

Informal Politics in Azerbaijan: Corruption and Rent-Seeking Patterns

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Abstract

In Azerbaijan, post-Soviet clientelist networks, united under the rule of the president's family, largely determine the patterns of corruption and rent-seeking. This article sheds light on how these networks operate.

Introduction

International indexes list Azerbaijan as one of the most corrupt countries in the world. The 2010 Transparency International Corruption Perceptions Index ranks the country 134 out of the 178 states that it tracks. The fact that Azerbaijan shares this ranking with countries like Nigeria, Sierra Leone, Zimbabwe and Togo demonstrates the extremely high level of corruption even more clearly. However, the index is based on perceptions and therefore does not say anything about the underlying corruption and rent-seeking patterns.

This article sheds light on the corruption structures and practises officials frequently employ. Section one surveys the informal structure of the political system. The pyramid of the various clientelist networks, united under the president's family, defines the patterns of corruption and rent-seeking. Considering this, the subsequent sections draw a distinction between corruption in general terms and corruption related specifically to the country's oil abundance. In this regard, section two analyses to what extent the ruling regime benefits from the sale of public posts and money illegally demanded from the population in exchange for public services. Section three sheds light on how members of the ruling elite systematically misuse their public positions to siphon off oil and gas revenues. This particular form of corruption (related to resource incomes) is generally characterized as "rent-seeking". Since oil revenues are more or less transparent, this corruption takes place indirectly by embezzling public investments carried out through the state budget, the state oil fund ("SOFAR") and the state oil company ("SOCAR").

Post-Soviet Clientelism and Corruption

It is distinctive for peripheral Soviet successor states that clientelist networks, tracing back to Soviet and pre-Soviet rule, exert a controlling power over the formal political order. These clientelist networks are the basis for the distribution of political and economic power. At the same time they determine the patterns of corruption and rent-seeking.

Clientelism is a mutual relationship between a person or group of persons higher ranked in the societal or political order and an entourage seeking protection and particular advantages. In the Soviet Union, high-ranked mem-

bers of the Nomenklatura privatized official positions and material goods in order to hand them down to their clientele in exchange for loyalty. As a result, politics—the distribution of power in practical terms—no longer involved society as a whole but focused on promoting the specific interests of a personal network. These informal networks had a pyramid structure because subordinates set up their own clientelistic networks at lower levels.

This system is characteristic of Azerbaijan. When Moscow appointed Heydar Aliyev as Secretary General of the Communist Party of Azerbaijan in 1969, his mission was to break the influence of clientelist networks in politics and administration. In fact, Aliyev immediately began to purge the party and administrative apparatus, removing 80 percent of the staff. Nevertheless, he similarly recruited new people according to local and personal criteria. Apart from his KGB colleagues, he mainly drew on relatives and friends from his home region Nakhchivan and Armenia, where his parents resided. By doing so, Aliyev became the unchallenged head of a patronage network that pervaded the entire republic. As he incorporated elements of the traditional networks from both regions, the so-called Nakhchivan-clan and the Yeraz-clan ("Yeraz" stands for "Yerevan Azerbaijanis") also gained political influence. It is disputed to what extent these groupings can be described as clans in the proper meaning of the word, since they do not share traditional common roots. They are rather patronage networks that are not deeply tied by cultural traditions.

Aliyev had come to office as a reformer. However, in the national press that enjoyed more liberties than before, Aliyev soon became a synonym for corruption and the abuse of power. The rule of clientelist networks in combination with the republic's oil abundance gave Azerbaijan one of the highest corruption rankings in the Soviet Union.

When Aliyev regained political power in 1993 as president, the old networks, among them the Nakhchivan-clan and the Yeraz-clan, expanded their monopoly power over the entire economy, including the oil sector and the financial system. In some cases, the extent of this power was apparent, as when Heydar Aliyev appointed his son Ilham as vice president of SOCAR. Since SOCAR is the key player in the Azerbaijani oil sector and the position of vice president is the most influential one within the

company, through this appointment, the Aliyev family secured its control over state oil policy. The family gained additional influence from the privatization process in general and the granting of licences in the course of building up the national oil sector and the associated transport system in particular. The low rates of economic diversification inherited from Soviet times and the state control over the economy proved advantageous to the clientelist exertion of influence.

