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**The cost of Azerbaijan's leaving the
Extractive Industries Transparency Initiative
(EITI):**

**Analysis of
the impact on the economy and civil society**

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Introduction

On March 9, Azerbaijan's membership in the Extractive Industries Transparency Initiative (EITI) was suspended, during the 36th EITI Board Meeting held in Bogota, Colombia.

Following the decision on the suspension, Shahmar Movsumov, executive director of the State Oil Fund of Azerbaijan (SOFAZ), chairman of the government commission on EITI and chairman of the EITI Multi-stakeholder Group, made an official announcement on Azerbaijan's leaving the EITI: "I kindly ask the International Secretariat to remove Azerbaijan from the list of countries implementing the EITI immediately" (Contact.az, 2017).

In his statement, Mr. Shahmar Movsumov explained the steps taken by the government of Azerbaijan to eliminate the gap between domestic legislature and EITI policies, and thereby minimize the disagreement between the Azerbaijani government and the EITI Board. He mentioned his belief that as a result of significant changes to current NGO regulations, Azerbaijan was able to accomplish the implementation of all the corrective actions required by the EITI Board since the previous evaluations of the NGO environment in Azerbaijan, stating: "We consider the Board's decision on the suspension of Azerbaijan as an unfair one. The mandate of the EITI has been shifted significantly far from transparency and accountability in extractive sectors. The irrelevant facts introduced by different advocacy groups on various occasions show that the Initiative failed to stick to its original mission and objectives". (Azernews.az, 2017)

Azerbaijan's membership in the EITI is considered a key asset to the country's oil and natural gas economy. As a result of leaving the EITI, Azerbaijan might be regarded as ineligible for future loans by the World Bank and other international institutions for projects, such as the Southern Gas Corridor Project (TAP&TANAP).

It is quite an important decision for the country, which was a founding member of the initiative, to leave it. It is going to have considerable effects on the economy and civil society in Azerbaijan.

This article aims to shed light on the possible domestic developments of Azerbaijan's suspension of the EITI.

In the beginning, essential information on the Extractive Industries Transparency Initiative (EITI) and its role in Azerbaijan's economy will be presented. Next, the article will move on to the history of Azerbaijan-EITI relations. After exposing the current tense situation between the parties and explaining the reasons for the tension, the article will move on to possible impacts of the decision to leave EITI on the economy and civil society in Azerbaijan. In the final section, concluding thoughts will be provided.

1. Extractive Industries Transparency Initiative (EITI): a Transparency Brand

In 2003, a coalition of representatives from civil society organizations (SCOs), governments and energy and mining companies agreed on a set of principles relating to increased transparency and accountability in resource rich countries, which became known as the Extractive Industry Transparency Initiative (EITI). The EITI is a voluntary global standard to promote the open and accountable management of oil, gas and mineral resources (EITI). There are currently 51 implementing countries, including developing as well as developed countries. The most basic requirements are that companies operating in the extractive industries sector report their payments to the host government and governments separately report all the revenue they receive. The two figures are then compared by an independent administrator and the findings, including any reporting gaps, are then published, giving civil society access to the results.

EITI fosters an alliance among several stakeholders in a country's extractive industries sector, including those representing businesses, civil society and the government, through the creation of an oversight mechanism referred to as a multi-stakeholder group (MSG). The idea that NGOs and other civil society organizations should freely and actively participate in the process reinforces the understanding that, while resources belong to the country as a whole, including all of its citizens, the revenues making up their sale should be equally shared and channeled into the better development of the entire local population. In this way, the EITI increases public access to information in order to hold governments more accountable for the management of resource revenues, lowering the opportunities for corruption and better mobilizing funds for service provision and increased development. In the past, EITI reports have helped uncover financial irregularities and have provided important insights for reform efforts in the oil, gas, and mining sectors (World Bank, 2013).

