

After the BTC Pipeline and EITI Validation:

Where are Prosperity and Transparency in Azerbaijan?

October 2012

CRUDE ACCOUNTABILITY

Crude Accountability is grateful to the Sigrid Rausing Trust and the Underdog Fund of the Tides Foundation for their generous financial support, which made this publication possible.

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Executive Summary

Between May 4 and May 11, 2012, Crude Accountability met with civil society activists, corporate representatives, and state agencies in Baku, Azerbaijan to discuss social and environmental practices related to the petroleum industry. These conversations helped clarify questions about how the Azerbaijani economy and society have changed in the six years since the completion of the controversial Baku-Tbilisi-Ceyhan oil pipeline, which spans from the Caspian Sea off the shore of Baku and terminates in Ceyhan, Turkey. The discussions revealed a number of civil society's most significant concerns about social and environmental side effects of the petroleum industry's continuing development.

The collective goal of Azerbaijani civil society organizations active in the petroleum sector is to obtain the release of corporations' disaggregated revenue and tax payment information. Only BP and Statoil currently publish this information. A secondary concern is inconsistent information disclosure across borders. For example, in the case of BP, more information is disclosed about Azerbaijani operations than to civil society in other countries with active projects. In the case of other European companies, civil society noted they received fewer responses to their requests for information than do their European counterparts. Additionally, civil society noted that the State Oil Company of the Azerbaijan Republic (SOCAR) is more transparent about its operations in neighboring countries.

Activists and experts interviewed also discussed macro level economic and social planning. They identified several critical democratic and social reforms that have not been adopted in Azerbaijan due to a lack of political will. Government spending on education and pensions has failed to keep pace with the fivefold increase in its GDP in the past decade, and approximately one million Azerbaijanis work abroad as a result of a non-diverse economy and low average wages. Transparency is also limited. Production-sharing agreements between companies and the government are not publicly available (although they are to Members of Parliament), and civil society organizations monitoring Azerbaijan's involvement the Extractive Industry Transparency Initiative (EITI) noted that a number of domestic oil sector companies have no physical offices or internet presence, indicating they are possibly fronts for stealing through government contracts.

Based on the assessment conducted for this report, there are several ways in which western civil society organizations can assist those in Azerbaijan. First, Azerbaijani civil society representatives requested assistance in encouraging the UK government to join EITI, which would increase the transparency of Western companies' activities within Azerbaijan. Civil society also expressed the need for diversified funding sources since foreign donors have downsized their presence in the country, and registering and receiving grants is difficult due to bureaucratic requirements. In addition

to these requests, the following concerns could be jointly monitored by domestic and international civil society:

Environmental issues

- A significant decrease in the biodiversity of the Caspian Sea in the past several decades
- Visible oil and gas pollution in the Caspian with undetermined sources
- The use of water injection/hydraulic fracturing (fracking) technology at the Azeri-Chirag-Guneshli oil fields, which presents potential risks related to increased seismic activity and toxic wastewater disposal
- Potential air shed degradation around the Sangachal oil and gas processing terminal due to the current operations and future expansion

Factors that impede civil society viability

- Intimidation and harassment by the police and authorities
- Government corruption
- Bureaucratic obstacles to registering as official non-governmental organizations (NGOs)
- Bureaucratic obstacles to receiving funding
- A decrease in available international funding

There have been several positive outcomes related to the growth of Azerbaijan's petroleum industry. GDP has increased, social programs such as housing for internally displaced people have been implemented, and the Azerbaijani government's involvement in EITI and large international projects such as the Baku-Tbilisi-Ceyhan pipeline have provided civil society with the opportunity to increase its voice. However, civil society still has many concerns regarding transparency, participation, the beneficial use of resources, and even its own safety. This report addresses the most urgent concerns presented.

Sarah Bedy

October 2, 2012

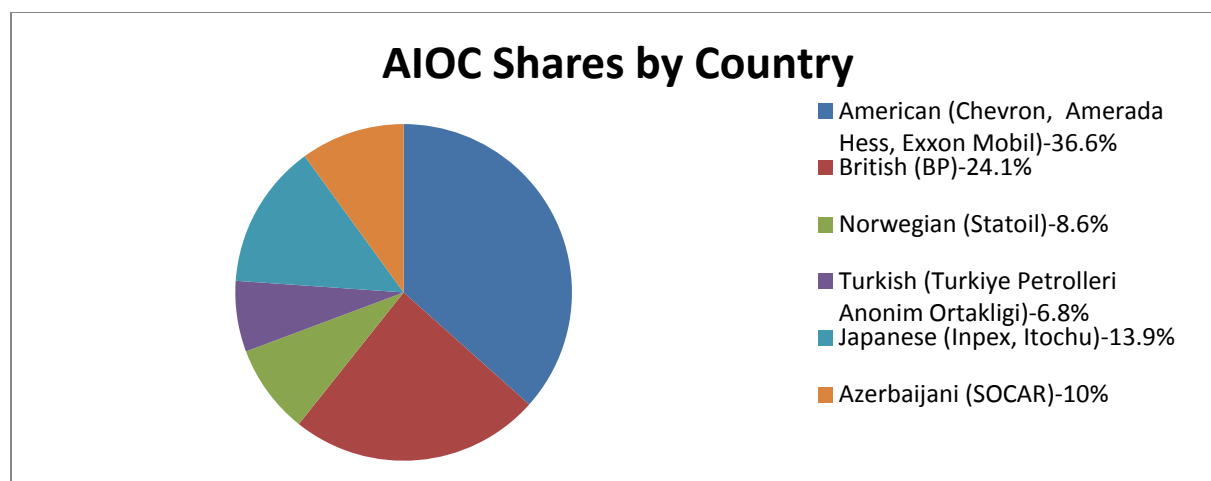
List of organizations interviewed for this report: staff from Open Society Foundations-Azerbaijan; European Bank for Reconstruction and Development; British Petroleum (BP); Economic Research Center; employees of the State Oil Company of Azerbaijan Republic (speaking unofficially); State Oil Fund of Azerbaijan; Revenue Watch Institute; the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry; Entrepreneurship Development Foundation; Oil Workers Rights Protection Organization

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Background

As the home of the first percussion-drilled oil well, first oil pipeline, and first oil tanker in the world, Azerbaijan has been a critical player in the international oil and gas industry for over 100 years.¹ Signaling a new phase of east-west cooperation, in September 1994 the State Oil Company of Azerbaijan (SOCAR) signed a production sharing agreement called the “Contract of the Century” with the BP-operated Azerbaijan International Oil Company (AIOC). The AIOC subsequently invested approximately \$60 billion in the Azerbaijani petroleum sector.² Today, BP extracts one third of its total global liquids production (gas and oil) from Azerbaijan, and Azerbaijan’s growing importance as a gas exporter to Europe, especially as a potential alternative to Russian gas, should not be underestimated in geopolitical terms.



