

AZƏRBAYCAN AVROİNTEQRASIYA
MİLLİ İCTİMAİ KOMİTƏSİ



AZERBAIJAN NATIONAL COMMITTEE
FOR EUROPEAN INTEGRATION

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PROGRESS REPORT

AZERBAIJAN

Implementation of the European Neighbourhood Policy in 2009

CONTRIBUTE TO A PEACEFUL SOLUTION OF THE NAGORNO-KARABAKH CONFLICT

The measures that the Azerbaijan Republic can take in this sphere largely depend on the country itself, the Republic of Armenia, which is the other party to the conflict, the OSCE Minsk Group and the general international environment. From this point of view, Azerbaijan has taken the following special measures and efforts in this direction in the current year:

- **Azerbaijan has been closely cooperation with all sides, including the special representative of the European Union for the South Caucasus**, holding high-level meetings and exchanging opinions with him during the year. In this way, the Azerbaijani authorities obtained full information about the EU's opinion and position on the conflict and were able to inform the EU about their own opinion.

- The Azerbaijani authorities filed a direct appeal with the UN to secure **the implementation of relevant UN resolutions** and held numerous meetings at the level of foreign ministers and presidents to ensure the discussion and successful implementation of the frame agreement prepared by the **OSCE Minsk Group** on the basis of the Madrid principles, demonstrating good will and their political flexibility and readiness to make concessions for the sake of the peaceful resolution of the conflict.

- Little progress was made **to encourage relations between people**. Several intellectuals paid a visit to Baku, Khankandi and Yerevan under the leadership of the Azerbaijani and Armenian ambassadors to Russia. At the same time, the Azerbaijani authorities imposed an unofficial but effective ban on NGOs' initiative to invite their Armenian counterparts to Azerbaijan.

- Significant progress was made in the sphere of normalizing relations between Turkey and Armenia in order to **intensify the dialogue between the parties interested in accelerating the negotiations aimed at a political solution and the EU**. This will help boost chances of security and peace in the region at large. However, there are factors that prevent this positive potential from being realized, and the major factor is Armenia's position which runs counter to international law and as a result, the Azerbaijani authorities' negative attitude to the unconditional normalization of Turkish-Armenian relations.

This year witnessed two important events that had an effect on the general political situation in the South Caucasus. One of them is that Russia recognized the independence of unrecognized entities and the other one is that serious steps were taken to normalize relations between Turkey and Armenia. Both events invite Azerbaijan to take a new approach to the reality, however, such a new approach is possible only if demonstrated by the other side to the conflict.

STRENGTHEN DEMOCRACY IN THE COUNTRY, INCLUDING THROUGH FAIR AND TRANSPARENT ELECTORAL PROCESS, IN LINE WITH INTERNATIONAL REQUIREMENTS

In 2009, Azerbaijan planned a referendum on changes to the constitution (March) and municipal elections (December). Unfortunately, during preparations for this important voting process, the recommendations given to the Azerbaijani government by the Venice Commission and the OSCE on reforming the Election Code were ignored as was the case during the past five years. No progress was made on the principle of forming the Electoral Code, restoration of rights of assembly, improvement of the election

environment and other serious obstacles. For this reason, international and local observers assessed the referendum as a process that failed to meet European standards and commitments to the Council of Europe (since the municipal elections will be held at the end of December, its assessment will be presented additionally). In 2009, as was the case in the past, leading opposition parties were deprived of their headquarters. The holding of rallies and demonstrations within the city was effectively banned, while opposition party leaders and activists were barred from visiting the regions of the country.

As in recent years, the authorities have continued to exert strong pressure on opposition and independent media in 2009. While the editors-in-chief of two major newspapers (the editor-in-chief of Azadliq newspaper, Qanimat Zahidov, and the editor-in-chief of Realny Azerbaijan newspaper, Eynulla Fatullayev) are still in prison, two young activists and bloggers – Emin Milli and Adnan Hajizadeh, were arrested on fabricated charges and sentenced to 2.5 and 2 years' imprisonment in a show trial which was accompanied with serious violations of the law. The authorities continue to totally control all TV channels, preventing opposition leaders from speaking out.

The development of democracy and the establishment of a law-governed state in a country require the clarification of the authorities of branches of power according to the principles of separation of powers and the establishment of a relevant balance between these branches. In Azerbaijan, this balance has been seriously disturbed in favour of the president. In contrast to OSCE and Council of Europe recommendations, the referendum on changes to the constitution, held in March 2009, lifted the provision banning the president from being elected for more than two terms in office. According to the Venice Commission, this step "strengthened the president's already strong position and is not line with European standards".

No substantial reform was carried out in the sphere of **local government** in Azerbaijan in 2009. The authorities of the municipalities remain restricted and uncertain. Compared to previous years, the financial potential of local government bodies has slightly weakened. Instead of the 48.3 million manats projected for nine months of 2009, the income of the municipalities across the country totalled only 15.5 million. There is still no specific division of powers between the municipalities and local executive authorities, and no substantial changes related to the specification of powers have occurred so far. In contrast to what was expected, no separate law on Baku's status as the capital city has been adopted in 2009, and Baku has not been given the right of self-government.

However, along with all this, 2009 has seen the following two important changes in the sphere of self-government in Azerbaijan.

Municipalities' accountability. The constitutional changes put to the referendum held on 18 March 2009 reflect the municipalities' accountability to the Azerbaijani parliament. This change, which has already come into force, runs counter to the Article 8 of the European Charter of Local Self-Government. According to Article 8 of the Charter, any administrative control over the activities of local government bodies should be aimed only at ensuring observance of the principles of the law and the constitution. Since Azerbaijan has a separate law that forms the legal basis of administrative control over the activities of municipalities and such activities are already being implemented, the enforcement of additional supervisory forms is inexpedient and incomprehensible. On the

other hand, the mechanism of ensuring the municipalities' accountability to the parliament remains uncertain. It is no accident that the Congress of Local and Regional Authorities of the Council of Europe expressed its serious protest at the changes put to the referendum.

Expansion of municipalities. On 29 May 2009, Azerbaijan adopted a law "On the establishment of new municipalities through the amalgamation of municipalities in the Azerbaijan Republic". The main purpose of the law was to resolve the problem arising from the great number of small municipalities. Since the law was adopted, the number of municipalities has been reduced from 2,757 to 1,718. In general, 1,044 municipalities have been abolished and five municipalities have been established. This means that the number of municipalities has been reduced by 1,039. Although independent experts welcome this step, they believe that if no reforms are carried out in parallel to resolve the issue of municipalities' authorities and their financial problems, it will be impossible to make serious progress on the development of local government.

STRENGTHEN THE PROTECTION OF HUMAN RIGHTS AND OF FUNDAMENTAL FREEDOMS AND THE RULE OF LAW, IN COMPLIANCE WITH INTERNATIONAL COMMITMENTS OF AZERBAIJAN (PCA, COE, OSCE, UN)

Situation of the Judiciary

In 2009, a new electoral procedure was launched to expand the corps of judges. At the same time, another test was held for employment with the Prosecutor's Office. The authorities of several judges who had committed offences in the past were terminated, and disciplinary action was taken against dozens of judges. Various training courses for judges and prosecutors continued with the participation of the OSCE, the Council of Europe, Germany's Technical Cooperation Organization (GTZ) and other international organizations. These courses also examined precedents set by the European Court of Human Rights. However, all these measures failed to ensure the independence and impartiality of the courts. The fact that the principle of separating branches of power has not been secured, the state of lawfulness in the country, the lack of transparency in appointments to high posts and the belonging of all powers - ranging from the appointment of judges to financial support for the courts - to the executive authorities, the lack of real entities for the public self-government of judges and so on prevent the independent judiciary from being established and working. The Council of Courts and Judges did not take any disciplinary action in 2009 in connection with about 100 complaints filed in 2007-2008 against judges who committed similar offences relating to violations of rights of assembly, association, freedom of speech and prevention of torture and rights of freedom, while the Supreme Court, the Court of Appeal and the Ministry of Justice refused to appeal to the Council of Courts and Judges to take disciplinary action. No answer was given to citizens in this regard, or the answers given were not substantiated.

