there is no political plurality in the legislative assembly. Over the last two decades, the ruling regime has conducted a policy of marginalization of real opposition with mixed success.

Shortly after the last parliamentary election in February 2020, which, according to ODIHR was not a genuine competition, the Presidential Office launched a so-called dialogue initiative with political parties. As a part of this process, small parties, which are mostly unknown to the public and have no influence on the political life of the country, were equipped with headquarters. Yet, real opposition parties such as the Republican Alternative Party and Musavat, which previously were subject to oppression from the regime, also entered this dialogue process. As a result, two members of the Republican Alternative Party, who had previously been indicted and served unjust prison terms, received a full acquittal from the Supreme Court of Azerbaijan. They were paid combined compensation in the sum of 300 thousand manats (approximately €150,000). One of this party’s members, the lawyer Erkin Gadirli, became a member of parliament. And the party was officially registered by the state in late August 2020.

The most radical opposition party – The Popular Front Party of Azerbaijan – boycotted the elections due to the restrictive environment. The party was subject to severe oppression throughout the reporting period. Earlier, it was stripped of its

Commitment to democratic institutions

2

'06 '22 10

2

1

Party system

2

'06 '22 10

3

2

1

headquarters and registration. The Popular Front remains the only political party which is not part of the dialogue process launched by the presidential administration. The public believes that this dialogue process is an attempt by the ruling elite to ensure opposition parties align themselves with the existing authoritarian rule in the country and the Popular Front is considered the only oppositional party resisting this policy.

Since the late 2000s, a number of influential interest groups have started developing in the form of NGOs, cultural, religious, social, human rights and ideological networks. They are concentrated mainly in the capital, Baku, as well as in some other major cities, and they are largely nonexistent in rural areas. These newly emerged groups started challenging the establishment (i.e., the domination of Soviet-style organizations such as trade unions, the Writers' Union and the Caucasus Muslim Board, which continue to exist as semi-official bodies). The new organizations have rapidly gained in strength and have started to pose a real challenge to the existing system, attracting more attention and mobilizing more active people.

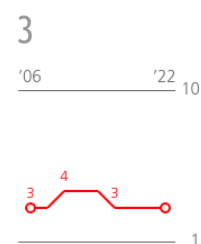
However, this unexpected success has made them primary targets in the ongoing crackdown. Many have faced numerous administrative and legal restrictions. Leaders of some organizations have been arrested on dubious charges and criminal investigations have been launched. Others have been stripped of their rented premises and some have lost their funds due to restrictions imposed on donors. Laws have been toughened and all of these actions have made the environment almost impossible to operate in. As a result, many have ceased their activities in the shrinking space for civil society.

Although Azerbaijani citizens did not have sufficient knowledge of or experience with basic democratic institutions such as separation of powers or multiparty systems after the collapse of the Soviet Union, there was strong support for democracy and Euro-Atlantic integration among the population. Yet, the crackdown on secular political parties and free media and shrinking space for civil society halted the process of democratization and led to the establishment of entrenched authoritarianism and personalistic rule.

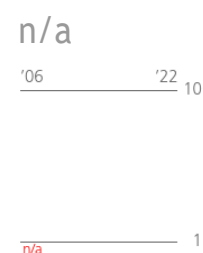
During the last few years, with a growing number of individuals educated in the West entering public life and through civic initiatives supported by international and local NGOs, knowledge of the basic principles of democracy has expanded, raising hopes for a gradual change that will ultimately lead to systemic transformation.

However, the government's "strategic" criticism of democratic principles and human rights as tools for the promotion of Western imperialism has stirred doubts about liberal-democratic values among some parts of the population. The global decline of democracy and the rise of authoritarianism as well as propaganda from neighboring Iran, Turkey and Russia have contributed to this. During the last parliamentary elections in February 2020, despite reported official numbers, citizens showed very

Interest groups



Approval of democracy



little interest in the political process due to distrust and fear. Anti-western sentiments increased during the war with Armenia in autumn 2020. People considered that the Western media were biased against the Azerbaijani cause, which aimed to restore its internationally recognized borders. Responses to the COVID-19 outbreak in liberal democratic countries were also points of debate. Many believed that authoritarian regimes handled the pandemic better due to the ability to immediately implement restrictive rules. However, the majority in Azerbaijan still believes that free and fair elections, government accountability and the rule of law are the best practices for creating prosperity and justice.

The bulk of social capital in Azerbaijan is present in rather homogenous family and kinship ties, regional identities and groups of close friends. Membership in such associations is based on the rights of birth, marriage or high interpersonal trust. These kinds of social trust and social relations have always been stronger in the rural areas outside the capital, and they have been gradually decreasing with expanding urbanization and modernization. Also, the rampant corruption and absence of the rule of law have been seriously damaging social trust in society. According to the joint European Values Study and World Values Survey report (2017 – 2021), 91.6% of Azerbaijanis say that family is very important in their lives.

Although participation in formal civic associations, such as NGOs, has generally been limited, it had steadily grown in the capital city until the recent crackdowns. Since early 2016, there has been some revival. In general, however, society remains accustomed to demanding action from the government rather than engaging in self-help. However, the war has positively affected the sense of solidarity and trust in society and resulted in the emergence of multiple voluntary organizations and citizen-led charity initiatives.

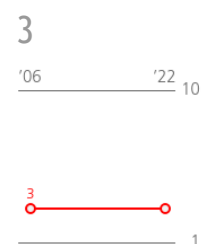
II. Economic Transformation

6 | Level of Socioeconomic Development

Azerbaijan's GDP per capita in 2019 was \$4,794, which was 1.13% more than the previous year, the State Statistical Committee reports. However, whereas in developed countries, GDP per capita aligns with average salary levels, the same cannot be said for Azerbaijan, where the average salaries are less than a tenth of GDP per capita.

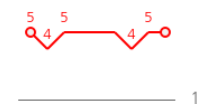
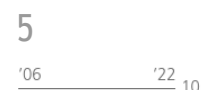
The World Bank reports that Azerbaijan's official national poverty was 5.1% in 2018. Yet, it claims that "given the recent increase in private consumption, the poverty rate is estimated to have fallen further in 2019."

Social capital



Question Score

Socioeconomic barriers



However, despite the lack of official data, it is estimated that the pandemic exacerbated the problem of poverty in the country in 2020 as many businesses were required to close in order to stop the spread of the coronavirus. Most people working in low-paying jobs, such as restaurants, cafes or movie theaters, were left unemployed. Even though the government handed out six one-time payments in the amount of AZN 190 (\$110) to citizens in need, many people reported having problems receiving these payments.

The State Statistical Committee reports that inflation was 2.8% in the first 11 months of 2020 and nominal income per capita decreased by 2%. According to the Baku Research Institute, “[T]his means that the nominal income of the population actually decreased by about 5%. This is not a small reduction and is a factor that directly affects the growth of poverty.”

Azerbaijan ranked 88th with a score of 0.756 out of 189 countries in the Human Development Index (HDI). According to the HDI, “Azerbaijan’s 2019 HDI of 0.756 is above the average of 0.753 for countries in the high human development group and below the average of 0.791 for countries in Europe and Central Asia.”

