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‘Implementation of the European Neighbourhood Policy in 2007’

Progress Report Azerbaijan

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1. BACKGROUND AND OVERALL ASSESSMENT

Azerbaijan and the EU first established contractual relations in 1996 through a Partnership and Cooperation Agreement which entered into force in 1999. The EU-Azerbaijan ENP Action Plan was adopted in November 2006 for a period of five years. Since then, its implementation has been guided and monitored on the basis of a first annual implementation tool, which sets out comprehensive sets of priorities and timelines for 2007, based on the priorities agreed jointly by the EU and Azerbaijan.

In addition, institutional cooperation through the EU–Azerbaijan Cooperation Council, the EU–Azerbaijan Cooperation Committee and two subcommittees enabled both sides to discuss and follow the implementation of the Action Plan closely.

This document reports on the overall progress made on the implementation of the EU - Azerbaijan ENP Action Plan between November 2006 and 31 December 2007, although developments outside this period are also considered when deemed relevant. It is not a general review of the political and economic situation in Azerbaijan.

There has been limited tangible progress towards meeting the Action Plan objectives in the area of democratic governance. These largely reflect the commitments entered into when Azerbaijan became member of the Council of Europe and the OSCE. The Azerbaijani government has not exploited the opportunities offered by the ENP Action Plan to carry out political and economic reforms in the country, in areas such as democracy, rule of law (particularly reform of the judiciary and fight against corruption), human rights and fundamental freedoms, sustainable economic development and the business environment. Carrying out the reform agenda will in the long term promote political stability and economic development.

Of particular importance in connection with the October 2008 presidential elections, is the further reform of the electoral code. Taking advantage of the cooperation with the EU, OSCE and the Council of Europe (in particular with the Venice Commission), it would be important for Azerbaijan to address without further delays issues such as the remodelling of the Central Election Commission and lower level commissions, to secure the confidence of voters and candidates. Ensuring that electoral campaigns, access to media and the elections themselves are free and fair would strengthen Azerbaijan's credibility and its aspirations to come closer to Europe.

The last two years Azerbaijan began exporting significant quantities of hydrocarbons, resulting in very high government revenues and making it one of the fastest growing economies in the world. Nevertheless, diversified development of the non-oil economy will be critical for the country's overall development. This would require that the government of Azerbaijan also target its efforts to improve the social services and infrastructure, to tackle poverty and generate employment.

2. POLITICAL DIALOGUE AND REFORM

Democracy, rule of law, human rights and fundamental freedoms

Objectives in this area include: strengthening the stability and effectiveness of institutions guaranteeing democracy and the rule of law; strengthening democratic institutions ensuring respect for human rights and fundamental freedoms; Reform of the judicial system; civil service reform; and ensuring the effectiveness of the fight against corruption.

The reform of the **electoral framework**, in line with the recommendations of the OSCE/ODIHR and the Council of Europe (CoE) Venice Commission, has yet to be addressed. While cooperation with these organisations continued throughout 2007, the revision of the electoral code (in particular related to the composition of the electoral commissions and to the complaints and appeals procedures), as well as the update of electoral rolls and the equitable access to news coverage of political parties and candidates, need to be addressed as a matter of urgency, in the perspective of the presidential elections in 2008.

Some initiatives can be reported as regards the strengthening of **local democracy**. In 2006, three national associations of municipalities were established, bringing together municipalities, villages and settlements. Cooperation with international stakeholders, notably the European Congress of Local and Regional Authorities, was undertaken, with a view to raise the efficiency of these associations and ensuring coordination. A law on delegating additional powers to municipalities was signed in October 2007. Decentralisation remains however very limited.

A national action plan for the protection of **human rights** was adopted in December 2006. While the existence of this comprehensive policy document as such represents progress, its concrete and effective implementation is now needed.

Measures were taken to clarify the legal and administrative framework of the **Ombudsperson** Institution. Its administrative status was upgraded in July 2007. The staff of the Ombudsperson office has participated in trainings both in the country and abroad. Further efforts are nonetheless needed to enhance the independence and legitimacy of that institution.

To **reform the penitentiary system**, efforts were made to improve conditions of detention, including through substantial construction and renovation works at places of detention and improving the training of prison staff. The authorities have however not made public the latest Committee for the Prevention of Torture (CPT)¹ reports. The conditions of prisoners on long-term or life sentences remain highly problematic. A number of prisoners claim to be prisoners of conscience.

Concerns have been expressed regarding pre-trial detention, in particular restrictions on access to a lawyer and persistent allegations of **torture**. Effective investigation of allegations of torture and ill-treatment remained minimal. Efforts have however been made to improve the human rights training of law enforcement officials. These include the introduction of a new recruitment examination, the adoption and distribution of training material to police officers, the establishment of a 24-hour complaints mechanism. The Ministry of Internal Affairs has developed constructive cooperation with civil society and the Ombudsperson. The latter is allowed to visit any detention centre without prior notice or permission. Full transparency and close cooperation are reported by external visiting organisations, such as the ICRC and the CPT when monitoring places of detention. No progress is reported as regards

¹ European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment.

the ratification of the Optional Protocol to the UN Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment.

As regards **trade unions and rights at work**, Azerbaijan has ratified all the fundamental conventions of the International Labour Organisation (ILO), but its implementation record remains poor. Accordingly, Azerbaijan is not eligible to the GSP+.

