

**OIL REVENUES AND NEW OPPORTUNITIES
IN SOCIAL POLICY IN AZERBAIJAN**

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PREFACE

This report covers issues related to Azerbaijan's oil revenues. It presents the results of an expert poll, opinions expressed during focus group discussions held with representatives of various strata and their generalization. At the same time, here are presented two articles: "The Oil Fund of Azerbaijan: Revenues in 2001-2008 and Expectations for the Near Future" and "The Efficiency of Social Programmes Financed from Oil Revenues."

The expert poll was conducted in December 2008 on the transparency of oil revenues in Azerbaijan and the expediency of spending them. Seventeen members of parliament, two representatives of government agencies, 61 NGO heads, nine leading media editors and journalists, six university teachers and staff members of the Azerbaijani National Academy of Sciences, five businessmen – 100 people in total – participated in the poll. The results of the poll are presented in the first part of the report.

The focus group discussions were held in November-February 2008 and were aimed at studying the opinion of various strata of the population on the problem of using oil revenues. Four focus groups were set up with 8-12 people in each. The focus groups included the following categories of participants:

1. young people;
2. refugees;
3. teachers;
4. unemployed and poor

The discussions lasted an average of 1.5 - 2 hours in accordance with a pre-developed and coherent scenario. In the course of focus group discussions, audio recording was carried out, and after decoding, it was presented in the form of expanded transcripts.

Among the judgments made by participants in the discussion, the most typical and repeating ones were highlighted. Simultaneously, contrasting or original estimates and proposals were recorded. The position in one group or another, as well as the prevailing view of all the study participants on each of the issues under discussion was determined by summation of the same or similar judgments.

The report was prepared with the assistance of Germany's Friedrich Ebert Foundation.

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HOW OIL REVENUES SHOULD BE SPENT

THE RESULTS OF EXPERT SURVEY

In December of 2008 with the assistance of Ebert Foundation expert survey on the problem of transparency of oil revenues and expediency of their spending in Azerbaijan was conducted. 17 deputies of Milli Medjlis, 2 representatives of state bodies, 61 NGO leaders, 9 editors and correspondents of leading mass media, 6 teachers of universities and researchers of NAS, 5 businessmen - in all 100 persons participated in the survey. Results of the conducted survey, comments and conclusion are indicated below.

1. How transparent is the policy of spending oil revenues in Azerbaijan (your impressions)?

1. The policy in the sphere of incoming revenues, their investment and spending is transparent 8
2. Only the policy regarding revenues is transparent. The policy of investing and spending revenues is not transparent enough 39
3. Transparency is clearly being imitated. In fact, all important information regarding the spending of oil revenues is kept secret from the public 49
4. Other opinions 3
5. Don't know 1

Only 8 of 100 respondents have stated that the policy in the sphere of incoming revenues and their spending is transparent for the general public. In opinion of 39 % of the respondents only the policy regarding revenues is transparent. But spending these money is realized without enough informing the public. However 49% of experts have considered that in Azerbaijan there is most likely imitation of transparency, whereas all real important information in the sphere is kept from the public.

2. How do you assess the current policy of the Azerbaijan Republic in managing oil revenues?

1. Acceptable 18
2. Unacceptable 60
3. Don't know 22

Majority of experts (60%) consider the current policy of the Azerbaijan Republic in managing oil revenues unacceptable. On the contrary 18% consider it successful, for 22% it is complicated to classify the situation. It is possible to suppose that it isn't result of not knowing the problem or unwillingness of giving one or another assessment. In the policy of managing oil revenues conducted in the country along with positive moments there are mistakes and abuses and this fairly complicates its identical assessing.

3. Where do you get information about the country's oil revenues from?

1. Newspapers	28.3 %
2. Television	14.8 %
3. The website of the Oil Fund	11.6 %
4. Seminars and conferences	26.8 %
5. Other sources	18.5 %
	Total - 100%

To get information about oil revenues respondents applies to all present sources. Here they give some advantages to newspapers and seminars and conferences conducted on the given problems.

4. How often do you inquire about oil revenues and their spending and do you search for relevant information?

1. Every day	31
2. At least once a week	28
3. At least once month	26
4. At least once a quarter	5
5. At least once in six months	2
6. At least once in a year	2
7. Less than once a year	1
8. I have not inquired about these issues yet	5

Absolute majority of experts (85%) systematically keep up with the information about oil revenues and their spending and consequently they have an opportunity to assess, to make conclusions and prepare the proposals.

5. Who should be making efforts to ensure the efficiency of the management of oil revenues? Please assess the role of various government, political and public agencies on a five-point scale (1 - lowest, 5 – highest).

Agency	Assessment					Don't know	Average
	1	2	3	4	5		
1. Parliament	11	5	4	10	68	2	4,2
2. National Bank	8	12	18	22	20	20	3,4
3. Accounting Chamber	2	5	13	22	50	8	4,2
4. Political parties	7	11	19	26	28	9	3,6
5. Trade Unions	18	15	15	12	17	23	2,9
6. NGO coalition	1	1	17	26	52	3	4,3
7. Media	1	1	18	30	45	5	4,2

As among respondents there are prevailed NGO leaders and activists then it is no wonder that they have chosen namely NGO coalition as source of impulses directed to improving managing oil revenues. Experts consider role of Parliament, Accounting Chamber and mass media as the same significant issue. Low assessing the role of Trade Union obviously makes conditional upon that in our conditions they have no authority in society. The following fact attract attention: namely in assessing potential of Trade Union and the National Bank in the process of improving managing oil revenues experts have felt the most trouble selecting one or another variant.

6. Please assess the efficiency of Azerbaijan's participation in the Extractive Industries Transparency Initiative in terms of public awareness of the country's revenues:

1. High	14
2. Average	55
3. Low	25
4. Don't know	6

In spite of the fact that many experts participating in the survey are members of NGO coalition which participates in implementation of the project on providing transparency of revenues in the industry realizing extraction and exploitation of natural resources they have been restrained in their assessment. A little more half of experts have considered that efficiency of the given initiative has an average level. A quarter of respondents quite consider it ineffective.

7. Do you think that Azerbaijan's participation in the Extractive Industries Transparency Initiative is enough for ensuring the effective management of revenues from the development of natural reserves?

1. Yes	9
2. No	73
3. I don't know anything about this initiative	8
4. Don't know	10

Overwhelming majority of respondents (73%) fairly note that initiative of transparency of revenues from extraction of natural resources given all its positivity doesn't provide transparency in spending these revenues. Namely here today there is weak branch.

8. What negative tendencies do you observe in the spending of growing oil revenues in Azerbaijan?

1. The spending of oil revenues on the construction of facilities that are of no public importance	66
2. The groundlessly expensive construction of various facilities (use of expensive materials).....	77
3. The expansion of the official apparatus	26
4. Abuse, misspending of public funds and corruption	75
5. Growing inflation	54
6. The extreme strengthening of national currency (as a result, this reduces the competitiveness of local products and services)	37
7. The slowing down of reforms	31
8. I do not see any serious negative cases	2

According to the experts, the first among tendencies is direct negative cases connected with baseless raise in prices at realization of infrastructure projects financed from oil revenues, and also accompanied by corruption and other abuses, the construction of facilities that are of no public importance. A second group of negative cases has institutional character, i.e. inflation, the extreme strengthening of national currency reducing competitiveness of local commodity producers and the slowing down of reforms. Though experts put them in less important place negative cases of institutional character are dangerous since they are lasting a long time.

9. What public goals do you think are the priority for financing from the growing oil revenues?

(Mark five options)

1. Direct investments to industry	42
2. The development of the infrastructure (roads and bridges, water supplies, energy and so on.)	43
3. The settlement of problems of refugees and displaced persons.....	10
4. The restoration of territories liberated from Armenian occupation	22
5. Support for the agrarian sector	61
6. Support for small and medium-sized businesses	74
7. Ecology	32
8. The development of education	82
9. Public Health	42
10. The development of sports and tourism	2
11. Increasing pensions for old and disabled people and allowances to families with many children	15
12. The construction of residential houses	3
13. Culture	13
14. The strengthening of the country's military capability and security.....	32

Among spheres of priority spending oil revenues according to the respondents education takes the first place. These expenses can realistically be investment in the future generation, they don't create excess inflation pressure, increase potential and common competitiveness of Azerbaijan in the world. Support for small and medium-sized businesses has been rated by experts as the second. These expenses also solve several tasks: they increase economic potential, create new work places and don't increase inflation pressure, since create new consumer costs which go to market of goods and services. Support for agrarian sector has been rated by experts as third and we can said about it the same thing which was said about expenses for development of small and medium-sized businesses. Priority for financing infrastructure projects, support for industry and development of health service have been equally noted by experts as essentially lower than named spheres. The fact that expenses for expenses for rising defensive capacity and ecology are not among priority spheres, and refugees aid, culture, the construction of residential houses and sport quite obtain paltry support of respondents, has caused certain surprize.

10. Do you accept the idea that some of oil revenues should be handed out directly to the population?

- 1. Yes26
- 2. No63
- 3. Don't know11

11. Do you think that the direct distribution of oil revenues among the population will help increase the population's interest in oil revenues and the government's policy of spending them?

- 1. Yes32
- 2. No52
- 3. Don't know16

As can be seen from answers to the questions #10 and #11 overwhelming majority of experts sufficiently estimate scantiness of oil and gas resources in Azerbaijan and doesn't support the idea of direct distribution of even part of oil revenues among the population. Respondents don't think that direct distribution of oil bonuses will sufficiently increase interest of people to policy of managing oil revenues. Prevailing such an opinion also causes surprize.

12. Please assess the activity of the Oil Fund of Azerbaijan:

- 1. It suits the current situation and is effective to some extent 13
- 2. It needs to be improved29
- 3. The Oil Fund is a smokescreen, and everything is decided by the presidential administration 57
- 4. Don't know 1

Only 13% of respondents consider activity of the Oil Fund useful and adequate to existent conditions, and 29% consider necessary to improve it. However more than half of experts agree with critical statement that Oil Fund is only "sign board" and all is solved in the Presidential Administration.

13. Please assess the effectiveness of spending on spheres financed by the Oil Fund on a five-point scale (1 - lowest, 5 – highest).

Spheres of spending	Mark					Don't know	Average estimation
	1	2	3	4	5		
1. The improvement of social conditions for refugees and displaced persons	12	25	28	17	8	10	2,8
2. The construction of the Oguz-Gabala-Baku water pipeline	8	18	20	23	21	10	3,3
3. The financing of the authorized capital of the State Investment Company	12	15	21	19	10	23	3,0
4. The construction of Baku-Tbilisi-Ceyhan oil pipeline (the financing of its Azerbaijani share)	4	3	24	25	34	10	3,9
5. The reconstruction of the Samur-Absheron canal	6	17	25	22	12	18	3,2
6. The Baku - Tbilisi - Kars railway project	5	6	18	30	25	16	3,2
7. The financing of the state programme on the education of young Azerbaijanis abroad in 2007-2015	4	9	13	22	42	10	4,0
8. The regulation of SOCAR's share in the ACG project	14	11	15	26	7	27	3,0

The fact that a quarter of respondents has no enough information about allocation of Oil Fund's money for financing Azerbaijani share in ACG project, also forming authorized capital of State Investment Company attracts attention and thus and so they have deviated from the assessment. Among other projects financed by Oil Fund support for the state programme on the education of young Azerbaijanis abroad and payment for Azerbaijani obligations in BTC have obtained the most high assessment. There is noted an average level of assessing effectiveness on financing water projects. Strangely enough experts have given the most low assessment to financing refugees and displaced persons aid programmes.

14. Is it necessary to start immediately returning the population's money deposited in the Soviet Savings Bank from the Oil Fund?

- 1. Yes 59
- 2. No 24
- 3. Don't know 17

Though majority of respondents doesn't agree with the idea of direct distribution of part of oil revenues among the population they have supported the idea of paying off people cheap deposits in the former soviet saving-banks from resources of Oil Fund.

15. What measures can increase the effectiveness of the management of oil revenues?

- 1. To increase parliamentary control over the activity of the Oil Fund.. 50
- 2. To include influential public figures in the Supervisory Board of the Oil Fund 59
- 3. To ensure access to the quarterly financial reports of contractors on state orders carried out at the expense of the Oil Fund and to information about expenses..... 40
- 4. Open discussions on the expediency of large expenses on this or that project 48
- 5. Other 16

As can be seen from answers, respondents have given the most highly support to the proposal about inclusion of authoritative representatives of civil society on the Supervisory Board of Oil Fund. Respondents have almost equally supported strengthening of Parliament monitoring, as well as more transparency and public debate at decision-making on financing those or other large programmes. Among proposals submitting by respondents were such interesting opinions:

- strengthening of democracy in the country;
- strengthening) of the public control and monitoring.

CONCLUSION AND RESULTS

1. Only 13% of respondents consider activity of the Oil Fund useful and adequate to existent conditions, and 29% consider necessary to improve it. However more than half of experts agree with critical statement that Oil Fund is only “sign board” and all is solved in the Presidential Administration. Such an attitude to the Oil Fund’s activity is explained by insufficient awareness of experts and also negative attitude to how oil revenues are spent and, as is well known, this is outside of Oil Fund’s competence. In any case, it seems, leaders of Oil Fund should strengthen informing citizen about its activity.
2. Majority of experts (60%) consider the current policy of the Azerbaijan Republic in managing oil revenues unacceptable. On the contrary 18% consider it successful, for 22% it is complicated to classify the situation idetically.
3. Only 8 of 100 respondents have stated that the policy in the sphere of incoming revenues and their spending is transparent for the general public. Another 39% consider only the policy in the sphere of incoming revenues, and spending these money is realized without enough informing and monitoring by the public. However almost half of experts have consider that in Azerbaijan there is most likely imitation of transparency, whereas all real important information in the sphere is kept from the public.
4. Among projects financed by Oil Fund support for the state programme on the education of young Azerbaijanis abroad and payment for Azerbaijani obligations in BTC have obtained the most high assessment. There is noted an average level of assessing effectiveness on financing water projects. Strangely enough experts have given the most low assessment to financing refugees and displaced persons aid programmes. The fact that a quarter of respondents have no enough information about allocation of the Oil Fund’s money for financing Azerbaijani share in ACG project, also forming authorized capital of State Investment Company attracts attention.
5. Three fourth of respondents note that initiative of transparency of revenues from extraction of natural resources given all its positivity doesn’t provide transparency in spending these revenues.

6. Most of all respondents connect improving managing oil revenues with increasing activity of the Parliament, the Accounting Chamber and mass media. Experts have felt difficulty in assessing the role of Trade Union and the National Bank in the process of improving managing oil revenues and vastly underestimated it. Experts have given the most support to proposal about inclusion of authoritative representatives of civil society on the Supervisory Board of the Oil Fund. Respondents have almost equally supported strengthening of the Parliament monitoring, and also more transparency and organization of public debate at decision-making on financing one or another large programmes.
7. Oil revenues are not only blessing for the country, but it is also accompanied by negative cases. According to the experts, the first among tendencies are baseless raise in prices at realization of infrastructure projects financed from oil revenues, and also accompanied by corruption and other abuses, the construction of facilities that are of no public importance. A second group of negative cases has institutional character, namely: inflation, the extreme strengthening of national currency reducing competitiveness of local commodity producers and the slowing down of reforms.
8. Among spheres of priority spending oil revenues according to the respondents education takes the first place. Support for small and medium-sized businesses have been rated by experts as the second issue. Experts have rated support for agrarian sector as third issue. The fact that expenses for rising defensive capacity and ecology are not among priority spheres, and refugees aid, culture, the construction of residential houses and sport quite obtain paltry support of respondents, has caused certain surprize. Overwhelming majority of experts sufficiently estimating scantiness of oil and gas resources in Azerbaijan hasn't supported the idea of direct distribution of even part of oil revenues among the population. In condition of falling in prices for energy resources there are no possibilities for this. However given majority of respondents have supported the idea of paying off people deposits in former soviet saving-banks from resources of Oil Fund.

THE RESULTS OF FOCUS GROUPS

Objectives and brief description of the programme of the study

As is known, Azerbaijan receives huge revenues from the implementation of oil and gas projects. They are concentrated in the Oil Fund from which they are spent either by transfer to the budget and by direct funding of priority projects (settlements for refugees, reconstruction of the Samur-Absheron irrigation system, construction of the Oguz-Qabala-Baku water pipeline, the Baku-Tbilisi-Kars railway, etc.). The financing of programmes to train young people abroad and develop medicine has also begun.

However, the selection of priority areas and specific decisions on the spending of Oil Fund money are carried out by the government without discussion with the civil society. People do not know how justified these decisions are and whether the allocated funds are being spent efficiently and accurately. The purpose of the focus groups was to identify different views on the topic based on which it will be possible to develop various proposals for improving the transparency of the spending of Oil Fund money, and public participation in this process.

In this regard, in November-February (2008-2009), under a project implemented by the FAR Centre, a study was conducted using focus groups (the managers were the doctor of philosophy and political scientist Rasim Musabayov, and a sociologist Yashar Zeynalov) on the views of different groups of the population on the use of oil revenues. A total of 4 focus groups were held, and from 8 to 12 people participated in each of them. Among them were:

1. Youth;
2. Refugees;
3. Teachers;
4. Unemployed, poor;

The discussions lasted an average of 1.5 - 2 hours in accordance with a pre-developed and coherent scenario. In the course of focus group discussions, audio recording was carried out, and after decoding, it was presented in the form of expanded transcripts.

Among the judgments made by participants in the discussion, the most typical and repeating ones were highlighted.

Simultaneously, contrasting or original estimates and proposals were recorded. The position in one group or another, as well as the prevailing view of all the study participants on each of the issues under discussion was determined by summation of the same or similar judgments.

PARTICIPANTS' OPINIONS AND ASSESSMENTS

1. Have you heard before this meeting about the existence of the "Oil Fund" and for what purpose do you think it is meant?

Most of the participants in the focus groups had heard about the existence of the Oil Fund. Young people and teachers had a clearer picture, while the refugees and the unemployed either had never heard about it or had scanty or ambiguous information.

- This is a necessary structure for the accumulation of oil revenues. The Fund is designed to redistribute funds in some sectors, as well as for stabilization in case of a fall in oil prices and a financial crisis. *(a functionary of a youth association, 24 years).*

- I know that many oil-producing countries have similar structures. Accumulated funds are mainly directed at eliminating the budget deficit. The Fund serves to stabilize the economy. *(a student of Baku Slavic University, 19 years).*

- For the most part, these funds should be accumulated for future generations. *(a student of National Aviation Academy, 21 years).*

- For the most part, these funds should be accumulated for future generations. *(a student of National Aviation Academy, 21 years).*

- I've heard about it, but I have little information about the activities of the Fund. I know that it is helping the refugees. *(a refugee from Agdam, born in 1963)*

- I've heard that the Oil Fund has allocated funds for the construction of settlements for refugees. We expect a lot from it. But, unfortunately, I have very little information about the activities of the Fund. I wish activities were carried out on this issue and the public was informed about how much revenues have come in and from where and in what areas they have been spent. *(a refugee from Agdam, an activist of the Gender Centre, born in 1955)*

- The Fund accumulates money from oil sales. It is also involved in investment. *(a male teacher of a Baku lyceum, 33 years)*
- I've heard about the Fund. Funds are being spent, but in reality there is nothing good. *(a female teacher from a Baku school, 61)*
- In 1918-1920, Azerbaijan already had such a fund. It is designed to accumulate funds from oil sales. *(a female teacher of a Turkish lyceum, 60 years)*
- I've heard about its existence, but I do not know what the Fund is intended for. *(an unemployed woman, born in 1984)*
- I've heard that the Fund is engaged in various investment projects. *(an unemployed man, born in 1969)*
- I've heard about the Fund, but I don't know how and where the funds collected there are distributed. *(an unemployed man, born in 1972)*

2. Is it right to accumulate state money in the fund and would it not be better to spend more of it on social problems?

Most of the participants in the focus groups showed no inclination to squander oil revenues. And such common sense was shown even by representatives of groups (refugees, the unemployed) who are in dire need of social support.