Azerbaijan’s Gender Inequality Index score in 2019 was 0.323, making it 73rd out of 162 countries. According to the UNDP “for every 100,000 live births, 26.0 women die from pregnancy related causes.” The agency states that the female participation in the labor market is 63.4%, compared to 69.7% for men.

| Economic indicators | | 2017 | 2018 | 2019 | 2020 |
|---------------------------|----------|---------|---------|---------|----------------|
| GDP | \$ M | 40865.6 | 47112.9 | 48174.2 | 42607.2 |
| GDP growth | % | 0.2 | 1.5 | 2.5 | -4.3 |
| Inflation (CPI) | % | 12.9 | 2.3 | 2.6 | 2.8 |
| Unemployment | % | 5.0 | 4.9 | 4.8 | 6.3 |
| Foreign direct investment | % of GDP | 7.0 | 3.0 | 3.1 | - |
| Export growth | % | - | - | - | - |
| Import growth | % | - | - | - | - |
| Current account balance | \$ M | 1684.6 | 6051.1 | 4364.9 | -227.6 |

| Economic indicators | | 2017 | 2018 | 2019 | 2020 |
|---------------------------|----------|---------|---------|---------|----------------|
| Public debt | % of GDP | 22.5 | 18.7 | 17.7 | 21.4 |
| External debt | \$ M | 15300.9 | 16211.0 | 15840.4 | 15811.9 |
| Total debt service | \$ M | 2232.6 | 2682.4 | 2162.9 | 1835.9 |
| Net lending/borrowing | % of GDP | 1.9 | 9.5 | 6.1 | - |
| Tax revenue | % of GDP | 13.2 | 13.0 | 14.2 | - |
| Government consumption | % of GDP | 11.3 | 10.5 | 11.1 | 15.9 |
| Public education spending | % of GDP | 2.5 | 2.5 | 2.7 | - |
| Public health spending | % of GDP | 1.0 | 0.9 | - | - |
| R&D expenditure | % of GDP | 0.2 | 0.2 | - | - |
| Military expenditure | % of GDP | 3.8 | 3.6 | 3.9 | 5.4 |

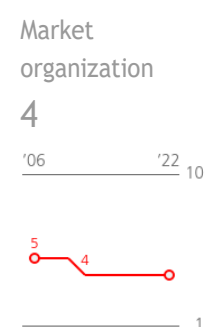
Sources (as of December 2021): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Although there are rules and laws aimed at regulating the market, they do not play a significant role in the real economy. Business transparency is an ongoing challenge. Small businesses, for instance, face many hurdles, especially because of the preferential treatment of large and state-owned enterprises. Tender procedures are obscure. Moreover, monopoly-holding officials fight possible competitors by restricting market access and forcing them out of business.

Only a few companies in Azerbaijan export. Since most exports are in raw materials, non-oil sector SMEs have problems to develop. Import procedures and non-tariff barriers also discourage small business from engaging in import activities. In 2019, private sector imports amounted to \$7.5 billion, an increase of 40% compared to 2018. However, economists argue that this increase does not directly correlate with growth in the private sector and is mostly a result of a decrease in the value of public-sector exports.

Azerbaijan ranked 34th out of 190 economies in World Bank's Doing Business 2020 Report. According to the report, there were improvements in registering property, obtaining credit, protecting minority investors and enforcing contracts. Azerbaijan scores particularly well in the sub-index "Starting a Business." Azerbaijan ranks 9th



out of 190 countries with only three procedures, 3.5 days and costs of 1.3% of the average income per capita.

Access to finance is one of the biggest problems for small entrepreneurs in Azerbaijan. The capital market is underdeveloped. Credit supply is therefore very limited, and almost 90% of SMEs use their own resources as operating capital.

The informal sector constitutes a significant part of the economy. Pricing is controlled by the state in many sectors of the economy, including oil, electricity and gas. Prices on non-regulated goods and services are also influenced by regular informal payments to tax and customs authorities.

Although there are rules and laws aimed at increasing market competition, these laws are often bypassed because of the high level of corruption in government offices. Since the fall of the Soviet Union, many large enterprises have been privatized, but they continue to be controlled by monopolies tied to high-ranking government officials. Many medium-sized companies are also owned by oligarchs or are informally tied to their large businesses.

In Azerbaijan state-owned enterprises are active in many sectors of the economy, including the oil and gas sector, communications, power and the water supply.

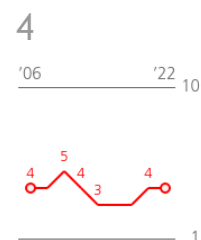
Azerbaijan is an oil-based economy, and the State Oil Company of the Azerbaijan Republic (SOCAR) controls the major share of this industry. Although SOCAR, just like other state-owned companies, does not have any officially delegated governmental powers, it enjoys a near-monopoly status in the oil industry. On October 23, 2019, the president signed a decree including the State Service for Antimonopoly Policy and Consumer Rights Protection in the organizational structure of the Ministry of Economy. This committee is responsible for overseeing the implementation of competition laws. However, it does not play any serious regulatory role and has been ineffective in enforcing competition laws. The committee lacks the independence needed to fight the monopolistic nature of the economy.

Azerbaijan has been selectively integrated into the world economy, especially in the area of energy exports. The Baku-Tbilisi-Ceyhan (BTC) pipeline transports the country's oil to international markets.

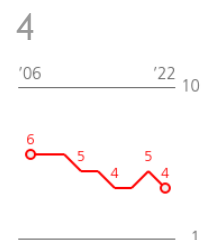
In the final days of 2020, the first commercial gas from Azerbaijan to the European market passed through the Trans-Adriatic Gas Pipeline, the last leg of the Southern Gas Corridor. This is the first time Azerbaijan's natural gas has been transported to the European continent via pipeline.

The country depends mainly on oil and gas exports, so much so that they account for more than 90% of Azerbaijan's overall exports. The oil and gas sectors are

Competition policy



Liberalization of foreign trade



monopolized by the state. Moreover, the state's share in non-oil sector exports is also quite high, amounting to more than one-third of total non-oil exports.

Azerbaijan's imports amounted to \$13.65 billion in 2019. Import tariffs in Azerbaijan remain high, with the simple average most favored nation applied tariff rate at 8.7% in 2019.

There are significant barriers that prevent local entrepreneurs from bringing products for sale into or out of the country. One is that the Customs Committee has been very corrupt and a major obstacle to trade. Official data indicate that thousands of businesses in Azerbaijan engage in foreign trade; however, in reality, the majority of exports are concentrated in the hands of a few businesses, which are mainly owned by either government officials or their relatives.

The biggest challenges that companies face in foreign trade are high transportation costs, high tariffs, corruption and extensive bureaucracy in customs as well as wide-ranging powers granted to the authorities. High informal fees and long wait times at the borders hinder Azerbaijan's potential as a competitive cargo transit route as well. The introduction of an electronic system for submitting export and import declarations may help to improve the situation.

In August 2019, the president issued a decree establishing the Agrarian Insurance Fund, which is "a non-profit legal entity that ensures organization, development and sustainability of the agricultural insurance system in Azerbaijan, as well as the formation of a governing structure and exercises control for its activity." The law came into effect in 2020 and is seen as a key step in helping diversify the country's economy with a view to broadening its export base.

The government also adopted the Standardization Law on July 19, 2019. The law calls for the creation of unrestricted turnover of goods, elimination of unnecessary technical obstacles in international trade and adaptation of state standards to international standards, among other things.

Azerbaijan started applying the green corridor access system for participants in foreign trade beginning on February 1, 2019. By the end of the year, 505 companies had joined the system, which aims to create favorable conditions for the participants in foreign trade, implement flexible and transparent customs control and facilitate international trade.

Negotiations between Azerbaijan and the World Trade Organization (WTO) regarding trade liberalization and membership have not yielded tangible results, as Azerbaijan apparently does not intend to become a member any time soon. Joining the organization would make the country subject to international standards, threatening the high degree of corruption that exists in the economy.

The banking sector of Azerbaijan is still recovering from the drop in oil prices which began in 2015 and the subsequent devaluation of the national currency.

The Financial Markets Supervisory Agency (FIMSA), created in 2016 to supervise the activities of banks, shut down 19 banks as a result of non-performing loans and a lack of liquidity. On November 28, 2019, the FIMSA was liquidated and its duties were handed over to the central bank, which shut down an additional four banks in 2020. Currently there are a total of 26 banks. Two of them were state-owned and the rest private. In 12 of the private banks, the share of foreign capital was more than 50%. Two are local branches of foreign banks.

In February 2019, the president issued a decree to help people with problem loans resulting from the devaluation of the currency in 2015. According to this decree, any individual loans of \$10,000 or less would be repaid from the state budget.

State Statistical Committee data suggest that the share of non-performing loans decreased from 12.2% in 2018 to 9.3% in 2019. However, many independent sources estimate that this number could be over 20%, if all problem assets were included. In 2019, the banks were also urged to restructure non-performing loans by extending credit terms and lowering interest rates.

