

## ENTREPRENEURSHIP DEVELOPMENT FOUNDATION

The Project:

**OIL REVENUES: CHALLENGES FOR AZERBAIJAN  
INFORMATION BULLETIN**

№1, February, 2007

**DIRECT DISTRIBUTION OF A PORTION OF  
OIL REVENUES AMONG CITIZENS****On the project**

Azerbaijan is on the eve of huge oil revenues. According to experts' calculations, if the present crude oil prices remain stable, our country will get at least 200 billion US dollars from the Azeri-Chirag-Guneshli deposit alone by 2024. It is expected that in 2009, Azerbaijan's cumulative oil revenues will exceed about 35 billion US dollars and in 2010 – 55 billion US dollars. The 2006 state budget of Azerbaijan was slightly more than 4 billion US dollars, and thus, we can expect that in 2010 the assets of the state oil budget will be 10 times higher than the state budget, even if the pace of state expenditure over the last two years is preserved.

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Such huge revenues will create wonderful opportunities for economic development, but may also lead to a number of consequences as is the case in other oil-producing countries. So it is quite likely that the following tendencies will be observed in Azerbaijan:

- The strengthening of the manat;
- Increasing inflation;
- The weakening of the competitiveness of local products and services;
- Slowing down of reforms;
- Increasing state investment;
- Increasing state management spending;
- Increasing social spending;
- Increasing military spending;
- Others.

Our country is already face-to-face with these problems today. How can we reduce the risks that come from these problems? The main purpose of this project is to discuss this problem and examine possible measures.

The project is being implemented with the support of the US Agency for International Development and the Eurasia Foundation. The project manager is the head of the Fund to Assist the Development of Entrepreneurship and Market Economy, Sabit Bagirov.

The duration of the project is 10 months. The following events will be held in this period:

- Seven round tables will be held;
- A sociological poll will be conducted;
- Special information bulletins will be published;
- A report called "Oil revenues: Problems that Azerbaijan might encounter" will be drawn up.

The first round table on the project was held on 24 January 2007. The subject of the round table was the following: "The direct distribution of oil revenues among citizens". Bazel Zavoyko, the representative of the International Monetary Fund in Azerbaijan, Rasim Musabeyov, scientific director of the sociological poll of the project, and Sabit Bagirov made reports at the round table.

The round table was attended by: Ali Masimli (member of parliament); Azer Amiraslanov (member of parliament); Azer Alasgarov (National Bank); Yadulla Hasanli (Ministry of Tax); Raqib Quliyev (Azerbaijan Technical University); Ali Alirzayev (doctor of economics, professor); Azer Mehdiyev ("Expert" economic magazine); Qubad Ibadoglu (Center for Economic Research); Sevgim Rahmanov (Association of Merchants and Manufacturers); Inqilab Ahmadov (PFMC); Alovzat Bayramov (Fund to Assist the Development of Entrepreneurship); Aydin Nizamov (EITI IB coalition); Irada Eyvazova (Center for Economic and Political Research); Ibrahim Ismayilov (BP Business Center); Togrul Juvarli (Turan news agency); Leyla Aliyeva (CNIS); Irada Yaqubova (ELS Center for Independent Research); Andrey Stokozyuk (World Bank); Murad Abiyev (Eurasia Foundation); Anar Ahmadov (Caucasus Research and Resource Center); Jeyhun Karamov (BP Azerbaijan); Ruslan Khalil ("Baki Xabar" newspaper); Anar Orujov (Caucasus Media Research Center); Salim Rzayev ([www.day.az](http://www.day.az)); Irada Bagirova (World Bank); Sanan Alizade (SGS); Adil Abdullayev (BM BAKMIL); Rasim Musabeyov (political expert); Bazel Zavoyko (International Monetary Fund); Sabit Bagirov (Fund to Assist the Development of Entrepreneurship and Market Economy).

The Fund to Assist the Development of Entrepreneurship and Market Economy is known in the country and abroad as one of the most active NGOs in the sphere of assisting the development of business, improving the business climate in Azerbaijan and analyzing economic reforms. Over the last 10 years, the Fund has implemented more than 20 projects, supported by various international organizations (Eurasia Foundation, the International Private Entrepreneurship Center in Washington, Open Society Institute, the European Commission and others).

# DISTRIBUTION OF OIL REVENUES TO POPULATION: OBJECTIVES, EXPERIENCE, IMPLICATIONS AND MECHANISMS<sup>1</sup>

**Sabit Bagirov**



Dear Ladies and Gentlemen!

Azerbaijan is on the eve of major oil revenues. Calculations show that with the price of crude oil of \$60 per barrel, the cumulative revenues to be fetched from the sale of Azerbaijan's share of the profit oil produced from Azeri-Chirag-Gunashli will exceed \$200 billion, while in peak years of oil production the revenues are expected to amount to \$10-20 billion.

Legal norms regulating the spending of oil revenues are reflected in the "Long-term strategy for the management of oil and revenues", approved by a presidential decree<sup>2</sup> in September 2004. The document indicates that if macroeconomic stability is preserved, oil and gas revenues can be used in the following directions:

- development of the non-oil sector, regions, small and medium-sized enterprise;
- development of the infrastructure;
- poverty reduction and solution of other social problems;
- strengthening the innovation base of the economy;

- development of the "human capital";
- strengthening the defense capability of the country;
- return of the country's occupied territories and restoration of life in these districts.

These directions of expenditure are also characteristic of many other countries. However, there is one spending direction which is not envisaged by the Azerbaijan legislation. It is direct distribution of the revenues among the country's population. Such experience exists in Alaska for example. "At the start of the oil boom there was a great need for developing the infrastructure (roads, dams, business centers, cultural institutions, water supply systems, sporting centers, swimming pools for schools, etc.) in the state of Alaska. But most expenses on such projects were later found ineffective and for this reason the Permanent Oil Fund of Alaska was established in 1976"<sup>3</sup>. The objective behind establishing the fund was to preserve the fund's resources for future generations. The fund's assets were invested in the securities of highly profitable companies, state bonds and in real estate. In 2005, the fund's assets reached \$30 billion. The

<sup>1</sup> This presentation was made at a roundtable meeting of the Entrepreneurship Development Foundation on 14 January 2007.

