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## Testing the Rentier State Theory: The Case of Azerbaijan

By Alper Almaz\*

### Abstract

This article shall focus on the political aspects of the resource curse theory, in particular the rentier state theory as a sub-theory of the resource curse. The rentier state is a political economy theory that seeks to account for state society relations in states that get most of their revenues, in the form of rents, from resource sector. Besides, the theory asserts that these rents have an effect on democracy, economic growth and security matters of the resource rich countries. Applying this theory to Azerbaijan shall contribute to Azerbaijan's political economy literature. In this paper, I argue that revenues generated from energy exports hinder democracy in Azerbaijan since they are used for fulfilling pockets of political elites and hampering emergence of any opposition to the dominant groups. In the very first part of the paper, the rentier state theory will be elaborated. More specifically, the concept of rentier state and how a rentier state behaves will be explained in detail so as to provide a framework for the case study of this paper. In the second part after giving a short brief about Azerbaijan's energy reserves and societal problems the rentier state theory will be applied to Azerbaijan in order to find out whether it suffers from the rentier state deficiencies. Indeed, the rentier effect and the repression effect of the theory will be analysed. In the final part, concluding remarks will be delivered with a laconic summary of the paper.

**Keywords:** Rentier State Theory, Azerbaijan, Energy Resources, Democracy



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### Introduction

A commonly debated problem worldwide is that many countries having rich natural resources experience an economic, political and social paradox. This phenomenon has been regarded as 'the paradox of plenty', 'the devil's excrement' or 'the resource curse'. In regardless of how it is called there is a general argument that resource abundant countries have suffered from low level economic performance and democracy problems. Indeed, different theories with different arguments have been put forward in order to explain whether there is a paradox of plenty. In this regard, the resource curse theory appears as a useful tool to analyse the effect of resources on democracy and economic performance in resource rich countries.

This article shall focus on the political aspects of the resource curse theory, in particular the rentier state theory as a sub-theory of the resource curse. The rentier state is a political economy theory that seeks to account for state society relations in states that get most of their revenues, in the form of rents, from resource sector. Besides, the theory asserts that these rents have an effect on democracy, economic growth and security matters of the resource rich countries. It should be noted that although the rentier state theory has traditionally been applied to the most of the oil rich Middle Eastern , North African and Latin American countries, the resource rich Caspian Region countries have not thoroughly analysed yet. Applying this theory to Azerbaijan shall thus contribute to the rentier state and Azerbaijan's political economy literature.

In this paper, I argue that revenues generated from energy exports hinder democracy in Azerbaijan since they are used for fulfilling pockets of political elites and hampering emergence of any opposition to the dominant groups. In the very first part of the paper, the rentier state theory will be elaborated. More specifically, the concept of rentier state and how a rentier state behaves will be explained in detail so as to provide a framework for the case study of this paper. In the second part after giving a short brief about Azerbaijan's energy reserves and societal problems the rentier state theory will be applied to Azerbaijan in order to find out whether it suffers from the rentier state deficiencies. Indeed, the rentier effect and the repression effect of the theory will be analysed. In the final part, concluding remarks will be delivered with a laconic summary of the paper.

### Analysis of the Theoretical Framework

#### *The Resource Curse Theory*

Before the 1980s, the traditional view supported that there is a positive relationship between natural resource abundance and economic development. Indeed, geographer Norton Ginsburg asserted that 'The possession of a sizable and diversified natural resource endowment is a major advantage to any country embarking upon a period of rapid economic growth'.<sup>1</sup> Similar mentality was reflected by the famous development theorist Walter Rostow, claiming that natural resource endowments would enable developing countries to realize industrial "take off", just as Australia, the US and Britain

had managed to do.<sup>2</sup> There are also other scholars underlining the significance of having natural resource for economic growth in developing countries.<sup>3</sup> Although dominant idea about the relationship between having natural abundant natural resource and development was optimistic until the 1980s, pessimistic views started to flourish among the political economy scholars.