In the following years the Aliyev family succeeded in preserving its dominance, thanks to Heydar Aliyev's assertiveness. Since his death in 2003, competition between the clientelist networks has increased, although the Aliyev family still controls the informal system. While the new president Ilham Aliyev weakened the position of the Yeraz-clan, the Aliyev family is now competing with the Baku-rooted Pashayev family of the president's wife. However, these competitions are never strong enough to lead to open struggles. The ruling clientelist networks are rather united by their common interest to preserve access to oil rents by authoritarian means of rule.

Figuring out how members of the ruling elite control the economy is complicated by the fact that companies are not listed publicly, making it nearly impossible to prove ownership. Moreover, the companies are often officially owned by people other than the elites themselves, but working in the elite's interests. Overall, the division of the national economy reflects the informal political power structure to a high degree. In this way, economic and political cooperation and rivalries are mutually dependent. Political Scientist Samuel Lusac points out that the political weakening of the Yeraz-clan had first and foremost an economic component. When Rafiq Aliyev, a key figure of the Yeraz-clan, owned AzPetrol Holding, he had a dominant position within the Azerbaijani oil transportation network. In October 2005, Rafiq and his brother Farhad, who was then Minister of Economic Development, were arrested for allegedly preparing a coup attempt against Ilham Aliyev. In December 2005, the Azerbaijani Economic Court transferred the property of AzPetrol Holding to Ibrahim Mammadov, who is a leading figure of the Kurdish-clan. Another leading figure of the Yeraz-Klan, Rasul Guliyev, controlled refineries in Baku and oversaw the refining and transport of Turkmen oil flows. He was forced into exile in 1996, allegedly for having ambitions to seize power.

Regarding the other clientelist networks, the Pashayev family possesses a huge economic empire. Pashayev-Holding is engaged in a wide range of business activities; first of all in the construction sector (Pashayev-Inshaat) and the banking sector (Pasha Bank), but also in the insurance industry and the tourism sector. As for the Aliyev family, Heydar Aliyev's brother Jalal is a key player.

He not only has an influential position within the ruling YAP, but manages an extensive business grouping. For example, he possesses a majority share of the mobile telephone network Azercell. Consequently, he is regarded as one of the most powerful persons in the country. Another key role is regularly attributed to Kamalladdin Haydarov, Minister of Emergency Situations. He is a close friend of Ilham Aliyev and one of the richest oligarchs in the country, not least due to his control over the cash flows of the tax authorities and the customs service.

General Corruption (Outside the Oil Sector)

To ensure a steady source of income, the ruling regime draws on corrupt networks pervading the state and society since Soviet times. As a result, the population is regularly confronted with systemic corruption. Therefore it is not surprising that corruption is generally perceived as something extremely centralized, although notions about who exactly is leading the corruption system vary. It is also unclear, whether all the money accrues to one or a few individuals and whether a share of the money is redistributed (for example, to Nakhchivan). Despite disagreement over the ultimate beneficiaries, there is general agreement about the nature of the system itself. As a member of a Western embassy in Baku told the author, it is most likely that sources of income open up at the lowest levels of the pyramid even though these are not directly controlled by someone at the top. The money then flows upward.

It is generally acknowledged that a significant share of the money originates from the illegal sale of official posts in the administration, the army, the education system, and numerous other bureaucracies. This specific corruption pattern had already been practised in Soviet times. The going rate is determined by an informal price list and varies depending on the rank within the pyramid, going up to several hundred thousand dollars. As Lala Shevket, leader of the Liberal Party of Azerbaijan pointed out, it is only possible to purchase posts at lower stages. The balance of power at the top is not put at risk by what happens at the lower levels.