During the past period, all complaints about mistreatment filed by journalists, political party members, NGO representatives, students and others with the law-enforcement agencies and courts (including the complaint filed by the editor-in-chief of Talishi-Sado newspaper, Novruzali Mammadov who died in prison) were rejected.

The numerous facts about torture, reflected in reports by local civil society institutions, including international organizations such as the OSCE and others, have still not been given an appropriate assessment. The government is not taking measures to investigate these, to hold to account officials responsible for them and pay compensation to the victims of torture and other forms of mistreatment.

Freedom of expression, defamation, violence against journalists

The defamation law remains too far from the legislative and judiciary practices of the Council of Europe and the European Court of Human Rights and too tough and restrictive with regard to critical journalists. Over the past period, eight journalists were imprisoned on the basis of laws on the protection of one's reputation. Numerous forms of pressure were exerted on journalists and bloggers. The well-known bloggers and young activists – Emin Milli and Adnan Hajizada – were arrested on fabricated charges of hooliganism. As of December 2009 well-known reporters (E. Fatullayev and Q. Zahid) remain in prison on dubious charges.

Broadcast system and media pluralism

Since the broadcasting system is officially and unofficially controlled by the government, the turnover of independent newspapers is very low. Since the newspapers have no opportunities of sale and have been expelled from the advertisement market, they are in a very difficult financial situation. Due to the lack of transparency in the financing of newspapers, newspapers close to the government are being financed in various illegal ways.

No transparency has been ensured in the sphere of distributing radio and television frequencies and issuing licenses. The government totally controls television and radio channels. There are few TV channels in regions and no radio channels at all. By revoking the licenses and frequencies of Radio Liberty, the BBC and Voice of America, the government has deprived these media of the opportunity to express different views. The activities of the country's largest broadcaster, the Azerbaijan State Radio and Television Company (AzTV), are not being regulated by any law. This broadcaster is being financed from the state budget, is working under the full control of the government and is promoting top officials of the country. There are no opportunities for pluralism of views on this channel.

The government retains its monopoly and full control over the Internet and communications sector. This delays the spread of the Internet and prevents its effective use as a free information channel.

Compared to the previous year, no progress was made in the sphere of access to information. Most of the provisions of the law on access to information remain on paper. Government agencies have not set up departments responsible for freedom of information, have no single registry of documents and information disseminated on the Internet is far from the circle of requirements determined by the law. Ignoring the requirements of the law, the government is still in no hurry to appoint an official representative responsible for freedom of information. The rate of responses to information queries does not exceed 25-30 per cent.

NGO registration and freedom of association

Although the policy of registering NGOs was softened for some time, later this problem emerged seriously again. Unfortunately, the Ministry of Justice continues to illegally turn down requests from citizens – journalists, teachers, lawyers, economists and so on - who want to exercise their rights of association. The practice of rejecting documents time and time again on the pretext that founding documents are faulty is still being used. The complaints filed with the courts about illegal actions by the registration authority are rejected at the best and at the worst, the courts refuse to consider them.

The founders of the Centre for Monitoring of Elections and Teaching of Democracy, the Centre for Regional Cooperation and Development of Communities, the Institute for Media Monitoring, the Centre for Journalistic Studies, the Centre for Research into Citizens' Problems and Legal Assistance, the Centre for Regional Human Rights and Education and other entities have already faced such arbitrariness in the courts.

The NGO founders appealed to the Supreme Court, the Ministry of Justice, the Court and Law Council and other authorized entities to take disciplinary action against high-handed judges, but to no avail. One of the reasons why the complaints about illegal actions by the Ministry of Justice which considers issues of registration is that minister (Fikrat Mammadov) is also head of the Court and Law Council which deals with the accountability of judges, including their dismissal.

At a time when independent NGOs have serious problems with registration, the process of creating fake NGOs has been continuing in 2009 with the active participation and support of government agencies and high-ranking officials. Those entities have no problems with registration. One of the purposes in setting up these entities which act as an alternative to organizations that carry out independent and real work in the sphere of elections, human rights, law, education and other spheres is to seize funds allocated for grant projects from the country's budget and from abroad. Another purpose is to weaken and knock out independent NGOs. At a time when joint projects and events arranged by independent NGOs and international organizations cooperating with them (including the OSCE, the Council of Europe and others) are boycotted, the government actively lobbies the fake NGOs in international organizations, registers them without hindrance and provides them with offices and up-to-date equipment and their staff with high wages. At events arranged by such entities, various government agencies, including judges and the law-enforcement agencies, are represented at a high level.

In 2009 the government tried to make conservative amendments to the law on NGOs. Those amendments were aimed at depriving the independent NGO sector of financial sources and weakening and taking control of this sector in Azerbaijan through groundless restrictions, strengthened supervisory mechanisms and considerable restrictions on the activities of international organizations in Azerbaijan. As a result of efforts by local civil society organizations and international organizations, the adoption of those conservative amendments was prevented. But there is still a risk that these attempts will be continued.

In 2009, there were no significant changes in the Public TV (ITV). ITV is financed directly from the budget. During the first two years of its work, the state allocated 16.1 million manats to the channel. In 2009, the funds allocated to ITV were increased to 13.5 million manats. According to the budget of 2010, this budget is planned to be about 8 million manats.

Thus, over the last two years, ITV has not experienced any financial difficulties, and the company's problems with equipment were successfully solved and new big studios and buildings were built for it.

However, Public TV is not really different from other channels in observing other principles and standards that are stipulated by the law and stem from Azerbaijan's obligations to European organizations. Over the last two years, there has not been any serious headway in this direction. The organizations that monitor the activities of ITV note that "it has a passive approach to public-political developments" and is not fulfilling the requirement to "observe pluralism and distance itself from political interests" at the appropriate level.

IMPROVE THE BUSINESS AND INVESTMENT CLIMATE, PARTICULARLY BY STRENGTHENING THE FIGHT AGAINST CORRUPTION

The State Anti-Corruption Programme for 2004-2006 was adopted at the same time as the law of the Azerbaijan Republic "On the fight against corruption" (the law took effect on 1 January 2005), and this provided for the setting up of a special state anti-corruption agency at the Anti-Corruption Commission (the commission was set up in April 2004, while its statute was adopted in May 2005).

In order to improve the public management system, a commission for affairs of state service under the president of the Azerbaijan Republic was set up in January 2005, whereas the anti-corruption department under the Prosecutor-General's Office was set up in October 2004.

The implementation of the aforesaid measures shows once again that there is political will to combat corruption and explains some institutional and legal mechanisms in this sphere. Though these mechanisms were adopted at the same time as the State Programme, the latter had a serious influence on the quality and conditions for the implementation of the programme. In addition, the programme was drawn up and implemented without the participation of public associations, civil society and society at large. These are two of the reasons why the programme was implemented by 30-40 per cent according to the assessment of the Azerbaijani civil society.

The adoption of the anti-corruption law is commendable, but the terms of the law do not propose appropriate and understandable tools to prevent cases of corruption and does not envisage mechanisms of using an improved anti-corruption mechanism in the public management system, revealing social, legal and economic causes, ensuring the transparency of the public management system, solving the problem of the conflict of interests and analyzing methods of corruption and legal and standard acts. This is the third main reason why the programme was not implemented well enough.

The state approaches this law as the main law, and this should be substantiated by other legal acts and norms, but their adoption is dragging on. Delays in the adoption of legal and standard acts in order to implement some of the conditions of the law have a negative impact on the hopes of the public. In order to persuade the public of the state's fight against corruption, a number of significant steps have been taken.

For example, one of the main conditions is the classification of violations of the law related to corruption in Article 9 of the law. With his decree issued on 2 March 2004, the president instructed the lawmakers and the government to bring the existing

legislative basis into line with this article, but changes to the Criminal Code were made only in April 2006 and changes to the Code of Administrative Offences were made in December 2006. For this reason, even partial implementation of the law and the implementation of the programme were impossible until the very last moment.