<sup>2</sup> <http://www.oilfund.az/index.php?n=67>

<sup>3</sup>Richard Steiner, Professor of Alaska Anchorage University  
<http://www.agroparty.ru/smi/200/>

average yearly dividends from such investment are 10%. The dividends are being spent on two areas: 1) compensation of inflation losses, 2) distribution among citizens (in 2003 every citizen received \$1,107)<sup>4</sup>.

Social programs similar to the distribution of oil revenues are also being implemented in Kuwait. There are two funds there: the general reserve stabilization fund - 1960) and the fund of future generations (cumulative - 1976). The funds have amassed \$90 billion. The social programs implemented by the government include<sup>5</sup>:

- a bank account is opened for every child being born and \$3,000 transferred into it;
- citizens have the right to receive an interest-free credit in the amount of \$220,000 for the construction of a house;
- parents receive a monthly allowance of \$170 for every child until the child comes of age;
- every housewife receives a monthly allowance of \$300;
- citizens' expenses on medical treatment and education abroad are paid for;
- there is almost no income tax for citizens.

In Saudi Arabia there are no such funds. Social programs include<sup>6</sup>:

- free education and public health;
- different benefits, subsidies and allowances help people live without having to work hard;

- every child being born receives an allowance of tens of thousands of dollars;
- citizens receive assistance in the amount of \$80,000 for the construction of a house;
- \$13,000 for people graduating from educational institutions.

In Azerbaijan, the distribution of part of oil revenues among citizens could pursue the following objectives:

- Direct cash incomes;
- Principle of justice;
- Greater confidence of people that they too play a role in the revenues;
- Slight improvement of the status of the poor and needy categories of the population;
- Encouragement of small enterprise development initiatives;
- Improvement of the public health;
- Increase of young people's opportunities to improve their education, etc.

Oil money is already present in some people's incomes today. These are the citizens receiving salaries from the state budget, as well as those receiving pensions and allowances from the State Social Protection Fund and receiving support from the State Oil Fund. As is known, part of the state budget revenues are provided due to transfers from SOFAR, from profit taxes of companies engaged in oil contracts, from profit taxes paid by subcontractors and from income taxes of those working in the oil sector of the economy. Therefore, the workers of all categories receiving salaries from the state budget have an oil component in their incomes.

Those receiving targeted social assistance also have an oil component in their incomes.

<sup>4</sup> [http://www.rol.ru/news/misc/press/05/12/13\\_001.htm](http://www.rol.ru/news/misc/press/05/12/13_001.htm)

<sup>5</sup> World practice in the formation and use of natural revenues. Problem of "privatization of revenues".

*G. N. Tereshchenko, deputy director of the department of economic analysis of the Analytical Department under the Council of Federation Administration. 02 May 2006*

<sup>6</sup> Monarchy of homebred lazybones. Olga Nikolayeva  
<http://www.glazev.ru/alert/6/28>

A part of the incomes of the State Social Protection Fund is also formed with oil money because the fund receives 22% payments from the salary fund of all oil sector employees.

There is another category of citizens with a share of oil money in their incomes. These are refugees and internally displaced people receiving significant funds from SOFAR for the improvement of their social status.

Therefore, a considerable portion of the population has an oil component in their incomes. Other citizens don't. Can this system of distribution of oil revenues be described as fair? Hardly. Natural endowment equally belongs to all citizens and the shares of all citizens must be the same. Therefore, direct distribution of part of oil revenues among all citizens will enable everyone to have access to the oil pie.

Surveys being held in the country show that most citizens do not feel involved in oil revenues and treat them as something strange. With such attitude public officers feel free in decision-making and actions, which increases the risk of ineffective use of oil revenues. Direct distribution of part of the revenues to the population will certainly boost people's interest in the volumes and spending of oil revenues and, as a result, will strengthen public oversight in this sphere.

Today many citizens are experiencing certain social problems. Some don't have enough money to buy medicines, some can't pay for communal utilities and others can't afford to pay for the education of their children. As a result, people's health deteriorates, they are stressed and, in the long run, human capital of the country reduces. Direct distribution of some oil

revenues to the population could become a second wind for many people and alleviate their current status.

Micro-financing institutions have been developing in the country of late and there are more opportunities for receiving micro-credits. Quite a few people are taking advantage of these opportunities and receive loans of several hundred to several thousand dollars to start their small businesses. However, since most such credits are provided with a high interest rate, people don't often venture to take them. Therefore, direct distribution of oil revenues would clearly increase the number of people interested in setting up their businesses.

There is another argument in favor of direct distribution of oil revenues – the widely spread facts of partial privatization of the revenues. "...The problem of 'privatization of revenues', i.e. the problem of loss resulting from incomplete exaction of it on the part of the state, is quite acute (not only in developing but also in developed countries). According to the calculations of independent US experts, in developed countries the level of privatization of revenues accounts for a third of the national income. In other (resource-based) countries this figure is significantly higher. Experts believe that this situation can be explained by the power of political influence of resource magnates"<sup>7</sup>.

Other researches show that "...the practical experience from the operation of these funds (except perhaps for the

<sup>7</sup> World practice in the formation and use of natural revenues. Problem of "privatization of revenues".

*G. N. Tereshchenko, deputy director of the department of economic analysis of the Analytical Department under the Council of Federation Administration. 02 May 2006*

<http://www.glazev.ru/alert/6/28>

Norwegian) can hardly be viewed as reassuring. Despite all constitutional restrictions and unending control on the part of international and non-governmental organizations, most countries without established democratic traditions are spending oil revenues not exactly for their intended purpose... It is therefore no wonder that specialists are starting to take interest in the third option - direct distribution of oil revenues among the country's population"<sup>8</sup>. Some experts<sup>9</sup> recommend that the Iraqi Constitution state the entitlement of every family to a share of oil revenues. They believe that this right should be preserved for 10 years. Over this period Iraq could establish democratic institutions and gain the opportunities of using the oil revenues correctly. At present, the situation is such that the Cabinet of Ministers in February 2007 approved a new draft law whereby oil revenues will be distributed among 18 regions of the country in proportion to their population. The draft law is to be ratified by parliament.

