

# EITI and Beyond: Perspectives from Azerbaijan

Report from multi-stakeholder workshop, 2 March 2012, Baku

*The government of Azerbaijan formally signed up to the Extractive Industries Transparency Initiative (EITI) in London, UK, on 17th June 2003. As one of the first countries to implement EITI, Azerbaijan has always attracted huge interest from the international community. To date, Azerbaijan has published a record 14 reports. In February 2009 it became the first country to pass the validation process and achieve full member status. In accordance with the EITI Validation Guide, Azerbaijan must be revalidated within five years (by 15 February 2014). This paper provides an update of the status of EITI in Azerbaijan and reflects on some of the impacts of the EITI process on transparency and accountability in the oil, gas and mining sectors in Azerbaijan. It also poses a number of questions relating to how Azerbaijan should move forward to improve transparency and accountability in these sectors and reflects on the future of EITI. An earlier version of this paper served as the background paper for a workshop held in Baku on 2 March 2012, entitled "EITI and Beyond: View from Azerbaijan". This paper also includes reflections and outcomes from the workshop itself.*

## Government position on EITI

The scope and quality of EITI implementation depends primarily on the government of the country that signs up to it. The government of Azerbaijan has been proactive in the deployment of EITI and has ensured that all oil, gas and (gold) mining companies are involved in the reporting process. A coalition of non-governmental organisations (NGOs) was created at the beginning of the EITI process in Azerbaijan. This coalition now has a role in developing EITI in Azerbaijan, together with the government and companies, as part of the Multi-Stakeholder Group (MSG). In 2004, the coalition included 32 NGOs; they now number 160.

The EITI philosophy requires that countries fulfil so-called "minimum requirements". However, there is no "upper limit". That is why different countries achieve different levels of implementation, both deepening (e.g. improving reporting) and broadening (e.g. expanding to areas such as contracting and revenue management, or along the value chain). Azerbaijan, along with roughly half the EITI countries, currently meets the minimum requirements of EITI. However, although Azerbaijan is one of the first members of EITI, producing among the highest number of reports, the government has not expanded the scope of these

reports, despite attempts by NGOs to encourage this. Azerbaijan considers it sufficient to produce only reports with aggregated (not individual) company data. Despite being ahead in some areas, Azerbaijan has shown little initiative in further developing EITI. Following a recent decision of the EITI International Board to intensify EITI implementation in post-validation countries, Azerbaijan has not demonstrated any tangible efforts in this transition.

Countries of the Caspian Region, such as Azerbaijan and Kazakhstan are developing EITI in a post-Soviet context, with some similar characteristics of government and civil society, but their status within EITI is quite different. Unlike Azerbaijan, Kazakhstan is still a candidate country and despite considerable efforts from its MSG, particularly the civil society organisations (CSOs), it is unable to resolve key obstacles to achieving compliance. This may in part be due to the fact that, in contrast to Azerbaijan, the 'champion' promoting EITI in Kazakhstan has recently changed, from the Ministry of Oil and Gas to the Ministry of Industry and Innovative Technologies, which is relatively unfamiliar with the EITI process. A further factor is fragmentation within the NGO coalition and their inability to agree on a unified position vis-à-vis government.



*"Without deviations from the norm, progress is not possible"*

*Frank Zappa, cited by Publish What You Pay*

## Benefits of EITI

For all EITI countries it is important to link progress on EITI with "desirable sustainability", without which it is impossible to assess the real benefits of EITI.

"Desirable sustainability" in Azerbaijan can be achieved primarily through fighting corruption, reducing poverty and ensuring economic diversification. In achieving these goals, EITI is identified as the first stage in the long and thorny road to sustainable development.

Unfortunately the progress of EITI in Azerbaijan does not seem to have had any influence on reducing corruption. The NGO coalition has highlighted this issue many times within the MSG and at EITI International Board meetings. A key reason for this is that the current EITI agenda is quite limited and covers only payments made by companies to the government and received by the government from companies, while corruption mostly happens at the level of public expenditure. Partly this is because budget expenditure is very difficult to tackle through civic oversight, and public expenditure reporting still lies outside the scope of EITI.

## Broadening and deepening EITI in Azerbaijan

Since 2011 the main aim of the work plan for Azerbaijan's MSG is to move beyond the minimum requirements of EITI and strengthen the process to reform EITI reporting, in particular to implement disaggregated reporting. Despite the attempts of the MSG, it has been impossible to get the companies involved in the MSG to agree to shift to disaggregated reporting. Although BP-Azerbaijan regularly reports on its revenues generated in Azerbaijan, this is not enough for full disclosure. Significantly, SOCAR (the State Oil Company of Azerbaijan Republic) does not provide individual reporting. Participants at the Baku workshop observed that most companies are in favour of disaggregated reporting. However, one or two companies still oppose it, due to pressure from their shareholders and internal decision-making. Another argument against disaggregated reporting is confidentiality, but participants felt that the government could resolve confidentiality issues with companies.

