



MASTER THESIS

Beyond Oil: A Political Economy Perspective on Azerbaijan's Growth Model

Global Management and Politics

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Abstract

This paper analyzes the development of Azerbaijan's economic growth model from a political economy perspective, focusing on the role of state institutions, oil revenues, and elite strategies. It tests the argument that the current model of the country is more accurately described as a hybrid of administrative Keynesianism and state capitalism. Six key phases of economic and political development are covered from the initial post-Soviet years to the post-Covid period. Relying on macroeconomic data, institutional reports, and sectoral trends, the study reveals that growth is primarily state-driven and heavily reliant on hydrocarbon exports. Despite developed policy initiatives aimed at diversification, structural dependence and limited private sector capacity persist. The findings suggest that without right institutional reform, Azerbaijan's development path will remain vulnerable to external shocks and dependent on government redistribution.

Keywords: Azerbaijan, political economy, post-Soviet economy, state capitalism, administrative Keynesianism, resource dependence

Introduction

Understanding how economies grow and develop has been a central topic of discussions in political economy, especially in countries undergoing systemic transitions. One of the most interesting examples of such transitions is found in the post-Soviet space, where newly independent states faced the dual challenge of building political sovereignty and restructuring their economic systems. One such example is Azerbaijan, where 1991 was a year of dramatic political and economic changes. As an independent state from the remainings of a command socialist economy, Azerbaijan developed a transition path to a market-oriented system under conditions of institutional weakness and uncertainty. The trajectory of this transformation, defined by the development of a resource-dependent growth model concentrated around oil and gas exports, has shaped the country's economic structures, political economic dynamics, and institutional arrangements. Considering this, looking more closely at Azerbaijan helps to better understand how resource wealth interacts with the way institutions work and develop. The central research question is: "How does Azerbaijan's growth strategy shape its resource-based growth model, and what are the strengths and weaknesses of its state-led development strategy?" The focus here is not only on the macroeconomic outcomes, but also on the structural and institutional characteristics that have shaped the post-Soviet economic path of the country.

The main motivation to analyze Azerbaijan comes from its unique economic structure. Despite the collapse of the Soviet Union system, transformation was neither smooth nor fully liberal in nature. Instead, a set of powerful political and economic actors kept control over the newly emerging market system, particularly in strategic sectors such as oil and gas. These actors played a key role in defining the economic trajectory of the country, and in shaping what became a resource-based development model. This transition raises a series of questions which are examined later in the paper as supporting factors for building a better understanding. Those questions are mostly related to how the transformation took place and who the key actors were, which sectors drove the economic growth, what the implications for economic growth and structural change are, and what political alignments supported or constrained these developments. These questions are relevant both in light of real-world events—such as the oil boom of 2005–2014 and renewed government commitments to diversification, as well as within the broader theoretical literature on growth regimes and transition economies. While

countries like Kazakhstan and Russia have attracted substantial scholarly attention, Azerbaijan remains underexplored in international political economy debates.

The interest in the topic arises both from gaps in the existing literature and from the empirical realities of post-Soviet development. This limited international investigation into Azerbaijan's economic growth model makes it an important case for exploration. Azerbaijan's experience is illustrative of broader issues in the political economy, such as how natural resources rich states structure their economies, and the consequences that follow in terms of institutional quality and sustained growth. Offering a detailed case study of how elite strategies, state structures, and sectoral patterns interact in shaping development path is the main contribution of the study to the existing literature.

The research methodology includes qualitative and quantitative data sources: national statistics from the State Statistical Committee of Azerbaijan, World Bank database and other statistics sites, together with public reports and academic sources accessed through ADA University's digital library further complement the empirical material.

The analytical framework of the paper is built around the concept of growth strategy developed by Hassel et al. (2020), which is used to explain set of economic and social policy decisions of governments to drive growth and employment. Drawing on the operational structure proposed by Di Carlo et al. (2024), the paper applies this approach to the case of Azerbaijan by analyzing growth regimes through key dimensions: the composition of aggregate demand, the structure of the productive economy, and the institutional strategies of elites.

The core idea that is derived from the findings is that Azerbaijan's growth model represents a hybrid regime combining elements of state capitalism, administrative Keynesianism, and informal elites control. The dominance of natural resource revenues has enabled macro-fiscal stability for a short-time period, yet created structural vulnerabilities, while efforts at diversification remain modest and largely state-directed. Despite recent initiatives, Azerbaijan continues to face the main common dilemma faced by many resource-rich countries which is: how to transform natural wealth into sustainable and inclusive economic development.

The thesis is divided into four main chapters. Chapter 1 provides the theoretical foundation, highlighting the limitations of neoclassical approaches in explaining the role of institutions and politics in economic development. It introduces the growth regimes' perspective as a more

suitable tool for examining capitalist economies from the perspective of political economy. Chapter 2 examines the five main stages of Azerbaijan's transition from socialism to a market economy, complemented by the sixth stage, which refers to the post-Covid period, which is another contribution brought to the table. Further, the chapter analyzes the oil and gas sector as a backbone of the economic growth model and for this it mainly focuses on the role of oil & gas in shaping the economy and geopolitics, and challenges of oil dependency. The next chapter turns to an analysis of Azerbaijan's current economic growth regime by identifying key growth drivers of aggregate demand, the major sectors driving growth and employment, and the growth strategies of elites. The main argument of the chapter is that the Azerbaijani case reflects features of an administrative Keynesianism regime, mixed with elements of state capitalism or patrimonial capitalism. The final part of the paper addresses the ongoing push for diversification drawing economic complexity theory. Despite that, as Ahmadov (2023) argues, there is still the possibility of oil depletion, volatility and Dutch disease.

Overall, the study offers a geopolitical and political economic perspective on Azerbaijan's economic growth from the transition to the present day, highlighting how structural legacies, elites strategies, and resource "curse" have combinedly shaped the state's development path while constraining its shift towards a more diversified and sustainable model.

Literature Review

1. The Growth Models Approach to the Study of Models of Capitalism

1.1 Neoclassical Models and Their Limitations

The importance of developing economic growth models has been a topic for discussion for many researchers, especially within the frame of political economy. The question does not often arise, according to Taylor et al. (2016). For political economics, those models serve as analytical tools for explaining how different economies achieve and sustain this growth by identifying the main sources of aggregate demand. Firstly, it is important to have understanding of what the growth model is, what are the different approaches and theories behind them. The neoclassical macroeconomic Solow-Swan model centers on factor accumulation and technology addressing the key issue of the extent to which full employment of all resources can be maintained in the long run, lays the foundation for the modern macroeconomic modeling approaches (Tsfatsion, 2024). As the author explains, the model emphasizes the supply-side factors and expects the economic growth to come from the accumulation of capital, expansion of labor force and the technological progress while assuming efficient market allocation of resources. However, Tsfatsion (2024) notes that while the model tends to explain some aspects of the growth it faces criticism as it cannot fully capture all the factors and the extent to which the predictions of the model are consistent with empirical macroeconomic data is questionable. Given that the Solow-Swan model assumes minimal state intervention, stable institutions and competitive markets, it is unlikely to capture the features of transitional, resource-driven economy like Azerbaijan with consideration of state playing a dominant role in investment and sectoral development. It can be clearly seen from the study on “Macroeconomic Analysis and Graphical Interpretation of Azerbaijan Economy in 1991-2012” made by Suleymanov & Aliyev (2015) that the turning point for high speed economic growth in Azerbaijan was the “Contract of the century” which was a governmental investment, an institutional dynamic. Later on the “Baku-Tbilisi-Ceyhan” pipeline in 2005 played an accelerator role for the growth of macroeconomic indicators. Keeping this in mind, the main point for now is to understand that the neoclassic Solow-Swan growth model is not sufficient for this phenomenon, thus the detailed discussion of Azerbaijan's case will be presented later in the following chapters. The article “Demand Drives Growth All The Way” by Taylor et al. (2016) concludes that even from purely economic perspective supply-side explanations are not the only reliable sources for the growth and demand-side deserve to be explored. With this

being considered, in order to approach the analysis from the political economy perspective the alternative demand-driven growth model would give more insights. This would include the exports, domestic consumption and investment.

1.2 Post-Keynesian and Political Economy Approaches

The Post-Keynesian economic models shift the focus on demand-side and the assumption of full employment and market clearing is replaced by the idea that output is constrained by insufficient demand and the growth in different economies can be a result of different demand compositions. Building on this, Baccaro & Pontusson (2015) highlight a broader shift in how scholars study capitalist economies, moving away from older supply-side explanations like Varieties of Capitalism (VoC) approach toward a new focus on growth models that examine how countries create and maintain enough demand to support economic growth. In addition, as discussed in “Diminishing returns: The New Politics of Growth and Stagnation.” by Baccaro et al. (2022, p. 33), Post-Keynesian macroeconomics provide a valuable framework for understanding not only the long-term trajectory of capitalism but also its contemporary dynamics. The results from the article “Operationalizing growth models” by Baccaro & Hadziabdic (2024) suggest that the majority of countries are either domestic demand-led or export-led. The main idea is that the components like consumption, government spending, net exports and investment representing the aggregate demand are the engines for economic growth and the level of contribution of each element defines a country's growth model. For more explanation, the study made by authors put main thresholds for the analysis, as an example “If the growth contribution of a demand component is greater than 40%, the growth model is “led” by that component” or “If the growth contribution of a demand component is greater than 50%, the growth model is strongly reliant on that component”^[1] etc. As a result of the study, the US is given as the economy where growth is strongly led by consumption, European countries characterized as export-led, “liberal market economies” as domestic-demand led, and Nordic countries have their own category. When it comes to the case of Central and Eastern European (CEE) economies, the response to the crisis moved them towards export-led growth.

Post-Keynesian model Kaleckian framework introduces the “wage-led” and “profit-led” concepts which are the results of the income distribution influence on consumption and investment behavior. This approach allows having different scenarios for different economies

depending on the policy changes or external crises, thus giving an idea that approaches and models are not universal. Kohler & Stockhammer (2022) critique the decomposition approach and advocate for the econometric analysis where household debt and asset prices were revealed as more influential variables rather than the shifts in factor income. For example, an economic growth being characterized as consumption-led does not give information about the driver of the consumption- be it wage dynamics, financial conditions or particular policies. As a counterargument the authors accept that growth decomposition does not give an exact answer why growth appears, they defend the approach for its being accessible, data-driven and flexible noticing that it should be correctly interpreted and explained. As Baccaro & Hadziabdic (2024) note, the methodology they proposed helps to make contribution to map the growth patterns but also encourage new researches in political economy and heterodox macroeconomics, bringing up the questions about welfare institutions and international trade shaping the growth models.

The identity and definition of the role of economic growth models in politics is given in the article "The politics of growth models" by Baccaro & Pontusson (2022). The authors argue that to understand a country's economic growth the strictly economic factors, labor market or innovation alone. As it was mentioned earlier, the authors critique supply-side Varieties of Capitalism (VoC) framework and suggest politically impactful demand-drivers. It is stated that the sustainability of stable growth models is the work done by the "coalition of organized interests" referring to the power of macroeconomic and governmental policies. Another study by Baccaro & Pontusson (2015) "Rethinking Comparative Political Economy: The Growth Model Perspective" also bring the "coalitions' interests" to the table and highlights that growth models are inherently political with continuous conflicts between them, social classes, and sectors. The essence of the "growth coalitions" is the alliances of socio-economic actors like firms and labor associations in the export-led model is an alignment of sectoral interests which depends on skill transferability and asset ownership Baccaro & Pontusson (2022). The approach of the study is supported by the claim that a country's growth model is shaped by the specific combination of demand-side drivers that sustain economic expansion. The authors bring Germany which represents an export-led growth model as an example of an economy where the policymaking is formed by coalitions of manufacturer exporters and their labor force for example. Politically, export-led models tend to empower business elites in tradable sectors and might coincide with wage suppression unless offset by gains from productivity. The

stabilized wage agreement takes place and the alliances influence macroeconomic policies including fiscal, monetary and exchange rate such that it would be in favor of their growth (Baccaro & Pontusson, 2022). The article clearly states that in the moments of crisis, growth coalitions may lose support, creating space for new electoral coalitions to advocate alternative policies. The consumption-led growth model is driven by government and household consumption driving the economic activity, yet as it is noted in the article prior to the 2008 financial crisis several EU countries and US exhibited debt-fueled growth patterns due to “easy credit”, not the increase in income, still labeled as “consumption-led growth” which is misleading. Another model is the investment or even FDI-led growth economies exemplified by Ireland foster technological advancement and innovation potential. More or less similar to Azerbaijan in the political sense, with the same challenges of undergoing the post-socialist transitions in 1990s CEE countries’ economies might give us insights, but taking into account the uniqueness of economy, we would rather refer to resource-rich countries like Kazakhstan and Russia as they are tested in the study and are more similar in terms of the socio-economic structure. According to the analysis during the pre 2008 period country had a strong export-led growth model, during 2009-2018 it shifted to strong consumption led growth model, while Russia used to have a balanced mix of consumption and export, later switching to more export-investment-led model (Baccaro & Hadziabdic, 2023). This showcases the flexibility of resource-rich economies during the transition periods as response to external shocks, domestic policy choices.

