

**AZERBAIJAN'S OIL REVENUES:
WAYS OF REDUCING
THE RISK OF INEFFECTIVE USE**

Policy Paper

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SUMMARY

The present research concerns some ways of developing an effective policy to manage the revenues acquired from the development of Azerbaijan's hydrocarbon resources.

In 2006, Azerbaijan will embark on a full-field development program of two gigantic hydrocarbon fields: Azeri-Chirag-Gunashli and Shah-Deniz. Calculations show that the Azeri-Chirag-Gunashli contract alone will fetch about \$170 billion in revenues to the country before 2025 provided that the crude price is \$45 per barrel. Besides, in peak years of production (2008-2012) the country's revenues may reach \$10-15 billion a year. For comparison, Azerbaijan's state budget in 2005 was \$2.4 billion.

In order to prevent the adverse impact of the revenue windfall on the country's economy and to lower the risk of the Dutch Disease, the government decided in late 1999 to set up the Oil Fund. This fund accumulates the bulk of oil revenues. However, revenues are also reaching the state budget both in the form of taxes and transfers from the Oil Fund. The financing of a number of state programs has been launched using the Oil Fund revenues.

This research provides a brief description of the situation involving ways of managing the growing oil revenues of both the Oil Fund and the state budget.

It looks at the main risks of losing a portion of the revenues, which include:

- 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;
- the independent media are weak.

The author's research of the existing statutory acts pertaining to the management of oil revenues and the State Oil Fund, in-depth interviews with several government officials and experts, as well as focus groups with leaders of key NGOs and the media, have led to the following suggestions towards reducing the risk of ineffective use of the country's hydrocarbon revenues:

- to modernize the legal framework for managing oil revenues;
- to boost the interest of the civil society in monitoring the process of managing oil revenues;
- to boost the capacity of civil society and independent media.

The modernization of the legal framework in which the management of oil revenues is taking place can be implemented by way of replacing the existing

uncoordinated legal acts with a special law on the Oil Fund and managing oil revenues. The law can be based on the following principles:

- parliament's exclusive decision-making right on spending SOFAZ resources;
- parliament's exclusive decision-making right on imposing restrictions on storage and placement of SOFAZ resources;
- rejection of the current SOFAZ budget concept whereby the fund's assets can also be used to finance different state projects and programs;
- distribution of a portion of oil revenues among citizens.
- targeted use of SOFAZ resources;
- establishing a parliamentary commission to observe SOFAZ's investment policy;
- having the SOFAZ executive director appointed by parliament on a presidential motion;
- attracting foreign managers for SOFAZ portfolio investment and placing its assets.

Boosting the civil society's interest in monitoring the process of managing oil revenues is an important factor of good governance of revenues. A government will be more responsible if it is aware of the civil society. Many citizens of the country do not realize that they too are entitled to a share in oil and gas revenues. Numerous opinion polls reveal that many treat these revenues as something belonging to the government elite, not to the ordinary people. Such a situation can only be changed by large-scale and comprehensive campaigns of cyclical nature which last for several years. This research provides several recommendations on how to organize such campaigns. For instance, one of the suggestions is to dedicate a certain day in a year to different activities under the motto "oil revenues belong to all". On such a day, a talk-show could be organized on a popular television channel, a special film could be shown by all regional television channels, a conference could be held, special posters could be put up in the streets, pocket calendars could be printed and handed out to people, etc.

In an effort to boost the capacity of civil society and the media, the research suggests that training sessions be provided about different aspects of oil contracts and the Extractive Industry Transparency Initiative. Another suggestion is to hold annual competitions for the best journalistic investigation concerning ways of using oil revenues.

INTRODUCTION

Azerbaijan is an oil country. Oil used to be brought here from different countries long ago. This is confirmed by well-known European and Middle Eastern travelers and historians. The country has experienced several oil booms. The first was registered in the first half of the 19th century, while the last (and maybe not?) is underway now.

Starting from 1994, the country has signed 25 PSAs. Although eight of them have now been stopped due to exploratory failures, work on other PSAs is powering ahead. Exploration work on two of these countries have revealed gigantic oil (Azeri-Chirag-Gunashli field has 5.3 billion barrels of oil) and gas (Shah-Deniz has 700 billion cubic meters of natural gas) fields.

The role the oil sector is playing in the country's economy (not to mention politics) today is confirmed by the following indicators for 2005:

- share of the oil sector in the GDP was 42%;
- share of oil and oil products in exports was 84%;
- share of the oil sector in total investment was 64% and in foreign investment 87%;
- share of the oil sector in state budget revenues was 40%

Due to the start of the full-field development of the ACG oil fields and the Shah-Daniz gas condensate field, the importance of the resource factor will grow even more. Whereas in 2005 a little over 20 million tons of oil and around 6 billion cubic meters of gas were produced, in 2010 these indicators are expected to reach 60-65 million tons of oil and 15 billion cubic meters of gas.