Source: BP (<http://www.bp.com/managedlistingsection.do?categoryId=9007997&contentId=7014999>) and OpenOil ([http://wiki.openoil.net/index.php?title=Azerbaijan International Operating Company \(AIOC\)](http://wiki.openoil.net/index.php?title=Azerbaijan_International_Operating_Company_(AIOC)))

Although the State Oil Fund of Azerbaijan (SOFAZ)’s annual report highlights development advances from an increase in the production of oil and gas in the past decade, the country’s rapid economic development is not without controversy.³ Azerbaijani civil society cites a lack of economic diversification, sector corruption, sub-standard labor conditions at state

¹ Gulnaz Hajiyeva and Ulker Aslanova, “First Oil Boom in Azerbaijan,” *United Nations: Azerbaijan*; www.un-az.org/undp/bulnews44/FirstOilBoominAzerbaijan.pps.

² Price Waterhouse Cooper, “Doing Business and Investing in Azerbaijan 2011 Edition,” *PWC*, <http://www.pwc.com/az/en/assets/document/az-dbg-2011.pdf>.

³ State Oil Fund of Azerbaijan, “2010 Annual report,” *SOFAZ*, http://www.oilfund.az/pub/uploads/annual_2010en.pdf.

companies, and high unemployment outside of Baku as critical issues to be addressed.⁴ Azerbaijan's government also remains politically repressive. It was ranked 2.4 out of 10 on a corruption scale in 2011 in Transparency International's Corruption Perception Index,⁵ and 162 out of 179 by Reporters without Borders with regard to media freedom in 2011. The latter organization has attributed negative pressures on free speech to the country's increasing petroleum wealth.⁶

Additionally, while Western involvement in Azerbaijan's petroleum sector has advanced environmental and labor standards (civil society representatives and industry workers interviewed said that BP's safety measures, for example, were more stringent than those at national companies), there are numerous risks associated with the industry's activities that could negatively impact Azerbaijan's citizens and environment. Among these is the offshore use of the controversial "fracking" process at the Azeri-Chirag-Guneshli field, as well as visibly apparent oil and gas leaks into the Caspian Sea and stresses on the air shed around the Sangachal refinery terminal near Baku. This paper sheds light on Western involvement in Azerbaijan's petroleum sector and identifies areas in which social, economic, and environmental policy affecting the sector can be improved.

Current Oil and Gas Production in Azerbaijan—Oil Hits its Peak as Gas Flows Abundantly

The rapid increase in oil and gas produced over the past decade has dramatically enriched the Azerbaijani government as well as foreign companies operating in the sector. In 2003, Azerbaijani daily oil production was roughly 300,000 barrels and climbing.⁷ In 2010, the industry produced 1.1 million barrels per day.⁸ After more than a decade of growth, production is expected to peak between 2012 and 2014, with the majority of oil produced in

⁴ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, Baku, May 11, 2012.

⁵ In this study, 10 signified "very clean" and 0 was "very corrupt". Transparency International, "Azerbaijan: Out of Tune?" http://www.transparency.org/news/feature/azerbaijan_out_of_tune; and Reporters without Borders, "Azerbaijan," *World Report 2011*; <http://en.rsf.org/report-azerbaijan,91.html>.

⁶ "The economic boom that the country has experienced since the Baku-Tbilisi-Ceyhan pipeline was inaugurated in 2006 has bolstered this trend [of forbidding pluralism and sustaining an oppressive polarization] by vastly increasing the authorities' resources and strengthening the impression that the international community cannot touch them." Reporters without Borders, "Azerbaijan," *World Report 2011*; <http://en.rsf.org/report-azerbaijan,91.html>.

⁷ U.S. Energy Information Administration, "Country Analysis Briefs: Azerbaijan," *EIA*; <http://www.eia.gov/EMEU/cabs/Azerbaijan/pdf.pdf>.

⁸ *Ibid.*

the Azeri-Chirag-Guneshli (ACG) fields.⁹ The AIOC cut oil production in ACG by 11.6 percent in early 2012 in order to conservatively to manage its resources.¹⁰

ACG's oil has been exported through the Baku-Tbilisi-Ceyhan (BTC) Pipeline since 2006. BTC is an investment of the AIOC financed with loans from the World Bank Group and the European Bank for Reconstruction and Development. Pre-construction estimates projected BTC to transport 1 mil bbl/day from the Caspian seabed in Azerbaijani waters. In 2010, Azerbaijan exported 777,000 bbl/day of oil, about 80 percent of which went through BTC.¹¹ In 2011, the country's total exports were \$23 billion, 90 percent of which was derived from oil and gas sales.¹²

With peak oil a present reality rather than future prospect, Azerbaijan's economic reliance on the industry appears highly precarious, except that Azerbaijani gas production is on a sharp ascent. Even so, the country's future economic growth is dependent on how well the ACG wells continue to produce and if the BP-operated Shah Deniz natural gas and condensate field reaches its full potential.

The Shah Deniz field began producing in 2006. As BP's largest-ever natural gas discovery, it transformed Azerbaijan from a net importer to a net exporter of gas.¹³ Shah Deniz' "Full Field Development" phase is planned to come online in 2016-2017, and is projected to triple domestic production and supply natural gas to Europe.¹⁴ The gas from Full Field Development will be produced through 26 new subsea production wells and routed through 500 km of subsea pipelines to the Sangachal oil and gas terminal south of Baku. It will then be refined and funneled to one of two candidate pipelines—the Nabucco West, which will run from the Bulgarian/Turkish border to Austria, or the Trans-Adriatic Pipeline, which will

⁹ U.S. Energy Information Administration, "Country Analysis Briefs: Azerbaijan," *U.S. Energy Information Administration*; <http://www.eia.gov/EMEU/cabs/Azerbaijan/pdf.pdf>; and *Ibid.*

¹⁰ The Guardian, "BP led Azerbaijan venture cuts oil output to a five year low" *The Guardian*; <http://www.guardian.co.uk/business/feedarticle/10394505>.