- It is possible that the accumulated funds should be spent on social needs of the population, but until then, economists should make the necessary measurements and studies so that not all funds are expended and inflation falls *(a functionary of a youth association, 24 years)*
- We cannot squander these funds. It is correct to collect public funds to address future financial crises. The social needs of the population can be improved through other measures. *(a girl and a student of Azerbaijan State Economic University, 19 years)*
- They should not be spent at random, and it is necessary to invest them, because oil will run out soon. *(a student of Baku Slavic University, 19 years)*
- Funds should be accumulated there. You can spend them on social issues, but not all of them. It is likely that they will be plundered. *(a student of Baku State University, 21 years)*
- It would be good to spend these funds on refugees and improve their conditions, as well as to invest them correctly to have additional income. It is correct to collect funds there. *(a male refugee from Agdam, welder, born in 1988)*

- It is correct to collect and spend them on certain places and the social needs of the population. *(a female refugee from Agdam, born in 1963)*
- It is correct to collect them, but some part of them should also be given to the poor. Once we get our land back, we can spend them there. But we should have stocks as well. *(a female refugee from Agdam, an activist of the Gender Centre, born in 1955)*
- Initially, these funds must be spent on improving living conditions and then accumulated. *(a female refugee from Nagorno-Karabakh, born in 1951)*
- We should spend more on education. *(a female lecturer of Women's University, 46 years)*
- Initially, these funds should be spent on specific objectives and sectors and then accumulated. *(a female teacher of a Turkish lyceum, 60 years)*
- The money should be given to the needy and the underprivileged (the sick and the unemployed). *(a woman, unemployed, born in 1968)*
- This is a very good idea to accumulate money in the Fund, but we must not forget about the poor. *(a man, unemployed, born in 1969)*
- It is right to accumulate funds in the Oil Fund and distribute them for necessary goals. *(a woman, unemployed, born in 1960)*
- It is correct to collect them, but some part of them should also be given to the poor. *(a man, unemployed, born in 1974)*

3. What social purposes do you think Oil Fund money should be spent on in the first place?

The priorities identified in the focus groups are the following: employment, strengthening of the army, refugee resettlement and education. Moreover, the refugees talked most of all about the strengthening of the armed forces though they themselves are in dire need of social assistance from the state.

- The public is not being informed about the expenses of the Fund. It is necessary to invest in education, sports and health. *(a functionary of a youth association, 24 years)*
- The construction of modern schools. *(a student of Baku State University, 20 years)*
- It is necessary to invest in the development of industry. *(a master of Azerbaijan State Economic University, 24 years)*

- It is necessary to invest in the social sphere, refugees and internally displaced persons, and then, in the areas that generate income. *(a male refugee from Agdam, welder, born in 1988)*
- It is necessary to create jobs for the refugees and the unemployed. *(a female refugee from Agdam, born in 1987)*
- I also believe that it is necessary to create jobs, but most importantly to strengthen the army, buy new weapons, improve conditions for military personnel and return our lands, and then, to improve conditions for internally displaced persons and the poor. It is necessary to provide them with free treatment and improve conditions for students and the quality of education. *(a female refugee from Agdam, technologist, was born in 1956)*
- In the military sphere, kindergartens and the opening of new schools and hospitals. It is necessary to return refugees to their homeland and create new jobs. *(a female refugee from Kalbajar, nurse, born in 1949)*
- They have opened settlements for refugees, but they must also create jobs. Some refugees say it would be better to open new businesses instead of aid allocated from the Oil Fund, and then we will know that we have a permanent job and are able to maintain our family. The assistance they offer is only enough for a week. We must also strengthen the army and improve conditions for military personnel. *(a female refugee from Agdam, an activist of the Gender Centre, born in 1955)*
- It is necessary to invest in education. This is our future, and then in the social sphere, refugees and internally displaced persons. *(a female teacher of Azerbaijan Pedagogical Institute, 59 years)*
- It is necessary to allocate credits to agriculture and to invest in education and only in appropriate specialities. *(a man, a lecturer of Azerbaijan Slavic University, 30 years)*
- It is necessary to invest in education and equip regional schools, and then help pensioners and orphanages. *(a woman, a lecturer of Women's University, 46 years)*
- It is necessary, first of all, to spend the funds on the sick and poor. *(an unemployed woman, born in 1984)*
- We should spend the funds on children and the disabled, create more jobs and provide jobs for the disabled and unemployed. *(an unemployed man, born in 1969)*

4. In some Arab countries, part of oil revenues is distributed directly to citizens (at birth, for education, building a house, etc.) Do you not think that this could be done in Azerbaijan?

Although many participants showed a positive reaction to this idea, most of it was accompanied by sceptical remarks like we have little oil, the money will be squandered and people will probably not get it. In short, in Azerbaijan the idea of direct distribution of the oil revenues to the population is not realistic. The direct allocation of funds from oil revenues to newborns was supported most of all, so that they get something from oil wealth in the future.

- It would be good if the state opened accounts for citizens and invested in human resources/capital. *(a functionary of a youth association, 24 years)*
- It is possible, but not in our country. *(a student of National Aviation Academy, 21 years)*
- It would be good if that was the case in the future. It is a very good idea. Once a child grows, he will know what to do with the money and if his family has a difficult time, they will not seek any help on the side, and will use this money. *(a student of Baku State University, 21 years)*
- It is a very good idea. In our country we need to do the same, at least in regard to children. *(a woman, a refugee from Agdam, born in 1956)*
- It is a good idea, especially for the elderly and single people. *(a woman, a refugee from Kalbajar, born in 1962)*
- It is necessary to do so for young families. *(a woman, a refugee from Agdam, an activist of the Gender Centre, born in 1955)*
- It would be good, but they will not do it here. *(a female teacher of Azerbaijan Pedagogical Institute, 59 years)*
- It is impossible. We have a large population, and there is not enough for everybody. *(a male teacher of the a Baku lyceum, 33 years)*
- There are many such experiments. Our income is limited and is not enough for everybody. *(a male lecturer of Azerbaijan Slavic University, 30 years)*
- It is necessary, particularly with regard to newborn children. *(a woman, unemployed, born in 1963)*
- It is necessary to distribute them among families to build their homes. *(a woman, unemployed, born in 1968)*
- It would be good to do it here, but our laws are not working, and we do not know how it will be done. *(a woman, unemployed, born in 1974)*
- Each citizen should receive revenues from oil. Everyone must have a bank account where the money will accumulate. *(a man, unemployed, born in 1979)*

5. Is it right to demand that the government immediately return the devalued savings of the Soviet era to the population from the Oil Fund?

The vast majority of participants in focus groups supported this proposal, believing that this is fair and the state has the resources to fulfill its obligations to the population.

- The state is obliged to do so. (a functionary of a youth association, 24 years)
- We have enough means and we need them back. There is a need for a mechanism. (a student of Baku State University, 21 years)
- It is necessary to return them. This will affect the welfare of the population. (a master of Azerbaijan State Economic University, 24 years)
- We must demand that the government return devalued deposits to people. (a male refugee from Agdam, born in 1984)
- We must demand it from the government. And who is doing it now? No-one. (a female refugee from Agdam, born in 1963)
- This is the right idea. The issue was raised on several occasions, but the people never got their money back. We must all demand this. (a female refugee from Agdam, technologist, was born in 1956)
- We lost our money in savings banks. We would like them returned. (a female refugee from Agdara, born in 1951)
- If possible, it is necessary to return deposits to people. (a man, a lecturer of International University, 44 years)
- It is necessary to return them. We must demand them. (a woman, a lecturer of Women's University, 46 years)
- It is necessary to return the money primarily to the elderly and needy families. (a woman, a music school teacher, 49 years)
- Yes, we must demand that the government return the money. (an unemployed woman, born in 1984)
- I believe it is better to give the money to poor people who need it immediately. (an unemployed woman, born in 1974)
- We must demand that the government pay the money. (an unemployed man, born in 1969)
- So many people earned that money and put it in banks, and they lost it. They must be returned. (an unemployed man, born in 1964)
- Those who had savings want them back. I didn't have money, so it's best not to return it, but give it to poor people. (an unemployed man, born in 1972)

6. If we embezzle the Oil Fund money, then what will we live on when oil runs out or energy prices fall sharply?

Many have no idea what will happen or hope that oil and gas will be enough for their lifetime. Others propose to develop the non-oil sector of the economy, particularly agriculture, tourism and support the development of private entrepreneurship. Sober proposals were made to use the current oil revenues more economically and efficiently and invest them in education and in human capital.

- It is necessary to pay attention to business development and reduce imports. It is necessary to invest in education and in human capital. *(a functionary of a youth association, 24 years)*
- It is necessary to invest in the non-oil sector, in science and health. *(a student of Azerbaijan State Economic University, 19 years)*
- We should already be thinking about this. It is necessary to invest in industry and information technology, and in education. *(a student of Baku Slavic University, 19 years)*
- It is necessary to invest in education and tourism. There should be a unified national programme on the development of tourism. *(a student of Baku State University, 21 years)*
- Try to spend less. *(A female refugee from Agdam, born in 1987)*
- If the oil runs out, we have good lands, particularly in Karabakh and we can develop agriculture there. *(A female refugee from Agdam, born in 1963)*
- I hope that oil will never run out. I think so. *(A female refugee from Kalbajar, nurse, born in 1949)*
- I agree that oil will not run out, but the Fund should retain the money. We will need this money one day. *(A female refugee from Kalbajar, born in 1962)*
- It is best to develop our own production in order to survive independently later, for example, to develop agriculture. *(a female lecturer of Women's University, 46 years)*
- It's necessary to invest in agriculture and other sectors. *(a female laboratory assistant of International University, 28 years)*
- To develop agriculture and animal husbandry. There is gold, cotton and other resources. *(an unemployed man, born in 1969)*

- There are lots of resources, for example, to develop fish farming. (*an unemployed man, born in 1974*)
- Money should be invested in production in order to get a good profit. We will not make any profit from the construction of bridges and roads. We must develop agriculture and new technologies. (*an unemployed man, born in 1972*)

CONCLUSION

Public awareness of the Oil Fund is rather low. Though many have heard about its existence, they have very limited and uncertain information. Most of the participants in focus groups showed no inclination to squander oil revenues. As priorities for funding from oil revenues, they mentioned jobs, strengthening of the army, refugee resettlements and education. The idea of direct distribution of oil revenues to the population caused a positive reaction in many participants, but was accompanied by sceptical remarks like we have little oil, the money will be squandered, and people will probably not get it. The direct allocation of funds from oil revenues was most of all supported in respect of newborns, so that they get something from oil wealth in the future. At the same time, the absolute majority of the focus groups supported the proposal on immediate compensation from oil revenues for the deposits devalued in state savings institutions. Concerning the future when oil and gas deposits are depleted, it was proposed to prepare for this through the development of the non-oil sector of the economy, particularly agriculture and tourism, and to encourage private enterprise. Sober proposals were made to use the current oil revenues more economically and efficiently and invest in education and in human capital.

AZERBAIJAN'S OIL FUND: REVENUES IN 2001-2008 AND EXPECTATIONS IN THE NEAR FUTURE

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1. CONTEXT: A BRIEF HISTORICAL BACKGROUND

Azerbaijan is a country that has a long oil history. According to the well-known Italian traveller Marco Polo, there were numerous oil wells in the Absheron peninsula in the 13th century, and the oil that was extracted from them was exported to many countries of the world. In order to extract oil, local residents drilled wells similar to water wells. The first industrial well in Absheron was drilled near Baku in 1848. The drilling of wells in Azerbaijan took on a larger scale in the early 1870s. This was the time of the first oil boom in Azerbaijan. In 1901, Azerbaijan extracted 10.979 million of the world's 22.5 million tonnes of oil. Subsequently, the level of extraction fell and rose for various reasons. Oil extracted reached a record level of 23.482 million tonnes in 1941. Before Azerbaijan gained independence in 1991, the level of extraction was about 12 million tonnes. In the following years, extraction dropped again, though insignificantly, until the beginning of the exploitation of the Azeri-Chirag-Guneshli deposit in 1997. On this group of deposits, the first production sharing agreement was signed with a consortium of oil companies in 1994. The signing of this contract marked the beginning of the second oil boom in the history of Azerbaijan. The agreement was signed by the following foreign companies: BP (Britain), AMOCO (USA), Lukoil (Russia), Pennzoil (USA), Unocal (USA), Statoil (Norway), McDermott (USA), Ramco (Britain), TPAO (Turkey) and Delta Nimir (Saudi Arabia). In the agreement, the Azerbaijani government is represented by SOCAR.

In the following years, Azerbaijan signed new production sharing agreements with oreign companies. The first attachment presents all the agreements signed by Azerbaijan.

Exploration and drilling work carried out within the framework of some of these agreements did not yield any results. However, great reserves were discovered in two deposits (Azeri-Chirag-Guneshli and Shah Daniz) and extraction work began.

2. WHY THE STATE OIL FUND OF THE AZERBAIJAN REPUBLIC WAS SET UP AND HOW

The country was expected to receive great revenues from the sale of hydrocarbon resources from the aforesaid two deposits. These could have been channeled into two directions: 1) the state budget and 2) a special account. The Azerbaijani government encountered the problem of choice between these two at the end of the 1990s. It did not seem expedient to channel all the revenues into the state budget because in some years (not so far) the volume of oil revenues was expected to be much higher than state budget revenues. Nor was it desirable to put all revenues in a separate account because a number of social and economic problems in the country had to be solved, and of course, money was required for that. These factors forced the Azerbaijani government to choose both of the directions we mentioned above. The decision was that some of the expected oil revenues (greater part) should be put in a special account, while the rest should be included in the state budget and used for various social and economic issues. Information about decisions on what types of oil revenues were put into the special account and what types were channeled into the state budget is given below. It must be noted here that things do not end with the putting of revenues in a special account as the main issue is to make effective use of them. To this end, it was required to set up a special state entity, and the country's president issued a decree on 29 December 1999 to set up the State Oil Fund of the Azerbaijan Republic.

The establishment of the Oil Fund was recommended by international financial organizations, and they gave the Azerbaijani government the required technical assistance in this sphere. It must be noted that the Azerbaijani government also took a serious approach to the issue of setting up the Oil Fund. Before the Fund was set up, special surveys were carried out and the experience of other countries was studied.

The duty of the Oil Fund is to collect, preserve and make effective use of revenues from the implementation of oil and gas exploration and development agreements signed with foreign companies. The money collected in the Fund can be used to solve the following issues, and it is already being used:

- to ensure macroeconomic and budget stability;
- to create financial guarantees for future generations;
- to ensure economic development;
- to solve social problems.

3. THE MAIN LEGAL ACTS THAT REGULATE THE ACTIVITIES OF THE OIL FUND

The activities of SOFAR are regulated by four main legal acts:

1. The decree by the president of the Azerbaijan Republic on the establishment of the State Oil Fund of the Azerbaijan Republic, 29 December 1999¹;
2. The statute on the State Oil Fund of the Azerbaijan Republic (approved by the decree issued by the president of the Azerbaijan Republic on 29 December 2000²);
3. The rules of keeping, placing and managing the currency reserves of the State Oil Fund of the Azerbaijan Republic (approved by the decree issued by the president of the Azerbaijan Republic on 19 June 2001³);
4. The rules of compiling and executing the annual programme of revenues and expenses (the budget) of the State Oil Fund of the Azerbaijan Republic (approved by the decree issued by the president of the Azerbaijan Republic on 12 September 2001⁴).

The 29 December 1999 decree by the president of the Azerbaijan Republic on the establishment of SOFAR. Under this decree, the following are sources of forming the assets of the fund:

- Azerbaijan's share in the profit oil extracted within the framework of the PSA;
- Bonuses paid according to the conditions of the PSA;
- Per-acre payments according to the conditions of the PSA;
- The dividends and revenues due to Azerbaijan from the division of profits from oil and gas projects;
- Transit revenues from oil and gas export pipelines;
- The use of assets within the framework of the PSA;
- Revenues from the management of assets (placement, investment and so on);
- Grants and other aid.

The decree gives instructions to the following government agencies:

- SOCAR: To sell the crude oil and gas due to Azerbaijan;

¹ <http://www.oilfund.az/az/content/25/9>

² http://www.oilfund.az/inside_az.php?zid=2&nID=128

³ http://www.oilfund.az/inside_az.php?zid=2&nID=127

⁴ <http://www.oilfund.az/az/content/25/156>

- The Cabinet of Ministers of the Azerbaijan Republic: To prepare the statute of SOFAR and a proposal on the composition of its supreme management body within two months and submit them to the president of the Azerbaijan Republic;
- The National Bank of the Azerbaijan Republic: To accumulate the assets of SOFAR in a special account before it starts operating.

The statute on SOFAR was approved by the 29 December 2000 decree issued by the president of the Azerbaijan Republic. The statute was then amended twice⁵. The document currently consists of the following chapters:

- General provisions;
- The main tasks of the Fund;
- The sources of forming the Fund;
- The use of the Fund's assets;
- Registration and accountability;
- Amendments to the statute on the Fund;
- The reorganization and abolition of the Fund.

The aforesaid decree gives the following relevant instructions to two government agencies:

- SOCAR: To transfer State Oil Fund assets to a special account in the National Bank of the Azerbaijan Republic by 5 January 2001;
- The National Bank of the Azerbaijan Republic: To submit within 15 days a proposal on keeping the Fund's assets in high-rating and authoritative banks of the world to the president of the Azerbaijan Republic.

According to Article 1.2 of the statute, the Fund reports to the country's president and bears responsibility only before the president. However, according to the law on the Audit Chamber, this body, which was founded by and reports to the parliament, oversees the revenues and expenses of the state budget and non-budgetary state funds (Article 2). It must be noted that SOFAR is also a non-budgetary state fund.

According to Article 1.4, the Fund's Observation Council ensures general control over the formation and spending of SOFAR assets.

According to Article 4.1 of the statute, the use of the fund's assets should be in line with the main directions of the use of these assets approved by the country's president every year.

⁵ The presidential decrees of 7 February 2003 and 1 March 2005.

According to Article 4.2, the Fund's assets can be used to solve socioeconomic and important national problems and to build and reconstruct infrastructure facilities of strategic importance. But who determines the importance of problems and infrastructure facilities and how? The statute does not answer this question. Thus, in this situation, it is possible that proposals will be accepted from a member of the presidential team who can easily make an appointment with the head of state and is trusted by him.

The members of the Observation Council of the Fund are appointed by the country's president (Article 5.5). The parliament's role in forming the Observation Council is to recommend this or that member of parliament to the country's president for membership of the Observation Council. In the current Observation Council, the parliament is represented by the deputy chairman of parliament⁶. According to the statute, the Observation Council should include members of public organizations (Article 5.4), but it does not include any. The issue of including a representative of the NGO sector in the Observation Council has been raised in various public discussions in recent years. The NGO Coalition to Increase Transparency in Extractive Industries has also sent a relevant appeal to the country's president. But the situation has still not changed.

The statute contains provisions on the inspection of the Fund's financial activity by an authoritative audit company. The audit company is picked by the country's president. As we said above, the Audit Chamber of the parliament can also check the Fund's financial activity. However, the legislative body needs to make a relevant decision to this effect. There is no such precedent in the country's history yet, and the parliament is unlikely to make such a decision in the current situation.

Seven audits have been conducted since SOFAR was set up: Six audits have been carried out by Ernst & Young (2001, 2002, 2003, 2004, 2005 and 2006) and one by Deloitte & Touche LLP in 2007. This company will also audit SOFAR's financial activity in 2008 and 2009. This is the result of a tender conducted in 2007. The auditors' conclusion is posted on the SOFAR website⁷. The reports are also given in the Fund's annual reports posted on this website.

The statute contains provisions related to the transparency of the Fund's activity. For example, Paragraph 5.3 shows that the auditor's report which reflects the results (conclusion) of the Fund's annual activity is published in the press. In practice, this information is posted on the SOFAR website, while the executive director of the fund holds news conferences from time to time. However, it must be noted that the information posted on the website includes general reports about the activity of SOFAR, but these reports are not enough

⁶ <http://www.oilfund.az/az/content/4>

⁷ <http://www.oilfund.az/index.php?n=20>

for analyzing the efficiency of the Fund's activity. That's to say many representatives of civil society can, in essence, find information about the Fund's revenues and expenses. However, the annual reports posted on the Fund's website cannot satisfy the expert community and financial analysts, of course.

