



Azerbaijan: Recent Developments and U.S. Interests

Jim Nichol

Specialist in Russian and Eurasian Affairs

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Summary

This report discusses political, economic, and security challenges facing Azerbaijan, including the unsettled conflict in the breakaway Nagorno Karabakh region. A table provides basic facts and biographical information. Related products include CRS Report RL33453, *Armenia, Azerbaijan, and Georgia: Political Developments and Implications for U.S. Interests*, by Jim Nichol.

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U.S. Relations

In testimony in June 2009, Assistant Secretary of State Philip Gordon stated that “Azerbaijan is an important partner of the United States on regional security (especially counterterrorism) and on helping our European allies diversify their supplies of natural gas.” He also stressed that the Administration was actively encouraging a settlement of the NK conflict.¹ The Administration’s *Congressional Budget Justification for Foreign Operations* states that Azerbaijan “has the potential to serve as a powerful regional model of reform and prosperity,” because it is a “secular, pro-Western, majority Muslim state with significant energy resources.” However, democracy and human rights conditions have “worsened,” according to the Administration.²

Cumulative U.S. aid budgeted for Azerbaijan from FY1992 through FY2007 was \$752.2 million (FREEDOM Support Act and agency funds). Almost one-half of the aid was humanitarian, and another one-fifth supported democratic reforms. Budgeted aid to Azerbaijan was \$26.8 million in FY2008 and an estimated \$24.9 million in FY2009, and the Administration requested \$30.135 million for FY2010 (the numbers for FY2008, FY2009, and FY2010 include FREEDOM Support Act and other foreign aid and exclude Defense and Energy Department funds). The Administration plans to focus in FY2010 on assistance to enhance judicial independence, help non-governmental organizations and political parties to represent citizens, strengthen legal defense, and improve election monitoring and administration. Another major aid priority will be strengthening the interoperability of Azerbaijani military forces with U.S. coalition forces in Afghanistan and with NATO, bolstering maritime security in the Caspian Sea, and improving airspace management. The Administration also has requested a substantial boost in assistance for the Organization for Security and Cooperation in Europe for conflict mitigation and reconciliation efforts in the Eurasia Region, from \$9.5 million in FY2009 to \$23.4 million in FY2010, some portion of which is planned to foster settlement of the NK conflict.³

Since FY2004, Azerbaijan has been designated as a candidate country for enhanced U.S. development aid from the Millennium Challenge Corporation, but it has not been selected as eligible for aid because of low scores on measures of political rights, civil liberties, control of corruption, government effectiveness, the rule of law, accountability, and various social indicators.

¹ U.S. House of Representatives. Committee on Foreign Affairs. Subcommittee on Europe. Hearing on Strengthening the Transatlantic Alliance: An Overview of the Obama Administration’s Policies in Europe. *Statement by Philip H. Gordon, Assistant Secretary of State*, June 16, 2009.

² U.S. Department of State. *Congressional Budget Justification for Foreign Operations, FY2009*, May 12, 2009.

³ *Congressional Budget Justification for Foreign Operations, FY2009*.

Figure 1. Azerbaijan



Source: Map Resources. Adapted by CRS.

Table I. Basic Facts

Congressional concerns about the ongoing NK conflict led in 1992 to Section 907 of the FREEDOM Support Act (P.L. 102-511) that prohibited most U.S. government-to-government assistance to Azerbaijan until the President determined that Azerbaijan had made “demonstrable steps to cease all blockades and other offensive uses of force against Armenia and Nagorno-Karabakh.” Congress eased many Section 907 restrictions on a year-by-year basis until the terrorist attacks on the United States in September 2001, after which it approved an annually-renewable presidential waiver (P.L. 107-115). The conference managers stated that the waiver was conditional on Azerbaijan’s cooperation with the United States in combating terrorism and directed that aid provided under the waiver not undermine the peace process. Congress has called for equal funding each year for Foreign Military Financing and International Military Education and Training for Armenia and Azerbaijan. Other congressional initiatives have included the creation of a South Caucasus funding category in FY1998 to encourage an NK peace settlement, provide for reconstruction, and facilitate regional economic integration. Congress also has called for humanitarian aid to NK, which has amounted to \$30.8 million from FY1998 through FY2008. Congress passed “The Silk Road Strategy Act” in FY2000 (as part of consolidated appropriations, P.L. 106-113) calling for enhanced policy and aid to support conflict amelioration, humanitarian needs, democracy, economic development, transport and communications, and border controls in the South Caucasus and Central Asia.

