

**AZERBAIJAN *DE JURE* AND *DE FACTO*:
REASONS OF FAILURE OF THE LAW ON UNFAIR COMPETITION
OF THE AZERBAIJAN REPUBLIC**

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Abstract

Violentia praecedit jus - Might over right or might is right, this is the way economic activities are conducted in many of the transition countries. Failure of laws and regulations able to coordinate the economic processes is attributed to various factors. Azerbaijan as formerly member of Soviet Union is also evidencing the malfunctioning of the laws and as a result unpunished predation of state officials due to lack of enforcement and regulation. Or is it vice-versa? Predation of officials leads to their inclination to block reforms and laws from due performance? In current work I sought to answer the puzzle advocating to indispensability of strong political will determined for positive change.

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Chapter 1

Table 1: State Capture and Administrative Corruption by Country

Introduction

“[U]nfair Competition exists when a government or quasi-government entity takes advantage of its tax exemption and other privileges to supply private goods to the market in competition with private suppliers”(Dennis Polhill, 1993).

The “Law on Unfair Competition” which was designed and implemented in 1995 today is far and wide violated. Firms and enterprises on the market are suffering from unequal opportunities that they are left to face after the advent of certain firms with dubious royal privileges on state’s market. Various cases impede fair and unhampered market activity in different spheres of state’s economy. The distinctive point of Azerbaijan’s case is that occurrence of breaching of the law on unfair competition is frequently effected not by private entities but by public entities or on their behalf.

To be more specific the law does not seem to be applied in practice and economic activities which this legislature is aim to control are not properly regulated or on the contrary over-regulated by government officials. This impedes development of entrepreneurship and SME sector since monopolistic practices as well as corruption hinder the emergence of the SME sector. Corrupt practices obstacle economic development of the country, implying individuals’ and entrepreneurs’ willingness to bribe officials and each other in order to have an access to the market and this way preventing just competition between firms and destroying incentives to establish a new business. In this light the following question arises: Why the law did not exert influence despite good intentions and a reasonably good design? In most areas subject to analysis, the law is adequate for the time being, unlike the legislative reform process itself. Currently, it is more important to fix the system for making laws than the laws as such (Booz Allen Hamilton, 2002).

As a former Soviet country Azerbaijan has underwent a transition period with all its troubles and tribulations, and however, still suffers from some ailments allegedly inherited from soviet

legacy and supposedly generic for all transition states. In such way, the purpose of the work is aimed at disclosing the actual culprits responsible for the lack of the order and ineffectiveness of the laws and regulations, by analyzing usual suspects of reform failures in context of transition countries and subsequently Azerbaijan. Literature review made throughout the research comprises of the works of following authors contributing to the study of transition economies prone to state capture phenomenon and instances of political corruption: J.Hellman, D.Kauffman, G.Jones (2000); J.Winiecki (1987); C.Polidano (2001); J.Stromseth (2008); A.Shleifer (1997); J. McMillan, C.Woodruff (2000); F.Schneider, D.Enste (2000); G.Ibadoglu (2001); A.Hirschman (1970); S.Djankov, I.Lieberman, J.Mukherjee, T.Nenova (2002), O.Kuznetsova, A.Kuznetsov (1999); L.Hammergren (1998); P.Stevens (2003); J.Sachs, A.Warner (1995, 2001); M.Ross (2001); R.M.Auty (1997, 2001), A.Gelb (2001); L.M.Ocampo (2001); R.Nowak (2000); S.Busse (2006) and others.

Chapter 1: Reasons of Failure of Laws and Reforms

1.1 State Capture Instances

Phenomenon of failure of the legal initiatives in transition countries is an area which concentrates upon itself extensive amount of work and literature sources. Many researches have mind boggled in their attempts to define the causes of unsuccessful reform initiatives by analyzing sources of resistance to change in policy. Various authors attribute it to different factors: *consequences of soviet legacy; partial reforms* (Hellman, Joel S., 1998; Charles Polidano, 2001), *weak institutional framework* (Charles Polidano, 2001; N.Mirimanova 2006), *absence of checks-and-balances mechanisms* (lack of accountability, weak judiciary (Jane Stromseth, 2008) and legislative branch), *state capture instances* (I. Amundsen, T. Sissener, T. Søreide 2000), *omnipresent corruption* (nepotism, cronyism, rent-seeking, bribery, extortion, malfeasance in office) (I. Amundsen, T. Sissener, T. Søreide 2000; N.Mirimanova 2006), *primacy of informal networks over formal regulations* (I. Amundsen, T. Sissener, T. Søreide 2000), *absence of political will determined for change in different levels of the government* (Charles Polidano, 2001), *absence of local demand for law from robust society* (Jane Stromseth, 2008)

Failure of laws and reforms in a particular state may, however, be as well explained by cases of a transplantation of a legal institution into a recipient-country without adopting necessary conditions and creating a base which was existent in a donor-country. This is also a reason why in a certain country a law may function properly facilitating the course of a reform while in another one the same law copy-pasted may cause serious hindrances and create unwanted negative consequences. This happens due to the fact that two different countries may have different historical backgrounds, different levels of social, economic and technological

developments, different cultural perceptions and different legal systems which should be always taken into account when “borrowing” a law from one country into another.

Contributing to the earlier factors blamed for failure of reforms is Hellman, who claims that “[T]he main political obstacles to reform in transition economies have been the early winners from partial economic reforms who succeeded in encoding their advantages in the legal and regulatory structure at large social cost” (J.Hellman, 1998). These leaders prevent further changes or reforms anticipating forfeiture of gained benefits and thus are prone to engage in state capture and administrative corruption, in order to maintain the role of the state as a personal milch-cow.

Why the failure of reforms is an oft-cited and oft-happening issue in Soviet-type system despite sometimes the apparent interest of incumbent governments to ameliorate the state of the economy? J.Winecky (1987), in his study applies a property rights based examination stressing modes of rent-maximization by elites as a key factor and variable. Economic bureaucrats and rent-seeking officials predominantly benefit from constant intrusion in the economic bubble and as a result are most concerned in the maintenance of the status quo by hampering the reforms.

Post-communist economic reforms surprisingly have not been characterized by the conventional short-term losers of transition – rioting workforce, bitter ex-bureaucrats, pensioners and mass of the unemployed. On the contrary, impeding the advancement of reforms in post-communist economies were indeed its earliest and biggest winners, such as entrepreneurs who benefitted from partial price liberalization, local officials able to ban market entry into their regions to protect their share of local monopoly rents, Mafia who have undermined the creation of a stable legal foundation for the market economy. They did not try to repel the launch of the reforms or wanted to undermine it after its fulfillment, on the

contrary, they often attempted to block or lag the economic reforms in a partial manner which generates concentrated rent for their own benefits while imposing high costs on the rest of society. (J.Hellman, 1998)

Empirical evidence suggests that those states with more recurrent elections and shorter administrative tenures and thus the most susceptible to electoral challenge from short-term losers of the reforms were more likely to adopt deep economic reforms than states that are more insulated from electoral constituency pressures. Partial reforms are proven to produce market distortions that cause mass instances of concentrated gains and spread losses in the short term. Winners are inclined to try to preserve these springs of extensive rents by blocking any attempts to abolish these distortions. (ibid)

Both deep and limited economic reforms create winners in the short term. If economic reforms continue to advance, then the market distortions that generate these concentrated rents will steadily smooth out over time and fade away. While this gradual advancement produces efficiency gains for the entire economy in long-run, they also affect the flow of private gains to the early winners of reform. If the winners give up a concentrated flow of rents produced by the early market distortions for the common good then progress in the implementation of market reforms will reduce concentrated private gains to the initial winners over time, while increasing efficiency gains for the economy as a whole (ibid). Intimidated by imminent losses, winners apply all efforts, usually quite successfully, to prevent reforms from advancing and their subsequent realization of corrupt vested interests.

