

# AZERBAIJAN



**Polity:** Presidential (dominant party)

**Economy:** Capitalist-statist

**Population:** 8,100,000

**GNI per capita at PPP \$ (2000):** 2,740

**Capital:** Baku

**Ethnic Groups:** Azeri (90 percent), Dagestani (3 percent), Russian (3 percent), Armenian (2 percent), other (2 percent)

**Size of private sector as % of GDP (mid-2001):** 60

The scores and ratings for this country reflect the consensus of Freedom House, its academic advisors, and the author of this report. The opinions expressed in this report are those of the author.

↓↓ and ↑↑ indicate score changes of .25 or more. ↓ and ↑ indicate changes of less than .25.

## NATIONS IN TRANSIT SCORES

	1997	1998	1999-2000	2001	2002
Democratization	5.60	↑ 5.55	↑ 5.50	↑ 5.56	↑ 5.44
Rule of Law	na	na	5.75	5.75	5.75
Economic Liberalization	5.13	↑ 5.00	5.00	↑ 4.92	↑↑ 4.42

## KEY ANNUAL INDICATORS

	1995	1996	1997	1998	1999	2000	2001
GDP per capita (\$)	312.6	407.4	503.3	559.1	571.5	652.1	696.9
Real GDP growth (% change)	-11.8	1.3	5.8	10.0	7.4	11.1	8.0
Inflation rate	412.0	19.7	3.5	-0.8	-8.5	1.8	2.0
Exports (\$ millions)	680.0	789.0	808.0	678.0	1,027.0	1,886.0	na
Imports (\$ millions)	955.0	1,338.0	1,375.0	1,724.0	1,433.0	1,539.0	na
Foreign Direct Investment (\$ millions)	282.0	661.0	1,093.0	1,024.0	550.0	117.0	314.0
Unemployment rate	0.7	0.8	1.0	1.1	1.2	1.2	1.3
Life Expectancy (years)	69.0	70.0	70.9	71.4	71.5	71.7	72.0

## INTRODUCTION

Ten years after gaining its independence, Azerbaijan maintains a strictly presidential system of government that exhibits clear authoritarian traits. Although the country has made great headway in building the foundations of a liberal democratic system, vestiges of the past remain and may take a long time to overcome. Likewise, economic reform has taken place to a certain degree but not to the extent seen in other countries in transition from communism. The government relies heavily on actual and projected income from the oil and gas industry.

The most pressing political issue in Azerbaijan is that of succession. President Heydar Aliyev, who is 79 years old, remains the center of the nation's political system. His power over all branches of the government is solid, and no major decision is made without his explicit approval. Aliyev seems in good health, but for simple reasons of age, his tenure in power is likely to be limited to a few years. Politics in both the opposition and government camps is focused on positioning for the post-Aliyev era.

Azerbaijan has experienced some positive social and economic changes during the last decade. Nevertheless, the country is still marred by hardship, and the conflict with Armenia continues to be the principal problem. Although a cease-fire has held since 1994, it has cemented the occupation of close to 20 percent of Azerbaijan's territory by Armenian troops and perpetuated the displacement of more than 1 million people, including 220,000 Azeris who were evicted from Armenia, 60,000 Azeris who were driven from Nagorno-Karabakh, 50,000 Meskhetian Turks who fled ethnic conflict in Uzbekistan, and more than 700,000 ethnic Azeris who were cleansed from areas outside Nagorno-Karabakh. Early in 2001, a high-profile negotiation session in Key West, Florida, renewed hopes for a negotiated settlement, but that optimism was gone by the summer. A solution to the conflict now seems as distant as ever, and advocates of military solutions have become emboldened.

Azerbaijan has also endured difficulties on the external front. In August 2001, for example, an Iranian warship forced Azeri exploration vessels out of Azerbaijan's Sharq-Alov field, claiming they were in Iranian waters. Subsequently, Iranian jets violated Azerbaijan's airspace on a daily basis until a Turkish diplomatic intervention forced them to stand down. Meanwhile, limited unrest erupted in the northwestern region of Zaqatala, where possibly externally inspired religious movements tried to tip the balance in this region in which north Caucasian minorities live.

In this increasingly tense regional atmosphere, developments on the domestic scene have produced mixed results. Azerbaijan is neither a fully democratic state nor a staunchly authoritarian country. Opposition forces, for example, express their dissatisfaction with government policies through a vibrant print media. At the same time, broadcast media remain under the government's control—

at least for now—though an unstoppable privatization process has finally begun. Independent TV channels, in particular, face numerous difficulties.

One setback and one advance marked the period covered by this report. Observers unanimously branded the parliamentary elections of November 2000 as neither free nor fair. These elections were a definite setback, because widespread fraud put into question the democratic intentions of the government, or at least parts of the governing bloc. In spite of this setback, the Council of Europe accepted Azerbaijan's membership in January 2001. This represents both a symbolic and a practical leap forward. It lends the Azerbaijani government a certain level of legitimacy as a member of the democratic club of nations. It also gives the COE a direct supervisory position in the Azerbaijani political scene, including on legislative, judicial, and human rights issues. In economic terms, Azerbaijan continues to struggle, but the benefits of the oil industry are gradually beginning to show. Whereas the economy in neighboring Georgia continues to deteriorate, the situation in Azerbaijan is slowly but steadily improving. This can be observed, for example, in the construction of new roads and in the restoration of historic buildings.

Azerbaijan's progress toward a democratic system of government and a market economy has been slow, and advances have been intertwined with setbacks. In addition, Azerbaijan's stability and development are excessively dependent on individuals and not on institutions. And since the mechanisms for a peaceful transfer of power are not in place, there is widespread concern that the country's fragile stability will be put in jeopardy when the time for a change in leadership finally arrives.

## DEMOCRATIZATION

### Political Process

1997	1998	1999-2000	2001	2002
5.75	5.50	5.50	5.75	5.75

The governmental structure of Azerbaijan is based on a strong executive. As in many post-Soviet states, Parliament is a considerably weaker force than the presidency. Moreover, the *aparət* (presidential office) wields significant authority that is comparable or superior to the government's, thus ensuring the executive's power even in the unlikely event of a conflict between the president and Parliament. This structure, coupled with the president's firm grip on the legislature, has ensured a stable political process in the country.

One of the main achievements in Azerbaijani politics in the 1990s that has contributed significantly to stability is the emergence and consolidation of a political party system. Unlike in neighboring Georgia and Armenia, where opposition politics are in a constant state of flux, Azerbaijan saw the establishment in the early 1990s of several major

political parties that remain the main opposition forces to this day. These parties have experienced only minor changes in their leadership. Although a certain level of fragmentation has undoubtedly occurred, with factions splitting away from the major parties, the main contenders for power are clear. Likewise, the government bloc contains factions with different interests and concerns. Since the resignation of three high-level foreign policy officials in late 1999, though, the ruling bloc has remained outwardly unified.

The government bloc consists of the ruling New Azerbaijan Party (YAP) and a collection of minor political groups that have been co-opted or otherwise tied to the regime. A significant number of YAP officials served under Heydar Aliyev during his tenure as leader of the Communist-led Republic of Azerbaijan from 1969 to 1982. Hence, YAP benefits from a large number of well-entrenched and experienced functionaries, though they tend to be averse to change. It also has a young wing that consists of foreign-educated and seemingly reform-minded members who have associated themselves with the ruling circles. These two groups have widely divergent worldviews, and their political as well as economic beliefs are often less than compatible.

The succession issue seems to have caused factionalism within the YAP, and whoever comes out on top of that struggle will be well positioned to become the country's next president. This power struggle may very well split YAP once Heydar Aliyev is out of office. In addition to the media's and the opposition's increasingly harsh criticism of the regime, the presence of the president's son, Ilham Aliyev, in the so-called reformist wing of the party has fueled speculation that the younger Aliyev is being groomed to succeed his father. Lending further credence to the allegations, Ilham Aliyev was elected first deputy chairman of the party in November 2001.

