

INFORMED CITIZENRY, ACCOUNTABLE GOVERNMENT AND EFFECTIVE MANAGEMENT OF OIL RESOURCES

Poverty is an outcome of the accountability and responsiveness of state institutions
Attacking Poverty, World Development Report, 2001

Azerbaijan is facing the danger of reduced economic growth, increased inequality, decreased child welfare, and greater vulnerability to economic and political shocks. All these are symptoms of a disease depicted within the “resource curse” paradigm¹.

Despite the gloomy picture described by scholars, the “resource curse” is avoidable² if complex set of actions is taken by the government. The forthcoming policy study will address only one of variables to be employed under the struggle against “resource curse”, i.e. improved transparency and accountability in use of oil resources.

This issue paper (i) describes symptoms of resource curse in Azerbaijan, (ii) examines steps already undertaken to enhance accountability and transparency in use of the country’s oil resources, and (iii) briefly outlines main hypothesis to be examined in the forthcoming policy study.

Resource curse in Azerbaijan³

Azerbaijan’s economy becomes increasingly dependent on oil, as illustrated through the “resource dependence indicators”. About 74% of FDI (foreign direct investment) is concentrated in the oil and gas sector⁴. Hydrocarbon sector brings half of the tax revenue, with one third of budget revenue coming from the State Oil Company of Azerbaijan (SOCAR). The oil sector’s large share in trade is more than 85% of exports⁵.

Increase in inequality, decline in growth and deterioration in social welfare are seen as harmful effects of resource curse. Inequality in Azerbaijan, as illustrated by GINI coefficient, increased from 0.3 in 1989-90 to 0.5 in 2000⁶, reflecting a widening inequality along geographic area and various social strata. Economic growth, although impressive, does not apply to non-oil sector. Average rate of GDP growth for the period 1995 – 2005 was approximately 13%, with real GDP growth in 2005 achieving 26%⁷. However, the increased GDP growth in oil sector is accompanied with the significant decline in non-oil sector⁸. About 42% of GDP⁹ is concentrated in hydrocarbon sector that accounts for

¹ For more details on harmful effects of resource curse see Michael Ross, “Extractive Sectors and the Poor” *Oxfam America Report 2001*, Michael Ross, “The Political Economy of the Resource Curse” *World Politics* 51 (January 1999), 297-322, Michael Ross, “Does Oil Hinder Democracy”, *World Politics* 53 (April 2001), 325–61, Terry Lynn Karl, “Understanding the Resource Curse” in *Covering Oil: A Reporter’s Guide to Energy and Development* published by Revenue Watch, Open Society Institute and Initiative for Policy Dialogue, 2005

² Joseph E. Stiglitz, “Making Natural Resources into a Blessing rather than a Curse”, in *Covering Oil: A Reporter’s Guide to Energy and Development*

³ Brief historical summary of petroleum wealth in Azerbaijan has been described in “Caspian Oil Windfall: Who Will Benefit” published by Caspian Revenue Watch/Open Society Institute, 2003 (Chapter 5 produced by Sabit Bagirov, Ingilab Akhmedov and Svetlana Tsalik), and “Some Common Concerns: Imagining BP’s Azerbaijan-Georgia-Turkey Pipelines System” published by PLATFORM, The Corner House, Friends of Earth International, CEE Bankwatch Network, Campagna per la Riforma della Banca Mondiale, and the Kurdish Human Rights Project.

⁴ EU/Azerbaijan Country Strategy Paper

⁵ John Wakeman-Linn, Paul Mathieu and Bert van Selm, “Oil funds and revenue management in transition economies: the cases of Azerbaijan and Kazakhstan”

⁶ UNICEF Innocenti Research Center (2003), *Social Monitor 2003*. Florence: UNICEF, p.93

⁷ *Country Profile 2006*, Ministry of Economic Development. <http://www.economy.gov.az/>

⁸ Rupinder Singh – Juhani Laurila, “Azerbaijan: Recent Economic Developments and Policy Issues in Sustainability of Growth”, 1999 <http://www.bof.fi/bofit/eng/6dp/abs/pdf/dp0599.pdf>

⁹ Asian Development Outlook, <http://www.adb.org/documents/books/ado/2006/aze.asp>

only 1% of employment. Therefore one cannot expect oil sector to contribute significantly into reducing the high unemployment rate in Azerbaijan (11% in 2003)¹⁰.