Therefore, the country is on the threshold of major oil revenues.

The calculations made by the author show that the ACG contract alone will fetch between \$30 and 200 billion to the country before 2025 depending on the crude oil price (calculations of anticipated revenues are based on a price range of \$15 to 50 per barrel).

What do these huge revenues mean to Azerbaijan?

1. OIL AND GAS REVENUES ARE ONLY AN OPPORTUNITY

The revenue windfall expected to start flowing in from the development of Azerbaijan's hydrocarbon resources will provide the Azerbaijani people with a historic opportunity to lay the foundation for sustainable economic development of the country, solution to poverty reduction problems and formation of a new competitive generation. But this is only an opportunity. It is possible to take it, but this opportunity can also be missed. The practice of many resource-rich countries

shows that not all of them can take this opportunity. There is a notion called the “resource curse” which has struck many countries rich in mineral resources.

Therefore, the problem facing Azerbaijan is one of good governance of oil and gas revenues. But what does that mean? Of course, it is a method of governance whereby revenues are wisely placed, spent and invested and certainly not embezzled. How can we save these revenues from ineffective governance and embezzlement? Before we attempt to answer this question, let’s find out where hydrocarbon revenues go, who disposes of them and what are the risks involved.

2. STATE BODIES ACCUMULATING OIL REVENUES

The main recipients of oil revenues in the country are the State Oil Fund, the State Budget and the State Oil Company. Revenues will also reach the State Social Protection Fund and a number of state enterprises, banks and other organizations. All these are state bodies, therefore, it is extremely important to ensure good governance in them.

Revenues of the State Oil Fund are formed by:

- Sale of the state share of the profit oil;
- bonuses;
- per-acre payments;
- transit fees;
- lease
- others.

Oil revenues of the State Budget are formed by:

- tax deductions of the State Oil Company from profit;
- tax deductions from the profit made by foreign contractors;
- tax deductions from the income of subcontractors providing services to contractors;
- tax deductions from the salaries of foreign companies’ staff.

Revenues of the State Oil Company are formed by:

- independent production and sale of oil;
- production and sale of oil products;
- participating share in oil contracts;
- other revenues.

Oil revenues of the State Social Protection Fund are formed by deductions in the amount of 22% of the salary fund of oil companies’ staff and subcontractors on oil contracts.

Different state companies, banks and other organizations providing services to oil companies also make profit.

3. STATE BODIES SPENDING OIL REVENUES

The Oil Fund resources are spend according to presidential decrees. This is stipulated by the Oil Fund Regulations which were approved by a presidential decree. Oil Fund expenditure including in a consolidated budget which is approved by parliament.

Prior to 2006, Oil Fund resources were used for:

- Financing the share of SOCAR in the Baku-Tbilisi-Ceyhan oil pipeline project;
- Improving the social status of refugees and IDPs;;
- Increasing state budget revenues.

The Oil Fund's expenditure plan for 2006 envisions the financing of:

- 1) activities aimed at addressing different social and domestic problems of refugees and IDPs – 110 million manats (about \$120 mln);
- 2) share of SOCAR in the Baku-Tbilisi-Ceyhan oil pipeline project – 38 million manats (about \$42 mln);
- 3) 2006 state budget (transfers) – 585 million manats (about \$641 mln);
- 4) Oguz-Gabala water pipeline construction project – 90 million manats (about \$99 mln);
- 5) reconstruction of the Samur-Absheron irrigation system – 37 million manats (about \$40 mln);
- 6) charter capital of the State Investment Company – 90 million manats (about \$99 mln);
- 7) activity of the State Oil Fund – about 4 million manats (about \$4.4 mln).

Therefore, a little over 954 million manats will be spent on all directions (about \$1,046 mln).

Apart from transfers into the state budget, all other expenditures are specific and have a specific addressee. Thus, the money allocated from SOFAZ for:

- the solution of refugee problems will be spent by the state committee for refugees and IDPs;
- the oil pipeline will be spent by BTC Co;
- the water pipeline will be spent by a winner of the tender procedure;
- the reconstruction of the Samur-Absheron irrigation system will also be spent by a winner of the tender;

- the creation of the charter fund will be spent by the investment company; and
- the activity of SOFAZ will be kept on the fund's accounts.

This knowledge of specific addressees will make future monitoring and audits of these expenditures a lot easier.

At the same time, the money transferred into the state budget (585 million manats) will be dissolved in the rest of the budget resources and it will be impossible to keep track of it.

So, how shall we go about keeping track of this money? Today, it would be possible only by means of total monitoring of all budget expenditures. This is a very tall task. Even the resources of the Chamber of Accounts won't be sufficient to do this. The Chamber of Accounts conducts inspections in strict accordance with an annual program approved by parliament. But this program covers only several state agencies and state projects. According to the Chamber's reports for 2005, the Chamber managed to control only about 8% of state expenditure.