The purchaser acquires the opportunity to recoup his or her investment and more by demanding illegal sums of money from the population in exchange for public goods. Such bribes have one of two purposes. Either people pay money in order to get their matters arranged more quickly and more effectively, or to gain material advantages at the expense of others. Among the population, a vast number of experiential reports circulate on how officials ask for money, leading to public cynicism. For example, it is widely believed that a portion of the money regularly collected from parents by teachers is passed to the respective school director. From there,

portions of the money are said to flow further upwards, finally accruing to the minister of education and from there to the president and his family. However, there is little evidence to trace the exact money flows. According to an Azerbaijani journalist, it might be possible that this notion just refers back to the arguments of officials, who use it to legitimize their material demands. However, an Azerbaijani businessman working in the construction sector confirmed that each entrepreneur needs a protector within the pyramid of power who receives a share of the profits. Other examples point to taxmen and customs officers collecting money, shares of which are then passed further upwards.

Rent-Seeking in the Oil Sector

In Azerbaijan, rent-seeking is embedded in the broader context, since members of the ruling elite accumulate oil money in different ways. Very often, there is only a blurry line between legal and illegal actions. On the one hand, the country's oil executives are profit-seeking capitalist entrepreneurs. On the other hand, they benefit from different forms of corruption. A illustrative example is an illegal business transaction that took place in the late nineties. According to Lussac, the key players were three top managers of SOCAR, the Georgian Oil Company and the "Azersun Holding," a company owned by a close friend of Heydar Aliyev. Under this scheme, out of 100,000 barrels of oil, which were processed in a Baku refinery, only 60,000 barrels were declared. The remaining 40,000 barrels were shipped and sold illegally in Armenia and Georgia.

However, such enrichment strategies only take place on an occasional basis. What is more important is that members of the ruling elite systematically misuse their public positions to siphon off oil and gas revenues. The way this takes place in Azerbaijan is an open secret among government representatives, local financial experts, Western diplomats and businessmen. Two features are characteristic for the country context. First, since oil revenues are more or less transparent, rent-seeking takes place indirectly, by embezzling public investments carried out through the state budget, the state oil fund and SOCAR. Second, the construction sector plays an important role.

The fact that oil revenues are more or less transparent is due to the regime's interest in promoting the country as a reliable supplier on the world market in order to attract more investment and maximise profits. At the international level, Ilham Aliyev claims that he is firmly committed to a transparent and accountable utilization of Azerbaijan's oil wealth to the benefit of the entire population. Accordingly, Azerbaijan plays a prominent role in the Extractive Industries Transparency Initiative (EITI). The country is not only one of the EITI pioneers, but

also the pilot country since it was the first to meet all of EITI's formal criteria. However, as independent experts and civil society representatives united in the Baku-based EITI-coalition complained to the author, the government is misusing the EITI in order to improve its image to strengthen their power and to maximise their profits, while pursuing their rent-seeking interests unrestrictedly on the expenditure side through public investments.

To siphon off public finances, members of the ruling elite regularly accept tenders from construction companies that are more or less directly associated with them. Such companies are often founded just for that reason during the tender process. The companies then embezzle a huge portion of the public finances assigned to them. In this regard, rent-seeking practices follow a simple pattern that varies only in small details. First, significant sums of money are transferred to the company. Second, the respective companies save money by producing poor quality-work. As Himayat Rizvangizi, chair of the Baku based NGO "Himayadar" noted, the booty is then divided up between the participating actors, drawing on cash payments and dubious bank transfer mechanisms in the process. Since expenditures are hardly transparent, little is publically known about the exact corruption rates, which in general depend on the situation and the actors engaged. Regarding the rent-seeking structure, Zhorab Ismayil, chair of the Baku-based "Free Economic Center" and member of the EITI-Coalition, identifies three crucial sites, in particular the state budget, the projects implemented by the SOFAR, and the company expenditures of SOCAR.

