



Empiric Study

How Is Oil Revenues Effectively 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), USA.

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% 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 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 \$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 nonflexible 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 trans-national 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 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.

Foreward

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), USA. 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 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 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.

1. 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.

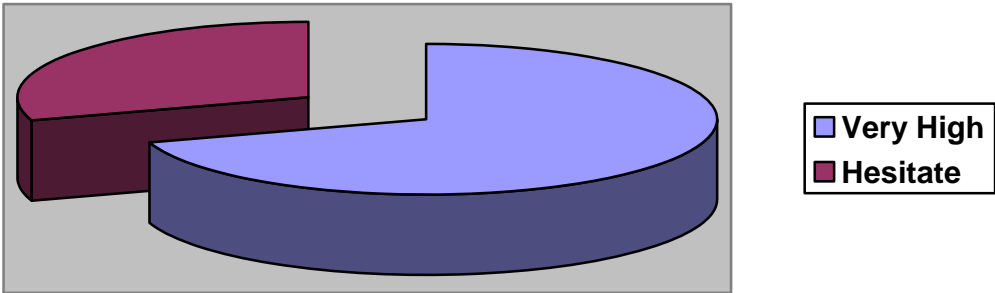
In response to the question “ Have you designed internal normative documents on public availability of information”, all government entities responded “Positively”. To them they had designed such normative documents on public availability of information.

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 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 (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.

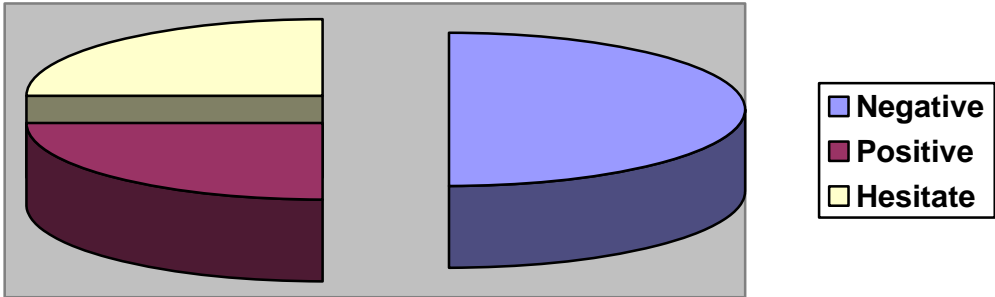
Of interviewed respondents, 25 per cent positively replied, but 75 per cent could not reply to the question “Does company have public declaration to ensure transparency of its operations inside the country”.

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.

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 replayed to the question “Are you interested 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 replied 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.

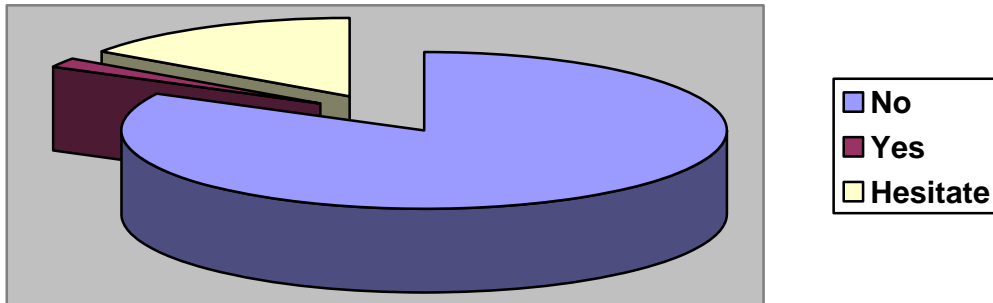
The survey held among residents is aimed at determining public awareness on expending oil revenues. For this purpose, the representatives of various layers of population were involved in survey. 80 percent of 500 respondents who participated in survey is higher- and the rest secondary-educated.

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 percent 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?

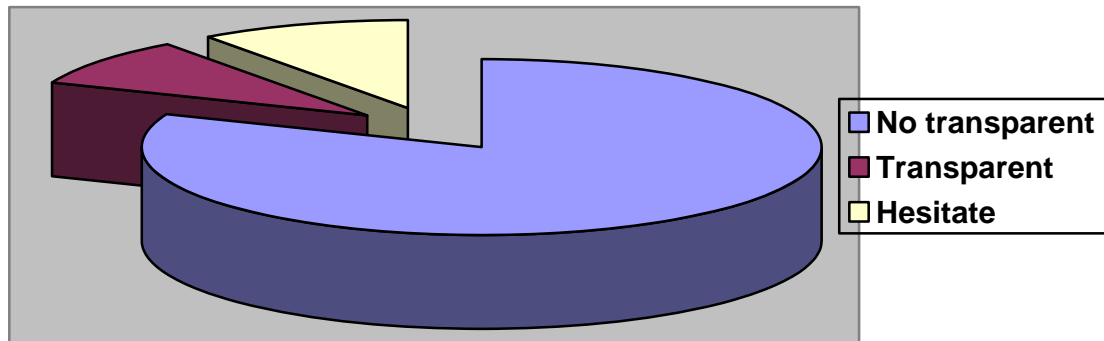


Answering the question “How do you obtain information regarding incomes and expenses of the State Oil Fund, including projects it implemented”, 34 per cent of respondents replied that they did not receive such information. 24 per cent got information from internet and 23 percent from media. 19 percent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

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.

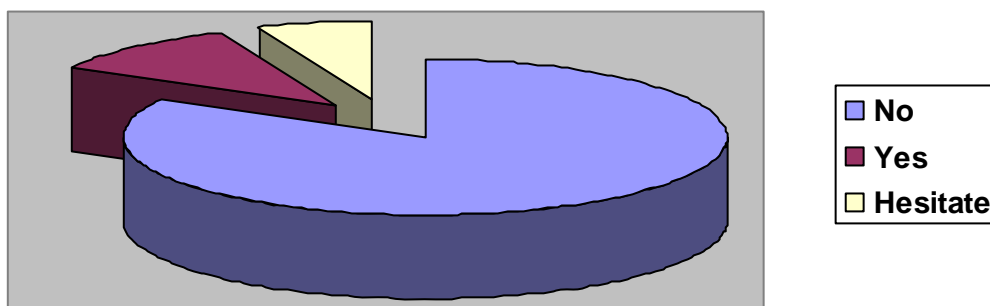
How do you think, are oil incomes expended transparently?



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

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.

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