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Center for Economic and Social Development

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ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

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Content

PREFACE	6
INTRODUCTION	8
STUDY 1: How Effectively Oil Revenues are used in Azerbaijan?	9
STUDY 2: Can Oil Wealth Cause Corruption in Azerbaijan?	19
Foreword	19
Introduction	20
Oil Sector Development: Opportunities and Risks	22
The Problem	25
Problem Severity	28
Alternative Strategies	31
The Budget or the Fund	31
Saving or stabilisation	33
Saving or investments	35
How much liquidity	36
Investing abroad or home	37
Corporate equity or bonds and T-bills	37
How much risk	37
Other issues of investment decisions	38
Conclusions	38
Recommendations	39
STUDY 3: Missed Oil Money	42
STUDY 4: Anti-corruption Initiatives in Oil Sector: Do Civil Society Organizations Matter?	49
Foreword	49
Building Political Will to Enhance Transparency and Curb Corruption in Oil Sector: Lessons from Azerbaijan	49
Endnotes	54
Conclusion	54
REFERENCES	56
ANNEX 1: Survey Questionnaires	58

PREFACE

Azerbaijan is free to run its economy since the collapse of Soviet Union. The soviet legacy, however, does not provide strong institutional and legal framework and traditions for public expenditure management, policy formulation and participation for accountability. The recent flush of oil money, being accompanied with early formulations of these elements of modern state, provides the economy therefore not only with opportunities but also with risks.

Exporting the oil does not necessarily make the overall society richer than before, but simply turns the non-liquid assets into cash. Cashing the all generations' reserves should also put a heavy duty on the current generation with a heavy emphasis on efficient and transparent administration of public resources. The risk is that oil money if not well administered, does not fully benefit the economy; it may get partially lost due to inefficiencies in the system and management, or may even be harmful for the sustainable development of the economy and society. This is a well-known phenomenon with developing countries rich of oil resources, and there is a rich vocabulary, including "the resource curse", "Dutch Disease", "the paradox of plenty" and other notorious terms recently coined by economists and other social scientists to denote the possible hazardous effects from oil money in the economy. There are many ways of how the oil money can destabilize the economy, and can be described using economic theories. Many remedies however fail, or cannot be implemented at all, due to the lack of institutional capacity, traditions of bottom-up control and system of checks and balances. The legacy of centralized economy does not help much develop these important prerequisites of reforming the public resource management.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

The oil, however, gets extracted and exported meanwhile, making the attention on this bottleneck of development not only important, but also urgent. The political and societal dimensions of development should therefore get the earliest and utmost attention of both the government and the public in large. The oil economy, on the other hand, may encourage the rent-seeking behavior, that cause difficulties for political and societal reforms, and link therefore the vicious cycle. The way out can be the government's and overall citizens' appreciation the finite life expectancy of oil revenues, and collaboration to prepare and implement multidimensional remedy plan that would include developing strategy, awareness, participation, legal basis and institutional capacity and framework. This can be the sure way towards the practices of using the oil money responsibly and effectively, to ensure so that this wealth provides lasting benefit to social welfare and security, economic growth, and overall quality of life. This would help the development of platform where the government and overall citizens present mutual interests to ensure that the oil money is managed in a most efficient way, and the used of it address high priority needs and are highly integrated and sustainable.

Elchin Rashid

INTRODUCTION

Hydrocarbon revenues dominate the economy of Azerbaijan since the past few years, and keep still growing, while the non-oil sector of the economy remains undeveloped and fragile. For example, Azerbaijan has experienced two-digit real GDP growth during the past few years, mainly due to the oil sector development, while its share in total employment is only 2% of the total employment, but the growth in the agriculture sector, which accounts 40% of total employment remains around 1%. Moreover, the oil revenues affect the fiscal structure and relations within the state and make the government more prone to rent-seeking behavior. For example, the investment expenditures of the government have increased by almost 1000% during the 2003-2007 years. But this increase has not been accompanied by an improvement in efficiency and transparency of investment planning and implementing processes.

The economy of Azerbaijan now faces serious challenges. The rapid influx of petrodollars far surpasses the institutional capacity of the implementing agencies and absorptive capacity of the economy. There are many problems resulting from past policy errors, soviet legacy in public resource management and little transparency and participation. There are many legacy processes in the current system that result in inefficient use of resources and allow corrupt practices to develop. There is an overt manifestation of inflation and of the challenges for the non-hydrocarbon export capacity at the same time. The fleeting nature of the hydrocarbon wealth is another reason to raise an alarm to expedite getting engaged in reform processes.

Many officials recognize the need for reforms, yet the changes are slow and ineffective. It is essential that the government and the public in general receive the information from different perspectives on how the economy functions and what are the tendencies

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

to get timely involved to save the economy and ensure the sustainable social development. This book is developed therefore to raise the awareness and introduce policy perspectives on effective use of oil management. The book presents four studies....

The first study encompasses the survey was conducted within the framework of "Monitoring of State Oil Fund of Azerbaijan Republic" Project with funding of The Partnership for Transparency (PTF). The aim of the survey at determining on level of public awareness on usage of oil revenues and becoming familiar with attitude of both government bodies and companies.

The second case study serves as a vivid example to demonstrate the problems with transparency issues in the management of State Oil Fund of Azerbaijan Republic (SOFAR) and of overall oil revenues. SOFAR is the fund where Azerbaijan accumulates oil revenues. The monitoring revealed some problems within the Fund's management, mainly the transparency issues.

The third study revealed that by doing so, as much as \$50mln had been misappropriated in a year alone. Once the price of houses constructed within the project was compared with the market price, it was evident that the houses had been artificially overpriced. And another problem is substandard work during the construction process thus aiming to consume few funds, but overprice the project.

The aim of the last study was to construct an analytical space for analyzing the way in which civil society, understood here in terms of the NGO sector, can play a positive role in assuring transparency in usage of oil revenues in Azerbaijan. Azerbaijan is getting daily \$ 40 million from oil sale now and the amount is expected to reach \$ 60 million by the end of 2009. It means the country with 8 million populations will get about \$ 30 billion money each year only from oil sale. The figures confirm that very important job now is to create political will to work toward enhancing of transparency in oil usage.

STUDY 1: How Effectively Oil Revenues are used in Azerbaijan?

About 81 percent of respondents interviewed point to ineffective use of oil revenues and lack of transparency over the revenues

Center for Economic and Social Development (CESD), Azerbaijan conducted survey among government bodies, oil companies and population within the framework of Monitoring of State Oil Fund of Azerbaijan Republic Project with funding of Partnership for Transparency (PTF)

About the country

Azerbaijan is located in the South Caucasus region, bordering the Caspian Sea, between Iran and Russia, with a small European portion north of the Caucasus range. It is also bordering Georgia and Armenia.

The rapid increase in oil production resulted in Azerbaijan's economy posting its fifth consecutive year of double-digit growth in 2006. Gross domestic product (GDP) expanded by a record 34.5% in real terms, the world's highest growth rate for the second year running. By far, the greatest engine of growth has been the industrial sector, in which value added was up by just over 56%, bringing cumulative growth in 2005-2006 to almost 150%. Within the industry sector, it is the oil and gas sector that is driving the growth. The non-oil economy is still growing strongly, expanding by 11.2% in 2006, but its contribution to GDP is falling as the oil economy expands. Non-oil sectors provided 47% of nominal GDP in 2006, down from 58% a year earlier and 61%

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

in 2004. The medium-term outlook for the economy of Azerbaijan is positive. GDP growth is expected to continue posting high double-digit growth over the next few years, mainly from increased oil and gas production and exports. Foreign investment is expected to decline over time as the major oil and gas projects move toward less intensive stages. However, the Government of Azerbaijan expects increased domestic public investment to offset some of this decline. Government expenditure rose by over 80% in 2006 and is projected to rise by a further 50% in 2007, which puts considerable pressure on inflation. In the long term, Azerbaijan's high dependence on oil exports poses a potential threat to the economy given the potential volatility in the international oil market.

Azerbaijan, the former Soviet republic, is increasing its importance thanks to the rich oil revenues in the country. Oil sector made up 60 % of the GDP in 2007. Azerbaijan's oil production to reach 450 million barrels in 2008. Revenues of the State Oil Fund of Azerbaijan will make up \$4,3 billion, however, due to increasing of oil price in the world market, the revenue are forecasted to



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



reach \$ 8 billion. Beside that, Azerbaijan State Budget receives \$ 6 billion from oil sale in 2008. More than \$ 25 billion are forecasted to be received from oil sale next year.

Azerbaijan is rich in mineral resources, mainly oil and gas. Our country is in the midst of an oil boom brought on by the development of its vast hydrocarbon resources in the Caspian Sea region. Oil

revenues are expected to peak in 2011. The country's oil and gas revenues are forecasted to be \$200 billion until 2024. The State Oil Fund of Azerbaijan (SOFAZ), created to invest the revenues garnered from the country's extensive oil reserves, is predicted to explode to over \$50 billion by 2010. Budget revenues of SOFAZ as at April 1, 2008 has reached \$6.1 billion, with assets standing at \$3.35 billion. That is to say, over half of SOFAZ funds are already spent. Azerbaijan also expects to boost natural gas production and export starting from 2010. The country has proven natural gas reserves of roughly 2 trillion cubic meters. So, in near-and medium-term perspective, oil and gas revenues will be averaged at 10 billions of dollars.

All this engineers and instigates the Government to initiate a policy how to spend petrodollars fast enough. The Economy Development Ministry has said the government spending from all the sources in the country for 2008-2011 (2008-2011 State Investment Program) is predicted to be AZN 15.6 billion (over

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

\$17 billion). Not only has aggravated too fast spending of the oil revenues the negative impact on the country's economy, but also has led to disbalance of inter-generation fairness in distributing oil revenues. Therefore, the economic and political reforms have lagged: instead, pseudo-institutions have been instituted in the guise of reforms.

Consequently, the domestic economy has seen the following negative tendencies:

- *The economy now strongly depends on one resource - oil, and the oil sector's contribution to Azerbaijan's GDP was 55% in 2007;*

- *Sharp changes in oil prices and oil revenues due to non-flexible demand for oil and fluctuating supply have caused Azerbaijan's economic situation and policy to remain reliance on global oil market stability;*

- *Because of sharp demand for investment dollars and technologies at the time of oil industry's establishment, the transnational corporations have been vested with full powers for payment and management issues;*

- *The oil industry usually accounts for 1-2 percent of the total labor resources, thus restricting employment opportunities, leading to sharp increase in unemployment and poverty;*

- *The oil sector employing high-qualified labor resources has appropriated and monopolized the most productive part of human capital;*

- *Reliance on depleted resources, oil in particular, hastens the Government to open the way for investment in mega-projects that are distinguished by low profitability;*

- *Instead of reduction, the number of red-tapes has mushroomed, state management expenditures have increased. Since public office expenditures financed out of 2008 State Budget grew*

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

46%, compared to 2007.

- *Transparency and accountability in the oil sector and public financial management has trended downward in comparison with other sectors of the economy.*

- *As State Budget is mainly based on oil sector, individual taxpayers are not duly traced, leading to indifference, civics stagnation.*

Foreword

The survey was conducted within the framework of "Monitoring of State Oil Fund of Azerbaijan Republic" Project with funding of The Partnership for Transparency (PTF). The aim of the survey at determining on level of public awareness on usage of oil revenues and becoming familiar with attitude of both government bodies and companies.

Results from the interviewing and questioning processes that affected government-linked entities, major oil companies, and population groups have been completely different from each other. Since 70 percent of respondents employed by government-linked institutions claimed that the citizens had an adequate access to information about how their government utilized oil revenues, yet 82 percent of citizens interviewed said they had no idea about revenue and spending from the state oil fund (SOFAZ). It is also regrettable that there were discrepancies between the government-linked entities and citizens interviewed regarding an approach to use of oil revenues. Unlike the government entities impacted by the survey, the majority of surveyed people were doubtful about effective utilization of and transparency over oil revenues. At the same time, there were different approaches to transparency in the extractive industries voiced by both government structures and extractive companies. Most of the companies

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

interviewed said they did not cooperate with civil society organizations, stressing there was no need for such cooperation. The government entities interviewed also said they just preferred cooperation with media outlets to such civil society institutions. Although all of government bodies interviews claimed about effective use of and transparency over oil revenues, 81 percent of surveyed people responded ice-versa. None of oil-producing companies interviewed obtained complete information on the targeted/correct use of funds they had paid to the government. Moreover, all of the public sector entities impacted by the survey supported the idea of regular reporting to a wide audience in a publicly accessible and comprehensible manner. Although they said all the projects were through monitoring and auditing, the interviewing of common people revealed lack of such reporting. Only 25 percent of companies' representatives interviewed in survey said they timely disclosed audit results to the public. The survey showed that the public access to audit results in terms of activities of either foreign oil companies or government-initiated projects was limited. Some 83 percent of respondents said they had not obtained information about SOFAZ's annual reports, yet the fact that 12 percent used the Internet as a database was a tremendous attention. 34 percent of public sector entities impacted by the survey assessed the activity of foreign extractive companies as 'transparent'. Much noteworthy is that the three groups interviewed had different approaches regarding the transparency.

In response to the question "Do the companies impacted by the survey encounter any cases of corruption in their activity in



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Azerbaijan", 75 percent of respondents found it difficult to answer the question and replied "Unsure". What deserves special attention was the company respondents' prudent answer to some important issues asked during the survey. Since they hesitated, responding to the questions. The survey results revealed three different approaches: everything is normal, it is difficult to assess the situation and everything is not so good.

I. About 70 percent of public sector entities impacted by the survey claimed the public had obtained adequate information about oil revenues

The aim of the survey conducted among government bodies at studying attitude of state official on usage of oil revenues and determining of transparency level of oil revenues. Survey questionnaires have been sent to 9 government bodies and 6 of them have responded to the CESD. 2 of them, however, did not respond questions.

In response to the question "How do you assess the level of transparency over oil revenues", all respondents from government entities replied "There is full transparency over oil revenue expenditures". The items "There is partly transparency over oil revenue expenditures", "There is no transparency over oil revenue expenditures", "I find it difficult to answer" were evaded by all the entities in fact.

In response to the question "Are you interested in making broader information on your activity to the public", all government entities responded "Positively". They claimed they reported to the public. Regarding the level of relations between the government entities and the public, the survey showed that there was a public relations department at each entity.