Area and Population: Land area is 33,774 sq. mi.; about the size of Maine. The population is 8.24 million (*The World Factbook*; mid-2009 est.). Administrative subdivisions include the Nakhichevan Autonomous Republic (NAR) and the Nagorno (“Mountainous”) Karabakh Autonomous Region (NK). NK’s autonomy was dissolved in 1991.

Ethnicity: 90.6% are Azerbaijani; 2.2% Dagestani; 1.8% Russian; 1.5% Armenian, and others (1999 census). An estimated 6-12 million Azerbaijanis reside in Iran.

Gross Domestic Product: \$73.7 billion; per capita GDP is about \$9,000 (*World Factbook*; 2008 est., purchasing power parity).

Leaders: *President:* Ilkham Aliyev; *Chairman of the Milli Mejlis (legislature):* Oqtay Asadov; *Prime Minister:* Artur Rasizade; *Foreign Minister:* Elmar Mamedyarov; *Defense Minister:* Safar Abiyev.

Biography: Ilkham Aliyev, born in 1961, graduated with a kandidata (advanced) degree from the Moscow State Institute of International Relations in 1985 and then taught history. In 1991-1994, he was in business in Moscow and Baku, then became head of the State Oil Company (SOCAR). He was elected to the legislature in 1995 and 2000. In 1999, he became deputy, then first deputy chairman, of the ruling New Azerbaijan Party. In August 2003, he was appointed prime minister, and was elected president in October 2003. He was reelected in 2008.

Contributions to Counter-Terrorism

After the terrorist attacks on the United States on September 11, 2001, Azerbaijan “granted blanket overflight clearance, engaged in information sharing and law-enforcement cooperation, and approved numerous landings and refueling operations at Baku’s civilian airport in support of U.S. and Coalition military operations” in Afghanistan.⁴ Azerbaijan has participated in International Security Assistance Force (ISAF) operations in Afghanistan since late 2002, and plans to increase to its contingent from 45 to 90 personnel, including medical and civil affairs specialists. After August 2003, about 150 Azerbaijani troops participated in the coalition stabilization force for Iraq. These troops withdrew from Iraq in late 2008. Azerbaijan has been a

⁴ U.S. Department of State. *Country Reports on Terrorism 2008*, April 30, 2009.

transit route for extremists moving through the Caucasus, but “the government has actively opposed them and has had some success in reducing their presence and hampering their activities,” according to the State Department. An anti-money laundering law was approved in February 2009 and a surveillance group was set up at the National Bank in August 2009.

Foreign Policy and Defense

President Ilkham Aliyev has emphasized good relations with the neighboring states of Georgia and Turkey, but relations with these and other countries have often been guided by their stance regarding the NK conflict. Relations with Turkmenistan are strained by competing claims over offshore oil and gas fields (see below). Azerbaijan is a member of the OSCE, Black Sea Economic Cooperation group, Council of Europe (COE), Economic Cooperation Organization, and Organization of the Islamic Conference.

Azerbaijan has viewed Turkey as a major ally to balance Russian and Iranian influence, and Armenia’s ties with Russia. In September 2008, Turkey’s President Abdullah Gül visited Armenia, ostensibly to view a soccer game, and this thaw contributed to the two countries reaching agreement in April 2009 on a “road map” for normalizing ties, including the establishment of full diplomatic relations and the opening of borders. Almost immediately, however, Turkish Prime Minister Recep Tayyip Erdogan stressed that the NK conflict would have to be settled before relations could improve, a stance decried by Armenia as setting preconditions on the normalization of ties. In late August 2009, Armenia and Turkey announced progress in drawing up protocols on the establishment of diplomatic relations and other measures. An Azerbaijani foreign ministry spokesman reportedly stressed that the possible opening of borders between Armenia and Turkey before the settlement of the NK conflict would contradict Azerbaijan’s national interests.⁵

