Analysis

Oil Wealth, Patrimonialism, and the Failure of Democracy in Azerbaijan

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Abstract

Azerbaijan's democratization attempts failed, not least because for those in power, control over the political process was essential in order to gain and maintain control over the country's petroleum riches. Organization of power along patrimonial lines defines the system that Azerbaijan's late president Heydar Aliyev created during his long rule and which his son, Ilham Aliyev, continued. This system distributes rents from oil exports through a patronage network in order to ensure the support of allies and various clientelist groups. The high oil-price environment of 2003–2008 brought an enormous increase in revenues from oil exports. Since about 2005–06, the government did not even care to maintain the façade of democracy as it did during the 1990s. The drop in oil prices will probably make the government pursue a more careful policy, but political change is unlikely as long as the system remains based on sharing the spoils from oil exports and keeping the public marginalized and powerless.

An Authoritarian and Corrupt Regime

On December 30, 2008, Azerbaijani authorities turned off BBC, Radio Liberty and Voice of America broadcasting services, effectively denying their citizens access to independent sources of information and the few remaining venues of debate on issues of public concern. Only a few days earlier, on December 26, the majority of Azerbaijani parliament members called for a referendum, set to be held on 18 March 2009, to amend the country's constitution from 1995. The proposed constitutional reform would abolish the rule that the same person cannot be re-elected as president after serving two terms in office. If adopted, this amendment would enable incumbent Ilham Aliyev to run for a third term after his second term expires in 2013; and then to remain president for an indefinite period of time. Aliyev, now 47, was elected president in 2003 for a five-year term, succeeding his ailing father Heydar Aliyev. In the controversial October 2008 election, which the main opposition Azadliq (Freedom) party bloc boycotted, he won a landslide 89 percent of the vote, a slight gain compared to his 76.8 percent showing in 2003.

The latest attacks on democracy and free media are not surprising; in effect, they mark the culmination of nearly 15 years devoted to forming an authoritarian political regime whose entire support mechanism rests on the availability of energy resources and the division of spoils from the export of petroleum. Petroleum revenues provide the vital resource to be exchanged through the web of patron-client relationships spanning the patrimonial system of authority, which is tantamount to a "personal fiefdom" of the ruler. The state works along clientelistic lines: the governing elite (patron) supplies benefits and favors to its supporters (clients) in exchange for political support and loyalty. More visibly, political clientelism manifests itself in the wide-reaching spread of graft and rent-seeking. In fact, Azerbaijan figures today among the most corrupt countries of the world: Transparency International's 2008 Corruption Perception Index ranked Azerbaijan 158th among 180 countries. The country appears in the same group as Burundi, the Republic of Congo, Sierra Leone and Angola.

If in the 1990s the form of government in Azerbaijan was duly described as semi-authoritarian, i.e. neither democratic nor outright authoritarian, by the early 2000s the regime moved in the authoritarian direction. In fact, democracy never took root in Azerbaijan. Azerbaijan falls into a group of countries from the southern belt of the former USSR, which after 1991 did not see a movement towards democracy and freedom as in the Baltic States, but the rise of repressive regimes and odious dictators (the most notorious example being the late president of Turkmenistan, Saparmurat Niyazov) or the establishment of hybrid regimes which blend democratic and non-democratic features (such as the one in Armenia).

It thus comes as little surprise that Azerbaijan does not fare well in international rankings on democracy and press freedom: The Polity project which provides an independent assessment of authority trends in all independent states has kept Azerbaijan's score at "-7" since 1998 (after Heydar Aliyev's re-election for a second term) on a 21-point scale ranging from "-10" (hereditary monarchy) to "+10" (consolidated democracy). On the Reporters Without Borders' annual Press Freedom Index, in 2008 Azerbaijan ranked 150 out of 173 countries. IREX, another media audit organization, in its 2008 Media Sustainability Index assigned a score of 1.84 to Azerbaijan on a scale from "0" representing unsustainable, anti-free press to "4" representing free and sustainable media. The ban on foreign broadcasts starting January 2009 completes the tide of restrictions on free media.