Since the late 1980s, a considerable number of the literature has started to emerge and challenged the traditional view. The new approach, called 'the resource curse', suggested that countries having rich natural resources are likely to experience poor economic performance<sup>4</sup> low level of democracy<sup>5</sup> and conflicts within/between states.<sup>6</sup> Indeed, Richard Auty, the first scholar introducing the 'resource curse' theory in his book "Sustaining Development in Mineral Economies: The Resource Curse Thesis", stated that "The new evidence suggests that not only many resource-rich developing countries fail to benefit from a favourable endowment; they may actually perform worse than less well-endowed countries. This counter-intuitive outcome is the basis of the resource curse thesis".<sup>7</sup> Besides, Sachs and Warner's research on the analysis for the resource abundant countries' economic performance during 1970-1989 have paved the way for dramatic increase in the resource curse studies. As a result of their study, they showed that there is a causal relationship between natural resource intensity and economic growth.<sup>8</sup>

One should ask that what the reasons behind the emergence of resource curse are. To put it differently, what makes resources cursed rather than blessing for states? Although answers have varied in the resource curse literature, the rentier state theory appears as one of the best analytical tool to illuminate the causes that make resources cursed.

### *The Rentier State Theory*

The rentier state theory can be regarded as sub-category research of the resource curse theory. Before delving into rentier state and its characteristics, it is crucial to provide a definition for the concept so as to understand properly the case study of this paper. According to Beblawi, in order to call a state as a rent-seeking or rentier state there should be certain characteristics, such as domination of rents in state economy, externality of rents and few people engagement in generation of rents.<sup>9</sup> Therefore, rentier state can be defined as a state "where the rents are paid by foreign actors, where they accrue directly to the state and where only a few are engaged in the generation of this rent, the majority being involved only in the distribution or utilization of it".<sup>10</sup> It should be underlined that although this definition may lead to the understanding that rents could be a product of loan or aid given by foreign actors, the rentier state concept has usually been applied to the countries generating rents from their rich resources. As an example of the rentier state Beblawi argues that most of the resource rich the Middle Eastern states, notably Saudi Arabia and Kuwait, can be regarded as '*par excellence*' of rentier states as they have enjoyed resource rents enormously.<sup>11</sup> In addition to the Middle Eastern countries, North African and some of the resource rich Latin American countries such as Libya, Nigeria, and Venezuela are acknowledged as rentier states.<sup>12</sup>

Having provided the definition for the rentier state concept, it is of crucial importance to account for in what ways rentier state causes resource curse and elaborate the effects of rents on social, economic and political life in resource abundant countries. In order to analyse these issues, the framework developed by Michael Ross is employed in this article.<sup>13</sup> Based on his framework, he argues that the effects of rentier state can be categorised under three groups, namely the rentier effect, the repression effect and the modernisation effect.



### *The Rentier Effect*

Based on Ross's reasoning it can be argued that governments of the resource rich countries have tendency to use rents to alleviate social pressures, and in this way acquire greater independence vis-a-vis the public.<sup>14</sup> He further contends that the rentier behaviour of the governments can be explained with 'taxation effect', 'the spending effect' and 'the group formation effect'. The following paragraphs discuss these three effects.

Firstly, the taxation effect assumes that as sufficient revenue generated from energy export is flowing to the state treasury, the governments are inclined to tax less, or none at all. Therefore, the public is less likely to demand for democracy and accountability. The reason behind the citizens' reluctance to raise their voices for democracy can be explained with historical practices. The general idea is that democratic representation and government accountability rose out of the ruler to impose new and higher taxes. In other words, there is a situation of 'without taxation there is no representation' in rentier states. It is thus argued that taxation system in rentier states makes citizens less demanding in terms of their political participation.<sup>15</sup> Lack of political participation enables government to misuse his/her power in order to line his pocket through involving rent-seeking behaviour.<sup>16</sup> Thus, it can be claimed that corruption of the state institutions is likely to occur due to the rent-seeking behaviour of the states. Besides, low level of taxation decreases willingness of state to satisfy the people's demands over democracy. This is why it can be concluded that rentier state suffers from democracy problems.