Along with that, it must be noted that SOFAR is the most transparent government institution (maybe only the National Bank can compete with it in this issue).

The rules of keeping, placing and managing the currency reserves of the State Oil Fund. These rules were approved by the 19 June 2001 presidential decree. The rules include the following chapters:

- General issues;
- Keeping the currency reserves of the Oil Fund;
- Managing the currency reserves of the Oil Fund;
- The report on the management of the currency reserves of the Oil Fund.

The "General Issues" chapter lists the goals of the aforesaid document, indicates the legislative basis of the rules and interprets the idea of "the Fund's currency reserves" and ideas of calculating the Fund's currency reserves in the balance currency, i.e. the Azerbaijani manat.

The chapter "Keeping the currency reserves of the Oil Fund" indicates the following: a) the minimum ranking of foreign banks where the Fund's currency reserves can be kept; b) the Fund's requirements for the ranking of its partners on the international financial market; c) the Fund's requirements for the ranking of commercial banks and other financial institutions which provide depositary services on securities; d) the Fund's steps when the ranking of its partners falls. This chapter shows the Fund's requirements for the ranking of the countries where its investment portfolio is kept in foreign currency.

The chapter "Managing the currency reserves of the Oil Fund" describes the general principles and directions of organizing the management of the Fund's assets, risk management issues and the main directions of the Fund's investments.

The chapter "The report on the management of the currency reserves of the Oil Fund" shows that quarterly information and an annual report are submitted to the Observation Council and the country's president.

Thus, the analysis of the rules shows that the Fund's activity is quite a closed sphere and it is difficult to assess from aside the efficiency of the Fund's activity on the management of its assets. As we noted above, the statute on SOFAR requires the Fund's activity to be audited by an internationally-

recognized auditor. However, such an audit does not answer the question about the efficiency of managing the Fund's assets.

The aforesaid rules are not the only document that SOFAR staff use in their daily activities. There is a special internal instruction approved by the executive director of SOFAR⁸. However, this document has not been posted on the SOFAR website.

The rules of compiling and executing the annual programme of revenues and expenses (the budget) of the State Oil Fund of the Azerbaijan Republic. These rules were approved by the 12 September 2001 decree issued by the president of the Azerbaijan Republic. They reflect SOFAR's general provisions and the structure of its budget, sources of revenues, articles of expenditure, procedures of approving the budget, mechanisms of implementing the budget and relevant norms related to reports on the implementation of the budget. Let's take a look at some important norms.

The document says that SOFAR's budget is compiled for the 1 January – 31 December financial year. The budget consists of articles on revenues and spending. The sources of revenues indicated by the document are the sources indicated in the presidential decree on the establishment of SOFAR and the statute on the Fund.

The document says that SOFAR's budget starts to be drawn up at the same time as the state budget, i.e. 11 months before the next calendar year. The draft budget of SOFAR should be submitted to the SOFAR Observation Council by 5 September. After that, the view of the Observation Council and the draft budget are submitted to the country's president for approval. According to Article 4.4 of the document, the budget of SOFAR is approved by 1 December. However, according to the document, this deadline may not be met. According to Article 4.5, if the SOFAR budget is not approved, for any reason, until 31 December, expenses on the management of the Fund in the next financial year can be at the same level as in the previous year. Thus, in fact, there is no deadline for the approval of the SOFAR budget.

SOFAR's budget should be published in the press after it is approved. According to the document, information about the Fund's revenues should be published in the press every quarter. The document does not require the expenses to be publicized.

The expenses stipulated in the budget are implemented through the state treasury.

If need be, relevant changes can be made to the SOFAR budget. The changes should be approved by the country's president.

⁸ The instruction regarding the internal procedures of managing the currency assets of SOFAR http://www.oilfund.az/download/az/2001_az.pdf p. 43

4. SOFAR'S BUDGET PRACTICE

Some uncertainties (related to the date for the approval of the budget and budget changes) in the rules of compiling and implementing the aforesaid programme of SOFAR's annual revenues and expenses (budget) lead to delays in the budget process. This is clearly seen from the following table.

Year	Budget approval date	Forecast on approved primary budget revenues	Forecast on approved primary budget expenses	Budget changes approval date	Changes in budget expenditure (growth), by times
2001	22.10.2001		16677.7 mln. AZM	-	-
2002	21.12.2001	880196.0 mln.AZM	153484.5 mln.AZM	01.11.2002	3,40
2003	27.01.2003	1219516.0 mln.AZM	1217755.0 mln.AZM	-	-
2004	31.03.2004	928720.4 mln.AZM	843696.2 mln.AZM	01.10.2004	-
2005	01.03.2005	1078033.3 mln.AZM	1072871.0 mln.AZM	28.12.2005	1.09
2006	28.12.2005	807842.6 thousand.AZN	954287.7 thousand.AZN	07.06.2006	1.07
2007	28.12.2006	1555739.6 thousand.AZN	977066.9 thousand.AZN	28.06.2007; 26.12.2007	1.14
2008	26.12.2007	807842.6 thousand.AZN	954287.7 thousand.AZN	11.07.2008	2.61
2009	26.02.2009	8361016.3 thousand.AZN	5319534.9 thousand.AZN		

**The dates shown in this table have been taken from the SOFAR website*

As we can see from the table, SOFAR's budget has never been approved by the deadline indicated in Article 4.4 of **the rules of compiling and executing the annual programme of revenues and expenses (the budget) of the State Oil Fund of the Azerbaijan Republic**, i.e. by 1 December of the previous year.

In 2002, 2005 and 2008, SOFAR's budget changes applied both to revenues and expenses. Expenses increased especially in 2002 and 2008. For example, in 2008 budget expenses increased from the planned 1,680,853.6

manats to 4,380,853.6 manats. The increase in expenses was related to the allocation of extra funding for a number of projects financed by the state. Following the change of 11 July 2008, the forecast on SOFAR revenues increased considerably: from the planned 3,609,361,000 manats to 10,144,743.2 manats. The forecast on revenues was increased by 2.81 times because the price of crude oil on the world market doubled in the first half of 2008. In general, analyses show that the forecast on SOFAR's budget revenues is based on a pessimistic scenario of annual crude oil prices.

5. REVENUES OF THE OIL FUND

As we said above, the revenues of the Oil Fund are obtained from the following sources:

- Azerbaijan's share in the profit oil extracted on the basis of the PSA;
- Bonuses paid on the basis of the PSA;
- Per acre payments paid on the basis of the PSA;
- Dividends and revenues due to Azerbaijan from the division of revenues from oil and gas projects;
- Transit revenues from export oil and gas pipelines;
- The commissioning of assets on the basis of the PSA;
- Revenues from the management of assets (placement, investment, etc.);
- Grants and other aid.

In order to identify the volume of the profit oil in the PSA, a certain amount is allocated for the financing of exploitation expenses (the exploitation expenses on one barrel of oil extracted within the framework of ACG are about two dollars). The remaining oil is divided into two equal parts. One of them is allocated for the financing of capital expenses, while the other is divided between Azerbaijan and the contractor as profit oil. As stipulated in the ACG agreement, this division depends on certain financial indicators of the contractor.⁹ The mechanism of dividing the profit oil is such that from the beginning of extraction at ACG (November 1997) to the first quarter of 2008, 30 per cent of profit oil belonged to Azerbaijan and 70 per cent to the contractor. In the first quarter of 2008, this correlation was 55/45, while beginning from the second quarter, it changed to 80/20 and currently, the profit oil is divided on the basis of this correlation.

⁹

Foreign companies engaged in talks with the Azerbaijani government paid large bonuses before the first contract was signed (on the Azeri-Chirag-Guneshli deposit), and then, shortly after the signing of every new contract. According to the contracts that were signed (Attachment 1), the bonuses paid by foreign companies are shown in the table in Attachment 2. The total volume of all bonuses paid by the end of 1997 was 700 million US dollars.

The bonuses played an important role in stabilizing the macroeconomic situation and solving problems related to the budget deficit. Calculations show that in 1995-2000, 62 per cent of the budget deficit was covered by the bonuses.

Some of the Oil Fund revenues are obtained from per acre payments. These payments are made by the contractor during the period of exploration. According to three of the contracts signed by Azerbaijan, it is planned to pay \$1,200 per year for every square kilometre of the contractual area. In the remaining contracts, the annual per acre payment is \$2,000 per square kilometre.

Oil extraction from the super-large Azeri-Chirag-Guneshli deposit began in November 1997 within the framework of the "First Oil Extraction" programme. The full-field development of this deposit began in 2006. In the same year, gas extraction began from the super-large Shah Daniz natural gas deposit. According to calculations made by the management of SOCAR, the Azeri-Chirag-Guneshli deposit holds 6.5 billion barrels of oil and 100 billion cubic metres of accompanying gas¹⁰, while the Shah Daniz deposit holds 0.85 trillion cubic metres of natural gas and about 100 million tonnes of gas condensate.¹¹ However, according to information from BP, the reserves extracted from ACG total 5.4 billion barrels¹², while natural gas reserves at Shah Daniz total about 22.1 trillion cubic feet and gas condensate – 750 million barrels.¹³ BP does not rule out the presence of additional reserves in the following layers of the deposit¹⁴, and has made proposals to the Azerbaijan government in order to obtain the right to extract them.

The extraction and sale of the aforesaid hydrocarbon reserves promises great revenues to the country during the contractual period. These revenues are already entering Azerbaijan. A great part of these revenues come from the sale of profit oil due to Azerbaijan. The revenues obtained before 2001, i.e. before SOCAR began operating, were collected in the accounts of the State Oil

¹⁰ Turan news agency, 27 October 2006

¹¹ Turan news agency, 2 August 2006

¹² <http://www.bp.com/genericarticle.do?categoryId=9006667&contentId=7014330>

¹³ <http://www.bp.com/genericarticle.do?categoryId=9006668&contentId=7014342>

¹⁴ Same place

Company. After SOFAR was set up, the remains of the money¹⁵ (270,964,700 US dollars) from the oil contracts signed in previous years (bonuses – 100 million dollars, money from the sale of profit oil – 162,346,200 dollars, money from leasing facilities – 360,000 dollars and tariffs for the transportation of oil by the Baku-Supsa pipeline – 8,258.6 thousands dollars) and kept in SOCAR's account at the International Bank of Azerbaijan were transferred into account of SOFAR. In 2002, 52.6 million dollars from the previous revenues of oil contracts were transferred to SOFAR's account from the National Bank. In 2003, another 124 million dollars were transferred from oil contracts signed in previous years (65.4 million dollars kept at the National Bank, 48.6 million dollars from Lukoil and 10 million dollars from Exxon Mobil)¹⁶. In 2002, 52.6 million dollars from the previous revenues of oil contracts were transferred to SOFAR's account from the National Bank. In 2003, another 124 million dollars were transferred from oil contracts signed in previous years (65.4 million dollars kept at the National Bank, 48.6 million dollars from Lukoil and 10 million dollars from Exxon Mobil).¹⁷

Table 1 contains information about SOFAR's revenues in 2001-2008. Most of the information in the table has been taken from annual reports by SOFAR.¹⁸ Only the figures in the brackets were calculated by the author and have an approximate nature.

¹⁵ The 4 January 2001 decree issued by the Azerbaijani president

¹⁶ The annual SOFAR report for 2003: http://www.oilfund.az/download/az/2003_az.pdf

¹⁷ The annual SOFAR report for 2003: http://www.oilfund.az/download/az/2003_az.pdf

¹⁸ <http://www.oilfund.az/az/account>

Table 1. SOFAR's revenues in 2001-2008

Source of revenues	2001, Million AZM /Million USD	2002, Million AZM /Million USD	2003, Million AZM /Million USD	2004, Million AZM /Million USD	2005, Million AZM /Million USD	2006, Thousands AZN/ million USD	2007, Thousands AZN/ million USD	2008, Million AZN /Million USD
SOCAR funds for 1 January	1241018.0/ 270.9	2346951.1/ 491.5	3387278.1/ (692.2)	4015033.8/ 815.6	4726257.4/ 964.0	1280457.0/ 1394.3	1267444.8/ 1454.5	
Sale of profit oil	826 601.7/ 177.8	975 882/ 200.6	869 008.3/ 176.9	1 294 834.7/ 263.8	2 713 094.8/ 579.9	896 258.0/ 1005.4	1675019.1/ 1954.6	11527.0
Bonuses	29 927.4/ 6.4	257 630*/ 52.6*	608 945.8*/ 124.0*	105 991.1/ 21.6	4 592.1/ 1.0	1 797.7/ 2.0	58068.0/ 68.0	2.8
Transit fees	54 797.0/ 11.7	61681.0/ 12.7	63 588.9/ 12.9	59 712.3/ 12.1	78 217.6/ 16.5	12 716.3/ 14.2	-	0.2
Acreage payments	50 064.1/ 10.7	52 704/ 10.8	94 555.3/ 19.3	43 261.0/ 8.8	40 756.0/ 8.8	7 570.9/ 8.6	5594.7/ 6.6	3.6
Lease payments	2 225.3/ 0.5	2 329/ 0.5	586.4/ 0.1	-	-	-	-	
Assets handed over to the government	-	-	24.4/ (0.005)	2984.3/ (0.607)	7612.9/ (1.625)	669.8/	1288.9/	2.7
Dividends under BTC project	-	-	-	-	-	-	-	97.2
Difference in the price of oil ¹⁹	-	-	-	-	316474.2/	10 972.7/ 12.5	59961.0/ 70.3	
Revenues from the management of SOFAR assets ²⁰	146 378/ 14.2	124 273.0/ (24.3)	183 784.1/ (37.4)	75 623.2/ (15.4)	139 576.3/ (29.8)	55 953.3/	72285.3/	231.2
Revenues from revaluation of the Fund's assets	-	-	-	-	-	-	13947.8/	
The total of revenues per year:	2 351 011.5/ 492.4	1 474 499/ 289.5	1 820 493.2/ (370.7)	1 582 406.6/ (322.1)	3 300 323.9/ 704.6	985 938.7/ 1 165.6	1886164.8/ 2260.8	11864.7
SOCAR funds for 31 December	2 351 011.5/ 492.4	3 821 450.1/ 781.0	4 015 033.8/ (815.6)	4 726 257.4/ 964.0	6 402 284.4/ 1 394.3	1 267 444.8/ 1 454.5	2092406.1/ 2475.4	8986.7/ 11219/2

* The bonuses received before the establishment of SOFAR and kept at the National Bank before being handed over to SOFAR in 2002 and 2003

** The figure in the last column has been taken from the information service of SOFAR (<http://www.oilfund.az/az/account/73>). When this report was being prepared, the outcome of the annual audit of SOFAR had not been announced yet.

¹⁹ Pursuant to the Law "On 2006 State Budget" of the Republic of Azerbaijan as well as under the Memorandum of Agreement signed between the Ministry of Finance, Ministry of Economic Development, State Oil Fund and State Oil Company, payments made to the Oil Fund from the differences between the contract price and domestic wholesale price of crude oil produced and exported from the Republic of Azerbaijan constituted another source of the Fund's revenues.

²⁰ All these revenues include: revenues from the investment of the Fund's money (assets), dividends, revenues from the sale of assets, revenues from the re-estimation of the Fund's currency reserves and so on.

It is interesting that not only the report for 2002, but also those for 2003, 2004, 2005, 2006 and 2007 do not contain information about revenues from the management of SOFAR assets in dollars. Only the report for 2001 provides relevant indicators of revenues. It is difficult to explain why some types of revenues are not given in dollars in the reports. Revenues from the management of SOFAR assets are obtained in foreign currency. Maybe these revenues are obtained in various types of currency and this is why they are not given in SOFAR reports. We believe that it is more groundless not to indicate revenues in foreign currency rather than indicate them in several types of currency.

Some figures given in the brackets were calculated on the basis of the average annual rate of AZN (were taken from reports by the International Monetary Fund²¹).

As we can see from Table 1, the revenues from the sale of profit oil in 2007 totalled 1,929.6 million US dollars. Of these revenues, 1,929.6 million US dollars were received from the Azari-Chirag-Gunashli deposits, 10.2 million US dollars – from the Mishovdag and Kalamaddin deposits and 12.4 million US dollars from the Kursangi and Qarabagli deposits. In the same year, 2.4 million US dollars were received from the sale of natural gas extracted at the Shah Daniz deposit.

The bonuses paid in 2007 totalled 68 million US dollars. Of this sum, 46 million US dollars were paid for the Shah Daniz deposit, 20 million US dollars for the D-222 (Yalama) deposit and 2 million US dollars from the Zig and Hovsan deposits.

Per acre payments totalled 6.6 million US dollars in 2007. Of this, 0.9 million US dollars came from the Inam deposit and 5.7 million US dollars from the D-222 (Yalama) deposit.

It must be noted that the tariffs for the transit of oil and gas by the BTC, Baku-Supsa and BTE pipelines are transferred to SOFAR²². Unlike previous years, SOFAR did not receive any revenues from this source in 2007.

The average annual revenues from the management of SOFAR assets (basic currency – US dollars) are given in Table 2.

Table 2. The average annual revenues from the management of SOFAR assets

	2001	2002	2003	2004	2005	2006	2007	2008
The average annual revenues from the management of SOFAR assets	3.87	2.15	4.42	1.88	2.79	8.5	8.3	3.79

²¹ <http://www.imf.org/external/pubs/ft/scr/2008/cr08216.pdf>

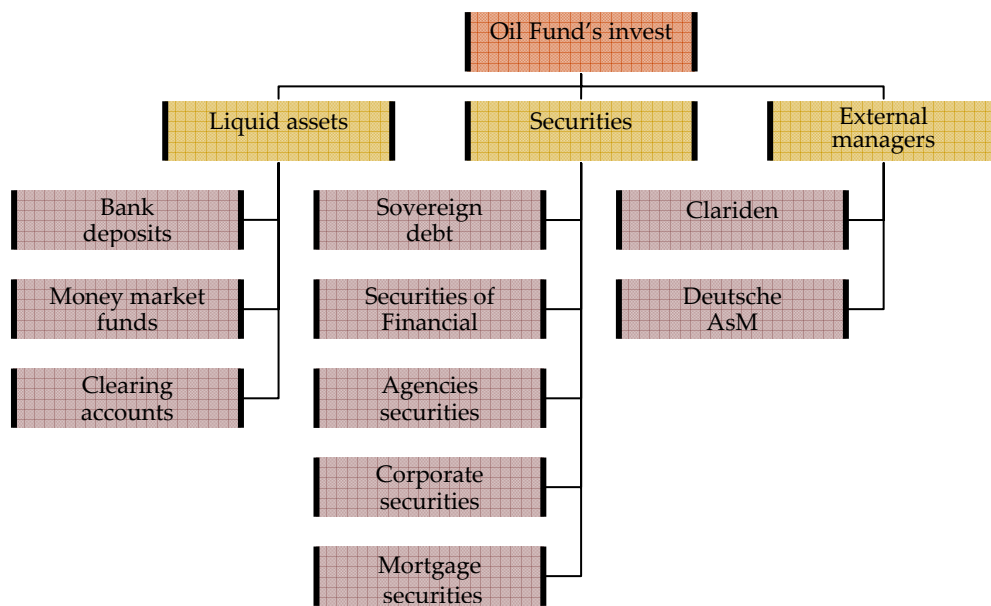
²² <http://www.oilfund.az/az/content/13/9>

*** The figure in the last column has been taken from the information service of SOFAR (<http://www.oilfund.az/az/account/73>). When this report was being prepared, the outcome of the annual audit of SOFAR had not been announced yet.*

The fact that profitability increased considerably depending on the placement of SOFAR assets in 2006 is also probably explained by the inflation of the dollar. In any case, according to SOFAR’s annual reports, the profitability of placement accounted for 2.9 per cent on the manat basis (AZN) in 2006.

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According to the situation existing in 2006, the scheme of the placement on SOFAR assets is described in Picture 1²³. In 2006, a great part of SOFAR assets – 51.6 per cent – were kept in a liquid condition for one year, 33.9 per cent for 1-3 years, 8.2 per cent – for 3-5 years, 2.8 per cent – for 5-7 year and 3.5 per cent for more 7 years.