Oil and Democracy

There are multiple reasons for the failure to democratize, but a country's abundance in natural resources tends to hinder the establishment of democracy and freedom. Political scientists, notably Terry Lynn Karl and Michael L. Ross, write widely about the "resource curse," identifying several negative effects of a country's dependence on a single resource, especially petroleum. In countries afflicted with the curse, natural resources are regarded as the only chance to develop. The state is thus eager to control the oil and gas industry via a national monopolist, such as a state oil company. With the influx of foreign capital into the enlarged public sector of the economy, the state grows and becomes stronger (in its capacities), whereas private businesses largely depend on government contracts, which are usually distributed to regime collaborators in return for political support or loyalty. Crony capitalism, understood as the system in which members of the government distribute economic favors to their personal connections, thus flourishes. This system allows the oil-rich government to control the rest of the economy and to gain autonomy from the public by implementing its decisions without relying on public taxes.

Since petroleum-rich countries are located mainly in the developing world where weak political institutions prevail, they must usually build their political systems at the same time as they develop the petroleum industry, with the industry exerting a negative effect on the institutions. In conditions with few restraints, high petroleum income creates an incentive structure for the political and economic elites to grab their part of the oil revenue "pie." Hence, petroleum revenues foster rent-seeking and corruption, and undermine the development of democratic institutions and free market structures.

Moreover, oil inhibits democratic transition and helps authoritarian rulers survive through various mechanisms. The first is the rentier effect: Oil-rich states do not need to tax their citizens because they enjoy high profits from oil exports. They also do not have to listen to their people or represent them as there is "no representation without taxation." Second, oil wealth leads to greater patronage spending, which, in turn, reduces pressures for democratization. Another aspect to the spending effect is that a rent-seeking government seeks to gain popular support by spending on social projects to diffuse opposition. Third is the group formation (or civil society) effect: oil revenues provide an authoritarian state with resources to prevent independent social groups from forming. Fourth, an overabundance of oil revenues stimulates greater repression as it allows the oil-abundant state to spend excessively on the armed forces, police and security agencies that can be used to silence pro-democracy forces. As a result, the state demobilizes society and deprives it of the ability and means to counterbalance state policy.

Towards the Formation of a Petro-State

At the time of Azerbaijan's independence from the Soviet Union, the political leaders knew full-well that the only viable option to quickly restore a shattered economy was to revitalize the petroleum industry, which declined during the late Soviet period. Petroleum shaped much of the modern history of this country, which was home to the world's first drilled oil well in 1848 near Baku, then part of the Russian Empire. By the early 20th century, Azerbaijan produced almost half of the world's oil. After a short-lived independence in 1918–1920, Azerbaijan was incorporated into the Soviet Union to serve as a hydrocarbon supplier for the Soviet economy. In the early 1990s the Azerbaijani Popular Front-led national independence movement took an anti-Russian position and sought sovereignty over its resources. Yet, a shortage of capital and the lack of modern technologies to extract technologically-complicated offshore reserves prevented Azerbaijan from developing its resources independently and forced Heydar Aliyev's government to attract foreign investments into its oil industry.

The desire to stay in office provided another motive for securing foreign investments. Typically, the leaders of oil-abundant states use their mineral riches to prolong their tenure as chief executive. After years of political turmoil and the military defeats against Armenian-backed Nagorno-Karabakh forces, Azerbaijan's first president, Abulfez Elchibey, resigned under pressure after only one year in office in 1993. Heydar Aliyev won election to the president's office in his place. Aliyev, who ran the country for much of the late Soviet time – first as First Secretary of the Azerbaijani Communist Party (1969–82) and later a member of the communist Politburo and USSR Deputy Prime Minister (until 1987 when he was ousted by Mikhail Gorbachev) – needed direct access to the country's oil export revenues in order to maintain his hold on power and only foreign investment in the petroleum industry could ensure that these revenues would start flowing.