¹¹ Price Waterhouse Cooper, "Doing Business and Investing in Azerbaijan: 2011 Edition," *PWC*; <http://www.pwc.com/az/en/assets/document/az-dbg-2011.pdf>; and U.S. Energy Information Administration, "Azerbaijan: Oil Exports," EIA, <http://www.eia.gov/countries/cab.cfm?fips=AJ&trk=p2>.

¹² CIA "Azerbaijan," *World Factbook*, <https://www.cia.gov/library/publications/the-world-factbook/geos/aj.html>.

¹³ BP, "Shah Deniz," *BP Caspian*; <http://www.bp.com/sectiongenericarticle.do?categoryId=9006668&contentId=7015092>; and U.S. Energy Information Administration, "Azerbaijan," *Country Analysis Briefs*; <http://www.eia.gov/countries/cab.cfm?fips=AJ>.

¹⁴ *Ibid.*

terminate in Italy.¹⁵ The Shah Deniz Consortium will select the final pipeline for export by mid-2013.¹⁶

In addition to private funding by BP and other consortium members, Shah Deniz Stage I was supported by a \$100 million loan from the European Bank for Reconstruction and Development (EBRD) in 2003 to SOCAR, and Lukoil secured a second loan, also from the EBRD for \$110 million in 2005.¹⁷ It remains to be seen whether international financial institutions will provide additional loans for further Shah Deniz development.



Source: US Energy Information Administration "Azerbaijan" Country Analysis Briefs;
<http://www.eia.gov/countries/cab.cfm?fips=AJ>

¹⁵ BP, "Shah Deniz Video," *BP Caspian*; http://clients.world-television.com/bp_media_coverage/GB4160/index.html.

¹⁶ Offshore Technology, "Azeri-Chirag-Guneshli Oilfield, Azerbaijan," <http://www.offshore-technology.com/projects/>; and BP, "The Nabucco West project has been selected as the single pipeline option for the potential export of Shah Deniz Stage 2 gas to Central Europe." June 28, 2012; <http://www.bp.com/genericarticle.do?categoryId=9006615&contentId=7075555>.

¹⁷ European Bank for Reconstruction and Development, "SOCAR: Shah Deniz Gas Condensate Field Development," *EBRD*; <http://www.ebrd.com/english/pages/project/psd/2003/15937.shtml> and European Bank for Reconstruction and Development, "Lukoil Overseas: Shah Deniz Gas Condensate Field Development," *EBRD*; <http://www.ebrd.com/english/pages/project/psd/2005/35605.shtml>.

Company Shares in Projects

AIOC-owned projects produced 80 percent of the total oil and gas in Azerbaijan in 2010, and the Azeri-Chirag-Guneshli field produced 80 percent of Azerbaijan's oil output in 2010.¹⁸ BP owns approximately 37.43 percent share of the field; with other shares owned by Chevron (11.26%), Statoil (8.56%), Exxon Mobil (8%), Amerada Hess (2.7%), and state-owned and Asian companies.¹⁹

BP's investments in Azerbaijan total over \$30 billion. As operator of Azerbaijan International Oil Company, BP is the operator of Shah Deniz, the BTC Pipeline (for which it was accountable to 12-15 monitoring bodies, including the World Bank Group, EBRD, companies, and NGOs), and the Alov-Araz-Sharg prospects.²⁰ In the past year it also signed a production sharing agreement with SOCAR to jointly explore the Shafag-Asiman block.²¹

Statoil is the second most significant Western petroleum investor in Azerbaijan. It operates the South Caucasus Pipeline, owns an equal share to BP on the BTC pipeline, and is the commercial operator for Shah Deniz, as well as owning a 10 percent stake in the Alov-Araz-Sharg field.²² ExxonMobil (15%) and Alberta Energy (5%) also have significant stakes in Alov-Araz-Sharg, although this project has been put on hold due to territorial disputes with Iran over the status of Caspian Sea.²³ Amerada Hess, ConocoPhillips, GDFSuez, and TotalINA are also invested in Azerbaijan's oil and gas sector.

¹⁸ U.S. Energy Information Administration, "Country Analysis Briefs: Azerbaijan," EIA <http://www.eia.gov/EMEU/cabs/Azerbaijan/pdf.pdf>.

¹⁹ Offshore Technology, "Azeri-Chirag-Guneshli Oilfield," *Azerbaijan*; <http://www.offshore-technology.com/projects/>.

²⁰ BP, "BP in the Region," *BP Caspian*; <http://www.bp.com/modularhome.do?categoryId=6070>.

²¹ BP, "BP and SOCAR joint exploration and development of a new offshore block," *BP Caspian*; <http://www.bp.com/sectiongenericarticle.do?categoryId=9036314&contentId=7067147>.

²² Statoil, "Azerbaijan," *Our Operations*; <http://www.statoil.com/en/About/Worldwide/Azerbaijan/Pages/default.aspx>.

²³ Turkish Petroleum Organization, "International Projects," *Turkish Petroleum Organization*; http://www.tpao.gov.tr/tp2/sub_en/sub_content.aspx?id=148.



Source: US Energy Information Administration; <http://www.eia.gov/countries/cab.cfm?fips=AJ>

Revenue Management—Substantial Transfers to the State Budget

The State Oil Fund of the Republic of Azerbaijan (SOFAZ) collects revenues and taxes from companies that have production sharing agreements with the Azerbaijani government. The Fund’s goal is to “manage efficiently accumulated oil revenues generated from development of [the] country’s oil fields jointly with foreign companies and to assign these assets to the development of advanced areas and implement projects of social-economic importance.”²⁴ SOFAZ’ reserves have quadrupled in a decade from approximately \$5 billion in 2001 to \$23 billion in 2010.²⁵ Nearly \$6 billion was transferred from SOFAZ to the state budget in 2010, which represented 52 percent of the Azerbaijani government’s revenues.²⁶ Ninety-seven percent of SOFAZ’s revenues in 2010 came from oil and gas sales.²⁷

²⁴ State Oil Fund of the Republic of Azerbaijan, “General Information,” *About the Fund*; http://www.oilfund.az/en_US/about_found/history/uemumi-melumat.asp.

²⁵ *Ibid.*, 9.