The legislation on **freedom of assembly** remains highly restrictive and has allowed for regular prohibition or restrictions of demonstrations. Draft amendments to the law on freedom of assembly were prepared in December 2007, in close consultation with the Council of Europe Venice Commission and PACE. These amendments, were they enacted, could significantly improve the current legislation.

The ECHR handed down several judgements condemning Azerbaijan for failing to respect NGO registration procedures, which remain complex and cumbersome. A presidential decree was signed in July 2007 to promote state aid to civil society organisations, inter alia through enhancing cooperation between the latter and the administration. Under a presidential decree in December 2007, a Council for State Support to NGOs was established. Questions remain regarding the appointment of the members of the council, which is under the control of the President, and the criteria for grant allocation.

The issue of **freedom of expression and media** remains a source of serious concern and requires urgent action by the authorities in order to conform to the corresponding provisions in the ENP Action Plan, the Partnership and Cooperation Agreement and the relevant obligations contracted by the country upon membership of the OSCE and the CoE. Media pluralism is limited, especially in the electronic media, and self-censorship among journalists is widely observed. Several leading independent media were closed down by the authorities. A number of cases of violence and harassment against independent journalists have been reported, yet these have rarely been investigated or prosecuted. The Media Regulatory Body is widely seen as lacking independence. The implementation of the law on freedom of information remains highly insufficient. The continued criminalisation of defamation and libel has led to an increase in the number of charges against independent journalists and the imprisonment of journalists. Five of the eight journalists jailed in 2007 were released following a presidential pardon in December 2007. A rapid and positive solution to the case of the remaining three journalists in jail and a revision of the current norms on libel and defamation would certainly contribute to improving the attainment of the relevant Action Plan objective. No progress was noted towards developing an independent public broadcasting service.

Regarding the protection of national **minorities**, the authorities did not address the absence of a legislative and institutional framework. Issues of concern include the limited access to education in minority languages and the lack of a dedicated complaints mechanism. Armenians and Chechens continued to face discrimination. No progress towards ratification of the Protocol n° 12 of the ECHR on the general prohibition of discrimination and the European Charter on Minority Languages is noted.

On **gender equality**, a draft law on preventing domestic violence, which remains significant throughout the country, and the establishment of women's counselling centres are under preparation. Further efforts are needed to include criminal responsibility in cases of domestic violence, to establish enforcement bodies and to set up shelter and crisis centres for victims. Further to the adoption of the 2006 law on gender equality, a national action plan on family

and on gender equality was prepared by the state committee on family, women and children, and submitted to the Cabinet of Ministers for approval.

Freedom of religion appears largely secured in Azerbaijan. The State Committee on Work with Religious Organizations has started elaborating the guidelines for the relations between the state and religions in close consultation with religious communities. In April 2007 the New Advisory Council was established under the Chairman of the state committee consisting of the leaders of the main religious communities. In view of complying with CoE obligations, a draft law establishing an alternative civilian service has been submitted to the CoE.

The **reform of the judiciary** advanced, in cooperation with international organisations. Efforts have been made in improving the selection and training of judges including the establishment of a Joint Training Commission with the CoE and salaries have been significantly increased. A code of ethics for judges was adopted by the judicial legal council in June 2007. The government should however further intensify its efforts to ensure the proper application of the legislative framework pertaining to the administration of justice and, more importantly, the independence of judges. The CoE has reported on allegations of dubiously motivated criminal prosecutions and disproportionate sentences. The timely execution of judgement remains an issue of concern, as stated in a ruling by the ECHR in October 2007. Corruption and pressure by the executive continued to widely affect the functioning of the judiciary. The mandate of the prosecutor general's office needs to be substantially amended in view of complying with CoE standards (including its limitation to the prosecution of criminal offences and to the representation of the public and state interest). The number of lawyers remains highly insufficient to guarantee fair access to justice. This is in part due to procedural restrictions on access to the profession. Measures should be taken to facilitate access to legal aid.

Efforts are being made to address the preoccupying issue of the absence of **juvenile justice** system in line with CoE commitments. The Ministry of Internal Affairs (MoI), in close coordination with international organisations is in the process of introducing alternatives to pre-trial custodial detention and special protection measures for delinquent children and child victims of crimes in cooperation the law enforcement bodies, in line with international standards.

Azerbaijan has not yet acceded to Protocol n° 13 to the ECHR on the abolition of the death penalty in all circumstances.

Some small steps towards a **civil service reform and administrative capacity building** were taken: the law on code of conduct of civil (state) servants was adopted in May and came into force in August 2007.

Although some legislative steps were taken, **corruption** remains pervasive including at high level. The former state programme on combating corruption for 2004-2006 was succeeded by a national strategy on increasing transparency and combating corruption adopted in June 2007. The national strategy provides for a number of activities aimed at increasing transparency in decision-making mechanisms and rules, admission to the civil service, revenues and expenditures of the state budget, financing of political parties, government procurements, privatization, the functioning of state authorities and municipalities, and other areas. In July 2007, a presidential decree on transparency and the development of anti-corruption strategies paved the way for stronger sanctions and stronger prosecutorial measures, which remain to be confirmed in practice. In October 2007 the law "On changes and addenda to a number of laws of Azerbaijan on the fight against corruption" was adopted

obliging state officials and civil servants to provide annual declarations of income. Despite these legislative acts, implementation and enforcement, as well as a change of culture and mentality still remain to be seen. The backsliding in corruption is confirmed by international surveys.

Cooperation on foreign and security policy, conflict prevention and crisis management.

