

The Empty Bucket of the State Oil Fund of Azerbaijan: Profits and Profiteering

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Executive Summary

Over its 28 years of independence, Azerbaijan has become known in the world market for its oil and gas. 2019 marked two important milestones in the modern history of Azerbaijan: 25 years since the country signed a ground-breaking Production Sharing Agreement (PSA) with the company BP to develop oil fields in the Azerbaijani sector of the Caspian Sea, and 20 years since the State Oil Fund of Azerbaijan (SOFAZ) was established.

Although Azerbaijan has generated enormous wealth from the development of its oil and gas reserves, the benefits have eluded the ordinary people of the country. Without effective, transparent, and accountable management of oil revenues, Azerbaijan has suffered from crippling corruption, stratification of society, stifled economic growth, and an increase in poverty. Money has been spent on buying civil servants' loyalty, glamorous sports and entertainment events, high end but not profitable real estate abroad, and western support.

The objectives of SOFAZ are to support socio-economic development, and to collect and save oil revenues for future generations to ensure cross-generational equality. Unfortunately, savings are slim, and the lack of transparency and accountability throughout the entire hydrocarbon revenue management system in Azerbaijan is an issue of major concern. The most concerning issue is how public investments from the state budget, which draw on SOFAZ funds, are managed. Transparency is an issue both in the accumulation of oil revenues, and spending of oil revenues.

According to SOFAZ regulations, when incomes from oil and gas revenues peak, at least 25% of revenues must be saved. This rule was violated four out of five peak years from 2011 to 2015, when spending of revenues was much more than 75%. As of January 1, 2019, SOFAZ received \$138.3 billion from the main oil reservoir of Azeri-Chirag-Gunashli (ACG) alone. As of September 2019, the Fund had only \$42.5 billion in its reserves.¹ Thus, the question arises: what have the citizens of the country gained from the spending of nearly \$100 billion in oil revenue?

Taking into account payments coming from The State Oil Company of the Azerbaijan Republic (SOCAR), total proceeds from oil production accounted for 65.3% of the state budget revenues between 2003 and 2018. As hydrocarbons comprise such a high percentage of the state budget, Azerbaijan can be classified as a rentier state: the level of

¹ <https://www.oilfund.az/en/report-and-statistics/recent-figures>

influence that citizens of the country have on government decision-making is significantly reduced because oil and gas development by foreign investors plays such an important role in economic stability of the state. The role of taxpayers in the budget process is decreased, and so is public participation.

SOFAZ's investment portfolio performs much worse than other international sovereign wealth funds. In 2018, SOFAZ's investment portfolio included fixed income and money market instruments (76.5%), equities (12.8%), real estate (5.3%), and gold (5.4%). The total average profit of the Fund in 2018 was only 0.35%.² The average annual profits of SOFAZ's investment portfolio from 2010 to 2017 amounted to 1.53%. In comparison, profits amounted to 7.6% for the Norwegian Pension Fund, 9.7% for the Alaskan Fund (USA), 11.5% for the Alberta Fund (Canada), and 15.5% for the New Zealand Sovereign Fund. Corruption and lack of transparency of SOFAZ investments hinder Azerbaijan's economic growth.

Whereas other funds may profit from real estate, SOFAZ has been losing money from its investments. Especially large losses were revealed for London and Moscow properties owned by the Oil Fund.

Over the past few years, Baku has hosted a number of over-the-top sporting and entertainment events under the guise of modernization: Eurovision song contest, the First European Games, Islamic Solidarity Games, Formula 1 Grand Prix, and others. All of these came with inflated price tags paid for by oil revenues. The Operating Committee of the Baku 2015 European Games was allocated 950 million AZN (\$609.2 million). In comparison, Belarus hosted the European Games in 2019, which cost \$180 million, for which the president of Belarus was widely criticized.³ Low transparency and accountability standards, combined with the high potential for corruption in the country, encourage economic interest in these lucrative projects.