Under Article 5 of the law, officials should submit their tax declarations under a procedure established by the State Anti-Corruption Commission. However, as a result of changes and addenda made to the law on 1 April 2005, the rules are established not by the commission, but by the law. This took effect after the approval of the law “On the submission of financial information by officials”. According to this law, officials should submit a declaration within 30 days of taking up their responsibilities. Presidential decree No 278 issued on August 2005 instructed the Cabinet of Ministers to draw up such forms and rules. However, the presidential decree was not implemented by the Cabinet of Ministers until November 2008. According to that law, members of the Azerbaijani parliament should submit financial information to an entity selected by the parliament of the Azerbaijan Republic; however, the aforesaid entity has yet to be set up.

The most recent document that was adopted on tackling corruption – the National Strategy to Increase Transparency and Combat Corruption – which covers the period 2007-2011 goes in the right direction. It must be noted that the state drew the right conclusion from previous shortcomings, took the preparation of the document more seriously and invited the civil society and the international community to participate in the preparation of the document. The special part of the strategy envisages the involvement of the civil society engaged in monitoring and assessment. Indeed, civil society has participated in a number of events upon invitation from the government and conducted some work on its own initiative (public awareness raising, monitoring of the program implementation, workshops for public officials).

According to Law 92-IIIQD of the Azerbaijan Republic, adopted on 7 April 2006, on changes and addenda to some legislative acts of the Azerbaijan Republic on the fight against **corruption**, Article 33 of the Criminal Code of the Azerbaijan Republic was changed. The chapter which was previously entitled “Crimes against interests of service in bodies of state power, state service and local government, as well as in other commercial and non-commercial organizations”, was changed and renamed “Corruption crimes and crimes against interests of service in bodies of state power, state service and local government, as well as in other commercial and non-commercial organizations”. Nine articles of the chapter (Articles 308, 309, 310, 311, 312, 313, 314, 314-1 and 314-2) were changed partially or totally and one new article (Article 312-1) was added. Apart from that, two articles of the Criminal Code of the Azerbaijan Republic (Articles 51 and 190) were changed partially, one new article (Article 193-1) and one article (Article 241) was removed. The changes are observed both in the disposition and sanctions of the articles. Prison terms in the sanctions stipulated by the articles and punitive measures such as confiscation of property were changed or added.

However, along with that, a number of measures to be implemented at the national level stipulated by the UN Convention against Corruption, the Council of Europe Convention on Criminal Accountability for Corruption and Convention on Civil and Legal Accountability for Corruption, as well as the Convention of the Organization for Economic Cooperation and Development against ***Bribery of Foreign Public Officials in International Business Transactions*** were reflected in the Criminal Code of the Azerbaijani Republic. For example:

Article 20 of the UN Convention against Corruption on “Illicit Enrichment” and Article 14 of the Council of Europe Criminal Law Convention against Corruption “Accounting Offences” were classified as criminal offences in the Criminal Code of the Azerbaijan Republic.

The policy of **privatization** in the banking system of Azerbaijan began with Decree No 1958 “On measures to privatize the Kapital Bank open joint-stock company” issued by the president of the Azerbaijan Republic on 9 February 2007. In order to secure the implementation of measures mentioned in the decree, the State Committee for the Management of State Property issued a relevant announcement on the holding of an auction (in the form of a competition) to sell newly-issued shares (parcel of shares) in order to increase the authorized capital of the Kapital Bank open joint-stock company. Newly-issued shares were put on sale in order to reduce the state share in the authorized capital of the bank to 50 per cent according to Decree 205 “On additional measures to deepen reforms in the financial-banking system of the Azerbaijan Republic” issued by the president of the Azerbaijan Republic. In this regard, in order to reduce the state-owned share in the authorized capital of the Kapital Bank open joint-stock company to 50 per cent, the authorized capital was doubled by issuing new shares and reached 24m manats.

Taking account of the proposals of the State Committee for the Management of State Property of the Azerbaijan Republic, the Ministry of Finance of the Azerbaijan Republic, the National Bank of the Azerbaijan Republic and consultancy companies and the requirements of the law of the Azerbaijan Republic “On banks”, the criteria and conditions of the auction in order to select the buyers who meet the economic interests of the Azerbaijan Republic were determined and signed by the three sides. In order to sell the newly-issued shares in the auction (in the form of a competition), a commission comprised of representatives of relevant government agencies and the Kapital Bank open joint-stock company was set up at the State Committee for the Management of State Property. The newly-issued shares (the nominal cost of one share was 10 manat) were split into five equal parcels with 240,000 shares in each and were offered to buyers in an auction (in the form of a competition) according to the criteria and conditions that were identified. Therefore, the nominal cost of each parcel of shares (lot) was 2,400,000 manats. The commission selected buyers in two stages. In the initial stage, the compliance of applicants with the criteria and conditions that meet the economic interests of the Azerbaijan Republic was assessed. In the subsequent stage, selection was carried out on the basis of their proposals regarding the institutional development and price of the bank. According to the results of the competition, the 50-per-cent stake in the bank was divided in the following way: Khalg Bank won two lots (20 per cent), Ata Holding won two lots (20 per cent), Azersun Holding won one lot (10 per cent). Thus, in the initial stage (this stage covers 2007), the state-owned share in the authorized capital of Kapital Bank dropped from 100 to 50 per cent. The second stage began in 2008.

In this stage, the auction, which held in the form of a competition in two stages to sell the state-owned 85 per cent of shares in the authorized capital of the Kapital Bank joint-stock company to legal persons, came to an end. The State Committee for the Management of State Property reported this yesterday. Five per cent of the state-owned shares in the authorized capital of the bank were sold to members of staff of the bank at the nominal cost and 10 per cent to physical persons who have the same rights as them. An auction was organized in the form of a competition in two stages in order to sell 85 per cent of state-owned shares in the authorized capital of the bank. Recommendations

from consultancy companies were taken into account, and on the basis of a decision adopted by the privatization commission, the structure of shareholders who own 85 per cent of the bank's shares is the following:

- Ata Holding open joint-stock company – 30 per cent;
- Pasha Holding limited liability company – 30 per cent;
- Khalg Sigorta limited liability company – 15 per cent;
- Azersun Holding limited liability company – 10 per cent.

Thus, after the privatization of Kapital Bank, the national banking system of Azerbaijan has one state-owned (the International Bank) and 44 private commercial banks. At present, foreign capital participates only in the authorized capital of 14 member banks of this system. Five of them (AccessBank, the National Bank of Iran, the National Bank of Pakistan, Nikoil Bank and Yapi Kredi Bank) are banks based on 100 per cent foreign capital.

However, even though Kapital Bank has been privatized, the banking market underwent no significant changes as these measures did not apply to the International Bank. Though Kapital Bank lost its second position on the market after this measure, state property is still dominating the banking system and the International Bank is still dominating the banking market since the policy of privatization is not sustainable in the country. Thus, according to information available on 1 July 2008, the total weight of 10 major banks in Azerbaijan accounts for 72 per cent of total assets, and the International Bank, which still belongs to the state, is playing a major role in increasing this indicator. Thus, the International Bank made more than 25 per cent of the 153,250,000 AZN made by Azerbaijani banks during the first half of this year. At the same time, the share of this bank in total assets was 39 per cent and in total deposits and credit portfolio – 62 and 42 per cent respectively. As can be seen, the dominant position of the International Bank in the main indicators that characterize the activities of the banking sector creates difficulties for the activities of other banks on this market. The concentration of a great volume of assets in the state-owned International Bank of Azerbaijan (IBA) in the banking sector of Azerbaijan and state support for this bank have a negative impact on the organization and development of free competition. Therefore, one of the most important issues for the banking system of Azerbaijan is to continue the process of privatization in this sector and privatize the International Bank which has a dominant position on the market, because the privatization of Kapital Bank proved that one of the most important factors in expanding the competitive environment on the banking market is the liberalization of the financial market through the privatization of the bank. Privatization is only a means of creating a competitive environment here. The main purpose is to improve possibilities of accessing sources of financing by applying legal rights that facilitate the allocation of credits and competition in the banking sector through the development of the credit registry. However, as a result of processes on the world financial market, Azerbaijani banks have suspended their activities aimed at crediting the economy and consumption. If we take into account that the revenues of bank and credit organizations operating in Azerbaijan form from interest rates, then this situation cannot but worry us. For example, a structural analysis of banks' revenues and expenses shows that their interest revenues exceed their interest spending, and their non-interest revenues are lower than their non-interest expenses. This also restricts the possibilities of economic entities to access sources of financing from borrowings.

