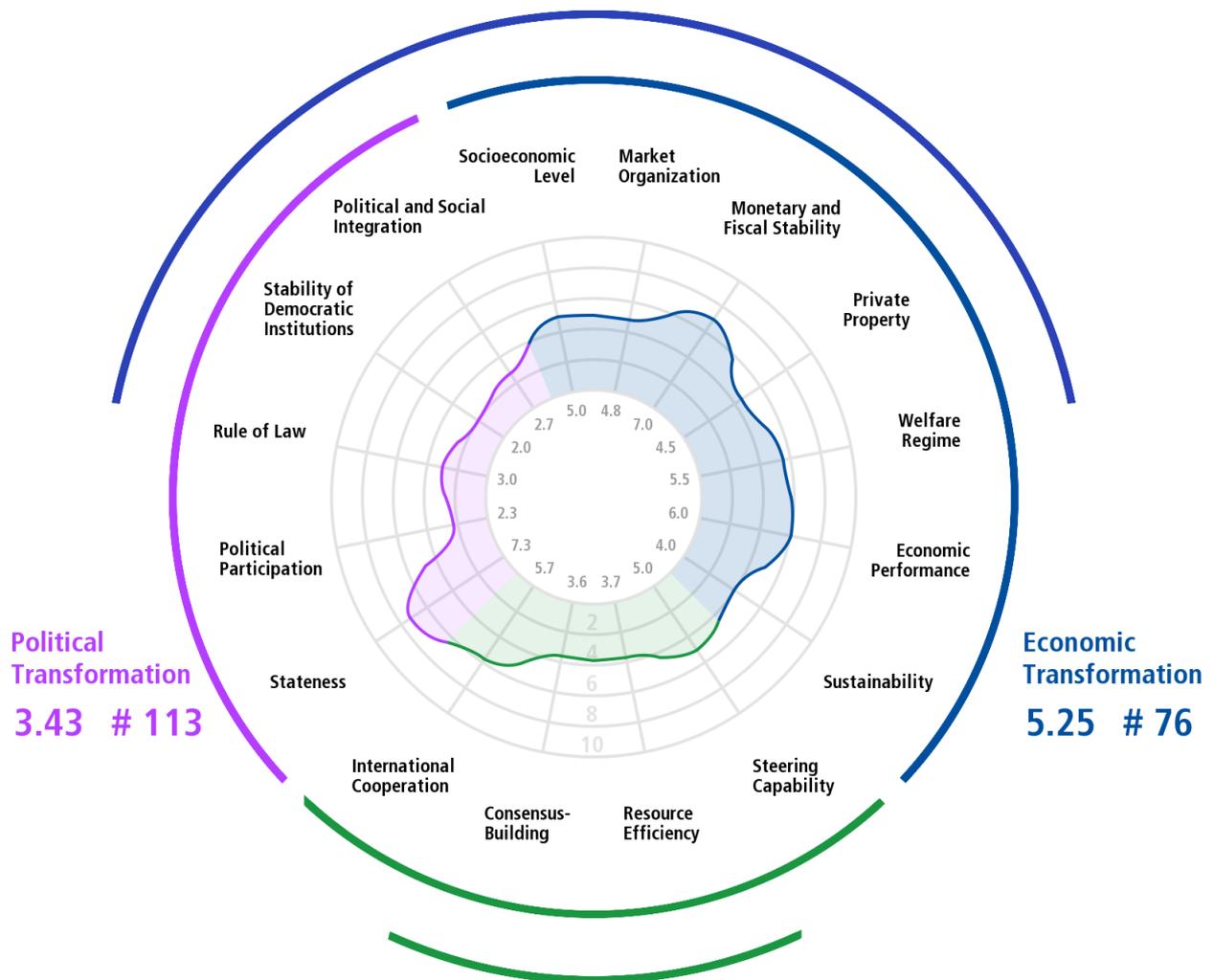


Azerbaijan

Status Index

4.34 # 98

on 1-10 scale out of 137



Political Transformation
3.43 # 113

Economic Transformation
5.25 # 76

Governance Index

4.00 # 98

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	9.9	HDI	0.754	GDP p.c., PPP \$	18012
Pop. growth ¹	% p.a.	0.9	HDI rank of 189	87	Gini Index	26.6
Life expectancy	years	72.7	UN Education Index	0.694	Poverty ³	% 0.0
Urban population	%	55.7	Gender inequality ²	0.321	Aid per capita \$	11.7

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

As was forecast in the previous report, a constitutional referendum in 2016, which extended the presidential term from five to seven years and introduced a vice presidency, paved the way for the gradual transformation of the country into a fully-fledged autocracy. In February 2017, President Aliyev appointed his wife Mehriban Aliyeva as the first vice president of Azerbaijan. Then, in snap presidential elections in April 2018, Aliyev was himself elected for a fourth time in a row and this time for seven years.

During the reporting period, the crackdown on opposition and civil liberties continued, as did the revolving door of arrests and disbarment of independent defense lawyers. In June 2018, the Council of Europe appointed a rapporteur on political prisoners in Azerbaijan.

Moreover, recent changes in the Azerbaijani Bar Association and amendments to the law on representation added to the plight of the rule of law in the country. However, the most profiled political prisoner, the leader of the Republican Alternative (REAL) Party, Ilgar Mammadov, was released from prison on a conditional basis in August 2018 after serving more than five years of his seven-year term. He is still subject to a travel ban, as are many other opposition politicians, journalists and civil society activists.

Even though the economic downturn since 2014 – which has happened due to falling oil prices – has forced the government to pay attention to the country's poor economic diversification and mismanagement, these two problems, along with others, still pose serious problems for Azerbaijan's economic development. The May 2017 default of the state-owned International Bank of Azerbaijan, the largest lender in the country, delivered a serious blow to the image of Azerbaijan as foreign entities were among the bank's major investors. The international image of the country suffered further due to the involvement of former and current officials and deputies in various international corruption scandals and investigations.

On March 10, 2017, the government of Azerbaijan withdrew from the Extractive Industries Transparency Initiative (EITI) after the country was suspended from the EITI board the day earlier. Moreover, Azerbaijan's inactive status in the Open Government Partnership, a multilateral initiative aiming to secure commitments from governments to promote transparency, was twice extended – first in June 2017 and then in December 2018 – “due to unresolved constraints on the operating environment for non-governmental organizations.”

However, there were also some important positive changes that contributed to the improvement of economic life. First of all, a liberalization of the visa system contributed to an unprecedented boost in tourism. There was also a string of changes to ministerial posts. While still limited in scope, these changes resulted in some notoriously corrupt officials being replaced by younger members of elite. The latest changes to the tax code and attempts to tackle corruption in customs might also contribute to improving the country's economy.

At the same time, in spite of the ongoing crackdown, Azerbaijan's civil society started showing some modest signs of revival and vibrancy. This is also evidenced by the presence of an increasingly vibrant social media community in the country.

Unfortunately, there were no significant developments in the Nagorno-Karabakh conflict, which remains unresolved and thus a serious threat to regional stability.

History and Characteristics of Transformation

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

The fall of the Russian empire in 1917 enabled nation-state building in Azerbaijan. In 1918, the Azerbaijani Democratic Republic – a parliamentary democracy with secular laws – was established. Although the first nation-state did not last long and was dismantled by the 1920 Bolshevik invasion, the nation-building process in Azerbaijan continued to grow and strengthen during Soviet rule.

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

On October 18, 1991, Azerbaijan declared its independence and, a few months later, the People's Front overthrew the last communist leader, Ayaz Mutallibov, amid the 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 troops from Azerbaijan with Russian President Yeltsin. But, a year later, he was overthrown in a military coup allegedly backed by Russian security forces. When a civil war was imminent, the country's former communist leader (1969-82) and Politburo member of the Communist Party of the Soviet Union (1982-87), Heydar Aliyev, seized the opportunity to take power.

Aliyev managed to bring stability to Azerbaijan by negotiating a cease-fire with Armenia, appeasing Russia by entering the CIS and subduing local warlords. But his most important achievement was the so-called "contract of the century," whereby Western companies were invited to develop Azerbaijan's oil fields. Aliyev embarked on a strategic initiative to build oil and gas pipelines in order to help Europe diversify its energy supply away from Russian dependency. Overall, Aliyev 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 power transition in post-Soviet Azerbaijan. Ilham Aliyev maintained the energy policies of his 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 for office again in 2013, when he was elected for a third term in a much-criticized election. Following his re-election, Ilham Aliyev continued to stifle independent voices and stymie Azerbaijan's democratic progress.

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

In 2015 and 2016, a severe economic crisis struck the country. Heavily dependent on fuel commodities, the poorly diversified Azerbaijani economy suddenly and steeply declined due to a fall in oil prices, corruption and incompetence, thus exposing its severe vulnerabilities. This forced the government to reevaluate its economic policies. However, so far positive changes in economic policies have been too limited to render significant results.

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

Azerbaijan lost control over 17% of its territory in a war with Armenia in the early 1990s. The cease-fire established in 1994 has mostly held for over two decades despite sporadic violations, including a major one in early April 2016, which claimed hundreds of lives on both sides.

Apart from in the occupied territories, Azerbaijan's government enjoys an unchallenged monopoly on the use of force in the country. During the reporting period, the ruling elite strengthened its grip on power further. In February 2017, the president of the country appointed his wife Mehriban Aliyeva as the first vice president. The position of vice president was created by the referendum in 2016, and this appointment ensures that power will remain in the hands of the ruling family if, for whatever reason, the head of state is unable to carry out his duties.

Moreover, in snap elections held in April 2018, President Ilham Aliyev was elected for a fourth term in a row, this time for seven years as the president's term in office was extended from five to seven years in the 2016 referendum.

However, there are some issues that pose potential threats to the progress of the state-building process, thus also challenging the stability of the current regime. One is the possibility that Russia and Iran might use the presence of ethnic minorities concentrated in the northern and southern parts of the country to instigate separatism, and another worth mentioning is the steadily growing signs of religious radicalism.

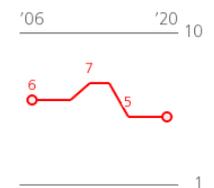
The entire population, irrespective of race, gender, religion or ethnic background, is legally guaranteed full citizenship. Despite some minor problems, this law is also enforced in reality.

Azerbaijan's national identity was gradually shaped by the secularly educated local intelligentsia in the second half of the 19th century after Russia incorporated the Muslim parts of the South Caucasus into its territory. The national identity process then significantly progressed during the Azerbaijan Democratic Republic (1918-20).