Picture 1. Oil Fund’s investment areas

Some changes were made to this scheme in 2007. For example, SOFAR refused to place its assets on the monetary market. Another interesting change

²³ The annual SOFAR report, 2006

was that the services of the World Bank were used (in the form of a foreign manager). There is still no information available about the placement of SOFAR assets in 2008 (as of 10 March 2009).

Table 3 shows the composition of SOFAR's currency assets by 31 December 2007.

Table 3. million USD

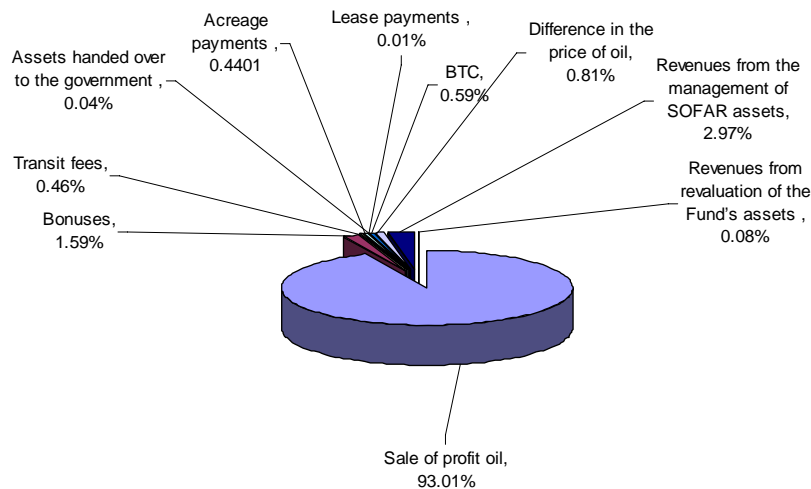
	SOFAR	Clariden	Deutsche AsM	World Bank	Total	%
Securities:	1869.8	41.1	81.9	106.0	2098.8	86.1
Sovereign debt	117.7	28.3	56.2	69.6	271.8	11.2
Bonds of agencies and international institutions	603.5	6.4		36.4	646.3	26.5
Bank and financial bonds	913.9	1.5	19.2	-	934.5	38.3
Corporate securities	234.7	-	6.5	-	241.2	9.9
Mortgage	-	4.9	-	-	4.9	0.2
EQUITIES	-	2.5	-	-	2.5	0.1
CASH:	327.1	6.2	1.3	1.0	335.5	13.8
Deposits and money market funds	279.7	6.2	-	1.0	286.9	11.8
Bank accounts	47.4	-	1.3	-	48.6	2.0
Total:	2196.9	49.8	83.1	107.0	2436.8	100

As we can see, foreign managers managed 9.8 per cent of the total volume of total assets by the end of 2007. In 2006, 8.6 per cent were entrusted to foreign managers. Clariden's actual annual rate of return was 6.43 per cent (6.28 per cent in 2006), Deutsche AsM's - 5.82 per cent (5.25 per cent in 2006) and the World Bank 7.08 per cent.

In 2007, a great part of SOFAR assets (43.3 per cent) was kept in 1-3-year period assets. Before 2007, 24.8 per cent of assets were kept in fixed-term assets, 27.8 per cent in 3-5-year assets, 3 per cent in 5-7-year assets and 1.1 per cent in assets for a period longer than seven years. By 31 December 2007, 13.8 per cent of SOFAR money was kept in liquid assets, 86.1 per cent in securities and 0.1 per cent in shares.

According to the 28 December 2005 decree issued by the country's president, 55 per cent of SOFAR assets in 2006 were kept in dollars, 35 per cent in euros and 5 per cent in pounds. Another 5 per cent of SOFAR assets were kept in the currencies of high-rating countries. According to a decree on 2007 issued by the country's president (28 December 2006), these rates were kept in force.

Picture 2 gives the composition of SOFAR's total revenue basket for 2001-2007 (except for what was handed over to SOFAR in 2001-2003 from the currency reserves kept in the accounts of the National Bank and SOFAR).



Picture. 2. The basket of SOFAR revenues

As we can see, a great part of revenues in these years was formed by revenues from the sale of profit oil. Taking account of the adoption of the second scheme for dividing the profit oil expected in 2008, we can predict a rise in the profit oil share in SOFAR's total revenue basket.

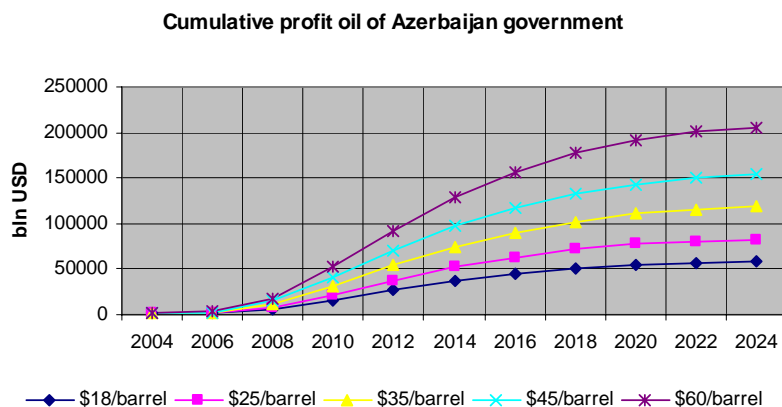
When this report was being prepared (February 2009), SOFAR's report for 2008 had not been made public yet. For this reason, it was impossible to make comparisons with 2008. Along with this, SOFAR has posted some information about 2008 on its website. According to this information, the volume of SOFAR funds totalled 8,987 million manats (11,219 million US dollars)²⁴ on 1 January 2009. As we can see from Table 1, by 31 December 2007 (or by 1 January 2008) SOFAR assets totalled 2,475.4 million US dollars. This means that SOFAR assets increased by 8,744 million dollars in 2008. The revenues were even higher in that year. No accurate figures have been announced yet, but if we take into account that the confirmed expenses of SOFAR in 2008 were 4,380,853,600 manats²⁵, we can assume that in 2008, the revenues of SOFAR totalled about 14 billion dollars. Great revenues are expected in the next few years as well. Of course, their volume will depend on the price of crude oil on the world market. 2008 was a year of great surprises. Three months after the price of one barrel of crude oil soared from 70 dollars at the beginning of the year to 147 dollars in July, the price slumped below 40

²⁴ <http://www.oilfund.az/az/content/15>

²⁵ The 11 July 2008 decree issued by the president of the Azerbaijan Republic

dollars. With such a fluctuation in prices, it is very difficult to make predictions.

Along with that, it is possible to assess the expected revenues on the basis of some pre-conditions (the expected dynamics of extraction, exploitation and investment expenses and theories about transport expenses and the expected price of oil on the world market). Such attempts are being made by the AIOC, SOCAR and SOFAR. Two years ago, the author of this paper examined five scenarios on the prices of crude oil (12, 25, 35, 45 and 60 dollars per barrel) based on some pre-conditions and made calculations regarding the expected revenues. Their results are given in Picture 3.



Picture 3.

As we can see, by the end of 2024, i.e. by the time the contract expires, the value of Azerbaijan's cumulative profit oil can be 50-210 billion US dollars (18, 25, 35, 45 and 60 dollars per barrel) depending on the price of oil.

It must be noted that Azerbaijan's revenues are not restricted to SOFAR's revenues. According to the contracts that have been signed, the contractor will pay taxes into the state budget from his profit. The tax on the ACG contractor's profit is 25 per cent and on the subcontractor's profit (the volume of service contracts) is 5 per cent. Other types of state budget revenues are formed by the income tax paid by the personnel.

SOCAR is one of the contractors in the contract on ACG and owns a 10-per-cent share. This means that 10 per cent of the contractor's profit oil belongs to SOCAR. And of course, this can also be added to Azerbaijan's revenues.

The State Social Security Fund also gets some revenues from the oil contracts.²⁶

²⁶

6. EXPENDITURE FROM SOFAR

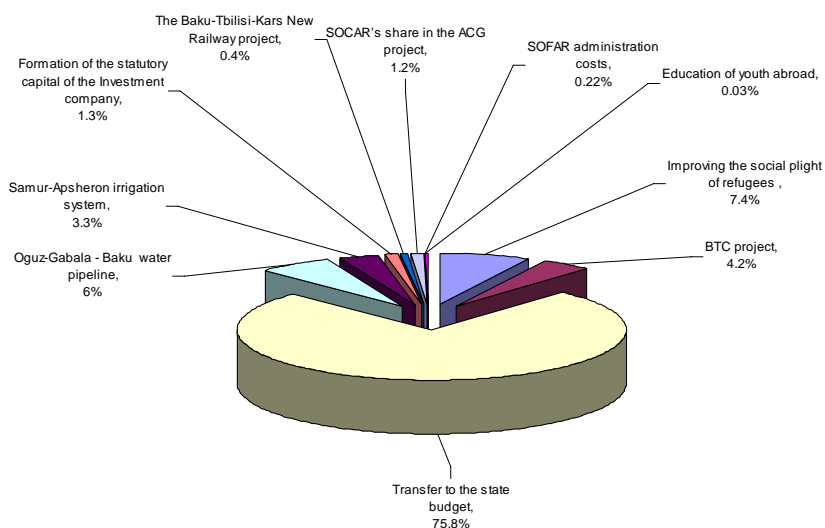
As we said, SOFAR was set up in the final days of 1999. The Fund started its work in 2001, and in the same year, SOFAR started financing various projects (investment and social) on the basis of presidential decrees. Table 4 provides information about SOFAR expenses in 2001-2008.²⁷

Table 4. Expenditure from SOFAR

Structure of SOFAR expenditures	2001, Million AZM	2002, Million AZM	2003, Million AZM	2004, Million AZM	2005, Million AZM	2006, Million AZN	2007, Million AZN	2008, Million AZN	Total, Million AZN
Improving the social plight of refugees	3583.3	188839.0	99812.9	74952.3	201948.2	110.0	154.1	145.0	523.0
BTC project	-	242298.7	576000.0	89000.0	205000	75.4	-	-	297.9
Transfer to the state budget	-	-	500000.0	650000	750000	585.0	585.0	3800.0	5350.0
Oguz-Gabala - Baku water pipeline	-	-	-	-	-	82.7	132.9	211.8	427.4
Samur-Apsheron irrigation system	-	-	-	-	-	37.0	76.0	120.6	233.6
Formation of the statutory capital of the Investment company	-	-	-	-	-	90.0	-	-	90.0
The Baku-Tbilisi-Kars New Railway project	-	-	-	-	-	-	20.7	5.3	26.0
SOCAR's share in the ACG project	-	-	-	-	-	-	87.6	-	87.6
Education of youth abroad	-	-	-	-	-	-	-	2.3	2.3
SOFAR administration costs	476.6	3034.0	4307.3	3555.6	7838.3	1.2	4.0	6.8	15.8
Total:	4059.9	434171.7	1180120.2	817507.9	1164786.5	981.4	1061.3	4291.8	7053.6

Picture 4 shows the structure of expenditure from SOFAR in 2001-2007.

²⁷ Annual SOFAR reports, www.oilfund.az



Picture 4. Expenditure from SOFAR

Table 5 provides figures that make it possible to compare the spending of oil revenues with the country's budget.

Table 5. compare the spending of oil revenues with the country's budget.

	2001 AZM	2002 AZM	2003 AZM	2004 AZM	2005 AZM	2006 AZM	2007 AZN	2008 AZN
Revenue	1109993.5	1474499.0	1820493.2	1582406.6	3300323.9	4929693.5	1886.2	11864.7
Expenditure	4059.9	434171.7	1180120.2	817507.9	1164786.5	4906879.0	1061.3	4291.8
Expenditure/ Revenue, %	0.36	29.4	64.8	51.7	35.3	99.5	56.3	36.2

Table 6 indicates figures that make it possible to compare the spending of oil revenues with the country's budget.

Table 6. SOFAR expenses and state budget expenditure

Year	Expenditure from SOFAR ²⁸ , million AZN	State Budget ²⁹ , Million AZN	The share of transfers from SOFAR in the state budget, %
2001	0,8	806.6	0
2002	86,8	931.7	0
2003	236,0	1 234.0	8.1
2004	163,5	1 501.0	8.6
2005	232,9	2 140.7	7.0
2006	981.3	3 789.7	15.4
2007	1061.3	6086.2	17.4
2008	4291,8	10680.9	40.2

According to SOFAR³⁰, the amount of money allocated from the Fund for various projects by 1 January 2009 is the following:

Directions of expenditures	Amount (in thousand manats)
1. The expenditures for financing some projects concerning solution of the social and settlement problems of the refugees and internally displaced persons	523
2. Financing of the participation of the Republic of Azerbaijan in Heydar Aliyev BTC Main Export Pipeline Project	297.9
3. Financing construction of the Oguz-Qabala-Baku water supply system	427.5
4. Financing the reconstruction of the Samur-Absheron irrigation system	234.5
5. Transfer to 2009 State Budget of the Republic of Azerbaijan	5 350
6. Formation of the statutory capital of the State Investment Company	90
7. Financing "Baku-Tbilisi-Kars railway" project	26
8. Financing "State Programme on education of Azerbaijan youth in foreign countries in 2007-2015"	2.3
9. Regulation of some issues related to SOCAR's share in the joint development of the deep underground parts of ACG field	87.6
Total:	7 036.5

²⁸ ARDNF-nun illik hesabatları, www.oilfund.az

²⁹ http://www.azstat.org/publications/azfigures/2007/az/020.shtml#t20_1

³⁰ <http://www.oilfund.az/az/content/15>

Transfers from SOFAR to the state budget and transfers for the social needs of refugees and displaced persons and for the implementation of infrastructure projects are handed over to various government agencies and are at the risk of being misspent or misused.

Is there a risk of some of the oil money spent on various government projects and programmes being lost (misappropriation or misspending by officials)? Based on the assessment of the level of corruption in the country by various international and local organizations, we can answer this question in the affirmative.

7. SUPERVISION OF REVENUES

When we say supervision of expenses, we mean the full and timely arrival of revenues. There are many types of revenues that the state is receiving from the extraction and use (sale, processing, etc.) of oil and gas reserves. There are also several government agencies that receive the revenues (SOFAR, the state budget, SOCAR, the SSSF, etc.). Since this report focuses solely on SOFAR, we would like to briefly examine issues of supervising the revenues coming into SOFAR.

As we said above, the Oil Fund is receiving revenues from the following sources:

- Azerbaijan's share in profit oil extracted within the framework of the PSA;
- The bonuses paid according to PSA terms;
- Per acre payments according to PSA terms;
- Azerbaijan's dividends and revenues from the division of the profit from oil and gas projects;
- Transit revenues from oil and gas export pipelines;
- The use of assets within the framework of the PSA;
- Revenues from the management of assets (placement, investments, etc.);
- Grants and other aid.

In 2003, Azerbaijan joined the international Extractive Industries Transparency Initiative. Within the framework of this initiative, Azerbaijan's aforesaid revenues have been made public twice a year (for the previous year and for the first half of the current year) since 2005. This statement is made at a

meeting attended by the main participants in the initiative – the government, companies and the NGO Coalition which represents the civil society. Then, it is posted on the SOFAR website. As a result of this initiative, every Azerbaijani citizen has the opportunity to obtain information about the country's oil and gas revenues. Of course, this is a good opportunity. But we should point out that this initiative does not replace the audit carried out in Alaska in 19...-19...³¹. That's to say participation in the initiative and publication of revenues simply means that the government's report on the revenues and the companies' reports on their payments are compared and a certain opinion is formed about the country's revenues. This opinion is prepared by an audit company (we should point out that in every reporting period, the audit company is selected transparently and according to the law). We should repeat that this opinion is not about the audit, it reflects the results of comparison. Despite that, the aforesaid initiative is of great importance.

Is there any institute that oversees whether government agencies receive in full and in a timely fashion the revenues that Azerbaijan is receiving (that's to say according to the terms of the contract)? Responsibility lies mainly with SOCAR and partially, with the Ministry of Energy. However, since SOCAR itself is a party to the contract, there is a conflict of interests, while the ministry has no institutional power to carry out relevant inspections yet.

8. RESULTLS AND RECOMMENDATIONS

1. By establishing SOFAR, Azerbaijan created an opportunity to reduce the negative impact of large oil revenues on the economy. However, the large amount of state spending in recent years raises questions as to whether this opportunity is being used appropriately.
2. SOFAR's budget practice should be improved. The rules on the compilation and execution of SOFAR's annual revenues and spending programme (budget) say that the budget of SOFAR is endorsed on 1 December at the latest. However, delays are continuing, which has a negative impact on the activities of the Oil Fund. At the same time, this also disrupts the state budget process in general.

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3. An analysis of the rules of maintaining, placing and managing the currency reserves of the State Oil Fund shows that the activity of the Fund is quite closed and it is difficult to assess its activities to manage its assets from aside (both by experts and civil society organizations). The fact that the Fund's activity is inspected by an internationally-recognized auditor does not answer the question as to whether the assets of the Fund are managed efficiently.
4. According to the statute on SOFAR, the assets of the Fund can be used to resolve socioeconomic and important national problems, as well as to build and reconstruct infrastructure facilities of strategic importance. However, who will define the importance of problems and infrastructure facilities and how? The statute does not provide an answer to this question. For this reason, there is a need to adopt additional legal norms or a special law on the management of the revenues.
5. The members of the Fund's Observation Council are appointed by the country's president. The issue of including a representative of the NGO sector in the Observation Council has been repeatedly raised in recent years at various public discussions on oil revenues. The NGO Coalition to Increase Transparency in Extractive Industries has sent a relevant appeal to the country's president. But the situation remains unchanged.
6. The institutions and mechanisms overseeing the full (i.e. according to the terms of the contract) and timely receipt of Azerbaijan's revenues should be clarified. Since SOCAR itself is a party to the contract (there is a conflict of interests), the terms of the contract should be overseen by the Ministry of Industry and Energy. It is necessary to increase the ministry's institutional powers and opportunities to carry out relevant inspections.
7. The spending of large amounts of oil revenues requires the strengthening of the relevant state supervision system (first of all, the Audit Chamber). At the same time, it is very important to involve civil society organizations in this supervision.