Develop and implement a comprehensive programme to improve the business climate, in particular by improving the conditions for starting a business, hiring and firing workers, registering property, getting credits, protecting investments, enforcing contracts and closing a business.

In 2007-2008, the Azerbaijani government adopted a number of important decisions to improve the business climate in the country. The One Stop Shop principle was introduced from 1 January 2008 in order to expedite the process of starting a business. This made it possible to reduce the time of the registration of new businesses with government agencies to three days. As a result of this, the number of new businesses sharply increased in the first half of 2008 (according to official statements, by up to 40 per cent) in comparison with the same period of 2007. This progress was also reflected in the latest report of the World Bank “Doing Business in 2009”. The country took 64th place for the “Starting a Business” indicator in 2008, but moved up to the 13th position in the 2009 report.

In 2007-2008, the system of real estate registration was improved as well. A registry of real estate was introduced. Quite an informative website of the state agency for the registration of property was opened. Accelerated registration for an additional official fee was introduced as well. The introduction and expansion of the electronic tax payment system for legal and physical persons over the last two years also helped improve the relevant indicator in the World Bank’s “Doing Business in 2009” report.

The situation in the sphere of ensuring the implementation of agreements also improved. Azerbaijan’s new rating is 26, i.e. the situation has improved by four points.

Owing to a number of changes in the country’s labour legislation, conditions of employment and dismissal became more market-oriented. Azerbaijan’s new indicator in the World Bank’s “Doing Business in 2009” report is 15, whereas the country took 80th place in the 2008 report.

The situation surrounding the protection of investors’ rights improved as well. Azerbaijan moved from the 107th position to the 18th position in the latest report of the World Bank.

As a result of these reforms in 2007-2008, the “Doing Business in 2009” report recognized Azerbaijan as a leader in the number of reforms and ranked it first among top reformers.

At the same time, the latest surveys, conducted by such institutions as the Fraser Economic Institute, the Heritage Foundation, Transparency International, the European Bank for Reconstruction and Development, the Asian Development Bank, the International Economic Forum and national organizations such as the Foundation to Assist the Development of Entrepreneurship and Market Economy, show that the government of Azerbaijan still has to do a lot to drastically improve the business climate in the country.

During 2009 some changes were made to the **Tax Code** (a relevant law was adopted on 19 June 2009). The changes to the Tax Code were brought in line with the budget process in terms of time, editorial changes were made related to the introduction of electronic tax invoices, sanctions for failure to pay taxes in time were toughened, the maximum rate of income tax was reduced, the profit tax was reduced, the upper limit of annual income which allows physical persons to use a simplified tax system was increased, etc.

IMPROVE FUNCTIONING OF CUSTOMS

One of the main directions of the “state programme on the development of the **customs system** of the Azerbaijan Republic in 2007-2011”¹, which was endorsed by presidential decree No 1925 issued on 1 February 2007, was the improvement of the legislative base and customs regulation to enhance the work of customs. One of the directions was the adoption of a new Customs Code. Relevant work began in previous years and the new draft Customs Code which was prepared by experts from Australia, New Zealand, Canada and Turkey was presented 14 December 2006. After that, work on the project continued. A delegation of employees of the State Customs Committee, the presidential administration, the Cabinet of Ministers, the parliament and the Ministry of Justice paid training visits to Estonia and Sweden, member states of the European Union, in order to learn to use international standards and international experience in the customs sphere and exchange experience. When the draft code was prepared, the advanced norms of the Harmonized Customs Code of the European Union, as well as the experience of EU member states such as Estonia, Latvia, Lithuania and Sweden, as well as member states of the Commonwealth of Independent States such as the Russian Federation, Ukraine, Belarus and Kazakhstan in the customs sphere were used.

The Customs Code was adopted by the parliament during the spring session in 2009. The biggest change in the customs sphere in 2009 was the introduction of the “**One-Window System**”.

In order to combat corruption by state officials the State Customs Committee approved the **Code of Honour** of officials of the customs service of the Azerbaijan Republic² in 2005. In order to solve problems that emerge in relations with businessmen during import and export operations, the State Customs Committee has set up a coordinating council. However, it is difficult to assess the establishment of this council by the committee as an effective step. It would be more correct to submit this or that decision or legislative act to existing independent associations of businessmen for consideration.

The process of drawing up the Code of Honour of officials of the customs service on the basis of the Arusha Declaration has got under way. In order to study the experience of the European Union in ethics, trips and training courses were organized. However, all this has a formal nature, because old and traditional rules in organizing the activities of customs officials are still in place, and this creates difficulties in regulating relations with businessmen.

Stakeholder meetings held at business associations are not regular yet. Instead such seminars with businessmen are held by small NGOs with limited budgets, and they cover a limited territory and audience from a regional point of view.

In the sphere of transparency and access to information government agencies are making little use of more popular media that have wider audiences such as television in order to provide the public with full and regular information. NGOs’ access to TV stations is restricted for political reasons.

Brief information about tariffs is posted both on the website of the Customs Committee and the website entitled Azerbaijan and the World Trade Organization (www.wto.az).

¹ <http://www.az-customs.net/az/001-010207.htm>

² www.az-customs.net/news/az/arc/vs17-03-2006.htm

The single online corporate information network which was launched with the support of the UN Development Programme has now expanded even more. Along with that, the automated system of customs clearance and control is expanding. All this boosts the general management possibilities of the customs service. As for the implementation of customs assessment rules in line with international and EU standards, work in this sphere is very slow, which is why problems concerning transparency and corruption have yet to be solved.

Though progress has been noted in 2009 in supplying the customs service with relevant laboratories, as well as with necessary technical means in the sphere of information technology and with other operational possibilities as part of the National Strategy on Information and Communications Technologies for the Development of the Azerbaijan Republic, the electronic management system has yet to be fully adopted.

As for boosting the training of customs officials, work in this sphere has become more intensive compared to the previous period.

SUPPORT BALANCED AND SUSTAINED ECONOMIC DEVELOPMENT, WITH A PARTICULAR FOCUS ON DIVERSIFICATION OF ECONOMIC ACTIVITIES, DEVELOPMENT OF RURAL AREAS, POVERTY REDUCTION AND SOCIAL/TERRITORIAL COHESION; PROMOTE SUSTAINABLE DEVELOPMENT INCLUDING THE PROTECTION OF THE ENVIRONMENT

Pursue stable economic growth through prudent fiscal and monetary policies, with a particular focus on keeping a stable non-oil fiscal deficit and low inflation

Continue process of public finance reform to improve efficiency, accountability, transparency and predictability

The global economic crisis of 2008 and 2009 became a source of fiscal tension in Azerbaijan whose economy is primarily based on oil extraction. It can be argued that the said economic crisis has had a serious impact on the government and the private financial sector in Azerbaijan. Let us first discuss the impact on the state's financial reserves and instruments. Given that the information on the conditions and countries where the international reserves of the National Bank (NB) in foreign currency (6231.78 \$ by July 2008) are kept is protected as a state secret, it is simply impossible to assess alternatively the risks in this direction. However, the weighted average returns (not considering the exchange rates) for management of the funds of the Azerbaijani State Oil Fund (SOF) reached 3.79% in 2008, and this is 3.79% less compared to the previous year.