Companies see value in the EITI because it creates a more broadly supportive and secure operating environment for businesses (Forbes, 2014). The process undergone by EITI countries allows for companies to build trust in local stakeholders, including government officials. Increased transparency and government accountability not only allows the country to bolster its reputation as a stable destination for foreign direct investment, but also allows opportunities for companies to be recognized for their contributions to the local populations' development (Forbes, 2014). Extractive industries are oftentimes the largest generators of foreign exchange and government revenues for developing countries, making it not only lucrative but also necessary for governments to showcase themselves as stable and trustworthy partners.

2. History of Azerbaijan-EITI Relations and Recent Developments

Azerbaijan was an initial avid participant in the EITI process, joining in 2003 and becoming the first country to complete the Validation process, the independent mechanism used by the EITI to establish a country's adherence to the initiative's principles, and was the first to be designated as an EITI Compliant Country. Azerbaijan kept up its laudable performance and was awarded the "2009 EITI Award" for its commitment to EITI principles and achievements in EITI implementation (EITI-Azerbaijan, 2009).

In 2013, the government made several changes to its legislation relating to SCOs, with additional changes following in 2014. In total, 26 changes were made, including those pertaining to the registration and foreign funding of SCOs (Contact.az, 2016). Due to reports of widespread curtailment of SCOs in Azerbaijan, the EITI Board sent a fact-finding mission to the country in September 2014, in order to independently assess the situation. It was deemed that conditions for activists were "clearly problematic" and reason for concern (Sherpa, 2015). Concurrently, in December 2014, the International Board of EITI approved a new Civil Society Protocol, which was added as part of the initiative's rules for membership, referred to as the EITI Standard. In view of the aforementioned change in standards and the known problematic relationship between SCOs and the government in Azerbaijan, the EITI Board called for an early Validation of Azerbaijan's status relative to the new rules. As such, on account of concerns that Azerbaijan was violating EITI rules, its status was downgraded from 'compliant' to 'candidate' in April 2015, adding that although there was some progress in addressing the initiative's concerns, it was still felt that civil society was not able to engage critically in the country's EITI process (EITI, 2015). Along with its downgraded status, the Azerbaijani government was given a list of corrective actions needed to restore its status.

Several months later, in October 2016, the EITI Board released its reassessment of Azerbaijan's Validation; namely, there were considerable improvements in several areas of concern compared to the first Validation in 2015, allowing Azerbaijan to keep its candidate status (EITI, 2015). However, the Board agreed that several requirements, including those relating to civil society engagement, had not been satisfactorily addressed and would need to be corrected within 4 months, or else the country would be suspended (EITI, 2015). A decision was reached in Baku on March 10, 2017, with authorities announcing their decision to withdraw from the EITI. The decision comes almost simultaneously to those of the Board, which would have announced Azerbaijan's suspension in the initiative (Financial Times, 2017).

3. EITI in Azerbaijan: Future Developments

Several organizations that are active in Azerbaijan are part of the EITI, including BP, the World Bank and the European Bank for Reconstruction and Development. The decision to withdraw from the initiative, rather than make the appropriate changes to the laws governing SCOs, throws into doubt the status of several current and future loan agreements, including \$46 bn for the construction of the Southern Gas Corridor pipeline (Financial Times, 2017).

Nevertheless, this is not the only area where Azerbaijan's leaving the EITI may have direct effects on domestic developments, there are several areas outlined below, which may be impacted by this change.

3.1. The EITI membership and international financial institution.

In general, the fossil fuel and other extractive industry sectors are considered to be strongly interlinked with illegitimate financial flows. The well-known 'resource curse' paradox creates the basis for understanding how countries with an abundance of natural resources have a large spectrum of the problems, which could very easily be solved with the better management of revenues from extractive industries.

Along these lines, one of the core roles of the EITI is to encourage the establishment of transparent means to acquire legitimate financial sources for extractive industries and to create sustainable economic development – a corruption free environment with good governance.

Being a founding member of the EITI, the NGO coalition of Azerbaijan has indicated its commitment to transparency and sustainable development, which has made Azerbaijan attractive for foreign investment and granted it approval by international financial institutions.

Azerbaijan quitting the EITI is going to harm the country's image, particularly in the context of attracting investment to the fossil-fuel and other sectors of the country.

