

BTI 2016 | Azerbaijan Country Report

Status Index	1-10	4.44	# 95 of 129	
Political Transformation	1-10	3.48	# 105 of 129	➔
Economic Transformation	1-10	5.39	# 72 of 129	➔
Management Index	1-10	3.76	# 103 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	9.5	HDI	0.747	GDP p.c., PPP \$	17515.6
Pop. growth ¹	% p.a.	1.3	HDI rank of 187	76	Gini Index	16.6
Life expectancy	years	70.7	UN Education Index	0.700	Poverty ³	% 0.0
Urban population	%	54.4	Gender inequality ²	0.340	Aid per capita	\$ -6.7

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

Executive Summary

The year 2013 was crucial for Azerbaijan: President Aliyev was re-elected a third time after the two-term limit was lifted in 2009. This marked an unprecedented case in the region and highlighted the Azerbaijani regime's intention of gradually transitioning the country into a Central Asian autocracy.

Some developments, however, posed a serious challenge to the ruling regime's hold on power, as Azerbaijan's social awakening, ignited by the Arab Spring, has begun to make inroads in society. Social networking has broken down barriers to the free flow of information, and civic activism among youth has grown exponentially, for which the government was unprepared.

This sudden thrust of civic engagement led to unexpected and sometimes violent mass protests in January 2013. At Bina Shopping Center, in a suburb of the capital Baku, small business owners protested the corrupt regulations imposed on businesses; noncombat-related deaths in the army, due to mistreatment of conscripts, caused youth to protest in downtown Baku; and, the surmounting abuse of power by local officials in the northern Ismayilli region resulted in a violent uprising. Although the government cracked down on such protests, and accused political opponents of incitement, tensions continued to build and the government's ability to contain them waned.

However, the fragmentation of opposition and its sinking into oblivion, as well as the government's strong grip on law enforcement and its repressive nature prevented this development from transforming into a bigger political movement.

Ilham Aliyev's election for a third term garnered strong international criticism due to widespread irregularities revealed to the public through social networks. In general, despite the increasingly oppressive nature of the government, social activism and the strengthening of civil society also continued. The Maidan Movement, which led to the overthrow of Viktor Yanukovich in Ukraine,

served as an additional morale boost for pro-Western democracy activists in Azerbaijan, despite the fact that the government imprisoned many of them.

Russia's annexation of Crimea, however, was a game-changer for the Azerbaijani government. While the world was preoccupied with the conflict in Ukraine, Aliyev launched a major crackdown, in which he arrested political opponents, civil society leaders, heads of local NGOs, and prominent human rights activists. In addition, the bank accounts of independent NGOs were frozen, prominent international donors were forced out of the country, legislation on donor's activities was tightened, criminal investigations against them were launched, and pressure on independent media was heightened. The ongoing crackdown had a negative effect on Azerbaijan's relations with its Western partners and caused mounting criticism from the international media.

The Nagorno-Karabakh conflict, which escalated in 2014, threatened stability in Azerbaijan as well. In order to boost nationalism, the Azerbaijani government intensified its belligerent rhetoric and several major breaches of the cease-fire occurred. In August 2014, the conflict nearly escalated into a full-scale war. In November, during military drills in Nagorno-Karabakh, Azerbaijan shot down an Armenian military helicopter which allegedly crossed the neutral zone established by the cease-fire. In December 2014, Armenia condemned two Azerbaijani captives to long prison sentences. Moreover, the Azerbaijani government imprisoned prominent Azerbaijani human rights activists and journalists, who were accused of spying for the Armenian secret service following their efforts to engage both sides in a reconciliation process.

Meetings of the two presidents, organized by Russian President Vladimir Putin in Sochi and by French President François Hollande in Paris were aimed at easing the tensions, but to no avail. Escalation continued through early 2015.

The economic situation in the country has remained stagnant over the past two years. The economy is still highly dependent on oil exports. Oil production continued to decline in 2013. Yet, to some extent, this was offset by growth in the non-oil sector, which was driven by government investment, resulting in a GDP growth rate of 5.8% in 2013.

However, in 2014, the GDP contracted by 2.5% due to low production and falling oil prices, as well as a contraction in the non-oil sector of the economy, as the government reduced its public spending.

In order to compensate for falling oil production and prices, the government is trying to boost Azerbaijan's gas production, and in December 2013 a \$45 billion deal was signed with a BP-led group to pump Azerbaijani natural gas through the Trans-Adriatic Pipeline (TAP) running from Greece to Italy. However, the project, which is expected to increase Azerbaijan's revenues from gas exports, will start supplying gas to Europe only in 2019.

History and Characteristics of Transformation

In the early 19th century, Russia incorporated Transcaucasia into its territories. Among the conquered lands were those that constitute today's Azerbaijan Republic, where the majority of the local population were Shia and Sunni Muslims.

Under Russian rule, a new class of secular native intelligentsia emerged, which modernized the local Muslim society and transformed the Shias and Sunnis of the South Caucasus into secular Azerbaijanis.

The fall of the Russian monarchy in 1917 allowed Azerbaijani nation-building to move on to a state-building process: in 1918, the first Azerbaijani Democratic Republic – a parliamentary democracy with secular laws – was established.

Although the first republic did not last long and was dismantled by the 1920 Bolshevik invasion – the identity-building process in Azerbaijan continued to grow and strengthen during Soviet rule.

In the late 1980s, during Gorbachev's perestroika, the dispute over Nagorno-Karabakh's sovereignty, contested between Azerbaijan and Armenia, reignited the Azeri nationalist movement. After January 1990, when Soviet troops entered the Azerbaijani capital of Baku, nationalists began to chant slogans of independence. This movement, led by the People's Front, positioned itself as an alternative to the local Soviet leadership.

On 18 October 1991, Azerbaijan declared its independence and, a few months later, the Peoples' Front overthrew the last communist leader of Azerbaijan, Ayaz Mutallibov, amid the chaos of 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 military troops from Azerbaijan with Russian President Boris Yeltsin. But, a year later, he was overthrown in a military coup allegedly backed by Soviet security forces. When civil war was imminent, former KGB General and Communist Party of the Soviet Union (CPSU) Politburo Member 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 into the CIS agreement, and cracking down on local warlords. But the most important achievement of Heydar Aliyev was the so-called Contract of the Century, whereby Western companies were invited to explore Azerbaijan's oil fields. Aliyev embarked on a strategic initiative to build oil and gas pipelines in order to help Europe diversify its energy supply away from Russian dependency.

Aliyev eventually succeeded in ending the war with Armenia and bringing stability and security to Azerbaijan through realignment with the West; however, he 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 in post-Soviet space. Ilham Aliyev maintained the energy policies of his late father, but continued to close the space for independent political activities, the media and civil society. 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 again in 2013, when he was elected for a third term in a much criticized election. Following reelection, Ilham Aliyev continued to stifle independent voices and stymie Azerbaijan's democratic progress.

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

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

Azerbaijan lost control over 17% of its territory during the war with Armenia in the early 1990s. The cease-fire established in 1994 has mostly held for two decades despite sporadic violations. In 2014, two major incidents seriously jeopardized the truce. First, in early August 2014, the bloodiest clashes since 1994 erupted between the two sides, claiming dozens of lives. Later in November, Azerbaijan downed an Armenian helicopter, which allegedly violated its airspace.

Monopoly on the
use of force

5

Both incidents caused serious concerns over the possibility of a resumption of a full-scale war. That is why several high-ranking meetings between the presidents of Armenia and Azerbaijan were organized by international partners to ease rising tensions.

Apart from the lost territories, Azerbaijani government enjoys an unchallenged monopoly on the use of force in the rest of the country.

However, there are some issues which pose potential threats to the progress of the state-building process, thus challenging the sustainability of the regime's monopoly on power:

- The possibility that Russia and Iran might use the presence of ethnic minorities concentrated in the northern and southern parts of the country, respectively, to instigate separatism as a pretext to destabilize Azerbaijan;
- Although the president of the country, Ilham Aliyev, is still the most powerful political figure in the country, he, unlike his late father, does not enjoy an absolute authority, since he shares power with some very powerful state officials and oligarchs;
- In addition, rising signs of religious radicalism are among other potential major challenges to the current situation.

Legally, the entire population, irrespective of race, gender, religion or ethnic background, is guaranteed full citizenship. Despite some minor problems, it is de facto reality as well.

State identity
8

Azerbaijani national identity was gradually shaped in the second half the 19th century after Russia incorporated Muslim parts of the South Caucasus during the war against Iran and the Ottoman Empire. It was invented and further developed by the secularly educated intelligentsia. The nation-building process resulted in the formation of the first Azerbaijani Republic in 1918, after the collapse of the Russian monarchy. Although this republic did not last long and was incorporated by the Soviet Union, two major ingredients of Azerbaijani identity worked well for the policies of the communist state. These were secularism, on which the Azerbaijani identity was built, and the Soviet state's national delimitation policies. Thus, Soviets actually strengthened Azerbaijan's nation-building process. After the collapse of the Soviet Union, Azerbaijani state identity faced some challenges, but generally upheld its dominance.

The current Azerbaijani government has so far successfully promoted loyalty to state identity through school curricula, textbooks, state propaganda, et cetera. Generally, it is consistent with the foundation of the nation-building process, which started in the 19th century. However, the cult of personality built around former President Heydar Aliyev (father of the current head of state) has been linked to the consolidation of state identity. Aliyev is portrayed as the nation's founder or savior, in a manner similar to Ataturk in the Republic of Turkey. However, there is a high probability that this policy will be questioned in the future, causing certain unease for the transformation.

In principle, nation-building and state-building in Azerbaijan are based on a strong secular legacy. Yet, after the collapse of the Soviet Union, there was a significant religious revival process in which both domestic and foreign actors played a role. It resulted in the emergence of local pro-Iranian, pro-Turkish and pro-Arabic religious groups, which tend to give preference to their recently acquired religious identities over the secular state-identity of Azerbaijan. But these religious groups have by and large been marginalized, which has helped to strengthen Azerbaijani state identity.