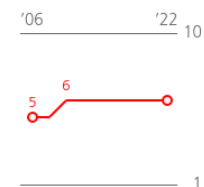
During the pandemic, some banks stopped giving loans to individuals. The central bank had issued a series of recommendations to banks of certain exemptions to customers. However, only a few of the banks followed these recommendations. The central bank also advised banks and other credit organizations not to impose any penalties on borrowers until January 1, 2021. Moreover, in 2020, the central bank required banks to restructure the loans of individuals and business affected by the pandemic.

In March 2020, the Cabinet of Ministers passed a law guaranteeing government loans to entrepreneurs who suffered losses as a result of the pandemic. According to some data, the percentage of non-performing loans decreased to 7.2% in September of 2020, as a result of the above-mentioned support schemes.

In May 2020, the central bank introduced new rules of temporarily regulating the activities of credit organizations, which included rules for classification of loans and risk groups. According to this new procedure, a bank's capital adequacy can be calculated without taking into account the risks of consumer loans issued by banks from May 2020 to January 1, 2021.

Banking system

6



8 | Monetary and fiscal stability

As a result of favorable foreign economic conditions, high oil prices and the increase in the non-oil exports, Azerbaijan enjoyed a fairly large positive balance of payments of \$5.143 billion in 2019. However, in the first nine months of 2020, the overall balance of payments turned into a negative \$1.804 billion.

Having a strong currency is regarded by the government as a prestigious indicator of strength and stability. The government was able to keep the manat's exchange rate against the dollar stable throughout 2020. Yet the central bank has reported that the national currency has nominally appreciated against currencies of a few of Azerbaijan's important foreign trading partners, such as the Turkish lira and Georgian lari. The real exchange rate of the manat also appreciated in 2020, equal to 6.6% on the non-oil sector in 2020. According to official data, the real effective exchange rate of the manat was 102.8, which is 3.7 points higher than in 2019.

The central bank announced the annual inflation rate to be 2.6% in 2019 and 2.8% in 2020. In early 2020, the central bank stated that it planned to maintain macroeconomic stability, particularly focusing on keeping inflation low. The central bank announced a reduction in its discount rate five times in 2020, lowering it to 6.25% in December. The bank stated that external and domestic demand were weak due to the coronavirus pandemic, and inflation remained below its target range and that this indicated that there was potential for easing the monetary policy.

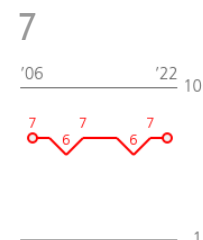
However, it should be noted that the credibility of official data, including the inflation rate is questioned by many experts, some of whom argue that the actual inflation is much higher than the official figures. The central bank is not a transparent body and is highly influenced by political decisions.

According to the Ministry of Finance, the state's budget revenues comprised AZN 24.2 billion in 2019, which is an increase of 7.5% compared to 2018, while the expenditures equaled to AZN 24.4 billion. This resulted in a budget deficit of AZN 205.2 million in 2019. The State Oil Fund's revenues increased by approximately 8% in 2019 and comprised AZN 19.031 billion. Transfers to the state budget from the State Oil Fund amounted to AZN 11.36 billion.

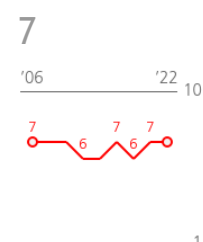
In 2019, foreign trade turnover comprised \$33.3 billion, an increase of \$7.7 compared with the year before. Exports were \$19.64 billion and imports \$13.67 billion, which resulted in a trade surplus of \$5.9 billion.

Government debt amounted to 19% of GDP. Official statistics put the foreign debt-to-GDP ratio at 17% in 2019. However, many economists argue that this number does not represent the real situation as it does not include credits incurred by public

Monetary stability



Fiscal stability



companies under state guarantee, which, if calculated, bring the total foreign debt up to 40%.

The government relaxed its fiscal policy in 2020 in order to ease the effects of the pandemic. It increased its expenditures in the form of health care spending, unemployment assistance and tax benefits.

Combined with the increased spending due to the pandemic, the decline in crude oil prices worldwide contributed to a significantly large budget deficit in Azerbaijan.

According to the data available for January to November of 2020, state revenues comprised AZN 22.24 billion. Transfers from the Oil Fund in the first nine months of 2020 increased by 18%, when compared to the same period in the previous year. According to the IMF, the government increased its budget spending on public health by AZN 0.37 billion, which is 0.5% of GDP. In April 2020, the government allocated AZN 3.3 billion to help businesses and individuals survive the coronavirus pandemic.

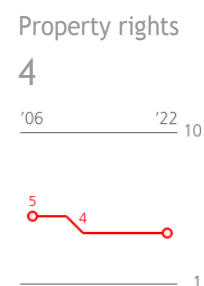
In June 2020, the president signed a decree making changes to the Tax Code to provide tax relief to businesses affected by the pandemic.

In 2020, as a result of COVID-19, production in Azerbaijan's national economy decreased, resulting in an increase in the ratio of public debt-to-GDP to 24.5%.

9 | Private Property

Property rights are not secure in Azerbaijan. The state and powerful oligarchs frequently violate them. Despite the existence of legislation on property rights, there are still some gaps in the law and enforcement of the law's provisions remains very poor. The constitution and other laws list conditions for expropriation, which is only allowed for "state needs." The civil code defines "state needs" as the construction of roads or strategic defense complexes. However, the Law on Expropriation of Lands for State Needs, introduced in 2010, expanded the definition of state needs, which has led to the large-scale demolition of buildings and entire districts in the capital. According to the law, private property is protected by the state against any other kind of infringement. However, because of high levels of corruption, government officials and oligarchs have the power to bypass the law and expropriate private homes and retail spaces for their own private purposes.

There are still many gaps in the legislation on registering property. State officials frequently interfere with legal processes in order to extract bribes. Politically motivated infringements on property rights are also a problem. However, the process of registering property has been simplified to some extent with the creation of the ASAN service centers.



Azerbaijan has flaws and gaps in the laws aimed at protecting intellectual property rights. However, new legislative acts, such as the Law on Enforcement of Intellectual Property Rights and Fighting Against Piracy, have recently been adopted. Additionally, the Center for Enforcement of Intellectual Property Rights was created under the Copyright Agency. The center is expected to issue copyright hologram stickers for certain products, such as software, books, etc.

Pervasive corruption remains the biggest problem for doing business in Azerbaijan. Extensive bureaucracy, weak legal institutions, a high level of corruption in customs and the concentration of businesses in the hands of high-level officials with monopolistic interests hamper investment in the non-oil sectors and create a lot of challenges for private businesses.

Privatization procedures are well-defined on paper, but preference is often given to companies with strong government connections, and tenders are not transparent at all. On April 28th, 2020, the president of Azerbaijan and the European Bank for Reconstruction and Development (EBRD) president discussed the prospects for privatization and commercialization of some state-owned enterprises.

The government adopted some tax reforms in December 2018, which went into effect in January 2019. These reforms include reducing the tax rate for small and medium-sized enterprises from 4% to 2% as well as exempting them from profit and land taxes. According to the EBRD, these reforms “aim to increase transparency and accountability, encourage businesses to formalize and promote economic diversification.”

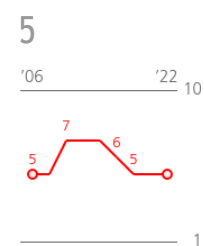
The government took a few steps in 2020 to assist businesses most affected by the pandemic, including tax benefits and tax exemptions, financial support, state guarantees of new loans, low interest rates on guaranteed loans coming from the state budget, as well as giving them the opportunity to restructure loans issued before March 1, 2020.

