The Limits of Political Power in resource-rich post-Soviet States


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Abstract:

According to the well-known rentier-state theory, resource rich states are ruled by autocrats who distribute resources that are wrongly classified as “free” to selected groups of people in order to sustain power and private benefits. However, research on statehood in Africa, South America, the Middle East and Asia indicates that indeed most states are captured by elites that use their political power to secure economic advantages, irrespectively of their resource base. How can we analyze policy in those regimes? It seems reasonable to analyze authoritarian states as profit-oriented organizations, notwithstanding their special relationship with their "clients". In order for authoritarian leaders to benefit, it is important for them to keep their position and to control the means necessary to extract profits. Both entail, first, the power to decide and second, the power to do something. Very simply put, the first demands a relatively weak but encompassing state, while the second calls for a strong state with an able and efficient bureaucracy. With an emphasis on various material and immaterial sources of power in principal-agent and agent-agent relationships, this paper focuses on Azerbaijan, for it is a prime example of post-Soviet resource-rich states, which, according to literature, are authoritarian quasi by default. From organizational theory follows that an organization tends to become less efficient the more coercive it needs to be. Further, the consolidation of power in organizations has interrelating internal and external dimensions. An economy of power is illustrated on the basis of various examples from Azerbaijan’s energy and electricity sector.
1 Setting the Scene

This paper shows how policy-makers in resource-rich, post-Soviet states are limited in making and implementing decisions. But first of all, it should probably be explained why a paper whose title includes the term “resource-rich” and “post-Soviet” draws its most important insights from neither the theory on the resource curse nor on transition.

Azerbaijan with over at least 60% of its exports and 20% of GDP (see Fig 1) stemming from natural resources, most of which are fuels, is per definition a petroleum economy (Nankani 1979: 2)\(^1\) and can also be considered a rentier-state suffering from the exhibiting symptoms of the resource curse (Ahmedov and Aslanly 2010).

Fig 1: Portion of natural resources in Exports and GDP in Azerbaijan\(^2\)

The central concept of the resource curse theory is “rent”. Rents are net profits that do not accrue from production but because of market failures. They can be defined “as returns in excess of costs (including normal returns to capital)” (Kolstad and Wiig 2009: 5318). Richard Auty coined the term “resource curse” to describe low economic development in countries with vast natural resources and accordingly high rents (Auty 1993). Jeffrey Sachs and Andrew Warner pioneered empirical work on the question why resource dependent economies perform below average (Sachs and Warner 1995; 1997). A broad body of literature further analyzes the strictly economic “Dutch Disease” effect of the exploitation of natural resources (1977). Resource curse in this context means that an economy is or becomes overly focused on one good.

The economic approach was widened to explain why states rich in resources seem particularly susceptible to corruption, dictatorship and underdevelopment (Damania et al. 2005) which is more relevant here. Although additional resources should have a positive effect on states (Kevin Morrison 2009), many authors find them responsible for the emergence of bad institutions (Acemoglu and Robinson 2006; Mehlum et al. 2006; Robinson et al. 2006). Different types of resources are found to pose different challenges for governance (Torvik 2009) with oil having a very negative effect (Karl 1997). According to the petro-state theory, the elites of states rich in fossil fuels provide welfare to the population in exchange for political loyalty (Karl 1997: 49). However, the population is in a weak negotiating position, because only a minority of the citizens is involved in the creation of rents (Davidson 2005: 89; Karl 1997: 48; Massabié 2008: 40; Schwarz 2008: 215; Youngs 2009: 10). As the state becomes the most important economic actor, political and economic rationality align (Davidson

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\(^1\) When Nakani coined the term in the 1970s, he did not consider the export of natural gas presumably because the developing countries he focused on did not yet export gas.


However, this paper will illustrate that economic diversification gets a whole new ring to it when demanded by a state official interested in rents. Natural resources might stabilize the system but are neither causal nor necessary for rentierism to develop. Unlike Auty suggests (Auty 2011), the answer to rentierism cannot be that politics ignores business altogether. Rather, private entrepreneurship needs to be regulated effectively in order for private actors not to profit from market failure and ultimately, rents. Rentier theory compellingly tells us from a macro-perspective based on individual economic interests with undisputable cynicism why change, in any sense, cannot happen – although, it does.

Transition literature traditionally focuses on the democratization of the Eastern European states most of which now belong to the European Union (EU). Linz and Stepan have famously defined the subject of transition literature:

“A democratic transition is complete when sufficient agreement has been reached about political procedures to produce an elected government, when a government come to power that is the direct result of a free an popular vote, when this government de facto has the authority to generate new policies, and when the executive, legislative and judicial power generated by the new democracy does not have to share power with other bodies de jure” (Linz and Stepan 1996: 3).

Recent studies often assess the EU’s political influence on the newly independent states focusing on norm diffusion or economic incentives (Azarch 2009; Franke et al. 2009b; 2010; Schimmelfennig and Scholtz 2008). While most papers presume a particularity of post-Soviet states because of their planned economic system (Cummings and Nørgaard 2003; de Melo et al. 1996), some compare the former Soviet Union to developing states all over the world (Heredia and Kirtchik 2010; Alexander S. Morrison 2008). In either case, transition literature points to the persistence of formal and informal structures - from Soviet rule or colonialism (Simons 2008). While formal structures have been altered with the break-up of the Soviet Union (or the end of colonialism), transition literature realized that unchanged informal structures continue to govern the actual political and economic live in most countries (Gelman 2011; Simons 2008: 50ff).

The transition process is essentially a competition for formal recognition between sets of informal institutions and international norms (Weißenberg 2003: 28ff), more specifically between groups or organizations with particularistic interests (Ellickson 1999; Weißenberg 2003: 41). Informal sets of rules dominate behavior, if individual conduct deviates from formal institutions (Weißenberg 2003: 1). Consequently, formal (public) institutions are weak in those contexts (Kamran Musayev 2010: 96). Therefore, in determining the degree of transition from authoritarian to democratic rule and from planned to market economies-real action is as important as laws (O'Donnell et al. 1991; Sticht 2006: 55ff). In further specifying established rent-seeking practices in economic management, Linz and Stepan note that a “mature post-totalitarian regime can also feature the coexistence of a state-planned economy with extensive partial market experiments in the state sector” (Linz and Stepan 1996: 43), thus building the foundation for an elite of state sector managers and a growing
but subordinate private sector”. Today, in Azerbaijan, this seems not only a question of specific sectors (Gawrich et al. 2011: 11), but of scale. Where the economy is not nationalized, big business is intertwined or identical with state-business on an individual level.

Simons attributes the persistence of informal power structures to the same people staying in power. “[T]he post-Communist political class was overwhelmingly post-Soviet: the bulk of its members had come of age and learned their political inclinations and habits in the Soviet system” (Müller 2007: 157; Simons 2008: 39, 40). It is thus only logical that political systems, that emerged not as a result of a revolution, but of the demise of a weak regime essentially depend on old informal relationships for coherence. The old elites are progressively consolidating their power and the most notable change is that they, themselves, instead of someone from Moscow, are ultimately in charge now. Both theories largely perceive the elite as a single block, ignoring that there are struggles for rent distribution that greatly influence politics and limit the discretion of decision-makers. They do not allow for the fragility and permeability that characterizes most if not all bigger social groups.

The following cases from the electricity sector are used to illustrate the political economy of power in Azerbaijan: 1st, from 2001 until mid-2006 the electric grids in the capital Baku and the somewhat adjacent third largest city of Azerbaijan, Sumgayit, were managed by Barmek. In the end, the private company was thrown out of the country and its CEO in jail. 2nd, in 2007, under pressure from international financial institutions (IFO), electricity tariffs were tripled. In 2010 the debts of power consumers who had not paid their bills totaling almost 1,6 bln AZN (1,9 bln USD) were written off. Why would the country invite private investment and then reject it? Why would one raise electricity tariffs and then waive the payables?
2 Theory

2.1 Decision-making

This paper considers two aspects of policy-making: decisions as well as their implementation. In both cases, political science theories were initially developed for Western democratic contexts and thus tend to overemphasize certain aspects when applied to resource-rich post-Soviet states. It is not the aim of the paper to provide a full state-of-the-art on policy analysis to show that a theory for (semi-) authoritarian regimes is missing. Therefore, a few approaches are sketched which are useful as a point of departure to understand decision-making in the present context.

Advocacy coalitions

Every state-program is an expression of the dominant strategy to solve a problem, respectively a manifestation of the belief-system underlying that strategy, according to Sabatier (Sabatier 1988: 131). The shifting influence of different actors is explained by tracing dominant orientations and policies over at least ten years (Sabatier 1993: 120f). Changes in the authority of different beliefs or paradigms can be caused by internal and external shocks (Sabatier 1993: 121f). Shocks “put the public spotlight on a problem in a policy subsystem and have the potential to draw in new – or redistribute – critical resources”. (Sabatier 2007: 204f) This variation in resources can lead to variation in the power structure. Only significant events allow for fundamental modifications in the character of policies (Sabatier 1988: 134) by changing the “core beliefs” (Sabatier 1998: 104) upon which policy is built.

The advocacy coalitions approach is based on three assumptions: 1st the existence of political subsystems on a macro level, 2nd a social-psychological notion of the individual at micro level, and 3rd advocacy coalitions at meso level (Sabatier 2007: 191f). Advocacy coalitions are formed by actors of different nature with similar belief systems within a political subsystem (Sabatier 1993: 120, 26f).

Summing up: External change causes trends in dominant belief patterns held by policy-makers and people who influence policy-making to alter. This leads to shifting resources and hence variation of the power structure. The theory is essentially linked to democratic systems as it assumes diverging ideological values most relevant for political struggles and supposes that many societal groups are included in the decision-making process. Most importantly it strives to explain shifting resources and power structures as responses to societal problems. The approach is thus essentially bottom-up.

While some assumptions do thus not fit Azerbaijan, it is an interesting question if the belief system seems to have changed over time or if the beliefs of distinguished political groups are specifiable. At a first glance, the biggest differences seem to lie in the groups approach to foreign policy, although even that has converged lately. One could argue that the “ideology” within the elite has not changed since the disintegration of the Soviet Union and not defend this on the ground that many people serving in the state now have served there then.

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Rationalist-institutionalist approaches to decision-making

Traditional policy research saw a clear difference between the state and society, one regulating (or steering) the other being regulated (or steered). To go from there to “governance” required three steps: 1st the state was no longer perceived as unitary actor but as a conglomerate of actors with different perspectives and 2nd society was differentiated into fields that were more or less easily governable. 3rd it became clear that actors within certain fields possess the ability to participate in the regulation of this field (Mayntz and Scharpf 1995: 9). Hence, theory went from regulating to governing, from ordering to managing, from formal to informal.

The power for self-regulation, as the ability to set binding lasting rules (Ostrom 1990: 15), depends on the autonomy groups are granted for experimentation as well as on the scope of rules in question. Rules provide stability of expectations (Ostrom 1990: 53) and Ostrom differentiates very helpfully three levels of rules (see Fig 2). She maintains that “it is usually the case that operational roles are easier to change than collective-choice rules, and collective-choice rules are easier to change than constitutional-choice rules” (Ostrom 1990: 54).