There are risks of In Azerbaijan unauthorized used of oil revenues in Azerbaijan as well<sup>10</sup>:

- lack of experience in managing major revenues;
- loopholes in legislation;
- weak opponent non-governmental institutions (political parties, NGOs, independent media);
- dependence of other branches of power on the executive branch;
- incomplete implementation of "good governance" principles;

- conflict of interest in SOCAR participation in PSAs;
- others.

The issue of distribution of oil revenues to the population is also discussed in other oil producing countries of the FSU. For instance, electoral manifestos of Kazakhstan's Nagiz Ak Zhol Party and the Movement for a Fair Kazakhstan stated the determination to distribute a part of oil revenues to the population<sup>11</sup>. There are quite a few politicians and experts in Russia who are of this opinion.

The following questions can emerge in connection with the distribution of oil revenues to the population in Azerbaijan:

- to be distributed are only the dividends received from the management (placement, investment, etc.) of oil revenues or the revenues proper?
- How much is to be distributed?
- Is distribution technically feasible?

Citizens of Alaska are receiving their shares only from annual dividends<sup>12</sup> (excluding spending on inflation compensation). The amount distributed to citizens depends on annual dividends. Over the past several years this amount averaged at around \$1,000.

Calculations show that if in 2008-2017 annual dividends from the management of ACG revenues amount to 10% (as much as in Alaska) and half of the dividends is distributed to the Azerbaijan population, then every citizen will receive about \$70-130. A family of four will receive an annual income of \$280-520. This is not a huge amount. In the Soviet time, most

<sup>8</sup> Oil wealth burden. Oksana Prikhodko. 12 June 2006. <http://www.zerkalo-nedeli.com/nn/show/508/47535/>

<sup>9</sup> Oil wealth burden. Oksana Prikhodko. 12 June 2006. <http://www.zerkalo-nedeli.com/nn/show/508/47535/>

<sup>10</sup> Azerbaijan's oil revenues: ways of reducing the risk of ineffective use. Sabit Bagirov, 2006

<sup>11</sup> <http://zonakz.net/articles/4print.php?artid=14772>

<sup>12</sup> Alaska has a population about 13 times smaller than Azerbaijan

enterprises paid the 13<sup>th</sup> salary at the end of the year, and considering the current average income in Azerbaijan, this amount will be similar to the 13<sup>th</sup> salary. Although this is not a significant income, it can still help many citizens improve their health and resolve some other problems.

This, however, is only one of many models of distributing oil revenues to the country's population. For instance, another model can be based on the distribution not only of dividends but of revenues proper. Calculations show that if the price of crude oil in world markets in 2008-2017 is around \$65, Azerbaijan will receive annual revenues of \$10-20 billion only from the sale of its oil (in 2008 – \$10.5 billion; in 2009 – \$13.5 billion; in 2010 – \$20.3 billion; in 2011 – \$20.1 billion; in 2012 – \$19.6 billion; in 2013 – \$18.7 billion; in 2014 – \$17.1 billion; in 2015 – \$15.3 billion; in 2016 – \$12.8 billion; and in 2017 – \$10.9 billion). If some of these revenues are distributed to the population, then the annual share of citizens can increase.

Calculations show that by the end of the ACG contract, i.e. late 2024, Azerbaijan's cumulative oil revenues only from the sale of profit oil may reach at least \$200 billion (if the crude price is not lower than now and of course of these revenues are not spent in the meantime). If for 17 years, between 2008 and 2024 annual expenditure of the government on different state investment programs are at a level of \$3 billion, then by the end of 2024 the cumulative revenues will reach \$150 billion. If another \$50 billion is distributed to the population, then by late 2024 SOFAR will accumulate \$100 billion. The distribution of \$50 billion to the population in 2008-2024 will enable every citizen to receive about \$ 6,000.

The \$100 billion left by 2025 can, with wise placement and investment, bring extra \$10 billion a year and the fate of this money will be determined by the next generation of the country's citizens.

I would like to repeat that there are many models for the distribution of oil revenues to the population. The option described above is a demo one. We have tried to show what kind of direct and real revenues our citizens can receive.

Using the experience of other countries, some oil revenues can be used not only for distribution to the population, but also for the implementation of different social programs which would be similar to direct distribution of money:

Exemption of citizens from income tax (as in Kuwait);

- Reduction between 2008 and 2017 (or in a more distant future) profit tax rate to ...%;
- Reduction of the tax rate for simplified accounting system;
- Reduction of the interest rate on mortgage loans;
- Allowance of \$... for every child being born;
- Free medical examination and diagnosing;
- Payment for education abroad;
- others.

There are many opponents of the distribution of revenues to the population not only in the government but also among political parties and public associations, independent experts and even the population. A questionnaire for the sociological survey<sup>13</sup> conducted in late 2006 by the Entrepreneurship Development

<sup>13</sup> Information bulletin of the Entrepreneurship Development Foundation, №1, 2007



Foundation contained the following question: " *What priority direction for spending oil revenues are you ready to support?*" Respondents were offered 14 answer options to this question and only 39.3% of those polled (a total of 1,000 were polled) expressed readiness to support direct payment of some oil revenues to the population. Most were in favor of strengthening the army - 70.2% and creation of new jobs - 65.1%.

Opponents of direct distribution of revenues to the population provide the following arguments to substantiate their position:

- distribution of revenues to the population may undermine macroeconomic stability;
- distribution of revenues to the population will stimulate import, not local production;
- distribution of revenues to the population will be accompanied by corruption and embezzlement of money;
- distribution of revenues to the population is technically not feasible;
- people will become lazy.

With regard to the first argument we can say that annual payments to the population will not be large enough to undermine macroeconomic stability. Of course, the money can to some extent trigger inflation, but this can be avoided by

reducing government spending, liberalization of foreign trade and other measures.

On the second argument we can say that there are many so far unused ways of encouraging local production.

The third argument is indeed worth reckoning with in Azerbaijan. Quite possible, some portion of the money will be embezzled by government officials. To reduce such losses, it is necessary to ensure transparency in the distribution of revenues to the population and establish thorough public oversight.

Technical feasibility of the distribution of revenues to the population can be proved by the generally successful experience in distributing privatization vouchers to the population. Since money will not be distributed in cash (into people's bank accounts), it will be technically easier than the distribution of privatization vouchers.