Because decisions are made by consensus within the EITI process, the opposition of one or two companies acts as a veto. It was observed that even those companies opposing disaggregated reporting could be convinced to change their position. However, these companies argue that disaggregated reporting is not mandatory under EITI so they do not feel obliged to make the change.

This is not only a problem in Azerbaijan but in all states that produce aggregated EITI reports. It is worth noting that there has never been a transition from aggregated to disaggregated reporting in the history of EITI. Azerbaijan has the chance to take the lead on this. Disaggregated reporting will bring considerable benefits to both local and international companies working in Azerbaijan. This will increase their credibility in the eyes of their shareholders, creditors, international and host country communities.

One of the more challenging issues for Azerbaijan is project-by-project reporting. This kind of reporting is also part of the US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the 'Dodd-Frank Act'). Section 1504 of the Act, also known as the Cardin-Lugar amendment, obliges all oil, gas and mining companies listed in the United States to disclose payments to host countries. This includes European companies, such as Shell and BP, as well as those based in emerging markets like China, India and Brazil.

Workshop participants observed that some companies behave differently at the global level and the country level. For example, while supporting EITI at the country level, companies such as BP, ExxonMobil and Chevron are attempting to block progress with the Dodd-Frank Act. In the words of the Publish What You Pay representative, they "use EITI as a shield", claiming that they are supporting transparency and accountability.

In most of the countries covered by EITI, local and international companies working in the extractive industries receive income on the basis of different types of contract, such as concessions, service contracts, joint venture agreements, and they pay a range of different payments and taxes to national and local governments. In aggregated reports it is not clear what individual companies' incomes and payments are, and what amount of profit they receive according to different contracts. Even if companies produce disaggregated reports, without separate reports for each of their agreements, EITI reporting still looks incomplete.

One might ask what additional information and societal benefits could result from the increased transparency of reporting on different contracts? First of all, reporting on projects builds a bridge between traditional EITI reports and contract transparency and creates an opportunity to expand the initiative and

apply it to contracts. Contract transparency is a key goal in expanding the scope of EITI. A fundamental aim of holding the government to account is determining whether or not a satisfactory deal has been reached, resulting in equitable socio-economic benefits to local society. An essential component of evaluating the fairness of a contract relates to the payments made. With aggregated data, this is much more difficult, if not impossible.

In Azerbaijan, all Production Sharing Agreements (PSAs) are made publicly available, because of their legal status. Disaggregated reports on agreements will help to compare contracts with EITI reports, and to check the terms of signed contracts against the way they are implemented. In other words, thanks to project-by-project reporting, it will be possible to verify that what should have been paid has actually been paid. Moreover, in countries where contracts are not publicly available (for instance, in Kazakhstan) reporting by projects will create an opportunity for greater transparency.

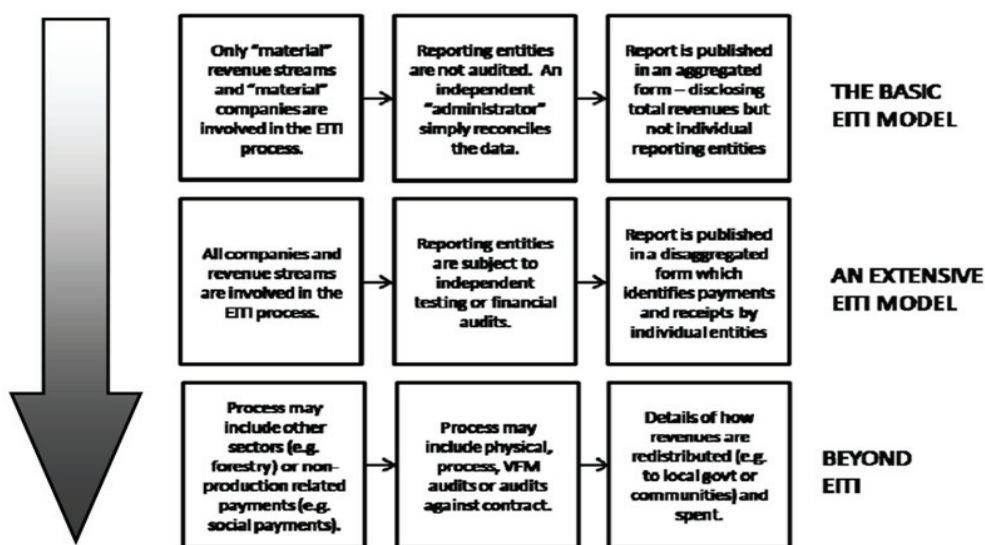
For Azerbaijan the transition to disaggregated reporting by projects has a special significance. Azerbaijan is the only country among EITI members in which the state revenues flow only from PSAs. Taking into account the state revenues from the oil and gas sector generated by PSA contracts, EITI reports will be an effective way to monitor and measure the implementation of PSA contracts and their effectiveness, by assessing how the interests of government and society have been balanced against company interests in the PSA. In PSA contracts the majority of government benefits flow not through taxes, but "profit oil"

*"Implementing EITI is like riding a bicycle. If you do not pedal, you will fall off."*  
**Ingilab Ahmadov**

which is calculated as the total oil produced minus "cost oil" (which companies claim to cover the cost of production). Unlike regular payments, it is quite difficult for a detached observer to monitor profit oil. A normal EITI agenda is not sufficient, as long as contracts remain beyond the focus of EITI. Applying EITI principles to contracts can only happen through an initiative that goes "beyond EITI".