In response to the question "Have you designed internal normative documents on public availability of information", all

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

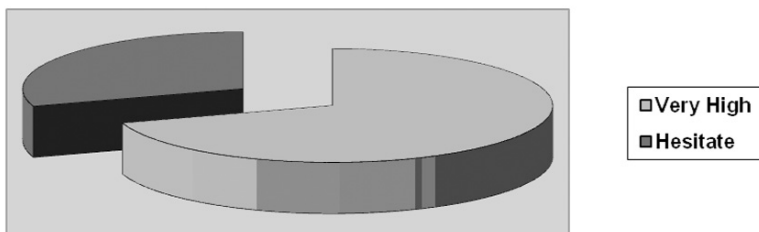
government entities responded "Positively". To them they had designed such normative documents on public availability of information.

In response to the question "Has your company joined the Extractive Industries Transparency Initiative (EITI)", 33.3 percent of those interviewed replied "Positively", while another 33.3 percent were unaware of the information on the campaign. The rest had difficulty to express a position. All of the companies impacted by the survey saw it inexpedient not to join the campaign.

In response to the question "How do you assess the activity of extractive companies", 33.3 percent of those interviewed replied "Completely transparently". The rest had difficulty to express a position. None of the entities replied to the questions "Partly" and "Their activity is not transparent".

In response to the question "What is the level of publicly accessibility on oil revenues", 70 percent replied "Highly", while The rest had difficulty to express a position. The questions "The public are passive", "The public accessibility is low" were evaded.

What is the level of publicly accessibility on oil revenues; respondents from the government



Those interviewed who gave a positive response to the question "Does your organization implement activity with SOFAZ

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

funding", indicated "The activity is directly monitored" while responding to the question "What methods are used in implementing SOFAZ-funded projects". Other answers to the question included "Civil society institutions have been involved in the process", "No monitoring methods are used", "I have difficulty to express a position".

In response to the question "Are the expenditures audited by an independent audit company", all government entities responded "Positively". Similarly, they also responded "Positively" to the question "Are SOFAZ-financed projects implemented through tender". Other answers included "No", "There is no need to issue tender", "I have difficulty to express a position".

In response to the question "If tender announced, how do the public access the information", all of the respondents indicated that the public obtained information through the media. As to the question "Has SOFAZ arranged auditing of projects it financed", the answer was "SOFAZ has requested an audit company to audit projects it financed".

In response to the question "What is the level of relationship with the Oil Fund during the project implementation", all of respondents replied that SOFAZ were regularly reported. Other answers were "Once the fund allocated, SOFAZ is not contacted", "SOFAZ is not interested in projects it finances", "I have difficulty to express a position".

Summary

Results of the survey held amongst government agencies showed that state officials were sure of efficient and transparent spending of oil revenues. Thus, all governmental agencies involved in the survey were sure of fully transparent spending of oil monies. Of the state organizations involved in the survey, 33.3 per cent joined the Extractive Industry Transparency Initiative

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

(EITI). All state structures which participated in the survey said that they conducted direct monitoring of projects implemented by them. The survey conducted amongst state organizations showed that the respondents did not unanimously approach to the importance of activities of civil society institutions in that regard. This appeared in the attitude towards the foreign oil companies. Of respondents who assessed activities of the foreign extracting companies, 33.3 per cent were sure of their fully transparent activities. The issue that 70 per cent of the state organizations involved in the survey said respondents had detailed information about oil revenues testified government's optimism in public awareness. There were many state organizations and respondents who thought that the society did not obtain information on spending of oil revenues.

II. None of interviewed companies can obtain detailed information on spending of their payments to government

Azerbaijan has signed 26 contracts with 30 companies from 15 countries since 1994. The aim of the survey is at determining attitude of both foreign and domestic companies on transparency in oil sector. Survey questionnaires have been sent to 15 companies and only 8 of them responded to CESD.

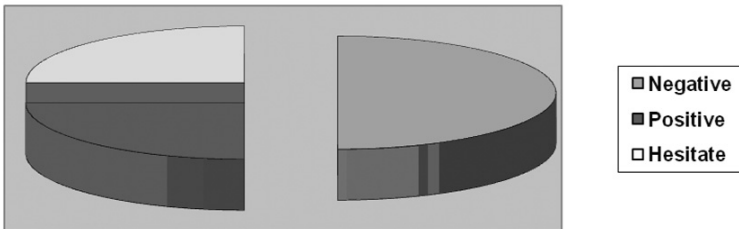
Of interviewed respondents, 25 per cent positively replied, but 75 per cent could not reply to the question "Does company have public declaration to ensure transparency of its operations inside the country".

Of interviewed respondents, 25 per cent positively answered the question "Are the results of independent audit of company's activity in Azerbaijan made available to the public in due time?", but other 25 per cent stated that no information was publicly available. 50 per cent of respondents were in difficulty to answer the question.

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

50 per cent of respondents negatively replied to the question "Is your company interested in publicly disclosing its private reports on payments to government". Although 25 percent of respondents positively answered the question, other 25 per cent could not reply.

Is your company interested in publicly disclosing its private reports on payments to government? View of companies



Answering the question "Is information on company's revenues from PSA considered commercial secret", 50 per cent of respondents stated that they consider the information commercial secret, but 25 per cent did not consider it commercial secret. Other respondents expressed difficulty in replying to the question.

Of respondents replying to the question "Does your company make cash payments on its financial operations (excluding salary) connected with its activities in our country", 50 per cent use cash payments. 25 per cent of the respondent companies make all payments in cashless. Other 25 per cent could not answer the question. The cashless payments in those companies were less than 50 per cent of all payments.

75 per cent of respondents who answered the question 'Do your company's charter or internal normative documents contain anti-corruption norms' expressed positive attitude, but other 25 per cent faced difficulty to reply. 75 per cent of the respondent companies positively replied to the question "Are you interest-

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

ed in obtaining information on targeted spending of companies' payments to government". 25 per cent of respondents could not answer this question. No company expressed unwillingness to obtain this information.

None of respondents positively answered the question "Do you have an access to detailed information on targeted spending of payments to government". 50 per cent of respondents mentioned absence of such an access and other part expressed difficulty to answer this question. Replying the question "Do problems appear in company's relations with government or governmental agencies", all respondents highlighted absence of any problems.

75 per cent of the respondents appeared in difficulty to answer the question "Does your company face corruption connected with its activity in the country". 25 per cent of respondents said they did not face such cases.

Answering the question "What is the level of your information on Azerbaijan government's activities in ensuring transparency of oil and gas revenues", 75 per cent of respondents said they possess certain information. 25 per cent of respondents highly assessed it. Of respondents replying to the question "How do you assess government's activities in protecting transparency of oil and gas revenues", 50 per cent highly assessed this activity, but other part made intermediate assessment.

75 per cent of respondents positively replayed to the question "Do you have information on the activity of Coalition of NGOs for EITI". Of interviewed respondents, 25 per cent said they do not have any information. 50 per cent of respondents made high assessment on the question "How do you assess NGOs' activities in protecting transparency of oil revenues". 25 per cent of respondents made intermediate assessment, but other 25 per cent appeared in difficulty to answer the question.

Summary

Results of survey held amongst companies showed that attitude of companies operating in Azerbaijan towards transparency was not unanimous. First of all, a total of 25 per cent of those involved to survey said they co-operated with civil society institutions, half of respondents did not have any contact with such institutions. Totally 25 per cent of those interviewed had public declaration on ensuring transparency of the operations carried out by them inside the country. Much noteworthy is that half of the interviewed companies considered the information about their incomes from PSAs commercial secret. 25 percent of respondents in total did not consider the information commercial secret. Interesting that PSAs with limited public access were considered commercial secret not only by governmental agencies, but also oil companies. However, ensuring access of population to this information is required by the legislation. Still using cash payments by half of interviewed companies limits opportunities to follow such payments. None of companies interviewed about targeted spending of payments to government is able to obtain detailed information. And this means that there is unawareness not only amongst population, but also companies.

III. 81 per cent of interviewed residents think that oil revenues are expended ineffectively and non-transparently.

The survey held among residents is aimed at determining public awareness on expending oil revenues. For this purpose, the representatives of various layers of population were involved in survey. 80 percent of 500 respondents who participated in survey

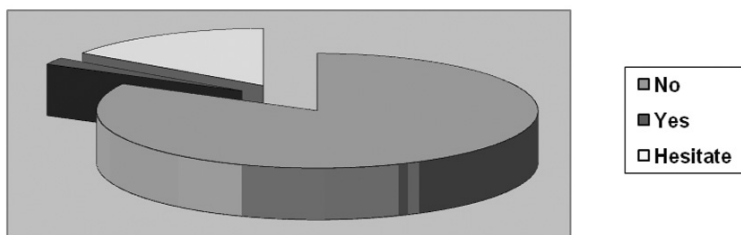
ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

is higher- and the rest secondary-educated.

54 percent of respondents involved in survey replied negatively and 29 per cent positively to the question "Are you aware of incomes of State Oil Fund?". And 17 per cent stayed in difficult to answer this question. Answering the question "Do you know how the resources of the State Oil Fund are expended", 63 per cent replied negatively and 19 per cent positively. Other 19 per cent was in difficult to answer this question.

To the question "Could you note incomes and expenses approved by the State Oil Fund for 2008", 81.43 per cent replied negatively and 2.86 per cent positively. And 15.71 per cent of respondents were in difficult to answer this question. And 51 per cent answered negatively and 21 per cent positively to the question "How do you think, does the State Oil Fund publicly disclose information on its incomes and expenses regularly". 26 percent of respondents appeared in difficulty to answer this question.

Could you note incomes and expenses approved by the State Oil Fund for 2008?



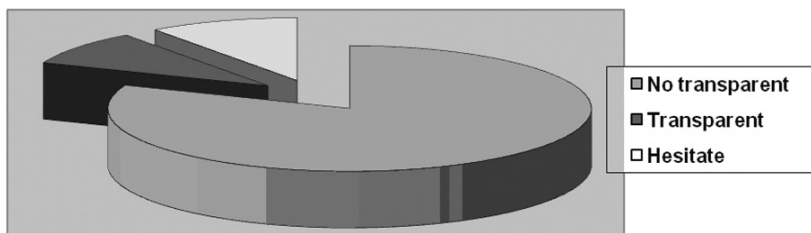
Answering the question "How do you obtain information regarding incomes and expenses of the State Oil Fund, including projects it implemented", 34 per cent of respondents replied that they did not receive such information. 24 per cent got information from internet and 23 percent from media. 19 percent of respondents stayed in difficult to answer this question.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

81 percent of the respondents answering the question "How do you think, are oil incomes expended transparently" do not think so. Those who think of transparently expending of incomes made up 9 percent of respondents. The rest 10 percent stayed in difficult to answer this question.

Only 7 percent of the respondent answering the question "How do you think, are oil incomes expended effectively" answered positively. And 81 percent of the interviewed persons thought that incomes were expended ineffectively. 11 percent of the respondents were in difficult to answer the question.

How do you think, are oil incomes expended transparently?

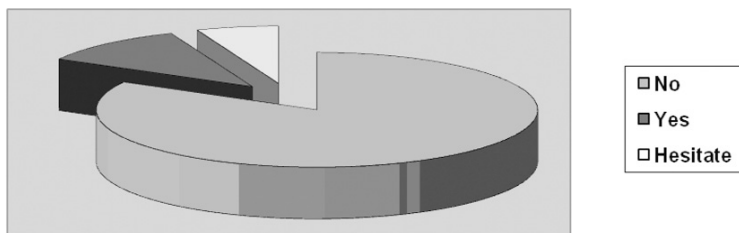


79 percent of the respondents answering the question "Are you familiar with any general, financial and other reports regarding the projects carried out at the account of resource of State Oil Fund?" said that they are not familiar with such reports. 9 percent of the interviewed persons are familiar with these reports. 13 percent of the respondents stayed in difficult to answer the question.

83 percent of the respondents answering the question "Are familiar with annual reports of State Oil Fund" answered negatively. 11 percent of respondents are aware of annual reports of the Fund. 6 percent of respondents could not make any choice. 20 percent of respondents answering the question

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Are familiar with annual reports of State Oil Fund?



"If the answer is clear, then could you inform how you got acquainted with these reports" answered they had received information from media, 12 percent got from the Internet". None of respondents informed that they got the information from bulletins of the Fund. 68 percent of respondents had difficulty to express a position.

Summary

Results of the survey impacting the population showed that they public had limited access to oil revenues, as well as SOFAZ's activity. The predominant part of respondents said they had no access to the information how oil revenues are spent. Since 19 percent of those interviewed said they had access to the information, whereas 3 percent said they had obtained information about the Fund's current revenues. However, 83 percent had no information on SOFAZ's reports. Survey results showed that public accessibility on use of oil revenues by either SOFAZ or any other government entities or agencies were inadequate, on one hand. Failure to join the educational campaigns by government entities who are only satisfied with press conferences seems to be one of the major problems, on the other hand.

Prepared by Shohlet Salimov

STUDY 2: Can Oil Wealth Cause Corruption in Azerbaijan?

Foreword

The case study serves as a vivid example to demonstrate the problems with transparency issues in the management of State Oil Fund of Azerbaijan Republic (SOFAF) and of overall oil revenues. SOFAF is the fund where Azerbaijan accumulates oil revenues. The monitoring revealed some problems within the Fund's management, mainly the transparency issues. According to the decree SOFAF has issued, it will not disclose the names of the partner financial institutions since September 2008. The justification for such decision is protection of "business secrets". However, this is a public wealth, and the issue is the management of the public wealth. Monitoring revealed the cases where the Fund's decisions cannot be financially justified. For instance, SOFAF deposited €25 million to Societe Generale Bank in France and kept it there for very short time by withdrawing money in after only 2 weeks. No explanation followed for such a step. Indeed, the Fund started cooperation with that bank in the period of its recession, when the bank was losing its assets. The annual income of Societe Generale Bank was only €0.9 billion in 2007, as opposed to €5.2 billion in 2006. SOFAF, however, refused to inform the public about getting in cooperation with this bank, and the reasons for 2-weeks operation.

Another case is that it is not now possible to identify where the \$560 million is allocated within the state budget 70% composed of oil revenues. There were some discussions in the parliament on that, but the Cabinet of Ministers still resisted to provide the public with an information. Now, under the pressure from civil soci-

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

ety organizations (CSOs), the government undertook the analysis of the issue.