Laziness. This argument can hardly be seen as serious. The money will not be large enough for people to quit working. The money can only help slightly improve people's status.

In conclusion we would like to indicate that the distribution of oil revenues to the population is worth giving a serious thought.





# EXPERT OPINION

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*Ali Masimov,*  
Member of Parliament

## Interview with MP Ali Masimov

Question: Ali bey, there is an international practice when part of oil revenues is distributed among the population in some oil-producing countries. What do you think about the proposal to introduce this practice in Azerbaijan?

Answer: A number of countries – Kuwait, Saudi Arabia, as well as Alaska – have some experience in distributing oil revenues. However, most countries are not distributing oil revenues directly among the population, but are using a model of indirect handover of oil revenues to the population. If we look at oil-producing countries, we can see that the number of the countries that use the mechanism of the indirect effect of oil revenues on the population's life is higher than the countries that directly distribute those revenues. There is nothing strange about it.

This is dictated by the objective reality, because the study of economic tendencies and the influence of economic results on social development on the basis of many factors in about 100 countries in the period from 1970 to 1990, and maybe to the end of the 20th century, shows that in comparison with countries rich in oil, gas, gold, silver and other mineral resources, the countries that do not have this wealth are developing more rapidly and are achieving more serious results. Although there is a lot of wealth in the world, people are wealth number one. Those countries work on the basis of more effective use of human wealth and intellectual potential and achieve more serious results.

There is another interesting aspect regarding oil-producing countries. History has shown and experience has proved many times that regardless of whether a country has oil, gas and other reserves, those countries achieve greater results not because of oil, but when they establish a special effective combination of the state, society and business. Norway is a graphic example of this. If this optimal correlation of the state, society and business is not based on democratic principles and economic freedoms, then we get a Nigeria. That's to say if the per capita gross

domestic product in Nigeria is 500 dollars, according to the figures of the last few years, in Norway, the per capita gross domestic product is 40,000 dollars. Nigeria is 80 times behind Norway in terms of GDP although oil extraction in Nigeria is not lower than in Norway. If this is a reality, I think it would be more expedient for Azerbaijan to switch to an innovative model without establishing a civil society, a common state and turning democratic principles into a norm of our life, but by using a more serious model and oil money and combining national values and developing them into democratic principles, as did Japan. Why? Although I am one of those who played a role in the collapse of the Soviet system, I have to say that the Soviet education system created a very strong intellectual potential where ideology did not work. On the other hand, we are facing difficulties today because we failed to create a citizen, but created a national.

Regardless of problems in our education system, young Azerbaijanis are not lagging behind local young people in the well-known universities of the world's developed countries. This is obvious in the United States of America, European countries, Turkey and Russia. This means that young Azerbaijanis do not have intellectual problems. But there are many nations, I do not mean to insult them, that have intellectual problems. If we do not have any intellectual problems, why should we not choose the innovative model? Why should we not establish a reliable mechanism of ensuring the social security of the needy population by using oil dollars to regulate social processes? Why should we not use our intellectual potential to make 10 times or even 100 times more money?

I believe that some of the oil revenues can be used in a well-established targeted social aid mechanism, because official statistical figures say that about 20 per cent of Azerbaijan's population are poor.

Although more questions appeared in this sphere after the hike in energy prices and this figure needs to be corrected, if we take 20 per cent as a control figure, we will see that more than 1.7m people are living below the poverty line. How many people get targeted social aid? 240,000 people. If we divide this figure, we will not get even 15 per cent. When will the remaining 85 per cent get aid?

This means that oil revenues can be used in order to improve this mechanism and speed up work in the sphere of raising the welfare of the poor stratum to the minimum consumer level. But if you distribute the money among everyone, both the rich, the middle class and the poor will get it, which will lead to serious inflation.

In the current period, we can clearly see that one of the most serious problems facing Azerbaijan in the near future will be the Azerbaijani-style Dutch disease. Among these problems, the rise in inflation and in the rate of the manat will have a very serious impact. If the government does not take serious measures, it will not be able to overcome the macro-economic dilemma between intervention and sterilization. If the government cannot overcome it, as inflation increases, the handover of that money will become an additional source of inflation, which means that if the rate of the manat increases in a short period of time, local production will not be stimulated and will be stifled, while import will be stimulated. This means that in this way, we will stimulate import. If we import apples from Argentina at a time when Azerbaijan has 90 per cent of all climate zones of the world, I am afraid that

we will start importing potatoes from neighbouring countries.

However, if we do everything - all these processes in a scientifically-substantiated way, we will see that in order for Azerbaijani agriculture to develop at a pace of more than 10 per cent in the next few years, it is necessary to spend effectively 400-500 million new Azerbaijani manats every year. Thus, it is possible to switch from the extensive method to an intensive one by spending 2.5-3 billion dollars, and this will enable us to raise agriculture to a qualitatively new level, because according to official statistical figures, the last year saw only a 0.9-per-cent growth, i.e. less than 1 per cent in agriculture. This means that there has been no growth at all and there has been a sharp drop in a number of products. This is one of the indicators of Dutch disease in Azerbaijan. No matter how much statistical figures embellish the situation and how much individual government officials console themselves in government reports, it is very simple and easy to understand that such a deplorable situation means that extensive resources have run out and agriculture should be developed on the basis of intensive resources from now on. Under these conditions, laws of society are like laws of nature and you can be punished if you do not obey them. This means that we should definitely take into account that it is necessary to make as much investment as necessary in agriculture in Azerbaijan, use it to overcome the crisis in agriculture and to start developing the processing, light and food industries on its basis. In the following stages, we should move on to other spheres.

I formulate the issue in the following way – as the pace of growth increases, the risk

increases as well. If we do not take this into account, we will encounter a lot of serious problems after the oil boom ends, for example, it is enough to look at the structure of export to see that is based on oil, a number of other raw materials and semi-finished products, as well as certain other materials. The end product almost does not exist. There are no hi-tech products at all. If hi-tech products do not account even for one per cent of a country's export, this government should sit and think properly and should turn its current policy into an innovative policy.