Therefore, the best way out of this situation is by stopping open-ended transfers into the state budget and by using the oil money to finance only specific projects. This is envisioned by the proposed principles of the new law on the Oil Fund and on managing oil revenues.

Unspecific transfers of the oil money into the state budget are diluted and eventually distributed to different ministries and government agencies.

4 RISK FACTORS ASSOCIATED WITH INEFFECTIVE MANAGEMENT OF RESOURCES

The risk factors associated with ineffective management of oil revenues in Azerbaijan are:

- government is inexperienced in managing major revenues;
- laws are imperfect;
- the judiciary is dependent on the executive branch;
- legislature is dependent on the executive branch;
- there are no effective tools to fight corruption;
- democratic institutions are too weak;
- civil society is too weak;
- independent media are too weak;
- others.

The government's lack of experience in governing major revenues is explained by the fact that everything was decided by Moscow in Soviet times. The local government could not dispose of the oil and other products on its own. For

instance, it had no right to sell the national resources in foreign markets, had no right to form its own hard currency reserves and, consequently, did not need to govern these reserves. All this was taken care of by the central government. On the other hand, the closeness of the Soviet economy, its isolation from global economic processes, stock and commodity exchanges did nothing to foster local specialists in transactions involving securities, financial analysis of investment processes, etc. Today, Azerbaijan is trying to solve these problems by training its own specialists and attracting foreign managers to manage the assets of the State Oil Fund and hard currency reserves of the National Bank.

Imperfect laws. The laws of the country, which gained independence 14 years ago, has practically been formed anew. This process was complicated also because the country changed its development course from a socialist and centrally managed Soviet system to a market liberal-democratic one. Another difficulty was posed by the fact that in parallel with that, a whole school of lawyers and law-makers was being formed in the country. In the Soviet times, laws were written in Moscow and of course it was not an easy task to create, over a short period of time, a system of perfect laws based on a completely different attitude towards private property and other relations between economic players. Such a situation was characteristic of all post-Soviet republics. Ambiguous and unclear definitions of certain provisions of laws precondition their arbitrary interpretation on the part of government officials and eventually lay the foundation for bribery. Quite often laws do not meet the requirements of international organizations in terms of transparency, accountability and other good governance criteria.

In Policy Study we looked at a number of drawbacks in the existing laws:

- on public service;
- on state procurement;
- on the Chamber of Accounts;
- on access to information;
- on state secrets;
- on fight corruption;
- on declaration of incomes for public officers.

Dependence of the judiciary on the executive branch. So far, Azerbaijani laws and governance traditions do not ensure the independence of the judiciary. Under article 99 of the Azerbaijani Constitution, the executive power in the Azerbaijani Republic belongs to the president. On the other hand, under article 109 of the Constitution, judges of the Constitutional Court, Supreme Court and Appeal Courts are appointed by the parliament on a presidential motion. Judges of all other courts are appointed by the president who also appoints the country's

prosecutor-general with the consent of parliament. In other words, the legislative realities are such that judges effectively operate under direct control of the presidential administration. The main criterion in appointing judges is their loyalty to the presidential authority.

Dependence of the legislative branch on the executive one: In the period of Azerbaijan's independent, i.e. over the past 15 years, three parliamentary elections have been held: in 1995, in 2000 and 2005. All these elections were marred by major irregularities and described by international organizations as being not free and undemocratic. Many politicians and political analysts are convinced that the executive branch was conducting these elections after having initially prepared the lists of future members of parliament. The opposition managed to get about 5 per cent of seats in the parliament. The process of voting was accompanied by numerous irregularities, as a result of which the country ended up with a parliament obeying to the executive branch. For all these years, the parliament was easily adopting laws the drafts of which had earlier been prepared either by the presidential administration or different cabinet ministries. Very rarely were drafts of new laws initiated by the parliament proper.

Weak mechanisms for fighting corruption. Azerbaijan cannot boast of good governance indicators today. In fact, in 2005 Transparency International ranked Azerbaijan 137th-143th (together with Cameroon, Ethiopia, Indonesia, Irak, Liberia and Uzbekistan) out of 159 countries of the world for corruption perception index, which is one of the good governance indicators. A high level of corruption in the country is confirmed by a sociological survey recently (May 2004) commissioned by Transparency Azerbaijan among 1,000 respondents. According to the survey, more than 86.9 per cent of those polled see the level of corruption in the country as quite high (52.2 per cent) or very high (34.7 per cent).

Over the past two years, the government has taken a number of measures to lower corruption in the country:

- law on fighting corruption has been adopted;
- the state program to fight corruption has been adopted;
- the law on declaration of incomes for public workers has been adopted;
- the state commission to fight corruption has been set up;
- a department to fight corruption has been established within the Prosecutor-General's Office;
- other measures have been taken.

The number of punishment for corruption-related crime has increased. However, the fight against corruption has not become a priority state policy yet.