Under the global financial crisis, the SOF decided to minimise the volume of the assets managed by foreign managers. At present, 8% of the Fund's assets are managed by foreign managers. The Fund believes that the management of the funds by foreign managers yields no expected results due to difficulties in global financial markets. In such case, unlike the assets managed by foreign managers more returns are earned from the funds managed by the Fund itself. Hence the returns earned by the SOF from the management in 2008 made annual 3.79%, whereas the returns earned from the foreign managers were equal to annual 0%. By January 1 2009, the Fund's assets have increased by 4.3 compared to the beginning of 2008 and were approximately 9 billion manats (11.2 billion dollars). However, it is not expedient to act during a crisis, pretending the Oil

Fund has 111 billion instead of 11 billion. In other words, the transfers in the amount of more than 4.9 billion manats from the SOF to the state budget for 2009 should be limited. The income part of the state budget of the Republic of Azerbaijan for 2009 is planned to amount to 12 billion 177 million manats whereas the expenses are expected to be 12 billion 355 million manats. The dependence of the state budget on oil factor has become stronger compared to 2008. While the share of direct oil revenues in the state budget incomes was 62.4% in 2008, this figure is planned to be **65.4%** in 2009. The direct incomes from oil revenues in 2009 will amount to 7.595 million manats, and direct tax payments from oil sector will be equal to 2.680 million manats. The State Oil Fund will provide 4.915 million manats (40.4% of budget incomes). 74% (1264.5 million manats) of the total income increase of the state budget (1693 million manats) in the current year will be possible precisely through the increase of oil sector payments. At the same time, the growth of non-oil budget deficit proves the dependence of the budget on oil revenues. While the correlation of the non-oil budget deficit of the state budget to non-oil GDP was 32% in 2007, in 2009 this figure is expected to be 42.5%.

It is more than 7 times compared to the budget of 2009. It may even be said that the fiscal deficit will be one of the serious problems in the budget for next year, as the amount of 1 billion 250 million manats constitutes more than 4 percent of the gross domestic product projected for 2010.

In relation to the continuation of the state financial reform, the International rating agency Fitch Ratings has again affirmed the existing BB+ level of its rating in long-term local and foreign currencies assigned for the Republic of Azerbaijan. At present, the Republic of Azerbaijan has the following ratings: BB+ rating affirmed by the International rating agency "Fitch Ratings", Ba1 rating affirmed by the International rating agency Moody's Investors Service and BB+ rating affirmed by the International rating agency Standard&Poors.

The draft state budget of 2010, submitted by the Cabinet of Ministers, has a deficit of about 1.25 billion manats. This is seven times higher than in the 2009 state budget and causes certain concern. If the average price of oil on the world market does not exceed 45 US dollars in 2010, this will require the use of additional funds from the State Oil Fund.

Among **social security measures** taken in the past period, can be noted the "state programme on the socioeconomic development of the regions of the Azerbaijan Republic in 2009-2013" which was approved by the 14 April 2009 presidential decree is particularly of note. The programme contains a list of measures to be taken in the regions of the country in the next five years.

In practice however, few of these measures are being implemented. In the sphere of the environment, the establishment of the Ministry of Ecology and Natural Resources in the Azerbaijan Republic in 2001 seen as an important step toward managing the **environment and natural resources**, has not had sustained and impactful implementation. In particular, the activities of the Ministry of Ecology and Natural Resources were aimed not at the deepening of reforms in the sphere of environmental management, but at activities to protect the environment. As a result, the lack of effective management failed to bring about the expected results in the sphere of environmental protection.

There are still no structures and procedures that would regulate the strategic planning of environmental issues in Azerbaijan and coordinate the activities of relevant

participants in this planning. The strategic planning of environmental protection issues is carried out within the existing departments of the Ministry of Ecology and Natural Resources. This planning is prepared by government officials, and the documents are not subjected to any independent assessment or ecological examination, and public participation in the process of adopting those documents is not secured.

The administrative structures and procedures existing in Azerbaijan are not being used enough. None of the planning documents we listed has undergone an ecological examination, whereas under Azerbaijani law, an ecological examination of strategic planning documents is important and this entity is authorized to issue a ruling on the compliance of planning with the country's ecological legislation and policy.

The action plan on environmental planning in Azerbaijan was prepared in 1998, however, it has not been approved by the government yet. After the Ministry of Ecology and Natural Resources was set up in 2002, the action plan was scrapped and new priorities were identified. Though these priorities have not been officially approved, they have been posted on the website of the Ministry of Ecology and Natural Resources.

The legal foundations of ecological assessment have not been identified in Azerbaijan. No strategic assessment and ecological examination of plans and programmes, which are considered to be political documents, and legal acts are being carried out, whereas the latter is compulsory according to the law. Only the impact on the environment, planned to be financed by international financial institutions, is being assessed in Azerbaijan.

Legal procedures of issuing permits in the environmental sphere in Azerbaijan have not been determined. Relevantly, integrated permits are not being used. The law on environmental monitoring is not perfect, and there are no procedures for ensuring an integrated system of permits, their monitoring and revision.

Though the Azerbaijan Republic ratified the Aarhus Convention on 9 November 1999, it has not honored some of its obligations under the convention, including the obligation to prepare procedures regarding public participation. Since Azerbaijan's national legislation does not contain frame norms regarding public participation, the government has no authority to prepare such procedures and improve them.

The dissemination of information regarding the environment has a formal nature. The Ministry of Ecology and Natural Resources has not created lists and registries of information and submitted them to the public. Information disseminated by the Ministry of Ecology and Natural Resources is not enough to draw a conclusion about the state of the environment. The website of the Ministry of Ecology and Natural Resources is the poorest and weakest government website.

According to the law, though it is planned to create ways of recording and registering natural resources, the situation in the sphere of registration is not satisfactory. Statistical reports are not being revised and the authenticity of statistical information is not being ensured. Since there are no methods of preparing monthly, quarterly and annual reports on the state of the environment, the reports are documents that only contain a collection of figures and do not reflect the state of the environment in region in full and comprehensively.

The Azerbaijani government has no communication strategy on the benefits of an environmental policy.

No significant work has been carried out in the sphere of increasing the environmental assessment. There is no sufficient legal basis for a state ecological assessment. The current legislation is limited to frame legislation. No specific procedures have been adopted.

According to the obligations of the Johannesburg Summit, measures must be taken to prevent environmental pollution, protect human health and make rational use of natural resources. According to a decree issued by the president of the Azerbaijan Republic, work is under way to buy and install a factory recycling solid waste. However, at the same time no single strategy or other planning documents on waste management are being prepared. The Ministry of Ecology and Natural Resources has been artificially sidelined from this work. This delays the study of the experience of the integrated waste management principle and its use in Azerbaijan.

Azerbaijan has possibilities of integrated management of water resources. Pilot projects have been implemented in various years to create various links of water management, the potential has been strengthened and necessary training has been held. Only the government's political will is needed to secure the adoption of integrated management.

With the installation of module water purifying stations in territories suffering from a shortage of water, 140,000 people were provided with high quality drinking water. The implementation of this programme is continuing. A major investment project is currently being implemented in order to provide the population of Baku with high quality drinking water. In order to reduce the amount of waste water discharged into the Caspian Sea, several module water purifying stations have been installed.

Some work has been carried out to cleanse oil-polluted territories, and the government intends to carry out serious work in this sphere.

The strengthening of cooperation on issues related to the environment. Azerbaijan has approved Annex B of the Kyoto Protocol to the UN Framework Convention on Climate Change. A national strategy and an action plan have been prepared. Though projects have been prepared within the framework of the clean development mechanism, they have not been registered at the UN level. Azerbaijan participates in the Eastern European, Caucasus and Central Asia components of the EU Water Initiative. Azerbaijan participates in selected activities of the European Environment Agency, especially in the Environment for Europe process. The Azerbaijani government is not cooperating well enough with the Georgian government to prevent the pollution of trans-border waters. However, Kura (on the Georgian border) and Araz (near the Armenian-occupied territories) monitoring laboratories have been opened near the border and a system of monitoring trans-border waters has been established.