Appendix 1

N	Dates when the contracts were signed and took effect	Names of deposits	Shares of SOCAR and foreign companies*, %
1	20.09.94 02.12.94	Azeri-Chirag-Guneshli	SOCAR(10); BP (34.1367); ChevronTexaco(10.2814); Lukoil(10.0000); Statoil(8.5633); ExxonMobil(8.0006); TPAO(6.7500); Devon Energy(5.6262); Itochu(3.9205); Amerada Hess (2.7213)
2	10.11.95 13.02.96	Garabag	SOCAR(7.5); Lukoil (12.5); Devon Energy (30.0); Agip-Lukoil(45); Agip(5)
3	04.06.96 04.10.96	Shah-Deniz	SOCAR(10); BP(25.5); Statoil (25.5); LukAgip(10); TotalFinaElf(10); OIEC(10); TPAO(9)
4	14.12.96 25.02.97	Dan Ulduzu, Ashrafi	SOCAR(20); BP(30); Unocal(25.5); Itochu(20); Delta(4.5)
5	13.01.97 13.06.97	Lankaran-Deniz, Talysh-Deniz	SOCAR(25); Elf(40); Total(10); DEMINEX(10); OIEC(10); PETROFINA(5)
6	03.07.97 05.12.97	Yalama	SOCAR(40); LUKOIL(32.4); ARCO(27.6)
7	01.08.97 05.12.97	Absheron	SOCAR(50); Chevron(30); Total(20)
8	01.08.97 05.12.97	Nakhchivan	SOCAR(50); ExxonMobil(50)
9	01.08.97 05.12.97	Oguz	SOCAR(50); ExxonMobil(50)
10	02.06.98 07.07.98	Kurdashi, Araz-Deniz, Kirgani-Deniz	SOCAR(50); Agip(25); MITSUI (15); TPAO (5); REPSOL (5)
11	20.07.98 01.12.98	Inam	SOCAR(50);); LASMO (12.5); BP (25); CTK (12.5)
12	20.07.98 18.12.98	Araz, Alov, Sharg	SOCAR(40); BP(15); Statoil (15); TPAO(10); Alberta Energy(5); ExxonMobil(15)
13	25.12.98 11.06.99	Atashgah, Yanan Tava, Mugan-Deniz	SOCAR(50); Japex(22.5); Inpex(12.5); Itochu(7.5); Telkoku(7.5)
14	02.06.98 13.11.98	Janub-Garb Gobustan	SOCAR(20); CNPC(50.26); Commonwealth Oil & Gas(29.74)
15	21.07.98 20.11.98	Muradkhan-li, Zardab, Jafarli	SOCAR(50); Ramco(50)
16	02.06.98 16.04.99	Kursangi, Garabagli	SOCAR(50); Frontera Resousers(30); Delta-Hess(20)
17	27.04.99	Savalan, Dalga, Lerik-Deniz, Jenub	SOCAR(50); ExxonMobil(30) ?(20)
18	27.04.99 21.04.00	Zafar, Mashal	SOCAR(50); ExxonMobil(30); Conoco(20)
19	27.04.99 09.06.00	Padar blok	SOCAR(20); Moncrief Oil(80)
20	12.09.00 25.10.00	Mishovdag Kamaledin	SOCAR(15); Moncrief Oil(49.7); Petoil(35.3)
21	09.01.01 12.06.01	Zig, Hovsan	SOCAR(50); Lukoil(50)
22	04.06.03 02.12.03	Pirsaat	SOCAR(20); Shengli (50); Intersun(30)
23	29.09.04 29.04.05	Binagadi group of fields	SOCAR(25); AZEN(75)
24	18.06.04 29.04.05	Garachu-khur	SOCAR(25); Noble Sky(75)
25	05.11.04 29.04.05	Kurovdag	SOCAR(50); Caspian Energi Group(50)
26	16.08.05	Surakhani blok	SOCAR(25); Rafi Oil FZE (UAE)(75)

**The companies and their shares are the same as when the contract was signed. Afterwards, some companies in a number of contracts sold their shares to other companies fully or partly.*

Appendix 2

million USD

Conditions for paying a bonus	Number of the contract*												
	1	2	3	4	5	7	8	9	10	11	12	13	
Within 30 days after a contract takes effect	135	8	37	8	37	30	10	10	32	32	100	10	
Within 30 days after the beginning of the drilling of the first exploration well													
Within 30 days after the approval of the exploitation program											20		
Within 30 days after daily oil production totals 40,000 barrels per day		25		25									
Within 30 days after stable production of 40,000 barrels of oil a day for a period of 60 days	67.5												
Within 30 days after stable production of 12,000 barrels of oil a day for a period of 60 days		42		42								25	
For every 100m barrels that have been extracted			1		2.5	1	1					2.5	
Since the exploitation program envisages every 100m barrels of oil or oil equivalent, within 30 days after the approval of that program								2.5	2.5	2.5	1		
Within 30 days of an events that happens at a later date, 1) When 12,000 barrels of oil or oil equivalent are extracted for 60 days; 2) Stable production from two wells for 60 days			50		10	25	30	10	10		50		
Within 30 days after the main export oil is pumped into the pipeline for 60 days	67.5												
Within 30 days after beginning of industrial oil production										10			

* The number of the contract is in the same order as in Appendix 1

EFFICIENCY OF SOCIAL PROGRAMS FINANCED BY OIL REVENUES

Azer Mehtiyev

Introduction

Azerbaijan possesses rich oil-gas resources, also some other mineral resources. According to the information of SOCAR there are 57 rich oil deposits in Azerbaijan, 18 of them are in Azerbaijan sector of Caspian Sea and others are on land. There are 3-5 milliard ton oil resource, and 5 trillion cube meter gas resource in Azerbaijan part of Caspian basin. Azerbaijan had signed 27 international contracts with participation of oil companies of different countries since 1994 for the purpose of exploitation these rich oil-gas deposits. Drawing foreign investment amounting 24 milliard 291 million US dollars to the oil sector of the country within 1995-2007 years is its result. In spite of one part of those contracts had stopped their work because of luckless results of exploration work (not finding commercial useful oil resources in deposits), production and export on some deposits and getting revenues already had been started, exploration works are continues on others.

Azeri-Chirag-Gunashli (Century's Contract) is a biggest agreement of Azerbaijan for sum of investment and production size, oil production started there in 1997, and extracting benefit oil started there since 2007. Big oil money comes to Azerbaijan from 2005 year.

Especially speedily growing oil revenues last years, starting from 2005 year Azerbaijan leads other countries for real growing temps of TIC (udm): the level of these indicators was such: 26,4% in 2005, 34,5% in 2006, 25,0% in 2007. Finance opportunities of state have sharply increased in this period. According to the experts' evaluation, the average price of one barrel of oil in world market is 45 \$, but only from "Century's Contract" Azerbaijan might gain 155 milliard \$ till 2030 year. Of course this situation creates possibilities for government to realize several social-economic programs, and for assignment considerable means for solution social problems (education, health, social defense and guarantee).

Nevertheless, gaining big revenues in such short time does not only create activity of government in its social-economic action, but also increases its responsibility. Such duties are standing in this period: providing efficient management, creating and strengthening durable social-economic development

base of community, avoiding cases of irrational usage of resources, providing effectiveness of implemented social programs, creating condition for taking advantage of revenues gained from natural resources by all levels of society, and to attain raising welfare of society.

While looking to practices of countries with rich resources, and their usage of these revenues, we see that most of them not only could not do all these duties, but also there are much more serious problems as becoming harder of social lives of population, deepening social stratification, and growing social-political tension. Will our country be able to avoid this syndrome called "curse of resources"? This is one of the main questions worried communities of Azerbaijan. It is clear that the answer of this question depends on efficiency of action of government.

It is a little time that big oil revenues come to Azerbaijan and government directs these means for solution of different social-economic problems. For this purpose to evaluate government's a long time policy of usage of oil revenues is early. But, description of cases in this sphere can find out forming tendencies and evaluate possible results. This is a main goal in this research.

Resource revenues' impact on social-economic development of the country: Brief summarize of foreign practice

General economic progress in world economy that happened in second part of XX century resulted with large exploitation of natural resources especially mineral resources, and requirement to natural resources grew speedily. In this situation, rich natural resources countries' becoming wealthy in a short time, increasing economic development temps, and progressing population's welfare were expected. But it is strange that, in natural resource rich countries of America, Asia and Africa first there were positive tendencies (60-70 years), then it was substituted with contrary tendencies (80th years): economic growing temps sharply decreased in these countries, life level of population got worse, poverty got increased, state debts increased, even political stability disordered in some countries, general decline processes deepened in society.

Rich natural resources should cause big economic superiorities, but it caused strengthening of decline, and such contradictory situation could not stay out of attention of international organizations, big research centers, and researchers. Some international organizations, big research centers, and separate researchers started academic investigation of this situation in natural resource rich countries since beginning of 90th years. Such investigations still go on.

J. Sax and E. Worner are one of the first authors of investigation in this sphere, they published a book in 1995, and it was result of investigation of data of 97 countries, they showed there that, from 1960 till 1990 countries with poor resources attained much more growth level than countries with rich resources. Especially surprising case is in 70th years one barrel of oil increased from 3 \$ to 10 \$ and difference in that time was big.

According to the World Bank's information, average descending temp of production of total inner crop (udm) per person was 1 % in Iran, 2% in Libya, 3% in Iraq and Kuwait in 1965-1998 years. That indicator was 6% in Qatar in 1970-1995 years.

Researches held by Oxfam-America organization showed that, oil and other mineral resources do not decrease poverty level, just sharpens it. As dependence on oil and oil revenues increases in the country, level of child death increases, education level of population decreases, life time of population shortens.

Researches investigate the contradictory situation of country's being wealthy with natural resources and its social-economic development, and characterize it as "curse of resources", and shows different explanations of it: "dependent development theory", "raw specialization trap",

"Holland syndrome", "rent directed action", "worthlessness of human capital".

But in most cases researchers' conclusions are this: rich resource revenues' impact on country's social-economic situation first of all depends on quality of institutes formed in the society (efficiency of state management, development level of court system, and civil society's ability of providing public oversight), and ability of government's activity.

These researches show that only Canada and Norway could display efficient usage of revenues gained from rich natural resources. It is connected with having good based institutes in those countries.

Some countries else as United Arab Emirate, Qatar and partially Kuwait turned to rent directed state, as oil resources per person are too high there, and raised to high consumption level, but even these countries' economy depends on oil sector. In another countries "resource curse" syndrome showed itself by this or other form.

For example, Nigeria extracted oil in amount 320 milliard \$ for 30 years, from 1970 till 2000, though it is still one of the most poor country in the world. In 1980 year TIC per person was 1400 \$ in this county but in 2001 this sum was 300\$. According to the different evaluation, ex president of Nigeria general Sani Abacha adopted more than 4 milliard \$ got from oil extraction.

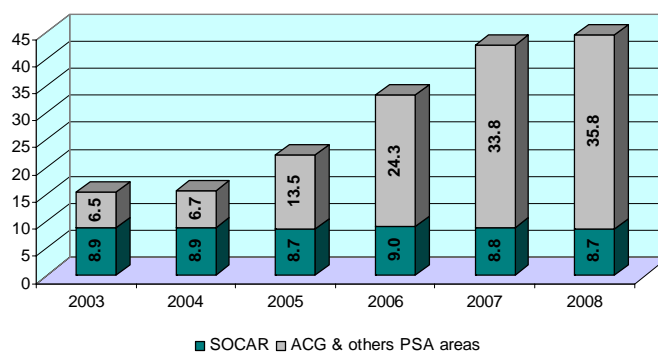
Oil-Gas revenues of Azerbaijan

Azerbaijan takes high profit by its hydrocarbon resources (oil-gas) in last years. Impact of these revenues is felt (both in positive and negative meanings) in all quantity and quality parameters of country, also in welfare level of population.

While speaking formation of oil-gas revenues of Azerbaijan we should note several important tendencies:

- from 2005 year oil production and export size speedily increases in the country after international oil agreements (especially on ACG agreement);
- from 2006 year gas production and export size speedily increases in the country after international agreements (especially on Shahdaniz agreement);
- price of oil in world market was in growing tendency from 2003 year till July of 2008. Price of one barrel of oil was 37\$ in world market in 2004 year, in July of 2008 this price increased to 147 \$, and on December of 2008 the price decreased to 43\$. Nevertheless, market price of oil was higher that 40\$ in 2004-2008 years;
- since 2006 extraction benefit oil had been started on ACG deposit;
- division of benefit oil on ACG deposit among Azerbaijan government and companies changed to favor of the government since 2008-division proportion was 30:70 at the end of 2007, at the beginning of 2008 was 45:55, and at the end of 2008 it was 80:20.

Last 5 years (2004-2005) oil extraction size grew for 3 times in Azerbaijan: reached to 44.5 million ton from 15.6 million. In this period oil production size of SOCAR remains invariable (approximately 8.7-9 million ton).

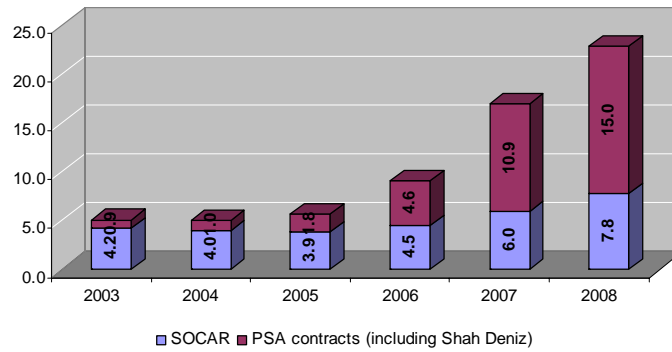


Scheme 1. Oil production in Azerbaijan in 2003-2008 years (million ton)

Growing in oil production happened within agreements, especially, on Abesh(?) production on ACG project: production here was twice much in 2005 than in 2004, reached 13.5 million ton from 6.7 million. High growing temp was

observed in 2006-2007 years, and oil extraction was 24.3 then 33.8 million ton. But from 2008 oil production of Abesh got comparatively invariable-totally 2 million much production was observed (35.8 million ton). It should be considered that, around 80% of oil is extracted by foreign companies within the agreements, and this tendency will continue in near period.

We witness approximately the same view connected to gas production.



Scheme 2. Gas extraction in Azerbaijan in 2003-2008 years (billion cubic meter)

There was a little growth in gas production of SOCAR in two years, unlike oil. Gas production is speedily increases since 2006 by agreements: 1.8 billion cubic meter gas had been extracted in 2005, it was 4.6 billion cubic meter in 2006 (3 times growth), in 2008 this indicator was 15.0 billion cubic meter. Country's production portion on agreements was 31.6% in 2005, 50, 5% in 2006, 64, 5% in 2007, 65, 8% in 2008.

Growing size of oil-gas production and export, impacted on appropriately growing dynamics and temps of UDM (umumi daxili mehsul-hansi termin islenir tapmadim). So, till 2005 growing UDM was happening with slow temps, but from 2005 growing changed fastly year by year: each next 2 years period- to compare 2006 with 2004, 2007 with 2005, and 2008 with 2006- size of UDM grew much than 2.1 times.

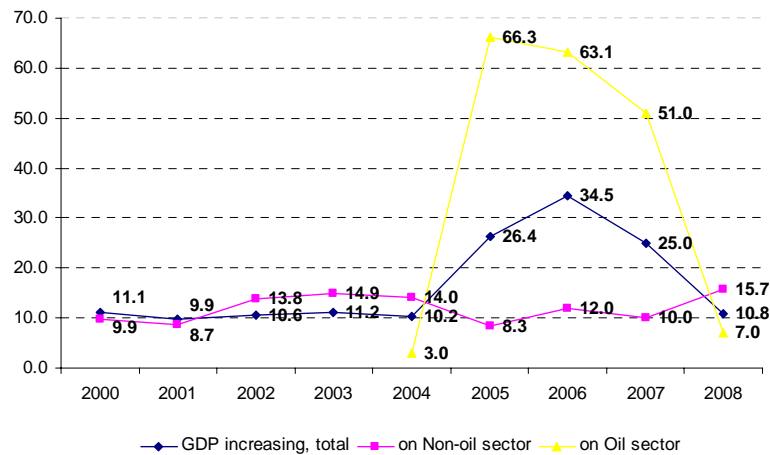
Table 1. Growing dynamics of size of UDM production on 2000-2008 years (with million AZN)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
UDM, total	4718.2	5315.6	6062.5	7146.5	8530.2	12522.5	18037.1	26815.1	38005.7
On non-oil sector	3055.8	3195.9	3693.9	4447.6	5242.5	6055.0	7079.1	9533.9	14750.7
On oil sector	1662.4	2119.7	2368.6	2698.9	3287.7	6467.5	10958.0	17281.2	23255.0

Source: Ministry of Economic Development, (<http://www.economy.gov.az/>; report of Cabinet of Ministries on activity for 2008 year, Baku 2009.

Till 2004 in UDM non-oil sector's portion was high, from 2005 year tendency of growing oil sector's portion started. In 2006-2008 years portion of oil sector in UDM was much than 60%.

While looking at growing dynamics of UDM in the country within 2000-2008 years period (scheme 3), we see that, in that period growing in non-oil sector was in stable extent: was changed in 9-15% intervals.



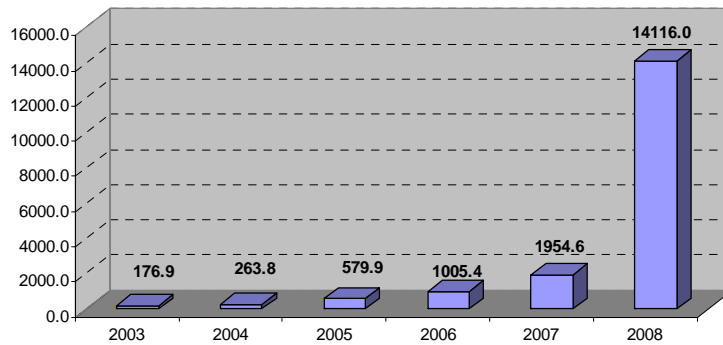
Scheme 3. Changing growing temps of yearly UDM in within 2000-2008 years in Azerbaijan.

In oil sector was low growing temps till 2005 (yearly 3-4%), in 2005 year growing UDM production was 66%, in next 2 years high growing temps continued. It was connected to speedily growing oil extraction size year by year in those periods (on ACG project), and increasing price of oil in world market. Nevertheless, as in 2008 oil production was stable and at the end of the year price of oil sharply decreased, it resulted with decreasing growing temps of UDM, in 2007 growing was 51.0% and became 7.0%.

As we know, included oil revenues are gathered mainly in 3 sources- State Oil Fund of Azerbaijan Republic, State budget and SOCAR- and are directed to solution of different social-economic problems. After SOCAR's payments and taxes for its own activity and portion from oil agreements, remaining means stays under its own order.

As it is known, State Oil Fund of Azerbaijan Republic was founded by 240№, 29 December 1999 year decree of President of Azerbaijan Republic 'about founding State oil Fund of Azerbaijan Republic'. Revenues (benefit oil in country's portion, bonuses, payments on acres, leasing payments etc.) on oil-gas agreements are mainly gathered in State Oil Fund. Since the Fund was established total size of its revenues was 20.0 \$ in 2001-2008 years, much of 72.0 % (approximately 14.5 milliard \$) included to the Fund in 2008 year.

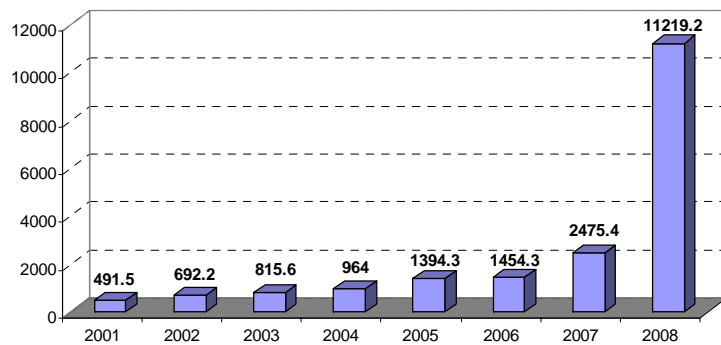
94, 2 % (18, 1 milliard \$) of revenues of State Oil Fund formed by selling benefit oil and gas in 2003-2008 years. Size of inclusions to Oil Fund from selling benefit oil and gas in 2003-2008 years was as below: from selling benefit hydrocarbons within agreements were 1.0 milliard in 2006, 2 milliards in 2007, and 14.1 milliards in 2008.



Scheme 4. Inclusions to State Oil Fund from selling benefit oil and gas during 2003-2008 years. (With million US dollars).

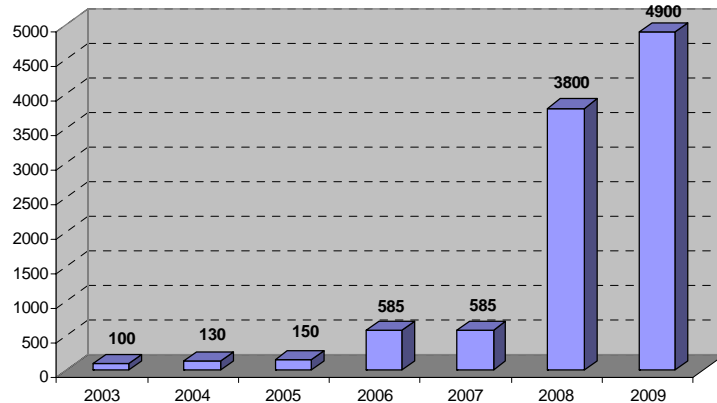
During 2003-2008 years general revenues of Fund revenues related to management of it was 2.7% (512.2 million \$), bonus payments 1.2% (220.1 million \$), dividends on BTC project 0.6% (119.6 million\$), revenues from difference between export price of raw oil with country internal wholesale price 0.4% (82.8 million\$), payments on acres 0.3% (56.5 million \$), transit fee 0.3% (55.9 million\$).

At the end of 2008 means remainder in State Oil Fund was 8 milliard 987 million manats (11 milliard 219 million \$). Changing means remainder in Oil Fund for the end of each year on 2001-2008 years was displayed in 5th scheme. As it is shown, for the end of 2008 year means remainder in the Fund passed 10 milliards, and reached 11.2 milliard\$.