To date, though, Ilham Aliyev has not launched a separate program or political team of his own that would confirm his modern and reformist credentials. However, given that Azerbaijan in many respects remains a traditional society, it is almost unthinkable that a son would publicly articulate a different political program while his father is still in office. In a sense, then, Ilham Aliyev is basing his independent political career on being a reformer but is unable to prove his credentials.

The Azerbaijani opposition displays tendencies toward both fragmentation and cooperation. Most major parties in today's political sphere find their roots in the Azerbaijan Popular Front Party (AXCP) of the late 1980s that led Azerbaijan to independence and governed the country from 1992 to 1993. The differences among these parties are centered more on personalities than on political ideology. In spite of having fragmented into several dozen parties, only a few of which can be considered major, the opposition has exhibited a substantial level of cooperation, whether in organizing demonstrations or simply coordinating policy in response to government policies or actions. Leftist forces are represented mainly by the Social Democratic Party and

the Communist Party but have little public appeal. Center-right and nationalist parties dominate. The opposition parties with the largest degree of popular support are the Musavat Party, the Azerbaijan National Independence Party (AMIP), the Democratic Party, and the AXCP, with the possible addition of the Liberal Party and the Vatandash Hamrayliyi Partiyasi (Civil Solidarity Party).

The Musavat Party benefits from a relatively strong cadre and is perhaps the least personality centered of the Azerbaijani parties. Founded in 1911, it is the oldest political party in Azerbaijan and is credited with establishing and ruling the first Azerbaijani republic between 1918 and 1920. Musavat produces the most popular political newspaper in the country, *Yeni Musavat*, and claims to be the largest opposition party. However, the relative lack of charisma of parts of its leadership and its association with the failed AXCP government of 1992–1993 are liabilities.

The AXCP is to an even higher degree tainted by its experience in the early 1990s. It has been further marred by tensions within the party. When former President Ebulfez Elcibey returned from internal exile in 1998, the party split in two wings: the “classics,” led by Elcibey, and the “reformers,” led by the 40-year-old deputy chairman, Ali Kerimov. After Elcibey's death in August 2000, the rift within AXCP led to its division into two irreconcilable wings, both claiming to be the legitimate ruling bodies of the party. The reformers, which clearly have a larger following among the party's rank and file, define themselves as centrist, dissociate their wing from neoliberal economic ideas, and promote a limited role for the state in the economy.

AMIP, led by Etibar Mamedov, is a main contender for a leading role in the opposition. It is decidedly liberal in the economic sphere, advocating a minimal economic role for the state, and has stayed in loyal opposition to both the AXCP government and the Aliyev regime. This has helped AMIP to emerge as the largest opposition party together with Musavat.

Finally, the Democratic Party is led by Rasul Guliyev, a former Speaker of Parliament under Aliyev. Guliyev is currently in exile in the United States after having been indicted for corruption while director of an oil plant in Baku. The Democratic Party stands out as a splinter group, not of the AXCP but of the Aliyev government.

It should be noted that these four main opposition parties broadly share Aliyev's foreign policy. Their main differences with the regime are related to the internal political and economic situation in the country. Musavat and the AMIP seem to be the two strongest opposition parties today.

The relationship between the government and opposition in Azerbaijan is generally hostile. The opposition, especially after the flawed elections of 1998 and 2000, denies the government's legitimacy and calls for its unconditional resignation and the holding of new and fair elections. The government, meanwhile, dismisses the opposition as unserious and provocative. There has been no dialogue between the government and the opposition since mid-2000,

when a row over the composition of the Central Electoral Commission (CEC) for the 2000 parliamentary elections led to an opposition boycott that incapacitated the body. In response, the government changed the relevant law and removed the opposition members' effective veto right over electoral commissions at all levels.

Yet under the surface, the situation is more complex. The opposition is divided over how to deal with the government, and a rift appears to have emerged. The AXCP and AMIP have traditionally been less oppositional and have not rejected cooperating with the government when it has been possible to strike compromises. On the other hand, among the larger parties, Musavat and the Democratic Party are more radical in their opposition to the current authorities and refusal to cooperate with the government. Musavat in particular is basing its political strategy on staunch opposition, thereby hoping to gain popularity among a disenfranchised population.

To a large extent, the rift between the government and the opposition stems from the legislative elections of November 2000. These elections were heralded as having the potential to play a crucial role in the stabilization of Azerbaijani politics. During the late 1990s, Azerbaijan clearly had achieved important progress in democratization. Significant legislative reform had prepared a good foundation for elections, press censorship had been abolished, and opposition media functioned, albeit not without difficulties. These positive developments, together with the regime's responsiveness to international criticism and advice, generated hope for improvements in the conduct of elections. In addition, with a looming succession crisis, it was thought, a legitimately elected Parliament could become a strong institution capable of handling the crisis after Heydar Aliyev's eventual departure from power.

In practice, though, the November 2000 parliamentary elections proved to be a watershed event of a different kind. As the election approached, ominous signs of undue government interference in the process became apparent. The registration of candidates was a central issue. Another was the use of state television—the only mass media available in many rural areas—to present an unmistakably biased view of the ruling party.

The Azerbaijani Parliament consists of 125 seats, of which 25 are awarded through proportional representation on party lists. The remaining 100 members are elected in single-member constituencies. Currently, though, the single-member Khankendi seat in Armenian-occupied Nagorno-Karabakh is vacant. Few parties have a truly nationwide representation, and only YAP and Musavat can lay claim to having a thorough infrastructure in all regions of the country. As a result, for the 2000 elections, not every party ran its own candidates in every region of the country. Instead, the opposition parties collectively secured a presence in practically every precinct by working together to present one credible candidate who had a good chance of winning.

A major problem arose, however, regarding the registration of candidates both for the proportional party list and for the single-member constituencies. Although 13 parties presented the 50,000 signatures necessary for registration on the party list, the CEC rejected the applications of 8, including Musavat and the AMIP, on dubious grounds. The CEC claimed that several thousand signatures had been forged without presenting conclusive evidence or leaving any possibility for the parties in question to address the claims. The situation was similar in the single-member constituencies, where more than half of the candidates were refused registration. This led to suspicion that the regime was attempting to predetermine the outcome of the election by regulating the list of candidates and participating parties, hence relieving itself of the need to alter the results on election day.

International criticism focused on the ban on parties in the comparatively less important proportional election. The single-member constituencies that were to elect 80 percent of Parliament received much less attention. As a result, in a decision whose constitutional basis was questionable at best, President Aliyev asked the CEC to reverse its earlier ban and allow all 13 parties to participate in the proportional vote. In contrast, only a small number of the rejected candidates for seats in single-member constituencies had their cases reviewed. Moreover, since the CEC reversed its decision only on October 11, the parties that received permission to contest the election had less than three weeks to set up a campaign. Voting was scheduled for November 5. The parties also had difficulty finding printing offices that were willing to produce their posters and flyers.

During Azerbaijan's brief electoral history, the Central Electoral Commission and its corollaries at the district and precinct levels have been a constant issue of concern. When the opposition boycotted the 1998 presidential election, it did so largely over the composition and functions of the CEC. This was a major issue again in 2000 when, under heavy international pressure, Parliament adopted a reformed electoral law in June. It also passed a new law on the CEC that gave the opposition the possibility to block a quorum at all levels of the electoral commission and thereby to affect decision-making power.