J.Hellman et al. in their works define corruption as “the abuse of public office for private gain”. It is usually perceived as evil bureaucrats extorting a private firm its revenues.

However, to date, more often case is on contrary the role of firms and their influence over state. This change has major implications for policy. New findings infer upon the collected evidence that opposite to general perceptions of corruption as terrorizing of firms by bureaucrats (who actually prevent firms from normal functioning) and defined as administrative corruption, many contemporary firms consciously engage in high level corruption and conspire with state officials or politicians for mutual gains. This strategic choice decision, is labeled as state capture by corporate sector, and is turning into omnipresent phenomenon in many of transition economies (J.Hellman, G.Jones, D. Kaufmann, 2000).

State capture is most generally defined as “[t]he actions of individuals, groups, or firms both in the public and private sectors to influence the formation of laws, regulations, decrees, and other government policies to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials.” (10th Anticorruption conference)

To measure and analyze administrative corruption and state capture they use data from the Business Environment and Enterprise Performance Survey (BEEPS) conducted in mid 1999 jointly by EBRD and the World Bank, and providing information on hindrances for the business sector in 22 transition economies (J.Hellman, G.Jones, D. Kaufmann, 2000).

Administrative corruption is labeled as illicit payments demanded from the firm in the (discretionary) implementation of existing regulations or laws. Administrative corruption is calculated as the ratio of yearly revenues paid to public officials to “get things done”. The results reveal substantial variation in the size of illicit payments in transition economies, ranging from 1.1 % of gross firm revenues in Croatia to 6 % in Azerbaijan. The survey also allows for the first time to arrive at a proxy estimate for state capture. In contrast with

administrative corruption, state capture labeled as the ability to affect the formation of the basic rules of the game via private payments to public servants. A cross-country index of state capture is presented as the degree to which the forms of corruption have had a direct impact on firms' business:

- Sale of Parliamentary votes on laws to private interests.
- Sale of Presidential decrees to private interests.
- Mishandling of funds by the central bank.
- Sale of criminal court decisions.
- Sale of commercial court decisions
- Contributions paid by private interests to political parties and election campaigns (ibid)

Table 1 – State Capture and Administrative Corruption, by Country

Country	Parliamentary Legislation	Presidential decrees	Central Bank	Criminal Courts	Commercial Courts	Political Party Finance	Capture Index (avg)	Capture Index Class.	Administrative Corruption Level of bribery % of firm revenues
Albania	12	7	8	22	20	25	16	Low	4.0
Armenia	10	7	14	5	6	1	7	Low	4.6
Azerbaijan	41	48	39	44	40	35	41	High	5.7
Belarus	9	5	25	0	4	8	9	Low	1.3
Bulgaria	28	26	28	28	19	42	28	High	2.1
Croatia	18	24	30	29	29	30	27	High	1.1
Czech Rep	18	11	12	9	9	6	11	Low	2.5
Estonia	14	7	8	8	8	17	10	Low	1.6
Georgia	29	24	32	18	20	21	24	High	4.3
Hungary	12	7	8	5	5	4	7	Low	1.7
Kazakhstan	13	10	19	14	14	6	12	Low	3.1
Kyrgyzstan	18	16	59	26	30	27	29	High	5.3
Latvia	40	49	8	21	26	35	30	High	1.4
Lithuania	15	7	9	11	14	13	11	Low	2.8
Moldova	43	30	40	33	34	42	37	High	4.0
Poland	13	10	6	12	18	10	12	Low	1.6
Romania	22	20	26	14	17	27	21	High	3.2
Russia	35	32	47	24	27	24	32	High	2.8
Slovakia	20	12	37	29	25	20	24	High	2.5
Slovenia	8	5	4	6	6	11	7	Low	1.4
Ukraine	44	37	37	21	26	29	32	High	4.4
Uzbekistan	5	4	8	5	4	6	5	Low	4.4
Overall	24	21	25	18	20	20	21		3.0

Source: J.Hellman et al. 'Grabbing Hand' of Government in Transition: Facing up to 'State Capture' by the Corporate Sector. The World Bank publication 2000

The high capture group includes Azerbaijan, Bulgaria, Croatia, Georgia, Kyrgyzstan, Latvia, Moldova, Romania, Russia, Slovakia, and Ukraine. Most of these economies are regarded as partial reformers in both the political and economic terms. While liberalizing and privatizing they dedicated less attention to the reform in the complementary institutional framework to support a legal and regulatory framework for the emerging market. While adopting basic rules of democratic elections, the concentration of political power, restrictions of political competition and limits to participation by civil society is still present in many of the countries. The evidence suggests that state capture flourishes in environment of partial economic and political liberalization (Joel Hellman, Geraint Jones, and Daniel Kaufmann, 2000)

While state capture brings advantages for particular individuals or groups in the basic legal or regulatory framework, administrative corruption implies the deliberate imposition of distortions in the implementation of existing laws, rules, and regulations with an aim to provide benefits to state/non-state actors resulting from the illicit and corrupt provision of private gains to public officials. Administrative corruption in its turn also comprises recognizable instances of “grease payments” and bribes to facilitate business activities and provision of government services.(World Bank, 2000).

The essential distinction between state capture and administrative corruption is the political relation substant to each form of corruption. State capture is situated in the area of competition, participation, and transparency in policymaking and legislative processes of the state. It mostly increases there, where economic power is highly centralized, forms of collective interest representation beyond the firm remain weak, and the market for political influence is monopolized by hegemonic firms. Administrative corruption is situated in the

area of discretion of public officials to grant discriminatory exemptions, to ration the provision of public services and to differentiate in the implementation of rules and regulations. Thus it is obvious that capture is mostly a function of political sway, where as administrative corruption is a function of bureaucratic discretion (Cheryl Gray, Joel Hellman, Randi Ryterman, 2004).

These distinct but kindred types of corruption have different impacts on the economy and society. Capture inclines more to undermine the competition by discriminatory restrictions to market entrance and allotting preferences to authorized and influential incumbents. Administrative corruption disrupts the rule of law by undermining the state's capability to carry out laws and regulations as well as the public's expectations for their consistent and impartial application. The negative consequences of state capture are institutionalized and transformed into the basic rules of the game by which market economy is manipulated, in such a way fundamentally distorting its further evolution and development. The negative effects of administrative corruption result in weakening of property rights with a grave impact on investment, growth and equity (ibid).

However, the general social effect of state capture is still ambiguous. It provides certain captor firms with concentrated gains, but on the other side results in externalities for all the rest participants of the economy. Fundamental and significant externalities maybe caused by small number of influential firms from capturing the state and extorting benefits from yet feeble and developing legal and/or regulatory systems. Such firms may exploit their relations with public authorities to impose hindrances to market entry or solicit harsh regulations for their competitors (Joel S. Hellman, Geraint Jones, Daniel Kaufmann, 2003). These illicit relations and informal network ties between firms and public authorities, between individuals

and public authorities, in between individuals and among firms, bring us to yet another potential culprit hampering the prevalence of the rule of law: cronyism, nepotism and informal economic transactions between market and political actors.

1.2 Cronyism Instances and Informal Economy:

Crony capitalism is a negative term attributed to an allegedly capitalist economy where success of entrepreneurship depends on close ties between businesspeople and state officials. It may involve favoritism in the allocation of legal permits, earmarked grants from government, discriminative tax breaks etc.