At least 1 out of every 3 dollars from the 2008 to 2015 state budgets was allocated to industry, construction, and minerals extraction, while up to 99% of the investment budget was directed into the construction sector, which has had a high corruption risk since the Soviet era.⁴

A significant share of Azerbaijan's state budget is spent supporting government employees who participate in repression and falsification of elections. In September 1, 2019, salaries of

² <https://www.oilfund.az/en/investments/information>

³ <https://www.fairobserver.com/region/europe/european-games-2019-minsk-belarus-human-rights-sport-europe-news-12221/>

⁴ <https://www.cbar.az/page-41/macroeconomic-indicators>

government employees increased on average by 40%.⁵ Monthly salaries of Central Election Committee (CEC) employees grew significantly, making the gap between their wages and the nominal average salary in the country even larger than it had been previously.⁶

Teacher salaries increased by 20% on average starting September 1, 2019 – also a politically motivated move.⁷ The majority of members of the Constituency and Precinct Election Commissions are heads and employees of state schools. Election falsification is mainly conducted with their direct participation. Despite the fact that health workers received a smaller base salary than teachers, it was the education sector that received an increase in pay. Pro-government journalists have received apartments and law enforcement employees got salary increases of up to 40% in government efforts to tighten control.

Oil and gas revenues over the past 10 years created unprecedented opportunities for Azerbaijan to invest in lobbying to hush critical voices from both inside the country and abroad, and to improve relations with the west. Azerbaijan was listed as one of the top 10 countries spending significant money on the services of lobbying companies in Washington, DC, including BGR Group and Podesta lobbying firm.⁸ The government of Azerbaijan also spent oil and gas revenues on the Azerbaijan America Alliance (AAA), the US Azeris Network, and the Assembly of the Friends of Azerbaijan (AFAZ), all registered as non-profit organizations in the US, but which promote Azerbaijani interests in the US.

A hike in oil revenues from 2010 to 2015 in Azerbaijan coincided with a rapid increase in the country's spending on its defense sector. However, with no transparency of defense contracts, it is difficult to track the use of military funding, another risk of corruption in spending.

Although over \$100 billion of oil money has already been spent, 24% of the people of Azerbaijan still suffer from poverty⁹ and lack basic services. There has been a decrease in GDP per capita since 2014, from \$6,072 to \$5,769 in 2018. Cancer related illnesses are on the rise in Azerbaijan. Environmental issues are also pressing.¹⁰ Quality of life in Azerbaijan has worsened over the past 10 years.

⁵ <https://novator.az/2019/06/19/maas-artimi-s%C9%99r%C9%99ncamlari-2/>

⁶ <https://president.az/articles/33594>

⁷ <https://banco.az/az/news/muellimlerin-maaslari-20-faiz-artirildi>

⁸ <https://sunlightfoundation.com/2014/05/08/what-countries-spent-the-most-to-influence-the-usa-in-2013/>

⁹ http://documents.worldbank.org/curated/en/614351556553124178/pdf/South-Caucasus-in-Motion.pdf?fbclid=IwAR0pAnKBEgBklUn_8gSkWQKKs1Zlb5VwFVTCNgIzqas-5vHIHcjTPH2vHk

¹⁰ <http://deyerler.org/361786-azjrbaycanda-eie-xjstjlikljri-artdr-v-hjkimlirdjn-sos-xjbjrdarldddd.html>

Corruption is rampant, and in 2019 and 2018, Azerbaijan received low ratings in Transparency International's Corruption Perception Index and in the Open Budget Index. Interestingly, Azerbaijan's ranking in the Corruption Perception Index correlates strongly with annual oil revenues, with the country scoring the worst during peak oil years.

The government of Azerbaijan signed various international conventions and joined different global bodies before the country's economy started to benefit from the returns from oil and gas, but once oil money started flowing, it began disregarding its international obligations.

The research conducted for this report concludes that the revenues from the sale of Azerbaijani oil have not reduced the unemployment rate, have not alleviated poverty, and have not liberalized, diversified, or modernized the national economy. In fact, in many areas the situation has gotten worse. The report presents concrete recommendations to increase transparency and accountability in spending of Azerbaijan's oil and gas revenues.