Weak democratic institutions. Democratic traditions in Azerbaijan date back to 1918, when, after a revolution in Russia, the Azerbaijani Democratic

Republic was formed. It existed for only two years. Then Soviet Russia annexed Azerbaijan again and established Bolshevik dictatorship here. The new era of democratic transformation started after Azerbaijan gained independence in 1991. The first election, which was quite close to democratic standards, was held in June 1992 when Abulfaz Elchibay was elected as president of the Azerbaijani Republic. The fact that the election broke the Soviet tradition of supervised voting and falsified vote count is confirmed at least by the information that the president received about 59 per cent of the votes, while the runner-up got about 35 per cent. All subsequent elections in the country were marred with major irregularities which were registered by international organizations. The country's parliament, elections to which were held in 1995 and 2000, was actually formed, not elected. The process was managed by the presidential administration. The presidential election held in 1993 (early election), 1998 and 2003 were marred with certain irregularities which were reflected in the reports of international organizations. At the same time, it has to be acknowledged that Heydar Aliyev really had the highest popularity rating in the country which was also confirmed by numerous sociological surveys. There are more than 50 political parties in the country, but the vast majority of them are midget parties. The conditions of political struggle in the country are too far away from being described as democratic.

Weak civil society organizations. There are about 2,000 nongovernmental organizations in Azerbaijan. Most of them are not registered. Until several years ago, registration of NGOs was extremely complicated. The situation has slightly improved over the past two years. The existing NGOs operate in different spheres: human rights, ecology, legal awareness, social support, etc. The weakness of civil organizations is mainly explained by the fact that they are very still very young and their financial status is not stable. Civil organizations, with only a few exceptions, have yet to become an effective instrument for monitoring the government's work.

Weakness of the independent media. There are independent print media in the country represented by a handful of newspapers. There are many more newspapers expressing the opinion of the authorities or the opposition. The daily print-run of independent newspapers is negligible and accounts for about 0.5 per cent of the capital city with the population of 3m people. The print-run of the opposition press is slightly bigger – about 2 per cent of the population of Baku. Such low print-run figures are explained by the poor purchasing power of the population. Therefore, the main source of information for the country's population is the six television channels, two of which are state-owned, three are owned by people close to the authorities and one other private channel is owned by people who are less affiliated to the government but are prone to their

influence nonetheless. The channel expresses the opinion of the government much more frequently than that of the opposition in politically active periods. According to article 57 of the Constitution, Azerbaijani citizens have the right to criticize the work and activities of state bodies and their officials, political parties, trade unions, other public organizations, and individual citizens. At the same time, according to the same article, insult and slander cannot be considered as criticism. Legal norms providing for an explanation of insult and slander are contained in articles 148 and 147 respectively. Censorship in the country is legally banned. According to article 6 of the Law on freedom of information adopted by the Azerbaijani parliament on June 19, 1998, state censorship in the media is unacceptable. The unacceptability of censorship in the media is confirmed by article 7 of the Law on the mass media. In practice, however, the presidential administration enforces unofficial censorship on pro-government and independent media. Opposition newspapers criticize the government systematically. Independent newspapers do that quite often too. However, no matter what scathing articles they may publish, this does not perturb the authorities too much. There is practically no reaction to critical articles, and this significantly weakens the role of the media in the fight against corruption. Opposition and independent newspapers publish articles about corruption quite often. But in many cases these articles are not a product of an in-depth journalistic investigation. Besides that, their coverage of the electorate is very insignificant. Television channels broadcast programs about corruption very rarely and even those few that are televised are very selective. There are extremely many cases when journalists were punished on charges of slander.

5. SOME WAYS OF REDUCING THE RISK

The suggestions towards reducing the risk of losses discussed in this paragraph do not cover all possible measures at improving the effectiveness of oil revenues. Besides, they have been designed on the basis of the current legislation and the decision-making practice. Neither is it ruled out that some of the proposed measures will have been implemented by the time this *Policy Paper* comes out.

The author's analysis of the existing legal acts pertaining to the management of oil revenues and of the activities of the State Oil Fund, as well as in-depth interviews with several government officials and experts, as well as focus groups with leaders of key NGOs and the media, have led to the following suggestions towards reducing the risk of ineffective use of the country's hydrocarbon revenues:

- to modernize the legal framework for managing oil revenues;
- to boost the capacity of civil society and independent media;
- to boost the interest of the citizens in oil revenues.

5.1. Modernizing legal framework for managing oil revenues

Adoption of the law on the Oil Fund and oil revenue expenditure

The activities of SOFAZ and the policy of spending oil expenditure are regulated by the following statutory documents:

- Presidential decree dated December 29, 1999 establishing the State Oil Fund;
- Regulations of SOFAR approved by a presidential decree dated December 29, 2000;
- Rules of storing, placing and managing hard currency reserves of the State Oil Fund. The Rules were approved by a presidential decree dated June 19, 2001;
- Rules for developing and executing the annual budget of the State Oil Fund, approved by presidential decree dated September 12, 2001. Subsequently, the rules were amended twice: on February 7, 2003 and on March 1, 2005.;
- “Long-term strategy for managing oil revenues”. This strategy was approved by a presidential decree on September 27, 2004.