Scheme 5. Growing dynamic of means (remainder) of State Oil Fund during 2001-2008 years. (To the end of the year, with million US dollar).

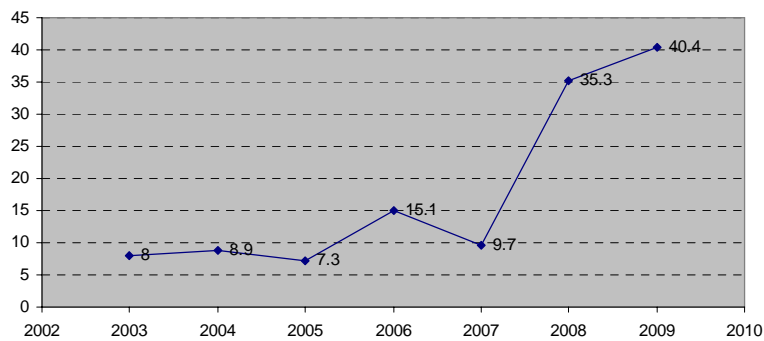
As it is known, taxes from SOCAR, other local and foreign oil companies, also, taxes from subcontractors' revenues from benefit and profit, and taxes from salaries of staff working there enter to state budget. Besides of it, starting from 2003 Oil Fund transfers money to state budget every year.



Scheme 6. Dynamics of sum transferred to state budget from Oil Fund within 2003-2009 years (with million AZN).

As it is shown, sum of transfer to state budget grew as a result of growing revenues of Oil Fund. Sum of transfers from Oil Fund to state budget was 585.0 million manats in 2006-2007 years, in 2008 year this amount doubled for 6 times and was 3.8 milliard manats. This sum considered to be 4.9 milliard manats in 2009. But connected to world finance crisis started in the middle of 2008, price of oil is decreased in the world market, and if payments of SOCAR and Abesh? To state budget decreases (probably it will be so), then increasing transfer from Oil Fund to state budget is expected.

As sum of transfers from Oil Fund to state budget increases year by year, portion of the Fund sharply grows in formation budget revenues: in 2007 year less than 10% of revenues of state budget entered from Oil Fund, this indicator passed 35% in 2008, and will pas 40% in 2009. (Scheme 7).



Scheme 7. Portion revenues of transfers from State Oil Fund to state budget in 2003-2009 years. (With percentage).

Other means on oil-gas revenues included to state budget is tax payments of SOCAR. We can see dynamics of payments by the company to state budget from 2nd schedule: in 2004 national oil company's payment to state budget was 384 million manats, in 2007 this indicator reached 1 milliard manat. We see from schedule data that, 1.35 milliard manats entered to state budget from SOCAR in 2008, but in the same year 600 million manats means assigned from state budget to SOCAR for the purpose of growing statue capital.

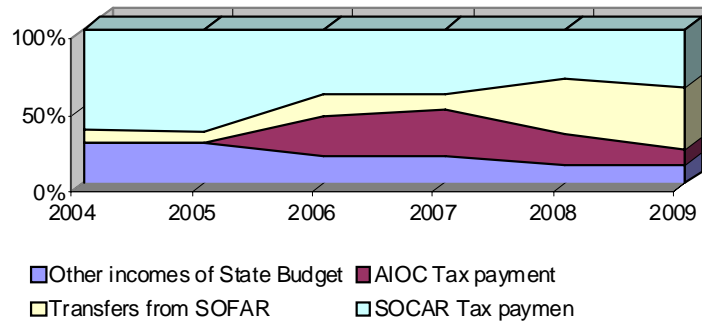
Table 2. Participation of oil sector in formation revenues of state budget within 2004-2009 years. (million manat).

	2004	2005	2006	2007	2008	2009 (proq)
Revenues of state budget, total	1481.2	2055.2	3882.0	6006.6	10762.7	12177.0
Total inclusions from oil sector	514.4	692.1	2257.8	3497.2	7238.7	7595.0
▪ Tax inclusions from SOCAR	384.4	542.1	700.8	1080.7	1351.6	1450.0
▪ Inclusions on benefit oil of Abesh	-	-	972.0	1831.5	2087.1	1230.0
▪ Transfers from State Oil Fund	130.0	150.0	585.0	585.0	3800.0	4915.0
Portion of inclusions from oil sector in budget revenues (percentage)	34.7	33.7	58.2	58.2	67.3	62.4
Other revenues of state budget	966.8	1363.1	1624.2	2509.4	3524.0	4582.0

(Source: data on 2004-2009 years was taken from appropriate reports of Cabinet of Ministries of Azerbaijan Republic, and data on 2009 year was taken from 10 December 2008 dated decree of President of Azerbaijan Republic about implementation law of Azerbaijan Republic "About state budget of Azerbaijan Republic for 2009 year").

As benefit oil extraction was started on ACG deposit from 2006 year, Abesh pays benefit tax to the state budget since that year. Inclusions to state budget by this source was 972 million manats in 2006, 1.8 milliard manats in 2007, 2.0 milliard manats in 2008. Revenues of state budget speedily grows by increasing Abesh 's payment to budget, at the same time increasing portion of oil sector in formation of state budget happened: special weight of oil sector's portion in budget inclusions was 34.7% in 2004, this indicator was 67.3 % in 2008.

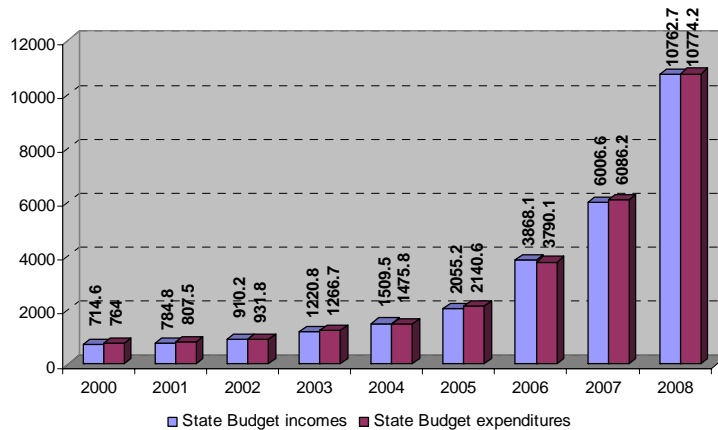
In general, we can see graphic description of changing portion of oil sector by general and source in state budget on scheme 8. Also, in this case one thing should be taken into consideration that as there is no information about the inclusions to state budget from the profit taxes of the employees working in different projects on oil contracts, inclusions on sources has not been included in the table and in the share of oil sector mentioned.



Scheme 8. Changing portion of oil sector in revenues of state budget within 2004-2009 years.

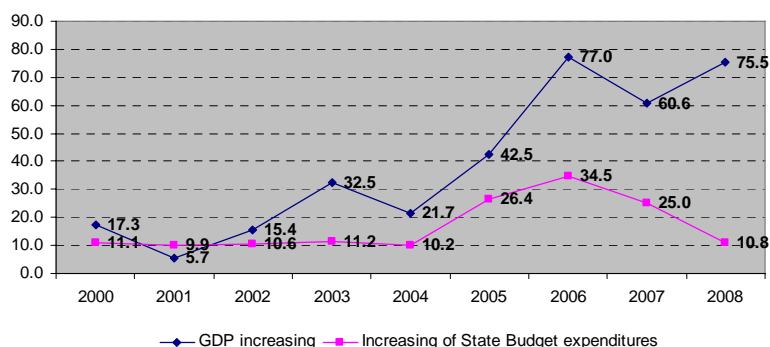
We should pay attention that, SOCAR and Abesh had bigger portion in formation state budget till 2007 (83%), in 2008 State Oil Fund got higher position in transfers (approximately 53%), this indicator will pass 65% in 2009.

Increasing oil-gas revenues resulted with fast growing state budget's revenues and expenses. Revenues and expenses of state budget were 1.2 milliard manats in 2003, but after 5 years in 2008 it passed 10 milliard manats.



Scheme 9. Changing dynamics of revenues and expenses of state budget within 2000-2008 years (million manat).

At last, starting from 2002 yearly growing temps of state budget passed ahead of growing temps of UDM in Azerbaijan. This difference became bigger in 2005-2008 years (scheme 10). So, growing temps of UDM was 10.2%, budget expenses' 21.7% in 2004, 26.4%-42.5% in 2005, 34.5%-77.0% in 2006, 25.0%-60.6% in 2007.



Scheme 10. Comparison budget expenses and growing temps of UDM within 2000-2008 years with previous years (with percentage).

However, in growing temps of both UDM and budget expenses, same tendency with a little difference happened till 2007, absolutely different process was observed in 2008: in spite of there is decrease in growing temps of UDM (10.8%), rising in growing temps of budget expenses occurred (75.5%).

THE SPENDING OF OIL REVENUES ON SOCIAL GOALS AND SOCIAL PROGRAMMES

After Azerbaijan regained its independence (1991), the crisis that enveloped the country's socioeconomic life deepened even further following the war. Failure to carry out flexible and correct economic reform aggravated the situation even further and left the country face-to-face with a serious financial deficit. First and foremost, all this resulted in problems deepening in the social sphere, the social infrastructure being destroyed, especially material-technical security in the state-owned sector falling into decline and the quality of the state's social services considerably deteriorating, and the result of it was that the social situation of the population deteriorated.

As the financial possibilities of the state expanded, the allocation of a great amount of money for the restoration and reconstruction of social spheres and the social infrastructure was important and inevitable. As oil money entered the country, the following happened: since 2005, the amount of money allocated to the social sphere and various social goals from the state budget has been rapidly increasing. At the same time, money is being allocated from the state budget and two other sources (SOFAR and SOCAR) where the country's oil revenues are accumulated for the settlement of social problems and for the financing of various social programmes.

As is known, according to Decree 128 issued by the president of the Azerbaijan Republic on 27 September 2004, a "long-term strategy on the management of oil and gas revenues" was approved. The strategy provides for the use of the country's oil and gas revenues in the following main directions:

- The development of the non-oil sector of the economy, regions and small and medium-sized businesses;
- The comprehensive development of infrastructure spheres;
- The implementation of poverty reduction measures and the settlement of other social problems;
- The stimulation of the level of the intellectual and technological base of the economy;
- The development of "human capital" (the training of highly qualified personnel, including abroad) and increasing the professional level of personnel;
- The strengthening of the country's military capability;
- The reconstruction of liberated territories and the implementation of measures to return displaced persons to their homes;

As we can see here, social objectives and the reconstruction of the infrastructure take centre stage among the main directions of the use of oil and gas revenues.

From its establishment to 1 January 2009, a total amount of 7,038.8 million manats has been allocated from the State Oil Fund for the settlement of various problems and for the financing of various projects on the construction of infrastructure facilities³². Some 5.35 billion manats of these funds, or 76 per cent, were transferred to the state budget and used for various purposes, including social objectives. Some 297.9 million manats were allocated from the Oil Fund for the financing of the country's share in the BTC main export pipeline, 26 million manats for the Baku-Tbilisi-Kars railway project, 90 million manats for the formation of the authorized capital of the State Investment Company and 87.6 million manats for the regulation of SOCAR's share in the Azeri-Chirag-Gunashli project. Over the past period, the main assets of the fund have been spent on the following socially-oriented projects:

- The improvement of the social and domestic situation of refugees and displaced persons and their settlement – 523 million manats;
- The construction of a water pipeline to the city of Baku from the Oguz-Qabala zone – 427.5 million manats;
- The reconstruction of the Samur-Absheron canal – 234.5 million manats;
- The financing of the state programme on the education of Azerbaijani youth abroad in 2007-2015 – 2.3 million manats.

On behalf of the state, SOCAR is actively involved in the implementation of a number of state programmes. Since 1998, the state has actively participated in work to improve the housing and domestic conditions of refugees and displaced persons and to provide them with food. According to the company's website, SOCAR is closely participating in the implementation of the state programme (2004-2008) on the socioeconomic development of regions in the Azerbaijan Republic. As an example, we can cite the construction of a polyclinic which caters for 150 patients per day, 68-bed surgery and maternity departments, a secondary school in the village of Yeniqishlaq in Neftchala District, the reconstruction of a stadium in the town of Neftchala, the construction of a secondary school in the village of Arkharasi in Salyan District, the refurbishment of secondary schools in the villages of Tazakand, Kursangi and Kolani, the refurbishment of the Shorsulu inter-district mental hospital, the construction of a cultural palace in the village of Qarabagli, etc³³.

The company built a school for 500 pupils and a five-storey 35-flat building for veterans in the town of Ali-Bayramli, two new schools for 400 pupils in the villages of Ashagi Salahli and Huseynbeyli in Qazakh District, schools for 240 and 100 pupils in the villages of Udulu and Qubadli in Hajiqabul District, a new school for 200 pupils and a sports complex with an area of 531 square metres in the village Pambiqkand in Salyan District, a new

³² <http://www.oilfund.gov.az>

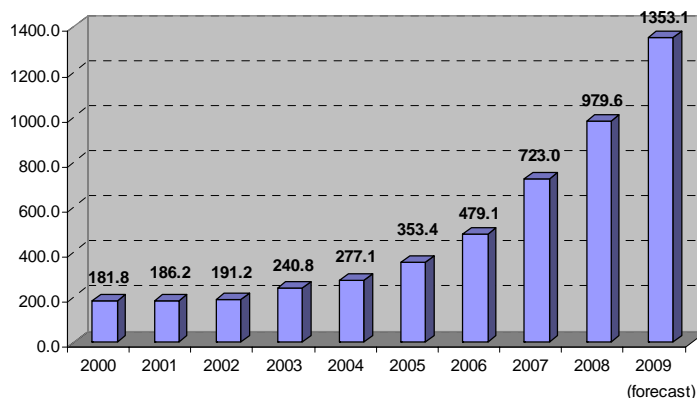
³³ <http://www.socar.gov.az/social-az.html>

school for 100 pupils in the village of Peyk in the same district and a new school for 100 pupils in the village of Mayak in Neftchala District.³⁴

Apart from this, SOCAR built a 235-bed central hospital in Balakan District, a district library, a new school for 450 pupils in the district's village of Ititala, a village house of culture and a medical centre, a diagnostics centre and lyceum for 500 pupils in Zaqatala District, secondary schools for 320 pupils in the village of Ashagi Layar, for 200 pupils in the village of Shuvashal and for 320 pupils in the village of Qalachiq in Qusar District, a central hospital in Yevlakh District, a secondary school for 800 pupils in the Khanlar District and a school for 320 pupils in the village of Chiyni in Agsu District in 2006-2008. Along with this, during this period, diagnostics centres were under construction in Qabala, Qazakh, Ganja, Quba, Jalilabad and Shamakhi. In the next few years, it is planned to build several more diagnostics centres (Goychay, Tovuz and Baku) and a medical centre in Fuzuli District.³⁵

Despite all this, the main source of funding for social programmes at the expense of oil revenues is the state budget. In recent years (especially from 2005), the amount of money allocated from the state budget for the sphere of education, health and social security and other spheres has been increasing from year to year.

Until 2005, the education expenditure of the state budget increased insignificantly from year to year. Since 2005, this expenditure has been increasing seriously in comparison with the previous year, and every two years, expenditure even doubled (Scheme 11). For example, in 2007 compared to 2005 and in 2006 compared to 2008, these expenses doubled.³⁶



Scheme 11. The amount of funding allocated from the state budget for education in 2000-2008 (million manats)

³⁴ The resolution of the Cabinet of Ministers of the Azerbaijan Republic to hand over the schools, houses and sports complexes built by the State Oil Company in regions of the country to the local executive authorities, 24 May 2007, No 082

³⁵ Source: The State Oil Company of the Azerbaijan Republic

³⁶ Source: The Ministry of Finance of the Azerbaijan Republic

Along with the previous mechanisms of financing, such an increase in funding allocated for education (i.e. financing of institutions of education) also made it possible to apply mechanisms of funding for programmes in the sphere of education. In 2007, five education programmes were implemented, while in the following year, the number of such programmes reached 12 (Table 3).

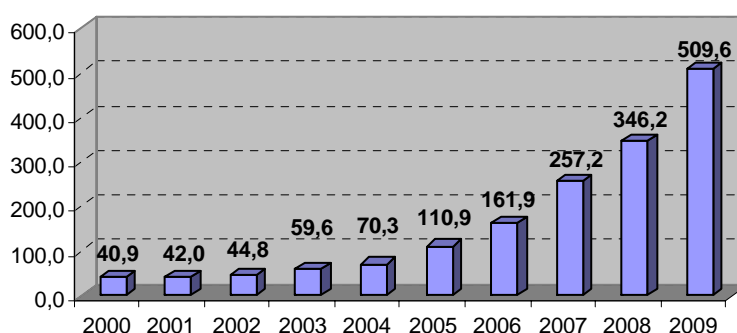
Table 3. Programmes financed under the Education section of the state budget in 2007-2009 (thousand manats)

	Programmes and events	2007	2008	2009
1.	The provision of free textbooks to pupils studying at the republic's secondary schools	7,000.0	8,899.9	9,675.9
2.	Expenses on financial support for the programme to build secondary schools in the Azerbaijan Republic, refurbish existing schools and provide them with modern teaching equipment (2005-2009)	18,537.6	8,868.3	4,012.8
3.	Expenses on financial support for the programme to provide secondary schools in the Azerbaijan Republic with information and communication technologies	12540.2	8550.4	19562.4
4.	Expenses on financial support for the state programme to develop the potential of gifted children (youth) (2006-2010)	1,786.1	595.3	612.0
5.	Expenses on financial support for the programme to hand over children from state-owned children's homes in the Azerbaijan Republic and the state programme on alternative care (2006-2015)	280.0	280.9	401.3
6.	Expenses on financial support for the development programme to organize education for children with special needs (disabled children) (2005-2009)		210.7	194.6
7.	Expenses on measures based on the programme to improve pre-school education in the Azerbaijan Republic (2007-2010)		5,768.4	5,768.4
8.	Expenses on financial support for the state programme to develop technical-professional education (2007-2010)		712.3	1,775.7
9.	Expenses on the maintenance of the Baku and Ganja children's villages and the SOS Youth House		425.2	543.9

10.	Expenses on measures to strengthen the material-technical base of school libraries and provide them with modern information technologies		852.7	938.0
11.	Expenses on the payment of special stipends to young talents (18 people)		65.0	177.1
12.	The purchase of educational laboratory equipment (chemistry, physics and biology) for secondary schools		4,012.8	2,006.4

Source: The Ministry of Education of the Azerbaijan Republic and the Ministry of Finance of the Azerbaijan Republic

We can see a similar situation in state budget spending on health. The total amount of money allocated to the health sphere from the state budget has been rapidly increasing since 2005. At the same time, every two years, the amount of money doubled (Scheme 12).³⁷



Scheme 12. The amount of funding allocated from the state budget to the health sphere in 2000-2008 (million manat)

Such a rapid increase in state budget funding for the health sphere made it possible to implement a number of programmes in the health sphere. Since 2007, six programmes have been implemented in the health sphere and nine since 2009 (Table 4). Another programme was added to this list in 2009 (a programme of measures to prevent the spread of HIV/AIDS in the Azerbaijan Republic in 2008-2012). Such programmes make it possible to follow changes in the treatment of specific diseases using funding allocated for the health sphere.