Despite the considerable GDP growth, poverty still remains significant in Azerbaijan. WB data puts Azerbaijan among those countries that, within the last 20 years, fell back from MIC (middle income) to LIC (low income) status and did not managed to return back to MIC¹¹. Poverty assessment report of 2002 shows poverty level as high as 47%¹². The latest government report claims poverty being decreased to 27% within less than 2 years. Such a drastic change in poverty level is perceived as controversial, and official statistics are contested by civil society and international community.

In Human Development Index Azerbaijan is ranked 101st, with the smallest per capita health expenditure and the highest child mortality rate among former Soviet Union countries¹³. Child mortality and infant mortality rates for the period 1991 – 2000 were estimated to be as high as 92/1,000 and 81/1,000 consequently¹⁴. The discrepancy between these figures and official statistics is very significant¹⁵. However, certain drawbacks in registration of childbirths and maternal mortality¹⁶ allow suggesting that official statistics underestimate the problem.

In terms of political situation, the country is ranked as semi-consolidated authoritarian regime¹⁷. All elections, including presidential elections in 2003, municipality elections in 2004 and the most recent parliamentary elections in 2005 were consistently marked with gross manipulations, significant irregularities and fraudulent behaviour in favour of ruling party¹⁸.

Serious shortfalls in government accountability in Azerbaijan prevent poor people from capitalizing on country's natural and human resources to get out of poverty. Azerbaijan is continuously among the most corrupt countries in the world¹⁹. It has the highest average bribe payment, as % of annual revenues, among 22 transition countries²⁰. As indicated in the Joint Staff Assessment Report, "*the impact of budgetary spending is adversely affected by serious governance problems at all levels*"²¹. Although this statement was made with regard to Azerbaijan's health sector, it describes, not less accurately, the state of things in any other sector of economic and social life in the country.

Government agencies responsible for budget processes are very reluctant to open up for civil society participation despite AzGov's commitment to international agreements with IMF, WB, Council of Europe, etc. The State Programme on Poverty Reduction and Economic Development (SPPRED) was adopted in February 2003 to "*produce national strategy for poverty reduction*"; it also was supposed to be a "focal point for ensuring better coordination of external (donor) assistance aimed at poverty reduction"²². However, financial allocations within the SPPRED were not reflected properly in the state budget document, thus making budget tracking for SPPRED very difficult. As indicated in the WB Country Assistance Strategy for Azerbaijan Republic, one of the major areas to be improved is "*further refinement of costing and prioritization of actions consistent with annual budget envelopes*,

¹⁰ Unemployment data is marked by significant discrepancy. The State Employment Services reported unemployment rate of 1.2%. SPPRED document refers to census data from 1999 to give a non-registered unemployment rate.

¹¹ Achieving the Millennium Development Goals: the Middle-Income Countries, a strategy for DFID: 2005-2008, p. 5,

¹² *Annual Report (2003) on the State Programme on Poverty Reduction and Economic Development*, p.17.

¹³ <http://www3.who.int/whosis/country/compare.cfm?country=AZE&indicator=PcTotEOHinIntD&language=english>

¹⁴ Reproductive Health Survey; According to the survey, infant and under five mortality declined in the 1996-2001 period, compared to the 1991-95 period (infant mortality from 74.4 to 85.9 and under five mortality from 96.8 to 88.4)

¹⁵ As indicated in the SPPRED Report, official statistics records infant mortality in Azerbaijan in 2002 as being 12.8 per thousand live births, and the under-five mortality rate as reaching 23.1 per 1000 in 2002

¹⁶ Official statistics does not record death from pregnancy and postpartum complications at home as maternal mortality; it does not register births of infants who die shortly after births. In addition early neonatal deaths and early deaths of premature infants are registered as stillbirths. For more information see "Primary Health Care Assessment" developed by USAID, and UNICEF's Multiple Indicator Cluster Survey

¹⁷ Democracy Score Ranking 2006, Freedom House

¹⁸ For detailed information on election irregularities in Azerbaijan see reports by OSCE, Office for Democratic Institutions and Human Rights, International Helsinki Federation for Human Rights, and Human Rights Watch