²⁶ *Ibid.*

²⁷ *Ibid.*

Civil society's largest criticisms of SOFAZ are that it has no civil society representatives on its supervisory board and that its social programs are at times ineffective. Possibly in response to the first criticism, the 2012 SOFAZ annual report will include civil society comments.²⁸

Social and Economic Outlook—Prosperity for the Few

Although the official unemployment rate in Azerbaijan is low (5.5%), this statistic excludes the one million Azerbaijanis who have left the country to earn higher wages in Russia.²⁹ In a country of nine million people, this absence is notable, particularly in the regions outside of Baku, where civil society organizations observe that there are whole villages without male residents. The shadow economy represents 66.2 percent of the country's GDP, and many forms of employment require bribery.³⁰ While the gas and oil sector represents 47 percent of the total GDP, only 1.8 percent of the population is employed in this industry.³¹ The discrepancy between the salaries of oil workers and those of others is demonstrated by the official wage data; in 2012, the average monthly salary in Azerbaijan was \$400 in the non-oil sector and \$1200 in the oil sector.³²

The EBRD has identified providing loans to medium-sized Azerbaijani companies as one of the most critical needs for developing Azerbaijan's economy outside of the petroleum sector.³³ Few of the approximately 40 banks within the country have the capacity to loan more than two or three million dollars at a time, making the startup and expansion of many companies difficult. Experts note that the economy is controlled by a small group of powerful oligarchs whose power would be undermined by the competition legitimate

²⁸ State Oil Fund of the Republic of Azerbaijan, "About the Fund," *SOFAZ*, http://www.oilfund.az/en_US/about_found/history/uemumi-melumat.asp.

²⁹ International Labor Organization, "Joint ILO-OECD study prepared for the G20 labour ministerial meeting in Paris on 26-27 September." *Today-AZ*; http://www.ilo.org/public/english/region/eurpro/moscow/news/press/g20_today_az_2909.pdf and Ina Ganguli, "Scholar Research Brief: Migration in Azerbaijan: The Transition to a Destination Country?" *IREX*, May 20, 2010; <http://www.irex.org/system/files/Ganguli.pdf>.

³⁰ Business Week, "No. 3 Biggest Shadow Economy: Azerbaijan," *Bloomberg Businessweek*; http://images.businessweek.com/ss/10/07/0729_worlds_biggest_shadow_economy/4.htm and Shahin Abbasov, "Fighting Corruption in Azerbaijan: A Mission with Teeth?" *Eurasianet.org*, February 23, 2011; <http://www.eurasianet.org/node/62947>.

³¹ Gubad Ibadoglu, Kanan Aslanli, and Sohrab Farhadov, "Evaluation of the Macroeconomic Condition in Azerbaijan in 2010: Analytical Review," *National Budget Group*, Baku 2011; 12.

³² National Budget Group, "Evaluation of the Macroeconomic Condition in Azerbaijan in 2010," *Analytical Review*; Baku 2011; 18.

³³ European Bank for Reconstruction and Development, "Azerbaijan," *EBRD*, <http://www.ebrd.com/pages/country/azerbaijan.shtml>.

business lending would encourage. Thus reform is not prioritized by the government, which is allied with these interests.³⁴

Azerbaijan has dramatically improved its poverty rate in the past decade, which fell to just 9.1 percent in 2010.³⁵ However, citizens above the poverty line face economic challenges such as high consumer prices. Inflation continues to rise more quickly than average salaries,³⁶ and the long-term availability of pensions is threatened since private employers do not contribute to the public pension fund.³⁷ National spending on education has also decreased as a percentage of expenditures, from 13 percent of GDP in 2006 to 10 percent in 2010.³⁸ One family interviewed for this report said that they earned \$900 monthly as a household and paid \$500 a month for their daughter's private tutoring to make up for the poor quality of public education. They explained that wealthy families bribe the schools to spare their children from having to attend useless classes.

Extractives Industry Transparency Initiative (EITI)

The Extractive Industry Transparency Initiative (EITI) is an international, voluntary system of disclosure of tax and revenue payments to the government by industry. Announced as a sustainable development initiative in 2002 by UK Prime Minister Tony Blair and endorsed by the United States in 2004, it has since been implemented by neither country. Despite its poor national record on political and economic transparency, Azerbaijan became the first EITI-“compliant” country in the world in 2009. Before Azerbaijan’s transparency plan was approved by the EITI international secretariat, activists hoped that it would shed light on industry corruption and open up space for dialogue with the government and corporations. They have seen some of these results realized. All 31 companies active in the petroleum industry in Azerbaijan are parties to the Memorandum of Understanding on EITI. Three companies represent the industry at the EITI decision-making Multi-Stakeholder Group (MSG) comprised of civil society, government, and extractives companies: BP, Chevron, and SOCAR, with Statoil acting as the alternate. In order to ensure their voice in the monitoring process, CSOs conducted an advocacy campaign to require a formal MSG before Azerbaijan was validated by the EITI Secretariat.

Source: Extractive Industries Transparency Initiative, “About,” EITI; www.eiti.org

³⁴ The Economist, “Azerbaijan: A Small Country Grows Drunk on Oil Wealth,” *How to Spend it*; <http://www.economist.com/node/21538212>.

³⁵ *Ibid*, 19.

³⁶ *Ibid*.

³⁷ Interview with Gubad Ibadoglu, Member, National Budget Group, Baku, May 9, 2012.

³⁸ *Ibid*; 34.

Civil Society Activism and Capacity

The largest civil society coalition within Azerbaijan was formed in response to the country's bid for accreditation by the Extractives Industry Transparency Initiative (EITI). This coalition, the NGO Coalition for Improving Transparency in the Extractives Industry, is a consortium of approximately 160 organizations.³⁹ The coalition currently has two top priorities: winning the public disclosure of petroleum company production-sharing agreements signed with the government, and making the companies' disaggregated reports of taxes and revenues publicly available.⁴⁰ Both of these objectives are intended to reduce government and private sector corruption.

The coalition also conducts advocacy to improve the way SOFAZ invests and spends petroleum revenues.⁴¹ For example, a recent proposal to build a \$110 million new headquarters for SOFAZ' 110 employees drew protest from civil society.⁴²

While the coalition has gained increased but limited access to government and corporate decision-making through its participation in EITI, it notes flaws in the process that must be corrected to ensure greater accountability. First, EITI participation is voluntary for companies, and there are no sanctions for those that are poor performers. This leaves civil society with little leverage when a company or government does not disclose information. Additionally, some European and North American countries have not joined EITI.⁴³ When interviewed, coalition members urged British NGOs to lobby for a change in this stance since UK participation would help activists living in closed regimes gain access to the information about their governments' revenues.⁴⁴ Members of the coalition also reported that they felt companies and the government sometimes used a "divide-and-conquer" strategy to appease a few civil society organizations in order to weaken the ability of the larger group to present a unified front to achieve its goals.