Crony capitalism, also called plutocracy (rule by wealth) or kleptocracy (rule by theft), can develop into a blunt corruption, preventing formation and function of a free market. Bribes to government officials are considered *comme il faut* and tax evasion is conventional. Corrupt governments may favor one set of business owners who unlike the others possess close ties to the government by virtue of racial, religious, or ethnic kinship. Personal relationships serve as social networks where problems are solved by resorting to social network connections by turning to other powerful people for support in their endeavors. These people form hubs in the network, which may be very few in transition state, thus focusing economic and political control in a small interlocking group. In a regular market this status quo will be unsustainable to maintain, since arrival of new entrants will expand the market, unlike the case of entwined market and state networks, then the government can maintain the small-hub network (Investopedia, 2009).

The exploitation of corrupt incentives during a long period of time aimed at influencing the policymakers and administration results in diminishing confidence in public servants and state institutions what in itself generates further incentives to secure access by applying to officially illegal means, further contributing to a weakening in accountability and legitimacy of the system. When formal means of access deteriorate, informal networks are given high priority and solidify over time as a way to gain privilege. Growth of informal economy networks weakens revenue collection, decreasing the collection of resources available to build a professional civil service and provide public goods (World Bank)

However, without doubt, as long as operations “outside the law” have more benefits and pay off better than those which are “in conformity with the law” people will opt for the first ones and engage in shadow economy business and underground economic transactions. This is mostly due to government overregulation (Johnson, Kaufmann, and Shleifer, 1997; Johnson, Kaufmann, McMillan, and Woodruff, 2000) as well as tax burden and obligatory social security contributions (Schneider and Enste, 2000). In cases given that the state level of tax is adequate and generally affordable, often tax inspections with an aim of extortion and frequency of informal payments made to official entities as necessary “grease payments” in the business cycle of some countries, incline entrepreneurs and market actors towards tax evasion. According to Schneider and Enste “[S]hadow economy includes unreported income from the production of legal goods and services either from monetary or barter transactions – hence, all economic activities which would generally be taxable were they reported to the state (tax) authorities”. With the reference to Mogensen et al. they suggest that “[t]he shadow economy develops all the time according to the ‘principle of running water’: it adjusts to changes in taxes, to sanctions from the tax authorities and to general moral attitudes, etc” (Friedrich Schneider, 2003). A percentage of shadow economy in Azerbaijan to country’s

GDP according to different sources amounts to 40-60%.(Standard & Poor's, 2009; G.Ibadoglu, 2001; Schneider, 2003)

Bloating shadow economy is usually a response of individual market actors to overburdening caused by the state and their silent protest in which they chose “exit option” to “voice option” (Albert O. Hirschman 1970).

However there is a tradeoff, when market actors transcend the formal economy's bounds they are depriving themselves of government and some private sector services available to firms that fully comply with regulations. In countries where such services are existent (credit services by state-owned or private banks, infrastructure services, organization of trade fairs, training of employees and managers, etc) market actors may prefer to abstain from informality and stay formal thus to enjoy offered range of services even if regulations are burdensome and taxes are high (case of Belgium). On the contrary, in countries where the quality of state offered services to businesses actors is poor the latter have rather narrow choice. When discernible benefits of complying with the law are insignificant, market actors fancy time and money saving more and go informal (Simeon Djankov, Ira Lieberman, Joyita Mukherjee, Tatiana Nenova, 2002).

In many countries the actuality is that the costs of establishing and conducting businesses are so high that they are left with the only alternative to operate informally. Different theories suggest different culprits for hindering the flow of business activity and establishing high entry barriers and cumbersome operations imposed by various regulations. According to Djankov et al. the public interest theory advocates that strictness of regulation results in high consumer welfare, where as the public choice theory conversely, sees regulation to be a mechanism for bureaucrats in their thirst for rents. In their research Djankov et al. made an

attempt to empirically address this question and inferred that states with less limited, less democratic and more interventionist governments usually excessively regulate their economies and even control the level of economic development, which supports the public choice approach with its emphasis on rent –seeking behavior of politicians. In such a way its obvious that entry and operations of businesses are usually regulated more heavily by less democratic governments without yielding tangible social benefits for the society. The primary beneficiaries obtained are the politicians and bureaucrats themselves. (Simeon Djankov, Ira Lieberman, Joyita Mukherjee, Tatiana Nenova, 2002)

In research conducted by International Alert Organization in South Caucasus the author N.Mirimanova (2006), states that corruption for most respondents implied bribes, nepotism, favoritism and extortion in the public sector with the emphasis on corruption in the upper echelons of the state’s authorities. In Azerbaijan, corruption was seen as ‘nuts and bolts of the state policy’ which bind the state structures together. However, respondents confessed that corruption helps resolute issues and problems when the state fails to fulfill its functions or when disobeying state’s laws actually improves the living conditions of a significant part of the locals.

Idiosyncrasies of the case of Azerbaijan are such that market actors go informal due to burdensome overregulation and extortions from the side of civil servants. Frequent tax inspections are often conditioned by informal requirement imposed to the lower rank civil servants by higher ones to “pass” daily solicited monies from revised/audited firms to higher rank officials, creating vicious cycle. Attempting to avoid meticulous and time consuming inspections, which *a priori* have predicted outcome, firms on the market prefer informal “grease payments” to appease the auditors and more or less defer next inevitable audition.

Firms conceal the actual revenues they yield, the number of employees, expenditures and production cycle by the virtue of the fact that on the top of formal costs they bear they are actually imposed informal ones.

However tax pressures are not the sole reasons prompting firms to go informal, sociologist Sarah Busse (2001) suggests that societies in transition economies are exposed to constant unrest, uncertainty and unpredictability fraught with perpetual problem solving process. Evolved over time patterned and generic reactions to the typical sets of problems, or in other words a society's "tool kit" for hard times make each society's environment unique in a way and distinguishes societies from each other. Individuals in a society share with each other their "tool kits" which they gained through their own experience with each. These "problem-solving" or "survival" strategies, which maybe either purposefully created or subconsciously learnt from others, are then conveyed openly or via exemplary behavior to their families and surroundings.

As a country advances toward a market economy, informal economic transactions persist and proceed playing key roles in the lives of individuals, filling the vacuum of incompletely developed formal institutions for various economic transactions (ibid), contributing to corruption and inequality.

World Bank's report on transition countries added to the policy debate on corruption suggesting that corruption in any institution hampers its functioning and distorts its objectives. Where as corruption in the judiciary is especially harmful due to the fact that legal system is one of the essential pillars of a market economy which encompasses a role of arbiter, formulator, and executer of public policy. The courts are responsible for upholding property rights, enforcing contracts, settling disputes and solving criminal cases. As a result,

corruption in the judiciary can display aspects of both state capture and administrative corruption.

Failure in performance of any of its roles is fraught with creation of wrong incentives for firms and individuals to resort to more costly private means of contract enforcement and protection. On the top of the economic costs, corrupt judiciary has a wider impact, undermining the trustworthiness of the state and impeding implementation of public policy. Moreover, since the courts and legal system are arbiters of any anticorruption programs, corrupt judiciary will virtually sabotage anticorruption efforts themselves (World Bank 2000).