The results of the monitoring demonstrates the lack of the transparency within the oil revenue management. Despite the CSOs' efforts, the public monitoring of the oil revenue management remains weak. Despite the legal requirement, the Fund does not let the CSO participation within the SOFAR's Monitoring Council. There is still no public representative within the Council, making, of course, the public monitoring of the Fund's management the most difficult. Monitoring revealed that the Fund's resistance to public representation derives from its having no interest in the public monitoring.

There are some problems with efficiency too. The Fund earned revenues only \$100 million from the management of its \$13 billion resources in 2008 year. The Fund uses arguments of avoiding high risks and refuses to provide the public with an information about low efficiency. Also, now there is no restriction for transfers from SOFAR to the state budget. As a result, the big portion of oil



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

revenues is spent in the same budget year. By now, approximately \$4 billion was transferred to the state budget. And it is estimated that more than 40% of the state budget will be formed through the transfers from SOFAR in 2009.

Another issue is linked to limitations in EITI requirements. Now, the Fund's expenditures do not get publicized through items, simply because, EITI requires only the announcement of transfers from oil companies to the government. Monitoring and researches by CESD aim to the identification of the items of these expenditures. Apart from that, there is a need for support of EITI Plus initiative in Azerbaijan.

The results of the monitoring demonstrated problems with efficient and transparent use of oil resources, and this may lead to the very early exhaustion of these resources. Fund does not apply the Norwegian model even if it states that it does. The best international practices are ignored in the Fund's management.

The researches show that the risk of inefficient and non-transparent use of oil money will persist, if the public monitoring does not get strengthened soon. The CESD project conducted with the support of Partnership for Transparency (PTF) aims to support the increase of the role of CSOs in public monitoring of SOFAR's and of overall oil resource's management.

Introduction

Our life could be different without oil. Oil affects and changes our priorities and the others' priorities concerning us. And we would run our economy differently without relying on oil resources. However, oil being a short-term resource only cannot be part of our national values and interests that are long-term, and ideally, permanent. Then there remains a room for oil for being instrumental only. Oil is short-term, but the fund is long-term, and

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



the effective management of the fund, shouldn't depend on the oil, and should behave as there is no oil at all. The experience of analogous fund in Norway (Norwegian Pension Fund) can be an example to that. Oil revenues are isolated from the society, or put in another way, the society is isolated from the oil revenues as there is no that sector. The strategy of the Oil Fund needs to be at least as efficient. That strategy must flow from the purpose and mission of the fund. If we want to ensure an intergenerational balance, or save the money for the future, then let's do it, not use for the short-term or any other non productive program and save the maximum, which should mean all the oil money at least. Why at least? Because, the fund may also generate money and that money can be partially accumulated in the fund.

Imagine, no Oil Fund, economy should still be able to stay alive, then it should be even better with the assistance coming from the fund, but we should never let the popular programs to eat

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

the seed corn too.

The main thing in the oil fund strategy can be divided into the decision of whether to transfer to the budget or not, and for the money that remains in the fund, how to invest. The principles of the modern finance can be applied to get closer to the best investment strategy. Diversity is the rule of thumb to lessen the risks: investing the oil wealth among a wide range of allocations diversified through many lines (countries, industries, businesses...) may guarantee a high return with lower risk. An index fund, where the weight for an each company invested is proportional to its market value, can be used as an instrument for diversifying. But the rule of diversifying works well only with realistic and prudent approach in every investment decision. Expert advice and some skepticism are necessary, the pitfalls and underlying risk beyond seemingly high returns need to be carefully analyzed. Neither intuition, nor the astrology can be a good advisor. By the same token, non-transparent management is likely to lead to satisfying behavior and inefficient investment decisions. For the management of a public fund, such as the Oil Fund, a methodology needs to be prepared, where the investment decisions will account not only the risks and returns from investments, but also brokerage and investment charges. Looking a better investment options are often exemplified as a trade-off between the good dinner and the good sleep. This is to say that a big number of more risky investments need to be made to increase the overall return for an investment portfolio, but then the group responsible for investments needs to have permanent control and keep the track of ups and downs to change the investment decisions in a timely manner. However, the good sleep can be guaranteed with government bonds that are often inflation indexed and have lower return and lower risks involved.

According to the State Oil Fund of Azerbaijan Republic

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

(SOFAR), the fund's assets is 8 320 mln manats (USD 10 216 mln.) in September, 2008. Following projects are financed by SOFAR;

1. Financing of the participation of the Republic of Azerbaijan in Heydar Aliyev BTC Main Export Pipeline Project (the project's financing closed in 2006) - 297,9 mln. manats

2. Settlement of the problems of refugees and internally displaced persons - conflict - 450,1 mln. manats

3. Construction of the Oguz-Qabala-Baku water supply system - 326,5 mln. manats

4. Reconstruction of the Samur-Absheron irrigation system - 176,1 mln. manats

5. Transfers to the state budget - 3400 mln. manats

6. Formation of the statutory capital of the State Investment Company (implemented in 2006) - 90 mln. manats

7. Financing "Baku-Tbilisi-Kars railway" - 23,3 mln. manats

8. Financing "The state program on the education of Azerbaijan youth abroad in the years 2007-2015" - 0,5 mln. manats

9. Repayment of State Oil Company's share in the project on joint exploration and development of Azeri, Chirag and Guneshli oilfields - 87,6 mln. manats

The 2008 budget of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) was amended by the Decree of the President of Azerbaijan dated July 11, 2008. In accordance with the Decree, taking into account that Azerbaijan will receive extra revenues from implementation of oil and gas agreements under the circumstances of high price of crude oil and in connection with amendments to the 2008 state budget, it is necessary to make amendments to the Fund's 2008 budget.

As per the Decree, the amount of revenues of the Fund from

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



sale of the Republic of Azerbaijan's share of hydrocarbons is increased to 9, 819 billion manats (\$1,2 122 billion) instead of the previous 3,473 billion mantas (\$ 4,287 billion), the amount of revenue items of the Fund on dividends from realizing of oil and gas projects (from BTC) and on management of SOFAZ's assets is increased accordingly to 10,482 billion mantas (\$ 12,941 billion). The State Oil Fund's assets are managed in accordance with the "Rules for accumula-

tion, investment and management of assets of the State Oil Fund of the Republic of Azerbaijan" (Investment Guideline) approved by Presidential Decree of June 19, 2001 and amended by Presidential Decree No. 607 dated December 12, 2001 and No. 202 dated March 1, 2005. The maximum weight of one financial institution or one investment in the investment portfolio of the Fund is set at 15% of total amount of the investment portfolio (exceptions are central banks, custodian banks and external managers).

50% of the total amount of the investment portfolio of the Fund is to be invested in assets denominated in US Dollars, 40%

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

in assets denominated in Euro, 5% in assets denominated in GBP, whereas 5% of the total amount of the investment portfolio of the Fund is to be invested in assets denominated either in currencies of countries with the long-term country ratings (sovereign debt) not less than the credit ratings A (Standard & Poor's, Fitch) or A2 (Moody's); in US Dollars or in US Dollars, Euro and GBP based on their respective weight. According to Investment Policy up to 60% of the Fund's investment portfolio can be managed by external managers. Oil Fund's investment portfolio should not be invested in currency arbitrage, swaps, forwards and futures (except for the purpose of hedging or optimizing the currency composition of the investment portfolio and structure of the Oil Fund's assets), precious metals and stones and real estate.

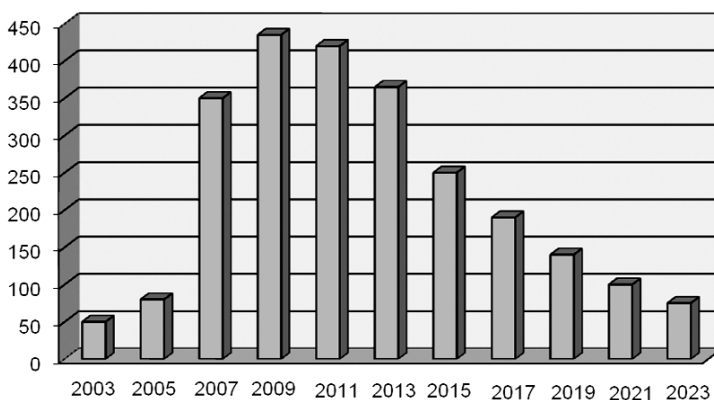
Oil Sector Development: Opportunities and Risks

The rapid increase in oil production resulted in Azerbaijan's economy posting its fifth consecutive year of double-digit growth in 2006. Gross domestic product (GDP) expanded by a record 34.5% in real terms, the world's highest growth rate for the second year running. By far, the greatest engine of growth has been the industrial sector, in which value added was up by just over 56%, bringing cumulative growth in 2005-2006 to almost 150%. Within the industry sector, it is the oil and gas sector that is driving the growth. The non-oil economy is still growing strongly, expanding by 11.2% in 2006, but its contribution to GDP is falling as the oil economy expands. Non-oil sectors provided 47% of nominal GDP in 2006, down from 58% a year earlier and 61% in 2004. The medium-term outlook for Azerbaijan's economy is positive. GDP growth is expected to continue posting high double-digit growth over the next few years, mainly from increased oil and gas production and exports. Foreign investment is expect-

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

ed to decline over time as the major oil and gas projects move toward less intensive stages. However, the Azerbaijani government expects increased domestic public investment to offset some of this decline. Government expenditures rose by over 80% in 2006 and rose by a further 50% in 2007, which puts considerable pressure on inflation. In the long term, Azerbaijan's high dependence on oil exports poses a potential threat to the economy given the potential volatility in the international oil market. The main challenge for Azerbaijan is to develop the non-oil sector to ensure that the economy continues to grow on a sustainable path after the oil boom, meeting both short-term expectations and longer-term demands. A key objective is to develop income-generating and new employment opportunities in the non-oil sector, in such priority areas as banking and finance, trade, and small- and medium-sized enterprise (SME) development.

Oil Production, Forecast, million barrels



Source: SSC, 2008

The above graph shows that Azerbaijan will have huge oil

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

revenues starting from 2009 until 2015. Income from oil sales is expected to peak in 2010. About 450 million barrels are estimated to be produced that year. At the current price (1 barrel=USD 76), USD 34.2 billion in income from oil sales is projected for one year alone.

Until its separation from the rest of the USSR, the republic was financially controlled by Moscow. Azerbaijan thus had little experience in independently managing its oil industry and the revenues accumulated (the only chance it had to do so was during its short-lived independence between 1918 and 1920).

Azerbaijan has an Oil Fund (SOFAZ) in which oil revenues are deposited, so the lion's share of responsibility for administering oil income falls on the managing of the Oil Fund resources. If Azerbaijan's oil advantage is to benefit not only this generation but also posterity, the Fund needs to be rescued from popular programmes. As in every issue concerning the nation's future, society's long-term interests need to be prioritised in order to prevent short-term or small group interests from taking over the Fund's resources. But first, those long-term interests need to be identified, and then a mechanism for adhering to them needs to be created and implemented.

The Fund was created eight years ago and serves to separate oil revenues from the rest of the economy. However, clearer resource management principles are needed to ensure that the Fund is operated in a way that will maximise the benefit to the overall economy. Money from the Fund is currently being spent with no strategy or criteria to measure the effectiveness of the spending decisions against alternative ways of using the Fund.

In addition to economic concerns, there is a reciprocal role between the Fund and democracy; not only does democracy guarantee effective management of the Fund, but effective management of the Fund will also instil feelings of ownership of and

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

responsibility for national resources among the citizens of Azerbaijan. They will come to view the Fund as their own money for their children and grandchildren and so forth, and will always be watchful of whether public officials are doing an efficient job.

What can be done with the Oil Fund can theoretically be done without it. In reality, "Oil funds can allow some revenues to be 'protected', allowing larger surpluses than would be possible otherwise". The benefit from creating the Fund thus lies in the political economy and the point of having the fund is to isolate the oil money from irresponsible government decisions. Research shows that countries that have developed a separate institution to isolate oil money from the economy have better managed the economy during the boom years and have been better able to prevent oil money from being consumed by internal rent pumps.

Many other oil-producing countries have had bad experiences, resulting in the emergence of the umbrella term of "oil curse". Now the government of Azerbaijan has officially acknowledged the need for careful handling of oil revenues.

Table 2: Azerbaijan's Oil Fund balance and non-oil economy over the years, in mln of AZN

Year	2007	2008	2009	2010	2011	2012
Oil Fund assets ¹	2659.9 8	11063.7 9	23112.3 2	34799. 1	45293. 5	5660 2
Oil Fund expenditures ²	1107	767	705	705	655	655
Return from Fund assets ³	106	443	924	1392	1812	2264
Oil Fund balance	-1001	-324	219	687	1157	1609
Non-oil GDP ⁴	10366	12755	14859	17038	19513	2234 6
Fund returns/non-oil GDP	1	3	6	8	9	10

Source: IMF 2007, MOF 2007 and author's calculations

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

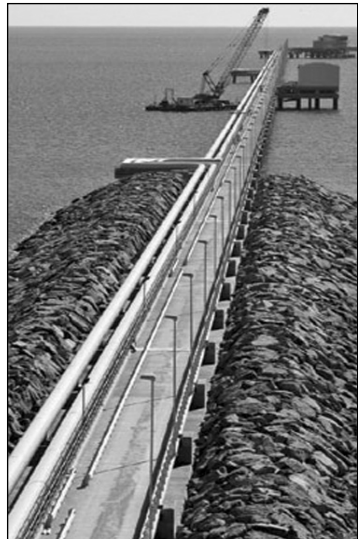
1. IMF projections (2007-2008 baseline scenario; 2009-2012 sustainable scenario)
 2. Ministry of Finance projections
 3. With 4% return rate as estimated with Pension Fund in Norway
 4. IMF projections
- * 1 USD= 0.81 AZN

In the early years, the expenditures made from the Fund exceeded its revenues. The monies were either transferred to the national budget or used for other social expenditures that duplicate the budget's function, and can thus be considered equivalent to transfers. The government is expected to increase expenditures further and spend more in the social sphere and infrastructure due to the upcoming elections in 2008. Later, the government may have more reasons to follow a strategy that is geared towards longer-term goals.

The Problem

Until the separation from the rest of the USSR, the republic was financially controlled from Moscow. Thus Azerbaijan had little experience in independently managing the oil industry and the revenues accumulated (the only chance was during the short-term independence between 1918 and 1920 years).