³⁹ Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, "Home," <http://www.eiti-az.org/en/>.

⁴⁰ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, Baku, May 11, 2012.

⁴¹ The Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, "EITI News," <http://www.eiti-az.org/en/eiti-az/156>.

⁴² The Coalition of Azerbaijan Non-Governmental Organizations for Improving Transparency in the Extractives Industry, "State Oil Fund's 110 million USD 'wastefulness'," <http://www.eiti-az.org/en/eiti-az/153>.

⁴³ Extractive Industries Transparency Initiative, "EITI Countries," *EITI*; <http://eiti.org/countries>.

⁴⁴ US President Barack Obama publicly committed the US to joining at the launch of the Open Government Partnership on September 20, 2011, and in July 2012 the US Secretary of the Interior announced that a Multi-Stakeholder Group would be formed in preparation for applying for candidacy. <http://eiti.org/US-establishes-national-EITI-Oversight-Group>

Accomplishments

The NGO coalition's greatest success to date has been delaying Azerbaijan's EITI validation until a Multi-Stakeholder Group (consisting of petroleum companies, the government, and NGOs) was established and a formal action plan that outlines annual activities within the initiative was developed and adopted.⁴⁵ Azerbaijani civil society worked effectively with international civil society, the media, and the EITI Secretariat to ensure that these conditions were met, and also advocated for the Multi-Stakeholder Group to do its own press releases (rather than allowing the Azerbaijani EITI Secretariat, which is run by the Azerbaijani government, to write them), and won.⁴⁶ The coalition reports that as a result of the EITI process, BP and Statoil have become more open to public requests for information.⁴⁷ Additionally, Open Society Foundations reports successful social and environmental safeguard negotiations between Azerbaijani civic activists and Chinese and Russian companies.⁴⁸

Innovative Partnerships

The Civic Response Network is an expert group of social and environmental monitors that audited construction of the BTC pipeline. Since 2007, the network has trained communities throughout Azerbaijan to negotiate with petroleum companies to improve local social and environmental conditions. Participants have reached compromises with international companies and local governments that led to the renovation of highways and roads, cleaning oil pools, expansion of labor rights, compensation for land loss, and inclusion social problems into the state political agenda. Some of the successful negotiations were completed with Russian companies, including Neftchala Oil, Global Oil, and Shirvan Oil; and Chinese-Azerbaijani joint-owned, such as Salyan Oil. International civil society often perceives companies headquartered in these countries as unlikely to make concessions on social and environmental issues, but the Azerbaijani case shows that they can be partners in addressing problems related to extraction.

Source: Civic Response Network, "About Us," <http://www.crn.az/view.php?lang=en&menu=1&type=0>

⁴⁵ Interview with Galib Efendiev, RWI Caucasus and Central Asia Coordinator, Revenue Watch International, Baku, May 10, 2012.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ Interview with Fidan Najafova, Transparency of Oil Revenues and Public Finance Coordinator, Open Society Institute-Assistance Foundation, Azerbaijan, Baku, May 7, 2012.

Operating environment

Freedom of the press is severely restricted in Azerbaijan, and the government regularly threatens civil society activists and journalists. In May 2012, the government implemented crackdowns on journalists and activists protesting human rights abuses before the Eurovision 2012 Song Contest was held in Baku. Members of the hip hop group “Balistan,” a vocal critic of the government, were detained and beaten by the police following their role in a March protest.⁴⁹ Five journalists were imprisoned in the first half of 2012, and one was murdered in 2011.⁵⁰ The president’s office and the legislative branch have expressed hostility directed at free speech:

On May 31, 2012, Ali Hasanov, a political advisor to Azerbaijan president Ilham Aliyev, called for public hatred against journalists and newspapers critical of the regime, according to local reports. Speaking to a group of loyalist civic organizations, he said, “They must not appear in front of the Azeri public anymore. They should be afraid to go to the streets. We have to display the public hatred against them.”⁵¹

In this environment, civil society often faces intimidation and harassment. This report’s author witnessed police “checking in” at civil society offices where employees stayed past five PM. One civil society activist reported that their office had been broken into and their emergency call card from the human rights organization Frontline and a copy of a production sharing agreement was stolen.⁵² The paperwork required to officially register a NGO is more difficult in Azerbaijan than in neighboring Georgia or Armenia; as a result, many NGOs remain unregistered and are more vulnerable to government harassment.⁵³

⁴⁹ Human Rights Watch, “Azerbaijan: Investigate Ill-Treatment by the Police,” News Releases, March 21, 2012; <http://www.hrw.org/news/2012/03/21/azerbaijan-investigate-alleged-ill-treatment-police>.

⁵⁰ *Ibid.*

⁵¹ Freedom House, “Journalists Face Open Hostility and Crackdowns in Azerbaijan,” <http://www.freedomhouse.org/article/journalists-face-open-hostility-and-restricted-access-information-azerbaijan>.

⁵² Interview with Mirvari Gahramanli, Chairwoman, Oil Workers Rights Protection Organization, Baku, May 7, 2012.

⁵³ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, May 11, 2012.

Funding

Civil society reported that it has become increasingly hard to find funding for environmental and social work.⁵⁴ One of the most significant foundations in the country, Open Society Foundations (OSF), is in the process of downsizing from several employees to one.⁵⁵ OSF is also changing its funding model from providing large operational grants to small grants, the recipients of which will be selected by the New York office rather than local staff.⁵⁶

One participant in the EITI NGO Coalition reported that his organization had gone more than a year with no funding.⁵⁷ Another reported that she had applied to the US and UK embassies for grants for sixteen years but had been consistently turned down, likely because of the nature of her work helping oil workers to organize. In addition to the scarcity of funding sources, the conditions set by the government to receive a foreign grant are onerous, including a requirement that foreign grant documents be translated into Azeri and notarized.⁵⁸

Sector Transparency—Bogus Companies Acting as Fronts for Government Corruption?