In our previous research we pointed to the important provisions of these documents and to the norms in them that may heighten the risk of ineffective expenditure of oil revenues.

The improving of the legal framework in which the management of oil revenues is taking place can be implemented by way of replacing the existing uncoordinated legal acts with a special new law on the Oil Fund and managing oil revenues.

The law should also reflect the following principles:

- parliament’s exclusive decision-making right on spending SOFAZ resources;
- parliament’s exclusive decision-making right on imposing restrictions on storage and placement of SOFAZ resources;
- rejection of the current SOFAZ budget concept whereby the fund’s assets can also be used to finance different state projects and programs;
- distributing a portion of oil revenues among citizens. In doing so, it is necessary to ensure that citizens are entitled to a fair share in the oil revenues;

- targeted use of SOFAZ resources;
- establishing a parliamentary commission to observe SOFAZ's investment policy;
- having the SOFAZ executive director appointed by parliament on a presidential motion;
- attracting foreign managers for SOFAZ portfolio investment and placing its assets.

Decision-making monopoly of the parliament on spending SOFAZ's resources. The use of this principle in the new law would mean the transfer of the decision-making right on spending SOFAZ resources from the president to parliament. According to the existing Regulations of SOFAZ, the spending of oil revenues is effected by annual presidential decrees on priority expenditure directions (paragraph 4.1.). The transfer of this right to parliament would enable decision-making by a broader spectrum of stakeholders because parliament represents not only different political forces but also many other sectors (business, education, health, etc.), regions, ethnic groups, etc.

Monopoly of parliament for restrictions on the storage and placement of SOFAZ resources. Today, decisions on storage and placement of SOFAZ resources are made by the SOFAZ executive director on the basis of the Rules for keeping, placing and managing the hard currency resources of the State Oil Fund, which have been approved by the president. In view of the adoption of the new law, it must reflect norms pertaining to these rules.

Rejecting the concept of the SOFAZ budget which, in addition to expenditure relating to the fund's current activities, also contains expenditure on different state projects and programs. According to the abovementioned Rules for developing and executing the annual program (budget) of the State Oil Fund, the fund's expenditure, in addition to expenses associated with the fund's current activities, also envisions expenditure on the implementation of various state projects and programs. Prognostication of the fund's expenditure, according to the said Rules, is performed jointly with the Finance Ministry. It might be appropriate to exempt SOFAZ from having to make a prognosis of its expenses on the said projects and programs. This work must be carried out within the framework of a single budgetary process.

Distribution of a portion of oil revenues among citizens. The high level of oil revenues for a number of years during peak levels of hydrocarbon production will make it possible to distribute a portion of them among citizens. **In doing so, it is necessary to ensure that all citizens are entitled to a share of the revenues.** By allocating funds for the solution of social problems of refugees and IDPs, the government is actually violating the right of other citizens to natural wealth

which is considered to be common. This policy also leads to the growing discontent of other citizens and conflicts. Such conflicts are not widespread, but the level of discontent has been on the increase lately. Calculations show that with a world market price of oil at \$50 per barrel, the country's revenues could reach \$15 billion in 2009. If \$8 billion is divided among citizens, this would mean that each of them will receive \$1,000. This is good money for a country in which almost 40% of the population lives beyond the poverty line. The annual income of these people does not exceed \$600 and it is not too difficult to understand how glad these people will be. Also, the attitude of many people toward oil contracts will also change profoundly. Sociological surveys show that many see them as a means of self-enrichment for the government elite.

Targeted use of SOFAZ resources. The implementation of this principle would mean the rejection of meaningless transfers from the fund to the state budget. Such transfers become negligible in total budget expenditure and it is impossible to keep track of them afterwards. Targeted use of the resources for specific projects would enable us to monitor how this money has been spent.

Establishment of a parliamentary commission to observe SOFAZ's investment policy. According to the Regulations on the SOFAZ, there is an Observation Council which is formed by the president. This council must be made up of representatives of the government, parliament and public organizations. Although three years have passed, representatives of the civil society have yet to be included. Under the said Regulations, the fund is not accountable to parliament, which means that the discussion of the fund's work is rather limited. When forming the parliamentary commission to monitor the fund's investment activities, the experience of Norway could be used. In Norway, this commission consists of MPs representing an opposition party. But even if the commission has a mixed composition, it will have a positive effect.

Appointment of the SOFAZ executive director by parliament on a presidential motion. According to the Regulations on the SOFAZ, the executive director is now appointed by the president, i.e. just like ministers. But for the nature of work this position is similar to that of the chairman of the National Bank, who is appointed by parliament on a presidential motion.

Attraction of foreign managers to SOFAZ portfolio investment and placement of its resources in foreign banks. This is envisioned by the existing Rules for storing, placing and managing the hard currency resources of the State Oil Fund. These norms must also be present in the new law.