10 | Welfare Regime

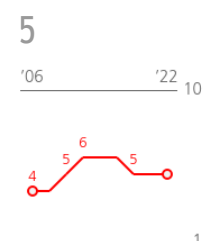
Provisions for pensions, illness compensation, disability, unemployment and maternity leave exist in national legislation; however, the welfare system in Azerbaijan suffers from considerable underfunding. Wages, pensions and illness compensation are low and do not cover living expenses. Health care is inadequate, especially for poor people. Another problem is a lack of child allowances, which can be seen as an important tool for avoiding malnutrition, as well as ensuring quality education and effective medical treatment.

Azerbaijan raised monthly minimum wages in March 2019 from AZN 130 to AZN 180. In September, the minimum wage was further raised to AZN 250. As of January

Private enterprise



Social safety nets



2020, the average monthly salary was AZN 712. However, these increases are still not sufficient to cover basic needs if taking into account the real cost of living. Family networks and money transfers from family members working abroad act as a stabilizing force for some segments of the population. It is reported that, in 2019, remittances sent from Russia via bank transfers equaled \$1.1 billion. However, the actual number is believed to be much higher, since many people choose unofficial routes for sending money to avoid fees.

According to official data, unemployment in the country is around 5%. However, government statistics are unreliable, and it is estimated that up to 25% of the working-age population is un- or underemployed. There is no viable state support for the vast majority of unemployed people.

Since January 1, 2019, the salaries of employees in non-oil and non-state sectors up to AZN 8,000 have been exempt from income tax for a period of seven years. Those earning more than AZN 8,000 are subject to a 14% tax rate. Moreover, employers outside the oil and gas and public sectors will need to make contributions to the Social Insurance Fund of 22% of their gross monthly income for the next seven years. If an employee's salary is higher than AZN 200, the employer will have to contribute 15%.

As part of the coronavirus relief efforts, the Cabinet of Ministers approved an action plan on April 4, 2020 aimed at assisting people who had lost their jobs. The government gave out a one-time payment of AZN 190 (\$110) to citizens in need six times throughout the year. Approximately, 600,000 people were designated to receive this assistance. However, people reported numerous problems receiving their payments. Many people reported that their applications were rejected for various obscure reasons.

In addition, the government started a financial support program amounting to \$126.5 million to help employers affected by the COVID-19 pandemic to cover the salaries of approximately 300,000 workers.

The constitution guarantees equal rights for all. In principle, all persons have equal opportunities for education and work. In practice, however, the effects of informal networks, widespread corruption and education costs (which effectively restrict access to education) undermine equal opportunity. Almost everyone in the country receives at least some form of basic education, which is why the literacy rate stands at 99.8%.

Since the collapse of the Soviet Union, women's social status has suffered to some extent, and social structures are still male dominated. In rural areas, the prevalence of religious and parochial traditions can at times lead to young girls dropping out of school. Legally, women are entitled to the same rights as men, and they do participate in labor force. However, female professions are generally underpaid, and gender-specific exclusion is evident.

Equal opportunity

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Although female professionals can be found (primarily in the capital) in both the country's older, Soviet-trained and the younger, Western-trained generations, government offices are predominantly staffed by men.

Due to cultural factors, women are often excluded from leadership positions. Most notably, the Cabinet of Ministers has only one female member – Bahar Muradova, the head of the State Committee for Family, Women and Children's Affairs. Yet, the speaker of the newly elected parliament is female and the overall representation of women in the National Assembly is significant (21 females out of 121).

Azerbaijan's Gender Inequality Index score in 2019 was 0.323. In this regard, the country lags behind not only Eastern European countries but also its neighbors Georgia, Turkey and Russia. According to the 2020 Human Development Report "[I]n Azerbaijan, female participation in the labor market is 63.4% compared to 69.7% for men."

There is a difference in the labor force participation rate between rural and urban areas. Generally, unemployment is higher in the cities because most people in rural areas are involved in subsistence farming. Additionally, there is a substantial wage disparity between urban and rural areas.

Religious or ethnic origin does not appear to be a factor hindering employment, but regional background still tends to be important in Azerbaijan: Azerbaijanis from Armenia and the Nakhichevan exclave generally have privileged access to public office and employment.

11 | Economic Performance

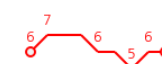
Azerbaijan's economy relies heavily on oil and natural gas, which poses many risks to economic development. A recovery in the price of oil which, along with gas, accounts for 75% of state revenues and 45% of GDP, combined with increased gas production has resulted in Azerbaijan's GDP growing by 2.22% in 2019. However, in 2020, as a result of the pandemic and falling oil prices, GDP contracted by 4.3% which includes a 6.5% reduction in the oil sector and 2.9% reduction in the non-oil sector.

Notwithstanding the effects of the coronavirus on the economy, the government managed to stabilize the state budget. According to official statistics, state budget revenues totaled AZN 24.124 billion in 2020, compared to AZN 24.199 in 2019. This was a result of increased transfers from the Oil Fund to the budget of AZN 12.2 billion, which marks an increase of 7.4% compared to 2019. Tax revenues amounted to \$6.915 billion in December 2019, up from \$6.228 billion in December 2018. A total AZN 656 million (or 80% of the AZN 819 million increase in budget revenues) came as a result of the increase in VAT and excise taxes, which comprise the main turnover taxes.

Output strength

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State budget expenditures totaled AZN 24.408 billion in 2019, which means that there was a budget deficit. In 2020, state budget expenditures amounted to AZN 27.492 billion, which resulted in an even higher budget deficit.

FDI inflows to Azerbaijan amounted to \$4.3 billion in 2019, which is a 4.9% increase compared to 2018. According to the central bank, FDI inflows totaled \$2.1 billion from January to June of 2020, which is a 23.5% increase from the same period last year.

The official statistics for 2019 put the unemployment rate at around 5%. In 2020, the unemployment rate increased to 7.2% due to the pandemic.

12 | Sustainability

Ecologically tolerable growth finds only marginal consideration in Azerbaijan and is institutionally not entrenched at all. Azerbaijan is party to the Kyoto Protocol and the Paris Agreement, but it still needs to implement their relevant provisions.

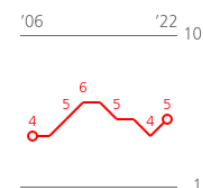
In 2020, the president signed a decree establishing the State Agency for Renewable Energy Sources under the Ministry of Energy of Azerbaijan. The agency is responsible for ensuring “the arrangement and regulation of activities in the field of renewable energy sources and their efficient use.”

The European Union launched a new initiative in 2019 called the EU4Climate with a budget of €8.8 million with the aim of supporting the six EU Eastern Partner countries. In Azerbaijan the aim of this project is to help the government to develop national capacities to integrate low-emission and climate-resilient actions into national development plans, as well as to align climate change legislation with EU standards. Azerbaijan also joined the International Bonn Challenge on forest landscape restoration in 2019 and committed to restoring 170,000 hectares of forests by 2030. On November 20, 2020, parliament adopted an amendment to the draft law “On Environmental Protection.” The amendment aims to reduce the impact of plastic waste on the environment in Azerbaijan beginning in 2019 – 2020.

These initiatives are an important step in Azerbaijan’s environmental policy. However, there have been very limited investments in clean energy, and most of the financing for it comes from international development banks.

Environmental
policy

5



Formal access to education in Azerbaijan is universal and free. The literacy rate is 99.8%, although the poor quality of secondary level education is a well-known fact. Inadequate training, poorly trained teachers and outdated textbooks still dominate all levels of education. State kindergartens and secondary schools are infested by widespread corruption.

According to the U.N. Education Index, which measures the educational attainment of a country by combining average years of schooling for adults with the expected years of schooling for children, Azerbaijan's score has been unchanged for the past few years and was 0.709 in 2017. UNESCO reports that the gross enrollment ratio in 2019 was 97.94% in elementary, 94.78% in secondary and 31.5% in tertiary education. It should also be noted that the Gender Parity Index for primary, secondary and tertiary school enrollment is 1.03, 0.997, 1.138, respectively. According to the World Bank, 69% of the population has completed secondary and 20% tertiary education, which is low for an upper-middle-income country.