Question
Score

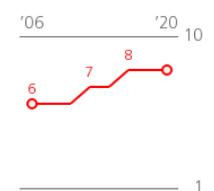
Monopoly on the
use of force

5



State identity

8



During Soviet times, Azerbaijan's nation-building process strengthened further. After the collapse of the Soviet Union, Azerbaijan's state identity faced some challenges but generally upheld its dominance, and it continues to gradually become stronger.

The current government has so far successfully promoted loyalty to the state through school curricula, textbooks, state propaganda, etc. 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 president) has been linked to the consolidation of state identity. This policy is likely to be questioned in the future.

In principle, nation-building and state-building in Azerbaijan are based on a strong secular legacy. Yet, in the post-Soviet period, there was a significant religious revival. 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. Some ethnic minorities have also expressed resentment against the rise of Turkic nationalism among the majority population in post-Soviet Azerbaijan.

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 control over the Karabakh region to the Azerbaijani government. In the early 1920s, after Sovietization, the communist state again put the status of the region into question. Eventually, the mountainous part of Karabakh, where the majority of the population were Armenians, was legally subordinated to Azerbaijan as an autonomous oblast.

In the late 1980s, during Gorbachev's perestroika, the Armenian majority in Nagorno-Karabakh demanded secession to join Armenia. In late 1989, the Supreme Soviet of the Armenian Soviet Republic passed a resolution on integrating Nagorno-Karabakh into Armenia. Hostilities between the two sides escalated into a major war after the collapse of the Soviet Union. Azerbaijan lost control over Nagorno-Karabakh and the adjacent seven districts.

A cease-fire was agreed in 1994. In 1992, the CSCE Council launched a peace process, and in 1994, the OSCE's Minsk Group, chaired by France, Russia and the United States, was established to find a peaceful solution to the conflict. However, it has not yet produced any results.

Apart from reaching peace with Armenia, issues like economic prosperity, inclusiveness, government accountability and 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 overwhelmingly secular nature, from time to time religious groups try to be active in political life, though they are heavy-handedly suppressed by the government.

Commemorations of Ashura by Shi'a Muslims as a day of mourning for the Prophet Muhammad's slain grandchild, Hussein, is the most crowded annual religious ceremony in the country. In 2016, the government applied legal and administrative restrictions on the observation of Ashura commemorations. However, in 2017 one of the most crowded Ashura ceremonies since the fall of the USSR was held in the country. Moreover, the biggest pilgrimage of Azerbaijani Shi'i believers to the Iraqi city of Karbala in decades took place in 2017 during the annual Arbaeen ceremonies that end the Ashura commemorations.

All of these developments have forced the government to implement combined repressive and appeasing measures to ensure the loyalty of the growing number of Shi'i believers. For instance, in 2017, as a part of this policy, the Foundation for the Promotion of Moral Values was created. Vigorous policies to regulate religious education and to increase government control over mosques, sermons and religious communities have also been implemented during the reporting period. However, the effectiveness of these top-down measures, which are sometimes reminiscent of the Soviet anti-religious policies, remains to be seen.

Since early 2014, the issue of Azerbaijani Sunni radicals joining Islamic jihadists in Iraq and Syria has regularly popped up in Azerbaijan's media. These were followed by the government's decision to close some mosques and imprison alleged homegrown jihadists. The main state security agency, after its restructuring and the appointment of a new head in December 2015, carried out a string of anti-terrorist operations with fatalities across the country. In December 2017, the spokesman of the general prosecutor's office reported that the overall number of people killed in operations against Salafi-affiliated alleged terrorists in the country was 16.

On July 3, 2018, the head of Ganja city was shot and severely wounded in an assassination attempt. The suspect was officially accused of religious radicalism. A week later, two policemen were killed during clashes between protesters and local law enforcement. In November 2018, the State Security Service announced that 60 people were arrested and five were killed during operations responding to the Ganja events in July 2018.

The diminishing space for the activities of civil society and independent media, well documented by international human rights organizations, is likely to boost the chances that various religious groups might replace the weakened secular and liberal-democratic forces as a main voice of dissent.

No interference of religious dogmas

9



1

The government also uses the country's Islamic identity as a resource in both domestic and foreign policies. President Aliyev declared 2017 as the Year of Islamic Solidarity in Azerbaijan, and the 4th multinational Islamic Solidarity Games were held in Baku.

The state provides basic services such as health care, education, tax collection, social security, transportation, and law and order through its fully functioning bureaucratic system and infrastructure, although the quality and standards of these services are not sufficiently advanced. Corruption, bribery and monopoly are still the biggest hindrances to the system. However, the increasing number of public centers run by the Azerbaijani Service and Assessment Network (ASAN) across the country and the range of services they provide has augmented efficiency in some areas by increasingly reducing mid- and low-level bureaucratic corruption.

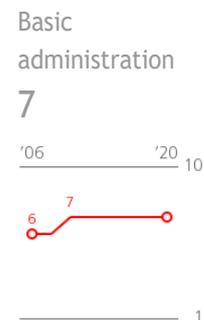
Pilot projects on implementing compulsory health insurance started in Mingachevir city and in Yevlakh region in November 2016 and in Agdash region in February 2018.

There have been some noticeable improvements in public transportation services in Baku. In late December 2018, the newly refurbished passenger rail line connecting Baku and Ganja was put in service. Earlier, on October 30, 2017, the long-delayed Baku-Tbilisi-Kars (BTK) railway connecting Azerbaijan with Turkey through Georgia became operational. So far used as a freight-only line, there are plans to run passenger trains from autumn 2019.

According to the World Health Organization (2015), 89% of the population of Azerbaijan has access to improved sanitation facilities and 87% to improved drinking water.

An 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 the heads of regional executive offices, appointed by the president upon their recommendations.

Independent Azerbaijan inherited the Soviet-established regional administrative system, which has remained largely unchanged since. The administrations 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, as well as for the political stability and the promotion of public loyalty to the regime in their respective provinces.



2 | Political Participation

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

In 2016, another referendum was held, which increased the term of the presidency from five to seven years and introduced a vice presidency. This referendum further strengthened the power of the president over the parliament. According to a constitutional amendment – Article 98 (1) – the president is vested with extensive powers to dissolve the parliament. The referendum was held in a highly repressive environment. Groups opposing the amendments were persecuted by law enforcement authorities.

After the referendum, in February 2017, the president appointed his wife as the first vice president, thus strengthening the ruling family's grip on power. In April 2018 snap elections, which, according to ODIHR, “took place within a restrictive political environment and lacked genuine competition,” Aliyev was elected president for a fourth term in a row and this time for seven years.

Since 2010, no real opposition has been represented in parliament, but parliament and the Constitutional Court are still rubber-stamp bodies.

Insignificant authority and distrust in the fairness of elections seriously reduce public interest in contests for municipal seats. Major cities, including the capital, do not have elected mayors.

Election commissions are composed overwhelmingly of regime loyalists, who carry out orders received from the presidential office. The ruling party exercises extensive control over news and information content, and it enjoys enormously disproportionate coverage. The opposition is denied access to television and radio networks in Azerbaijan. Election days are marred by multiple voting, ballot stuffing, interference with vote counting and other irregularities.

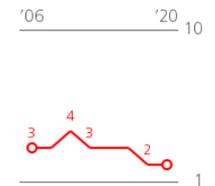
The president is the effective ruler of the country. The referendum in 2016 further strengthened presidential powers and introduced the office of vice president, to be appointed by the president. The first vice president replaced the prime minister as first in the line of succession. Hence, the president was given the right to pick his successor without seeking approval from parliament.

Parliament and local municipal representatives, despite being nominally elected, remain powerless actors in the policy-making process. Yet, the vested interests of the state elite, the oligarchs, government ministers and other high-ranking officials limit the president's decision-making to some extent.

The military is under the control of the president, while the head of the powerful state police, Ramil Usubov, is regarded as more loyal to the chief of the presidential

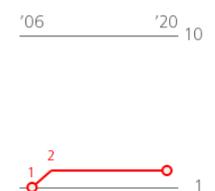
Free and fair elections

2



Effective power to govern

2



administration, Ramiz Mehdiyev, who is the second most powerful figure after the president. Since the death of former President Heydar Aliyev, Ramiz Mehdiyev has enjoyed more autonomy than the other oligarchs. Members of parliament are often protégés and relatives of oligarchs.

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

Yet, the demand for skilled professionals in business 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.

Moreover, a process of replacing oligarch ministers with younger administrators has been going on for some time. Usually these young administrators are family members of the old high-ranking Soviet nomenklatura, though they are more loyal to the clan of the first vice president.

The freedoms of assembly and association are guaranteed by the constitution, but severely restricted in reality. No rallies are allowed in city centers. The government closely monitors authorized rallies in designated places and frequently launches various forms of oppression against participants of authorized rallies, which include long- and short-term imprisonment, job loss, pressure on family members, etc.

In 2013, the government launched a massive crackdown on civil society, journalists and political opponents. Despite the fact that many jailed activists were released afterwards, the crackdown never stopped and the revolving door of arrests has continued.

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 the access of government critics to these places. The offices of opposition groups, political parties and NGOs are the only places, thus far tolerated by law enforcement, where dissidents can gather and organize public events.

The government also pressurizes hotels and other venues in the country not to provide opposition parties and independent NGOs with space to hold their events. During the reporting period, multiple attempts by the Initiative Group of the Republican Alternative Party to find a venue to convene its founding conference were either rejected or disrupted by the authorities. However, some opposition parties were previously allowed to hold conferences, though not in central locations in the capital. The situation is even more dire in the provinces, with Nakhichevan Autonomous Republic being the most restrictive place.

Association /
assembly rights

3

'06 '20 10



The constitution of Azerbaijan guarantees freedom of expression. However, during the period under review, the government continued to restrict the media. According to the 2018 World Press Freedom Index: “President Ilham Aliyev has been waging a relentless war against his remaining critics since 2014. Independent journalists and bloggers are thrown in prison if they do not first yield to harassment, beatings, blackmail or bribes. Independent media, such as Zerkalo and Azadlig, have been stifled economically. Others, such as Radio Azadlig, have been closed by force. The main independent news websites are blocked. [...] The regime has also had Azerbaijani journalists detained in Georgia and Ukraine, and sued in France.” In the same report, Azerbaijan was ranked 163 out of 180 countries, while in 2017 the country was ranked 162nd.