The government of Azerbaijan and the BP-led Azerbaijan International Operating Company consortium

(AIOC), in which the Azerbaijan State Oil Company (SOCAR) obtained a 10 percent share, signed the first major production-sharing agreement (PSA) for the offshore Azeri-Chirag-Guneshli (ACG) fields (with an estimated 5.4 billion barrels of oil) in 1994. Since then, Azerbaijan has concluded more than 25 PSAs to develop oil and gas deposits onshore and in the Azerbaijani section of the Caspian Sea. ACG started producing oil in 1997, though only at a small scale. The launch of the Baku–Tbilisi–Ceyhan pipeline (for ACG oil) and the South Caucasus Pipeline (for Shah Deniz gas) in 2006 began the era of large profits. According to country expert Sabit Bagirov, revenues from PSAs began flowing into Azerbaijani government coffers before the production of the "early" ACG oil in 1997.

The government used the oil-related bonuses it received beginning in the early 1990s to cover budget deficits, finance social projects, and stabilize the exchange rate of the national currency through 1999. Typically, the public funds for social projects flow through a knot of bureaucratic agencies, which use their positions to extract profits by direct access to the funds and through various techniques of bribe inducement from the final recipient. Moreover, since all oil contracts had to be negotiated with the president, foreign companies and Western governments courted the chief executive, giving him a great deal of external and domestic legitimacy. Therefore, oil and gas exports enriched the government coffers and contributed to regime stability, allowing the government – through patronage, public spending and rent-seeking – to buy public support and undermine civil society institutions.

Oil Dependency

Azerbaijan has enjoyed a new era of abundance since 2005, particularly since the BTC came on stream a year later. An increase in oil production made Azerbaijan one of the fastest growing economies in the world over the last five years. It would not be an exaggeration to say that the Azerbaijani economy exists on the basis of its oil exports and revenues. According to Ingilab Ahmadov, Director of the Public Finance Monitoring Center in Baku, oil makes up 52.8 percent of GDP, 64 percent of budget revenues, and 80.6 percent of exports. On this basis, the country's economy expanded with an average real GDP growth rate of 21.1 percent between 2003 and 2007 and about 13 percent in 2008. According to the Economist Intelligence Unit's forecast, in the coming two years, GDP growth will slow to an average rate of 6.8 percent due to currently low oil prices. While state budget revenues were $4.3 billion in 2005, the recently approved national budget for 2009 envisages $15.11 billion in revenues (based on an average oil price of $70 per barrel). If the price of oil stays at $45 per barrel, by 2025 the ACG contract alone will generate nearly $150 billion. With a higher price on oil ($60 per barrel) by 2025, the total revenues may exceed $200 billion.

Azerbaijan is not only very vulnerable to falling oil prices, but its oil will also not last forever. According to data from the BP Statistical Review of World Energy (2008), Azerbaijan holds only about 0.6 percent of the world's proven oil reserves and produces around 1.1 percent of the world oil output. If production continues at the current level, the remaining reserves of oil will last for about 22 years. Oil production will peak in 2010. According to a World Bank study, budget and State Oil Fund revenues will also peak in 2010. Even according to calculations based on a relatively moderate price of oil (around $60 per barrel), the country's annual revenues may well remain in the range of $10–15 billion, at least in the years of peak production (peak production was supposedly reached in 2008 and could last until 2012).

The Role of SOCAR and SOFAZ

In addition to the budget, Azerbaijan's oil wealth contributes to SOCAR and the State Oil Fund (SOFAZ, http://www.oilfund.az/en), two state organizations under exclusive presidential control. Since the parliament has only a marginal political and oversight role, the president faces no constraints in spending the country's national wealth. His natural wish to stay in office drives his calculations on where and how to allocate wealth; the result is that the calculus of power maintenance and political survival drive economic policy making. Confirmed by a presidential decree, SOCAR's 2004 legal charter envisages that the company "may be reorganized and terminated by the President of Azerbaijan Republic". Nearly half of all government spending runs through SOCAR, which has its own budget that is independent of the state budget.