Ethnic consciousness among some “Southern Azerbaijanis” in Iran has grown, which Iran has countered through increasingly repressive actions. Azerbaijani elites fear Iranian-supported Islamic fundamentalism and question the degree of Iran’s support for an independent Azerbaijan. Azerbaijan is a founding member of GUAM (an acronym of members Georgia, Ukraine, Azerbaijan, and Moldova), which has discussed energy, transport, and security cooperation, partly to counter Russian influence.

Frictions in Azerbaijani-Russian relations include Azerbaijan’s allegations of a Russian “tilt” toward Armenia in NK peace talks. In 1997, Russia admitted that large amounts of Russian weaponry had been quietly transferred to Armenia, and in 2000 and 2005-2007, Russia transferred heavy weaponry from Georgia to Armenia, fueling Azerbaijan’s view that Russia supports Armenia in the NK conflict. Azerbaijani-Russian relations appeared to improve in 2002 when the two states agreed on a Russian lease for the Soviet-era Gabala early warning radar station in Azerbaijan and they reached accord on delineating Caspian Sea borders. Perhaps seeking Russian support for his new rule, Ilkham Aliyev in March 2004 reaffirmed the 1997 Azerbaijani-Russian Friendship Treaty. In late 2006, Russia’s demands for Azerbaijan and Georgia to pay substantially higher gas prices appeared to contribute to the cooling of Azerbaijani-Russian relations. After the August 2008 Russia-Georgia conflict, Azerbaijan

⁵ Open Source Center. *Central Eurasia: Daily Report* (hereafter *CEDR*), September 1, 2009, Doc. No. CEP-950174.

appeared to move toward better relations with Russia. During Russian President Medvedev's late June 2009 visit to Baku, Azerbaijan agreed to send small amounts of gas to Russia (see below).

According to former Armenian Foreign Minister Vartan Oskanyan, Article 4 of the Commonwealth of Independent States' Collective Security Treaty (signatories including Russia, Armenia, Belarus, and all the Central Asian states except Turkmenistan) pertains to aggression from outside the commonwealth, so does not pertain to the NK conflict (since Azerbaijan is a member of the commonwealth).⁶ After the CST Organization agreed to form large rapid response forces in February 2009, however, some policymakers in Armenia claimed the forces could be a deterrent to possible Azerbaijani aggression.⁷ Some policymakers in Azerbaijan likewise viewed the formation of the forces as a threat.⁸ The Secretary-General of the Collective Security Treaty Organization (CSTO), Nikolai Bordyuzha, has proclaimed that the CSTO would never intervene in the NK conflict, but also has stressed that Armenia and Russia have close bilateral military ties.⁹

Azerbaijani armed forces consist of 66,940 army, air force, air defense, and navy troops. There also are about 5,000 border guards and more than 10,000 Interior (police) Ministry troops.¹⁰ The military budget was about \$800 million in 2007 and \$2 billion in 2008. The legislature approved a \$1.5 billion military budget for 2009 (about 10% of all budget expenditures), but President Aliyev stated in January 2009 that military spending would be \$2.3 billion. Under a 10-year lease agreement, about 1,400-1,500 Russian troops are deployed at Gabala. Azerbaijan reportedly received foreign-made weapons of uncertain origin and armed volunteers from various Islamic nations to assist its early 1990s struggle to retain NK. In 1994, Azerbaijan joined NATO's Partnership for Peace (PFP) and began an Individual Partnership Action Plan (IPAP) in 2005, but President Aliyev has not stated that the country seeks to join NATO. Some Azerbaijani troops have participated in NATO peacekeeping in Kosovo since 1997 and operations in Afghanistan since 2002. The bulk of Azerbaijani weapons reportedly come from Russia, Ukraine, and Belarus, although some NATO-compatible communications and other equipment have been received.¹¹