Alternative to the adoption of a new law

If there is stiff resistance to the adoption of the new law or if its adoption delays, it might be worth, as an alternative to the adoption of the law, amending

the above-mentioned legal acts pertaining to SOFAZ and to the management of oil revenues. The essence and the list of proposed amendments could be defined on the basis of the previous study which revealed the loopholes in the said statutory acts.

Improving legal acts pertaining to public service

In the previous study we looked at a number of drawbacks in the existing laws:

- on public service;
- on state procurement;
- on the Chamber of Accounts;
- on access to information;
- on state secrets;
- on fight corruption;
- on declaration of incomes for public officers.

The elimination of drawbacks in these laws would lower the risk of corruption at the stage of expenditure of oil revenues.

5.2. Boosting the potential of the civil society and mass media

Measures towards both quantitative and qualitative growth of NGOs would be appropriate in the country today. The existing procedures for the registration of NGOs are too complicated and need to be simplified. Namely, it is very important to amend the current law on public associations and funds or to adopt a new law on non-commercial organizations. The existing law does not provide for the establishment of any non-commercial organizations than NGOs and foundations. For instance, an attempt to establish a non-profit Think Tank would not be materialized, which is why such institutes are established in Azerbaijan in the form of Ltd. It does not make sense to set up an NGO because of a membership issue involved.

Even if the existing law is left unchanged, then at least the legal acts of the Justice Ministry pertaining to registration have to be reconsidered. They make the registration procedure extremely complicated and leave room for the ministry officials to deny or delay the registration of an NGO. There are numerous provisions in these acts which are completely meaningless and unfounded.

There are still cases when ministry officials consult those of the presidential administration on whether to register NGOs which take a critical stance towards the incumbent authorities. For example, Transparency International – Azerbaijan was registered only in late December 2005, i.e. registration was granted only five years after the organization was set up. And this too happened with assistance of the US ambassador.

Boosting the potential of the civil society and, most importantly, the NGOs dealing with the monitoring of oil revenues could be possible by providing training and roundtables.

These measures are part of the action plan of the Coalition of 67 Azerbaijani NGOs, "To Improve Transparency in Extractive Industry", for 2006-2007. The Coalition was established in May 2004 and aims to monitor oil revenues within the EITI framework. Azerbaijan is one of the EITI pilot countries. The establishment and work of the Coalition are a good example of NGO public policy in Azerbaijan. The Coalition is also a signatory to an MoU signed on November 24, 2004 between the government, 22 petroleum companies and the Coalition proper. This Memorandum signaled the launch of the EITI in Azerbaijan, as a result of which the country's revenues and all payments made by petroleum companies have become transparent. The Coalition also strives to improve public awareness of oil contracts and country revenues and to conduct roundtables and training sessions for NGOs and the media. The Coalition's plan for the next two years has been prepared with the participation of the author of the present research, who happens to be the coordinator of the Coalition. The plan proposes the implementation of different projects, including projects concerning such areas as:

- increasing public interest and capacity,
- to boost the capacity of the Coalition,
- to improve legislation in order to boost transparency in the extractive industry,
- to cooperate with other countries and public associations involved in the EITI,
- to cooperate with international financial institutions,
- to exercise control over the use of extractive industry revenues,
- to increase oil revenues (by way of reducing ineffective expenditure).

It is also important to ensure that NGOs work in a coordinated fashion because over the past few years several NGOs have been engaged in issues of increasing the budget transparency and monitoring expenditure in different areas (education, health, etc.).

The focus groups and in-depth interviews with heads of a number of media outlets and journalistic associations held by the author of the research have revealed some important directions of improving journalists' awareness of oil contracts, anticipated revenues, legal acts pertaining to the management of oil revenues and government expenditure of the revenues. Besides, the focus groups and interviews have shown that it is also important to make journalists more interested in monitoring the spending of oil revenues and carrying out

journalistic investigations. Therefore, the following measures could be instrumental in improving the effectiveness of the media in the area of monitoring oil revenues:

- training journalists;
- providing a series of lectures at journalistic faculties;
- conducting a special roundtable for the editors of the leading mass media;
- arranging competitions for the best journalistic investigation about how oil revenues are spent;
- arranging competitions for the best short film;
- creating special clips and broadcasting them on television channels.

All these measures will certainly boost the potential of the more active part of Azerbaijani society.

5.3. Boosting citizens' interest in oil revenues

Many citizens do not yet realize fully that they too are entitled to a share of the oil and gas revenues. Opinion polls show that people treat these revenues as something belonging to the government elite, not to the ordinary people. The reason for this is that people do not know enough about oil contracts, about how much the country is earning today and how much it will earn in future, and how this money is being spent.