Objectives in this area include: strengthening political dialogue and cooperation on foreign and security matters; addressing common security threats, including non-proliferation of weapons of mass destruction and illegal arms exports; and strengthening efforts and cooperation in the fight against terrorism

Since June 2007, Azerbaijan has been invited to align itself with CFSP declarations on a case-by-case basis. By the end of 2007 Azerbaijan aligned with more than a half of the CFSP declarations.

No further steps were taken towards accession to the Rome Statute of the International Criminal Court (ICC). However, some provisions of the Rome Statute have been incorporated into the criminal code. In particular, the code provides for criminal responsibility for crimes against humanity and war crimes, in line with the definitions in the Rome Statute.

With regards to cooperation in addressing common security threats, no further steps have been identified for Azerbaijan's accession to the Ottawa Convention.

Strengthening regional cooperation.

In order to improve integrated border management at the national and regional level, a project on regional border management in South Caucasus (2008-2009) was launched in the framework of the ENPI Assistance Programme. During the kick-off Ministerial Meeting held in Brussels in October 2007 participating countries agreed to implement measures on a bilateral basis (Azerbaijan-Georgia, Georgia-Armenia).

Azerbaijan is co-founder (together with Armenia, Georgia and the European Commission) of the Caucasus Regional Environmental Centre (REC). The REC Caucasus, with headquarters in Tbilisi, promotes capacity building and cooperation between various stakeholders, including between neighbouring countries. Azerbaijan has signed the new Charter for the REC.

In May 2007, Azerbaijan participated with Georgia, Ukraine and Lithuania in a summit of the Heads of States organized by Poland, with the aim of further strengthening political and economic relations, including the energy sector, between the Black Sea, Baltic Sea and Caspian Sea regions. A joint communiqué was signed on creation of a new European energy corridor.

Contribute to a peaceful solution of the Nagorno-Karabakh conflict

An informal meeting of President Aliyev and President Kocharian took place during the CIS Summit in St Petersburg in June 2007. A significant and well noted people-to-people contact in form of the visit of a delegation of Azerbaijani and Armenian intellectuals to Xankendi/Stepanakert, Yerevan, and Baku in June 2007 also took place.

Although co-chair countries of the OSCE Minsk Group (United States, France and the Russian Federation) have stated that over the last years the two sides had significantly narrowed their differences and that only a few issues remained to be settled, a document elaborated by the Minsk Group, containing the basic principles for a conflict settlement, which was presented to Azerbaijan and Armenia at the OSCE Ministerial Meeting in Madrid in October 2007, is still under discussion.

3. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy

Azerbaijan's economic growth rate fell from 34.5 % in 2006 to 24.7 % in 2007, which nevertheless represents one of the highest, if not the highest, growth rate in the world for the past year. The primary impetus for the booming economy came through the hydrocarbon sector. The latter is responsible for over 90 % of country's GDP. Non-oil sector grew only by 11.3 %, at a rate lower than a year earlier, driven mostly by developments of services and construction, areas linked also to the hydrocarbon boom. This shrinking non-oil sector, coupled with real appreciation of the local currency, the Manat (20 % since 2005) points at loss of competitiveness and first symptoms of a an increase in revenues from natural resources, which might de-industrialise a nation's economy by leading the exchange rate to a strong appreciation, which makes the non-oil sector less competitive. In fact, labour cost in the non-oil sector, measured by the wage rate had increased 3.6 times, which represents a much higher rate compared to the increase of productivity, a clear case for loss of competitiveness.

In 2007 average inflation rate stood at 16.7 % and the 12 month year on year inflation had reached even 19.2 % in November same year. This represents an 11 year high and is still lower compared to the reported unofficial figure: The Economic Research Centre based in Baku (ERC) publishes an alternative consumer price index (CPI). ERC uses the same methodology and consumer basket as the State Statistical Committee (SSC), however, its CPI differs significantly from the one reported by the (SSC). In fact, the change in the CPI measured by ERC reached 29.8 % in 2007.

Limited competition on the import markets, which are dominated by monopolistic structures, could explain the fact of significantly higher prices of imported goods in Azerbaijan, compared to those in neighbouring countries.

Looser fiscal policy drove growth in consumption and investment and stimulated private demand, which also benefited from rising incomes.

Given the limited scope of monetary policy to combat inflation (due to undeveloped financial market and lack of competition between commercial banks), fiscal policy measures needs to be supportive. In fact, reduction in the rate of growth of the fiscal expansion is necessary to reduce the high inflation.

In September 2007 the government finalized the long expected sell of 50 % of the smaller of the two state-owned banks - Kapital Bank. The tender has been criticized for lacking transparency. The full privatisation of the bank is to be completed during the course of 2008. It needs to be stressed, however, that there is currently a still stand with regards to the privatisation of the largest state owned bank – the International Bank of Azerbaijan. It holds

48 % of the bank system's assets and it seems that its privatisation is going to be postponed once again.

Further challenges to the Azerbaijani economy, which need to be tackled with priority, remain the level of corruption, the monopolistic structures in the economy and the business climate. Improving business conditions and the investment climate in the non-oil sector would be crucial to ensure the diversification of the economy.