The opposition wasted no time in exercising this power. It boycotted the CEC's first three meetings and in practice incapacitated the body. In response, the government pushed through a revision of the law in July that removed the opposition's *de facto* veto right and gave the ruling party the power to appoint electoral commission chairmen at all levels. Still, the OSCE and other international organizations concluded that the law provided "a comprehensive legislative framework for the conduct of elections" and presented "significant improvements as compared to the previous law."

In the week preceding the elections, though, a number of additional precincts were created on military bases and in prisons throughout the country. Both domestic and in-

ternational observers had difficulty gaining access to these polling stations. In addition, an audit of voter registration lists showed an error margin of 30 percent. That is, the lists included people who were not living at their stated address, were deceased, or simply were not real people. On election day, numerous violations were noted. These included various forms of ballot stuffing, the falsification of results protocols, and intimidation of voters and opposition members of precinct-level electoral commissions.

More important, perhaps, the official voter turnout figures, which precincts reported hourly, were artificially altered from early on in the day. Observers noted numerous instances in which official turnout figures were two or three times higher than the turnout observed on location. Official figures showed a turnout of 68 percent, whereas observers noted an actual turnout of approximately a third of the electorate. Furthermore, the computerized system used at the district level to tabulate precinct results and send them electronically to the CEC exhibited serious flaws. Domestic and international observers were denied access both to the computers and to the data entered in them. One might call these events electronic ballot stuffing.

By the evening of November 5, the ruling YAP claimed victory with more than 70 percent of the vote. Only one opposition party, the AXCP, was initially acknowledged to have narrowly overcome the 6 percent threshold to gain seats on the party list. Officially, Musavat, the AMIP, and the Democratic Party each received between 1.5 percent and 5 percent of the vote. These figures stood in stark contrast to the results of independent exit polls and to the vote counting that most international observers witnessed. According to these unofficial sources, the YAP received far from a majority of votes. In some, but by no means all, precincts, the ruling party did receive a plurality of votes. In others, individual opposition parties received greater support. In particular, Musavat enjoyed a large following and established its position as the main opposition party.

In many areas, Musavat reportedly emerged victorious, even if, as its officials claimed, it did not receive 50 percent of the vote. The AMIP also displayed strength. The showing of the AXCP, no doubt due to its internal rifts, was weak in comparison. Many opposition candidates seemed to challenge the YAP, but its candidates prevailed in all but a few single-member constituencies.

The composition of the newly elected Parliament left the leaders of the main opposition parties outside the legislature. Musavat, the AMIP, and the Democratic Party were all denied representation on the party list system. Nevertheless, they were able to secure victories in a few single-member constituencies. Initially, only the AXCP was reported to have passed the 6 percent threshold for proportional representation. This situation rapidly led to a unanimous opposition boycott of Parliament. Although the AXCP somewhat reluctantly participated in the boycott at first, it soon decided to take advantage of the privilege of being "permitted" into Parliament. Moreover, two

minor parties, the Civil Solidarity Party and the Communist Party, officially passed the threshold. However, these parties hardly waged a campaign and, according to all estimates, had a very low following in Azerbaijani society going into the election. It was fairly apparent, then, that their inclusion in Parliament had been engineered. With the entry of three nominally opposition parties in Parliament, the ruling party's take of the vote declined to 62 percent.

On November 6, the OSCE and the Council of Europe issued a short joint report giving roughly equal importance to the progress made in the previous five years and the significant shortcomings of the election and the counting process. Although the report noted "serious deficiencies in regard to implementation of the election legislation," it proved instrumental in securing Azerbaijan's preliminary admission into the COE on November 9. The COE observed that Azerbaijan was "willing to comply with Council of Europe standards" at the same time that it asked the government of Azerbaijan "to submit, within a month, a report responding to the criticisms voiced by the international observer mission after the parliamentary elections on 5 November 2000, and to rectify the instances of reported frauds." In the report it issued on November 7, the U.S.-based National Democratic Institute expressed more unambiguous disappointment with the conduct of the vote. The organization noted that "the November 5, 2000, Parliamentary elections represent a continuation of a pattern of seriously flawed elections in Azerbaijan that fail to meet even minimum international standards."

Many observers have criticized Azerbaijan's admission into the Council of Europe in spite of the highly flawed elections. Yet its decision must be viewed in proper perspective. Russia was admitted in 1996 at the height of its war in Chechnya and while it was in violation of some of the COE's most central principles. Likewise, had the COE decided against admitting Azerbaijan, Armenia would have joined alone, even though its military occupation of Azeri territory is in direct violation of COE provisions. By admitting Russia in 1996 and linking Azerbaijan's membership with Armenia's, the Council of Europe had placed itself in a situation in which it had little choice but to accept Azerbaijan regardless of the conduct and outcome of the election.

Although parliamentary elections are an important event, Azerbaijan remains a presidential republic. The most recent presidential elections took place in 1998, and an opposition boycott helped Aliyev to an easy victory with 75 percent of the vote. Only one major contender, AMIP chairman Etibar Mamedov, competed against him. Observers reported that Aliyev clearly received a majority of the vote. They doubted, though, that he received the constitutionally mandated two-thirds of the vote needed to win in the first round, and the outcome led to widespread allegations of fraud.

The next election is scheduled for 2003, and President Aliyev has declared his intention to run. Opposition voices claim that his candidacy would violate the spirit of the Con-

stitution, which stipulates that a president can sit only for two consecutive terms. Aliyev was elected in 1993 and re-elected in 1998; however, the Constitution was promulgated only in 1995. Legally speaking, then, Aliyev is eligible to run in 2003 since his current term can be considered his first.

This election is likely to determine Azerbaijan's future, and opposition candidates are already beginning the scramble to become the common, unified candidate. The succession issue has become the major determinant of Azerbaijani political life, and with Aliyev solidly in command, the opposition is fully aware that it has little chance of coming to power while Aliyev is still alive and well. Their role extends only to influencing government policy by capitalizing on public opinion or foreign pressure.

In this deadlocked context, the opposition is focusing its strategy on preventing the regime from engineering a smooth succession of power either to Ilham Aliyev or to some other member of the ruling elite. Its influence is strong enough to create substantial concern in ruling circles regarding the viability of a dynastic succession, and already divisions within the ruling bloc and attempts to co-opt certain opposition forces suggest that the government is taking this group seriously. However, the country's stability is endangered by the intense focus on succession. When succession finally becomes a reality, a major political struggle is likely to break out, and the stakes for everyone involved will be extremely high.

#### Civil Society

1997	1998	1999-2000	2001	2002
5.00	5.00	4.75	4.50	4.50

In 2001, Azerbaijan showed further progress in the development of civil society. Most of the developments took place within the internal capacity of the NGO sector rather than in its external influence on political decision making in the country. According to data from the Ministry of Justice, there are around 1,400 NGOs registered in Azerbaijan. Nearly 100 new NGOs were registered in 2000 alone. However, according to the U.S.-based Initiative for Social Action and Renewal in Eurasia, only 300 NGOs are truly active in the country. See chart for their spheres of activity.

The new Law on Nongovernmental Organizations and Funds, which Parliament adopted on June 13, 2000, regulates the activities of NGOs. This law replaced the previous law dating from 1992 and now forms the main legal basis for the activities of NGOs. Nearly 150 local NGOs participated in the discussion of the law together with representatives of Parliament and the president's office, but only a few of their suggestions were accepted. Although the law's aim was to ease the registration process for NGOs, it does not differ much from its predecessor.