1.3 Comprehensive Analysis

Worded analysis of literature gives ground to compare and suggest, influence of which of the above factors has the major impact on malfunctioning of the legal regulations. Soviet legacy indeed may have a profound impact on transition country's development. Traditional channels of distribution of corporate information, planed economy and directives, might have been removed, but new market channels are still incompletely materialized. Personal ties and social networking sustain as significant factors for business success or failure and for engendering corruption. Markets seem to be fusing with systems of personalized political relocation instead of substituting it. (O.Kuznetsova, A.Kuznetsov 1999) However, key determinant of progress of transition is the degree of reforms implemented by the state in area of political or market liberalization. Countries with ubiquitous and deep reforms indicate a distinctly higher liberalization index and much better growth performance. Reforms concerning institutional development are also crucial. The econometric analysis incorporated an independent indicator for the development of a legal framework, which appears to play an important role in reform. The results suggest that developing an appropriate legal structure is indispensable, but not

necessarily in advance of other reforms. However, if development of the legal system is delayed too long - if one puts off the implementation of the rule of law, enforcement of discipline, and security of property rights - then other reforms are unlikely to produce significant benefits. However, the outcome of finding itself in an environment of omnipresent rent-seeking and corruption as a consequence of first steps of reforms is very common for a transition economy. Corrupt interests that gain private benefit from these changes very soon institute themselves and oppose further reform undertakings, defying open entry to the market, fair competition, complete liberalization, and a robust rule of law, what leads to the emergence of an underground economy and contributes to a profitability of usage of informal ties in order to advance. Unfair competition, partial liberalization, benefits of doing business in the realm of informal economy, and the biased rule of law lags the transformation and economic progress (Thomas Wolf, 1999). Consequently vested interests of winners' clan lead to establishment of informal crony ties between market and state and subsequent state capture. However, described chain of events is a causation mechanism that was ignited by one single factor: absence of genuine will intended for change, either from the part of the competent and accountable government leaders or from the side of robust and comprehensive civil society. I opine that the strongest factor and the root of all evil is centralized upon the absence of the political will determined in pursuance of further reforms, establishment of a strong market, creation of a fair and independent judiciary and a system of checks-and-balances. The resistance for change is explained by vested interest and rational choice in maintaining the status quo which brings private gains and exclusive benefits. As stated by C.Polidano (2001), only manifest support for reform on the part of political leaders can ensure that the various governmental structures will make reform a priority. In the absence of political commitment for reforms radiated from the top echelons of power, no structure of governmental institutions is likely to function effectively for long without firm leadership (ibid).

Chapter 2: Theoretical Framework of the Case

2.1 State Capture Theory

As it is clear from the table 1, index of state capture and administrative corruption is very high in Azerbaijan. It is considerably due to the fact of incidence of partial reforms in the country, both in terms of political and economic transition. Based on facts worded in earlier chapters, the analytical strand of thought alongside of which I intend to build my further analysis will comprise of state capture theoretical and empirical paradigms, corruption and political will evidences.

Some firms, by virtue of acquired connections and ties with government, have the capacity to influence the state and reap private gains without necessity to corrupt the officials. Fortunate place of many older firms, with tight ownership ties with a state and thus a secure favorable position on the market, induce de nova firms (L.Solanko, 2003; J.S. Hellman, G.Jones, D.Kaufmann 2003) to “buy” laws or decrees to advance on the market and acquire property rights to compete effectively against influentially protected companies. It was proved that incumbent influential firms by virtue of networks do not have to resort for purchases of regulations by definition. Lose the game those who don't have a “krysha” or a roof that is able to distribute patronage and guarantee artificially acquired dominance in market competition preventing other firms from entrance and those who are “in” from full-fledged, healthy functioning (Anticorruption resource centre).

Assessment of state capture performed by BEEPS queried specifically about bribes made by firms to public officials to influence their decision. It, however, did not address more subtle

forms of state capture, such as direct ownership by public officials of stakes in private enterprises or other symbiotic networks of public and private origin that do not directly involve bribery. These more subtle forms of state capture are however generic in many transition countries of FSU (Joel Hellman and Mark Schankerman, 2000; Joel S. Hellman, Geraint Jones, Daniel Kaufmann, Mark Schankerman, 2000; Cheryl Gray, Joel Hellman, Randi Ryterman. 2004).

The survey on the degree of state capture held during the period of 1999-2002 by BEEPS revealed only two transition countries with significant declines in state capture which were Azerbaijan and Lithuania (both from high levels in 1999) (Cheryl Gray, Joel Hellman, Randi Ryterman. 2004) I would however ascribe it to the fact as Hellman and Kaufman describe it “[T]he concept of the State capture in most of the FSU needs modification since there exists no truly independent private sector to capture the State but a fused group of economic/political actors organized in vertical networks dominating the distribution of resources and power. Social networks and “clans” remain there and being the very fabric of the State, have no need to capture it” (Anticorruption resource centre). Thus Kleptocratic political leaders and public officials themselves can also be engaged in capturing the state to satiate their own private interests or very often those of their immediate family (Cheryl Gray, Joel Hellman, Randi Ryterman. 2004). Evidence confirms that countries experiencing a clear break with their past leadership in the beginning of transition, establishing new mechanisms of political accountability accounted for enhanced participation of civil society and political competition, ended up with notably lower incidence of state capture and administrative corruption (World Bank) Countries with weak institutional framework, which in transition countries by definition, is weak and feeble, are subject to usurpation of power and authority by powerful “winners” of reforms and later on serving their vested interests.

Where state capture has formed deep-rooted vested interests, breaking up monopolistic structures will be a challenge. Its success will first of all depend on the role and degree of the political leadership while simultaneously implementing strategies to promote competition and entry policy, providing new entrants with ability to compete with powerful incumbents (Joel Hellman, Geraint Jones, and Daniel Kaufmann, 2000)

2.2 Phenomenon Of Political Will

So as it is clear, the presence of political will determined for change and implementation of reforms for the benefit of all instead of a few, is thus indispensable. As it has been noted by earlier researchers (Post Lori., Raile Amber, Raile Eric, 2008) despite the ubiquity of the concept, “political will” is prone to substantial ambiguity, which makes it a useful rhetorical tool in political arena. This vagueness of the term also owes to the potential and intentional nature of political will (ibid). In their turn political actors as well have inclination to delude and mislead what also contributes to the difficulty of measurement of political will.

Political will is sometimes also characterized as “[t]he slipperiest concept in the policy lexicon and the *sine qua non* of policy success which is never defined except by its absence” (Hammergren, 1998).

Lori et al. examine the concept of political will in a number of ways. Their ideal-type definition of political will calls for “[a] sufficient set of political actors with a common understanding of a particular problem on the public agenda genuinely intending to support a commonly perceived, potentially effective policy solution”. It comprises of four complementing each other components which they delineate as essentials:

1. A sufficient set of political actors

2. With a common understanding of a particular problem on the public agenda
3. Genuinely intending to support
4. A commonly perceived, potentially effective policy solution.

They frame the definition in terms of necessary conditions because failure in any one of these areas detracts from the prospects for responsive and effective policymaking. The first necessary condition for the existence of political will is that *a sufficient set of political actors* intends to support the policy, or merely involvement of which political actors supporting the initiative would imply its success? (Post Lori., Raile Amber, Raile Eric, 2008)

The second necessary condition Lori et al. advocated for the existence of political will is that a sufficient set of political actors has *a common understanding of a particular problem on the public agenda*. Implying that the political actors assent that a particular issue or condition has reached problem status, agree on the nature of the problem and acknowledge that the problem requires concerted government action. (ibid)

The third necessary condition in our definition of political will is that a sufficient set of political actors *genuinely intending to support a particular policy*. This necessary condition lies at the core of political will but is perhaps the most problematic to ascertain. How is it possible to determine the intentions of political actors? Moreover, how do you decide on their genuineness? Though anticipating and predicting an actual intent is not possible, several indirect indicators of intent and constraints on action are discernible. The most apparent indicator appears when political actors make convincing, obliging political statements or undertake actions of a similar nature. According to Lori et al. game theorists call it “reputational costs” when politicians “bargaining” in front of an audience advocate one

choice and then later switch to a diverse one. A case involving high reputational costs makes the statements of political actors more credible and more binding (ibid)

The fourth necessary condition for the definition of political will offered by Lori et al. is that the *support is aimed at a commonly perceived, potentially effective policy solution*. This prerequisite is the most contentious in the definition as they acknowledge themselves, since genuine support in favor of a particular political strategy may exist not knowing whether the strategy will prove efficient. However, if taken in consideration the fact that political actors have many ways to sabotage a policy initiative or to ensure that it remains ineffective, it becomes obvious that such conduct defies offered definition of political will. Therefore, the emphasis Lori et al. advances is more focused on behavior that undermines political will on attempts to predict whether a policy will be “effective” by according to evaluative standards. (ibid)

In the case of Azerbaijan a *sufficient set of political actors* comprises out of the Executive (President and Cabinet of Ministers, as it is Presidential Democracy) and Legislative (Parliament) branches. However, I do not necessarily agree with the authors on the thought that acquiescence of only three leading governmental branches: executive, legislative and judicial is adequate to name the initiative a ubiquitous “political will”. If worded governmental branches *de jure* give their assents for the change but lower level bureaucrats, local municipalities and other civil servants *de facto* continue to adhere to self-interested behavior, no “political will” despite its recognition and encouragement from top levels will be able to actually penetrate through the lower layers of bureaucratic swamps. Accordingly, despite the fact of endorsement of new legislature, correspondent to the European standards from the side of higher executive powers, lower lines of authority which embrace various

ministry servants, members of the parliament, city executive board and members of judiciary, being reluctant to change the habitual practiced rhythm of work which brings private benefits, stiffly abide by entrenched regulations and corrupt practices.