Employment and social policy

Unemployment is a major concern in Azerbaijan, in particular for young people. A number of measures have been introduced with a view to **increasing employment** and improving the effectiveness of the labour market. These include the creation of better conditions to promote entrepreneurship and self-employment, boost investment activity, strengthen social protection, legalise informal labour and improve institutional capacity. The government, in cooperation with the International Labour Organisation, has prepared the employment strategy of the Republic of Azerbaijan for the years 2006-2015. This includes a decent work programme promoting, in particular, equal opportunities for men and women. It also focuses on education and vocational training and development of small and medium-sized enterprises. In May 2007, the “Implementation of the employment strategy of the Republic of Azerbaijan for 2007-2010” was approved by presidential decree. The key objective for this strategy is a reduction of unemployment, an improvement of the labour market, social protection of unemployed and vulnerable individuals. Sound implementation of the strategy will require adequate leadership among the different ministries involved and monitoring mechanisms.

As regards the **social situation and the reduction of poverty**, the state programme for poverty reduction and sustainable development for the years 2006-2015 is not yet adopted, pending, for months, inter-ministerial consultation. The principal objective of the programme is to improve material welfare of citizens, to reduce poverty by half by 2015 as well as to provide social protection. The average salary of state employees has, increased, on average, by 42 % in 2007. While the poverty levels have decreased over the last years thanks to significant GDP growth, poverty is still a challenge. According to the government, in 2007, about 16 % of the population lived below the poverty line (down from 39.7 % in 2003). The main source of rural poverty is lack of access to basic services and poor physical infrastructure while urban poverty relates to employment opportunities and wages.

As regards **social inclusion and protection**, a number of measures have been introduced concerning the reform of the social security system. A mechanism of targeted social assistance has been applied since July 2006 in accordance with the law on targeted state social assistance. This mechanism mostly covers low-income families and the poor. As a result, over a quarter of million people were benefiting from social assistance. Furthermore, Azerbaijan is working with the World Bank towards improving the effectiveness and transparency in providing public pensions and social assistance. The State social security fund has established relations with EU countries directly as well as in the framework of the International Social Security Association. As regards bilateral cooperation in the field of social security and pensions, relevant agreements have been signed with Lithuania and Poland.

Agriculture is expected to play a major role in the framework of the above-mentioned state programme for poverty reduction and sustainable development. No progress was made concerning the establishment of an Agricultural Bank aiming at improving access to credit

facilities and at encouraging private investment in the agricultural sector. Crediting projects in the area of agricultures are managed by non-bank credit organisations.

4. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

The EU-Azerbaijan bilateral trade grew in 2000-2006 with enhanced dynamism and the EU progressively became Azerbaijan's main trade partner (45.3 % share in its overall external trade in 2006). The increase in 2006 was particularly significant, the yearly turnover increased by 85.3 % compared to 2005 and amounted at € 7.42 billion, the Azerbaijani exports to the EU being of € 5.46 billion, (yearly growth by 117.7 %), and the EU exports € 1.96 billion (yearly increase by 30.8 %). In 2007 the growth in bilateral turnover continued, although with less dynamism - the total turnover increased by 20.8 % compared to 2006, and reached € 8.96 billion, the Azerbaijani exports to the EU being of € 7.36 billion (yearly growth by 34.9 %) and the EU exports € 1.59 billion (yearly decrease by 18.6 %).

Azerbaijan is a beneficiary of the general arrangements under the EU Generalised System of Preferences (GSP), but does not make a sufficient use of the opportunities offered by this scheme.

Concerning WTO accession, some progress was made. Negotiations on goods and services were concluded with Turkey, Georgia and the Republic of Moldova and are on their way with the EU, the USA, Japan, Canada and Korea. Concerning the documentation for the next working party meeting, a revised legislation action plan was sent to the WTO Secretariat in December 2007.

The future enhancement of trade relations with the EU will mainly depend on regulatory convergence of Azerbaijan's legislation and practices to the EU most important trade-related rules, in particular in the areas such as industrial standards, sanitary and phyto-sanitary measures, intellectual property rights, public procurement and customs. Azerbaijan made only limited progress in the implementation of the objectives in the area of regulatory convergence to the trade-related EU legislation contained in the PCA and in the ENP Action Plan.

No significant progress was made in the area of **customs** legislation, as neither the revised customs code under preparation (aiming at harmonising the customs legislation with the EU and international provisions and standards, including WTO requirements in areas such as customs valuation, trade facilitation and security of the supply chain) nor its implementing provisions were adopted. Work is proceeding in the area of computerisation of the customs department. However the use of risk-based profiles in the current customs declaration processing system is lacking and the IT operational capacity should be further developed as foreseen in the state programme on the development of the Azerbaijan Republic Customs System in 2007-2011. In order to improve communication with the public, some guidelines on business relations based on international standards were prepared. In order to enhance the implementation of the customs ethics policy, several workshops and trainings were organised to further familiarise the Azerbaijani customs with EU practices.

Azerbaijan has made some progress on the **free movement of goods and technical regulations**. A new law on technical regulations was drafted with the assistance of WTO experts and submitted to the Cabinet of Ministers. To implement this law, eight by-laws are being prepared. Further, a state programme on the development of the standardisation sector has been established. Azerbaijan is reflecting on the ways and means to implement EU

standards and render the use of standards voluntary. ISO standards are already being applied. The main sectors for approximation with EU rules in this field have been identified: oil, machinery, information technologies and food.