In May 2017, the journalist Afgan Mukhtaly, who contributed to Berlin-based Azerbaijani Meydan TV, was abducted in Georgia and forcefully brought to Azerbaijan where in early 2018 he was sentenced to six years in prison. In March 2017, another prominent journalist and anti-corruption blogger Mehman Huseynov was detained. In December that year, he was sentenced to two years in prison on trumped-up charges. In December 2018, a new accusation of “resisting a representative of the authorities with the use of violence dangerous to his health and life” was brought against him; however, the charges were later dropped due to public protests. In August 2017, Mehman Aliyev, a prominent journalist and editor-in-chief of the renowned news agency Turan, was detained on suspicion of tax evasion. Yet, a month later, he was released, and accusations brought against him were dropped. According to information provided by the European Federation of Journalists in December 2018, 11 local journalists served prison sentences at the time.

Journalists from Meydan TV have been barred from leaving the country due to the criminal investigation launched by the prosecutor’s office against this media company. Prominent investigative journalist Khadija Ismayilova, conditionally released from prison, remains under a travel ban as well.

The Azerbaijani government tried to extradite former Azerbaijani journalist, active social media user and government critic Fikret Huseynli, who is now a citizen of the Netherlands, while he was traveling to Ukraine. He could not leave Ukraine for a few months, while an extradition request of Azerbaijani authorities was considered, but the request was eventually turned down.

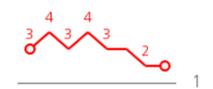
Azerbaijani authorities also sued French journalists for an investigative video documentary broadcast on the France 2 television channel. Two French journalists were “accused of defaming the Azerbaijani government by referring to it as a ‘dictatorship.’” However, the Azerbaijani authorities lost the case in two French courts.

Television stations in the country are fully controlled by the government. Independent voices do not have access to television. The government always highlights the fact

Freedom of expression

2

'06 _____ '20 10



that access to the internet is unrestricted, and that the number of users is increasing. However, bloggers who criticize the government, especially on Facebook, are constantly pressured, persecuted and jailed, and the government has blocked some websites. In recent years, troll attacks on critics of the government from fake profiles on social media accounts are among the popular methods employed by the authorities to harass independent voices and opponents of the regime. Freedom on the Net 2018 ranks internet in Azerbaijan as partly free. The report places Azerbaijan among the countries where internet freedom has declined in recent years.

Still, it should be added that social media has played a significant role in forcing the government to take public concerns into account. In some minor cases, the authorities have succumbed to pressure coming from social media. During the reporting period, Azerbaijanis living abroad have been particularly successful in using online video channels as well as live videos on social media to empower critical voices and to reach the Azerbaijani audience.

3 | Rule of Law

The executive branch dominates the other branches of the government, and there is practically no functioning system of checks and balances in the country. All important decisions are made by the presidential administration.

Parliament remains a rubber-stamp body, without providing checks and balances on the government. In addition to having legally restricted powers, the parliament's inability to control the government derives from the way it is composed: members of parliament are not truly elected but rather appointed by the presidential administration. Accordingly, members of parliament are protégés and relatives of influential executive office holders. They simply carry out orders received directly from the executive branch, which is, in fact, the sole possessor of legislative authority.

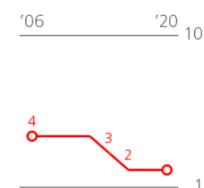
There is no independent judiciary either. The courts are corrupt and operate as a punitive mechanism in the hands of the executive power. The situation has deteriorated further due to a wave of disbarments of independent defense lawyers.

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 same applies to the selection of defense lawyers. The government heavily interferes and has the last say in court decisions on political, economic and other sensitive cases. Thus, while the administrative capacity of courts may have improved, their political independence has rather deteriorated.

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

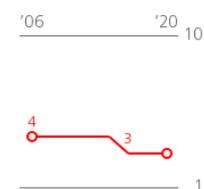
Separation of powers

2



Independent judiciary

3



Defense attorneys only play a largely formal 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. The dismissal and disbarment of defense lawyers who do not bend to the pressures of the executive is a worrying issue.

After the changes to the leadership of the Azerbaijan Bar Association in December 2017, disbarment of human rights lawyers intensified. Moreover, until January 2018, disbarred independent defense lawyers were able to practice non-criminal law. But since a new law enacted in January 2018, only bar-approved members have been allowed inside a courtroom.

The European Court of Human Rights (ECHR) remains the widely trusted last chance for justice-seekers in Azerbaijan. However, in the last few years, the government has delayed decisions made by the ECHR.

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

The system is based on corruption. This is endemic and affects almost every aspect of the lives of Azerbaijani citizens, being found on every level from top to bottom. However, in recent years, the government has made some efforts to reduce mid- and low-level corruption.

The State Commission on Combating Corruption and the Anti-Corruption Department of the prosecutor general's office are key government agencies for fighting against corruption. However, it should be added that these offices are frequently used as tools to silence political opponents, active civil society members and independent media, and to punish state officials who have fallen from grace.

The reawakening of civil activism, particularly among the younger generation inspired by the Arab Spring and the popularization of social networks, has led to further suppression of civil rights and liberties in Azerbaijan. In recent years, the government has launched a major crackdown against political dissent, civil society, human rights activists, the media, international NGOs and youth organizations.

Although civil rights are protected by the constitution, cases of police violence take place on a rather frequent basis. The ombudsman's office is more formal than functional and operates just as the government's spokesperson on issues within its jurisdiction.

Legally, Azerbaijan is fully committed to gender equality – the constitution contains relevant provisions, and the country has signed many international conventions. Nevertheless, patriarchal norms and values are still dominant in society. Hence,

Prosecution of
office abuse

4

'06 _____ '20 10

4

_____ 1

Civil rights

3

'06 _____ '20 10

5

4

3

_____ 1

Azerbaijan ranked 97 out of 149 countries in the 2018 Global Index of the Global Gender Gap Report. However, the transformation process is accelerating and women's status both within the family and in public life is gradually improving.

Even though Azerbaijan has decriminalized homosexuality, there is still a serious infringement on the rights of sexual minorities. The country remains the worst place in Europe to live as an LGBTQ citizen, according to the 2018 ILGA-Europe Rainbow Index.

Ethnic discrimination appears not to be a major problem in Azerbaijan. Azerbaijanis of various religious backgrounds enjoy equality and tolerance, although some religious groups named by the government as “non-traditional,” such as evangelists and some Muslim groups, often face government restrictions.

4 | Stability of Democratic Institutions

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

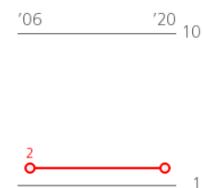
The government imitates a multiparty system. It tolerates only parties that agree not to criticize the government. In 2002, a referendum was held to eliminate party-list proportional representation, leaving a majoritarian (single-member constituency) system. In the 2010 elections, only political parties that did not challenge the authority of the government and operated under its broad supervision were given seats in parliament. The situation was repeated in 2015. Real opposition parties are not represented.

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

Elected municipal representatives exist. However, there are neither elected mayors of cities nor elected regional governors. Regional and city legislatures do not exist either. All power is concentrated in the hands of heads of local executives appointed by the president. Thus, informally, municipalities completely depend on those powerful rulers.

Performance of democratic institutions

2



The government always stresses its commitment to building a democracy and strengthening democratic institutions. However, the continuous crackdown on political opponents, civil society and the media only testifies that this is just lip service and that it is not ready to democratize.

For instance, the referenda of 2002, 2009 and 2016 eliminated the party-list proportional representation system, phased out the two-term presidential limit and extended the president's term of office from five to seven years.

So far, almost all government agencies and power players have been loyal to this policy, with the police being the most anti-democratic institution. Relatively young bureaucrats who have been exposed to a Western education or lifestyle replaced aging officials in some high-ranking government posts, but they have brought only minor changes.

Traditional secular parties used to be in strong opposition to the government, but they never clearly defined their ideology. However, during the past few years, this tendency has changed. Well-defined, liberal, democratic-minded organizations, led by people from the newly emerged young middle-class, have been seriously challenging the dominance of the traditional opposition parties. However, the aforementioned crackdowns have seriously damaged, if not halted, this process.

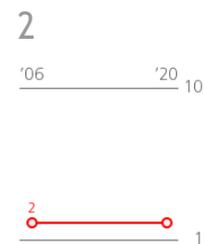
5 | Political and Social Integration

Azerbaijan is politically dominated by one ruling party. Currently, there are two major registered opposition parties, Musavat and the People's Front. Both have declared their commitment to liberal-democratic principles, but they have never pursued a systematic promotion of these values. Similar to the ruling party, they are prone to personalistic politics. After the 2010 and 2015 parliamentary elections, neither party was allowed to be represented in parliament.

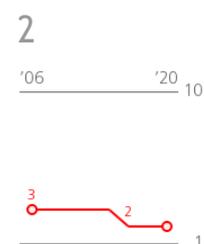
The People's Front Party was stripped of its headquarters. In addition, imprisonment of its activists and high-ranking members has intensified throughout the years, including during the reporting period. By the end of 2018, three of the party's deputy chairmen were in jail serving long-term prison sentences. Party leader, Ali Kerimli, was briefly detained in November 2018.

However, the entry of Western-educated youth into public life during the last few years, and the emergence of young middle-class and strong mid-level career professionals interested in public life, have paved the way for the birth of new pro-Western political groups such as the Republican Alternative (REAL) and the NIDA civic movement. Nonetheless, these organizations have suffered serious blows from the government. The entire leadership of NIDA was imprisoned in 2013 and then released in 2015 and 2016.

Commitment to democratic institutions



Party system



Arrested in 2013, REAL leader, Ilgar Mammadov, was released in 2018. However, the organization's attempts since 2017 to rent a venue to hold a founding conference to transform the movement into a political party were rejected by the authorities. The formation of the Republican Alternative Party was nonetheless announced after a founding conference was held online on April 7 and 8, 2018. However, the REAL Party is not officially registered.

The rest of the political parties are mainly controlled by the regime and pursue a pro-government agenda or even an agenda set by the government.

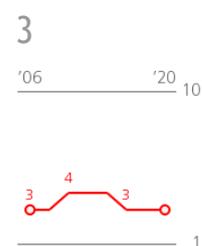
Since the late 2000s, a number of influential interest groups have started developing in the form of NGOs, cultural, religious, social, human rights and ideological networks. They are concentrated mainly in the capital, Baku, as well as in some other major cities, and they are largely absent from rural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

However, this unexpected success has made them primary targets in the ongoing crackdown. Many have faced numerous administrative and legal restrictions. Leaders of some organizations have been arrested on dubious charges, and criminal investigations have been launched. Others have been stripped of their rented premises and some have lost their funds due to restrictions imposed on donors. Laws have been toughened and all of these actions have made the environment almost impossible to operate in. As a result, many have ceased their activities. However, since early 2016, very limited independent activity has resumed in Baku.