Another approach based on the studies by before mentioned authors are three aspects of growth regimes such as the engine of growth, the institutions organizing the economy, the main components of aggregate demand. The engine growth represents the sectors that contribute to social welfare and low/high value-added services. The institutions organizing the economy is about five institutional pillars from financial systems and product market regulation to labor relations, skill formation and social protection- collectively shaping national growth strategies by influencing production structure, employment patterns and economic dynamics. Last but not least, private consumption and investment, public spending and net exports form the main components of aggregate demand regime (Hassel et al., 2020).

One more valuable comparative political economy study on Italy by Di Carlo et al. (2024) introduces another type of consumption-led capitalist growth regime called “administrative

Keynesianism". Once being an example of mixed-market economy, a statist model of capitalism Italy has been an example of a hybrid model. In Northern Italian regions growth is manufacture-based and driven by exports supported by strong national institutions, while South is dependent on state and showcases the administrative Keynesianism. The approach of the authors is supported by Crouch's intuition. It is described as a regime where household consumption and employment is supported by state through weak-structured national welfare policies, employing people in public sectors, even indirect support of shadow economies through tolerating the unofficial employment and corporate tax regulations. Another main idea is the fact that state intervention plays a role of engine for underdeveloped regions and the state is the employer of last resort. The empirical analysis reveals that the focus of regional dimension of growth, highlighting that this method can give insights for countries with major territorial socioeconomic inequalities. In addition, the analysis shows how policies like Eurozone's fiscal constraints had asymmetric effect disrupting growth Southern regions. The authors state that those considerations are essential while designing effective industrial policies and universal national strategies should be avoided. Back in the 1994's article "The Political Economy of Growth: A Critical Survey of Recent Literature" Alesina & Perotti argue that not the democracy itself but rather political stability and minimum inequality would contribute to economic growth. While the fiscal policies might like imposing higher taxes might not always have a positive effect, they can create a suitable sociopolitical environment for more capital accumulation and productivity by reducing social tensions. Then overall net impact of redistributive policies on economic growth depends on decision whether the benefits of reducing social unrest offset the potential reduction in investment caused by higher tax policies.

Study by Hassel et al. (2020) which focuses on advanced capitalist economies also summarizes that there are main aspects of growth regimes which are considered to be crucial. The sectors that contribute to the labor market, add value to the economy with job creation and gains from productivity form the engine of growth. The role of institutions organizing the economy is also highlighted. The welfare state is the significant component of growth regimes in national political economy including labor market regulations, educational systems and social protection (Esping-Andersen, 1990). Coming to the growth strategies the authors refer to "... a (relatively coherent) series of decisions and reforms, taken by either governments or producers' groups (economic and social actors) in order to boost growth and stimulate job creation in a specific nation, and the rationale for these decisions" and during crisis periods they often involve the protection of dominant production regimes (Hassel et al., 2020, p. 7). In the brought

examples from EU countries the authors find out that giving privilege to export-led regime in exposed sectors like manufacturing yields more gain than protected non-tradable sectors, for this the article also sheds a light to Baccaro & Pontusson's (2022) discussion on whether the export-led and consumption-led growth regimes can coexist, and empirically the trade-off between those regimes exist. The five regimes discussed in the article will be referred later on while discussing the possible application of models for Azerbaijan.

Drawing on the insights from the reviewed literature, it becomes clear how macroeconomic policies, electoral policies and coalitions of interests shape a country specific growth trajectory. Often being institutionalized via central banks and fiscal regulations, macroeconomic policies defend the economic growth models from governmental shifts, as usually the main economic strategy remains stable across governments. During the stable period the sustainability of the formed growth "formula" is attainable, however crises or prolonged stagnation may destroy the balance and make the model vulnerable to changes. The chapter captures theoretical foundation and the following parts will explore how Azerbaijan's resource dependence, historical and institutional dynamics might shape its current economic growth model. In light of these dynamics, a comprehensive analysis of Azerbaijan's political and economic context is important to assess the applicability of suggested growth models and identify the one which aligns with its political and economic vision.

2. The Foundations of Azerbaijan's Economic Growth Model

2.1 The Early years: Azerbaijan's Transition from Socialism to a Market Economy

Before delving into specifics of Azerbaijan's economic development it is important to first have an understanding of principles of "transition economy". Different perspectives on transitional economies have been discussed by different scholars. For example, while investigating the challenges arising during transition period, Brauers & Zavadskas (2006) have introduced a MOORA model method according to which privatization is the key driver and optimizer of many aspects. According to Gunes & Hajiyeva (2020) during the initial stages of transitions economies can rely on neither the legacy institutions of the old system nor the developed new structure. This creates high uncertainty and complicates the market formation and policymaking. Baranick & Salayeva (2005) state that the transition is not just economic but political and for successful economic transition solid state-building is the key condition.

Both studies are focused on Azerbaijan's case and highlight that country's economic model has been highly conditioned by past choices, delayed structural diversification as a result of natural resource revenues consolidating executive dominance.

Following the collapse of Soviet Union in 1991, like other post-socialist countries Azerbaijan has struggles with distorted price mechanism and economic dependence on other USSR states. However, in political terms Azerbaijan had to bear the burden of the occupied Karabakh region, the consequences of the war which definitely negatively affected both the economic growth and social transitioning country, made "systematic transition" very complicated to achieve (Baranick & Salayeva, 2005). Most of the studies regarding the economic development of Azerbaijan divide the timeline to five main periods and those five periods will be analyzed in this paper to understand the specify of each turning point that had shaped the economic growth model of each economic era.

The first period referred as "recession" (1991-1994) and as Baranick & Salayeva (2005) state the result of the official launch of market economy in 1991 by the means of Law on Basic Economic Development the was the annual hyperinflation of 1.664 % in 1994 mainly caused by incorrect policy implemented by Central Bank. Drastic decline of GNP per capita, of national income, and a high unemployment rate were noticed. According to the World Bank database, the 1994 GDP volume was about 2.67 times less than in 1991. The political situation was also uncertain. The first president was dependent on central Communist party administration which still existed, the second president tried the Turkey oriented policy in 1992, which was not successful, simultaneously the war with Armenia weakened the unstable regime even more, the refugee problem arose, the market share in post-Soviet arena was lost to the addition of the collapse of "inter-republican trade arrangements". All these factors deepened the economic crisis. Nevertheless, the welcoming events of that period were the establishment of National Bank and currency (Suleymanov & Aliyev, 2015). From the political economy perspective, the economic growth model for this period is absent as the state was struggling with institutional collapse, but it laid first-level ground for state-led resource-dependent model. There was not a structured growth "coalition" but the glimpse of prior elite consolidation began to take shape around control of strategic assets. The delays in establishing a legal framework for privatization led exploitation of state assets by the former Soviet-era managers (Ibadoglu, 2012).

Despite the initial internal political and socio-economic chaos, Heydar Aliyev managed to establish a stable government in 1993, signing ceasefire agreement with Armenia and establishing the foundation of the future economic trajectory for success by signing “Contract of Century” in 1994. With this, a new era has begun, and at first glance, seemed like long-lasting turning point in turbulent transition. The FDI inflows after the contract were a major achievement, symbolizing Azerbaijan's entry to global energy market through strategic resource management. From 1993 to 1995 there was a 59.1% increase in FDI amount, yet from this investment only 0.5% was distributed to the second source of employment at that time – agriculture, and no investment was made in manufacturing, which resulted in production sector decline (Aras et al., 2016).

The new period of restructuring broadly spanning 1995 to 2005, made a pivotal shift in Azerbaijan's post-Soviet development roadmap. While some scholars take the phase as limited to the timeframe from 1995 to 2000, the extended one gives more comprehensive understanding of economic reforms and institutional frameworks. In fact, it was a geopolitical and economic victory that could fit the country out of post-Soviet stagnation. However, it is essential to contextualize the general situation during the first turning point of the economy – the oil boom in order to correctly analyze the consequent steps. An IMF working paper by Rosenberg & Saavalainen (1998) studied the difficulties Azerbaijan faced as petroleum-rich former socialist state during the process of switching to market economy, in particular it talks about “Dutch disease”, unbalanced growth as “crowding-out effect”, and macroeconomic adjustment problems as a result of large FDI inflows are discussed. The authors discuss the potential curse of oil-dependent development back in 1998, and yet the possible consequences still are the main topic of the Azerbaijani economy. One of the main policy recommendations was the saving of oil revenues in significant amounts through a fund and next year in 1999 the State Oil Fund of Republic of Azerbaijan (SOFAZ) was founded, in addition sustainability of transparency in the fund management was mentioned. Support of non-oil export industries, SMEs, and private sector development are the issues that still dominate the discussions. Comparing the real GDP growth rates of first and second stage, the numbers given by Ibadoglu & Niftiyev (2022) are (-14.55) % for 1991-1994 and 7.12% for 1995-2000. The economic growth model from a political economy perspective reflects state-centric, externally driven, resource-dependent growth without proper coalitions and lacking sectoral domestic balance.

Despite the laid groundwork for macroeconomic stabilization and development of oil sector, the non-oil sector remained weak and the economy grew vulnerable to global oil price fluctuations.

The third phase of Azerbaijan's economic development, often characterized as "peak" or "boom" years (2005-2010) showcases a mix of domestic and global events that eventually converged to produce exceptionally high economic growth and rapid transformation of fiscal landscape. The problem of exporting the crude oil and gas was solved through the Baku-Tbilisi-Ceyhan pipeline in 2005 and Baku-Tbilisi-Erzurum gas pipeline constructed by 2007. Here, it is necessary to mention the political importance of these energy corridors in addition to the previous cooperation with global oil companies. This step could be seen as the real "declaration of presence" in global energy market for Azerbaijan, a bargaining power in international diplomacy. Domestically, this strengthened the governmental control over economic planning and resource allocation. This stage also involves the 2008 financial crisis and the impact of which cannot be overlooked as it affected an economy that had only recently achieved relative stability following the years of struggle to identify and state itself. According to the data from World Bank the GDP growth rate was 34.5% the all time highest rate in economic history of the country while for 2008-2009 it decreased to 9.3%. In their article Chubrik & Walewski (2010) state that with the average fall of oil prices by 37% during 2008-2009 and subsequent reduction in oil export income was the most visible effect which resulted in deterioration of current account surplus. With this, the "bargaining power" which was newly emerging started reducing and due to the GDP contractions of key trading partners such as Turkey, Russia and Georgia the total drop of 21.9% in non-oil exports was recorded. SOFAZ saw a revenue decline despite the increase in state budget, the real savings fell considerably. Authors also calculated the growth of Gross Domestic Income (GDI) which fell by 18% in comparison with previous years. The policies directed at increase of budget spending in education, social protection in one hand, and cut in infrastructure and construction in other hand, as a response to crisis were not successful in terms of long-term fiscal sustainability (Chubrik & Walewski, 2010). More details on oil industry will be discussed in the following section. Approaching to the social-economic development in the regions of Azerbaijan, encouraging major sectors of the regions, producing of export-oriented products, ensuring new job opportunities were the main objectives of "State Program on Socio-Economic Development of the Regions of Azerbaijan Republic for 2004-2008" (SPSEDR, 2004, pp. 3-4). In 2009 president I. Aliyev declared that

the transition period from capitalist to market economy which started from the collapse of USSR has ended. In this light small and large scale privatization, price liberalization, and governance and enterprise restructuring played an important role during the whole period, but according to the study for 2012 the highest transition indicator values were found for trade & forex system and price liberalization (Suleymanov & Aliyev, 2015). For the first time since gaining the independence macro-economic stability was achieved and growth rate was seen at 11.8%. From the political economy point of view, this stage reflects elements of administrative Keynesianism. The state had gained recognition and has reputation in the eyes of the nation as it became a global player. The large-scaled investments in social development also helped to position itself as stable growth provider. Simultaneously the weak private sector development and the state being the reallocator of labor and main employer can also be a characteristic of administrative Keynesian regime.

The fourth stage would be considered as period from 2012 till the oil price crisis in 2015. According to IMF's 2012 report by Albino-War & Shahmoradi the decline in non-oil sector development was seen as a major problem existing in the country at that time. The indicator that could be a proxy for political economy could be the index of economic freedom and according to the article by Suleymanov & Aliyev (2015) the number never exceeded 58.9 out of 100 implying mostly unfree economy and political issues are seen as much more influential than the real figures. Generally, the period before 2015 oil price crisis can be characterized as a yield of increase in oil production, accompanied by rapid economic growth, increasing fiscal revenues, and large-scale public investments which increased the position in international arena but also increased dependence on hydrocarbon exports. The development of small and medium enterprises was weak due to the restricted access to finance, and on the other hand, the appreciation of manat led to decrease in exports. Despite the fact that in 2015, 60% of the industrial production, 80% of the transport sector, 99% of agriculture, and 75% of communication sector was privatized, because of the legacy of USSR the state monopoly in strategic sectors put a barrier in economic development (Aras et al., 2016). The financial crisis as a result of sharp decrease in oil prices, which led to devaluation of national currency AZN, made the government to attempt changing the traditional distributive approach based on oil revenues to development of non-oil sectors. This period and especially the period of crisis showed the vulnerability of the economic model and signaled about the structural weakness.

The elite networks were reinforced from oil revenues and state authority was consolidated, nevertheless there was no preparation for external shocks.