Secondly, the 'spending effect' posits that governments use rents on popular social welfare programmes (education, health etc.), subsidization of certain sectors (i.e. energy and agriculture), and creation of employment opportunities in the resource sector so as to legitimise their power.<sup>17</sup> In addition to authority legitimisation through spending rents instead of free elections, the rentier states invest its energy revenues in patronage networks to avoid emergence of democratic demands from the citizens.<sup>18</sup> Therefore, it can be asserted that authoritarian regimes are likely to maintain their powers in the rentier states as long as rents flow to state treasury. Besides, one can further claim that most of the citizens in rentier states become more obedient to the ruling elites owing to the government's spending on popular social programmes.

Thirdly, the 'group formation effect' suggests that rentier states have a tendency to use its "largesse to prevent the formation of social groups that are independent from the state and hence that may be inclined to demand political rights".<sup>19</sup> To put it differently, emergence of opposition to status quo or independent social groups are very likely to be suppressed by the governments as they are perceived as a threat to the very existence of their states. Chaudhry explains the lack of civil society and independent civil institutions in rentier states, in particular Saudi Arabia, Iraq and Libya with the 'group formation effect' of the rentier state theory.<sup>20</sup> One can claim that the rentier behaviour thereby undermines a necessary precondition for a democratic state which is civil society presence.

All in all, in light of the explanatory factors for rentier effect, the taxation, spending, and group formation effects two generalisation can be put forward. First, revenues generated from energy export are likely to contribute to authoritarian regimes. Second, states that fund themselves through rents are inclined to be less democratic than governments financing themselves through taxes.

### *The Repression Effect*

The people in resource abundant countries may demand democracy as much as the people elsewhere. However, resource revenues enable governments to spend more on internal security matters in order to reinforce their authority and hamper democratic aspirations. Besides, protection of the resource extraction is of crucial importance to the

rentier states as resources are the main source of revenue. This is because investing in security apparatus to protect resources is likely to happen.<sup>21</sup> It is thus asserted that having larger military forces to strengthen autocratic government and protect resources is another characteristic for a rentier state.

According to Ross, there are two reasons behind presence of large military forces in rentier states.<sup>22</sup> The first argument is that as governments in rentier states are more prone to suppress popular uprisings as they are regarded as a challenge to their authority. Hence, the more military forces they have the easier to repress oppositions. The second argument suggests that resource abundance might result in ethnic or regional conflicts not only within state but also between states.<sup>23</sup> More specifically, if energy resources are concentrated in a region populated by minority groups, resource extraction may lead to conflicts as everyone naturally competes for getting more from energy resources. Therefore, the central authority has large military apparatus to prevent eruption of any conflict in resource rich regions for the security of energy infrastructures.

Having explained the basic concepts and theoretical framework of this article next section will be devoted to analyse Azerbaijan in terms of its energy profile and application of the rentier state theory to Azerbaijan in order to identify whether it is a rent-seeking state or not.

### *The Modernisation Effect*

Ross derived the modernisation effect from the work of Ronald Inglehart. Despite the fact that modernisation effect is not directly related with resource wealth, this effect argues that democracy is "collection of social and cultural changes—including occupational specialization, urbanization, and higher levels of education—that in turn are caused by economic development".<sup>24</sup> To put it differently, if economic development brought about by resource wealth does not pave the way for social and cultural changes, democratization will not take place. Ross utilized different quantitative methods so as to test Inglehart's arguments. Basically, there are two arguments derived from Inglehart's work. The first is that higher education levels will lead to emergence of more articulate public; the second is increasing occupational specialization will create more independent workforce which will definitely strengthening labour's bargaining power vis-a-vis political elites. In other words, if both (higher education levels and greater occupational specialization) happen, state will become more democratic.

Ross tested these two arguments and he found no direct causal relationship between democracy and urbanization and higher level of education. However, it can be argued that the modernization effect can still be used for explaining why many rentier states have a high level of GDP whereas having low levels of education and health conditions.