Although Azerbaijani citizens did not have sufficient information about or experience with basic democratic institutions such as separation of powers or multiparty systems after the collapse of the Soviet Union, there was strong support for democracy and Euro-Atlantic integration among the population. During the last few years, with a growing number of individuals educated in the West entering public life and through civic initiatives supported by international and local NGOs, knowledge of the basic principles of democracy has expanded, raising hopes for gradual change that would ultimately lead to democratization.

However, the government's constant criticism of democratic principles and human rights as tools for the promotion of Western imperialism has stirred doubts about liberal-democratic values among some parts of the population. The global decline of democracy and the rise of authoritarianism as well as propaganda from neighboring Iran, Turkey and Russia have contributed to this. In addition, the crackdown on secular political parties and the shrinking space for civil society contribute to the expansion of political Islam, which aims at Shariah law. However, positive liberal-

Interest groups



Approval of democracy

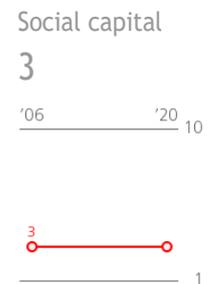


democratic changes in neighboring Georgia and more recently in Armenia counter these trends, and the majority still believes in the merits of secularism, free and fair elections, government accountability and the rule of law.

The bulk of social capital in Azerbaijan is present in rather homogenous family and kinship ties, regional identities and groups of close friends. Membership in such associations is based on the rights of birth, marriage or high interpersonal trust. These kinds of social trust and social relations have always been stronger in the rural areas outside the capital, and they have been gradually decreasing with expanding urbanization and modernization. Also, the rampant corruption and absence of the rule of law have been seriously damaging social trust in society.

According to the World Values Survey (2010-14), 93.9% of Azerbaijanis say that family is important in their lives. Azerbaijanis ranked the 6th highest out of 59 nations in response to the question of whether “tradition” and “to follow the customs handed down by one’s religion or family” are important to them (51.7% said they were). Yet, for clarification, it is important to add that Azerbaijan usually ranks among the least religious nations in global surveys (e.g., in the 2015 Gallup international survey).

Although participation in formal civic associations, such as membership of NGOs, has generally been limited, it had steadily grown in the capital city until the recent crackdowns. Since early 2016, there has been some revival. In general, however, society remains accustomed to demanding action from the government rather than engaging in self-help.



II. Economic Transformation

6 | Level of Socioeconomic Development

2016 was the most difficult year for the country in the last decade with a decline in GDP of 4%. There was no real turnaround in 2017, but, according to official statistics, there was at least a modest recovery of 0.1% growth. However, as the national currency had lost more than 50% of its value in the previous four years, inflation was on the rise and reached a peak of 12.9% in 2017. According to the World Bank, “high inflation adversely affected household income and reduced real purchasing power.” An increase in nominal average wages of 6% in 2017 was not enough to compensate for the higher prices.

Azerbaijan’s ranking in the Human Development Index declined to 80th in 2017, compared to 78th place in 2015. According to the State Statistical Committee, Azerbaijan’s GDP per capita was \$4,186 in December 2017, compared to \$3,928 in December 2016. However, even though in developed countries the GDP per capita aligns with average salary levels, the same cannot be said about Azerbaijan, where the average salaries are less than a tenth of the GDP per capita. The average monthly wage in October 2017 was \$309.

In Azerbaijan, 5.9% of the population lived in poverty in 2016, according to the Asian Development Bank. However, the World Bank estimates that, as a result of the increase in the inflation rate and decline in real wages, “poverty likely increased in 2017 and was probably worsened by the 50% cut in the coverage of the country’s most important social assistance program.”

Economic indicators		2015	2016	2017	2018
GDP	\$ M	53074.5	37867.5	40865.6	46939.5
GDP growth	%	1.1	-3.1	-0.3	1.4
Inflation (CPI)	%	4.0	12.4	12.9	1.9
Unemployment	%	5.0	5.0	5.0	5.2

Question
Score

Socioeconomic
barriers

5

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Economic indicators		2015	2016	2017	2018
Foreign direct investment	% of GDP	7.6	11.9	7.0	3.0
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ M	-222.5	-1363.4	1684.6	6051.1
Public debt	% of GDP	18.0	20.6	22.5	18.8
External debt	\$ M	13450.4	14769.4	15467.7	16212.2
Total debt service	\$ M	1908.5	1765.4	2276.7	2856.8
Net lending/borrowing	% of GDP	-2.7	2.5	1.9	-
Tax revenue	% of GDP	15.6	14.6	13.2	-
Government consumption	% of GDP	12.4	12.8	11.3	10.2
Public education spending	% of GDP	3.0	2.9	2.5	-
Public health spending	% of GDP	1.4	1.4	-	-
R&D expenditure	% of GDP	0.2	0.2	0.2	-
Military expenditure	% of GDP	5.5	3.7	3.8	3.8

Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Azerbaijan is considered a market economy. However, although there are rules and laws aimed at regulating the market, they do not play a significant role in the real economy. Small businesses, for instance, face many hurdles, especially because of the preferential treatment of large and state-owned enterprises. Moreover, monopoly-holding officials fight possible competitors by restricting their access to the domestic market and forcing them out of business.

Only a small percentage of companies in Azerbaijan export. Since most exports are in raw materials, non-oil sector SMEs have problems to develop. Import procedures and non-tariff barriers also discourage small business from engaging in import activities. Nevertheless, in 2017, the private sector's exports increased significantly from \$1.7 billion to \$4.8 billion. Likewise, the volume of private sector imports also increased from \$6.8 billion to \$7.1 billion.

According to the World Bank's 2019 Doing Business Report, Azerbaijan ranked 25 out of 190 countries in the ease of doing business, compared with 57 and 65 in 2017



and 2018 respectively. It also scores well in the subindex “Starting a Business” – the country ranks 9 out of 190 countries, with only three procedures, 3.5 days and costs of 1.3% of the average income per capita. This was also the result of government efforts to improve the country’s business environment, encourage investment and support local production. In 2015, the president signed a decree on the reduction of licensing requirements, ensuring transparency and easing procedures. In addition, in 2015, parliament adopted the law “On the Suspension of Inspections in the Field of Entrepreneurship.” According to this law, all “unnecessary inspections” were suspended for a period of two years.

The government also established the “One Window” Export Support Center in order to increase Azerbaijan’s export capacities. According to the executive director of the Center for Analysis of Economic Reforms and Communication, this new system allows business to spend less resources, leading to faster implementation of export procedures. In reality, though, many hurdles still remain, such as high taxes, limited or no access to credit and a monopoly on the import of many goods.

Access to finance is one of the biggest problems for small entrepreneurs in Azerbaijan. The capital market is underdeveloped. Credit supply is therefore very limited, and almost 90% of SMEs use their own resources for their operating capital. Moreover, the devaluation of the currency has resulted in banks tightening their credit conditions, which has substantially decreased entrepreneurs’ access to credit.

The informal sector constitutes a significant part of the economy. According to a study by the Association of Chartered Certified Accountants, the size of the shadow economy in Azerbaijan was 67% and 66% in 2016 and 2017 respectively. Pricing is controlled by the state in many sectors of the economy, including oil, electricity and gas. Prices on non-regulated goods and services are also influenced by regular informal payments to tax and customs authorities.

Although there are rules and laws aimed at increasing market competition, these laws are often bypassed because of the high level of corruption in government offices.

Since the fall of the Soviet Union, many large enterprises have been privatized, but they continue to be controlled by monopolies tied to high-ranking government officials. Many medium-sized companies are also owned by oligarchs or are informally tied to their large business.

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

The main laws on market competition are the Law on Anti-Monopoly Activity, the Law on Unfair Competition and the Law on Natural Monopolies. The State Committee on Anti-Monopoly Policy and Consumer Rights Protection is responsible

Competition policy

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for overseeing the implementation of competition laws. However, it does not play any serious regulatory role and has been ineffective in enforcing competition laws. The committee lacks 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.

In 2016, the president signed a bill to amend the Law on Anti-Monopoly Activity, which added the concept of cartel agreements to the existing legislation. Additionally, in April 2016, Article 199 of the criminal code, dealing with monopolistic actions and the limiting of competition, has been revised. The new law provides law enforcement agencies with wider powers when it comes to prosecuting anti-competitive actions.

Azerbaijan has been selectively integrated into the world economy, especially in the area of energy exports. The Baku-Tbilisi-Ceyhan (BTC) pipeline transports oil from the Caspian to Western markets. In May 2018, the Trans-Adriatic Pipeline was officially opened in Turkey. The project is part of the Southern Gas Corridor, which will connect the Shah Deniz gas field in Azerbaijan to Western Europe through the South Caucasus Pipeline, TANAP and the Trans-Adriatic Pipeline.

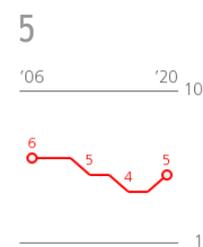
The country depends mainly on oil exports, so much so that, according to the CIA World Factbook, approximately 90% of all exports in 2017 were accounted for by the oil sector, which is monopolized by the state. Moreover, the state's share in non-oil sector exports is also quite high, amounting to more than one-third of total non-oil exports.

Imports in 2017 grew by 2.9% and were worth \$8.78 billion. Import tariffs in Azerbaijan remain high, with the simple average most favored nation applied tariff rate comprising 9% in 2015. Azerbaijan adopted a new set of tariffs in 2018, switching to a three-level differentiated tariff system, which will include only three rates of 0%, 5% and 15%, depending on the imported good. Accordingly, most raw materials are tariff-free, while finished and agricultural products are applied a 15% tariff. The purpose of imposing higher tariffs on agricultural and other products is to promote local production and reduce reliance on imports.

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

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

Liberalization of
foreign trade



permits and standardization procedures. High informal fees and long waiting times at the borders hinder Azerbaijan's potential as a competitive cargo transit route as well. Yet the introduction of an electronic system for submitting export and import declarations may help to improve the situation.

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 of Economic Development. However, the law does not address the grounds for refusal of such approvals, leaving much to the discretion of government authorities. This creates complications for entrepreneurs and excludes many from foreign trade.

In December 2016, the president signed a decree on the "Roadmap of the National Economy and its Main Sectors." The goal is to transition to an export-oriented economy that yields higher value-added products. One of the strategic targets of the roadmap is to support the export of agricultural and industrial products. The roadmap envisions that the share of agricultural products as a proportion of non-oil exports will significantly increase by 2025.

In 2017, the government took some steps aimed at increasing both the production and the export of non-oil products. It made promotion of products with a "Made in Azerbaijan" brand on foreign markets one of the priorities of the country's foreign trade policy. In 2018, the cabinet of ministers expanded the list of non-oil products intended for export.