The Priorities of the State Program on Reduction of Poverty and Economic Development (SPRED), and the Continuation of the Obligations to Achieve the Millennium Development Goals

In 2009, the global financial crisis has had a negative impact on further implementation of reforms aimed at poverty reduction. According to official reports, the Azerbaijani government has reduced the poverty level in the country by 3.4 times within the last five years (*Report of the "Azadinform" Agency, December of 2009*). According to the information provided by the Ministry of Economic Development, the poverty level in the

country was 13,2% at the beginning of 2009. The Ministry informs that, as a result, this figure in 2008 has been reduced by 2,6 percent (*Ministry of Economic Development, 2009*). It should be noted that the State Program on the Reduction of Poverty and Economic Development remains in force until 2015.

Surveys carried out by the Ministry of Economy and Social Development show that the reduction of funds sent from the CIS countries, in particular from Russia, had a negative impact on the Azerbaijan's population's living standards in 2009. Thus according to the calculations made by the Russian press, the funds of approximately 3 billion USD had been sent to Azerbaijan prior to the global financial crisis, and now this figure has reduced by about 3 times (Ministry of Economy and Social Development, www.cesd.az). According to independent experts, the global financial crisis of 2009 has created difficulties for meeting the undertaken obligations on the priorities of the State Program on Reduction of Property and Economic Development (SPRED), and the continuation of the Obligations to Achieve the Millennium Development Goals. In particular, the difficulties have been observed in the improvement of the population's living standards and in decrease of the maternal and infant death rate, according to the Millennium Development Goals (www.bizimiyol.az).

Though serious laggings in this regard were not observed in 2009, the global financial crisis and oil price reduction in the world market have made significant difficulties for meeting the undertaken obligations on the priorities of the State Program on Reduction of Property and Economic Development (SPRED), and the continuation of the Obligations to Achieve the Millennium Development Goals.

To carry out the reforms in the social protection system, particularly for improving social protection arrangements and target efficiency of social assistance.

According to the Ministry of Labour and Social Protection of Population, at present about 150 thousand families receive the targeted social assistance in the country. Their number will be increased by 60,000 and reached to 160,000 next year, as a result of the increase in the minimum wage. The poverty criteria went up to 55 manats in 2009, and this constitutes 75 percent of the minimum wage (*the press-releases made by the Ministry of Labour and Social Protection of Population in the print media, as well as on www.525.az, www.olaylar.az*).

In spite of the foregoing, the reforms carried out in 2009 in the social protection system for improving social protection arrangements and target efficiency of social assistance can not be considered fully satisfactory. First, the government failed to increase the amount of poverty criteria to the level of the minimum wage in 2009. This was not a successful result from the point of view of the organization of social protection. Second, the number of negative cases in the process of granting the targeted social assistance increased further in 2009. In spite of dismissing the heads of 10 targeted social assistance centers and 40 inspectors for the past 3 years, it was impossible to strengthen the control in this field (www.azadliq.az). Third, the interruptions in granting the targeted social assistance were observed in some regions in 2009. Though the Ministry of Labour and Social Protection of Population links this not to financial problems, but to the establishment of a new system dealing with the distribution of the targeted social assistance at the ministry, granting the assistance has been suspended in the largest city of the country at the end of 2009. (www.modern.az)

Taken as a whole, the shortcomings causing irregularity and corruption in the reforms implemented in the social protection system for improving the social protection

arrangements and target efficiency of social assistance continued to exist in 2009. The interruptions and delay in some social programs for granting assistance have been observed due to the shortage of financial resources in the said sector in 2009.

Further reform efforts in the field of education to promote human resources development

In 2009, a series of reforms were implemented in the field of education in order to comply with European standards. The most important among them was the adoption of the Law on Education, following a fifteen-year-long discussion. The Law was adopted at the regular meeting of the National Assembly on July 1, 2009, and in contrast to the other readings, this time the Commission on Science and Education of the National Assembly considered some recommendations made by various institutions. The recommendations made by the Azerbaijan National Committee for European Integration (ANCEI) are among them; for instance, the removal of unnecessary details, the involvement of citizens in the educational process regardless of their political affiliation, etc. In general, the inclusion of the following progressive articles in the Law can be seen as a positive development: the independence of educational institutions from political parties, socio-political and religious organizations and movements; increasing the independence of the educational institutions; strengthening the national background and regional component of education; right to receive education in the minority languages, as well as in foreign languages, with the compulsory teaching of the Azerbaijani language, history, literature and geography; election of the head of the educational institutions for 5 years (for not more than two periods), etc. Despite this, a number of issues still remain unsolved. The main problem relates to the mechanisms for the implementation of the requirements of the Law. It requires fundamental changes in the structure, management, accreditation and assessment, form and content of the education, to enable the Azerbaijani education establishments to integrate into the European education system. According to the experts of ANCEI, it would be expedient to highlight the shortcomings in the Law at the discussion of the draft laws “On Science and State Scientific-Technical Policy”, “On Higher Education”, “On General Education” planned to be reviewed at the autumn sessions of the National Assembly. However, these draft laws have not been submitted for discussion yet.

The process of application of a new Curriculum in schools continued in 2009. The publication of new textbooks for the 2nd grade of primary schools by the Ministry of Education on the basis of anonymous examination and tender during last year can be assessed as positive development.

At the same time, corruption in secondary and higher schools is still one of the greatest issues in this field, though some headmasters have been arrested for bribery. On December 15, a horrible crime was committed in Nakhchivan. While implementing a non-governmental project of taking a poll related to corruption cases at the Nakhchivan State University, I.Nasibov and V.Zeynalov, the local NGOs activists, were attacked and beaten savagely by the vice-chancellor of the said university and other people. These events met with strong criticism from a number of local and international organizations.

Though the reforms have been implemented in some ways in the field of education, their pace and sustainability do not comply with the undertaken obligations.

FURTHER CONVERGENCE OF ECONOMIC LEGISLATION AND ADMINISTRATIVE PRACTICES

Strengthen the institutions responsible for standardization, accreditation, conformity assessment, metrology and market surveillance

The first significant innovation in this field was changing the status of the competent entity – the State Agency on Standardization, Meteorology and Patent. By decree of the President dated November 19 2008, the Agency has been reformed and granted the status of a committee. The regulations of the new entity were approved on August 31, 2009. In accordance with the regulations, a new structure has been defined. In the tourism sector, new standards have been defined this year for certification of tourist-excursion services. These standards lay new demands both before the entities engaged in tourist-excursion services and hotel and hotel-type residences. The application of these standards is of great importance, as they eliminate shortcomings in the field of tourism which is considered a potential priority sector of the country. At the same time, the rules of packaging of alcoholic beverages and foodstuffs have been improved by the new standards. The State Agency on Standardization, Meteorology and Patent has strengthened its efforts in establishing the National Accreditation System. In order to establish the normative base in this field in accordance with international standards, the appropriate departments of the Committee are conducting more intensive work.

The foundation documents of the National Accreditation System have already been developed. They are “The Accreditation system, basic provisions”, “The mark of conformity of the Accreditation system”, and “The rules on maintaining the register”. Furthermore, the application of the international standard ISO/IEK 17025 (General requirements for the competence of testing and calibration laboratories) is being planned. We would also like to state that at present, the accreditation sphere exists under the AZS National Certification System.

<http://www.azstand.gov.az>

Continue reforms in the field of public investment policy

The state investment policy has also been underlined in Law of the Republic of Azerbaijan of June 19, 2009 on making addendums and amendments to the law of the Republic of Azerbaijan entitled “On the Budget System.” These amendments reflect the specifications on development of investment programs. According to the older edition of the law, the development of the initial draft of the state investment program by the appropriate executive authority was planned only for the next year. In the new edition, plans for the state investment program for next year and the following three years have been approved. Prediction-making for the following three years can be assessed as positive change. The other tendency in the changes is the inclusion of a new article in the law in relation to the execution of investment programs and project approval procedures. According to the new article, the execution of the projects shall be reviewed each year by December 25. The distribution of state investment expenditures for the coming year shall be implemented by the appropriate executive authority no later than the end of January of that year, taking into account the projects that are planned to be executed in the coming year. Such amendment made to the law in some way could positively direct the assessment of the execution of the state investments and planning them for next year.