The major challenge to the nation-state identity came from Armenians in Nagorno-Karabakh who launched a separatist movement just before the collapse of the Soviet Union.

In 1919, after World War I, a mandate for the region was given to the British, and they handed the control over Karabakh region to the Azerbaijani government of the time. The General Governorate of Karabakh was established under the authority of Azerbaijani Republic. In the 1920s, after sovietization of the region, the communist state again brought the question of the disputed territories into question. Eventually,

Karabakh was designated a province of Soviet Azerbaijan, albeit in the mountainous part of it, where majority of the population were Armenians. An autonomous oblast, legally subordinate to Azerbaijan, was created. In the late 1980s, during Gorbachev's perestroika, the Armenian majority in Nagorno-Karabakh Oblast demanded to secede from Azerbaijan and join Armenia. In late 1989, the Supreme Soviet of the Armenian Soviet Republic passed a resolution about integrating Nagorno-Karabakh into Armenia. Hostilities between two sides transformed into a major war after the collapse of the Soviet Union. Azerbaijan lost control over Nagorno-Karabakh and the adjoining seven regions. A cease-fire was established in 1994. In 1992, the Minsk Group, chaired by France, Russia and the United States, was established to broker peace between the two countries. However, it has not yet produced any results.

Apart from Armenians in Nagorno-Karabakh, some ethnic minorities have expressed resentment against the rise of Turkic nationalism among the majority population after the collapse of the Soviet Union, although Azerbaijani state identity continues to gradually strengthen among these minorities, as well.

However, issues, such as peace with Armenia, economic prosperity, inclusiveness and government accountability, as well as the successful establishment of a regime of the rule of law, are key for securing and sustaining the state identity.

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 Azerbaijani society has managed to preserve its overwhelming secular nature, the rise of religious groups has instigated debate about the role of religion in politics. From time to time, some religious groups try to be active in political life, though they are heavy-handedly suppressed by the government.

Most recently, some religious groups raised the issue of wearing headscarves in public schools, which led to the imprisonment of dozens of religious activists. Since early 2014, the issue of Azerbaijani radicals joining Islamic jihadists in Iraq and Syria has regularly popped up in Azerbaijani media outlets. Although the credibility of these reports was questioned, nonetheless, they were followed by the government's decision to close some mosques and imprison alleged homegrown jihadists.

While the government does not tolerate independent religious groups, it uses the country's Islamic identity as a political tool in both domestic and foreign policies. And for these ends, the semiofficial Caucasus Islamic Board, headquartered in Baku, and the State Committee for Work with Religious Communities are used as policy agencies.

Major Muslim holidays have been celebrated in the country since the collapse of the Soviet Union. Commemorating Ashura by Shia Muslims as a day of mourning for the Prophet Muhammad's slain grandchild Hussein is the most important annual

No interference of
religious dogmas

8

religious event. Although its observance continued even during Soviet times, attendance has been steadily growing since independence.

Construction of “the biggest mosque of the Caucasus,” named after the current president’s father Heydar, was completed in Baku in December 2014. According to some observers, construction of this new mosque was launched to compensate for the previous closures and demolition of popular mosques operated by independent religious groups.

The state provides such basic services as health care, education, tax collection, social services, transportation, law and order through its fully functioning bureaucratic system and infrastructure, although the quality and standards of these services are not sufficiently advanced.

Basic
administration
7

According to data from the World Bank, 82% of the population of Azerbaijan has access to improved sanitation facilities, and 80% uses an improved drinking water source.

A well-functioning informal hierarchy of power exists in the government structure. Each of the powerful oligarchs (high ranking officials) supervises several ministries. These oligarchs (some are ministers themselves) also share responsibility for the performance of heads of regional executive offices, appointed by the president upon their recommendations.

Independent Azerbaijan inherited the Soviet-established regional administrative system, which has remained almost unchanged since. The administrative apparatus in the provinces and cities are led by heads of executive offices, who enjoy relative independence and vast administrative powers. They possess personal responsibility for economic performance and social well-being; for the provision of political stability and the promotion of popular loyalty to the regime in their respective provinces. Unofficially, all of the regional state institutions including the law enforcement and judiciary, accept the authority of the local chief executive.

2 | Political Participation

In a highly disputed referendum in 2009, an amendment was made to the constitution lifting the two-term limit on presidency. This amendment paved the way for President Ilham Aliyev to be elected for the third time in presidential elections in 2013.

Free and fair
elections
3

In its preliminary statement of findings, the International Election Observation Mission (EOM) concluded that the 2013 presidential election “was undermined by limitations on freedom of expression, assembly and association that did not guarantee

a level playing field for candidates.” The final report of the OSCE ODIHR’s similarly concluded that “the counting was assessed in overwhelmingly negative terms.”

The last legislative elections, held in 2010, were the least credible. Representatives of major opposition political parties were prevented from getting even a single seat in the country’s parliament.

In addition to the lack of trust in elections, insignificant authority seriously reduces interest in contests for municipal seats. The ruling party overwhelmingly dominated the most recent municipal election, held in 2014, which completely lacked electoral competition, and went almost unnoticed by the population. It should be emphasized that major cities, including the capital, do not have elected mayors.

Lack of political will among the leadership remains the most important problem, hindering free and fair elections. Election commissions are composed overwhelmingly of regime loyalists, who carry out orders received from the presidential office.

Throughout the years, the government has consistently limited space for political competition. Airtime for candidate debates on state TV and radio has shrunk significantly. The costs of airing campaign ads have skyrocketed, making them unaffordable for the economically strangled opposition. Distributors of leaflets on the streets are harassed, intimidated and taken to police stations. Rallies are only allowed in places designated by the government, which are usually inconvenient, hard-to-reach locations. All of these restrictions, combined with other types of pressures, including intimidation and harassment of activists, have significantly reduced the challenging power of the systematically weakened opposition parties.

Election days are marred by multiple voting, ballot stuffing, interference with vote counting and other irregularities. Furthermore, the results achieved despite these irregularities are later subject to adjustment in the Central Election Commission, according to the designs of the government.

The Constitutional Court remains a rubber-stamp body, with no serious power to challenge the election results.

At the national level, the president exercises control over the governance of the country. Parliament and local municipal representatives, despite being nominally elected by the people, remain passive participants in the governance process. Yet, the entrenched interests of the state elite, who are the so-called oligarchs/government ministers and other high-ranking officials, limit the president’s power. The military is under control of the president, while head of the powerful state police, the Minister of Internal Affairs, Ramil Usubov, is regarded as more loyal to the Chief of Staff (in

Effective power to govern

2

the presidential administration) Ramiz Mehtiyev, who is the second most powerful person after the president. Since the death of former president Heydar Aliyev, Ramiz Mehdiye has enjoyed more autonomy in comparison with the other oligarchs.

Parliament members are often protégés and relatives of oligarchs. Since the 2010 parliamentary elections, no opposition to the ruling party remains in the parliament.

Meritocracy in the bureaucratic system is compromised by deep-rooted clientelism, cronyism and nepotism. Traditionally, two major regional groups tied to the regime (Nakhichevanis and ethnic Azerbaijanis from Armenia) have dominated the system. However, since 2003, groups tied to the president's wife have slightly undermined the monopoly of these two regional groups among high-ranking officials.

Additionally, the demand for skilled professionals in businesses and important state structures paves the way for meritocracy. This is starting to somewhat challenge regional clientelism among mid-level career specialists in both business and government positions.

Particularly three major powers, namely Russia, the U.S. and the EU, are able somehow, directly or indirectly, to influence Azerbaijan's government policies. For decades, the Azerbaijani ruling elite has boasted of its so-called "balanced politics," which means remaining equidistant from the West and Russia. "Balanced politics" is officially credited with Azerbaijan's having avoided the fates of Georgia and Ukraine. However, Russia, particularly after Putin's ascendance to power, has obviously had more levers to assert pressure on Azerbaijan. Preferring regime interests over state interests has forced the Azerbaijani ruling elite to avoid seeking full cooperation with the EU and the Transatlantic space, especially in the realms of human rights and democracy. This has made the government more vulnerable to Russia's pressure. For example, before the presidential election of 2013, Putin visited Baku with two military ships with the clear intention of displaying Russia's military power.

Freedom of assembly is guaranteed by the constitution, but severely restricted in reality. In the late 1980s and early 1990s, Baku citizens were able to organize opposition rallies in the central Freedom Square, but the regime has effectively closed Freedom Square for protest purposes since the mid-1990s. After the 1998 presidential elections, the opposition was denied permission to hold demonstrations in downtown Baku. Gradually through administrative measures, protest rallies were pushed to hard-to-reach outskirts of the capital. However, since spring 2011, opposition and youth groups have organized a string of unauthorized protests in the city's downtown, which have attracted more and more supporters and reached its peak in 2013.

This trend forced the government to modify its position on authorized locations for opposition demonstrations. During the presidential campaign of 2013, new, relatively

convenient sites were included in the government-approved list for rally locations, albeit still outside of Baku's city center.

The government closely monitors participants and especially those active in the organization of rallies, launching various forms of oppression against them, which include long and short-term imprisonment, firing from jobs, et cetera.

All of the specially designated venues for press conferences and roundtables are under the control of government officials, and they use both administrative and financial methods to restrict access by independents and government critics to these places. Sealed by the law enforcement in 2014, the office of the Institute for Reporters' Freedom and Safety (IRFS), was the last easily accessible place for the opposition and critical-of-government civil society groups to hold press conferences and roundtables.

The government also pressures hotels and other venues in downtown and other central parts of Baku not to provide opposition parties and independent NGOs with space to hold their events. However, both Musavat and the People's Front Party were allowed to hold their conferences in the outskirts of the capital.

The situation is direr in the provinces, with Nakhichevan being the most restrictive place. Yet, in the past two years, there were several protest rallies held in some provincial locations, not authorized by the government. These were sparked by widespread corruption in (local) government institutions and defiant behavior by high-ranking officials and/or their relatives, as was the case in the Ismayilli region.