### **Applying the Rentier State Theory: The Case of Azerbaijan**

#### *Azerbaijan in Brief: Energy and Recent Societal Problems*

Azerbaijan is a country that is abundantly endowed with oil and gas resources. Based on British Petroleum (BP) Statistical Review of World Energy 2013, proven oil reserves in Azerbaijan are estimated around 7 billion barrels equalling to 0.4 per cent of the world's confirmed reserves.<sup>25</sup> Besides, the same report points out that 31.5 billion cubic feet natural gas deposits are proven there.<sup>26</sup> Owing to its large oil and gas deposits, Azerbaijan has become a significant player in the world's future energy security. Especially, since its independence from the Soviet Union in 1991, Azerbaijan's has benefited from energy exports enormously. For instance, Azerbaijan's GDP has been growing spectacularly from \$1.3 billion in 1994 to \$25 billion in 2008. Besides, the oil and gas revenues coming from



exports amounting to %52 per cent of Gross Domestic Product (GDP) which is a significant contribution to the national economy of Azerbaijan.<sup>27</sup>

Although it is expected that rising state revenues, since independence, would bring prosperity and democracy to Azerbaijan, it is otherwise proven. Indeed, it is asserted that Azerbaijan is becoming a country where the people confront with inequality and democracy problems. For instance, based on the Economist Intelligence Unit's (EIU) Democracy Index 2012, Azerbaijan is regarded as an authoritarian regime and ranked the 139th out of 167 countries in the world for economic and political freedom.<sup>28</sup> Another report released by Human Rights Watch puts forward that Azerbaijan performs low in term of human rights protection.<sup>29</sup> Indeed, same report further points out that political opposition activities and criticism of the government are unlikely to happen due to the government's suppressive behaviours on elites. In light of this brief information it is now appropriate to apply the theoretical framework to Azerbaijan in order to identify whether Azerbaijan is suffering from rentierism.

### *Is Azerbaijan a Rentier State?*

As aforementioned, there are certain foundation characteristics, notably domination of rents in state economy, externality of rents and few people engagement in generation of rents that should be fulfilled in order to call a state as rentier.<sup>30</sup> It can be asserted that Azerbaijan fulfils the foundation characteristics put forward by Beblawi.

First, Azerbaijan is richly endowed with natural gas and oil resources.<sup>31</sup> Second, revenues generated from energy export accounts for a considerable proportion of the country's GDP, as well as its total exports. Based on Azerbaijan State Institute of Statistics' Report of 2011, the share of crude petrol and oil products constituted %92 percent of Azerbaijan's total exports and %47.8 percent of its GDP.<sup>32</sup> According to these figures, one can argue that Azerbaijan's economy is highly dependent upon rents generated from its energy resources. Third, the state holds a significant position in the production and redistribution of oil and gas revenues through the State Oil Company of the Republic of Azerbaijan (SOCAR). Even though the SOCAR is the most crucial player in national energy sector there are a number of western companies involved in resource production through 'Production Sharing Agreements'. Yet, SOCAR is the main player in energy politics of Azerbaijan.

Having revealed that Azerbaijan has foundation characteristics of a rentier state in terms of its definition by Beblawi the next part elaborates the effects of rentier state on Azerbaijan through employing theoretical framework articulated by Michael Ross (2011).

### *The Rentier Effect in Azerbaijan*

As has been previously contended rentier states use rents so as to hamper demands for democracy and prevent the emergence of opposition to the ruling authority. Besides, rents utilisation by the government reinforces existence of autocratic regimes. Based on Ross's reasoning there are three distinct ways, namely, taxation, spending and group formation that cause rentierism.<sup>33</sup>

Lack of a systematic and effective tax system is one of the characteristics that can be attributed to rentier states.<sup>34</sup> The reason why governments are likely to tax less or not at all in rentier states is that taxing may cause increase in demand for democracy, political participation and accountability. Besides, rents enable governments to ignore lack of effective tax system. Therefore, through taxing less rentier states aim to impede democratic aspirations of the citizens. In Azerbaijan, tax revenues in 2009, 2010 and 2011 constitutes %14.2, %12.2 and %12.2 of Azerbaijan's GDP respectively.<sup>35</sup> Compared to the percent of resource revenues which is %47.8 in 2001, in GDP, this shows that

taxation does not form a significant proportion of total GDP. As most of the state income comes from the energy exports, one can contend that the tax system in Azerbaijan is not of importance to maintenance of current authority and its economy. It should also be noted that tax enforcement in Azerbaijan is poorly carried out and undermined by inefficiency and corruption.<sup>36</sup>