The fifth stage starts with the consequences of the pivotal economic event – the 2015 oil price crisis. Clearly the government was not prepared for that, the conventional instruments as money supply and credits were not enough, thus institutional and administrative reforms were needed. The strengthening of financial securities and predictability by allowing the exchange of currency only in banks, stabilizing the market by using additional foreign currency reserves from central bank of Azerbaijan (CBA), and establishment of legal entity called Financial Market Control Chamber, dozens of presidential decrees aimed at business liberalization and new institutional reforms to support development of non-oil sector were among the policies and initial reactions of the government in order to prevent from the further economic disasters. The most prominent role during this time was played by SOFAZ as its sovereign fund helped to fix the fiscal deficit (Ahmadov, 2016). In 2016, the president I. Aliyev signed the decree about “Strategic Roadmaps for the National Economy and Main Economic Sectors” together with the World Bank (World Bank, Nov 12, 2018). With the joint efforts three main issues were analyzed: the sustainable financing, exploration of fiscal rules depending on oil reserves as a result of IMF recommendations, and high exchange rate and interest rate risks as 98% of government debt was held in foreign currency. According to the same source in August 2018, “Medium to long term debt management strategy for Azerbaijan Republic's public debt” was published which based on sound analysis outlined the directions of borrowing projected for 2018-2025 and for developing the local currency government bond market steady rise in domestic debt was anticipated by the state authorities.

According to Ibadoglu & Niftiyev (2022) consumption increased in 2019, FDI inflows increased from 1.4 billion USD in 2018 to 1.5 billion USD in 2019 which only accounted for 2.98% and 3.13 % accordingly and the real GDP growth in 2019 was 3.4 times higher than in 2003. This period can be called as post-boom and can be seen from a political economy perspective a sort of “readjustment” as the government with strengthening domestic institutions and diversification strategy tried to reduce vulnerability to unexpected external factors.

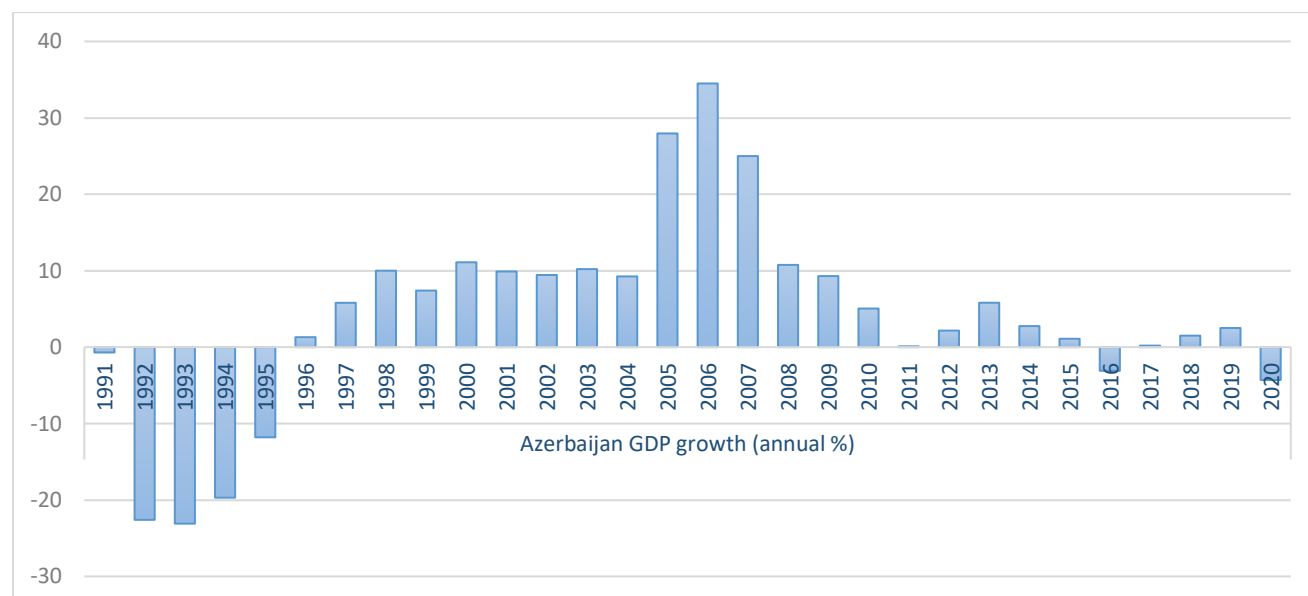
As an addition to previously conducted researches the new, 6th stage the post-Covid period also demands to be considered. This phase is a contribution to the existing literature and there are

several necessary reports and comments from that period which are essential for current situation evaluation, as there was not only the pandemic but also one of the most prominent political events for the country-the second Karabakh war. The impact of the global pandemic was studied by Topchubashev Center think tank's researcher Hasanov (2021) and presented as main five charts some of which are presented below. Due to the negative aggregate demand shock, the institutions were forced to change the GDP growth projections from pre-march 2.6% to negative 3% to a post-pandemic period. The confidence index reflecting economic activity, expectations about price and employment have fell. The demand for Azerbaijani exports, especially the hydrocarbon products reduced as oil prices experienced downturn. Moreover, Azerbaijan's main trading partner at time, Italy was among the countries experiencing the hardest times during the Covid. According to the analysis from Ibadoghlu (2022) another factor which had an impactful effect of Azerbaijan's exports later on causing the increase in energy prices was the Russian Ukrainian war, resulted in SOFAZ's increased revenues. This helped to withstand the possible destructive macroeconomic consequences during 2021-2022, as it had contributed to the lowering of the interest rate and keeping the fiscal policy stable. However, the sustainability of it still remains dependent of how effective the economy can be diversified, as this process does not seem to be long-term.

Coming to the political stress, Azerbaijan was dealing with the liberalization of the occupied territories, the war which started in September,27 2020. The country had to invest to the military forces and at the same time it was coping with the global pandemic. The reconstruction plans in newly liberated Karabakh and East Zangezur increased the need for investment, thus setting new tasks for the national economy.

Overall, the transition period from socialist to capitalist market for Azerbaijan seems to be finalized although, the vulnerability of the economy due to oil dependency, underdevelopment of private sector creates an obstacle for confident declaration of "capitalist market economy". As it is shown in the Graph 1 below, the maximum GDP growth was achieved during the oil boom period, when the economy was flourishing, however it did not last for too long, although today Azerbaijan has obtained a more or less stable economy and institutional framework in comparison with other post-Soviet states. The political stability is also another achievement gained through the years of transformation.

The following section will provide a more detailed assessment of the role of the oil and gas sector in shaping Azerbaijan's economic trajectory and further the current structural dynamics and challenges that define the country's growth model today will be examined.



Graph 1. GDP growth in Azerbaijan for 1991-2020 in percentage, (created by author based on the data from from the World Bank, 2025,

<https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2023&locations=AZ&start=1991&view=chart>)

The Analysis of Energy Sector as the Backbone of the Growth Model

2.2.1 The Role of Oil & Gas in Shaping the Economy and Geopolitics

The oil and gas industry has been the central pillar of Azerbaijan's political economy since independence, shaping both domestic development strategies and the external relations. Azerbaijani oil played significant role during the second World War and generally in Soviet Union, as 2/3 of all oil was produced here, it was at second place after USA at that time. From the moment the "Contract of the century" was signed in 1994 between the SOCAR and International Consortium of oil companies. Later in 1996 a major cooperation document was signed to work on the development of "Shah-Deniz" oil field. Among them were the "BP" of Great Britain, "Lukoil" of Russia, "Statoil" of Norway, "Elf-Aquitane" of France, "OIEC" of Iran, and "Turkish Petroleum A.O." (Ministry of Energy of Republic of Azerbaijan, 2020). The economic development had begun and now Azerbaijan became an important independent player in the global energy field. In 2006 the volume produced lead to the record GDP growth

of 32.5% (Ibrahimov, 2013). Referring to the number from State Statistics Committee (2025), the total number of operating enterprises increased from 16 to 193 during 1995-2023, volume of industrial products (works, services), at factual prices was recorded at 344 million manat in 1995 to 44.545 million manat in 2023. According to Ahmadov (2023) in 2022 this sector contributed to 47.8% of the total GDP, 92.5% of exports, roughly 60% of state revenues, and this trend does not drastically change since 2005.

According to the report made by International Energy Agency (IEA) for 2023 co-funded by the EU, the energy profile of Azerbaijan, the demand for hydrocarbon is four times less than the production, thus the country has one of the highest level of energy-sufficiency ratios in the world. While Azerbaijan's share in global gas market is not as much as in oil, it is expected to increase in the upcoming years. The exploration of hydrocarbons thus, helped to establish a regional pipeline infrastructure. The Azerbaijani government started considering developing a substitute for the primary Russian transportation corridor following the fall of the USSR. The majority of oil is currently transported by two significant pipelines that were repaired in the late 1990s: Baku-Supsa, often referred as "western route" connecting Azerbaijan and Georgia, and Baku-Novorossiysk which connects Azerbaijan with Russia. For sure, at more than 4 B USD, the Baku-Tbilisi-Ceyhan (BTC) pipeline is one of the biggest projects in the region and is a component of South Caucasus Pipeline (SCP).

Azerbaijani executives demonstrated the state's successful use of economic factors in foreign policy by shifting investment to other sectors and foreign capital, guaranteeing foreign investors and offering state protection for country's businessmen (Sadigov, 2016). The article "The role of oil and gas in Azerbaijan's foreign policy" by Giorgi (2016) reveals that in June 2013 out of all projects the Trans Adriatic Pipeline (TAP) was selected to deliver Shah Deniz gas which is operated by BP with Lukoil owning a 19.99% share of it, to markets in Europe. Further, it states that the primary advantage of TAP is the assistance provided by the governments of the transiting nations, which lowers the risks associated with infrastructure investment. The role of Italy was also significant in this project with the Intergovernmental Agreement with Albania and Greece. The author also highlights the importance of good relations with neighboring Turkey and Georgia for Azerbaijan, as those are the main states through which the resources are transported. It is not a surprise that the most important project with an investment plan of 19.5 billion USD is in Türkiye, and called "massive investment

born of brotherhood” on the official socar.com.tr site. Beyond this flagship initiative, SOCAR expanded its presence across several countries, establishing offices and fuel stations in markets such as Russia, Ukraine, Georgia, Germany, Austria, and Switzerland. Strengthening its role as regional and global energy actor, Azerbaijan continues to pursue strategic partnerships.

As reflected in Table 1, from the latest available data Italy has been the number one importer of Azerbaijani crude oil and actively participate in country's energy sector. Italian giant energy company ENI, which has been a participant of the “Contract of the Century”, holds 5% stake in Baku-Tbilisi-Ceyhan (BTC) pipeline, while its subsidiary Agip is involved in the development of major Shah-Deniz gas field. Other Italian firms such as “Saipem S.p.a”, “Codest”, “IRD” have also participated as subcontractors in various energy infrastructure projects. Recently in 2024, the partnership between countries intensified with the development of Trans Adriatic Pipeline (TAP) which links the Caspian region to European markets, and acts as a key segment of Southern Gas Corridor. Italy has been the main contributor to the export revenue for Azerbaijan through the years, and according to UN COMTRADE database on international trade, the trade value of crude petroleum in 2024 was 6.75 billion USD. This strategically significant partnership not only highlights the central role of Italy as a trading partner but also reflects the broader political and geopolitical alignment between the states.

Alongside its long-standing energy cooperation with European allies like Italy, Azerbaijan has developed a strategic engagement with Israel which goes beyond energy exports and includes security, defense technology, and regional diplomacy. It is notable that Israel recently awarded SOCAR with an offshore gas exploration license (Wrobel, March 2025). In 2023, Azerbaijan was the number one crude petroleum provider for Israel, at a volume valued as 1.39 billion USD- nearly doubled that of Gabon, the second major exporter (OEC.World). In 2024, Azerbaijani oil exports generated 14.4 billion USD in revenue. SOCAR, which holds 33.34% interest as part of a consortium including BP and Israel's NewMed Energy, won the tender to drill offshore gas fields back in October 2023 (Wrobel, March 2025). Despite the trade embargo Türkiye imposed on Israel after the conflict, it could not stop the flow of Azerbaijani oil through its territory, as it remains structurally dependent on SOCAR. As part of this expansion, the subsidiary SOCAR Tamar LLC was established, allowing Azerbaijan to acquire a 10% stake in Israel's Tamar project, one of the Mediterranean's largest oil fields.

The deepening of bilateral energy relations comes amid broader geopolitical repositioning. In March 2025, Israel officials announced it was in talks with the US to establish a trilateral cooperation framework with Azerbaijan. Framed around mutual interests in security, energy, and diplomacy, this initiative positions Azerbaijan as a strategic bridge between the Middle East, the South Caucasus, and the West (Huseynov, 2025). Following high-level visits and increasing collaboration in energy, the proposed arrangement also aligns with discussions around Azerbaijan's potential inclusion in the Abraham Accords (Huseynov, 2025). Such move, probably would trigger some tension with another important energy partner which is Russia, especially considering that the gas supply from Russia to EU after the war with Ukraine is being realized through Azerbaijan - the transit country. The article "Russia's Energy Interests in Azerbaijan: A Retrospective Analysis and Prospective View" by Ibadoghlu (2024) predicts that Russia's stake of the European gas market will decline after 2025, when it is anticipated that gas supplies to the West via Ukraine would stop, and it seems that Gazprom's agreement to extend the strategic partnership with SOCAR is intended to prepare for the upcoming year, even if it has declared that it will continue to transit gas through Ukraine. Moreover, when it comes to oil, Russian "Lukoil" has 25% interest in the geological exploration project of the Shallow Water Absheron Peninsula (SWAP) and represents the biggest business which represents Russian energy objectives. As of right now, SOCAR has 50% of the participation shares, and BP owns the other 25%. For more than 30 years Russian has been actively involved in upstream, midstream, and downstream projects in Azerbaijan's oil and gas industry. Following President Putin's recent visit to Azerbaijan, "Gazprom" and "Lukoil" will increase their operations in Azerbaijan with new business joining the list. According to the article dated April 30, 2024 by Global Witness, based on the data provided by Rystad Energy, Lukoil is expected to make 7 billion USD between 2024 and 2033 after accounting for taxes, investment, and operating costs. The document that Global Witness was able to get revealed that Shell, Uniper, Engie and Enel are among the European businesses that have long-term commitments to import gas from Shah-Deniz to the EU. Based on the information from that document, Lukoil made 757 million USD in 2021 from that field.