So far, EITI membership was one of the key elements in the relationship between Azerbaijan and the World Bank (WB) and the European Bank for Reconstruction and Development (EBRD).

EITI membership also made it is easier for transnational companies such as British Petroleum (BP) to operate and invest in Azerbaijan. The presence of strong, domestic pressure groups in the governments and societies of other countries is going to make it hard for transnational companies, such as those from the United Kingdom, to operate in Azerbaijan. BP has already expressed its disappointment with the "decision to suspend Azerbaijan despite the progress that has been made and highlighted by the EITI Board statement" (Financial Times, 2017). BP also expressed its regret

at Azerbaijan's decision to leave the EITI, stating, "We believe the Board decision and consequences are not in anyone's interests." (Financial Times, 2017)

The World Bank, on the other hand, declared the continuation of its support for Azerbaijan, "in its on-going effort to develop a clear, inclusive and transparent framework for revenue management and overall transparency in the extractives industry". Yet, it has not been made clear if there will be financial assistance provided for the country's future infrastructure projects, such as the Southern Gas Corridor Project.

The Southern Gas Corridor is a 3500 km pipeline system meant to expand the existing South Caucasus Pipeline running through Azerbaijan, and continue to Georgia, Turkey, Greece, Albania and Italy, carrying natural gas from the Shah Deniz field to Southern Europe. The project has been termed the "global oil and gas industry's most significant and ambitious undertaking yet," by BP (BP-Azerbaijan). Initially, gas flows along this route are expected to be around 10 bcm, but within a few years they are expected to expand to 80 bcm or even 100 bcm (European Commission). Not only international businesses and financial institutions, but also the government of Azerbaijan itself has been investing heavily in the infrastructure project, with the State Oil Fund of Azerbaijan (SOFAZ) allocating more than \$1.23 billion to the project between the years 2014 and 2016 (Azvision.az, 2017).

The project is an important opportunity for Azerbaijan to amplify its energy exports to the EU and Southern Europe, while not only the countries currently part of the pipeline consortium, but also Croatia, Bosnia and Herzegovina, Bulgaria and others have voiced their desire to join this project. The project is meant to diversify the European energy market away from Russian dependence, and provides Azerbaijan with an additional, stable, export path. At present, the stakeholders involved in the Southern Gas Corridor have voiced their dismay at the Board's decision and Azerbaijan's withdrawal from the initiative, but have stressed their continued support for the country and belief it continues to surpass the organizations' own internal principles (Financial Times, 2016).

While Azerbaijan is keen to realize the Southern Gas Corridor Project, if international financiers would change their minds on funding the project, the lack of foreign investment would lead to the depletion of SOFAZ assets, which were accumulated and reserved for future generations.

In addition, lack of foreign direct investment is also going to affect the overall economy of the country. Currently, following the dive in oil prices in the world market, Azerbaijan critically needs investment in the economy. The lack of the interest on the part of international donors could lead to greater disturbances in the economy and hence in the public agenda of the country. This development would also slow down the country's current economic reforms.

3.2. The internal dynamics of the EITI Azerbaijan NGO Coalition

Following the last elections in the EITI Azerbaijan NGO Coalition in April 2016, tensions were raised over the influence of different interest groups.

The NGO landscape in Azerbaijan is quite diverse, including such groupings as:

- 1- Ones, which are camped around governmental institutions
- 2- Ones, which are camped around oppositional institutions
- 3- Independent NGOs.

The members of each group are represented in the EITI NGO Coalition, which lead to the ongoing clashes. Low representation of independent NGOs in the Board, which has been the case in previous years, was also one of the reasons why the EITI NGO Coalition failed to properly function in Azerbaijan.

The existing trends within the EITI Azerbaijan NGO Coalition have been causing concern even before the Azerbaijani government decided to leave the EITI. Many independent experts were expecting the crisis to deepen and the Coalition to fail in its functioning. Many of the new members of the Coalition's Board, who gained support in the last election, do not have adequate experience or qualifications regarding extractive industries and the overall economy of the country. The Azerbaijani case clearly demonstrates how the lack of a strong voice of independent and qualified civil society members can lead to the disruption of the entire Coalition process.