Due to the Azerbaijani government's failure to require publicly disaggregated reporting, BP and Statoil are the only petroleum companies operating in the country to publish their annual revenues and taxes. While Statoil releases this information on all of its global projects, BP's transparency regarding its operations in Azerbaijan is unusual compared to its practices in other countries—it ranks 14th out of 31 companies in Revenue Watch and Transparency International's annual report assessing petroleum companies' disaggregated disclosure practices.⁵⁹ In addition to revenues, BP Azerbaijan also discloses industrial accidents by number and type, percentage of its local employees who are Azerbaijani

⁵⁴ *Ibid.*

⁵⁵ Interview with Fidan Najafova, Baku, May 7, 2012.

⁵⁶ *Ibid.*

⁵⁷ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, Baku, May 11, 2012.

⁵⁸ *Ibid.*

⁵⁹ Revenue Watch International and Transparency International, "Promoting Revenue Transparency: 2011 Report on Oil and Companies," RWI and TI; http://www.euractiv.com/sites/all/euractiv/files/TI_PRT_2011_report_FINAL_EN.pdf.

nationals, and information about community development projects.⁶⁰ Statoil discloses its investments, revenues, taxes, social investments and number of employees.⁶¹

Civil society noted that the transparency standards of petroleum companies seem to vary by country. Statoil appeared more responsive to press inquiries in its home country, Norway, than in Azerbaijan.⁶² Likewise, SOCAR, the largest taxpayer in Georgia, appears to disclose more information about its operations abroad in countries like Georgia, Ukraine and Turkey than in Azerbaijan.

Additionally, corruption was an important factor mentioned by NGOs. The public has no access to production sharing agreements between the Azerbaijani government and foreign companies, and the EITI NGO Coalition expressed concerns about the legitimacy of some of the companies registered as operating in the extractives industry. Only 26 of the 31 that are signatories to the EITI MOU have websites, and some have no office.⁶³ NGO research indicates that some companies were established only a few months before they received contracts, indicating a lack of experience and potential corruption.⁶⁴

Company Websites and Outreach

Western companies offer varying levels of disclosure about their work in Azerbaijan. BP offers extensive information on its website and has six community liaison officers stationed in three public information centers throughout Azerbaijan.⁶⁵ Statoil maintains a webpage

⁶⁰ BP, "Sustainability Report 2010," *BP*;

http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/s/BP_sustainability_Report_2010_final_dec_2011.pdf.

⁶¹ Statoil, "Annual Report 2011," *Sustainability*;

<http://www.statoil.com/AnnualReport2011/en/Sustainability/KeySustainabilityData/EconomicImpactByCountry/Pages/EconomicImpactByCountry.aspx>.

⁶² *Ibid.*

⁶³ SOCAR released a statement addressing civil society's allegations. Please see "There are no physical entities among founders of SOCAR trading unit," below. Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry EITI NGO Coalition of Azerbaijan, May 11, 2012; and SOCAR, "There are no physical entities among founders of SOCAR trading unit." *SOCAR*, July 20, 2012; http://en.in-en.com/article/html/energy_101110117938862.html.

⁶⁴ *Ibid.*

⁶⁵ BP, "Reports and Publications," *BP Caspian*,

<http://www.bp.com/genericarticle.do?categoryId=9006625&contentId=7037156>.

with descriptions and ownership share statistics for its projects.⁶⁶ Chevron has a webpage with hiring statistics, the history of its involvement in Azerbaijan's petroleum sector, and its social investments in the country.⁶⁷

ExxonMobil, Amerada Hess, and GDFSuez lack a dedicated webpage for their Azerbaijan projects. TotalNA's involvement can only be sourced to a press release announcing that major reserves were found in the Absheron field, which Total operates, owning a 40 percent share.⁶⁸ The AIOC does not have a website, and SOCAR, the Azerbaijani state oil company, has not established a website for its reports, although it has promised to do so.⁶⁹

Working Conditions—Comparatively High Wages, but Dangerous Conditions

Only two Western companies, BP and Chevron, individually disclose their local hiring statistics. In 2010, Azerbaijani citizens made up 87 percent of BP's national professional staff and 100 percent of non-professional staff (with a total workforce of 2159). Chevron's workforce was 75 percent Azerbaijani.⁷⁰ Oil workers interviewed in Baku stated that there was little corruption in the hiring process at BP, where the salaries are ten times higher than their local counterpart, because of the requirement for advanced skills.⁷¹ However, workers reported that the danger pay was too low at SOCAR (12%), because the equipment was often from the Soviet era and failed to meet modern safety standards.⁷² Workers also reported a variety of other health and safety concerns associated with working for local companies, such as visible leaks on platforms and fields, and dangerous gas fires. In 2011, there were 57 injuries at SOCAR and 21 employees were killed.⁷³ Workers reported that many of their colleagues die within one to two years of retiring, possibly due to inhalation of

⁶⁶ Statoil, "Azerbaijan," *Statoil*, "<http://www.statoil.com/en/About/Worldwide/Azerbaijan/Pages/default.aspx>."

⁶⁷ Chevron, "Azerbaijan Fact Sheet," *Chevron*; <http://www.chevron.com/documents/pdf/azerbaijanfactsheet.pdf>.

⁶⁸ Total, "Total Makes Major Gas Discovery in the Caspian Sea," *News*; <http://www.total.com/en/about-total/news/news-940500.html&idActu=2636>.

⁶⁹ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry, Baku, May 11, 2012.

⁷⁰ Chevron, "Azerbaijan Fact Sheet," *Chevron*; <http://www.chevron.com/countries/azerbaijan/>.

⁷¹ Interview with SOCAR employees, Baku, May 9, 2012.

⁷² Interview with Mirvari Gahramanli, Chairwoman, Oil Workers' Rights Protection Organization, Baku, May 7, 2012.