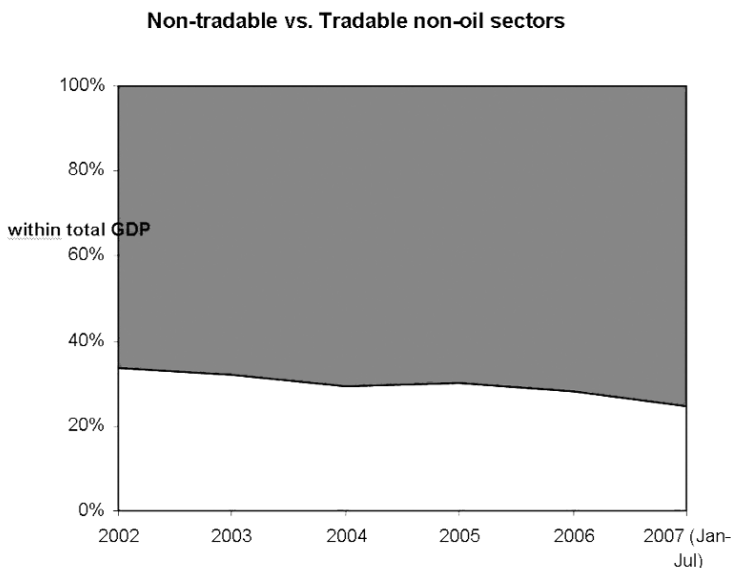
We have an Oil Fund where we accumulate the oil money, so the huge part of responsibility of admin-



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

istering the oil falls on the managing the Oil Fund resources. This is to say that as one of the ways of making the oil advantage not only for this generation, we need to rescue the fund from popular programs. Like in every issue concerning the nation's life, the society's long-term interests need to be central in managing the fund's resources in order to avoid the annoying signals of short-term or small group interests. But for that those long-term interests need to be identified, then the mechanism of sticking to those interests need to be identified and implemented.

**Figure 1: Dynamics of non-oil economy of Azerbaijan:
percentage shares of tradable and non-tradable goods**



Source: NBA, Azerbaijan

The fund is founded 8 years ago. Just the existence of the fund, already separates the part of the oil money from the rest of the economy. However the more clear resource management princi-

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

ples needed to ensure that the fund's operation serves to the best of the overall economy. Money is spent from the fund, but no strategy and no criteria to measure the effectiveness of the decisions against the alternative ways of the use of the fund.

Also, there is a reciprocative role on the impact on democracy; not only the democracy guarantees effective management of the fund, but the effective management also will add to the feeling of ownership and responsibility among citizens; they will discuss it more as their own money for the children and grandchildren and so forth, and will always be watchful if public officials do the efficient job.

Sabit Bagirov outlines the following risk areas in the management of oil revenues:²

- the government is inexperienced in managing revenue windfalls;
- laws are imperfect;
- the judiciary is dependent on the executive branch;
- the legislature is dependent on the executive branch;
- democratic institutions are weak;
- civil society is underdeveloped;
- independent media are weak.

He comments the current SOFAZ budget concept as allowing its assets to be used to finance state projects and programs, and argues for the rejection of it.

Instead, he suggests that the fund should make portfolio investments and the only expenses for the fund to be the operation expenses for the fund. We however, in this paper, while agreeing with the portfolio strategy recommend the ceiling for budget transfers, and exclude the administrative expenditures from the Oil Fund budget regard to and treat the Oil Fund as a state agency, and thus include their administrative expenses within the state budget.

The author also lists the state organs most interested in the

² Problems of Good Governance in Extractive Industries, Sabit Bagirov

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



transfers into the state budget. These are, according to the author, the Ministry of Taxation and the State Customs Committee as the main sources of the budget revenues in the first place, and the Finance Ministry and "a lot of state bodies"

because, with this situation, they are likely to receive a portion of them.

The other dimension, besides the institutional, is the social side of the problem, where the citizens support the short-term oriented government expenditures and popular programs, and as the author puts it, it makes it easy for the state agencies "to convince ordinary citizens that the existing practice is correct and is socially-orientated".

Problem Severity

What can be done with the Oil Fund can theoretically be done without it. In reality "oil funds can allow some revenues to be "protected," allowing larger surpluses than would be possible otherwise". So the benefit from creating the fund lies in the political economy and the point in having the fund is to isolate the oil money from the irresponsible government decisions. And the research shows that the countries who managed to develop a separate institution that would at least partly sterilize the economy from the oil money, have better managed the economy during the boom years and could better save the oil money to be consumed by the internal rent pumps.³

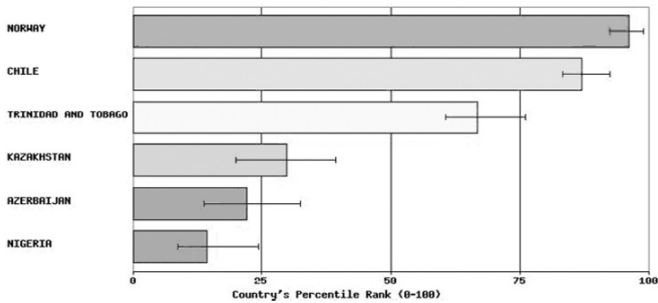
³ International Best Practice In Sustainable Development

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

Many other countries producing oil had a bad experience resulting in the emergence of an umbrella term of "oil curse". Now the government of Azerbaijan has officially acknowledged the need for careful handling of the oil revenues.

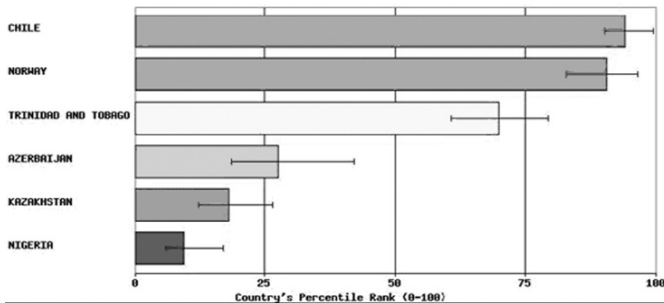
Government effectiveness, Rule of law, Regulatory quality and Voice and accountability is very low in Azerbaijan based on the study mentioned in the figures below.

Figure 2: Government effectiveness in selected countries (all dependent on the single resource)



Source: Converting black gold into human gold

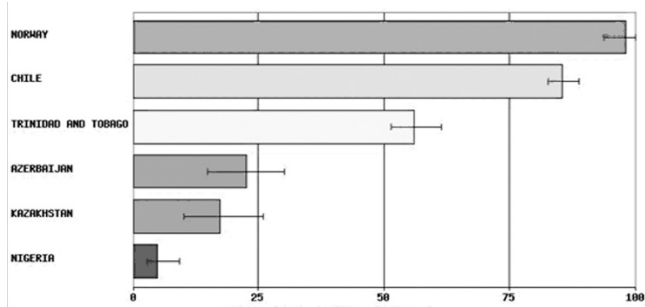
Figure 3: Regulatory quality in selected countries (all dependent on the single resource)



Source: Converting black gold into human gold

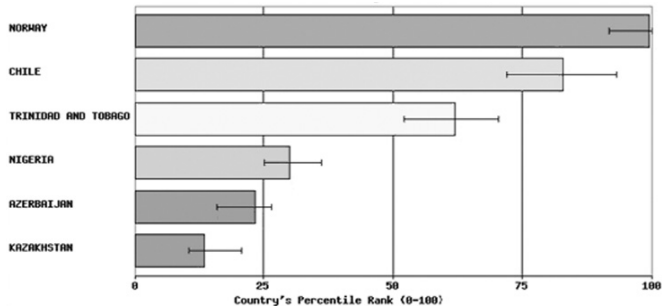
**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

Figure 4: Rule of law in selected countries (all dependent on the single resource)



Source: Converting black gold into human gold

Figure 5: Voice and accountability in selected countries (all dependent on the single resource)



Source: Converting black gold into human gold

Above graphes show that all these make the more inefficient use of the oil money possible, and all these make the short-term boom to translate into the disaster in the post production years.

Amar Inamdar summarized the potential negative effects from the management of oil resources in 3 statements:

- 1. Spend today, don't save for tomorrow.
- 2. Spend on the powerful, not on the weak.

3. Draw down inherited capital, don't work.⁴

Alternative Strategies

Our lives would be different without oil. Oil affects and changes our priorities as well as others' priorities concerning us. And we would run our economy differently if we did not have oil resources to rely upon. However, as a short-term and finite resource, oil cannot be part of our national values and long-term interests, which should ideally be permanent. That leaves room for oil to serve as a temporary instrument only. Oil is short-term, but the Fund is long-term, and the effective management of the Fund should not depend on oil, but behave as if there were no oil at all. Norway's Pension Fund is analogous to Azerbaijan's Oil Fund and could serve as an example of successful management. Oil revenues are isolated from Norwegian society, or, put another way, society is isolated from the oil revenues almost as if the sector did not exist. The strategy of the Oil Fund needs to be at least as efficient. That strategy must flow from the purpose and mission of the Fund. If Azerbaijan wants to ensure an intergenerational balance or save money for the future, then it must resist short-term or any other non-productive programmes and save the maximum amount, which should include at least all of the oil money. By at least I mean that the Fund may also generate additional money and that money can be partially accumulated in the Fund.

If the economy can survive without the Oil Fund, then it should be even more robust with assistance coming from the Fund. However, popular programmes must not be allowed to eat the seed corn.

The main strategic issues regarding the Oil Fund are whether

⁴ Amar Inamdar, For Project Design & Management Pty Ltd

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



to transfer the revenues to the state budget or not, and how to invest the money that remains in the Fund. The principles of modern finance can be applied to help identify the best investment strategy. Diversification is the rule of thumb for lessening risk: investing the oil wealth among a wide range of allocations diversified across many levels (countries, industries, businesses, etc.) may guarantee high returns with lower risk. An index fund, which ensures that the investment in each company is proportional to its market value, can be used as an instrument for diversifying. But diversification only works well with a realistic and prudent approach to every investment decision. Expert advice and some scepticism are necessary, and the pitfalls of the underlying risk lurking behind seemingly high returns need to be carefully analysed. Decisions should not be guided by intuition or astrology. By the same token, non-transparent management is likely to lead to self-satisfying behaviour and inefficient investment decisions. For the management of a public fund such as the Oil Fund, a methodology needs to be prepared in which investment decisions will take into account not only the risks and returns from investments, but also brokerage and investment charges. Better investment options are often described as a trade-off between a good dinner and a good night's sleep. This is to say that a large

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

number of riskier investments could indeed increase the overall return for an investment portfolio, but then the group responsible for investments needs to have permanent control and keep track of ups and downs in order to be able to change investment decisions in a timely manner. However, a good night's sleep can be guaranteed with government bonds; although these yield lower returns, they are often inflation indexed and entail lower risk.

The Budget or the Fund

Meral Karan provides information on how Oil Fund (SOFAZ) resources should be used by the state agencies and treats the Fund as a secondary state budget. However, this approach conflicts with the mission and purpose of the Fund and will not provide the expected benefits.⁵

Let us look at and compare the international experience first. The table below compares the growth of expenditures in several countries. "After the boom" is a relative term, since the countries on the list still produce oil. In addition, "boom" refers here to the rise in production but not to the production itself.

Table 3: Average annual growth of budget expenditures, %

Country	Prior to the boom	Oil boom period	After the boom
Azerbaijan	12.9	85	-
Saudi Arabia	27.5	112.5	30
Nigeria	29.6	70	-3.0
Norway	12.7	32	17.2

Source: IMF. International Financial Statistics and own calculations, 2008

Norway's economy is widely considered to be the most successful in translating its oil money into sustainable development of the country. The Norwegian government's determination to spend its oil revenues wisely is considered the key to the country's economic suc-

⁵ Fighting the resource curse: The Azerbaijan response. Meral Karan

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

cess as well as its ability to overcome the pitfalls associated with the oil boom.

To manage its oil wealth, Norway established the Petroleum Fund (the prototype of Azerbaijan's Oil Fund), where it accumulated all of its oil money. This money then was transferred into bonds and corporate equities to generate a more stable flow of income that was not dependent on the current rate of oil production in the country. Later, the Fund's functions were integrated with the national insurance scheme, and the fund continued to function under the name of the Pension Fund. The strategy of isolating the economy from oil money did not change, however. The amount of money the government may withdraw from the Fund for budgetary purposes is again not a function of the country's current oil production, but of the growth rate of the Fund apart from current oil revenues. However, there were cases when the non-oil deficit of the budget was over the estimated annual non-oil growth of the Fund.⁶

Ulrich F.W. Ernst characterises Norway's strategy in managing the oil revenues as follows:⁷

1. The Norwegian economy is isolated from oil revenues; fund reserves are entirely invested abroad.

The exchange rate between the krone (local currency) and other European currencies is kept stable through economic rather than monetary policies.

The name of the fund has been changed to better reflect its image and mission.

However, there is some emerging sensitivity to "domestic" arguments, since the amount of capital flowing out of the country is increasing while the fund continues to grow. The fund is becoming the largest single-managed fund in the world.

2. Investments are made in both fixed income and equity instru-

⁶ Bjorn Taraldsen. 2007. Management of the Norwegian Government Pension Fund. Norwegian Central Bank. Norway.

⁷ Foiling the resource curse: Norway's Petroleum Fund. Ulrich F.W. Ernst

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



ments - since 1998, up to 50% of the total reserves have been permitted to be invested in stock markets (foreign only). Now the investments in foreign markets have reached a level of approximately 40 percent.

The issue is to determine whether a 50% ceiling and the current 40% of investments in the equity market is sufficient or too large. This is more a debate over how much risk can be afforded versus the expected returns.

Now the fund is spreading investments across industries and regions to diversify in an effort to reduce risk. And the management guidelines now limit the fund's investments to 5 percent of the capital of any given company (the limit was 3% before 2006). The fund's exposure in the companies in which it has invested now averages 0.3 percent.

3. Ethical issues are intertwined with the investments. Efforts must be made to avoid conflicts of interest and to make the fund's allocations internationally responsible. The fund should not invest in businesses involved in non-peaceful or environmentally bad practices.

If these ethical standards were to be applied in Azerbaijan, some countries, businesses and particular companies would have to be stricken from the list of the investment options for SOFAZ.

The first item to consider is how much of the oil money to save,

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

i.e. accrue in the Fund, and how much to consume, i.e. allocate for state budget expansion. This is not a consume or invest? question, however, because the elements of the state budget may also suggest investments in the future. Instead, it is a question of how much money from the current economy needs to be taken and saved in the Fund. This requires an analysis of where that money will provide the best long-term benefit for society.