The cost of private tutoring, which is important to pass the centralized exam system for universities is high, resulting in many students from poor families scoring too low to receive tuition-free admission to desired programs.

For decades, corruption has dominated higher education, but newly launched institutions like the ADA University, the French-Azerbaijani University and Baku Higher Oil School have become corruption-free zones in this industry.

Azerbaijan's Human Capital Index score, which measures human capital productivity is valued at 0.58, which means a child born in Azerbaijan today can be 58% as productive as a person with a complete education and optimal health.

The government's expenditure on education in 2019 comprised 2.9% of GDP, compared to 2.4% in 2018. In 2020, it was expected to be 3.8% of GDP, while in 2021 education expenditures are expected to amount to 4.3%.

All educational institutions were temporarily closed from March 2, 2020 to reduce the rate of transmission of the coronavirus. Elementary schools were due to reopen in February 2021, as part of the easing of the strict lockdown measures.

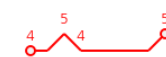
On November 16, 2019, the president signed an order approving the State Program on Improving International Competitiveness of the Higher Education System in the Republic of Azerbaijan for 2019 – 2023. The aim of the program is to educate a new generation of highly qualified specialists in the field of education management, development and leadership and to modernize quality indicators in the education system with international double diploma programs. The program is funded by the State Oil Fund (SOFAZ) and assistance from international as well as local organizations and individuals, with an allocation of AZN 10 million from the SOFAZ's 2020 budget.

Research remains a seriously underdeveloped area of the economy: according to Trading Economics, only 0.2% of GDP was spent on research and development in 2018.

Education policy /
R&D

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Governance

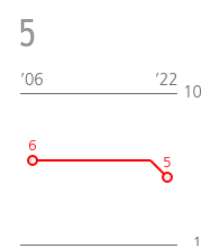
I. Level of Difficulty

Azerbaijan has favorable conditions for good governance. Yet several factors negatively affect its development. The first is that there has been a long-standing conflict over Nagorno-Karabakh with Armenia. During the war in 2020, Azerbaijan managed to reacquire territory it lost in the early 1990s. However, a comprehensive peace agreement and thus a final settlement of the conflict is long in coming. Moreover, the war exacerbated another structural constraint originating from Azerbaijan's big neighbors. In the past few years, Russia's aggressive foreign policy has posed an imminent threat to the region. Now Russian troops have entered the conflict zone as peacekeeping force. This increases the dependency of Azerbaijan on its northern neighbor. In addition, Turkey provided significant diplomatic and military support to Azerbaijan during the war, increasing Ankara's political influence in the region as well. Finally, the structure of Shi'a Islam makes Azerbaijan's growing young Shi'a believers dependent on the Iranian religious establishment.

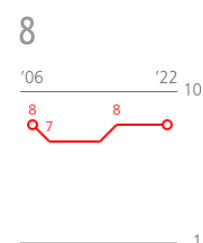
As a landlocked country, Azerbaijan is reliant on its neighbors for the export of oil and gas that comprise the overwhelming majority of its foreign earnings. Even though economic activity, including oil output shrank significantly during the COVID-19 pandemic, relatively high oil prices kept Azerbaijan's economy relatively healthy in the face of these restrictions. The recent war will probably be a heavy burden on the country's economy.

The historical roots of civil society in Azerbaijan are very weak. In terms of local traditions, Azerbaijan is a fairly hierarchical society with obedience to authority, in which the population has no tradition of organizing collective action. Still, in the context of the Muslim world, in the late 19th and early 20th century, Baku developed its own intelligentsia and political culture, which could have been an embryo for modern civil society. That potential was crushed by communist rule; civic organizations during the Soviet period were controlled by the totalitarian state. Moreover, the purges of the 1920s and 1930s almost completely eliminated the independent Azerbaijani intelligentsia. It was not until the 1960s that, especially in academia and culture, a new national elite emerged. However, in the 1970s and early 1980s, the intelligentsia suffered again, this time from increasingly dominant clientelist practices based on regionalism, nepotism and cronyism.

Structural
constraints



Civil society
traditions



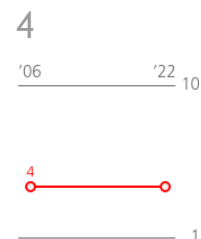
Since independence, NGOs supported by international organizations have emerged as significant players in public life. They have succeeded in mobilizing public opinion around a variety of social issues. Nevertheless, entrenched authoritarianism, which does not tolerate any independent activity and aims to monopolize every aspect of public life, seriously impedes this development.

The COVID-19 pandemic has been marked by a new crackdown on the main opposition Popular Front Party and the National Council of Democratic Forces, which is run by allies of the Popular Front. President Aliyev strongly criticized the opposition and almost openly declared that COVID-19 restrictions should be used to eliminate the “fifth column” and “the enemies of the nation.” Dozens of members of the Popular Front Party of Azerbaijan (PFPA) were detained, some were convicted. Among those arrested was a prominent opposition figure, Tofiq Yaqublu, one of the leaders of the National Council of Democratic Forces.

In July 2020, the frozen conflict between Armenia and Azerbaijan flared up again and resulted in the death of a prominent Azerbaijani general. Despite the lockdown, thousands poured into the streets demanding retaliation. The government responded with arrests of Popular Front activists and blamed them for unrest during this patriotic march. The president’s speech in regard to the protest was strongly criticized on social media and public discontent grew further. In early September, a court sentenced Tofiq Yaqublu, and he went on hunger strike to protest the decision. His action received widespread public support and the government was forced to backtrack and release Yaqublu to home confinement.

In late September, the conflict in Nagorno-Karabakh turned into a full-blown war. Hostilities lasted for six weeks, until Russia brokered a truce. Although Azerbaijan recaptured much of the territories it had lost in the early 1990s, it did not conquer Nagorno-Karabakh in full and a lasting peace is still far off. The conflict resulted in several thousand fatalities. The majority of casualties were youth born between 2000 and 2002.

Conflict intensity



II. Governance Performance

14 | Steering Capability

For a long time, the government tried to persuade external actors in particular – but also internal ones – that it had adopted a gradual and deliberate strategy of promoting democracy. But, while acquiring self-confidence due to the inflow of oil revenues, it started talking more openly about a “special way of building democracy,” which in reality meant rejecting democracy and consolidating the authoritarian regime.

Even though the government has adopted strategic roadmaps, reorganized ministries, created new agencies, cooperated and sought international assistance since the economic downturn of 2014, its strategic and institutional capacity to prioritize and organize policy measures remains limited. Securing power is the utmost priority for the ruling elite, but genuine economic and political reforms may jeopardize this priority. So, during the reporting period, the government continued its efforts to consolidate authoritarianism further. The major systemic problems of the economy, such as the deeply entrenched high-level corruption and oligarchic monopolies, remain largely intact. The COVID-19 outbreak did not result in any compelling changes to these priorities.

Following the outbreak of the COVID-19 pandemic, on April 1, 2020, the Ministry of Economy published a package of measures aimed at assisting the most vulnerable individuals and the most affected businesses. Entrepreneurs and citizens who had suffered as a result of the pandemic were provided with certain tax benefits. The government also established a State Fund to fight COVID-19 based on private and corporate donations. In December 2020, economy minister Mikayil Jabbarov announced that, during the pandemic, Azerbaijan had managed to keep its main economic indicators at the level of the beginning of the year and the country’s strategic foreign exchange reserves remained almost unchanged. Official figures show that, due to state support, the agricultural sector performed well. Agricultural output in 2020 rose noticeably and agricultural exports maintained at 2019 levels. The most important concerns were over the banking sector: four banks lost their licenses.

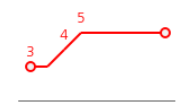
Yet, assistance to businesses and unemployment benefits were too little to compensate for the losses of entrepreneurs and material suffering of the population. For example, unemployment benefits – a monthly payment to families without any income – during the strict lockdown months amounted to AZN 190, which is approximately €100. According to state officials, a total of 600,000 citizens had been designated to receive this payment by December 2020.