Trade unions are Soviet style semi-official institutions fully controlled by the government.

The political climate in the country continued to grow increasingly restrictive in 2013 – 2014, becoming especially severe in 2014, after Russia's annexation of Crimea. Although pressure on media has been part of the overall attempt to suppress the opposition and restrict the operations of independent NGOs, the government has been particularly careful to avoid giving rise to domestic criticism before the first European Olympic Games held in Baku in June 2015, which were expected to attract a lot of international attention.

According to the Committee to Protect Journalists, there are numerous jailed journalists in Azerbaijan. Among them is the most prominent investigative journalist Khadija Ismayilova, who was detained on dubious charges. Although some imprisoned journalists were released by presidential pardon in late December 2014, the overall plight of freedom expression continues to deteriorate.

Television stations in the country are fully controlled by the government. Independent voices do not have access to television to express their opinions. Several TV

Freedom of
expression
3

programs delivered from satellites abroad face technical interference launched by the Azerbaijan government.

Azeri services of foreign broadcasting agencies, such as the Voice of America, BBC and Radio Free Europe/Radio Liberty (RFE/RL) remain off air, since they were banned from broadcasting on FM waves in early 2009. However, since then, they have continued delivering information via Internet. In December 2014, government law enforcement representatives raided and sealed the local office of Radio Free Europe/Radio Liberty, based on trumped up tax evasion charges.

Only one opposition print media outlet, Azadliq, continues operation, while others gave in to governmental pressure by largely reducing their critiques of the government. Informal restrictions were imposed on Azadliq Newspaper, and it was fined large sums on charges of defamation, following lawsuits filed by friends of the government.

Legal amendments that limit access to information were introduced after investigative journalists revealed widespread corruption linked to the ruling family.

Azerbaijan's freedom of press dramatically decreased, according to various reports by organizations such as the Freedom House and Reporters Without Borders.

Although serious criticism of social problems had been growing in social media, the government's increased repression and large-scale persecution of activists has resulted in self-censorship and a decline in criticism.

On several occasions, journalists have been attacked and beaten, such as in the case of the severe beating of Nakhichevani journalist Ilgar Nasibov. Repressions have also led to ordinary citizens feeling the climate of fear.

The government always highlights the fact that access to the Internet is unrestricted, and that the number of users is actually increasing. While it is true that access to the Internet is not restricted and, so far, there have only minor incidents when sites were blocked in the past, bloggers who criticize the government, especially those on Facebook, are constantly pressured, persecuted, jailed and so on.

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. Separation of powers exists only on paper. All the important decisions are made by the presidential office.

Separation of
powers
2

Parliament continues to remain a rubber-stamp body, without the capability to effectively check and balance the executive office. Apart from having legally

restrictive powers, the parliament's inability to challenge government policies derives from the way it is composed. Parliamentary elections are a mere formality. Deputies are not elected, but selected and appointed by the high-ranking executive office i.e., the presidential administration. The receivers of parliamentary seats are protégés and relatives of influential executive office holders. Members of parliament are simply carrying out orders received directly from the presidential office, which is the possessor of actual, yet informal, legislative authority.

The country's judiciary is only formally independent and is effectively controlled by the executive power.

Professional examinations are included in the selection process for judges. However, political loyalty to the regime, assessed through background checks and interviews, remains the top priority. The executive heavily interferes and has the last say in court decisions made regarding political, economic and other publicly sensitive cases. Thus, while the administrative capacity of courts may have improved, their political independence has actually deteriorated.

Independent
judiciary

3

No significant improvements have been made in combatting widespread corruption in the courts either. In the rulings of ordinary civil and criminal cases, corruption is still an important deficiency, heavily interfering with decision-making.

Defense attorneys to a great extent play ceremonial role and have minimal influence over court rulings. The bar association is also controlled by the executive, and is frequently used as a tool to penalize independent defense attorneys. During the last few years, some defense lawyers were dismissed from politically sensitive cases and some others were even disbarred, due to their success in bringing public and international attention to the irregularities existing in the courts.

The aforementioned practices exist in all three branches of Azerbaijan's judiciary, i.e., district courts, appeal courts and cassation courts under the Supreme Court of the Republic of Azerbaijan.

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

There is no political will or intention to fight corruption. Despite the existence of the State Commission on Combatting Corruption and the Anti-Corruption Department of the Prosecutor General's Office of Azerbaijan, only mid-level officials, i.e., bank clerks, employees at construction companies, teachers and other education officials, as well as elected municipality members, have been targeted, while high ranking officials have not faced any prosecution.

Prosecution of
office abuse

4

The anti-corruption campaign has been launched since the Arab Spring to mislead the public opinion.

The Anti-Corruption Department of Prosecutor General's Office of Azerbaijan has been used as a tool to silence political opponents, active civil society members and media organizations, as well. For instance, bogus corruption charges were brought against numerous NGOs, human rights defenders, journalists and news outlets, like RFE/RL.

During the last two years, public attention was absorbed by the corruption scandal, involving the former rector of a private university, who now lives in exile in France. He shared some hidden camera videos, including one that showed illegal haggling over a parliamentary seat. The head of the State Commission on Combatting Corruption was mentioned as the primary receiver of the bribe. Although an investigation was launched and the member of parliament was jailed (later released in May 2014), high-ranking officials and their relatives, who were involved in the case, avoided prosecution. The main witness died in exile under suspicious circumstances, while the Prosecutor General's office brought charges of tax evasion, bribery and abuse of office power against the rector. His family members were targeted and sentenced, as well.

In the past few years, investigative journalist Khadija Ismayil, who is currently in prison, published a number of reports, as part of the Organized Crime Corruption Reporting Project (OCCRP) disclosing the offshore businesses of high-ranking officials and members of the ruling family, as well as their involvement in corrupt practices in local Azerbaijani businesses.

In January 2013, President Ilham Aliyev was named the 2012 Person of the Year by the OCCRP because "his name figured prominently on stories of crime and corruption."

The reawakening of civil activism, particularly among the younger generation inspired by the Arab Spring and the popularization of social networking, has led to further suppression of civil rights and liberties in Azerbaijan. The government launched a major crackdown against political dissent, civil society, human rights activists, the media, international NGOs and youth organizations. This escalated particularly after the 2013 presidential election, and Russia's annexation of Crimea.

Law enforcement brutality and human rights violations were reported by many human rights organizations in the aftermath of the 2013 youth-led opposition rallies. These were caused by social issues, such as the rise of non-combat-related deaths in the army and the abuse of power by state officials. The crackdown on the opposition and civil society, which encompassed prominent human rights activists, independent media outlets, international organizations, et cetera, included trials, detentions, intimidation and physical assaults.

Civil rights
3

Although civil rights are protected by the constitution, cases of police brutality take place on a rather frequent basis. The Office of the Ombudsman is ceremonial and operates as the government's spokesperson on issues within its jurisdiction.

Azerbaijan is a rather conservative society. Although, legally, Azerbaijan is fully committed to gender equality and contains gender equality provisions in its constitution and has signed many international conventions, society's patriarchal nature is still dominant. Azerbaijan ranks low on the Gender Equality Index. However, the transformation process is accelerating and women's status both within the family and public life is gradually increasing.

Even though Azerbaijan has decriminalized homosexuality, the country's legal framework does not specifically ban discrimination based on sexual orientation. Nor does it mention protection of the LGBT community. Thus, there is still a serious infringement of rights of LGBT citizens. Police brutality remains a common occurrence, and often involves humiliation, physical violence, et cetera. As a result, LGBT citizens often do not report acts of intimidation towards them, due to fear of police brutality, harassment and, most importantly, social stigma.

In January 2014, the twenty-year-old director of the Free LGBT non-governmental organization, Isa Shakhmarly, committed suicide. His suicide was followed by the first-ever LGBT news conference held in Azerbaijan, in which activists discussed their plans for seeking new legislation to protect sexual minorities in Azerbaijan.

Ethnic inequality does not appear to be a problem in Azerbaijan. Azerbaijanis of various religious backgrounds enjoy equality and tolerance, although some non-traditional religious groups, such as evangelists and some minority Muslim groups, often face government restrictions.

4 | Stability of Democratic Institutions

Azerbaijan is an authoritarian state with democratic institutions existing only nominally. In reality, all power is vested in the hands of the executive. Since 1995, the parliament has been dominated by the ruling New Azerbaijan Party, and the government has gradually restricted presence of opposition parties in the legislature by manipulating elections.

The government imitates a multiparty system. It tolerates only those parties, which agree to relinquish criticism of the government. In 2002, a referendum was held to eliminate party-list proportional representation, leaving only a majoritarian (single-member constituency) system. In the 2010 elections, only political parties presenting themselves as opposition, but which in reality do not challenge the authority of the

Performance of
democratic
institutions
2

government and operate under its broad supervision, were given seats in the parliament. Real opposition parties were left outside of the legislative body.

Despite the fact that currently the parliament is heavily dependent on the executive and exists only in a formal sense, there is still a legal basis for separation of powers. In case there are free and fair elections, the parliament can contribute to the system of checks and balances, and fulfill its role as a body assuring accountability on the part of the executive.

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 corrupt practices, the judiciary will also be professionally able to meet its obligations as a democratic institution.

Elected municipal representatives exist. However, they are not centralized, that is, there are neither elected mayors of cities, nor elected regional governors. Regional and city legislatures do not exist either. All the power is concentrated in the hands of heads of local executive offices appointed by the president. Thus, informally, municipalities completely depend on those powerful heads of regional or city executive offices. The same applies to the local judiciary.

While, historically, after the collapse of the Soviet Union, there was a strong support for the concept of democracy among the population, people knew very little about its basic principles. However, during the last few years, with a growing number of individuals exposed to Western education entering public life, and through civic initiatives supported by international and local NGOs, knowledge of these principles has expanded among the population, raising hopes for gradual change that would lead to democratic governance in the country. Nevertheless, recent crackdowns have seriously damaged, if not halted, this process.

