

INFORMED CITIZENRY, ACCOUNTABLE GOVERNMENT AND EFFECTIVE MANAGEMENT OF OIL RESOURCES

Problem description

Azerbaijan, with its increasingly oil-dependent economy, notorious corruption, high level of poverty and low HDI ranking, allegedly faces a danger of resource curse.

According to poverty assessment for the year 2001¹, 49% of population in Azerbaijan lived under poverty line. After “introducing a revised HBS methodology” in 2002, the overall poverty level was estimated as 46.7%². In the Human Development Report for 2005 Azerbaijan is ranked 101st, with the highest infant mortality rate and the smallest per capita health expenditure among CIS countries³.

GDP growth in oil sector is anticipated to increase from -2 bln. in 2004 to 35 in 2008. Whereas non-oil sector growth is anticipated to decline from USD 10 bln. in 2004 to 5 bln. in 2006⁴. With 74.3% of FDI in the oil and gas sector Azerbaijan is particularly exposed to the so-called “Dutch disease”⁵.

Unfortunately, no data is available to test the relationship between oil-dependence and poverty in Azerbaijan. HDI ranking is available for two years only. Poverty assessment based on HBS has been introduced only in 2001. In addition, we are far from suggesting that resource profusion per se does lead either to mismanagement or to disproportionate allocation of resources. In fact, many scholars claim direct relationship between resource abundance and economic development⁶.

However, for resource abundance to be translated into economic development and prosperity, we need effective, transparent and accountable governance structure at place. Azerbaijan will have drastically higher oil revenues than ever before. The country has already been managing a \$1 billion oil fund; however, international experts question whether Azerbaijan can manage an oil fund that could eventually be worth \$30 billion⁷. If we fail to ensure transparent and accountable management of these revenues, Azerbaijan can further fall into the “resources curse” entailing reduced economic growth, increased inequality, decreased child welfare, and greater vulnerability to economic and political shocks⁸.

We believe the World Development Report calling poverty “*an outcome of the accountability and responsiveness of state institutions*”. 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 first ten the most corrupt countries in the world⁹. It has the highest average bribe payment, as % of annual revenues, among 22 transition countries¹⁰. As indicated in the Joint Staff Assessment Report, “*the impact of budgetary spending is adversely affected by serious governance problems at all levels*”¹¹. Although this statement was made with regard to health sector in Azerbaijan, 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,

¹ *State Programme on Poverty Reduction and Economic Development*, p.34

² *Annual Report (2003) on the State Programme on Poverty Reduction and Economic Development*, p.17. A poverty line was accepted as 120,000 AZM in 2001, and changed to 175,000 AZM in 2002.

³ <http://www3.who.int/whosis/country/compare.cfm?country=AZE&indicator=PcTotEOHinIntD&language=english>

⁴ IMF projections

⁵ *EU/Azerbaijan Country Strategy Paper*

⁶ Early theories on relationship between extractive industries and economic growth are described in *Extractive Sectors and the Poor*, an Oxfam America Report by Michael Ross, 2001.

⁷ *ADB Country Strategy and Program Update 2005-2006: Azerbaijan*, p.2

⁸ These harmful effects of extract industries were borrowed from *Extractive Sectors and the Poor*, an Oxfam America Report by Michael Ross, 2001.

⁹ *Global Corruption Report, Transparency International*

¹⁰ http://www.worldbank.org/wbi/governance/pdf/quinghua_presentation_hellman.pdf

¹¹ *Joint Staff Assessment Report*, p. 7 2004

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”¹². 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, within the Medium-Term Expenditure Framework and Public Investment Programme*”. Lack of transparency and effectiveness in resource management remains significant¹³. 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.

These problems are reflected at municipality level as well. The amount and source of budget profit, the amount and direction of budget expenditures in municipality budget documents are indicated in a very vague form. This causes significant problems with performing social monitoring and financial control over budget expenditures. Lack of transparency at municipality level is related to very limited skills of municipality members in terms of developing budget documents, identifying priorities and preparing strategic programmes of social and economic development at local level. Executive Committees *de facto* 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; in addition, these subsidies and other forms of allocations from the central state budget are not regulated by any specific mechanisms or procedures. Municipality budget formulation is a very formal process of putting random numbers in the annual request for certain allocations from the central budget. Needless to say that municipality budget is not based on any programs or projects; consequently, no external donors can contribute into it.

Project aim

Certain research has been done by Caspian Revenue Watch to develop recommendations on improving transparent and accountable management of oil resources in Azerbaijan¹⁴. Among other suggestions, it highlights importance of holding public hearing to “gauge public opinion on spending priorities”¹⁵. Our main concern, however, rests in the observation that civil society in Azerbaijan has been hardly able to provide an informed feedback to the government. In addition, experience of holding public hearing demonstrates that this technique, when applied at local (municipality) level, brings certain results¹⁶, whereas attempts to apply it at national level were rather unsuccessful.

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. In many cases, they are only widening the distance between decision-makers and citizen. 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?]. Slow growth of civil society in Azerbaijan is due not only to “heavy

¹² *Annual Report (2003) on the State Programme on Poverty Reduction and Economic Development*, p.6

¹³ <http://www.ekspert.az/download/report.doc>

¹⁴ <http://www.revenuewatch.org/azerbaijan/reports/>

¹⁵ *Caspian Oil Windfalls: Who Will Benefit*, Caspian Revenue Watch, OSI/Central Eurasia Project, p. 28

¹⁶ Public hearing on municipality budget was held in Xanereb municipality in Barda within the “Budget Transparency” project implemented by Expert Economic Magazine with the support from Oxfam GB in Azerbaijan. Municipality budget for 2004 has been discussed and accepted at the public hearing with 50 community and municipality members. However, it has been acknowledged that municipality budget documents are far from being comprehensive and the municipality budget formation process has long way to go before it reaches acceptable standards.

economic and political emphasis on the oil industry”¹⁷. Political culture in Azerbaijan leans toward the strong-state model providing very little support for local participation in solving economic and social problems.