The Soviet System had created a political class, striving after the retention of power, and related privileges after the dissolution of the Soviet Union. This political class produced small group of elites. It is argued that they are the basis for the distribution of resource incomes in Azerbaijan.<sup>37</sup> Besides, they are claimed to control every arm of government and have shaped the political institutions to serve their own purposes.<sup>38</sup> Economically and politically strong these elites spend energy revenues for strengthening their own networks. Therefore, one can argue that the reason why the Aliyev family has been ruling the country since the early 1990s is the small political elites that support the family. Indeed, the constitutional change in 2009 enabling a lifelong presidency is likely to cause reinforcing ruling elites' authority and their rentier behaviours.<sup>39</sup>

The 'spending effect' is another factor that contributes to reinforce the rentier states. In other words, it is concerned with how governments of rentier states maintain their power. As Ross put forwards that rents are spent by governments for preventing demands of the citizens.<sup>40</sup> Analysing Azerbaijan from this perspective "in the absence of an impartial judiciary and civil service, ministries form lines of patronage whose ability to deliver rewards (such as tax relief, relaxed regulation and preferential contracts) depend upon proximity to the Aliyev family and their cronies".<sup>41</sup> Since the three key branches of government, Constitutional court, the Parliament and the executive, do not provide checks and balances, but facilitate corruption and cronyism, political elites are likely to misuse their powers in order to maintain their regime and provide benefits for their supporters.<sup>42</sup> For example, the production sharing agreements with a number of western companies are claimed to be corrupted. Revenues generated from these agreements are used for enriching ruling elites, their family and their associates.<sup>43</sup>

The 'group formation effect' is the third component explaining rentier state in this article. The general idea is that emergence of any groups challenging the ruling authority and demanding more democracy from the government is likely to be prevented in rentier states, because they view these kinds of civil society groups as competitors in the distribution of the rent and even in political power. Applying to this Azerbaijan, for instance, before the parliamentary elections of 2005 Rafik Aliyev, owner of the largest private oil company in the country, and Farhad Aliyev, a former minister of economic development were arrested over alleged coup attempts against the government.<sup>44</sup> However, opponents of this charge argue that since both had links to the Entrepreneurs Council, a business group that has been challenging the chair of State Customs Committee and his established network of corruption, they were suppressed and put into jail.<sup>45</sup> Ismailzade asserts that Farhad and Rafik Aliyev were perceived as a threat to the dominant political elites and their networks.<sup>46</sup> What is more, rentier states perform state control mechanisms over an area where opposition could emerge. In Azerbaijan religion and religious groups are two matters that governments are concerned with their potential to create oppositions to the dominant ruling elites.<sup>47</sup> This is because the government of Azerbaijan is eager to maintain a useful relationship with Sheikh ul-Islam Haji Allahshukur Pashazade - the head of the Spiritual Board of Muslims of the Caucasus in order to control religious groups.<sup>48</sup> Unlike other civil society groups, this organisation receives benefits from the government. Therefore, it should be noted that on the one hand the governments of the rentier state are likely to undermine existence of civil society groups, as in the case of suppressing potential opposing people; on the other hand, they support groups that can serve the interests of the dominant regimes.



### *The Repression Effect in Azerbaijan*

The repression effect entails that the rentier governments are inclined to spend state income on security matters so as to strengthen their authority and retard democratization. Concerning Azerbaijan, it spends 4.6 percent of its GDP on its security apparatus.<sup>49</sup> Indeed, it is the fourth highest country who spent considerable amount of money relative to its GDP in the world for. As most of the GDP comes from the resource exports, one can assert that they facilitate military expenditure. The interesting thing with World Bank assessment of military expenditure in terms of GDP is that the countries behind Azerbaijan, namely, Oman, Algeria and Jordan are regarded as rentier states as well.