Fig 2: “Linkages among rules and levels of analysis” (Ostrom 1990: 53)

The above differentiation is helpful, because it allows distinguishing easily between two analytical approaches to regulation.

At a more general level, the first or second, there is governance as steering (Bulmer 1998: 366). Within this approach, decisions are explained as outcome of the interaction of strategic actors with bounded rationality whose actions, preferences and perceptions are largely but not completely determined by the institutional framework within which they act (Crouch 1993: 72; Scharpf 2000: 319, 72, 75f). One of the most interesting notions for this paper is that governance compasses multiple levels of formal hierarchies (Hooghe and Marks 2001; Marks and Hooghe 2004) and of actors outside the formal policy-making process (Bache and Flinders 2004: 96; Bernard 2002: 240; Crouch 1993: 88).

However, an essential assumption of governance does not hold in the present context. Namely, it is believed that the state loses some of its capacity to govern because private corporations use their trans-nationality and size to defy control by nation-states. Subsequently, states are left to compete for corporations and investment instead of steering both (Scharpf 2000: 336, 38, 41). This leads to situations where corporations can affect formal public institutions because of their size and personal contacts with political decision-makers (Weißenberg 2003: 133f). Governance posits that public and private actors have different interests, although there are tight networks between public institutions
and private organizations. This might be true for some international corporations doing business in Azerbaijan, but not for national ones.

Somewhat bottom-up is the state capture theory. This theory of regulation perceives state action as the result of lobbying by private agents (Dabscheck 1983: 502). Mostly business-oriented interest groups “make use of the coercive power of the state to protect and advance self-interest” (Dabscheck 1983: 502). Weißenberg notes that state capture describes a situation when corporations can influence the development of formal public institutions (law, decrees, regulations) using illegal and intransparent transfers (Weißenberg 2003: 133). The decisions corporations and individual actors seek to influence this way usually pertain to concrete questions rather than the operational than the institutional level. Regarding incentives, a fundamental difference between political and economic motivation is easily confused with a likeness: “Politicians are viewed as being similar to entrepreneurs seeking to enhance their electoral success” (Dabscheck 1983: 503). Yet, electoral and economic success being distinguishable motives, a need for a completely different kind of analysis emerges if politicians are entrepreneurs. Notwithstanding that neither transition nor resource-curse theories are applied here, they are very convincing in this: The political and economic elites in FSU Eurasia are the same people.

In a newer perception, state capture is used largely synonymously with rentierism (Grzymala-Busse 2008: 640; Iwasaki and Suzuki 2007: 396), executed in the forms of clientelism and predation. The respective authors indicate the tension between discretion and sovereignty.

“All these strategies involve the formation of distinct state institutions and capacities. State seizure does not simply corrode the state. Although extractive rulers seek to maximize their discretion by weakening regulation and oversight, they also construct rules and durable practices of redistribution, budgeting, and authority.” (Grzymala-Busse 2008: 639).

When the merger between the state and big business is complete, how can one capture the other? One would not speak of state-capture in feudalist systems and there is no reason to do so in some modern authoritarian states either. What happens is that the business elites as the political elites act in their own interest whether in formally nationalized sectors of the economy or in the private realm. Intriguingly, both rationalist-institutionalist concepts are very elitist, with public participation either providing legitimacy as well as information needed for efficient steering or being reduced to wealthy elites.

**Elite theory as an unequivocal starting point**

One of the standard books on elites is Robert Putnam’s 1976 “The comparative study of political elites”. Elitists argue “that behind the diverse façades of government, power was always confined to a ruling few” (Putnam 1976: 3) and define those people with more political power as political elite (Putnam 1976: 5). Putnam differentiates between two abilities: to influence individuals and to influence collective decision making (Putnam 1976: 5). He notes that “[e]ven among the very powerful, few people directly decide public policy” (Putnam 1976: 6) and therefore differentiates between direct, indirect and spurious (seeming) influence (Putnam 1976: 6f). An important insight for the analysis of power is that “frequently, even a very powerful decision-maker will take into account the possible reactions of other actors.” (Putnam 1976: 7)
Putnam notes that the exact distribution of power within societies varies not only internationally, but also between political sectors and over time (Putnam 1976: 12). In Azerbaijan’s energy sector, this political stratification (Putnam 1976: 11) is very top-heavy as all activities require vast technical knowledge and investment capital, while most of them are by law limited to state-agencies. Currently, the power sector is clearly dominated by Azerenerji which has almost a perfect monopoly.

With regard to political recruitment processes in countries as diverse as the Soviet Union, Italy and the U.S., Putnam concludes that “elections are easily overrated” (Putnam 1976: 54) while “[p]atron-client affiliations and personal recommendations are virtually universal credentials for recruitment”(Putnam 1976: 61). At the same time “[w]ealth is a powerful resource under almost any system [...] for it can often be used to buy credentials required for recruitment” (Putnam 1976: 52) and vice versa, as the comfortable positions of many ex-political officials on corporate boards suggest.

As there may be “distinct groups within the same political strata” (Putnam 1976: 14), drawing on Suzanne Keller (1963) the term “strategic elites” is suggested to signify functionally different groups at the top. This already points to the fact, that “unadorned power [or coercion], whether based on force or organization is neither the most efficient nor the most common means” (Putnam 1976: 136) to rule. Instead, the elite “tries to transform coerced obedience into willing obedience, to convert its power into authority, by making its rule legitimate” (Putnam 1976: 136) for other groups and nonelites.

According to Max Weber, traditions, charisma or conformity of the procedural rules and laws with societal values can produce legitimacy. Putnam stresses output in the form of social welfare as an important source of legitimacy in modern polities, “but performance legitimacy provides less security to elites than other forms of legitimacy” (Putnam 1976: 137). Still, authoritarian regimes try to appeal to the public by stressing the good they do, as other sources of legitimacy are less available. Obviously, this relationship between ruler and ruled is inefficient. Although

“[p]atron-client ties can sometimes provide personalized elite responsiveness to nonelites [...]. this type of linkage has two grave deficiencies. First [...] the patron-client relationship is fundamentally asymmetric. [...] Second, patron-client transactions typically provide particularistic, rather than universalistic benefits. The patron offers favors, not policies. [...] clientelism may insulate elites from demands for programmatic changes that might benefit large classes of people and thereby threaten the political and socioeconomic status quo.” (Putnam 1976: 158)

However, the effects of those policies are not a matter of “if” but of “how much” of the political system is subject to particularistic relations. For Azerbaijan, this is to a great extent the case, according to the Word Bank (Hellman et al. 2000).

2.2 Justifications

If elites try to gain legitimacy by providing output and by justifying what they do with aspiration for a greater good, they will have to hearken back to what they think the public wants. On a personal level, of course, favors are exchanged (see above) but this does not make for a national vision. Going back to the question of belief system: did the big theme change? I would say no.

James Scott describes in his 1998 book “Seeing like a State” very vividly the key theme of nations aspiring to catch up to better standards of living with what he terms “high modernism”. His point of
departure is that great developmental projects “to improve the human condition” (Scott 1998) were futile. He conceives state-making as attempt to make society “legible” (Scott 1998: 3, 29) in order to administrate it. Where the populace tries to maintain its autonomy (Scott 1998: 54), authoritarian leaders coerce it into fatal schemes (Scott 1998: 5). Using urban panning as example, Scott notes that what seems legible (easily understandable) from far away, might be completely confusing and impractical up close and vice versa (Scott 1998: 58). He concludes that the need for simplification and a lack of communication deem grand development schemes – like, for example, planned national economies (Scott 1998: 201ff) – failures (Scott 1998: 4).

However, national, as well as international, development programs are still carried out for people with the objective to make their lives better. - The overall idea being positive outcomes for everyone. “High-modernist ideology”, therefore “tends to devalue or banish politics” (Scott 1998: 94).

Thus, for example, the State Program for the Development of the Fuel and Energy Sector in Azerbaijan 2005-2015 aims to “to meet fully the electric power, gas and other energy demand of both the population and economy” (CAREC Institute 2005). However, the state wants to achieve its uncontroversial goals not by creating the framework conditions for private entrepreneurship and individual endeavor, as neoliberal paths of modernization would suggest (Casula 2005), but traditionally, by having the state do it based on a national plan. As the electricity sector in Azerbaijan is nationalized and largely monopolized, there is no competition. Wholesale and retail prices for fuel and power are centrally determined by the national tariff council and consumers cannot chose between different service providers. Still today, year after year, the utilities promise reliable supply. Ostrom’s statement nicely sums up the practical challenges of modernizing a country: “New institutional arrangements do not work in the field as they do in abstract models unless the models are well specified and empirically valid and the participants in the field setting understand how to make these new rules work.” (Ostrom 1990: 14)

With regard to Russia, that exerts similarities with the Soviet Union in the Berzhnev era⁴ (Casula 2008: 11), “any prospects of an authoritarian modernization” (Casula 2008: 11) are called into question, because instead of opening up the society for change - a prerequisite for true modernization - the elites want to preserve the status quo. They thus pursue stabilization (in the sense of rigidity) while preserving the impression of progress.

All in all: The old elites managed to hold on to power because the grand scheme they promoted in the Soviet Union – an abstract idea of modernization accomplished through urbanization and industrialization managed by technocrats – still captures what the masses want. Still, it is obvious for the population, when governments do not (cannot) fulfill their promises in the present which is why governments invoke the future (O’Donnell and Schmitter 1991: 15). Thus, while modernization is the vision leaders evoke to gain support or at least acceptance, it is questionable that they can achieve this abstract goal for three reasons: 1st the complexity of society and multitude of concrete wishes the concept covers, 2nd the unwillingness of elites to allow for true change, and 3rd the organizational challenges that the implementation of grand schemes entails – especially when this implementation is not fully supported by all people involved in the process.

⁴ Heydar Aliyev ruled Azerbaijan as First Secretary during that time.
2.3 Implementation

State of the art

In the post-Soviet context, implementation to date was not a big issue for political science. The studies that have been undertaken usually analyze (the conditions for) the implementation of health policies (e.g. Antoun et al. 2011; Atun and Olynik 2008; Chalmers and Quliyeva 2004; Darsania and Zarnadze 2011; Oblapenko and Sutter 1997; Strasser et al. 2011). Few others look at the execution of international policies and law (in different fields), which were obviously not created within the target-country but by external actors (Abdullabzade 2007). A search of the Social Sciences Citation Index that does not include those topics, barely yields ten results (2011a). Some authors study the success of policy programs with a focus on implementation under the umbrella-term “governance” without recourse on implementation literature (Sehring 2009).

The standard book for implementation research was written by Pressman and Wildavsky (1973) on the implementation and impact of labor policy in the U.S. They conclude that a program should be direct and simple (Wildavsky and Pressman 1973: 147). Interestingly, the insights from research on political decision-making seem largely lost when a country’s administration is analyzed. While it is noted that different bureaucrats have different interests, those interest are assumed to derive from their position as the agent of one specific organization (Wildavsky and Pressman 1973: 110ff). Goggin refers to this work as an example of first generation implementation research which typically elaborated on the implementation of one or few specific political programs (Goggin et al. 1990: 13).