The government, which always stresses its loyalty to building a democracy and democratic institutions, with the recent crackdown proved once more that all of those vows are in fact just lip service, and that it is not willing to tolerate democratization either of society or of the government itself.

Furthermore, until recently, old-style secular political parties were in strong opposition to the government, but never clearly defined their ideology. However, during the past few years this tendency has changed. Well-defined, liberal-democratic-minded organizations led by the newly emerged young middle-class have been seriously challenging the dominance of the traditional oppositional political parties.

Commitment to
democratic
institutions
2

5 | Political and Social Integration

Azerbaijan is an authoritarian state, dominated by one ruling party. During the 1990s and early 2000s, three major political parties challenged the ruling elite. Similar to the ruling party, all three parties were prone to personal politics and regional-based clientelism. After the 2003 elections, one of them, namely the National Independence Party gradually disintegrated after the resignation of its longstanding leader. The other two, i.e. Musavat and the People's Front Party, tried to unsuccessfully challenge the ruling New Azerbaijan Party in the 2005 parliamentary elections.

In the 2010 parliamentary elections, neither party was allowed into parliament, and this, along with growing government pressure, seriously damaged both political parties.

Both of these two major registered political opposition parties have declared their loyalty to liberal-democratic principles, but never pursued a well-defined systematic promotion of adequate values. In 2014, the chair of Musavat resigned and was replaced by a new leader, which resulted in prolonged disputes and significant fragmentation, accelerating the party's decline.

The People's Front Party, in turn, was stripped of its headquarters and many of its active party members have been jailed in the last couple of years.

However, the entry of Western-educated youth into public life during the last few years, and the emergence of young social middle-class and strong mid-level career professionals interested in active public life, have paved the way for the birth of new pro-Western political groups, such as the Republican Alternative and NIDA. Nonetheless, these organizations have suffered a lot due to ongoing government pressure. Both of these new organizations not only declared their pro-Western agenda, but also have actively promoted their views on mainstream and social media. Neither, at least in the initial phase, was exposed to region-based clientelism. Still, the sustainability of these characteristics remains to be seen in the future.

The rest of the political parties are mainly controlled by the regime and pursue the government set agenda.

During the past few years, a number of influential interest groups have started developing in the form of NGOs, cultural, religious, social, human rights and ideological networks, like the Free Thought University, the Institute for Reporters' Freedom and Safety (IRFS), the Human Rights Club, ODA Theater, the Intellectual Extreme Network (kultura.az), the Women's Association for Rational Development (WARD), the Free Writers Center (AYO), the Center for Protection for Freedom of Religion and Conscience (DEVAMM), Support for Economic Initiatives, the Intelligent Citizen Enlightenment Center Public Union and Legal Education Society

Party system
2

Interest groups
3

(LES) and others. They are concentrated mainly in the capital Baku, as well as in some other major cities, though largely absent from rural areas. These newly emerged groups have started challenging the establishment, i.e., the domination of Soviet-style organizations (for example, Soviet trade unions et cetera), which continue their formal existence as semi-official bodies. The emerging new organizations were rapidly gaining strength and started posing a real challenge to the existing system, attracting more attention and mobilizing more active people around themselves. However, this unexpected success made them primary targets in the ongoing crackdown. Many faced numerous administrative and legal restrictions: leaders of some organizations were arrested on dubious charges, and criminal investigations were launched; some others were stripped of their rented premises and still others lost their funds due to restrictions imposed on donors; laws were toughened and all of these actions made the environment almost non-operational. As a result, many have ceased their activities. The process was halted, at least for the time being.

After the fall of the Soviet Union, there was strong support for the concept of democracy and integration into the Euro-Atlantic space. According to the Caucasus Barometer's 2013 survey, 55% of Azerbaijan's population believe that "democracy is preferred to any other kind of government," while a survey conducted by the Pew Research Forum in 2013 confirms that 51% of Azerbaijani Muslims "prefer democracy over a powerful leader."

Approval of
democracy
n/a

The majority is still loyal to the implementation of government accountability and the rule of law. However, the rise of Islamists who support Shariah principles, as well as the government's constant criticism of democratic principles and human rights as tools for promotion of Western imperialism have raised doubts about democratic values among some sections of the population. At the same time, support for democracy has always been superficial, lacking deep knowledge about its basic principles and values.

The bulk of social capital in Azerbaijan is centered in rather homogenous family and kinship circles, regional identities and in 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 greater in the rural regions outside the capital, and with expanding urbanization and modernization, they have been gradually decreasing. They have been declining in comparison with Soviet times as well.

Social capital
3

Although participation in formal civil associations, such as membership in NGOs has generally remained limited, but had been steadily growing in the capital city until the recent crackdowns.

In general, however, society remains accustomed to demanding action from the government rather than engaging in self-help.

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Socioeconomic
barriers
5

Azerbaijan's economy has remained rather stagnant in the past two years. Despite official statistics, the level of socioeconomic development has not seen much change. In 2013, Azerbaijan ranked 76th in the Human Development Index. The official GDP per capita comprised around \$7812 in that year. Whereas in developed countries, GDP per capita aligns with the average salary level, in Azerbaijan the official per capita numbers are more than 10 times the average salaries. Despite large oil wealth, the majority of the Azerbaijani population receive very low salaries, that are enough to cover only basic needs. These salaries are mostly uniform for government-funded jobs. Salaries in private firms tend to be higher, with the highest being paid by foreign companies. This leads to a big income gap between Western-educated and locally educated, as well as rural and urban, populations. According to World Bank estimates, the Gini Index of Azerbaijan, which measures income inequality within an economy, is 33.7.

People who have ties to the ruling elite enjoy more privileges and better lifestyle than the rest of the country.

Most IDPs and refugees still struggle with poverty. Although, according to the World Bank, the poverty rate has been in decline, and in 2013, only 5.3% of the population was living under the poverty line.

Legally, women are entitled to the same rights as men. However, due to cultural factors, they are excluded from positions of leadership. Female professions have traditionally been underpaid, and gender-specific exclusion is evident. Dire living conditions, especially in provincial towns and rural areas, have resulted in high (labor) migration. Conservative estimates place the number of temporary or permanent emigrants – mainly to Russia – at approximately 1-1.5 million. However due to the economic crisis in Russia, the return of some labor migrants from Russia is expected.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	13245.4	52902.7	73560.5	75198.0
GDP growth	%	26.4	4.9	5.8	2.0
Inflation (CPI)	%	9.7	5.7	2.4	1.4
Unemployment	%	7.3	5.6	5.5	-
Foreign direct investment	% of GDP	33.8	6.3	3.6	5.9
Export growth	%	48.9	24.2	1.5	-1.1
Import growth	%	9.5	1.3	10.0	4.1
Current account balance	\$ M	167.3	15040.4	12231.7	10208.8
Public debt	% of GDP	13.3	11.1	13.8	15.9
External debt	\$ M	2118.2	7029.0	9219.1	-
Total debt service	\$ M	222.5	415.8	2498.3	-
Cash surplus or deficit	% of GDP	-	15.4	-	-
Tax revenue	% of GDP	-	12.2	-	-
Government consumption	% of GDP	10.4	10.9	11.2	10.9
Public expnd. on education	% of GDP	3.0	2.8	-	-
Public expnd. on health	% of GDP	0.9	1.2	1.2	-
R&D expenditure	% of GDP	0.22	0.22	-	-
Military expenditure	% of GDP	2.3	2.8	4.7	4.8

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

7 | Organization of the Market and Competition

On paper Azerbaijan has a market economy. Although there are clear rules and laws aimed at regulating market competitiveness, they are just formality.

Market-based
competition

4

Small businesses in Azerbaijan face various forms of discrimination. The reason is the lack of competition and preferential treatment of large and state-owned enterprises.

Only a small percentage of firms in Azerbaijan engage in export. A significant share of firms that export are state-owned, which is a result of high rates of export of raw materials, especially oil. This hinders the ability on non-oil sector SMEs to develop. Import procedures and tariff-free barriers also discourage small businesses from engaging in import activities.

Small businesses also face numerous irregular inspections, which most of the time result in unofficial payments (bribes) to the inspectors in order to keep “good relations” with them.

Access to finance is also one of the biggest problems that small entrepreneurs in Azerbaijan experience. The credit supply is very limited, and in fact, almost 90% of SMEs use their own resources for their operating capital. Credit terms are unfavorable because of high interest rates, short loan terms and tough guarantee requirements.

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. At the end of 2014, the oil prices declined worldwide. However, the price of oil in Azerbaijan, which produces and sells a significant quantity of oil to neighboring countries, remained unchanged. Prices on non-state 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 competitiveness, these laws are bypassed, taking into account the high level of corruption in government offices.

Anti-monopoly
policy

3

Since the fall of the Soviet Union, there has been a lot of privatization of large enterprises, however they continue to be controlled by monopolies tied to high-ranking government officials, including minister oligarchs and their kin. Many small, and especially mid-sized, businesses are also owned by the oligarchs and informally tied to their large business.

Moreover, monopoly-holding officials fight possible competitors by restricting their access to the domestic market and forcing them out of business.

Azerbaijan is an oil-based economy and the State Oil Company (SOCAR) controls the major share of this industry. However, some foreign oil companies, primarily BP, played significant role in the post-Soviet oil industry of Azerbaijan.

The State Committee on Anti-Monopoly Policy and Consumer Rights Protection within the Ministry of Economic Development exists as mere formality and does not play any serious regulatory role in country's economy. The committee's main responsibilities are to promote market competitiveness, prevent unfair competition and abuse of small firms by businesses that have more dominant market positions, as well as to protect consumer rights. However, it has been ineffective in enforcing competition laws. The committee lacks resources and capabilities, and most importantly the independence needed to fight the monopolistic nature of the economy and help transform it into a modern market economy. The biggest factor contributing to the ineffective implementation of legislation and the committee's incompetence is the consolidation of monopolies and oligopolies in the hands of high-ranking government officials.

In the last two years, there were many reports in the local media about the possibility of adoption of the Competition Code by the Azerbaijani legislature. However, it has so far been delayed.