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

The devaluation of the national currency in recent years has had a considerable impact on the banking sector in Azerbaijan. One of its main consequences was dollarization: the depreciation of the manat (AZN) led to a run on the banks, with people trying to get dollars in exchange for manats or to change their manat accounts to dollar accounts. Some even tried to withdraw their entire holdings. Dollarization remained high in 2017, and over 74% of bank deposits were denominated in foreign currency.

One of the biggest events in Azerbaijan's banking sector in 2017 was the crisis involving the largest state-owned bank in the country, the International Bank of Azerbaijan (IBA). In 2016, the Financial Market Supervisory Authority announced plans to restructure the bank, calling IBA a threat to the banking sector. Thus, the authorities started pouring a significant amount of capital into IBA and transferred some of its bad assets to a separate entity. However, in May 2017, IBA announced that it was restructuring \$3.3 billion of its debt and swapping it for sovereign bonds. Meanwhile, the government announced plans to privatize the bank by 2018. The

Banking system

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process of restructuring the bank was completed in September 2017, but privatization is still ongoing. Many experts expect that, as a result of this restructuring, the country's external debt will go up by \$2.5 billion.

Aside from this, there have been a number of reforms in Azerbaijan's financial sector in recent years. One was the creation of the abovementioned Financial Market Supervisory Authority (FIMSA) in February 2016. This board is in charge of licensing and regulating the securities market, banks and other credit organizations, as well as ensuring transparency in the financial sector. FIMSA has taken some firm steps by closing 11 banks for failing to comply with capital requirements, bringing down the total number of banks in Azerbaijan to 30.

Official data from Azerbaijan's central bank suggests that the amount of non-performing loans increased from 9% in 2016 to 13.8% in 2017, creating a more dangerous situation for the economy. Moreover, many other independent sources estimate that this number is much higher.

Additionally, currency devaluation and the closure of banks have shattered trust in the banking sector, which is reflected in the decreased amount of deposits in the banks. Total deposits comprised AZN 2.6 billion in 2017, which is considerably less than the AZN 23.4 billion of deposits in 2015.

8 | Monetary and fiscal stability

With the increase in oil prices, Azerbaijan's economic position improved, meaning that in 2017, the country had a positive balance of payments of \$1.97 billion, and the current account balance totaled \$1.7 billion.

On February 21, 2015, the Central Bank of Azerbaijan (CBA) devalued the manat by 33.5% to the dollar and continued this policy until early 2017, when at one point the dollar to manat rate reached a peak of 1.92. However, the central bank was later able to stabilize the currency and thus the official average exchange rate has been hovering around 1.70 manats to the dollar since April 2017. According to the central bank, the real effective exchange rate of manat increased by four percentage points compared with 2017 to 98.9% in 2018. This was mainly due to an increase in the national currencies of Azerbaijan's trade partners against the U.S. dollar.

Even though the CBA announced that it was transitioning to a floating exchange rate in 2015, it continued to intervene and regulate the exchange rate and was somewhat successful in achieving stability. The central bank also tightened its money supply.

With the depreciation of the manat, purchasing power decreased considerably. In 2017, the official inflation rate reached 12.9%. At 16.4%, the inflation rate has been particularly high for food products. Thus, in order to curb inflation, the central bank continued its tight monetary policy. Official data for December 2018 indicates that

Monetary stability

7

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the inflation rate in Azerbaijan has declined a lot, dropping to 2.3%. The IMF and the World Bank predict that the inflation rate will remain low in Azerbaijan because the price of oil on the global markets will be around \$70 per barrel. The government, on the other hand, has approved its budget for 2019 based on an oil price of \$60 per barrel. However, many predict that the price of crude oil will be less than that. In this scenario, the pressure on the manat will rise, and the inflation rate may again approach double digits.

Having a strong currency is regarded by the government as a prestigious indicator of strength and stability. Although the central bank lost many of its powers with the establishment of the Financial Market Supervisory Board, it is still responsible for the country's monetary and currency policies. Overall, however, the CBA is not a transparent body, and it is highly influenced by political decisions.

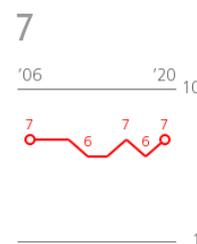
Since Azerbaijan is highly dependent on oil exports, the sharp decline in global oil prices led to a serious decline in state revenues in 2015 and 2016. However, with the rise of oil prices, oil revenues increased again in 2017. The State Oil Fund's revenues were almost 20% higher in 2017 than in 2016. Foreign trade increased too, by 28% to \$22.6 billion in 2017, up from \$17.7 billion the year before.

The government continued its tight fiscal policy in 2017. As a result, state budget expenditures continued to decline, dropping to \$17.6 billion in 2017. According to the Ministry of Finance, there was budget deficit of approximately 1.1 billion AZN (or \$671 million) in 2017, equal to 1.6% of GDP.

In August 2018, the president signed an amendment to the Law on the Budget System, which aims to reduce the state budget's dependency on oil revenues and keep expenditures low even in periods of high oil revenues, thereby changing the government's procyclical fiscal policy, which sees government spending being increased during economic booms and reduced during recessions.

World Bank data suggests that, as of 2017, net government lending/borrowing as a percentage of GDP has increased to -1.7 from -1.2 in 2016. Foreign debt substantially increased in 2017. The official statistics show that it increased by \$2.5 billion in 2017, resulting in a 22.8% foreign debt-to-GDP ratio. According to the World Bank, Azerbaijan's public debt-to-GDP ratio reached an all-time high of 54.1% in 2017; however, it decreased to 48.4% in 2018.

Fiscal stability



9 | Private Property

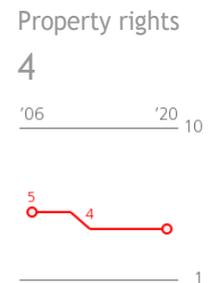
Property rights are not secure in Azerbaijan. The state and powerful oligarchs frequently violate them. Despite the existence of legislation on property rights, there are still some gaps in the law and enforcement of the law's provisions remains very poor. The constitution and other laws dealing with 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 has 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. However, because of high levels of corruption, government officials and oligarchs have the power to bypass the law and expropriate private homes and retail spaces for their own private purposes.

Starting in 2009, private property rights came under attack because of government-sanctioned evictions and the demolition of private houses in several districts of Baku. The most recent attack came in 2013 to 2016, when the government evicted residents in the Sovetsky district of central Baku. The government provided citizens with AZN 1,500 per square meter, making it difficult for them to buy new apartments in the same district or in the vicinity. However, private companies later took over the process, and it was said that they were offering much higher compensation. In 2018, the cabinet of ministers announced that an additional 2,000 residential and non-residential properties would be demolished in the same part of the city.

There are still many gaps in the legislation on registering property. State officials frequently interfere with legal processes in order to extract bribes. Politically motivated infringements of property rights are also still a problem. However, the process of registering property has been simplified to some extent with the creation of ASAN service centers. According to the 2019 Doing Business Report, Azerbaijan ranks 17 out of 190 economies on "the ease of registering property."

Azerbaijan has flaws and gaps in the laws aimed at protecting intellectual property rights. It ranks 36th in the field of intellectual property protections, according to the 2018 Global Competitiveness Report. However, new legislative acts, such as the Law on Enforcement of Intellectual Property Rights and Fighting Against Piracy, have recently been adopted. Additionally, the Center for Enforcement of Intellectual Property Rights was created under the Copyright Agency. The center is expected to issue copyright hologram stickers for certain products, such as software, books, CDs and DVDs. Products without these marks will be considered pirated, and fines will be imposed on their distributors.

In 2017, the president signed an order aimed at improving governance in the areas of patent protection, standardization, metrology and accreditation. He also ordered a



reorganization of the relevant state committee. Moreover, in 2018, the president signed an order establishing the Patent and Trademarks Center under the Intellectual Property Agency, which is tasked with assessing and registering inventions, useful models, industrial samples, trademarks and geographical indications.

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 medium-sized enterprises being taken away from their owners when they do not have links to the ruling elite.

According to the 2019 Doing Business Report, Azerbaijan ranks 25th in “ease of doing business” and 9th in “starting a business.” The introduction of e-invoicing and a unified tax return for social security contributions streamlined tax collection. The government also introduced an insolvency law, broadening the scope of assets that can be used as collateral. Azerbaijan also set up a collateral registry and improved access to credit information by establishing a new credit bureau.

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

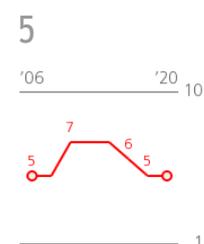
Although there are laws in place that make opening or registering private enterprises easy, there is still a lot of irregularity in the implementation of these laws. The operations of private businesses are prone to pressure from government, oligarch-owned monopolies and widespread corruption. If businesspeople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

10 | Welfare Regime

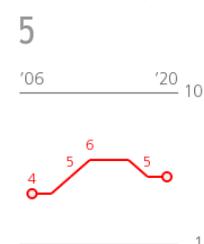
Provisions for pensions, illness compensation, disability, unemployment and maternity leave exist in national legislation; however, the welfare system in Azerbaijan suffers from considerable underfunding. Wages, pensions and illness compensation are low and do not cover living expenses. Health care is inadequate, especially for the poorer sections of the population.

The minimum wage has risen in the last few years. In December 2017, the minimum wage was increased to 130 manats, approximately \$75 per month. However, taking into account the real cost of living, this is not enough to cover basic needs. Family

Private enterprise



Social safety nets



networks and money transfers from family members working abroad act as a stabilizing force for some segments of the population.

Government statistics are unreliable, but 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 labor offices. There is also no state support for the vast majority of unemployed people. In June 2017, President Aliyev signed the Law on Unemployment Insurance, which went into effect on January 1, 2018. According to this, employees are offered unemployment benefits when they lose their jobs because of staff reduction or the liquidation of their workplace. Also, 0.5% of the monthly wage of an employee will be transferred to an unemployment insurance fund as an insurance premium. Therefore, if an employee becomes unemployed, he or she will start receiving an insurance payment.

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

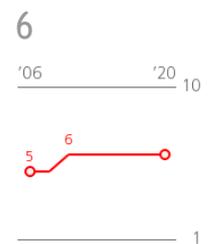
Since the collapse of the Soviet Union, women's social status has suffered to some extent, and social structures are still male-dominated. In rural areas, the prevalence of religious and parochial traditions often results in young girls dropping out of school.

Legally, women are entitled to the same rights as men, and they do participate in labor force. By December 2017, the overall labor force participation rate in Azerbaijan had dropped to 66.1%. According to the State Statistical Committee, 5 million people were seasonally employed or actively looking for a job in 2017, and 48.6% of them were women. Female professions have generally been underpaid, and gender-specific exclusion is evident.