Thus the information on the execution of state investment projects of the previous year will assist in defining the projects planned for next year in a short period of time, and to an extent, this could deal with the cases of uncompleted projects. On the other hand, this amendment directly grants power to the Cabinet of Ministers to distribute the state investment expenditures of the following year. In the past, this power was issued not by the law, but the decree of the President on budget execution.

It should be stated that the amendments made to the “On budget system” law in relation to state investments cannot be considered a fundamental improvement of the normative-legal base of state investments and legal reforms in this field, since the law does not reflect the legal base of the questions on development, assessment, execution, management and accounting the state investment projects, as before.

At the same time, in accordance with sub-item 7.2 of decree of the President of the Republic of Azerbaijan on the application of the law of the Republic of Azerbaijan “On the Budget of 2009”, the Ministry of Economic Development has been obliged to develop the “rules on development, execution, monitoring and assessment of the State Investment Program” by examining the international practices together with the concerned state authorities.

Pursuant to the said instruction, the ministry has developed the “rules on development, execution, monitoring and assessment of the State Investment Program” by taking into account the international practices together with the USAID’s Public Expenditures Reform Support Project and submitted them to the state authorities accordingly.

(<http://economy.gov.az>)

STRENGTHENING EU-AZERBAIJAN ENERGY BILATERAL COOPERATION AND ENERGY AND TRANSPORT REGIONAL COOPERATION, IN ORDER TO ACHIEVE THE OBJECTIVES OF THE NOVEMBER 2004 BAKU MINISTERIAL CONFERENCES

2009 appeared to be difficult in terms of future supply of Azerbaijani natural gas to the European market. Most difficult of all was to reach an agreement with Turkey. Fourteen rounds of negotiations have been carried on between “Botash” and SOCAR on issues of “package” price decisions and volume of supply. However, despite repeated optimistic statements of the Turkish leadership we have so far failed to reach any agreement. Consequently, Azerbaijan’s joining “Nabucco” project becomes a question mark, as well as future supply of Azerbaijani natural gas to the European market.

Although in the summer 2009 the relevant intergovernmental agreements were signed, construction of “Nabucco” gas pipeline remains questionable for a variety of reasons. Resource base of future gas pipeline is obscure. In addition, completion in Turkmenistan of two gas pipelines construction at once – to China and Iran, as well as recent agreements achieved with Russia to supply annually 30 bln. cubic metres of Turkmenistan gas make virtually hopeless participation of Turkmenistan in “Nabucco” project. Secondly, despite high price of the project Russian “South Stream” has great prospects for realization and primarily owing to strong resource base. Thirdly, Russia’s positions have been strengthened because leading European countries are not enthusiastic towards “Nabucco” project. This gives Russia both political support and extra advantages while taking funds from Western financial market. Moreover, in 2009 “Nabucco” was excluded from the EU list of priority projects and removed into the list of so-called “Southern Gas Corridor” projects. In the fourth place, Russia and Turkey improved their

relations last year and are currently at the stage of dynamically growing economic co-operation and “traverse” to “Nabucco” Russian-Turkish projects (“Blue Stream -2”, Samsun- Ceyhan oil pipeline) create additional problems for this European project. Finally, uncertainties over Iran makes improbable pumping of Iranian natural gas to Europe. The only slight chance here is the statement of this country’s Minister of Energy that notwithstanding all political realities it opens transit through the country for Iranian natural gas.

In such ambiguous situation and problem with Turkey, Azerbaijan was seeking for other options. In November Gazprom signed a Contract with SOCAR, stipulating to supply from 2010 - 500 million cubic meters of gas to Russia and in December a decision was made to increase these supplies up to 1 billion cubic meters per annum. Another 500 million cubic meters of natural gas will be sold to Iran in 2010. In both cases, we are talking about SOCAR’s own gas supplies. And, since the question of future natural gas supplies from the second phase of Shah Deniz field is left open so far, these agreements can be considered as pilot projects. Meanwhile, Azerbaijan is playing for time, seeking for options and securing itself.

Search for new routes to transfer Azerbaijani natural gas to Europe has continued though it was rather panic borne. In 2009 there were rumours about on possibility to realize quite hypothetical project “white stream”, initiated by Ukraine. In autumn president of Azerbaijan paid a visit to Romania with whom a preliminary agreement is reached to supply to this country liquefied natural gas in the volume of 1 billion cubic meters per annum.

There were few changes, if any in 2009 in the institutional sphere of fuel and energy sector in Azerbaijan. And those changes that did take place testified primarily about strengthening of the role of State sector in FEC. The government does not disguise its intentions to turn SOCAR to a huge vertical-integrated concern. An important event was liquidation of “Azerigas” CJSC and its inclusion into SOCAR system. It was an incontrovertible decision, though quality of work of “Azerigas” in recent years was inevitably leading to either of these decisions: this CJSC had to be either privatized or included into SOCAR composition. In order to strengthen SOCAR the choice was made in favour of the latter. In previous years the government had repeatedly stated “Azerigas” distribution network would be privatized and that would be natural in the circumstances of world trends to reduce state sector share in FEC. Current decision is arguable more because SOCAR itself gladly took advantage of opportunity of Georgia’s FEC privatization and took control over private gas distribution networks in this country. At the same time, SOCAR starts actively construct its own petrol filling stations in Azerbaijan, although formerly the entire sector of petrol sale had been denationalized and separated from wholesale dealer. Another energy monopolist – “Azenergy” had actually restored control over the country’s power grid (though, nominally Baku power grid is still under the Ministry of Economic Development). Some five years ago, those grids had been given for private administration. Renunciation of reformation of sector is multi-directional and will be gaining strength.

Serious legislative shifts in FEC sphere have not been observed. And neither a law “On oil” was adopted nor legislative frameworks for functioning of Oil fund of the country have appeared. As a result, in 2010 91% of SOCAR revenues will have been allocated to budget expenditures, while next year’s budget on expenditures will remain at the level of

real budget of 2009. The only innovation in FEC sphere has become an introduction of special tax treatment for service companies, being involved in the activity in Azerbaijan, including the foreign ones while they work outside the country. In 2009, the president signed two important documents, addressed to develop alternative electric-power industry and energy conservation/ energy efficiency. Pursuant to the first decree, a State agency is being established in the country on alternative energy and it will be functioning under the Ministry of Energy and Industry. The second document regulates relations between power and gas consumers and the producers. European Union Twinning programme aimed at harmonization of the legislative acts of Azerbaijan and EU has been working very slowly.

Starting from 2009 share of government in lucrative oil of consortium comprised 80%. If we add here SOCAR's own oil, then the government possessed huge volumes of oil. It also got chance to vary those volumes in connection with changes of current state of the market. Total output of oil and gas in SOCAR itself has dropped for 11 months of 2009 by 1, 5% and 11, 4%, respectively and investments to oil production have been diminished by 27%. However, increase by 17% of AIOC oil production (up to 38 mln. of tons) and by 12% of gas (up to 9,1 billion cubic metres) enabled to improve (amend) the situation. All SOCAR external projects have been successfully developed. It even got direct credit support of Central bank of the country for external projects (750 mln. dollars), although it announced earlier that it will attract funds from international markets of capital. The nature of non-economic activity of SOCAR has become more systematic. The company aims at working down the chain – from production and transportation and up to processing and sales. Precisely with this purpose it has expanded its activity in Georgia, it is going to purchase as pilot 30 refuelling station in Ukraine and is continuing negotiations with a range of European countries.