One of the main features of the law that dissatisfies NGOs is Section 2.4, which does not allow local NGOs

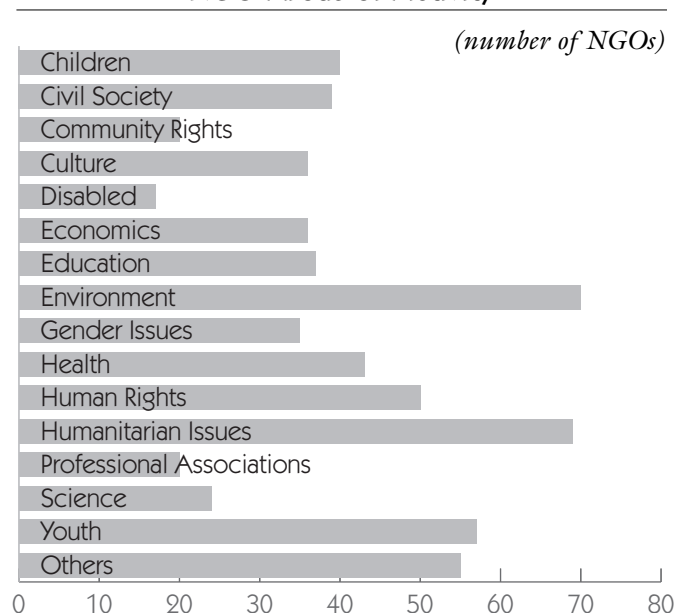
receiving grants from foreign legal entities to participate in political processes. As a result, since most of the local NGOs depend heavily on foreign funding, they were not allowed to monitor the November 2000 parliamentary elections. Another issue of contention for local NGOs remains the registration process with the Ministry of Justice. The Law on the Registration of Legal Entities clearly specifies a time frame for processing the applications of NGOs, but most often groups have to wait for months beyond that before they are registered.

According to Azerbaijan's newly adopted tax code, NGOs in Azerbaijan do not pay taxes on grants. Instead, they pay a 27 percent tax on any profit that they make on commercial activities. The wages of individuals working with NGOs are taxable at the progressive scale rate.

The public's perception of NGOs remains weak, especially in the areas outside the capital, Baku. According to a survey that ISAR conducted in 2000, only 7 percent of Azerbaijan's population has some awareness of what the NGO sector is. It must be noted, however, that media reports on the activities of NGOs have increased and NGO relations with governmental bodies have improved over the past few years. To create more awareness of this sector among the general population, as well as within governmental and business sectors, ISAR organized an annual fair of Azerbaijani NGOs for the second consecutive year in 2001. This event took place on May 25 and 26 in Baku. Nearly 80 domestic NGOs from various regions of the country participated in the fair.

In 2001, the internal capacity of Azerbaijani NGOs and the third sector in general experienced progress in certain areas. An increase in Internet access and the availability of Internet resources are significant changes from previous years. The Open Society Institute, ISAR, and Azerweb

#### NGO Areas of Activity



Source: Initiative for Social Action and Renewal in Eurasia

(managed by Save the Children) provide some of the best Internet resources, including a directory of local and international NGOs as well as news-related items. Individual organizations also showed greater attempts to create their own Web sites. The local NGO Azerbaijan Young Lawyers Union has also implemented an e-mail project called Electronic Legal Assistance to NGOs. From July 25 to August 1, 2001, an on-line conference among 40 NGOs of Azerbaijan, Georgia, and Armenia took place with the help of the U.S.-based organization Project Harmony.

Western organizations have paid significant attention to the training of NGOs in Azerbaijan. In March 2001, for example, ISAR sponsored a four-day conference entitled "The Role of NGOs in Azerbaijani Society." In addition to representatives of governmental bodies, businesses, and the mass media, the conference hosted over 100 NGO representatives from Baku, Sheki, Ganja, Mingchevir, Lenkoran, Salyan, and Quba. More than 15 specialists from Western and Eastern European countries also took part in the event, which was intended as a forum for exchange of information and expertise on how to improve relations between NGOs and other sectors of society. Nevertheless, the internal organizational capacity of NGOs and their management structures remains weak. Most NGOs are organized around one or two individuals, who obtain their skills and know-how through NGO resource centers or individual training sessions.

NGOs that work on women's issues have also shown progress in their activities. In August 2001, the Center of Young Leaders organized a women's leadership training seminar in the Gazakh region. Around 8 women activists from Azerbaijan also participated in a three-day training seminar in Georgia that was organized by the Institute for Democracy in Eastern Europe. In total, the event brought together 32 women from the south Caucasian countries.

Azerbaijani NGOs remain heavily dependent on foreign grants and assistance, and a shortage of funding limits their activities and capacity for growth. Local philanthropy is poorly developed, and the state provides almost no funding. Assistance from major local business entities goes to specific NGOs, usually based on personal connections. Thus, competition for limited resources contributes to an unhealthy environment for cooperation among local organizations.

Azerbaijani NGOs showed little progress in participating in the political life of the country. Although some groups have made proposals on the solution of the Nagorno-Karabakh conflict and other political events in the country on several occasions, no real mechanism for their participation in decision-making processes exists. NGOs also have little influence on matters of decentralization and local self-governance.

A major setback for the activities of NGOs has been the turmoil associated with the work of foreign missionary organizations and so-called religious propaganda. For example, in response to the danger of Wahhabism, which reportedly has

been spreading in the country, President Aliyev established the State Committee on Religious Affairs in 2001. This body immediately started the reregistration process of nearly 2,000 mosques, churches, and other religious communities and organizations. According to Rafiq Aliyev, chairman of the committee, the state has reregistered only 410 groups.

Religious organizations initiated activities in Azerbaijan almost immediately after the country became independent. Islamic groups from different countries, including Iran, Turkey, Saudi Arabia, and the UAE, have financed the construction of many new mosques and the establishment of religious schools, or *madrassas*. Moreover, a number of Christian missionary organizations have also begun activities in the country, often under the cover of charity or humanitarian outreach. These organizations are more active in the country's provinces than in Baku.

For most of the 1990s, these religious organizations conducted grassroots work without posing a threat to the national security of Azerbaijan. However, the government has pursued criminal investigations into the activities of the Islamic Party of Azerbaijan, which is allegedly funded by Iran, and the religious group Jeysullah, which assassinated famous historian and political figure Ziya Bunyatov. Many Muslim groups have also sent Azeri youth to study Islam in foreign countries.

The educational system in Azerbaijan is still heavily dependent on the state. According to the Ministry of Education, there are 48 institutions for higher education in the country, 30 of which are state owned and 18 of which are private. Although there is no official political influence over these institutions, public funding effectively keeps the state in control of the system.

#### Independent Media

1997	1998	1999-2000	2001	2002
5.50	5.50	5.50	5.75	5.50

Azerbaijan's entry in the Council of Europe in 2001 raised expectations for the faster development of a free and independent media in Azerbaijan. In practice, though, there was not much positive change for most of the year, and representatives of the media continued to struggle with the authorities in their daily work. However, a standoff between the media and the authorities at the end of 2001 led to some significant reforms.

According to the president's office, there were more than 650 different media outlets in Azerbaijan in 2001. These include newspapers, magazines, news agencies, journalists' unions, and television and radio companies. The majority of these were established by political and private entities.

Although official censorship was abolished in 1998, newspapers and magazines have been hit hard by government pressure. According to the Azeri Committee on

the Protection of Journalists Rights, nearly 70 journalists were assaulted or subjected to various kinds of pressure from government authorities in the first half of 2001. The total amount of fines extracted from newspapers was 310 million manats (roughly \$65,000) during the same time period.

Authorities also effectively use the judicial system to put pressure on print media. In 2001, for example, the chief of staff of the president's office sued Shahbaz Khuduoglu, editor of the newspaper *Milletin Sesi*. Likewise, the mayor of Baku filed charges against the editor of the newspaper *Bakinskiy Bulvar*. Courts found both newspapers guilty of assaulting the dignity of these individuals, sentenced the editors to six months in prison, and closed the papers down. However, under heavy pressure from local and international media unions, President Aliyev granted amnesty to both editors. The government also uses fiscal policy to put pressure on newspapers. Often by increasing the tariffs on paper, authorities have tried to limit the ability of newspapers to expand their markets.