Export of Crude Petroleum, thud. Tons by Country; Value, thsd. US dollar							
Year 2023		Year 2022		Year 2021		Year 2020	
Italy	7.077.115,4	Italy	6.640.524,2	Italy	6.064.567,2	Italy	4.121.246,1
Israel	1.394.267,6	Israel	1.672.358,2	Israel	887.544,0	China	386.274,0
India	1.227.040,9	India	1.625.428,0	Croatia	751.238,2	Croatia	470.782,6
Germany	871.933,8	Spain	998.958,1	Spain	552.660,7	Greece	487.262,9
Spain	769.586,8	Czechia	919.890,5	India	584.154,8	India	452.729,6
Türkiye	676.306,6	Croatia	952.386,4	Germany	628.145,0	Israel	434.440,2
Czechia	682.886,7	Portugal	742.619,1	Portugal	587.003,9	Ukraine	296.088,6
Croatia	590.404,9	UK and Ireland	752.508,1	Tunisia	506.120,7	Spain	327.657,5
Greece	455.309,0	Germany	563.706,6	Ukraine	373.411,6	Tunisia	312.279,4
UK and Ireland	432.278,6	Indonesia	605.892,1	UK and Ireland	368.687,2	Portugal	239.730,5
Ireland	366.641,2	Türkiye	502.220,1	Türkiye	331.599,3	Türkiye	225.150,8
Romania	382.756,7	Tunisia	498.823,5	Belarus	270.984,5	Viet Nam	174.452,4
Other countries	1.314.301,4	Other countries	3.008.308,7	Other countries	1.312.804,4	Other countries	1.435.476,1
TOTAL	16.240.829,6		19.483.623,6		13.218.921,5		9.363.570,7

Table 1. Export of Crude petroleum, thsd. Tons by Country (created by author based on data from State Statistics Committee of Azerbaijan, 2025)

Natural gas, mln. cubic meter; value, thsd. US dollar							
Year 2023		Year 2022		Year 2021		Year 2020	
Türkiye	3.681.484,9	Italy	11.045.330,1	Türkiye	1.684.196,1	Türkiye	1.898.389,6
Italy	8.052.416,1	Türkiye	2.208.273,8	Italy	3.079.395,9	Georgia	264.113,5
Georgia	346.625,0	Georgia	349.732,0	Georgia	356.530,5	Islamic Republic of Iran	10.978,0
Bulgaria	470.340,3	Other countries	1.386.340,0	Other countries	414.275,8	Greece	17.041,0
Greece	900.286,2						
Other countries	227.191,6						
TOTAL	13.678.344,1		14.989.675,9		5.534.398,3		2.190.522,1

Table 2. Export of Natural gas, mln. cubic meter by country (created by author based on data from State Statistics Committee of Azerbaijan, 2025)

According to the most recent news the EU has expressed skepticism over whether Azerbaijan can fulfill its commitment to supply 20 billion cubic meters (cbm) of gas annually by 2027 (eurasianet.org, 2025). On the other hand, as stated by Azerbaijan, in order to reach the given target, the EU has to back significant expenditures to expand pipeline capacity. At the same

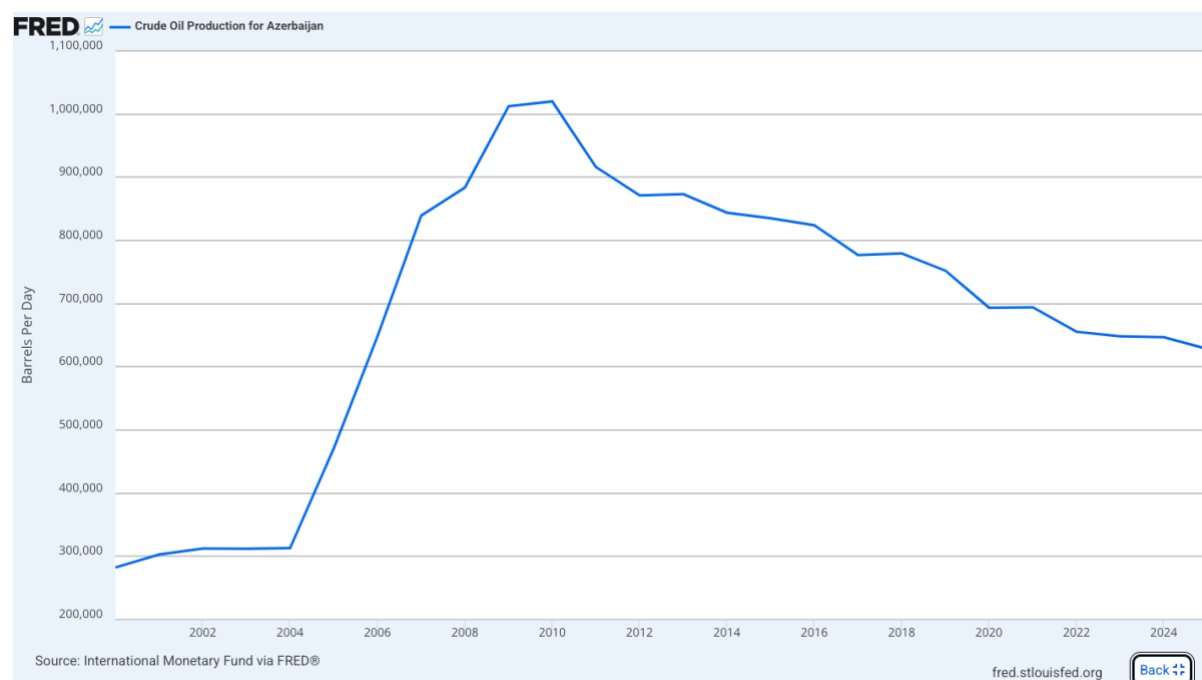
time, Brussels policymakers are hesitant to approve those expenditures for additional infrastructure because there are doubts on the ability to supply gas to any new pipelines. Thus, this ongoing negotiation deadlock reveals the underlying tension between Azerbaijan's strategic ambitions and the EU's long-term energy transition goals. As a result, despite strategic progress in energy diplomacy, Azerbaijan's role in Europe's future energy mix remains uncertain and potentially constrained by its own infrastructural and resource limitations.

2.2.2 Challenges of Oil Dependency

Whether the economic boom coming from oil was a blessing or a curse is still a topic of debate. On the one hand, it enabled to obtain a rapid economic growth, increased the investment made to infrastructure, and more importantly strengthen its geopolitical position, on the other hand, it deeply rooted the state's dependence on natural resources, limited the economic diversification, and thus, made vulnerable to external shocks as it happened in 2015, making the long-term sustainability questionable. Politically Azerbaijan faced trade-offs balancing its pursuit of global recognition and market access with maintaining strategic autonomy, deliberately avoiding membership in NATO, the EU, or the EAEU. As an alternative, it became a solid trade partner of EU, and especially important to mention Italy as number one partner. Referring to the available data from in Table 3 below reveals that the share of energy sector in the total exports is significant and takes first place among top 5 categories. A sharp drop between the energy sector and other categories shows that non-oil sector plays a marginal role in the export basket. The production amount demonstrated in graph 2 however, shows a descending trend signaling about the issues with long-term sustainability of the recourse-based growth model. In their econometrics based study Humbatova et al. (2019) state that the relative proximity of the economic growth rate with the oil production and pricing rate can be directly linked to the thinking of models from both an economic and mathematical perspective. Even while demand and economic growth play a significant role in global oil prices, it can be concluded that Azerbaijan, one of the smallest oil exporters, experiences economic growth that is mostly reliant on fossil fuel production and prices.

Azerbaijan Exports By Category- Top 5	Value	Year
Mineral fuels, oils, distillation products	\$23.36B	2024
Edible fruits, nuts, peel of citrus fruit, melons	\$496.99M	2024
Plastics	\$368.89M	2024
Pearls, precious stones, metals, coins	\$215.33M	2024
Cotton	\$213.52M	2024

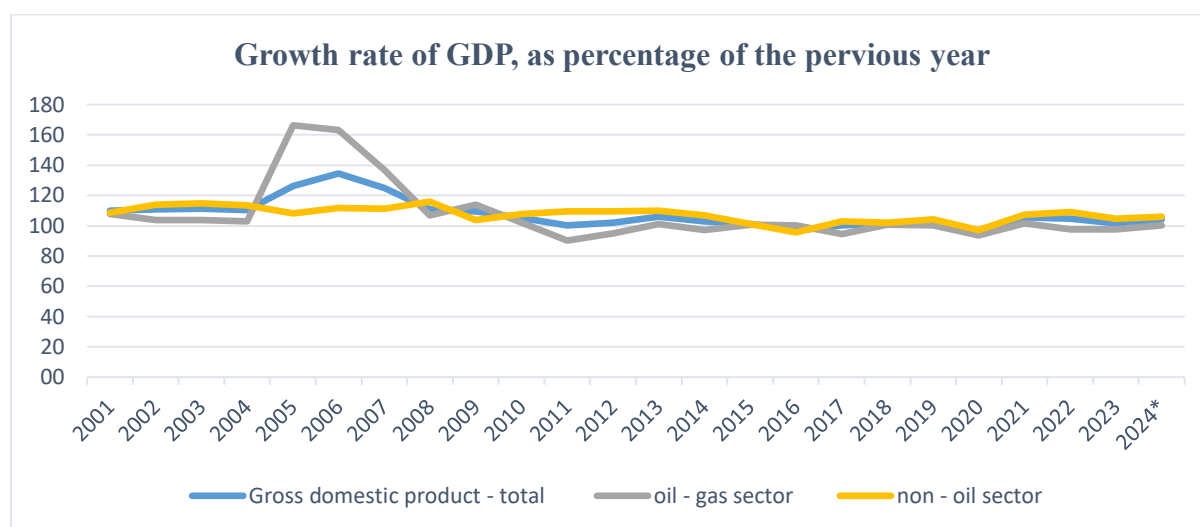
Table 3. Azerbaijan's Export Value by Category (Tradingeconomics.com, 2025, <https://tradingeconomics.com/azerbaijan/exports-by-category, exports-by-category>)



Graph 2. Crude Oil Production for Azerbaijan for 2000-2025 (IMF via FRED, 2025, <https://fred.stlouisfed.org/series/AZENGDPMOMBD>)

The Impact of global oil price shocks on Azerbaijan's economy is analyzed by Zulfugarli (2020) where the author's result of econometric analysis suggests that oil price fluctuations have a statistically significant impact of macroeconomic indicators like aggregate output, exchange rates, inflation, and interest rates. The study emphasizes that since fiscal policy, which is largely reliant on oil revenues, continues to be the primary transmission route, both the oil and non-oil sectors respond to price volatility. In addition, it is demonstrated that the effects are asymmetric with short-term gains during high-price periods yielding less severe and long-lasting effects than negative oil price shocks. The appreciation of real currency rate during oil booms and the dominance of non-tradable industries like construction and services are two clear indicators of Dutch Disease in Azerbaijan. Since oil windfalls are accumulated and transferred to the state budget, which finances a sizable amount of public spending, SOFAZ's

operations have been crucial in this context. The terminology “windfall” is the term used in the literature and defined by Ahmadov (2023) the situation where the government searches for easy profit as a consequence of the excess margins from exploitation of oil. Over time, this has led to the development of non-oil sector throughout time, primarily expanding due to government investment rather than internal competitiveness or external demand. The 2015 oil shock crisis theoretically was an opportunity which favored for economic structural shift, but it did not happen. The lack of responsiveness from tradable non-oil industries was more binding structural problem. As Ahmadova et al. (2021), Hajiyeve & Rustamov (2019), and Hasanov (2013) state that institutional development and regulatory reform could be used to solve the limitations. However, they mention that the government still relies on short-term measures and SOFAZ transfers to stabilize the economy rather than adopting structural changes to increase competitiveness or accelerate WTO entry. An analysis of macroeconomic indicators is presented in the graphs below in order to show how these structural dynamics are reflected in changes in oil prices, production patterns, and economic growth by sectors.