Expanding the traditional agenda of EITI to will also help to reveal the real income of SOCAR, including separating SOCAR's commercial profits from the state share of profit oil. SOCAR has a dual role: on the one hand the company generates profit as a commercial entity, but on the other hand it is responsible for selling the government's profit oil and generating revenues. Sometimes the overall picture is quite confusing. Without the leadership of national companies it is difficult to make real progress in increasing transparency and accountability.

At the Baku meeting, the representative of the EITI Secretariat provided examples of how countries have introduced innovations to the EITI process at the country level. For example, Peru covers not only direct payments to sub-national levels, but also transfers between different sub-national levels; Mongolia produces highly disaggregated reports with very detailed information on social and environmental payments; Liberia has included forestry and agriculture in its EITI reports; while Kyrgyzstan has modelled its electricity sector reporting on the EITI.



Adapted from: Revenue Watch (2008) EITI Beyond the Basics, p.12 [www.revenuwatch.org/publications/eiti-beyond-basics](http://www.revenuwatch.org/publications/eiti-beyond-basics)

## Next steps

What steps should be taken to further develop EITI in Azerbaijan? How can it be deepened and broadened so as to achieve “desirable sustainability” in the country? How can governance and transparency initiatives “beyond EITI” help to build on the gains already made by EITI?

In this post-validation period, Azerbaijan needs to breathe new life into the initiative. A priority next step is to accelerate the transition to disaggregated EITI reporting, both company-by-company and project-by-project. The 2010 and 2011 MSG work plans highlighted this task as a most important priority. The 2012 work plan suggests that it can be resolved within the year and the government has called on companies to show solidarity by changing to disaggregated reporting. The decision must be taken with the MSG. Civil society believes that if the government really wants to shift to disaggregated reporting, it can persuade the companies. The EITI Secretariat regularly calls on the Azerbaijan government to initiate disaggregated reporting as soon as possible.

Workshop participants concluded that it would be easier to introduce disaggregated reporting at the country level rather than getting the EITI Secretariat to make it into a mandatory requirement. International NGO representatives felt that grassroots actions could be effective in broadening the scope of EITI and going “beyond compliance”. The NGO coalition should be aware that it has the potential for influence at the national level and should keep pushing for change. However, local NGOs felt more guidance from the Secretariat would stimulate in-country progress as well. Local NGOs can also take part in international campaigns, such as the “Publish-What-You-Pay” campaigns to ensure that the Dodd-Frank Act and the comparable EU transparency and accountability directives are brought into effect. This can be done by local NGOs writing letters of support to the campaign organisers.

A company representative at the meeting suggested that civil society organizations should approach companies for one-to-one meetings to talk about EITI issues and build on this dialogue. Further bilateral meetings, for example between civil society and government representatives, could also serve to build trust and mutual understanding outside of the MSG meetings.

Some warned of the danger of focusing too much on the issue of disaggregated reporting and suggested considering why it is required, and the potential to introduce partially disaggregated reporting (e.g. relating to social investment and environmental spending). Several participants were interested in the notion of including environmental NGOs more in the EITI dialogues and building links between the goals of the EITI and environmental coalitions. The EITI Secretariat representative noted the importance of making linkages with other processes within the country so that EITI does not remain dislocated from these other processes.

Participants at the meeting recognized that the consensus approach to decision-making sometimes impedes the expansion of EITI and can act as a bottleneck – as with the companies’ decision-making on whether or not to move towards disaggregated reporting.

Participants noted that dissemination and education are improving in Azerbaijan, following civil society pressure. They are now using mass media, including TV. The EITI website is used more and more ([www.eiti.az](http://www.eiti.az)). Participants noted the need to involve local people living outside Baku, who currently see no relevance in the EITI agenda. This would mean developing information materials that are accessible, and disseminating them through appropriate channels.

In future it is also worth discussing how to strengthen EITI so that it has a more tangible effect on sustainable development indicators in the country, notably by reducing corruption and poverty. A major step would be to increase the accountability of public expenditure. It is impossible to extend the principles of EITI directly to public expenditure within existing frameworks, so it will be necessary to develop a desirable and robust form of revenue management. NGO participants also called for increased transparency about the smaller companies operating in Azerbaijan’s oil and gas sector, their shareholders, where they are registered and their turnover – essentially extending EITI along the value chain.

Participants noted that a transparency initiative needs to be comprehensive – it cannot be a partial transparency. It is clear that promoting transparency in Azerbaijan’s extractive industries is in the government’s interest, and it should be developed through deepening and broadening EITI, as well as through initiating actions “beyond EITI”.

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