This situation can only be changed by large-scale and comprehensive campaigns of cyclical nature which last for several years. It might be worth conducting public activities capable of attracting public attention to the theme of oil revenue spending. This could be done with the aid of the mass media and contact with broad public. For instance, one of the suggestions is to dedicate a certain day (week) in a year to different activities under the motto "oil revenues belong to all". On such a day (week), the following activities could be held:

- a talk-show could be organized on a popular television channel;
- a special film could be shown by all regional television channels;
- a conference could be held;
- special posters could be put up in the streets;
- pocket calendars could be printed and handed out to people;
- special books, brochures and booklets could be printed and handed out to people;
- other activities.

Boosting the civil society's interest in monitoring the process of managing oil revenues is an important factor of good governance of revenues. A government will be more responsible if it is aware of the civil society.

6. ANTICIPATED DIFFICULTIES AND WAYS OF OVERCOMING THEM

6.1. Adopting the Law on the Oil Fund and managing oil revenues

Transfer of presidential powers to parliament

The principles of the new law proposed in paragraph 4.1 concern presidential powers. The suggestion is to hand presidential powers concerning the spending of oil fund resources over to the parliament. What will the president's reaction be? Mostly likely he will be opposed to the move, but he might also treat the suggestion positively.

The president is most likely to take a negative stance towards the hand-over of such powers to parliament. These powers are an important component of his political authority. By disposing of these resources, the president can easily deal with different waves of public indignation or solve the problem of financing emergency situations. On the other hand, the president effectively controls the current parliament. The opposition is too weak, while the ruling party has absolute power in it. This factor may prompt the president to succumb to the pressure of the politicians who are urging the president to hand over his powers to parliament.

Besides, the president may be tempted by the idea that the hand-over of these powers would relieve him from responsibility for decision-making. At the same time, he will still have the ability to have any decision adopted by parliament. In other words, the same result can be achieved without a visible damage to democratic principles.

How strong are the positions of the president's assistants and consultants who are in favor of providing the parliament with the right to dispose of oil revenues? The analysis carried out by the author shows that there are several people in the president's entourage who agree with this. But the vast majority of his assistants are ardent supporters of authoritarianism and unlimited power of the president in many issues, including everything that has to do with oil revenues.

What to do? What instruments of persuasion and pressure do the civil society and media have? How effective can the opposition's actions be? Is it possible to count on the assistance of international institutions in these issues?

The situation in the country is such that the efforts of international institutions, the World Bank, the IMF and others can prove to be the most effective. It is as a result of persistent recommendations of these institutions that eventually yielded fruit and the State Oil Fund was established. It is also thanks to these institutions that changes were made to the law on the budgetary process and the oil fund expenditure became part of a consolidated budget.

Of course, it would be wrong to deny that the media, civil society and political parties can also have an impact. This idea will be strongly supported by MPs from the opposition and others. Many MPs will definitely be interested in acquiring powers to dispose of oil revenues. In order for all these bodies to really support the idea of handing over expenditure powers to parliament, some work must be carried out with them, i.e. roundtables, publications, analytical reviews, etc.

Rejecting the current budget concept of SOFAZ

The rejection of the SOFAZ budget concept (which, in addition to expenses related to the fund itself, also envisions expenses on different state projects and programs) will be the result of the president's readiness to assign his powers to dispose of the fund's resources to parliament. However, even if the president decides not to do that, it will still be possible to give up the existing concept. To do that, it would be necessary to include expenditure of oil revenues on different state projects and programs into a list of all other state budget expenditure which would specify the funding source. By doing so, the government would ensure that the concept of forming a plan of state expenditures is observed. This work could be vested only in the Ministry of Finance. On the other hand, the Oil Fund would be left to perform its direct functions of placing and storing the resources and making portfolio investment. Under such circumstances, the Oil Fund's budget would only include expenses on its own operations.

Distribution a portion of oil revenues among citizens.

This idea is not expected to go down well with the administration of some ministries and the National Bank. Some of them (especially the National Bank) will be wary of macroeconomic repercussions of this move, while others will be worried about the subsequent reduction in oil revenue expenditure, which, in its turn, will mean less money for the ministries receiving these resources under different programs and projects. But these people have to understand that the expenditure of oil revenues through the budget or by means of distribution to citizens basically means the same from the standpoint of increasing the circulation of cash. The difference is that in one case this is done by citizens, while in the other by government officials who also manage to misappropriate a portion of this money.

For the president, this idea may seem attractive because his team may start a good PR campaign, which may come in handy ahead of the 2008 presidential election.

Targeted use of SOFAZ resource

Who can be opposed to this?

Direct transfers from the Oil Fund into the state budget reduce tension in the state bodies which are responsible for budget revenues. These, of course, are the Ministry of Taxation and the State Customs Committee. The Finance Ministry, which is responsible for the draft of the next year's budget, feels more at ease if there is an opportunity to take the necessary amount from the Oil Fund. Therefore, just like the said ministries, it will also be opposed to the proposed principle. Other opponents may include major state companies which are large taxpayers. With transfers from the oil fund into the state budget, their delaying payment of taxes may not be so noticeable for the country's leadership.