Second generation implementation research from roughly the 1980s distinguishes itself in that it focused on a set of variables – the form and content of policy, organizations and their resources, the talents and interrelationships of people - to explain implementation success or failure (Goggin et al. 1990: 14). Those are interesting for the present paper as they provide guidance for the structuring of queries into implementation in Azerbaijan. O’Toole notes that political science more or less stopped to research national policy implementation for “Western” contexts since 1990 (O’Toole Jr. 2000: 264). In any case, Smith (1973) remarks that the problems implementors face in developed countries are very different from the obstacles they see in poorer countries (Smith 1973: 199). It is hence likely that literature on countries “closer” to Azerbaijan provide interesting insights.

The most relevant work has been done on South America. “The capacity to implement state-initiated policies depends on the ability to tax, coerce, shape the incentives facing private actors, and make effective bureaucratic decisions during the course of implementation” (Geddes 1994: 14). All of those abilities depend “on the existence of effective bureaucratic organizations” (Geddes 1994: 14). Geddes underlines stresses the dilemma politicians face in deciding between doing what they support politically and what supports them politically (Geddes 1994: 18). With a focus on political survival as main explanatory variable she explains why politicians would chose not to develop bureaucratic and organizational capacity by not selecting officers on professional grounds and following a laissez-faire strategy with regard to operational rules (Geddes 1994: 19).

Putnam holds that “[a]s new regimes turn to the practical tasks of governing, political reliability can no longer be the prime criterion for elite recruitment” and that “conflicts between elite members recruited because of their ideological loyalty and those recruited because of their technical expertise” surface (Putnam 1976: 60). This is debatable, as Geddes’ comments on the effect of loyalty as basis for recruitment in Brazil show. It
“reinforced the customary Brazilian practice of seeking individual improvement through personal connections with the politically powerful. With many of its political leaders co-opted, the working class did not mobilize itself to demand policy changes [...]. Instead, political action tended to follow the pattern already established by higher status participants in the political system” (Geddes 1994: 70).

Political participation tends to be individualistic and focused at the implementation stage of policy making— with appeals for exceptions and requests for government jobs. “As a result, the president had a great deal of autonomy in the formulation of policy” (Geddes 1994: 70f). This approach is an exhilarating point of departure. However, it seems worthwhile to explore these arguments more in depth over multiple levels and recapture what this means for implementation of decisions by top policy-makers.

The organization of bureaucracy

Not everyone working in the administration is part of the elite. Yet, civil servants do populate an echelon of practical power as they can and determine how decisions are implemented (Palumbo and Calista 1990: 7). Initially, they are employees of a public organization. Therefore, employment contracts are to used “coordinate individual goals with the goals of the organization” (Staffhorst 2010: 37). But,

“[i]f one accepts the concept that human behavior cannot be directed by simple financial stimuli alone, that sentiments have an impact on activities, one must soon also admit that the allocation of power and the system of power arrangements have a decisive influence over the kind of adjustments people are able to make within an organization, and over the practical results and the efficiency of that organization.” (Crozier 1964: 147)

Individual action of bureaucrats cannot be completely determined by rules (Eisenstadt 1964). In fact, if this was the case, there would be no use in lobbying them for personal favors. Rules cannot capture everything people are expected to do and not to do in their jobs (Tyler 2010: 12). On the contrary, assuring that people act in the interest of their employer is problematic (Staffhorst 2010: 18f) and an organization needs a supportive social atmosphere to guarantee it (Berger and Luckmann 1969; Hollinger and Clark 1983). If autocratic regimes use the bureaucracy to create access to wealth, “the spread of bureaucratic organizations mostly gives rise to “illicit” or semi–illegal practices of bargaining between different organizations” (Eisenstadt 1964: 253). With turf wars emerging that hinder policy implementation (Bunce 2004: 213).

Furthermore, hierarchy expands over multiple levels. Thus, there is not one layer of elite recruiting everybody else after their choosing. Rather there are people at every level of the administration who use their power to distribute favors to their own supporters (Friedberg 1977: 1f). It follows that state-organizations (ministries, public corporations) develop a life of their own. At the same time, the centralization popular in authoritarian regimes endows only leaders to make formal decisions. Rationally, it cannot be expected that those decision from the top have a chance of being implemented, because they are necessarily impersonal and not supported by promises of immediate personal gain for people at low hierarchical levels (Crozier 1964: 80ff).

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In the end, the apparently strongest states – in the sense that they are centralized, have a vast bureaucracy and are stable (rigid) over time – are the weakest, because they are highly inefficient and the people in charge of deciding cannot get things done.

2.4 Summary & Suggestion

All theories geared at countries with a background like Azerbaijan agree that rents are the main driver for politics. If political and economic rationality align when the state becomes the most important economic actor (Davidson 2005: 88; Karl 1997: 15; Luciani 1990; Nonneman 2006: 5), then naturally, this should be the case in communist planned economies. As famous researchers of reputed transition realize, post-communist regimes still feature significant aspects of planned economies (Linz and Stepan 1996: 43). Therefore, obviously, the re-conceptualization of state capture as rentierism fits post-Soviet contexts (Grzymala-Busse 2008: 640; Iwasaki and Suzuki 2007: 396). This is a good thing though, because if everyone in the arena competes for the same things (money and power) we are away from othering political systems and back to traditional political science.

Putnam notes that the exact distribution of power within societies varies not only internationally, but also between political sectors and over time (Putnam 1976: 12). In Azerbaijan’s energy sector, this political stratification (Putnam 1976: 11) is very top-heavy as all activities require vast technical knowledge and investment capital, while most of them are by law limited to state-agencies. Strategic elites – a more elegant version of networks or clans – compete for power and business-monopoles. These elites justify their totalitarian strife with the need to catch up to more advanced nations – and the implicit assumption that development works best if centrally planned and executed, without the potential chaos of open political “arguments” (Scott 1998: 94). Every state-program is an expression of the dominant strategy to solve a problem, respectively a manifestation of the belief-system underlying that strategy, according to Sabatier (Sabatier 1988: 131). Although, in theory, the demise of the Soviet Union was a significant shock, elites soon realized what needed to be done in order to regain their power (and maybe a bit more). Most importantly: the shock was external and therefore relatively easy to contain in a political system that had learned to isolate itself from political influence. It needed the credible promise of stability and prosperity.

This should be the theme for the electricity sector: Adaptive reaction to external changes and then a secure return to the old ways. In volatile situations, elites cannot afford to patiently wait for solutions to develop – for agents to develop the capacities for self-rule. There are no grace periods and decision-makers need to produce results fast – for their peers and their people. Policy will therefore not be based on programs, but ad-hoc.

When state apparatuses evolve (even if for dubious reasons), they become increasingly complex and harder to control. The multitude of administrative levels and organizations is elusive and the decision-maker will hardly reach administrators in the lowest levels, not to mention the public. Top decision-makers will expect all their subordinates to do as they say. However, pragmatic political loyalty is not the same as obedience (Palumbo and Calista 1990). Therefore, less immediate orders will be less powerful. In addition to political decisions, the distribution of favors becomes increasingly difficult as “the spread of bureaucratic organizations mostly gives rise […] bargaining between different organizations” (Eisentadt 1964: 253) and competition.
A brief but informative history of privatization in Azerbaijan

The privatization law of 1993 incurred the State Property Committee (SPC) authority over the transfer of all property subject to privatization. The privatization of large national enterprises, of which the management of the Baku and Sumgayit grids is ultimately an example, was thus managed by Azerbaijan’s SPC and facilitated under the Privatization Program 1995-1998. Starting in mid-1996 the mandatory privatization of small and medium enterprises took off with a mixture of voucher- and cash-based privatization (Ünal and Erdal 1998) while the privatization of large state enterprises planned for 1998 required discrete approval by the President of Azerbaijan in each case (Janet Matthews Information Services 1998).

The voucher based method of privatization while striving to be more equitable than the cash method had been criticized for being vulnerable to exploitation by investment funds. In Azerbaijan, a block with four vouchers that were to expire in August 2000 was given to each citizen. The SPC was responsible at the time for distributing and administering the vouchers (Government Accountability Project 2008: 2) which could have been used to obtain shares of, for example, SOCAR in case of its privatization. This caught the interest of a group of investors led by the so-called Pirate of Prague, Viktor Kozeny.6

In June 1998, the Azeri Ministry of Finance withdrew the trading license for the voucher fund (called Sigma) from the SPC because of alleged negligent accounting and tax evasion. It had been decided not to privatize SOCAR in order to keep Azerbaijan’s main asset and secure its profits for the country itself. In various trials the leading actors involved in Kozeny’s attempt to acquire SOCAR in order to resell it were accused (Mendelsohn 2003) and convicted for conspiracy to violate the U.S. Foreign Corrupt Practices Act by U.S. courts (2008b; Glovin 2009).7

Subsequently, Azerbaijan adopted a new privatization law in 2000, abolished the voucher privatization and in 2001 the SPC as well as other state agencies were combined under the Ministry for Economic Development (MED) which from then on handled privatization in Azerbaijan (Gacek and Moser 2001). The President of Azerbaijan decreed that Bakielektriksabaka” JSC was also part of the MED from 14.06.2000 (BES 2009a). Farhad Aliyev, who had been Minister of Trade, became the first minister of the MED.

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6 He had illegally obtained ca. 1 bln USD in the Czech privatization process.

The power sector prior to the privatization of the distribution networks

In 1996 President Heydar Aliyev had issued a five-year program for the privatization Azerenerji’s distribution networks after the company’s outstanding debts were to have been paid. The first attempt to privatize the 16 grids failed, as bids were only received for few networks. Therefore, the national grid was divided into five zones (Baku, Nakhichevan, North (Sumgayit), South (Ali Bayramli) and West (Ganja)) in the form of joins stock companies which were offered for private management (ABS Energy Research 2004: 88).

When Azerenerji was transformed into a closed joint stock company in 1996 to prepare for privatization when financially self-sufficient, the utility had 525 mln USD worth of outstanding debt for electricity provided to major industrial organizations, many of which were state-owned. At the same time Azerenerji owed 485 mln USD for fuel (1997). No information is available regarding the status of the Baku grid or its management by the Baku City Executive Committee (BES 2009a).

Electricity tariffs had been raised to 0,0125 USD per kWh in the end of 1996. But this price was by no means cost covering as generation, distribution and transmission amounted to about 0,0375 USD / kWh while investment needs were huge (1997: 6). In July 2000, a two-tariff system was introduced which entailed a special price for industrial enterprises, businesses and organizations including state-agencies in order to boost economic growth. The price was set at 130AZM per kWh (about 0,0325 USD) (Turan news agency 2000). Energy prices, according to the IEA; had thus been raised to international level with the exception of utilities for households (IEA 2000: 47).