³⁷ Source: The Ministry of Finance of the Azerbaijan Republic

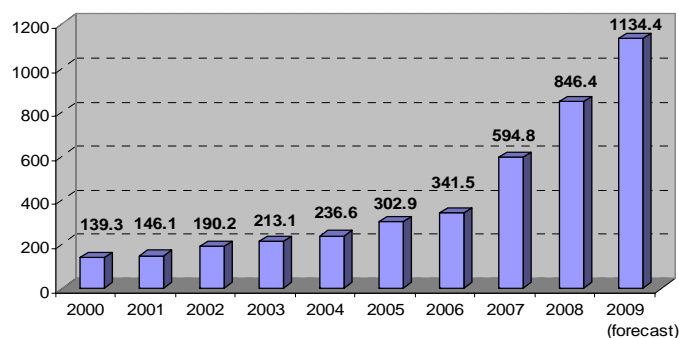
Table 4. Health programmes funded from the state budget in 2007-2009 (million mantas)

	Names of programmes	2007	2008	2009
1.	A programme of measures to treat the chronic kidney deficiency	12.4	14.4	19.3
2.	A state programme to treat sugar diabetes	12.0	13.8	19.2
3.	A state programme to treat hereditary haemophilia and thalassaemia	9.1	9.2	10.6
4.	A programme of measures on the immunoprophylaxis of infectious diseases	1.9	1.1	5.1
5.	A state programme to protect mother and child health	4.8	5.2	5.2
6.	A state programme to develop the donorship of blood and its components and blood services	0.7	0.8	3.0
7.	A programme of measures to provide oncological patients with basic anti-tumour medicines		5.0	10.6
8.	A programme of measures to prevent and combat the spread of HIV/AIDS in the Azerbaijan Republic 2008-2012			1.98
9.	Expenses on the application of mandatory medical insurance		4.0	50.2
10.	A programme of measures to train public health personnel		1.4	0.13

Source: The Ministry of Health of the Azerbaijan Republic and the Ministry of Finance of the Azerbaijan Republic

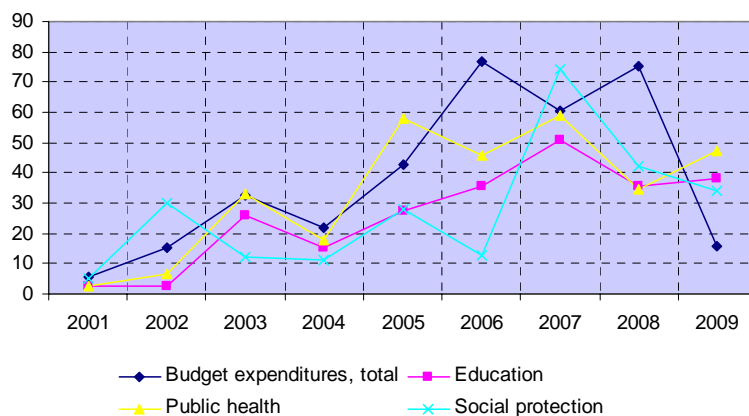
State budget spending on social security has been rapidly increasing since 2006 (Scheme 13). The amount of expenses on this section of the budget totalled 846.4 million manats, which is 2.5 times more than in 2006 (341.5 million manats).³⁸

³⁸ The Ministry of Health of the Azerbaijan Republic



Scheme 13. The amount of funding allocated from the state budget to the health sphere in 2000-2008 (million manats)

When we compare the annual pace of growth in state budget spending on education, health and social security with the annual pace of growth in general budget spending (Scheme 14), we see that the pace of growth in general budget spending has normally been higher than spending on each of these three spheres (only in 2005, was the pace of growth in health spending higher than general spending and only in 2007, was social security spending higher than general spending). However, a completely different situation is expected in 2009: it is predicted that this year the pace of growth in spending on each of the three spheres will be higher (15.7 per cent) than general budget spending (38.1 per cent on education, 47.2 per cent on health and 34 per cent on social security).



Scheme 14. Changes in the annual pace of growth in budget spending on social spheres in 2001-2009 (compared to the previous year)

As state budget revenues increased, state investment expenses also started to increase rapidly: state budget spending on industry, construction and

mineral resources increased from 7.6 per cent of general spending in 2005 to 40.2 per cent in 2008. In other words, if in 2005, the state budget allocated only 162.8 million manats to this sphere, 879.6 million were allocated in 2006, 1.9 billion manats in 2007 and 4.3 billion manats in 2008. This money which was mainly used on state capital investment was spent on various infrastructure projects, including the construction and reconstruction of social facilities. In 2006-2008, a great amount of money was allocated from this part of the budget for the construction and refurbishment of institutions of education, health, culture and sports, for the construction of houses for veterans and martyrs' families and for the improvement of social conditions for refugees and displaced persons (Table 5).

Table 5. The amount of money allocated from the state budget for socially-oriented projects as state capital investment in 2006-2008³⁹ (thousand manats)

	2006	2007	2008
Socially-oriented projects, total	121,999.2	404,954.4	780,544.4
• Refurbishment, construction and reconstruction of institutions of education	43,387.7	92,729.0	19,5594.2
• Refurbishment, construction, restoration and reconstruction of health institutions	24,172.6	72,018.5	156,517.2
• Refurbishment, construction, restoration and reconstruction of houses of veterans and martyrs' families	11,345.0	18,723.6	44,619.1
• Refurbishment, construction, restoration and reconstruction of cultural institutions	12,004.0	77,879.5	173,523.3
• Refurbishment, construction and reconstruction of sports institutions	14,360.0	57,487.6	103,966.0
• Measures to improve the social conditions of refugees and displaced persons	1,284.2	3,976.7	6,746.4
• Other social spheres	15,445.7	82,139.5	99,578.2

³⁹ “Azərbaycan Respublikasının 2008-ci il dövlət büdcəsinin icrası haqqında” Azərbaycan Respublikasının Qanun layihəsinə və dövlət bədcəsinin icrasına dair illik hesabatı Azərbaycan Respublikası Hesablama Palatasının rəyi. Bakı, 2009. səh. 165

As we can see from the table, over the last three years, more than 330 million manats have been spent on the construction and refurbishment of institutions of education at the expense of state capital investment, 253 million on the construction and refurbishment of health institutions, 263 million on the construction and refurbishment of cultural centres, 175 million manats on the construction and refurbishment of sports facilities and more than 73 million manats on the construction and refurbishment of houses and other facilities for veterans and martyrs' families.

According to the government's information, 161 new schools were built and 129 schools were refurbished in the country in 2008 alone. Over the last five years (2004-2008) 1,300 new schools have been built for 350,000 pupils, while 506 schools have been provided with modern equipment.⁴⁰ At the request of the Ministry of Health, 16 new hospitals, 42 outpatient clinics, eight diagnostics centres and 19 assistant-maternity centres were built in regions of the country in 2004-2008. During this period, 18 Olympic sports complexes were built in various regions of the country, and another 15 are under construction. In 2004-2008, 33 buildings were built for veterans and martyrs' families in regions, seven rehabilitation centres for veterans⁴¹ and so on.

More detailed information about the activities and measures carried out by the state in the social and social infrastructure sphere in 2004-2008 in view of the country's growing financial possibilities due to the country's oil revenues is available in the report on the activities of the Cabinet of Ministers of the Azerbaijan Republic in 2008.

Assessment of the efficiency of social programmes financed from oil revenues

In order to assess the efficiency of social programmes financed from oil revenues, it is first of all necessary to explain the efficiency of general state spending (money spent from the state budget and other sources). Economic literature and experience provides two meanings (ideas) about the term "effective"⁴²:

⁴⁰ Azərbaycan Respublikası Nazirlər Kabinetinin 2008-ci ildə fəaliyyəti haqqında Hesabat. Bakı, 2009, səh. 175

⁴¹ In the same place, p – 368-369

⁴² *А.В. Улюкаев*. Проблемы государственной бюджетной политики. Москва, «Дело», 2004. 544 стр., стр. 418-419

1. **Effectiveness** – the extent of achieving the planned result. In theoretical approaches, the idea of “effectiveness” is associated with the idea of “social effectiveness”. For example, if in the health sphere the number of healthy people rises from 45 to 78 in every 100 and if in education the number of pupils who leave the school rises from 50 to 75 in every 100, this means “effectiveness”;
2. **Efficiency** – it means the minimization of spending (expenses) on one product (service). In theoretical approaches, the idea of “efficiency” is associated with the idea of “economic efficiency”. For example, if daily spending on one bed decreases in the health sphere or the cost of road construction decreases per each kilometre, this means efficiency (more simply, we can put this way: maximum effect with minimum spending).

A comparison between the objectives that were set (for example, improving housing conditions for martyrs’ families) and the results that were achieved (for example, the 20-per-cent increase in the number of martyrs’ families provided with housing in one year through the construction of new flats) characterizes the effectiveness of activities, in other words, their social importance. In activities aimed at providing budget services (for example, the construction of flats with a total area of 12,000 square metres with 5 million manats allocated from the budget), a comparison between the level of those activities (for example, the construction of flats only with a total area of 8,000 square metres instead of the 12,000 square metres planned with 5 million manats allocated from the budget) characterizes the efficiency of activities or production.⁴³

While assessing the results of budget activities (use of resources) by government agencies, the resources engaged in the process, the activities and measures that were carried out, and their direct results and end results are differentiated and each of them is characterized by specific indicators.

Spending (expenses) and resources (input) are monetary and other resources channeled into the implementation of a programme. For example, monetary spending, workers and their working hours, expenses on equipment, hardware and materials (fuel, energy and so on). Spending indicators characterize the volume of monetary and other resources channeled into the implementation of a programme (process), activities and measures. These indicators reflect the sum of money and the volume of financial and other resources allocated for the economic expenses of specific sectors, auxiliary sectors, paragraphs, individual ministries and government agencies and spent on specific activities.

⁴³ *Ussher C., Kibblewhite A. Outcomes Focused Management in New Zealand. – A Background Paper (New Zealand Treasury WP 01/05), 2001*

Action and activity are measures aimed at achieving the objectives of a programme and implemented with resources allocated for the programme. Activities include all steps stipulated in the methods of implementing the programme – the development of a strategy, the provision of services, the implementation of processes and so on.

Direct (or intermediate) results (output) are products created by activities implemented regarding a programme. According to it, the indicators of the direct results characterize the volume and quality of the work and quality acquired as a result of the implementation of the programme or measures, i.e. the quantity and quality of general work. For example, the number of new schools, hospitals and flyovers built in one year, the number of computers and computerized schools, the amount of insulin and the number of patients who received insulin, the number of pensioners who receive pensions, the number of those who receive unemployment benefits, the number of families which receive targeted social aid and other information reflect the quantity of the work that was carried out.

End results of social importance are the changes that happen in the welfare of society (people) following the implementation of a programme. The end results are:

- *For programmes related to human development* – changes in the life, activities, behaviour, knowledge, skills, world outlook and spiritual values of participants in the programme (beneficiaries);
- *For health programmes* – improvements in the health of the population;
- *For environmental protection programmes* – changes in the characteristics of the environment;
- *For transport programmes* – changes in methods of moving (transporting) people and goods;
- *For economic development programmes* – changes in the economic situation of this or that area.

The main purpose of the end results is to reflect the changes achieved as a result of the implementation of the programme and show its contribution to increasing the welfare of society. In other words, the end results of social importance reflect the ability (influence) of the processes and activities that are implemented to secure the attainment of the objective(s) declared in the programme. These make it possible to assess the effect acquired by society (or individual social groups) from the activities of government agencies (i.e. those which are in charge of budget funds) during a specific period, i.e. changes in the level of welfare. This means the end results characterize the complex of actual results in essence and their influence on the situation of society.

Certain difficulties come up in the process of assessing the end results of social importance. For example, the implementation of socioeconomic programmes yields not just one, but several end results, which consistently supplement each other (as one creates another) and result in the objectives of the programme being implemented. Though different sources (literature) have different approaches to the number of levels of end results and their interpretations, in most cases, three levels stand out⁴⁴:

- **The preliminary level of the end results** (*outcome*) – they are not regarded as the end result of a programme, but act as an important reference point in achieving the objectives that are set;
- **The intermediate level of the end results** (*short-term impact*) – these ensure a link between the results of the first level and long-term results;
- **Long-term end results** (*long-term impact*) – these reflect the positive changes that are set as objectives of a programme and are achieved by society in the process of implementing the programme, but manifest themselves very late in terms of time.

The indicators of the efficiency of the use of resources characterize the resources spent on every direct or end result or the volume of expenses in terms of value and natural figures. Indicators of economy make it possible to assess the value of the resources that are used and are expressed in the value of the resources that are used, for example, the average salary. These indicators are expressed in terms of value without exception. Indicators of effectiveness reflect the level (degree) of the attainment of the goal that has been set by providing this or that service planned during a specific period. Indicators of the efficiency of expenses measure the correlation between the end results that are achieved and the monetary resources spent on their attainment. They are expressed in terms of value (money) without exception.

When we talk about the effective use of budget resources, we mean the selection of the best possible option for implementing the tasks that are set or solving a problem. In this case, the resources spent on the implementation of the best option can be regarded as effectively used. However, indicators of effectiveness and efficiency do not always coincide.

Currently, policy measures (targeted budget programmes, application of a system of assessing the mechanism and results of state procurement and so on) are being implemented in various spheres in order to increase the effectiveness

⁴⁴ Мониторинг результативности бюджетных расходов: определение и основные принципы внедрения. Москва, 2002. www.iopp.ru

of budget expenses in the world. Along with this, all government agencies in developed countries appraise their activities on the basis of specific indicators and prepare annual reports on this basis. However, the decisive condition for the professionalism of such reports is the existence of an effective monitoring and appraisal system for budget programmes. The planning of activities and accountability for activities is directly linked to the way the government is planning and implementing expenses.

For the time being, there is no real mechanism of measuring the effectiveness of budget expenses in the law or in practice. Even the legal acts that regulate the activities of the budget system do not have an idea about “the efficiency of expenses” as the most importance principle of the budget system. The weak steps that have been taken in the sphere of compiling and implementing the budget on the basis of programmes are not systemic.

Though some programmes have been applied in budget expenses in recent years, such expenses have a very little share in the budget. Though the parliament includes various programmes linked to the socioeconomic sphere in the budget package put up for debate by the parliament for the next financial year, those documents do not reflect in an interrelated manner the specific obligations of those who are in charge of budget resources, the strategic goals of the state in implementing those programmes, the means (as well as activities) of achieving those goals, indicators that make it possible to identify whether an objective has been achieved or not and the financial needs of the programmes. To be more precise, even though the goals of the programme and its general directions of activity are listed, the obligations, means, indicators of measurement and the volume of financial resources are not indicated at all on the basis of the aforesaid scheme.

The lack of mechanisms for assessing the effectiveness (effectiveness and efficiency) of spending while drawing up the budget and programmes manifests itself in annual reports on the activities of government agencies. The reports mainly reflect the resources that have been spent, the activities that have been carried out and the volume of the work that has been done and present general information for assessing the effect (end result) of these activities and expenses on the welfare of society.

Despite all this, let us try to assess some indicators of the effectiveness of the use of the resources spent on separate social spheres from the state budget and other sources at the expense of oil revenues in recent years on the basis of information presented in government reports.

Perhaps, it is a bit too early to assess the long-term effects of social expenses, and as we said above, the lack of necessary information makes it

impossible. However, it is possible to assess these expenses in terms of their effect on economy, assignment, lawfulness, productivity, transparency, accountability, international comparativeness and institutional changes, and on this basis, to identify tendencies in possible long-term effects (end results).

A number of surveys carried out by civil society institutions in recent years have shown that the value of projects carried out with state resources (the state budget, the Oil Fund, the Oil Company and other sources) is overstated, the spending of resources is exaggerated, the cost of resources is overstated, the quality of services is low, the procedure of state procurement is closed, no tenders are being held, resources are being misspent and there are other forms of corruption.

For example, an expert of the Association to Assist Economic Studies, Rovshan Agayev, has carried out a survey on the construction of schools: "The survey shows that the difference between expenses on one pupil and investments in the construction of schools in various parts of Azerbaijan is almost 500 per cent. For example, in a school built in the town of Khudat average expenses on one pupil total 927 manats, while in a school built in Khinaliq, they totalled 4,333 manats (or 5,100 US dollars). The same sharp differences can also be observed in the construction of kindergartens. In the village of Korgoz, expenses per one pupil totalled 4,380 manats, while in Bulbula – expenses were 2.3 times lower and totalled 1,950 manats.

In Tovuz District, one classroom cost 84,000 manats (about 100,000 US dollars), whereas in Baku's Khatai District, the cost of an extra classroom was 4.3 times lower.

A 20-classroom school (for 400 pupils, according to the norms of the Education Ministry) built by the US embassy with the financial support of the US military command in the village of Yeni Qala in Baku's Azizbayov District cost 300,000 dollars (255,000 manats). Expenses on one classroom totalled 15,000 dollars (12,700 manats), and on one pupil – 750 dollars (638 manats). This is six times cheaper than a school of the same size (380 pupils) which the Ministry of Education built in Qabala with budget money. What is more, the school built by the embassy has all the necessary equipment – a heating system and a 20-tonne water tank."⁴⁵ The expert also discovered that there a similar situation in social facilities built by SOCAR.

Incidentally, it must be noted that the document on the programme on the construction of schools and refurbishment of existing schools and their

⁴⁵ **R.Ağayev.** Hökumət bir sinif otağını təqribən 100 min dollara tikir. ABŞ səfirliyi bu işi 8 dəfə ucuz görür. Mediaforum saytı, 2007-11-26 <http://www.mediaforum.az>

provision with modern teaching equipment in the Azerbaijan Republic (2003-2007), which was approved by Decree 1147 of the president of the Azerbaijan Republic dated 17 February 2003, identifies the following construction and refurbishment norms:

- During the construction of a new school – 700 manats for one pupil;
- During the construction of additional classrooms in existing schools – 100 manats for one pupil;
- During the refurbishment of existing schools – 50,000 manats for one school.

It is clear how different the facts listed in the aforesaid survey are from these norms.

As is known, a project to improve the social-domestic condition of families of refugees and displaced persons and to solve the problem of settling them is being implemented with money from the State Oil Fund. Journalist Hijran Hamidova, who has been investigating activities carried out within the framework of this project, has discovered that the value of houses and other facilities built in settlements for refugees and displaced person was overstated, high expenses were indicated, the quality of the houses was not appropriate and these houses built with state funding were actually sold to residents. Surveys show that though one square metre in these settlements costs 500 manats, similar houses are built for 187 manats in Baku.⁴⁶

A survey carried out by the Committee to Protect the Rights of Oil Workers, which is monitoring the project to build the Oguz-Qabala-Baku water pipeline financed from the Oil Fund, showed that instead of the previously announced 480 million manats, 730 million manats (about 930 million US dollars) will be spent on the full construction of the pipeline. That's to say every kilometre of the pipeline will cost 2.8 million manats (3.4 million dollars). This money is almost the same as money spent on the construction of one kilometre of a road. The committee's survey shows that in comparison with similar projects implemented in other countries, the Oguz-Qabala-Baku water pipeline is more expensive. For example, Russia is expected to spend 20 billion roubles, or 750 million dollars, i.e. 550,000 dollars per kilometre, on the construction of a 1,400 km transregional water pipeline which will connect Volgograd to Astrakhan region and Kalmykia to Stavropol. Though it is expected that the length of that pipeline will be at least half the length of the Oguz-Qabala-Baku water pipeline, its will cost almost seven times cheaper than the pipeline in Azerbaijan. We should take into account that the Russian pipeline is designed to

⁴⁶ H.Həmidova. Milyonların aqibəti-3. "Mədən sənayesində şəffaflıq" jurnalı, № 3 (08), noyabr 2008, səh. 26-34

improve water supplies to a region with a population of 6.5 million, while the Azerbaijani pipeline is designed to improve water supplies to a geographic area with a population of 2.5 million.⁴⁷

The Committee to Protect the Rights of Oil Workers has discovered another social impact of the implementation of this project: Citizens have still not received compensation for privately-owned land plots through which the pipeline passes. This issue was raised in the annual report on 2008 by the human rights representative (ombudsman) of the Azerbaijan Republic: "In many cases, land plots were taken back from citizens under the pretext of state and public needs without a court decision and compensation. In connection with construction and renovation work carried out by local executive authorities in district centres, citizens' privately-owned shops and other amenities were knocked down in the same way. A number of complaints received by the ombudsman again raise this problem during the construction of the Oguz-Qabala-Baku water pipeline."⁴⁸

Various violations of the law in the use of budget funds and in the implementation of investment projects carried out with special state funds are also pointed out in reports by the Audit Chamber of the Azerbaijan Republic. The Audit Chamber says in its reports that violations of the requirements of the law "On state procurements" are quite common in the implementation of investment projects: "Procurements for the refurbishment, construction, reconstruction and equipment of facilities with budget funds were carried out without holding a tender and under the pretext that it is necessary to carry out planned work in a short period of time and that there is an urgent need (in fact, there was no need for that, i.e. there was enough time to hold a tender) on the basis of a direct contract with the consent of the relevant executive authorities. Construction and assembly work was carried out through the signing of contracts with contractors without involving organizations engaged in financial-budget analysis and without determining possible prices, which was in violation of Article 27 of the law "On state procurements".⁴⁹