Question
Score

Prioritization

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Strategic programs have been geared toward making Baku a venue for various types of international events. Hosting these events has forced the government to carry out significant infrastructure renovations, including in public transportation, roads and railways, and has contributed to the promotion of the country's international reputation. When the government attaches high priority to projects in the energy and transportation sectors or to venues for international sporting and entertainment events, such as the first European Youth Summer Olympic Festival, the Eurovision Song Contest, Formula One and the Islamic Games, it tends to successfully implement them, irrespective of spiraling costs. These costs are often the result of widespread corruption – siphoning money off projects for officials' private purposes, for example.

Following the outbreak of the COVID-19 pandemic in Azerbaijan, the government introduced a strict lockdown in the country. Highly prioritized official events, such as the Baku Forum, UEFA EURO 2020 and Formula One Race were canceled.

The government continues to intentionally delay WTO accession due to protectionist practices that mainly benefit powerful oligarchs and their corrupt businesses. However, due to the priority given to improving the business environment, Azerbaijan has steadily improved its position in the World Bank's Doing Business rankings in recent years. Azerbaijan ranked among the top twenty improvers in the 2020 report.

During the last few years, the government has prioritized inbound tourism. In 2019, three million visitors from 192 countries visited Azerbaijan. It was an 11% increase compared with the same period in 2018. In January and February 2020, there was a 20% increase in arrivals. The pandemic created insurmountable challenges to tourism. In March 2020, arrivals dropped by 62% and then almost halted due to the closure of borders.

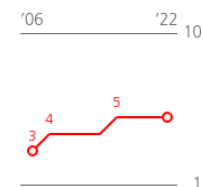
The president frequently emphasizes diversifying the economy as a priority. Despite some remarkable achievements, the economy continues to rely heavily on oil revenues. The government has been even less successful in decentralizing the political system and facilitating democratic reforms, including in implementing the rule of law. The main obstacle is the government's reliance on autocratic, patrimonial methods of rule.

The government is willing to learn from the experience of international organizations in those areas that do not jeopardize its authoritarian nature or the vested interests of high-ranking officials.

The economic downturn after the fall of oil prices in late 2014 exposed the incompetence of the government, as well as its flawed policies and corrupt practices. The crisis caught the government unprepared. However, the government was able to some extent to draw lessons from its own mistakes and adjusted its policies. It made

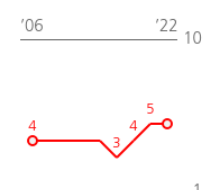
Implementation

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Policy learning

5



attempts to systemize its approach to the deteriorating situation and to consolidate control over the economy. The situation forced the government to engage in some liberalization, such as easing the tough visa policies from before the crisis. Along with other measures, this, for instance, contributed to a boost in inbound tourism.

The downturn also forced government agencies to expand their collaboration with Western experts when carrying out economic reforms. For instance, Azerbaijan hired McKinsey to develop roadmaps of reforms. Due to its collaboration with Western advisers, Azerbaijan managed to improve its position in the World Bank's Doing Business Report.

However, the government has completely brushed aside Western advice on issues relating to political reforms, building civil society and implementing the rule of law. The COVID-19 outbreak was used by the government to crack down on nonconformist opposition and strengthen its political control.

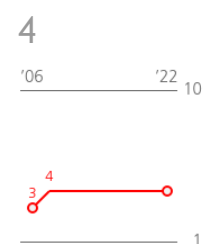
15 | Resource Efficiency

The state budget depends heavily on hydrocarbon revenues, which led to high GDP growth rates for several years until the fall in oil prices in late 2014. However, because there had been no diversification of the economy, there were concerns that, once the country ran out of oil reserves, growth would slow down, eventually leading to economic decline. The actual drop in GDP in 2015 (to \$53.07 billion) and in 2016 (\$37.87 billion) proved these concerns true. In 2017, real GDP rebounded to \$40.75 billion and in 2019, for the first time in five years, Azerbaijan's GDP growth exceeded 2% in real terms. However, the lockdown adopted to tackle the COVID-19 outbreak and another plunge in oil prices earlier in the year resulted in more than 4% decrease in GDP in 2020.

The state debt is not at critical levels. It stands at approximately 20% of GDP for government debts and around 40% for state companies. It is manageable because the country has significant liquidity buffers. However, the budget is not effective because it is not audited. There is formally an independent audit performed by parliament. However, parliament itself is not an independent body as it is completely under the control of the executive. The planning and implementation of the state budget are not transparent. Planning is not conducted with the involvement of interested parties. As a result, important budget expenditures are hidden from the public. Deviation in the actual budget from the planned budget has been a regular practice for many years. Existing legislation on the budget grants the executive considerable independence to amend the budget without seeking prior approval from parliament.

The government introduced several exam procedures, which are conducted by the State Exam Center, for hiring state employees based on meritocracy. While the exams earned public trust, the last phases of the selection process – interviews – are still

Efficient use of assets



powerful tools in the hands of the authorities to reject “potentially disloyal” candidates. The lack of political will for decentralization has resulted in the country lagging behind its South Caucasian neighbors in reforming the territorial and administrative systems inherited from the Soviet past.

The COVID-19 pandemic forced the government to reallocate resources to increase expenses for health care. In 2020, health care expenses increased 70% in comparison with the previous year. However, a lack of information provided by the government makes it difficult to assess the nature of these expenses. In January 2020, the gradual introduction of mandatory health insurance throughout the country started. The initial plan was to complete the process in 2020, but the coronavirus outbreak delayed this. Therefore, the vast majority of the population used its own funds both for tests and treatments during the pandemic, notwithstanding the hike in government health care expenditures.

Traditionally, policy coordination was a major problem for the government. State policies were often developed in such a rushed manner that no time was allowed for coordination with relevant state agencies. Some ministers and other high-ranking officials had a sense of being independent potentates, without responsibility or accountability to their colleagues. There was no sense that the Cabinet of Ministers functioned as a coherent unit. Key oligarchs had their own private economic interests, which often involved near-monopolies on certain sectors of the economy. The prime minister’s role was and still remains de facto ceremonial.

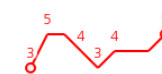
Nevertheless, during the reporting period, the head of state significantly consolidated his decision-making capabilities by sidelining some of the most powerful members of the “old elite,” like the former Head of the Presidential Administration Ramiz Mehdiyev, and Minister of the Interior Ramil Usubov. The military success in the war with Armenia further strengthened the president’s firm hand. Beyond this, the Vice President’s Office has been steadily sidelining old entrenched ministers and oligarchs and assumed control over the management of the country’s economy through newly appointed officials and ministers. This development significantly improved the government’s policy coordination capabilities during the reporting period. At the same time, these changes provided the ruling family with uncontested monopolistic powers over the country’s economy and politics.

Policy coordination during the COVID-19 pandemic was conducted via The Operational Headquarters under the Cabinet of Ministers established on February 27, 2020. The headquarters held frequent press conferences where representatives of various government agencies informed the public about the most recent figures and measures taken to fight the outbreak. However, independent journalists encountered obstacles when trying to attend these press conferences and it was obvious that questions asked by the representatives of pro-government media were pre-cleared with authorities.

Policy
coordination

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Corruption in Azerbaijan is widespread and centralized. There are a number of regulations and commitments to fight corruption on the part of the government. For instance, Azerbaijan is a member of the Council of Europe's Group of States Against Corruption (GRECO) and the OECD's Anti-Corruption Network. There is also an anti-corruption law, which was passed in 2004, and a Commission on Combating Corruption established in 2005; however, they have not become substantial tools in the fight against corruption for reasons of patchy enforcement and a weak judiciary.

ASAN, the one-stop state agency for public services provided to Azerbaijan citizens, which was established in 2012 and has since expanded, was successful in reducing low- and mid-level corruption and has proved efficient.

Traditionally, in the higher education institutions, students had to pay bribes to professors in exchange for satisfactory marks on examinations. However, teaching staff at some institutions established in post-Soviet times such as the Caucasus University, the ADA University, the French-Azerbaijani University and the Baku Higher Oil School have been exceptions. There have also been significant improvements in other higher education institutions in reducing this bribery practice since the appointment of Mikayil Jabbarov as head of the Ministry of Education in 2013. The trend has continued during the tenure of his successors.