One of the largest—and truly independent—newspapers is *Zerkalo*, which has a daily circulation of 5,500 copies. *Zerkalo's* weekly publication enjoyed a circulation rate of 10,000 until former editor in chief Rauf Talishinskiy established his own newspaper, *Echo*, and thereby divided the readership. Although reasons for this split are still not clear, there are rumors that *Zerkalo* experienced an ideological rift among its own staff. Other major newspapers remain the *Yeni Musavat* (18,500 copies), *Azadlig* (6,000 copies), and *Uch Nogte* (8,500). Most newspapers are closely affiliated with political parties. The few English-language newspapers in Azerbaijan are aimed primarily at foreign citizens and the business community.

A major change for the print media in the country was the restoration of the Latin alphabet in 1992. Azerbaijan had used this alphabet during from 1918 until 1939, when the Cyrillic alphabet was imposed. However, since the use of Cyrillic for half a century meant that most Azerbaijanis could not read the Latin alphabet, newspapers continued publishing their text in Cyrillic. Interestingly, many newspapers and magazines did print their headlines in Latin. In June 2001, though, a presidential decree forced all print media to use the Latin alphabet exclusively, starting from August 1. A number of media outlets protested the decision and argued that it was intended to lower the public's ability to acquire information, given its lack of knowledge of the Latin alphabet. Moreover, observers of the situation predicted that the circulation of newspapers and magazines would fall. However, such fears were not realized, and leading newspapers actually saw an increase in demand immediately after August 1. This move is important, as it brings Azerbaijan closer to the Western world and, in particular, to Turkey.

The television industry in Azerbaijan also experienced many difficulties in 2001. While two new private broadcasters, Azad Azarbaycan and Lider TV, were established

during the year, another private company, ABA TV, was forced to close down. Tax authorities seized equipment worth \$320 million from ABA, claiming that the company had obtained it illegally. The president of ABA, Faig Zulfugarov, subsequently fled to the United States, where he asked for political asylum. There, he blamed the shutdown on the station's record of independent reporting. Regional broadcasters were also under substantial pressure by local authorities in 2001. Hayal TV and Gutb TV, which are based in the town of Quba, were forced to close down for allegedly lacking official permission to broadcast. However, both stations were formally registered with the Ministry of Justice. In truth, the shutdowns appeared to be linked to demands from the local governmental administration for majority shares in the companies and equal representation among their leaderships. ANS TV remained the most independent and trusted television and radio company in Azerbaijan, with Space and Lider TV following.

The state-run broadcaster operates two television channels but is not popular owing to the inferior quality of its programs. However, these are the only channels that cover the entire territory of the republic. Many regions do not have access to private channels. According to the chief of the presidential Office on Sociopolitical Affairs, Ali Hasanov, a new bill on public television was in preparation in 2001 and scheduled for submission to Parliament at the end of the year. The expertise of the Council of Europe, as well as that of Russian, German, and British public television, was taken into consideration in the drafting of the bill.

One of the most important developments in the area of independent media in 2001 was the president's decree of July 20 on the establishment of the National Council on Press, TV, Radio, and the Internet. This law, aimed at regulating the media sector in the country, will create a national body of 39 members that consists of three standing commissions on the press, television and radio, and the Internet. The president will appoint 18 members of the council, and public organizations will nominate the rest. To date, though, the council has failed to bring about major changes in the country's media.

The difficulties surrounding the media's operation in the country were highlighted on December 12, 2001, when an unsanctioned demonstration outside the headquarters of the YAP was dispersed by force. The demonstration took place after the YAP Congress had accused opposition media outlets of undermining Azerbaijan's statehood. International journalism NGOs and the secretary general of the Council of Europe intervened and demanded an end to such harassment. President Aliyev stepped in a week later and held a three-hour meeting with representatives of the media. Importantly, he called the YAP's accusations against the independent media plainly "wrong."

Having taken the views of the media into account, President Aliyev signed a decree on "additional measures on increasing state attention to the mass media" and allowed

significant amendments to the country's mass media law on December 28. These amendments abolished the system of media registration, removed prohibitions on advertisement and financing, and cancelled legislation that had allowed executive authorities to close media outlets. On the president's recommendation, libel lawsuits by state officials against the media were also dropped. Together, these changes amounted to a dramatic improvement in the country's media legislation. They might also translate into a real change in attitude on the part of the leadership. Journalists expressed hope that the president's newly-found relationship with the media will trickle down and influence the attitudes of lower-level officials as well.

Azerbaijan's journalist and media unions experienced further growth and development in 2001. For example, a new organization was recently established whose membership includes journalists from Azerbaijan, Georgia, Chechnya, Kabardino-Balkaria, Adygeya, Ingushetia, and Karachayev-Cherkessia. Azeri journalists also expanded their regional and international links by obtaining membership in various international associations and unions. Some of the major journalists' unions in Azerbaijan are Yeni Nesil, led by Arif Aliyev; the Journalists' Trade Union, led by Azer Hasret; and the Baku Press Club.

The Internet continues to be a growing industry in Azerbaijan. The number of Internet clubs in Baku, as well as in the regions, has grown at a staggering rate. This, in turn, has provided cheaper and faster Internet access to the public, especially to young people. The development and expansion of the Internet has also contributed positively to the growth of independent media. However, much to the dissatisfaction of the media, the Ministry of Communication recently raised tariffs on Internet usage.

#### Governance and Public Administration

1997	1998	1999-2000	2001	2002
6.25	6.25	6.25	6.25	6.00

Governance and rule of law in Azerbaijan have been severely impeded by the continuing occupation of close to 20 percent of the country's territory by the Republic of Armenia. The former Nagorno-Karabakh Autonomous Province is now administered by officials of the self-styled and unrecognized Nagorno-Karabakh Republic. In addition to Nagorno-Karabakh, the provinces of Kelbajar, Jibrail, Lachin, Qubatlil, and Zangilan, as well as large parts of the provinces of Agdam and Fizuli, are under occupation. As a result of the ethnic cleansing that occurred between 1992 and 1994, the entire populations of these provinces and the whole non-Armenian population (mainly Azeris and Kurds) of Nagorno-Karabakh were internally displaced. Hence, there is a vacuum of recognized government authority in these areas. Under current Azerbaijani legislation, Nagorno-Karabakh is no longer autonomous. However, Azerbaijan would offer to grant

Nagorno-Karabakh a high level of territorial autonomy in the event that a negotiated settlement of the conflict is reached and Armenian troops are withdrawn.

Azerbaijan also suffers from the fact that its territory is divided into two noncontiguous parts. That is, Nakhchivan, a small portion of Azerbaijani territory, is wedged between Iran and Armenia and has an 11-kilometer border with Turkey. According to the 1995 Constitution, Nakhchivan has the status of an autonomous republic. It is populated almost exclusively by Azeris.

The Azerbaijani Constitution provides for the division of powers among the legislative, executive, and judicial branches of government. However, even a quick glance at the Constitution reveals the unmistakable dominance of the executive branch and, in particular, of the office of the president of the republic. The president appoints the prime minister and the cabinet, signs laws, can issue decrees that have the force of law, and may overrule Parliament if it thrice refuses his candidate for prime minister.

These large presidential powers are not unusual in former Soviet states, and the constitutional powers of the legislative and judiciary branches are still relatively significant. For example, since many of the president's powers are exercised "in coordination with" the legislative branch, Parliament could theoretically block many presidential initiatives. In addition, the legal basis for Parliament to be the ultimate rule-making institution is present. However, in practice, both the legislative and judicial branches are relatively weak and, for most practical purposes, heavily influenced by the presidential office. This is especially the case for Parliament, which is under the tight control of the president's YAP.