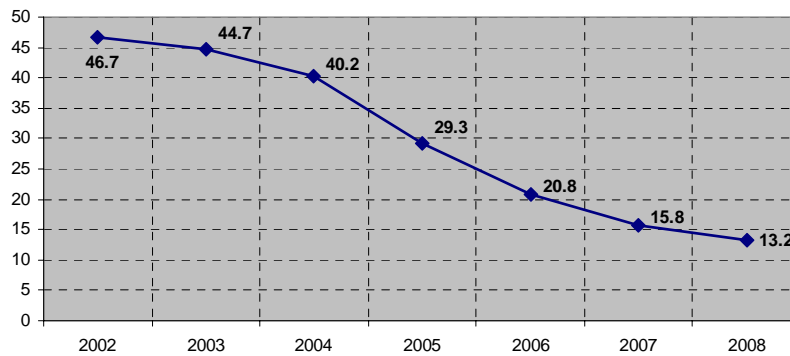
The most notable thing in the social sphere in the recent period are official reports on the fall in the level of poverty in the country. Government reports

⁴⁷ Neftçilərin Hüquqlarının Müdafiəsi Komitəsi. Oğuz-Qəbələ-Bakı su kəməri: sosial-iqtisadi effektivliyin qiymətləndirilməsi üzrə ilkin tədqiqat. http://www.nhmt-az.org/ts_general/az/layihe/prj2-14.htm

⁴⁸ Azərbaycan Respublikasının İnsan Hüquqları üzrə Müvəkkilinin (Ombudsmanın) 2008-ci il üzrə illik məruzəsi (qısa icmal). 06.03.2009 tarixinə olan hesabat. <http://www.meclis.gov.az/?/az/report/57>

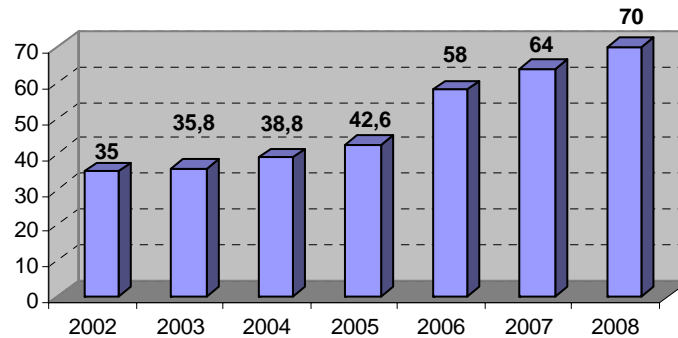
⁴⁹ Azərbaycan Respublikası Hesablama Palatasının 2007-cı ildə fəaliyyəti haqqında Hesabat. <http://www.meclis.gov.az>

show that the level of poverty in the country has fallen from 46.7 per cent in 2002 to 13.2 per cent at the end of 2008 (Scheme 15).⁵⁰



Scheme 15. The annual fall in the level of poverty in the country (per cent)

However, it is very important to focus attention on the indicators used for determining the level of poverty. For example, if in 2002 the level of poverty in Azerbaijan was 35 manats, in 2008, this indicator was only 70 manats (Scheme 16). Calculations show that with the current prices, this comprises only one third of the minimum monthly consumer budget per person. It must be noted that the established level of poverty is taken as a basis for implementing the targeted social aid (TSA) programme in Azerbaijan.



Scheme 16. Annual changes in the level of poverty in Azerbaijan, manats

Another point is that a daily income of 2-2.5 US dollars is still taken as a basis for calculating the level of poverty in our country, whereas UN Human Development reports set the daily income at 4 and 11 US dollars.⁵¹

⁵⁰ Azərbaycan Respublikası Nazirlər Kabinetinin 2008-ci ildə fəaliyyəti haqqında Hesabat. Bakı, 2009, səh. 25

⁵¹ Доклад о развитии человека 2007/2008. Показатели развития человека

Though allocations to the spheres of education and health have been rapidly increasing since 2005, it is impossible to say that the quality of services to the population in these sectors has increased similarly. On the contrary, for example, in the sphere of education, out-of-school education (i.e. individual lessons with teachers) has been expanding more rapidly in recent years. Another example is that even though paid services have been abolished in state-owned health institutions from 1 February 2008 on orders from the ministry of health, the population is still unofficially paying most of the health services from their own pockets. This could be explained by the failure of funds allocated to those sphere to meet the real needs (poor resources), shortcomings in the mechanism of financing (for example, funding not for the results of work, but on the basis of assignments, etc.) and other factors.

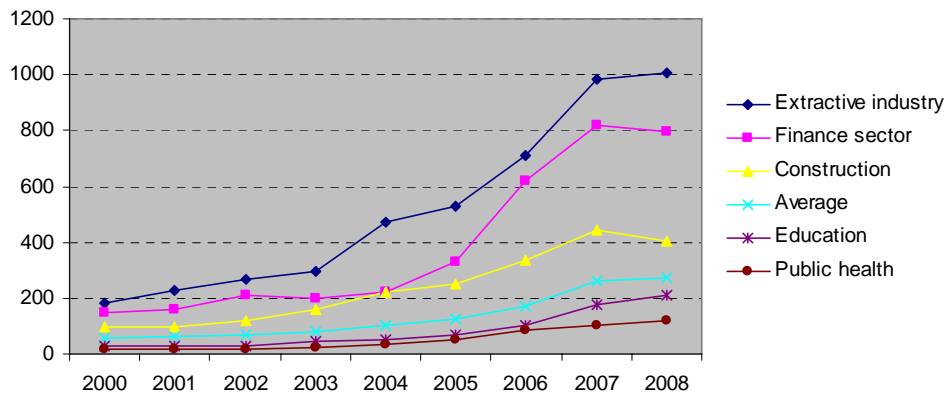
Of course, it must be noted first and foremost that salaries in those spheres are very low. After agriculture, education and health are spheres with the lowest salaries in the country (Table 6).

Table 6. The dynamics of growth in average monthly salaries in separate spheres of the country's economy in 2000-2008 (manat)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Average figure in the country	49.8	55.9	65.1	79.0	101.4	130.1	167.4	250.9	268.0
Agriculture and forest economy	15.5	17.0	18.6	23.6	30.4	43.7	59.0	100.9	114.8
Extractive industries	183.0	234.5	266.1	294.9	460.5	531.8	712.0	983.1	1003.5
Processing industries	63.9	65.2	71.6	90.9	100.3	121.4	157.9	221.5	249.6
Construction	93.6	94.0	112.4	157.6	222.7	250.1	335.6	443.5	406.7
Financial activity	142.1	155.6	210.3	200.0	221.7	330.6	613.3	824.5	792.7
State administration and defence	43.7	48.1	53.7	64.3	88.6	141.6	178.2	245.1	278.6
Education	35.1	35.5	34.8	43.2	52.3	69.5	97.8	169.1	213.7
Health and social services	16.5	17.3	18.6	22.3	30.2	47.7	78.0	110.1	126.2

Source: the State Statistics Committee - www.azstat.org

The graphic picture of information from the table (Scheme 16) provides a better description of the situation. As we can see, the average salary both in the sphere of education and health has always been lower than the average monthly salary in the republic, though in 2003-2008, the salaries of education and health sector employees increased by about five times. Currently, the average monthly salary in the extractive and financial sectors is from three to five times higher than in the social sphere.



Scheme 17. The dynamics of growth in average monthly salaries in separate spheres of the country's economy in 2000-2008 (manat)

Another thing that draws attention is that since 2004, the pace of growth in the sphere of education and health has been lagging behind the average pace in the country.

The salaries of teachers in Azerbaijan are much lower than the average monthly salary in the country, while, for example, in Japan and Korea, teachers' salaries are 2.5 times higher than average statistical salaries. In France, Germany, Portugal and Spain, teachers have the status of state servants and their salaries are paid according to the work of state servants. In Norway, teachers' income is only half of that of a minister. While the average annual salary of a teacher in Azerbaijan hardly reached 2,000-2,500 dollars, in developed countries this figure fluctuates from 25,000 to 45,000 dollars. Currently, the average monthly salaries of education sector employees are 30-35 per cent lower than in countries with weak economies such as Georgia and Moldova and are half of teachers' salaries in Russia and Kazakhstan.⁵² We can cite similar examples in the health sector.

⁵² R. Ağayev. «2» alan təhsilimiz. Niyə bir peşəkar repetitorun nüfuzu bütöv bir məktəbin hörmətindən yuxarı başa keçib? <http://www.sei.az/news-51.html>

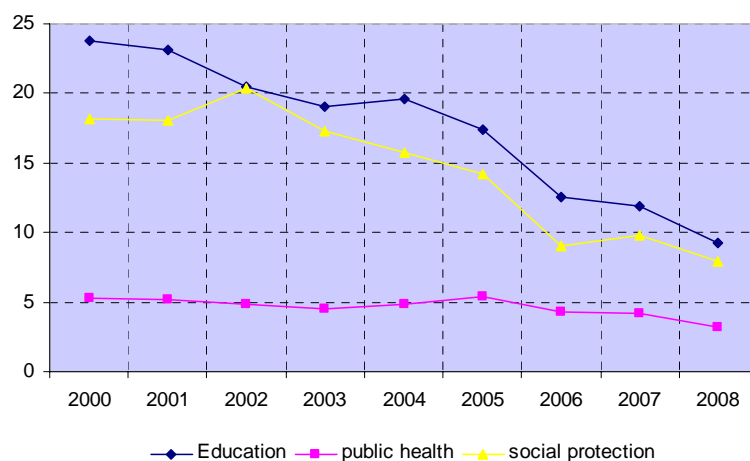
While assessing the efficiency of funds allocated to social spheres from oil revenues, one of the most important issues is the ability of the funds channeled into these spheres to meet their needs. The information given above about the level of salary payments to employees of these sectors could also be approached from this point of view. Incidentally, we would like to remind you that 65-70 per cent of all funds allocated from the state budget to the spheres of education and health are spent on salaries. When budget expenses on these spheres are planned, needs in individual spheres of spending are not taken into consideration and expenses are not planned correctly.

For example, on the basis of Order 141 "On the provision of guaranteed medical aid to the population of the Azerbaijan Republic" issued by the Ministry of Health of the Azerbaijan Republic on 1 December 2005, guaranteed medical services and examinations at all health institutions should be free of charge. The order approved a list of medicines (60 medicines) and medical accessories and auxiliary materials that should be given to patients free of charge. According to the ministry's Order 132 issued on 2 October 2008, 55 new medicines were added to the list of medicines that should be given to the population free of charge. The health section of the 2009 state budget has allocated 85.6 million manats for the purchase of medicines, bandage accessories and materials⁵³ (this accounts for 16.8 per cent of all health expenditure). However, the roughest calculations show that these funds (if used correctly) can meet only 30-35 per cent of health institutions' demand for those medicines.

International comparison is also important while assessing the efficiency of state funding allocated to the social sphere. Such comparisons are given as the share of state education and health spending in budget spending and in the country's GDP and as per capita annual education and health spending, and can be made on the basis of separate specific indicators as well.

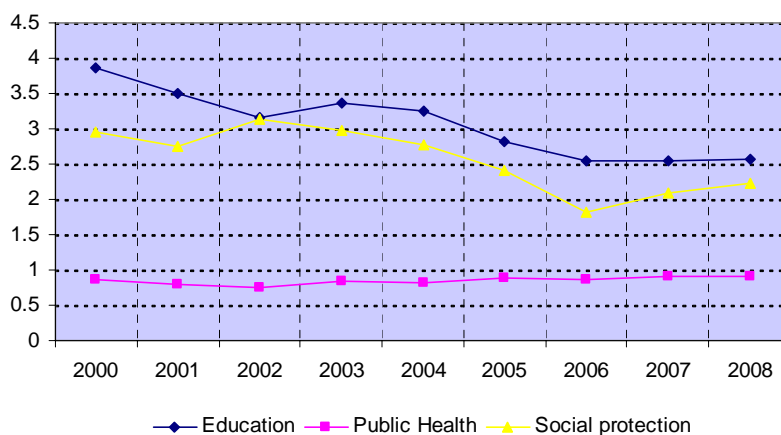
Though the absolute sum of state budget spending in social spheres has been rapidly increasing since 2005, their share in general budget spending is falling from year to year (Scheme 17). For example, if the share of education spending in the general expenses of the 2000 state budget accounted for 23.8 per cent, in 2008, this indicator accounted for 9.2 per cent. If the share of health spending in general budget expenses accounted for 5.3 per cent in 2000, in 2008 it accounted for 3.2 per cent. Social security spending dropped from 18.2 to 7.9 per cent in the same period.

⁵³ Azərbaycan Respublikasının 2009-cu il dövlət büdcəsi zərfi. Bakı, 2008. I hissə, səh.81



Scheme 18. Changes of separate expenses in the general expenses of the state budget in 2000-2008 (per cent)

A comparison between these expenses and the country's GDP also creates an interesting panorama (Scheme 18). The share of spending on education and health in GDP is falling from year to year: if in 2000 the share of state budget spending on education in GDP was 3.9 per cent, in 2008 it fell to 2.6 per cent; though the amount of state budget spending on health has been rapidly increasing in recent years, its share in GDP is still less than one per cent. Though the share of spending on social security in GDP dropped from three per cent in 2000 to 1.8 per cent in 2006, it slightly increased in the following years and reached 2.2 per cent.



Scheme 19. Changes in the share of social spending in the budget in 2000-2008 (per cent)

It must be noted that despite the rise in state budget funding for education and health in recent years, state spending on these services in Azerbaijan is still too far from international standards.

For comparison, we should say that in 2005, member states of the Organization for Economic Cooperation and Development (OECD) spent 6.1 per cent of their GDP on education on average. State spending accounts for 86 per cent of all education spending in those countries.

In these countries, the share of education spending in general state expenses increased from 11.9 per cent in 1995 to 13.2 per cent in 2005.⁵⁴

In general, in most countries of the world, the share of state spending is increasing in general education spending. For example, in comparison with 1991, the share of state education spending in GDP increased from 7.1 to 7.7 per cent in Norway in 2005, in France - from 5.5 to 5.9 per cent, in the USA - from 5.1 to 5.9 per cent, in Britain - from 4.8 to 5.4 per cent, in Italy - from 3 to 4.7 per cent, in Kuwait - from 4.8 to 5.1 per cent, in Chile - from 2.4 to 3.5 per cent, in Latvia - from 4.1 to 5.3 per cent, in Malaysia - from 5.1 to 6.2 per cent, in Saudi Arabia - from 5.8 to 6.8 per cent and Iran from 4.1 to 4.7 per cent.⁵⁵

In countries where human potential is highly developed, the share of state health spending in GDP is mainly from 6 to 9 per cent (for example, in Norway - 8.1 per cent, in Canada - 6.8 per cent, in Sweden - 7.7 per cent, in Japan - 6.3 per cent, in France - 8.3 per cent, in the USA - 6.9 per cent, in Germany - 8.2 per cent, Britain - 7 per cent and so on), while in countries with average developed human potential (including Azerbaijan), it is from 2 to 5 per cent, (for example, in Kazakhstan - 2.3 per cent, in Colombia - 6.7 per cent, in Ukraine - 3.7 per cent, in Ecuador - 2.2 per cent, in Iran - 3.2 per cent, in Venezuela - 2 per cent, in Belarus - 4.6 per cent and so on).⁵⁶ In this indicator, Azerbaijan is behind even Armenia (1.4 per cent) and Georgia (1.5 per cent). In most of the countries which have a developed health system, the population is paying for part of medical aid. The share of the population's personal expenses in general health spending fluctuated from 10 to 30 per cent in different countries, while the average indicator is 24 per cent.⁵⁷ In our country, the population's payments in 2005 were more than 70 per cent,⁵⁸ and this figure has been stable in recent years.

⁵⁴ Education at a Glance 2008: OECD Indicators www.oecd.org/edu/eag2008

⁵⁵ Доклад о развитии человека 2007/2008. стр.265-268

⁵⁶ Доклад о развитии человека 2007/2008. стр. 247-250. Country indicators relate to 2004

⁵⁷ www.oecd.org ; <http://www.euro.who.int/eprise/main/>

⁵⁸ A review of Azerbaijan's health sector, World Bank, 2005

Despite increasing state budget allocations for the health sphere, per capita health spending from the budget was about 45-50 US dollars in 2008, whereas the minimum sum recommended by the World Health Organization for countries with transitional economies is 150 US dollars.⁵⁹

While assessing the efficiency of the use of state funding allocated for the social sphere, the course of the reforms in those spheres should also be the focus of attention. One of the main problems of social spheres in our country is the lack of an incentive for increasing the efficiency of the use of resources in this sector. An acute shortage of funding creates a fertile environment for losing the required motivation, but in most cases, the majority of problems are “artificial”. Our country has a system of organizing, managing and financing education and health that does not prompt teachers and doctors to make effective use of resources and achieve possible maximum indicators in providing these services.

For this reason, it is important to create a new system of incentives both for institutions of education and health and for teachers and doctors. Institutions of education and health should be interested in increasing the effectiveness of their activities. This entails renunciation of the current principle of maintaining and financing existing institutions for the number of their staff members and adoption of modern methods of payment for quality.

For several years now, experiments and pilot projects have been carried out regarding reforms in the country’s education and health sectors. The main direction of these reforms is to improve mechanisms of financing. However, it is notable that the reforms have yet to enter a serious stage. For example, though some outlines of reforms both in health and education are clear, there is still no clear-cut framework for them and the results expected from the reforms have not been announced to society. Instead of implementing these reforms, the government agencies that are supposed to implement them are actually creating obstacles to them.

Along with that, the strategic objectives identified in the state programme on poverty reduction and sustainable development in the Azerbaijan Republic in 2008-2015, which was approved by Decree 3043 issued by the president of the Azerbaijan Republic on 15 September 2008, include such social objectives as the expansion of the population’s opportunities to obtain income, a significant cut in the number of poor people, the development of an effective social security system in order to reduce social risks for the old population, needy families and socially sensitive groups, the continuation of systemic measures to improve living standards for refugees and displaced persons, the development of the

⁵⁹ <http://www.health.gov.az/news.php?id=78>

social infrastructure and improvements in the system of public utilities. The programme also includes the objective of increasing the quality of the main services in the spheres of education and health and creating equal opportunities for accessing them.

Conclusion and recommendations

The volume of state budget funding allocated to social spheres has been steadily increasing in recent years owing to large oil revenues coming into the country. Apart from that, various programmes and projects are being implemented in the sphere of updating and improving material-technical support for the social sphere in the country at the expense of SOFAR and SOCAR. However, on the one hand, corruption which has enveloped the administrative system and on the other, failure to carry out required reforms in social spheres reduce the effectiveness of the use of funds allocated to these spheres. Along with that, since there are no real mechanisms either in legislation or in practice in order to measure the effectiveness of social spending, it is difficult to assess the effectiveness of social spending and programmes. The first steps that have been taken to compile the budget on the basis of programmes are not systemic yet.

The lack of mechanisms for assessing the effectiveness of spending while drawing up the budget and programmes manifests itself in reports by government agencies as well. The reports focus on the resources that were used, the activities that were carried out and the volume of the work that was done, but do not provide information for assessing the effects of these activities and spending on the welfare of society.

It is necessary to carry out the following recommendations in order to increase the effectiveness of social expenses (budget expenses on the whole) and programmes:

- To clarify the framework (goals, targets, steps, duration and expected results) of reforms in social spheres, to inform the public about it and expedite reforms;
- To develop a system of indicators that would make it possible to assess the strategic objectives and targets of the government in general and its different agencies, ways and means of attaining them, the results expected from activities and the results of their activities in order to increase the effectiveness and accountability of government agencies;

- To adopt a mechanism of drawing up budget expenses totally on the basis of programmes and correct planning of needs for resources in order to implement a programme;
- To clarify the strategic goals of the state in implementing the goals and targets of every programme, as well as in implementing that programme, to specify the obligations of those who are in charge of budget funds in the programme and to develop indicators that will make it possible to assess the results;
- To ensure the accuracy and transparency of the mechanism of state procurement;
- To create an effective monitoring and appraisal system for programmes.