2.3 Consequences of Resource Endowment

Further exacerbates the state-of-affairs the fact of country's oil-bearing potential. Earlier researches have suggested that resource abundant states demonstrate inferior performances than other states. (Stevens, 2003; Sachs and Warner 1995, 2001)

Given the isolated and strategic nature of the oil industry, the accumulation and allocation of profits are controlled by persisting elites with deep-rooted interests in the existing power structures (Oksan Bayulgen, 1998).

Extensive literature (UNDP 2006; Ross 2001; USAID 2006; CMI U4ISSUE 2006; Stevens P. 2003; CMI NUPI 2000) has shed light on current phenomenon in oil states, where elites at power are reluctant to "hive off" the offices after their terms are over due to ubiquitous opportunities of rent-seeking and seizing the natural resource wealth of the state. These ruling elites further may commit attempts to modify the legislation or constitution in order to extend or even eternalize their "political spans". Same tactics were deployed in Azerbaijan when after President Heydar Aliyev's demise the rein of governance was passed to his son Ilham Aliyev. The authors Franke A., Gawrich A. and Alakbarov G. (2007) cite in their work that "[t]his kind of dynasticism is the first indicator that power is conceived of as something personal/familial not related to political institutions. It's more likely to show that a ruler wants to keep power in family which leads to an understanding of state power as a family business". This takes place not only in Azerbaijan, but as well in Kazakhstan, Turkmenistan and other Central Asian states rich with natural resources (ibid 2007).

Politicians and bureaucrats in resource rich countries tend to capture and take advantage of country's resource abundance by rent seeking practices and corrupt behavior. Engagement in illicit practices and rent seeking allows them to skim personal benefits from resource endowments by robbing their countries. In these countries majority of political and administrative power holders as such are rational self-maximizing individuals with a narrow interest in exploiting their countries' resource endowments for their own private gains (P.Stevens, E. Dietsche, 2007).

Elite in such countries as well as in Azerbaijan is engaged in predatory behavior and “[m]ay repress a potentially dynamic peasant society and defect a country from pursuing a development strategy in line with its underlying comparative advantage.” (Auty R.M., 1997) More insidiously, after gaining substantial private gains from oil such elites perceive an effective, efficient and watchful civil service as a threat to the benefits they enjoy (Francisco G. Carneiro, 2007) and usually block reform initiatives. This is why in the case of Azerbaijan presupposing existence of sufficient set of political actors and assuming occurrence of the fact of its common understanding of a particular problem on the public agenda, is still ineffective due to the fact that *genuine intention to support and execute a commonly perceived, potentially effective policy solution* is virtually blocked by political elites and their surroundings.

As it is defined by Auty, the mediocre performance of countries with rich resource endowment can be associated with two characteristics commonly assigned to resource wealth:

1. Rent-seeking rivalry conceives “extractive” political states due to the fact that rent extraction brings more immediate (often personal) economic and political benefits to ruling

elite than wealth creation where as by expanding competition the scope of rent-seeking activity diminishes (Auty, 2001)

2. Rent seeking is utilized by an “extractive” incumbent government with the late-motive to stay in power. It incurs substantial costs such as political trade-offs needed to “buy off” the loyalty of other powerful interest groups for them to stay united with the incumbent regime.

“[W]hile incumbent governments in resource-rich economies may very well have a developmental model that they believe will generate better economic and social welfare outcomes, the trade-offs that they are obliged to make and the exogenous economic consequences associated with the extraction and trade of the natural resource combined will introduce distortions to the structure of the economy and in the quality of governance institutions of the country.” (ibid 2001)

It makes resource-bearing states very susceptible to growth collapses and to sudden political change. The susceptibility to growth collapses occurs do the fact that excessive dependence on natural resource revenues hampers competitive diversification of the economy (Auty and Gelb, 2001) . The susceptibility to sudden political change owes to the often made political trade-offs to appease cases of dissent. It may further result in deteriorating of societal checks and balances and lead to formation of repressive political states (Francisco G. Carneiro, 2007).

2.4 Comprehensive Analysis

The performed analysis gives grounds to state that the political will in case of Azerbaijan even if existent is feeble and hardly reaches its destination. Certain decrees aimed at promotion of democracy and fair economy issued and ratified by the highest executive authority most of the time can not percolate through rigid and corrupt apparatus and stay

jammed in rampant swirls of the bureaucratic “red-tapes”. However, plausibility of the game in a good cop and a bad cop also seems rather naïve. Being assured in an absolute good will of the highest authority and boondoggling and corrupt practices of the other political servants is myopic, when revoking that incumbent highest authority of the country often turns a blind-eye on its surroundings behaving as warlords and monopolizing the key industries of the economy. This almost total capture of the state by adjacent and loyal to the incumbent government elite is undoubtedly allowed with the purpose of seizure of the economy what guarantees that the wealth of country’s economy and of the populace stays in the government’s coffers. Wealth is might; as long as citizens are dispossessed of considerable monetary resources which will render them powerful enough to rebel, the incumbent elite will dictate the rules. In order to avoid accumulation of monetary wealth by citizens, majority if not all of the lucrative industries of the economy are stranglehold by the government. Perfectly aware of the fact that middle class and contingent to it SME sector is considered to be the “backbone of the economy” the government deploys its tools (seizure of customs sector, construction sector, media sector, transportation sector, real-estate sector and etc.) to guarantee the flow of the monies directly into its treasury, curbing the development of SME and financial independence of the society.

Chapter 3: Empirical Evidence of Violation of the Law

3.1 Foreword

I have chosen several cases reflecting the state capture rudiments based on evidences from the literature. I suggest that following cases confirm and conform to state capture phenomenon described in the literature, however as noted earlier by Hellman and Kaufman their particularity is attributed to the context of FSU countries, where captor firms in private sector are sharing ownership with the state. I opine that infringement of the law on unfair competition is in fact due to high state capture, ubiquitous political corruption instances and absence of political will aimed for distributive rather than capture economy.

The World Bank Institute surveys revealed that enterprises which purchased parliamentary laws, presidential decrees, and influence in central banks impose considerable indirect costs on the development of the rest of the economy. State capture is a profitable enterprise for a few of private and public entrepreneurs capable of creating national and international networks to coordinate personal vested interests. Firms and actors left overboard of the corrupt network and acting uncoordinatedly are inflicted large damages as a result of inability to prevent the network's practices. "[T]hese companies are as powerless as the poorest of the people" (Ocampo, Luis Moreno. 2001)

3.2 First Case

To start with one of the attributes of corruption, nepotism and conflict of interests is clearly depicted in the case below, which is “Straddling”, which is “[t]he process by which some power-holders systematically use their political office to enter into, secure and expand their private business interests, should be regarded as another form of embezzlement. In some countries the political elite has nationalized foreign businesses, property and monopoly rights, and redistributed these to the members of the ruling families (Inge Amundsen, Tone Sissener, Tina Søreide, 2000).