Azerbaijan progressed on **sanitary and phyto-sanitary** issues. It adopted a law on phyto-sanitary control. The State Office on Control of the Consumer Market started controls for EU exports including on fishery products. Staff of this office was trained inter alia on Community rules. Member States are authorised to import, on a bilateral basis, fishery products (caviar) and snails from Azerbaijan. Since the country wishes to expand fishery products exports to the EU, the European Commission's Food and Veterinary Office conducted, in September 2007, an inspection visit which identified deficiencies in the control system. Azerbaijan exports hazelnuts to the EU, but over the past years aflatoxins (a contaminant) were detected in those exports; an FVO inspection is planned for 2008. Azerbaijan participated in workshops under the European Commission's "Better training for safer food" programme. In order to prevent another outbreak of avian influenza, the country closely monitored the situation among wild and domestic birds throughout the reporting period.

In the **establishment and company law** sector, Azerbaijan continued to attract foreign direct investment, in particular thanks to the opening of the Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline. A number of legislative steps have been introduced, such as the new legislation to facilitate entrepreneurship - the "one stop shop" counter for registration of businesses. It was launched in January 2008 and according to national authorities, the number of newly registered companies during the first two months of 2008 equalled to the number of newly registered business during the whole 2007. However, it is still not known whether all of them will be involved in economic activities, or the registration is driven primary by consideration of personal nature, e.g. tax advantages. International surveys on the ease of doing business placed Azerbaijan rather low, mainly because of excessive bureaucratic difficulties for importers and exporters. Further progress in the field of accounting can be reported as the use of international financial reporting standards (IFRS) is compulsory for big companies since 1 January 2008.

Concerning **services**, Azerbaijan introduced significant changes in the financial services sector and has continued to implement the recommendations of the IMF Financial Sector Assessment Report (FSAP). The drafting of a "New capital framework law" which follows the Basle II principles for effective banking supervision started with the support of the European Bank Supervisors Committee. A new strategy for the "Development and modernisation concept of the financial sector in Azerbaijan (2007-2008)" was prepared. In this context, a draft law on insurance activities was submitted to the Parliament. Further, a draft law on non-banking credit institutions was prepared and a "deposits insurance fund" became operational in August 2007. Notwithstanding these generally positive developments, further efforts are needed to assure the continued development of Azerbaijan's banking system and insurance industry. Azerbaijan has asked the IMF to establish a new IMF Financial Sector Assessment Programme during 2008.

Other key areas

Good progress was achieved in the area of **taxation**. Six new treaties on avoidance of double taxation with EU Member States entered into force since 2006. A new agreement with Estonia was signed in October 2007. The provisions on discriminatory excise duties on imported goods in the tax law were not modified. An amendment of the tax code lowered the profit tax rate from 24 to 22 %. Furthermore, in order to favour capital investments, some amendments

to the tax code extended the possibility to carry over deductible expenditures to compensate profits surplus. As far as administrative capacity is concerned, as from January 2008, in the framework of the implementation of the one-stop shop principle, registration of commercial entities is done by the Ministry of Taxes. The implementation of the Automated Tax Information System (ATIS), including the possibility to lodge the tax return declaration by e-mail, is ongoing and all functions of the tax administration are now automated. Services dealing with taxpayers' assistance and education were enhanced. A department providing services to tax payers was created and operates at central and districts level. The telephone information service of the Ministry is now available in the whole country and a pilot project on a computer terminal to provide services to taxpayers was launched and will be extended to all regions in the future. A ministerial order on the implementation of the priorities of the ENP Action Plan by the Ministry of Taxes for the period 2008/2010 was approved and covers all major tax-related priorities of the Action Plan.

Since the adoption of the **competition law**, an Anti-monopoly Service (SAS) was established under the Ministry of Economic Development, replacing the antimonopoly policy department in December 2006, and its charter was adopted. A number of implementing legal acts were adopted since then. A new competition code was drafted and submitted to the Parliament, with the objective to approximate Azerbaijan's legislation in this field to EU rules. No progress in the field of state aid is to be reported.

In the area of **intellectual property rights**, Azerbaijan made some progress in complying with its PCA obligations and TRIPS provisions in the context of the WTO accession negotiations by acceding to the Madrid Protocol on International Registration of Marks in April 2007 and to the WIPO Treaty on Performances and Phonograms and to the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations already before the reporting period. Azerbaijan has now complied with all its PCA obligations with regard to the accession to international conventions. However, further steps are needed to ensure full compliance with the relevant PCA obligations. This concerns in particular the amendment of the legislation on authors' and related rights as well as the adoption of the draft law on the reserve of rights of broadcasting organisations. Ensuring sound enforcement and effective implementation of IPR-related legislation remains a key challenge as very limited progress can be registered in this area. Azerbaijan should therefore adopt, as a matter of priority, a law on IP enforcement and fight against piracy as well as a coordinating body to supervise enforcement activities.

Work on electronic **procurement** is starting with the aim of bringing the legislation closer into line with EU standards: information on all tenders is already available, registration of tenders is operated on line, tender documentation and clarification distributions are carried out via internet. However, there is a need to reinforce the administrative capacity of the State Procurement Agency to better meet the requirements of e-procuring. As far as legislation is concerned, the conditions and circumstances under which preferences for domestic suppliers are foreseen in the current public procurement law are not transparent enough. Clear rules are needed to allow foreign suppliers to anticipate when a tender will be open to international bidders. There is a need to increase contracting authorities' awareness of, and compliance with, relevant legislation. It is still difficult to obtain information on public procurement. Azerbaijan is not yet party to the WTO Agreement on Government Procurement (GPA).

The State Statistical Committee is functioning well and its budget is regularly increased on a yearly basis. Salaries were increased by 25 % in February 2007. Lack of staff is no longer a problem.