In 2017, Mikayil Jabbarov was appointed head of the Ministry of Taxes and since then significant efforts to reduce widespread corruption in the tax system have also been made. This trend continued during the reporting period. For instance, in 2019 – 2020, more than 250 amendments were made to the Tax Code. These changes have been particularly significant in reducing in-person communication between taxpayers and tax authorities and increasing electronic capacities for communication purposes. These steps contributed to the reduction of the shadow economy and bribery practices by tax authorities.

In 2016, in accordance with the recommendations of the World Customs Organization, Azerbaijan introduced the Green Corridor gating system for custom purposes, which contributed to a decrease in bribery practices among state customs officials and increased transparency in customs control. However, state kindergartens, secondary schools, the state health care system, police, courts and municipalities are still infested with widespread bribery. A high level of bribery in public service is still a major problem. Corruption remains one of the biggest problems in government expenditures, as well.

Despite the existence of such laws as the Law on Rules of Ethics, the Conduct of Civil Servants and the Law of the Azerbaijan Republic On the Prevention of Conflicts of Interest in the Activities of Public Officials, conflicts of interest due to crosscutting family interests among central and local officials remain a major problem for decision-making and running the state institutions.

Anti-corruption
policy

3

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The legislature urges public officials to submit financial disclosures. In practice, however, implementation of this requirement is very limited. Most importantly, the reports are not publicly accessible. Again in 2005, Azerbaijan adopted a transparency law which guarantees access to information. However, in reality, it is very difficult and sometimes impossible to obtain information from the authorities. In 2012, for instance, after questionable business dealings by the ruling family were exposed by local and international media, the government made amendments to the state legislation designed to restrict access to corporate information.

16 | Consensus-Building

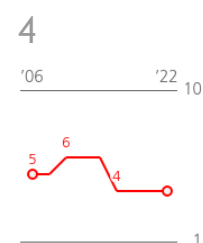
Until recently, the government and major political actors claimed that they were pursuing a path to democratization, but insisted that stability, security and social order were prerequisites for democracy and that the democratization process should be gradual, cautious and based on cultural modernization. However, the opposition has always accused the oligarchs – particularly the ruling family – of monopolizing political power and business, and using stability, social order and cultural progress as excuses to turn the republic into a monarchy. The events that unfolded in Azerbaijan following the presidential election of 2003 somewhat upheld the opposition’s claims, and the appointment of president’s wife as the first vice president in 2017 further cemented this assumption.

All main political parties in Azerbaijan agree on the need for a market economy (except for some radical leftist youth groups). Yet, the corrupt oligarchic and monopolist nature of the ruling regime has hampered the development of a fully functional market economy. However, the economic downturn since 2014 put pressure on the government to implement some changes to its previous corrupt practices and move forward with reforms to the market economy, albeit with little success so far.

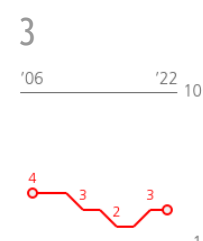
During the reporting period, the ruling family strengthened its grip on power, which is vested in individuals rather than in government institutions. Accompanied by a rhetoric of reform, in 2019 – 2020, the replacement of old entrenched members in important government posts with relatively young, in many cases, Western-educated officials continued. This string of replacements of old officials with young members of the elite who have been more exposed to the outside world and are more sensitive to public opinion has boosted hopes that the government might eventually move in the right direction. However, the situation is ambiguous, and these reorganizations sometimes render the opposite results, as was the case with the changes in the Azerbaijani Bar Association.

Overall power remains in the hands of the ruling family, which neither favors democratization nor relinquishes its monopolist grip on the country’s business sector. In addition to rigged elections and purging of the last vestiges of the rule of law,

Consensus on goals



Anti-democratic actors



crackdowns on the independent media, domestic and international NGOs, civil society and human rights activists, as well as persecution of political dissent and further reduction of civil liberties, have been among the main indicators of the regime's non-democratic nature.

The government prioritizes the preservation of stability as the most important political objective. Accordingly, the country's stability is extolled as the government's best achievement. All potential conflicts, whether they have a religious, ethnic or social basis, are prevented and suppressed. The government has often sought to suppress dissent rather than engage in consensus-building. A lack of comprehensive long-term policies, a reliance on authoritarian measures for short-term purposes and, most importantly, the government's rejection of a real democratic opposition, all contribute to the preservation and even aggravation of problems.

The fact that the ruling elite is often viewed as composed mainly of Azerbaijanis coming from Nakhichevan and Armenia serves as a source of potential tensions in society as well because people from other regions resent having unequal access to power and wealth. Yet, it seems that the policies and changes implemented under the auspices of the first lady, Mehriban Aliyeva, who in 2017 became the first vice president, aim to address this unease.

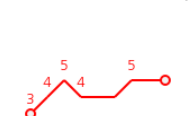
The government frequently praises its religious tolerance as part of the national tradition. It holds many pro-forma international events on multiculturalism, religious tolerance and dialogue. However, the government has also been frequently criticized for oppressing freedom of religion.

Starting in 2013, the government has launched a crackdown in an attempt to close the public space for any independent activity and critical voices. Both local and international NGOs have begun to encounter serious restrictions. Numerous international donors and NGOs have been forced out of the country. Strict laws have been adopted, bank accounts have been frozen, and travel bans have been imposed. Trumped-up criminal cases have been launched, and many local NGO activists have been imprisoned, with some activists seeking refuge in foreign countries. Almost no space has been left for independent NGO activities and, even though imprisoned NGO activists were later released, the revolving door of arrests and releases still continues, albeit more slowly and with less intensity. On January 30, 2020, the Parliamentary Assembly of the Council of Europe adopted a Resolution on Reported Cases of Political Prisoners in Azerbaijan, which noted a "troubling pattern of arbitrary arrests and detention of government critics, civil society activists and human rights defenders through retaliatory prosecutions and misuse of criminal law in defiance of the rule of law." Overall, civil society in Azerbaijan has been effectively stifled, and the government tries to imitate civil society by replacing real NGOs with GONGOs (government organized non-governmental organizations).

Cleavage /
conflict
management

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Civil society
participation

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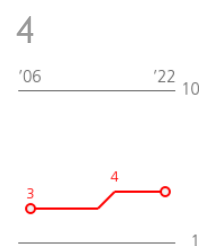
However, it should be noted that independent civil society and youth activism have shown some promising signs of revival during the reporting period, particularly in Baku. Some independent civil society groups resumed their seminars, trainings and public lectures. They were able to rent venues for these purposes which was almost impossible when the crackdown was at its peak. But this development is still very fragile and heavily dependent on the tolerance and the goodwill of the state authorities. It should be said that since the 2010 introduction of social media, as well as high speed internet, which appeared in the country a couple years earlier and since have both rapidly expanded, put an end to the government's monopoly on the flow of information. Thus, social networks have played an important role in the empowerment of Vox Populi, including local civil society.

A genuine and comprehensive reconciliation process with political opponents can only be initiated by the ruling elite; so far, however, it has demonstrated no interest in this, except in cases when former rivals pledge loyalty to the regime.

During the reporting period, the government launched a dialogue process with the secular opposition, which was met with skepticism by government critics. The main negotiator on the government side was the head of the Department for Relations with Political Parties and Legislative Authority of the Presidential Administration, Adalat Valiyev. The process started immediately after the snap parliamentary elections in February 2020, which were heavily criticized by local and international observers as another missed opportunity. There were several meetings between Adalat Valiyev and political parties. However, the public views the vast majority of the included political parties as puppets loyal to the government. Initially, the only real opposition party that participated in these meetings was the Republican Alternative Party. As a result of this dialogue, the Supreme Court acquitted the Republican Alternative Party leader, Ilgar Mammadov, who spent several years in prison and paid him AZN 234,000 (approximately €110,000) as compensation for moral damages. The public immediately criticized Mammadov for this deal. There is no doubt that Mammadov softened his criticism of the government thereafter.