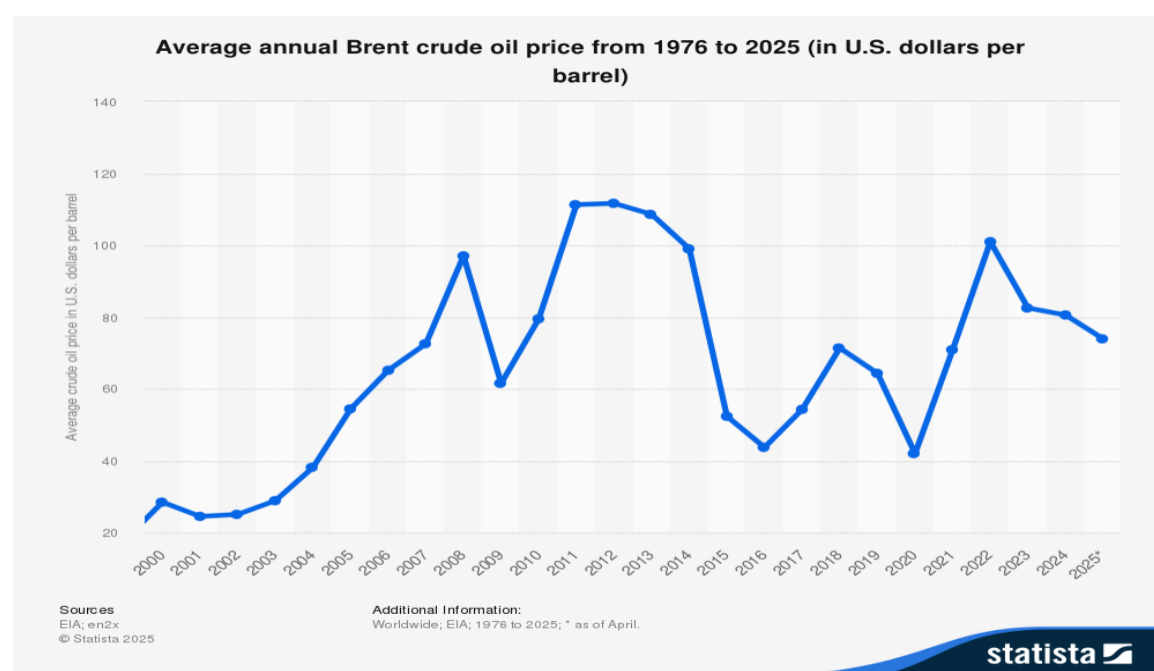


Graph 3. Growth rate of GDP, as percentage of the pervious year (created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

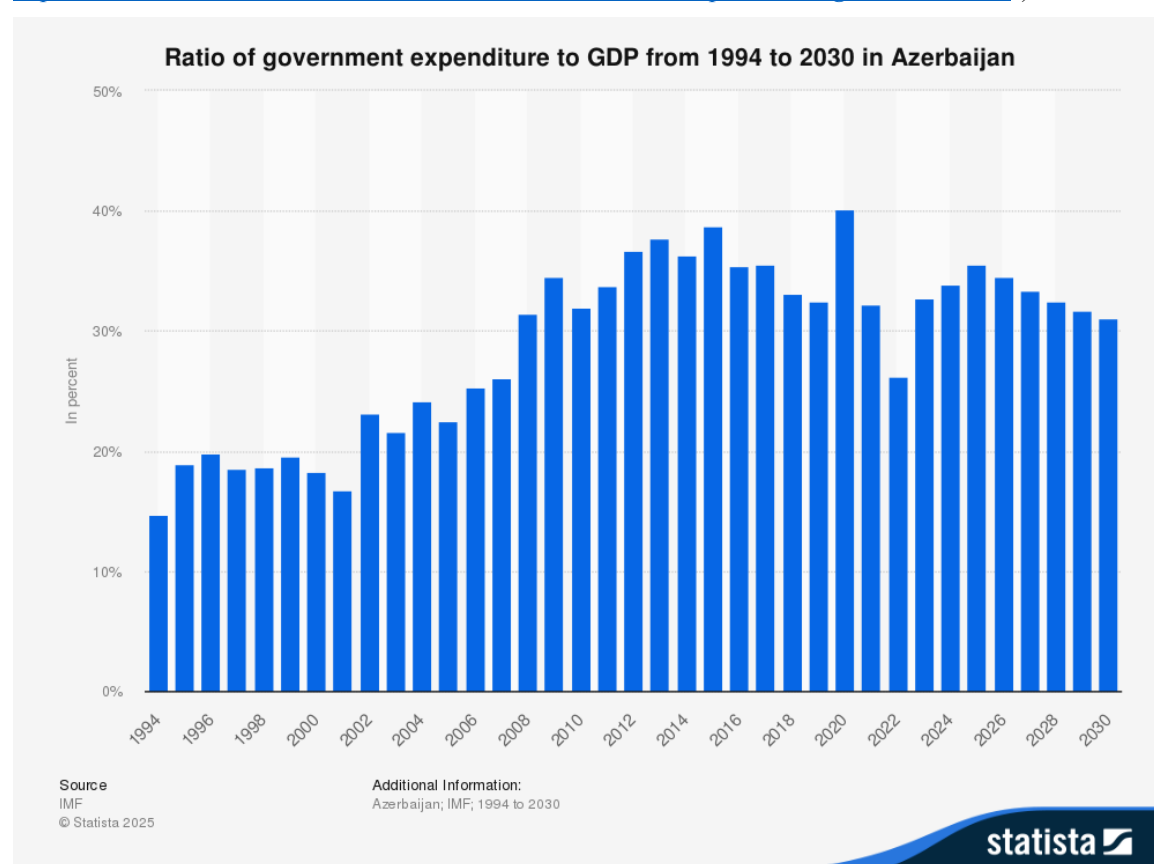
While theoretical and econometric assumptions offer valuable insights, visualizing key trends over times assists in observing these dynamics within Azerbaijan's broader development path. The expansion of the oil-gas sector and a rise in crude oil output, as shown in Graph 2 is strongly correlated with Graph 3 illustrating annual GDP growth rate. This parallel is especially noticeable in period of 2005 and 2008 when sectors growth and production levels both

experienced significant accelerations. This is also supporter by Graph 4 where crude oil prices have seen increase globally. The fiscal revenues were increased but the non-oil sector did not see any significant GDP growth rate which exposes the structural vulnerabilities in the development pattern. As oil prices sharply declined during 2014-2016 and production began a gradual descent, the limits of this growth framework became more apparent. Although the non-oil sector maintained moderate stability in output, it lacked the capacity to act as an autonomous engine of growth, reflecting institutional rigidities, weak global integration and thus, weak export capacity. As it was discussed earlier, the oil windfalls of mid 2000s drove massive fiscal inflows funneled through SOFAZ, its role stayed as stabilization, rather than serving as catalyst for structural reform or productivity like investing in tradable non-oil sector. In fact, as Zulfugarli (2020) stated the transfers along with the share of revenues generated around 60% of state budget during 2018-2019. This might be the core of the problem of diversification that the country currently experiences. The pro-cyclical fiscal behavior as it is common for resource-rich countries, can be observed from the ratio of government spending to GDP from the Graph 5. According to Ilzetzki & Vegh (2008) the developing countries apply this type of fiscal policy because of limited options in borrowing during recession while expanding spending as a political tool. During 2016 the spending was decreased but not drastically as the government relied on SOFAZ as a short-term instrument, which means that the State Fund operates as a “shock response” instrument rather than true sovereign wealth fund with long-term counter-cyclical logic. The case in 2020, reflects that despite the oil price crash, the government managed to increase government spending through the record level of transfers in value of 12.2 million AZN. Even though it might seem as a help to withstand the shock, it is not sustainable in the long-run. As it is demonstrated Azerbaijan's growth trajectory remains sensitive to commodity cycles and reliant on resources. At this point, it becomes crucial to unpack how domestic demand has been maintained, and whether this support has come from productive sectors or redistribution.

The next chapter turns to the political economy reassessment of Azerbaijan's current growth regime through the examination of institutional structures, the main aggregate demand drivers, sectoral dynamics, and elite strategies that formulate the development path.



Graph 4. Global Oil Price Movements for 2000-2025 (EIA, Statista, 2025, <https://www.statista.com/statistics/262860/uk-brent-crude-oil-price-changes-since-1976/>)



Graph 5. The ration of government expenditure to GDP for 1994-2025 and forecast till 2030 (IMF, Statista, 2025, <https://www.statista.com/statistics/457532/ratio-of-government-expenditure-to-gross-domestic-product-gdp-in-azerbaijan/#:~:text=Ratio%20of%20government%20expenditure%20to%20GDP%20in%20Azerbaijan%20>

[01994%20to%202030&text=The%20ratio%20of%20government%20expenditure,approximately%2035.61%20percent%20in%202025.&text=Between%201994%20and%202025%20a,percentage%20points%20can%20be%20observed. \)](#)

Methodology

The methodology is based on a qualitative case study approach using a combination of primary and secondary sources. Reports from institutions like the European Bank for Reconstruction and Development, the European Training Foundation, and the State Oil Fund of Azerbaijan (SOFAZ) are used alongside statistical data from the State Statistics Committee of Azerbaijan and trademap.org. Relevant academic literature is also used to support the analysis and contextualize the findings within the broader political economy framework.

Analytical Framework

The analysis in this chapter applies the growth regimes perspective introduced by Hassel et al. (2020), which examines how state institutions shape demand patterns and guide economic development through targeted policy strategies. While the original framework guides the overall analysis, to organize the analysis, framework developed by Di Carlo et al. (2024) for the Italian case is used. The framework focuses on three core dimensions: aggregate demand composition, the structure of the productive economy, and institutional strategies of elites. The reason behind choosing this approach is the analytical clarity and its relevance to contexts where growth is state-mediated and regionally uneven, thus features closely relate to the Azerbaijani case. The analysis will be based on macroeconomic statistics, existing literature, and policy reports. While, no formal econometric techniques are used, the study is grounded in a political economy perspective, focusing on how long-term institutional structures and systemic barriers that shape the economic development.

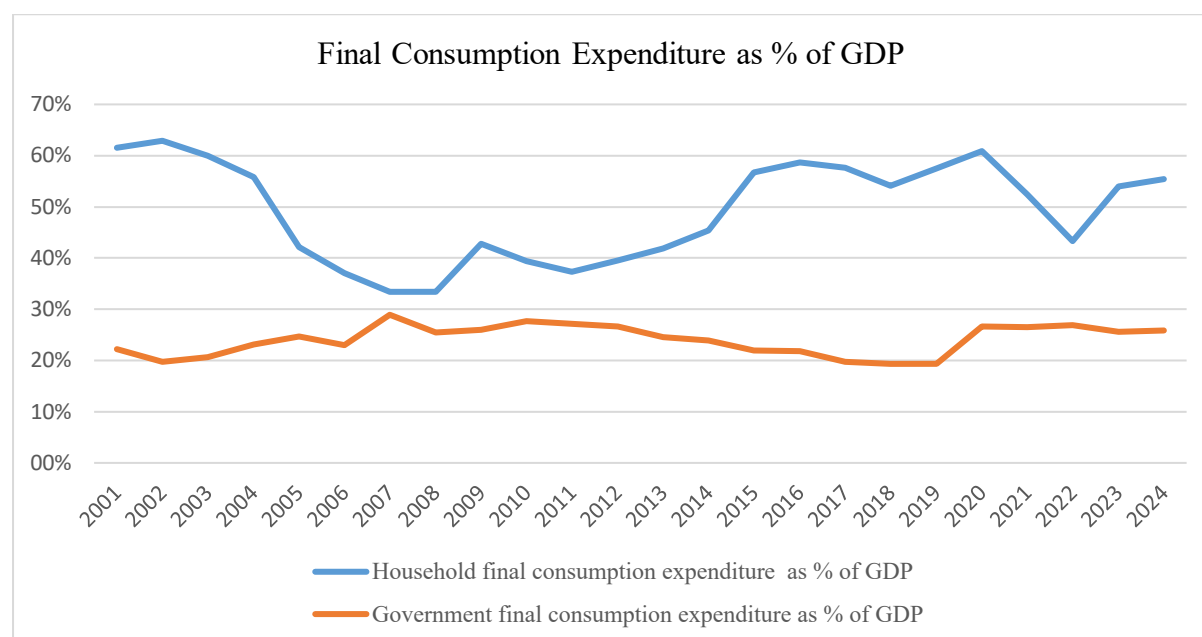
3. Identifying Azerbaijan's Current Economic Growth Model