Azerbaijan has somewhat integrated into the world economy, especially in the area of energy exports. The Baku-Tbilisi-Ceyhan (BTC) pipeline crossing the territories of Azerbaijan, Georgia and Turkey transports oil from the Caspian to Western markets. The country has also recently agreed to the Trans-Adriatic Pipeline project, which will transport gas from the Caspian to Western Europe.

The situation is rather different in other sectors of foreign trade. Significant barriers hinder local entrepreneurs' ability to bring products into or out of the country for sale. In this regard, the customs committee has been very corrupt and a major obstacle to trade. According to the Doing Business Report, Azerbaijan ranks 166th among 189 economies on ease of foreign trade, because of high costs, paperwork and time associated with exporting and importing.

The biggest challenges that companies face in foreign trade are: high transportation costs; high tariffs, corruption and extensive bureaucracy in customs; wide-ranging powers granted to the authorities; and additional expenses related to obtaining permits and standardization procedures. High informal fees and long wait times at the borders hinder Azerbaijan's potential as competitive cargo transit route as well.

The Decree on Foreign Trade lists products, such as construction services, that can be imported and exported upon approval of the Cabinet of Ministers or the Ministry

Liberalization of
foreign trade

4

of Economic Development. However, the law does not discuss the grounds for refusal of such approvals, leaving much to the discretion of government authorities. This creates complications for entrepreneurs and excludes many from import/export activities. Thus, trade still remains largely restricted to few big players.

Negotiations between Azerbaijan and the WTO regarding trade liberalization or membership have not yielded tangible results, as, in reality, Azerbaijan does not intend to become a member of the WTO because joining this organization would make the country subject to international standards, threatening the high degree of corruption that exists in the economy.

Although, in general, the banking system in Azerbaijan is expanding, it is uncompetitive and to a great degree controlled by the ruling regime. There are overall 44 banks in the country. About ten years ago, nearly 60% of bank assets were government-owned. Although the process of privatization of state-owned banks has officially been completed, in reality the vast majority still belongs to high-ranking government officials. Officially, the International Bank of Azerbaijan (IBA) remains the only majority state-owned bank. In 2014, in order to preserve the state's share in the bank at over 50%, the Central Bank injected new capital into the IBA. The Central Bank is also vested with supervisory functions.

Foreign capital in the banking system is negligible. Only 21 banks have some foreign capital participation, while six banks have majority foreign capital. This adds up to a share of bank assets by foreign owned banks well below 10%. International banks cannot operate in Azerbaijan under free terms.

In January 2014, the minimum capital requirements for banks drastically increased fivefold, from 10 million to 50 million AZN, leading to some banks closing their regional branches.

The stability of the country's banking sector is low, and the government does not reveal full and correct information about the health of the banking system, such as the extent of nonperforming loans. Although, according to the World Bank, the percentage of nonperforming loans constituted 4.5% in 2013, the country report issued on Azerbaijan by IMF claimed that "these figures are understated because only the overdue portion of principal and interest is reported as NPL."

In the last few years, there was an almost-chaotic increase in consumer bank loans for the purchase of cars, household items, technical equipment, as well as for small business operations, the purchase of homes and [home?] repairs. However, in 2014, due to a sharp increase in consumer credit defaults, banks moved to impose several loan restrictions.

Banking system

6

8 | Currency and Price Stability

The Central Bank of Azerbaijan (CBA) continued to maintain its policy of a near-fixed exchange rate against the U.S. dollar in 2013-2014. During 2013, the CBA intervened in the market by purchasing \$2.5 billion in order to maintain exchange rate stability. The nominal exchange rate has remained stable at approximately 0.78 AZN per U.S. dollar.

Anti-inflation /
forex policy

7

Having a strong currency is regarded by the government as a prestigious indicator of strength and stability. The Central Bank is not an independent and transparent body, and is highly influenced by political decisions. Thus, the policies of the CBA are carried out, not based on factors that benefit the country's economy, but rather on political factors that benefit the regime.

In December 2014, with world oil prices falling and the stronger U.S. dollar, demand for U.S. dollars increased in Azerbaijan. The weakening of the ruble, which led to the depreciation of the currencies of some post-Soviet countries, also played a psychological role in the increased demand for the dollar. As a result, in late 2014, the government sold 8% of its international reserves (\$1.7 billion) to maintain the stability of its national currency.

Although rising state oil revenues in the 2003 – 2008 period also caused serious inflation, at some point reaching 25%, with decreasing oil revenues, inflation rates decreased to around 1.5% in 2014. The low inflation rate was also helped by falling world food prices.

Azerbaijan's external debt remained low, comprising 8.5% of its GDP in 2014, according to the official data from the Ministry of Finance. The current account surplus decreased following a reduction in oil exports. Yet, the non-oil fiscal deficit slightly improved as a result of falling imports in 2014 due to weak demand resulting from decreased consumer credit and new import regulations.

Macrostability

7

The government had established the State Oil Fund in order to preserve macroeconomic stability by limiting the flow of revenues into the state budget. For some time, this institution has helped to preserve macroeconomic stability. In the past few years, however, the government has drastically increased its budget expenditures. Experts estimate that the current level of expenditures will put the budget under serious pressure.

According to the data from the Central Bank, Azerbaijan recorded a budget surplus of 0.6% in 2013. Although there are no official statistics for 2014 (as of March 2015), it is estimated that the year closed with a budget deficit, stemming from low oil prices.

Despite the lower oil revenues, the government plans to increase military spending amid escalated tensions with Armenia.

9 | Private Property

Property rights are not secure in Azerbaijan. The state and powerful oligarchs frequently violate them.

Property rights
4

Despite the existence of legislation on property rights, there are still some gaps in the laws, and enforcement of current provisions remains very poor. The constitution and other laws dealing with property rights 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 led to the large-scale demolition of buildings in subsequent years. According to the law, private property is protected by the state against any other kind of infringement. But, because of high level of corruption, government officials and oligarchs have the power to bypass the laws and expropriate private homes and retail spaces for their own private purposes.

Starting in 2009, private property rights came under massive attack because of government-sanctioned evictions and demolitions of private houses in several districts of Baku, culminating in 2011-2012 during the construction of the Winter Park in the capital's prestigious downtown. The president publicly announced that the compensation of 1500 AZN per square meter, offered by the government, was fair and would not be increased. Yet, actual prices for apartments for sale in the same district were much higher.

The most recent attack came in 2013-2014 when the government initiated evictions of residents of the Sovetsky District in central Baku. The government provided citizens with the same price of 1500 AZN per square meter, making it difficult for people to afford to buy new apartments in the same district or its vicinities. As a result, many are forced to relocate to the outskirts of the city.

Many gaps remain in legislation for registering property. State officials frequently interfere with legal processes in order to extract bribes. Politically motivated infringements on property rights remain a problem as well. However, the process of registering property has been simplified to some extent with the creation of ASAN service centers. According to the Doing Business Report of 2015, Azerbaijan ranks 10th among 189 economies "on the ease of registering property."

In January 2015, the president issued a decree on the registration of undocumented homes built without prior government consent. However, a few years earlier, the president issued a similar decree, which did not yield expected results.

Azerbaijan has flaws and gaps in the laws aimed at protecting intellectual property rights. However, recently, new legislative acts, such as the law on Enforcement of Intellectual Property Rights and Fighting Against Piracy, have been adopted. Additionally, the Center for Enforcement of Intellectual Property Rights was created under the Copyright Agency in order to enforce IP rights. The center is expected to issue copyright hologram stickers for certain products, such as software, books, CDs, DVDs, et cetera. Products without these marks will be considered pirated and fines will be imposed on their distributors.

Major local private companies are usually owned by government officials and their kin. Since the mid 1990s, there have been many cases of large or mid-scale enterprises taken away from their owners, who do not have links or ties to the ruling elite.

The “one window” registration system adopted in 2008 has resulted in an increase in the number of businesses over the past few years.

Moreover, according to Doing Business report, “Azerbaijan made starting a business easier by introducing free online registration services and eliminating preregistration formalities, [and] by reducing the time to obtain an electronic signature for online tax registration.”

However, 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 the investment in the non-oil sector and create a lot of challenges for private businesses.

Although there are laws in place that make opening or registering private enterprises easy, there is still a lot of irregularity in the implementation of these laws. The operations of private businesses are prone to the pressure originating from government, oligarch-owned monopolies and widespread corruption. If businesspeople are in trouble with the government, they can be subjected to biased and unexpected pressure from state agencies like the tax authorities or customs.

Additionally, the process of obtaining business licenses, certifications and loans acts as administrative barriers hindering competition and toughening the environment for business operations. Moreover, corrupt government authorities continue to violate business procedures to advance their own interests.

Privatization procedures are well-defined on paper, but preference is often given to companies with a strong government connection, and tenders are not transparent at all.

Private enterprise
6

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 the poorer sections of the population.

The minimum wage has risen in the last several years, to 105 AZN (equivalent to \$134). However, it has been offset by increasing prices, and thus is still too low to cover basic needs.

The rural population is less affected by poverty than parts of the urban population; inhabitants of small towns, in particular, can take refuge in the largely privatized agricultural sector. Family networks and money transfers from family members working abroad act as a stabilizing force for segments of the population. However, due to the economic shock in Russia in 2014, the remittances sent to Azerbaijanis by relatives ought to be less than previously, which would have a negative impact on the country's economy.

Because on the unreliability of government statistics, it is estimated that up to 25% of the employable population is unemployed. The state lacks an active employment policy and a functioning system of employment exchange. There is also no state support for the vast majority of the unemployed. Social stabilization constitutes one of the central challenges in the country's future.

In 2013, Azerbaijan and the European Union launched a project, funded by the EU, aimed at developing private pensions through the creation of a legal framework for non-state pension funds. In late 2014, the government also adopted the Draft of the Reform of Pension System.

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 (nepotism) and widespread corruption and education costs (which effectively restrict access to education) undermine equal opportunity in Azerbaijan. Since the collapse of the Soviet Union, women's status within society has suffered somewhat and social structures remain male-dominated.