Members of the media regularly attend sessions of Parliament. This, in turn, gives the public access to legislation. However, concerns have been voiced that the executive amends legislative acts after Parliament passes them.

Like the national level, the subnational level supports both appointed and elected administrations. The centrally appointed executive representatives in the regions wield the most power because they are direct extensions of the central executive power. A major development in 1999 was the introduction of multiparty elections for municipal governments. However, the first elections were marred by substantial allegations of irregularities. In comparison with the executive representatives, though, municipal governments have only limited powers. They are responsible for local taxes and payments, municipal property, local social security, and economic development. They also raise revenues through taxes and are in charge of their own budgets.

To a large extent, the civil service operates as it did in the Soviet period and is plagued by inefficiency and corruption. Major structural reforms have not been implemented, and the wage levels of civil servants have fallen drastically to a few dozen dollars a month. This is hardly conducive to building an effective and dynamic civil service with an ambition to serve the public. The lack of for-

eign assistance has made matters worse. Here, as in many other areas, Section 907a of the U.S. Freedom Support Act has been a big problem for Azerbaijan's development. This section, which was added under heavy pressure from the Armenian lobby at a time when Azerbaijan had no diplomatic representation in the United States, prohibits government-to-government assistance from the United States to Azerbaijan because of its "blockade" of Armenia. Successive American administrations have tried to remove this piece of legislation but failed.

In the aftermath of the September 11 terrorist attacks and in light of Azerbaijan's immediate and unwavering support for the United States, Congress passed a bill sponsored by Senator Sam Brownback (R-Kans.) that gave the president the authority to waive Section 907a until December 31, 2002. The bill also gives the president the right to extend that waiver indefinitely. The repeal of Section 907a will mean increased assistance to Azerbaijan, especially for controlling its borders more effectively. It may also lead to more technical assistance to the government on economic policy. Yet for the past nine years, this provision has prevented the United States from giving assistance that could have contributed to reforming or training Azerbaijan's civil service.

## RULE OF LAW

### Constitutional, Legislative, and Judicial Framework

1997	1998	1999-2000	2001	2002
5.50	5.50	5.50	5.25	5.25

With Azerbaijan's admission to the Council of Europe, many local and international observers expected great changes in the judicial and legislative systems. To date, the country's legislative foundation has been reformed greatly to bring it up to European standards. However, there is room for improvement in the areas of human rights and the rule of law.

The Constitution of Azerbaijan, which was adopted by a referendum on November 12, 1995, provides for an independent judicial system. In practice, though, judges and courts depend heavily on the executive branch. The president appoints Supreme Court and Constitutional Court judges, who are subject to confirmation by Parliament. The president directly appoints lower-level judges. Courts of general jurisdiction hear criminal, civil, and juvenile cases. District and municipal courts try the majority of cases. The Supreme Court may also act as the court of first instance, depending on the nature and seriousness of the crime.

The government appoints prosecutors to offices at the district, municipal, and national levels. Prosecutors are ultimately responsible to the minister of justice. The Constitution prescribes equal status for prosecutors and defense attorneys before the courts. In practice, though, the pre-

rogatives of prosecutors outweigh those of defense attorneys. Article 65 of the Constitution also provides for public defenders. Investigations often rely on obtaining confessions rather than obtaining evidence against suspects. There is widespread belief in the country that judges and prosecutors are corrupt. In the past year, the executive branch has used courts on numerous occasions to put pressure on mass media outlets. Some of the prominent court cases led to the imprisonment of editors at the newspapers *Milletin Sesi* and *Bakinskiy Bulvar*.

The Constitution provides a full range of civil rights and freedoms. Among them are rights to property (Article 29), intellectual property (Article 30), national and ethnic identity (Article 44), and use of one's mother tongue (Article 45). Although the government respects most of these rights in practice, it frequently obstructs free assembly and free association. Political parties have been prohibited from conducting street rallies on numerous occasions, and the registration process at the Ministry of Justice has often been an impediment.

Membership in the Council of Europe has proven to be of noticeable benefit, because Azerbaijan continues to improve its legislative foundation. In 2001, the Milli Mejlis (National Assembly) ratified the European Convention on Human Rights, which will enable Azerbaijani citizens who are unhappy with the rulings of local courts to appeal directly to the European Court of Human Rights. At year's end, Azerbaijan also signed the European Convention on Extradition. The convention provides for extradition of persons who are wanted for criminal prosecution or sentencing, but it does not apply to political or military offenses. A new criminal code, civil code, family code, and code on administrative violations were all adopted in 2000 to replace Soviet-era laws.

The Constitutional Court of Azerbaijan, created in 1998, is the highest judiciary body in the country. Upon request from high state bodies, the Constitutional Court interprets the Constitution of Azerbaijan. It consists of nine judges. The Constitutional Court has yet to prove its independence from the executive branch, because most of its decisions have been on nonsensitive and nonprovocative matters such as the housing code, pensions, and the labor code. The Constitutional Court does have a good record of cooperation with international organizations and the Constitutional Courts of other countries. The Commission on Human Rights, which was created in 1999 with a \$400,000 grant from the UNDP, has failed to produce significant improvements in the human rights situation in the country.

In 2001, President Aliyev made changes to the State Commission on Pardons. Whereas the old commission comprised only governmental officials, the new one includes representatives of NGOs and the mass media. The opposition has argued that these changes are symbolic and intended to deceive the international community, whereas the real workings of the commission will not change. Throughout the year, President Aliyev issued several decrees that par-

done some prisoners and lowered the sentences of others. The most prominent pardon was the one given to Nariman Imranov, the former minister of national security, whose life sentence was changed to 15 years in prison. In February 2001, Parliament approved the Amnesty Law, submitted by President Aliyev. Under the law, almost 2,300 prisoners are eligible for release and a further 800 will have their terms reduced.

During the period covered by this report, much of the legal debate centered on political prisoners. Before being admitted to the Council of Europe, the government committed itself to freeing all political prisoners in the country. In practice, however, this proved to be a problematic task, as the government, local human rights organizations, and the COE couldn't agree on the definition of "political prisoner" and, thus, on the list of all persons to be released. The numbers varied widely, from 50 listed by the U.S. State Department to 700 according to the Human Rights Center of Azerbaijan. Finally, on October 25, 2001, after numerous monitoring visits by its experts, the Council of Europe unveiled a list of 23 jailed persons whom it considers political prisoners. Those 23 include former Interior Minister Iskander Hamidov; former Defense Minister Rahim Gaziev; former coup leader and Prime Minister Suret Huseinov; the leader of the self-proclaimed Talysh-Mughan Republic, Alikram Humbatov; and former Ganja (city) Police Chief Natig Efendiev, who was extradited from Turkey the previous year.

Another major legal change in 2001 was the imposition of tighter governmental control over the activities of religious groups and sects. Article 48 of the Constitution provides that persons of all faiths may choose and practice their religion without restrictions, and the Azerbaijani government generally respected this right. In 2001, however, the growing threat of Wahhabism and other forms of religious fundamentalism in the northern regions and in Baku forced the government to crack down on religious activity in the country. On June 21, President Aliyev created the State Committee on Religious Affairs and began a reregistration process for more than 2,000 mosques, churches, temples, and other religious sects. The commission will also keep a close eye on the activities of missionaries, which, it claims, try to entice uninformed and needy people into their sects.

There are several independent human rights organizations in the country. The most prominent of these are the Human Rights Center of Azerbaijan, the Institute for Peace and Democracy, the Azerbaijan National Committee of the Helsinki Citizens' Assembly, and the Bureau for Human Rights and the Rule of Law.