Saving or stabilisation

The traditional literature suggests that the budgets in oil-producing countries depend on the oil prices on the international market. The Oil Fund thus needs to include a stabilisation function, i.e. a way to bridge budget deficiencies in recession years. This paper argues and takes as a basis for further analysis that (1) it is not the oil price but overall oil revenues that matter (the latter includes many other factors, including the amount of oil production) for the decisions between the budget and the Fund, and (2) it is not the budget but the overall income that depends on oil revenues; due to political processes and decisions, the budget is often linked to short-time oil revenues. The Fund could eliminate that link and allow the budget to rely on long-term and secure incomes.

Stabilisation should not protect the economy from fluctuations in oil prices but be negatively linked to the overall revenues. It should link budget transfers to the spending capacity of the government (i.e. how much of government expenditures reach beneficiaries, generate benefits and translate into sustainable development).

Yelena Kalyuzhnova focuses more on the stabilising role of oil funds, and thus provides analyses and recommendations on how to protect the economy from sharp changes in oil prices.⁸

She sees the role of an oil fund "as formalising - or giving insti-

⁸ Overcoming the curse of hydrocarbon: goals and governance in the oil funds of Kazakhstan and Azerbaijan. 01-DEC-06 Comparative Economic Studies. Kalyuzhnova, Yelena

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

tutional focus to - a set of fiscal rules". She also evaluates the effectiveness of the fund as deriving from this role, i.e. She admits that "history provides many illustrations, where stabilisation policies relating to commodities collapsed with the rapid exhaustion of finance". She further argues that the stabilising approach should be pragmatic and that there is no universal set of management techniques to make that function optimal.

She also concludes that the fiscal policy of the oil-producing state must take into account the size of oil revenues in the economy.

John Wakeman-Linn, Paul Mathieu and Bert van Selm conclude that oil funds improve coordination between monetary and fiscal policy and that they function best when they can be separated from the state budget (and thus cannot be easily deployed by state agencies). The authors dismiss the necessity of a stabilisation function for oil funds, arguing that "Shortfalls in state budget must be made up through changes/improvements in the state budget".⁹

The standard macroeconomic literature suggests that real exchange rate appreciation will be accompanied by an increase in oil revenues. Generally, oil revenues increase the wealth of the overall country and consumers, which leads to an increase in the aggregate demand. The latter has several effects:

- exports go down for the reason that people consume more
- imports go up for the same reason
- exports go down again due to the negative effects of the oil money running into the domestic market; local productivity goes down for every tradable good except oil due to the decrease in the competitiveness of local production

Jeffrey Davis, Rolando Ossowski, James Daniel and Steven Barnett justify oil funds on political economy grounds: "Such funds may help the government to resist spending pressures if there are

⁹ Oil Funds in Transition Economies: Revenue Management
Azerbaijan and Kazakhstan
John Wakeman-Linn, Paul Mathieu and Bert van Selm, October 16, 2002

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



constraints on borrowing. These may reflect explicit fiscal rules or may arise from political difficulties in issuing debt."¹⁰

As for the stabilisation function, the authors justify it for the case when there is instability in fiscal revenue - this complicates fiscal management, budgetary planning, and the efficient use of public resources. Sharp cuts in expenditures can be disruptive and costly and increases in revenues can be a temptation to raise spending to unsustainable levels.

Large fluctuations in resource revenues may give rise to real exchange rate volatility, and increases in these revenues may lead to the "Dutch disease." There are also sometimes concerns that large revenue inflows may be misused or otherwise subject to poor governance.

However, while the stability of incomes from investments provides a sense of assuredness, it cannot serve as the sole criterion for an investment decision. The main criteria are the expected growth

¹⁰ Stabilization and Savings Funds for Nonrenewable Resources
Experience and Fiscal Policy Implications
Jeffrey Davis, Rolando Ossowski, James Daniel, and Steven Barnett
2001 International Monetary Fund, April 13, 2001

and the minimisation of risk.

In addition, the revenue from deploying nonrenewable resources represents a depletion of wealth that could be saved for the future generations. It is also not sustainable for the long-term, and in that respect it differs from other revenue types.

Saving or investments

The next question analyzed is about determining whether to save the oil money in the fund, or invest the money in the social and economic life of the country. This will serve to make the analysis more comprehensive, since not all the public investments are made through the State Budget, and some public investments are regularly made from the extra-budgetary organizations, including SOFAZ. Thus, in addition, to the above discussions on whether to consume or to save, and whether to allow the transfers into the State Budget or not, the separate analysis need to be conducted on whether to allow some of the oil money into public investments, and what rules and limitations can apply in here.

The public investments made from SOFAZ, besides the resources spent for investments, have an opportunity cost of the regular dividends earned by the portfolio investment of the fund. Meaning, the public investments generating the public good will decrease the fund's resources and the capacity to generate the income for the future generations. The basic cost-benefit approach will advise to compare the benefits of the public good from an investment with the cost of the resources spent. However, the cost in this case, as it will be discussed below, may be different from the opportunity cost of the invested money.

The benefits will generally include the public good as a result of an investment (bridge, vaccination, application of standardization,...), increased employment during the implementation stage and the transfers to the State Budget (e.g. in the form of taxes), while the costs may include the increased inflationary pressure due to the

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

oil money flowing into the economy. There exists however the threat of the overestimation of financially unmeasurable benefits. The extent of this threat is linked to the size of the corruption and the gaps in the investment project preparation and appraisal capacity of the government. Thus the more straightforward cost-benefit comparison where the benefits are expressed in the financial values need to be introduced to consider the public investments using the SOFAZ resources. This rules out the majority of infrastructure, institutional, environmental and other investments. Instead, the investments in the productive sector and loans to the private sector can be considered.

Even in that, the explanation must be provided on why the investment cannot be made using the State Budget. The size of the investment may serve as a justification for the investment not to be included in the annual State Budget, i.e. the public investment project needs to be so large (i.e. have a such a great cost) that one project alone will bring the substantial incremental change into the budget on the expenditure side that cannot be balanced by the revenue side.

However, such a large investment will also decrease the fund's portfolio that is capable to generate annual revenues for the State Budget. Then the additional explanation is needed on why the project cannot be implemented in the future

All these are to say that the proposed investments will have the goal of the development of key industries where the expected returns will overweight the returns from the SOFAZ's corresponding portfolio investments. The rule may be the borrowing from the SOFAZ's resources, rather than the use of it. And the borrowings may only be consulted by an individual project rather than by the State Budget or any sector in general. The rule of the borrowing may guarantee the investments to have the expected return greater than the corresponding return generated by SOFAZ's portfolio investments. However, from the SOFAZ's perspective these investments can be considered as the fund's investment in the domestic

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

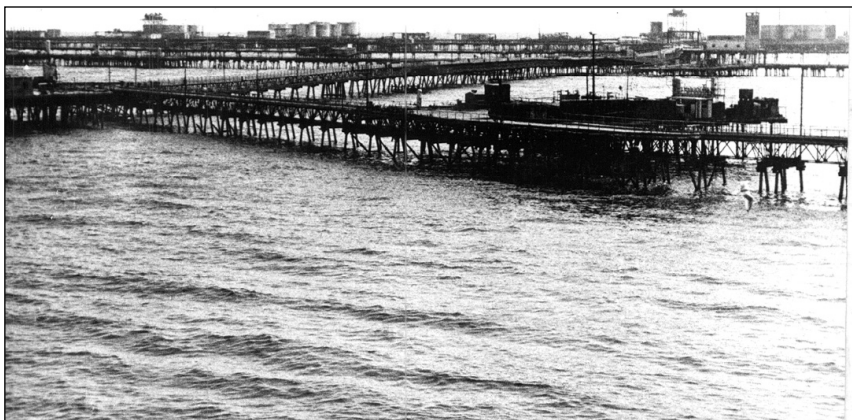
economy, that is discussed in the further subchapters. And since, as discussed above, the strategy needs to serve to the maximization of overall profits, the conclusions made in the following subchapter may be applied in here too.

How much liquidity

Overall strategy needs to consider how the investments are liquid, i.e. how easily and to what extent the investments can be retrieved for a better reallocation among the investment alternatives. Then, it will consider the flow of money into the Oil Fund: this is the inflow, outflow and the net flow for a period between investment decisions.

The portfolio, during the oil production in the country, can also be constructed to as an investment that will hedge the changes in the oil prices, i.e. the incomes they generate will be negatively correlated with the oil revenues of the country. This is to say, that holding currency from the countries heavily relying on oil exports is a bad hedging, since their currencies appreciate or depreciate roughly in parallel with manat and the budget income and consumption.

How much illiquidity can the fund afford for a particular investment vis-?-vis the expected returns from an investment? The answer will provide the range of the currencies of various countries to be



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

considered as investment options. There might be no rigid answer, but rather correlations with amount of the fund resources, the net inflow of the money from all sources and the liquidity of other investments made.

The overall liquidity of the fund investments need to be correlated to the short-term use of the fund, i.e. to its stabilization function. I.e. the amount to be retrieved from the fund will depend on the fluctuations in the consumption needs.

However, since the current budget very much relies on the oil revenues it will also be sensitive to the fluctuations of the oil prices in the international market. There are two ways and their combination to protect the budget from oil price fluctuations. One is to sterilize the domestic economy and the other is to use the fund as a budget stabilization mechanism.

Investing abroad or home

Investments: prioritization between foreign markets and domestic investments. The fund is not an extraordinary budget and domestic investments should not replicate the function of the budget.

Domestic investments - business sector only, no budgetary spending, and not for development of any business, but as a credit at market prices only.

The Pension Fund in Norway, the most exemplary use of oil revenues by most authors, is treated as a saving fund only, and manages as an investment portfolio.

Strategy will include allocation of financial resources of the fund, selection and prioritization of investments, preparation of investment policy and ethic guidelines, reporting to the public, continuous analysis of the current investments vis-?-vis with an investment market and production of regular recommendations for the future behavior.

Corporate equity or bonds and T-bills

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Investing in only bonds and T-bills issues by foreign companies and governments can be safest investment strategy in the sense that incomes from investments are more fixed and liquid. This is the buy and hold strategy relying on the dividends the investments will generate. In that the fund is interested to invest in currencies that are internationally more liquid and the rate relative to others will remain positive or the expected inflation rate will be smaller enough to be compensated by the incomes the investments generate. E.g. buying the corporate debt should not be considered.

How much risk

The overall risk is the function of the diversification. Monte-Carlo portfolio management principles can be applied to arrive to the optimal allocation where the overall return from investments are maximized taken into the account the expected returns from each investment and probabilities (risk factor) associated with each investment.

The overall risk can also be alleviated by applying the hedging principle, where systematic risks are minimized by allocating the money in the assets having the negatively correlated growth rates. This will account the systematic risks rather than the individual assessment of risks associated with per investment. This will increase the level of the risk the Fund can afford with each individual investment option. And since, there exists a positive correlation with the expected return rate and the risk associated in the investment options in the stock market, the strategy is also expected to increase the overall returns.

The diversification level, ceilings and numbers as a function of the Fund's overall assets, once determined, need to become a principle rather than a mere methodology, and be reflected in the Fund's operational guidelines

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



Other issues of investment decisions

The operational asset-management guidelines need to be prepared to govern the allocation of the fund's resources. The guidelines need in the first place to adhere the fund's strategy which in its turn should be commensurate with the fund's mission and objectives. To ensure that, it needs to be ensured that the guidelines are free from political interference and are disclosed to the public.

Conclusions

The efficiency gap in the management of oil money in Azerbaijan is enormous. Improvements need to be made in the oil money accumulation, saving and spending processes so that this short-term national resource can better serve the long-term development needs of the nation. The necessary changes include redefining and streamlining the Oil Fund in parallel with improvements in budgetary and public investment work.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Sustainable long-term development needs to be a major focus and the only criterion for the use of oil money, as with any public resource. The short-term availability of this resource, however, makes the issue more subtle and brings additional concerns. The need for sustainable long-term development makes the macroeconomic concerns a priority. This is to say that the nation's strategy for the use of oil money needs to focus on the long-term growth of GDP, fiscal stability and independence, and monetary concerns in order to avoid inflation, account for the capacity of the public sector and prevent the creation of an environment conducive to corruption. The strategy must clearly delineate the share and dynamics of national consumption, public investments, government expenditures and trade with other countries with the hydrocarbon resources deducted and oil money added to the national assets. A good strategy will measure and use the oil money not for separate consumption expenditures or investment projects, but in line with all public spending, while accumulating and saving that oil money separately.

Macroeconomic development strategies flow into the financial strategy of the Oil Fund as an institution that accumulates and saves money. Once the extent of the application of oil money (i.e. what exactly needs to be accumulated in the Fund) is determined to reflect the nation's the most pressing long-term interests, then strategies for portfolio investments, transfers to the state budget and public investment projects (if the strategy finds it appropriate) must be adopted and implemented.

The recommended improvements regarding the development of the institutional and legal framework will address and make the implementation of the proposed financial strategy for the Oil Fund possible. This will include the development of instructions, guidelines and standards for portfolio investments as well as the rules and standards for transfers from the Fund to the state budget and other domestic public and private uses. The recommended

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

institutional and legal improvements are on the other hand based on the existing situation and current practices, and have political feasibility implications for the suggested changes, which are more extensively discussed in the analysis section of this paper.

A strategy is important for creating the rules for the effective management of the Fund. Having these strict rules is no less important for saving the nation's resources from short-term and populist programmes, as they are for stemming corruption. And the presence of clear efficiency criteria and strict rules along with civil society development facilitates transparency in the management of the Fund. Reciprocally, that transparency becomes a guarantee of the effective management of the Fund and the growth of society's wealth, and thus increases the sense of ownership and the level of civil society along with democracy.

Recommendations

The following is the list of recommendations by this chapter for the management of oil money in Azerbaijan:

- The amount of transfers from the Fund into the State Budget in any year, shouldn't be above the Fund's average (calculated for the several past years) portfolio profits that will additionally account the fluctuations, population change (that would change the Fund's assets per capita) and the inflation and the overall depreciation the Fund's assets in all invested currencies.

- The Fund resources should initially be invested abroad only; the domestic investments will be allowed after the new management principles adopted and evaluated through several years, and the extent of the rules limiting the domestic investments will also be a function of the level of domestic corruption as evaluated as an extrapolation of results from the reports from several external independent sources.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

- The diversification principle need to be prepared to illustrate the ceilings expressed in percentages of the Fund's resources can be allocated in each country, in each currency, each type of the business, and each company, as well as ceilings expressed in percentages of the invested company's assets.