3.3. The reversible trends in the relations of the Government and Civil Society in Azerbaijan

Following the April 2015 Validation by EITI and the downgraded status of Azerbaijan from 'compliant' to 'candidate', the government has made several steps to win favour among the EITI Board members.

In its October 2016 Validation, the EITI Board did not find the developments within the country satisfactory and required full freedom for civil society, so that NGOs could be fully functional and properly keep the government accountable for its oil & gas revenues and expenditures. Moreover, it was announced that if the EITI Board's ultimatum on amending the restrictions on NGOs before the next meeting (March 2017) was not fulfilled, Azerbaijan's EITI membership would be suspended.

The speed of reforms in Azerbaijan did not match the expectations of the EITI Board; hence, Azerbaijan's membership was suspended. The following day, Shahmar Movsumov, executive director of SOFAZ, chairman of the government commission on EITI and chairman of the EITI Multi-stakeholder Group, announced the cessation of Azerbaijan's activities in the initiative.

With its 2014 independent fact-finding mission and the following Validations, the EITI could have changed the current trends in government-civil society relations in Azerbaijan. The current concern is whether Azerbaijan is capable of making another ‘U-turn’ without external motivation, such as retaining its membership in international initiatives such as the EITI.

In this regard, not expecting a ‘U-turn’ in the short term, the current EU-Azerbaijan rapprochement is going to be decisive for the long-term relations between the government and NGOs. President Ilham Aliyev’s visit to Brussels in February 2017, and subsequent meetings with high-ranking officials of EU, has demonstrated the willingness of both parties to bridge the distance between them. The EU’s active guidance in this area can have positive effects on civil society in the country.

3.4. The reputational cost for the country and the members of the government

The Extractive Industries Transparency Initiative (EITI) membership of Azerbaijan had a positive impact on the reputation of the country and the members of government. Providing the image of being a sustainable and trustworthy partner, EITI membership was a powerful asset to avoid accusations of corruption and the mismanagement of oil money. In this regard, SOFAZ has done a distinguished job in managing resource revenues, celebrated by the 2009 ‘EITI Award’ for its commitment to EITI principles and achievements in implementation of the Initiative’s goals.

With Azerbaijan’s revoking of EITI membership, it loses its protective shield against accusations of corruption and bribery. Now, the international business activities of members of government may be viewed as more suspicious, and they may be accused of money laundering or the general mismanagement of fossil fuel revenues, even though they are embarking on legitimate financial activities.

This development may also harm the standing of Azerbaijan in the Corruption Perceptions Index of Azerbaijan by 'Transparency International' and the Civil Society Index of Azerbaijan by CIVICUS.

Conclusion

As a founding member of EITI, Azerbaijan has enjoyed the benefits of its membership in the organisation. However, the changes to NGO legislature in Azerbaijan have strained the relations between the parties, and in order to have a fully functional local NGO community, the EITI has demanded the reversal of changes to the NGO legislation in the country. Due to the lack of adequate developments in this field, according to EITI standards, the EITI Board suspended the membership of Azerbaijan. Following the decision, Azerbaijan announced its intention to leave the Initiative.

Azerbaijan's revoking EITI membership is expected to have a negative effect on the economy of Azerbaijan. It will make the economy of the country less attractive for foreign investment, which is vital for economic reforms in Azerbaijan, and it will limit the government's options for advancing its ambitious infrastructure plans, such as those regarding the Southern Gas Corridor Project (TAP&TANAP).

Exiting the EITI may also have negative effects on the environment of civil society in Azerbaijan. Additionally, the current positive situation in EU-Azerbaijani relations raises hopes for the avoidance of any negative effects on civil society in Azerbaijan, despite leaving the EITI.

Nevertheless, considering the importance of the Southern Gas Corridor Project (TAP&TANAP) for the European gas market, the government of Azerbaijan may expect that European and international investments in this project will remain actual.

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