



BULLETIN

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Azerbaijan After a Decade of President Ilham Aliyev's Rule

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Ilham Aliyev, who has been ruling Azerbaijan since 2003, will seek to stay for a third term in a 9 October election. The election process will be a signal whether the authorities in Baku wish to cooperate further with the European Union. Azerbaijan has a chance to boost political ties with the European Union and go beyond energy cooperation. This choice, however, would require Azerbaijan to adopt EU standards for the rule of law and democracy. The alternative is to keep an equal distance from the EU and Russia and maintain the status quo in domestic policy, which may result in stagnation of its economy.

Two Decades of Aliyevs. The expansion of transport routes for Azerbaijani oil and gas to bypass Russia and reach world markets was a strategy of the late President Heydar Aliyev (1993-2003). The results of this policy have become evident during the presidency of his son, Ilham. In 2006-2013, the Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline started to notably affect economic growth. While yearly revenue from oil was \$886 million in 2003, in 2010 it was already \$19 billion. In 2012, the mining sector brought revenues in excess of \$32 billion. Investments based on revenues from oil and gas are visible in the dynamically expanded capital city. The oil boom has increased the incomes of Azerbaijanis, who in the first half of 2013 saw average wages rise by 5.95%.

It is likely that in the next decade the period of economic growth based on revenues from oil and gas will not end. Last year saw the peak of oil production, and although it has begun to slowly decrease (by 2.2% in the first half of 2013), around 2018 Azerbaijan will start gas exports to Europe from the second phase of the Shah Deniz gas deposit. It will be transported by the planned Trans-Anatolian Pipeline (TANAP) through Turkey to the Greek border. Another important transport project is the Baku-Tbilisi-Kars rail route, which will create a connection to Turkey through Georgia. It will strengthen Azerbaijan's role as a centre of transit between Europe and Central Asia and China.

However, Azerbaijan is facing challenges typical for countries dependent on the mining sector. Fluctuations in oil and gas prices may result in periods of worsening economic conditions and decreasing standards of living. The result of reliance on the mining industry is weakness in other sectors of the economy. The effective use of export earnings from hydrocarbons for the sustainable economic development of the country is impeded by the opacity of government spending. A lack of government tenders triggers corruption and nepotism. Constraints on media freedom and civil society by the authorities make it difficult to conduct independent monitoring of government officials' activities. The state's tendency to bypass legal procedures indicates the strong links between political and business elites and is evident not only in comparison with the EU but also to countries of the Eastern Partnership (EaP). In Transparency International's 2012 ranking of perceived corruption, Azerbaijan was 139th, while Georgia was 51st. Among the EaP states, only Ukraine was worse. Even more revealing is Azerbaijan's ranking compared to other Caucasian countries in the 2013 Doing Business report: Azerbaijan was 67th, while Armenia was 32nd, and Georgia, 9th. The report notes a lack of progress in improving the business environment.

The Foreign Policy of President Aliyev. Ilham Aliyev has continued the "multi-vector" policy initiated by his father. Thus, he has tried to maintain an equal balance in relations with the EU and Russia. One manifestation of this tendency was Azerbaijan's accession in 2011 to the Non-Aligned Movement. Azerbaijan's significant oil and gas reserves meant it has been capable of independent policies despite Russian attempts to dominate the region.

An example of this was its economic support of Georgia (investments and cheap gas), which didn't stop even after the Russo-Georgian conflict of 2008. Of total foreign direct investment in Georgia in the first quarter of 2013, 17% came from Azerbaijan. The government in Baku has also been assertive, for example, demanding in 2012 that Russia pay a higher fee for the use of the site of radar station in Gabala, a lease the Russians eventually quit. Although Azerbaijan is not seeking NATO membership, it cooperates with the alliance on the transport of troops and supplies to Afghanistan. Nearly 100 Azerbaijani soldiers also serve in that country.