- All the oil rent money need to be isolated from the rest of the economy, and accumulated in the Oil Fund.

- No direct transfers should be allowed from the Fund into any public investment project or program.

- The Fund shouldn't be regarded and treated as an extraordinary budget and/or replicate any of the functions of the State Budget.

- The Fund should select the saving function only and employ the smooth distribution function at the expense of the stabilization function.

- The ethical standards need to be prepared to outline the countries, the businesses and the companies to be excluded from the list of potential investment allocations.

- The correlation needs to be determined, where the more the Fund grows, and the more the Fund's management evolves, the more the percentage share of it can be invested in equity shares rather than in the T-bills.

- The relationship between the risk, expected return, number of investments and overall Fund resources needs to be determined for the investors to serve the maximization principle, sticking to the Fund's rules but not on their own discretion that may have a goal not fully overlapping with the Fund's goal.

- Principles need to be developed for the future possibilities in investing in the domestic business sector, in the form of the separate bank that would expect the return for the Fund from the investing in the local business higher than from the investment abroad.

- Develop a long-term, diversified investment strategy.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

With a longer-term spending policy in place, SOFAZ can then shift its investments to a longer-term horizon and be able to diversify from the highly liquid but low-yield investments it made in 2001.

- The fund's investment decisions, as well the management strategy need to be transparent; there are efficiency implications in the transparent management and strategy.

- The allocation report needs to be prepared for the every portfolio investment by the Fund. The report will replace the feasibility study, as a justification of selection based on transparent criteria and methodology, as well as the appraisal document that would explain why the selection is made vis-?-vis with other possible allocations.

- Clarify the SOFAZ mission and objectives. The decree establishing the Oil Fund explains that it can be used for the "socio-economic progress of the country" and for "solving the most important national problems." Detail mission and objectives are recommended to be settled on.

- Develop flexible strategy to provide higher returns on investment.

- Apply benchmark indexes for each class of assets and each active management mandate. The actual return for each asset class is then compared to the benchmark for that class.

- Develop long-term investment strategy which considers investment in both equity and securities, and set limits to the various asset classes.

- The regular (at least, annual) evaluation of the Fund's management needs to be conducted where the Fund's performance (profit, risks, ethical standards and administrative management) will be evaluated against the allocation reports prepared, and the average expectations in the market.

- The transparent selection criteria to be prepared, and the selections reports, as well the annual evaluations to be transparent

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

to the public.

- The investment methodology needs to be prepared and discussed attracting the experts. This methodology, need to be evaluated and updated annually from the perspective of the Fund's mission only.

- The standards (financial and ethical) and administrative principles (such as preparation of the allocation report and appraisal, and evaluation principles) need to be developed based on the recommendations here and/or of different expert groups.

- The portfolio investment guidelines and the instructions for the investment group need to be prepared based on the methodology and recommended administrative principles, and applied.

Prepared by V.Bayramov and E.Rashid

STUDY 3: Missed Oil Money

Foreword

What is notable is to focus on social projects addressing to improve the social situation for refugees and IDPs suffering from the Armenian-Azerbaijan Nagorno-Karabakh conflict financed through the State Oil Fund of the Republic of Azerbaijan (SOFAZ). The survey in monitoring showed that the problem with utilization of these funds is so severe. Conducting tender is required by the law, yet no tender was therefore conducted. Major problem is misappropriation of funds through overestimating expenditures. The monitoring revealed that by doing so, as much as \$50mln had been misappropriated in a year alone. Once the price of houses constructed within the project was compared with the market price, it was evident that the houses had been artificially overpriced. And another problem is substandard work during the construction process thus aiming to consume few funds, but overprice the project.

Missed Oil Money

Every year, SOFAZ allocates funds to finance the projects aimed at improving social conditions and providing resettlement of refugees and IDPs. According to SOFAZ, the funds allotted to finance such projects amounted to AZN 385.2 mln as at 1 April 2008. Between 2001 and 2007, 49 settlements consisting of 15,713 houses had been constructed for temporary settlement. Last year, the Fund allocated AZN 154.2mln to finance projects related to IDPs, yet the actual amount spent was AZN 154mln. The funds were intended for construction of private houses, social service and infrastructure facilities in the Agdam, Agjabedi, Fizuli, Beylagan, Goranboy, Sabirabad regions, as well as Ramana, Pirshagy towns of Baku's Sabunchu District.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

SOFAZ Expenditures

Years	2002	2003	2004	2005	2006	2007
Approved expenditure from SOFAZ (million USD)	54,0	33,7	22,2	49,9	136,2	190,4
Expenditure was spent (million USD)	46,6	24,7	18,5	49,9	135,9	190,1
Difference (million USD)	7,4	9	3,7	0	0,3	0,3

11 settlements consisting of 4413 houses were constructed in Fizuli, Bilasuvar and Ramana in monitoring. There are 5 settlements with 2104 houses alone in the Zobucuk area, Fizuli. Total area of the dwelling space is 110215,72 square meters. According to the documents made available in monitoring, a one-room, two-room, three-room houses built in Fizuli cost, respectively, 18,089 manats, 22,620 manats, 29,437. It is worth noting that although the price of houses by other lots were more expensive, we will make comparisons to figures available.

Table of a three-room house built in Zobucuk area, Fuzuli

#	Work description	Unit	Volume	Work unit valueИ, (A3H)	Total value (A3H)
	A. Vertical planning of the area (under project)	1 house	1	135	135
	<i>E-1. Three-room dwelling house (for one)</i>				
	1. Earth-moving				104
1.	Mechanical digging, re-filling and rammer of II group land	M3	56	1,7	95
2.	Also manually	M3	5,5	1,7	9
	2. Foundations				2871
1.	Tightening of land with road-metals	M2	45,6	1,7	78
2.	Presurface preparation, E7,5	M3	4,3	46,75	201
3.	Ribbon-like concrete foundation, E12,5	M3	15,67	51	799
4.	Cast concrete foundation, E12,5	M3	0,38	68	26
5.	Building 60cm in thickness walls made of sawed limestone	M2	38,5	33	1271
6.	Also 40cm in thickness	M2	18,1	22	398
7.	Also 20cm in thickness	M2	1,83	11	20
8.	Plastering sawed limestone continuous pedestal	M2	88,8	0,4	36
9.	Vertical waterproof finish by filling sheet asphalt	M2	104	0,4	42
	3. Walls				3222
1.	Building 40cm in thickness walls made of sawed limestone	M2	112	22	2464

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

2.	Also 20cm in thickness	M2	26,3	11	289
3.	Reinforcing of masonry	T _H	0,08	520	42
4.	Making of cast concrete column, B15	M3	0,8	70	56
5.	Making of cast concrete belt (together with binding bolts) and throwing, B12,5	M3	3,78	70	265
6.	Laying of cast concrete beam, B15	M3	1,33	70	93
7.	Horizontal waterproof finish of walls with mortar of cement	M2	32	0,4	13
4. Ceiling and roof					2695
1.	Laying of wooden beams	M3	0,82	220	180
2.	First planking, $\tau=30\text{MM}$	M2	63	6,8	428
3.	Making of foiled heat layer made of mineral cotton, ($\tau=60\text{MM}$)	M2	63	3	189
4.	Coating of ceiling with chipboard along 50x50MM racked shooting ranges, $\tau=4\text{MM}$	M2	63	4	252
5.	Making of access door to go up to the shed (0,8X08M)	M2	0,64	20	13
6.	Building of roof with wooden frame, including wooden cornices	M3	2,82	220	620
7.	Painting of wooden cornices	M2	13,85	1	14
8.	Installation and painting of roof window, 1000X600MM	Piece	2	12	24
9.	Fixing of zincified wavy metal sheets on wooden ornament	M2	110,8	8	886
10.	Placing of rain gutters	M	36	1,5	54
11.	Also IIBC-type pipes for watershed, $\text{D}76\text{ MM}$	M	14,4	2	29
12.	Fire protection of wooden goods	M3	2,82	2	6
5. Floors					824
1.	Placing of wooden beams/logs	M3	0,82	220	180
2.	Wooden flooring, $\tau=29\text{ MM}$	M2	53,7	12	644
6. Doors and windows					746
1.	Installation of wooden door blackout (including fixatives)	M2	9,9	30	297
2.	Installation of metallic window blocks together with glass cover	M2	9,6	46,75	449
7. Veranda and stairs					185
1.	Building of 20cm veranda sides made of sawed limestone	M2	5,3	11	58
2.	Presurface preparation	M3	0,14	46,75	7
3.	Building of stairs made of sawed limestone	M3	0,47	45	21
4.	Gravel-base concrete foundation of veranda, ($\tau=80\text{MM}$), B12,5	M3	0,75	20	15
5.	Stoning of footsteps and small squares	M2	10,5	8	84
8. Finishing works					2314
1.	Plastering of outwalls and inside walls	M2	313	4	1252
2.	Emulsion painting of inside walls	M2	155	3	465
3.	Masonry painting of housefront with waterproof	M2	158	2	316
4.	Oil-bound painting of floors and ceilings with	M2	116,7	2	233
5.	Oil-bound painting of wooden doors	M2	23,8	2	48
9. Pavement					236
1.	House perimeter Gravel tightening of land of 1m in width and making of concrete pavement ($\tau=100\text{MM}$)	M2	39,4	6	236
10. Domestic electrical work (for one house under project)					2040
	A. (50x50x85(III)CM) gas and electrical stove with 4 burners and baking oven	Piece	1	140	140

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

	B.Construction and lightening of lavatory /under project/	Facility	1	700	700
	C. Installation of metallic door and gates, fencing of courtyard area and doubly painting of steel structures/ under project/	Set	1	1000	1000
	D. 100mm gravel and sand coating of internal courtyard playground and pathway / under project/	Facility	1	100	100
	Total of one three-room house				15372
	VAT	18%			2767
	Total:				18139

We conducted analysis on three-room house for usual majority of two and three room houses. According to the expert estimations, with 20-25 percent income to contractor, the price is AZN 11.694, 14.251 and 18.139, accordingly. Each house is AZN 9,000 higher than actual price.

Per sq. meter of 1, 2 and 3 room houses is constructed for 505 AZN averagely. But in expert estimations, the average price is 319 AZN. Let's call the difference of 186 AZN per sq. m as "useless expenditures" for now. The average difference for 3 houses is 36.6 percent. The company owner says that he could construct houses in settlements for 288 AZN per sq. m, provided that nobody should want bribe or commission from him.

How are petrodollars misused?

Factual higher prices are related to exaggeration of value of works and materials. For example, while the real price of land works of three-room house in the expert estimations is 104 AZN, this figure is factually 250 AZN in monitoring documents in spite of the same work scopes, that is 2,3 times more expensive. The fundamentals had to be completed for 2.871 AZN in total. However, the contractor has performed these works for 4.566 AZN (1.695 AZN more). There is a difference of 1.611 AZN in wall works. The price in the monitoring table is 4.833 AZN, in the expert estimations 3.222 AZN. Hydro isolation of walls with cement is 10 times higher - 128 AZN instead of 13 AZN. Also

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



placing of ceiling and roof cover is deferent at 1.700 AZN. Though costs of placing of floor is noted 1.051 AZN, the contractor fulfilled this work per house 227 AZN more expensive - 824 AZN. The sale price of wooden materials is 220-240 AZN. This price changes between 300-380 AZN in constructions. Placing of door and windows is 746 AZN as for expert, but it is 1.381 AZN, that is 653 AZN more expensive for the contractor for unknown reasons. In

some cases, the real prices are simply multiplied by 2. Verandah and stairs are for 313 AZN, but 185 AZN in expert. There is 1.200 AZN difference in completion works - 3.519 AZN was expended instead of 2.314 AZN. Plastering of walls rose from 1.252 AZN up to 1.565 AZN. The cost of preparation of concrete pavement in 1 m width along the perimeter of building is 236 AZN. The contractor multiplied this figure by two. Interior electric works, construction of WC, preparation and painting of metal door and gate and yard are accordingly 400 AZN, 900 AZN and 1.900 AZN in the contractor. Respectively, these costs were 100, 700 and 1.000 AZN in the expert estimations. All these works cost 3.550 AZN

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

according to the contractor, but 2.040 AZN according to the expert. As saying of the contractor, he offered real prices, however being multiplied the said figures by 2, the monitoring table was returned to him.

The price of stove placed by the contractor to kitchen is mentioned 250-300 AZN in the bidding documents. The sale price of stove was 120-125 AZN last year. Adding the transportation costs of the company to it, the occurred difference is 529.560 AZN - more than half million only for the settlements where we conducted research. Note that the contractor does nothing for this work. The stoves were able to be received and placed to house also by the Committee of Refugees or customer. And instead, he could construct 45 1-room or 37 2-room houses for refugees at the cost of that resource.

50 million USD "wastefulness"

We conducted analysis under the contractual prices in the State Admission Commission Act on commissioning of the object construction of which completed on the work of 3 sub-contractors of 5 companies working in the settlements - "Shams-95", "Alibeyli", "Inshaatchi", "MIN" Ltd and "Azeragartikinti" Joint Stock Company. The analyzed 1.017 houses is totally 23 percent of 4.413 houses that under construction in 11 new settlements - about one fourth. And this gives ground to say opinion about the performed works.

In our received documents, the financial resources allocated on the contract for the houses constructed in Fuzuli region are distributed as follows: 29 % to "Azeragartikinti" (298 houses), 23 % to "Inshaatchi" (210 houses), 20 % to "Shams-95" (208 houses), 19 % to "Alibeyli" (202 houses), and 9 % to "MIN" Ltd (99 houses). We have not included the contractual prices of 77 houses constructed by "Azeragartikinti" into the table as we do not have

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

those prices. The company constructed 375 houses in Fuzuli region and 364 houses in Bilasuvar region last year - 739 houses in a year. Considering that the average price per sq. m of house is 505 AZN in contract, comparing the sale prices with our drawn table, there is 186 AZN more expenditure per sq. m. Total area on the work of 5 companies is 53582.35 sq. m and extravagance is AZN 10 million. And this is 38 percent of the resources allocated for the mentioned purpose. AZN 20.5 million was extravagated in total area of 110215.72 sq. m in 5 settlements total - again 38 percent. To implement analogical comparison on Bilasuvar and Raman containing 2.309 houses totally referring the gained figures, it is enough to multiply the figures by 2. So, as a result of the investigations on three regions that were subject to monitoring, we come to the conclusion that only in construction of houses, there is about AZN 40 million extravagation. The Committee of Refugees could construct more 3000 houses for IDPs at the cost of this amount. Our accurate estimations show that 38-40 percent of the allocated resources are not expended as specified. "Wastefulness" in utilization of resources may be applied to the social spheres.