⁷³ *Ibid.*

fumes; and that back pain, stomach pain, and heart disease are common due to the bad food and water supplied by the company.⁷⁴

Environmental Concerns

Since 2006, the AIOC has used water-injection techniques (fracking) at the ACG field.⁷⁵ According to one assessment, “waterflooding” accounted for 80 percent of oil production at the site in 2010, and ACG accounted for 20 percent of BP’s global water-injection capacity.⁷⁶ While the water used for injection is comingled produced water and seawater and is unlikely to impact the Absheron peninsula’s limited freshwater supply, the wastewater produced contains harsh minerals that could endanger the unique sea life in the Caspian if not properly contained. Of further concern is the potential for water-injection techniques to trigger seismic activity, which would be damaging to the Caspian’s ecosystem. BP’s Shah Deniz Full Field Development feasibility study has indicated that the Caspian seabed contains mud volcanoes, a rare geological formation similar to geysers, which could be disrupted by the project.⁷⁷

There is also visible oil and gas film on surface of the Caspian Sea near Baku, the source of which is unknown. This pollution has negative impacts on both human and wildlife populations, and is contributing to the reduction of native species including the Caspian seal and endangered sturgeon, as well as impacting the health of those living in the vicinity. Areas most affected by oil such as Baku Bay, Absheron Archipelago and surrounding islands and other oil industry sites have been described as virtual “dead zones.” In some places levels of radioactivity near oil production sites are 50 to 150 times higher than permissible background levels.⁷⁸

The Sangachal Terminal, one of the largest oil and gas separation facilities in the world, is operated by BP and feeds into the Turkey-bound BTC pipeline.⁷⁹ Sangachal is slated for

⁷⁴ Interview with SOCAR employees, Baku, May 9, 2012.

⁷⁵ Azerbaijan International, “Shah Deniz Offshore Platform,” *BP Developments*, Summer 2006; http://www.azer.com/aiweb/categories/magazine/ai142_folder/142_articles/142_bp_developments.htm.

⁷⁶ Fuad Islamov, “Water Injection in Azeri-Chirag-Guneshli Fields,” Khazer University, Baku (2009).

⁷⁷ Offshore Technology, “Shah Deniz, Azerbaijan,” *Offshore Technology*; http://www.offshore-technology.com/projects/shah_deniz/.

⁷⁸ “Coastal Profiles, Azerbaijan,” http://www.caspianenvironment.org/itcamp/azeri3_5.htm

⁷⁹ BP, “Sangachal Terminal,” *Our Projects and Operations*, <http://www.bp.com/sectiongenericarticle.do?categoryId=9006674&contentId=7015100>.

expansion for Shah Deniz “Full Field Development.” In the past, residents in a nearby settlement have reported concerns with fumes from Sangachal and attributed these fumes to leading to health problems such as stillbirths.⁸⁰

Social Investments by Western Companies and SOFAZ

Investments by Western Companies

BP and Chevron are the only Western companies that individually disclose their social investment projects in Azerbaijan.⁸¹ Chevron and BP provide financial support to the Caspian Compassion Project, which provides dentistry and ophthalmology services for poor and conflict-impacted people; and also provides resources for medical aid, micro loans to entrepreneurs, and funds Junior Achievement programs to train students in business skills.⁸² BP’s social investments range from charitable projects to underwriting technical assistance to improve the Azerbaijani government’s capacity to manage petroleum resources.⁸³

In 2006 BP and its BTC co-venturers committed \$6 million to be distributed by the EBRD over several years to provide micro loans and technical assistance to private ventures in Azerbaijan and Georgia.⁸⁴ Additionally, in 2011, the AIOC spent \$800,000 on the enterprise development and training program for the development of local hydrocarbon companies, and allocated \$800,000 to community development initiatives.⁸⁵

SOFAZ Social Investment Projects

SOFAZ funds several social investment projects, some of which are controversial due to their social or environmental impacts. These projects are planned and operated through

⁸⁰ Bankwatch, “Boom Time Blues,” *Bankwatch*;

http://bankwatch.org/documents/boom_time_blues_final.pdf.

⁸¹ The World Bank, “Report no. 44365-AZ: Azerbaijan Country Economic Memorandum - Diversification of export at the expense of the New Silk Road,” *The World Bank*, December 23, 2009;

http://siteresources.worldbank.org/AZERBAIJANEXTN/Resources/Azerbaijan_CEM_FINAL_AZE.pdf.

⁸² Caspian Compassion Project, “Who We Are,” *Caspian Compassion Project*; <http://www.ccpaz.tk/>.

⁸³ BP, “Sustainability Report 2010,” BP, 46;

http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/s/BP_sustainability_Report_2010_final_dec_2011.pdf.

⁸⁴ BP, “Sustainability Report 2011,” BP, 47;

http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/s/BP_Sustainability_Report_2011.pdf.

⁸⁵ *Ibid*, 48.

government ministries, but civil society is beginning to hold SOFAZ accountable to international best practices.⁸⁶

Oguz-Gabala water pipeline —AZN 747.0 million was invested in this project between 2006 and 2010.⁸⁷ “The pipeline came into operation in 2010. The project sought to use an underground water source in Oguz-Gabala region to create a gravity-fed water supply to Baku city at a flow rate of 5 cubic metres per second, providing residents with good quality water.”⁸⁸

According to a local NGO, this project cost nearly twice as much as the original estimate and took more than twice as long to implement.⁸⁹ Civil society noted that the Environmental Impact Assessment documents pre-construction were not made public, so those living along the water pipe’s route were not aware of any potential negative side effects of the project (in fact it seems only a feasibility study was done, not an impact assessment for all stages of the project).⁹⁰ Additionally, several landowners along the pipeline route received no compensation for their land.⁹¹ Even those who received compensation sometimes received land that was less fertile or suffered damage to other property. The water diversion is showing signs of creating desertification in the region from which it is piped, including the drying up of fruitful trees and wells for drinking water and agricultural use.

Education of Azerbaijani youth abroad —“A total of AZN 19.8 million has been spent to fund the programme since 2008. As of 1 January 2011, this state programme had funded the education abroad of a total of 733 young Azerbaijani students. Of these, 51 have graduated.”⁹²

SOFAZ staff stated that if a student is accepted by one of the foreign universities listed on the application, the only other requirement for qualifying for the program is that participants must live in Azerbaijan for five years after graduation. However, some members of civil society point out that for those students who are not accepted to the state program, there is no appeal right.⁹³ Additionally, it has been noted that there are decreasing numbers of participants who attend universities in the US involved in the program: “Experts believe that the reason of declining number of students sent to the US universities is political. The

⁸⁶ Interview with the Coalition of Azerbaijan Non-Governmental Organizations For Improving Transparency in the Extractives Industry EITI NGO Coalition of Azerbaijan, May 11, 2012.

⁸⁷ State Oil Fund of the Republic of Azerbaijan, “2010 Annual Report,” *SOFAZ*, 13.

⁸⁸ *Ibid*, 13.

⁸⁹ Oil Workers Rights Protection Organization, “Provision of Transparency in Public Revenues,” *Independent Monitoring Report*, January 2012, 7, http://www.nhmt-az.org/ts_general/download/Independent_Monitoring_Report_Baku_2012.pdf.

⁹⁰ *Ibid*.