The lack of progress in resolving the Nagorno-Karabakh conflict is the biggest failure of Aliyev's foreign policy. The ineffectiveness of the OSCE Minsk Group's mediation in this matter is disappointing for Azerbaijan. The EU's activities in Nagorno-Karabakh are also perceived by the government in Baku as insufficient. Azerbaijan wants the Union to replace France as a mediator in the Minsk Group. France is seen in Baku as favourable to Armenia due to the Armenian diaspora in France and traditionally strong French-Armenian ties. Azerbaijan has been increasing military spending every year and holds increasingly assertive policies regarding the Nagorno-Karabakh issue. Azerbaijani society's hostility towards Armenians is heated by the authorities. A striking example of this was the president's pardon of Azeri military officer Ramil Safarov, who murdered an Armenian colleague during NATO training in Budapest in 2004.

EU-Azerbaijan Economic Relations. The EU is the most important economic partner of Azerbaijan. Currently, the EU-Azerbaijan Association Agreement is in negotiations. In contrast to Georgia, it will not, however, include an agreement on free trade with the EU, since Azerbaijan must first become a member of the WTO. According to the government's strategy, the EU will become a major energy partner with Azerbaijan. In June, the Shah Deniz consortium selected the Trans-Adriatic Pipeline for gas exports from the TANAP pipeline to Europe. This move has been received with disappointment by Central European EU Member States. They expected Nabucco West to be chosen, which would have increased the energy security of the region. However, the decision to export gas to the EU countries (Greece, Italy and Bulgaria) doesn't mean a change in Azerbaijan's strategy, and the European market remains the priority. The construction of TANAP will strengthen EU-Azerbaijan economic and political ties.

The Election and the Opposition's Chances. The upcoming presidential election will probably be a challenge for Azerbaijan-EU relations. So far, none of the elections in the country have been considered by the Council of Europe or the OSCE as compliant with democratic standards. The actions of the authorities in Baku before this election does not indicate any change. If there is a blatant falsification of the election results, post-election protests and a violent government reaction, it may provoke a crisis in relations between EU countries and Azerbaijan.

This year, the Azerbaijani opposition has managed to unite and select a single candidate. Initially, prominent film director Rustam Ibragimbekov had been chosen. However, the Central Election Commission didn't approve his registration as a candidate because he also holds Russian citizenship. The united opposition National Council's candidate now is Cemil Hasanli, a professor at Baku State University. The opposition's chances to win the election will be determined by the degree of mobilisation of opponents of the ruling elite. The strength of anti-government protests was visible in Ismaili, a city in north-central Azerbaijan, in January this year. However, a month before the election there's no sign of significant activity by the opposition electorate.

Conclusions and Recommendations. The development of the mining sector has provided funds for the development of Azerbaijan's economy. At the same time, however, the foundation of the economy on income from the sale of oil and gas carries risks for sustainable development. Other industries constitute a minor part of the economy. At the same time, the political elite use a non-transparent system of government expenditures, which enables widespread corruption. Therefore, despite the likely continuation of economic development based on revenues from oil and gas in the next decade, the lack of significant change in the political system will leave Azerbaijan's economy vulnerable to crises resulting from declines in hydrocarbon prices. The EU must persuade the authorities in Baku to transform their system and allow more input by civil society and the opposition on how the government spend funds from the export of oil and gas. It should also encourage the authorities in Baku to join the WTO and integrate economically with the European Union to increase the competitiveness of the Azerbaijani economy. This may also facilitate EU businesses in the Azerbaijani market.

Poland and the EU should try to convince Azerbaijani politicians about the long-term benefits of Union support of state transformation. The financial support and expertise that the EU provides has already delivered results in reform of administration. It is an instrument, that, if compliant with the principle of conditionality, allows the EU to supervise reforms. Further assistance should, however, be dependent on the government's political will to approximate to the EU. This will be tested by the presidential elections. The EU should warn the government in Baku that the lack of political pluralism and an exaggerated assessment of its own potential can become a trap. Such hubris may result in stagnation of the reform process and the loss of an important partner, namely the EU.

The EU should increase its activities to find a resolution to the Nagorno-Karabakh issue as the current stagnation of the peace process may lead to a resumption of further conflict or war. It is necessary to consider a proposal to send a monitoring mission to the region based on the experiences of the EU missions in Georgia. Such a mission, however, could only occur with the agreement of both sides of the conflict.