In each settlement, there were constructed administrative building (including warehouses), post office, public club center, medical station, kindergarten with 50 places, school with 15 classrooms (including boiling room) from the social facilities. "Inshaatchi" Firm has constructed 6 social facility costing AZN 1.7 million totally (around) in Zobujug settlement, Fuzuli region. The price of furniture placed in social facilities and buildings totally AZN 200 thousand. The value of administrative building is AZN 101 thousand, post office AZN 60 thousand, the cost for construction of the club is AZN 184 thousand in the State Commission Act. The kindergarten was constructed for AZN 387

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



thousand and the school for AZN 842,3 thousand. Out-patient's clinic completed for AZN 150 thousand. The work scopes and costs are the same in "IMAY" company. The contractual value of the construction works carried out by the company is AZN 1.7 mil., and the price of furniture placed in the facilities is AZN 173 thousand. Total cost of the main road of 14.94 km and the most of 24.1 km that were constructed by "Azeragrartikinti" JSC is AZN 6.3 mil., - AZN 423 thousand per km. Extending of Shukurbeyli Transformer Sub-station constructed in Fuzuli region by "Gidromashservis" CJSC and construction of Zobujug Transformer Sub-station completed in AZN 2 mln. 27 thousand. "Azerservis" LTD company constructed inner roads in 23.52 km length and AZN 3.2 mil., in the 1st and 2nd settlements. 21.049 km of the roads are covered with gravel and 2.471 km with asphalt.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



Bidding "games" in the State Oil Fund

**\$ 185 million is
distributed between
companies without
bidding**

According to our received information, major part of the resources on social infrastructure fields is also allocated to "Azeragartikinti" JSC - 42 percent. This is about half of the works. "Azeriservis", "Gidromashservis", "Inshaatchi" and

"IMAY" companies accordingly took 21, 14, 12 and 11 percent of the works. Also the value of the works carried out in social fields is quite different than the reality. For example, the schools constructed in the settlements are 3-5 times higher in comparison with other companies. The two-storeyed school building for 250 students (with 15 classrooms) with the total construction area of 1152 sq. m constructed by "IMAY" company in Zobujug costs AZN 846 thousand. It is about AZN 56.4 thousand per classroom and AZN 3.1 thousand per student. There were constructed 5 such schools in "Gayidish". The value of the school constructed by "Inshaatchi" Firm in Zobujug is about the same - AZN 842.3 thousand. Only two schools costs about AZN 1.7 million. In

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

2005-2006, AZN 2.34 million was allocated for construction of 15 schools in the IDP settlements. The schools constructed by the Ministry of Education in Baku city is cheaper enough than one constructed for IDP children - the difference between investments addressed to school construction is 5 times.

Experts says that the transformer installed in the settlements by "Gidromashservis" is more expensive than the real value. At present, the price of 110/35-10 kW transformer is AZN 660 thousand in market (last year it was cheaper). Taking into account that 2 transformers cost AZN 1.3 million, with profit to the contractor, the works were performed at max. AZN 280 thousand for installation and other equipment. AZN 400 thousand that is 20 percent of the allocated AZN 2 mil. 27 thousand manats was not expended as planned. It is just the estimate calculated for 2008. The value of furniture purchased for the social facilities is also exaggerated more. The logistics of the administrative representative in Ramana included chairs and tables that only produced in local shops and naturally their value was not a thousand AZN at all. Considering that under furniture there were chairs and tables, cupboard, TV set and at the best, air-conditioner in the administrative representative office, max. AZN 5 thousand was expended for such furniture. And here "extravagation" exceeds 50 percent.

Tariffs of bribe

Nonconformity of constructions built for IDPs to the quality standards and serious financial violations attract the attention of the force structures, even investigation started. However as they were NF resources, the issue was closed for the reason of the country's international image. And the financial and law-enforcement bodies that are authorized to conduct investigation in companies misuse the situation. When such facts are found, "price" is measured in AZN 100 thousands and goes beyond contractor.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Even some ministries have definite "tariffs". To evade from value added tax (VAT) contractors receive invoice just from "companies" specially established for this purpose. In this case, they pay not 18 percent, but 6 percent. Naturally, financial bodies know these machinations well and in such case, 3 percent of total resource is "optimal" for both parties. Because one party expended 6+3 percent instead of 18 percent and other party did not pay 3 percent to the public budget, but put into its own pocket. Since this year 18 percent VAT is transferred to the centralized fund of the Ministry of Taxes and the resource already goes to the public budget not to pocket of a group. However this does not mean that bribe reduced in utilization of oil revenues.

Procurement Agency is unaware of "held" tenders

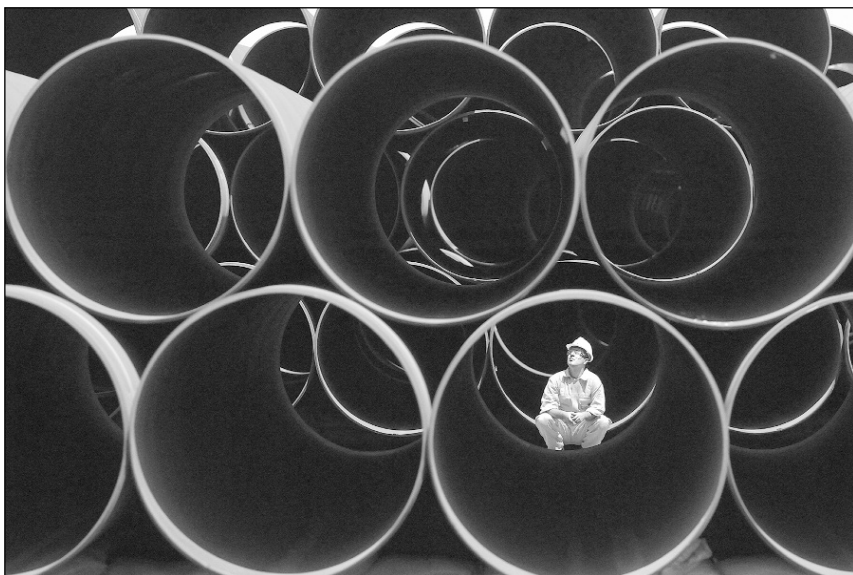
SOF informed that the resource is transferred to the account of customer only after submittal of completely substantiated respective documents (order on fund transfer, documents on conducting procurement procedures, copy of contract, scope of works under contract and price-list, invoice of contractor, certificate jointly signed by customer and contractor on works done in the accounting period etc.) of customer for the purpose to control expenditures. In case the required documents are not submitted to the Fund, project is not financed. Costs of the done works and record of the paid funds are kept and accounting-control system is renewed regularly. In spite of these notes, last year AZN 150 million was distributed between companies without bidding. As a unit realizing financing and responsible for correctness of all documentation, the Fund should analyze not only offers of "winner" of "tender", but also those of other applicants.

Though they claim that they agreed holding of bidding with the president, there is no document confirming existence of such agreement. According to the accounts for the last year informed

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

in the web-site of the State Procurement Agency, there placed only information of totally 16 tenders held, total contractual value of which is AZN 1246.77 thousand concluded on QMKIDK. It is not a value of one contract concluded on the said projects. Entrusting of works to definite companies is explained with their professionalism. However, our investigations show that each contractor has a permanent engineering-technical staff containing 10-12 persons and this is not sufficient for large-scale constructions.

Last year, to provide the settlement constructed in Fuzuli and Bilasuvar with irrigation water, installation of irrigation facilities and transformer sub-stations was entrusted to "Hydromashservis" CJSC that owned by Ayaz Orujov, Executive Director of IDPs Social Development Fund, customer. Mr. Orujov was appointed to the position of Director of IDPSDF in spring, last year. At present, chairman of Supervisory Board of "Hydromashservis" is his brother Akif Orujov. According to the Article 13 of the Law on State Procurement - Conflict of Interests in State Procurements,



**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

the contractors that under legal, financial or organizational control of a procurement agency are not allowed to participate in procurement procedures held by the said agency. Those who has direct relationship, incorporation and subordination relations with representative or officer of an applicant participating in procurement procedures, those who are employee or officer of applicant participating in procurement in three years period prior to the procurement procedures can not be a representative, advisor and executor of other obligations related to procurement, of procuring agency. Constructions of houses, infrastructure and facilities in the settlements in Fuzuli were divided between companies after Ayaz Orucov came. But Bilasuvar was distributed in Topchubashev's time. In spite of managing post, Mr. Orujov engages in entrepreneurship activity indirectly. At the same time, "Hydromashservis" dealing with sale-purchase, sells also construction materials to contractors higher than market prices.

Prepared by Hijran Hamidova

STUDY 4: Anti-corruption Initiatives in Oil Sector: Do Civil Society Organizations Matter?

Foreword

The aim of this chapter is to construct an analytical space for analyzing the way in which civil society, understood here in terms of the NGO sector, can play a positive role in assuring transparency in usage of oil revenues in Azerbaijan. Azerbaijan is getting daily \$ 40 million from oil sale now and the amount is expected to reach \$ 60 million by the end of 2009. It means the country with 8 million populations will get about \$ 30 billion money each year only from oil sale. The figures confirm that very important job now is to create political will to work toward enhancing of transparency in oil usage.

The chapter seeks how civil society plays/or can play role in building political will in Azerbaijan. Of course, no doubt that governments are the main location of political will. Government programs can enhance transparency or use oil revenues more effectively. But we have to recognize the role of civil society organizations (CSOs); civil society, the media, business corporations, and active individuals can all play roles in creating political will. Sustained political commitment depends on systematically building institutions outside government that will influence the government activities to enhance transparency and fight against corruption.

The main objective of the chapter is to analysis what role of CSOs plays in enhancing of transparency in oil spending and how civil society can build political will for participatory gov-

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

ernance in oil-rich Azerbaijan. Participatory approaches to fighting corruption, and especially the importance of active involvement by civil society and the media, are now generally accepted as fundamental to any successful anti-corruption reform program. From this perspective, CSOs are playing fundamental role in building political will to enhance transparency and curb corruption in oil sector.

The chapter found that in case of Azerbaijan political will set up and supported by CSOs is key to enhance transparency and fight with misusing/corruption in oil sector.

Building Political Will to Enhance Transparency and Curb Corruption in Oil Sector: Lessons from Azerbaijan

The sustainable long-term development needs to be a major focus and only criterion with the use of oil money, as with any public resource. The short-term availability of this resource, however, makes the issue more subtle and brings additional concerns. The need for sustainable long-term development makes the macroeconomic concerns priority. This is to say that the nation's strategy for the use of oil money needs to focus on the growth of GDP in the long term, fiscal stability and independence, and monetary concerns to avoid inflations and account the capacity of the public sector and implications for corruption. The strategy must clearly delineate the share and dynamics of national consumption, public investments, government expenditures and trades with other countries with the hydrocarbon resources deducted, and oil money added to the national assets. The good strategy will measure and use the oil money not as a separate consumption expenditures or investment projects, but in line with all public spending, while accumulating and saving that oil money separately.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

The key initiative is to increase role of CSOs in usage of oil revenues by building political will. In order to build political will in Azerbaijan, CSOs set up EITI NGO Coalition and started influencing the government's policy related to the oil revenues. The first initiative on the EITI was put forward by British Prime Minister Tony Blair in 2002. In June 2003, the current president of the Azerbaijan Republic, Ilham Aliyev, attended a London conference and made a statement about Azerbaijan joining the EITI and being a pilot country in the implementation of the EITI. In November 2003, President Ilham Aliyev issued an instruction to the Cabinet of Ministers, and on 13 November the Cabinet of Ministers decided to set up an inter-ministerial commission to implement the commitments undertaken by Azerbaijan at the London conference. The commission includes a number of government officials, including representatives of the State Oil Fund, the Foreign Ministry, the Ministry of Economic Development, the Ministry of Industry and Energy, the Ministry of Finance, the Tax Ministry, the Ministry of Ecology and Natural Resources, the State Statistics Committee and the State Oil Company.

After establishing EITI NGO Coalition, CSOs has work to increase the awareness of government agencies involved in the EITI. At the same time, work was carried out to create mutual understanding between the sides involved in the EITI and an exchange of opinions was held on its implementation. Both existing and potential spheres were identified during the process of identifying extractive industries in Azerbaijan. The existing spheres are oil and gas extraction while potential spheres are extraction of precious metals, including gold, silver, platinum, and at the same time, metal extraction, including iron and copper. Work was carried out to create mutual understanding between the sides involved in the initiative in

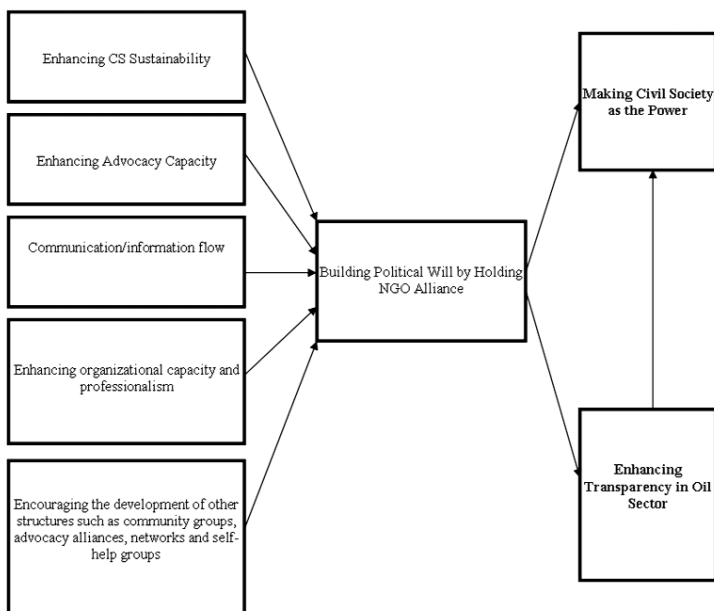
ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

Azerbaijan. This included regular meetings, and extracting companies, various government officials and non-government organizations actively participated in these meetings. The meetings discussed practical issues and established a deadline for extracting companies and the Azerbaijani government to submit a report on incomes from extractive spheres. Report forms and instructions on fulfilling them were prepared.