Although female professionals can be found (primarily in the capital) in both the country's older, Soviet-trained and the younger, Western-trained generations, government offices are predominantly staffed by men. Due to cultural factors, women are often excluded from leadership positions. Most notably, it comes as no surprise that the cabinet of ministers has only one female member – Hicran Huseynova, the head of the State Committee for Family, Women and Children's Issues. Azerbaijan's Gender Inequality Index score in 2017 was 0.318. In this regard, the country lags behind not only Eastern European countries but also its neighbors Georgia, Turkey and Russia.

There is a difference in the labor force participation rate between rural and urban areas. Generally, unemployment is higher in the cities because most people in rural

Equal opportunity



areas are involved in subsistence farming. Additionally, there is a wage disparity between urban and rural areas. The vast majority of foreign and local companies with high-paying jobs are concentrated in the capital; therefore, the difference in salaries between people working in Baku and other parts of the country is substantial. Another issue is the participation of internally displaced persons (IDPs) in the labor market. Most of them have had difficulties finding jobs, especially in rural areas, and they still depend on government assistance or remittances from their relatives living abroad.

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

11 | Economic Performance

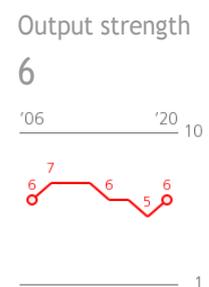
Azerbaijan's economy relies heavily on oil and natural gas, which poses many risks to economic development. Declining oil prices since mid-2014 had weighed heavily on economic performance and resulted in a 4% contraction of GDP in 2016. However, higher oil prices in 2017 increased oil revenues, although, as a result of the sharp decline in the construction sector, overall GDP grew by only 0.1% that year. The economy continued to expand in 2018, supported by stabilizing oil production and somewhat higher oil prices, resulting in 1.3% GDP growth.

However, according to the Ministry of Finance, state budget revenues in 2017 were AZN 16.45 billion, while expenditures were approximately AZN 17.6 billion. Thus, the country had a budget deficit of around 1.6% of GDP. According to the State Statistical Committee, GDP totaled \$40.75 billion in 2017 and \$21.77 billion in the first half of 2018. World Bank data suggests that GDP per capita growth in 2017 was still negative (-1.0%, compared to -4.2% in 2016).

The rise in global oil prices had a positive effect on the balance of payments. There was a surplus of \$1.97 billion in 2017, while the current account also became positive and totaled \$1.7 billion in 2017. As a result of the devaluation of the national currency, in 2016 the inflation rate exceeded 12%. It rose to 12.9% in 2017 but rapidly came down to 2.3% in 2018, which exceeded the International Monetary Fund's 3.5% forecast.

The foreign public debt of Azerbaijan increased substantially in 2017. According to the Ministry of Finance, it went up by almost \$2.5 billion that year alone. As a result, the foreign debt-to-GDP ratio increased to 22.8%.

According to the United Nations Conference on Trade and Development (UNCTAD), the foreign direct investment inflow to Azerbaijan in 2017 was \$2.9 billion, which is a 36% decrease from \$4.5 billion in 2016.



The state budget remains heavily subsidized by the State Oil Fund (SOFAZ). The contribution of SOFAZ to the budget was \$3.6 billion in 2017, down from \$9.3 billion in 2015. It seems that the oil fund is failing in its main purpose of saving the oil windfall for future use. Instead, the country has grown dependent on large yearly transfers from the fund. According to the State Statistical Committee, SOFAZ's revenues were AZN 12.138 billion in 2017, while expenditures amounted to AZN 11.016, which means that they managed to close the year with a surplus of AZN 1.122 billion, approximately \$637 million. In the first nine months of 2018, SOFAZ had a revenue of AZN 14.44 billion and AZN 8.01 billion in expenditures. The fund transferred AZN 7.79 billion to the state budget during the same period.

Official statistics for 2017 and 2018 report an unemployment rate of around 5%. However, independent sources estimate that around 25% of the population are unemployed.

12 | Sustainability

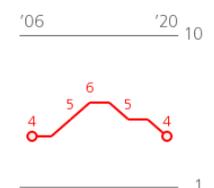
Ecologically tolerable growth finds only marginal consideration in Azerbaijan and is institutionally not entrenched at all. The creation of the Ministry of Ecology and Natural Resources in 2000, as well as the partial deindustrialization and modernization of the petroleum and natural gas sectors, achieved in cooperation with international consortia and donors, has not resulted in much improvement for the environment. Azerbaijan is party to the Kyoto Protocol, but it still needs to implement its relevant provisions.

Serious environmental challenges remain. Damage incurred from 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 October 2016, the president signed an order on the “National Strategy for the Protection and Sustainable Use of Biodiversity in the Republic of Azerbaijan for 2017-2020.” The purpose of this strategy is to take concrete steps in the field of “sustainable use of genetic resources; conservation of biodiversity and transfer to future generations; poverty alleviation; maintenance of ecological balance; ensuring transition to a ‘green economy’; promotion of environmental education; restoration of endemic and local fauna species; development of the protected areas network; and reducing the threats to biodiversity.”

Other measures include the presidential Strategic Roadmap for Public Utilities of late 2016, which calls for stations for renewable energy sources with a capacity of 420 megawatts or plans forged in 2018 by the Ministry of Ecology and Natural Resources to introduce payments for plastic bags beginning in 2019. 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, the

Environmental
policy

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legislation still needs further development and better implementation, which is hindered by a high level of corruption. Additionally, there has been very limited investment in clean energy, and most of the financing for it comes from international development banks.

The educational system in Azerbaijan is still poor. Inadequate training, poorly trained teachers and outdated textbooks still dominate all levels of education. State kindergartens and secondary schools are infested by widespread corruption.

According to the U.N. Education Index, which measures the educational attainment of a country by combining average years of schooling for adults with the expected years of schooling for children, Azerbaijan's score has been unchanged for the past few years and was 0.709 in 2017.

In principle, however, formal access to education in Azerbaijan is universal and free. The literacy rate is over 95%, although the poor quality of secondary level education is a well-known fact. Enrollment in tertiary education is about 20%, which is low for an upper-middle income country. For decades, corruption has dominated higher education, but newly launched institutions like the ADA University, the French-Azerbaijani University and Baku Higher Oil School have become corruption-free zones in this industry.

The government spent 1.7 and 2.1 billion manats on education in 2017 and 2018 respectively. The 2019 budget includes 2.275 billion manats for education, which is 11.3% more than in 2018. Education expenditures account for 9.2% of the country's total budget expenditures.

The 2017 to 2018 school year was declared “the Year of Quality in Overall Education.” The purpose was to “achieve the quality necessary for the development in the area of education in accordance with the challenges of the modern era.” Additionally, in 2016 to 2017, the state funded new school readiness programs. According to official data, 55% of five-year-old kids attended these programs in the first year, with attendance increasing to 65% in 2018. According to Education Minister Jeyhun Bayramov, the plan is to increase this figure to 90% by 2020. In November 2018, the Ministry of Education, the European Union and UNICEF launched a joint project called “Expanding Inclusive Education for Children with Disabilities in Azerbaijan.”

Research remains a seriously underdeveloped area of the economy; according to Trading Economics, only 0.2% of GDP was spent on research and development in 2015. The Science Development Foundation was established in 2009, but it has not made any difference. Comparative analyses of annual data provided by SCImago Research Group show that Azerbaijan's scientific output has not improved since the creation of the Scientific Development Foundation. The lack of a merit-based selection process is the primary cause of failure. Political loyalty and cronyism

Education policy /
R&D

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'06 _____ '20 10



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dominate the unofficial selection criteria. In January 2019, President Aliyev signed a decree to implement additional measures to improve public administration in the country. According to this, the activity of the Science Development Foundation will be reorganized based on the self-financing principle.

Governance

I. Level of Difficulty

Azerbaijan has favorable conditions for good governance, yet several factors negatively affect its development. The first is that there is a long-standing conflict over Nagorno-Karabakh and seven adjacent territories that were occupied by Armenia in the early 1990s. Another structural constraint originates from Azerbaijan's big neighbors. The country borders Iran and Russia to the south and north respectively. For the past few years, Russia's aggressive foreign policy has posed an imminent threat to the region. Azerbaijan has a young, religious Shi'a population. The structure of Shi'a Islam makes its adherents dependent on the Iranian religious establishment.

In recent years, Erdogan's Turkey has also extensively interfered in the internal affairs of Azerbaijan, causing the closure or restructuring of some educational institutions and media outlets.

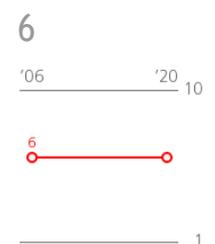
Azerbaijan is landlocked and thus dependent on foreign countries for the export of the oil and gas that comprise the overwhelming majority of its foreign earnings.

The historical roots of civil society in Azerbaijan are very weak. In terms of local traditions, Azerbaijan is a fairly hierarchical society with obedience to authority, in which the population has no tradition of organizing collective action.

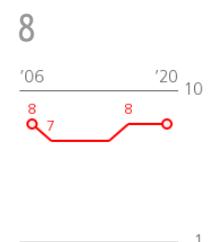
Still, in the context of the Muslim world, Baku in the late 19th and early 20th century developed its own intelligentsia and political culture, which could have been an embryo of modern civil society. That potential was crushed by seven decades of Soviet rule; civic organizations during the Soviet period 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 that, especially in academia and culture, a new national elite emerged. However, in the 1970s and early 1980s, the intelligentsia suffered again under the reintroduction of clientelist 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 ongoing crackdown, which started several years earlier, has seriously undermined this development.

Structural constraints



Civil society traditions



The Nagorno-Karabakh conflict, which has ethnic roots, is still the main violent conflict in the country. Although a cease-fire has been in effect since 1994, in early April 2016 a major armed clash with hundreds of fatalities on both sides occurred, leading to concerns of renewed war.

Representatives of other major ethnic groups such as the Lezgins and Talyshes have in the past advocated separation, but they are currently unorganized and peaceful.

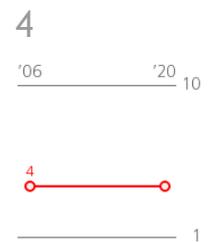
Social dissatisfaction, religious radicalism and the government's drive to close the space in which free media, freedom of assembly and independent political activities take place are other potential sources of conflict in society.