Before the disintegration of the USSR, 90% of the installed capacity in Azerbaijan had been fired by natural gas (IEA 2000: 64). In the beginning of the 1990s, gas was replaced by heavy fuel oil due to gas shortages (see Fig 3). In 2000, only about 75% of installed capacity (5,1 GW) were functional because of over-ageing and low maintenance of the plants. Production losses, according to one source, accounted for 85% of output (IEA 2000: 64). The overall efficiency was very low, under 30%.

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8 Considering the reported inefficiency of the Baku refinery which provided a part of the used fuel oil with it outdated equipment and old national pipeline system, efficiency over the energy value chain up to generation is likely to be much lower than shown in the figure.
For Azerbaijan the reliability of the high voltage transmission network is very important as “[m]ore than 50% of consumers are concentrated in the east of the country – in the greater Baku area –, whereas the major power stations are located in the centre of the country, about 350 km away” (IEA 2000: 65). This reliability was low (Tokyo Electric power Company 2010: 73) with technical losses as high as 20% (see Fig 4).

In 2000 the IEA called the stage of reform of Azerbaijan’s electricity sector “embryonic” (IEA 2000: 21). There was no agency solely responsible for energy issues in Azerbaijan. Policy was rather made by the president’s office and the state-owned companies that were active in the sector (IEA 2000: 46). The electricity and gas distribution were to be privatized though public tender by 2001 (IEA 2000: 44).

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10 The report shows some obvious flaws in calculations and data IEA. 2000. Black Sea Energy Survey. Paris: OECD., however, it is still one of the most reliable sources available.
3.2 Barmek

Barmek operations 2001-2005

An international tender for the management of the Baku regional distribution company was launched in the end of 2000. It caught the interest of six different companies. Siemens, which had won the tender promising to invest 770 mln USD into the Baku grid over 25 years (2001d), withdrew its bid after unsuccessful negotiations with the government of Azerbaijan (2001c). Finally, the responsibility was given to Barmek in September 2001. The private Turkish company secured the concession to operate the Baku grid in conjunction with a 3 mln USD payment to the government. “Barmek will invest $ 300 million of its own money in Baku electroset in 25 years and asked for no government guarantees” (2001b). Information regarding the exact amount of promised investment varies substantially, but the exact number appears to be 296.5 mln USD. It is not clear how this investment was supposed to be structured. In this context, the formulation “of its own money” might signify foreign direct investment. Barmek also did not ask for higher electricity tariffs, as Siemens had done, in order to recover its costs (2001b).

The tender stipulated the electricity tariffs for the first three years (2002 – the end of 2004) to be at 96AZM / kWh (0.024 USD/kWh) for the population, 156 AZM / kWh (0.039 USD / kWh) for companies, while the price of electricity for public organizations was kept at 130 AZM / kWh (0.033 USD / kWh). The wholesale tariff of 50 AZM / kWh (0.013 USD / kWh) (2001b) would thus allow for some return if transmission and collection of payments were efficient.

Considering very low collection rates in 2001- Bakuelectroset had in total only paid for 27% of the electricity received from Azerenerji, while collection rate from households was at 47% - Barmek undertook to increase the rate of payment to Azerenerji to 50% during its first year of operation (2001a). The management contract further obliged Barmek to pay for 55% during its second year of operation (2003), 60% in the third, 75% in the fourth and finally 100% in 2006 (AssA-Irada 2002b). The observant reader might realize at this point that the main challenge for Barmek in order to accomplish this goal was to increase payment from state-run industries – or the company would have to take up loans. So it did. Barmek reportedly had to borrow 10 bln AZM (1.6 mln USD) from commercial banks in order to pay Azerenerji at least 50% of electricity delivered in the beginning of 2002. Faced with the necessity to take up another loan for the same purpose as collection rates did not reach the overall level of 50% fast enough, Barmek threatened to cut the power to all consumers with debt. However, although household consumers owed about 50 bln AZM (12.5 mln USD) total, according to Barmek-president Huseyin Arabul, the company was more concerned with the debt of public organizations.

Annual electricity consumption of 1.094 surveyed metered households in Baku in 2002 was between 2.376 kWh and 2.952 kWh which is similar to the average household consumption in Germany. Those households spent on average 2% of their yearly income on electricity – roughly the same as in the U.S. at the time (Julian A. Lampietti et al. 2007: 112). Based on Barmek data, it is estimated that collection rates from third group customers (households) in 2002 varied between 65% for the poorest fifth of the consumers and 81% for the richest fifth of the consumers (Julian A. Lampietti et al. 2007: 112). However, at the time Barmek serviced ca. 450.000 consumers in the Baku area (AssA-Irada 2002d) and the data presented here might not be representative.
State-agencies had accumulated 60 bln AZM (15 mln USD) worth of debt in only three months in 2002. Hence, power was cut first to the Education Ministry and then the Health Ministry (2002i). Other notorious debtors were the Baku Metro, Baku Sewage and Absheron Water. Azerbaijan’s Prime Minster Artur Rasizade then promised to resolve the situation (AssA-Irada 2002e). In May 2002, the government cleared part of the debt of Azerbaijan’s internally displaced persons by paying Barmek 800 mln AZM (200.000 USD) (AssA-Irada 2002f) of the almost 16 bln AZM (4 mln USD) owed by the State Committee for refugees in total (2002b). Among the debtors were also state agencies that in principle should have had plenty of money such as SOCAR and the State Customs Committee which was headed by Kamaladdin Heydarov since 1995 (AssA-Irada 2002c). Later, in June 2002, Barmek and the Ministry for Economic Development signed an agreement that the government from that month on would pay 80% of the electricity bills of some state companies (specifically Baku Metro, as well as the sewerage, water and heating service agencies) while the organizations themselves would pay only 20%. However, as previous debts were not covered by the new terms of engagement, debts of over 50 bln AZM (12,5 mln USD) remained even after at least SOCAR had paid its debt (2002b). In any case, overall collection rates, according to one source, were up to 50% by July 2002 (AssA-Irada 2002a).

In November 2001, an international tender had been launched for the management of three further regional distribution companies for 25 years – for Sumgayit, Ganja and Alibayramli JSCs (German 2001). Barmek bid for and won the management of the Sumgayit grid (AssA-Irada 2001) to start working in Sumgayit in October 2002 (2004h). Its operations were to be facilitated by a privileged tax regime (2002i). In this context, Barmek was to invest 100 mln USD over 25 years to improve Sumgayit’s electricity supply (2002j). The other grids were to be managed by the Azeri company Bayva (2004i).

Mr. Arabul, president of Barmek, announced in fall 2002 that the company would neither be able to prepare Baku’s grid for the winter nor to pay Azerenerji for the electricity provided if state organizations did not finally pay off their debts to Barmek which by then amounted to over 64 bln AZM (16,2 mln USD) (2002e). In November 2002, the government set out to re-negotiate the contract with Barmek because according to Finance Minister Avaz Akeperov it was unhappy with Barmek’s collection rates (German 2002). One month later, the chairman of the parliamentary standing commission on economic policy, Sattar Safarov, accused Barmek of misusing its monopoly position in power distribution (2002f). On top of that, Azerenerji claimed that it provided Barmek with power to sell in Sumgayit at very low prices (vis-à-vis generation cost of 200 AZM/kWh), disregarding the substantial state subsidies to Azerenerji and the fact that the retail price of electricity to consumers was fixed well below generation cost at 96 AZM / kWh. It was also clear that the investment required to modernize the power grids in Azerbaijan was substantial, while the government was not willing to guarantee the investments and unable to grant soft loans. The time to recuperate the investment was therefore excessive.

Yet, in 2003, Barmek according to its own data fared markedly better than Bayva and did provide reliable access to electricity (Tab 1).
Barmek reported various advances during its years of activity. On taking on the management of the Baku grid, Barmek promised to invest almost 10 mln USD into the company during the first year. One opposition party criticized this figure for being too low and also protested against the proposed sale of electricity meters to the population at 50 to 60 USD a piece (2002c). Then, a few days later, the company announced that meters would be installed free of charge while their costs would be accounted as investment (2002h). However, after the contract with Barmek about the management of the Baku grid had been terminated, the (new) Minister for Economic Development Heydar Babayev was unwilling to count the expenses for the installation of meters for the public as investment (AssA-Irada 2006b). During the first six months of its presence in Azerbaijan, Barmek has invested 10,2 bln AZM (2,55 mln USD) to modernize the grid in Baku. It estimated that another 50 bln AZM (12,5 mln USD) would be required (2002d). At that rate, the company would have invested only 127,5 mln USD over 25 years – thus not even half of what was contractually agreed. Yet, three months later, in September 2002, the company reported to have invested 24 bln AZM (6 mln USD) (2002e) and the total for 2002 was about 7,1 mln USD (2002g) (see Tab 2).

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Tab 1: Electricity consumption and service quality by location in 2003

<table>
<thead>
<tr>
<th>Location</th>
<th>Billing Method</th>
<th>Mean Household Consumption (kWh per month)</th>
<th>Winter Supply (hours per day)</th>
<th>Summer supply (hours per day)</th>
<th>Collection Rate (Payments/Billing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baku*12</td>
<td>Meters</td>
<td>265</td>
<td>24</td>
<td>24</td>
<td>63%</td>
</tr>
<tr>
<td>Sumgayit*</td>
<td>Meters</td>
<td>374</td>
<td>24</td>
<td>24</td>
<td>24%</td>
</tr>
<tr>
<td>Alibayramly</td>
<td>Norms</td>
<td>628</td>
<td>17</td>
<td>22</td>
<td>25%</td>
</tr>
<tr>
<td>Ganja</td>
<td>Norms</td>
<td>na</td>
<td>10</td>
<td>22</td>
<td>na</td>
</tr>
<tr>
<td>Goycay</td>
<td>Norms</td>
<td>503</td>
<td>15</td>
<td>18</td>
<td>42%</td>
</tr>
<tr>
<td>Guba</td>
<td>Norms</td>
<td>na</td>
<td>9</td>
<td>15</td>
<td>na</td>
</tr>
<tr>
<td>Imishly</td>
<td>Norms</td>
<td>960</td>
<td>8</td>
<td>20</td>
<td>7%</td>
</tr>
<tr>
<td>Ismailly</td>
<td>Norms</td>
<td>na</td>
<td>18</td>
<td>21</td>
<td>na</td>
</tr>
<tr>
<td>Mingecev</td>
<td>Norms</td>
<td>260</td>
<td>9</td>
<td>21</td>
<td>28%</td>
</tr>
<tr>
<td>Sabirabad</td>
<td>Norms</td>
<td>447</td>
<td>8</td>
<td>20</td>
<td>35%</td>
</tr>
</tbody>
</table>