In rural areas, the prevalence of religious and cultural traditions often result in young girls dropping out of school. Although female professionals can be found (primarily in the capital) among both the country's older, Soviet-trained and the younger, Western-trained generations, government offices are predominantly staffed by men. Given the low level of access to education for girls and women, particularly in rural

Social safety nets
6

Equal opportunity
6

areas, Azerbaijan ranks poorly on the Gender Equality Index and lags behind not only Eastern European countries, but also its neighbors Armenia, Georgia and Russia.

Ethnic origin does not appear to be a factor hindering hiring. Regional origin has tended to be important in Azerbaijan: Azerbaijanis from Armenia and the Nakhichevan exclave have privileged access to power and influence.

11 | Economic Performance

Although macroeconomic data suggest largely positive developments are underway (e.g., relatively low inflation, low national debt, a positive trade balance), they do not sufficiently capture the country's low economic performance, which can be attributed to the lack of diversity in industrial production (i.e., the extreme dominance of the oil/natural gas sector), high unemployment rates and low levels of domestic demand (i.e., an impoverished population).

Azerbaijan's economy grapples with typical "Dutch Disease" problems associated with an undiversified economy. The government adopted a tighter fiscal policy in 2014, which further limited non-oil sector growth. Foreign direct investment (FDI) remains tightly concentrated in the oil and gas sector, and attracting FDI to the non-oil sector remains one of the country's most pressing tasks.

Decreasing oil production in the past few years has weighed heavily on economic growth, with GDP hovering between zero and five percent since 2010 (after double-digit growth rates in the previous decade). With oil revenues falling and prices decreasing, the overall current account surplus has also narrowed.

The state budget remains heavily subsidized by the State Oil Fund. Indeed, the transfers from the oil fund to the budget amounted to less than \$1 billion in 2007, but to over \$9.49 billion in 2014, almost a third of the fund's assets. In other words, the oil fund appears to be failing its main purpose of saving the oil windfall for future use. Instead, the country has grown dependent on large yearly transfers from the fund amounting to almost 58% of the budget.

Output strength
6

12 | Sustainability

Ecologically tolerable growth finds only marginal consideration and is not at all entrenched institutionally. Creation of the Ministry of Ecology and Natural Resources in 2000, and partial de-industrialization and the modernization of the petroleum and natural gas sector, achieved in cooperation with international consortia and donors, have not resulted in much improvement for the environment.

Environmental
policy
5

Serious environmental challenges remain. Damage incurred by the production and processing of petroleum and natural gas, industrial pollution (especially near Sumgayit), poor water quality, degradation of arable lands, deforestation, pollution and overfishing in the Caspian Sea, and the threat to nature reserves continue to pose massive problems.

In 2003, a National Program on Environmentally Sustainable Socioeconomic Development was developed. Later, the State Program on Renewable and Alternative Sources of Energy (2008–2015) and the Concrete Action Plan (2010–2020) for alternative sources were adopted. These initiatives are an important step in Azerbaijan's environmental policy, taking into account the fact that the energy sector is the main source of pollution in Azerbaijan. However, this legislation still needs further development and better implementation, which is hindered by a high-level of corruption.

Azerbaijan is also party to the Kyoto Protocol, but it still needs to implement its relevant provisions.

The educational system in Azerbaijan remains very poor. A high level of corruption, inadequate training, ill-trained teachers and outdated textbooks continue to dominate all levels of education.

Education policy /
R&D
4

Access to education in Azerbaijan is almost universal and free. The literacy rate is over 95%. However, the poor quality of secondary level education is a well-known reality. According to a recent World Bank publication, "in the 2009 Program for International Student Assessment (PISA) test for 15-year olds, Azerbaijan did very poorly: out of 65 countries, it ranked 64 in reading, 63 in science, and 45 in mathematics." As a result, the government refused to participate in the program again in 2012.

A similar assessment was made by the State Commission, which supervises university entrance exams on a national level. According to figures released by the commission, the performance of high school students has been steadily worsening for years. In many cases, this has led the commission to decrease passing scores necessary to matriculate into particular departments, in order to fulfill enrollment quotas in universities.

Yet, still enrollment in tertiary education remains at about 20%, which is assessed by the World Bank as low for an upper-middle income country. Azerbaijan ranks 90th in the World Economic Forum's Global Competitiveness Index's ranking for higher education, while the primary education pillar is ranked even lower at 108th (out of 144 countries).

The aforementioned World Bank publication states that “an inadequately educated workforce is considered the third most problematic factor for doing business, after corruption and tax rates.”

A state program aimed at sending more students to study abroad was launched some time ago. However, despite the positive results that it has created, such as a higher number of students with foreign education, there are flaws with the program as well. Corruption and political loyalty considerations negatively impact the selection process and damage merit-based assessment.

With the appointment of a new Western-educated Minister of Education in 2013, there were hopes that there would be some improvements in the education system. However, nothing changed.

Research and development remain underdeveloped areas of the economy, as only 0.2% of GDP is spent on R&D. Recently, there have been regular discussions on prioritizing research, increasing funding and creating additional incentives for innovation, but actual steps are yet to be taken.

In 2009, by presidential decree, the Science Development Foundation was established. In 2013, for its main science grant competition, the foundation allocated 4.5 million AZN (\$5.77 million, at the 2014 exchange rate), and 4.2 million AZN (\$5.38 million at the 2014 exchange rate) in 2014. However, the meritocracy of the competitors is questioned by many local observers. Political loyalty to the ruling elite is among the unofficial selection criteria. Grants are informally confirmed by the presidential office. Cronyism also plays a significant role.

Comparative analyses of annual data provided by SCImago Research Group, which ranks countries by measuring scientific indicators developed from the journals contained in the Scopus Database, show that Azerbaijani scientific output was not improved since the creation of the Scientific Development Fund. Moreover, in 2013, the country ranked much lower in scientific output and citations in comparison with the previous years.

The Knowledge Foundation was created in 2013. From the official documents outlining goals of this foundation, it seems that the main purpose behind its creation is to “enlighten” the public with regards to the goals of government policies, i.e., mere propaganda purposes. It should be remembered that an organization with a similar name existed during Soviet times; this organization was part of the state propaganda machine.

Transformation Management

I. Level of Difficulty

Azerbaijan has favorable conditions for governance, yet several factors negatively affect its development. First, there is the frozen conflict between Azerbaijan and Armenia over the disputed Nagorno-Karabakh region and some adjacent territories that were occupied by Armenia in early 1990s. Moreover, the cease-fire is shaky and, starting in 2014, renewed confrontation accelerated and the death toll rose further as this report was being prepared in early 2015.

Structural
constraints

6

Another structural constraint originates from Azerbaijan's big neighbors. Azerbaijan borders Iran and Russia to the south and north, respectively. For the past two years, Russia's provocative foreign policy has proven that the threat coming to the region from President Putin's ambition is imminent. During the 2013 elections, some pro-Russian elements in Azerbaijani society became extremely active, which was undoubtedly initiated and encouraged by Russia's leadership.

Furthermore, in the north, Azerbaijan has a sizable minority population of Lezgins, which population is divided across the Russian-Azerbaijan border. This makes Azerbaijan vulnerable to provocations originating from Russia. In recent years, Russia has used ethnic separatism as a tool to exert its influence over its neighbors, particularly over post-Soviet ones.

Azerbaijan has a young religious Shia population. The structure of Shia belief makes Shias dependent on the Iranian religious establishment. According to Shia dogmas, each believer is required to choose a spiritual leader, called a Marja al-taqlid, and follow his guidance both in religious and lay life. The majority of Marjas followed by Azerbaijani Shias are Iranian grand ayatollahs.

In addition, for years Azerbaijan's government has jeopardized its existing structural constraints even further by resisting important economic and political reforms in its domestic and foreign policies.

Azerbaijan is essentially landlocked, dependent on foreign countries for the export of the oil and gas that comprise the overwhelming majority of its foreign earnings. It still suffers from the Soviet legacy, including the absence of infrastructural connections to world markets. Nonetheless, Azerbaijan refuses to join the WTO

because it seeks to avoid international regulations, which could pose a threat to the corrupt businesses of the local monopolist oligarchy entrenched in the government. The government has also rejected signing the European Neighborhood Policy, unlike Georgia, Ukraine and Moldova.

Lastly, there is no doubt that the lack of democracy and shutting down civil society activism are helping religious radicals to jeopardize the secular nature of Azerbaijani society.

Azerbaijan's civil society traditions are very weak. In terms of local traditions, Azerbaijan is an authority-accepting and rather hierarchical society, in which the population has no tradition of organizing to obtain results.

Civil society
traditions
8

Still, in the context of the broader Muslim world, Baku in the late 19th – early 20th century developed its own intelligentsia and political culture, which could have been an embryo of modern civil society. That potential was crushed by the seven decades of Soviet 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 under Khrushchev that the intelligentsia began to rebuild itself. In the 1970s and early 1980s, the intelligentsia suffered again under the reintroduction of clientalist policies based on regionalism, nepotism and cronyism.

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, the recent crackdown has seriously undermined, if not all but stopped this development.

The Nagorno-Karabakh conflict, which has ethnic tensions at its roots, remains the only violent conflict in the country. Although a cease-fire has been in effect since 1994, and no major military activities are underway, sporadic outbreaks of violence do take place. In 2014, two major and several other significant incidents occurred, leading to worries of renewed war.

Conflict intensity
4

After one of these incidents in August 2014, Russian president Vladimir Putin organized a meeting between the presidents of Azerbaijan and Armenia which was followed by another meeting organized by U.S. Secretary of State John Kerry during the NATO summit held in Wales in September 2014. In October, French President Hollande also called a meeting between the Azerbaijani and Armenian heads of states. However, it seems the talks did not decrease the tension and serious incidents occurred afterwards. In November 2014, Azerbaijan downed Armenian helicopter, which allegedly crossed the neutral zone. There was intense fighting between the two sides due to attempts by Armenian forces to recover the bodies of the crew members

of the downed helicopter left in neutral zone. Clashes were still ongoing in early 2015.