The NK Conflict

In 1988, NK petitioned to become part of Armenia, sparking ethnic conflict. In December 1991, an NK referendum (boycotted by local Azerbaijanis) approved NK's independence and a Supreme Soviet was elected, which in January 1992 futilely appealed for world recognition. The conflict over the status of NK resulted in about 30,000 casualties and over one million Azerbaijani and Armenian refugees and displaced persons. The non-governmental International Crisis Group (ICG) estimates that about 13-14% of Azerbaijan's territory, including NK, is controlled by NK Armenian forces (the Central Intelligence Agency estimates about 16%).¹² A

⁶ CRS interview, October 26, 2006.

⁷ *CEDR*, February 5, 2009, Doc. No. CEP-950302.

⁸ *CEDR*, February 8, 2009, Doc. No. CEP-950079. The head of Azerbaijan's presidential foreign relations department, Novruz Mammadov, however, stated that he did not view the creation of the forces as a threat, because Azerbaijan has good relations with all the CSTO members except Armenia. *CEDR*, February 5, 2009, Doc. No. CEP-950290.

⁹ *CEDR*, March 20, 2009, Doc. No. CEP-950105; June 1, 2009, Doc. No. CEP-358003.

¹⁰ International Institute of Strategic Studies. *The Military Balance*, February 1, 2009.

¹¹ Shahin Abbasov, "Azerbaijan Mum About Israeli Spy Plane, Satellite Projects," *Eurasia Insight*, August 17, 2009.

¹² ICG. *Nagorno-Karabakh: Viewing the Conflict from the Ground*, September 14, 2005. CIA. *The World Factbook*, <http://www.cia.gov>. The casualty estimate is from the State Department, *Background Note: Azerbaijan*, May 2008.

ceasefire agreement was signed in July 1994 and the sides pledged to work toward a peace settlement. The “Minsk Group” of concerned member-states of the Organization for Security and Cooperation in Europe (OSCE) facilitates peace talks. The United States, France, and Russia co-chair the Minsk Group.

On November 29, 2007, Undersecretary of State Nicholas Burns, Russian Foreign Minister Sergey Lavrov, and French Foreign Minister Bernard Kouchner presented the Foreign Ministers of Armenia and Azerbaijan with a draft text—*Basic Principles for the Peaceful Settlement of the Nagorno-Karabakh Conflict*—for transmission to their presidents. These officials urged the two sides to accept the *Basic Principles* (also termed the Madrid proposals, after the location where the draft text was presented) that had resulted from three years of talks and to begin “a new phase of talks” on a comprehensive peace settlement.¹³ The Basic Principles call for the phased return of the territories surrounding NK to Azerbaijani control; an interim status for NK providing guarantees for security and self-governance; a corridor linking Armenia to NK; future determination of the final legal status of NK through a legally binding expression of will; the right of all internally displaced persons and refugees to return to their former places of residence; and international security guarantees that would include a peacekeeping operation.¹⁴

In March 2008, the U.N. General Assembly approved a resolution that called for Armenia to “immediately and unconditionally” withdraw from “occupied” Azerbaijani territory. The resolution—introduced by Azerbaijan—was approved with a vote of 39 for and 7 against, with 100 abstentions. The United States voted against the resolution in part because, according to Deputy Assistant Secretary of State Matthew Bryza, it violated the provisions of the *Basic Principles* and thus harmed the peace process.

In the wake of the Russia-Georgia conflict in early August 2008, Armenian President Sarkisyan asserted that “the tragic events in [Georgia’s breakaway South Ossetia region] confirm that every attempt in the South Caucasus to look for a military answer in the struggle for the right to self-determination has far-reaching military and geopolitical consequences.”¹⁵

Turkish Prime Minister Recep Tayyip Erdogan visited Russia, Georgia, and Azerbaijan in mid- to late August 2008 to propose the formation of a “Caucasus Stability and Cooperation” group to discuss regional peace, economic cooperation, and energy security, and which would include Turkey, Russia, Georgia, Azerbaijan, and Armenia, but would exclude the United States and the EU. Turkish President Abdullah Gul visited Armenia and Azerbaijan in early September to further discuss forming the group and to mediate the NK conflict. Armenian President Sarkisyan welcomed Turkey’s efforts as an attempt to create a favorable atmosphere in the region, but on September 11, 2008, called for continuing the Minsk Group talks.