Annual growth in Azerbaijan is almost 35 per cent. Of course, most of it is related to oil. But there is also growth unrelated to oil. That growth is higher than the average indicator in the CIS. If you turn that growth into absolute figures, it is more than 4 billion new Azerbaijani manats. In that case, let's find out what is the share of the 20 per cent of rich and middle class people in those 4 billion and what is the share of the 20 per cent of poor people in it. When this figure is made public, we will see that if oil revenues are divided mechanically, then if someone buys 1 kg of meat, this will not boost local production, but will only lead to the export of 1 kg of meat, apples or pears. However, by ensuring the social security of extremely poor people who have reached the level of degradation, we will be able to form new labour force.

On the other hand, this method will allow us to set other elements in motion. The other elements are that we can ensure a certain principle of justice in the division of oil revenues by carrying out reforms in all spheres of society and life, including in the economy. On the other hand, it is important to improve the tax mechanism.

A certain reduction of the tax burden, the creation of an effective mechanism for the development of small and medium-sized businesses, the elimination of centralized monopolies and monopolies established by small kings in regions of the country, the elimination of officials' arbitrariness, the expansion of the application of economic freedoms in Azerbaijan, enabling Azerbaijani citizens to work and show initiative in all legal spheres, as I said,

would indirectly help form a mechanism of the fair distribution of those oil revenues.

In general, it is impossible to avoid reforms, of course, because, as I said before, it is necessary to establish a civil society and a law-governed state in our country, turn democratic principles into a norm of our life and national values into our priorities so that we can make perfectly fair use of oil revenues in the real sense of the word.



*Qubad Ibadoglu*  
Chairman of the Center  
for Economic Research

Judging by the world's experience in distributing oil revenues (Saudi Arabia, Kuwait, Alaska, etc.), I do not share the view that this practice should be applied in Azerbaijan as well. I would like to substantiate my opinion on the example of the rich and poor strata.

First, the inequality that exists in Azerbaijani society will not lead to significant changes in the life of the rich who will benefit from this, because against the background of their extremely high incomes, this share will be miserable and will turn into an insignificant payment. Second, oil revenues have played a significant role in the enrichment of this stratum. They have already indirectly benefited from oil revenues in the corrupt and non-transparent environment in society, and if it continues like this, they will benefit from them in the future. Under

these conditions, it would not be fair to grant an additional share to the stratum that has already indirectly benefited from oil revenues.

As for the poor stratum, we can think of various means that would enable them to benefit from oil revenues and it is possible to make this effective in two directions. First, these activities would improve living standards, and second, they would increase trust in the government. However, the activity of the factors that promote inflation under the current conditions would increase the level of inflation for the poor even further. The results of a survey conducted by the Center for Economic Research in the Aran-Qabala region with the aim of monitoring targeted social aid showed that targeted social aid has not led to any great changes in people's lives in terms of meeting their needs. All the participants in the survey clearly said that the aid they received allowed them to buy four or five types of the most important daily products. For this reason, there is no doubt that most of the oil money distributed on the basis of this principle will be spent on consumer goods, especially food, which will push up the prices for the main consumer goods even more.

At the same time, it is not possible to ensure the effective social security of the poor stratum with the help of individual forms of social security until all elements of the social security system are fully operational. According to the results of the survey, 25 per cent of the respondents spent the aid they received on solving health problems. The main reason is that there is no compulsory medical insurance mechanism in the country. Due to the lack of this mechanism, the purpose of any social aid undergoes changes, while its essence is distorted. From this point of view, the distribution of oil revenues, even if it is targeted, would not be that effective under the current social security system.

In my opinion, one of the counter-arguments that affect the distribution of oil revenues among the population is that in this case, the

government might become more complacent and lose interest in reforms, while society might get inactive.

For this reason, I am against distributing oil revenues among the population and using them to finance major investment projects, because major investment projects, especially infrastructure facilities built with oil money, will still require major refurbishment and exploitation expenses even after the oil money runs out, which will create an additional financial burden for the state in the end.

Having said this, I am not against updating the main assets left over from the post-Soviet period, but I think that stimulating the private sector in various ways using oil money and involving it in this process would be more effective.



*Inqilab Ahmedov,*  
Director of Public  
Finance Monitoring  
Center

The direct distribution of assets of the Oil Fund among the population would not be effective in Azerbaijan

Taking the experience of Alaska as a basis, a number of experts have said lately that this would be possible and useful in Azerbaijan as well. In our view, this practice cannot be regarded as the most effective way of spending oil revenues in countries where it has been applied, as well as in Azerbaijan. Along with other priority

directions, the direct distribution of money among the population would be not only ineffective, but also devalue the idea of spending these revenues on the long-term development of the country.

The effective use of oil revenues should entail mainly the following principles:

1. These revenues should serve not to ensure the advantage of individual strata or spheres, but to increase the competitiveness and sustainability of the economy. If there is such an exception, it should be well substantiated. (For example, a certain amount of SOFAR assets can be spent on improving the living standards of refugees and displaced persons every year).
2. These revenues should be spent in a way that would not disrupt the equality of market principles which form the

basis of the economy and the competitive conditions for everyone.

3. These revenues should serve to implement the priorities outlined by the government.

4. These revenues should not cause the competitiveness of the economically-active population to fall in comparison with other nations, in other words, they should not cause the coefficient of economic competition to weaken in conditions when people live and work in relatively fertile conditions.

5. These revenues should not weaken the requirements set to the government for improving the living standards of the population at the expense of oil money.

Taking the aforesaid as a basis, the direct distribution of some of Oil Fund assets among the population might lead to the following negative consequences.

1. If distributed against economic and investment laws, this will reduce the revenues that could be acquired in terms of relatively smaller investments.

2. This money which will in fact be channeled into solving current social problems of individuals will lead not to the drastic settlement of the problems, but to their recurrence.

3. As a country that takes 29<sup>th</sup> place in the world by per capita oil extraction, this money will not play a significant role in the consumer basket and deposit portfolio of every citizen.

4. As soon as some of the money that is paid enters the market, the already difficult macroeconomic problems and financial balance will become even more severe.

5. Keeping this money as an untouchable deposit in special accounts in banks implies ineffective use of that money. In conditions when there are no substantial and different financial and securities market tools, the imposition of a ban on the use of this money by individuals in the short-term will be no different from SOFAR putting it in foreign banks as a deposit. On the contrary, it is more expedient for the fund which is gaining more and more experience to manage the assets in the world securities market.