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12 * Barmek
<table>
<thead>
<tr>
<th>ITEM</th>
<th>2002&lt;sup&gt;13&lt;/sup&gt;</th>
<th>2003&lt;sup&gt;14&lt;/sup&gt;</th>
<th>2004&lt;sup&gt;15&lt;/sup&gt;</th>
<th>2005&lt;sup&gt;16&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>INVESTMENTS, of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baku</td>
<td>USD 7.100.000</td>
<td>17.500.000</td>
<td>25.500.000</td>
<td>26.000.000*</td>
</tr>
<tr>
<td></td>
<td>AZM 28.400.000.000</td>
<td>55.000.000.000</td>
<td>74.000.000.000</td>
<td>80.000.000.000*</td>
</tr>
<tr>
<td></td>
<td>USD 7.100.000</td>
<td>13.750.000</td>
<td>18.500.000</td>
<td>20.000.000*</td>
</tr>
<tr>
<td>Sumgayit</td>
<td>AZM 15.000.000.000</td>
<td>28.000.000.000</td>
<td>24.000.000.000</td>
<td>24.000.000.000*</td>
</tr>
<tr>
<td></td>
<td>USD 3.750.000</td>
<td>7.000.000</td>
<td>6.000.000</td>
<td></td>
</tr>
<tr>
<td>FEE COLLECTION RATE</td>
<td>32% 54,60%</td>
<td>74,5% (Baku)</td>
<td>80,41%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>61,6% (Sumgayit)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VALUE OF ELECTRICITY</td>
<td>AZM 590.000.000.000</td>
<td>833.000.000.000</td>
<td>858.600.000.000</td>
<td>919.000.000.000</td>
</tr>
<tr>
<td>RECEIVED FROM AZENERJIS</td>
<td>USD 147,500.000</td>
<td>208,250.000</td>
<td>214,650.000</td>
<td>229,750,000,000</td>
</tr>
<tr>
<td>AGREED PAY RATE (TO AZENERJIS)</td>
<td>50% 55%</td>
<td>60% 75%</td>
<td>60% 75%</td>
<td>60% 75%</td>
</tr>
<tr>
<td>PAYMENTS TO AZENERJIS</td>
<td>AZM 340.000.000.000</td>
<td>382.000.000.000</td>
<td>451.000.000.000</td>
<td>498.000.000.000</td>
</tr>
<tr>
<td></td>
<td>USD 85.000.000</td>
<td>95.500.000</td>
<td>112.750.000</td>
<td>124.500.000</td>
</tr>
<tr>
<td>ACTUAL PAY RATE (TO AZENERJIS)</td>
<td>57,63%</td>
<td>45,86%</td>
<td>52,53%</td>
<td>54,19%</td>
</tr>
<tr>
<td>DEBT OF STATE-AGENCIES</td>
<td>AZM 60.000.000.000**</td>
<td>72.000.000.000</td>
<td>n.a</td>
<td>186.000.000.000</td>
</tr>
<tr>
<td></td>
<td>USD 15.000.000.000**</td>
<td>18.000.000</td>
<td>n.a</td>
<td>46.500.000.000</td>
</tr>
</tbody>
</table>

Collection rates for power improved due to management by Barmek (Julian A. Lampietti et al. 2007: 110). In 2003 state-agencies reportedly paid 85,7%, industrial consumers 88,2%, commercial enterprises 77,4% and the population 45,8% of the electricity consumed (AssA-Irada 2003). Acknowledging the death of Heydar Aliyev on 12 December 2003, Barmek promised not to cut power to customers indebted to the company for 40 days (Safarova and Zeynalov 2003). Ilham Aliyev had succeeded his father in office in October. By mid-2004, Barmek had installed ca. 250.000 meters as well as transformers and power lines (AssA-Irada 2004b). Their investment was well in line with the contractually specified 300 mln USD investment over 25 years.


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Barmek under fire

Initially, Barmek had met some, partly ill-founded, resistance against its proposed supply contracts from the population (2002k). In 2004, 50,000 of Barmek’s clients had filed complaints against the company of which a third was deemed valid (AssA-Irada 2005g). Triggered by those complaints, the MED under Farhad Aliyev set up a monitoring group in February 2005 to oversee the activities of both private companies that managed the grids in Azerbaijan - Barmek and Bayva -, as well as Azerenerji (C. Babayev 2005). The monitoring group was also to assess if the companies fulfilled their commitments (AssA-Irada 2005f). Facing elections in November 2005, many parliamentarians felt they had to defend power consumers against the distribution companies with regard to reliability of supply. However, the private companies claimed that Azerenerji had failed to deliver electricity which had led to power cuts (2005c).

Consumers, especially in the regions, complained not only about electricity, but also about gas supply. Azerigaz, a state-agency, was criticized for nontransparent excessive billing and low reliability of supply. Reacting to popular demands, President Ilham Aliyev demanded that the population be supplied with heat and power (2005n). By May 2005, the Prosecutor-General’s Office had charged six managers of Azerigaz with embezzlement and had announced that inspections of Bayva and Barmek were to follow (2005s). By June 2005, Barmek CEO Mr. Arabul, complained of lengthy inspections by the Prosecutor-General’s Office, the Tax Ministry, and the MED that hindered Barmek’s operations (2005l). In the same week, the Tax Ministry accused Barmek of 19 bln AZM (4,75 mln USD) tax evasion (2005m) which was later reduced to 16,6 bln AZM (4,1 mln USD) (AssA-Irada 2005e). The ministry then seized that amount from the company (Wetherall 2006b). Consequently, the EBRD refused to loan Barmek 50 mln USD for investments (AssA-Irada 2005c). One month later, Azerenerji launched its first attempt to break off its contract with Barmek and Bayva presumably in order to manage the grids itself. Allegedly the companies did not invest, were not efficiently managing the grids and had debts to Azerenerji (2005e).

In September 2005, Barmek fired some of its top managers in an effort to improve service and fight corruption (2005j) probably reacting to attacks from the public and governmental organizations. One of those fired as well as another manager were incarcerated for having bought used transformers while reporting them as new, embezzling 400 mln AZM (100.000 USD) that way (2005k). After Mr. Arabul was summoned to testify against his employees before court, he himself was threatened to be charged based on this testimony (AssA-Irada 2005a). Mr. Arabul issued a statement in October 2005 urging governmental agencies not to create obstacles for Barmek’s operations. While “President Heydar Aliyev created favourable conditions for investment” (Hamid 2005), the MED had confirmed to owe Barmek 186 bln AZM (46,5 mln USD) which had led to arrears at 66 bln AZM (16,5 mln USD) to Azerenerji (Hamid 2005). Still, the government did not undertake to clear its debt with Barmek. Azerenerji on its part appealed to the Cabinet trying – for the second time – to break off its contract with Barmek (Hamid 2005).

17 Relieving the head of the of the department for the investigation of grave crimes, Tahir Kazimov, from his position at the same time 2005r. Senior Azeri Prosecutor Sacked. Turan, 5.5.2005.
After Bayva’s contract had been terminated per presidential decree in December 2005 – reportedly because the company saw itself unfit for the task of management and had requested the termination - , management of the Ganja and Ali Bayramly networks was transferred to Azerenerji and thus re-nationalized (2005d).

Presumably in a last attempt to convince the authorities of the value of its presence in Azerbaijan, Barmek proposed to invest 616 bln AZM (154 mln USD) into the Baku and Sumgayit grids in 2006-2007 (2006k). But in February 2006, Azerenerji president Etibar Pirverdiyev undertook to leave the contract with Barmek for the third time, again accusing Barmek of breach of contract and non-payment for electricity delivered (2006d). This time Azerenerji was successful: The president of Azerbaijan took a stance against Barmek and urged the company to comply with its contract, otherwise official agencies were to make it comply (2006g; AssA-Irada 2006d). In the same week, the Prosecutor General initiated criminal proceedings against Barmek for breach of contract and corrupt conspiracy with Farhad Aliyev (2006t), because Barmek had paid consulting fees to a British company affiliated with the ex-Minister for Economic Development (2006r). More to the point, it was alleged that Farhad Aliyev had obtained a 50%-share in Barmek Azerbaijan, which was held for him by the British Swadcrest Ltd. and earned him 560,000 USD during Barmek’s operations in Azerbaijan (Muradova and Abbasov 2006).

Barmek did indeed pay Azerenerji less than the contractually determined portions of electricity delivered (see Tab 2). However, if the debts of state-agencies are taken into account, Barmek’s payments almost meet the requirements. Between 2005 and March 2006, this debt grew to 52,9 mln AZN\(^\text{18}\) (66,1 mln USD) (2006j) and by June 2006 it had reached 100 mln USD (2006n). However, statements regarding the nature of those debts vary: while Barmek claims that the agencies are neither paying their share of 20% to Barmek nor did the government pay 80% of their energy bills as agreed (2006s), the Azeri side posits that 80% of the energy delivered to public agencies did not appear in the value of energy delivered from Azerenerji to Barmek while the rest was a problem of collection that Barmek has to tackle itself (2006i). By 2006 the Prosecutor General criticized Barmek for allegedly investing but revenue collected from consumers instead of fresh money (Muradova and Abbasov 2006). As mentioned above, from the information available it is not clear if this constitutes a breach of contract, because usually, investment is investment no matter if the money is from operational profits or elsewhere.

The government of Azerbaijan confiscated Bakiletrikavtomat from Barmek (2006f; 2006o), after some Barmek employees had accused the company of mismanagement (Ahmad Musayev et al. 2006), but promised to reimburse Barmek for its investments into the plant (Muradova and Abbasov 2006). In spring 2006, more Barmek employees got arrested on various charges (2006e; 2006x; AssA-Irada 2006e), more people were burned in the fight against corruption (2006h; Ismayilov 2005a), Barmek’s bank accounts were frozen (and unfrozen again), and the Minister for Energy spoke publicly about terminating the contract with Barmek (AssA-Irada 2006c).

By April 2006, Barmek was ready to leave Azerbaijan if the government were to pay compensation for terminating its 25-year concession. Mr. Arabul demanded the reimbursement of 3 mln USD signature bonus as well as 10 mln USD for each remaining year of the contract, as envisaged in the agreement (2006u). The Barmek president was then banned from leaving Azerbaijan (2006v).

\(^{18}\) The AZM was converted into the AZN (new Manat) in January 2006 at a conversion rate of 5000:1.
Afterwards, the allegations against and treatment of Barmek become a bit chaotic, one official for example criticized alleged investments of only 3 mln USD since 2001 which is counter to all media reports up until the end of 2005 (AssA-Irada 2006a), and Barmek’s equipment was not allowed to clear customs (2006w). Barmek and various Azeri governmental organizations and ministries accused each other of breach of contract and in July 2006 Heydar Babayev announced that the contract with Barmek was being terminated (2006b). In August 2006 Mr. Arabul announced his resignation from the post as head of Barmek Azerbaijan (2006p) which marked the end of the country’s endeavor into privatization in the power sector.

The Azeri Bayva, which had managed all grids but in the cities of Baku and Sumgayit, agreed to dissolve its contract and ceased operations in 2005. Its networks had covered mostly rural areas and suffered from collection rates from households as low as 5,3% with an overall collection rate of 35,5% in 2003. Bayva was fully reimbursed for its 191 bln AZM (47,8 mln USD) investment (2004i). Barmek-Azerbaijan, on the other hand, being part of the much bigger Turkish Barmek group was not ready to leave Azerbaijan that fast. It took another seven months (until July 2006) and the detention of it CEO Arabul before Barmek decided to stop its operations in Azerbaijan thus allowing the full re-nationalization of its networks (2006a). Barmek filed a suit against the government of Azerbaijan with the International Center for Settlement of Investment Disputes (ICSID) in August 2006 (2006m), demanding 1 bln USD from Azerbaijan for the seizure of the concessions (Goldhaber 2011), notwithstanding suits still pending against before Azeri courts (2006c).