Public Internal Financial control and related issues

On external audit, international accounting standards are applied since 1 January 2008.

With regard to budgeting, accounting and reporting as part of **public internal financial control**, the Ministry of Finance continued its work on a three year programme for translation of international financial reporting standards to public bodies, including the development of verifiable accounting registers. In order to increase transparency in public finance management, work began with international support on the reform of the treasury management system including income management and forecast of transfers. In addition, training courses on the application of international standards to public and private financial managers were provided.

On enterprise policy, since the adoption and implementation by the entrepreneurship development department of the state programme 2002-2005, limited progress was made in this field. A decree on Some measures related to development of entrepreneurship in the Republic of Azerbaijan was adopted in April 2007, identifying the priority areas for the development of small business. In this context, two drafts on a State programme on entrepreneurship development in the Republic of Azerbaijan (2007-2012) were produced. Although SMEs represent one of the most viable opportunities to grow and diversify the economy in Azerbaijan, the SME growth potential is limited by a lack of access to credit. A State fund for entrepreneurial development was established in order to facilitate access to finance for SMEs.

A new inspection law was adopted. In terms of internal control and internal audit, World Bank financed assistance produced a draft PIFC strategy and action plan that has been partially adopted by the Ministry. The introduction of the principles of managerial accountability and internal audit is in the very early stages of conceptualisation.

5. COOPERATION ON JUSTICE, FREEDOM AND SECURITY

The new Southern Caucasus Integrated **Border Management** programme consists of one common training component, two bilateral cooperation Azerbaijan-Georgia and Georgia-Armenia components, and three national components, enhancing strategic border management capacities across the region with the goal of introducing coherent integrated border management systems. Elaboration of training activities in preparation for this programme is underway (*see also regional cooperation*). A comprehensive national border strategy was developed corresponding to European standards and including harmonization of structures implementing border control and management functions. Azerbaijani State Border authorities cooperated closely with neighbouring border agencies (Iran, the Russian Federation) on training with a view to extending international border cooperation to all levels and establishing inter-communication between all enforcement agencies. In addition, work continued on demarcation of borders with Georgia and the Russian Federation. However, a comprehensive education and training strategy on border management including improved understanding of Schengen rules and standards remains to be developed.

2 100 Chechens have sought refuge in Azerbaijan. They remain mainly in and around Baku and receive only minimal assistance without being granted refugee status by the government. They are not allowed to work and their basic needs are covered by the humanitarian community.

On the issue of **the fight against organised crime**, Azerbaijan cooperated actively with Interpol and other international organisations in the implementation of UN the Convention against Trans-national Organised Crime and its relevant Protocols on trafficking and smuggling of persons, which it had ratified in 2003. In addition, it concluded inter-governmental agreements and joint memoranda on mutual legal assistance in criminal matters with neighbouring CIS countries as well as Turkey, Iran and Bulgaria, with a view to combat all types of crime following the adoption of the law on legal assistance in criminal matters in 2001.

With regards to the **fight against human trafficking**, in order to protect, rehabilitate and provide reintegration to victims, several regulations were adopted and special rehabilitation centres were established. The Ministry of Justice and the Ministry of Labour and Social Protection engaged in counselling activities and awareness actions targeting youth groups, young people and children. However, actions recommended by OSCE to combat trafficking in human beings need to be implemented and regional cooperation between relevant law enforcement bodies and new mechanisms of protection, assistance and rehabilitation for victims remain to be developed. Adequate resource provision to enable international cooperation to continue is a priority. The national action plan on fight against trafficking in human beings remains to be implemented and awareness-raising increased. A number of complaints have allegedly taken place but the authorities do not seem to address them sufficiently.

A national strategy on combating **drugs** was elaborated in June 2007 alongside the approval of a five year action programme to combat drug addiction. Several regulations and pieces of legislation were adopted in order to implement 1988 UN Convention on Illicit Traffic of Narcotic and Psychotropic Substances. A State Commission on Fighting against Drug Addiction and Illegal Turnover of Drugs was also established. Azerbaijan actively cooperated with the regional Interpol Bureau in Baku and is fully engaged in the regional SCAD (Southern Caucasus Anti-Drugs) programme in the fight against illegal narcotics. It also established bilateral cooperation with its neighbours on smuggling through relevant agreements and memoranda.

With regard to the fight against **money-laundering**, Azerbaijan cooperated closely with the Council of Europe's Moneyval group experts and a first round of discussions on practices to combat money laundering took place in December 2007. New legislation to establish the required institutional framework and financial instruments is under preparation while a draft action programme to criminalize income gained from illegal activity awaits presidential verification and final review. Furthermore, the criminal code was revised to introduce a specific provision on terrorism financing and the criminalization of assets, property and other proceeds from trafficking in drugs and a new article was inserted criminalize illegally obtained or sourced income. A training programme for the financial intelligence unit and law enforcement personnel on anti-money laundering was developed in cooperation with EU and foreign embassies. Cooperation with international financial institutions in this area needs ongoing attention.

With regard to cooperation in **criminal matters**, Azerbaijan has not acceded to the 1980 Hague Convention on Child Abduction nor the 1981 Council of Europe Convention on the Protection of Personal Data. No progress was made in the development of a network for enhanced cooperation with EU judicial and law enforcement authorities.

6. TRANSPORT, ENERGY, ENVIRONMENT, THE INFORMATION SOCIETY, RESEARCH AND DEVELOPMENT

The Ministry of **Transport** is still in the process of formulating a broader national transport policy in lieu of the traditional unimodal approach. The Ministry is being strengthened with a view to enabling it to implement a national transport policy including a transit strategy.