SOFAZ is also under presidential "jurisdiction." A 1999 presidential decree established the body as an "extra-budgetary institution," making it "accountable and responsible to the President of the Republic of Azerbaijan," while leaving no role for the parliament to scrutinize the president's unrestricted powers to determine the national oil fund's expenditures. As of 2008, SOFAZ had accumulated $10.21 billion. SOFAZ Executive Director Shahmar Movsumov predicts that by 2023, SOFAZ's funds may reach more than $200 billion. Without any overarching long-term development strategy, the governments of the late Heydar Aliyev and the successor government of Ilham Aliyev have spent SOFAZ money on various infrastructural and social projects, including financing Azerbaijan's share in the BTC, improving the living conditions and providing accommodation for refugees and IDPs, constructing a water pipeline from the Oguz/Gabala area to Baku and the Samur-Absheron canal, and financing Azerbaijani students' education abroad. Some SOFAZ funds have also been transferred to the state budget to be further used to cover the increase in the number of public sector employees and their salaries, sponsor state investment projects, build up the military (national defense expenditures rose to $1.85 billion in 2008, up from $1.1 in 2007) and support other public projects.

Outlook

Petroleum has helped the Aliyev governments to enhance their capacities to pre-empt any challenge to their hold on power. It contributed to the disappearance of democratic elements of the hybrid regime of the 1990s and the consolidation of a highly personalistic regime thereafter. The state owns the country's oil resources through the national oil company which reports to the president, not the parliament; oil revenues are collected in the state oil fund which is also under presidential control.

Since so much depends on oil, the country's economy is especially vulnerable to adverse effects of boom-and-bust cycles. If low prices persist at or below $40 a barrel, the government will most likely have to cut back on projected government expenditure plans, and, perhaps, call off some of its over-ambitious public spending projects. The government will suffer a loss in extra revenues that it would otherwise have earned and invested in sustaining its support constituencies, but whether the recent fall in prices is going to translate into political instability or political change remains to be seen.

First, like other resource-affluent states, Azerbaijan has stored part of its earnings from oil in the state oil fund, which can be used to avoid shortages during bust periods through, for instance, transfers to the state budget. *Euromoney* reported on January 6, 2009, that with an oil price of $100 per barrel in September 2008, SOFAZ was collecting $2.5 billion a month, with the oil price at about $50, the fund still gains $700 million a month. In an interview with *Euromoney* published in the same edition, SOFAZ Executive Director Movsumov claims that $40 a barrel would still provide the state fund with about $200 billion in revenue over the next 15 years. The reason is that production costs are relatively low and even at $40 a barrel, profits are still considerable. Therefore, it is premature to speak about an economic crisis in the case of Azerbaijan. Real problems can be expected to occur when the country runs out of oil and the government's revenues fall dramatically. Nevertheless, economic crisis will be one of the most probable drivers of regime change in this Caspian petro-state.

Second, the stability of the regime depends on the ruler's personal survival backed by his informal network of patronage and clientelism. Comparative research shows that personalistic regimes are not the best candidates for democratization since they are least vulnerable to internal elite splits, usually breaking-down at times when the ruler dies or the economy collapses. The patrimonial leader's inner circle is usually composed of his family members, close friends and cronies who benefit from sharing in the spoils and enjoy favors provided by the ruler. Since their well-being largely depends on the survival of the dictator, they have few incentives to initiate or participate in opening the regime. Rather, they favor the maintenance of the status quo and, consequently, support the regime and ruler. Moreover, petro-dollars help keep the society demobilized and incapacitated. Absent any serious economic hardship or succession crisis, these factors render democratic political change in such conditions especially hard to achieve.

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The views expressed in this text are those of the author alone.

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