¹⁹ *Global Corruption Report*, Transparency International

²⁰ http://www.worldbank.org/wbi/governance/pdf/quinghua_presentation_hellman.pdf

²¹ *Joint Staff Assessment Report*, p. 7 2004

²² *Annual Report (2003) on the State Programme on Poverty Reduction and Economic Development*, p.6

within the Medium-Term Expenditure Framework and Public Investment Programme". Lack of transparency and effectiveness in resource management remains significant²³. It is very difficult to track national expenditure because there is a very vague, if any, link between expenditure choices and reform plans (or declared policy objectives). The lack of linkage between reforms and expenditure implications of these reforms is also due to very poor cost evaluation of policies/reforms as stipulated in the PRSP.

Decision-making is highly centralized. Coordination between various government agencies is poor with substantial political competition between different ministries and key officials within the government for access to financial resources. Citizen can participate in decision-making process through voting, by self-organizing into non-governmental agencies, and through institutions of self-governance established in 1999. Institution of local self-governance, however, is accompanied by the great degree of confusion.

Decentralisation reform has still long way to go. According to Article 142 of the Constitution of Azerbaijan Republic, local self-governance is carried out by municipalities formed through elections. However, *de facto*, local self-governance is exercised through Executive Committees, the Presidential appointees at local level. Executive Committees manage all financial resources and allocations from the state budget. In many cases, taxes that should feed the municipality budget (as stipulated in the legislation) are misallocated into regional tax departments. The tax-raising capacity of municipalities is very limited; taxes on the most lucrative assets and activities remain under control of executive committees. In many cases subsidies from the state budget remain the only revenue sources of municipalities. These subsidies and other forms of allocations from the central state budget are not regulated by any specific mechanisms or procedures. Although the legislation defines municipalities as independent from any local state administration authority²⁴, municipalities, in many cases, are treated by Executive Committees as their junior-level employees. Central government authorities are very reluctant to transfer power to local self-governance, and Executive Committees are very anxious about losing control over regional property. In most cases, Executive Committees usurp areas delegated to municipality jurisdiction, and actual power at local level is exercised by Executive Committees.

Transparency may help to avoid resource curse

For resource abundance to be translated into economic development and prosperity, Azerbaijan needs effective, transparent and accountable governance structure at place.

Certain measures have already been undertaken to ensure transparent and accountable management of oil resources in Azerbaijan. The State Oil Fund of Azerbaijan (SOFAZ) has been created to perform stabilisation and saving functions. It publishes wide range of information, including annual revenue reports, on its internet site²⁵. The roles and responsibilities of SOFAZ, its management and revenue structure, as well as challenges in improving its transparency and accountability has been analysed in great detail in *Caspian Oil Windfalls*, the publications prepared by Caspian Revenue Watch and in publication by Christian E. Petersen and Nina Budina "Governance Framework of Oil Funds: The Case of Azerbaijan and Kazakhstan". Therefore, this paper will not go into further details on that subject. The question to tackle here could be "*what is the internet accessibility for poor women and men, specifically in rural area of Azerbaijan?*" and "*how technical are reports provided by SOFAZ: are they easy to understand by people who does not hold any technical expertise in that area?*"

Azerbaijan has joined the EITI (Extract Industries Transparency Initiative)²⁶. The EITI National Commission comprised of 5 ministries²⁷, SOFAZ, NGO EITI Coalition and independent auditing

²³ <http://www.ekspert.az/download/report.doc>

²⁴ [The Law on the Status of Municipalities](#), Article 14.4.

²⁵ <http://www.oilfund.az>

²⁶ <http://www.eiti-az.org>

²⁷ Ministry of Industry and Energy, Ministry of Finance, Ministry of Ecology and Natural Resources, Ministry of Economic Development, and State Statistics Committee

company has been established to ensure transparent and accountable management of oil revenues and expenditures. NGO Coalition consists of 18 local NGO. The recent survey²⁸ on attitudes of government agencies to EITI campaign shows that 3 government agencies, officially members of EITI National Commission, are unaware of this initiative. Out of 11 government agencies covered by the survey, only 3 adopted the practice of browsing the internet site of EITI National Coalition. Interestingly, both government and NGO Coalition representatives assessed existing public oversight mechanisms as ineffective. But each side consider this to be the responsibility of the other: government blamed NGO Coalition due to its “inability to offer effective public oversight mechanisms”; whereas NGO Coalition members argue that public oversight will be improved if, among other measures, government involves NGO representatives into SOFAZ Supervisory Board and finances monitoring of projects by NGO Coalition members.