Representatives of minority ethnic groups, such as the Lezgin and the Talysh, have in the past advocated for separation, but at the moment remain quiet.

Social dissatisfaction, religious radicalism and government's intention to close the sphere in which free media, freedom of assembly and independent political activities, in general, occur are other potential sources of conflict in society.

In 2013, there were a series of public demonstrations held in Baku and other parts of the country, which were repressed by the law enforcement and riot police. In January 2013, in Ismayilli, there were violent protests against public administration officials, as a result of which private properties, allegedly belonging to the high-level officials, were vandalized and burnt down.

II. Management Performance

14 | Steering Capability

For a long period, the government tried to persuade internal and, especially external, actors that it had adopted a gradual and conscious strategy in terms of promoting democracy. But, while acquiring self-confidence due the inflow of oil revenues and strengthening its financial and political situation, it started talking more openly about a "special way of building democracy," which in reality meant rejecting democracy's development and consolidating the authoritarian regime. This, along with the plight of media and civil society freedoms, will certainly weaken the republican foundations of the state.

In terms of socioeconomic development, the government is focused on projects, such as improving the façades of big cities, by implementing construction projects and renovation efforts, especially in the capital Baku.

Strategic programs are geared towards making Baku the venue for big sporting events, as well. Although the government is discussing the promotion of tourism, the complicated procedures for getting visas and the high prices of services, combined with their low quality, make Azerbaijan a less desirable tourist destination than neighboring Turkey and Georgia.

Question
Score

Prioritization
5

While there have been some projects intended to improve the education system, in reality no significant changes have been introduced, and, for the most part, both public secondary and post-secondary schooling continue to deteriorate.

The government also tries to develop state programs aimed at the youth, which are intended to secure their political loyalty. The results of these programs are yet to be seen.

For a long time the government was talking about balancing its foreign policy between major global and regional powers. However, in the last two years, it has significantly damaged relations with the West, which makes it vulnerable to the pressure coming from bigger neighbors, particularly Russia.

Due to the increase in oil and gas revenues, implementation of projects and policies has significantly improved over the past decade. However, the recent decrease in oil revenues, due to the fall of prices and production, will force the government to substantially reduce spending.

Another real constraint remains widespread corruption. Government officials often rush mid-size project implementation, compromising the quality of the work; moreover, overspending often appears related to the siphoning of money off projects for officials' private purposes.

Maintenance is another big problem. While projects are generally finished in timely manner, it seems that upkeep of these projects is often overlooked.

Nevertheless, when the government attaches high priority to projects in the energy and transportation spheres or venues for huge sporting and entertainment events, such as the first (and possibly last) European Olympic Games and the Eurovision Song Contest, it tends to successfully implement them – irrespective of spiraling costs. Often the Azerbaijani government attracts big international names like Zaha Hadid or Simon Clegg to realize these ideas.

Officials frequently emphasize their priority for diversifying the economy, but their achievements are not impressive, and the economy continues to rely heavily on oil revenues. The government intentionally delays the negotiations for the accession to the WTO because of protectionism, mainly for the benefit of local oligarchs and their corrupt businesses.

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

Implementation
5

The strengthening economy and rising oil revenues have made government officials bolder and more arrogant. Still the government is willing to learn from the experience of international organizations that do not jeopardize its authoritarian nature and personal interests of high-ranking officials. This is especially true in terms of technology, e-governance implementation, business registration, as well as in creating new types of modern educational institutions. The government also created ASAN (State Agency for Public Service and Social Innovations) service centers with Western advice in order to provide a variety of public services. These centers eliminated some low-level corruption and received a great deal of praise from the population.

Policy learning
3

However, the government has completely brushed aside Western ideas, consultancy and advice on issues relating to political reforms and building civil society. In 2013-2014, many international organizations active in these areas were either forced to leave the country, or the government downgraded their presence.

Nevertheless, the country has been independent for nearly 20 years, and some local experience has accumulated. As a whole, however, top-down management remains the rule.

15 | Resource Efficiency

The state budget depends heavily on oil revenues, which has led to high GDP growth rate in the country in the past several years. However, because there is no diversification of the economy, there are concerns that once the country runs out of oil reserves, the growth will slow down, eventually leading to economic decline. Actual decrease in GDP growth in 2014 and falling oil prices raised these concerns. Yet, the government argues that even if Azerbaijan does run out of oil reserves, it still has significant gas reserves, which can turn the country into a gas hub for Europe.

Efficient use of
assets
4

The question of how to use oil revenues appropriately has hung over the Azerbaijani government for years. Although some steps were taken, such as establishing the State Oil Fund, keeping transparent income records on oil revenues and separating oil revenues from the state budget, the expenditure of oil revenues (once transferred from the fund to the state budget) raises serious concerns among citizens and experts.

The government has undertaken numerous projects for the betterment of the economic and social situation in the country. Massive investments have been used to construct new roads, schools and hospitals. Yet, little transparency exists in this process, and many believe that government officials artificially increase the budgets for such projects, allowing room for the misappropriation of funds. Some improvements in social services and education have also been made. Yet much

remains to be done. Enormous sums of money have been wasted on allegedly prestigious projects, primarily in sports.

The government implements a specially designated program to send students abroad. However, the selection process is corrupt, since the officials pick students who are politically loyal to them. Hence, a significant number of brilliant students, who genuinely deserve to participate in the program, are rejected. Still, there are many Western-educated youth who are graduates of various exchange programs, or have completed their education with financial support from their families. Upon their return, they primarily choose to work in private enterprises, or in international and foreign organizations because of the significant role of meritocracy in their hiring practices, and due to the low salaries in state institutions. However, there are a few who join state institutions as high-level managers. But they are not able to change the system. On the contrary, they are assimilated to the corrupt practices dominant in the government. Generally, in hiring practices for state institutions, political loyalty, connections and membership in certain networks play a significant role.

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

Policy
coordination
4

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

Nevertheless, in very important political decisions that are crucial for the longevity of the regime, i.e., in combatting the opposition, the government shows unity.

Unlike his president-father who was the absolute authority in the country, the current head of the state, in spite of remaining the most powerful figure, is still influenced significantly in his decisions by several other powerful oligarchs. Still, the overall dynamics are of the gradual consolidation of authoritarian rule, accompanied by the increasing influence of the president.

Corruption in the country is widespread and has a centralized nature. The government is not interested in combating corruption on a high level and the large majority of government institutions are badly compromised. The anti-corruption law, which was passed some time ago, and the Commission on Combating Corruption have not been transformed into substantial tools in the fight against corruption.

Anti-corruption
policy

2

Unlike Georgia and Armenia, Azerbaijan failed to cooperate with international organizations on implementation and improvement of anti-corruption policies. An influential study by Börzel and Pamuk (2011) found that the 2011 fight against corruption in Azerbaijan, launched just after the Arab Spring, led to the strengthening of the executive's apparatus and the expansion of its control over society, and that it was, on the whole, based more on internal political struggles than a desire to root out corruption in the long term.

However in comparison with other state agencies, the Ministry of Foreign Affairs, the State Exams Committee and the State Oil Fund are involved in less corrupt activities, and recently some new initiatives, such as the ASAN service were launched to reduce low and mid-level corruption.

For decades corrupt practices have dominated higher education as well, but some recently established institutions, like the ADA University (former Azerbaijan Diplomatic Academy) have become corruption-free zones in higher education.

16 | Consensus-Building

The most significant political actors from the opposition claim that they struggle for democratization of the country and support republicanism as the only way of governance. However, there is ongoing debate among supporters of parliamentary democracy and presidential system.

Consensus on goals

4

Until recently, the government claimed that it also pursued the path to democratization, but insisted that stability, security and social order should be developed prior to democracy, and that the democratization process should be gradual, cautious and based on the cultural progress of the people.

However, the government has recently come up with new confusing claims. Some officials are discussing a "distinct way of democracy," the explanation of which is vague. At the same time, in December of 2014, the president himself stated that the task of building a democratic Azerbaijani state has already been accomplished.

The opposition has always accused the government of monopolizing power and using factors such as stability, social order, and the cultural progress of the people as an excuse to turn the republic into a monarchy. The events that unfolded in Azerbaijan following the 2013 presidential election somewhat uphold the opposition's claims.

There are some religious groups, both Sunni and Shia, which posit that democracy and a Western model of governance are unacceptable for the country, and that the government in Azerbaijan should be based on Sharia law.

Likewise, young pro-government and independent ethnic nationalist groups are also gradually challenging the legitimacy of the application of liberal democracy to the Turkic-speaking world.

Almost all political actors in Azerbaijan agree on the need for a market economy. But, as usual, there are discussions between supporters of a laissez-faire approach to the economy and advocates of the government having greater social responsibilities.

Most recently, radical communist views have become popular among some youth groups.

Still, the corrupt oligarchic nature of the ruling regime hampers the economy from exploiting the benefits of a fully functional market economy. Monopolies in both exports and imports are in the hands of corrupt oligarchs, who, at the same time, are high-ranking state officials. The concentration of both administrative and business power in the hands of the corrupt elite has contributed to the existence of a huge informal sector. Customs, tax and transportation authorities are especially notorious for this. However, in the last two years the names of the heads of the State Oil Company and the Central Bank also came up in international corruption scandals. However, either regulated (as regular salaries) or unregulated (as bribes) unofficial incomes exist in almost all jobs belonging to the public sector.

The ruling party has a very strong grip on power, and power is furthermore not transparent. Real power is vested in individuals rather than in the functional government offices.

Some state agencies try to hire young, Western-educated staffers to implement policies in a more efficient manner, but power is overall in the hands of policymakers who do not favor radical democratization or market reforms. The case of the ADA University (formerly the Azerbaijan Diplomatic Academy) and ASAN is telling: When the president sought to develop modern institutions that would operate with integrity, that development had to transpire outside the realm of government agencies, indicating the pervasive nature of the opposition to reform in many state sectors.