3.1 The main growth drivers of aggregate demand

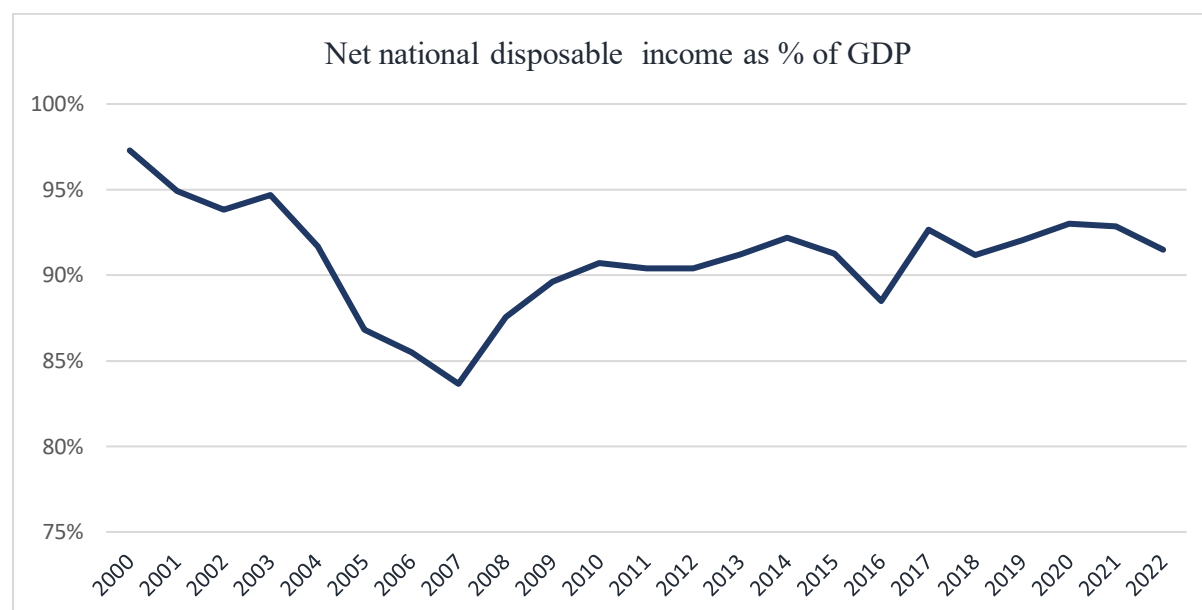
To identify the underlying growth dynamics of Azerbaijan's current development model, it is important to analyze the composition of aggregate demand which includes consumption, investment, government spending, and net exports. It is important to note, that it is not a pure macroeconomic identity but rather a reflection of institutional choices, sectoral priorities, and state-society relations. As it is discussed throughout the paper, for Azerbaijan aggregate

demand has historically been shaped by state-led public expenditure, investment from oil revenues, a trade structure dominated by fossil fuels. Starting with government spending and referring to the Graph 5 the expenditure as share of GDP rose steadily from below 20% to over 35% during 1990s-2008, peaking around 40% in 2020 despite global oil price crash. Using the pro-cyclical pattern highlights the central role of public expenditure not only as a fiscal tool but also as a political instrument, maintaining political alliances and ensuring continuity of the ruling order. While Central bank made notable attempts in constructing models to support monetary policy, institutions like Ministry of Finance and SOFAZ demonstrated limited engagement in building comprehensive models to evaluate the long-term growth impacts of fiscal policy or public investment dynamics, despite the centrality in driving aggregate demand (Ahmadov, 2023). The obstacles to the institutionalization of economic modeling are not purely technical, but deeply embedded in the political economy of public administration. Ahmadov (2023) in his article mentions strategic documents "Azerbaijan 2030" and the 2022-2026 Socio-Economic Development Strategy noting that these documents outline broader ambitions including diversification, human capital enhancement and innovation, yet it is unclear to what extent they are realistic in the existing economic modeling. Those are goals rather than analytically driven priorities; in order to make the strategies effective better institutional coordination, governance environment which prioritizes long-term economic rationality over short-term political gains and reliable data systems must be required (Ahmadov, 2023). The trend of economic growth mostly depends on a range of institutional conditions where the main processes of economic activity take place. The challenges of state to transform high income from the export of natural resources, namely oil and gas, into efficient production with high labor productivity and added value, leads to a number of negative macroeconomic and structural consequences.

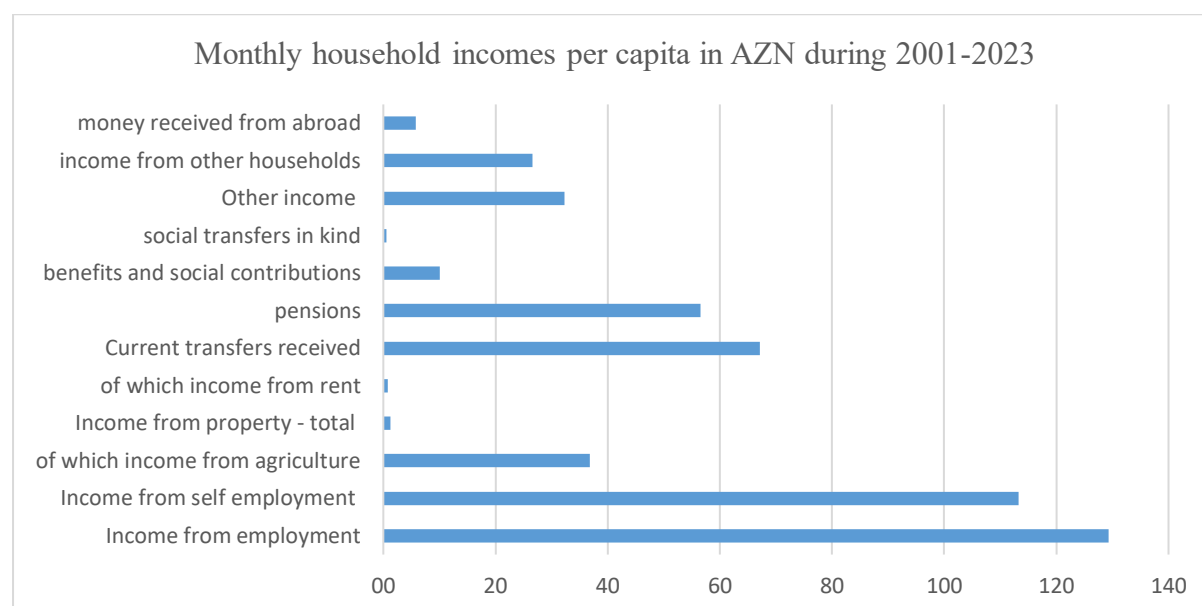
The findings of Zeynalova & Mammadli (2020) reveal that household consumption in Azerbaijan is primarily supported by fiscal mechanisms, like corporate taxes, VAT revenues, and movements in exchange rates, rather than increase in disposable income. Thus, it can be suggested that public finance plays a key role in sustaining domestic demand, consistent with the logic of administrative Keynesianism described by Di Carlo et al. (2024), where in the absence of a fully developed private sector, state spending and fiscal tools support consumption. In Azerbaijan's case state indirectly motivates household consumption through macroeconomic management rather than market-driven productivity.



Graph 6. Final Consumption Expenditure, as % of GDP (annual averages based on quarterly data; graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

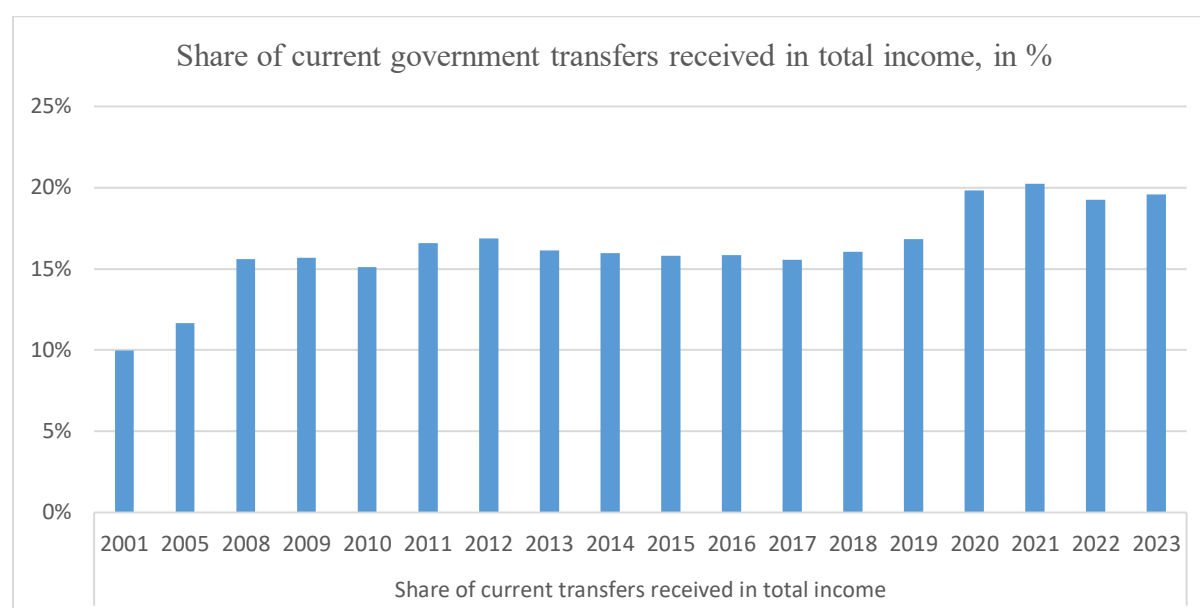


Graph 7. Net national disposable income as % of GDP (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)



Graph 8. Monthly household incomes per capita in AZN during 2001-2023 (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

Several clear illustrations are presented in the graphs and support the argument that domestic consumption in Azerbaijan is significantly sustained by government-led redistribution mechanisms, consistent with the characteristics of administrative Keynesian growth regime. The continuous increase in both household and government final consumption expenditure as % of GDP illustrated in Graph 6 combined with the Graph 9 points to the model where state not only acts as a direct consumer but also stimulates consumption through fiscal transfers. The steady rise in net national disposable income as % of GDP particularly in high oil revenue periods, reflects the capacity of the state to redistributive resource rents toward domestic demand (Graph 7). Moreover, the composition of monthly household incomes in Graph 8 demonstrates that a significant share comes from sources such as pensions, social benefits, and other public transfers which rise over time and remain around 20% for the last four years.



Graph 9. Share of current government transfers received in total income, in % (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

Taking 2020 as a reference point across the graphs reveals very important political-economy dynamics. The role of the state as main actor in stabilizing the aggregate demand during external shocks can be seen as positive aspect. Thus, during the crisis time, the government responded with increased public expenditures and expanded fiscal transfers to households, which illustrated that despite the fact that the market is not diversified, the state has a capacity to redistribute oil-derived revenues. With the increased state transfers, the continuity of household consumption, combined with relatively stable disposable income levels the global downturn was amid, which illustrates the power of state to sustain short-term macroeconomic and relative social stability. This is not only an economic tool, but rather a political instrument sustaining the public expectations and maintaining legitimacy.

Talking about the investment it is important to mention two main institutions: Azerbaijani Investment Company (AIC) OJSC which was created in 2006 under the ministry of Economy of Republic of Azerbaijan to develop the non-oil sector by direct investment in business projects and Azerbaijan Investment Holding (AIH) established in 2020 to control the state-owned enterprises according to national socio-economic priorities, reports reporting directly to the president.

While the main goal of AIC is to support overall economic growth, reduce reliance on imports, and encourage diversification, the AIH ensures the investment transparency, economic efficiency, competitiveness, and financial sustainability of governmental companies like SOCAR, “AzerGold” SJSC, “Azeraluminium” LLC, “Azerbaijan aluminium” OJSC, “Tamiz Shahar” OJSC which is a waste management company, “Azercotton Agricultural Industrial Complex” LLC, and from financial sector the largest state-owned “International Bank of Azerbaijan” OJSC together with 75% state-owned “Azer Turk Bank” OJSC. In addition to that, according to the information from the official reports of State Oil Fund of Azerbaijan (SOFAZ) the large-scale public projects it has been financing are the infrastructure, development and educational programs. Thus, the state has been relying on SOFAZ as a tool, rather than encouraging the private sector initiative. Projects such as Baku-Tbilisi-Kars railway, the previously mentioned BTC oil pipeline, the rural areas infrastructure activities, the Karabakh reconstruction projects reflect this approach. In addition, the fund has been financing the education abroad for youth, and for 2019-2023 program the amount allocated was 83,4 million AZN. The Figure 1. below illustrates the SOFAZ assets allocation as of March 31, 2025. Another recent report from European Bank for Reconstruction and Development (EBRD) for May 2025, reveals that Azerbaijan's economic growth in 2024 was driven by non-oil sector and public investment.

Overall, the presence of abovementioned institutions shows that investment in Azerbaijan is largely shaped by the state rather than by market forces. This is consistent with the core idea of the AK regime, where the state plays an active role not just by stabilizing the demand, but in boosting the investment. Due to the limited capacity of the private sector, public investment becomes a driver of development, and supports not only growth but also social and political stability. Beyond the economic purpose, the investment decisions serve as supporting the employment, reducing the inequality across regions, even though for now, it is not at the desired level, and ensuring that the government is the central and main body shaping the economy. This showcases the fact that Azerbaijan's market transition from socialism to capitalism is incomplete and might be considered as hybrid, yet to understand the broader dynamics of aggregate demand, it is also essential to look beyond domestic drivers and examine the role of external demand through the net exports analysis.

Beyond Oil: A Political Economy Perspective on Azerbaijan's Growth Model

AZN 297.9 MLN. BTC Main Export Pipeline(Financing of the project was completed by SOFAZ in 2006)	AZN 2 702.7 MLN. Improvement of social condition of refugees and IDPs(SOFAZ finances the project)	AZN 779.6 MLN. Oguz-Qabala-Baku water supply system(Financing of the project was completed by SOFAZ in 2011)	AZN 1 469.6 MLN. Reconstruction of the Samur-Absheron irrigation system (Financing of the project was completed by SOFAZ)
AZN 1 663.3 MLN. Construction of "STAR" Oil Refinery Complex (Financing of the project was completed by SOFAZ)	AZN 87.6 MLN. Repayment of SOCAR's share in the project on joint exploration and development of ACG oilfields(Financing of the project was completed by SOFAZ in 2007)	AZN 1 530.3 MLN. Southern Gas Corridor(Financing of the project was completed by SOFAZ)	AZN 3 949.5 MLN. Transfers to the Central Bank of the Republic of Azerbaijan
AZN 159 552.2 MLN. Transfers to the state budget	AZN 90.0 MLN. Formation of the statutory capital of the State Investment Company (Financing of the project was completed by SOFAZ in 2006)	AZN 748.6 MLN. Baku-Tbilisi-Kars railway (Financing of the project was completed by SOFAZ)	AZN 212.7 MLN. State Program on education of Azerbaijani youth abroad (Financing of the project was completed by SOFAZ)
AZN 111.8 MLN. State Program for the education of young people at prestigious higher education institutions of foreign countries for 2022-2026		AZN 99.5 MLN. State Program on Raising Competitiveness of Higher Education in Azerbaijan in 2019-2023	

Figure 1. Allocation of SOFAZ assets as of 31 March, 2025 (SOFAZ report on recent figures, 202, <https://www.oilfund.az/en/report-and-statistics/recent-figures> 5)

Earlier discussions about the oil and gas sectors as a backbone of the economic model revealed that Azerbaijan's exports are dominated by hydrocarbon sector, but it is useful to look at the exports by commodities to have a clearer picture. The Table 4. below based on data from to trademap.org, presents the top 10 products and their percentage from general net exports, illustrating that the gap between hydrocarbon exports and other sectors is a warning signal.