On the other hand, however, we do believe that oil revenues must be monitored and controlled not only by international agencies, but also citizen themselves. Our research is based on the assumption that citizens can be involved into monitoring of oil revenues and expenditures through institutions of local governance. There are some cases where local governance institutions were successfully managing resource¹⁸, including distribution and implementation of development and poverty alleviation funds¹⁹. We do acknowledge that very little evidence demonstrates direct relationship between decentralized management of development funds and poverty reduction. There is also a risk that local elites will capture control over decentralized resources, thus having no impact on poverty reduction.

However, we assume that local government, specifically when it is elected, has an inherent capacity to be held accountable. Thus, elected local government institutions can be in a better position to channel people’s voices and to monitor/control oil revenues, at least the portion of these revenues allocated as development funds. We believe 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 expenditures²⁰.

Our project does not target the question of “which economic area oil money shall be allocated to”. Instead, we aim to focus on examining the feasibility of consultative process at local (municipality) level around management of oil revenues and expenditures. Particular attention paid to consultation process at local (municipality) level is based on the assumption that, in particular Azerbaijani context, participatory governance is more feasible and productive at local (municipality) level rather than at national level. Institution of municipalities represents local governance in Azerbaijan. They are most immediate agencies of governance closest to citizen. Municipalities embed an accountability mechanism (through direct election and community monitoring groups) that distinguishes them from Executive Committees.

In the long-term perspective we believe in building an effective and viable mechanism to ensure that decisions about managing and spending oil revenues are made with participation of all stakeholders, particularly poor women and men. We have to take into account that most policy decisions are made through incremental changes. Therefore there is not much optimism about drastic changes around transparency of oil resources, particularly in Azerbaijan. However, we strongly believe that setting up institutions and gradually changing believes and attitudes will be rewarding in the long-term perspective.

Methodology²¹

We will start by assembling evidence about specific features of local governance in Azerbaijan. This will include collecting information and data along four main categories:

- 1) Participation (What are the forms of participation at the local level in Azerbaijan? Whether turnout in local elections is higher than for national ones? What is the central government’s commitment to devolving power needs? Who gets elected in local governance structure?)

¹⁷ UN Resident Coordinator Report 2000 - Azerbaijan

¹⁸ Gautam N. Yadama and Arun Agrawal, *How do Local Institutions Mediate Market and Population Pressures on Resources? Forest Panchayats in Kumaon, India*. *Development and Change* Vol 28(1997), 435-465

¹⁹ *Out of Reach: Local Politics and the Distribution of Development Funds in Madhya Pradesh*, Vikas Singh, Bhupendra Gehlot, Daniel Start, Craig Johnson, 2003, ODI

²⁰ 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, center for Policy Studies at CEU, International Budget Project

²¹ Based on Eugene Bardach, 2000, *A Practical Guide for Policy Analysis: The Eightfold Path To More Effective Problem Solving*, Chatham House Publishers of Seven Bridges Press, LLC

- Who has the actual power of distributing resources at local level? What resources can be allocated at local level and what resources still remain under jurisdiction of central government?)
- 2) Representation (Who gains representation through public office in municipalities in Azerbaijan? What are accountability mechanisms? Bureaucratic accountability of elected officials: who pays salaries? Who maintains services delivery posts? Whom does the municipality member report? Accountability to the public: what are mechanisms of popular control above elections? How do people express their likes and dislikes between elections)
 - 3) Empowerment (How locally-informed version of “how to participate in governance” were constructed in AZB? Whose influence is prevailing in developing “empowerment” discourse? How development is perceived by local communities? What does development mean for them? What are symbols of development? What is the national-level discourse of development? Whether opportunities for participation at municipality issues are related to social position)
 - 4) Distribution of benefits (How do local municipalities engage in the governance and delivery of poverty alleviating development? To what extent do they engage citizens in the governance of these programs? How do citizens through collective action engage with local governments in these poverty alleviation programs? Where municipality money is spent? Whether schools repaired are those where elite’s children go? Whether infrastructure built is the one that municipality elite is benefiting from (irrigating their own land, etc.)? Are benefits broad based or go primarily to a few community leaders/municipality leaders).

Our previous experience of working at local level demonstrates certain risks for data collection. This includes reluctance of people to tell politically sensitive issues to a stranger, aggressive unwillingness of Executive Committee to allow any kind of “information leakage”, even if data is collected for research purposes only, etc. Given these constrains, data and information will be collected through in-depth interviews and focus group discussions within municipalities covered by program area of international organizations, where we have connections with both municipalities and Executive Committees.

Next step will be identifying policy alternatives, i.e. “*alternative strategies of intervention to solve or mitigate the problem*”. This will also include “*modeling the system in which the problem is located*”, i.e. constructing a causal model enabling us to identify roots of problem and interventions to address the problem. When modeling the system, we will focus on structural causes of weak municipality involvement into any type of policy issues, including those around management of oil revenues and expenditures. Principal questions here are “What is the role of municipalities and other local governance institutions in holding central government accountable?” and “How to build informed citizenry and how to mobilize it around issues of budget transparency and accountability without threatening political stability?”.

Alternatives will be assessed against certain evaluative criteria applied to the projected outcomes of suggested policy alternatives. List of preliminary evaluative criteria include (i) political feasibility; (ii) legality; (iii) cost-effectiveness; and (iv) equity.