In the road sector, Azerbaijan is rehabilitating and upgrading its main road corridors and the road transport service department's road maintenance capacity is being reinforced. Road safety remains an issue of concern. In the rail sector the rolling stock is gradually being renewed.

In the aviation sector, it is urgent to sign the horizontal air transport agreement negotiated with the European Commission in 2004 in order to provide for legal certainty for air operations. Azerbaijan has applied for membership in Eurocontrol. In 2007, a proper regulatory authority (Civil Aviation Authority) was created in order to separate regulatory and operational functions. Azerbaijan needs to further strengthen its administrative capacity including in the field of air safety oversight.

In the maritime sector Azerbaijan has set up a maritime administration, separating the regulatory functions from the operational activities, which are presently carried out by the Caspian Shipping Company (CASPAR). Although the maritime administration has strengthened its capacities in port state control and flag state implementation, there is a need to further strengthen the administrative capacity of the maritime administration as well as to clarify its relation to the Ministry of Transport. Furthermore Azerbaijan is considering transferring some of the activities currently carried out by CASPAR to the port authorities.

Azerbaijan is a booming energy producer and develops increasingly as a transit country for Caspian resources inter alia to the EU. The country's GDP grows impressively, as a result of the expanding oil production and the new gas production. Oil is flowing commercially through the Baku-Tbilisi-Ceyhan (Turkey) pipeline, inter alia thanks to the Azerbaijani-Chirag-Guneshli oil field, the country's main reserve. Gas production from the Shah Deniz field started up and the strategic transit gas pipeline Baku-Tbilisi-Erzurum (Turkey) was put into operation, thus allowing first quantities of gas to reach the EU market through the Turkey - Greece Interconnector. Azerbaijan cooperated actively in the EC's feasibility study regarding a Trans-Caspian/Black Sea energy corridor. It agreed with Georgia, Poland, Lithuania and Ukraine to work jointly on the extension of the Odessa-Brody oil pipeline to Gdansk in Poland. This might open possibilities to increase significantly Caspian oil supplies. These developments are important for the EU's energy security, in particular in relation to strategic projects such as the "Nabucco" gas pipeline (from Turkey to Austria) or the Burgas-Alexandropolis oil pipeline.

Azerbaijan and the EU significantly increased energy cooperation inter alia through the signature, in November 2006, of a Memorandum of Understanding on a strategic partnership in the field of energy.

Regional dialogue continued through the “Baku initiative” for EU-Black Sea/Caspian energy cooperation. Under this initiative ministers agreed a roadmap aiming at convergence of markets, security of supply, sustainable energy development and regional cooperation.

Azerbaijan improved the transparency of oil and gas revenues through participation in the Extractive Industry Transparency Initiative (EITI). The Tariff Council, the competent body for electricity tariffs, became fully operational. Azerbaijan improved bill collection rates and increased tariffs. This enhances the financial performance of the electricity and gas companies Azerenergy and Azerigas and supports progressive convergence with the internal energy market. The government aims at cost-recovery tariffs and the development of a new system of targeted social assistance. Azerbaijan pursued the rehabilitation of the electricity sector and constructed new power plants and networks. Azerbaijan continued to develop an electricity corridor with Georgia and Turkey. The country increasingly puts emphasis on the development of renewable energy sources. Azerbaijan further implemented the state programme on the use of alternative and renewable energy 2005-2013 inter alia through investments in wind power and small hydro.

Key **environment** issues concern threats related to climate change, air quality, water quality, waste management, nature protection, coastal and marine pollution, air quality, water quality, waste management, nature protection and land use (in particular desertification). Azerbaijan made progress on climate change. A second national communication, a greenhouse gas inventory and adaptation measures are under preparation. Altogether 17 Clean Development Mechanism (CDM) projects have been prepared, but not yet registered at the UN level. Azerbaijan participates in activities undertaken under the EU Water Initiative.

Work is ongoing to implement existing strategies and plans, but continued attention is required. Overall, framework legislation and sectoral legislation is in place in many areas, but require further development, in particular on environmental impact assessment as well as on implementing legislation.

While administrative structures on environment are in place, a major challenge is to strengthen administrative implementation capacity at all levels of the country, including coordination between authorities. There are some ongoing activities to integrate environment considerations into other policy sectors such as energy. Monitoring as well as enforcement require special attention. Azerbaijan has not published state-of-the-environment reports since 2002 but carries out some activities to inform and involve the public. As regards environmental impact assessment, procedures and consultation with the public require particular attention.

Azerbaijan has ratified relevant international and regional conventions and protocols, except the Protocol on Strategic Environmental Assessments to the UNECE Convention on Environmental Impact Assessment in a Trans-boundary Context. Azerbaijan participates actively in regional cooperation under the Caspian Environment Convention and Caspian Environment Programme. The European Commission and Azerbaijan have enhanced cooperation and information exchange, including on climate change, water, sustainable development and protection of mountains, sustainable integrated land use of Eurasian steppes, obsolete pesticides and the classification and labelling of chemicals. The scope of the existing EU-Azerbaijan sub-committee on energy and transport was broadened to cover also environment protection. Azerbaijan is co-founder (together with Armenia, Georgia and the European Commission) of the Caucasus Regional Environmental Centre (REC). The REC

Caucasus, with headquarters in Tbilisi, promotes capacity building and co-operation between various stakeholders, including between neighbouring countries. Azerbaijan has signed the new Charter for the REC.