Being more specific, the affair stands thus: the Ministry of Emergency Situations has ascertained obligatory requirements for participants of the market, both private and public entities, regarding security issues. Each enterprise has to possess in its office premises fire alarm system and fire extinguishing equipment, otherwise it is subject to a high penalty and fines. However, Ministry is quite “picky” in its choice of facility standards and accepts fire extinguishing equipment purchased from and incorporated by one particular service providing private company “CaspiYildiz” (transl. “the star of the Caspian”). “CaspiYildiz” is the only holding company on the market which possesses certificates for its fire extinguishing equipment, since government abstains from assigning certified rights for the fire extinguishing equipment of other firms providing similar services. After incorporation of fire alarm system by other service companies compulsorily requirement is to invoke “CaspiYildiz” to conduct the audit; fire extinguisher are incorporated solely by “CaspiYildiz”. The company has been on the market since 1996 and on its website (Ministry of Emergency Situations) indicates board of directors comprising of private individuals, when as a matter of fact “CaspiYildiz” is known to be under the auspices of the Ministry itself, and more precisely it allegedly belongs to Minister. Discriminative practice of “CaspiYildiz” results in monopolistic activity on the market and further contributes to unfair competition between the analogous firms.

Corruption or the abuse of power for personal gain, comprising of bribery, extortion, nepotism or conflict of interests is a precursor of deep institutional malfunction, conventional for the environment of excessive regulation, high discretion in economic activity and allocation of resources by government instead of the market. Its occurrence is attributed to low likelihood of disclosure and/or punishment mechanism. (R.Nowak, 2000)

3.3 Second Case

Case of abuse of power or trading in influence could be drawn from following instance of corruption on the country's market. The abuse of office can be observed in the actions of the former head of the Ministry of Customs (incumbent Minister of Emergency Situations) who made use of his authorities and employed them with private purposes by imposing tariffs and quotes on the imported goods thus creating favorable conditions for the development of his own business enterprise. Worded minister established a private juice producing company on the local level and meanwhile imposed high tariffs on all imported juice products to the country. This action has made business activity of the many similar juice producing or importing companies to become unprofitable enterprises. Obtained case is an example of the abuse of power and office and may be characterized as premeditated malfeasance in office. Consequences of current trading in influence are infringement of rights of companies on the market and breaching of the Law on Unfair Competition. This case corresponds with the definition of corruption of the World Bank as “[a]buse of public power for private benefit”. Transparency International (TI) has also applied a definition for the similar cases such as “[t]he abuse of entrusted power for private gain”. In such way, political corruption can be explained as “[a]buse of political power for private benefit” (Anticorruption Resource Centre)

3.4 Third Case

Next case of the state capture in context of the FSU can be observed in the case of construction works in the capital and real estate development, which is by itself also an instance of the infraction of the law in question. State and private companies under the patronage of monopolistic elites have captured the construction sector and impede the development of fair competition among the construction sector participants by following means: in order to purchase a land spot for a construction site, legal or physical entity is forced to make high “grease payments” to receive the permission for the start of the building works. Frequently the sum of the “grease payments” is insomuch high that erector should either back out or pay the sum out of the amount allocated directly for the construction itself thus exhausting the monetary resources in the budget left for the construction works. The constructor in such manner has to consequently opt for a low-quality and secondary raw materials which are less costly and thus jeopardize the safety of the erection and compromise the subsistence of the finished building. Another scenario develops when on the ground of formal state inspections government civil servants examine the buildings constructed by private firms which compete with those under their own patronage and inevitably find a few requirements discrepancies and nonconformance to standard of construction. The firm is consequently terminated of its license falling a pray to violation of the law on unfair competition and providing further freedom of operation to arbitrariness of “protected” private enterprises.

3.5 Comprehensive Analysis

Brought empirical evidence illustrates the undoubted proof of the state capture and corruption in the highest echelons of power in the country. Involvement of political actors in corruption practices themselves and violation of rules which their positions are assumed to secure, gives grounds to state that private gains from infusion of state and market, prompts political actors to solidify their individual and unified efforts in preventing the further implementation of reforms which would create favorable conditions for firms to enter the market and compete on the equal basis. This lack of impartiality and informal sponsorship of incumbent firms on the market indeed contributes to the formation of inference that changing the status quo is inexpedient to incumbent political actors and thus explains the absence of discernible political will aimed at the positive change. With this reason, any prospect of the establishment of accountability or popular justice in the country is blocked by elite. In such a way, judicial institutions as the direct enforcement mechanisms of laws and regulations are “misappropriated” by the government and are perceived as highly corrupt and incompetent by local population and thus unable to resolute the cases of law infringements in the country perpetrated by the worded officials.

At this stage impotence of the Law on Unfair Competition maybe attributed to the facts as those described earlier, such as personal intervention and involvement of government officials in infringements of the law cycle by demanding bribes and grease payments (above formal levying of taxes), trimming regulations in a way to correspond to their private demands and appointment of relatives as heads of the companies in the market. Worded, distorts fair competition practices since any day firms under protection of the civil servants given freedom

and discretion to operate may compromise and sabotage the activity of any particular firm on the market given that this firm attracts more clients or generates more revenue than theirs.

Failure in the performance of the law on unfair competition and on its behalf the underperformance of entire regulation, based on the data above I accord to a weak judiciary, incompetence of which is profitable for the officials and the elite in power.

Chapter 4: Role of Judiciary Authority

Booz Allen Hamilton (2002) in his diagnostic analyses of Commercial Legal and Institutional Reform of Azerbaijan stated that the country has established most of the implementing institutions necessary for each area of law, which are however very feeble and inept at controlling. Surveys held reflected respondents' opinion of main obstacles to be: "[i]nsufficient knowledge and experience with the subject matter, insufficient funding, lack of authority to fulfill their mandates, and systemic corruption". The lack of knowledge is anticipated due to the vast quantity of changes taking place in recent years and can be addressed through training and education; other limitations however appear as rather rigid to defeat. Country's courts received the lowest score given of the 10 countries assessed by Booz Allen since 1998. This reflects the undisputed negative perception developed by enterprise and legal communities as a result of poor functioning of the courts. Courts were rated and assessed as the implementing institution for contracts. The 10 scores to date were: Poland (83%), Romania (73%), Kazakhstan (66%), Serbia (63%), Macedonia (62%), Bulgaria (61%), and Albania (51%), Ukraine (49%), Armenia (41%) and Azerbaijan (39%).

During the assessment in the country made by Booz Hamilton, the most outspoken and frequently encountered topics regarding public institutions was ubiquitous corruption. Individuals as by common consent complained of extortion and cases of unofficial payments they collided with, of inappropriate audits and assessments, and general rent-seeking behavior. This was accompanied by a fear of complaining publicly and overtly, creating an environment of silent compliance with puny formal protests or lobbying for change (ibid).

He suggested the uniqueness of the case of Azerbaijan in comparisons to other countries subject of his assessment due to the absence of supporting institutions. Naturally development

of such institutions is a prolonged, extensive process for renowned historical reasons, however countries with backgrounds analogous to that of Azerbaijan seem to be advancing and outwalking the country. It is conventional for general public in Azerbaijan, to avoid taking a controversial and openly defying public stand and mostly adhere to behavior reflected in proverb: “The nail that sticks up gets hammered down.”(ibid)

Underperformance is mostly attributed to a slow pace of change in government. As previously socialist state after its independence Azerbaijan officially announced transmittance from planned economy and command politics to market economy where in actuality same traits were inherited in newly independent state, since there was no profound historical experience of democracy rule or capitalism to draw from (democratic regime lasted only for 2 years from 1918-20 before the forced intervention of soviet troops). There is, however, some evidence suggesting transformation processes in the society, but the habits hereditary from decades under the KGB will be hard to change if Government on its part will not openly promote and welcome dissent, consider and prosecutes cases of abuse of power and corruption (ibid).