In the sphere of electric-power industry the government continued the policy of building up of energy systems capacities. Total capacity of energy system has already comprised 6400 megawatt at peak electric energy consumption of 4500-4800 megawatt. Thus, for the past 5 years 9 electric power stations were put into operation in Azerbaijan and up to the year 2013 it is planned to construct 2 more thermal power plants and 2 hydroelectric power stations, including huge station "Janub". In the past few years energy production is dropping annually by around 10%, which is explained by recession in demand. This somehow paradoxical situation is explained in the government by necessity to have capacity reserve, by preparation of power system to the predicted industrial growth and export of electric power outside the country. However, most likely large-scale construction of new stations has become part of infrastructural boom in the country in order to support GDP growth and working places. Electric power export from the country (including electricity exchange) looks so far problematic for the range of the reasons, including, due to non-preparedness of infrastructure and high cost effectiveness of the energy produced.

Excessive production of electric power will hamper the growth of energy-effectiveness of economy and the programme for energy saving. Consumption of electric power and gas per capita, as well as ratio of energy expenditures to GDP was ranking as the highest in the region. Development of alternative electric-power industry creates additional problems for "Azenergy" and the company will use all efforts to block such projects, for instance, with the help of restricted access to the integrated public network (grid). This year the Azerbaijani government for the first time ever receives direct grant support of 13

million dollars for the country's budget, which will predominantly be drawn by Ministry of Industry and Energy to technically support the reforms in the sector and tackling of a range of institutional issues.

Constantly changing conditions at oil and gas market have significantly impacted the development of the "eastern corridor" energy carriers – from Central Asia through South Caucasus to Turkey and Europe. As one of examples to this, one can name the decision to fill being designed Samsun-Jeyhan pipeline with Russian, Kazakhstan and Turkmen oil. Azerbaijan has good business relations with Kazakhstan. Joint project on development of transport corridor for Kazakhstan oil is in progress. One more guarantee for energy security of Europe on oil and petroleum products supply can be Kazakhstan's intention to construct one more pipeline, parallel to Baku-Supsa in order to pump growing volumes of Kazakhstan gas. Azerbaijan has no objections to construction of pipeline at its territory. The issue is being discussed in details by Kazakhstan government and decision will soon be declared.

More complicated situation is with Turkmenistan. Despite all USA and EU efforts it is ready to diversify the routes on all the directions, except for European one. Moreover, late 2009 Azerbaijan's relations with Turkmenistan became again aggravated. The latter seized to International Court of arbitration for arguable, from its standpoint, fields, including part of Azeri-Chirag-Guneshli fields. It is clear, that this action will not be successful, but this removes further the prospect for pumping of Turkmenistan gas in western direction. It worth to notice that Russia expressed its readiness to return to construction of Pre-Caspian gas pipeline, which is important for Turkmenistan, if the latter refuses to participate in "eastern corridor".

4. Jobs on transport communications were slacking – due to world economic and constant political perturbations in the region. Particularly, Kars-Akhalkalaky railway, a strategic by its priority, has been constructed very slowly, although it was many times declared that it is a natural extension of pipeline communications, leading to Turkey. Some analysts are certain there might be political motives, as well that are connected with probable opening of Gumri-Kars road. Construction data at intricate Turkish road section is very scarce. At Georgian road section, at 29 km only 4-5 have been constructed, not because of lack of crediting but owing to technical problems, that have been arisen by Georgian side. Nevertheless, there is no any rush here, since for fully functioning of BTC one has to bring in order the entire section of railroad from Baku to Akhalkalaky. Azerbaijan has recently signed an agreement with the World bank, that will allocate 450 million dollars for up-dating of the railroad. Traffic volumes through the TRACEKA corridor have been reduced by 27% last year. This actualizes the issue of bringing in order in the soonest possible time Baku- border of Georgia route, where only some sections are to be constructed. It is not yet possible to download in full volume the transport corridor form Central Asia to Europe through South Caucasus because of notable disagreement between the countries-partners on tariffs and procedures of customs that failed to be unified in 2009.

STRENGTHEN REGIONAL COOPERATION

The Russia-Georgia war in 2008 made significant adjustments to the practice of regional cooperation in the South Caucasus, destroying the status quo that prevailed here for years both in "frozen" conflicts and in the degree of the influence of outside powers. First of

all, this was reflected in increased foreign policy activity by Turkey, which not only invited the South Caucasus and Russia to the Caucasus platform to promote stability and cooperation in the region, but also entered into rather fruitful talks with Armenia to normalize bilateral relations. Almost in a year, the policy of regional cooperation underwent drastic changes that may contribute to the comprehensive integration of the South Caucasus and to the settlement of the Nagorno-Karabakh conflict.

In accordance with the logic of this policy, Turkey's Foreign Minister Ahmet Davutoglu said that "joint efforts with the OSCE Minsk Group may result not only in the opening of the Turkish-Armenian border, but the border between Azerbaijan and Armenia", specifying that the matter depends on Armenia's withdrawal from the occupied territories of Azerbaijan. The Armenian side, represented by its Foreign Minister Edward Nalbandian, hastened to deny the report, noting that "the attempt to link the process of normalizing Armenian-Turkish relations and the Karabakh conflict resolution might fail both the first and second one", while "the protocols on the establishment of Armenian-Turkish diplomatic relations and the development of bilateral relations", initialed on 31 August, do not contain a mention of the Nagorno-Karabakh conflict. Azerbaijani President Ilham Aliyev and Foreign Minister Elmar Mammadyarov said that "the opening of the Armenian-Turkish border without the Armenian-Azerbaijani Nagorno-Karabakh issue being settled is contrary to the national interests of Azerbaijan". These statements seem to be explained by the fact that after the war in Georgia, Armenia actually lost its last land connection to Russia, which may promote the formation of a realistic approach to resolving the conflict with Azerbaijan.

With regard to the current regional cooperation, as we know, the South Caucasus countries jointly participate in various international and European programmes aimed at removing the old and new socio-economic risks and challenges. One programme, aimed at fighting the spread and use of drugs in the South Caucasus (SCAD), is being implemented by the UN and the European Union. Currently, a "drug control programme in the South Caucasus" is being implemented, within the framework of which training courses entitled "Methods of treating and rehabilitating drug users" were held in July.

Another example of regional cooperation is the work of the Environmental Resource Centre for the South Caucasus. On 3 August 2009, Tbilisi hosted a regional presentation meeting of the project "Promotion of policies and practices of managing community forests in the mountainous regions of the Caucasus". The event was aimed at presenting the goals and stages of project implementation, as well as at drawing the attention of government agencies and civil society to the problem of community forestry. The meeting was attended by representatives of the Ministries of Environment and Natural Resources and Agriculture, relevant national forest agencies, NGOs from the South Caucasus, the media, as well as international organizations, RECs and the European Commission. The 7th meeting of the stakeholders' committee on issues of clean fuel and automobile transport was held in July at the Aarhus Centre (Tbilisi). This committee was set up within the framework of the project "Clean fuel and road transport in the EECCA countries" by the Caucasus REC.

Other examples of regional cooperation are: the EU project "The second phase of the trans-border management of the Kura river basin - Armenia, Georgia and Azerbaijan", the GTZ project "Rehabilitation of degraded landscapes" and "Sustainable land management to reduce soil degradation and poverty in the South Caucasus" which is

being implemented by the Caucasus REC in partnership with CENN with financial assistance from the European Union (EU).

Since January 2009, the Caucasus Regional Environmental Centre has been managed by a new executive body. The collective troika includes the executive director - Malak Shukurova (a representative of the Azerbaijan Republic) and two deputy executive directors - Georgi Arzumanyan (a representative of the Republic of Armenia) and Sofiko Akhobadze (a representative of Georgia). On the basis of consensus, the troika carries out ongoing management of the REC Caucasus in accordance with the policies and guidelines approved by the board, as well as in constant communication with the founders.

The post of executive director shall rotate annually among the members of the troika. Representatives of the European Union noted “the unique importance of the organization and the clear position of the EU regarding support for the Caucasus REC” (www.rec-caucasus.org). They also emphasize the role of the governments of the founder countries for their support for the Caucasus REC.

Thus, it can be noted that regional cooperation is gaining momentum, and in some areas, we can see first steps towards the integration of the South Caucasus. Further progress in this direction will undoubtedly be linked with the new programme of the European Union aimed at the association of the South Caucasus with this representative structure.