Anti-democratic
actors
2

In spite of its official pro-democracy stance, the ruling regime is the main anti-democratic veto actor in Azerbaijan. Not only did the incumbent fail to facilitate democratic reform in national or local governance, signs of growing authoritarianism became undeniable in the last few years, particularly in 2013-2014. Crackdowns on independent media, domestic and international NGOs, civil society and human rights activists, persecution of political dissent, and further reduction of civil liberties were among the main indicators of the ruling regime's anti-democratic nature.

Some local and international observers claim that there are few reform-minded actors within government structures. Usually, they mention the leadership of Ministries of Foreign Affairs, Finance, Education, as well as Central Bank officials and the first lady's family members. However, it seems that so far these have largely failed to bring any serious changes to government policies, although some initiatives like the aforementioned ADA and ASAN have been realized.

The government prioritizes the preservation of stability as the most important factor in its domestic and international policies. Moreover, the stability factor is propagandized as the government's best achievement and the basis for its legitimacy.

All potential conflicts, whether they have religious, ethnic or social basis, are prevented and suppressed. Members of radical Islamic groups are often arrested. However, the government's suppression of liberal democratic and secular dissent, and exclusion of them from consensus-building, still benefits Islamic groups, who use the lack of political freedoms, the lack of the rule of law, as well as increasing social inequality due to corruption, as propaganda in their recruitment efforts. The Azerbaijani government is trying to lessen social tensions by using different kinds of material-based incentive measures, which are mainly reminiscent of Soviet policies.

Although ethnic cultural centers have been established, a lack of comprehensive policies for long-term solutions and the reliance on autocratic measures for short-term purposes contribute not to the solution, but to preserving the problem.

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. Furthermore, the government has often sought to suppress dissent rather than engage in consensus-building.

The Azerbaijani government frequently praises the religious tolerance it claims exists as part of local tradition. It holds many international events on multiculturalism, religious tolerance and dialogues, and effectively collaborates with the Orthodox and Catholic churches, the local Mountain and Ashkenazi Jews, as well as with people of some other faiths. However, the government is frequently criticized for oppressing freedom of religion, as in the recent joint Norway Helsinki Commission and Article 18 report. The regime differentiates between "traditional" and "non-traditional" religious groups. As such, evangelists and some Muslim groups frequently face restrictions by the government.

Starting in 2011, despite all the existing legal and bureaucratic hurdles, the role of NGOs supported by international donors was becoming more prevalent in the decision-making process. Social networking served as an important tool for civil society and NGOs to raise public awareness and deliver their messages to the authorities.

However, since 2013, and especially in 2014, in an attempt to close the space for independent and critical voices, an unprecedented crackdown on domestic NGOs and international donors was launched. The primary cause of this crackdown was government's loudly expressed fear of the region's color revolutions, which increased after the Maidan events in Ukraine. Numerous international donors and NGOs were forced out of the country; strict laws were imposed; and their bank accounts were frozen, making the environment inoperable in the country for international donors and independent domestic NGOs. Criminal cases were launched to investigate NGOs' financial activities. Many local activists were imprisoned; some sought refuge in foreign countries.

Irrespective of the current crackdown, the space for independent political and civic activities has been very limited for quite some time. On the one hand, opposition political parties and independent civic organizations have been pressured to gradually cease their operations. On the other hand, the government has created GONGOs and cultivated fake opposition parties.

So far, there are two officially registered and more or less significant real opposition political parties, which are the People's Front Party and Musavat. Only Musavat has headquarters. However, recently, a leadership change in the party has led to significant internal conflicts and fragmentation. The People's Front Party had moved to new headquarters following the 2013 elections, after being without an office for several years. Nevertheless, the party was forced out of the new headquarters as well, after demolition of the building by government agencies due to a suspicious blast, which state officials attributed to a gas leak.

During the past few years, new successful political groups, like the Republican Alternative (REAL) Movement and NIDA youth group have emerged, and have been active and steadily expanding their base. However, the government launched a severe crackdown against both of these organizations, imprisoning several leading figures.

Both local and international NGOs have met with serious restrictions, especially in 2014. Their bank accounts were frozen; travel bans were imposed; their activities were restricted; and criminal cases were launched against many of them. Almost no space was left for NGOs' independent activities. Many international NGOs like NED, NDI and the Peace Corps were forced out of the country. Religious groups have also been constantly targeted in the past few years. The general trend aimed at closing the space for the "non-traditional religious groups" (i.e., wahhabists, evangelists et cetera) has continued.

A comprehensive process of reconciliation has not been initiated because the government continues to portray its political predecessors as the causes for current economic and political troubles and failures. However, some steps were taken. For instance, the law on former presidents was passed to allow state pensions to them or their families. Former president Mutallibov, who had been in exile in Moscow since 1992, was allowed to return to the country in July 2012.

Reconciliation
4

Due to political reasons, parliamentarians who were the authors of the Declaration of Independence of 1991 have been repeatedly denied pensions as retired lawmakers. The government justifies its action by claiming that they were elected before independence.

Genuine reconciliation must be driven by a willingruling elite; however, so far the ruling elite has demonstrated little in this regard. Although the government verbally describes itself as interested in dialogue, it has at times only simulated the process and used dialogue to further alienate its real political rivals.

The elite has genuinely reconciled only with those former rivals who have either lost political clout or stopped seriously challenging the government's grip on power, as well as with those who agreed to keep a low public profile.

17 | International Cooperation

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

Effective use of
support
5

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

Contrary to Armenia and Georgia, the government did not negotiate a European Association Agreement, arguing that its provisions do not match Azerbaijan's interests and jeopardize independence and sovereignty. The government claims that it tries to maintain a non-alignment policy and neutrality. However, it is obvious that the primary reason behind its decision is an unwillingness to implement democratic reforms because the regime considers democracy a threat to its hold on power. The government's long-term policy, outlined in articles and books by one of the main ideologues of the regime, is aimed at building a "distinct style of democracy," which basically means securing regime's longevity. And in the economic realm, refusal to

sign the agreement occurred primarily because of the government's reluctance to give up corrupt practices in its economic policies.

In January 2011, major agreements were signed between the Azerbaijani government and the European Union in several areas of joint cooperation, including education, capacity building, and the reform of state agencies. However, in 2013, Azerbaijan curtailed the activities of the OSCE office in the country, and has made moves to reduce the presence of international NGOs in the democracy field, such as the U.S. National Democratic Institute, IREX and a few others. Furthermore, the government has tightened the laws on NGOs and their funding.

The Azerbaijani government has been rather consistent in fulfilling its major economic and business commitments to the international community. For instance, it has never sought to renegotiate oil contracts signed in 1994.

However, although the current government tries to act as a reliable partner, problems emerge with the acceptance of international law when material interests of the ruling elite are directly concerned. This was the case when Azerbaijan failed to sign the European Association Agreement, and so far the government has not accepted the tariff and competition rules for joining the WTO.

The biggest question marks surround Azerbaijan's commitments to Council of Europe and the OSCE in the field of democracy and human rights, which have grown increasingly critical of Azerbaijan's record in the area – which, however, has not prevented Azerbaijan from assuming the PACE presidency in 2014. The country's poor record on human rights has also been criticized by the European Union and many international organizations. Recently, the situation has further deteriorated to a level that threatens government's international credibility.

On the one hand, Azerbaijan is a locomotive of regional cooperation, actively investing in Georgia, Russia, Romania, Turkey, Serbia and the Central Asian republics. It promotes east-west and north-south energy and transport corridors; builds railways, ports, transport hubs and airports; and has expanded its presence in regional organizations such as the Black Sea Economic Cooperation (BSEC), the Economic Cooperation Organization (ECO) and CIS.

On the other hand, there is no cooperation between Azerbaijan and Armenia due to the Nagorno-Karabakh conflict.

The country has remained compliant with the rules of regional and international organizations, except on the issues of democracy and human rights.

Azerbaijan also invests in efforts at extending and diversifying gas pipelines to Europe. The selection of the Trans-Adriatic pipeline, which will transport natural gas from Azerbaijan's Shah Deniz field to the markets in Europe will further contribute to regional cooperation.

Credibility
6

Regional
cooperation
7

Strategic Outlook

So far, the Azerbaijani government has managed to maintain its grip on power by providing security, stability and oil money. Yet, the future of Azerbaijan and long-term prospects for the ruling elite hinge on the progress of reforms. The revolutions across Middle East reminded the Azerbaijani government of its frailty if it fails to deliver on much-needed social services, economic development and political pluralism.

However, despite these challenges, the government remains characteristically unwilling to engage on such initiatives. It responded poorly to the country's recent spark in civic activism and sociopolitical mobilization of youth swept by globalization, Internet communications and information flows. Instead of focusing on accountability, anti-corruption measures and good governance, the government narrowed the space for political dissent, shut down independent media outlets and non-governmental organizations, and restricted international aid. It continues to be marred by high-profile corruption and a lack of accountability in state-run institutions.

The Ukrainian crisis and Russia's takeover of Crimea worsened the situation by providing the Azerbaijani government with pretexts to legitimate authoritarianism. Although Azerbaijan has not shown an inclination to join the Eurasian Economic Union, it also refused to sign the European Union Action Plan, which will inevitably stymie Western integration and lend Azerbaijan to a more Middle East-style autocratic regime. Azerbaijan's refusal to liberalize politically and economically, however, poses a grave threat to the country's future, part of which threat includes external pressure from Russia.

The systematic eradication of secular and liberal civil society will also contribute to the rise of radical Islamists. The government is working to curb radical Islam through suppression, but the most prudent way to combat rising religious extremism is to improve secular education and discourse, while strengthening democratic institutions and civil society.

Due to the wealth accumulated in the oil fund during the production boom, the majority of the population thus far does not suffer from serious economic problems. However, because oil production and prices are steadily decreasing and the economy is not diversified, a serious economic downturn looms.

Another challenge is the Nagorno-Karabakh conflict, which once again started to escalate in 2014 and currently poses a serious threat to stability in the region. Resolving the conflict with Armenia, however, is intrinsically linked to forging closer ties with Europe and, in turn, accepting EU values and standards.