The calls for change in the private sector are, however, still often interrupted and undermined by deep-rooted private sector interests reportedly highly benefitting from patronage and strong cohesion between political and economic interests. Firms with robust entrenched connections operate aggressively and effectively against any reforms that would compromise their welfare and privileges by working surreptitiously to prevent competition and continue manipulating the system. Further obstacle to reform is the soviet legacy of competition through bribery system and “blat” networks of formalized corruption. Entrepreneurs, bankers, judges, and others were deeply involved in a composite system of bribery and influence peddling which poisoned the entire system. The current situation is nevertheless exacerbated

by the fact that many still do not see any ethical, moral, or economic basis for condemning or changing this behavior perceiving it as a *comme il faut*. (ibid)

However, there is a strong desire for change among the disenfranchised private sector actors, which is yet too unfocused to be able to trigger immediate change. Country's civil society is still relatively weak with a few worthwhile institutions actively or effectively seeking reforms in the commercial environment or capturing and articulating the frustrations expressed regarding the lack of supporting institutions. The response from the government is as well rather meager, although a number of market-oriented reforms were passed in recent years, the quality of the legislation is limited and the lawmaking process is flawed. Realization of any initiatives is obstructed by problems of insufficient capacity and generic institutionalized corruption, accompanied by recognized covert and overt resistance to reforms from the part of some ministries and agencies. The political will is by itself not yet strong for planning the profound reforms and battling ubiquitous corruption and entrenched resistance. Substantial reforms, when started will require very strong leadership and effective punishment and preventive mechanisms. (ibid)

Despite the perceived or actual levels of corruption, the absence of discipline, ethics, or accountability for judges further undermines the credibility and competence of the judiciary. The application of telephone justice during the court cases poses a serious problem as well, adding more to a contemptuous attitude towards judges. Thus returning confidence and trust to judiciary is a process requiring high-profile reformers and high-profile reforms, in the direction of which regrettably no steps have been undertaken yet neither by the government nor independently by the judiciary. (ibid)

As a result of surveys held by USAID received comments from respondents indicated that private sector community has in great part capitulated and given up on the courts while attempting to replace them with an alternate judicial system instead of trying to reform the existing one, what reflects little belief in government for supplying the coveted changes. The 2000 USAID Rule of Law assessment stated that “[a]necdotal evidence is that enterprises avoid the court system, preferring settling matters out of court to bribing judges and other court officials and risking incorrect decisions.” In 2002, same is confirmed signifying unimproved concerns about bribery, corruption, extortion and incompetent judiciary. The vast majority of cases litigated in economic courts are regarding administrative disputes with government entities on tax, licensing, and privatization. Country’s lawyers and business community actors confessed in tendency to avoid the court procedure for solving commercial and contractual cases, and preference to settle down private commercial issues informally using the peer pressure and the influence of elders since it was were more effective than litigation.(ibid)

Good news is that despite the distrust expressed by majority of interviewees, some lawyers have successfully litigated cases against the government stating that persistence, time, and money factors appear to be the key to successful litigation in the country. However, different parties possess different financial resources and many of them can not afford pursuing litigation with such a zeal and determination (ibid).

Independence granted to judiciary according to Constitution of the country is rather symbolic, since hybrid relationship has developed between the Ministry of Justice and the executive authority. The Ministry allocates financial resources for the judiciary and is also accountable for overseeing court administration in terms of case management as well as judicial training

and certification. In this sense judges feel constant pressure and surveillance from the government with respect to their settlement of cases. USAID notes in its report that “[a]lmost any judge can be arrested on a corruption charge on an executive branch whim, communicated through the procuracy. That judges are aware of this probability is probably sufficient to keep them from considering any ruling that would not be in the interests of the state, the President, and his party.”(ibid)

Cases of telephone calls from the upper echelons to court room, twist arms of the judges, who are then hesitant to rule against the government even knowingly that the law favored the other party. As a result business community of the country ended up facing two alternatives ways in dealing with authorities: engaging in the “red-tape” with its litany or making use of bribes. Study’s results provide considerable evidence that individuals prefer bribes to pave their way through taxes and regulations, which holds true for both SMEs and large businesses since by either parties justice system is perceived as weak, corrupt and incompetent. High price of conducting a business also comprises the necessity of loyalty demonstration to the government to be permitted to operate (N.Mirimanova, 2006).

Despite the fact that majority of the respondents preferred resorting to bribes in terms of business solutions, they have nevertheless acknowledged its great harm in the long-term span by its eroding effect on the institutions and social fabric and further contribution to an absolute arbitrariness. However this is a typical occurrence whereby civil servants, businessmen and citizens situate themselves among the victims of corruption, blaming institutions and social conditions instead of admitting their own partial responsibility in creating and sustaining obtained institutions and conditions (ibid).

For market participants the conditions of network economy are thus more favorable since more can be achieved by informal social ties than by compliance with formal rules. Adhering to *status quo* seems the best solution currently and prompts the individuals to stay inert and idle to cases of rights infringement, without appealing to laws on everyday basis. In such a way corruption in the country is difficult to discern since it is used and perceived as a natural mechanism of social networks and a tool facilitating daily interpersonal relations between the actors on the market. Social and regional networks alongside with “patron-client” or “broker-client” transactions are vital paths for accessing resources and support and guarantying survival of the fittest. Individuals rely on friends, relatives, or acquaintances to circumvent bureaucratic obstacles what can be explained as a historical strategy developed as a reaction to an imposed governance (Adrian Karatnycky, Alexander Motyl, Amanda Schnitzer, 2001)

Chapter 5: Recommendations

As a result of performed analysis the conclusion can be made that the *status quo* of state capture instances and high level of corruption in political, economic and social spheres will most probably be maintained due to lack of political will and strong temptation for officials to skim the cream off and reap benefits attainable from the tops of their positions. Paramount requirement of change which is presence of genuine political will or strong robust civil society are not met. Reflection of top-down approach, strong and genuine political will, which would empower further attempts to influence the state of affairs and contribute to transparency and accountability is not observed in the country's case. While the second one, strong civil society, manifesting the bottom-up approach which when strong and determined would influence the status quo and extrude corrupt officials from their positions, demanding for accountable and transparent leadership does not seem to be feasible as well due to lack of coordination and highly defragmented strata of society.

Further recommendation will deem practicable and efficient only under the condition of the moral change in higher echelons of power, where all three branches of government executive, legislative and judicial have to make commitment and pledge to adhere to accountable and transparent stewardship. Enforcement apparatus have to be on place to establish checks-and-balances mechanism, eliminating discretion and arbitration which are omnipresent and omnipotent in Azerbaijan. However, absence of both of the two necessary agents of change: political will determined for a credible leadership, and a strong civil society united in its mission of the establishment of transparent system, *a priori* guarantees futility of efforts. Influence and pressure from external sources, such as international organization or international society will not be able to breakthrough the solid crust of entrenched corrupt

interests of the country, unless similar attempts are employed from both sides of the equilibrium: external and internal. Solutions proposed below will be fully executable solely in case of presence of genuine political will from upper and lower echelons of power.

Since the one of the major challenges that all transition countries face in initiation of the anticorruption strategy is credible leadership, a profound and coherent anticorruption program, as said earlier, cannot be inflicted from the external sources, but requires allegiant leadership from within from the highest authorities of the state. However, insidious and ubiquitous corruption practices leaving small hope to find the loopholes for an anticorruption strategy are undermining the faith in state and its reputation. Support of highest echelons of power such as presidents or prime ministers would have its say in anticorruption battle and breaching of state capture; however, in case of their reluctance, leadership vibes can be radiated both from a determined minister with the clout, resources and authority to launch reforms in his domain or from a regional administrative determined in the necessity of change in his area (World Bank, 2000).