Various sources stress that the problems in the energy sector have not been solved after Barmek quit the country (Gismatoglu 2006; Rovsanoglu 2007).

**Summary of Barmek’s activities**

In the first years of its operations in Azerbaijan, Barmek reported some substantial successes specifically rising collection rates for electricity supplied to consumers, investments and rising payments to Azerenerji (see Tab 2). Barmek’s position seems to have weakened after the death of Heydar Aliyev and its “fall from grace” seems rather sudden after the Minister for Economic Development had been ousted in October 2005, with attacks from Azerenerji intensifying from December 2005 onwards. Media reports also started to turn against Barmek in December 2005. While throughout Barmek’s operation in Azerbaijan, issues regarding debt to Azerenerji and security of power supply / power cuts had been raised (2005w), Barmek had seemed to be successful.

Power supply was at least once used for political purposes. Following Heydar Aliyev’s death, service to the private printing house Cap Evi was interrupted (2004f) because of a defect cable. Barmek did repair the cable, but “the printing house’s director was implicitly told that power supplies could not be resumed as the director the Azarneftyyag Azerbaijani oil and lubricants refinery, Ramiz Mirzayev, prohibited electricity supplies to the printing house” (Abulfazgizi 2004). A vital switchboard was installed on the refinery’s territory. The printing house closed down in March 2004 because of constant power outages (2004j). In 2006, Ramiz Mirzayev was appointed deputy minister of industry and energy of Azerbaijan (2006q).
3.3 Electricity Tariffs

Setting national electricity and fuel tariffs is energy policy and while it is more straightforward than the manipulation of market conditions to achieve ends in energy policy it also entails a level of planning very reminiscent of communist times. The ends in the case of Azerbaijan as everywhere are to ensure reliably affordable and efficient energy supply of the population, here with emphasis on affordability and supply (CAREC Institute 2005).

Tariff reform

Although the tariffs for the electricity are set nation-wide by the Tariff Council, it does seem reasonable to pay special attention to developments in Baku. At least, an independent company is responsible for distribution and marketing of electricity and somewhat disaggregated information is therefore available in some cases.

The Business Environment and Enterprise Survey (BEEPS) is one of the few sources aspiring to assess the quality of power supply in Azerbaijan. 170 entrepreneurs were asked among others things how many days in 2001 they did not receive electricity from the national grid. On average this number was six days. They found this to be a minor obstacle to their business (European Bank for Reconstruction and Development and World Bank 2002). For 2007 it indicates that businesses experienced 3,6 power outages per month which lasted for 3 hours on average. However, the surveyed entrepreneurs regarded power outages only as a minor obstacle for their business (European Bank for Reconstruction and Development and World Bank 2009). These figures point to the worsening of power supply in Azerbaijan between 2001 and 2006.

Still, retail prices for the supply of electricity to households were raised in January 2007 for the first time since 1997. They increased threefold from 96 AZM / kWh (0,024 USD / kWh) to 0,06 AZN / kWh (0,075 USD / kWh). While the old price had not been cost covering - not even if the cost of fuel is not taken into account – experts suggest that cost recovery could have been achieved through a price of 0,06 USD per kWh (Julian A. Lampietti et al. 2007: 110). Own calculations suggest that the current price could cover TPP-generation cost – depending on the actual investment cost. Considering the investments into power plants, electricity generation in TPP currently costs between 0,035 and 0,059 € / kWh, depending on the amount of investments. The costs of transmission are not included in this price, neither are the investments to modernize the transmission and distribution systems (see above) nor the costs for metering and billing. There is a margin between 0,022 AZN / kWh (0,02 € / kWh) and loss after deducting the real price of generation at national gas prices, which are markedly below international gas prices. For transmission 0,018 € / kWh are added to the retail price. However, transmission and distribution more likely cost over 0,05 € / kWh

In 2007, when the 1996 electricity prices were augmented threefold, average consumer prices had increased to 126% of the 2005 level and GDP PPP per capita of 164% of 2005 had more than kept up (World Bank 2011b). Yet, the price increase led to a drop in consumption of over 4 TWh from 2006 to 2007 (see Fig 3). The fact that price increases had an impact on power consumption proves that metering and payment collection have been improved while the population is becoming more aware of demand management (see also Econ Pöyry AS 2009: 23). This impression is confirmed by claims that collection rates have been further improved from 53% in 2007 to 73% in 2009 (ADB 2010). These are positive developments. However, state agencies are still reluctant to pay for
electricity (Econ Pöyry AS 2009: 24). Also, after the price increases for gas and power, losses in the electricity system spiked respectively. Furthermore, if the gas distribution network were to be rehabilitated so that people could use gas instead of electricity for heating in winter, annual demand would fall substantially (Econ Pöyry AS 2009: 26).

The electricity sector is still heavily directly subsidized. Furthermore, the wholesale prices for fuel are heavily subsidized. The wholesale price for natural gas was last raised in 2007 and is set at 42 AZN / 1,000 m³ (52,50 USD / 1,000 m³) (Heydar Babayev 2007b) and national crude prices were set at 53,6 AZN / ton (9,1 USD / bbl)\(^{19}\) from 2010 (Heydar Babayev 2009). While the international oil and gas prices increased about fourfold between 1990 and 2008 (see Fig 8), wholesale fuel prices in Azerbaijan stayed relatively low even considering the latest price increases – covering production cost and transport –, which added to opportunity cost. On top of that SOCAR has waives payables for oils and gas to fire the thermal power plants several times ultimately funneling oil money into subsidies for electricity consumption.

**Fig 5: World crude oil price and average gas price in Europe\(^{20}\)**

With regard to investment and metering, the separate consideration of Baku Electric Grid JSC seems worthwhile. By 2008, the company had equipped 564,928 of its 652,774 consumers (90.3%) with electricity meters (BES 2009b: 12). According to Baku Electric Grid, the company has invested 331 mln AZN (414 mln USD) into the Baku grid from 2007 until December 2010 (BES 2009c; 2010).

It could be argued that given the very low payment rates until about 2005 and the need for meters which was only satisfied in 2008, as well as bad management of the billing procedure and unreliable supply, raising electricity tariffs before 2007 could have stirred up protests (as in the case of the four-fold increase of gas prices in 2005 (2004!) without generating relevant returns.

\(^{19}\) One ton of Azeri light crude equals 7,325 bbl.

Consumer’s debts

Up to now it seems clear that Azerbaijan has raised its electricity tariffs to cover the cost of generation in order to satisfy international investors and to be able to improve supply. Yet, it has already been mentioned that the government of Azerbaijan wrote off the substantial debts of several state agencies in the order of 1.56 bln AZN (1.94 bn USD) in 2010 to Azerenerji (2010b). More specifically, Barmek Azerbaijan was relieved of 466,4 mln AZN (583 mln USD) debt to Azerenerji. The companies that had been managed by Barmek and then by the state - Bakielektrikshebeke JSC (389,1 mln AZN – 486, 4 mln USD) and Sumgayitelektrikshebeke JSC (296,5 mln AZN – 370,6 mln USD) were likewise let off their debts. State-agencies of which most are located in the Baku area were equally subject to debt write-off (2010b). How does this fit into the picture?

Azerenerji did not have to finance this write-off itself as the amount it had to pay to SOCAR for fuel was reduced by the same figure. Now, while raising electricity tariffs seems to be in line with good governance / management, as well as a sign of economic development, the latter practice does not. It has been mentioned that part of the debt write-off is likely connected to the settlement between Barmek and Azerbaijan. However, the more important reason for the specific timing of the state gift to households and public consumers in August 2010 is most likely that elections were held in November 2010.

Not last, it is unclear how Azerenerji respectively Baku Electric Grid would have ever collected the debts of power consumer that claimed faulty billing procedures. Something similar had been done in December 2009, when the consumers debt for natural gas totaling 327 mln AZN (409 mln USD) was written off. In this case, SOCAR, that had taken over Azerigaz, had been reimbursed from the national budget (2009b). Concluding, it could be argued that given the high level of tax evasion in Azerbaijan21 and the friable influence of central authorities on the actual distribution of public benefits, the top decision-makers really do not have many other opportunities to hand out public benefits but those which are - centralized.

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4 Analysis

4.1 Political Context of Barmek’s ousting

It is undisputed that Barmek suffered from a wider campaign against everyone tied in any way to Farhad Aliyev. "The state-sponsored attacks on the so-called "Farhadians" has [sic] damaged the country's investment climate" (Wetherall 2006b).

Farhad Aliyev was detained in his office by the Ministry of National Security on October 19 2005 and accused of planning a coup against the president. One day later, the Health Minister Ali Isanov, one of the founders of the ruling party YAP, as well as Akif Muradverdiyev, part of the presidential administration, were dismissed from their positions (Ismayilov 2005b). According to an analyst Ismayilov, "[w]hile ex-Economic Development Minister Farhad Aliyev had a popular image as a reformer, and was seen as pro-Western, Isanov and Muradverdiyev have no such reputation" (Ismayilov 2005b) Official sources accuse both ministers of planning a coup together with Rasul Guliyev (2005p; Ismayilov 2005b). Rasul Guliyev had been the speaker of parliament of Azerbaijan from 1993 to 1996 under President Heydar Aliyev. He was living in exile in the U.S. for nine years after having been charged with embezzlement of 117 mln USD and subsequently lost his position. In exile he led the “Azerbaijan Democratic Party”. Mr. Guliyev had planned to return to Azerbaijan in October 2005 in order to run for political office in the November elections (2005q), in spite of a pending international warrant from Azerbaijan. This attempt led to his arrest on October 17 2005 as well as to the arrest as some of his supporters who had gathered in Baku to greet him (2005t).

Farhad Aliyev was succeeded in office by Heydar Babayev (Minister of Economic Development until October 31 2008). The European Court of Human Rights ruled in 2010 that several breaches of the European Convention on Human Rights had occurred in relation with the detention of Farhad Aliyev prior to his trial (Nielsen and Rozakis 2010). In any way, the coup charges against Farhad Aliyev had been dropped already by December 2005 (2005g). “After being held in pre-trial detention for 18 months, they [Farhad and Rafiq Aliyev] were tried and convicted of unrelated economic crimes” (2008a) in a trial that was “marked by irregularities and lack of due process” (2008a). Farhad Aliyev was convicted to ten years in jail for corruption, abuse of power, and “other economic crimes” (Ismayilov 2007b). Thus, the question remains: Why was Farhad Aliyev, of all people, ousted for corruption in a context that seems to have been ripe with a country-specific mixture of politics, personalism and patronage?