Commodity type	2023 as %	2024 as %
Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral . . .	91,5	87,98
Edible fruit and nuts; peel of citrus fruit or melons	1,51	1,87
Plastics and articles thereof	1,36	1,39
Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad . . .	0,49	0,81
Cotton	0,48	0,8
Edible vegetables and certain roots and tubers	0,63	0,79
Aluminium and articles thereof	0,58	0,74
Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	0,53	0,7
Commodities not elsewhere specified	0,01	0,56
Fertilisers	0,25	0,48

Table 4. Azerbaijan's Exports by Commodity type as a % of NX (trademap.org, 2025, https://www.trademap.org/Product_SelProductCountry.aspx?nvpm=1%7c031%7c%7c%7cTOTAL%7c%7c%7c2%7c1%7c1%7c2%7c1%7c%7c1%7c1%7c1%7c1%7c1)

When it comes to non-oil and gas exports, it is not just what Azerbaijan sells, but also where those goods are sold. Looking at 2024 numbers, the top destinations of edible fruit and nuts group are Russia with 80.3% Germany with 4.4%, Ukraine with 3.3 %, and Italy with 2.9% of share. For plastics and articles thereof, the top 3 buyers are Russia (63.9%), Belarus (7.4%), and Belgium (4.1%). It is particularly noteworthy that 99.1% of the total value of Azerbaijan's export of natural and semi-natural stones went to Switzerland – mainly in the form of gold exports valued at 211 million USD. Cotton and aluminium industries, both ranking among top 10 exports, are seen as sectors with potential for further development. Their main market is Turkey, accounting for 79.1% and 59.3% of their export share respectively. For aluminium, it is also important to highlight that 16.8% is exported to the USA and 8.9% to Japan. In regard with this, EBRD report (May, 2025) Azerbaijan faced high tariffs on aluminium from the USA in 2024. The report also states that in the medium run, Azerbaijan's transportation and logistics industries may benefit from trade along the Middle Corridor, which connects China and Europe, granting access to new markets. Still, even this relatively diversified segment reflects a common pattern; firstly, a small number of trade partners and secondly, high concentration in primary or semi-processed goods. This creates a vulnerability where both external shocks and geopolitical shifts could quickly reshape trade performance. While presence of niche markets like Switzerland and Japan might seem promising, it does not yet represent a systematic shift in the export base, and probably will not in the near future.

To sum up, Azerbaijan's aggregate demand is still predominantly driven by state-led channels, be it through household consumption, government investments and spending, or an export market still depending on hydrocarbons. The next chapter turns to the production side of the economy, analyzing which sectors are the actual drivers of growth and employment. Moreover, revealing to what extent they reflect the political priorities embedded in the country's economic model.

3.2 The economy's major sectors driving growth and employment

Taking a closer look to the major sectors driving the economy, exploring how different branches contribute to both GDP and employment reveals important patterns in country's economic structure. By identifying which sectors carry the greatest weight and where most people work, it becomes possible to understand the dynamics of growth, challenges of productivity, and existing imbalances in sectors. According to the available data from

statista.com for the 2013-2023 period, the economy continues to be dominated by the industrial sector, although the balance between sectors has not remained stable.

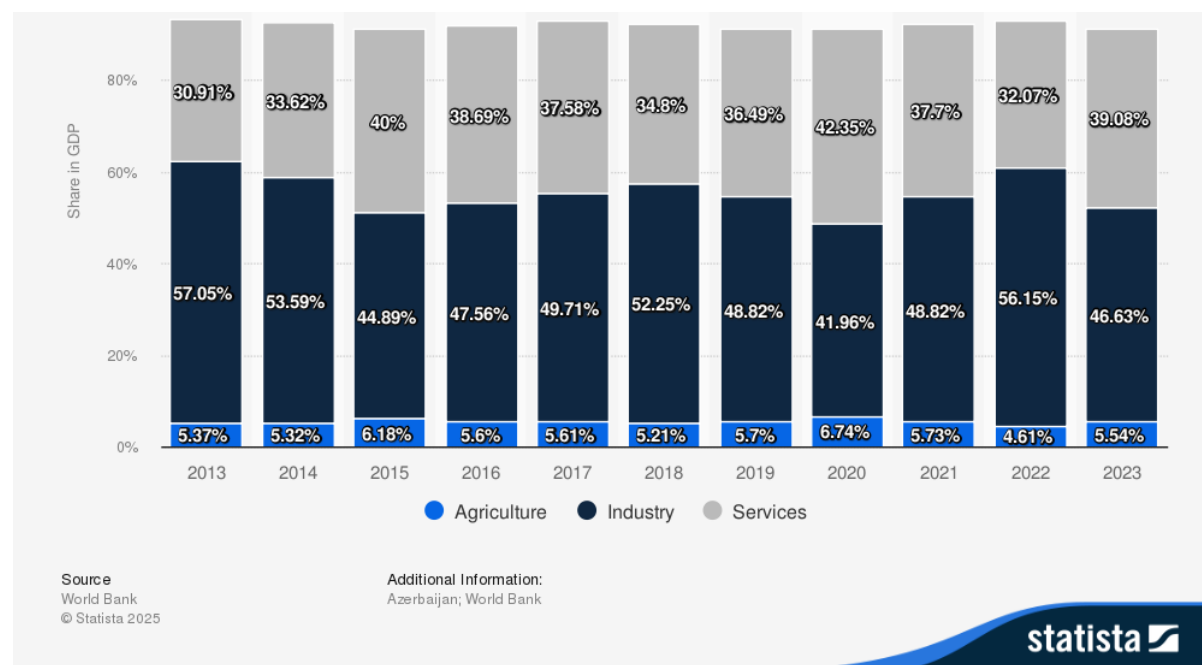


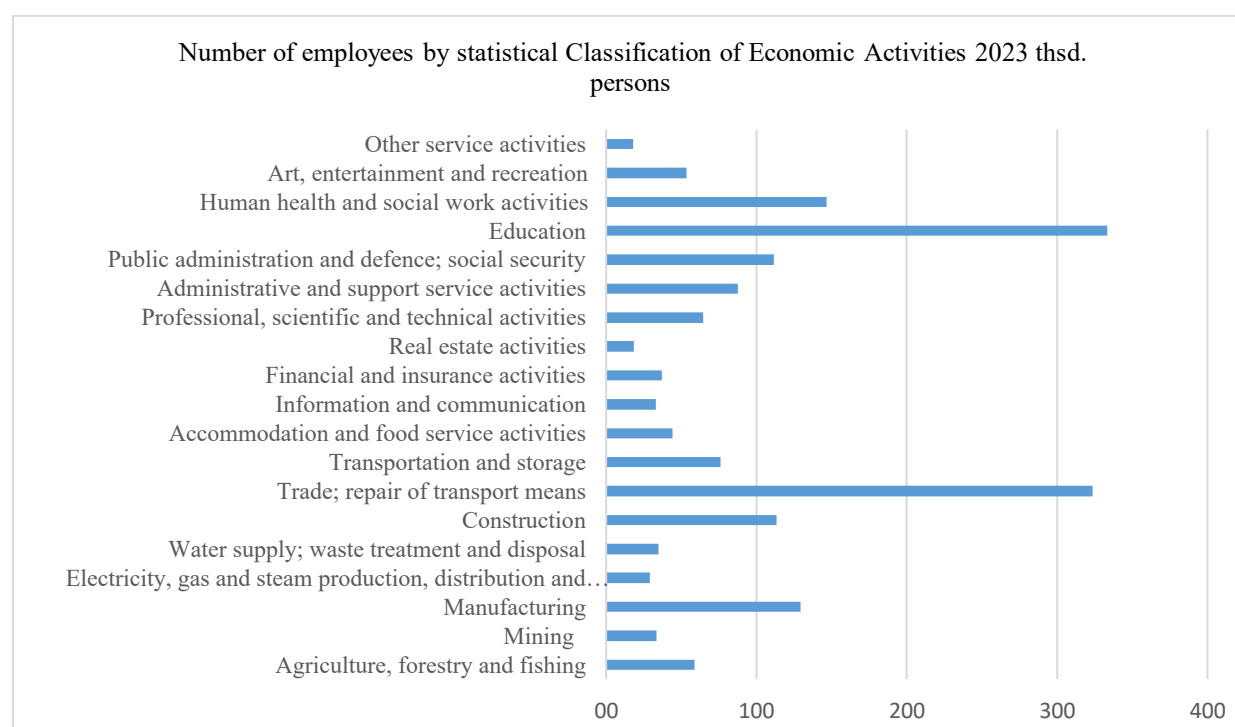
Figure 2. Share of economic sectors in the GDP for Azerbaijan during 2013-2023 (Statista, 2025, <https://www.statista.com/statistics/457577/share-of-economic-sectors-in-the-gdp-in-azerbaijan/>)

According to Figure 2. in 2013, industry accounted for 57% of GDP, but this dropped notably to around 42% by 2020, before increasing back in 2022, and falling slightly again in 2023. The services sector moved in the opposite direction, such that its share increased as industry declined, peaking in 2020 at 42.3%, likely showing both pandemic-related dynamics and shifts in domestic demand. Agriculture remained low and relatively unchanged throughout the period, fluctuating between 5%-6%. The main industries are defined as mining (64.3%), manufacturing (29.8%), oil and gas (4.9%). Based on the data obtained from the State Statistics Committee (2025), in 2024, the value added produced in oil and gas sector increased by 0.4%, while in non-oil and gas increased by 6.4%. The breakdown of the GDP is illustrated below in Table 5.

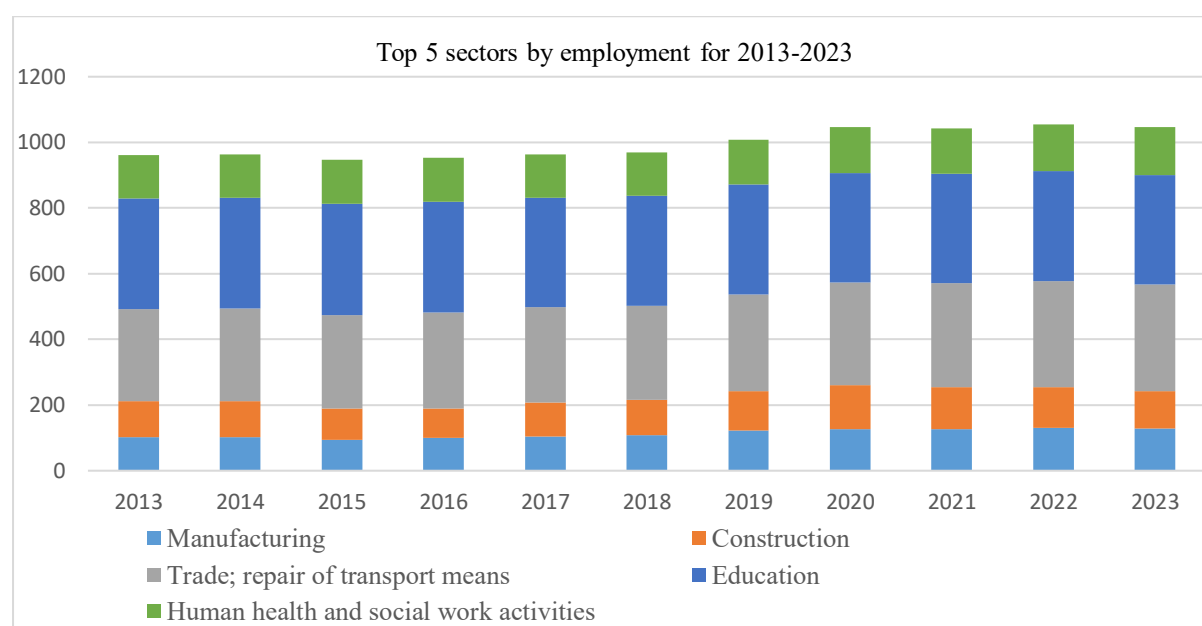
Sector	Share of GDP (%)
Industry	35,9
Trade; Vehicle Repair	10,7
Transport and Warehouse	7
Construction	6,7
Agriculture, Forestry and Fishing	5,7
Tourists' Accommodation and Public Catering	2,4
Information and Communication	1,9
Other Fields	19,9
Net Taxes on Product and Import	9,8

Table 5. Share of economic sectors in the GDP for 2024, in % (table created by author based on the data from State Statistics Committee of Azerbaijan, 2025,

https://www.stat.gov.az/source/system_nat_accounts/?lang=en)