The Constitution and laws of Azerbaijan do not impose any discrimination on women or ethnic minorities. There are 11 female members of Parliament, and 2 women occupy ministerial positions. Members of ethnic minorities also occupy senior governmental posts. In the Azerbaijani political atmosphere, however, ethnicity is not a big issue.

The fact that especially Muslim minority populations like Lezghins and Talysh are thoroughly intermixed with Azeris and that members of these minority groups are often bilingual also reduces the salience of ethnicity in politics and helps members of these minority groups play a role in politics irrespective of their ethnicity. However, explicitly ethnically or religiously based political parties are denied registration, and the participation of women in politics is hindered to a certain extent by social norms.

In 2000, the government enacted a new criminal code that bans acts of torture and authorizes punishments for violators of the law of up to 10 years in prison. The government also adopted the definition of torture that is contained in the UN Convention on Torture. Although there is no systematic torture in prisons, numerous cases have been reported in which police have physically abused detainees. The government rarely takes action to punish abusers. Authorities also often ignore procedures for the arrest and detention of persons. Individuals are frequently detained without legal warrants, and relatives of suspects are occasionally detained as part of an attempt to reveal a suspect's whereabouts.

#### Corruption

1999-2000	2001	2002
6.00	6.25	6.25

Azerbaijan has the reputation of being a country marred by corruption to a larger extent than most other countries. Although its legal system prohibits government officials and members of Parliament from involvement in economic life, the spirit of these laws is not adhered to. Family members of senior officials are prominent in the business life of the country, including in the broadcast media. The country's Law on Financial Disclosure has recently become an issue of controversy as political parties have been asked to publicize their financial sources. Audits of the executive and legislative branches do occur. Irregularities were discovered at several Kyrgyz embassies that were recently audited.

Azerbaijan ranked fourth from the bottom in both Transparency International's and the World Bank's global indexes of corruption for the period 1999–2000. Each index tracked 90 countries. In its 2001 Corruption Perceptions Index, Transparency International ranked Azerbaijan as one of the 10 most corrupt countries in the world. As in neighboring Georgia and Armenia (not included in Transparency International's rankings for 2001), the population of Azerbaijan perceives the government and bureaucracies at all levels as unanimously corrupt—and it does so with good reason. Bribe taking by officials down to the level of primary school teachers is endemic in the former Soviet states, and Azerbaijan is no exception. The level of red tape in the bureaucracy and the need to obtain signatures and stamps from several officials for simple proce-

dures have fostered an environment of rampant corruption in the country.

More detailed studies of actual occurrence of corruption corroborate this picture. In a recent study by the UN Inter-regional Crime and Justice Research Institute, for example, most Western European cities and countries showed less than 1 percent of their populations having direct experience with official corruption. In contrast, 10–20 percent of the populations of post-Communist countries typically experienced corruption. Among capital cities, Baku ranked fifth with 19 percent, after Tirana, Vilnius, Ulaanbaatar, and Minsk.

Another interesting indicator is that of state capture, the phenomenon of special interest groups hijacking the state for their narrow self-interest by manipulating policy formation and shaping rules and policies to their advantage. In a recent World Bank Business Environment Survey examining the so-called purchase of legislation, decrees, and judiciary rulings in transition economies, Azerbaijan emerged as the country in the former Communist bloc with the highest degree of state capture. It was followed closely by Moldova, Ukraine, and Russia. Over 40 percent of firms surveyed in Azerbaijan reported that their business had been directly affected by illicit private influence on state institutions. In assessing this information, however, it should be noted that the booming oil industry in Azerbaijan has created a more vibrant business climate than one will find in most former Soviet states. This, in turn, may have increased both competition and incentives for corruption. Nevertheless, the image of Azerbaijan is clear: corruption has become a major problem that pervades most of Azerbaijani society. It is a major impediment to the economic and social development of the country.

The public's reaction to the omnipresent corruption has been a mixture of apathy and frustration. Unlike in neighboring Georgia, there are no high-profile cases in which senior officials have been accused of corruption. There are also no high-profile anticorruption activists within the government. This explains the lack of public anticorruption activism in Azerbaijan. Yet widespread corruption in the country's leadership has been perhaps the main reason for the gradual decline of the ruling party's popularity, as evidenced by unofficial accounts of election results as well as by opinion polls. However, the public's apathy toward politicians, the government, and even the opposition is exemplified by the citizen who expressed his intention to vote for the ruling YAP in the 2000 parliamentary elections only because officials of that party could be thought to have already filled their pockets. The opposition, however, would have to start "stealing" from scratch if it came to power. Whether fair or unfair, this attitude is a good indicator of widespread and deeply rooted malaise in Azerbaijani society and of a political system that undermines the very governance of the country.

Investigations of high-level officials for corruption are rare in the country. When they do occur, they often lead to the settling of scores within the government's ranks rather

than to the initiation of serious anticorruption drives. The corruption allegations against former Foreign Minister Hasan Hasanov and former Speaker of Parliament Rasul Guliyev, for example, were both compelling, and there was little doubt these two figures had embezzled enormous amounts of funds. Yet the initiation of legal proceedings against them was in all likelihood related not only to their crimes but also to their rifts with President Aliyev. Such investigations frequently die out when political winds change.

## ECONOMIC LIBERALIZATION & SOCIAL INDICATORS

Privatization				
1997	1998	1999-2000	2001	2002
5.25	5.00	5.00	4.75	4.25
Macroeconomic Policy				
1998	1999-2000	2001	2002	
5.00	5.00	5.00	4.50	
Microeconomic Policy				
1998	1999-2000	2001	2002	
5.00	5.00	5.00	4.50	

During the past decade, Azerbaijan has undertaken many positive economic reforms and has experienced a dramatic shift from a centralized command economy to a market system. In particular, the comprehensive economic stabilization program that President Aliyev initiated in 1995 has led to significant macroeconomic improvements. In 2001, Azerbaijan's economy remained on this course of development. Inflation was kept at a minimal level, industrial output and gross domestic product increased thanks to increased oil production, and the gradual privatization of state property continued.

In addition, on April 30, 2001, President Aliyev abolished the Ministry of State Property, the Ministry of Economy, the Ministry of Trade, the State Committee for Entrepreneurship Support, and the Agency of Investments. In their place, he established the Ministry of Economic Development as the central executive body in the economic sector that is responsible for carrying out state policy in the sphere of socioeconomic development, international cooperation, macroeconomics, trade, investment, development of entrepreneurship, privatization and management of state property, regulation of monopolistic development, and competition. Farhad Aliyev, the former minister of state property, was appointed minister for economic development.

As in the 5 previous years, real GDP in Azerbaijan grew in the first 10 months of 2001 by 9.3 percent, while real

wages increased by 24 percent. Industrial production was up by 5.4 percent in the first 9 months of 2001, and the State Oil Company of Azerbaijan reported an increase in oil production. Although the growth of GDP is a positive factor, its heavy dependence on the oil and gas sector remains a concern among local and international economists.

Foreign investments are also disproportionately concentrated in the oil and gas sector. According to the newly created Ministry of Economic Development, 65 percent of investments are made in the oil and gas sector and only 16 percent in other industrial sectors. Another disturbing fact is that the majority of foreign investments are made in Baku and on the Apsheron peninsula; the rest of the country receives only a minimum of foreign investment. Nazim Imanov, a prominent opposition economist, argues that 93 percent of all budget revenues come from Baku, whereas the regions contribute only 7 percent. The opening of the Baku Steel Company in June 2001 was positive news. Some \$50 million was invested in this private steel-producing plant, which aims at satisfying the steel needs of Azerbaijan and neighboring countries.