Some experts as well as some journalists perceive the developments of 2005 as a general trend of Azeri politics towards Russia (Babajew 2009: 244). More precisely it is alleged that Farhad Aliyev as well as his brother who then ran AzPetrol were incarcerated with the help of the FSB in a Russian move to regain control over Azerbaijan. NUPI, an independent think tank, does note heightened Russian interest in the 2005 elections (Torjesen and Øverland 2006). However, it does seem reasonable that while Russia is willing to export its “managed democracy” (Управляемая демократия), the elites in CIS countries are willing to import it and do not have to be forced by the

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Russian Secret Service. Some analysts support the thesis that Farhad Aliyev worked with the opposition (Franke et al. 2009a), specifically the People’s Front of Azerbaijan (2005u). Others trace the changes back to power politics of Ilham Aliyev. Thus, some experts conclude that “Heydar Aliyev’s death untied the hands of many powerful members of this old guard, which wished to control the [...] president. It was led by the president’s uncle, Jalal Aliyev, and his close associate, Ali Insanov […], a chief of the powerful Yerazi clan” (International Crisis Group 2010: 3). Those analysts do not deem the connection with Rasul Guliyev important but subsume the affair under Ilham Aliyev’s general consolidation of power (Küpeli 2010: 49) or “elite reshuffling” (Wetherall 2006a).

Prior to the 2005 Parliamentary elections Ilham Aliyev supposedly strengthened new elites from Baku at the expense of old YAP elites who were mainly from Nakhichevan. However, this interpretation does not withstand close observation. While it is true that Farhad Aliyev has served the YAP for a long time as came to power under Heydar Aliyev, which makes him part of the old elite, and was succeeded by Heydar Babayev, who was born in Baku, the latter is six years older and also rose to power under Heydar Aliyev. The marked difference between the ousted Ministers and Farhad Aliyev’s successor Heydar Babayev is that the latter did indeed have no affiliation with the ruling YAP (Fatullaev 2004). However, the current cabinet still features many men who would be classified as “old guard” not least the two most important political figures aside from the president – Prime Minister Artur Raiszde and Minister for Emergency Situations Kemaladdin Heydarov. One source stipulated in August 2004 that Farhad Aliyev wanted to become Prime Minister (Huseynli 2004). This cannot be verified although it would obviously be the start of a political fight between him and the acting Prime Minister then and now - Artur Raiszde. In any case, available information suggests that power struggles within the ruling elite which did not immediately touch the power of President Ilham Aliyev rather than Russian interests were decisive for Farhad Aliyev. To be sure, these power struggles are less politically than economically motivated (Wetherall 2006b). Two issues seem pertinent in this context.

First, Farhad Aliyev undertook political initiatives which were unpleasant to some powerful business-figures. He was in favor of Azerbaijan joining the WTO, after it had been an observer country in the organization since 1997, for opening a national economy to the world markets and exposing it to global competition is considered an important step to economic growth. Obviously, an economy has to be ready for this move with regard to two crucial points: productivity and investment potential. Otherwise, products from all over the world would swamp the national market and crowd out local products, severely hurting the economy. This is presumably why the minister slowed the accession process in the end of the 1990s (1999) and was cautious in the accession talks (2002a). The U.S. Trade and Development Agency (TDA) supported Azerbaijan’s WTO accession with more than 3,5 mln USD worth of loans between 1997 and 2005 (2005u). Now, it is a point for debate if Azerbaijan would have been ready to enter the WTO by 200723, as Farhad Aliyev announced in May 2004 (2004c), and if entering it would have lifted productivity as well as investment potential to new levels making Azeri products competitive(AssA-Irada 2005b).

However, if the economy is basically divided into monopolistically structured sectors (Qulliyeva 2002) which are in the hands of a few families (2010a), productivity is surely not increased as there is no incentive for much investment. Thus, allowing for national competition is the first step to bring a

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national economy up to world standards. Reacting to rising inflation, from 2004 onwards Farhad Aliyev promoted stronger measures against monopolies in Azerbaijan to improve the business climate (2005v) and submitted corresponding draft legislation to the Cabinet of Ministers (2005x). This made him the “most outspoken official on this issue” (2004k) and put him at odds with Kamaladdin Heydarov who stated that “there is no monopoly in Azerbaijan” (2004e). Kamaladdin Heydarov, Chairman of the State Customs Committee from 1995 until 2006, whom some sources hold to be the richest and one of the most powerful figures in Azerbaijan (2010a), was explicitly targeted by Farhad Aliyev’s campaign against monopolization (2004k). Specifically, Mr. Aliyev pointed to “delays in customs and high tariffs as reasons for Azerbaijan’s rising prices” (2005b). After President Ilham Aliyev (not related) had put a stop to the public fighting of the two ministers, their dispute picked up again in August 2005 (2005u) by “leaking compromising reports to the mass media and accusing each other of inflating prices of goods and sabotaging economic reforms” (2005h). Shortly afterwards, Farhad Aliyev saw his life endangered, according to one source (2005i) and was relieved of his position.

In the end, turf wars between the two ministers rather than grand political plans explain one half of the story24. To this conclusion also points a report by the opposition newspaper Yeni Musavat25 prior to the 2010 parliamentary elections, it stated “[i]t is obvious that up to now it has become customary for [Kamaladdin] Heydarov to become the winner of all infighting. It is already an open secret that the former economic development minister, Farhad Aliyev, was the victim of the infighting with the "super minister"” (also 2010a; 2010c). The U.S. embassy reporter goes a step further stating that “[h]istorically, those who have fought with Heydarov have always fared poorly: Farhad Aliyev and Heydar Babayev were (in succession) driven out as Minister of Economic Development in part after falling on Heydarov’s bad side” (2010a).

The indictment of Farhad Aliyev opened the possibility to launch deep investigations into several companies that were privatized while he was in office. The heads of those companies were accused of corruption / embezzlement / tax evasion and arrested: Agabay Huseynov (director of Azarkabel - Azeri Cable), Nuraddin Zulfuqarli (chairman of the board of Bakielektrostamp - Baku fittings plant), Logman and Rovshan Zulfugarly (Bakupoladtokme steel mill) (Ismayilov 2005a), and Tayyar Sukurov (head of NJT 2000 - plastic pipes, fittings etc.) as well as some of the latter’s brothers (2005f). Soon after Farhad Aliyev had been incarcerated, in spring 2006, the company group AzPetrol (AssA-Irada 2006c) and Dutch Fondel Metals Participation- both owned by Farhad Aliyev’s brother Rafiq Aliyev – were also investigated and eventually re-nationalized (Harnish 2006). Settlement before the ICSID was sought. The settlement award rendered jointly on those two companies is publicly available and indicates that they did not have rightful claims against Azerbaijan as the party being sued (2009c). The settlement explicitly contains the provision that Azerbaijan is allowed to publish the settlement in order to show that it is not culpable (2009a). On September 28 2009, the case of Barmek against Azerbaijan was settled as well. However, other than in the disputes with AzPetrol and Fondel Metals, the Barmek settlement is not public. In the light of the motivation for publication of the first

24 As a side-note Mr. Heydarov was appointed Head of the Ministry of Emergency Situations shortly after its establishment in December 2005. "As emergency planning minister, Mr Heydarov is now in charge of substantial resources in terms of security forces...Having added political power to Mr Heydarov’s economic wealth, Mr Aliyev is likely to have warded off any interest on his part in the presidency" EUI. 2006. Baku’s “Yukos Affair”. In Business Eastern Europe. London: The Economist Intelligence Unit Limited..
25 which sometimes, in any way, appears to value ideological persuasiveness over factual correctness,
settlement, was most likely found guilty at least in parts. In the same direction points that the
government of Azerbaijan wrote off the debt of Barmek Azerbaijan in the amount of 466,4 mln AZN, as well as the debts of the companies that had been managed by Barmek - Bakielektrikshebeke JSC (389,1 mln AZN) and Sumgayitelektrikshebeke JSC (296,5 mln AZN) (2010b). So, what happened to Barmek?

The second reason for the permanent attacks by Azerenerji on Barmek is most likely that the former wanted to re-nationalize the Baku and Sumgayit grids, as it had done with the grids formerly managed by Bayva (Muradova and Abbasov 2006). Thus, subsequent to the ousting of Barmek, the management of the Baku and Sumgayit grids was transferred to the re-founded state-owned Baku and Sumgayit JSCs (Tokyo Electric power Company 2010: 4-9). By 2010, the distribution system had been restructured again, now comprising seven distribution companies which are part of Azerenerji, with the Sumgayit grid being one of them, and Baku Electric Grid JSC as the distribution company formally independent of Azerenerji (Tokyo Electric power Company 2010: 73).

In 2007, Baku Electric Grid reported distribution losses of almost 38%. Compared to about 5% in well-managed grids, this number is outstandingly high. Furthermore, the electricity received from Azerenerji was neither paid in full in 2007, nor by 2009 (Tokyo Electric power Company 2010: 75). This brings us to the second aspect of the power system which will be analyzed in this paper: Tariffs and subsidies in the electricity sector.

4.2 Economic context to the 2007 tariff increase

In 2001, one point of contestation during the negotiations between Siemens and the government of Azerbaijan about the management of the Baku grid was the low retail price for electricity. From 2001 and 2007, the issue has been raised multiple times by Barmek and Bayan, as well as Azerenerji. However, only in 2007 the tariff system was restructured and prices rose substantially for all consumers (see Tab 3). Why were the tariffs raised suddenly in 2007 and not gradually when private companies were still active in the sector?

Tab 3: Electricity prices in Azerbaijan

<table>
<thead>
<tr>
<th>Year</th>
<th>199726</th>
<th>200027</th>
<th>200228</th>
<th>200429</th>
<th>200530</th>
<th>200731</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AZM</td>
<td>USD</td>
<td>AZM</td>
<td>USD</td>
<td>AZM</td>
<td>USD</td>
</tr>
<tr>
<td>wholesale</td>
<td></td>
<td></td>
<td>50 0,013</td>
<td>71 0,018</td>
<td>71 0,018</td>
<td>0,048</td>
</tr>
<tr>
<td>households</td>
<td>50 0,013</td>
<td>50 0,013</td>
<td>96 0,024</td>
<td>96 0,024</td>
<td>96 0,024</td>
<td>0,06</td>
</tr>
<tr>
<td>private organizations</td>
<td>50 0,013</td>
<td>130 0,033</td>
<td>156 0,039</td>
<td>295 0,074</td>
<td>295 0,074</td>
<td>0,06</td>
</tr>
<tr>
<td>public organizations</td>
<td>50 0,013</td>
<td>130 0,033</td>
<td>130 0,033</td>
<td>130 0,033</td>
<td>154 0,039</td>
<td>0,06</td>
</tr>
</tbody>
</table>

The prices for basic services, such as power and water, have to be seen in the context of overall economic development. The disintegration of the Soviet Union led to enormous inflation between 1.128% and 1.737% per annum in 1993 to 1994 which decreased to a substantial 411% in 1995 (World Bank 2011b). In the end of 1996, when the electricity tariffs were adjusted for the first time after independence, consumer prices had thus risen to 83% of the level of the year 2005, while the gross domestic product (GDP) at purchasing power parity (PPP) per capita stood at only 41% of the amount in 2005 (Fig 5). In 2001, almost 50% of the population were considered poor by national standards (Fig 5), raising electricity prices was not politically feasible when the government negotiated contracts with private companies for grid management (see above).