The rise in tensions between the authorities and religious activists was one of the latest noticeable developments. In late 2015, state police launched an armed operation in Nardaran (a Shi'a stronghold on the outskirts of Baku) against a group of believers led by outspoken cleric Haji Taleh Bagirzade. The operation left several people dead, both believers and policemen.

In July 2018, Elmar Valiyev, who was the head of Azerbaijan's second-largest city, Ganja, and was known for his heavy-handed rule, was shot in the head. The government blamed religious radicals for this terrorist attack. A week later, two police officers were killed during violent protests in the city center. Shortly afterwards, the president fired Elmar Valiyev (who had survived the attack) and appointed a new executive head of Ganja.

In late 2015, Azerbaijan's main security agency appointed a new head and the institution was reorganized (it was previously called the Ministry of National Security, becoming the State Security Service after the reorganization). Since then, it has conducted several operations against alleged Sunni radicals, which have resulted in the death of dozens of suspects. After the events in Ganja, the State Security Service led similar operations against alleged Shi'i radicals, which again resulted in multiple fatalities.

Conflict intensity



II. Governance Performance

14 | Steering Capability

For a long time, the government tried to persuade external actors in particular – but also internal ones – that it had adopted a gradual and deliberate strategy of promoting democracy. But, while acquiring self-confidence due the inflow of oil revenues, it started talking more openly about a “special way of building democracy,” which in reality meant rejecting democracy and consolidating the authoritarian regime. This, along with the plight of freedoms, has weakened the republican foundations of the state. The appointment of Aliyev’s wife as the first vice president during the reporting period was another vivid illustration of the authoritarian leanings of the ruling elite.

Strategic programs have been geared toward making Baku the venue for various types of international events. Hosting these events has forced the government to carry out significant infrastructure renovations, including to public transportation, roads and railways, and has contributed to the promotion of the country’s international reputation.

The economic downturn after the fall of oil prices in late 2014 exposed the incompetence of the government as well as its flawed policies and corrupt practices. The crisis caught the government totally unprepared. Hence, responses to the crisis in its early stages were poorly organized and chaotic. However, during the course of events, the government was able to some extent to draw lessons from its own mistakes and to adjust its policies. It also made attempts to systemize its approach to the deteriorating situation and to consolidate control over the economy. The situation forced the government to engage in some liberalization, such as easing the tough visa policies implemented before the crisis. Along with other measures, this contributed to a boost in inbound tourism.

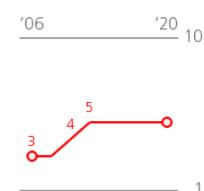
During the reporting period, major changes to customs and tax regulations as well as to the leadership of both the tax and customs ministries intended to contribute to advancing fair market practices. However, the effects of these changes remain to be seen because so far, the major systemic problems of economy, such as the deeply entrenched high-level corruption and oligarchic monopolies, are still largely intact.

Despite the fact that since the economic downturn the government has adopted strategic roadmaps, reorganized ministries, created new agencies, cooperated and sought international assistance, its strategic and institutional capacity to prioritize and organize policy measures remains limited. Securing power is of the utmost priority for the ruling elite, but genuine economic and political reforms may jeopardize this priority.

Question
Score

Prioritization

5



When the government attaches high priority to projects in the energy and transportation sectors or to venues for international sporting and entertainment events, such as the first European Youth Summer Olympic Festival, the Eurovision Song Contest, Formula One and the Islamic Games, it tends to successfully implement them, irrespective of spiraling costs. These costs are often the result of widespread corruption – siphoning money off projects for officials’ private purposes, for example. The government has intentionally delayed WTO accession because of protectionism, mainly for the benefit of powerful oligarchs and their corrupt businesses.

Due to the priority given to improving the business environment, Azerbaijan has steadily improved its position in the World Bank’s Doing Business rankings. In Doing Business 2019, the country was named as one of the “10 economies showing the most notable improvements.” However, while officials frequently emphasize their priority of diversifying the economy, real achievements in this area are not impressive, and the economy continues to rely heavily on oil revenues.

The government has been even less successful in decentralizing the political system and facilitating democratic reform, including in implementing the rule of law. The main obstacle is the government’s reliance on autocratic, patrimonial methods of rule.

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

During the period under review, government agencies have expanded their collaboration with Western experts in carrying out reforms. That was the case during the recent major changes to the country’s tax code, for example.

However, the government has completely brushed aside Western advice on issues relating to political reforms, building civil society and implementing the rule of law.

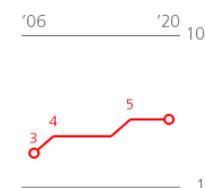
15 | Resource Efficiency

The state budget depends heavily on oil revenues, which led to high GDP growth rates for several years until the fall in oil prices in late 2014, reaching an all-time high of \$75.24 billion in 2014. However, because there had been no diversification of the economy, there were concerns that, once the country ran out of oil reserves, growth would slow down, eventually leading to economic decline. The actual drop in GDP in 2015 (to \$53.07 billion) and in 2016 (\$37.87 billion) proved these concerns true. In 2017, real GDP rebounded to \$40.75 billion – in line with the rising oil prices.

The state debt is not at critical levels. It stands at approximately 20% of GDP. It is manageable because state currency reserves exceed the state debt. However, the budget is not effective because it is not audited according to the results. Moreover,

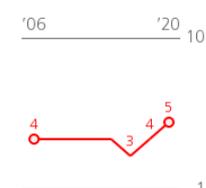
Implementation

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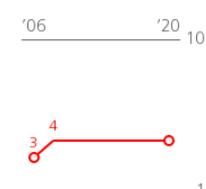
Policy learning

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Efficient use of assets

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there is also no independent audit. The Chamber of Accounts, for instance, is completely dependent on the executive.

The planning and implementation of the state budget is not transparent. Planning is not conducted with the involvement of interested parties. As a result, important budget expenditures are hidden from the public. For instance, official information about investment expenditures, which consist of one-third of the budget, is not available.

Deviation of the actual budget from the planned budget has been a regular practice for many years. For instance, the state budget for 2018 was planned and confirmed in September 2017. However, it was changed in May 2018, and the changes amounted to 30% of the budget. The existing legislation on the budget grants the executive with considerable independence to amend the budget without seeking approval from parliament.

Strict loyalty to the ruling elite remains the highest priority during the hiring of government personnel, even for low- or mid-level positions. Any criticism of the system by public employees can result in punitive measures. The government introduced several exam procedures, which are conducted by the State Exam Center, to hire state employees based on meritocratic selection. While the exams earned public trust, the last phases of the selection process – interviews – are still powerful tools in the hands of the authorities to reject “politically unreliable” candidates. During the reporting period, the most notorious example, which vividly illustrates this situation, happened during the selection process for the state-controlled Azerbaijani Bar Association, which took place in early 2018. There is no doubt that some lawyers who are critical of the government were intentionally turned down by the authorities during the interviews, despite the fact that they had successfully passed the first stage of the exam.

The lack of political will for decentralization has resulted in the country lagging behind its South Caucasian neighbors in reforming the territorial-administrative system inherited from the Soviet past. Azerbaijan has neither elected city mayors nor elected local councils and legal bodies except for in the Nakhichevan Autonomous Republic. The pro-forma municipalities are completely dependent on the heads of the local executive power, who are appointed by the president of the republic.

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 relevant state agencies. Some ministers and other high-ranking officials have a sense of being independent potentates, lacking responsibility or accountability to their colleagues. There is no sense that the cabinet of ministers functions as a coherent unit.

Moreover, key oligarchs have their own private economic interests, which often involve a near-monopoly on certain sectors of the economy. As a result, an informal understanding exists as to which sectors or even regions are controlled by which oligarch, and some forms of coordination are simply off limits for other stakeholders. Vested interests and conflicts among the various ministries and ministers often prevent effective coordination of state programs.

Nevertheless, the government shows unity in very important political decisions that are crucial for the stability of the regime (e.g., combating the opposition and implementing major projects).

Unlike his father, who had absolute political authority, the current head of the state is influenced significantly in his decisions by powerful oligarchs and takes their interests into consideration, even though he is still the most powerful figure. However, his authoritarian rule has been gradually consolidated, and significant advancements to this effect have been made during the period under review.

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

The economic downturn since 2014 has put pressure on the government to introduce more serious measures to combat corruption in order to save the troubled economy and be able to satisfy the basic social needs of the population.

Compared with other state agencies, the Ministry of Foreign Affairs, the State Examination Center and the State Oil Fund are less involved in corrupt activities. ASAN, the one-stop state agency for public services provided to citizens of Azerbaijan, which was established several years ago and has since expanded, was initially launched to reduce low- and mid-level corruption and has proved an efficient tool.

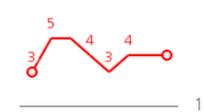
There have also been some improvements in higher education. However, state kindergartens and secondary schools, as well as the state health care system, are still infested with widespread bribery.

During the reporting period, significant efforts to reduce widespread corruption in the tax and customs systems were also made.

Policy coordination

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'06 _____ '20 10



Anti-corruption policy

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'06 _____ '20 10



16 | Consensus-Building

Until recently, the government and major political actors claimed that they were pursuing a path to democratization but insisted that stability, security and social order were prerequisites for democracy and that the democratization process should be gradual, cautious and based on cultural modernization. However, the opposition has always accused the government of monopolizing power and using stability, social order and cultural progress as excuses to turn the republic into a monarchy. The events that unfolded in Azerbaijan following the presidential election of 2013 somewhat upheld the opposition's claims, and the appointment of president's wife as the first vice president in 2017 further cemented this assumption.

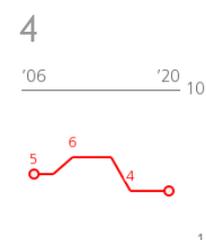
All main political parties in Azerbaijan agree on the need for a market economy (except for some radical leftist youth groups). Yet, the corrupt oligarchic nature of the ruling regime has hampered the development of a fully functional market economy. However, as described above, the economic downturn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

The ruling elite has a very strong grip on political power, which is vested in individuals rather than in government institutions. Some state agencies try to hire young, Western-educated staff to implement policies in a more efficient manner, but, overall, power is in the hands of policymakers who do not favor democratization or market reforms. That means that, during this and previous reporting periods, there was a string of replacements of old entrenched ministers with young members of the elite who have been more exposed to the outside world and are more sensitive to public opinion. This has boosted hopes that the government might eventually move in the right direction; however, the situation is ambiguous, and these reorganizations do not always render expected results, as was the case with the recent changes in the Azerbaijani Bar Association.