On November 2, 2008, Russian President Medvedev hosted talks in Moscow between Armenian President Serzh Sarkisyan and Azerbaijani President Ilkham Aliyev on a settlement of the NK conflict. Little progress in reaching a settlement was reported, but a joint declaration signed by

¹³ U.S. Department of State. Office of the Spokesman. Media Note: Support for Basic Principles for Peaceful Settlement of the Nagorno-Karabakh Conflict, November 29, 2007.

¹⁴ The White House. *Joint Statement on the Nagorno-Karabakh Conflict by U.S. President Obama, Russian President Medvedev, and French President Sarkozy at the L’Aquila Summit of the Eight*, July 10, 2009.

¹⁵ Open Source Center. *Europe: Daily Report*, August 27, 2008, Doc. No. EUP-085016.

Aliyev and Sarkisyan (also termed the Meindorf declaration after the castle where talks were held) upheld a continued mediating role for the Minsk Group.

Presidents Aliyev and Sargisyan met to discuss NK peace settlement issues on the sidelines of the May 2009 EU summit that launched the EU Eastern Partnership program of enhanced trade and other ties with the South Caucasus and other former Soviet republics. Although the Minsk Group co-chairs reported some progress in the talks, Nevruz Mehmedov, the head of foreign affairs in Azerbaijan's presidential administration, reportedly stated that the co-chairs were "misinforming the international public and the president and secretary of state of the United States by speaking about progress in the negotiation process."¹⁶ At a summit of the G-8 (Group of Eight industrialized countries) heads of state in L'Aquila, France, a joint statement called for Armenia and Azerbaijan to accept the Madrid Proposals, which will "will allow the drafting of a comprehensive settlement to ensure a future of peace, stability, and prosperity for Armenia and Azerbaijan and the broader region."¹⁷

President Medvedev again hosted Minsk Group-facilitated talks between the Armenian and Azerbaijani presidents on July 17, 2009. In early August 2009, former Armenian Foreign Minister Vartan Oskanyan reportedly called for Armenians to support the Madrid Proposals as the best chance for a peace settlement that would provide for self-determination for NK. Presidents Aliyev and Sagisyan may meet in October 2009 in Moldova.

Political and Economic Developments

The Azerbaijani constitution, approved by a popular referendum in November 1995, strengthened presidential power and established an 125-member legislature (Milli Mejlis) with a five-year term for deputies. The president appoints and removes cabinet ministers (the Milli Mejlis consents to his choice of prime minister), submits budgetary and other legislation that cannot be amended but only approved or rejected within 56 days, and appoints local officials. The U.S. State Department viewed an August 2002 constitutional referendum as flawed and as doing "very little to advance democratization."

In October 2003, Ilkham Aliyev handily won a presidential election, beating seven other candidates with about 77% of the vote. Protests alleging a rigged vote resulted in violence, and spurred reported government detentions of more than 700 opposition party "instigators." Trials reportedly resulted in several dozen prison sentences. In early 2005, the OSCE issued a report that raised concerns about credible allegations of use in the trials of evidence derived through torture. Aliyev in March 2005 pardoned 114 prisoners, including many termed political prisoners by the OSCE.

Changes to the election law were approved by the legislature in June 2005, including some making it easier for people to become candidates for a November 2005 legislative election. Azerbaijan's Central Electoral Commission (CEC) declared that the ruling Yeni Azerbaijan Party won 54 seats and independents, 40 seats. Opposition party candidates were declared the winners in a handful of constituencies. The U.S. Embassy in Azerbaijan issued a statement urging the

¹⁶ *Interfax*, May 12, 2009.