⁹¹ *Ibid*, 8.

⁹² *Ibid*, 15.

⁹³ Interview with Gubad Ibadoglu, National Budget Group, Baku, May 9, 2012.

recent years' involvement of US-educated youths in democratic developments in the country and their leading role in these processes, are considered to be the product of brainwashing and US universities are informally banned at the state level."⁹⁴

Conclusion

While Azerbaijan's GDP has increased due to the growth of its petroleum sector, social and environmental rights and protections have not kept pace with this expansion. The Azerbaijani government's participation in EITI represents an important first step toward transparency and accountability, as well as engagement with civil society by the government. However, there are many areas in which transparency is still needed, such as the disclosure of production-sharing agreements between the government and foreign companies, and publicly disclosed disaggregated revenue reporting, an area in which Western companies other than BP and Statoil should be leading.

Government corruption is a larger issue that civil society attempts to address through mechanisms such as EITI. Without leverage through such international programs, the government will have little incentive to reform, with little chance for public debate about expenditure of oil revenues. Freedom of speech and assembly are not protected, and civil society faces constant threats to its advocacy and even to its existence. It is incumbent on the companies that are profiting from Azerbaijan's natural resources to set an example for transparency and public participation.

Petroleum companies within Azerbaijan pay much higher wages than any other sector of the economy, most of which are underdeveloped. However, while jobs at Western companies are obtained by having the appropriate qualifications and offer safety measures, those at local petroleum companies are often dangerous, offer significantly lower salaries than their Western companies (10 times less according to workers interviewed), and are perceived as requiring bribery and connections to obtain. Furthermore, the petroleum sector employs only a small fraction of the Azerbaijani population.

Western companies including those in the AIOC and BTC consortiums are making some effort to stimulate and diversify the economy of Azerbaijan through job training and social welfare programs. However, these measures do not address the root causes of Azerbaijan's democratic and economic challenges: civil society representatives report that Western governments, especially those in Europe, seem hesitant to pressure the Azerbaijani

⁹⁴ Economic Research Center, "Research Report on "State Programme for Education of Azerbaijan Youth Abroad in the Years 2007/2015," *Economic Research Center*; <http://www.erc.az/files/reports/education.pdf>

government to enact critical social and democratic reforms that would increase opportunities for public participation and diversify the economy. Civil society representatives speculate that this hesitancy may be due to Europe's dependency on foreign gas and oil.

Recommendations

In light of the many challenges faced by rights advocates within the country, Western civil society can assist the work of Azerbaijani civil society in several ways.

For international civil society

- Significant pressure should be placed on Western governments to join EITI, as well as to encourage companies to voluntarily disclose disaggregated revenue information. Once the US officially signs on and the UK joins EITI, the reporting of Western companies will shed light on partnerships with non-transparent companies in Azerbaijan and set an important example of the expectations for compliance with international standards.
- Legislation such as the US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2011 will shed light on payments from American companies to foreign governments.⁹⁵ Its implementation and enforcement should be monitored, and disclosed information should be analyzed.
- International financial institutions (IFIs), such as the EBRD and World Bank, should be held publicly accountable for investments in the extractives industry in Azerbaijan. Past IFI investments include several pipelines, Shah Deniz Stage 1, and the Sangachal Terminal, all of which have profound impacts on the environment and the local population. As these projects continue to function and expand, IFIs should be an ally, whether willingly or as a result of advocacy, in enforcing the highest possible social and environmental outcomes.
- International civil society should engage Azerbaijani civil society in global advocacy campaigns seeking more information about the impacts of controversial extraction practices such as hydraulic fracturing. Involvement in establishing international industry best practices and norms will have a positive impact on Azerbaijan's political and economic sectors as it becomes more integrated with Western Europe and the United States.

⁹⁵ Securities and Exchange Commission, "H.R. 4173" *About Laws*;
<http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>

- In the case of the settlement near the Sangachal terminal, a current assessment of the conditions of the settlement should be conducted. If it is still inhabited and residents continue to experience health problems, a methodology should be devised to test for current toxin levels.
- Western civil society organizations should help to train Azerbaijani civil society organizations to conduct long-term precise and practical environmental quality tests to measure local air and water conditions.
- Since many Azerbaijani NGOs lack human and financial resources, Western organizations can assist in publicizing environmental and social concerns to capture international attention.

For Western companies and IFIs operating in Azerbaijan

- Western companies should institute standard media and civil society inquiry policies for every country where business is conducted, ensuring consistent transparency of operations.
- Western companies and IFIs should comply with international best practice standards for safety, labor standards, and environmental protections.
- Western companies and IFIs should encourage local business partners to comply with international best practices for safety, and labor and environmental protections. Supply chain-wide safeguards should be instituted to decrease harmful practices; and mentoring might be helpful in assisting local companies to meet international standards.
- Companies should continue to meet and work with Azerbaijani civil society to set an important precedent for this free speech-limited country.
- IFIs should support the reform of business practices in Azerbaijan through technical assistance, especially creating space for independent business startups to diversify the economy.⁹⁶
- IFIs should promote their own best practices, for example, disclosure of information about the BTC pipeline was unprecedented and such practices should be encouraged within the business community.

⁹⁶ “Property rights and freedom from corruption remain weak, and government interference and control hurt overall monetary stability and foreign investment. The overall regulatory reform process has slowed, eroding some of the gains from earlier years.” The Heritage Foundation, “Azerbaijan,” *Economic Freedom Rankings*; <http://www.heritage.org/index/country/azerbaijan>

- IFIs should couple support for extractive projects, such as Shah Deniz or Sangachal Terminal expansion, with support for environmental cleanup, since industrial pollution of the Caspian and environs has shown to be harmful to both human health and animal and plant biodiversity. Health should be prioritized as much as wealth when assessing the development of a country.

For the government of Azerbaijan

- Require disaggregated reports by company, listing revenue and taxes paid to the government of Azerbaijan.
- Disclose extractive sector production-sharing agreements with private and semi-private companies.
- Ensure that state-owned enterprises meet international standards for labor rights and environmental protections.
- Uphold international human rights conventions; especially those pertaining to civil society and journalists.
- SOCAR has agreed to publish more information about its operations in Azerbaijan its website; build upon this practice and ensure that information available in Turkey and other parts of the Caucasus is also available in Azerbaijan.

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http://images.businessweek.com/ss/10/07/0729_worlds_biggest_shadow_economy/4.htm

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