In the area of **information society**, Azerbaijan is implementing a “State Programme on development of communication and IT 2005-2008” (e-Azerbaijan) that is setting out the necessary steps in the areas of regulation, economic reform, including the liberalisation of the markets and technical upgrading in order to achieve Azerbaijan’s transformation to an information society. While regulatory functions are currently still carried out by the Ministry of Communications and Information Technology which also owns stakes in several operators, there are plans to set up an independent regulatory body. The regulatory framework is starting to be developed, e.g. in the fields of interconnection and Universal Service. Certain regulatory functions are exercised by the State Tariffs Council, which has rebalanced the fixed telephony in 2007. Azerbaijan has also drafted an action plan in order to introduce e-government applications. In the framework of the “AzDATAKOM” programme the digitalisation of the electronic communications network is being carried out.

Regarding the **audiovisual sector** Azerbaijan has not signed the Council of Europe Convention on Trans-frontier Television and still has to ratify the UNESCO Convention for the Protection and Promotion of the Diversity of Cultural Expressions.

Research and innovation (R&I) activities remain extremely modest. Azerbaijan has still not adopted a national research strategy that would allow for an upgrading of its capacity in technological research and innovation, with a view to its integration into the European Research Area and into the Community R&D framework programme.

7. PEOPLE-TO-PEOPLE CONTACTS, EDUCATION AND HEALTH

Azerbaijan approved a programme for the development of **vocational training** and education with a focus on improving governance, transparency, school autonomy and upgrading of training content. It refers to modernisation of the vocational education and training system in line with contemporary requirements. The total budget for education increased by 53.8 % in 2007 with an additional net increase of 2 % on general education, providing a sound financial basis for reform plans. The government implemented the regulation on accreditation and attestation for higher and secondary education adopted in 2006 and work began on the establishment of a national qualifications agency and drafting of a policy for a national qualifications framework with relevant stakeholders. Tempus in particular had a positive impact on **higher education** in terms of modernisation of educational structures and programs, especially in the field of curriculum development, providing new study courses and specialisations for the labour market. A network between Azerbaijan universities was established for the exchange and dissemination of the Tempus project results. The development of relevant labour-market skills for young people after secondary education remains a strategic issue of concern alongside insufficient policy coordination between state institutions and the social partners. A shift towards a more integrated and coherent education and training strategy, with a lifelong learning perspective, is the future policy challenge. In the area of **education**, a government programme of some € 1.7 million was approved in April 2007 to promote the international education of 5 000 young persons under the responsibility of the Committee for Education. The UNESCO Convention against Discrimination in Education of 1960 was finally ratified. In addition, participation in Erasmus Mundus, Erasmus Mundus External Cooperation Window was promoted.

In the area of **youth**, Azerbaijan registered an increase in participation rates in the relevant actions of the Youth in Action programme as compared to 2006. Azerbaijani young people and youth workers were involved, for instance, in a large-scale project on conflict management combining training and youth exchanges, which involves other partners from the Southern Caucasus countries as well as from EU Member States. In addition the Ministry of Youth and Sport signed a protocol of cooperation with Lithuania to stimulate future cooperation within the framework of Youth in Action.

With regard to **cultural cooperation**, the necessary preparatory measures were taken to proceed to ratification of the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions though no formal exchange of views took place.

Azerbaijan continued **health** sector reform with a view to enhancing access, in particular for the poor and quality of services, including in the rural areas. In December 2007 the Azerbaijan decided to establish an agency for compulsory medical insurance. Continued reform, which helps to reduce poverty, will lead to improved primary health care service, better health sector investments, enhanced management and improved medical education. Azerbaijan participated in the EU Network of competent authorities in health information and knowledge. Azerbaijan strengthened surveillance of communicable diseases, but they remain a challenge, in particular HIV/AIDS and tuberculosis.

8. FINANCIAL COOPERATION – 2007 KEY FACTS AND FIGURES

With the entry into force of the European Neighbourhood and Partnership Instrument (ENPI) the strategic, policy-driven character of EC assistance was strengthened and the EC financial allocations generally increased. The introduction of cooperation instruments such as twinning and TAIEX strengthens the EC's ability to provide expert advice and to support technical cooperation in regulatory areas.

Since the adoption of the ENP Action Plan with Azerbaijan, EC assistance was increasingly geared towards supporting the achievement of the policy objectives outlined in the Action Plan. € 92 million were allocated to Azerbaijan under the National Indicative Programme for 2007-2010. The programme focuses on three priorities: democratic development and good governance (public administration reform and public finance and tax management, rule of law, judicial reform, human rights, civil society development and local government, education, and people-to-people contacts); socio-economic reform (with emphasis on regulatory approximation with the EU standards in trade, improving the investment climate and strengthening social reform), fight against poverty and administrative capacity building (strengthening the relevant sectoral markets to diversify the economy, regulatory aspects); and legislative and economic reforms in the transport, energy and environment sectors.

The 2007 Annual Action Programme for Azerbaijan represents € 19 million in the framework of the bilateral cooperation. Assistance focuses on the reform of the energy sector through a sector support programme combined with twinning and TAIEX complementary actions.

Azerbaijan is also eligible for cooperation activities, financed under the ENPI multi-country and regional programmes.

Azerbaijan also benefits from cooperation activities financed under the ENPI multi-country and regional programmes and is eligible under the ENPI Cross Border Cooperation component.