Different approaches and strategies are applicable to different cases of state capture by authorities. Cases may vary depending on the degree of strength of the state and of the market. Foremost challenge would be to disentangle the synthesis of state and market, separating them from each other and securing the autonomy of each one (10th International Anti-Corruption Conference).

However, to improve the market (commercial) environment, merely changing the laws or assisting implementing institutions is not sufficient; supporting institutions and legislative process should be improved and commercial rights and freedoms clarified (Booz Allen Hamilton, 2002). Where as to improve the area of the state, focus should be set on the review

of regulatory and institutional settings of state agencies and their operational practices in order to pinpoint and reduce factors which favor corruption. Restricting discretionary powers and arbitrariness of civil servants, intensifying internal control, adopting preventive measures, recruiting and promoting new staff through transparent procedures and adherence to merit-based selection (OECD, 2004), launching projects via resorting to fair tender announcements, tracing and reporting improvements – may compound the list of measures to be undertaken (ibid)

Involvement of civil society and private sector in corruption surveys conducted by state services and encouragement of their participation in actual fight against corruption will contribute significantly to the change process and assist in identifying the locus of corruption activities. The government of Azerbaijan should support and encourage activities of NGOs and youth movements. Constructive and open critique of corrupt behavior in private sector and civil society should not be prosecuted but on the contrary should be welcomed and followed up in serious and consistent manner. In case of significant violation, instances of extortion or minor “petty corruption” behind the allegations, corresponding legal actions from an authorized state body should be applied accordingly to different degrees of corruption leaving no exemptions. Representatives of the private sector/business community should be included in the work of the existing Commission for Fight against Corruption at the Civil Service Executive Board (ibid).

To be able to apply legal actions after the instances of reported corrupt behavior fair and credible judicial system should be in place. Enforcement mechanisms and punishment deterrence should be present and hang as the sword of Damocles above potential

transgressors, guaranteeing high fines, penitentiary and dismissal from the office when concerning civil servants, to intimidate and prevent illicit activities.

Current judicial system undoubtedly should be subject to reform and guaranteed sovereignty from executive and legislative branches. Jointly with this, uniformed Code of Ethic/Code of Conduct for Public Officials based on international standards (e.g. such as Council of Europe Model Code of Conduct for Public Officials) alongside with the explicit codes of conduct for professions particularly exposed to corruption (police officers, prosecutors, tax officials, lawyers, accountants, doctors etc.) should be designed and ratified. Additionally exhaustive and up-to-date guidelines for civil servants embracing issues of corruption, conflict of interests, ethical standards, sanctions and delineating appropriate comportment standards should be designed and publicized leaving no discretion for personal whims of civil servants. Additionally, regulations on the protection of “whistleblowers” in public institutions should be adopted and an internal campaign to raise awareness of those measures among civil servants should be launched (ibid).

High attention should be devoted to macroeconomic stability since it gives grounds for the establishment of more predictable environment over time with less distortions and sharp fluctuations in inflation, exchange and interest rates which usually creates opportunities and incentives for corrupt behavior. Macroeconomic stability followed by economic growth increases the capacity of the state to accumulate revenues and contributes to the development and enlargement of the middle class. Increase in inflow of revenues, allows accountable government to increase provision of public goods and services and to reduce tax burdens minimizing loopholes for corruption. Moreover, accumulation of fiscal revenue allows increasing funding of public institutions and remuneration of the civil service, reducing incentives to extract bribes for basic services (Cheryl Gray, Joel Hellman, Randi Ryterman,

2004). However, exerted efforts will prove futile in case of absence of the enforcement and punishment mechanisms. Officials should be coerced to abstain from rent-seeking activities and bribery by facing the alternative of being imposed high penalties and appreciating their positions considerably enough to be reluctant to risk its official dividends by engaging in illegitimate transactions. Trade-off should be obvious and sharp.

Backed up by fair judiciary and government support, middle class and business communities can feel increasingly empowered to resist corruption, and while observing transparent flow of the funds from levied taxes into adequate provision of public goods and social services, individuals will be more willing to pay taxes instead of being inclined to evasion. This behavior will certainly be supported by the fact that citizens acting as “watchdogs” for civil servants by reporting corruption and extortion instances to competent bodies will prevent the occasions of racketeering and forcible paying of informal fees despite compliance to formal ones. The alternative of paying “only once” instead of “numerous times” will create positive incentives to adhere to the obtained state of affairs making citizens more vehemently protect their rights and control civil servants. It has to be indicated that same punishment imposed on civil servants must be inflicted upon private actor in case of barratry or giving a bribe, so to prevent private entities from temptation of creating for themselves more favorable conditions by paying official to distort a law or a regulation or turning a blind eye. Once again it should be conditioned by the fact that officially imposed taxes are moderate and adequate, official circumlocution is restrained, regulations (for establishing a business, obtaining a license, import-export transactions etc.) and administration are transparent and of small duration/brief, so that individuals will not try bribe in order to get through the red-tape procedures more quickly. Political stability in its turn also lengthens the official office spans of politicians and bureaucrats, mitigating their short-term interests to extract as much rent from the economy as

possible before they are forced from office (ibid). However, case of Azerbaijan with recently amended constitution allowing perpetual terms of office for the President, should be regarded in a more distinct manner. Emphasize should be placed on the fact of an absolute irreplaceability of the strong and genuine political will, determination for change and curbing corruption on the part of the incumbent leadership which should be started with self-application.

In such a way, having a competition law only on the books, or having an up-and-running competition agency, can not be considered a satisfactory condition for efficient realization of the law. Significant impact of institutional dimensions of implementation – independence, transparency and effectiveness of appeals – advocate that in order to facilitate the entry and growth of enterprises, competition authorities have to become more accountable to civil society, and erect auxiliary precautionary measures to secure against improper influence from pressure groups in government and elsewhere (Mark A. Dutz, Maria Vagliasindi, 1999).

Conclusion

Aiming at discovering the culprits of the malfunctioning of the law this research has indeed come to a reasonable conclusion. Unlike previous researches current work was intended to look for the actual causes of the failures of the laws and reforms, disregarding reasons such as soviet legacy, incomplete reforms, informal networks and corruption as the main accounts of policy fiasco but on the contrary, labeling them as consequences of something more deep and entrenched. Analysis of the literature based on previews drawings of different authors, examination of indigenous empirical evidence and theoretical framework pointed out to an absence of Political Will as the root of the evil, leading to stalling of the reforms, maintenance of weak judiciary and legislative authorities, state and business capture nurtured by cronyism and nepotism. Indeed the absence of the Political Will from the part of competent leaders, and in fact absence of competent leadership accountable and transparent in its *modus operandi*, is resulting in deep rooting of corruption in country. The situation would be ameliorated in the case of existence of robust civil society, legislative branch and opposition. However due to the absence of the latter, population does not discern the competent opposition parties accountable and mature enough to substitute the incumbent leadership. Opposition is indeed feeble and segmented which deems it as an absolutely incapable of coping with succession of the authority. My contribution to a policy debate of roots and sources of failure of the reforms was based on the case of Azerbaijan and built on comparative analysis of empirical data and theoretical paradigms. As stated earlier, countries with weak institutional frameworks during transition periods are subject to usurpation by early “winners” of the reforms which benefit from weak and dependent legislature, submissive judiciary, and thus lack of checks-and-balances mechanism essential for accountability. This gap in legislature and institutional

framework attributes to unpunished robbery and predation of states economy explained very precisely by quote *Occasio Furem Facit* – the hole calls the thief.

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