Ross provides two explanations for high military expenditure in rentier states.<sup>50</sup> First, it is resulted from the purpose to preserve ruling elites' authority and integrity of the government through suppressing domestic aspirations. Second, having large military apparatus aim to protect energy resources and related facilities that may be located in unstable territories. Applying these explanations to Azerbaijan, Human Rights Watch asserts that torture and maltreatment of prisoners who are against the government happen in Azerbaijan.<sup>51</sup> For instance, a jailed journalist whose name is Novruzali Mamedov died in prison as he was claimed to be ill treated there.<sup>52</sup> Besides, two prisoners died in 2001 when they were under custody. Last example is the death of Elmar Huseynov who had been criticizing political elites in term of their undemocratic policies and demanding for democracy and accountability.<sup>53</sup> The reason behind why they all died has remained shadowy. Therefore, it can be argued that ambiguous deaths of people under custody and ill treatment of them are general reflections of Azerbaijan's repressive regime. The second explanation that Ross provided for elucidating the repression effect can be linked to not only Azerbaijan's external security concerns but also need to protect pipelines closing to Nagorno-Karabakh, the disputed land with Armenia. Besides, the greatest security concern of Azerbaijan is about being compressed between Russian Federation and Iran as they are competing with each other so as to benefit from the energy resources in the Caspian Sea. The recent conflict between Iran and Azerbaijan over oil exploration rights in Sardar Jangal Oil field can demonstrate the need for spending more in military sector, because even a small war between the two can disrupt energy production and be detrimental to Azeri economy.

### *The Modernisation Effect in Azerbaijan*

The modernisation effect propounds that wealth generated from natural resources undermines democratisation process of resource rich states by preventing rising education levels and occupational specialization. Although Ross did not find statistically important correlation between authoritarian behaviour of resource rich states and modernisation, one could claim that modernisation effect can account for why rentier states enjoy a high level of GDP while possessing low levels of education and health conditions.

Ross looked at the correlation between occupational specialization and democracy. So as to measure these two, Ross analysed "the number of men and women in the economy's industrial and service sectors as a fraction of the men and women in the economically active population".<sup>54</sup> In Azerbaijan, the number of people who work in elementary occupations<sup>55</sup> accounts for a third of Azerbaijani labour.<sup>56</sup> Keeping in mind that occupational specialisation requires considerable level of education, it can be seen that labour force in Azerbaijan is doing simple and routine tasks. Therefore, one could assert that absence of educated people who have occupational specialisation is likely to weaken democratic demand from the people. Put differently, economic development based on the oil and gas export fails to increase occupational specialisation that tend to hinder autocratic regime in Azerbaijan.



## Conclusion

This paper tries to analyse the applicability of the rentier state theory to its non-traditional zone of application. Based on Ross's theoretical framework, this study shows that Azerbaijan indicates the symptoms of the rentier state. First, Azerbaijan's less reliance on taxation but more reliance on energy revenues has a negative impact on its citizens' democratic aspirations. Besides, poor enforcement of tax system in Azerbaijan illustrates that Azerbaijan is suffering from inefficient and corrupted state institutions as they do not carry out taxation system effectively. Second, this article shows that on the one hand Azeri government does not let the emergence of opposition groups, as the in case of imprisoned famous businessmen; on the other hand, the government has tendency to advocate the groups that reinforce its authority such as religious organizations. Third, relative to its GDP, Azerbaijan has spent considerable amount of money on security apparatus. Based on this article's framework, it is seen that the reason behind high security expenditure is to do with protecting major energy infrastructure that brings income to the state treasury and preserving the authority of the government.

However, one can argue that there should be other causes as well resulting in the resource curse or rentier state behaviour. Although this study does not take into account the presence of inefficient state institutions, historical legacy of the Soviet Union and weak democracy culture, incorporation of these factors into the rentier state theory could provide more accurate picture. To put it differently, inclusion of these factors while analysing resource rich states is of great significance to better understand political economy of resource rich states. Besides, these factors will enable us to comprehend why some resource rich countries (Azerbaijan, Libya or Iraq) are cursed but why other resource rich ones (Norway, Australia etc.) are blessed. Nevertheless, based on utilisation of Ross's theoretical framework it can be concluded that Azerbaijan is suffering from rentier state deficiencies and can be regarded as a rentier state.



Notes:

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