As a matter of fact, many state bodies are interested in transfers from the Oil Fund because in this case they are likely to receive a portion of them

The president is likely to stick to the practice of the last few years when certain amounts were transferred from SOFAZ into the state budget. This practice ensures stability of budget revenues.

In fact, supporters of unspecific transfers into the state budget may also include those who receive salaries from the state budget. In other words, it is very easy to convince ordinary citizens that this practice is correct and is socially oriented.

What is to be done under such circumstances? How can the president be persuaded to give up unspecific transfers into the state budget? How is it possible to convince ordinary people that the seeming social orientation of the transfers, first of all, breaches the principle of equal entitlement of all citizens (whether they are public workers, refugees or not, etc.) to oil revenues and, secondly, creates the risk of embezzlement of oil revenues on the part of government officials?

There is one effective remedy – educational and explanatory work with citizens and those in state administration who can potentially become allies. Of course, explanatory work must first of all be held with representatives of other branches of power: judicial and legislative. It would be a lot easier to find allies there than in the executive branch. But the author of the present research know a number of high-ranking officials who will unconditionally be in favor of suspending unspecific transfers of SOFAZ money into the state budget.

Establishing a parliamentary commission to monitor SOFAZ's investment policy

The establishment of such a commission puts the executive branch on a hot seat at all times and in all countries. But this is what is required by democracy and by the interests of reducing the risks of losing natural resource revenues.

Who can act as allies in the establishment of the parliamentary commission? There are overt and covert allies in other branches. There will be some in the executive branch too.

Appointing the SOFAZ executive director by parliament on presidential motion.

Here, we can express the same suppositions as above. The presidents will perhaps be less inclined to agree with this principle because he has the right (established by a presidential decree) to appoint the executive director. But there are several arguments which can convince him to give up the existing practice. First of all, the right of the president to personally appoint the SOFAZ head is rather dubious. Secondly, the possession of such a right means that the president is sharing responsibility for possible mistakes in the management of oil revenues.

Possibility of attracting foreign managers for portfolio investments and placement of SOFAZ assets.

This principle is unlikely to have serious opponents because many people understand that this is a necessary measure and is explained by the fact that Azerbaijan does not yet have enough experience for independent management of revenue windfalls.

6.2. Improving the potential of civil society organizations and the media and citizens' interests in oil revenues and expenditure

The main problem in this area is financial. The cost of activities listed in paragraph 4.2 and 4.3 depends on the number and nature of the activities (roundtables, training sessions, journalistic competitions, short films, special editions, TV programs, etc.) and the number of areas they cover. The more money is spent, the higher the effect. However, we have to keep in mind that starting from a certain amount the effectiveness will start declining despite the growing expenditure.

Is it possible to expect obstacles on the part of the authorities? This is unlikely to happen. Especially if these activities are carried out by the NGO Coalition (mentioned above) which is the government's partner in the EITI.

6.3. Role of international institutions

International financial institutions such as WB, IMF, EBRD, ADB, as well as the European commission and development agencies of a number of leading countries (such as USAID, DFID, etc) have been playing an important role in facilitating the country's shift to democratic society and liberal economy. By providing technical and financial assistance, they actually act as partners of the government in many reforms. Although this relationship is not always smooth and at times even tense, the country is undergoing reform, slowly but steadily.

The role of international institutions and different international and national NGOs in developing the civil society in Azerbaijan is also quite important.

All this leaves hope that international institutions will help both the government and civil society organizations ensure good governance of oil revenues.

The role of international institutions is facilitating the above-mentioned good governance of oil revenues can be quite extensive. Such assistance on the part of international institutions could be in the form of:

- technical assistance to the government and civil society organizations;
- financial assistance to civil society organizations.

The NGO Coalition of Azerbaijan intends to conduct a roundtable attended by representatives of the Oil Fund and international financial institutions to discuss the key principles of the new law on the Oil Fund and managing oil revenues.

7. CONCLUSION

The analysis of the situation surrounding the management of oil revenues and the government policy being implemented in this area shows that there is room for improving management by means of reducing the risk of losing a portion of the revenues. These reserves can be enacted by adopting a new law on the oil fund and on managing petroleum revenues and by stepping up the activity of civil society. However, every suggestion has supporters and opponents. As a matter of fact, these people are not firm in their convictions and it is possible to win over people from the other camp. In other words, the degree of success depends on how thought-out the action plan is, who is implementing it and what are the financial conditions.

Some of the recommendations made by the author of this Policy Paper have already been included into the Action Plan of the Azerbaijan NGO Coalition. Also, approval has already been received from a number of international donors for financing different sections of the plan.

There are reasons to believe that the MoU signed on November 24, 2004 between the government commission, oil companies and the NGO Coalition will create a constructive environment for the discussion of many recommendations.

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The views in this report are the author's own and do not necessarily reflect those of the Center for Policy Studies, Central European University or the Open Society Institute.

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