¹⁷ The White House. *Joint Statement on the Nagorno-Karabakh Conflict by U.S. President Obama, Russian President Medvedev, and French President Sarkozy at the L'Aquila Summit of the Eight*, July 10, 2009.

government to investigate and rectify some voting irregularities but also praised the election as evidence of democratization progress. The CEC and courts eventually ruled that 625 (12.2%) of precinct vote counts were suspect, and repeat races were held in May 2006 in ten constituencies. The opposition Azadliq electoral bloc refused to field candidates in what it claimed were “rigged” elections. OSCE monitors judged the repeat race as an improvement over the November election but stated that irregularities still occurred.

A presidential election was held on October 15, 2008. In early June 2008, the legislature approved changes to the electoral code. Some of the changes had been recommended by the Venice Commission, an advisory body of the Council of Europe. However, other recommendations of the Venice Commission were not considered, including those on eliminating the dominance of government representatives on election commissions.¹⁸ The opposition Azadliq (Freedom) party bloc decided on July 20 that it would boycott the election on the grounds that the election laws were not fair, their parties faced harassment, and media were constrained.¹⁹ This bloc includes the Popular Front Party (Reform), the Liberal Party, and others. In early September 2008, the Azadliq bloc joined with other parties to form an Opposition Cooperation Center (OCC) coalition, including the Musavat Party, the Civil Development Party, and the Public Forum for the Sake of Azerbaijan. Incumbent President Aliyev won a resounding victory, gaining nearly 89% of the vote against six other candidates. According to a report by election monitors from OSCE/ODIHR, the Parliamentary Assembly of the Council of Europe (PACE), and the European Parliament (EP), the voting process was peaceful, well organized, and efficient, but there was a “lack of robust competition and of vibrant political discourse facilitated by media.” The observers also raised concerns that there appeared to be “significant procedural shortcomings [in vote counting] in many cases, and manipulation in some instances.”²⁰

Proposed amendments to the constitution were overwhelmingly approved by citizens in a referendum held on March 18, 2009. According to a small delegation from PACE, the voting “was transparent, well organized, and held in a peaceful atmosphere.” They criticized the dearth of discussion in the media of the merits of the constitutional amendments and voiced regret that some changes to the amendments proposed by the Venice Commission were not made before they were voted on. Some opposition parties had in particular objected to an amendment lifting term limits on the presidency during a “state of war,” and had called for a boycott of the referendum. After the vote, they claimed that the government’s report of turnout and results was exaggerated.²¹

According to the U.S. State Department’s *Country Reports on Human Rights Practices for 2008*, the Azerbaijani government’s human rights record remained poor and worsened in some areas in 2008. Arbitrary arrest and detention, particularly of individuals considered by the government to be political opponents, and lengthy pretrial detention continued. The number of persons tortured in custody by security forces, including to obtain confessions, reportedly increased. President Aliyev pardoned over 150 prisoners, including nearly a dozen alleged political prisoners,

¹⁸ European Commission for Democracy Through Law (Venice Commission). *Joint Interim Opinion on the Draft Amendments to the Electoral Code of the Republic of Azerbaijan*. 74th Plenary Session, March 14-15, 2008, Opinion no. 390/2006, CDL-AD(2008)003, March 18, 2008.

¹⁹ Open Source Center. *Central Eurasia: Daily Report* (hereafter *CEDR*), April 24, 2008, Doc. No. CEP-950216.

²⁰ OSCE/PACE/EP. Republic of Azerbaijan Presidential Election, 15 October 2008: Statement of Preliminary Findings and Conclusions, October 16, 2008.

²¹ *CEDR*, January 23, 2009, Doc. No. CEP-950024 and Doc. No. CEP-950276; February 23, 2009, Doc. No. CEP-950103; March 19, 2009, Doc. No. CEP-950277.

although several dozen political prisoners were alleged by some observers to still be imprisoned. Corruption was pervasive in the judiciary and law enforcement. The presumption of innocence in criminal cases, the right to review evidence, the right of defendants to confront witnesses and present evidence at trial, the right to a court-approved attorney for indigent defendants, and the right of appeal for defendants and prosecutors were generally not respected.