Important recent news in the oil and gas sector of Azerbaijan includes the signing of the gas agreement between Azerbaijan and Turkey; agreement on a gas pipeline by the governments of Azerbaijan, Turkey, and Georgia; and progress toward the construction of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline. According to David Woodward, president of the Azerbaijan International Operating Company, the construction of the BTC pipeline is expected to start in the first half of 2002 and to be completed by early 2005. Currently, necessary talks with Western financial institutions are under way to secure funding for this \$2.9 billion project. This much debated and questioned pipeline is slowly but steadily becoming a reality.

Progress also continues in the privatization process. According to the Ministry of Agriculture, 178 billion manat (\$37 million) worth of state-owned properties and 606 billion manat (\$127 million) worth of municipal properties have been privatized to date. Thus, nearly 94.4 percent of all rural land and property that was earmarked for privatization has indeed been transferred to private hands. Privatization in the agricultural sector has been completed in 26 provinces. In the industrial sector, the denationalization of medium and large enterprises, as part of Azerbaijan's long-awaited second stage of privatization, is set to begin. Three hundred enterprises, mainly in the communication, air transport, fuel and energy, mechanical, and chemical sectors, will be put up for auction. At the same time, the privatization of small enterprises is still under way. The Ministry of Economic Development reported in October 2001 that 1,477 small enterprises and facilities had been privatized in the first 10 months of the year and 24,577 total since the start of the privatization process. Overall, the privatization process in Azerbaijan is run according to the Law on the Privatization of State-Owned Property.

As a result of the privatization process, the share of the private sector in Azerbaijan's economy has continued to grow. In some sectors, such as agriculture, the share of private production is close to 100 percent, whereas in the service and industrial sectors it is around 50 percent. Currently, nearly 30 percent of the total workforce is concentrated in the agricultural sector. According to the Azerbaijan Confederation of Entrepreneurs, some 70 percent of the able-bodied population (nearly 2.6 million people) work in the private sector of the economy.

In 2001, Azerbaijan promulgated a long-awaited new tax code that consolidates most of the country's taxes into a single, comprehensive law. The new code also seeks to promote the development of small and medium-size businesses by lowering most tax rates.

Azerbaijan's banking sector consists of the National Bank of Azerbaijan (NBA), which fulfills the functions of a central bank with \$640 million in reserves, and numerous commercial banks. In 2001, President Aliyev reappointed Elman Rustamov as chairman of the NBA, thus indicating his approval of reforms in the banking system in the past few years. Although the NBA is still highly dependent on the executive powers of the government, it has managed to keep itself out of politics. It has a good record of cooperation with international agencies such as the World Bank, the International Monetary Fund, and the International Finance Corporation on reform of the country's banking system.

The national currency, the manat, remains weak and unpopular with the public, which prefers to invest in U.S. dollars and pounds sterling as a secure way of fighting inflation. According to some local economists, nearly 80 percent of all transactions in the country are made in cash. The number of commercial banks in Azerbaijan has decreased in the past few years as the NBA has tried to tighten regulations and increase the levels of founding capital needed to form a commercial bank. Currently, there are 4 large state-owned banks and nearly 50 commercial banks. The latter are weak and still inexperienced in the management of banking operations. They are often created to fulfill the credit needs of their shareholders and are not prepared to respond to the growing needs of local and international companies. In 2001, the minister of finance dismissed Fuad Akhundov, chairman of the International Bank of Azerbaijan, the largest and most reliable bank in the country. Although the reasons remain unclear, some say the decision was related to the government's plans to privatize the bank.

In 2001, Azerbaijan experienced a positive trade balance for the second year in a row. The surplus amounted to \$440 million. After the collapse of the Soviet Union, the government was confronted with the challenge of shifting trade patterns from traditional partners in the Soviet republics to neighboring countries of the Middle East and Europe. Today, Azerbaijan's major trading partners are Russia, Turkey, Georgia, Iran, and the European Union.

However, the trade patterns and prospects of foreign investment are hampered by the de facto monopoly that the ruling circles keep on foreign trade. For trade and investment to take off, this pattern of activity will have to change.

During the period covered by this report, Azerbaijan continued to cooperate with international financial institutions, which in turn provided loans for covering the nation's budget deficit. Although the deficit has been reduced to 1 or 2 percent of GDP, the government continues to borrow from the IMF and World Bank. According to First Deputy Prime Minister Abbas Abbasov, the foreign debt of Azerbaijan amounted to \$1.14 billion by October 2001. Most of the loans have been spent on macroeconomic stabilization, investment projects, and payments on the national balance.

Private entrepreneurship remains one of the most struggling segments of the Azerbaijani economy. A high level of corruption and harassment by governmental officials and tax police, in addition to a weak legal system, creates few incentives for business development. In the past few years, the private sector has experienced a consolidation of businessmen into unions and confederations. One of these unions is the Azerbaijan Confederation of Entrepreneurs, which according to its president, Aliakbar Mamedov, unites over 600 private entities from 12 regions of the country.

To create transparency in the collection of oil revenues, President Aliyev formed a special State Oil Fund in 1999 into which all revenues from the extraction and sale of oil and gas, as well as bonuses from contracts with Western oil companies, will be collected. The fund is subordinated to the president. First Deputy Prime Minister Abbas Abbasov has reported that to date, \$435 million has been accumulated in the oil fund. President Aliyev has appointed a relatively unknown economist, Samir Sharifov, as executive director of the fund. Nevertheless, concern remains that the Azerbaijani economy is too dependent on oil exports, which in turn has increased corruption in the government and bureaucracy.

Although Azerbaijan's economy continues to grow, the uneven distribution of these economic gains has contributed to increasing levels of inequality. Azerbaijan is not a traditional developing country. Although the literacy rate and access to health services remain strong, high levels of unemployment and poverty limit opportunities to enjoy sustainable development and economic security. According to the United Nations Development Program, average life expectancy is 71.3 years. Official unemployment figures, which are highly unreliable, remain at the level of 15–20 percent. Nearly two million Azerbaijanis have emigrated abroad, mainly to Russia, to earn a living.

Despite these difficult circumstances, the government has decided to further reduce compensation for vulnerable segments of the population. Under heavy pressure from international financial institutions to balance the federal

budget, the government has determined to slash social benefits from \$200 million to \$30 million in 2002. The majority of the general public remain unaware of these changes owing to poor publicity of the issue.

Other important sectors such as education, health care, and science also remain underfunded. According to the latest draft of the state budget for the year 2002, science will receive 1.2 percent, the health sector 5.2 percent, education 21 percent, and social benefits 13 percent of the total budget. According to Minister of Education Misir Mardanov, in the past decade, not a single secondary school has been built in the country.

The difficult social situation in Azerbaijan became undeniable when the Society of Karabakh War Invalids staged a hunger strike and public demonstrations in 2001 to demand higher payments. The standoff between the authorities and the strikers went on for weeks and contributed to domestic instability. It ended when the police arrested 50 participants of the hunger strike. According to news reports, the prosecutor-general's office accused the invalids of "organizing mass demonstrations," "incitement to illegal actions and violence," and embezzlement of more than \$200,000.

Internally displaced persons suffer the most from Azerbaijan's severe social and economic conditions. Living in tent camps for the eighth consecutive year, this vulnerable segment of the population is receiving less and less international assistance. According to sources with the UN High Commissioner for Refugees, aid dropped from \$11 million in 1999 to \$7 million in 2001. Many Western relief agencies based in the area could soon be on their way out as well. To compensate partially for their expected withdrawal, President Aliyev issued a decree to divert some money from the State Oil Fund to the urgent needs of refugees and internally displaced persons.

President Aliyev also issued a decree in March 2001 to create a commission for the development of a Poverty Reduction Strategy Program. The commission is made up of representatives of governmental offices, NGOs, and academic institutions. The program itself must outline concrete steps that the government should take in the economic and social sectors to reduce poverty. Under agreements with the IMF, the World Bank, and the Asian Development Bank, Azerbaijan must complete the program within a one-year period.

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