Unfortunately the survey does not address questions about transparency and accountability of NGO Coalition members to their constituencies. The researcher’s main concern rests on the observation that civil society in Azerbaijan has been hardly able to provide an informed feedback to the government. Highly centralized decision-making in the country is not the only difficulty faced by civil society in Azerbaijan. Unfortunately, NGOs in Azerbaijan are far from being fully transparent and representative. Among other difficulties, civil society in Azerbaijan faces a major challenge of legitimacy [whether NGOs truly represent interests of poor women and men?] and capacity [whether recommendations developed by NGO are bolstered by evidence rather than being based on certain political preferences?].

Informed public participation beyond transparency

Attempts towards increased transparency and accountability regarding oil resources in Azerbaijan were focusing predominantly on disclosing information about management of oil revenues and expenditure. However, as suggested by Richard G. Steiner, concept of transparency shall be distinguished from that of informed public participation²⁹: “*transparency is a necessary but not sufficient component of informed public participation in democracy. To have an active voice, the public, or at least a representative body of the public, needs to have a legitimate and formalised role overseeing and interacting with industry and government*”.

The further investigation, in the forthcoming policy paper, will attempt to analyse whether municipalities in Azerbaijan can serve as “representative body of the public”. The research is built on the assumption that local government, specifically when it is elected, has an inherent capacity to be held accountable³⁰. Thus, elected local government institutions can be in a better position to channel people’s voices and to monitor decisions around management of oil revenue and expenditure, at least the portion of these revenues allocated as development funds. The researcher believes that elected local government institutions are best placed to implement at least three out of six activities in monitoring oil revenues and expenditures, namely: (1) simplifying and disseminating information; (2) identifying and setting priorities; and (3) tracking revenues and expenditures³¹. In addition, municipalities are best placed to hold public hearings to “*gauge public opinion on spending priorities*” as suggested by Caspian Revenue Watch³².

The main hypothesis to be tested in the research claims that informed public participation in management of oil revenues and expenditures is more effective when implemented through institutions of local governance. There are some cases where local governance institutions were

²⁸ “Three Views of EITI Implementation”, Economic Research Centre, 2006.

²⁹ Richard G. Steiner, “Models of Public Oversight of Government and Industry” in *Caspian Oil Windfalls: Who Will Benefit*, p. 71

³⁰ Harry Blair, “Participation and Accountability at the Periphery: Democratic Local Governance in Six Countries”, *World Development*, Vol.28, No.1, pp. 21-39, 2000,

³¹ These are main activities suggested for monitoring of oil revenues and expenditures, i.e. (1) simplifying and disseminating information; (2) identifying and setting priorities; (3) influencing revenue policies; (4) identifying trends and providing projections; (5) highlighting best practices; and (6) tracking revenues and expenditures. For more information see Jim Shultz, *Follow the Money: a Guide to Monitoring Budgets and Oil and Gas Revenues*, Revenue Watch OSI, cHimenter for Policy Studies at CEU, International Budget Project

³² *Caspian Oil Windfalls: Who Will Benefit*, Caspian Revenue Watch, OSI/Central Eurasia Project, p. 28

successfully managing resource³³, including distribution and implementation of development and poverty alleviation funds³⁴. The researcher does acknowledge that very little evidence demonstrates direct relationship between decentralized management of development funds and poverty reduction. In addition, there is a risk that local elites will capture control over decentralized resources, thus having no impact on poverty reduction. This risk will be assessed throughout the research. The researcher also acknowledges the limitation of the research, which does not aim suggesting the most effective way of spending oil money. Neither is it argued that involving more citizens into debates will improve spending decisions and oil money will be used in most effective and efficient way. There is a high risk that resulting from involvement of wide range of public into discussions around expenditure of oil revenue government may fall victim of highly politicised debates and it may surrender to populist decisions rather than considering long-term strategic objectives. All these risks will be taken into consideration when examining options for most effective and viable mechanisms of informed public participation in management of oil resources in Azerbaijan.

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