The signing of the memorandum on mutual understanding between the sides that joined the EITI (three sides - the government represented by the EITI commission, foreign and local extracting companies and the coalition of non-government organizations) on 24 November 2004 is of special importance here. Report forms for local and foreign companies were agreed between the parties to the memorandum. These forms are now reflected in the memorandum. Procedures for the disclosure by the government of revenues in the extractive industry were prepared and after the memorandum was accepted, Azerbaijan started implementing the EITI. The memorandum was first joined by 21 local and foreign companies and then by one more foreign company. These companies represent 11 countries: the USA, Britain, France, Japan, Russia, Canada, Turkey, Norway, China, the United Arab Emirates and Azerbaijan.

CSOs are mostly focused on establishing transparency in the broad economic system, and the Centre for Economic and Social Development in Azerbaijan works to ensure that future revenue funds will be invested in the region and expended for the benefit of the public - in poverty reduction, education, and public health - through the promotion of transparency, civic involvement and government accountability. The Centre has put the issue of transparency on the national agenda in Azerbaijan, as a key to reducing poverty and achieving economic growth.

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



Above picture shows the importance of building of political will. By doing it, NGO Alliances are able to promote sustainable development in the country.

"Political will" is not, however, simply the "will of politicians". There are leaders throughout society - professional groups, the private sector, trade unions and other civil society groups - who can be energized in the cause of containing corruption and furthering integrity. The emergence of a champion can lead to the establishment of a coalition in support of change, which is drawn from several sectors.

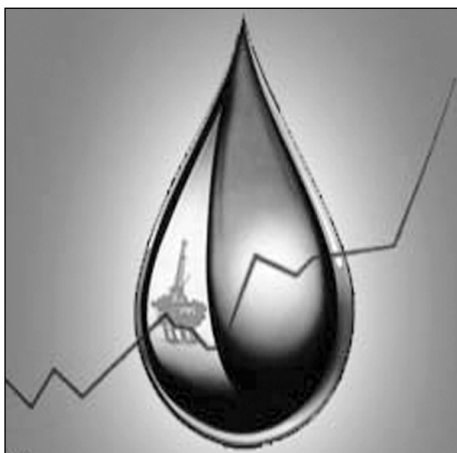
A vibrant civil society can play a significant role in the fight against corruption, legitimizing political leadership and counterbalancing recidivism. On the other hand, a weak civil society may also undermine reform, failing to provide leadership for the role

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

it must play in strengthening the reformers' position. As an activist force for change, it is a crucial catalyst for building political will.

Political will", as the concept refers to the demonstrated credible intent of political actors (elected or appointed leaders, civil society watchdogs, stakeholder groups, etc.) to attack perceived causes or effects of corruption at a systemic level. It is a critical starting point for sustainable and effective anti-corruption strategies and programs. Without it, governments' statements to reform civil service, strengthen transparency and accountability and reinvent the relationship between government and private industry remain mere rhetoric. Neither the presence nor the absence of political will can be presumed in any single initiative. It is manifest in the degree to which reform initiatives are participative and incorporate a range of political actors and civil society. Political will is affected by many variables that can be the subject of action. The rules of the political game, such as the prevalence (Sahr Kpundeh, 2008).

The CSOs are one of main power groups in Azerbaijan although there is still no "warm" relations between some government bodies and civil society groups. But through CSOs actions related to become strong institute in the country, now CSOs has real power to influence decision-making process. Even due to the development of civil society institutes, the Council on Civil Society Organizations has been established with decree of the Azerbaijan



ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

President and members of the council have been selected by CSO in the national NGOs meetings.

Since CSOs are getting stronger the attitude of the government bodies to CSOs has been dramatically changed. If there are almost none relations among two national institutes, to-day CSOs are able to attend the monitoring of state projects. The government, in fact, is not really interested in cooperation with CSOs, however, civil society institutes use different methods to make the government more accountable.

The political will is important to create the rules for the effective management, and having the strict rules is no less important in saving the nation's resources from the short-term and populist programs, as well as from the corruption. And the presence of the clear efficiency criteria and the strict rules along with the level of development of the civil society makes the transparency in the management more possible. Reciprocally, that transparency becomes a guarantee of the fund's effective management and growth in the society's wealth, and increases the sense of ownership and the level of civil society along with democracy.

It is, however, crucial to build political will to fight corruption and enhance transparency, and to play a full part in regional and global initiatives to fight corruption, not only by signing and ratifying the EITI Memorandum and other international documents, but also forcing their successful implementation. Only after NGOs' pressure the Azeri government and some oil companies did public disclosure of necessary information and periodically gave information to public about their activities. Azerbaijan NGOs Coalition actively participates in monitoring of usage of oil revenues and building of "Baku-Tbilisi-Ceyhan" Pipeline and play key role in anti-corruption initiatives.

CSOs are trying to strengthen public disclosure or awareness in oil revenues by having access to audit report. Selection Group

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

where civil society institutions have representative determine an audit company and an agreement on the provision of the appropriate services is concluded between the audit company and the EITI Committee. The experience of E?T? NGO Coalition in Azerbaijan confirms that building of political will is crucial to enhance transparency and curb corruption in oil sector.

Throughout the process, we made successful steps towards the democratization of the society at large. For instance, our major attempt was to provide for equal participation and representation of interests of key stakeholders in our final choice of Audit Company. Accessible public information on oil revenues and awareness activities in co-operation with civil society institutions; Building the capacity of civil society institutes; Development of the scope and authority of media via co-operation with media; Campaigning for more public awareness and interest of citizens for the efficient use of oil revenues.

Correspondingly, our future plans will seek to extend the transparency at companies by pushing them to come up with disaggregated figures and elaborate monitoring activities to achieve efficiency and finally make maximum use of Oil fund financed projects by making related information accessible to the mass-media and carrying out awareness activities; Development of institutional and expertise capacity in order to fulfil the commitments of the Coalitions as per the memorandum on EITI.

These future plans and other ideas will underpin our recommendations for improved decision-making in terms of companies' responsibilities to further provide their reports with disaggregated figures, elaborate MOU and promote social investments locally.

The recommended improvements addressing the development of institutional and legal framework will address and make the implementation of the proposed financial strategy for the Oil Fund possible. This will include the development of instructions,

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

guidelines and standards for portfolio investments and the rules and standards for the transfers to the State Budget and other domestic public and private uses. The recommended institutional and legal improvements are on the other hand based on the existing situation and current practices and have political feasibility implications for the suggested changes, more extensively discussed in the analysis section of the paper.

The macroeconomic development strategies flow into the financial strategy of the Oil Fund as an institute accumulating and saving that money. Once the extent of the application of oil money (i.e. what exactly need to be accumulated in the Fund) is determined to reflect the nation's the most long-term interests, the strategies for portfolio investments, for transfers to the State Budget and to the public investment projects (if the strategy finds it appropriate) must be adopted and implemented.

However, we are confronted with several challenges in a sense that, first of all, the implementation still remains restricted to only oil and gas sector and companies do not seem interested in disaggregated reporting. So far no working plan has been set in place to consider all stakeholders' interests. Another challenge is the lack of human and financial resources and low public awareness in this regard. The major concern is that the idea of additional measures towards more transparency is not promoted at higher levels.

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ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

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The main strategy is to build political will in Azerbaijan we reached was concentrating power of CSOs and by this way influencing on decision-making process. After establishing EITI NGO Coalition we were able to focus transparency issues in oil sector, to require information from both government bodies and oil companies. Aliancing strategy was used in other sectors, such on state budget transparency, health service. Developing civil society (programs aimed to increase organizational and advocacy capacity of the sector, developing resource centers and structures as community groups, advocacy alliances, networks, self-help groups) is the main task to build political will in Azerbaijan.

Endnotes

Our vision socio-economic development that reaches all levels of society and becomes sustainable, rational thinking in public decisions and active public participation. We believe that active citizen participation and transparent system are necessary elements to foster and accompany the civil society development. We believe that promoting the socio-economic rights through awareness programs is important for active public participation. We believe that developing the sense of ownership is essential both

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?



for private and community development. We value strategic partnerships with governmental agencies, and various sectors of civil society as essential for the society's sustainable development. We believe that high-quality applied research and professional learning projects are the key to initiating and maintaining the development processes. And we believe the power of civil society institutes is the key in achieving sustainable development.

Conclusion

By building political will CSOs were able to influence the government's decision-making process in Azerbaijan. The main way to reach political will was to set up CSOs Alliances in order to concentrate all opportunities in civil society sphere. Now, Azerbaijani CSOs has right to attend auditing process in oil revenues, State Oil Fund of Azerbaijan Republic regularly report to EITI NGO Alliance.

At the same time NGOs in the country are working towards enhancing transparency of budget expenditure, where oil money

ENDING DEPENDENCY: HOW IS OIL REVENUES EFFECTIVELY USED IN AZERBAIJAN?

is more than 50 percent of the total budget revenues. The government has again conceded to NGOs pressure and campaigns and has published the oil budget and distributed it among different groups, and also through informative methods such as live TV talk-shows and published articles. The Attention of influential groups such as government, parliament, the media and others was drawn to oil and budget issues. The CESD also attended parliamentary discussions and some of the suggestions they submitted were considered in the formulation of the budget. Prior to this intervention, budget documents had never been publicly published in the country. However, due to the CESD campaign the government now publishes budget documents and some CSOs have taken this advocacy on budget transparency further, and now, four years after the initiative started, even ordinary people have access to budget information! That's the power that civil society has in ensuring transparency and accountability.

Prepared by V.Bayramov

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ANNEX 1: Survey Questionnaires

Survey Questionnaires for Government Bodies

How do you assess the level of transparency over oil revenues?

There is full transparency over oil revenue expenditures

There is partly transparency over oil revenue expenditures

There is no transparency over oil revenue expenditures

I find it difficult to answer

Are you interested in making broader information on your activity to the public?

Yes

No

Hesitate to respond

Have you designed internal normative documents on public availability of information?

Yes

No

Hesitate to respond

Has your company joined the Extractive Industries Transparency Initiative (EITI)?

Yes

No

Hesitate to respond

How do you assess the activity of extractive companies?

Completely transparently

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

Partly

Their activity is not transparent

Hesitate to respond

What is the level of publicly accessibility on oil revenues?

Highly

Some extend

Low

Are the expenditures audited by an independent audit company?

Yes

No

Hesitate to respond

Are SOFAZ-financed projects implemented through tender?

Yes

There is no need to issue tender

No

I have difficulty to express a position

If tender announced, how do the public access the information?

Mass-Media

Internet

Bulletins

Other

Has SOFAZ arranged auditing of projects it financed?

Yes

SOFAZ has requested an audit company to audit projects it financed

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

No

I have difficulty to express a position

What is the level of relationship with the Oil Fund during the project implementation?

SOFAZ were regularly reported

Once the fund allocated, SOFAZ is not contacted

SOFAZ is not interested in projects it finances

I have difficulty to express a position

Survey Questionnaires for Companies

Is your company interested in publicly disclosing its private reports on payments to government?

Yes

No

Whether your company cooperate with NGOs and Mass-Media institutes?

NGOs and Mass-Media representatives are invited companies' events.

Public Relations Department cooperate NGOs and Mass-Media

There is no any cooperation with indicated organizations

There is any cooperation with NGOs, but we coopeare with Mass-Media

We are not interested in cooperating with NGOs and Mass-Media

Other

Does your company have public declaration on activities done in Azerbaijan in order to enhance transparency?

Yes

No

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

Hesitate to answer

What from following is your company interested in having public disclosure?

Total Production

Reserves

Number of employees

Relations with the government

Shareholders

Other

Is your company interested in public disclosure of financial figures?

Yes

No

Hesitate to answer

If your respond yes what figures public has access?

Revenues

Taxes paid

Payments to the Government

Expenses

Dividends paid

Is audit on the company's activities in Azerbaijan submitted regularly to the public?

Yes

No

Hesitate to respond

Is your company interested in informing the public on payments to the government?

Yes

***ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?***

No

Hesitate to respond

Does your company consider secret revenues obtained from Production Share Agreement (PSA)?

Yes

No

Hesitate to respond

Does your company make cash payments on its financial operations (excluding salary) connected with its activities in our country?

Yes

No

Hesitate to respond

If your respond "Yes", please respond following;

What percentage of all payments

Directions of cash payments

Do your company's charter or internal normative documents contain anti-corruption norms?

Yes

No

Hesitate to respond

Do you have an access to detailed information on targeted spending of payments to government?

Yes

No

Hesitate to respond

Do problems appear in company's relations with govern-

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

ment or governmental agencies?

Yes

No

Hesitate to respond

**Does your company face corruption connected with its
activity in the country?**

Yes

No

Hesitate to respond

**What is the level of your information on Azerbaijan govern-
ment's activities in ensuring transparency of oil and gas rev-
enues?**

High

Some extend

Low

Hesitate to respond

**How do you assess government's activities in protecting
transparency of oil and gas revenues?**

High

Average

Low

Hesitate to respond

**Do you have information on the activity of Coalition of
NGOs for EITI?**

Yes

No

Hesitate to respond

How do you assess NGOs' activities in protecting trans-

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

parency of oil revenues?

High

Average

Low

Hesitate to respond

Survey Questionnaires for Population

Are you aware of incomes of State Oil Fund?

Yes

No

Hesitate to answer

Do you know how the resources of the State Oil Fund are expended?

Yes

No

Hesitate to answer

Could you note incomes and expenses approved by the State Oil Fund for 2008?

Yes

No

Hesitate to answer

If your respond is "YES", please indicate this figure

How do you think, does the State Oil Fund publicly disclose information on its incomes and expenses regularly?

Yes

No

Hesitate to answer

**ENDING DEPENDENCY: HOW IS OIL REVENUES
EFFECTIVELY USED IN AZERBAIJAN?**

How do you obtain information regarding incomes and expenses of the State Oil Fund, including projects it implemented?

Mass-Media

Internet

I am unable to get those information

Hesitate to respond

How do you think, are oil incomes expended transparently?

Yes

No

Hesitate to answer

How do you think, are oil incomes expended effectively?

Yes

No

Hesitate to answer

Are you familiar with any general, financial and other reports regarding the projects carried out at the account of resource of State Oil Fund?

Yes

No

Hesitate to answer

Are familiar with annual reports of State Oil Fund?

Yes

No

Hesitate to answer

If the answer is clear, then could you inform how you got acquainted with these reports?

Mass-media

Internet
SOFAZ's bulletens
Hesitate to respond

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