Thus, considering all this, it would be more expedient in the current conditions to manage Oil Fund assets more effectively and most importantly, more transparently at the institutional level.





# AZERBAIJAN: THE POPULATION'S EXPECTATIONS FROM OIL REVENUES AND THEIR SPENDING

In the last 10 days of December 2006, the sociological service Puls-R (scientific leadership by Rasim Musabayov) carried out an omnibus survey, part of which was to study public opinion about oil revenues and their spending in Azerbaijan. This survey was carried out at the request of the Entrepreneurship Development Foundation within the framework of the project Oil Revenues: Challenges for Azerbaijan, sponsored by the Eurasia Foundation (USA).

A total of 1,000 people were polled. Selection was random. Selection was carried out in respondents' places of residence among people at the age of 18 and older. The poll was carried out in Lankaran, Lerik, Siyazan, Devechi, Sheki, Oguz, Khanlar, Agstafa, Samukh, Khyzy, Neftchala, Tartar, Agjabadi, Agsu and Goychay districts – a total of 15 districts and 12 cities: Baku, Lankaran, Liman, Sheki, Ganja, Agstafa, Ali-Bayramli, Bilasuvar, Barda, Yevlakh, Zardab and Kurdamir.

In the process of identifying poll units (respondents), their proportional correspondence to the main demographic parameters (sex, age, education and social status), which characterize the Azerbaijani Republic according to the results of the 1999 population census, was observed whenever possible. Below are the final results of the sociological poll and comments on them.

1. Most of Azerbaijan's oil revenues are accumulated in a special Oil Fund. What do you think about it?

	Number	%
1. This is the right decision, I know about it and approve of it	256	25.6
2. I have heard about the Oil Fund, but I don't know what it is for	524	52.4
3. This is the first time that I hear about it and that's why I cannot say anything	220	22.0
Total	1,000	100

It is notable that almost one fourth of the respondents heard about the Oil Fund for the first time from the interviewers only during the poll, while half of the respondents had no idea about its purpose and work, although they knew that there was such a fund in the country. However, taking into account that this is something completely new for Azerbaijan and that only a limited number of countries have experience in setting up special funds in international practice, we can regard as positive the fact that for most respondents this question was not completely unexpected and people are ready to perceive relevant information.



## 2. Do you have any information as to how oil revenues were spent this year (2006)?

	Number	%
1. Yes, detailed enough	56	5.6
2. I have general information	370	37.0
3. I've heard something, but I don't remember	260	26.0
4. I don't know anything, but I'd like to know and understand	258	25.8
5. I don't know because that does not interest me	56	5.6
Total	1,000	100

As we can see from the disposition of answers, only a small number of respondents said that they have sufficient information about the spending of oil revenues and the same number said that this does not interest them. Most of them have only general information or have heard about it, but do not remember. One fourth of the respondents who said they do not know anything about the spending of oil revenues would like to get information and understand it. Thus, public interest in increasing the population's awareness not only in the context of oil revenues, but also their spending is obvious.

## 3. Do you think that society is being informed well enough about incoming oil revenues, their management and spending?

	About incoming oil revenues		About the spending of oil revenues	
	Number	%	Number	%
1. Yes, well enough	119	11.9	75	7.5
2. Information is not enough and clear	494	49.4	477	47.7
3. All important information is hidden from people	201	20.1	273	27.3
4. Don't know/Don't want to answer	186	18.6	175	17.5
Total	1,000	100	1,000	100

The answers to the question confirm the previous idea that the work to inform the population about oil revenues and especially, about their spending does not meet public interest. Almost half of the respondents regard this information as insufficient and unclear, while another 25 per cent are sure that important information is being hidden from the people. It is notable that the overwhelming majority of people are interested in this problem, although the number of respondents who had difficulty answering is high as well. The respondents believe that citizens are informed about oil revenues slightly better than about their spending.

## 4. Do you believe information published about the volume of extracted oil and gas, money made from them and its spending?

	Number	%
1. Yes, completely	72	7.2
2. Probably yes	419	41.9

3. Probably not	270	27.0
4. Absolutely not	131	13.1
5. I have no idea about it	108	10.8
Total	1,000	100

The respondents are dissatisfied not only with the volume and quality of information about oil revenues and their spending, but also complain about its authenticity. About 40 per cent of the respondents do not believe official information about this issue completely or partially. This is a high percentage, although there is no need to dramatize the situation, because almost every second respondent still believes this information. Nonetheless, the answers to the questions about public awareness of incoming oil revenues, their management and especially, their spending, show that it is necessary to significantly increase transparency in the work of relevant government agencies and improve their ties with the public. But this is the job not only of agencies directly dealing with the management of oil revenues and their spending, but also of non-government organizations and mass media.

5. Which of the statements given below better reflects your opinion about oil revenues and their spending in Azerbaijan?

	Number	%
1. Oil revenues will help the progress of Azerbaijan, solve many of the existing problems and lead to an increase in my personal welfare	435	43.5
2. Oil revenues will probably speed up the development of the country, but will not affect my welfare, I don't really hope that this will directly affect me and my family	389	38.9
3. I do not expect anything good for the country and for myself from the oil revenues	144	14.4
4. Don't know/don't want to answer	32	3.2
Total	1,000	100

The percentage distribution of the answers shows that an insignificant minority (14.4 per cent) demonstrated complete pessimism and does not see anything good for themselves and for the country from the oil revenues. The remaining respondents are approximately equally divided into those who suppose that the oil revenues will help develop the country and cause an increase in their personal welfare and into those who do not rule out benefits for the country, but do not expect any direct dividends for themselves. Thus, public opinion is to a great extent free from overstated expectations that were typical of the period of the signing of the oil contracts that were seen as a panacea for all problems (Karabakh, unemployment, growth in welfare and so on). Most people realize the importance of growing oil revenues for the country, but without any illusions and hopes for benefits.