Of the major opposition parties, Musavat joined the dialogue process with the government later in 2020, whereas the Popular Front refused to do so. The latter boycotted the snap parliamentary elections as well. The leader of the party, Ali Karimli, insisted that a specific agenda should have been announced beforehand and argued that the talks were actually an imitation of political dialogue. Members of his party and its allies continue to be subject to government prosecution due their strong opposition to the ruling regime.

Reconciliation



17 | International Cooperation

The government generally cooperates with international partners in the area of economic development and technical cooperation. Foreign partners play an essential role in implementing major economic projects. Azerbaijan also hires experts, primarily from Western countries, to run important local projects and state businesses. Difficulties arise from the fact that the long-term development strategy of the current ruling elite does not include democratization and implementation of the rule of law.

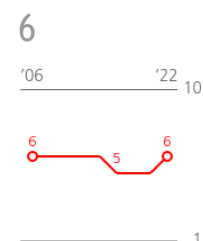
In February 2017, Azerbaijan and the European Union started new negotiations on a comprehensive agreement. Previous negotiations aiming at an association agreement did not yield results. However, no progress was made in the new negotiations primarily due to the unwillingness of the government to commit itself to genuine democratic reform. Still, the EU remains Azerbaijan's biggest market and second biggest importer with a 51% share of Azerbaijan's exports and a 16% share of its imports. Over 400 EU companies did business in Azerbaijan in 2019. The EU is also one of Azerbaijan's largest foreign investors and the union supports the economic diversification of Azerbaijan and promotes reforms to improve the business climate in the country, including through special assistance for agriculture and rural development.

The EU also remains the largest foreign donor supporting civil society in Azerbaijan. According to the Cooperation Implementation Report on Azerbaijan, it provided €31.6 million in COVID-19-related assistance to Azerbaijan in March 2020. This is complemented by other EU regional support, such as medical equipment supplied to Azerbaijan via the World Health Organization.

In September 2020, Baku launched a war to recapture the territories lost in its war against Armenia in 1994 – a clear violation of the cease-fire agreement. At least to some extent, this put Baku's credibility into doubt. Apart from this violation of an international agreement, the Azerbaijani government has been consistent in fulfilling its major economic and business commitments to the international community. Problems emerge with accepting international liberal norms when the political interests of the ruling elite are directly affected. This was the case when Azerbaijan failed to negotiate an association agreement with the European Union and failed to join the WTO. The biggest question marks surround Azerbaijan's commitments to the Council of Europe and the OSCE in the field of democracy and human rights. Those organizations have grown increasingly critical of Azerbaijan's record in these areas. The country's poor record on human rights has also been criticized by other international organizations – to no avail.

Still, Azerbaijan actively participates in alliances with neighbors, other countries in the region and worldwide. In 2019, the 18th Summit of the Non-Aligned Movement took place in Baku and Azerbaijan assumed the leadership of this movement for 2019 – 2022. On May 4, 2020, President Aliyev chaired an online Non-Alignment

Effective use of support



Credibility



Movement (NAM) Contact Group Summit which focused on the fight against COVID-19. The president also initiated a special session of the United Nation's General Assembly on COVID-19 in September 2020. During the COVID-19 crisis, Azerbaijan also acted as a donor country, donating \$5 million to the World Health Organization, \$5 million to Iran, sending medical supplies to Xian City and Mianyang in China, and humanitarian aid to Bosnia and Herzegovina to support its fight against the pandemic.

The Azerbaijani government exercises a vigorous diplomacy to maintain good relations with neighboring countries. The country has prioritized trilateral cooperation with Turkey and Georgia. Energy transportation pipelines (such as the Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline) cemented the interdependence of this trio in the past. The joint Baku-Tbilisi-Kars railway project runs through these countries, which is designed to be part of the New Silk Road connecting Europe with China and was completed in 2018. However, no passenger transport via this railway was launched during the reporting period.

This regional partnership continues to play an important role in the EU-Azerbaijan energy cooperation. In mid-November 2020, the European leg of the Southern Gas Corridor between Azerbaijan and Europe, the Trans-Adriatic Pipeline, became operational and, in December 2020, the first delivery of Azerbaijani gas via this corridor happened.

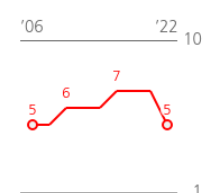
During the reporting period, Azerbaijan continued construction of a railway station and terminals to unload goods in an area of 35 hectares in Astara (Iran) as a part of its commitment to the North-South International Transport Corridor project.

Launching the war in September 2020 in violation of the cease-fire agreement of 1994 certainly is the opposite of regional cooperation. In a way, it continued Azerbaijan's non-cooperation with Armenia as a result of the Nagorno-Karabakh conflict. For years, Baku had rejected establishing any bilateral relations as long as Armenia did not abandon its occupation policy. The trilateral agreement signed on November 10, 2020, between Azerbaijan, Armenia and Russia, which terminated the war has certain clauses which might open prospects for future cooperation.

Incidentally, during the war between Azerbaijan and Armenia, Turkish military support for Azerbaijan proved indispensable and it will certainly result in a further strengthening of partnership between the two countries (which politically had been closely aligned in the past). Along with Turkey, Azerbaijan is also one of the most vigorous members of the Turkic Council, which is an international organization promoting cooperation between the Turkic-speaking people of Eurasia.

Regional cooperation

5



Strategic Outlook

So far, the Azerbaijani government has managed to maintain its grip on power by providing security and stability. Moreover, the president substantially increased his popularity after a successful six-week war with Armenia in autumn 2020. At the same time, the government's iron fist diminished space for independent political and economic activity and it carried out multiple crackdowns on civil society, media and the opposition. Authoritarianism has been consolidated by expanding the power of the executive and establishing full control over all spheres of public life. The flow of large sums of oil money has provided the government with the means to satisfy the basic needs of the people, reduce poverty and carry out some degree of modernization and infrastructure renovation.

However, the unexpected economic downturn after the fall of oil prices in late 2014 and the pandemic's beginning in 2020 have exposed deep economic and political vulnerabilities in the existing system. The pandemic revealed the critical situation of the job market, despite official propaganda which states that the situation is not critical. Despite some progress in diversifying the economy, for instance, in agriculture and tourism, the country's economy is still hugely dependent on fuel prices.

Thus far, despite some positive changes, such as the replacement of some of the old entrenched officials with younger members of the elite, the Azerbaijani government has tried to respond to the challenges it faces with half-hearted measures. The ruling family has remained characteristically unwilling to embark on major economic and political reforms and has continued its path toward strengthening its grip on power. However, it is clear that the economy cannot move to a qualitative stage of development without institutional and structural reforms. The future of Azerbaijan and its long-term prospects hinge on liberalization of its political and economic systems, and implementation of the basic principles of the rule of law. Specifically, the government must meaningfully combat the rampant, high-level corruption, proceed with market reforms and accelerate its efforts to diversify the economy.

One of the areas of concern in social policy remains the health care system, which was unprepared for the unexpected crisis. As a result, a significant proportion of people infected with the COVID-19 virus were completely excluded from the state health care system. People in difficult situations used their private resources to pay for testing, treatment and medicine. The transition to an insurance system that provides quality and affordable health care for everyone must be completed as soon as possible.

During the reporting period, Azerbaijan achieved a major military breakthrough in the Nagorno-Karabakh conflict. However, the conflict is far from resolved. The country must be active in re-energizing the opportunities offered by the Minsk Group, the agreed conflict resolution format of the Organization for Security and Cooperation in Europe (OSCE), to achieve a durable,

comprehensive settlement of the conflict, which could enormously boost regional cooperation. Azerbaijan should also seek international cooperation to find resources, but also to use them efficiently and transparently for reconstruction of the returned territories in and around Karabakh. There are hopes that, if fulfilled, building new economic, transport and communications infrastructure as outlined in the November 10 peace deal will strengthen regional cooperation and reconciliation.