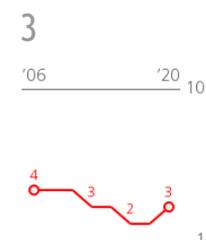
Moreover, the situation is further complicated because the ruling regime remains the main actor vetoing democratization, despite its official pro-democracy stance, rhetoric and some aforementioned improvements in policies. Signs of growing authoritarianism during the reporting period are clear. Crackdowns on the independent media, domestic and international NGOs, civil society and human rights activists, as well as persecution of political dissent and further reduction of civil liberties, have been among the main indicators of the regime's non-democratic nature.

Unfortunately, there has also been a rise in non-democratic actors in the opposition in the last few years due to the stifling of local democratic forces as well as an overall decline of trust and confidence in democratic institutions among the politically active public.

Consensus on goals



Anti-democratic actors



The government prioritizes the preservation of stability as the most important political value. Accordingly, the country's stability is propagandized as the government's best achievement.

All potential conflicts, whether they have a religious, ethnic or social basis, are prevented and suppressed. The government has often sought to suppress dissent rather than engage in consensus-building. However, during the reporting period, some policies aimed at easing tensions with Shi'i believers were also implemented.

A lack of comprehensive long-term policies, a reliance on authoritarian measures for short-term purposes and, most importantly, the government's utter rejection of the liberal-democratic opposition, all contribute to the preservation and even aggravation of problems.

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

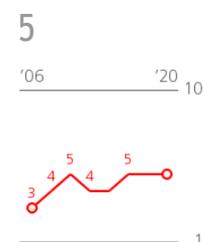
The Azerbaijani government frequently praises its religious tolerance as part of the national tradition. It holds many pro-forma international events on multiculturalism, religious tolerance and dialog. However, the government has also been frequently criticized for oppressing freedom of religion.

Starting in 2013, the government has launched a crackdown in an attempt to close the space for any independent activity and critical voices. Both local and international NGOs have begun to encounter serious restrictions. Numerous international donors and NGOs have been forced out of the country. Strict laws have been adopted, bank accounts have been frozen, and travel bans have been imposed. Trumped-up criminal cases have been launched, and many local NGO activists have been imprisoned, with some activists seeking refuge in foreign countries. Almost no space has been left for independent NGO activities and, despite the fact that many imprisoned NGO activists were later released, the revolving door of arrests and releases still continues, albeit more slowly and with less intensity.

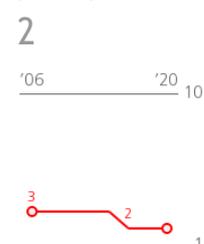
Overall, civil society in Azerbaijan has been effectively stifled, and the government tries to imitate civil society by replacing genuine NGOs with GONGOs (government-organized non-governmental organizations).

However, it should be noted that independent civil society and youth activism have shown some promising signs of revival during the reporting period, particularly in Baku. Some independent civil society groups resumed their seminars, trainings and public lectures. They were able to rent venues for these purposes, which was almost impossible when the crackdown was at its peak. But this development is still very fragile and heavily dependent on the tolerance of the state authorities.

Cleavage /
conflict
management

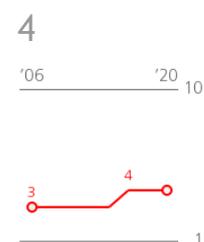


Civil society
participation



A genuine and comprehensive reconciliation process with political opponents can only be initiated by the ruling elite; so far, however, it has demonstrated no interest in this, except in cases when former rivals pledge loyalty to the existing regime. Unlike in the past, the government did not even express pro-forma statements about dialog with the main secular, liberal-democratic opposition during the reporting period. The only exception is some efforts on the part of the government to ease tensions with Shi'i believers in the country.

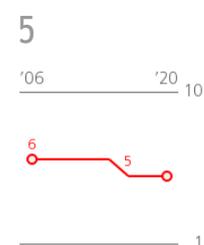
Reconciliation



17 | International Cooperation

Azerbaijan's government generally cooperates with international partners in the area of economic development and technical cooperation. Foreign partners play an essential role in implementing major economic projects. Azerbaijan also hires experts, primarily from Western countries, to run important local projects and state businesses.

Effective use of support



Difficulties arise from the fact that the long-term development strategy of the current ruling elite does not include democratization and implementation of the rule of law. That is why on March 9, 2017, a decision to suspend Azerbaijan's membership of the Extractive Industries Transparency Initiative (EITI) was made due to the country's unwillingness to stop its crackdown on civil society. The next day, Azerbaijan decided to withdraw from EITI. For the same reason, the Steering Committee of Open Government Partnership extended Azerbaijan's inactive status in this organization during the reporting period.

In February 2017, Azerbaijan and the European Union started new negotiations for a comprehensive new agreement, while previous phases of negotiations aiming to create an association agreement did not bring results. The new agreement should replace the 1996 Partnership and Cooperation Agreement. It is obvious that the unwillingness of Azerbaijan's government to commit itself to genuine democratic reform was the main reason that, unlike its South Caucasian neighbors, Azerbaijan so far has not been able to reach an agreement with Brussels. Still, the European Union is Azerbaijan's biggest trade partner and investor.

In the economic realm, a delay in joining the WTO is occurring primarily because of the government's reluctance to give up corrupt practices in its economic policies.

In 2013, Azerbaijan curtailed the activities of the OSCE office in the country and moved to reduce the presence of international NGOs in the field of democracy and human rights.

The Azerbaijani government has been consistent in fulfilling its major economic and business commitments to the international community. However, during the reporting period, the level of confidence in the country's government among foreign investors suffered a serious setback when in May 2017 the country's biggest lender, the International Bank of Azerbaijan (IBA), suspended payments on some of its liabilities and asked its foreign creditors for support while it restructured several billion dollars of bad loans.

Moreover, although the government tries to act as a reliable partner, problems emerge with the acceptance of international liberal norms when the material interests of the ruling elite are directly affected. This was the case when Azerbaijan failed to negotiate an association agreement with the European Union and failed to join the WTO.

The biggest question marks surround Azerbaijan's commitments to the Council of Europe and the OSCE in the field of democracy and human rights. Those organizations have grown increasingly critical of Azerbaijan's record in this area. The country's poor record on human rights has also been criticized by other international organizations but to no avail. The situation has by no means improved.

During the reporting period, the image of Azerbaijan was marred due to the involvement of its former and current high-ranking officials in international corruption scandals. The names of Azerbaijani officials and the government emerged in multiple major bribery, money-laundering and other similar investigations in several countries across the world. The Parliamentary Assembly of the Council of Europe (PACE) ordered an independent investigation into the relationship between the Azerbaijani government and PACE. This investigation proved that more than a dozen PACE members accepted gifts and bribes from the Azerbaijani government.

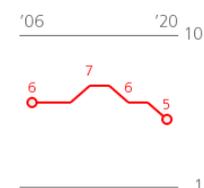
The Azerbaijani government exercises vigorous diplomacy to maintain good relations with neighboring countries. However, there is no cooperation between Azerbaijan and Armenia due to the Nagorno-Karabakh conflict. Baku rejects establishing any bilateral relations as long as Armenia does not abandon its occupation policy.

Azerbaijani authorities have remained compliant with the rules of regional and international organizations, except on the issues of democracy and human rights.

Azerbaijan has prioritized trilateral cooperation with Turkey and Georgia. Energy transportation pipelines (such as Baku-Tbilisi-Ceyhan) have cemented the interdependence of this trio in the past. And the joint Baku-Tbilisi-Kars railway project, which is designed to be part of the "New Silk Road" to connect Europe with China, was completed in 2018. This railway is touted by the government as another achievement of its claimed strategic partnership.

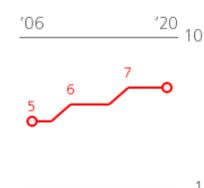
Credibility

5



Regional cooperation

7



During the reporting period, the country maintained – and to some extent developed – bilateral relations with Russia, Iran, Kazakhstan and Turkmenistan. In 2018, the decades-long dispute over the delimitation of the Caspian Sea between Azerbaijan, Russia, Kazakhstan, Turkmenistan and Iran ended in a framework agreement, which might pave the way for more energy exploration and pipeline projects.

Strategic Outlook

So far, the Azerbaijani government has managed to maintain its grip on power by providing security and stability. Yet, this has primarily been achieved through an iron fist, squeezing the space for independent political and economic activity, and through the ongoing crackdown on the secular democratic opposition, independent media outlets and civil society.

Authoritarianism has been consolidated by expanding the unchecked powers of the executive and establishing full control over all spheres of public life. The system of checks and balances has been left without actual powers. Moreover, the flow of large sums of oil money has provided the government with the means to satisfy the basic needs of the people, reduce poverty and carry out some degree of modernization and infrastructure renovation.

However, the unexpected economic downturn after the fall of oil prices in late 2014, as well as corruption and mismanagement, have exposed the deep economic and political vulnerabilities of the existing system.

The future of Azerbaijan and the long-term prospects of the ruling elite hinge on the progress of urgently needed reforms. It is obvious that recovery will be very difficult to achieve without liberalization of the political and economic systems, and implementation of basic principles of the rule of law. Specifically, the government must meaningfully combat the rampant, high-level corruption, proceed with market reforms and diversify the economy.

Yet, thus far, the Azerbaijani government has tried to respond to the challenges it faces only with half-hearted measures. The ruling elite has remained characteristically unwilling to embark on major economic and political reforms. The ruling family has continued its path toward strengthening its grip on power. The president was elected for seven years, and his wife became the first vice president of the republic. This has also been accompanied by relatively positive changes, such as the replacement of some of the old entrenched oligarch ministers with young members of elite.

Despite some progress in diversifying the economy, such as in agriculture and tourism, the country's economy is still hugely dependent on fuel prices. Moreover, arbitrary power to consolidate control over economic life is still the main response to new problems.

In addition, shrinking space for civil society, independent media and secular opposition, has boosted the opportunities for political Shi'i Islam to replace the weakened democratic forces as the strongest voice of dissent. The government is working to curb political Islam, primarily through suppression.

However, it should be underlined that the secular nature of the Azerbaijani society remains relatively strong. Moreover, local civil society, which has critically suffered from the

unprecedented crackdown launched by the government in 2013, has shown promising signs of revival over the last few years, although the situation is still very fragile.

Another major challenge is the Nagorno-Karabakh conflict. It currently poses a serious threat to stability in the region. Resolving the conflict with Armenia has been intrinsically linked to forging closer ties with Europe and, in turn, the acceptance of liberal values and standards by Armenia and Azerbaijan. The Velvet Revolution in Armenia is a promising development in this direction. The fact that the Azerbaijani government did not use this opportunity for military provocation during the turbulent times in Armenia was a good sign. However, the prospects of conflict resolution in Nagorno-Karabakh are still mired in uncertainty.