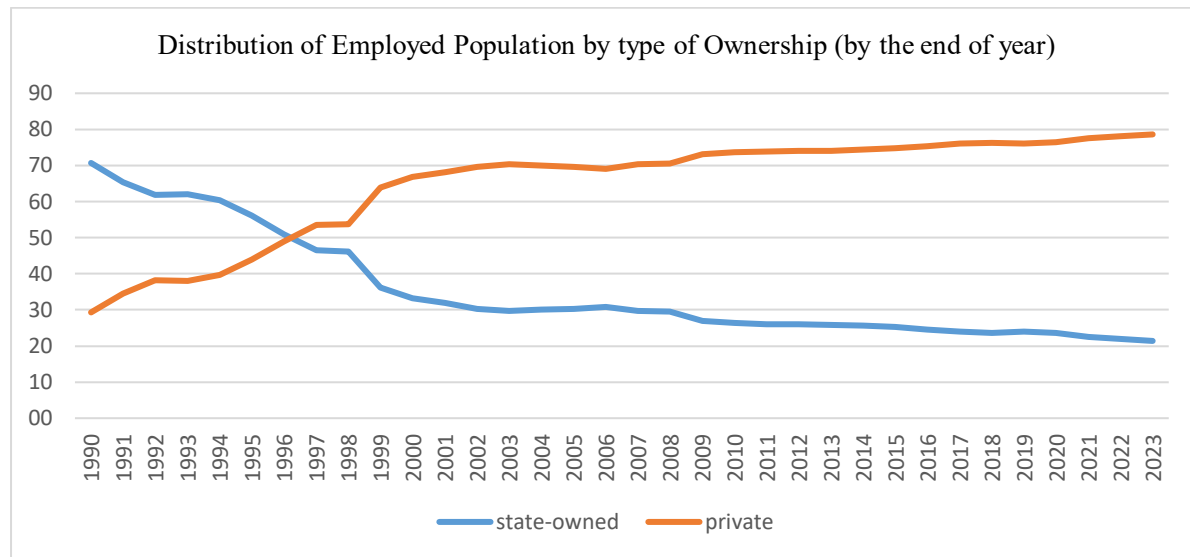
Graph 10. Number of employees by statistical Classification of Economic Activities 2023 thsd. persons (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)



Graph 11. Top 5 Industries by Number of Employees in thsd. Persons (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

Observing the number of employment makes clear that sectors like manufacturing, trade and trade repair of transport means, human health and social activities, construction, and education has been ranked in the top for the indicated period. Despite all the focus on extractive industries in the GDP structure, the mining and industry sectors create relatively few jobs. This mismatch reflects a pattern where growth is resource-led, but employment remains tied to state-regulated or state-financed sectors. As it is seen, the top 5 industries barely have changed over the last decade, and these areas are either directly funded by state or operate under strong government control. This supports the earlier discussion around Administrative Keynesianism, where the state is the “employer of last resort” (Di Carlo et al., 2024). As the report from European Training Foundation (ETF) by Nikolovska (2024) points out, structural issues in the labor market, informality and mismatch remain unresolved, and the underdeveloped private sector still leaves the state as main employer. The Graph 12. visualizing the shift from state to private ownership from late 90s might trigger some confusions, yet the overtook of private sector is only “formal”, the reality on the ground reflects something else. The decline in state ownership does not translate into a fully liberalized economy; instead the huge companies known as private are strongly supported by the government. From a political economy perspective, this reveals a hybrid system where formal privatization has occurred, but the development burden still heavily lays on the state. Thus, as F. Mehralizadeh (2020) state that despite the fact that, the share of private enterprises is significantly more, the weight of public sector is felt more as

natural monopoly exists especially in telecommunications and banking sectors. In addition, the author states that the privatization process in Azerbaijan is not considered as “successful” by experts, and serious reforms are needed for further development. All the trends observed till now create a background for looking at how elite strategies shape the economy, pointing towards a mixed system which reflects the features of administrative Keynesianism and state capitalist model with patrimonial patterns.



Graph 12. Dynamics of Distribution of Employed Population by type of Ownership (by the end of year in %) (graph created by author based on the data from State Statistics Committee of Azerbaijan, 2025)

3.3 The growth strategies of elites

The analysis above gives a foundation to the thought that the model for Azerbaijan as it is for many post-Soviet states, is the “state capitalism”, sometimes also called “patrimonial capitalism”. As Robinson (2013) explains, this model often operates not through formal institutions alone but through personal networks and informal arrangements, where access to resources is shaped by elite connections rather than transparent rules. In Azerbaijan’s case, the control over strategic sectors like energy, and the management of public resources, specifically the oil revenues reflect this setup. Ahmadov’s (2023) thoughts support the argument, as he mentions that despite formal shifts toward liberalized market principles, the core features of Azerbaijan’s economic management still reflect a state capitalist model, which got roots in the dominance of public finance over private capital and driven by oil revenues. In addition, state-directed investment remains central to shaping the structure of direction of the economy.

Given the states' clear monopoly over the energy market, it is reasonable to conclude that Azerbaijan's energy policy is highly centralized. The main obstacles on the road to liberalization of the energy market are the authoritarian nature of the political government and ties within the elite, which are upheld by corruption. Public institutions seem unable to provide solid institutional restraints on corrupt practices and political interference, given the turbulent past filled with many reorganizations. However, the main forces behind reforms that push for liberalization and improving strategies and policy tools seem to be the increasing economic pressure, the wealth of potential from alternative and renewable energy sources, the opportunities for international and European cooperation, and the growing need for infrastructure upgrading (Nasibov, 2021). The main phases of economic activity occur in a wide range of institutional settings, which have a significant impact on the rate of economic growth. Ahmadov (2023) states that governments of resource-rich counties are more confident in the times of economic or political threat, and they can also obtain additional social credits by reducing the tax burden. This shifts Azerbaijani government's role as a tax collector to the central figure of a revenue distributor.

The analysis reveals that elite strategies in Azerbaijan rely on maintaining control over main economic sectors, directing public investment, and using state institutions as tools of redistribution and stability. Instead of breaking away from Soviet inherited centralized structures, the model has been adopted to fit the needs of continuity of regime, where political loyalty moves together with resource allocation. The next chapter briefly addresses the question of the possibility of meaningful diversification under this framework.

4. Diversifying the economy

Today, while the problem of diversification stays on the agenda of the government and has been a long-standing priority in public discourse, Azerbaijan's economy remains dominated by extractive sectors. According to the Economic Complexity Index (ECI) mentioned by Ahmadov (2023), Azerbaijan ranks low in trade (85th), technology (78th), and most important research (127th) which reflects a low-tech production base. The fact that the sharp drop in ranking happened in last two decades, and only Venezuela being ahead of Azerbaijan in that decline highlights the seriousness of the issue.

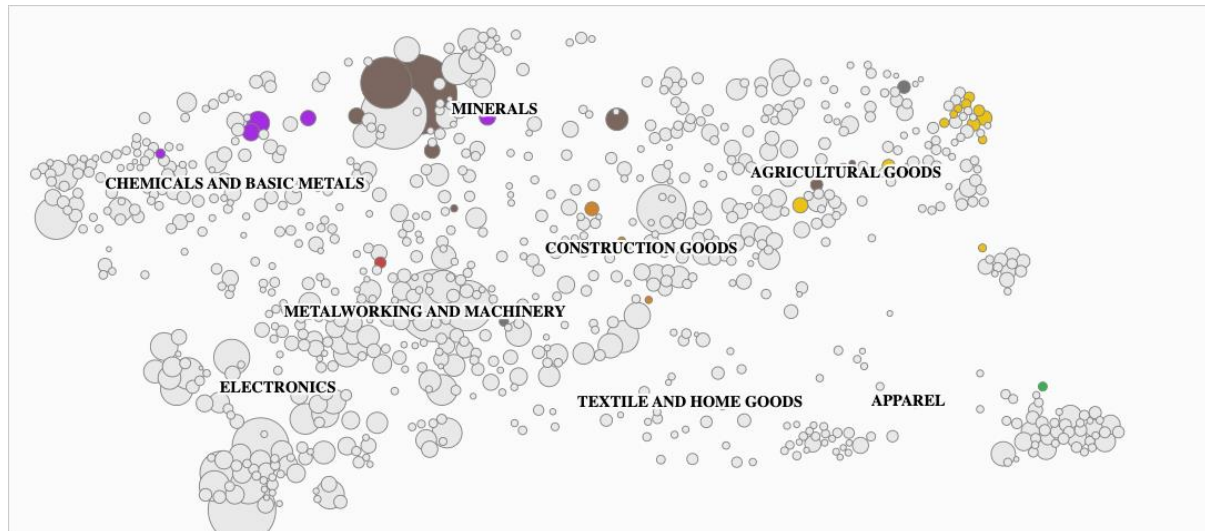


Figure 3. Product Space Map for Azerbaijan exports and potential to develop (atlas.hks.harvard.edu, 2025, <https://atlas.hks.harvard.edu/countries/31/paths>)

The Product Space Map from Harvard Growth Lab confirms the concentration of exports around minerals and basic agricultural goods, with limited links to more complex sectors like electronics or machinery (2025). This shows the country is largely producing what it already knows, with little shift toward high-valued goods, meaning that even non-oil exported goods are low-complexity goods. To move forward Azerbaijan should gradually build capabilities in related, but more sophisticated products. For example, aluminium, chemicals, or construction materials (Ahmadov, 2023). If guided well, especially through the reconstruction efforts and public investment, diversification could move to a practical strategy for a long-term sustainable growth. In addition, developing the existing agricultural products such as pomegranate in niche markets and cotton in general market might also yield some results. Many initiatives such as increasing subsidies for non-oil sector, support for small and medium enterprises by KOBIA (the government agency of development of SMEs) in a form of grants, identifying the potential for possible alternative energy production by attracting FDIs are implemented. Alongside, the main concern is how to build new transition bridge to non-oil driving economic activities bypassing the macro volatility, because while some initiatives are underway, the past failures to meet own targets like set in “Azerbaijan 2020” raise concerns over whether the diversification is real or merely symbolic. Thus, the need for a long-term development strategy rooted in comparative advantage and local economic empowerment is unavoidable. The current growth model, shaped by state capitalism and containing the features of administrative Keynesian regime, has mostly relied on oil-backed public spending while ignoring the urge of enabling sustainable and inclusive economic development.

Conclusion

Concluding, the development of Azerbaijan's economic growth model from a political economy perspective, focusing on the role of historical dependency on natural resources revenues, state institutions, and components of aggregate demand in shaping the trajectory of economic development were explored in the paper. The study tested the argument of Azerbaijan following a hybrid model combining features of administrative Keynesianism and state capitalism, because conventional neoclassical frameworks did not seem to be sufficient to explain such unique economy. As it was argued in the literature by Taylor et al. (2016) and Tesfatsion (2024) models that assume competitive markets and efficient allocation fail to account for the institutional and political drivers central to economies like Azerbaijan in this case. Elaborating on Baccaro & Pontusson's (2015) growth models framework, the study demonstrated that Azerbaijan's economic path is not driven by market-led productivity gains but rather by state-managed redistribution and investment, funded largely by oil revenues. The administrative Keynesian aspect can be visible in the heavy reliance on government consumption, employment, and fiscal transfers to sustain domestic demand. Simultaneously, elements of state capitalism are evident in the dominance of state-owned enterprises, elite control over strategic sectors, and central planning.

The analysis identified six phases of political and economic development from 1991 to post-Covid period. The oil boom years enabled rapid economic growth through export revenues and public spending, yet this did not translate into structural changes. The post 2015 crisis period revealed the weaknesses of the model, particularly its dependence on fluctuations of global oil prices and SOFAZ transfers to stabilize the economy. Despite declared diversification goals, the structure of export basket, employment, and investment remains narrowly based and politically centralized. The empirical evidences support these conclusions, such that the analysis of sectoral contributions to GDP and employment proved that sectors with high growth like oil and gas are capital-intensive, while state-financed services like education, health and trade are the main employers. The combined results derived from export data and the Product Space map showed that hydrocarbon products dominate, while non-oil exports contribute marginally and are concentrated in a few primary goods and partner countries. This indicates a low level of economic complexity with limited growth toward higher-value production.

The view of Hassel et al. (2020) that growth regimes depend on how institutions shape production, labor markets, and demand align with results of the findings. The case of Azerbaijan illustrated how elite-driven strategies can sustain growth temporarily but also limit long-term institutional development. As was stated by Ahmadov (2023) and Robinson (2013), political control over the key sectors may lead to limited reforms, competition, and innovation, thus making the current model vulnerable to external shocks.

The research has several limitations, such as focusing primarily on macroeconomic patterns, institutional arrangements, and sectoral trends and not incorporating econometric modeling or exploring micro-level effects like household income distribution, informality, or regional disparities. Future studies may explore firm-level data or conduct comparative analysis with other post-socialist or resource-rich economies to identify more generalizable patterns and suggest diversification policies.

Overall, Azerbaijan can be considered as an interesting case for the political economy literature on growth regimes. It showcases how short-term economic stability can be achieved by states through centralized control. At the same time, it also shows how long-term transformations require deeper institutional restructuring, private sector development, and shift from rent-based redistribution. Understanding such hybrid regimes helps identifying the gap between macroeconomic analysis and the political foundations of development, especially in transnational and resource-dependent economies.

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