6. Which of the problems given below worry you most of all? (no more than three answers were allowed)

	Number	%
1. Education	160	16.0
2. Crime	105	10.5
3. The unsolved status of the Armenian-Azerbaijani conflict	688	68.8

4. Officials' arbitrariness	140	14.0
5. Poverty	415	41.5
6. Corruption	257	25.7
7. Restoration of roads, bridges and infrastructure	47	4.7
8. Unemployment	392	39.2
9. Public Health	95	9.5
10. Moral decline	48	4.8
11. Ecology	23	2.3
12. Other answers:	61	6.1
Public utility problems	2	0.2
Water supply problems	25	2.5
Social problems	2	0.2
Energy supply problems	26	2.6
Health	1	0.1
Housing problems	3	0.3
Return of savings invested in Soviet banks	1	0.1
The poor condition of irrigation channels	1	0.1
None	1	0.1
13. Don't know/don't want to answer	4	0.4

The overwhelming majority of respondents believe that the settlement of the Karabakh conflict is a priority. Adjacent economic problems – poverty reduction and unemployment – take second and third places. Corruption takes fourth place. It is followed by education problems, officials' arbitrariness, improvement of the health sphere and the fight against crime. Among other problems which the respondents named at their own initiative is the provision of stable energy and water supplies. Thus, along with problems the settlement of which implies the mobilization of large financial means (poverty, unemployment, education and health), the respondents also highlighted problems that suggest first of all improvements in state management mechanisms (corruption, officials' arbitrariness and the fight against crime).

#### 7. Which priority direction of the spending of oil revenues are you ready to support?

	Number	%
1. Army build-up to return Armenian-occupied lands	702	70.2
2. Creation of jobs	651	65.1
3. Construction and repair of roads and bridges, development of water and heat supplying systems, gas and power networks	180	18.0
4. Subsidies to goods that are in great demand in order to ensure moderate prices	195	19.5
5. Issue of low-interest credits to small and medium-sized businesses	244	24.4

6. Issue of low-interest credits to agricultural enterprises	281	28.1
7. Rise in pensions and welfare payments for the disabled and families having many children	359	35.9
8. Construction and crediting of cheap accommodation	200	20.0
9. Settlement of ecological problems	76	7.6
10. Development of education	230	23.0
11. Development of public health sphere	202	20.2
12. Development of culture	60	6.0
13. Direct payment of some oil revenues to the population	393	39.3
14. Other answers	7	0.7
15. Don't know/don't want to answer	5	0.5

The respondents' answers to this question totally correspond with the answers to the previous question of the questionnaire which investigated priority problems in the country. The absolute majority of the respondents (more than 70 per cent) agree that it is necessary to channel oil revenues into measures to strengthen the army in order to liberate the occupied territories. It is followed by the creation of new jobs, i.e. elimination of unemployment. The rise in pensions and allowances and the direct payment of part of oil revenues to the population can be seen in the context of poverty reduction. We would have thought that the idea of direct payments should enjoy more support. But on seeing that the government is in no hurry to compensate the loss of devalued deposits in savings banks, people do not believe that the direct distribution of money is realistic in our conditions. The number of people who spoke out in favour of non-market subsidies to goods that are in great demand in order to maintain low prices for them is not high as we expected. A much greater number of respondents supported the idea of allocating loans to small and medium-sized businesses and to farmers (more than 50 per cent in total).

8. Which negative consequences can large oil revenues that are expected to flow into the country have?

	Number	%
1. Growing corruption	313	31.3
2. Reforms will slacken as easy money exempts people from the need to think and act	113	11.3
3. Authoritarianism will increase as the authorities will have not only power, but also large financial resources	89	8.9
4. The imbalanced development of the country will increase. Baku will flourish while the province will decline	85	8.5
5. The stratification between the poor and the rich will increase	173	17.3
6. Price hikes, inflation	7	0.7
7. There will be no negative consequences	27	2.7
8. Don't know/don't want to answer	193	19.3
Total		100

This was quite a difficult question for the respondents and almost every fifth respondent had difficulty answering it. A very small number of them (less than one per cent) expects inflation pressure from the growing oil revenues, which is an axiom for specialists. The participants in the poll put corruption and the deepening stratification of society into the rich and the poor in the first place among the possible negative consequences. The logic is simple. Since the country will get additional revenues, the number of those who will want to lay their hand on them will increase, and since they are in a minority, stratification will increase. The respondents also predict the slackening of reforms and increasing authoritarianism.

#### 9. Which measures can increase the effectiveness of the management of oil revenues?

	Number	%
1. Increasing parliamentary control over the work of the Oil Fund	195	19.5
2. Including authoritative representatives of the public (scientists, NGO heads, journalists and others) in the management of the Oil Fund	408	40.8
3. Open discussions on the expediency of all major payments for the implementation of various projects	254	25.4
4. Other answers:	10	1.0
More impartial information for the population about the activities of the Oil Fund	6	0.6
No measures will help	3	0.3
5. Don't know/don't want to answer	133	13.3
Total		100

The distribution of the respondents' answers shows that people trust the public more than the parliament, although it is the parliament that plays a decisive role in controlling not only the receipt, but also the spending of oil revenues. The participants in the poll also think that openness is an important condition for increasing the effectiveness of the management of oil revenues, although in view of local realities, they do not really believe in the effectiveness of public criticism. Quite a high number of respondents had difficulty in answering this question as society is not really informed about the essence of the problem yet.

#### 10. How do you see the future of Azerbaijan?

	Number	%
1. The situation in the country will improve soon	537	53.7
2. I suppose that there will be no significant changes	348	34.8
3. The situation will worsen soon	81	8.1
4. Don't know/don't want to answer	34	3.4
Total		100

The answers of the participants in the poll show that positive expectations prevail. I should remind you that the poll was conducted in the last 10 days of December, i.e. before the tariffs for energy and public utilities increased several times over. There is no doubt that the atmosphere before the holiday also increased positive moods. But even if we take account

of the aforesaid circumstances, a great number of respondents suppose that the situation in the country will remain as it is, while about eight per cent of sceptics turned out to be visionaries against the background of the January price hike and predicted that the situation would worsen, which turned out to be a reality soon. However, all this does not diminish the impartiality and truthfulness of the positive expectations. The answer to this question was not difficult for the respondents, and the number of those who had difficulty answering it was at a minimum level.