The government further limited media independence in 2008, according to the State Department. Although the opposition party press continued to operate and to criticize government actions, most broadcast media adhered to a pro-government line. The BBC, Voice of America, and Radio Free Europe/Radio Liberty were banned from FM radio, restricting their access. Some observers alleged that verbal or physical assaults on journalists increased in 2008. Several journalists remained imprisoned. Libel remained a criminal offense, although the number of libel prosecutions decreased significantly. Government restrictions on the freedom of association and assembly worsened. The government continued to require that all rallies be held far outside the city center. The government denied several opposition requests to hold political rallies and broke up unsanctioned demonstrations. Political parties, religious groups, businesses, and NGOs faced long delays and other difficulties in obtaining legal permission to operate. The government often adopted a heavy-handed approach toward practicing Muslims that reportedly included forcibly shaving beards, banning prayers outside mosques, and pressuring certain television stations not to run religious programming. The country was primarily a source and transit point for women, men, and children trafficked for sexual exploitation and forced labor. There was no evidence of official complicity in trafficking, but corruption in some government agencies facilitated trafficking. The government made some efforts to assist trafficking victims.²²

Among recent human rights developments, after Internet blogger Emin Milli criticized democratization in Azerbaijan on German television in early July 2009, he and fellow blogger Adnan Hajizade were physically attacked in Baku and then arrested on charges of hooliganism and battery. Outgoing Deputy Assistant Secretary of State Matthew Bryza stated on August 12 that he had raised U.S. concerns about the case with President Aliyev. Changes to the law on NGOs were signed into law in July 2009. Although some provisions restricting foreign funding and foreign-based NGOs were dropped, other provisions of concern to some observers were retained, including requirements that NGOs provide membership lists to the government and that foreign-based NGOs sign agreements with the government on allowable operations.

The collapse of the Soviet Union and the NK conflict in the early 1990s contributed to the decline of Azerbaijan's GDP by over 60% by 1995. The economy began to turn around in 1996-1997. GDP growth in 2006-2007 was estimated at more than 25% per year, which contributed to a rise in consumer price inflation to double digits. Rising oil and gas exports (and rising world prices for oil) fueled GDP growth, along with the expansion of the construction, banking, and real estate sectors. The global economic downturn and the decline in oil prices contributed to a slowdown of GDP growth to about 11% in 2008. The Economist Intelligence Unit (EIU) estimates that GDP growth will be 3% or less in 2009 and that inflation will decline to about 5%. Budget revenues have fallen off in the first half of 2009, including as a result of tax cuts introduced by President Aliyev to stimulate the economy. Some of the budget shortfall has been alleviated by withdrawals from the State Oil Fund, which has permitted stepped-up government spending for social programs and continued infrastructure projects. The EIU warns that the \$10.5 billion fund might

²² U.S. Department of State. Country Reports on Human Rights Practices for 2008, February 25, 2009.

be depleted.²³ According to the International Monetary Fund, “strong political action” is needed “to counter the vested interests” that discourage competition in several sectors of the economy.²⁴ Up to one-fourth of the population lives and works abroad because of high levels of unemployment in Azerbaijan.

Energy

The U.S. Energy Department in December 2007 reported estimates of 7-13 billion barrels of proven oil reserves, and estimates of 30-48 trillion cubic feet of proven natural gas reserves in Azerbaijan. U.S. companies are shareholders in three international production-sharing consortiums that have been formed to exploit Azerbaijan’s Caspian Sea oil and gas fields, including the Azerbaijan International Operating Company or AIOC, led by British Petroleum (developing the Azeri, Chirag, and Gunashli fields). The United States backed the construction of a large (one million barrels per day capacity) oil pipeline from Azerbaijan through Georgia to Turkey’s Ceyhan seaport on the Mediterranean (the Baku-Tbilisi-Ceyhan or BTC pipeline) as part of Azerbaijan’s economic development, and because this route neither allows Russia to gain undue control over Azerbaijan’s resources nor forces Azerbaijan to seek export routes through Iran. Construction began in 2003 and the first tanker was filled in Ceyhan in mid-2006. A gas pipeline from Azerbaijan’s offshore Shah Deniz field to Turkey was completed in March 2007. In mid-November 2007, Greece and Turkey inaugurated a gas pipeline connecting the two countries that permits some Azerbaijani gas to flow to an EU member-state. An extension is planned to be built to Italy to complete this Turkey-Greece-Italy (TGI) pipeline project.