With regard to the state budget, rent-seeking is not limited to public construction projects, but it is definitely centred there. There are several reasons for this. On the one hand, it is an easy and lucrative form of siphoning money. According to Azerbaijani financial experts, 40 percent of the over 13 billion U.S. dollar state budget of 2009 was spent on public investment projects. On the other hand, various ministries benefit from the high allocations, since they all run their own construction projects. As an Azerbaijani journalist noted, in this regard, the ministers run their ministry like absolute autonomous landlords. For example, Hamish Macdonald revealed in a report broadcast on Al Jazeera in 2008 that the construction of the 80 million dollar five-storey complex of the Baku international bus station was carried out by "Baku 21st Century", a company that apparently belongs to the Transport Minister. The same is true for AzVirt, a company that was contracted to build a 14-kilometer road from the city of Baku to the airport. Aside from the question of necessity—a new motorway to the airport had just been finished—the construction cost 23 million U.S. dollars for every kilometer, well above comparable

international prices. The government justifies these high costs with compensation payments to residents, who had to be relocated. However, the budgets do not reflect this. In contrast to this, the construction of a 22 kilometer stretch of motorway south of Baku that was funded by the Worldbank cost 1.5 million U.S. dollars per kilometer.

SOFAR was awarded the United Nations Public Service Award in the “Improving Transparency, Accountability and Responsiveness” Public Service Category in June 2007 in Vienna. However, while the revenues and expenditures of SOFAR are indeed subject to a maximum of transparency, the same does not hold true for the management of SOFAR financed projects carried out by contractors. In a report on the use of SOFAR funds to improve the living conditions of refugees, the Azerbaijani journalist Hijran Hamidova revealed precise details on how and to what extent contracted construction companies saved money through poor quality work and how they exceeded costs. In addition, the author published fixed corruption rates which varied according to the contractor and subcontractor, as well as to the project stage. She further stated that the legal and fiscal authorities were also engaged in the embezzlement of assigned funds, since they asked for bribes to remain quiet about irregularities uncovered during inspections. Summing up, the journalist determined that almost half of the allocations from SOFAR were used for corrupt purposes.

Rent-seeking practises at SOCAR have not yet been investigated to the same extent. Notwithstanding, several local NGOs have gained information based on informants within the company. Zhorab Ismayil claimed that the numerous social construction projects carried out by SOCAR itself provide an opportunity for rent-seeking. This is affirmed by Mirvari Gahramanli. “In some cases, the construction costs are too high, while other projects exist only on paper”. Both experts further stated

that there is evidence that rent-seeking also takes place in acquisitions. In this regard, overpriced materials and products are regularly purchased from persons and companies that are close to the management. In other cases, quantities were ordered that far exceeded the need. This took place both with large scale purchases (pipeline facilities) and small (soap). According to Zhorab Ismayil, the money is accumulated by persons in key positions within SOCAR and redirected upwards. In contrast, the ties between SOCAR and multinational companies have been kept free from corruption, most likely in order not to damage the company’s international reputation. According to Lussac, in the nineties, Heydar Aliyev even fired a high-ranked manager (Marat Manafov) who had asked foreign companies for a bribe of between 50 and 360 million dollars for his team and him.

Conclusion

As in other peripheral Soviet successor states, clientelist networks dating back to Soviet and pre-Soviet rule control the formal political order of Azerbaijan and its entire economy. These networks also determine the patterns of corruption and rent-seeking. Such practises are, however, embedded in a broader context, since members of the ruling elite accumulate money in different ways. Frequently, there is little distinction between legal and illegal actions. Much of the public sector is corrupt, as demonstrated by the sale of public posts and the illegal demands for money from the population in exchange for public services. Members of the ruling elite are rent-seeking, since they systematically misuse their public positions to siphon off oil and gas revenues. Since oil revenues are more or less transparent, such corruption takes place indirectly when officials embezzle public investments carried out through the state budget, the state oil fund (SOFAR) and the state oil company (SOCAR).

About the Author

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Related Internet Links

- Public Finance Monitoring Center: <http://www.pfmc.az/>.
- Oil Workers’ Rights Protection Organization: http://www.nhmt-az.org/ts_general/eng/index.php.
- Samuel Lussac (2010): The State as a (Oil) Company? The Political Economy of Azerbaijan, in: garnet-eu.org, http://www.garnet-eu.org/fileadmin/documents/working_papers/7410.pdf.