11. If you suppose that the situation in the country will improve, to what extent do you link it to the oil revenues and their effective use? (this question was not put to the respondents who noted a lack of significant changes and the possible deterioration of the situation in the country)

	Number	%
1. This is of decisive importance	233	54.3
2. This is important, but together with other factors (reforms and so on)	246	57.3
3. The situation will improve in any case	54	12.6
4. Don't know/don't want to answer	38	8.8
Total	429	100

As we can see from the distribution of answers, most respondents who expect the situation in the country to improve directly link it to the growth in oil revenues. But of the overall number of participants in the poll, their number was less than 25 per cent. A slightly high number of respondents do not link their positive expectations only to growing oil revenues and place emphasis on its combination with other factors (reforms and so on). And finally, there was a group of respondents (they were in a clear minority) who can be described as thoughtless optimists as they believe that the situation in Azerbaijan will improve in any case.

12. How do you see your own future?

	Number	%
1. My situation is likely to improve	470	47.0
2. I suppose that there will be no significant changes	412	41.2
3. My situation is likely to worsen	81	8.1
4. Don't know/don't want to answer	37	3.7
Total		100

The personal expectations of the respondents with regard to changes in their own situation are not really different from the assessments made in the previous question on the situation in the country. Positive moods prevail. The recent growth in tariffs was not taken into account here either.

13. Do you link the improvement of your material situation to the growth in oil revenues and their spending by the government?

	Number	%
1. Yes	272	27.2
2. Partly	315	31.5
3. No	337	33.7
4. Don't know/don't want to answer	76	7.6
Total		100

As we can see from the diagram, the respondents split into two equal groups with some dominance of sober-minded people who are not inclined to directly link their situation to the oil factor that does not depend on their personal actions and to changeable oil prices. But most of them still directly or indirectly hope that the influx of oil money into the country will cause positive changes in their welfare.

Social-demographic parameters:

14. Sex:

	Number	%
1. Men	547	54.7
2. Women	453	45.3
Total		100

15. Year of birth and age groups:

	Number	%
1978-1985 (18-25 years old)	205	20.5
1968-1977 (26-35)	234	23.4
1953-1967 (36-50)	372	37.2
1952 (51 and older)	189	18.9
Total		100

16. Marital status:

	Number	%
1. Married	768	76.8

2. Single	163	16.3
3. Divorced	10	1.0
4. Widower (widow)	59	5.9
Total		100

17. Nationality:

	Number	%
1. Azerbaijanis	959	95.9
2. Russians	9	0.9
3. Lezgins	26	2.6
5. Tatars	4	0.4
7. Tats	1	0.1
8. Ukrainians	1	0.1
Total	1,000	100

18. Education:

	Number	%
1. Primary	24	2.4
2. Secondary	438	43.8
3. Secondary special	241	24.1
4. Higher and incomplete higher	297	29.7
Total		100

19. Social group:

	Number	%
1. Worker	125	12.5
2. Servant	196	19.6
3. Intelligentsia	88	8.8
4. Student, pupil	42	4.2
5. Housewife	159	15.9
6. Pensioner	127	12.7
7. Businessman	53	5.3
8. Serviceman	1	0.1
9. Peasant	87	8.7
10. Unemployed	122	12.2
Total		100



20. Do you regard yourself as a refugee or a displaced person?

	Number	%
1. Refugee	12	1.2
2. Displaced person	37	3.7
3. None	951	95.1
Total		100

21. Overall average monthly income per one family member

	Number	%
1. Up 40 manats	79	7.9
2. From 40 to 60 manats	271	27.1
3. From 60 to 200 manats	461	46.1
4. More than 200 manats	139	13.9
5. Don't know/don't want to answer	50	5.0
Total		100

As we can see from the distribution of answers, more than one third of respondents have an income that is below the minimum subsistence level and should be regarded as poor.

## Conclusions and proposals:

1. The absolute majority of people are interested in the problem of oil revenues and their spending and have a certain but superficial idea of them. The poll revealed a clear public interest in improving the population's awareness of the situation and problems in this sphere. The respondents are unhappy not only about the volume and quality of information about oil revenues and their spending, but also express their complaints about its authenticity. It is necessary to significantly increase transparency in the work of relevant government agencies and improve their ties

with the public. This is the job not only of agencies directly dealing with the management of oil revenues and their spending, but also of non-governmental organizations and the mass media.

2. Public opinion is to a great extent free from overstated expectations that were typical of the period of the signing of the oil contracts that were regarded as a panacea for all problems (Karabakh, unemployment, growth in people's welfare and so on). Most people realize the importance of growing oil revenues for the country, but have no illusions or hopes for benefits.

3. There is a direct correlation between the problems that the population regards as a priority and the problems into which they supposed the growing oil revenues should be channelled. The absolute majority of participants in the poll agree that it is necessary to increase the financing of measures to strengthen the army in order to liberate the occupied territories. It is followed by the creation of new jobs, i.e. a solution to the problem of unemployment and a rise in pensions and allowances. The idea of direct payments, although it seems attractive, does not seem to be realistic for most respondents, just like subsidizing goods that are in great demand in order to maintain low prices for them. The idea of allocating loans to small and medium-sized businesses and farmers was greatly supported. We can say that in the population's consciousness about the spending of oil revenues, conservative-market approaches, strange as it may seem, prevail over socialist approaches of equality.

4. The possible negative consequences of the growth in oil revenues and risks of their thoughtless spending are still perceived as inappropriate in public consciousness. A very small number of respondents expect inflation pressure. In this context, a much higher number of respondents are concerned about corruption and deepening of society's stratification into the rich and the poor. They also predict the slackening of reforms and increasing authoritarianism.

5. In the issue of controlling the receipt and spending of oil revenues, people trust the public more than the parliament, although it is the parliament that plays a decisive role according to the constitution. The participants in the poll also regard openness as an important condition for increasing the effectiveness of the management of oil revenues, although in view of local realities, they do not really believe in the effectiveness of public criticism.

6. Positive expectations in society also prevail with regard both to changes in the situation in the country and in the personal situation of the respondents themselves. Perhaps, these expectations turned out to be a bit more overstated, because the poll was conducted in the last 10 days of December, i.e. before the tariffs for energy and public utilities increased several times over. There is no doubt that the atmosphere before the holiday also boosted the positive moods. Although most people directly and indirectly hope that the influx of oil money into the country will have a positive influence on their welfare, many still rely on themselves more.



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