At a meeting in early May 2009 in Prague, the EU, Azerbaijan, Georgia, Turkey, and Egypt signed a declaration on a “Southern [energy] Corridor” to bolster east-west energy transport. The declaration calls for cooperation among supplier, transit, and consumer countries in building the proposed Nabucco gas pipeline from Turkey to Austria, finishing the Italian section of the TGI pipeline, and other projects. Richard Morningstar, the U.S. Special Envoy for Eurasian Energy, stated that the Obama Administration supported the “Southern Corridor” program and considered “Eurasian energy issues to be of the highest importance.”²⁵ Turkmenistan’s refusal to sign the declaration may not have reflected a lack of interest in a trans-Caspian gas pipeline. In April 2008, Turkmenistan had signed a memorandum of understanding with the EU to supply 353.1 bcf of gas per year starting in 2009, presumably through a trans-Caspian pipeline that might link to the SCP and to the proposed Nabucco pipeline. Perhaps buttressing Turkmenistan’s interest in a trans-Caspian pipeline, in early April 2009 a section of a gas pipeline from Turkmenistan to Russia exploded, halting Turkmen gas shipments. Each side blamed the other for the explosion. On the other hand, in late July 2009 Turkmen President Gurbanguly Berdimukhamedov reasserted Turkmenistan’s claims to offshore oil and gas fields also claimed by Azerbaijan (termed by Azerbaijan the Azeri, Chirag and Kapaz fields) and stated that Turkmenistan would ask for international arbitration of the claims. In late August 2009, tensions with Azerbaijan appeared heightened when President Berdimukhamedov ordered the establishment of a naval

²³ Economist Intelligence Unit. *Country Report: Azerbaijan*, August 2009.

²⁴ International Monetary Fund. *Azerbaijan: 2008 Article IV Consultation, Preliminary Conclusions of the IMF Mission*, March 12, 2008.

²⁵ U.S. Department of State. *Press Release: Remarks at the EU Summit “Southern Corridor-New Silk Road,”* May 8, 2009.

base to “to protect our sea border and our country’s Caspian Sea coast from evil-minded foreign persons.”²⁶

Azerbaijan’s State Oil Company (SOCAR) and Russia’s Gazprom gas firm agreed in July 2009 that SOCAR would send 1.7 billion cubic feet of gas per year to Russia beginning in 2010. The gas would be transported by a 140-mile gas pipeline from Baku to Russia’s Dagestan Republic that was used until 2007 to supply Azerbaijan with up to 282.5 billion cubic feet of gas per year. SOCAR indicated that the volume of gas transported to Russia could increase in future years. The small amount of gas initially involved is not expected to impact plans for supplying Nabucco.

At a special July 24 government meeting in Ashgabat, Turkmen President Gurbanguly Berdymukhamedov ordered Foreign Minister Rashid Meredov to have lawyers investigate the legitimacy of Azerbaijan’s claims to the Omar, Osman and Serdar fields. These fields are known as Azeri, Chirag and Kapaz in Baku. Berdymukhamedov also expressed a desire to probe the legality of foreign energy companies’ participation in the fields’ development. Berdymukhamedov called for the lawyers’ findings to be sent to an unspecified international arbitration court, according to the Turkmen state-owned TDH news agency.

The fact that a BP-led consortium has already begun development work in the Omar/Azeri and Osman/Chirag fields under a 1994 agreement with Azerbaijan suggests that Baku holds a “one-sided” approach to the issue, Berdymukhamedov said. “Such one-sided work practices in the Caspian are unacceptable for Turkmenistan.”

Author Contact Information

Jim Nichol
Specialist in Russian and Eurasian Affairs
jnichol@crs.loc.gov, 7-2289

²⁶ *CEDR*, August 31, 2009, Doc. No. CEP-950194.