**Fig 6: Economic development in Azerbaijan - selected indicators**

The strong economic growth in Azerbaijan has already been hinted at. GDP growth rates kicked-off after the signing of a contract for oil exploration with big transnational multinational oil corporations brought substantial foreign direct investment into Azerbaijan. One would suspect that huge foreign investment into only one economic sector and economic growth up to 34.5% would increase inequality in a country. However, the scarce data available on equality between 1990 and 2010 show nothing like that and are therefore quite suspicious (see Tab 4). This could point to the fact that Azerbaijan has always been authoritarian and export-oriented such that there is not systemic change. However, these numbers indicate that the situation of the fifth of the population that fared worst economically, had improved markedly.

**Tab 4: Income distribution and GDP**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1995</th>
<th>2001</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (constant 2000 USD)</td>
<td>3.748.177.102,0</td>
<td>5.794.606.298,5</td>
<td>18.499.278.246,2</td>
</tr>
<tr>
<td>GINI index</td>
<td>0,35</td>
<td>0,365</td>
<td>0,3371</td>
</tr>
<tr>
<td>Income share held by highest 20%</td>
<td>42,0%</td>
<td>44,2%</td>
<td>42,1%</td>
</tr>
<tr>
<td>Income share held by fourth 20%</td>
<td>22,6%</td>
<td>21,5%</td>
<td>21,7%</td>
</tr>
<tr>
<td>Income share held by third 20%</td>
<td>16,5%</td>
<td>15,6%</td>
<td>16,2%</td>
</tr>
</tbody>
</table>

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33 Ibid.
IEA data show that annual power consumption has increased 1.5 GWh between 1990 and 2006 (IEA 2010). In itself this necessitates an increase of available generation capacity by ca. 420 MW. Yet, considering that the power plants and grids in Azerbaijan were in an extremely bad shape in the early 90s and that the whole system experienced great losses during the whole time, far more extra capacity was needed to even out the increases. The World Bank estimated in 2005 that between 1.95 bln and 3.6 bln USD would have to be invested until 2015 in generation only (World Bank 2005: 61). Transmission and distribution needed between 683 mln and 1.26 bln USD. Investments by Azerenerji are usually financed as subsidies through government funds or international loans (Tokyo Electric power Company 2010: 6-1). The same presumably hold true for Baku Electric Grid JSC. Although Azerbaijan thus did invest its own money into the expansion of generation capacity and the improvement of the grids, international financial organizations were key players in the power sector. Not only did they help significantly to upgrade the high voltage transmission grids, but they also funded the refurbishment of the biggest power plants which suffered badly from low maintenance and old age. The international banks demanded a sound price policy for electricity in order to finance their projects.

Gas prices for households were doubled to 70.000 AZM / 1.000m³ (1.75 USD / MWh) effective in January 2005 (2004b) but at the same time Russian gas supply to Azerbaijan was interrupted due to a dispute over gas prices between Russia and Turkmenistan which led to significant shortage in Azerbaijan (Sultanova 2005). Thus, it is impossible to tell in how far the price increase was responsible for electricity consumption to rise by about 1.7 TWh from 2005 to 2006 (18,20 TWh to 19,95 TWh) (See Fig 3). It is likely that both factors added to consumption and diminished reliability of supply in winter (Julian A. Lampietti et al. 2007: 110). The comparison between load data in summer and winter 2009 reveals more than a doubling of peak load in winter which indicates that electricity is still an important factor for space heating (see Fig 6). The impacts of electricity prices in the context of heating in winter thus have to be taken into account when setting tariffs especially as available gas heating systems are often unsafe as they lack a safety shutdown. On the other hand, the effect of tariff increase on consumer demand management support tariff increases.

Fig 7: Load dispatch of Azerenerji 28 June (left) and 16 January 2009 (right)

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Higher electricity tariffs enable the government to decrease fuel subsidies to Azerenerji and thus reduce the opportunity cost of power generation versus resource export. As oil production in Azerbaijan has peaked notwithstanding new discoveries, the government is pursuing the strategy to export natural gas. Given that natural gas is the main fuel for power generation (see Fig 2) and expected further increases in electricity consumption, there is a serious incentive to improve sector management and raise electricity tariffs in order to promote the efficient use of electricity.

According to one sector study, until about 2006, “priority to allocate financial resources for capital investment has been given to power generation facilities, leaving transmission and distribution facilities left behind without necessary investment” (Tokyo Electric power Company 2010: ii) leaving grids and transformers in bad shape.

Exact data regarding payment rates for electricity are difficult to obtain for all phases of sector development - prior to, during and after private management. When Barmek was still managing the Baku grid, as well as in later years, the most effective and basically only means to make consumers pay for power was to cut electricity in case they did not (Tokyo Electric power Company 2010: 75). Beginning in March 2005, power consumers with arrears were also incurred extra fines of 0,01% of their debt per day (AssA-Irada 2005d).

While the pressure on consumers grew, most sources still testify to the unreliability of power supply, indicating that power outside of Baku was provided only “limited hours per day” in 2006 (see Tab 1)(Julian A. Lampietti et al. 2007: 110). This stands contrary to expectations of swift overall development and rising standards of living that were nurtured by outstanding economic growth rates. It is basically a chicken and egg dilemma: while the companies say they need higher income for investment in order to improve supply, consumers are not ready to pay higher prices unless supply is improved first (Information and Resource Center for the Azerbaijani Oil Industry 2008).
5 Conclusion

As had been suspected, Azerbaijan soon abolished the short venture into privatization to have the state take care of electricity again. While in the first case of privatization, Azerbaijan’s elites proved their worth in stripping Viktor Kozeny of a few hundred million Dollars they could record as investment, the Barmek episode was not as professionally executed. It was not obviously a case where the state needed to defend itself from greedy investors. However, presumably to get into big business, the responsible members of the elite had to be convinced in the Barmek case. The idea behind (the extraction) of certain favors is twofold: There is immediate personal gain, but there is also a trump card – namely provable illegal action – in case things get awry. The privatization process did proceed rather fast, with the grids completely under private management within two years.

From an economic point of view, the privatization of the grids in 2001 is debatable. First of all, the grids are the only natural monopoly in the electricity sector. They defy the ultimate reason for privatization which is the introduction of competition. They necessitate, on the other hand, detailed regulation and good management from the part of the state where the networks are located. Given that Azerbaijan did not even have an energy law in 2001, this condition was clearly not met. Therefore, privatizing the networks instead of generation or instead of just the marketing seems rather ill-advised. Secondly, considering the very bad shape of the power infrastructure in Baku [if the status of the grid can be deduced from the state of the infrastructure in general], the high rate of power theft, and the low payment rates by consumers (Tokyo Electric power Company 2010: 73), grid management was not exactly the jewel of state-property. Hence it was not anything that would naturally attract foreign investment without governmental support. Furthermore, the state was ready to “give up” marketing and distribution of electricity as they provide the lowest margins. Thirdly, the regional networks were completely dependent on Azerenerji for the availability of electricity and current in the high voltage network for distribution (C. Babayev 2005). At the same time, the contract provided Barmek with no means to make Azerenerji deliver. There do not seem to have been purchase contracts for power between Barmek and Azerenerji. Rather, at the end of the month Azerenerji metered what it had delivered and expected payment for it at the (low) government set price. Barmek, of course, had to sell the electricity at a low government set price. This construction seems to combine the in-transparency of markets (from the point of view of the state) with the rigidity and top-down logic of planned economies – thus: the worst of two worlds.

The second privatization program represented a policy adjustment after the dangers of voucher privatization had become apparent. Was policy implementation successful in this case? In order to justify Barmek’s ousting, the authorities basically had to prove that implementation was unsuccessful. They needed to show that the goals pursued through privatization had not been accomplished, because otherwise there would have been no reason to terminate the contract with Barmek. From the perspective of the president of Azerbaijan, who had entrusted his Minister of Economic Development with the privatization process, the problem of multiple levels of hierarchy with personal interests at each level clearly shows. Also, political analysts convincingly ascribe the fight between Ministers Aliyev and Heydarov basically to turf wars that had to be calmed down by the president. When the fight between Farhad Aliyev and Kamaladdin Heydarov in 2005 had become too public, Ilham Aliyev had to put a stop to it as both were threatening to expose widespread fraud and corruption in the others’ sphere of influence. Thus, the tension between power-hungry patrons
threatened to blow out of proportion. This is well in line with the idea that competition between state organizations grows as state the apparatus evolves.

Over the course of its active time in Azerbaijan, from the outside it seems unclear at various points in time, why Barmek consistently widened its engagement in Azerbaijan. When the company still negotiated about the management of Sumgayit power network, it was already clear that especially first tier consumers, which are state agencies, were very reluctant to pay the utility. Furthermore, it was apparent that the administration would not support Barmek fully against the claims of state-run Azerenerji. Thus, it is very probable that there were personal interests involved on both sited of the deal.

While the networks were still privately managed, the government knew exactly whom to support in disputes over electricity bills. The state agencies that were unable or unwilling to pay the “monopolistic” private company were protected or partly redeemed with public money. However, when both sides of the dispute were national, the government decided to bail everyone out. Maybe this was meant to generate a calm atmosphere shortly ahead of the elections.

The limits in political decision-making in Azerbaijan show with regard to electricity tariffs. While in liberalized economies, people would not protest the government in case of rising prices, this represents a clear danger if price are state-controlled – as the incident with Azerigaz shows. Although it is debatable, if Azerbaijan’s electricity sector needs to be self-sufficient, given its social function, demand management is clearly an issue. An increasing standard of living and low electricity prices invite wasteful behavior and impede secure supply. Yet, prices were not raised immediately after 2004, when the agreement preventing tariff adjustments expired. Instead, the Tariff Council waited two more years and then implemented a shock-therapy. Shortly after the change of government to Ilham Aliyev and only one year before parliamentary elections, faced with complaints about supply in electricity as well as gas, rising electricity tariffs to cost covering levels seemed politically not feasible.

As for the implementation: The distribution companies’ employees responsible for collecting the bills had at times such a bad reputation, that some people considered letting them into their homes a threat (2002k). On a more obvious level: Why does a consolidated authoritarian state have such great difficulty to make his population pay for the service is renders to them? Why does it, ultimately, write off the debt not only of its population, but of its own agencies? It appears the downside of being a state-elite that is largely separated from the rest of the population is that the population does not identify with state institutions. A game develops in which, in Putnam’s words, the elite, tries to fleece the nonelite as well as other strategic elites – and of course, each of them fights back.

Formal decisions are taken in the form of presidential decrees, while the parliament as legislative is irrelevant. Policy changes are accompanied by personnel changes (elite reshuffling). Official policy goals are modernization and stability (to facilitate modernization). They are provided by the state for the people, who are to receive but not to participate. Procedural goals - "good governance" - are framed as aspects of modernization to be achieved in the future and used as weapons in turf wars. Policy implementation is problematic. In the case of Barmek, officials invoked inadequate policy implementation (reliable public electricity supply) to break off the contract with the company. The debt of power consumers had to be written off, because the national power company could neither get public nor private consumers to pay their bills.
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